

Illinois Partnership Distributions

Lorman Seminar

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Orientation – Illinois Statutes

Orientation – US Income Tax

Overview – Transfers

Overview – Distributions

Special Members

Termination of Partnership

Orientation – Illinois Statutes

IL Non-Corporate Entities

- **General Partnership**
 - **Uniform Partnership Act (UPA)**
 - **Uniform Partnership Act (RUPA)**
- **Limited Partnership**
 - **Revised Uniform Limited Partnership Act (RULPA)**
- **Limited Liability Company**
 - **Limited Liability Company Act (LLCA)**

Orientation – US Income Tax

Internal Revenue Code

Title 26 of United States Code

- **Subtitle A - Income Taxes**
 - **Chapter 1 - Normal Taxes and Surtaxes**
 - **Subchapter K - Partners and Partnerships**
 - **Chapter 2 - Tax on Self-Employment Income**
- **Subtitle B - Estate and Gift Taxes**
- **Subtitle F - Procedure and Administration**
 - **Chapter 79 – Definitions (Sections 7701-7704)**

Subchapter K

- **Part I: Determination of Tax Liability**
- **Part II: Contributions, Distributions and Transfers**
- **Part III: Definitions**
- **Part IV: Special Rules for Electing Large Partnerships**

Definitions

- **Partnership**
- **Partner**
- **Distribution**
- **Liquidation of a partner's interest**

Overview – Transfers

3 Types of Transfers to a Partner

- **Non-Partner Transactions**
- **Guaranteed Payments**
- **Distributions**

Overview – Distributions

Tax Treatment of Distributions

- **Sale or Exchange of Partnership Interest**
- **Sale or Exchange of Hot Assets**
- **Sale of Contributed Property**

Sale or Exchange of Partnership Interest

Partners (Section 731(a)):

- **Gain not recognized unless money exceeds adjusted basis**
- **Loss not recognized except on certain liquidation of partnership interest**
- **Gain or loss treated as though from sale or exchange of partnership interest**

Sale or Exchange of Partnership Interest

Partners (Section 741):

- Gain or loss shall be recognized to the transferor partner.**
- Gain or loss shall be considered as gain or loss from the sale or exchange of a capital asset.**

Sale or Exchange of Partnership Interest

Partnership (Section 731(b)):

- No gain or loss recognized

Sale or Exchange of Partnership Interest

Exceptions (Section 731(c)):

Subordinate to Rules For -

- Payments to a retiring partner or a deceased partner's successor**
- Hot Assets**
- Contributed Property**

Sale or Exchange of Hot Assets

Section 751(b)

- **Hot Assets**
 - Unrealized receivables
 - Substantially appreciated inventory items
- **Partner receives more than the partner's interest in the property distributed.**

Sale of Contributed Property (7 Year Rule)

- **“Section 704(c) Property”**
 - Contributed within past 7 years
 - Contributed with built-in gain or loss
- **Distributions to Non-Contributing Partner (Section 704 (c))**

Sale of Contributed Property (7 Year Rule)

- **Distributions to Contributing Partner
(Section 737)**
 - Net precontribution gain
 - Character of gain
 - Exclusion of property contributed
 - In addition to Section 731
 - Subordinate to Section 751(b)

Basis of Distributed Property *(Other Than Money)*

- **Current Distributions**
 - Partnership's adjusted basis immediately before the distribution. (Section 732(a)(1)).
- **Liquidating Distributions**
 - Partner's adjusted basis of partner's interest minus money distributed in transaction. (Section 732(b)).

Basis of Distributed Property *(Other Than Money)*

- **Allocation of Partner's Basis**
 - **2 Classes of Property**
 - **Allocating Increase**
 - Unrealized appreciation
 - Fair market values
 - **Allocating Decrease**
 - Unrealized depreciation
 - Adjusted bases

Basis of Distributed Property *(Other Than Money)*

- **Special election to adjust partnership's adjusted basis**
- **Subordinate to Section 751(b)**
- **Recapture income on disposition of Section 1245 or 1250 property**

Special Members

- **Special Member #1: Dual-Capacity Partner**
- **Special Member #2: Withdrawing Partner**

Special Member #1 Dual-Capacity Partner

- **Transfers to a partner in the capacity as one who is not a partner (Section 707)**
- **Two categories of transfers**
 - **Non-partner transactions**
 - **Guaranteed payments**

Special Member #1 Dual-Capacity Partner

Non-Partner Transactions

- **Actual Transactions**
- **Deemed Transactions**

Special Member #1 Dual-Capacity Partner

Actual Non-Partner Transactions:

- **Loan of money or property**
- **Sale of property**
- **Rendering services**

Special Member #1 Dual-Capacity Partner

Deemed Non-Partner Transactions:

- **Section 707(a)(2)(A) - Services/Property for Allocation/Distribution**
- **Section 707(a)(2)(B) - Money/Property for Money/Property**
 - **“Disguised Sales” Regulations**

Special Member #1 Dual-Capacity Partner

“Disguised Sales” Regulations

- **Reg Section 1.707-3, et seq**
- **Partner transfers property, not money**
- **Partnership transfers money/consideration**
 - **Would not have been made but for the transfer of property by partner**
 - **Not dependent on the entrepreneurial risks of partnership operations**

Special Member #1 Dual-Capacity Partner

“Disguised Sales” Regulations

- **Facts and Circumstances – 10 Factors**
 - **The timing and amount of the partnership’s transfer**
 - **Contributions or loans to the partnership**
 - **Disproportionately large transfer of money/consideration**

Special Member #1 Dual-Capacity Partner

“Disguised Sales” Regulations

- **Two-year rule – Presumption of Sale**
 - **Exceptions**
 - Reasonable guaranteed payment for capital
 - Reasonable preferred return
 - Operating cash flow distribution
 - Reimbursement for preformation of expenses
 - **Reporting**

Special Member #1 Dual-Capacity Partner

“Disguised Sales” Regulations

- **Presumption of No Sale**
- **Examples**
- **Special Rules for Liabilities**

Special Member #1 Dual-Capacity Partner

Controlled Partnership

- **Losses disallowed**
- **Gains treated as ordinary income**
- **Sale or exchange Involving**
- **Constructive ownership rules**

Special Member #1 Dual-Capacity Partner

Guaranteed Payments

- **General Rule: Section 707(c)**
- **Income to partner**
- **Deduction to partnership**

Special Member #2 Withdrawing Partner

Transfers to a retiring partner or a deceased partner's successor in interest (Section 736)

- **Definitions**
 - **Retiring partner**
 - **Withdrawing partner**
 - **Liquidation of a partner's interest**
 - **Service partnership**

Special Member #2 Withdrawing Partner

- **Purpose - Sort transfers into types so that other Subchapter K sections can be applied**
- **General Rule - 2 Types of Transfers**
 - **Distributions**
 - **Service partnership exception**
 - **Income payments**
 - **Distributive share**
 - **Guaranteed payment**

Special Member #2 Withdrawing Partner

- **Limits on amounts of transfers**
- **Unreceived receivables**
- **Goodwill**
- **Noncompete covenant**
- **Taxable year of partnership**

Special Member #2 Withdrawing Partner

- **Allocation Between Distribution & Income Payment**
 - Fixed annual amounts
 - No fixed annual amount
- **Election of installment sale treatment of distributions**

Special Member #2 Withdrawing Partner

Death of Partner

- **Basis of partnership interest**
- **Income in respect of a decedent**
 - **Income payments (Section 736 (a))**
 - **Payments for IRD property**
- **Basis of partnership property**

Termination of Partnership

Termination of Partnership

Section 708 – 2 types of events causing termination

- Discontinuance of partnership form or cessation of business
- Sale or exchange of 50% or more of partnership interests within 12 months

Termination of Partnership

Illinois Law

- **Different and Independent From Tax Law**
- **3 Stages in Process of Termination**
 - **Dissolution**
 - **Winding up**
 - **Termination**

Termination of Partnership

Tax Effect of Termination:

Taxable year closes for all partners

Termination of Partnership

Types & Date of Termination

- **Discontinuance of partnership form or cessation of business**
- **Sale or exchange of 50% partnership interest**
- **Two-person partnership**

Termination of Partnership

- **Transactions Which Are Not Sales or Exchanges**
 - Liquidation of partnership interest
 - Acquisition of partnership interest
 - Gift of partnership interest
 - Conversion of partnership
- **Nontaxable Exchanges Terminate Partnership**

Termination of Partnership

Consequences of Termination

- **By Sale or Exchange**
 - Transactions deemed to occur
 - Tax Consequences
- **By Discontinuance of Form or Cessation of Business**

Termination of Partnership

- **Merger or Consolidation**
- **Division of Partnership**

Coming Up:

- **Marketable Securities**
- **Hot Assets**
- **7 Year Rule**
- **Adjustment to Basis**