



The Estate Planner's Guide to the Taxation of Partners and Partnerships

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Agenda

- TAX ISSUES AT FORMATION
- TAXATION OF PARTNERSHIP OPERATIONS
- DEATH OF A PARTNER
- LIQUIDATION OF THE PARTNERSHIP

FORMATION OF THE PARTNERSHIP

- Generally tax-free
- §721(b) – “Investment partnerships”
- §752 – Transfers of property with debt in excess of basis

OPERATION OF THE PARTNERSHIP

- Income and deduction items can be allocated between partners in any manner they choose as long as the allocations have **SUBSTANTIAL ECONOMIC EFFECT**
- Does the partnership agreement require capital accounts to be maintained according to Reg. §1.704-1(b)(2)(iv)?
- Restricting transfers to boost valuation discounts may cause income tax problems!
 - Might trigger family partnership rules
 - Affects the amount of basis that transfers with gift
 - Affects the inside basis step-up under a §754 election

CHOICE OF TAXABLE YEAR AT DEATH



Election to Close Books

PARTNER	MARCH GAIN	NOVEMBER GAIN
Mom	\$300	Zero
Son	\$300	\$150
Daughter	\$300	\$150

Default Pro Rata Method

PARTNER	MARCH GAIN	NOVEMBER GAIN
Mom	\$150	\$50
Son	\$375	\$125
Daughter	\$375	\$125

LIQUIDATION OF THE PARTNERSHIP – 2 OPTIONS

(1) Sell assets and liquidate with cash distributions

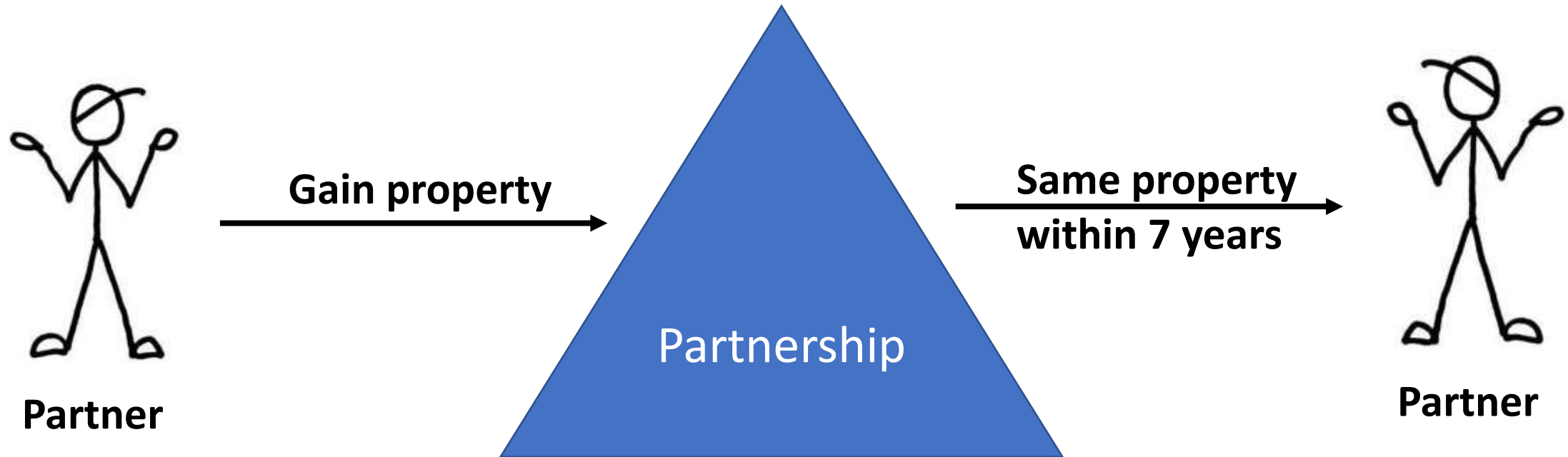
- Built-in gains allocated to transferor
- All other gains allocated as agreed
- Cash distributions taxable to extent they exceed outside basis

(2) Distribute assets to partners

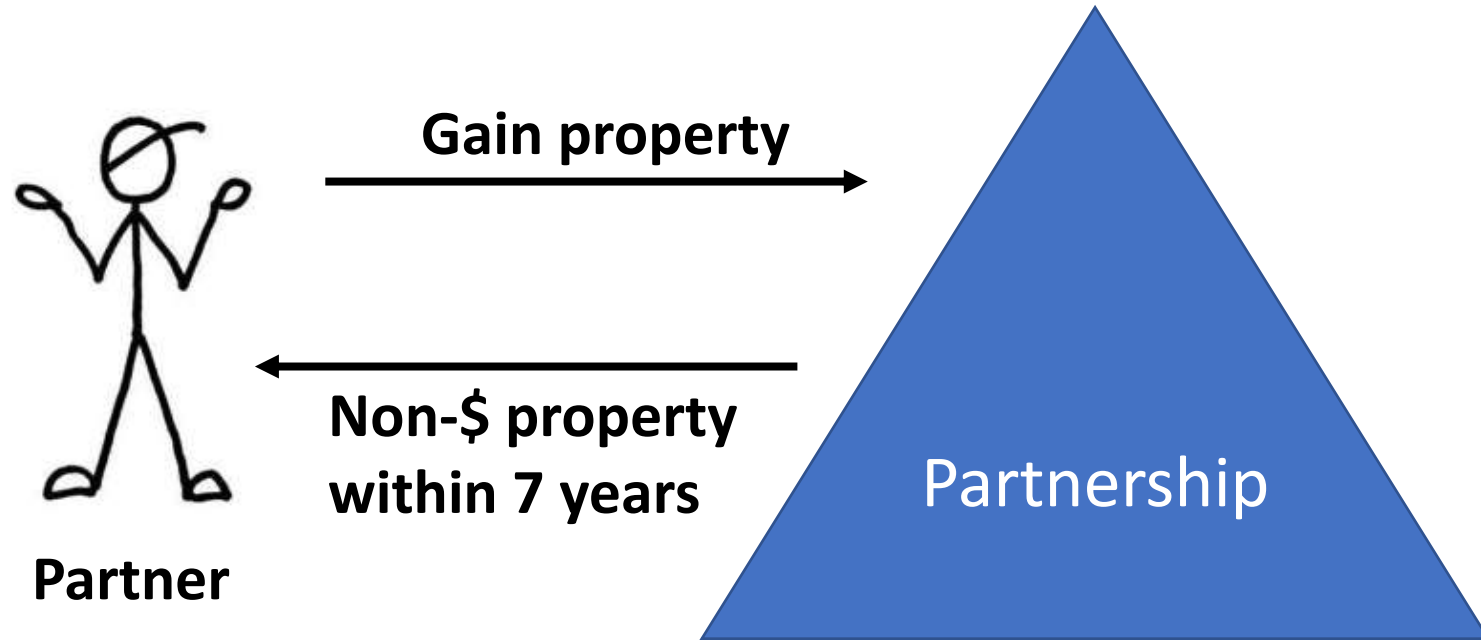
- §704(c)(1)(B)
- §737
- §731(c)



LIQUIDATION OF THE PARTNERSHIP - §704(c)(1)(B)



LIQUIDATION OF THE PARTNERSHIP - §737



LIQUIDATION OF THE PARTNERSHIP - §731(c)

- Distributions of **marketable securities** treated as distributions of cash

EXCEPTIONS

- Return to Sender
- Partnership acquired securities in nonrecognition transaction
- Securities not marketable for first 6 months following contribution
- “Investment partnership” distributes to “eligible partner”



LIQUIDATION OF THE PARTNERSHIP – ORDERING RULES



(1) Apply §704(c)(1)(B)

(2) Apply §731(c)

(3) Apply §737