**EXAMPLIFY PASSWORD:**

**Advanced Partnership Tax** **Spring 2024**
**Bogdanski**

WRITE YOUR EXAM NUMBER HERE: ________

# FINAL EXAMINATION
**(Three hours)**

## INSTRUCTIONS

This examination consists of three essay questions, each of which will be given equal weight in determining grades. Three hours will be permitted for this examination.

The suggested time limit for each question is one hour. Experience has shown that failure to budget one's time according to this limit can result in a drastic lowering of one's overall grade on this examination.

At the end of the three hours, you must turn in this set of questions in the original envelope in which this set came. You must submit your answers using Examplify. If you wish to submit handwritten partnership balance sheets with your answers, you must (1) enclose them in the envelope, clearly labeled with your exam number and the question to which they relate, and (2) refer to them in your answers.

No credit will be given for anything written on this set of questions. Only your electronic answer file and any enclosed balance sheets will be graded.

Pay close attention to the final portion, or "call," of each question. Failure to respond to the matters called for will result in a low score for the question. On the other hand, discussion of matters outside the scope of the call of the question will not receive credit. Be sure to explain as thoroughly as possible your answers to the questions posed. Your reasoning, discussion, and analysis are often as important as any particular conclusion you reach.

Unless otherwise instructed, assume that:

- all partners described in the question are individuals and U.S. citizens;
- all entities described in the questions are organized and operated exclusively in the United States;
- all parties described in the questions use the calendar year as their taxable year for federal income tax purposes; and
- all parties described in the questions report their income using the cash method of accounting for such purposes.

Any references to "the Code" are to the Internal Revenue Code of 1986, as amended.

## QUESTION 1
## (One hour)

Dawn and Ellen form a general partnership, Gco. In the formation transaction, Dawn contributes to Gco $10,000,000 cash, and Ellen contributes to Gco "The Tower," a building that Ellen has owned, free and clear of any mortgages or other liens, for many years. The Tower sits on leased land. At the time of the contribution, Ellen's adjusted basis in The Tower is $7,000,000. The Tower's fair market value is $10,000,000.

The Gco partnership agreement calls for equal allocations of income, gain, loss, deductions, and credits between Dawn and Ellen. The agreement's allocations have substantial economic effect within the meaning of section 704(b) of the Code and the regulations thereunder.

Assume that the Code calls for depreciation deductions to be taken on The Tower over a 10-year recovery period using the straight-line method. In other words, assume that for federal income tax purposes, Gco's depreciation deduction on The Tower is $700,000 a year for each of 10 years.

In its first year of its operations, Gco's gross income and operating deductions (including the rent on the land underlying The Tower) just happen to offset each other exactly. Thus, taking the $700,000 depreciation deduction into account, Gco has a net operating loss for the year of $700,000.

Assuming that Gco does not elect to be taxed as an association, what are the federal tax consequences of the transactions just described to Gco, Dawn, *and* Ellen, with *and* without all available tax elections? Be sure to discuss the amount, timing, and character (capital or ordinary) of any income, gain, loss, or deduction realized or recognized by each party; and each party's basis in the partnership interest or assets that party holds (actually or constructively), at each stage of the transactions.

Discuss.

**(End of Question 1)**

**QUESTION 2**
**(One hour)**

Lilco is a profitable limited liability company. Lilco has an unsecured line of credit from a bank, whereby Lilco can borrow funds on short notice. Throughout the time discussed in this question, the outstanding principal balance on Lilco's debt under the line of credit is $300,000.

Lilco's operating agreement provides that all of the company's income, loss, deductions, and credits are to be shared equally among Lilco's three members – Ava, Brian, and Chen. The agreement requires that Lilco maintain capital accounts for each member in accordance with the regulations under section 704(b) of the Code (the "Regulations"); and that upon liquidation of a partner's interest, the partner is to be paid the amount currently shown in that member's capital account. The agreement also contains a "qualified income offset," as that term is defined by the Regulations, as to each member.

As of the end of the day on December 31, 2023, taking into account all of Lilco's 2023 operating results, Lilco's balance asset is as follows (figures shown are thousands of dollars}:

| <u>**Assets (in thousands)**</u> | | | <u>**Liabilities (in thousands)**</u> | | |
|---|---|---|---|---|---|
| **Asset** | **Adjusted basis** | **Fair market value** | ***Debt*** | | |
| Cash | $ 200 | $ 200 | Bank line of credit | | $ 300 |
| Inventory | 450 | 600 | *Total debt* | | *$ 300* |
| Capital assets (stocks held for investment) | 1,150 | 1,300 | ***Equity (partners' capital)*** | | |
| | | | **Partner** | **Adjusted basis** | **Fair market value** |
| | | | Ava | $ 600 | $ 600 |
| | | | Brian | 600 | 600 |
| | | | Chen | 600 | 600 |
| | | | *Total equity* | *$ 1,800* | *$ 1,800* |
| **Total assets** | **$ 1,800** | **$ 2,100** | **Total liabilities** | **$ 1,800** | **$ 2,100** |

None of Lilco's assets were contributed to Lilco by a member.

On January 1, 2024, Ava sells her membership interest in Lilco to a buyer, Rico, for $600,000 cash. Over the course of 2024, Lilco sells the inventory for $600,000.

Assuming that Lilco does not elect to be taxed as an association, what are the federal income tax consequences of the transactions just described – to Ava, Brian, Chen, Rico, *and* Lilco – with *and* without all other available elections? Be sure to discuss the amount, timing, and character (capital or ordinary) of any income, gain, loss, or deduction realized or recognized by each party; and each party's basis in the partnership interest or assets that party holds (actually or constructively), at each stage of the transactions.

Explain.

**(End of Question 2)**

**QUESTION 3**
**(One hour)**

Jen, Karl, and Luis form a general partnership, XYZ. In forming XYZ, Jen and Karl each contribute $60,000 cash to the partnership, and Luis contributes Greenacre, a parcel of undeveloped real estate that Luis has held as investment for several years. At the time Luis contributes it to XYZ, Greenacre has a fair market value of $120,000, but it is subject to a nonrecourse mortgage of $60,000, so that Luis's "equity" in Greenacre is $60,000. Luis's adjusted basis in Greenacre immediately before the contribution is $20,000. XYZ takes Greenacre subject to the mortgage.

The XYZ partnership agreement, which has substantial economic effect within the meaning of section 704(b) of the Code, provides that each partner has a one-third interest in partnership income, gain, loss, deductions, and credits.

In the first year of its operations, XYZ repays to the lender $10,000 of principal on the Greenacre mortgage, so that at the end of the year the outstanding balance on the debt is $50,000. For that first taxable year, XYZ's gross income and deductions (including interest payments on the mortgage loan) just happen to be equal, so that XYZ's taxable income for the year is zero.

Assuming that XYZ does not elect to be taxed as an association, what are the federal tax consequences of the transactions just described to XYZ, Jen, Karl, *and* Luis, with *and* without all available tax elections? Be sure to discuss the amount, timing, and character (capital or ordinary) of any income, gain, loss, or deduction realized or recognized by each party; and each party's basis in the partnership interest or assets that party holds (actually or constructively), at each stage of the transactions.

Discuss.

**(End of examination)**