

- 20.
- a. The partnership recognizes no gain or loss as a result of the distribution.
  - b. Since this is a proportionate nonliquidating distribution, Hayden would only recognize gain if the cash received exceeded his outside basis. He would only recognize loss under limited conditions, and only if his interest in the partnership terminated. Therefore, he has no recognized gain or loss.
  - c. Hayden takes a basis in the inventory equal to the partnership's basis in the inventory, or \$60,000. His \$420,000 basis in the partnership is reduced first by the \$100,000 cash distribution, then by the \$60,000 inventory distribution. He takes a basis in the land equal to the partnership's basis in the land, or \$75,000. The land distribution reduces his basis in the partnership interest to \$185,000.

#### Example 9

- 21.
- a. A partnership recognizes no gain or loss on a distribution that does not alter the partner's proportionate ownership of hot assets.
  - b. Laura recognizes no gain or loss on the distribution. Gain is recognized on a nonliquidating distribution if the amount of cash or certain marketable securities received exceeds the partner's outside basis immediately before the distribution.
  - c. The cash is deemed distributed first and reduces Laura's outside basis to \$20,000. The account receivable is distributed next, and takes a substituted and carryover basis of \$0. The land is distributed last and takes a substituted basis of \$20,000. The receivable distribution does not change Laura's outside basis. The value she received was \$220,000 (compared to her basis of \$100,000), but she recognizes no gain or loss because of the basis allocation and ordering rules.

#### Examples 8 and 9

- 22.
- a. Kim recognizes a \$15,000 gain on the distribution. Her outside basis for her partnership interest is reduced to \$0. The partnership does not recognize any gain or loss on the transaction.
  - b. The \$20,000 cash is deemed distributed first and reduces Kandy's outside basis to \$40,000. The land takes a \$30,000 carryover basis to Kandy, and her outside basis for her partnership interest is reduced to \$10,000. The partnership recognizes no gain or loss on the transaction.
  - c. Kandy recognizes no gain or loss on the cash distribution, the land takes a substituted basis to Kandy of \$12,000, and her outside basis for the partnership interest is reduced to \$0.
  - d. The cash is deemed distributed first and results in a \$10,000 taxable gain to Kerri because it exceeds her basis in the interest before the distribution. The inventory takes a \$0 substituted basis. Kerri's outside basis is reduced to \$0 as a result of the cash distribution. The inventory distribution does not affect her basis. The partnership recognizes no gain or loss on the distribution.

#### Examples 3 to 9

23. In some of these situations, the partnership making the distribution may wish to make an election under § 754 to adjust the basis of partnership assets. If a § 754 election is made as a result of a distribution, the basis increase is allocated to partnership assets, and all the partners share in the increase and any resulting deductions.
- If a § 754 election is made, the partnership would increase its basis in remaining partnership assets by \$15,000 (\$15,000 gain recognized by Kim).
  - A § 754 election would not be made in this case because the land's basis carried over to Kandy in the distribution.
  - If a § 754 election is made, the partnership would increase its basis in partnership assets by \$18,000 (the \$18,000 decrease in the land basis) to reflect the reduction of the asset's basis in the hands of the partner.
  - If a § 754 election is made, the partnership would increase its basis in remaining partnership assets by \$26,000 [\$10,000 gain recognized by Kerri plus \$16,000 (\$16,000 inside basis of inventory – \$0 remaining outside basis in interest after cash distribution)].

pp. 11-29 and 11-30

24. a. Mark does not recognize a gain or loss on the distribution, since this is a nonliquidating distribution. Gains are only recognized in a nonliquidating distribution if distributed cash exceeds the partner's basis in the partnership, which did not happen in this case. Losses are not recognized in nonliquidating distributions.
- b. Mark's basis in the two inventory items is limited to the basis in his partnership interest, less the amount of cash received, or \$9,000. Since the partnership's basis in the two inventory items (\$20,000) exceeds the amount Mark can allocate to these assets, his basis in each item is determined in three steps as follows:
- The inventory items both are initially allocated a basis equal to the partnership's basis in the assets, or \$10,000 each.
  - Since the second inventory item is depreciated in value, Mark's basis is reduced to the amount of its fair market value, or \$5,000. The first inventory item is appreciated, so its basis is not further reduced in this step.
  - Mark now has inventory with bases totaling \$15,000 and a capital account that can absorb \$9,000 of basis. Therefore, he must reduce the bases in the inventory items an additional \$6,000. This reduction is applied proportionately to the two inventory items:

$$\$6,000 \times \frac{\$10,000}{\$15,000} = \$4,000$$

$$\$6,000 \times \frac{\$5,000}{\$15,000} = \$2,000$$

The basis in the first inventory item is reduced to \$6,000 (\$10,000 – \$4,000) and the basis in the second inventory item is reduced to \$3,000 (\$5,000 – \$2,000).

Example 10

- 31.
- a. Emma recognizes a \$15,000 capital gain.
  - b. No gain or loss is recognized by Francie. The \$40,000 basis in the partnership interest remaining after the reduction for the \$20,000 cash is allocated to the capital asset.
  - c. Georgie does not recognize any gain or loss as a result of the distribution. The inventory has a basis to Georgie of \$10,000, and the capital asset is allocated the \$22,000 basis of Georgie's partnership interest remaining after the reduction for the cash and the amount allocated to the inventory.
  - d. Harris recognizes a \$60,000 capital loss on the distribution. He received only cash and unrealized receivables in the distribution, and his basis in the assets received (\$30,000 basis in cash + \$0 carryover basis in the account receivable) is less than his \$90,000 basis in the partnership interest before the distribution.

Examples 12 and 14 and Concept Summary 11.2

- 32.
- a. None. Since the \$25,000 cash received did not exceed Bob's basis in his partnership interest, no gain is recognized. After reducing Bob's basis in his partnership interest by the cash received, the inventory is distributed next and takes a carryover basis of \$14,000. Finally, the land is distributed and absorbs the remaining \$21,000 (basis of \$60,000 – \$25,000 cash – \$14,000 inventory).
  - b. \$14,000 and \$21,000. See explanation in a. Although the partnership's basis in the distributed land was \$30,000, Bob cannot assign a basis greater than \$21,000.
  - c. Bob will recognize a gain of \$15,000 which will be either a capital gain or a § 1231 gain, depending on Bob's use of the land.
  - d. Section 731(b) provides that no gain or loss is recognized to a partnership on a distribution to a partner of property, including money. Since Bob received a pro rata distribution, no gain or loss is recognized by the partnership; however, the land distributed to Bob had a basis to the partnership of \$30,000 and was limited to a basis of \$21,000 to Bob. It appears that \$9,000 of the land's original basis has been lost!
  - e. Students might answer "make a § 754 election." However since the partnership is liquidating, this is not viable. The "lost basis" likely arose because at some point in the past, inside and outside bases were not in balance, and the partnership would have had to step down the basis of its assets to achieve balance—which it wisely opted not to do. By not making the § 754 election previously, the partnership deferred the disappearance of basis to the last possible moment, liquidation of the partnership.
  - f. No. Bob would have the same \$14,000 basis for the inventory, \$21,000 basis in the land, and a remaining outside basis of \$0 for the partnership interest.

Example 12 and Concept Summary 11.2

33.

- a. No gain or loss. The cash is distributed first, followed by the inventory. The land is distributed last and absorbs Bob's remaining basis of \$61,000 (\$100,000 basis – \$25,000 cash – \$14,000 inventory).
- b. Bob's basis in the inventory is a carryover basis of \$14,000. His basis in the land is \$61,000 (see calculation in a.).
- c. The partnership has no gain or loss.
- d. If this had been a nonliquidating distribution, Bob's basis in the land would have been limited to the partnership's \$30,000 basis. Bob would have a remaining basis in the partnership interest of \$31,000.

34.

- a. \$14,000 loss. Jamie cannot allocate to the inventory more than \$6,000. Her remaining basis is \$14,000 after the reduction for the \$10,000 cash distribution. She recognizes a \$14,000 capital loss on the liquidation, and the basis of the inventory is \$6,000.
- b. \$6,000. See explanation in a. above.
- c. None.
- d. A non-inventory, non-unrealized receivable, such as a chair, could be distributed with the other property to absorb the remaining basis and possibly provide an ordinary loss later.
- e. Yes. No loss would be recognized, and Jamie would have a \$14,000 outside basis remaining for the partnership interest.

§ 731(a)(2) and Examples 7, 14, and 15

35.

- a. No gain or loss. Instead, the \$58,000 basis of Julie's partnership interest remaining after the reduction for the \$50,000 cash received is allocated to the land parcels.
- b. Julie's remaining \$58,000 basis in the partnership interest, after the distribution of cash, is allocated to the two land parcels as described in Example 13.
  1. The land parcels are both initially allocated a basis equal to the partnership's basis in the assets, or \$20,000 each.
  2. Because the second land parcel is appreciated in value, Julie's basis is increased to the amount of its fair market value, \$30,000.
  3. Julie now has land parcels with bases totaling \$50,000 (\$30,000 + \$20,000) and a capital account that must absorb \$58,000 of basis. Therefore, she must increase the bases in the parcels an additional \$8,000. This increase is applied to the two land parcels in proportion to the fair market values of the respective properties.

$$\$8,000 \times \frac{\$10,000}{\$40,000} = \$2,000$$

$$\$8,000 \times \frac{\$30,000}{\$40,000} = \$6,000$$

The basis in the first property is increased, then, to \$22,000 (\$20,000 + \$2,000) and the basis in the second property is increased to \$36,000 (\$30,000 + \$6,000).

- c. If the land had been held as inventory, Julie could not increase its basis above the partnership's basis in the assets. Therefore, she would have allocated bases of \$20,000 to each parcel, and she would have realized and recognized a capital loss of \$18,000.

#### Examples 13 and 14

36.

- a. None. After reducing the basis of Julie's partnership interest by the \$50,000 cash received, Julie allocates the remaining \$58,000 of basis to the desk received in the liquidating distribution. Under § 731(a)(2), loss is recognized only if the sum of cash received plus the basis of any unrealized receivables or inventory distributed is less than the adjusted basis of the partnership interest prior to the liquidating distribution, and no other property is distributed.
- b. \$58,000. Example 15 and § 732(b)
- c. If Julie's child uses the desk for any period of time, it is converted to a personal-use asset. None of the loss is recognized as it results from the sale or exchange of a personal-use asset. Julie could have preserved the deductible loss in several ways. First, Julie could have insisted that the partnership sell the desk and distribute \$52,000 cash in liquidation of her interest. If this were done, Julie would recognize a capital loss of \$56,000 (basis of \$108,000 – \$52,000 cash) as a result of the liquidation.

Another alternative would be for Julie to place the desk in use in another trade or business. The basis of the desk is \$58,000 for depreciation purposes. Julie would be converting a \$58,000 capital loss into an ordinary deduction. Although a depreciable desk with a \$58,000 basis probably will arouse the interest of any examining IRS agent, there is no apparent limitation or restriction on such tax planning.

pp. 11-11, 11-12, and Example 15

38.

- a. \$40,000. Under § 737(a), Winston recognizes gain of the lesser of (1) the excess of the value of the property over his basis in his partnership interest (as of the date of the distribution), or (2) precontribution gain on the property contributed by Winston in 2007. The excess value of the distributed property is \$40,000 (\$100,000 value – \$60,000 basis). The precontribution gain on the property contributed in 2007 was \$50,000. Therefore, Winston will recognize gain of the lesser of these amounts, or \$40,000.
- b. Winston's \$60,000 basis in his partnership interest is increased by the \$40,000 gain recognized. His basis is then reduced by the partnership's \$30,000 basis in the distributed property. His basis after the distribution, then, is \$70,000.
- c. Under the nonliquidating distribution rules, Winston will take a carryover basis of \$30,000 in the property distributed by the partnership.
- d. The partnership increases its basis in the precontribution gain property by the amount of gain Winston recognizes, \$40,000. The partnership's basis, in this situation, is increased to \$60,000. This is less than the \$70,000 value at the contribution date because \$10,000 of precontribution gain still exists.

- e. If the precontribution gain property were contributed to the partnership more than seven years before the property was distributed to Winston, § 737 would not apply to the distribution. Winston would recognize no gain and would have no increase in his basis in his partnership interest. The partnership would have no increase in its basis in precontribution gain property.

#### Examples 19 and 20

41.	a.	Cash received		\$ 90,000
		Add: Liabilities assumed by Dale		<u>10,000</u>
		Total amount realized		<u>\$100,000</u>
	b.	\$30,000 (Barry's one-third share of unrealized accounts receivable.)		
	c.	\$20,000		
		Total realized		\$100,000
		Less: Basis of Barry's interest:		
		Capital	\$40,000	
		Debt share	<u>10,000</u>	<u>(50,000)</u>
		Gain to Barry		\$ 50,000
		Less: Ordinary income		<u>(30,000)</u>
		Capital gain		<u>\$ 20,000</u>
		Concept Summary 11.4		
	d.	Cash paid		\$ 90,000
		Add: Liabilities assumed by Dale		<u>10,000</u>
		Dale's basis in partnership interest acquired		<u>\$100,000</u>

#### Example 27

42. \$50,000. The gain would be treated as \$35,000 ordinary income and \$15,000 capital gain.

		Cash received		\$ 90,000
		Add: Liabilities assumed by remaining partners		<u>10,000</u>
		Total amount realized		\$100,000
		Less: Basis of Barry's interest		
		Capital	\$40,000	
		Debt share	<u>10,000</u>	<u>(50,000)</u>
		Total gain recognized		<u>\$ 50,000</u>

Barry is treated under § 736(a) as having received an income payment of \$30,000 for the unrealized receivables, thereby creating ordinary income. (The \$30,000 amount represents Barry's 1/3 portion of the partnership's \$90,000 unrealized receivables.) The \$5,000 payment for partnership goodwill (\$90,000 payment – \$85,000 stated value of assets) is not provided for in the partnership agreement. Therefore, the partnership may deduct this amount as a § 736(a) payment and Barry will report the amount as additional ordinary income. The remaining portion of the liquidating distribution, \$65,000 (\$100,000 – \$30,000 accounts receivable – \$5,000 goodwill), is treated under § 736(b) as being in exchange for Barry's interest in the remaining partnership property. The recognized gain on this part of the distribution is \$15,000 (i.e., \$65,000 – \$50,000) and is treated as a capital gain.

#### Examples 23, 24, and 26

44.

- a. Ben's total gain is \$70,000, consisting of a capital gain of \$45,000 and ordinary income of \$25,000. In calculating the gain, Ben's amount realized is \$120,000 (the sum of cash received and liabilities transferred). While the overall gain is \$70,000 [(\$80,000 cash + \$40,000 debt share) – \$50,000 interest basis], \$25,000 of this amount relates to a § 751 asset (unrealized receivable) with a zero basis, which generates ordinary income. Examples 31 and 32
- b. The transfer of a partnership interest as a result of death is not considered a sale or exchange. Thus, no gain or loss results. If the partnership reports taxable income, Ben's share would be allocated between Ben and his successor in interest (his brother). p. 11-31

46.

- a. No termination. A termination only occurs if Polly sells a 50% or more interest in both the partnership capital and profits.
- b. No termination. A termination does not occur because of the death of a partner. The transfer of the interest to Ron's estate is not a sale or exchange within the meaning of the termination provisions.
- c. Termination. This is a sale of 50% of the interests in partnership capital and profits. Also, by buying out Ron's interest, Rick now will operate a sole proprietorship.
- d. No termination. A gift of a partnership interest is not normally considered to be a sale or exchange for purposes of the termination provisions.
- e. No termination. All the sales are counted for the 50%, 12-month rule. However, because the first and last transactions occur more than one year apart, no 12-month period exists during which sales are made of 50% or more of the interests in partnership capital and profits.

pp. 11-31 and 11-32