QUESTION ONE
(One hour)

Xena and Yao form a general partnership, GP. In the formation transaction, Xena contributes to GP $2,000,000 cash, and Yao contributes to GP Blackacre, a building that Yao has owned. Blackacre is situated on leased land. At the time of the contribution, Yao's adjusted basis in Blackacre is $1,400,000. Blackacre's fair market value is $2,000,000.

The partnership agreement of GP calls for equal allocation of income, gain, loss, deduction, and credit between Xena and Yao. 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 Blackacre over a 10-year recovery period using the straight-line method. In other words, assume that for federal income tax purposes, GP's depreciation deduction on Blackacre is $140,000 a year for each of 10 years.

In its first year of its operations, GP's gross income and operating deductions (including the rent on the land underlying Blackacre) just happen to offset each other exactly. Thus, taking the $140,000 depreciation deduction into account, GP has a net operating loss for the year of $140,000.

Assuming that GP does not elect to be taxed as an association, what are the federal tax consequences of the transactions just described to GP, Xena, and Yao, 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.

QUESTION TWO
(One hour)

Ace and Bailey are the only members of a limited liability company, L2Co. The operating agreement of L2Co calls for equal allocation of income, gain, loss, deduction, and credit between Ace and Bailey. The agreement provides that the members' capital accounts are to be maintained in accordance with the regulations under section 704(b) of the Code, and that upon liquidation of a member's interest, distributions are to be made in accordance with each member's positive capital account balance.

At the start of the year, the balance sheet of L2Co is as follows:

Assets			**Liabilities**		
Asset	**Adjusted basis**	**Book value**	***Debt***		
Cash	$ 200	$ 200	Loan from Bank		$ 500
Account receivable	-0-	400	*Total debt*		*$ 500*
Capital asset	1,000	800	***Equity***		
			Partner	**Adjusted basis**	**Book value**
			Ace	$ 850	$ 450
			Bailey	350	450
			Total equity	*$ 1,200*	*$ 900*
Total assets	**$ 1,200**	**$ 1,400**	**Total liabilities**	**$ 1,200**	**$ 1,400**

The book values of the assets are also the fair market values of those assets. None of the assets were contributed to L2Co by a member.

The loan from Bank is a recourse loan, that is, all of the assets of L2Co are subject to seizure by Bank if the loan is not repaid. In addition, Ace has personally guaranteed the debt.

As the year begins, Ace sells his membership interest in L2Co to Pat. Pat pays Ace $450 in cash for the membership interest. As part of the sale, Pat personally guarantees the debt to Bank.

Assuming that L2Co does not elect to be taxed as an association, what are the federal tax consequences of the transactions just described to L2Co, Ace, Bailey, and Pat, 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.

Explain.

QUESTION THREE
(One hour)

Kareem and Lana are equal partners in a general partnership, Genco. The partnership agreement of Genco calls for equal allocation of income, gain, loss, deduction, and credit between Kareem and Lana. The agreement's allocations have substantial economic effect, within the meaning of section 704(b) of the Code and the regulations thereunder.

Kareem and Lana agree to admit Mia as a partner in Genco. Immediately prior to the admission of Mia, the balance sheet of Genco is as follows:

Assets			**Liabilities**		
Asset	**Adjusted basis**	**Book value**	***Debt***		
Cash	$ 300	$ 300	*Total debt*		*-0-*
Capital asset no. 1	900	900			
Capital asset no. 2	150	600	***Equity***		
			Partner	**Adjusted basis**	**Book value**
			Kareem	$ 900	$ 900
			Lana	450	900
			Total equity	*$ 1,350*	*$ 1,800*
Total assets	**$ 1,350**	**$ 1,800**	**Total liabilities**	**$ 1,350**	**$ 1,800**

Capital asset no. 2 was contributed to the partnership by Lana. At the time Lana contributed it to Genco, capital asset no. 2 had an adjusted basis of $150 and a fair market value of $600.

In exchange for past and future services to Genco, Mia receives a one-third interest in partnership capital. Upon admission, Mia receives a $600 capital account, and Kareem's and Lana's capital accounts are reduced to $600 each. The partnership agreement is also amended to provide that all income, gain, loss, deduction, and credit are to be allocated one-third to each partner. Mia's partnership interest has a fair market value of $600 at the time Mia is admitted to the partnership.

Assuming that Genco does not elect to be taxed as an association, what are the federal tax consequences of the transactions just described to Genco, Kareem, Lana, and Mia, 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.