Basis of A Partnership

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What is a Partnership?

• An unincorporated tax-reporting entity not a tax paying entity with two or more “persons” who carry on a trade or business with the intent to divide profits/losses
• Termed a flow-through entity, as income and losses flow through the return to the individual partners using a Form K-1
• “Persons” means an individual, corporation, an estate, trust or another partnership

Partnership Agreement

• A partnership agreement is highly recommended, but not required
• The agreement explains how the partnership will divide profits and losses as well as other issues related to taxation and how the business will operate
Partnership Agreement

- The partnership agreement includes the original agreement and any modifications.
- The modifications must be agreed to by all partners or adopted in any other manner provided by the partnership agreement.
- The agreement or modifications can be oral or written.
- Partners can modify the partnership agreement for a particular tax year after the close of the year but not later than the date for filing the partnership return for that year.
- This filing date does not include any extension of time.
- If the partnership agreement or any modification is silent on any matter, the provisions of local law are treated as part of the agreement.

Partnership Agreement Fall Back Provision §704(b)

- If a partnership agreement does not provide for the allocation of income, gain, loss, deduction, or credit to a partner.
- Or if the partnership agreement provides for the allocation of income, gain, loss, deduction, or credit (or item thereof) to a partner but such allocation does not have substantial economic effect.
  - Then the partner’s distributive share of such income, gain, loss, deduction, or credit (or item thereof) shall be determined in accordance with such partner’s interest in the partnership.
- If the partnership agreement provides for the allocation of income, gain, loss, deduction, or credit to a partner, there are three ways in which such allocation will be respected under section 704(b).

Allocations §704

- Allocations of a partner’s distributive share of partnership income, gain, loss, deductions or credit will be respected if they:
  - (1) Are either in accordance with the partners ‘ interests in the partnership or
  - (2) Have substantial economic effect.
- Allocations are the same as distributions.
**Partner’s Basis in a Partnership**

**Why is it Important?**

- Used to measure gain or loss from the sale of taxable exchange of a partner’s interest or liquidation in the partnership (§§741 and 731)
- Used to determine the basis of partnership property received in a liquidation of the partner’s interest in the partnership (§732(b))
- Used to limit deductibility of a partner’s share of partnership losses (§704(d))

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**Alternative Rule for Determining Basis**

- §705(b)
- This will not be discussed in today’s session

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**Partnership Basis**

- Outside Basis – to account for the partner’s cost basis and their interest in the partnership
- Outside basis represents its after tax investment in the partnership
  - Determines how much a partner can withdraw or deduct from the partnership for tax purposes without recognizing gain or without being limited in the allowable flow through of partnership losses
### Must Account For the Following Items

- Contributions
- Distributions
- Allocation of profit and losses
- Acquisition of a partnership interest other than by contribution

### Zero Basis

- Basis cannot be reduced below zero
- Partner is taxed on distributions of cash in excess of the basis
- Must also take a zero basis in any Noncash Property Distribution

### Partnership Inside Basis

- The partnership’s basis in its assets is known as “inside basis”
- In addition to contributions of property, the partnership may acquire property by means of purchase
- Generally, the partnership’s basis in contributed property is the same as the adjusted basis of the property in the hands of the contributing partner at the time of contribution
- Similarly, the partnership has a holding period in the property which dates back to the contributor’s acquisition of the property
Terms

- **Book Value**: Upon contribution of an asset, an entity is said to “book” the value of an asset using the current fair market value of the asset.
- **Inside Basis**: The entity’s tax basis in an asset, called inside basis, is the same as the contributing person’s basis in the asset.
- **Outside Basis**: Outside basis is determined at the interest holder, partner level.
- **Capital Accounts**: Person’s capital account consists of the book value of any assets contributed by that person minus any distributions to that person from the entity and/or liabilities to the entity.

Book

- Thomas contributes an asset to the partnership that he purchased for $500 but now has a fair market value of $1000.
- Theresa contributes an asset that she purchased for $750 but now has a fair market value of $250.
- The partnership will “book” the value of the assets on its books as being $1000 and $250, respectively.

Inside Basis

- The entity’s tax basis in an asset is the same as the contributing person’s basis in the asset.
- In our example, the partnership will have a tax basis, or inside basis, of $500 in the asset that Thomas contributed, while the entity will have an inside basis of $750 in the asset that Theresa contributed.
- While book value and inside basis refer to the asset, outside basis and capital accounts do not reference a person’s interest in the partnership.
First Example

<table>
<thead>
<tr>
<th></th>
<th>Book</th>
<th>Inside Basis</th>
<th>Outside Basis</th>
<th>Capital Account</th>
</tr>
</thead>
<tbody>
<tr>
<td>Thomas</td>
<td>$1000</td>
<td>$500</td>
<td>$500</td>
<td>$1000</td>
</tr>
<tr>
<td>Theresa</td>
<td>$250</td>
<td>$750</td>
<td>$750</td>
<td>$250</td>
</tr>
</tbody>
</table>

Example 2 Inside Basis

- Dave and Donna form an equal partnership to operate an orchard
- Dave contributes $100,000
- Donna contributes land with a FMV of $50,000 and a tax basis of $10,000
- Donna also contributes equipment that has a FMV of $50,000 and a tax basis of $75,000
- Upon contributing the land and the equipment, Donna will not recognize any of the land’s $40,000 built-in gain ( $50,000 - $40,000) or any of the equipment’s $25,000 built-in loss ( $50,000 - $25,000)

Example 2 Continued

- The partnership’s tax basis in the contributed land will be $10,000
- The partnership’s tax basis in the contributed equipment will be $75,000
- The partnership’s holding period for the assets will be the same as Donna’s holding period
- The partnership’s aggregate basis in its assets totals $185,000 (cash, land, and equipment)
Therefore, the partnership’s inside basis is $185,000
Example 2

<table>
<thead>
<tr>
<th>Partner</th>
<th>Book (FMV)</th>
<th>Inside Basis (Asset)</th>
<th>Outside Basis (Ownership interest)</th>
<th>Capital Account</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dave</td>
<td>$100,000</td>
<td>$100,000</td>
<td>$100,000</td>
<td>$100,000</td>
</tr>
<tr>
<td>Donna</td>
<td>$50,000</td>
<td>$10,000</td>
<td>$10,000</td>
<td>$50,000</td>
</tr>
<tr>
<td></td>
<td>$50,000</td>
<td>$75,000</td>
<td>$75,000</td>
<td>$50,000</td>
</tr>
<tr>
<td></td>
<td>$200,000</td>
<td>$185,000</td>
<td>$185,000</td>
<td>$200,000</td>
</tr>
</tbody>
</table>

Partner’s Basis in the Partnership Interest – Outside Basis

- A partnership interest is an item of property
- Like any other item of property, it has a basis for tax purposes
- A partner’s basis in his/her partnership interest is referred to as “outside basis”
- Upon formation of the partnership, a partner’s initial outside basis will generally equal the amount of money and the adjusted basis of property contributed
- If the partner purchases his/her partnership interest, the outside basis will equal the purchase price
- Additionally, a partnership interest may be acquired by means of an inheritance or a gift

Outside Basis is made up of Two Components

- The first is the partner’s tax capital account and the second is the partner’s share of partnership liabilities
- Generally, the sum of the partners’ outside bases will equal the partnership’s inside basis in its assets
- This fundamental concept correlates to the balance sheet equation of Assets = Liabilities + Owners’ Equity
- In the partnership context, this can be thought of as Assets = Liabilities + Partners’ Tax Capital Accounts.
§754 Election

- Although inside basis generally equals total outside basis, some distributions of property from the partnership or transfers of partnership interests can disrupt this equality.
- Through means of the IRC section 754 election, the partnership is able to make upward or downward adjustments to the basis of its assets in order to restore the normal equality in the balance sheet and thus recreate the equality between inside basis and total outside basis.

Outside Basis Adjustments

- Increased
  - Money contributed
  - Property contributed
  - Services contributed
  - Liabilities
    - Partnership assumption of individual liabilities of the partnership
    - Increase in partner’s share of liabilities of the partnership
    - Depletion deductions in excess of basis for the property subject to depletion
    - Share of distributive taxable and non-taxable income

- Decreased
  - Money distributed
  - Adjusted basis of property distributed
  - Distributive share of losses
  - Non-deductible non-capitalized expenditures
    - Rev Ruling 96-10
  - Distributive share of non-deductible expenses
  - Depletion with respect to certain oil and gas property of the partnership, and the excess of the partner’s proportionate share of adjusted basis of such property by POS6(a)(3)
  - Reduction in a partner’s share of partnership liabilities
    - Rev Ruling 96-4

Example 3

- In Year One, Partner A receives an allocable share of $1,000 of partnership taxable income and $500 of partnership income that is exempt from tax.
- The partnership makes no distributions.
- Partner A’s capital account, and his basis in his partnership interest, is increased by $1,500.
- In Year Two, the partnership distributes $1,500 to Partner A.
- Partner A’s capital account and outside basis is decreased by $1,500.
- Because of the previous basis increase, Partner A will not be subject to double taxation.
Outside Basis

- Outside basis functions to ensure that over the partnership's life, the partner does not withdraw more or less than his/her investment without a tax impact
- Both IRC sections 705(a)(2) and 733 indicate that basis cannot be reduced below zero
- A distribution of money to a partner in excess of his/her outside basis results in a gain under IRC section 731(a)(1)

§705(a)(2)(B)

- “Expenditures of the partnership not deductible in computing its taxable income and not properly chargeable to capital account”
  - Charitable contribution deductions under IRC section 170;
  - Losses, expenses, and interest disallowed between related parties under IRC section 267;
  - Downward basis adjustments to the stock of a controlled foreign corporation (owned by the partnership) under IRC section 961(b);
  - Premiums on life insurance contracts if not deductible under IRC section 264(a).

Example 4

- The ABC Partnership has equal three partners
- The Partnership donates $60,000 to a qualified charitable organization
- The charitable donation is not deductible by the partnership
- Each partner takes a $20,000 charitable contribution deduction into account in preparing his/her own tax return and each partner's capital account (and his/her basis) is reduced by $20,000
### Basis Examination Techniques

- Does the Form 1065 balance sheet on Schedule L reconcile to the partnership books and records? Does it reflect FMV or adjusted basis?
- Is the taxpayer maintaining book capital accounts according to the safe harbor rules under the substantial economic effect test in the 704 regulations?
- Does it appear from a quick review of the Schedules K-1 that the partners have bases in their partnership interests?
- Does it appear from the Schedule M-2 and Schedule K that there have been distributions of cash in excess of a partner's basis?
- If so, then gain must be recognized for the excess.

### Basis Examination Techniques

- Does it appear from the Schedule M-2 and Schedule K that there was a property distribution?
- If there was, was there sufficient outside basis to reduce it by the full amount of the adjusted basis of the partnership asset?
- If not and a substituted basis was used, was the property later disposed of and the correct amount of gain reported on the partner's return?
- If there was a potential loss from the disposition, was it disposed of to a related party?
- If it was, then the loss rules under IRC section 267 apply and it must be deferred until the related party disposes of the property to an unrelated party.

### Capital Accounts

- Each partner’s equity in the partnership is reflected in a capital account.
- It is important to distinguish between:
  - Tax capital accounts,
  - IRC section 704(b) book capital accounts, and
  - Book capital accounts which are based on generally accepted accounting principles (GAAP).
  - IRC section 704(b) book capital accounts are described in greater detail in Chapter 6.
- Generally, book capital accounts reflect the FMV of assets at the time of contribution and distribution. The book capital accounts thus accurately show the partners' economic interests in the partnership and track their "business deal." In Example 1-1, Dave and Donna have contributed equally to the partnership. Because Dave contributed cash to the partnership, his tax capital account and his book capital account are equal. Donna’s capital accounts, however, reflect a book/tax disparity.
Capital Accounts

- Book capital accounts reflect the FMV of assets at the time of contribution and distribution
- The book capital accounts thus accurately show the partners' economic interests in the partnership and track their "business deal"
- In our example, Dave and Donna have contributed equally to the partnership
- Because Dave contributed cash to the partnership, his tax capital account and his book capital account are equal
- Donna’s capital accounts, however, reflect a book/tax disparity

**Partnership’s Balance Sheet upon Formation for Dave and Donna**

- Dave has a basis in his partnership interest of $100,000, which is the amount of money he contributed to the partnership
- Donna has a basis in her partnership interest of $85,000, which is the adjusted basis of the property she contributed
- Dave and Donna’s economic arrangement – an equal partnership – is reflected in their book capital accounts, which both reflect the $100,000 of value they each contributed

<table>
<thead>
<tr>
<th>Assets</th>
<th>Book</th>
<th>Tax</th>
<th>Capital Accounts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>100,000</td>
<td></td>
<td>100,000</td>
</tr>
<tr>
<td>Land</td>
<td>50,000</td>
<td>100,000</td>
<td>Dave 100,000 100,000</td>
</tr>
<tr>
<td>Equipment</td>
<td>50,000</td>
<td>75,000</td>
<td>Donna 100,000 85,000</td>
</tr>
<tr>
<td>Totals</td>
<td>200,000</td>
<td>185,000</td>
<td>200,000 185,000</td>
</tr>
</tbody>
</table>

**Book vs Tax Basis**

- Book basis = FMV
- Tax Basis = actual adjusted basis of the property
### Tax-Exempt Income

- Tax exempt income that increases basis would only be income which is permanently tax exempt
- Income that is tax deferred like non recognized gain on a like-kind exchange should not trigger a basis increase

### Contributions of Property – General Non-Recognition Rule

- The creation and operation of partnerships entails the contribution of money, property, or services by the partners to the partnership
- The contribution of services to a partnership in exchange for a partnership interest may be a taxable transaction
- The contribution of property to a partnership in exchange for a partnership interest generally receives tax favored treatment under IRC section 721
- As a general rule, no gain or loss is recognized on the contribution of money or property to a partnership
- This is true whether the contributions take place upon formation or at a later date
- This general non-recognition rule provides partners a significant element of flexibility for property contributions

### Different from Corporation Law

- In contrast, the contribution of property to a corporation is generally a recognition event unless the control requirements of IRC section 351 are satisfied
Contributions of Property – General Non-Recognition Rule

- When a partner contributes appreciated or depreciated property to a partnership, the property has an inherent built-in gain or built-in loss that accrued in the hands of the partner.
- Property with built-in gain or built-in loss is referred to as “section 704(c) property.”
- At the time of contribution, the section 704(c) property will have a tax basis that differs from its fair market value (FMV).
- The property’s FMV at the time of contribution is referred to as its “book value.”
- Because of the IRC section 721 non-recognition rule, property with a built-in gain or built-in loss can be contributed to a partnership with no immediate tax consequence.

Property Contributed

- The basis of property contributed to it by a partner is the adjusted basis of such property to the contributing partner at the time of the contribution.
- Since such property has the same basis in the hands of the partnership as it had in the hands of the contributing partner, the holding period of such property for the partnership includes the period during which it was held by the partner (Reg. §1.723-1).
- These regulations apply to transactions on or after May 15, 2002.

Partner's Gain or Loss

- A partner generally recognizes gain on a partnership distribution only to the extent any money (and marketable securities treated as money) included in the distribution exceeds the adjusted basis of the partner’s interest in the partnership.
- Any gain recognized is generally treated as capital gain from the sale of the partnership interest on the date of the distribution.
- If partnership property (other than marketable securities treated as money) is distributed to a partner, he or she generally does not recognize any gain until the sale or other disposition of the property.
Effect on Outside Basis and Basis in Distributed Property

- A partner’s basis in its partnership interest is reduced by the amount of money distributed to the partner §733(1)
- A partner’s outside basis is also reduced by the basis the partner takes under section 732 in distributed property
- In the case of a distribution of property in liquidation of a partner’s interest, the partner generally takes a basis in the distributed property equal to its outside basis, as reduced by any money distributed in the same transaction §732(b)
- In the case of a non liquidating distribution of property, the partner takes a basis in the distributed property equal to the partnership’s basis in the property immediately before the distribution § 732(a)(1)

Example

- A partnership distributes $600 of cash and a capital asset with a tax basis of $400 and an FMV of $800 to Taylor in liquidation of Taylor’s interest in the partnership
- Taylor has an outside basis of $1,000
- Assuming section 751(b) is inapplicable, Taylor takes an $800 basis in the capital asset
- If the distribution was not in liquidation of Taylor’s interest in the partnership, Taylor would take a $400 basis in the capital asset

Distributions

- The primary function of the distribution provisions of subchapter K is to provide for non recognition of gain(and loss)
- The enactment of the general non recognition rule for partnership distributions was motivated by two considerations
  - Congress was concerned that treating distributions as recognition events “would result in the taxation of gains where there were no real gains and the recognition of losses where there were no real losses.” S. Rep. No. 83-1622, at 95 (1954), reprinted in 1954 U.S.C.C.A.N. 4621, 4728
  - Congress wanted to “remove deterrents to property being moved in and out of partnerships as business reasons dictate.” Id. at 96, reprinted in 1954 U.S.C.C.A.N. 4729
Gain Recognition

• §731(a)(1)
  – A partner does not recognize gain in connection with
    a partnership distribution to the partner except to the
    extent the amount of money distributed exceeds the
    partner’s basis in its partnership interest (outside
    basis)
  – Therefore, a partner recognizes no gain on a
    distribution of property and is permitted to recover its
    basis before recognizing gain on a distribution of
    money
  • As a result, §731(a)(1) is one of the most taxpayer-favorable
    provisions of the code

Example 1

• The adjusted basis of Pete’s partnership interest is $14,000
• He receives a distribution of $8,000 cash and land that has
  an adjusted basis of $2,000 and a fair market value of
  $3,000
• Because the cash received does not exceed the basis of
  her partnership interest, Pete does not recognize any gain
  on the distribution
• Any gain on the land will be recognized when he sells or
  otherwise disposes of it
• The distribution decreases the adjusted basis of Pete’s
  partnership interest to $4,000 ($14,000 – ($8,000 +
  2,000))

Loss Recognition

• In general, a partner does not recognize a loss in
  connection with a partnership distribution to the partner
  unless the distribution is in liquidation of the partner’s
  interest in the partnership and no property other than
  money, is distributed to the partner §731(a)(2)
• If a loss is allowed under section 731(a)(2), the amount of
  the loss is equal to the excess of the partner’s outside
  basis over the sum of the amount of any money
  distributed and the basis the partner takes in any
  distributed unrealized receivables and inventory items.
Example

• A partnership distributes $2,000 of cash and inventory with a tax basis of $4,000 and an FMV of $8,000 to partner Pete’s in liquidation of P’s interest in the partnership
• Pete has an outside basis of $10,000. Assuming section 751(b) is inapplicable, Pete recognizes a capital loss of $4,000
• Loss on partnership of $4,000 due to the liquidation

Liabilities

• The pro rata share of liabilities increase a partner’s adjusted basis only if the liability either
  – Creates or increases the partnerships basis in any of its assets
  – Gives rise to a current deduction to the partnership
  – Is a non Deductible, Non Capital expense of the partnership

Partner’s Assumption of Individual Liability

• If only one partner is required to pay the liability in the event of a default by the partnership, only that partner may increase basis, for that liability
Liabilities

- A partner’s outside basis is made up of his/her tax capital account and his/her share of the partnership’s liabilities
- Therefore, determining a partner’s debt share is a critical component in determining the partner’s adjusted basis in his/her partnership interest
- An increase in a partner’s share of partnership liabilities is considered to be a contribution of money by the partner to the partnership
- Conversely, a decrease in a partner’s share of partnership liabilities is considered to be a distribution of money to the partner by the partnership
- This deemed distribution of money may result in the recognition of gain under §731(a) or §751 if the amount of the distribution exceeds the partner’s adjusted basis in his/her partnership interest

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Liabilities

- When a partner contributes property subject to a liability to a partnership, two transactions are deemed to occur:
  1) the partner is treated as having received a cash distribution equal to the entire liability assumed by the partnership and
  2) the partner is treated as having made a cash contribution equal to his/her share of the partnership’s liabilities
- These events are treated as having occurred simultaneously, resulting in a net deemed distribution or a net deemed contribution of money
- In the case of recourse debt, careful tax planning can ensure that a partner contributing debt-encumbered property will not realize an IRC section 731 gain
- In the case of nonrecourse debt, the rules operate to ensure that the contributing partner has sufficient basis to prevent an IRC section 731 gain

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Definition of a “Liability”

- §752 regulations were amended in 2005 to provide a definition for the term “liability”
- For transactions entered into after June 24, 2003, Treas. Reg. section 1.752-1(a)(4)(i) states that an obligation is a liability for purposes of IRC section 752 only if, when, and to the extent that incurring the obligation
  - (A) creates or increases the basis of any of the obligor’s assets (including cash)
  - (B) Gives rise to an immediate deduction to the obligor; or
  - (C) Gives rise to an expense that is not deductible in computing the obligor’s taxable income and is not properly chargeable to capital
### Treas. Reg. section 1.752-1(a)(4)(ii)

- Defines the term “obligation” in the following manner:
  - An obligation is any fixed or contingent obligation to make payment without regard to whether the obligation is otherwise taken into account for purposes of the Internal Revenue Code
  - Obligations include, but are not limited to, debt obligations, environmental obligations, tort obligations, contract obligations, pension obligations, obligations under a short sale, and obligations under derivative financial instruments such as options, forward contracts, futures contracts, and swaps

### Debt

- A debt that is created for the sole purpose of generating tax savings is not genuine and must be disregarded for tax purposes
- A business motive for incurring a partnership liability must exist
- Similarly, a bona fide debt cannot be ignored

### A Nonrecourse Debt

- A nonrecourse debt is one in which the property is the only security for the loan, and therefore the creditor cannot pursue the partners individually
- In this case, the creditor expects to be repaid from the partnership’s profits
- Treas. Reg. §1.752-1(a)(2) states that a partnership liability is treated as nonrecourse to the extent that no partner or related person bears the economic risk of loss
A Recourse Debt

- A recourse debt is one in which the creditor can pursue the partners
- If the partnership is not profitable and does not make payments on the loan, then the creditor can look to the partners to repay the debt
- Treas. Reg. §1.752-1(a)(1) states that a partnership liability is treated as a recourse liability to the extent that any partner or related person bears the economic risk of loss for the liability

Partner’s Share of Recourse Liabilities

- A partner’s share of a recourse partnership liability equals the portion of that liability for which the partner or related person bears the economic risk of loss
- A “related person” means a person having a relationship to a partner that is described in Treas. Reg. section 1.752-4(b)
- It is important to bear in mind that a partner may be able to include partnership liabilities in his/her basis when a person considered to be related to that partner actually bears the economic risk of loss

Economic Risk of Loss

- The concept of economic risk of loss is crucial in determining the proper sharing of partnership recourse debt
- Economic risk of loss is evaluated based on the extent to which a partner would be obligated to make a payment under a hypothetical liquidation of the partnership
- This constructive liquidation is described in Treas. Reg. section 1.752-2(b)(1)
- The goal is to determine to what extent each partner would either have to contribute to the partnership or pay a creditor with no right to reimbursement
Assumption of Liabilities

- An increase in a partner’s share of partnership liabilities is considered to be a contribution of money to the partnership that increases the partner’s outside basis
- Additionally, a partner who assumes a partnership’s liability is treated as having contributed money to the partnership
- Certain conditions must be met before a person can be considered to have assumed a partnership liability:
  - The partner must be personally liable for the debt;
  - The person to whom the liability is owed must know of the assumption and is able to directly enforce the obligation;
  - The partner alone must bear the economic risk of loss, i.e., there is no right to reimbursement from another party

Timing of Basis Adjustments

- Rev. Rul. 66-94 provides guidance on determining a partnership's basis for loss purposes
  - Contributions to a partnership and Distributions from a partnership (including cash) reduces the partner’s basis before losses are taken
  - Losses are suspended on a pro rata basis and retain their origin as ordinary or capital
    - §1.704-1(a)(2)

Economic Effect

- In order for an allocation to have economic effect, it must be consistent with the underlying economic arrangement of the partners
- This means that in the event there is an economic benefit or economic burden that corresponds to an allocation, the partner to whom the allocation is made must receive such economic benefit or bear such economic burden
Substantial Economic Effect

- Two-part analysis
  - The determination of whether an allocation of income, gain, loss, or deduction to a partner has substantial economic effect involves a two-part analysis that is made as of the end of the partnership taxable year to which the allocation relates

Examination Techniques - Liabilities

- Are liabilities properly allocated to the partner's basis according to the economic risk of loss concept?
- Are recourse liabilities for general partners being properly allocated to the proper partner?
- Are direct loans being allocated properly?
  - No special allocation should be made to the partner loaning the money
- The general partner making a direct recourse loan can still seek reimbursement from the other general partners
- Are guarantees of recourse loans by either a limited or a general partner being allocated under normal recourse rules?

Examination Techniques - Liabilities

- No special allocation should be made for these guarantees unless the guarantor waives all rights of subrogation and then all of the liability may be allocated to that partner
  - There should be a side agreement substantiating this
- Was there a relief of liabilities over the adjusted basis in the partnership interest?
  - If so, then this is a deemed cash distribution (IRC section 752(b)) and gain will be recognized (IRC section 731(a))
Documents to Request for the Audit

- Partnership agreement and all amendments
- Partnership books and records (that is, working trial balance, depreciation schedules, income statements, balance sheets, general ledger, etc.)
- Prior and subsequent year partnership tax returns
- Current year financial statements
- Partnership book capital account calculations
- Partner basis calculations (if the quick test reveals lack of basis)
- Copies of all loan documents including, but not limited to, promissory notes, deeds of trust, mortgages, loan payment histories, loan guarantees, and/or loan indemnification agreements
- Calculations of adjusted basis in property contributed
- Proof of ownership by the partnership in property contributed

Interview Questions

- Is the balance sheet on the Form 1065 reflected at FMV or at adjusted basis?
- Does the partnership maintain book capital account work papers?
- Does the Schedule M-2 reflect the book capital accounts?
- Were the assets reflected on the balance sheet on the Form 1065 contributed by the partners or purchased by the partnership?

Schedules L, M-1, and M-2

- Schedules L, M-1, and M-2 are not required to be completed if the partnership answered “Yes” to question 6 of Schedule B
- The balance sheets should agree with the partnership’s books and records
- Attach a statement explaining any differences
Question 6

6. Does the partnership satisfy all of the following conditions?
   a. The partnership’s total receipts for the tax year were less than $250,000.
   b. The partnership’s total assets at the end of the tax year were less than $1 million.
   c. Schedules K-1 are filed with the return and furnished to the partners on or before the due date (including extensions) for the partnership return.
   d. The partnership is not filing and is not required to file Schedule K-1.

If “yes,” the partnership is not required to complete Schedules L, M-1, and M-2. Item F on page 1 of Form 1065; or item L, on Schedule K-1.

Scoop Dates for Post Filing Season

- July 15, 2015
- August 5, 2015
- September 23, 2015
- October 21, 2015

July Webinars

- The Partnership Form K-1 – July 8, Noon to 1:00 - An overview of Form 1065 K-1 preparation and the resulting Form 1040 income issues will be discussed.
- Bartering and Trading Income – July 13, Noon to 1:00 - A question IRS auditor always ask, Dow you have any bartering or trading income? How this income is reported and the adjustments needed to be made on the tax return will be discussed.
July Webinars

- **Correspondence Audits – July 14, Noon – 1:00** - IRS's chief audit stream is correspondence audit. They do more of them than face to face and other types of audits combined. Responding to the audit request and providing logical and concise information to resolve the issue is an important part of the audit process. What are the dos and don'ts in providing the information and how best to handle the audit will be discussed.

- **Preparing for an IRS Audit – July 22, Noon to 1:00** - Your client has been informed that they will be subject to and IRS audit. Tips on how to preparer, what information you should gather, pre-audit analysis and other issues will be discussed.

- **Issues Related to Estates, Procedures and Developments in Estate Tax Law – July 23, Noon to 1:00** - What's new with Estates tax law? An overview of some of the recent estate issues and a review of typical estate tax issues that you face with your clients.

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2015 Ethics Summer Webinars

- **July 15, 2015** To register: [http://goo.gl/JBkNu](http://goo.gl/JBkNu)
- **August Ethics Webinars will post soon to the CALT website**
- **August 3 Part 2**
- **August 11 Part 1**
- **August 12 Part 2**
- **August 18 Part 1**
- **August 19 Part 2**
- **Remaining Ethics webinars will all be held in December**

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Upcoming August Webinars

- **August 4 -10 and W-4 Complying with Hiring Employees** - Your client hires employees and comes to you to get started correctly. This class will make the forms necessary to be in compliance with Immigration, the IRS, Iowa Workforce Development and the Iowa Department of Revenue. The forms themselves are covered so the taxes can be filed correctly.

- **August 5 - Minister Tax Law** - Under the Internal Revenue Code of 1986 ministers are accorded some unique tax benefits for income, social security and Medicare taxes, which present several potential examination issues for ministers' tax returns in addition to income and expenses issues found in most examinations. We will discuss the following issues: Parsonage/Housing Allowance, ODF or Compensation Issues, Self Employment Tax, Employee or Independent Contractor and Business Expense: Operation of Section 263.

- **August 6 – Form 911 and Matching with Form W-2 - IRS match forms 911 and information to amounts reported on Form 941. When the numbers don’t add up IRS issues a Combined Annual Withholding Report Notice (941-X) and it’s up to you to find your client and resolve the discrepancies. Tips on how to resolve the issue and prevent the notice from being issued will be discussed.**

- **August 10 - Fringe Benefits** - An overview of fringe benefits that employees enjoy and whether or not they are taxable income or exempt from tax will be discussed. Publication 15A will be used for this class.
2015 Farm Tax Schools

- November 9, 2015 to December 15, 2015
- 8 Locations in Iowa
- Registration and the Fall Brochure will be out in August
- The program is intended for tax professionals and is designed to provide up-to-date training on current tax law and regulations.
- The program stresses practical information to facilitate the filing of individual and small business returns, in addition to farm returns.

2015 Farm Tax Schools- Dates and Locations

- Waterloo: Nov 9-10
- Sheldon: Nov. 10-11
- Red Oak: Nov. 11-12
- Ottumwa: Nov. 12-13
- Mason City: Nov. 16-17
- Maquoketa: Nov. 23-24
- Denison: Dec. 7-8
- Ames: Dec. 14-15 – live as well as attendance via webinar available

CALT Website

http://www.calt.iastate.edu/
Tour of the CALT Website

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