QUESTION ONE
(One hour)

Ava and Babs are partners in a general partnership, Pco. The partnership agreement, which includes all of the "big three" provisions required to meet the primary test for economic effect under the regulations under Section 704(b) of the Code, provides that all items of income, loss, deduction, and credit of Pco are to be shared equally by Ava and Babs.

Pco recently sold off most of its assets and paid off all of its liabilities as part of going out of business. Pco's balance sheet at the start of 2021 is as follows:

Assets			Liabilities		
	Adjusted basis	*Current fair market value*		*Adjusted basis*	*Current fair market value*
Cash	$ 200,000	$ 200,000	*Debt*		-0-
Blackacre, unimproved land	100,000	250,000			
Account receivable from customer for services rendered by Pco	-0-	250,000	*Equity*		
			Ava	$ 150,000	$ 350,000
			Babs	150,000	350,000
			Total equity	*$ 300,000*	*$ 700,000*
Total assets	**$ 300,000**	**$ 700,000**	**Total liabilities**	**$ 300,000**	**$ 700,000**

Neither partner has made any contributions to Pco beyond the cash contributions the partners made when Pco was formed many years ago.

As 2021 begins, Pco makes final liquidating distributions to the partners, as follows: (a) Pco distributes to each partner $100,000 cash, (b) Pco distributes Blackacre to Ava, and (c) Pco distributes the account receivable to Babs.

Assuming that Pco does not elect to be taxed as an association, what are the federal income tax consequences of the liquidating distributions just described –to Ava, Babs, and Pco –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.

QUESTION TWO
(One hour)

Lco is a limited liability company with three members: Xu, Yoko, and Zoe. The members each contribute cash to form Lco. Xu contributes $200,000 cash; Yoko contributes $400,000 cash; and Zoe contributes $600,000 cash.

The operating agreement of Lco (the "Agreement") provides that income, loss, deduction, and credit of Lco are to be shared equally by the three members. The Agreement satisfies the alternate test for economic effect under the regulations under Section 704(b) of the Code (the "Regulations"). That is, the agreement provides that capital accounts are to be maintained according to the rules set forth in the Regulations; and that upon liquidation of the partnership or of any partner's interest, liquidating distributions are to be made in accordance with a partner's positive capital account balance. The Agreement also contains a "qualified income offset" applicable to each member, and a "minimum gain chargeback" provision applicable to each member. No member is obligated to restore a deficit balance in the member's capital account.

Shortly after its formation, Lco borrows $4,800,000 from a commercial lender and uses the loan proceeds, along with its $1,200,000 of contributed cash, to purchase a building, the Tower. Assume that the Tower's $6,000,000 basis is properly depreciated using a straight-line method over a 10-year recovery period; ignore any applicable convention. Thus, the depreciation deduction with respect to the Tower is $600,000 per year.

The terms of the loan require payments of interest only for the first four years in which the loan is outstanding. The loan is a nonrecourse loan; in the event of a default, the lender's only remedy is to repossess the Tower. The lender has no recourse to any other assets of Lco, nor do any of the members have personal liability.

In the first three years of its operations, Lco's gross income just happens to be matched exactly by its operating deductions, including the interest payments that Lco faithfully makes on the debt. The operating deductions just mentioned, however, do not include depreciation. Taking into account the depreciation deduction with respect to the Tower, Lco has a net operating loss for each of the first three years of $600,000.

Assuming that Lco does not elect to be taxed as an association, what are the federal income tax consequences of the transactions just described –to Xu, Yoko, Zoe, and Lco –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.

QUESTION THREE
(One hour)

Farah and Kay form a limited partnership, Realco. Farah is the general partner and Kay is the limited partner.

Each partner contributes a parcel of undeveloped real estate to Realco to get it started, as follows: Farah contributes Bustacre, with an adjusted basis to Farah immediately before the contribution of $160,000 and a fair market value at that time of $100,000. Kay contributes Gainacre, with an adjusted basis to Kay immediately before the contribution of $30,000 and a fair market value at that time of $190,000. Realco assumes a mortgage on Gainacre securing a recourse equity loan that Kay had previously taken out on Gainacre. At the time of the contribution and assumption of the liability, the outstanding balance on the mortgage loan is $90,000, so that Kay's "equity" in Gainacre immediately before the transfer is $100,000.

By assuming the mortgage, Realco becomes contractually obligated to make all payments due on the loan, and to reimburse Kay for any amounts that Kay pays on the loan.

The partnership agreement, which includes all of the "big three" provisions required to meet the primary test for economic effect under the regulations under Section 704(b) of the Code, provides that all items of income, loss, deduction, and credit of Realco are to be shared equally by Farah and Kay.

About a year after Realco is formed, in a transaction not planned or contemplated when Realco was formed, Realco sells Bustacre to an unrelated third party for $120,000 cash.

Assuming that Realco does not elect to be taxed as an association, what are the federal income tax consequences of the transactions just described –to Farah, Kay, and Realco –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.