Partnership Taxation
Bogdanski **Spring 2019**

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. At the end of the three hours, you must turn in this set of essay questions in the original envelope in which this set came.

If you are using a computer, then unless you have been otherwise expressly authorized by the law school, you must submit your answers using Examplify. If you are writing answers by hand, you must write them all in the bluebook(s) you have been provided, and return the bluebook(s) along with this set of questions in the envelope.

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 or bluebook(s), 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.

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.

Unless otherwise instructed, you should assume that all partners described in the question are individuals; and that all partners and partnerships described in the questions use the calendar year as their taxable year, and the cash method of accounting, for federal income tax purposes. Any references to "the Code" are to the Internal Revenue Code of 1986, as amended.

QUESTION ONE
(One hour)

Ruth, Sadie, and Taz form a limited partnership, RST, to engage in investment activity. In the formation transaction, Ruth transfers to RST $100,000 cash in exchange for a limited partner's interest.

In the same formation transaction, Sadie transfers to RST a parcel of real estate, Blackacre, in exchange for a limited partner's interest. Immediately before the formation of RST, Blackacre has a fair market value of $100,000 and an adjusted basis in Sadie's hands of $40,000. Sadie had held Blackacre for many years as an investment. Likewise, RST holds Blackacre for investment.

Also in the formation transaction, Taz transfers to RST Taz's promise to perform future services in exchange for a general partner's interest; Taz becomes the sole general partner of RST. Taz's partnership interest is immediately vested – that is, it is not subject to a risk of forfeiture.

The services Taz is to provide to RST include both (a) ongoing, active management of RST's investments, and (b) tax return preparation work of a type for which many other investment firms engage an outside contractor. In a prior career, Taz was a tax accountant.

The partnership agreement of RST states that all profits and losses are to be shared equally among the three partners. This allocation has substantial economic effect for purposes of section 704(b) of the Code.

The partnership agreement also provides that only Ruth and Sadie have a capital account in RST at the outset. That is, Taz's partnership interest entitles Taz only to a share of future profits of RST, if any. If RST were to be liquidated immediately after its formation, or if Taz were to leave the firm at that time, Taz would not be entitled to any of the capital contributed to RST by Ruth or Sadie.

Eighteen months after RST is formed, RST sells Blackacre to an unrelated party for $130,000 cash.

Assuming that RST does not elect to be taxed as an association, what are the federal income tax consequences of the transactions just described – to Ruth, Sadie, Taz, *and* RST – 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.

Discuss.

(End of Question 1)

QUESTION TWO
(One hour)

Hua, Imma, and Jared are the partners in Firm, a limited liability partnership that performs professional services for clients. The partnership agreement of Firm states that all profits and losses are to be shared equally by the three partners. This allocation has substantial economic effect for purposes of section 704(b) of the Code.

On December 31, 2019, after taking into account Firm's tax results for 2019 on the partners' individual tax returns, and after taking into account 2019 distributions to partners, the balance sheet of Firm is as follows:

Assets			**Liabilities**		
	Adjusted Basis	***Fair Market Value***		***Adjusted Basis***	***Fair Market Value***
			Debt		-0-
Cash	$ 360,000	$ 360,000		*Partners' Equity*	
Accounts receivable	-0-	75,000	Hua	$ 220,000	$ 300,000
Supplies (previously expensed)	-0-	15,000	Imma	220,000	300,000
Office building	300,000	450,000	Jared	220,000	300,000
Total Assets	***$ 660,000***	***$ 900,000***	***Total Liabilities***	***$ 660,000***	***$ 900,000***

Firm has no goodwill or going concern value. None of the assets shown were contributed to Firm by a partner.

On January 1, 2020, Jared resigns from Firm. On that date, in liquidation of Jared's partnership interest, Firm pays Jared $340,000 cash.

Assuming that Firm does not elect to be taxed as an association, what are the federal income tax consequences of the transactions just described – to Hua, Imma, Jared, *and* Firm – 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 THREE
(One hour)

Gina and Leah form a limited partnership, LP. Gina is the sole general partner, and Leah is the sole limited partner. To form LP, Gina transfers $20,000 cash to LP in exchange for her partnership interest, and Leah transfers $80,000 cash to LP in exchange for her partnership interest.

The LP partnership agreement provides that each partner will have an initial capital account equal to the amount of cash contributed by that partner. Thereafter, capital accounts will be maintained as required by the regulations promulgated under section 704(b) of the Code (the "Regulations"). Upon liquidation of any partner's interest, the partner will receive a final distribution equal to any positive capital account balance of that partner.

The partnership agreement also provides that if upon liquidation of a general partner's interest, that general partner has a negative capital account balance, that general partner will restore the negative amount to the partnership by a cash payment within 30 days of termination of the partner's interest. In contrast, the partnership agreement does not require that a limited partner restore any negative capital account balance; however, the agreement contains a "qualified income offset" provision (as defined in the Regulations) with respect to any limited partner.

The partnership agreement allocates all items of income, loss, deduction, and credit as follows: 20 percent to Gina and 80 percent to Leah.

Shortly after it is formed, LP borrows $400,000 from a bank. The loan is a recourse, unsecured loan. The loan documents call for LP to pay the bank interest only for the first year in which the debt is outstanding, with principal repayments to commence (and interest payments to continue) in the second year.

In the first year of its existence, LP has gross income of $25,000 and deductions (including a deduction for interest paid to the bank) of $175,000, for a net operating loss of $150,000.

In the second year of its existence, LP has gross income of $125,000 and deductions (including a deduction for interest paid to the bank) of $75,000, for taxable income of $50,000. Also in the second year, LP repays $100,000 of principal to the bank.

Assuming that LP does not elect to be taxed as an association, what are the federal income tax consequences of the transactions just described – to Gina, Leah, *and* LP – 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.

Discuss.

(End of examination)