

BARRANCA TAX LAW - CPE Seminars

Taxation of Partnerships and LLCs: Complex Tax Issues

Chapter 4: Partnership Terminations

ACTUAL TERMINATIONS (Case Study)

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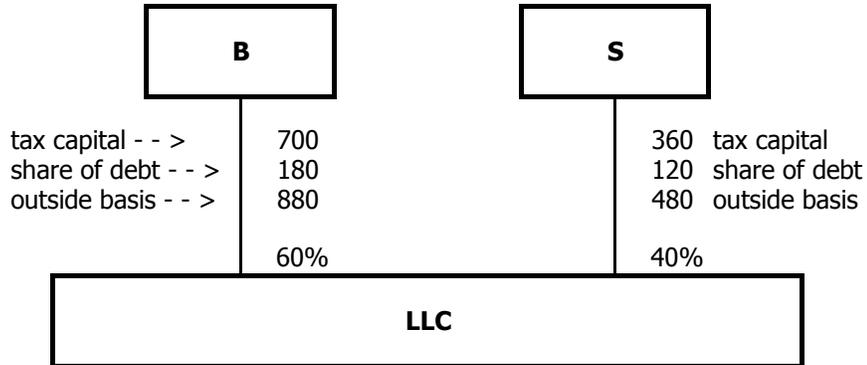
Taxation of Partnerships and LLCs: Complex Tax Issues

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CASE # 1 - Multi-Member LLC to SMLLC

Flow-Chart PRE-TRANSACTION

STRUCTURE immediately BEFORE B purchases S's interest.



Inside Basis

	<u>Tax</u>	<u>FMV</u>	<u>Tax</u>	<u>FMV</u>	<u>Tax</u>	<u>FMV</u>
	100%	100%	60%	60%	40%	40%
<u>Assets</u>						
Cash	100	100	60	60	40	40
Inventory	400	600	240	360	160	240
Capital Asset	200	380	120	228	80	152
Equipment	360	360	216	216	144	144
Accum Deprec	(160)		(96)	0	(64)	0
	<u>900</u>	<u>1,440</u>				
<u>Liabilities</u>						
	<u>300</u>	<u>300</u>	180	180	120	120
<u>Capital</u>						
B	360	684	360	684		
S	240	456			240	456
	<u>600</u>	<u>1,140</u>				
	<u>900</u>	<u>1,440</u>				

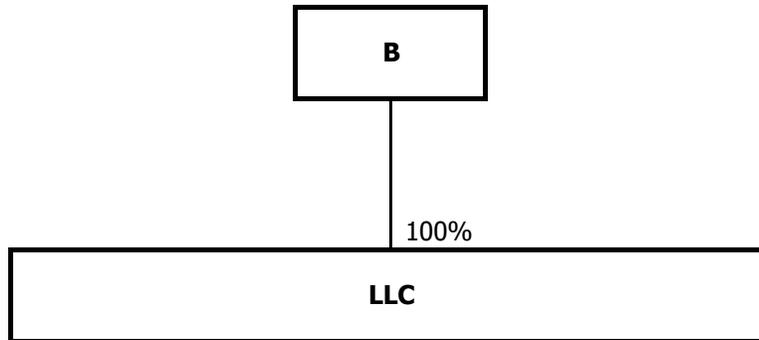
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CASE # 1 - Multi-Member LLC to SMLLC (continued)

Flow-Chart POST-TRANSACTION

STRUCTURE immediately AFTER B purchases S's interest.



Inside Basis

			Sec. 732 Distribution		Sec. 1012 Purchase	
	<u>Tax</u>	<u>FMV</u>	<u>Tax</u>	<u>FMV</u>	<u>Tax</u>	<u>FMV</u>
	100%	100%	60%	60%	40%	40%
<u>Assets</u>						
Cash	100	100	60	60	40	40
Inventory	400	600	240	360	160	240
Capital Asset	200	380	120	228	80	152
Equipment	360	360	216	216	144	144
Accum Deprec	(160)		(96)	0	(64)	0
	<u>900</u>	<u>1,440</u>				
<u>Liabilities</u>	<u>300</u>	<u>300</u>	<u>180</u>	<u>180</u>	<u>120</u>	<u>120</u>
<u>Capital</u>						
B	360	684	360	684		
S	240	456			240	456
	<u>600</u>	<u>1,140</u>				
	<u>900</u>	<u>1,440</u>				

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CASE # 1 - Multi-Member LLC to SMLLC (continued)

Section 732 - Basis in Distributed Assets (60% Portion)

B's Pre-Distribution Basis in LLC Interest

outside basis		
tax capital		700,000
share of liabilities		<u>180,000</u>
		880,000
add: debt assumed	180,000	
less: entire pre-distribution share of UTP debt - deemed distrib under 752(b)	<u>(180,000)</u>	
net debt relief - Req. 1.752-1(f)	<u>0</u>	<u>0</u>
		<u>880,000</u>
 basis in distributed assets under Sec. 732:		
cash		60,000
inventory		<u>240,000</u>
		<u>300,000</u>
 remaining basis allocable to "cold assets"		<u><u>580,000</u></u>

Section 732 Basis Allocation Re: COLD ASSETS

	<u>TIER 1</u>	<u>TIER 2</u>	<u>TIER 3</u>		<u>TOTAL</u>	<u>Inside</u>	<u>Sec. 732</u>
	adjusted	unrealized	Sec. 732 FMV	%	tier 3	Tax Basis	<u>Tax Basis</u>
	tax basis	appreciation			basis layer	in hands of	<u>Basis Adjust</u>
		(cold assets				distributee	
		ONLY)				partner	
capital asset	120,000	108,000	228,000	65.52%	152,000	380,000	260,000
equipment - net	<u>120,000</u>		<u>120,000</u>	<u>34.48%</u>	<u>80,000</u>	<u>200,000</u>	<u>80,000</u>
	<u>240,000</u>	<u>108,000</u>	<u>348,000</u>	<u>100.00%</u>	<u>232,000</u>	<u>580,000</u>	
					232,000		

NOTE: For purposes of determining tier-three FMV, actual FMV must be reduced by accumulated depreciation.

equipment - FMV	216,000
equipment - accum deprec	<u>(96,000)</u>
Sec 732 FMV	<u><u>120,000</u></u>

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CASE # 1 - Multi-Member LLC to SMLLC (continued)

Section 1012 - Purchase Acquisition (40% Portion)			
	Allocation of Purchase Price	Inside Tax Basis	Sec. 1012 Basis Adjust
<u>purchase price</u>			
cash paid	456,000		
debt assumed	120,000		
	<u>576,000</u>		
<u>purchase price allocation</u>			
cash	40,000	40,000	0
inventory	240,000	160,000	80,000
capital asset	152,000	80,000	72,000
equipment	144,000	144,000	0
accumulated depreciation		(64,000)	64,000
	<u>576,000</u>		<u>216,000</u>

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CASE # 1 - Multi-Member LLC to SMLLC (continued)

JOURNAL ENTRIES		
	<u>Debit</u>	<u>Credit</u>
<u>Federal Form 1065 - "Final Return"</u>		
1	Capital - S Capital - B	240,000 240,000
<u>Schedule C or Divisional Trial Balance</u>		
2	inventory capital asset equipment accumulated depreciation capital - B	 80,000 72,000 0 64,000 216,000
<i>Section 1012 Basis Adjustments re: Purchase Transaction</i>		
3	capital asset equipment capital - B	 260,000 80,000 340,000
<i>Section 732 Basis Adjustments re: Deemed Distribution Transaction</i>		
	<hr/> <hr/> 796,000	<hr/> <hr/> 796,000

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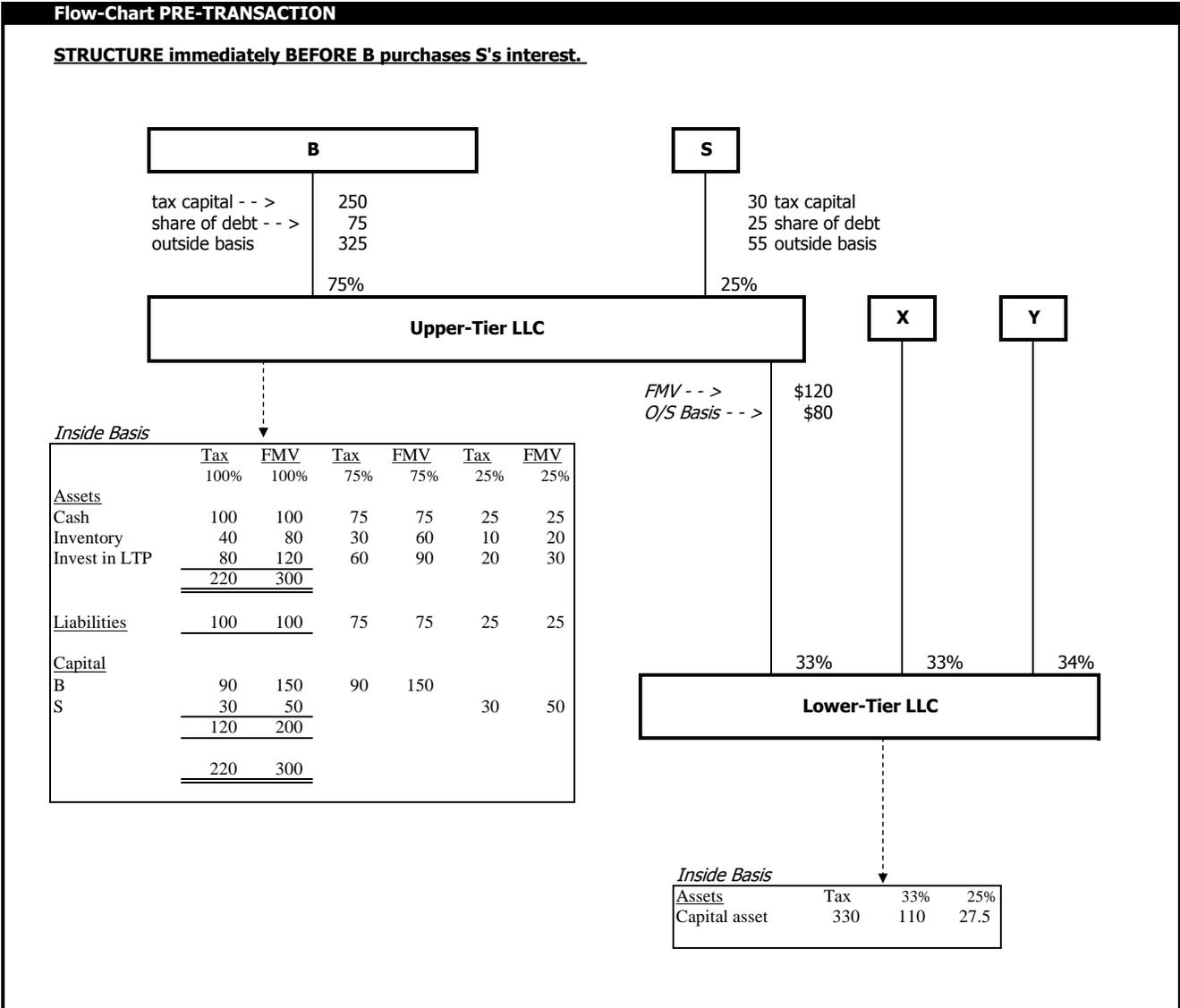
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CASE # 1 - Multi-Member LLC to SMLLC (continued)

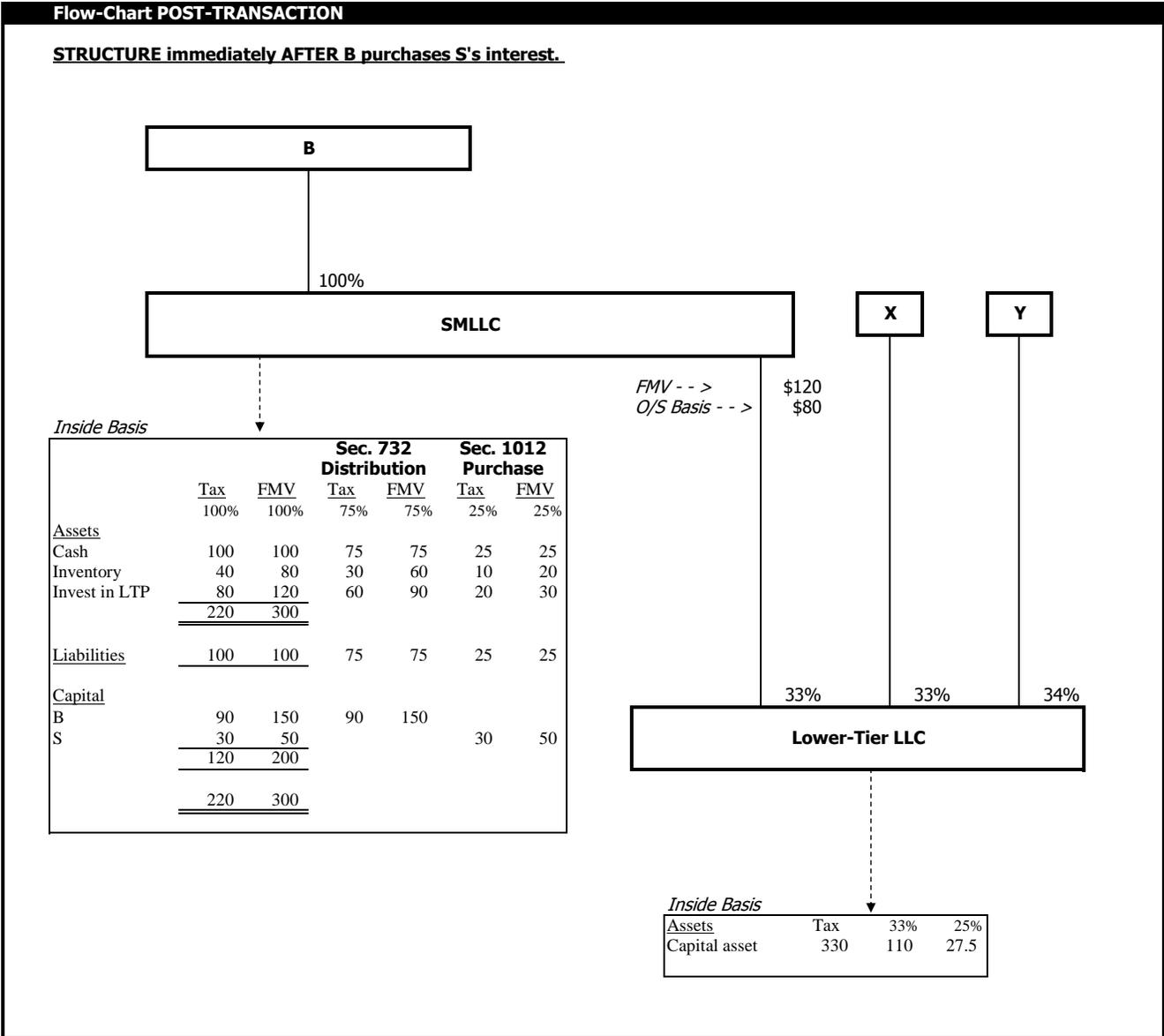
TRIAL BALANCE WORKSHEET									
	<u>MULTI-MEMBER: Final Partnership Return</u>					<u>SINGLE-MEMBER: Schedule C or Divisional</u>			
	Pre-Transaction Closed Trial Balance dr (cr)	Buyout of Partner S Interest dr (cr)	Post-Transaction dr (cr)	Deemed Liquidating Distribution dr (cr)	Final Fed Form 1065 Schedule dr (cr)	Opening Trial Balance dr (cr)	Sec 1012 Basis Adjust dr (cr)	Sec 732 Basis Adjust see NOTE A dr (cr)	Adjusted Trial Balance dr (cr)
Balance Sheet									
cash	100,000		100,000	(100,000)		100,000			100,000
inventory	400,000		400,000	(400,000)		400,000	80,000		480,000
capital asset	200,000		200,000	(200,000)		200,000	72,000	260,000	532,000
equipment	360,000		360,000	(360,000)		360,000	0	80,000	440,000
accum deprec	(160,000)		(160,000)	160,000		(160,000)	64,000		(96,000)
									0
									0
Liabilities	(300,000)		(300,000)	300,000		(300,000)			(300,000)
									0
Capital									0
Partner - B	(360,000)	(240,000)	(600,000)	600,000		(600,000)	(216,000)	(340,000)	(1,156,000)
Partner - S	(240,000)	240,000	0	0		0			0
						0			0
									0
	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>

NOTE A: All basis increases under section 732 should be treated as newly acquired property for depreciation purposes.

CASE # 2 - Multi-Member LLC to SMLLC



CASE # 2 - Multi-Member LLC to SMLLC (continued)



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CASE # 2 - Multi-Member LLC to SMLLC (continued)

Section 732 - Basis in Distributed Assets (75% Portion)

STEP 1 - Post-distribution basis in LTP interest - Sec. 732

outside basis			
tax capital			250,000
share of liabilities			<u>75,000</u>
			325,000
add: debt assumed	75,000		
less: entire pre-distribution share of UTP debt - deemed distrib under 752(b)	<u>(75,000)</u>		
net debt relief - Req. 1.752-1(f)	<u>0</u>		<u>0</u>
			<u>325,000</u>
 basis in distributed assets under Sec. 732:			
cash			75,000
inventory			<u>30,000</u>
			<u>105,000</u>
 investment in LTP - sec. 732 basis			<u>220,000</u>

STEP 2 - LTP assets - Section 743(b) step-up (step-down) [see Rev. Rul. 92-15, Situation 2]

post-distribution basis in LTP interest - section 732			220,000
post-distribution share in inside basis of LTP property:			
total LTP assets	330,000		
	<u>33.33%</u>		
UTP's proportionate share in LTP's inside basis	110,000		
	<u>75.00%</u>		
	<u>82,500</u>		<u>82,500</u>
Section 743(b) step-up (step-down)			<u>137,500</u>

Section 732 - Basis Adjustment

	Outside Tax Basis	Inside Tax Basis	Sec. 732 Basis Adjust
cash	75,000	75,000	0
inventory	30,000	30,000	0
investment in LTP	220,000	60,000	160,000

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CASE # 2 - Multi-Member LLC to SMLLC (continued)

Section 1012 - Purchase Acquisition (25% Portion)			
	Allocation of Purchase Price	Inside Tax Basis	Sec. 1012 Basis Adjust
<u>purchase price</u>			
cash paid	50,000		
debt assumed	<u>25,000</u>		
	<u><u>75,000</u></u>		
<u>purchase price allocation</u>			
cash	25,000	25,000	0
inventory	20,000	10,000	10,000
investment in LTP	(A) <u>30,000</u>	20,000	<u>10,000</u> (A)
	<u><u>75,000</u></u>		<u><u>20,000</u></u>
<u>OUTSIDE BASIS - Purchase Price allocated to Invest in LTP</u>	(A) <u>30,000</u>		(A)
<u>INSIDE BASIS - LTP Assets</u>	25.00%		
LTP basis in property - total partnership	330,000		
partnership interest - 100%	<u>33.33%</u>		
	110,000		
partnership interest - 25% portion: acquired via purchase	<u>25.00%</u>		
	<u>27,500</u>		
section 743(b) step-up (step-down)	<u><u>2,500</u></u>		

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CASE # 2 - Multi-Member LLC to SMLLC (continued)

JOURNAL ENTRIES		
	<u>Debit</u>	<u>Credit</u>
<u>Federal Form 1065 - "Final Return"</u>		
1 Capital - S	30,000	
Capital - B		30,000
<u>Schedule C or Divisional Trial Balance</u>		
2 capital asset	10,000	
investment in LTP	10,000	
capital - B		20,000
<i>Section 1012 Basis Adjustments re: Purchase Transaction</i>		
3 investment in LTP	160,000	
capital - B		160,000
<i>Section 732 Basis Adjustments re: Deemed Distribution Transaction</i>		
<u>LTP Trial Balance</u>		
1 capital asset	140,000	
capital - LLC		140,000
to record section 743(b) adjustment re: sec. 754 election		
Two components:		
Re: sec. 732 transaction	137,500	
Re: sec. 1012 transaction	2,500	
	<u>140,000</u>	
	<u>350,000</u>	<u>350,000</u>

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CASE # 2 - Multi-Member LLC to SMLLC (continued)

TRIAL BALANCE WORKSHEET									
	<u>MULTI-MEMBER: Final Partnership Return</u>					<u>SINGLE-MEMBER: Schedule C or Divisional</u>			
	Pre-Transaction Closed Trial Balance dr (cr)	Buyout of Partner S Interest dr (cr)	Post-Transaction dr (cr)	Deemed Liquidating Distribution dr (cr)	Final Fed Form 1065 Schedule dr (cr)	Opening Trial Balance dr (cr)	Sec 1012 Basis Adjust dr (cr)	Sec 732 Basis Adjust see NOTE A dr (cr)	Adjusted Trial Balance dr (cr)
Balance Sheet									
cash	100,000		100,000	(100,000)		100,000			100,000
inventory	40,000		40,000	(40,000)		40,000	10,000		50,000
invest in LTP	80,000		80,000	(80,000)		80,000	10,000	160,000	250,000
									0
									0
Liabilities	(100,000)		(100,000)	100,000		(100,000)			(100,000)
									0
Capital									0
Partner - B	(90,000)	(30,000)	(120,000)	120,000		(120,000)	(20,000)	(160,000)	(300,000)
Partner - S	(30,000)	30,000	0	0		0			0
						0			0
									0
	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>

NOTE A: All basis increases under section 732 should be treated as newly acquired property for depreciation purposes.