

PARTNERSHIP TAXATION

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to
FIFTH EDITION**

RICHARD M. LIPTON, ESQ.

Partner, Baker & McKenzie LLP

PAUL CARMAN, ESQ.

Partner, Chapman and Cutler LLP

WALTER D. SCHWIDETZKY

Professor of Law

University of Baltimore School of Law

ROSS D. COHEN, ESQ.

Partner, Dentons Bingham Greenebaum LLP

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Carolina Academic Press
700 Kent Street
Durham, North Carolina 27701
Telephone (919) 489-7486
Fax (919) 493-5668
E-mail: cap@cap-press.com
www.cap-press.com

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PARTNERSHIP TAXATION

ADDITIONS, SUBSTITUTIONS AND INSERTIONS

CHAPTER 12: FOREIGN PARTNERSHIPS, FOREIGN PARTNERS, AND PARTNERSHIPS WITH TAX-EXEMPT ENTITIES

§ 12.08 READING, QUESTIONS AND PROBLEMS

B. QUESTIONS AND PROBLEMS

PROBLEM 9 IS RESTATED AS FOLLOWS:

ABC manufactures and sells widgets in the United States. A and B are U.S. domestic individuals, but C is a non-U.S. entity that is primarily engaged in the business of manufacturing and selling widgets around the world. C's stock is not publicly traded. ABC makes annual allocations and distributions of the partner's allocable shares of income. C also loaned \$100x to ABC on April 1, 2021, to support the capitalization of ABC. ABC pays C \$5x of interest annually. What portions of the allocations, distributions, and payments to C will be subject to FATCA withholding? What must C do to avoid the withholding?

CHAPTER 14: FAMILY PARTNERSHIPS

§ 14.03 INCOME TAX ISSUES FOR VACATION/RENTAL HOMES

Add at the end of the section:

As discussed below in section 14.06, expenses from activities not engaged in for profit, even if otherwise deductible under the hobby loss rules, are considered miscellaneous itemized deductions.¹ Thus, such expenses are not deductible for tax years 2018 through 2025.²

Certain expenses, such as property taxes and interest on mortgages, are deductible without regard to the limitations on the deductibility of miscellaneous itemized expenses – subject to some limitations. Property taxes are not miscellaneous itemized deductions because they are excluded by I.R.C. § 67(b)(2). Similarly, interest is excluded from miscellaneous itemized deductions under I.R.C. § 67(b)(1).

However, property taxes are subject to a separate limitation under I.R.C. § 164. Prior to 2026, an individual may not claim a deduction of more than \$10,000 in the aggregate per year of certain taxes, including state and local income and property taxes (\$5,000 in the case of a married individual filing a separate return).³

Investment interest expense is deductible to the extent of investment income of the taxpayer for the year.⁴ Interest attributable to a passive activity is deductible to the extent of the passive activity income.⁵ However, the deductibility of interest from a trade or business is subject to an overall limitation of 30% of the taxpayer's earnings before depreciation, amortization, interest and taxes (depreciation and amortization are backed out only for years before 2022).

Personal interest is an allowable deduction only if it fits in certain specified preferred categories.⁶ One of those categories is acquisition indebtedness for a qualified residence.⁷ A “qualified residence” means the taxpayer's principal residence and one other residence of the taxpayer which is used by the taxpayer as a residence for the purposes of I.R.C. § 280A(d)(1).⁸ For years prior to 2026, the interest on no more than \$750,000 (\$375,000 in the case of a married individual filing separately) of acquisition indebtedness is deductible. After 2025, the limits go up to \$1,000,000 and \$500,000, respectively.

So one might asked, “What does all this have to do with a family limited partnership?” In Chapter 1 we talked about the entity and the aggregate theories. I.R.C. § 280A is applied to a partnership under the aggregate theory. Prop. Reg. § 1.280A-1(e)(3) provides that, for the purposes of I.R.C. § 280A, the partnership is treated as making personal use of property on any calendar day which any member of the partnership would be considered to have made personal use of the property.⁹

¹ Temp. Reg. § 1.67-1T(a)(1)(iv).

² I.R.C. § 67(g).

³ I.R.C. § 164(b)(6).

⁴ I.R.C. § 163(d)(1).

⁵ Temp. Reg. § 1.469-2T(d)(3). The passive activity loss rules do not apply to a residence subject to I.R.C. § 280A(c)(5). *See* I.R.C. § 469(j)(10).

⁶ I.R.C. § 163(h)(1) and (2).

⁷ I.R.C. § 163(h)(3)(A)(i).

⁸ I.R.C. § 163(h)(4)(A).

⁹ *See also* S. Rept No. 94-938 (PL 94-455), Tax Reform Act of 1976, 1976-3 C.B. (Vol. 3) pp. 153-54 (June 10, 1976).

So if a vacation home is placed in a partnership, the I.R.C. § 280A limitations apply in the same manner as if the partners owned the property directly.

However, CCA 200029046 indicated that the entity theory applies to determine ownership of a residence for the purposes of I.R.C. § 121, finding that the ownership of a residence by a family limited partnership did not qualify for the exclusion of gain of a principal residence because the residence was owned by the partnership rather than the taxpayer. The taxpayer considered in the CCA had also requested a ruling that the interest paid on the debt used to acquire the residence qualified as home mortgage interest under I.R.C. § 163(h). The IRS declined to rule on the I.R.C. § 163(h) issue.

So if a residence is placed in a partnership, the individual taxpayer may lose the benefit of the I.R.C. § 121 exclusion, and it is unclear whether the taxpayer would be entitled to a home mortgage deduction.

CHAPTER 17: LEGISLATIVE UPDATES AND NON-SUB K PROVISIONS

§ 17.05 QUESTIONS AND PROBLEMS

A. TAX CUTS AND JOBS ACT (“TCJA”)

1. ABC is in the construction equipment leasing business. Substantially all of the value of the business is in the equipment, all of which has a recovery period of less than 20 years. DEF purchases all of the equipment from ABC in 2022. Absent other facts, would you expect that DEF would be able to take 100% bonus depreciation in regard to the cost of the equipment under I.R.C. § 168(k) in 2022?
2. ABC is in the construction equipment leasing business. Substantially all of the value of the business is in the equipment, all of which has a recovery period of less than 20 years. D purchases C’s interest in the partnership from C in 2022. The partnership has an I.R.C. § 754 election in place. Absent other facts, would you expect that D would be able to take 100% bonus depreciation in regard to the cost of the equipment under I.R.C. § 168(k) in 2022?
3. ABC runs a cryptocurrency mining business. Though the income of the partnership fluctuates, the partnership has \$50,000,000 of income in 2021. The partnership has \$20,000,000 unadjusted basis invested in computer equipment in 2021. The partnership has no employees. Absent other facts, what would the aggregate deduction available to the partners under I.R.C. § 199A.
4. ABC is the operator of a shopping mall. In 2021, ABC has \$50,000,000 of gross rental income, \$20,000,000 of depreciation deductions and \$20,000,000 of interest expense.
 - a. Assuming ABC has no other items of income or deduction, what would ABC’s I.R.C. § 163(j) limitation be for 2021?
 - b. How would your answer change if the same facts existed in 2022?
 - c. How would your answer change for 2022 if ABC makes the election to be treated as an electing real property trade or business?

B. QUALIFIED OPPORTUNITY ZONE FUNDS

5. In January 2022, Money Bags sells bitcoin, which he has held as a capital asset since 2009. His basis in the bitcoin is \$10. He sells the bitcoin for \$10,000,000. Within 180 days of the sale Money Bags invests \$10,000,000 in a qualified opportunity zone fund (“QOF”).
 - a. How much gain does Money Bags recognize in 2022?
 - b. What is Money Bags’ initial basis in the QOF?
 - c. What will Money Bags recognize in 2026?

d. In 2027, Money Bags will have held the interest in the QOF for five years. Does anything happen?

e. In 2029, Money Bags will have held the interest in the QOF for seven years. Does anything happen?

f. In 2023, Money Bags sells the interest in the QOF for \$12,000,000 and elects to treat the basis in the QOF as equal to the fair market value. How much gain does Money Bags recognize in 2023?

CHAPTER 18: PARTNERSHIP DEBT WORKOUTS

§ 18.11. QUESTIONS AND PROBLEMS

1. ABC buys a fleet of business cars from Quick Fingers paying 10% down and agreeing to pay the rest over five years. Although the cars were represented to ABC as being new, upon delivery and inspection all of the cars are refurbished. ABC files a suit claiming that the debt to pay the balance is not valid under state law. Quick Fingers settles for one quarter of the face amount of the debt. Does ABC have cancellation of indebtedness income?
2. ABC buys a fleet of business cars from Honest Abe paying 10% down and agreeing to pay the rest over five years. The week after ABC buys the cars the Environmental Protection Agency promulgates regulations requiring new cars to have an upgraded catalytic converter with an effective date prior to the date of the purchase. ABC is, thus, required to upgrade the catalytic converters of the new cars. ABC complains to Honest Abe, and since ABC is a repeat customer, Honest Abe agrees to reduce the purchase price of the cars by the amount of the cost to upgrade the catalytic converters. Does ABC have cancellation of indebtedness income?
3. ABC, an LLC treated as a partnership, borrowed money from Neighborhood Bank to buy Strip Mall. ABC was a newly formed entity but had capitalization equal to 50% of the purchase price of Strip Mall. Neighborhood Bank initially offers a recourse loan (for state law purposes) at 7% per annum, but in further discussions Neighborhood Bank says that it will offer a loan at 4% if C guarantees the debt. A and B do not have personal liability for the debt. The Strip Mall is very successful, and after a few years Neighborhood Bank releases C from the guarantee. Does C have income from the release of the guarantee?
4. ABC, an LLC treated as a partnership, borrowed money from Neighborhood Bank to buy Strip Mall. ABC was a newly formed entity but had capitalization equal to 50% of the purchase price of Strip Mall. Neighborhood Bank extends ABC a recourse loan (for state law purposes) at 7% per annum. A, B and C do not have personal liability for the debt. After a few years, the neighborhood in which Strip Mall is located starts to decline. Strip Mall is not able to break even. ABC files for bankruptcy. Pursuant to the plan in bankruptcy, Strip Mall is sold, the proceeds are distributed to Neighborhood Bank, and the LLC is dissolved with nothing being distributed to A, B or C. The debt to Neighborhood Bank is also discharged pursuant to the plan. At the time of the discharge, the amount of the debt is \$20,000,000 and the sale proceeds from the Strip Mall were \$10,000,000. None of A, B or C are subject to the jurisdiction of the bankruptcy court. A had put every penny A had into the deal and is now approximately \$2,000,000 insolvent. Neither B nor C is insolvent. Do A, B or C have income on the cancellation?
5. ABC, an LLC treated as a partnership, borrowed money from Neighborhood Bank to buy Strip Mall. ABC was a newly formed entity but had capitalization equal to 50% of the purchase price of Strip Mall. Neighborhood Bank extends ABC a recourse loan (for state law purposes) at 7% per annum. A, B and C do not have personal liability for the debt. Initially, the project does very well, and after a few years, ABC refinances the bank debt so that outstanding debt is \$500, interest only nonrecourse. The neighborhood in which Strip Mall is located starts to decline. Strip Mall is not able to break even. Neighborhood Bank forecloses on the property. At the time of the foreclosure, the amount of the debt is \$500 and the cash proceeds from the foreclosure sale from the Strip Mall are \$100. ABC's basis in Strip Mall at the time of the foreclosure sale is \$100. None of A, B or C are subject to the jurisdiction of the bankruptcy court. A had put every penny A had into

the deal and is now approximately \$2,000,000 insolvent. Neither B nor C is insolvent. Do A, B or C have income on the cancellation? Does ABC recognize gain on the foreclosure sale?

6. ABC, an LLC treated as a partnership, borrowed money from Mezz Fund to buy Strip Mall. ABC was a newly formed entity but had capitalization equal to 50% of the purchase price of Strip Mall. Mezz Fund extends ABC a recourse loan (for state law purposes) at 7% per annum. The neighborhood in which Strip Mall is located starts to decline. Strip Mall is not able to break even, and ABC enters into negotiations with Mezz Fund. At the time of the negotiations, the amount of the debt is \$500. The value of Strip Mall at the time of the negotiations is \$600. ABC agrees to issue Mezz Fund a preferred equity interest valued at \$500 in exchange for the cancellation of the debt. A had put every penny A had into the deal and is now approximately \$2,000,000 insolvent. Neither B nor C is insolvent. Do A, B or C have income on the cancellation?

7. ABC, an LLC treated as a partnership, borrowed money from Mezz Fund to buy Strip Mall. ABC was a newly formed entity but had capitalization equal to 50% of the purchase price of Strip Mall. Mezz Fund extends ABC a recourse loan (for state law purposes) at 7% per annum. The neighborhood in which Strip Mall is located starts to decline. Strip Mall is not able to break even, and ABC enters into negotiations with Mezz Fund. At the time of the negotiations, the amount of the debt is \$500. The value of Strip Mall at the time of the negotiations is \$100. ABC agrees to issue Mezz Fund a preferred equity interest valued at \$100 in exchange for the cancellation of the debt. A had put every penny A had into the deal and is now approximately \$2,000,000 insolvent. Neither B nor C is insolvent. Do A, B or C have income on the cancellation?

ERRATA

PAGES 206 AND 207

In each table, the word “lane” should be changed to “land.”

PAGE 517

In the last paragraph, the reference to “I.R.C. § 208A(f)(1)(B)” should be “I.R.C. § 280A(f)(1)(B).”