(3) Starting out, T will get $80,000 basis in his ptsh int per §722, & U will get $20,000. The $200,000 recourse loan will provide $100,000 additional basis to T & U each, as §752 treats an increase in personal liability as a contribution. Determination of the amount each partner gets of a recourse liability involves the "doomsday scenario" of §1.752-2, to determine who would have to pay the debt. Since T & U are general partners & §1.752-2 assumes all partners are solvent, we can allocate the $200,000 evenly between them. This results in T having a basis of $180,000 & U having a basis of $120,000.

The allocation change from 50/50 to 60/40 must pass muster under §704 to be allowed/respected. §704 requires,

among other things, that the allocation have "substantial economic effect." The facts state that the ptsh agreement meets the "big 3" test for economic effect, but doesn't mention substantiality. "Substantiality" requires that the amounts received by the partners are affected other than mere tax avoidance. They seem to be here, & the allocation will likely be respected.

1

The next issue is the effect of the change on the taxable year. The facts don't state if the gross income & deductions were accrued/earned/received at any specific point, so I will assume a consistent amount throughout the time in question (July 1 – Dec 31). This ~~~~ consistent amount means that there will not be a difference in the out come between closing the interim closing of the books or the

3

2

proration option for the changed allocation. As the 50/50 split & the 60/40 split each lasted 3 months, we can evenly devide the effect on the deductions & gross income (as 3 months is 1/2 of the 6 months total).

2

2

The first 1/2 of the deductions (under the 50/50 split) would yield $35,000 in gross income each ($140,000 ÷ 2, then 50/50) & $50,000 in deductions each ($200,000 ÷ 2, then 50/50). The second half of the deductions & gross income (under the 60/40 split) would yield $42,000 gross income to T ($140,000 ÷ 2, then 60%) & $28,000 gross income to U ($140,000 ÷ 2, then 40%) & $60,000 deductions to T ($200,000 ÷ 2, then 60%) & $40,000 to U ($200,000 ÷ 2, then 40%). The final outcome can be seen an exhibit 3.1, which shows the balance sheet after all these

the "2" is because 3 months is 1/2 of 6 months

events have occured. There hasn't been a distribution, but the income & deductions have passed through (assuming no §465 at risk or §469 passive activity limitations, which I don't see apparent here). I don't know what the interest rate is, so I can't subtract the payment from the cash asset of the ptsh.

Sorry about the 1st answer (problem 1), I blanked.

Exam Number 1358

Question 3

Exhibit 3.1

TU

	Assets			Liabilities	
	Basis	Value		Basis	Value
cash	$440,000	$440,000		*Debt*	
			bank	$200,000	$200,000
				Equity	
			T	$147,000	$157,000
			U	$93,000	$83,000
Total Assets	$440,000	$440,000	Total Liabilities	$440,000	$440,000