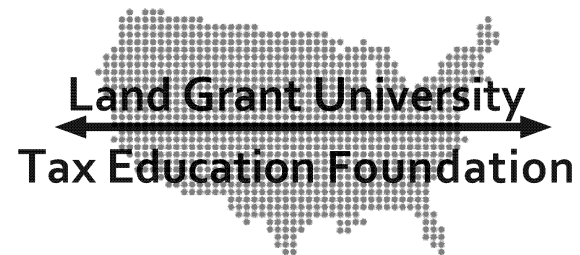


# 2022 NATIONAL INCOME TAX WORKBOOK

CHAPTER 7: PARTNERSHIP TAX  
ISSUES



## LEARNING OBJECTIVES

PP. 253

- Partnership Profit Interests
- Partnership Elections
- Basis in a partnership Interest

## ISSUE #1 PARTNERSHIP PROFITS INTERESTS

Partnership

Capital Interest

Partner

Partner

Partnership

Profits Interest

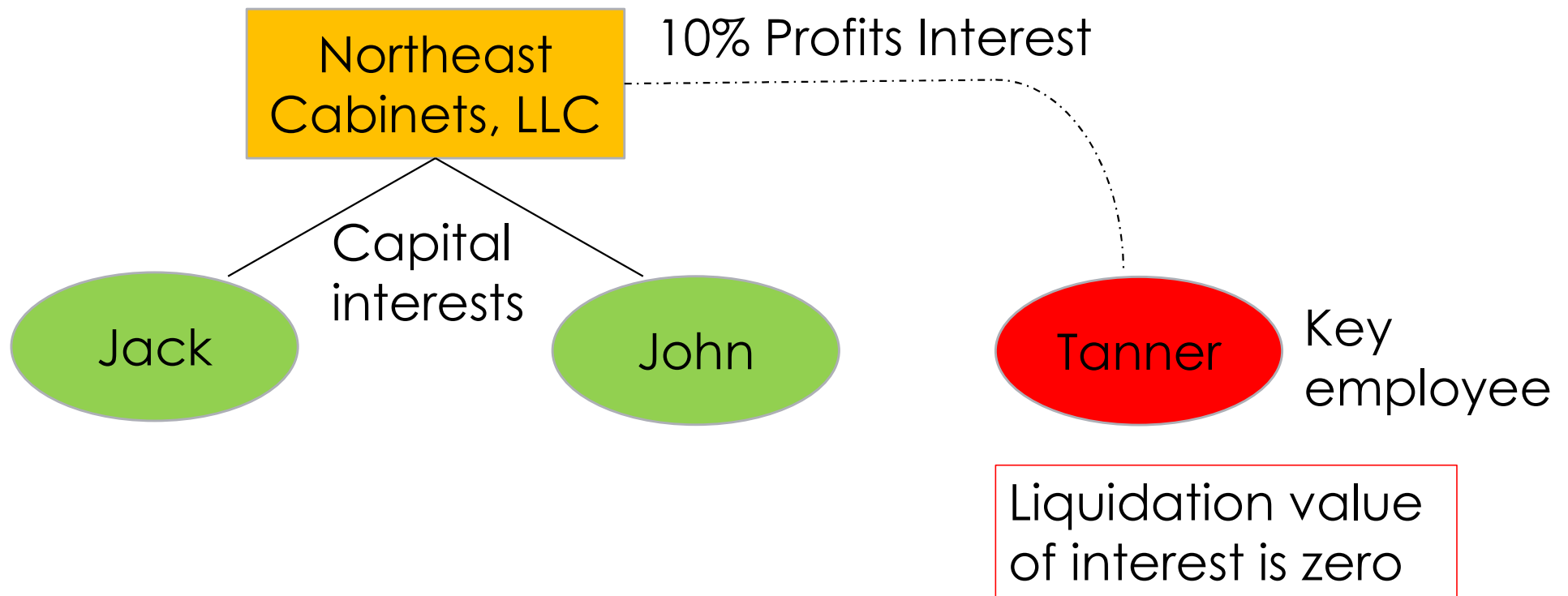
Partner

Partner

Amount that would be distributed if the partnership sold all its assets at FMV, after paying liabilities

Gives the partner only an interest in future income and gains

## EXAMPLE 7.1 – KEY EMPLOYEE



# PROFIT INTEREST IN EXCHANGE FOR SERVICES

PP. 254



**TAXABLE**

*Section 83*



**NONTAXABLE**

# PARTNERSHIP AGREEMENT

PP. 255



Schedule:

Capital Interests Partners:

50%

50%

Profits Interests Partner:

0%

Liquidating distribution provisions:

Liquidating distributions in accordance with capital account balances

should  
be

## VESTED INTERESTS

PP. 255

Rev Proc 93-27 provides guidance on vested interests

Receipt of a profits interest generally nontaxable, but will be taxable if:

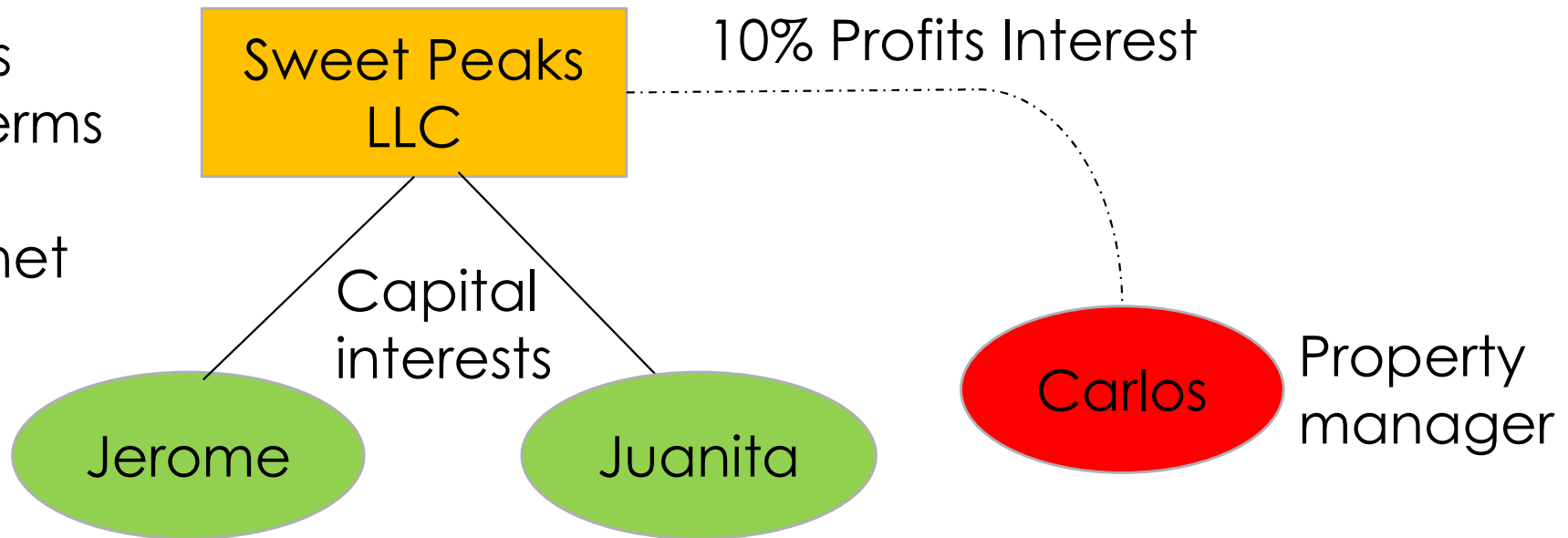
1. Substantially certain predictable stream of income
2. Partner disposes of the interest within 2 years
3. If a limited partnership interest in a PTP

Decision made at time of receipt of the interest

## EXAMPLE 7.2 – CERTAIN PREDICTABLE INCOME

PP. 255

3 leased  
buildings  
8 year terms  
360,000  
annual net  
income



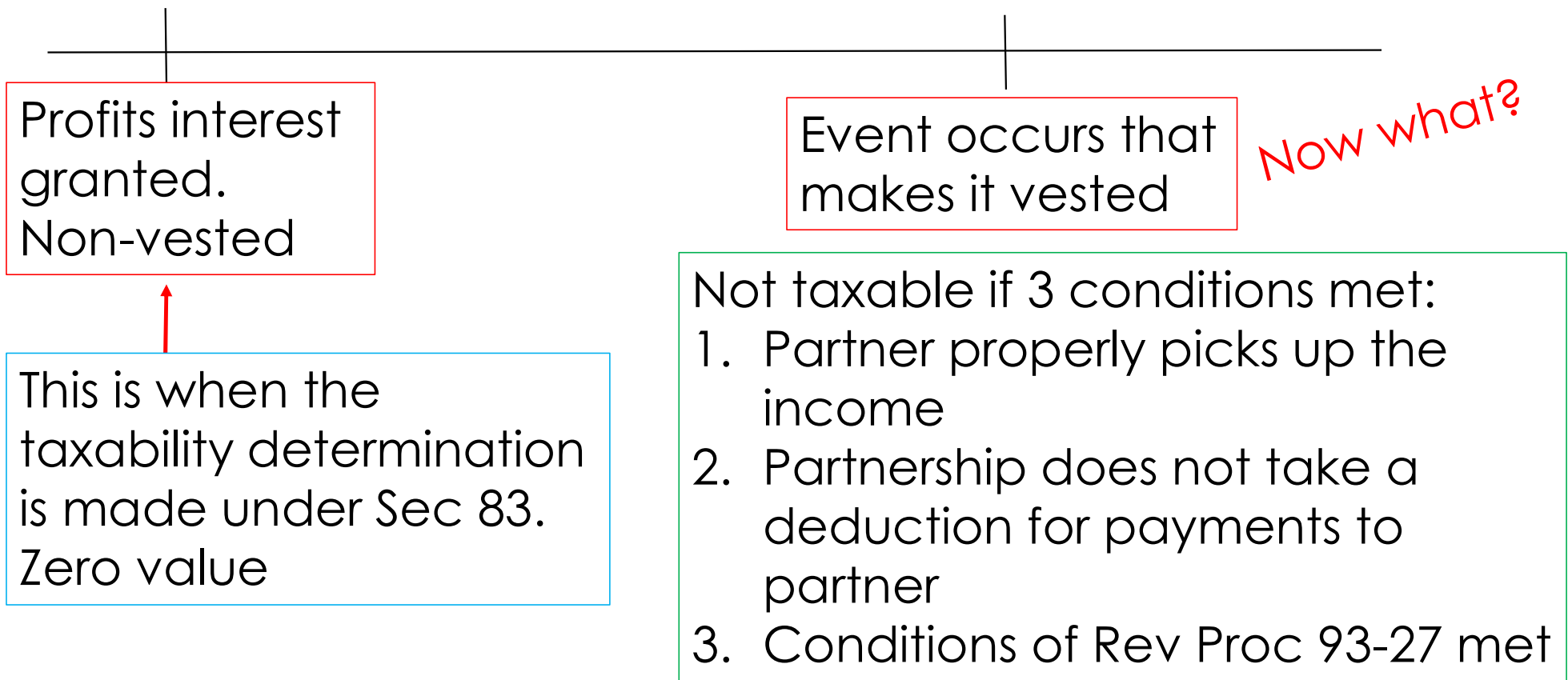
Taxable at time of receipt –  
substantially certain and  
predicable stream



# NON-VESTED INTERESTS

PP. 255 & 256

Rev Proc 2001-43 clarifies Rev Proc 93-27



## PROPOSED CHANGES

PP. 256

Notice 2005-43 – still proposed!!

Proposed Reg 1.83 -3 safe harbor would apply to granting partnership interests for services.

Make election?

| granted

| vests

Elect Safe Harbor – FMV of partnership interest granted for services is treated as being equal to the liquidating value of the interest. Zero

Don't elect safe harbor – hold interest until it substantially vests. Compensation income equal to the liquidation value on the date the interest substantially vests, less any amount paid for the interest.

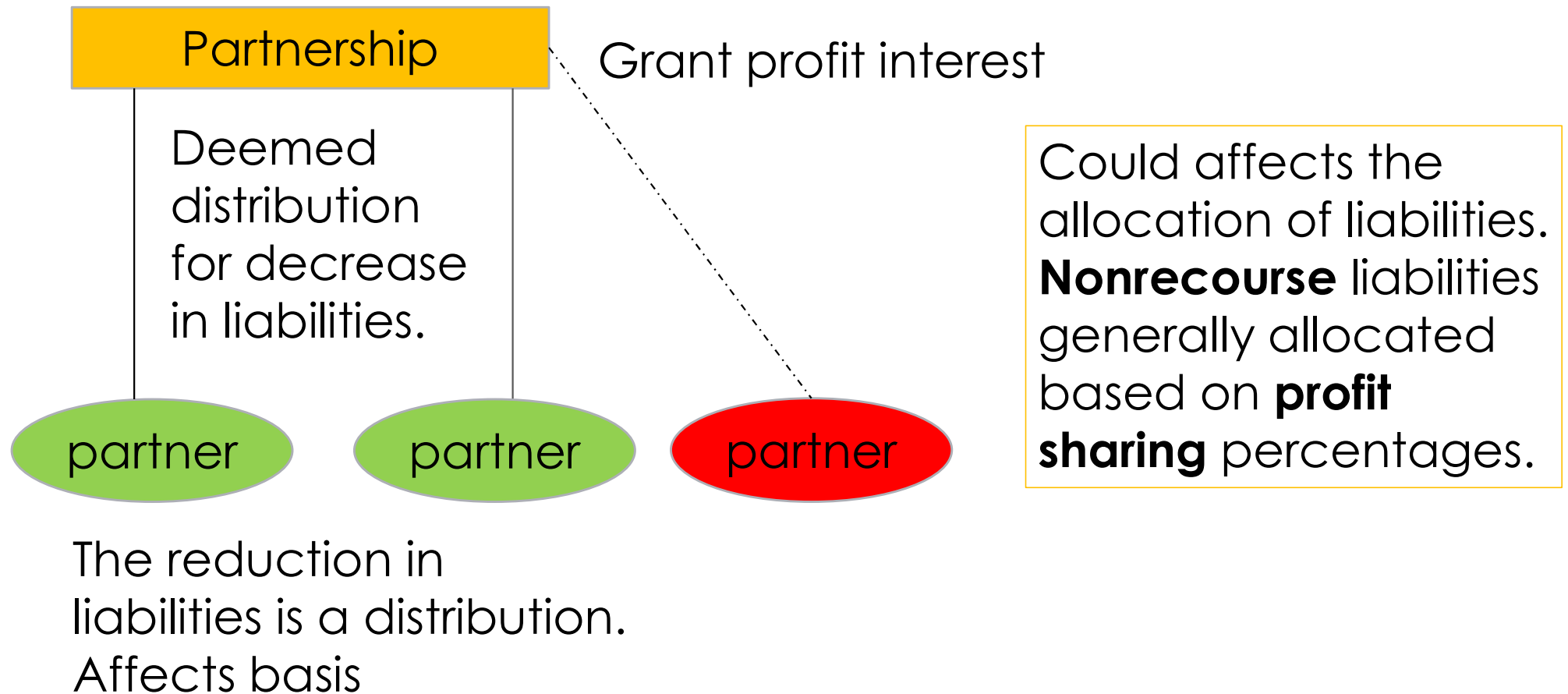
## PLANNING POINTER

If the partnership interest is transferred in exchange for services, subject to a risk of forfeiture, before the proposed changes become final, might want to make the election.

Why? Has a value of zero and no compensation income.

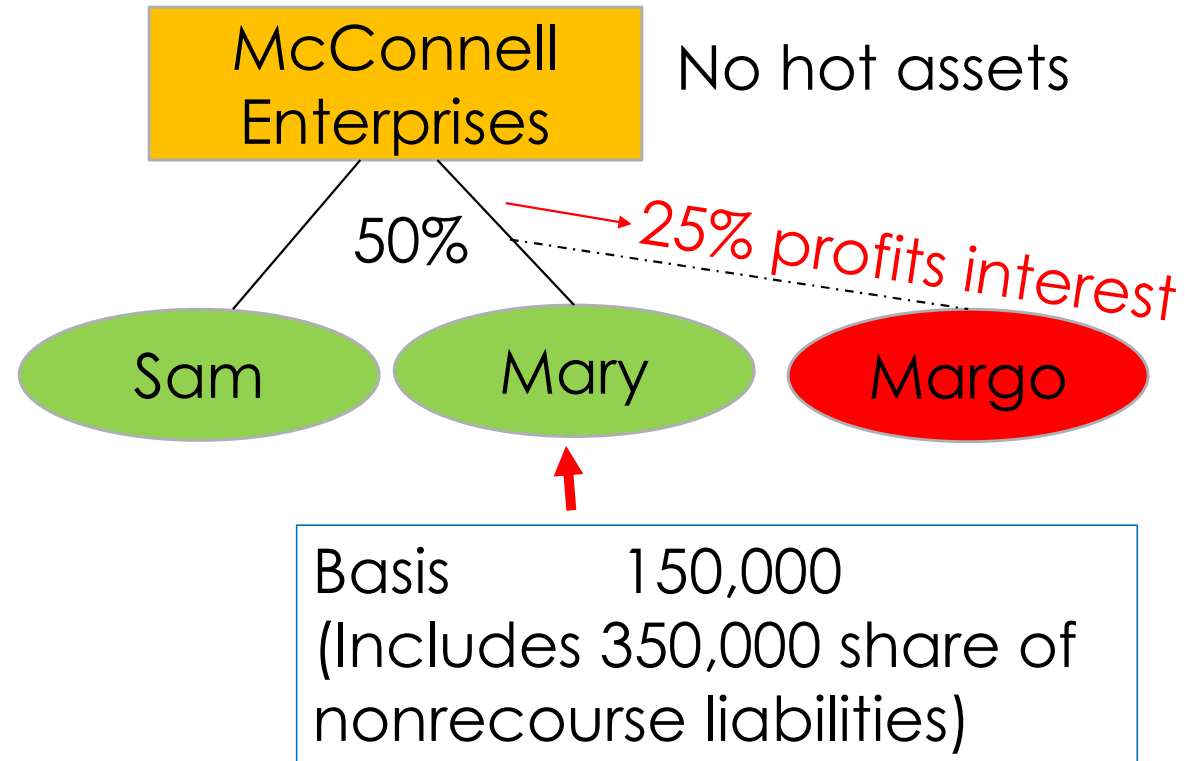
# INCOME ON TRANSFER OF PARTNERSHIP INTEREST

PP. 256 - 257



## EXAMPLE 7.3 DEEMED DISTRIBUTION

PP. 257



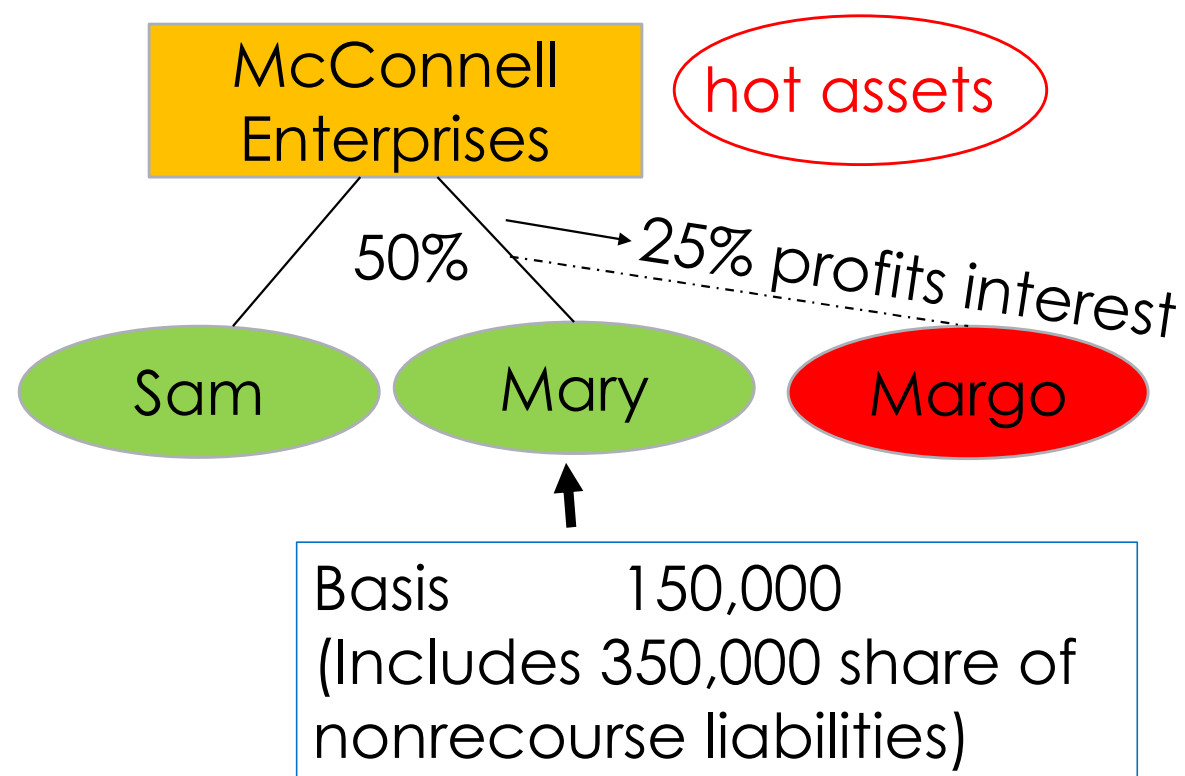
**Surprise!**

Constructive distribution

Mary's share of  
nonrecourse debt  
reduced by 175,000  
Basis (150,000)  
Capital gains 25,000

## DEEMED SALE OF HOT ASSETS

PP. 257



Surprise!

Constructive distribution

Mary's share of  
nonrecourse debt  
reduced by 175,000

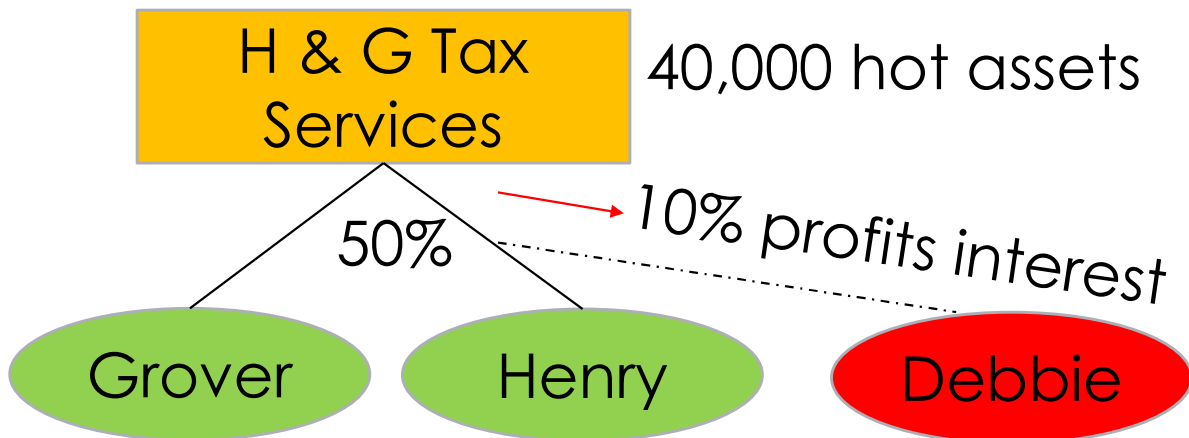
Basis (150,000)

~~Capital gains~~ 25,000

Ordinary income

## EXAMPLE 7.5 - NO INCOME - RECOURSE DEBT

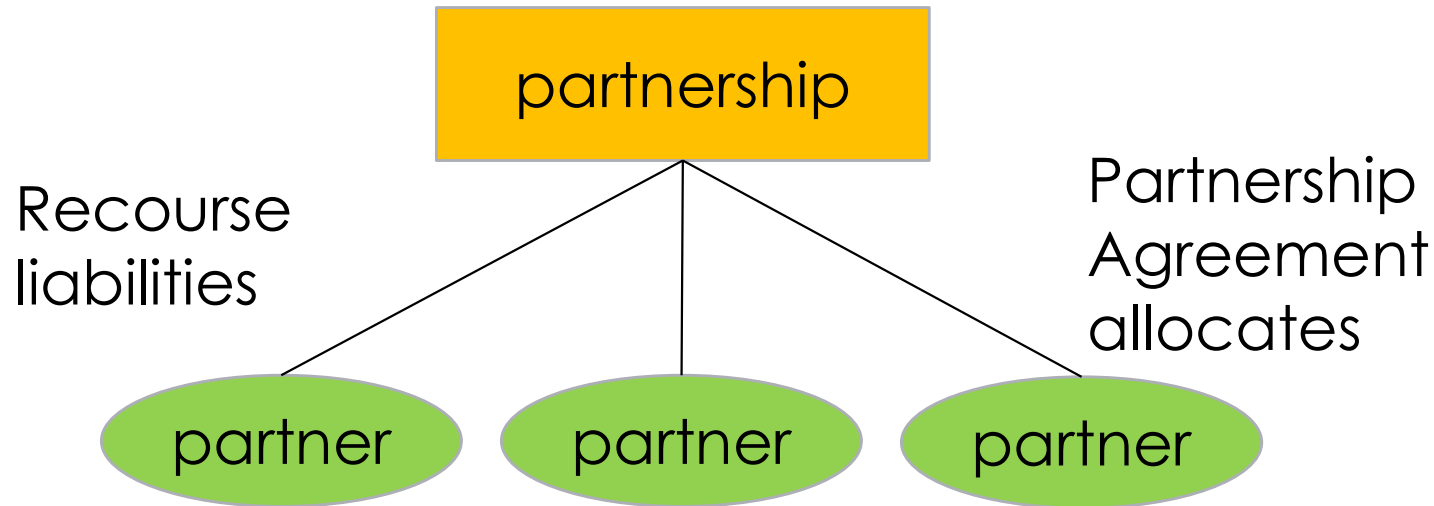
PP. 258



Each has basis of  
200,000,  
Includes 50,000  
recourse debt

No reduction in Henry's  
partnership liabilities and  
no deemed sale of hot  
assets.

## PRACTITIONER NOTE: ALLOCATING RECOURSE LIABILITIES



However, must be a “commercially reasonable expectation” that the partner will have the ability to make required payments.

Facts and circumstances test



## CARRIED INTERESTS

PP. 258

2017 Act added IRC 1061  
Recharacterizes certain long-term capital gains as short-term capital gains

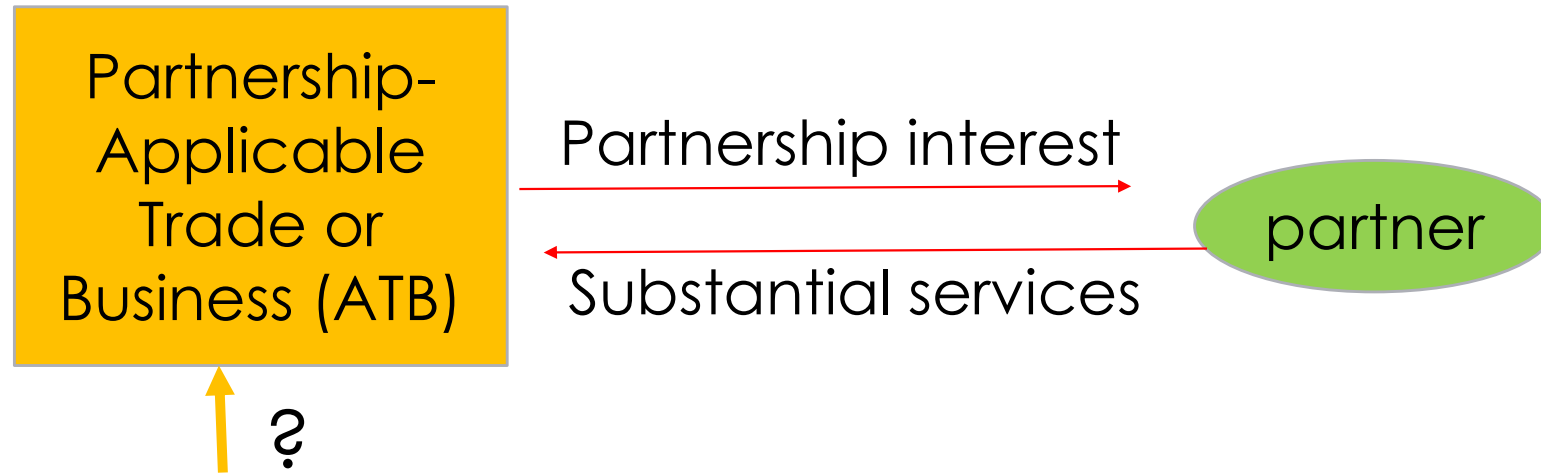
Applies to ***APPLICABLE PARTNERSHIP INTERESTS***

Must hold for 3 years to get long-term capital gains treatment.



## APPLICABLE PARTNERSHIP INTEREST

PP. 259



Activity conducted on regular basis

Raising and returning capital (Private Equity Firms)

Either:

- Investing in specified assets (securities, commodities, real estate, cash equivalents)
- Developing specified assets

## CALCULATING AND REPORTING

PP. 259 - 260

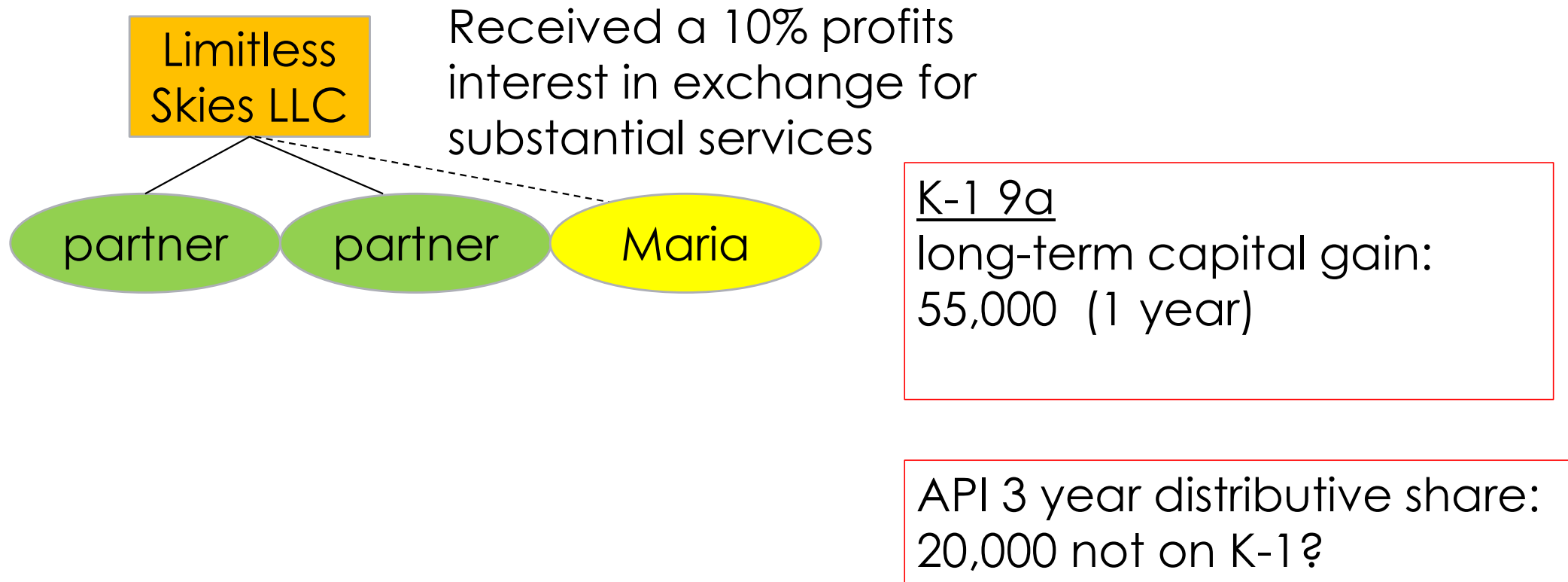
### BASIS CONCEPT

Taxpayer's net long-term capital gain	XXX,XXX
Net long term capital gains if the holding period is 3 years instead of 1 year	<u>(XX,XXX)</u>
Recharacterized to short-term capital gains	XXX,XXX

Partnership must attach the worksheet to the K-1.  
(page 260)

## EXAMPLE 7.7 RECHARACTERIZATION AMOUNT

PP. 261



**Schedule K-1**  
**(Form 1065)**

 Department of the Treasury  
 Internal Revenue Service

**2021**

For calendar year 2021, or tax year

 beginning  /  / 2021 ending  /  / 
**Partner's Share of Income, Deductions,  
Credits, etc.**

▶ See back of form and separate instructions.

Part I Information About the Partnership		Part III Partner's Share of Deductions, Credits, etc.	
<b>A</b>	Partnership's employer identification number	<b>1</b>	Ordinary business income (loss)
<b>B</b>	Partnership's name, address, city, state, and ZIP code	<b>2</b>	Net rental real estate income (loss)
<b>C</b>	IRS center where partnership filed return ▶	<b>3</b>	Other net rental income (loss)
<b>D</b>	<input type="checkbox"/> Check if this is a publicly traded partnership (PTP)	<b>4a</b>	Guaranteed payments for services
<b>Part II Information About the Partner</b>		<b>4b</b>	Guaranteed payments for capital
<b>E</b>	Partner's SSN or TIN (Do not use TIN of a disregarded entity. See instructions.)	<b>4c</b>	Total guaranteed payments
<b>F</b>	Name, address, city, state, and ZIP code for partner entered in E. See instructions.	<b>5</b>	Interest income
<b>G</b>	<input type="checkbox"/> General partner or LLC member-manager <input type="checkbox"/> Limited partner or other LLC member	<b>6a</b>	Ordinary dividends
<b>H1</b>	<input type="checkbox"/> Domestic partner <input type="checkbox"/> Foreign partner	<b>6b</b>	Qualified dividends
		<b>6c</b>	Dividend equivalents
		<b>7</b>	Royalties
		<b>8</b>	Net short-term capital gain (loss)
		<b>9a</b>	Net long-term capital gain (loss) <b>55,000</b>
		<b>9b</b>	Collectibles (28%) gain (loss)

 20,000 not  
on K-1?

One year API

Section 1061 <b>Worksheet A</b> revised 1-10-22		
API One Year Distributive Share Amount and API Three Year Distributive Share Amount (completed by a Passthrough Entity that has issued an API and attached to the Schedule K-1)		
Passthrough Entity Name _____ EIN _____		
API Holder _____ SSN or TIN _____		
Line	Description	*API Gains and (Losses)
1	Net long-term capital gain (loss) from Schedule K-1 (Form 1065) box 9(a), Schedule K-1 (Form 1120S) box 8(a), or Schedule K-1 (Form 1041) box 4a <sup>(a)</sup>	\$
2	Capital gains or (losses) <b>included in line 1</b> that are not subject to §1061 under §1.1061-4(b)(7)	\$
3	Capital Interest Gains or (losses) under §1.1061-3(c)(2) included in line 1 <sup>(b)</sup>	\$
4	<b>API One Year Distributive Share Amount</b> Subtract the sum of lines 2 and 3 from line 1	<b>\$ 55,000</b>
5	Amounts included in line 4 that would not be treated as long-term gain or (loss) if three years is substituted for one year under paragraphs (3) and (4) of §1222	\$
6	Any Lookthrough Rule adjustment applicable to the disposition of an API by the Passthrough Entity under §1.1061-4(b)(9) <sup>(c)</sup>	\$
7	<b>API Three Year Distributive Share Amount gain or (loss)</b> Subtract the sum of lines 5 and 6 from line 4	<b>\$ 20,000</b>

Prepared by  
partnership

Attached  
to K-1

Reported on Sch D as  
long term



Now  
what?

Section 1061 <b>Worksheet B</b>		
Owner Taxpayer Reporting of Recharacterization Amount (The Owner Taxpayer must complete and attach to their tax return)		
Taxpayer Name _____		SSN/TIN _____
Line	Description	*Gains and (Losses)
1	<b>API One Year Distributive Share Amount</b> from Worksheet A, line 4, which is attached to the Schedule K-1 - combined net amount from all APIs and increased by the API One Year Distributive Share Amount of collectibles gain or loss and/or unrecaptured §1250 gain, if applicable.	\$
2	<b>API One Year Disposition Amount</b> (from Table 1, line 4) - combined net amount from all APIs	\$
3	<b>One Year Gain Amount</b> (Add lines 1 and 2) If the sum of line 1 plus line 2 is zero or less, enter zero on line 3 and skip to line 8.	\$ <b>55,000</b>
4	<b>API Three Year Distributive Share Amount</b> from Worksheet A, line 7, which is attached to the Schedule K-1 - combined net amount from all APIs, increased by the amount of API Three Year Distributive Share Amount of collectibles gain or loss and/or unrecaptured §1250 gain, if applicable.	\$
5	<b>API Three Year Disposition Amount</b> (from Table 2, line 4) - combined net amount for all APIs	\$
6	<b>Three Year Gain Amount</b> (Add lines 4 and 5) If the sum of line 4 plus line 5 is zero or less, enter zero	\$ <b>20,000</b>
7	<b>Recharacterization Amount</b> (treated as short-term capital gain) Subtract line 6 from line 3 (If zero or less, enter zero)	\$ <b>35,000</b>
8	<b>Section 1061(d) Recharacterization Amount</b> (as determined in §1.1061-5(c))	\$
9	<b>Section 1061 Adjustment to Form 8949</b> Add lines 7 and line 8 (This amount is an adjustment to increase short-term capital gain and decrease long-term capital gain amounts on Form 8949, Parts I and II. See FAQ 3 for instructions on how to report adjustments on tax return)	\$ <b>35,000</b>

Prepared by the taxpayer



Treat as S/T capital gain

Form 8949 increase S/T CG  
& decrease L/T CG



Form  
8949

PP. 261

**Part I Short-Term.** Transactions involving capital assets you held 1 year or less are generally short-term (see instructions). For long-term transactions, see page 2.

**Note:** You may aggregate all short-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS and for which no adjustments or codes are required. Enter the totals directly on Schedule D, line 1a; you aren't required to report these transactions on Form 8949 (see instructions).

**You must check Box A, B, or C below. Check only one box.** If more than one box applies for your short-term transactions, complete a separate Form 8949, page 1, for each applicable box. If you have more short-term transactions than will fit on this page for one or more of the boxes, complete as many forms with the same box checked as you need.

- ☐ **(A)** Short-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS (see **Note** above)
- ☐ **(B)** Short-term transactions reported on Form(s) 1099-B showing basis **wasn't** reported to the IRS
- ☐ **(C)** Short-term transactions not reported to you on Form 1099-B

1	(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold or disposed of (Mo., day, yr.)	(d) Proceeds (sales price) (see instructions)	(e) Cost or other basis. See the <b>Note</b> below and see <i>Column (e)</i> in the separate instructions	Adjustment, if any, to gain or loss. If you enter an amount in column (g), enter a code in column (f). <b>See the separate instructions.</b>		(h) <b>Gain or (loss).</b> Subtract column (e) from column (d) and combine the result with column (g)
	Section 1061 Adjustment							35,000

**Part II Long-Term.** Transactions involving capital assets you held more than 1 year are generally long-term (see instructions). For short-term transactions, see page 1.

**Note:** You may aggregate all long-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS and for which no adjustments or codes are required. Enter the totals directly on Schedule D, line 8a; you aren't required to report these transactions on Form 8949 (see instructions).

**You must check Box D, E, or F below. Check only one box.** If more than one box applies for your long-term transactions, complete a separate Form 8949, page 2, for each applicable box. If you have more long-term transactions than will fit on this page for one or more of the boxes, complete as many forms with the same box checked as you need.

- ☐ **(D)** Long-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS (see **Note** above)
- ☐ **(E)** Long-term transactions reported on Form(s) 1099-B showing basis **wasn't** reported to the IRS
- ☐ **(F)** Long-term transactions not reported to you on Form 1099-B

1	(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold or disposed of (Mo., day, yr.)	(d) Proceeds (sales price) (see instructions)	(e) Cost or other basis. See the <b>Note</b> below and see <i>Column (e)</i> in the separate instructions	Adjustment, if any, to gain or loss. If you enter an amount in column (g), enter a code in column (f). <b>See the separate instructions.</b>		(h) <b>Gain or (loss).</b> Subtract column (e) from column (d) and combine the result with column (g)
	Section 1061 Adjustment							(35,000)



**SCHEDULE D**  
**(Form 1040)**

**Capital Gains and Losses**

OMB No. 1545-0074

Department of the Treasury  
Internal Revenue Service (99)

- ▶ Attach to Form 1040, 1040-SR, or 1040-NR.  
▶ Go to [www.irs.gov/ScheduleD](http://www.irs.gov/ScheduleD) for instructions and the latest information.  
▶ Use Form 8949 to list your transactions for lines 1b, 2, 3, 8b, 9, and 10.

**2021**

Attachment  
Sequence No. **12**

PP. 261

term capital gains or losses, go to Part II below. Otherwise, go to Part III on the back.

**Part II Long-Term Capital Gains and Losses—Generally Assets Held More Than One Year** (see instructions)

See instructions for how to figure the amounts to enter on the lines below.

This form may be easier to complete if you round off cents to whole dollars.

	(d) Proceeds (sales price)	(e) Cost (or other basis)	(g) Adjustments to gain or loss from Form(s) 8949, Part II, line 2, column (g)	(h) Gain or (loss) Subtract column (e) from column (d) and combine the result with column (g)
<b>8a</b> Totals for all long-term transactions reported on Form 1099-B for which basis was reported to the IRS and for which you have no adjustments (see instructions). However, if you choose to report all these transactions on Form 8949, leave this line blank and go to line 8b .				<b>(35,000)</b>
<b>8b</b> Totals for all transactions reported on Form(s) 8949 with <b>Box D</b> checked . . . . .				
<b>9</b> Totals for all transactions reported on Form(s) 8949 with <b>Box E</b> checked . . . . .				
<b>10</b> Totals for all transactions reported on Form(s) 8949 with <b>Box F</b> checked . . . . .				
<b>11</b> Gain from Form 4797, Part I; long-term gain from Forms 2439 and 6252; and long-term gain or (loss) from Forms 4684, 6781, and 8824 . . . . .				<b>11</b>
<b>12</b> Net long-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1 . . . . .				<b>12 55,000</b>
<b>13</b> Capital gain distributions. See the instructions . . . . .				<b>13</b>
<b>14</b> Long-term capital loss carryover. Enter the amount, if any, from line 13 of your <b>Capital Loss Carryover Worksheet</b> in the instructions . . . . .				<b>14 ( )</b>
<b>15 Net long-term capital gain or (loss).</b> Combine lines 8a through 14 in column (h). Then, go to Part III on the back . . . . .				<b>15 20,000</b>

Nets out  
to 20,000

X

## ISSUE #2 PARTNERSHIP ELECTIONS

### **Electing out of Subchapter K**

#### 1. INVESTING PARTNERSHIPS

For investment purposes only and not for the active conduct of a trade or business

#### 2. OPERATING AGREEMENTS (JOINT VENTURES)

Joint production, extraction or use of property, but not for purpose of selling services or property



Members must be able to determine their income without computing partnership taxable income

## INVESTING PARTNERSHIPS

- Joint purchase, retention, sale or exchange of investment property
  - Hold as co-owners
  - Reserve right to take or dispose their share
  - Do not actively conduct business

## OPERATING AGREEMENTS

- Joint production, extraction or use of property
  - Own property as co-owners
  - Reserve the right to separate
  - Do not jointly sell services

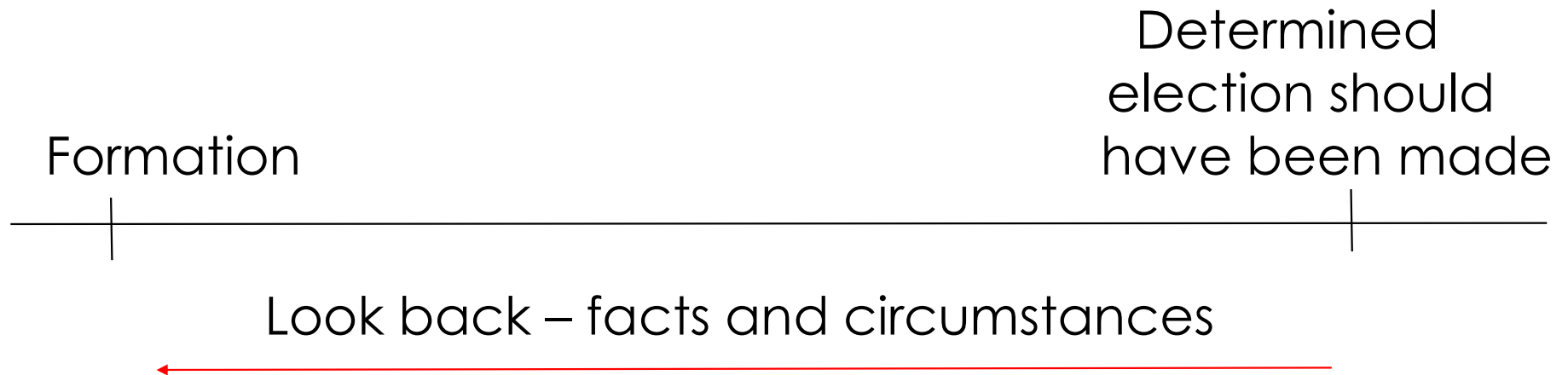
## MAKING THE ELECTION

- By the extended due date for filing the return
- Statement – attached to properly filed 1065
- Include:
  - Names, addresses, ID #
  - Statement that it qualifies
  - Statement that all members elect
  - Where a copy of the agreement is available

(No numbers on 1065, only the attached statement)

## PRACTITIONER NOTE: DEEMED ELECTIONS

PP. 263



1. An agreement exists at the beginning
2. The members report their respective shares

## PARTIAL ELECTION (IF ELIGIBLE FOR A FULL EXCLUSION)

ELECTION – Within 90 days of beginning of first year

### **Subchapter K – Partners and Partnerships (Sections 701 to 777)**

Part I — Determination of Tax Liability (Sections 701 to 709)

Part II — Contributions, distributions, and transfers (Sections 721 to 755)

Part III — Definitions (Section 761)

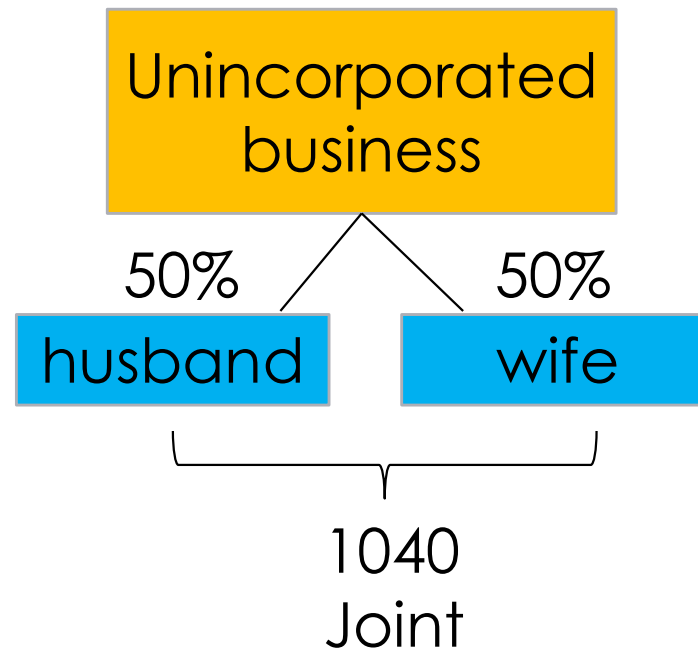
Part IV — SPECIAL RULES FOR ELECTING LARGE PARTNERSHIPS (Sections 771 to 777) [Repealed]

Partnership rules to  
be followed

Partnership rules from  
which exclusion is  
request

## QUALIFIED JOINT VENTURE

General rule:  
Partnership



Elect:  
Not to be treated  
as a partnership



## ENTITY-LEVEL ELECTIONS

PP. 263 & 264

IRC 168 elections:

- Slower method of MACRS
- Alternative Depreciation system
- Certain Bonus depreciation



IRC 179 – tricky:

- 1,080,000 limit applies at both entity and owner level
- Taxable income limit applies at both levels

IRC 263 elections:

- De minimis safe harbor
- Qualifying building expenditures
- Capitalization of amounts paid for repairs and maintenance



## RECOVER BASIS RATABLY

Liquidating distribution



Recover basis  
= gain/loss recognized

Liquidating fixed-sum payments



Elect to recover basis ratably  
= gain/loss recognized as each payment received

(Except Hot assets)

## EXAMPLE 7.8 – NO ELECTION. 731 GENERAL RULES

PP. 264 & 265

$$475,000 - \text{basis } 250,000 = \text{gain } 225,000$$

sales	47,500	47,500	47,500	47,500	47,500	47,500	47,500	47,500	47,500	47,500	47,500
Hot assets	<u>(10,000)</u>	<u>(10,000)</u>	<u>(10,000)</u>	<u>(10,000)</u>	<u>(10,000)</u>	<u>(10,000)</u>	<u>(10,000)</u>	<u>(10,000)</u>	<u>(10,000)</u>	<u>(10,000)</u>	<u>(10,000)</u>
<b>Ordinary Income = 100,000 (some say all in first year)</b>											

### Capital assets:

Balance	37,500	37,500	37,500	37,500	37,500	37,500	37,500	37,500	37,500	37,500	37,500
Basis 6 yrs	<u>(37,500)</u>	<u>(37,500)</u>	<u>(37,500)</u>	<u>(37,500)</u>	<u>(37,500)</u>	<u>(37,500)</u>	<u>(37,500)</u>	<u>(25,000)</u>	= 250,000		
Cap Gain	-0-	-0-	-0-	-0-	-0-	-0-	-0-	12,500	37,500	37,500	37,500
								<b>Capital Gains = 125,000</b>			

**Total gain = 225,000**

## EXAMPLE 7.8 – ELECT TO RECOVER BASIS RATABLY

PP. 264 & 265

$$475,000 - \text{basis } 250,000 = \text{gain } 225,000$$

sales	47,500	47,500	47,500	47,500	47,500	47,500	47,500	47,500	47,500	47,500	47,500
Hot assets	<u>(10,000)</u>	<u>(10,000)</u>	<u>(10,000)</u>	<u>(10,000)</u>	<u>(10,000)</u>	<u>(10,000)</u>	<u>(10,000)</u>	<u>(10,000)</u>	<u>(10,000)</u>	<u>(10,000)</u>	<u>(10,000)</u>
<b>Ordinary Income = 100,000 (no change)</b>											

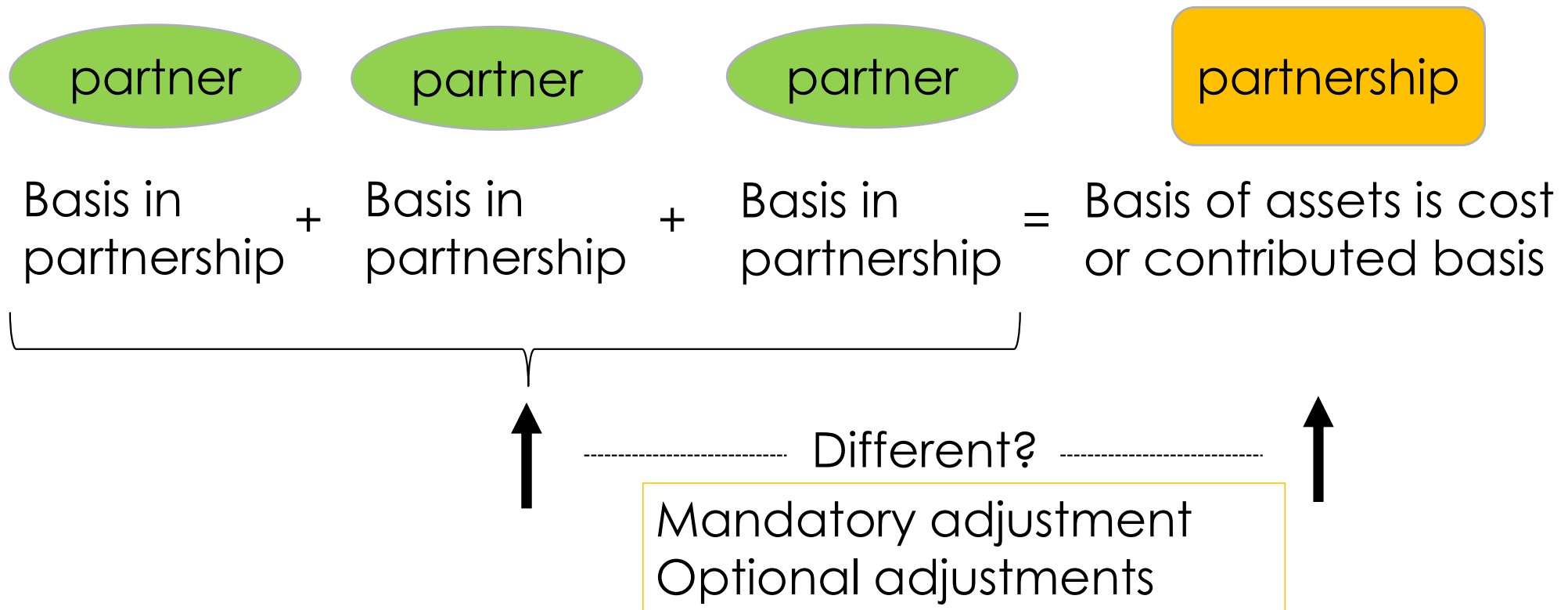
### Capital assets:

Balance	37,500	37,500	37,500	37,500	37,500	37,500	37,500	37,500	37,500	37,500	37,500
Basis	<u>(25,000)</u>	<u>(25,000)</u>	<u>(25,000)</u>	<u>(25,000)</u>	<u>(25,000)</u>	<u>(25,000)</u>	<u>(25,000)</u>	<u>(25,000)</u>	<u>(25,000)</u>	<u>(25,000)</u>	<u>(25,000)</u>
Cap Gain	12,500	12,500	12,500	12,500	12,500	12,500	12,500	12,500	12,500	12,500	12,500
<b>Capital Gains = 125,000</b>											

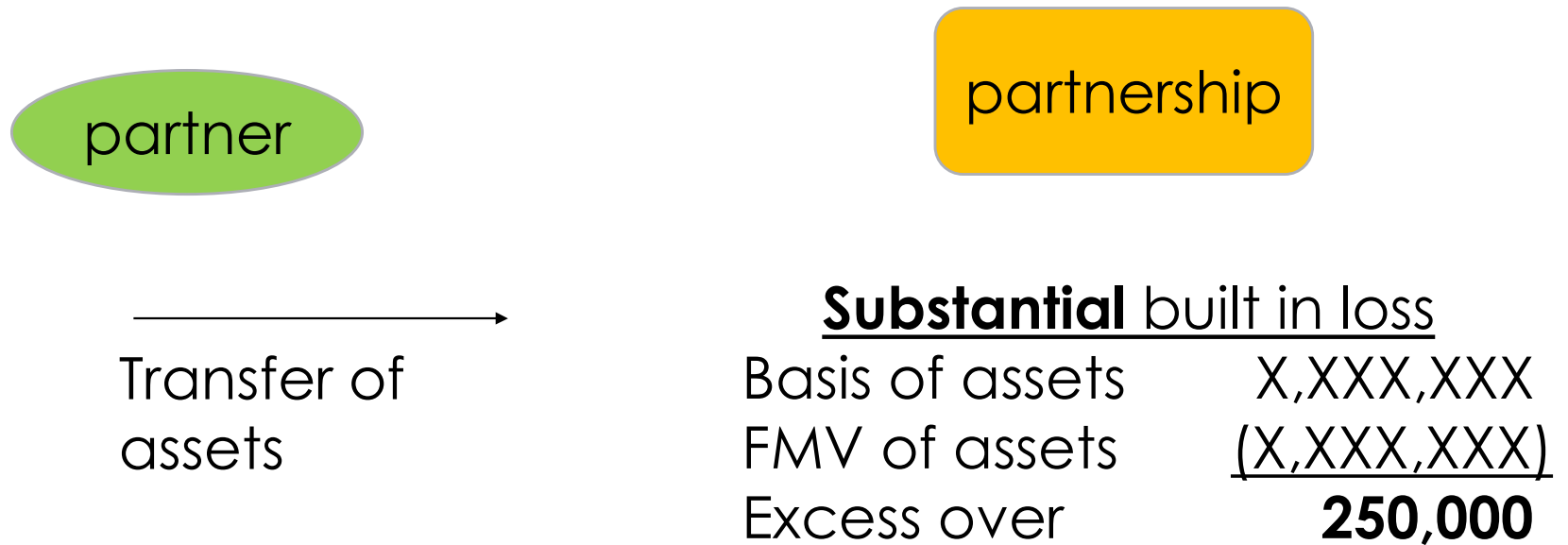
Recognizes income sooner

**Total gain = 225,000**

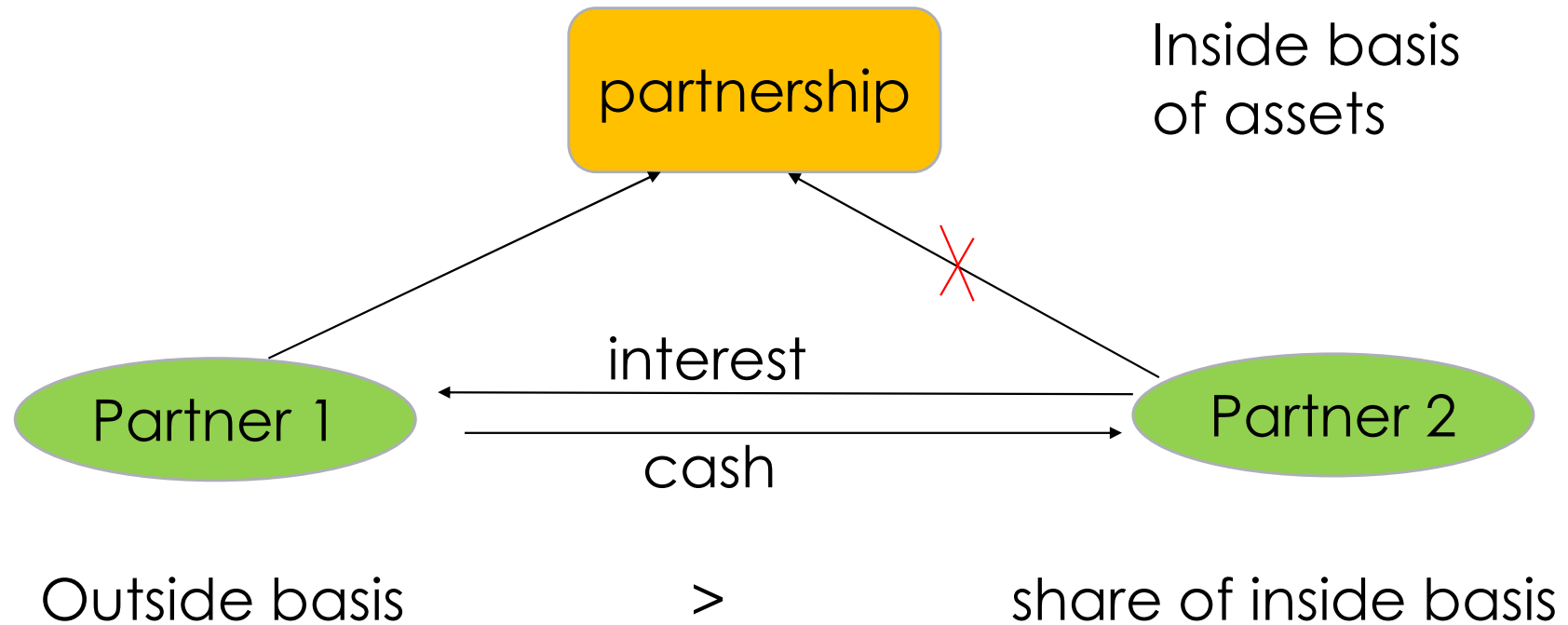
## 754 ELECTION TO ADJUST BASIS OF PARTNERSHIP ASSETS



## PRACTITIONER NOTE: MANDATORY



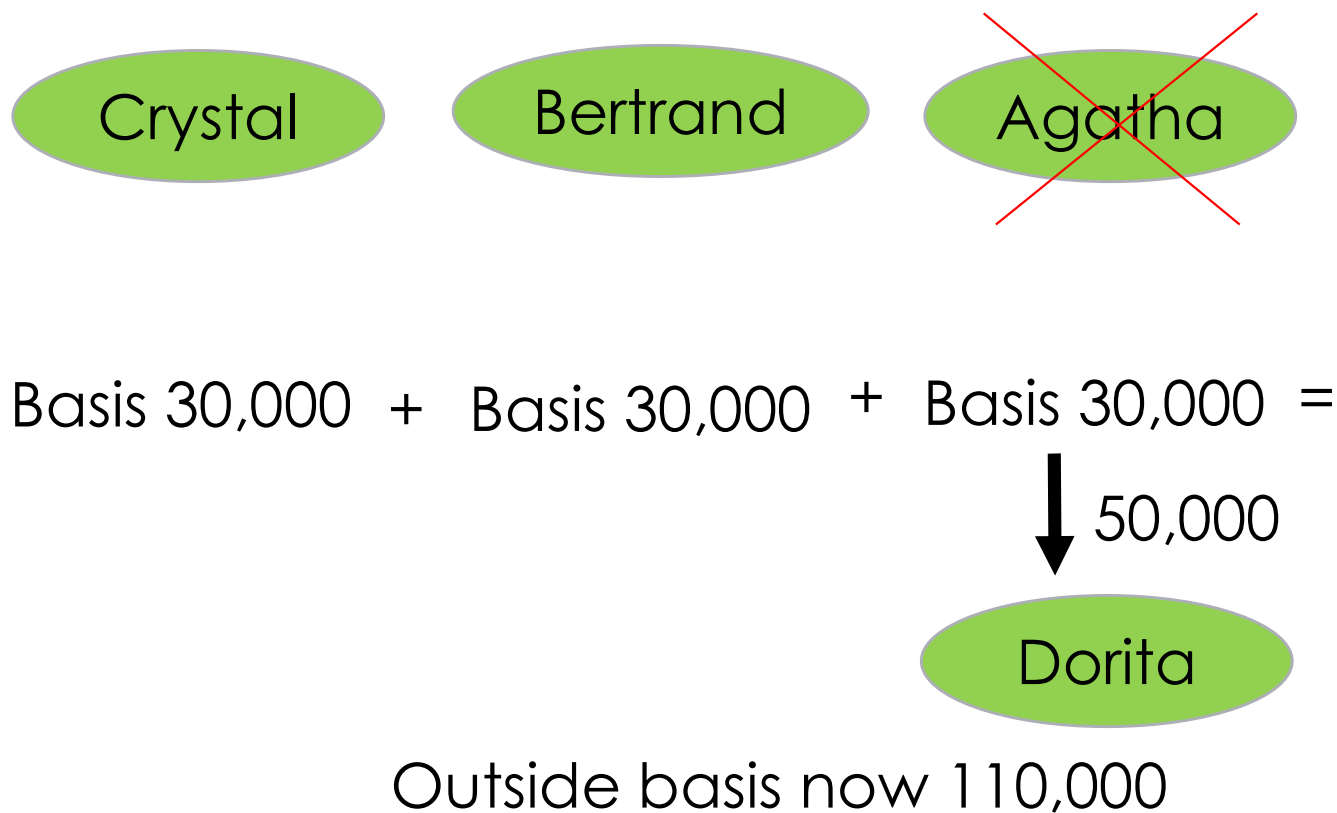
OPTIONAL #1



Benefits new partner

743

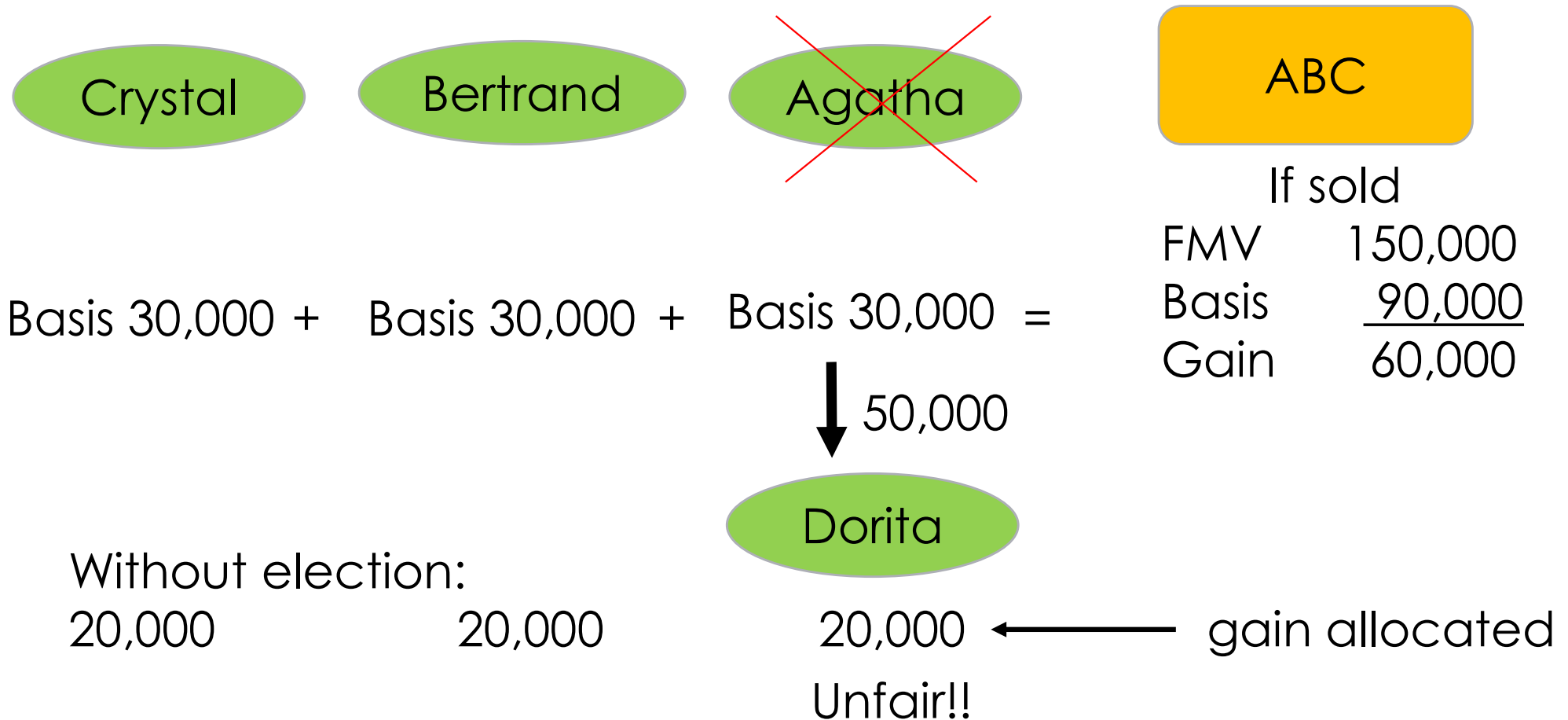
## EXAMPLE 7.9 OPTIONAL ADJUSTMENT #1



ABC	
Asset = land	
FMV	150,000
Basis	90,000
≠	90,000



## EXAMPLE 7.9 IF LAND SOLD FOR 150,000



## EXAMPLE 7.9

If election made, there is a basis adjustment for Dorita equal to the amount of gain recognized by Agatha.

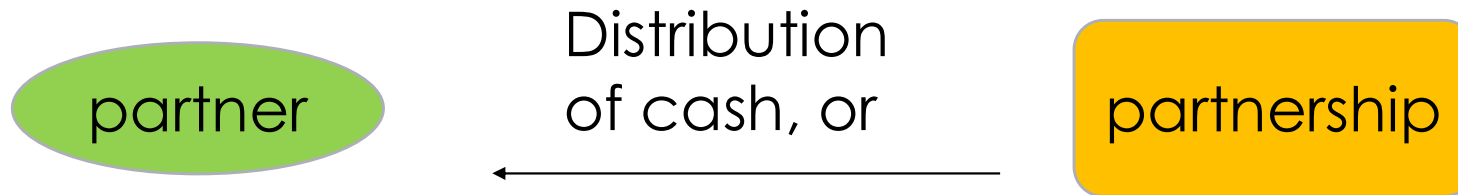
New basis in the land for Dorita is 110,000:

Original basis	90,000
adjustment	<u>20,000</u>
New basis	110,000

Upon sale:

Bertrand + Crystal  $150,000 - 110,000 = 40,000 / 2 = 20,000$  gain  
Dorita no gain

## OPTIONAL #2



Distribution of property  
where outside basis is less  
than inside basis

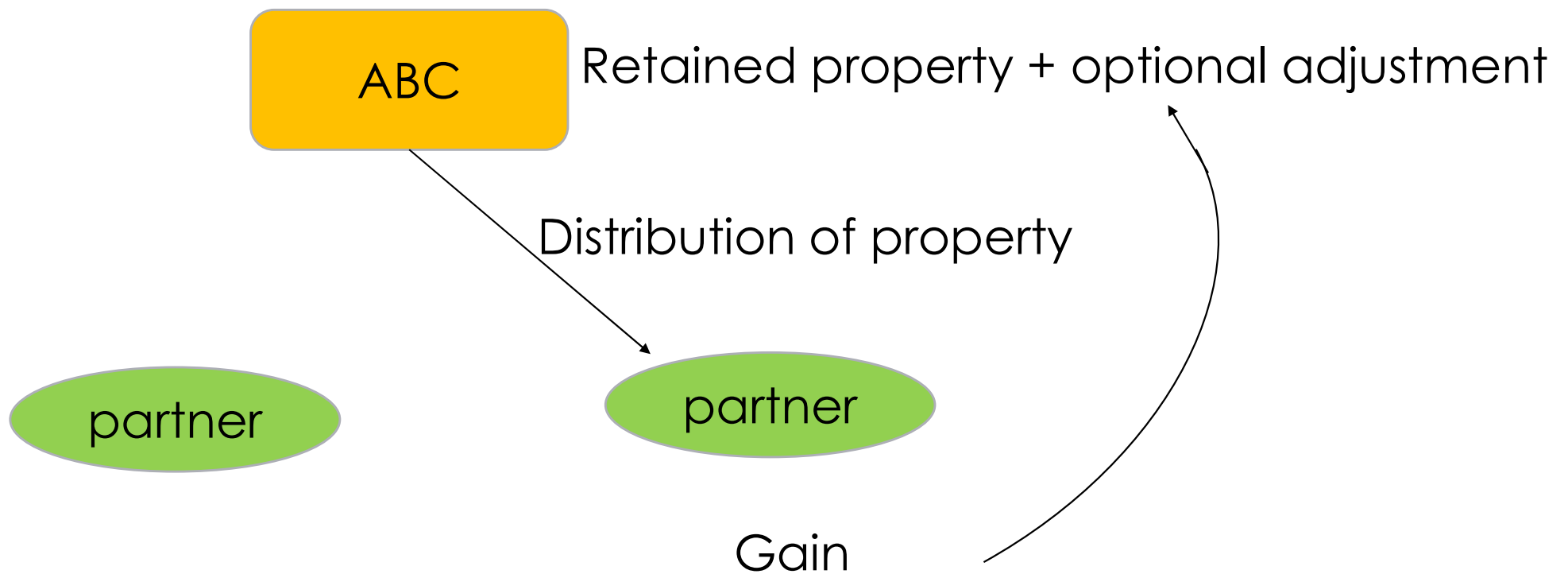
**Gain is recognized**

# 734

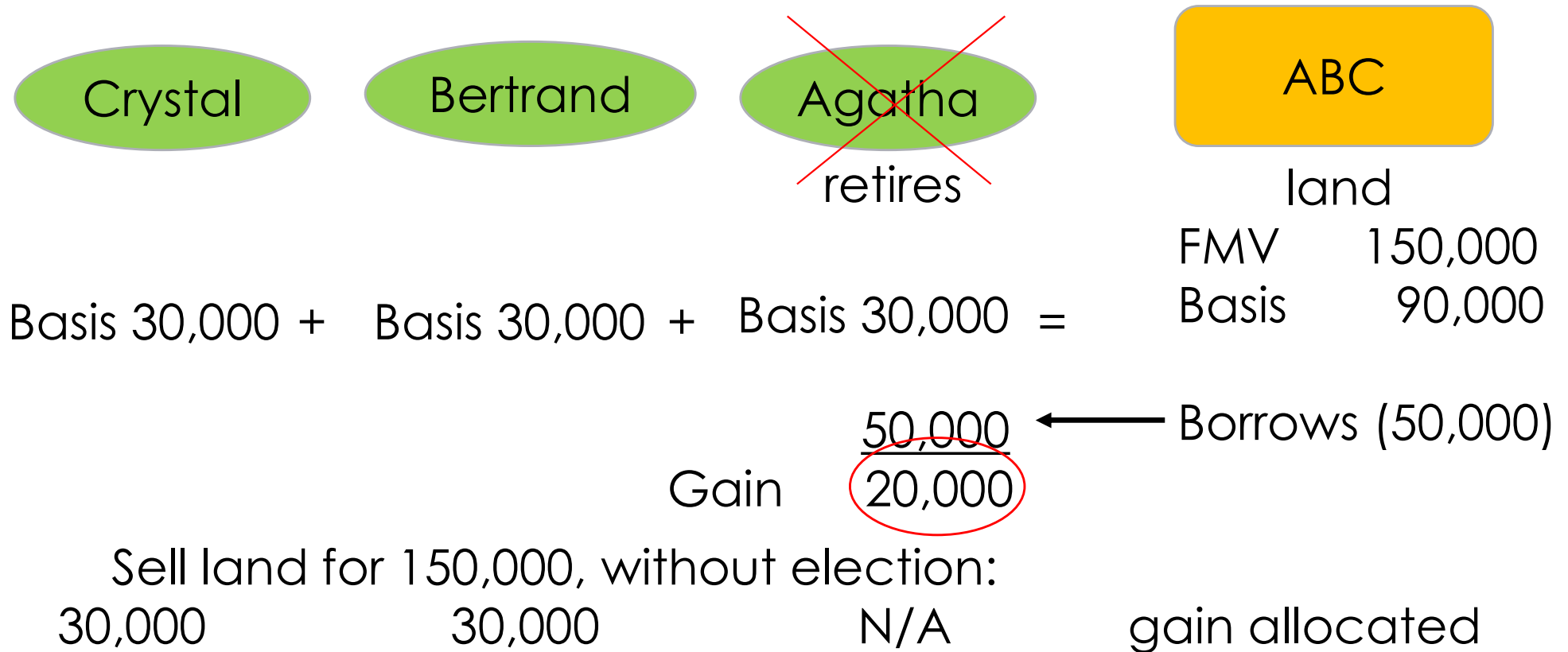
Benefits partnership

## OPTIONAL #2 DISTRIBUTION OF PROPERTY

PP. 267



## EXAMPLE 7.10 OPTIONAL ADJUSTMENT #2



Unfair to Crystal and Bertrand!! Real gain should be 20,000 each

## EXAMPLE 7.10

Crystal

Bertrand

ABC

land

Basis 30,000 + Basis 30,000

FMV 150,000

Basis 90,000

754 Increase +20,000

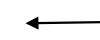
110,000

With election:

20,000

20,000

gain allocated



Gain

40,000

fair

## OPTIONAL #3

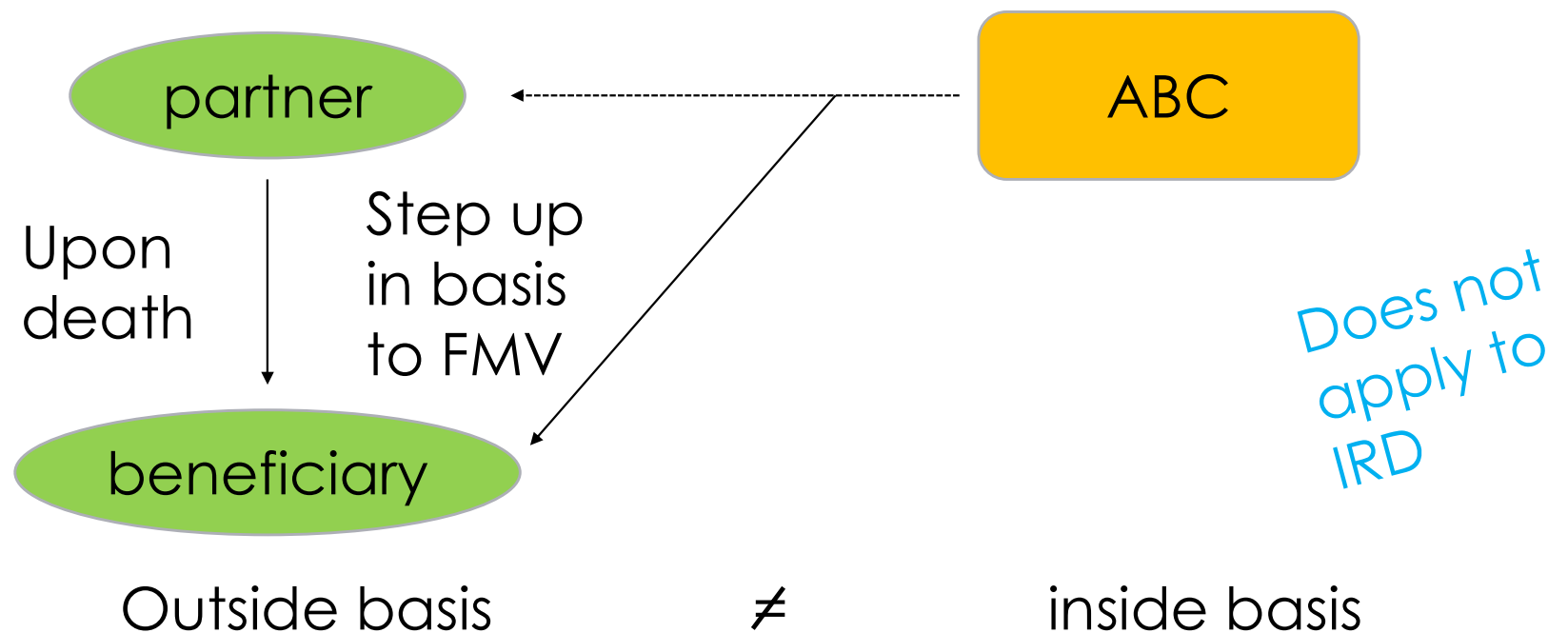


Gain is recognized because liabilities in excess of basis

Benefits partnership

# TRANSFER ON DEATH

PP. 266



Optional basis adjustment can correct this



**Very detailed examples:**

Example 7.11 – Calculating the adjustment on transfer of a Partnership Interest

Example 7.12 – Calculating the adjustment on a distribution of Cash or Property

Example 7.13 – Allocation of Basis Adjustment – transfer of a Partnership Interest

## COMPUTATION



Election



Transfer of an interest by sale, exchange,  
or upon death



Distribution of property

## 754 ELECTION

PP. 271 & 272



By due date of return when transfer or distribution takes place.  
1065 due 3/15



Once made, optional basis adjustment must be made each time:

- Partnership interest sold or exchanged

- Transferred at death

- Distributions which resulted in recognition of gain or loss

## STATEMENT

PP. 272

Name, address and TIN

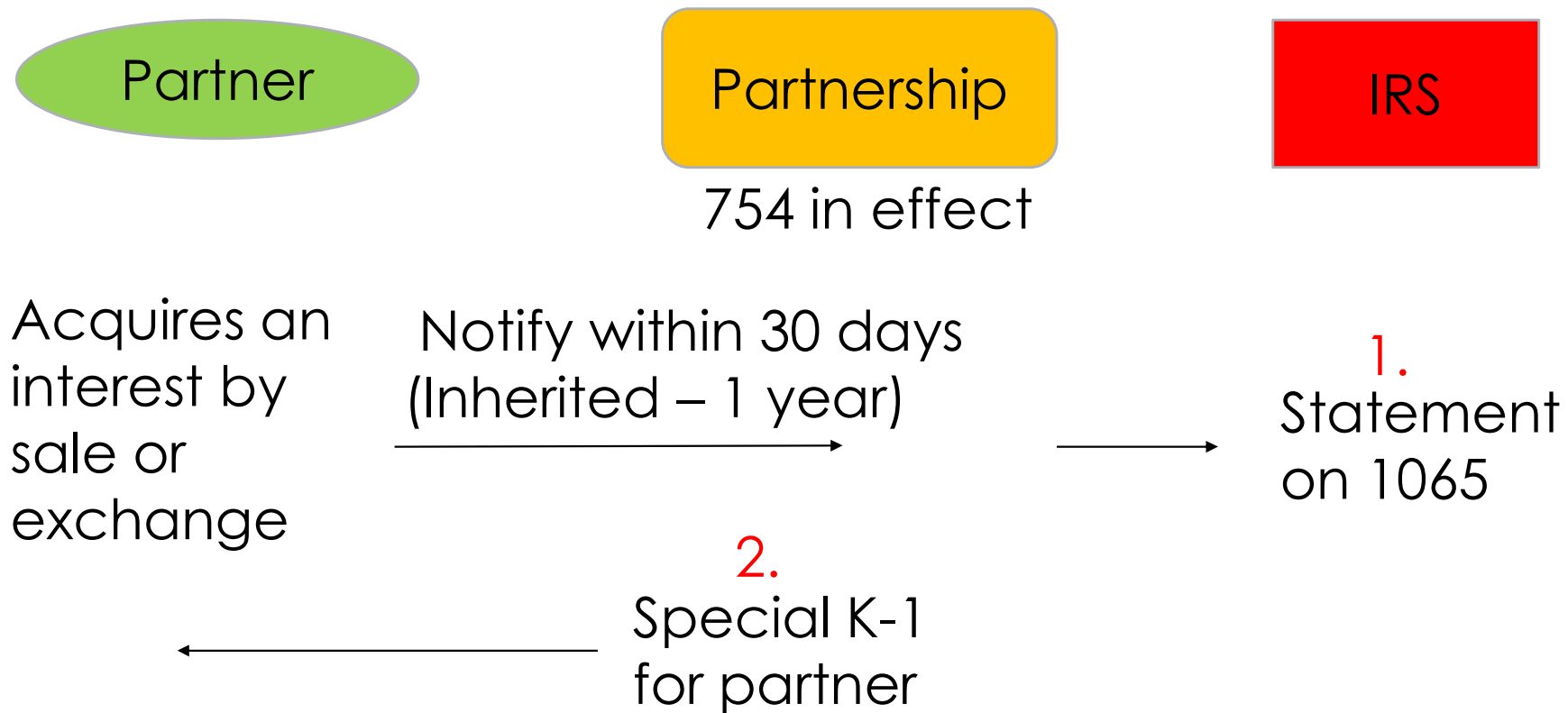
Declaration -754 election applies to 734(b) and 743(b)

Signature (removed to facilitate electronic filing)

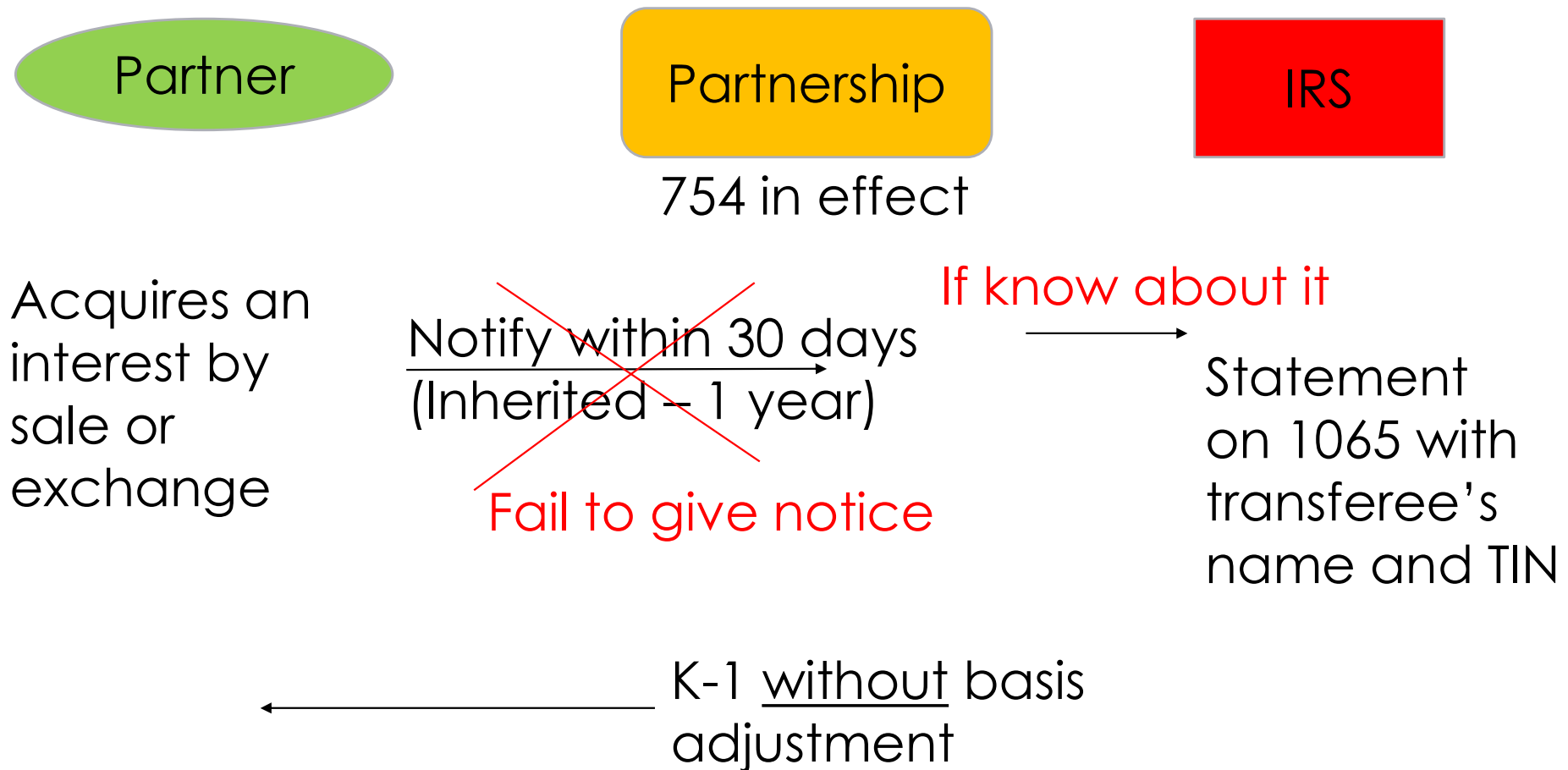
Check YES on lines 10a and 10b, Schedule B

transferor to, a foreign trust? If "Yes," the partnership may have to file Form 9920, Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts. See instructions . . . . .		<input type="checkbox"/>	<input type="checkbox"/>
<b>10a</b>	Is the partnership making, or had it previously made (and not revoked), a <u>section 754 election</u> ? . . . . . See instructions for details regarding a section 754 election.	<input checked="" type="checkbox"/>	<input type="checkbox"/>
<b>b</b>	Did the partnership make for this tax year an optional basis adjustment under section <u>743(b) or 734(b)</u> ? If "Yes," attach a statement showing the computation and allocation of the basis adjustment. See instructions . . . . .	<input checked="" type="checkbox"/>	<input type="checkbox"/>

## REPORTING 743(B)



## REPORTING 743(B)



Optional basis adjustment because of a distribution to a partner;

Attach a statement

If increases recovery property, treat as newly purchased.

If decreases basis, reduces subsequent depreciation

# REVOCATION OF 754 ELECTION

PP. 273

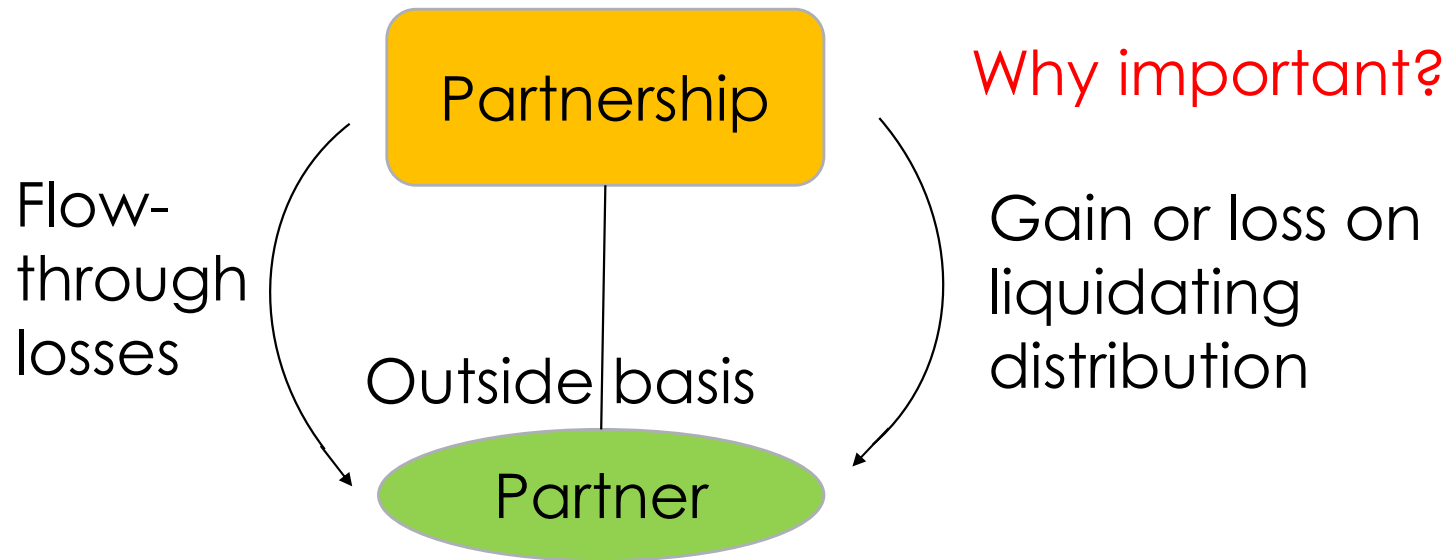
Form <b>15254</b> (February 2021)	Department of the Treasury - Internal Revenue Service <b>Request for Section 754 Revocation</b> ► Go to <a href="http://www.irs.gov/Form15254">www.irs.gov/Form15254</a> for instructions and the latest information.	OMB Number 1545-2297
Name of partnership		
Employer identification number		Principal business activity code number (see instructions)
Number, street, and room or suite no. If a P.O. box, see the instructions.		
City or town, state or province, country, and ZIP or foreign postal code		
Tax year end section 754 election was made (MM/DD/YYYY)		Revocation tax year begins (MM/DD/YYYY)
Name of contact person (see instructions)		Contact person's telephone number
If Form 2848, Power of Attorney and Declaration of Representative, is attached (see instructions for when Form 2848 is required), check this box <input type="checkbox"/>		
<b>Caution:</b> In order to prevent delays in processing this request, the partnership must provide all information required by Form 15254. Include any documentation in support of the request even if not specifically requested by Form 15254 and its instructions.		
<b>Part I - Information for All Requests</b>		
1. Has the partnership previously revoked a section 754 election? See instructions <input type="checkbox"/> Yes <input type="checkbox"/> No		
2. Does the section 754 election result in or is it expected to result in a substantial administrative burden to the partnership? <input type="checkbox"/> Yes <input type="checkbox"/> No		
a. Has the nature of the partnership's business changed, or is it expected to change <input type="checkbox"/> Yes <input type="checkbox"/> No		
b. Has there been a substantial increase in the assets of the partnership or a change in the character of partnership assets <input type="checkbox"/> Yes <input type="checkbox"/> No		
c. Has there been, or is there expected to be, an increased frequency of retirements or shifts of partnership interests <input type="checkbox"/> Yes <input type="checkbox"/> No		
3. Will the revocation of the section 754 election result in an avoidance of a reduction in the basis of partnership assets under section 734(b) or section 743(b)? If yes, provide documentation of the amount. See instructions. <input type="checkbox"/> Yes <input type="checkbox"/> No		
<b>Part II - Reason for the Request</b>		
In the space provided below, tell us why the partnership is filing this revocation request. Attach additional statements if needed. Attach supporting documents. See instructions.		

- Change in nature of business
- Increase in assets
- Character of assets
- Frequency of shifts in partners



## ISSUE #3 BASIS IN A PARTNERSHIP INTEREST

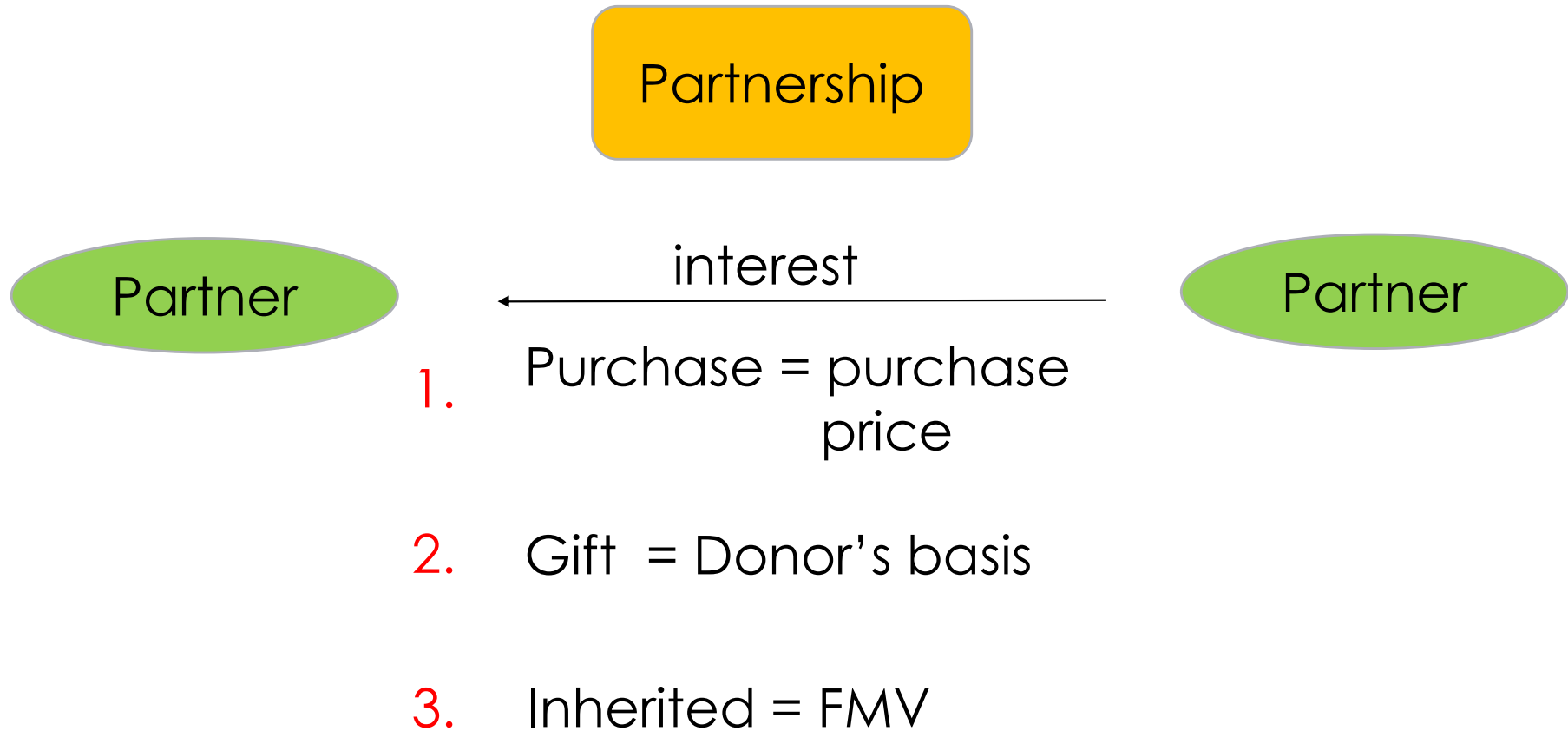
PP. 275



How do you calculate and adjust the basis of a partnership interest?

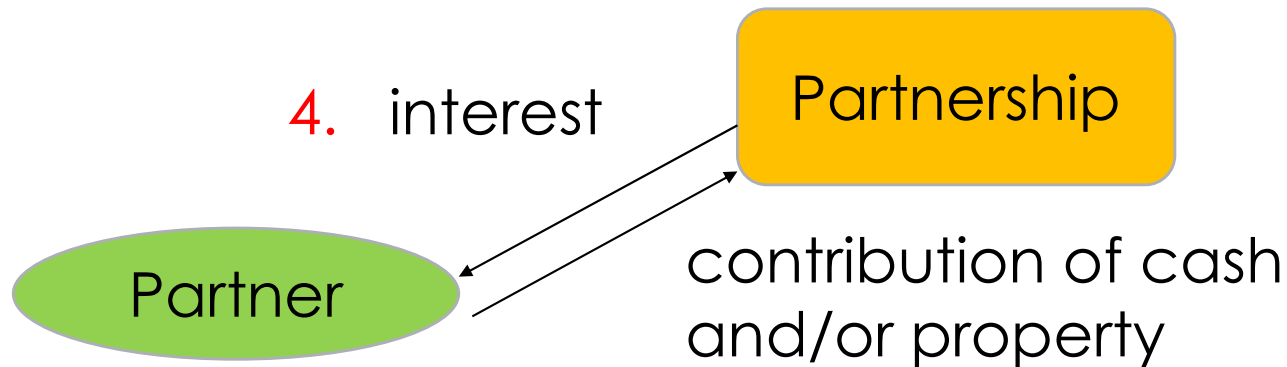
## INITIAL BASIS

PP. 275



## INITIAL BASIS

PP. 275



721 – no gain recognized by partnership or partner

722 – initial basis equals money and adjusted basis in the property contributed

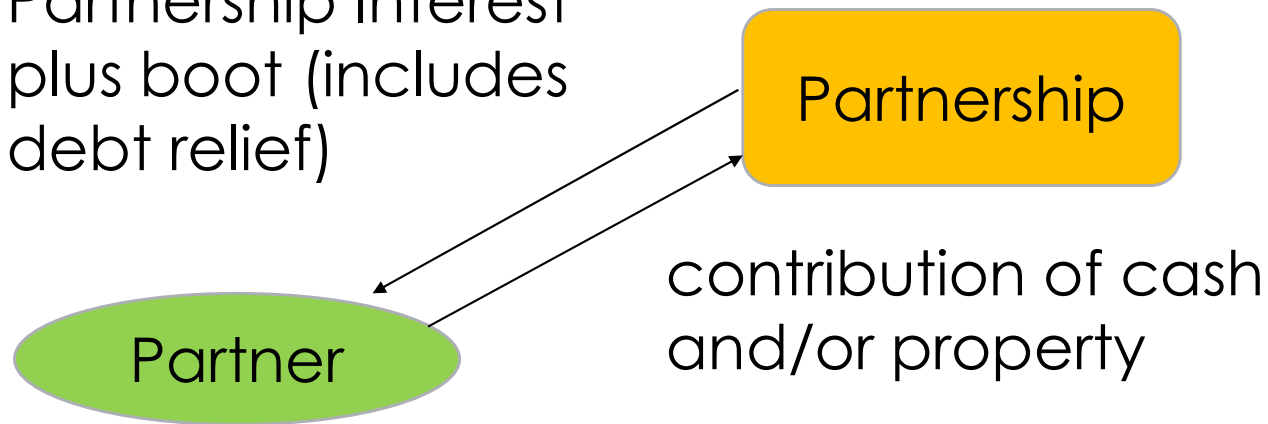
752 – increase in share of liabilities considered contribution of money

Exception on next slide!

## INITIAL BASIS

PP. 275

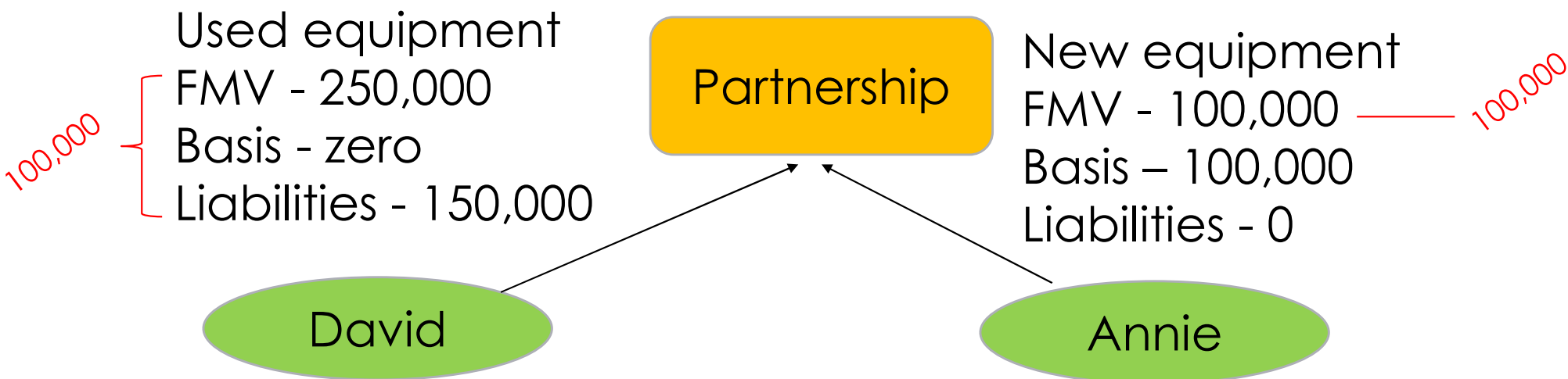
Partnership Interest  
plus boot (includes  
debt relief)



Gain, if boot > basis

## EXAMPLE 7.14

PP. 275 + 276



Initial basis	0
Liabilities to partnership (150,000)	
Liabilities assumed	<u>75,000</u>
Tentative basis	(75,000)
Recognized gain	<u>75,000</u>
Adjusted basis	0

Initial basis	100,000
Liabilities to partnership	0
Liabilities assumed	<u>75,000</u>
Tentative basis	175,000
Recognized gain	<u>0</u>
Adjusted basis	175,000

## ADJUSTMENTS TO OUTSIDE BASIS

PP. 277



Increase:

- Adjusted tax basis of additional contributed property
- Increase share of partnership liabilities
- Share of partnership income or gain
- Share of tax-exempt income



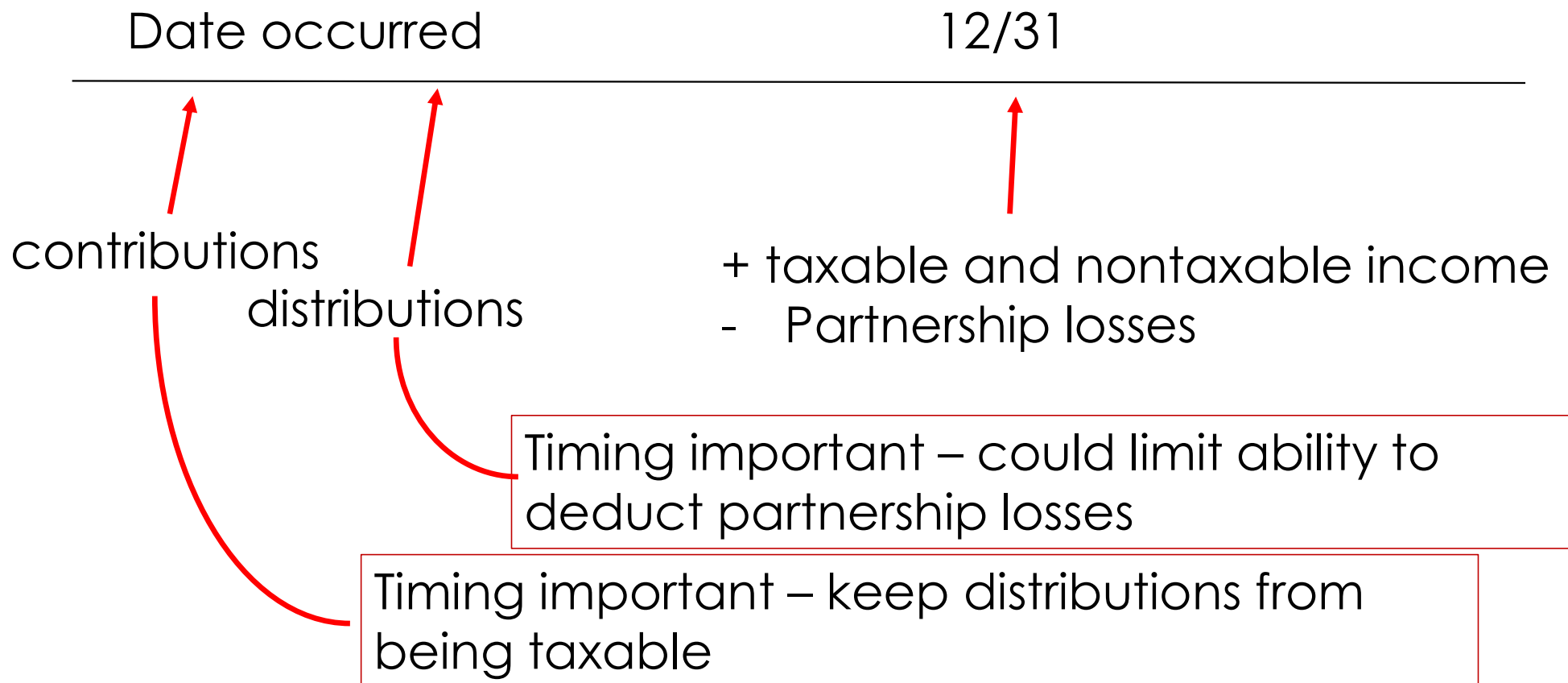
Decrease:

- Cash distributions & tax basis of property distributions
- Decrease share of partnership liabilities
- Share of losses and deduction
- Share of nondeductible expenses



## TIMING OF BASIS ADJUSTMENTS

PP. 277





## TRACKING BASIS

PP. 277

Who is responsible for tracking basis?

Partner

Partner's responsibility to track outside basis.

- Limits deductibility of losses
- Determines whether cash distributions are tax free

Partnership

Outside basis has no effect on partnership tax reporting

No requirement to report outside basis to the IRS



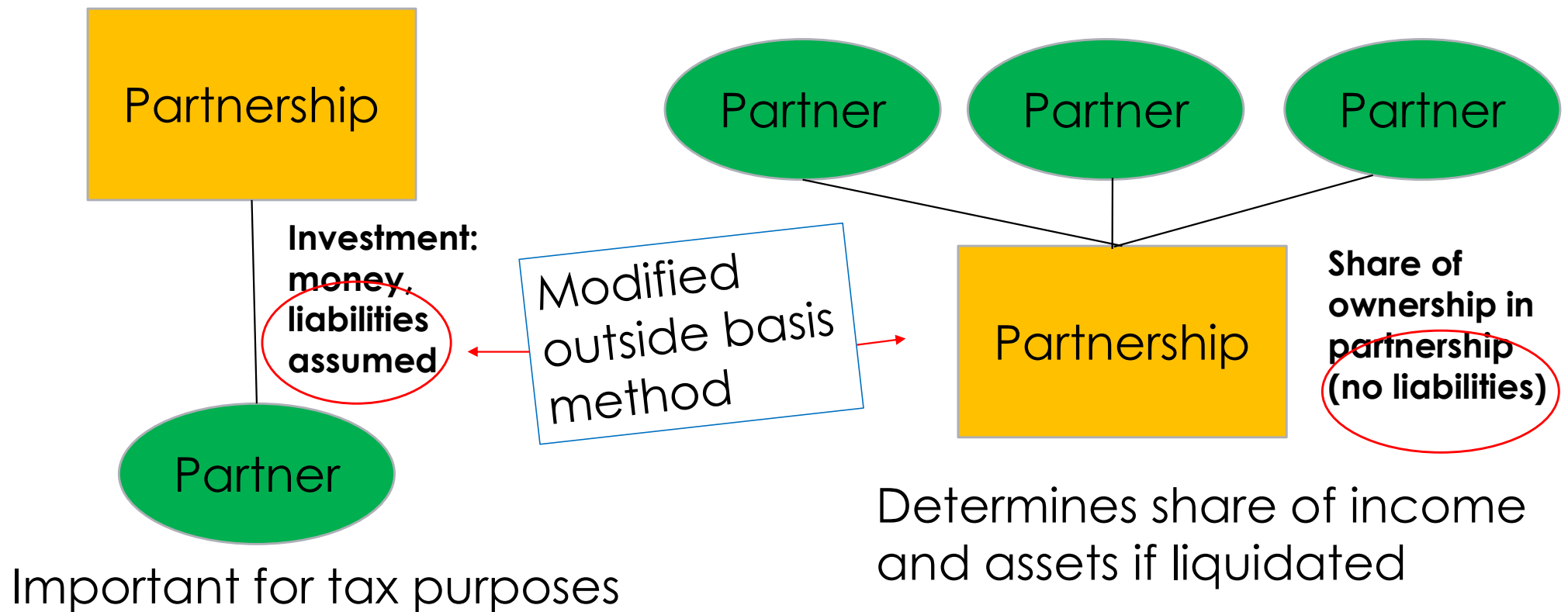
IRS

CHAPTER 11- RULINGS AND CASES – page 434

*Kohout v Commissioner TC MEMO 2022-37*

*“If the partner cannot establish the adjusted basis in his or her interest, then the partner cannot deduct any partnership loss. Proof of basis is a specific fact that the taxpayer has the burden of proving.”*

# Tax Basis in Partnership $\neq$ Tax Basis Capital Account



## EXAMPLE 7.15

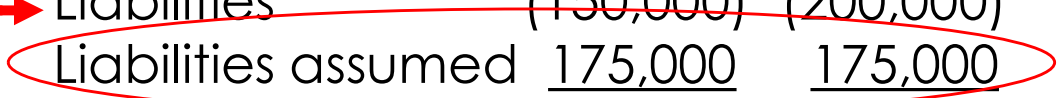
PP. 279- 282

### Tax Capital Account

	<u>George</u>	<u>John</u>
Cash	100,000	150,000
New Equip	<u>250,000</u>	<u>250,000</u>
Assets	350,000	350,000
Liabilities	<u>(150,000)</u>	<u>(200,000)</u>
Capital acct	200,000	200,000

### Initial Outside Basis

	<u>George</u>	<u>John</u>
Cash	100,000	150,000
New Equip	<u>250,000</u>	<u>250,000</u>
Assets	350,000	350,000
Liabilities	<u>(150,000)</u>	<u>(200,000)</u>
Liabilities assumed	<u>175,000</u>	<u>175,000</u>
Initial outside basis	375,000	375,000



# OUTSIDE BASIS

PP. 282

		<u>George</u>	<u>John</u>
	Assets contributed	350,000	350,000
	Liabilities contributed	(150,000)	(200,000)
	Liabilities assumed	<u>175,000</u>	<u>175,000</u>
Initial outside basis	→ Initial outside basis	375,000	375,000
	<u>2022:</u>		
	Allocated income	140,000	140,000
	Actual distribution	(200,000)	(150,000)
Figure 7.22 – pg 282	→ Change in liabilities	<u>(5,000)</u>	<u>(55,000)</u>
Ending outside basis	→ Ending outside basis	310,000	310,000

Short cut  
next slide!

## QUICK FORMULA FOR OUTSIDE BASIS

John's  
K-1

	Beginning	Ending
Profit	%	%
Loss	%	%
Capital	%	%
Check if decrease is due to sale or exchange of partnership interest . ► <input type="checkbox"/>		
<b>K Partner's share of liabilities:</b>		
	Beginning	Ending
Nonrecourse . . . \$		\$
Qualified nonrecourse financing . . . . \$		\$
Recourse . . . . \$	<b>175,000</b>	<b>120,000</b>
Check this box if Item K includes liability amounts from lower tier partnerships ► <input type="checkbox"/>		
<b>L Partner's Capital Account Analysis</b>		
Beginning capital account . . . . \$	<b>200,000</b>	
Capital contributed during the year . . . \$		
Current year net income (loss) . . . . \$	<b>140,000</b>	
Other increase (decrease) (attach explanation) \$		
Withdrawals and distributions . . . . \$ (	<b>150,000</b>	)
Ending capital account . . . . . \$	<b>190,000</b>	

Not if interest  
acquired by  
purchase or  
inherited  
or distribution  
limited by  
basis

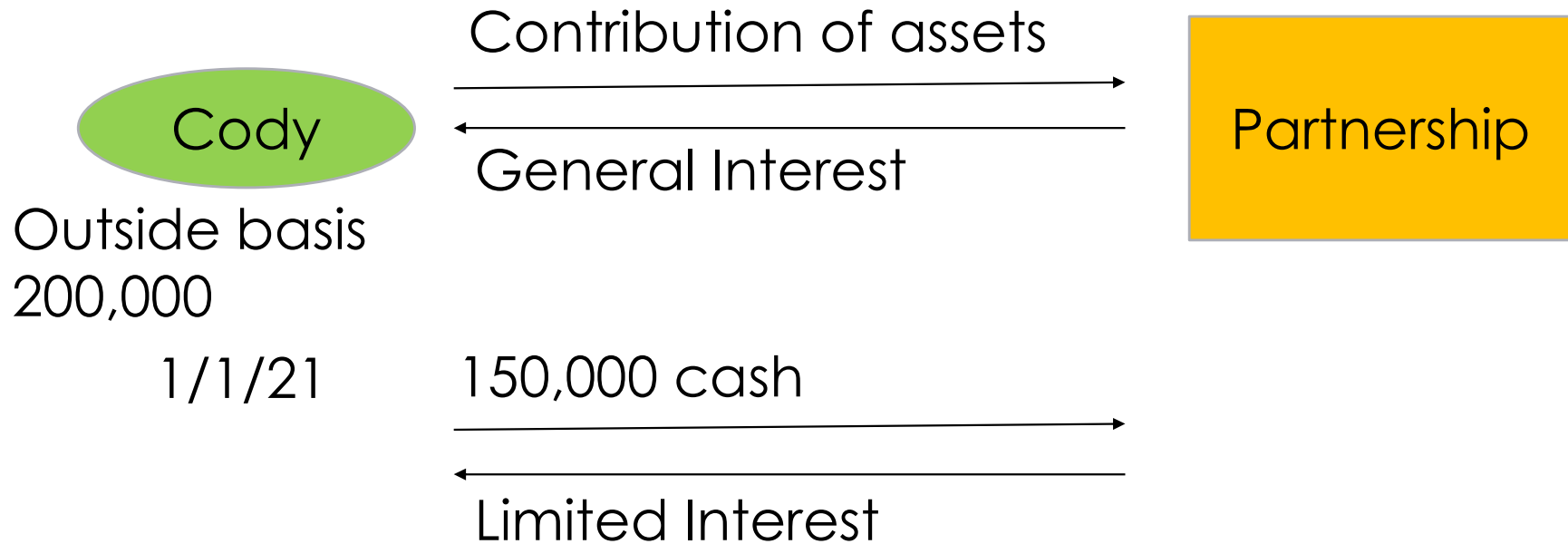
190,000  
120,000  
310,000 outside  
basis

## UNITARY BASIS

A partner has a single unitary basis in total partnership interest. Even if:

- Acquired at different times and in different ways
- General and limited interest
- Different classes of partnership interest

## EXAMPLE 7.16 - 2021



In 2021, partnership allocated 50,000 income to limited interest, but none to general interest



## EXAMPLE 7.16 - 2022

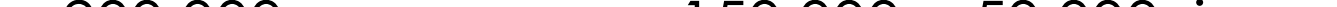
PP. 284

Cody:	<u>General Interest</u>	<u>Limited Interest</u>	
FMV	500,000	225,000	= 725,000

Cody  
retained

Cody sells  
for 225,000

Unitary basis      200,000      +      150,000 + 50,000 income



300,000

$$400,000 \times 225/725 = 124,138$$

Sales price	<u>225,000</u>
Gain	100,862

## SCHEDULE K-2 AND K-3

New for 2021 Partnership tax returns  
Also applies to S corps

Intended to improve **international tax information reporting**



10/25/22 – Draft Instructions for 2022  
Partnership Schedule K-2 and K-3 issued by  
IRS.

## SCHEDULE K-2 AND K-3

PP. 284

26 frequently asked questions:

- + 1. What are the Schedules K-2 and K-3? (added February 16, 2022)**
- + 2. Why is the IRS creating Schedules K-2 and K-3 for Forms 1065, 1120S, and 8865? (added February 16, 2022)**
- + 3. Why is the IRS creating Schedules K-2 and K-3 now? (added February 16, 2022)**
- + 4. What are the benefits of the Schedules K-2 and K-3 for taxpayers? (added February 16, 2022)**
- + 5. Do Schedules K-2 and K-3 require new information that wasn't previously required for partners or shareholders to accurately complete their own returns? (added February 16, 2022)**
- + 6. What is the authority underlying Schedules K-2 and K-3? (added February 16, 2022)**

**X**

Any  
Questions