Termination of a Partnership

- Termination Occurs When –
  - Within a 12 month period at Least 50% of the total interest is sold in Partnership’s Capital AND Partnership’s Profits

Termination of A Partnership

- Upon termination –
  - Partnership is deemed to
    1. Contribute its assets and liabilities to a new partnership
    2. Distribute interests in the new partnership to the partners
Section 754 Election

- Made on either –
  - Final Return of Old Partnership
  - Initial Return of New Partnership

Basis Adjustment – Sec. 743(b)

- Sec. 743(b) applies to –
  - Sales
  - Exchanges
  - Transfers Upon Death

Basis Adjustments – Sec. 743(b)

- Calculated under Sec. 743(b)
- Allocated to the assets under Sec. 755
### Basis Adjustments – Sec. 743(b)

**Total adjustment** -

- Difference between
  - Incoming partner’s basis for his interest and
  - His share of the basis of the partnership property

### Basis Adjustments – Sec. 743(b)

- Adjustment relates only to the incoming partner
- Adjustment has no affect on other partners

### Sec. 743(b) Mechanics

- Make the Sec. 754 election
- Compute the total adjustment
- Allocate the adjustment to the assets
Making the Sec. 754 Election

- Attach a statement declaring a Sec. 754 election to the return

Election is In Effect Until Revoked

- Revocation needs permission of IRS

Time of Election

- Timely filed return for the year during which the distribution or transfer is made
Request for Revocation

- Must be filed within 30 days of year end

Amount of Sec. 743(b) Adjustment

- Adjusted basis of new partner's interest less
- His share of the adjusted basis of partnership property

Amount of Sec. 743(b) Adjustment

- Facts:
  - Smith buys a 1/3 interest in a partnership for $22,000
  - Partnership has liabilities of $10,000
  - Basis of Partnership Assets is $55,000
Calculation of Sec. 743(b) Adjustment

**Basis of Smith’s interest**

- Cost: $22,000
- Share of Liabilities: $3,333
- Total Basis: $25,333

Calculation of Sec. 743(b) Adjustment

- Basis of Partnership Assets: $55,000
- Smith’s share of basis: \( \frac{1}{3} \times 55,000 = 18,333 \)

Calculation of Sec. 743(b) Adjustment

- Smith’s basis in his partnership interest: $25,333
- Smith’s share of basis of assets: $18,333
- Sec. 743(b) adj.: $7,000
Allocating the Sec. 743 Adjustment

- Must allocate the total Sec. 743(b) adjustment between –
  1. Capital gain property
  2. Ordinary income property

Why?

Amount allocated to Ordinary Income Property

- Gain or loss allocable to new partner related to ordinary income property if the partnership sold all its assets

- Why?

Amount Allocated to Capital Gain Property

- Total adjustment
  - Less –
    - Amount allocated to ordinary income property
Allocation Among Ordinary Income Assets

- **Basis Adjustment to Each Asset**
  - General Rule
  - Income allocated to new partner if asset sold
- **Why?**

Allocation Among Ordinary Income Assets

- Exception where negative adjustment to capital assets exceeds basis –
- Amount allocated under general rule is reduced by –

Amount allocable to capital assets in excess of basis times 

\[
\frac{\text{FMV of asset}}{\text{FMV of all ordinary income assets}}
\]

Allocation Among Capital and 1231 Assets

- Same concept as with ordinary income assets
- General rule –
  - Gain or loss allocated to new partner if asset sold
Allocation Among Capital and 1231 Assets

- Exception where total basis adjustment differs from sum of amounts determined under general rule
- Exception will apply where purchase price differs from FMV of all the assets

Effects of Sec. 743 Adjustments

- Adjustments apply to transferee partner only
- Transferee partner may be –
  - New Partner
  - Existing partner who increased partnership interest

Effects of Sec. 743 Adjustments

- Basis adjustment is considered
  - Whenever income, deduction, gain or loss is recognized
Compliance After Sec. 754 Election

- Once made, election stays in effect

Compliance After Sec. 754 Election

- Whenever adjustment required by Sec. 743(b)
- Attach statement to partnership return –
  1. Name and taxpayer I.D. number of the transferee
  2. Computation of adjustment
  3. Assets affected

Compliance after Sec. 754 Election

- Purchaser must notify the partnership of a sale
- Must be done within 30 days of the sale
- Must be in writing
Compliance After Sec. 754 Election

- Partner who inherits an interest must notify the partnership
- Must be within one year of the death
- Must be in writing

Distributions Deemed To Be Sales

If distribution changes distributee’s share of ordinary income assets –

Value of that shift is treated as a distribution followed by a purchase/sale

Deemed Distributions

- Payments by partnership on behalf of a partner

Examples:
1. Charitable Contribution
2. Partner’s medical expenses
3. Foreign Taxes on Partnership Income
Deemed Distributions

4. Alimony
5. Medical insurance on a partner
6. Personal expenses of a partner

Deemed Distributions

- Reduction in share of partnership debt
- Purported loans may be distributions

Distributions During Year

- Treated as being made on the last day of the year
Distribution of Securities

- Money includes Marketable Securities
- General Rule
  Gain recognized where value exceeds basis

Definition of Marketable Securities

1. Stock
2. Other equity interests
3. Debt
4. Options
5. Forward or futures contracts
6. Derivatives

Distributions of Securities

- Exceptions to General Rule
  1. Where security was contributed by the distributee
  2. Where property was not a marketable security when acquired
  3. Where securities were received in a non recognition transaction
  4. Where the partnership is an investment partnership and the partner is an eligible partner
### Proportionate Non liquidating Distributions

- Money distribution reduces basis in partnership interest
- Gain recognized only after basis reduced to zero
- Where cash and other property are distributed –
  - Cash is treated as distributed first

### Proportionate Non liquidating Distributions Effect on Basis

#### Money Distribution –

<table>
<thead>
<tr>
<th>Basis of partnership interest reduced by money distributed</th>
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<tbody>
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#### Property Distribution –

<table>
<thead>
<tr>
<th>Basis of property distributed –</th>
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<tbody>
<tr>
<td>Same as the basis to the partnershipIncludes any Sec. 743(b) adjustment related to the distributee</td>
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</tbody>
</table>
Proportionate Non liquidating Distributions Effect on Basis

- Basis of the Partnership Interest –
- Reduced by basis of distributed property

Sale of Distributed Property

Characterization of Gain or Loss

- Sale of “unrealized receivables” –
  - Ordinary
- Sale of inventory items –
  - Ordinary

Sale of Distributed Property

Holding Periods

- Distributee takes the partnership holding period