Consequences of Liquidating Distribution

- Gain recognized only if money exceeds basis
- Basis reduced by money received
- Remaining basis transferred to other property

Basis of Other Properties Received

- First to unrealized receivables and inventory items
- Amount is the adjusted basis of each property to the partnership
Basis of Other Properties Received

Where basis available is less than the partnership’s basis in the properties –
– Decrease is allocated first to properties with unrealized depreciation

Where basis to allocate is more than the partnership basis in the unrealized receivables and inventory items –

1. The excess is allocated first by assigning to each property their basis to the partnership, and

2. Adjusting upward or downward depending on how much basis in the partnership interest is left to allocate, if any.
**Basis of Other Properties Received**

- Any increase is allocated first to properties with unrealized appreciation in proportion to their amounts of unrealized appreciation.

- Then in proportion to FMV

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**Basis of Other Properties Received**

- Any decrease is allocated first to properties with unrealized depreciation in proportion to their unrealized depreciation.

- Then in proportion to their adjusted bases

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**Potential Capital Loss**

- If only cash, unrealized receivables and inventory items are received –

  - Capital loss is recognized where basis of partnership interest exceeds basis of the property received
Partnership Results of Distributions

No Sec. 754 Election in Effect

- No partnership gain or loss
- No basis adjustment to the remaining property

Partnership Results of Distributions

Sec. 754 Election in Effect

Amount of Sec. 734(b) adjustment

1. Amount of gain recognized where only money is distributed

2. Amount of loss recognized where only money, unrealized receivables and/or inventory items are the only properties distributed
Partnership Results of Distributions

Sec. 754 Election in Effect

- If the basis of the assets distributed must be reduced –
  - Excess is added to the basis of the partnership’s assets

Partnership Results of Distributions

Sec. 754 Election in Effect

- If the basis of the assets distributed must be increased –
  - Difference is subtracted from the basis of the partnership’s assets

Sec. 734(b) Adjustment Relates to the Partnership As a Whole

1. All the partners are affected by a Sec. 734(b) adjustment
2. Includes the distributee if he remains a partner
Sec. 734(b) Adjustment

Section 755

- Allocation between Sec. 1221/1231 assets and ordinary income assets
- If the partner recognizes a gain or a loss
  - The adjustment is allocated only to capital gain assets

Allocation Between Sec. 1221/1231 Assets and Ordinary Income Assets

- If no capital gain property –
  - Hold the adjustment in abeyance until capital gain property is acquired

Allocation Between Sec. 1221/1231 Assets and Ordinary Income Assets

- If there is not sufficient basis to fully absorb a negative adjustment
  - Reduce basis to zero
  - Hold the remainder in abeyance until capital gain property is acquired
Allocation Between Sec. 1221/1231 Assets and Ordinary Income Assets

- If the adjustment is caused by the distributee partner’s adjusted basis being less than or greater than partnership’s basis in that property, then –

Allocation Between Sec. 1221/1231 Assets and Ordinary Income Assets

- The adjustment is allocated to the remaining partnership assets that are of a character similar to that of the distributed property

Allocation Between Sec. 1221/1231 Assets and Ordinary Income Assets

- If there are no assets in that class –
  - The adjustment is held in abeyance until an asset in that class is acquired
Allocation Between Sec. 1221/1231 Assets and Ordinary Income Assets

- If there is insufficient basis to fully absorb a negative adjustment –
  - Basis should be reduced to zero
  - Any remainder should be held in abeyance until an asset of that class is acquired

Allocation Within a Class

- Increase –
  - Allocated first to properties with unrealized appreciation

Allocation Within a Class

- Decrease –
  - Allocated to properties with unrealized depreciation
Disproportionate Distributions

- Where partner receives a distribution not in proportion to his share of such property in exchange for a portion of his share of other partnership property

Disproportionate Distributions

- Consequence of disproportionate distribution –
  - Treated as Sale

Disproportionate Distributions

- Basis of partnership assets will be increased by the gain recognized
Disproportionate Distributions

- Partner’s share of ordinary income appreciation is his share of the partnership’s –
  - Unrealized receivables
  - Substantially appreciated inventory items

Unrealized Receivables

- Same definition as in prior classes

Substantially Appreciated Inventory Items

- Inventory Items –
  - Same definition it has for the sale of a partnership interest
Substantially Appreciated Inventory Items

- Substantially Appreciated –
  - Must be substantially appreciated in the aggregate
  - Total fair market value must exceed 120% of the total adjusted basis

Payment for Retiring Partner’s Interest When Capital is Not a Material Income Proceeding Factor

- Capital is a material income producing factor –
  - When a substantial portion of the gross income is produced from capital

Retired Partner Defined

- A partner who has ceased being a partner under local law
Payments for Retiring Partner’s Share of Unrealized Receivables

Sec. 736(a)

- If amount is fixed –
  1. Ordinary income
  2. Deductible by the partnership

Sec. 736(a)

- If amount is contingent on future income –
  1. Partnership income is allocated to the retired partner
  2. Character is determined under normal rules

Payments for Goodwill

- If Capital is not a material income producing factor –
  Partnership can treat as:
  1. Distributive share of income or guaranteed payment depending upon whether the amount is fixed or contingent, or
  2. A partnership distribution
Payment for Property Other Than Unrealized Receivables and Goodwill

Sec. 736(b)

- Always considered a distribution

Allocating the Payment Among Sec. 736 Categories

- Allocation is based on relative fair market values

Accounting for a Series of Payments

- Partnership and the retiring partner may agree on the allocation between Sec. 736(a) payments and Sec. 736(b) payments
Accounting for a Series of Payments

- If no agreement –
  - Allocation depends on whether the total payments are –
    - Fixed or Contingent upon future earnings

Payment for Retiring Partner’s Interest When Capital is a Material Income Producing Factor

- All payments are considered distributions

Payment for Retiring Partner’s Interest When Partner is a Limited Partner

- All payments are considered distributions