

CHAPTER 14: NEW LEGISLATION



1

BENEFICIAL OWNERSHIP INFORMATION P 557-558

- FinCen removed ownership interest reporting requirement
- US Companies & US Persons
- Reporting Company: entities formed under foreign law & registered to do business in a US State or Tribal Jurisdiction
- Formed before March 26, 2025 – 30 days from that date
- Formed after March 26, 2025 – 30 calendar days after registration is effective

2

PARTNERSHIPS P 558

- Allocation of recourse liabilities amount Partners & Related Parties
- I.R.C. §752(a) – increase in Partners share of Partnership’s liabilities
= Contribution of Money by the Partner
- I.R.C. §752(b) – decrease in Partners share of Partnership’s liabilities
= Distribution of Money to the Partner
- Recourse – partner or related persons bears economic risk of loss
- Nonrecourse – no partner or related person bears economic risk of loss

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PARTNERSHIPS P 558

- Treas. Reg. 1.752-4(b)(1) – related to Partner
 - Relations to each other
 - 50% or more
 - Family – excludes siblings
 - Others excluded – pass-through entities & controlled groups

4

UNINCORPORATED ORGANIZATIONS P 558

- Applicable credits available to Entity
- Clean Energy Credit
- Fuel, energy & manufacturing credit
- Entity retains the credits if Elected OUT of Subchapter K

5

PARTNERSHIP PENALTY RELIEF P 559

- Relief for failure to furnish correct payee statements
- Notice 2025-2: unrealized receivables or inventory
- Fails to timely furnish Part IV Form 8308 to transferor and transferee
- Due Date: later of January 31 of year following §751(a) exchange occurred OR 30 days after Partnership received notice of the exchange

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PARTNERSHIP BASIS SHIFTING P 559

- Executive Order 14219 dated February 19, 2025
- Ensuring Lawful Governance and Implementing the Presidents “Department of Governing Efficiency” Deregulatory Initiative
- Removes Basis Shifting transactions-of-interest (TOI) regulations
- Notice 2024-54, 2024-28 & I.R.B. 24 – withdrawn
- Notice 2025-23 revokes 2024-54

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PAYMENTS FROM PARTNERSHIPS P 560

- I.R.C. 707(a) applies without IRS regulations
- Allows recharacterization of payments
- Distributions of property
- To a Partner for services
- After July 4, 2025

8

TAX-EXEMPT ENTITIES

P 560

- Technical Guides
- TG 3-8: Disqualifying and Non-Exempt Activities, Inurement and Private Benefit – IRC Section 501(c)(3)
- TG 3-27: IRC Section 501(c)(3) Foundation Classification – Other Public Charities – IRC Section 509(a)(1) and 170(b)(1)A(iv), (v), (ix) and Section 509(a)(4)
- TG 70: Charitable Trusts

9

TAX-EXEMPT ENTITIES

P 561-562

- Amends definition of Covered Employee
- Whether Excise Tax on excess compensation
- Any employee or former of an applicable tax-exempt organization or predecessor
- Tax year beginning after December 21, 2016
- Prior to amended definition: only 5 highest-compensated employees were covered employees

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EMPLOYEE RETENTION CREDIT

- Fact Sheet 2025-07, October 22, 2025
- H.R. 1 §70605(d)
- Prevents IRS from allowing or refunding ERC's after July 4, 2025
- Effective quarters: 3rd & 4th 2025
- New Claims filed after January 31, 2024
- Does not apply to amended returns
- Appeals rights after IRS Letter 105-C is received

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2025 NATIONAL INCOME TAX WORKBOOK

Chapter 4: Business Entities Tax Issues



12

CHAPTER ISSUES

P 121

- Basis & Holding Period of Contributed Assets
- Character of Gain or Loss on Sale of a Partnership Interest
- Form 7217, Partner's Report of Property Distributed by a Partnership
- Form 8308, Report of a Sale or Exchange of Certain Partnership Interest
- Partnership elections
- Homeowners Associations

13

LEARNING OBJECTIVES

P 121

- Understand the basis and holding period of property contributed to a corporation or partnership
- Explain the character of gain or loss on the sale of a partnership interest
- Know when property distributed from a partnership must be reported
- Know when the sale or exchange of a partnership interest must be reported
- Discuss the I.R.C. § 754 optional basis adjustment
- Understand when a partnership makes an optional basis adjustment
- Know how to calculate and allocate the optional basis adjustment
- Explain how to request revocation of a section 754 election
- Know how to report income and expenses of a homeowner's association

14

ISSUE I

Basis & Holding period of contributed assets

15

Transfer of
appreciated
property

Transfer of
depreciated
property

In exchange
for
Corporate
Stock

Gain/Loss
by
transferring
shareholder

CONTRIBUTIONS
TO A
CORPORATION
P 123

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CONTRIBUTIONS TO A CORPORATION

P 123

- I.R.C. §351 -- Nonrecognition Rule
- No gain/loss on transfer of property in exchange for stock
 - Cash or cash equivalents
 - Assets
 - NOT services
- Shareholder controls at least 80%
 - Total stock
 - Voting power of all classes of stock

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TRANSFEROR'S BASIS

P 123

- I.R.C. § 351 – deferred gain is recognized when transferor sells the stock
- Basis of property contributed
 - Reduced by FMV of any property received
 - Reduced by money received (BOOT)
 - Reduced by loss recognized on the exchange
 - Increased by Dividend received
 - Increased by gain recognized on the exchange

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TRANSFEROR'S BASIS

P 123 - 124

- Treas. Reg. § 1.358-2(b)(2) – allocation of basis
 - Stock & Securities received
 - Proportion to FMV of each class of stock & securities
- I.R.C. § 362 –
 - corporate basis in transferred property = transferor's basis
 - Corporate basis is increased by gain the transferor recognized

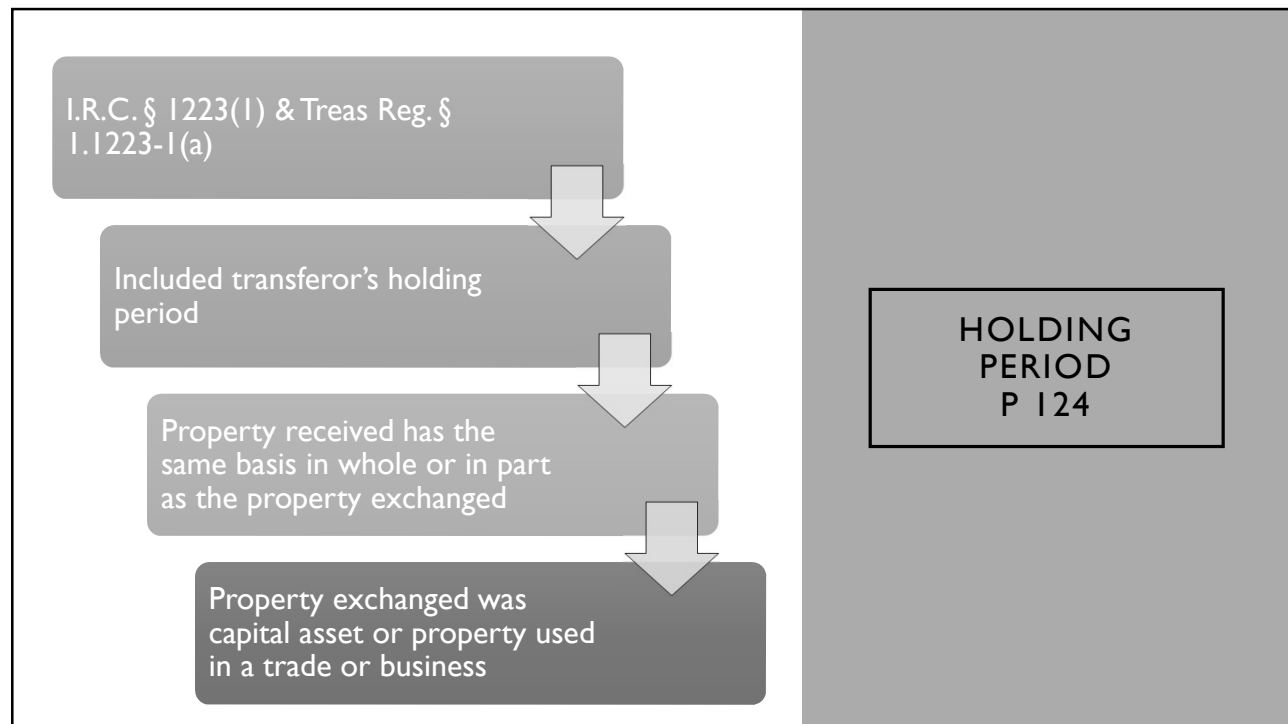
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TRANSFEROR REALIZES GAIN

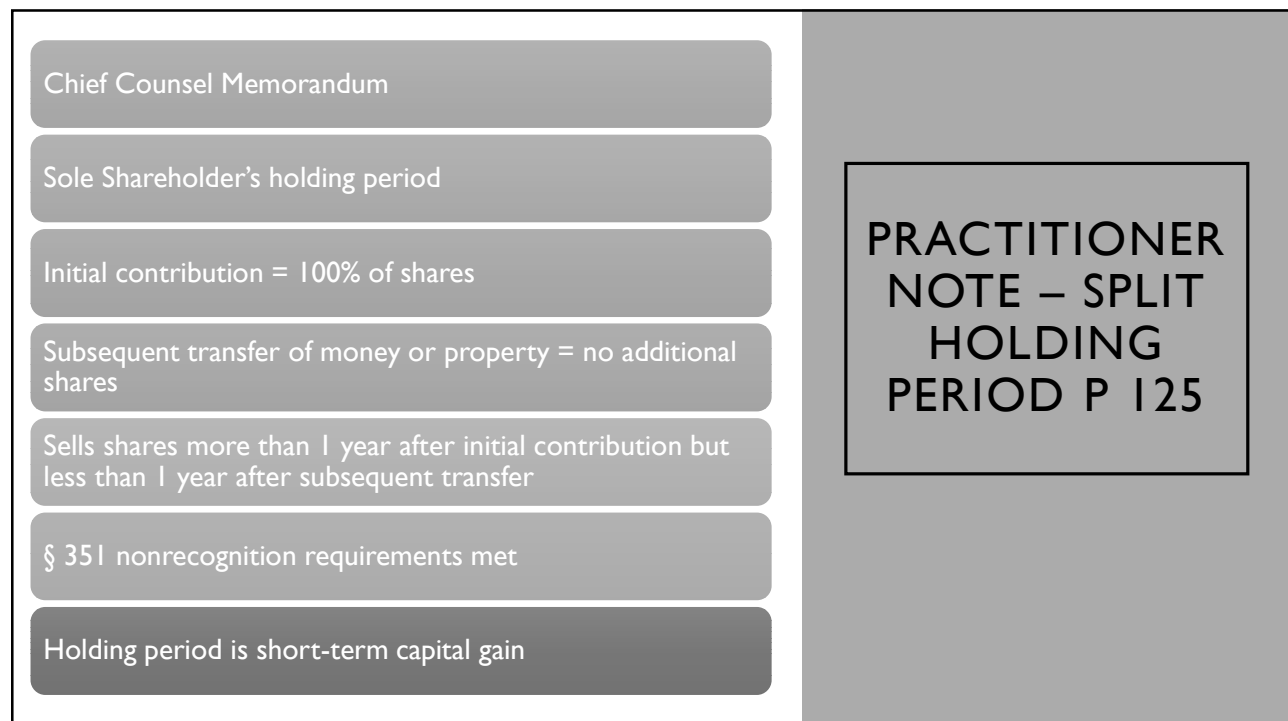
P 124

- I.R.C. § 362(d) -- transferor realizes a gain because of the assumption of a liability
- Gain cannot increase the corporation's basis above FMV
- Section 362(e)(2) limits the importation of built-in losses.
- Corporation's aggregate adjusted bases of property that is transferred > FMV of the property immediately after the transaction = the corporation's basis becomes the property's FMV
- No carryover basis
- The transferor and the transferee can elect to apply the basis adjustment to the transferor's stock.

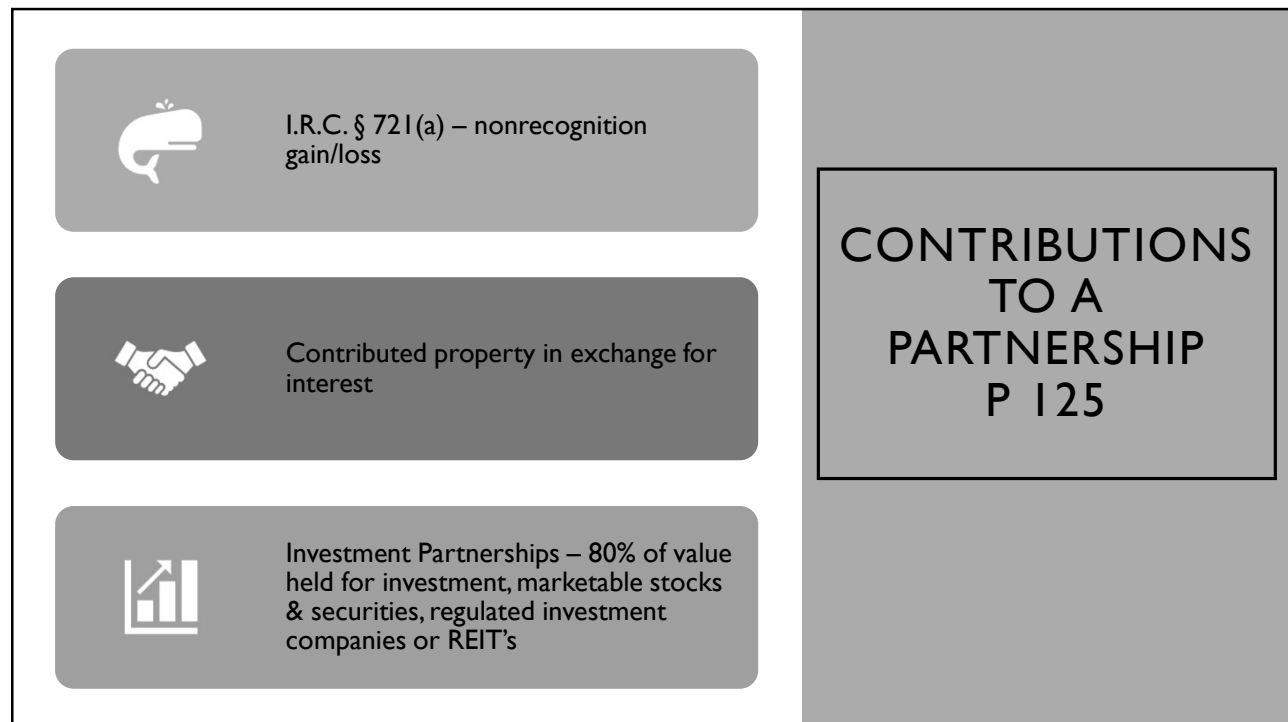
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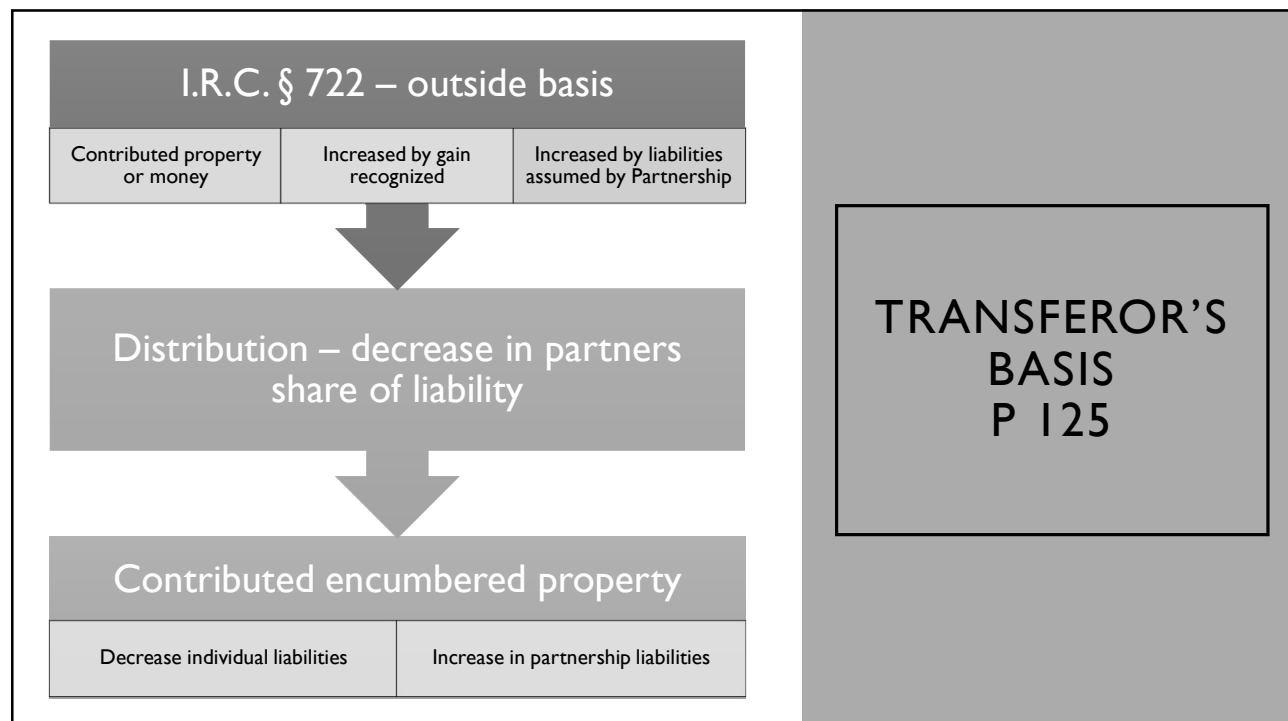
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23



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TRANSFeree'S
BASIS AFFECTS
HOLDING
PERIOD
P 126

- I.R.C. § 723
- Inside basis = the adjusted basis of the property to the contributing partner
- Increased by the amount of gain recognized
- Optional basis adjustments are discussed in Issue 5.
- Practitioner Note – Disguised Sale Rules

25

TRANSFeree'S
BASIS AFFECTS
HOLDING
PERIOD
P 126

- I.R.C. § 1223
- Capital Asset or § 1231 property
 - Holding period = same as contributed property
- Cash or other property
 - Holding period = contribution date
- Practitioner Note – Divided Holding Period

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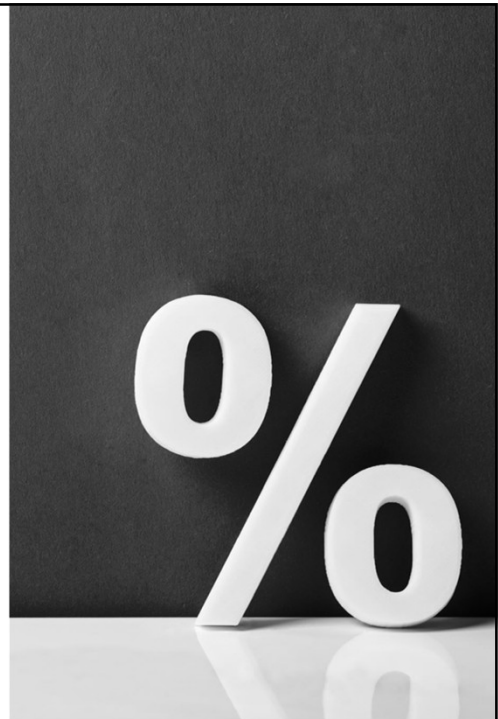
ISSUE 2

Character of gain or loss on the
sale of a partnership interest

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SALE OF PARTNERSHIP INTEREST P 127

- I.R.C. § 741
- Sale or exchange of capital asset
- I.R.C. § 751 – HOT Assets
 - Unrealized receivable
 - Inventory
 - Ordinary Income



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**SALE OF
PARTNERSHIP
INTEREST
P 127**

Rawat v. Commissioner

**Recharacterization of holding
period**

**Installment sale of partnership
interest**

**Inventory gain = ordinary
income (not sale of inventory)**

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**HOLDING PERIOD
P 127**

Rev. Rul. 84-111
(Situation 3)

Partnership
interest exchanged
for stock in new
Corporation

Exchange
terminated
Partnership

Assets & Liabilities
assumed by
Corporation

§ 351 – no
gain/loss
recognized by
partners

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HOLDING PERIOD

P 127 - 128



PARTNERS
STOCK BASIS =
PARTNERSHIP
INTEREST
BASIS
REDUCED BY
ASSUMED
LIABILITIES



HOLDING
PERIOD =
PARTNERSHIPS
HOLDING
PERIOD



§ 1223(1) –
HOLDING
PERIOD OF
HOT ASSETS



BEGINS THE
DAY
FOLLOWING
THE DATE OF
EXCHANGE

31

INSTALLMENT SALE REPORTING

P 128

1

Rev. Rul. 89-
108

2

I.R.C.
453(b)(2)(B)

3

Cannot use
installment method

- Sale of inventory
- Ordinary Income

4

Only
Partnership
Interest may
use Installment
Method

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ISSUE 3

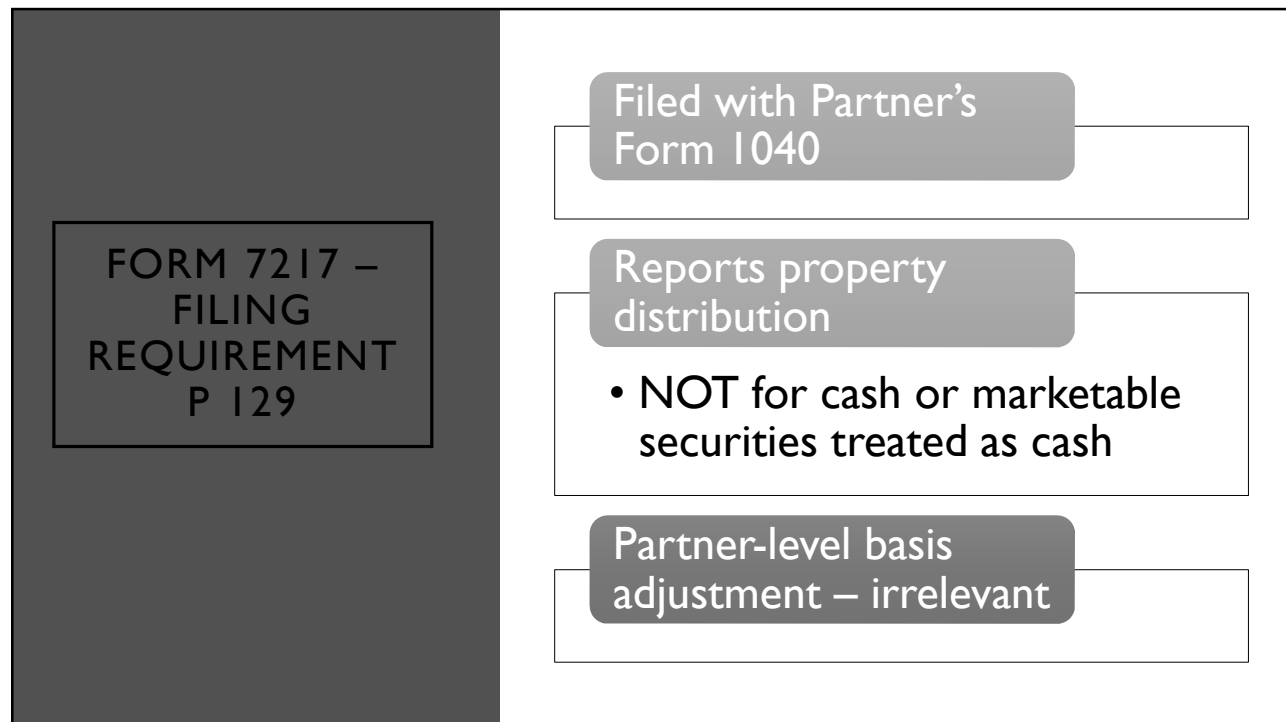
Form 7217, Partner's Report of Property Distributed by a Partnership

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FORM 7217 – BASIS REPORTING P 129

- Beginning 2024
- Reports all distributions of property
- Nonliquidating – adjusted basis immediately before distribution
- Liquidating – adjusted basis reduced by money distributed in same transaction
- Allocation ordering rules
 - HOT assets – unrealized receivables, inventory
 - Other distributed properties

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EXAMPLE 4.5: REPORTING A DISTRIBUTION P 129

- Candace Kelly, Robert Kelly, and Sergei Nivola formed Great Divide, LLC in 2010.
- The LLC is taxed as a partnership.
- Each individual contributed cash in exchange for a one-third partnership interest.
- On August 15, 2025, the partnership liquidated Sergei's one-third partnership interest by distributing to him \$180,000 cash and land with a \$54,000 FMV and a \$30,000 basis.
- At the time of the liquidation, Sergei has a \$200,000 basis in his partnership interest.

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EXAMPLE 4.5: REPORTING A DISTRIBUTION P 129

- Sergei recognizes no gain on the cash distribution, and he has a \$20,000 (\$200,000 basis – \$180,000 cash) basis in the distributed land.
- The partnership can make an optional basis adjustment to its remaining assets,
- The partnership reports the information that Sergei needs to complete Form 7217 on his Schedule K-1 (Form 1065), box 19, code C, and on an attachment to Schedule K-1.
- Sergei reports the distribution as shown in **Figure 4.1**. Figure 4.1 shows the 2024 forms as the 2025 form was not available at the time of this writing.

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FIGURE 4.1: REPORTING A DISTRIBUTION P 130

Form 7217 (December 2024) Department of the Treasury Internal Revenue Service		Partner's Report of Property Distributed by a Partnership Attach to your tax return. Go to www.irs.gov/Form7217 for instructions and the latest information.		OMB No. 1545-0123 Attachment Sequence No. 217
Partner's name Sergei Nivola		Partner's TIN XXX-XX-XXXX		
Distributing partnership's name Great Divide, LLC		Distributing partnership's EIN XX-XXXXXXX		
Date property was distributed to partner 8/15/2025				
Part I Aggregate Basis of Distributed Property on Distribution Date. File a separate form for each date a partner received distributed property.				
1	Was this distribution in complete liquidation of the partner's interest in the partnership?	☒ Yes	☐ No	
2	Was any part of the distribution treated as a sale or exchange under section 751(b)?	☐ Yes	☒ No	
3	Partnership's aggregate basis in distributed property (taking into account any basis adjustments under section 732(d), 734(b), or 743(b)) immediately before the distribution. This line should equal the total of Part II, line B, column (b)			\$ 30,000
4	Adjusted basis of the partner's interest in the partnership immediately before the distribution			\$ 200,000
5a	Cash received in the distribution			\$ 180,000
5b	Fair market value of marketable securities (as defined in section 731(c)) received in the distribution			\$ 0
5c	Add lines 5a and 5b			\$ 180,000
6	Enter the smaller of line 4 or line 5c			\$ 180,000
7	Gain recognized. Subtract line 6 from line 5c. If zero, enter -0- and go to line 9			\$ 0
8	Is U.S. tax required to be paid on the gain entered on line 7?	☐ Yes	☒ No	
9	Partner's basis in partnership interest reduced by cash received in the distribution. Subtract line 5a from line 4. If zero or less, enter -0-. See instructions if you recognized gain under section 737 as a result of the distribution			\$ 20,000
10	Aggregate basis to be allocated to the distributed property. For a non-liquidating distribution, enter the smaller of line 3 or line 9. For a liquidating distribution, enter the amount from line 9. Line 10 should equal the total of Part II, line B, column (e)			\$ 20,000

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FIGURE 4.1: REPORTING A DISTRIBUTION P 131

Part II Allocation of Basis of Distributed Property								
(a) Description of distributed property (if applicable, include property code. See Pub. 946, Appendix B.)	(b) Partnership's basis in distributed property immediately before the distribution	(c) Check applicable box(es) below. See instructions.					(d) FMV of distributed property	(e) Partner's basis in distributed property after application of section 732
		(i) 732(c)	(ii) 732(b)	(iii) 734(b)	(iv) 743(b)	(v) Reserved for future use		
1 Land	\$ 30,000	☐	☐	☐	☐	☐	\$ 54,000	\$ 20,000
2	\$	☐	☐	☐	☐	☐	\$	\$
3	\$	☐	☐	☐	☐	☐	\$	\$
4	\$	☐	☐	☐	☐	☐	\$	\$
5	\$	☐	☐	☐	☐	☐	\$	\$
6	\$	☐	☐	☐	☐	☐	\$	\$
7	\$	☐	☐	☐	☐	☐	\$	\$
8	\$	☐	☐	☐	☐	☐	\$	\$
9	\$	☐	☐	☐	☐	☐	\$	\$
10	\$	☐	☐	☐	☐	☐	\$	\$
11	\$	☐	☐	☐	☐	☐	\$	\$
12	\$	☐	☐	☐	☐	☐	\$	\$
13	\$	☐	☐	☐	☐	☐	\$	\$
14	\$	☐	☐	☐	☐	☐	\$	\$
15	\$	☐	☐	☐	☐	☐	\$	\$
16	\$	☐	☐	☐	☐	☐	\$	\$
17	\$	☐	☐	☐	☐	☐	\$	\$
18	\$	☐	☐	☐	☐	☐	\$	\$
19	\$	☐	☐	☐	☐	☐	\$	\$
20	\$	☐	☐	☐	☐	☐	\$	\$
21	\$	☐	☐	☐	☐	☐	\$	\$
22	\$	☐	☐	☐	☐	☐	\$	\$
23	\$	☐	☐	☐	☐	☐	\$	\$
24	\$	☐	☐	☐	☐	☐	\$	\$
25	\$	☐	☐	☐	☐	☐	\$	\$
26	\$	☐	☐	☐	☐	☐	\$	\$
27	\$	☐	☐	☐	☐	☐	\$	\$
28	\$	☐	☐	☐	☐	☐	\$	\$
29	\$	☐	☐	☐	☐	☐	\$	\$
30	\$	☐	☐	☐	☐	☐	\$	\$
A If applicable, enter any totals from any attached Parts II. See instructions	\$						\$	\$
B Totals for all items	\$ 30,000						\$ 54,000	\$ 20,000

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ISSUE 4

Form 8308, Report of a Sale or Exchange of Certain Partnership Interests

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**FILING FORM 8308,
REPORTING SALE
OR EXCHANGE OF
CERTAIN
PARTNERSHIP
INTERESTS P 132**

Reports 751(a) exchanges

Deemed sale (gain/loss)

Collectibles

Unrecaptured 1250 gain

Partner's share

Attached to Form 1065 – calendar year
of exchange

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**FILING
FORM 8308 –
FURNISHING
A COPY
P 132**

- Treas. Reg. § 1.6050K-1(c)(1) -- required to file a Form 8308
- Must furnish a statement to the transferor and transferee by the later of
 - January 31 of the year following the calendar year in which the section 751(a) exchange occurred, or
 - 30 days after the partnership has received notice of the exchange.

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FILING
FORM 8308 –
FURNISHING
A COPY
P 132

- A partnership must use a copy of the completed Form 8308 as the required statement
- More than one section 751(a) exchange.
 - partnership does not use the Form 8308 as the required statement
 - the partnership must furnish a statement that includes the information required to be shown on the Form 8308 with respect to the section 751(a) exchange to which the person to whom the statement is furnished is a party.

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PENALTIES
P 133

I.R.C. § 6722

Failure to furnish correct payee statements

Failure to include all information require to be shown on statement

Reasonable Cause Exception

Transferor required to report

Practitioner Note – Penalty Relief

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EXAMPLE 4.6: REPORTING SALE ON FORM 8308 P 133

- Alex Liddell, Lacy Williams, and Theresa Rygg are equal members in Precision Architecture, LLC.
- The LLC is taxed as a partnership.
- On March 15, 2025, Alex purchased Theresa's one-third interest for \$600,000.
- Of the total purchase price, \$35,000 is attributable to Theresa's one-third share of the company's accounts receivable, with a \$0 basis.
- The LLC files and furnishes Form 8308, as shown in **Figure 4.2**.
- Figure 4.2 shows the 2024 forms as the 2025 form was not available at the time of this writing.

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FIGURE 4.2
P 134

Form 8308 Report of a Sale or Exchange of Certain Partnership Interests
(Rev. October 2024)
Department of the Treasury
Internal Revenue Service

OMB No. 1545-0123
Go to www.irs.gov/Form8308 for instructions and the latest information.

Name of partnership: Precision Architecture, LLC
Phone number: 404-555-5555
Employer identification number: XX-XXXXXX

Number, street, and room or suite no. if a P.O. box, see instructions.
3 Peach Tree Lane
City or town, state or province, country, and ZIP or foreign postal code
Atlanta, GA 30033

Check if this is an amended Form 8308 ☐ or filed in respect to an administrative adjustment request ☐

Part I Transferor Information
Beneficial owner of the partnership interest immediately before transferring that interest:

Name: Theresa Rygg
Identifying number: XXX-XX-XXXX

Number and street (including apt. no.): 2335 Elm Circle
City or town, state or province, country, and ZIP or foreign postal code: Dunwoody, GA 30318

Check if providing record holder information: ☐ Check if the transferor is foreign: ☐

Notice to Transferees: The information on this form has been supplied to the IRS. The transferor in a section 751(a) exchange is required to treat a portion of the gain realized from the exchange as ordinary income. For more details, see Pub. 541, Partnerships.

Statement by Transferor: The transferor in a section 751(a) exchange is required under Regulations section 1.751-1(a)(3) to attach a statement relating to the sale or exchange to their return. See the instructions for Form 8308 for more details.

Part II Transferee Information
Beneficial owner of the partnership interest immediately after the transfer of that interest:

Name: Alex Liddell
Identifying number: XXX-XX-XXXX

Number and street (including apt. no.): 65 Middleton Rd.
City or town, state or province, country, and ZIP or foreign postal code: Sandy Springs, GA 30319

Check if providing record holder information: ☐

Part III Transfer of Partnership Interest

1 Date of sale or exchange of partnership interest: 03 / 02 / 2025

2 Type of partnership interest transferred:
A Capital ☒ B Preferred ☐ C Profits ☐ D Other ☐

Part IV Partner's Share of Gain (Loss) Required by Sections 751(a) and 1(h)(5) and (6)
The amounts in column (c) should be reported to the selling partner on their Schedule K-1 in box 20 using the relevant code.

	(a) Partnership-level deemed sale gain (loss)	(b) Percentage interest in the partnership transferred	(c) Number of units in the partnership transferred	(d) Partner-level deemed sale gain (loss)	(e) K-1 box 20 code
1 Section 751(a) gain (loss)	105,000	1/3		35,000	AB
2 Section 1(h)(5) collectibles gain					AC
3 Section 1(h)(8) unrecaptured section 1250 gain					AD

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ISSUE 5

Partnership Elections

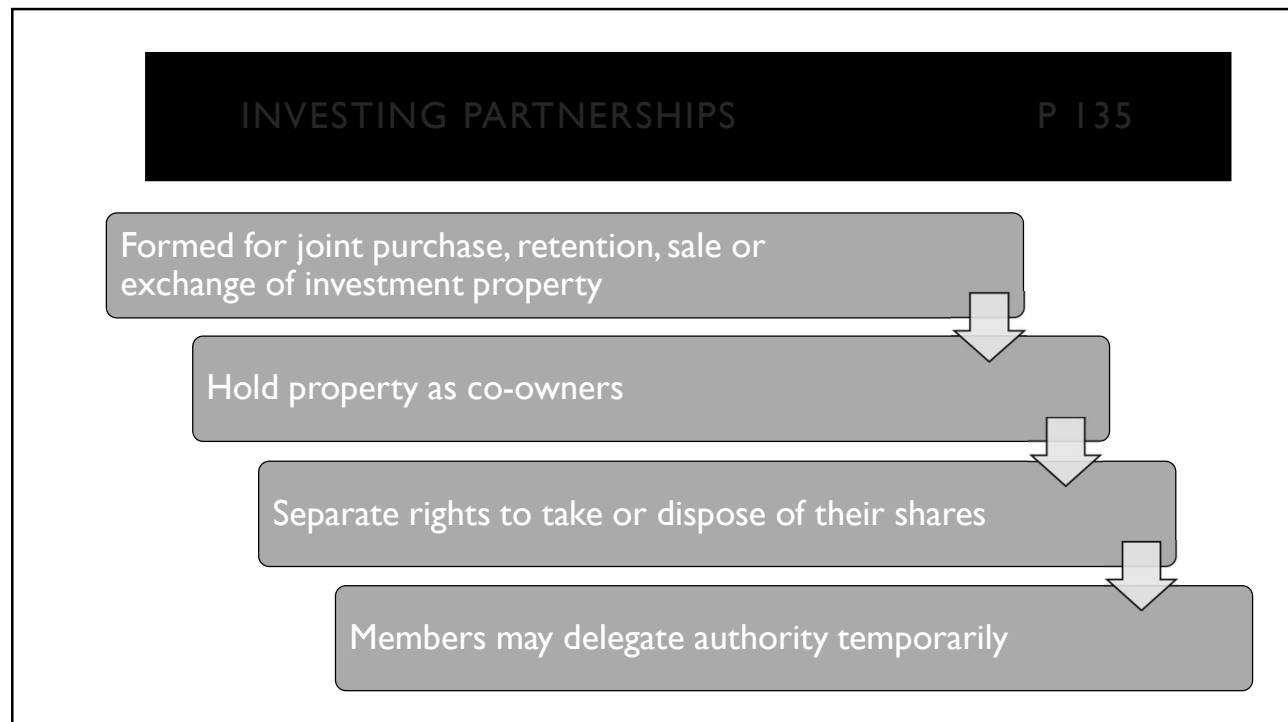
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ELECTING OUT OF SUBCHAPTER K

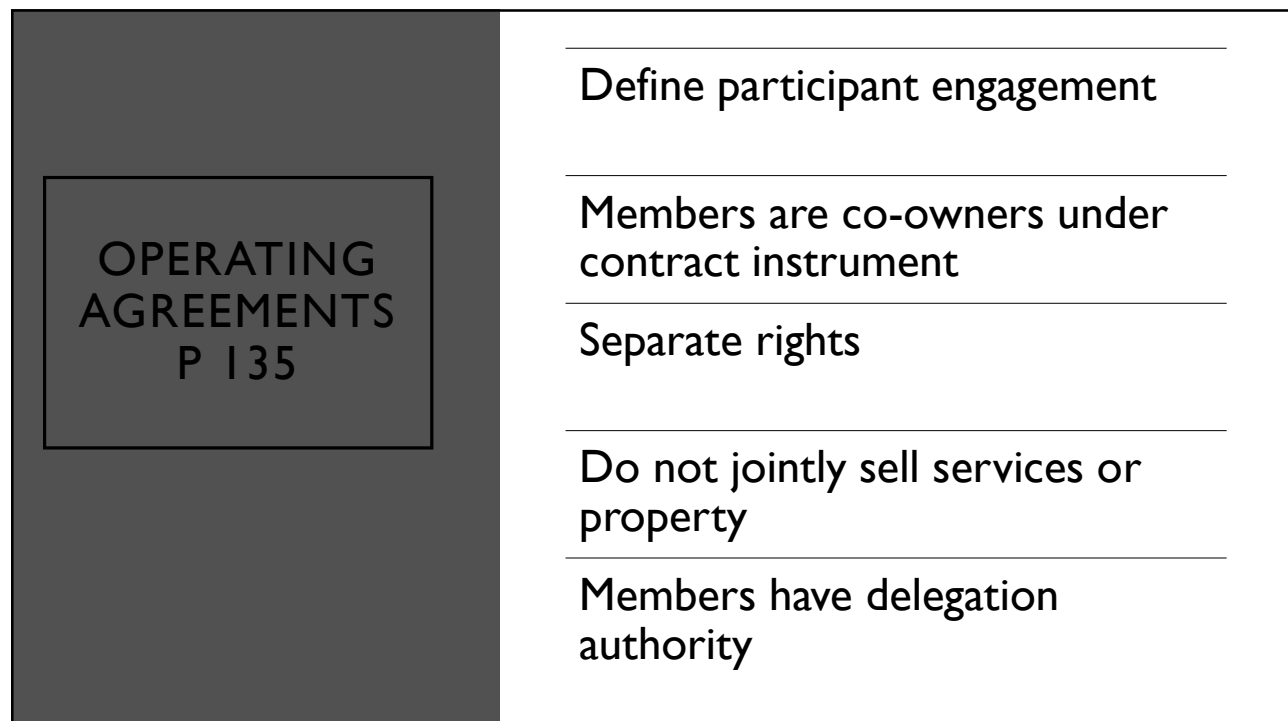
P 135

- Unincorporated organization
- For investment purposes only
- Not active trade or business
- For the joint production, extraction, or use of property
- Not for the purpose of selling services or property produced or extracted (operating agreements)
- Members determine income without computation of partnership taxable income

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MAKING THE ELECTION P 135

Electing out of Subchapter K

No later than the due date of Form 1065 with extension

Attach a statement to Form 1065

Statement must contain:

- Names, addresses, and identification numbers of all the members of the organization
- Why the organization qualifies for the exclusion
- All the members of the organization elect to exclude
- Indicate where a copy of the operating agreement is available

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MAKING THE ELECTION P 136

Practitioner Note –
Deemed Election

- Agreement among the members of the organization to exclude the organization beginning in the first tax year of the organization; or
- If the members who own substantially all the capital interests in the organization report their respective shares of income, deductions, and credits on their own returns.

Cross-Reference – Qualified
Joint Venture

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MAKING THE ELECTION P 136

- Partial Exclusion
 - All members must agree
 - Indicate partnership rules for exclusion
 - Treas. Reg. 1.761-2(a)(1) and (a)(2) or (a)(3)
 - File no later than 90 days after beginning of 1st tax year
 - Effective only after IRS approval

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ENTITY LEVEL ELECTIONS

P 136

- I.R.C. § 77 election to include commodity credit corporation loans in income
- I.R.C. § 168(b)(5) election to claim a slower method of MACRS depreciation on a recovery class of assets placed in service during that tax year
- I.R.C. § 168(g)(7) election to use the alternative depreciation system
- I.R.C. § 168(k)(5) election to claim additional first-year (bonus) depreciation on fruit trees and grape vines in the year of planting rather than in the year placed in service
- I.R.C. § 168(k)(7) election to not claim additional first-year (bonus) depreciation on a class of property

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ENTITY LEVEL ELECTIONS

P 136

- I.R.C. § 169(a) election to amortize the cost of pollution control facilities over 60 months
- I.R.C. § 179 election to expense certain depreciable assets
 - \$1,250,000 limit (for 2025)
 - entity level is phased out qualifying purchases by the entity in excess of \$3,130,000 (for 2025)
 - Qualifying investment of the partnership is not included in the qualifying investment amount

55

ENTITY LEVEL ELECTIONS

P 137

- I.R.C. § 180 election to expense fertilizer and other land conditioning costs
- I.R.C. § 263 elections to claim deductions under the de minimis safe harbor, the safe harbor for qualifying building expenditures, and the capitalization of amounts paid for repairs and maintenance

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ELECTION TO RECOVER BASIS

P 137

- General Rule – capital accounts reduced by cash distributions
- Excess distributions = taxable event of the partner
- Fixed-Sum Payments – made on liquidation can elect to recover basis ratably
 - Partner makes the election on 1st year return
- NOT available for HOT Assets

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I.R.C. § 754 ELECTION TO ADJUST BASIS P138

- Inside Basis
 - Cost of property
 - Contributed property: adjusted basis of contributing partner
- Outside Basis
 - Partnership interest
 - Equal the partners inside basis
- § 754 Adjustment: adjusts inside & outside basis to be equal

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PRACTITIONER NOTE

P 139

- Mandatory Basis Adjustment
- I.R.C. § 743(a) requires a basis adjustment if there is a substantial built-in loss immediately after the transfer (including transfers by death).

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PRACTITIONER NOTE

P 139

- A partnership has a substantial built-in loss if
 - the partnership's adjusted basis in partnership property exceeds the FMV of such property by more than \$250,000, or
 - the transferee would be allocated a net loss in excess of \$250,000 upon a hypothetical disposition by the partnership of all the partnership's assets in a fully taxable transaction for cash equal to the assets' FMV immediately after the transfer of the partnership interest

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WHEN TO MAKE THE ELECTION

P 139

- Transfer of a partnership interest by sale or exchange, or upon the death of a partner,
- The new partner has an outside basis in excess of his or her share of the inside basis
- Distribution of cash to a partner where gain is recognized, or distribution of property where outside basis is less than allocable inside basis
- Contributions of property to a partnership where the contributing partner recognizes gain due to liabilities in excess of basis

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TRANSFER ON DEATH OF A PARTNER

P 140

- Beneficiary basis = FMV on date of death
- Inside & Outside basis discrepancy
- Optional Basis Adjustment Election
 - Cash
 - Property
 - Unrealized gain/loss = pre-distribution unrealized gain/loss
- Cross-Reference – Income in Respect of Decedent

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COMPUTING THE ADJUSTMENT

P 140

- § 754 election
- upon the transfer of a partnership interest due to a sale, an exchange, or the death of a partner, the partnership
- increases its adjusted basis in the partnership assets by the excess of the transferee's outside basis (basis in the partnership interest) over the transferee's inside basis (proportionate share of the partnership's adjusted basis in its assets); or
- decreases its adjusted basis in the partnership assets by the excess of the transferee's inside basis over the transferee's outside basis.
-

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COMPUTING THE ADJUSTMENT

P 140

- A transferee partner's inside basis equals the sum of his or her share of partnership liabilities plus his or her share of the partnership's previously taxed capital.
- Previously taxed capital is generally defined as
 - the amount of cash that the transferee would receive on a liquidation of the partnership in a fully taxable transaction for cash equal to the FMV of the partnership assets, plus
 - the tax loss that would be allocated to the transferee on the liquidation, less
 - the tax gain that would be allocated to the transferee on the liquidation.

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COMPUTING THE ADJUSTMENT – DISTRIBUTION P 141

Partnership increases basis in remaining assets by:

- the gain recognized by the distributee partner because cash received exceeds basis in the partnership interest, or
- the excess of the partnership's adjusted basis in the distributed property over the basis of the property in the distributee partner's hands.

Partnership decreases basis in remaining assets by:

- the loss recognized on the distribution by the distributee partner under I.R.C. § 731(a)(2) (A loss can only be recognized on a liquidating distribution consisting solely of cash, unrealized receivables, or inventory.); or
- the excess of the distributee's basis in the distributed property over the adjusted basis of the property in the partnership's hands before the distribution.

65

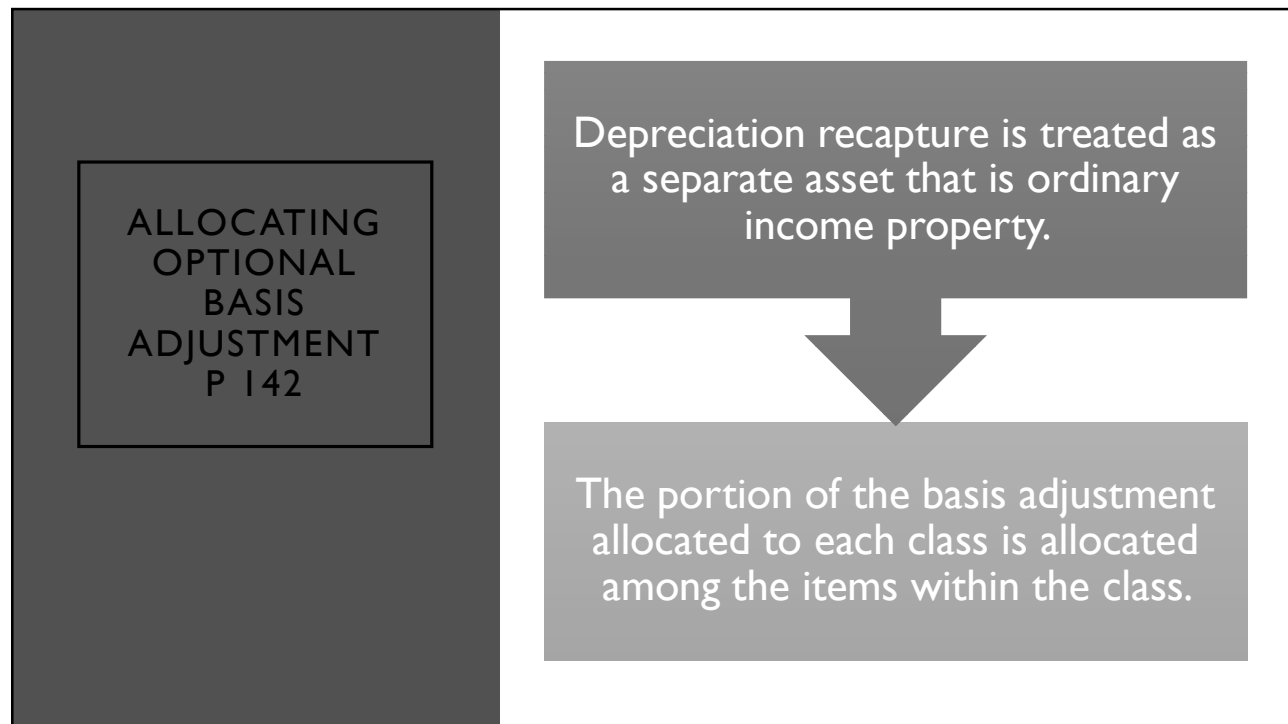
ALLOCATING OPTIONAL BASIS ADJUSTMENT P 142

I.R.C. § 755 provides the rules for allocations of basis adjustments

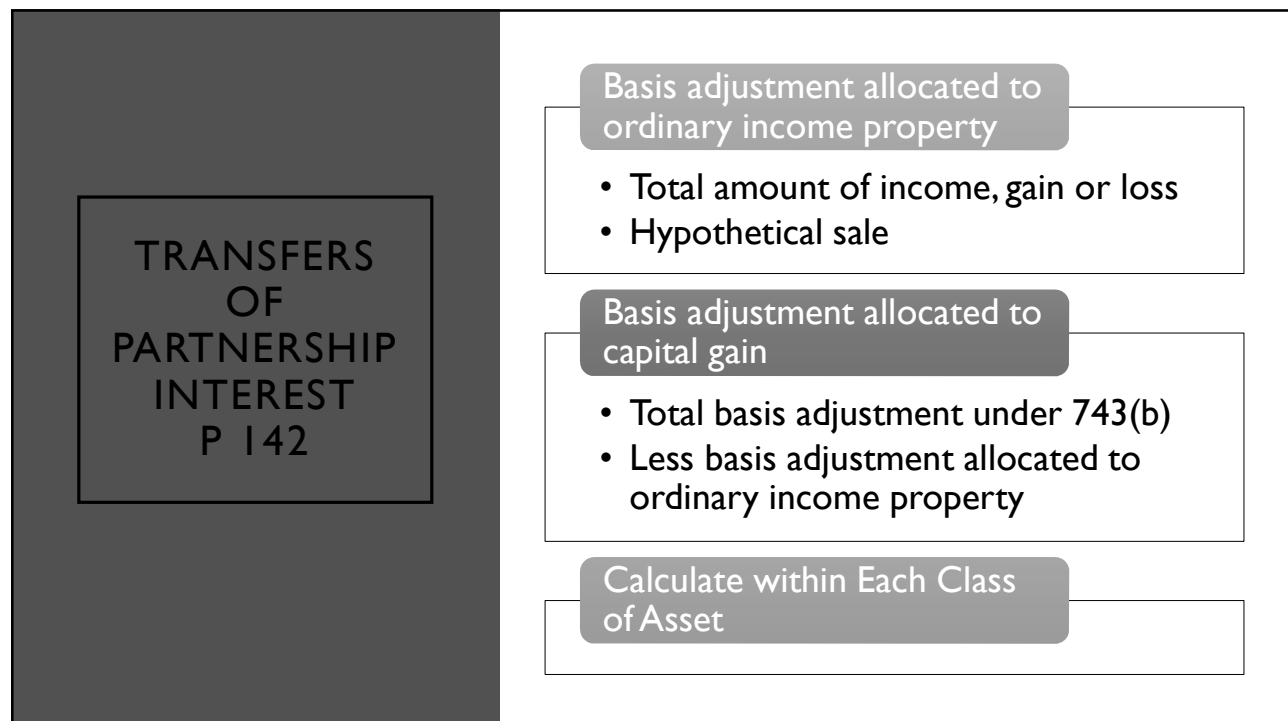
§§ 734(b) and 743(b) allocates partnership property.

- First, the partnership determines the FMV of its assets.
- Second, it allocates the basis adjustment between the following two classes of property:
 - Capital gain property (capital assets and I.R.C. § 1231 property)
 - Ordinary income property (assets other than capital gain property)

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**EXAMPLE 4.12:
ALLOCATION
OF BASIS
P 142**

Sims Design Group partnership has three equal partners.

One partner sold her partnership interest when a § 754 election was in effect

There is a \$55,000 ($\$165,000 \div 3$) optional basis adjustment.

The partnership's assets are shown in **Figure 4.8**.

There is no depreciation recapture on the building.

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FIGURE 4.8: ASSETS OF SIMS DESIGN GROUP P 143

Asset	Basis	Fair Market Value	Difference
Accounts receivable	\$ 0	\$ 15,000	\$ 15,000
Nondepreciable capital assets	100,000	265,000	165,000
Land	40,000	60,000	20,000
Building	<u>60,000</u>	<u>25,000</u>	<u>(35,000)</u>
Total	<u>\$200,000</u>	<u>\$365,000</u>	<u>\$165,000</u>

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FIGURE 4.9: ASSET CLASSIFICATION

P 143

Asset		Basis	Fair Market Value	Difference
Capital gain property:				
	Nondepreciable capital assets	\$100,000	\$265,000	\$165,000
	Land	40,000	60,000	20,000
	Building	60,000	25,000	(35,000)
Total capital gain property		\$200,000	\$350,000	\$150,000
Ordinary income property:				
	Accounts receivable	\$0	\$15,000	\$15,000

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EXAMPLE 4.12: ALLOCATION OF BASIS P 143

Optional basis adjustment to the ordinary income property is allocated based on a hypothetical sale of the ordinary income property by the transferee partner.

The transferee partner would receive \$5,000 ($\$15,000 \div 3$) on the sale of the ordinary income property.

The transferee partner allocates \$5,000 of the basis adjustment to the ordinary income property and \$50,000 ($\$55,000 - \$5,000$) to the capital gain property.

The total amount of gain that is allocated to the transferee from the hypothetical sale of the capital gain assets is \$50,000 ($\$150,000 \div 3$).

72

FIGURE 4.10: ALLOCATION OF BASIS

P 144

Nondepreciable capital assets	$(\$165,000 \div \$150,000) \times \$50,000$	\$55,000
Land	$(\$20,000 \div \$150,000) \times \$50,000$	6,667
Building	$[\$(35,000) \div \$150,000] \times \$50,000$	(11,667)
Total basis adjustment		<u>\$50,000</u>

73

PARTNERSHIP DISTRIBUTION

P 144

- Special Rule Partnerships Capital Gain Property
 - Allocation within class
 - Increases within a class are first allocated based on unrealized appreciation to the extent of unrealized appreciation.
 - Any remaining adjustment is allocated in proportion to FMV.
 - Decreases within a class are first allocated based on unrealized depreciation to the extent of unrealized depreciation.
 - Any remaining adjustment is allocated based on adjusted basis, but not below zero.

74

PARTNERSHIP DISTRIBUTION

P 144

- If an increase in the basis of undistributed property cannot be made because the partnership does not own property of the character that must be adjusted
- The increase is carried over until the partnership acquires such property.
- If a decrease in the basis of all the property of a like character has been reduced to zero
- The adjustment is made when the partnership later acquires property of a like character for which the adjustment can be made.

75

754 ELECTION

P 144 - 145

- Optional basis adjustment under §§743 and 734 only if the partnership has filed a § 754 election.
- Once 754 election, optional basis adjustments must be made each time a partnership interest is sold, exchanged, or transferred due to a partner's death; and upon distributions to a partner if the distribution results in the recognition of gain or loss.
- The election must be made by the due date of the return (including extensions)
- The partnership can file for an automatic 12-month extension (from the original due date of the election)

76

REPORTING §754 ELECTION

P 145

- Notice Requirement – transferee must notify the partnership within 30 days
- Failure to Give Notice
 - Partnership isn't required to make adjustment until notified
 - Partnership isn't notified but knows of the transfer
 - Attaches statement with transferee's name & TIN
 - Writes on front of 1065: "RETURN FILED PURSUANT TO REG 1.743-1(k)(5)"
 - Reports transferee's share of partnership without adjustment

77

EFFECT OF ADJUSTMENTS

P 145 - 146

- Basis of transferee's partnership property
- Special basis with property of adjusted basis
- Adjustment reported on Schedule K
- Adjustments reported on transferee's Schedule K-1
- Practitioner Note: Section 179 & Bonus Depreciation

78

REVOKING §754 ELECTION

P 146

- Revoke the election only with IRS approval.
- To revoke the election, the partnership files the request on Form 15254, Request for Section 754 Revocation.
- Form 15254 must be filed no later than 30 days after the close of the partnership year for which the revocation is to be effective.
- A revocation application will not be approved if the primary purpose is to avoid a reduction in the basis of assets upon a transfer or distribution

79

TRANSFeree PARTNER'S BASIS ELECTION P 146

- Non-liquidating Distribution Basis = adjusted basis immediately before distribution
- Basis adjusted by BOOT
- Purchased or Inherited Basis
- Within 2 years
- Elects 743(b) adjustment – basis is same as if 732(d) elections
- Unavailable for HOT Assets

80



732(D) BASIS ELECTION P 147

- Partner files with Form 1040
- Within 1 year of distribution – depreciation, depletion or amortization property
- Any tax year that is not later than tax year basis adjustment affects
- Adjust basis of property received

81

**MANDATORY
ELECTION**

P 147

- Special Basis Rules – NO 754 election
- FMV of all partnership property (other than money) exceeded 110% of its adjusted basis to the partnership;
- an allocation of basis under section 732(c) upon a liquidation of the partner's interest immediately after the transfer of the interest would have resulted in a shift of basis from property not subject to an allowance for depreciation, depletion, or amortization, to property subject to such an allowance; and
- a basis adjustment under section 743(b) would change the basis to the transferee partner of the property actually distributed.

82

ISSUE 6

Homeowner's associations

83



HOMEOWNERS ASSOCIATIONS P 148

- Organization of real property owners
- Enforces covenants, conditions & restrictions that limit certain uses of property
- Owns & maintains common areas
- Members is customarily mandatory
- § 528 Election for tax-exempt status

84

501(C)(4) TAX-EXEMPT ORGANIZATION P 148



85

501(C)(4) TAX-EXEMPT ORGANIZATION P 148

Qualifications:

- serve a community that bears a reasonably recognizable relationship to an area ordinarily identified as governmental,
- not conduct activities directed to the exterior maintenance of private residences, and
- allow public use and enjoyment of common areas or facilities that the HOA owns and maintains.

Practitioner Note: Condominium Associations

86

501(C)(4) TAX-EXEMPT ORGANIZATION P 148

Community – Rev. Rul. 74-99

Geographical unit bearing a reasonable recognizable relationship to an area ordinarily identified as a governmental subdivision or unit or district

Service to Member

Public Access to Common Areas

87

501(C)(7) TAX-EXEMPT ORGANIZATION P 150



GROSS RECEIPTS
TEST



SUBSTANTIALLY
SUPPORTED BY ITS
MEMBER



65% GROSS RECEIPTS
FROM MEMBERS



35% GROSS RECEIPTS
FROM NONMEMBER
SOURCES

88



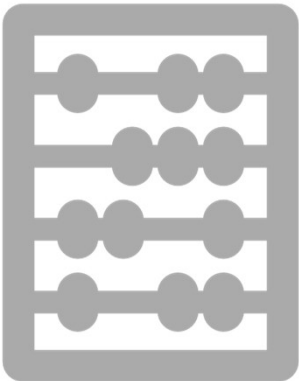
File Form 8976 within 60 days of formation



File Form 1024, Application for Recognition of Exemption Under Section 501(a)

**APPLYING FOR
EXEMPT STATUS
P 150**

89



**RETURN REPORTING
P 150**

- File Form 990 series annually
- Failure to file for 3 consecutive years – status is revoked
- \$ 1,000 or more gross income subject to tax -- unrelated trade or business income
- Gross income = gross receipts – cost of goods sold
- Example, Not UBTI – lemonade stand at block party
- Example, UBTI – commercial parking lot

90



SECTION 528 P 151

- HOA not exempt
- Excludes exempt function income from gross income
- Taxes on nonexempt function income
- Files Form 1120-H, U.S. Income Tax Return for Homeowners Associations

91



HOA DEFINED UNDER § 528 P 151

- An organization that is a condominium management association, residential real estate management association, or a timeshare association
- Elects to have § 528 apply for the tax year
- No part of net earnings benefit any private individual.
- Must pass the 60%-gross-income test and the 90%-expenditure test

92

60% GROSS INCOME TEST P 151

60% or more gross income
= exempt function income

- Membership dues
- Fees

Assessments of owners

- Nonexempt function income
- Interest
- Dividends
- Investment income

93

EXEMPT FUNCTION INCOME P 152

Paying	Paying the principal and interest on debts incurred for the acquisition of association property
Paying	Paying real estate taxes on association property
Maintaining	Maintaining association property
Removing	Removing snow from public areas
Removing	Removing trash

94

**CAPITAL
IMPROVEMENTS
P 152**

Assessments for capital improvements

NOT treated as gross income

NOT included in 60% test

95

**90%
EXPENDITURE
TEST
P 152**

Qualifying expenditures include both current operating and capital expenditures on association property.

They also include expenditures on association property that may produce nonexempt function income.

96

90%
EXPENDITURE
TEST
P 152

Qualifying expenditures may include (but are not limited to) expenditures for the following:

Salaries of an association manager and secretary

Paving of streets, Street signs

Security personnel

Legal fees

Upkeep of tennis courts, Swimming pools, Recreation rooms and halls

97

90%
EXPENDITURE
TEST
P 152

Replacement of common buildings, facilities, air conditioning, etc.

Insurance premiums on association property

Accountant's fees

Improvement of private property to the extent it is association property

Real estate and personal property taxes imposed on association property by a state or local government

98

ASSOCIATION PROPERTY

P 153

- For purposes of the expenditure test
- Association property is defined as real and personal property owned by the organization or owned as tenants in common by the organization's members
- Some property privately owned by the members of the organization (if it affects the overall appearance or structure of the units)
- Property owned by or normally owned by a governmental unit and used for the benefit of residents of that unit (e.g., sidewalks and roadways)
- In some instances, association property may include privately owned property if it affects the overall appearance or structure of the residential units

99

TAX ELECTION

P 153

- File Form 1120-H, U.S. Income Tax Return for Homeowners Associations
- By due date of return
 - 15th day of 4th month following close of calendar or fiscal year
- Election is irrevocable without IRS approval
- Fiscal year end June 30th
 - Due date is 15th day of 3rd month
- 12-month extension available

100

- 30% nonexempt income
- 32% for timeshare associations
- Taxable income adjustments:
 - A \$100 specific deduction is allowed.
 - No net operating loss deduction is allowed under I.R.C. § 172.
 - No deduction is allowed under subchapter B, part VIII, (relating to special deductions for corporations).

TAX RATES P 153

101

CAPITAL CONTRIBUTIONS P 157

Exempt functional income: membership dues, fees, assessments from owners

Capital contributions:

Included in income unless segregated from other funds

Used only for capital improvements

Special assessments

102

WASHINGTON ATHLETIC CLUB V. UNITED STATES

- The court reasoned that the club members had no investment intent for the additional monies collected, considering the following factors:
- A long-term member who paid more dues had no greater rights on liquidation than a new member.
- Upon termination of membership, a member simply forfeited all amounts previously paid, losing any right to share in the club's assets on liquidation.

103

WASHINGTON ATHLETIC CLUB V. UNITED STATES

- Membership conferred no significant rights other than the use of the club facilities and the right to vote for the board of directors
- Designating the payments for capital improvements, while pertinent, was not the deciding factor in determining if the payments were capital contributions, and there must be some purpose for the payments, other than to receive services.
- The court concluded that the capital contribution did not qualify as a contribution to the capital of the corporation under § 118.

104

REV. RUL. 75-371

P 157

- Nonexempt condo management association
- Special assessment of owners – pro-rata by value of owner's unit
- Purchase outdoor furniture
- Contribution of capital to each unit owner

105

QUESTIONS



106