Presentation of Income & Deductions

- Two Categories
  - Separately stated items
  - Non separately stated items

- Separately stated items
  - Tax consequences depend on the partner
Presentation of Income & Deductions

- Separately stated items
  - Shown separately on Schedule K

Presentation of Income & Deductions

- Non separately stated items
  - Tax consequences do not depend on the partner

Presentation of Income & Deductions

- Non separately stated items
  - Relate to trade or business
  - Shown on page 1 of Form 1065
Calculating Taxable Income

- Income and deductions treated similar to individual

What is taxable to a Partner?

- Partner taxed on share of –
  - Ordinary income
  - Separately stated items

How is Basis Affected?

- Basis Adjustment –
  - Increased by income and gains
  - Decreased by losses and deductions
Distributions to a Partner

- Not taxable
- Reduce basis

Guaranteed Payments

- Payments not dependent on operating results

Guaranteed Payments

- Deductible by the Partnership
- Ordinary income to the Partner
Partnership Level Characterization

● Character is determined at the Partnership level

● What is meant by Character?

Partnership Level Characterization

● Character of contributed property
  – Unrealized receivables
  – Inventory
  – Capital loss property

Allocating Partnership Income

● Determined by the Partnership agreement

● Agreement may be –
  – In writing
  – Oral
Substantial Economic Effect

- Allocation must have it

Substantial Economic Effect

- Economic Effect
  - Maintenance of capital accounts
  - Follow capital accounts on liquidation
  - Deficit restoration obligation

Substantial Economic Effect

- Substantiality
  - Not substantial if –
    - Aftertax consequences of a partner are enhanced compared to consequences if allocation not made,
    - AND
Substantial Economic Effect

- Substantiality
  - Not substantial if –
    - Strong likelihood that aftertax consequences of no partner will be substantially diminished compared to such consequences if allocation not made

Potentially Non-Substantial Allocations

- Shifting Allocations
- Transitory Allocations

Capital Account Accounting

- Contributed property accounted for at FMV
- Capital accounts credited with FMV
- Basis does not change
Gain on Sale of Contributed Property

- Allocated 100% to contributing partner to extent of FMV over basis at date of contribution

Effect on Basis of Partnership Operations

- Basis increased by income
- Basis decreased by losses

Effect on Basis of Partnership Operations

- Contributions to partnership increase basis
- Distributions by the partnership decrease basis
Effect on Basis of Partnership Operations

- Tax Exempt Income
- Non-deductible Expenditures

Loss Limitations

- Limited by –
  - Basis in partnership interest
  - “At risk” amount
  - Possibly passive investment income

Partner’s Basis in Partnership Interest

- Allowable loss can not exceed partner’s basis in his partnership interest
Partner’s Basis in Partnership Interest

- **Sum of**
  - Basis in capital account
  - Share of Partnership Debt

Partner’s Basis in Partnership Interest

- **Share of Partnership Debt**
  - Recourse debt
  - Non recourse debt

Partner’s Basis in Partnership Interest

- Basis increased by separately stated income items before losses considered
“At Risk Amount”

- Allowable loss can not exceed “At risk” amount

Passive Activity Rule

- If partner’s activity is passive –
  - Loss allowed only to extent of passive income