Advanced Partnership Tax **Spring 2022**
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. If you are using a computer, you must submit your answers using Examplify. If you are writing answers by hand, you must write them in the authorized exam booklet(s) you have been provided, and return the booklet(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, your exam booklet(s) (if any), 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;
- 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)

Three wealthy individuals – Ana, Bob, and Cai – form a general partnership, ABC. Under the ABC partnership agreement, which satisfies the three requirements of the primary test for substantial economic effect in the regulations under section 704(b) of the Code, the partners share income, gain, deduction, and loss equally. The agreement adopts the traditional method of applying section 704(c) of the Code.

In the formation of ABC, the partners transfer the following assets to ABC in exchange for their respective partnership interests: Ana transfers $100,000 cash; Bob transfers Blackacre, a parcel of real estate, with a fair market value of $200,000 and an adjusted basis in Bob's hands immediately prior to the exchange of $100,000; and Cai transfers $300,000 cash.

Shortly after it is formed, ABC borrows $400,000 on a recourse basis from a bank. Several weeks later, ABC uses the $400,000 loan proceeds, along with the $400,000 cash contributed by Ana and Cai, to purchase some additional assets for a purchase price of $800,000.

Assuming that ABC does not elect to be taxed as an association, what are the federal tax consequences of the transactions just described, to ABC, Ana, Bob, and Cai, 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)

XYZ, a limited liability company classified as a partnership for tax purposes, has the following balance sheet as of December 31, 2022:

	Assets			**Liabilities**	
	Adjusted basis	**Fair market value**		**Adjusted basis**	**Fair market value**
Cash	$ 90,000	$ 90,000	Debt		-0-
Capital assets	12,000	60,000		*Members' capital*	
Inventory	18,000	30,000	Xi	$ 10,000	$ 60,000
			Yon	15,000	60,000
			Zeke	95,000	60,000
Total	$120,000	$180,000	Total	$120,000	$180,000

Under the XYZ operating agreement, which has substantial economic effect, the members share income, gain, deduction, and loss equally.

None of XYZ's assets were contributed by any member to XYZ. None of the members acquired their XYZ interests in 2021 or 2022.

On January 1, 2023, in an operating distribution, XYZ distributes to *each* member $15,000 cash, and a capital asset with a fair market value of $5,000 and an adjusted basis in the hands of XYZ immediately before the distribution of $1,000. Thus, each member's distribution has an overall fair market value of $20,000.

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, Xi, Yon, and Zeke, 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.

(End of Question 2)

QUESTION 3
(One hour)

In early 2022, Gemma and Latifah form a limited partnership, LP. Gemma is the sole general partner of LP, and Latifah is the sole limited partner. In the formation transaction, Gemma contributes $50,000 cash to LP in exchange for her partnership interest, and Latifah contributes $50,000 cash to LP in exchange for her partnership interest.

The partnership agreement provides that for the first five years of its operations, the income, gain, loss, and deductions of LP are to be allocated as follows: 80 percent to Latifah and 20 percent to Gemma. In the agreement, Gemma and Latifah agree that capital accounts of LP will be kept in accordance with the regulations promulgated under section 704(b) of the Code (the "Regulations"). Gemma and Latifah further agree that upon any liquidation of LP or of a partner's interest, liquidating distributions will be made according to the amount in the distributee partner's capital account.

In addition, Gemma agrees that upon any liquidation of LP or of Gemma's interest, if Gemma has a negative capital account, Gemma will pay the negative amount to LP within 14 days. Latifah does not agree to restore a negative capital account, but Latifah agrees to be subject to a "qualified income offset," as defined in the Regulations.

Shortly after it is formed, LP borrows $100,000 from an unrelated investment banker, and uses the loan proceeds to buy Whiteacre, a parcel of vacant land, for $100,000. The debt is nonrecourse – that is, upon any default, the banker's only remedy is to foreclose on Whiteacre. Neither LP nor either of its partners are personally liable for the debt. No principal payments are due on the loan for three years; only interest is required to be paid during that initial period.

For its 2022 taxable year, LP has gross income of $80,000 and deductions of $130,000 (including interest deductions), for a net operating loss of $50,000.

For its 2023 taxable year, LP has gross income of $150,000 and deductions of $200,000 (including interest deductions), for another net operating loss of $50,000.

Assuming that LP does not elect to be taxed as an association, what are the federal tax consequences of the transactions just described, to LP, Gemma, and Latifah, 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)