PARTNER’S SHARE OF PARTNERSHIP DEBT; DISPOSITION OF A PARTNERSHIP INTEREST

Accounting 551T - Lecture 4
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Partner’s Share of Partnership Debt

- **Basis of Partnership Interest**
  - Basis of Capital Account plus
  - Share of Partnership Debt

Partner’s Share of Partnership Debt

- **When do we need to know?**
  - When determining whether allocable losses are allowable
  - When determining gain or loss on sale of a partnership interest
Increase in Partnership Debt

• Considered a deemed contribution

Decrease in Partnership Debt

• Considered a deemed distribution

Contribution of Encumbered Property

• Determine effect on basis under general rule
• Then take the effect of the debt into account
Distribution of Encumbered Property

- Determine each partner's share of the new amount of debt
- Distributee has deemed contribution for the amount of debt related to the property

Debt Versus Equity

- Same consideration as in a corporation

Partner’s share of Recourse Debt

- Assume hypothetical liquidation – Assets are worthless
- Contractual obligations outside the partnership agreement
- Obligation imposed by the partnership agreement
Partner’s Share of Nonrecourse Debt

- Three steps in allocating
  1. Partner’s share of minimum gain
  2. Partner’s share of Code Sec. 704(c) gain
  3. Partner’s profit sharing ratio

Partner’s Share of Minimum Gain

- Minimum gain
  - Outstanding balance of the nonrecourse debt in excess of –
  - The adjusted BOOK basis of the partnership assets securing each nonrecourse debt

Partner’s Share of Minimum Gain

- Allocate the nonrecourse debt up to the minimum gain in the same manner as the deductions that gave rise to the minimum gain
Partner’s Share of Code Sec. 704(c) Gain

- Sec. 704(c) gain –
  - Excess of value over basis at time property was contributed
- Maximum Sec. 704(c) gain -
  - Value less basis at date of contribution

Partner’s Share of Code Sec. 704(c) Gain

- Calculate gain if property sold for the nonrecourse debt
- Compare gain to the maximum 704(c) gain

Remaining Nonrecourse debt

- Allocate remaining nonrecourse debt in accordance with profit sharing ratio
Amount Realized – Sale of a Partnership Interest

- Amount of cash, plus FMV of other property

Basis of Partnership Interest

- Partner’s Initial Basis –
  1. Basis of property contributed
  2. Cost if partnership interest purchased
  3. FMV at date of death (or alternate valuation date) if inherited
  4. Same as donor’s basis, if gift

Basis of Partnership Interest

- Subsequent adjustments -
  - General rule

- Keep a running tally of cumulative adjustments
Basis of Partnership Interest

- Subsequent Adjustments –
  - Alternate rule
- Basis is determined by reference to share of total adjusted basis of partnership property

Installment Sale of Partnership Interest

- General Rule –
  Must use installment sale method if buyer’s note received
- Election –
  Can elect to report entire gain in year of sale

Installment Sale of Partnership Interest

- Seller's share of liabilities taken into account as part of the total contract price and year of sale payments only to the extent they exceed the basis in the partnership interest
Installment Sale of Partnership Interest

- Gain recognized -
  - Treated pro rata between ordinary income and capital gain
- Depreciation recapture -
  - 100% recognized in year of sale

Exchange of a Partnership Interest

- The non recognition provisions do not apply to the exchange of a partnership interest

Where Partnership Holds Ordinary Income Property

- Sale price attributable to:
  1. “Unrealized receivables”
  2. “Inventory” items

  Treated as amount realized from sale of property that is not a capital asset
Where Partnership Holds Ordinary Income Property

**Amount of Ordinary Income** –

- The amount that would be allocated if the partnership sold all its assets

Where Partnership Holds Ordinary Income Property

**Definition of Unrealized Receivables**

1. Depreciation recapture
2. Franchises and trademarks
3. Right to payment for services rendered
4. Right to payment for goods

Where Partnership Holds Ordinary Income Property

**Definition of Inventory Items**

1. Any property held for sale
2. Property which is neither a capital nor a Sec. 1231 asset
3. Potential gain from the sake of Sec. 1246 stock
4. Any property which if held by the selling partner would be in the first three categories