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Almost every form and publication has a page on IRS.gov with a friendly shortcut. For example, the Form 1040 page is at IRS.gov/Form1040; the Pub. 501 page is at IRS.gov/Pub501; the Form W-4 page is at IRS.gov/W4; and the Schedule A (Form 1040/SR) page is at IRS.gov/ScheduleA. If typing in a link above instead of clicking on it, be sure to type the link into the address bar of your browser, not a Search box.

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Partnerships

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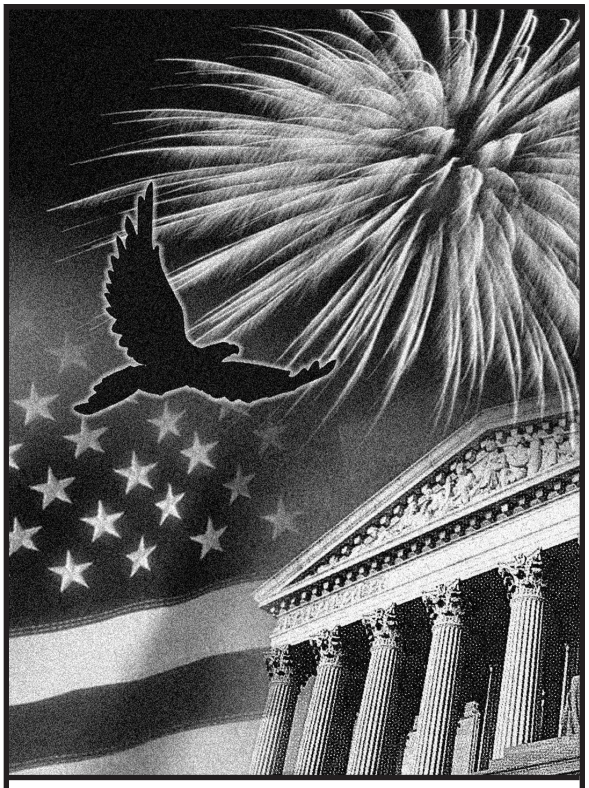

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Reminder

Qualified Opportunity Investment. If you held a qualified investment in a qualified opportunity fund (QOF) at any time during the year, you must file your return with Form 8997, Initial and Annual Statement of Qualified Opportunity Fund Investments, attached. See Form 8997 instructions.

Technical terminations. Technical terminations do not apply for partnership tax years beginning after 2017.

Bipartisan Budget Act. The Bipartisan Budget Act of 2015 (BBA) created a new centralized partnership audit regime effective for partnership tax years beginning after 2017.

Electing large partnerships. The BBA repealed the electing large partnership rules for partnership tax years beginning after 2017.

Partnership representative. Under the centralized partnership audit regime, partnerships are generally required to designate a partnership representative. See *Role of Partnership Representative*, later.

Electing out of the centralized partnership audit regime. A partnership can elect out of the centralized partnership audit regime for a tax year if the partnership is an eligible partnership that year. See *Electing Out of the Centralized Partnership Audit Regime*, later.

Business interest expense limitation. Public Law 115-97 amended section 163(j) to reflect a limitation on business interest expense. For tax years beginning after 2017, a business interest expense deduction may be limited for certain taxpayers. The Instructions for Form 8990, Limitation on Business Interest Expense Under Section 163(j), explain when a business interest

expense deduction is limited, who is required to file Form 8990, and how certain businesses may elect out of the business interest expense limitation.

Photographs of missing children. The Internal Revenue Service is a proud partner with the *National Center for Missing & Exploited Children® (NCMEC)*. Photographs of missing children selected by the Center may appear in this publication on pages that would otherwise be blank. You can help bring these children home by looking at the photographs and calling 1-800-THE-LOST (1-800-843-5678) if you recognize a child.

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Introduction

This publication provides supplemental federal income tax information for partnerships and partners. It supplements the information provided in the Instructions for Form 1065, U. S. Return of Partnership Income, and the Partner's Instructions for Schedule K-1 (Form 1065). Generally, a partnership doesn't pay tax on its income but "passes through" any profits or losses to its partners. Partners must include partnership items on their tax returns.

For a discussion of business expenses a partnership can deduct, see Pub. 535, Business Expenses. Members of oil and gas partnerships should read about the deduction for depletion in chapter 9 of that publication.

For tax years beginning before 2018, certain partnerships must have a tax matters partner (TMP) who is also a general partner.

The TMP has been replaced with partnership representative for partnership tax years beginning after 2017. Each partnership must designate a partnership representative unless the partnership has made a valid election out of the centralized partnership audit regime. See *Designated partnership representative* in the Form 1065 instructions and Regulations section 301.6223-1.

Withholding on foreign partner or firm. A partnership that has foreign partners or engages in certain transactions with foreign persons may have one (or more) of the following obligations.

Fixed or determinable annual or periodical (FDAP) income. A partnership may have to withhold tax on distributions to a foreign partner or a foreign partner's distributive share when it earns income not effectively connected with a U.S. trade or business. A partnership may also have to withhold on payments to a foreign person of FDAP income not effectively connected with a U.S. trade or business. See section 1441 or 1442 of the Internal Revenue Code.

Withholding under the Foreign Investment in Real Property Tax Act (FIRPTA). If a partnership acquires a U.S. real property interest from a foreign person or firm, the partnership may have to withhold tax on the amount it pays for the property (including cash, the fair market value of other property, and any assumed liability). See section 1445 of the Internal Revenue Code.

Withholding on foreign partner's effectively connected taxable income (ECTI). If a partnership has income effectively connected with a trade or business in the United States (including gain on the disposition of a U.S. real property interest), it must withhold on the ECTI allocable to its foreign partners. See section 1446(a) of the Internal Revenue Code.

Withholding on foreign partner's sale of a partnership interest. A purchaser of a partnership interest, which may include the partnership itself, may have to withhold tax on the amount realized by a foreign partner on the sale for that partnership interest if the partnership is engaged in a trade or business in the United States. See section 1446(f) of the Internal Revenue Code.

Withholding under the Foreign Account Tax Compliance Act (FATCA). A partnership may have to withhold tax on distributions to a foreign partner of a foreign partner's distributive share when it earns withholdable payments. A partnership may also have to withhold on withholdable payments that it makes to a foreign entity. See sections 1471 through 1474 of the Internal Revenue Code. A partnership that has a duty to withhold but fails to withhold may be held liable for the tax, applicable penalties, and interest. See section 1461 of the Internal Revenue Code.

Comments and suggestions. We welcome your comments about this publication and suggestions for future editions.

You can send us comments through *IRS.gov/FormComments*. Or, you can write to the Internal Revenue Service, Tax Forms and Publications, 1111 Constitution Ave. NW, IR-6526, Washington, DC 20224.

Although we can't respond individually to each comment received, we do appreciate your feedback and will consider your comments and suggestions as we revise our tax forms, instructions, and publications. Do **not** send tax questions, tax returns, or payments to the above address.

Getting answers to your tax questions. If you have a tax question not answered by this publication or the How To Get Tax Help section at the end of this publication, go to the IRS Interactive Tax Assistant page at *IRS.gov/Help/ITA* where you can find topics by using the search feature or viewing the categories listed.

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Useful Items

You may want to see:

Publication

- ❑ **334** Tax Guide for Small Business
- ❑ **505** Tax Withholding and Estimated Tax
- ❑ **535** Business Expenses
- ❑ **537** Installment Sales
- ❑ **538** Accounting Periods and Methods
- ❑ **544** Sales and Other Dispositions of Assets
- ❑ **551** Basis of Assets
- ❑ **925** Passive Activity and At-Risk Rules
- ❑ **946** How To Depreciate Property

See *How To Get Tax Help* at the end of this publication for information about getting publications and forms.

Forming a Partnership

The following sections contain general information about partnerships.

Organizations Classified as Partnerships

An unincorporated organization with two or more members is generally classified as a partnership for federal tax purposes if its members carry on a trade, business, financial operation, or venture and divide its profits. However, a joint undertaking merely to share expenses is not a partnership. For example, co-ownership of property maintained and rented or leased is not a partnership unless the co-owners provide services to the tenants.

The rules you must use to determine whether an organization is classified as a partnership changed for organizations formed after 1996.

Organizations formed after 1996. An organization formed after 1996 is classified as a partnership for federal tax purposes if it has two or more members and it is none of the following.

- An organization formed under a federal or state law that refers to it as incorporated or as a corporation, body corporate, or body politic.
- An organization formed under a state law that refers to it as a joint-stock company or joint-stock association.
- An insurance company.
- Certain banks.
- An organization wholly owned by a state, local, or foreign government.
- An organization specifically required to be taxed as a corporation by the Internal Revenue Code (for example, certain publicly traded partnerships).
- Certain foreign organizations identified in section 301.7701-2(b)(8) of the regulations.
- A tax-exempt organization.
- A real estate investment trust.
- An organization classified as a trust under section 301.7701-4 of the regulations or otherwise subject to special treatment under the Internal Revenue Code.
- Any other organization that elects to be classified as a corporation by filing Form 8832.

For more information, see the Instructions for Form 8832.

Limited liability company (LLC). An LLC is an entity formed under state law by filing articles of organization as an LLC. Unlike a partnership, none of the members of an LLC are personally liable for its debts. However, if the LLC is an employer, an LLC member may be liable for employer related penalties. See Pub. 15, Employer's Tax guide (Circular E), and Pub. 3402, Taxation of Limited Liability Companies. An LLC may be classified for federal income tax purposes as either a partnership, a corporation, or an entity disregarded as an entity separate from its owner by applying the rules in Regulations section 301.7701-3. See Form 8832 and section 301.7701-3 of the regulations for more details.

TIP *A domestic LLC with at least two members that doesn't file Form 8832 is classified as a partnership for federal income tax purposes.*

Organizations formed before 1997. An organization formed before 1997 and classified as a partnership under the old rules will generally continue to be classified as a partnership as long as the organization has at least two members and doesn't elect to be classified as a corporation by filing Form 8832.

Community property. Spouses who own a qualified entity (defined below) can choose to classify the entity as a partnership for federal tax purposes by filing the appropriate partnership tax returns. They can choose to classify the entity as a sole proprietorship by filing a Schedule C (Form 1040) listing one spouse as the sole proprietor. A change in reporting position will be treated for federal tax purposes as a conversion of the entity.

A qualified entity is a business entity that meets all the following requirements.

- The business entity is wholly owned by spouses as community property under the laws of a state, a foreign country, or a possession of the United States.
- No person other than one or both spouses would be considered an owner for federal tax purposes.
- The business entity is not treated as a corporation.

For more information about community property, see Pub. 555, Community Property. Pub. 555 discusses the community property laws of Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin.

Partnership Interests Created by Gift

Gift of capital interest. If a family member (or any other person) receives a gift of a capital interest in a partnership in which capital is a material income-producing factor, the donee's distributive share of partnership income is subject to both of the following restrictions.

- It must be figured by reducing the partnership income by reasonable compensation for services the donor renders to the partnership.
- The donee's distributive share of partnership income attributable to donated capital must not be proportionately greater than the donor's distributive share attributable to the donor's capital.

Purchase considered gift. For purposes of determining a partner's distributive share, an interest purchased by one family member from another family member is considered a gift from the seller. The fair market value of the purchased interest is considered donated capital. For this purpose, members of a family include only spouses, ancestors, and lineal descendants (or a trust for the primary benefit of those persons).

Partnership Interests Held in Connection With Performance of Services

For tax years beginning after 2017, to get long-term capital gain treatment for certain gains attributable to "applicable partnership interests," the required asset holding period is greater than 3 years. Under section 1061 of the Internal Revenue Code, the amount of the taxpayer's net long-term capital gain with respect to applicable partnership interests for the tax year that exceeds the amount of such gain figured as if a 3-year (not 1-year) holding period applies is treated as short-term capital gain. Net long-term capital gain is the net of long-term capital gain over long-term capital loss.

Applicable partnership interest. An applicable partnership interest is any interest in a partnership that, directly or indirectly, is transferred to (or is held by) the taxpayer in connection with the performance of substantial services by the taxpayer, or any other related person, in any "applicable trade or business." The special recharacterization rule applies to:

1. Capital gains recognized by a partner from the sale or exchange of an applicable partnership interest under Internal Revenue Code sections 741(a) and 731(a); and
2. Capital gains recognized by a partnership, allocated to a partner with respect to an applicable partnership interest.

Applicable trade or business. An applicable trade or business means any activity conducted on a regular, continuous, and substantial basis (regardless of whether the activity is conducted through one or more entities) which consists in whole or in part of:

- Raising or returning capital, and either:
- Investing in or disposing of "specific assets" (or identifying specified assets for investing or disposition), or
- Developing specified assets.

Specified assets. Specified assets are:

- Securities (as defined in Internal Revenue Code section 475(c)(2), under rules for mark-to-market accounting for securities dealers),
- Commodities (as defined under rules for mark-to-market accounting for commodities dealers in Internal Revenue Code section 475(e)(2)),
- Real estate held for rental or investment,
- Options or derivative contracts with respect to such securities,
- Cash or cash equivalents, or
- An interest in a partnership to the extent of the partnership's proportionate interest in the foregoing.

Security. A security for this purpose means any of the following.

- Share of corporate stock.
- Partnership interest or beneficial ownership interest in a widely held or publicly traded partnership or trust.
- Note, bond, debenture, or other evidence of indebtedness.
- Interest rate, currency, or equity notional principal contract.
- Interest in, or derivative financial instrument in, any such security or any currency (regardless of whether Internal Revenue Code section 1256 applies to the contract).
- Position that is not such a security and is a hedge with respect to such a security and is clearly identified.

Business Owned and Operated by Spouses

If spouses carry on a business together and share in the profits and losses, they may be partners whether or not they have a formal partnership agreement. If so, they should report income or loss from the business on Form 1065. They should not report the income on a Schedule C (Form 1040) in the name of one spouse as a sole proprietor. However, the spouses can elect not to treat the joint venture as a partnership by making a qualified joint venture election.

Qualified Joint Venture Election

A "qualified joint venture," whose only members are spouses filing a joint return, can elect not to be treated as a partnership for federal tax purposes. A qualified joint venture conducts a trade or business where the only members of the joint venture are spouses filing jointly; both spouses elect not to be treated as a partnership; both spouses materially participate in the trade or business (see *Passive Activity Limitations* in the Instructions for Form 1065 for a definition of material participation); and the business is co-owned by both spouses and is not held in the name of a state law entity such as a partnership or LLC.

Under this election, a qualified joint venture conducted by spouses who file a joint return is not treated as a partnership for federal tax purposes and therefore doesn't have a Form 1065 filing requirement. All items of income, gain, deduction, loss, and credit are divided between the spouses based on their respective interests in the venture. Each spouse takes into account his or her respective share of these items as a sole proprietor. Each spouse would account for his or her respective share on the appropriate form, such as Schedule C (Form 1040). For purposes of determining net earnings from self-employment, each spouse's share of income or loss from a qualified joint venture is taken into account just as it is for federal income

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tax purposes (that is, based on their respective interests in the venture).

If the spouses do not make the election to treat their respective interests in the joint venture as sole proprietorships, each spouse should carry his or her share of the partnership income or loss from Schedule K-1 (Form 1065) to their joint or separate Form(s) 1040. Each spouse should include his or her respective share of self-employment income on a separate Schedule SE (Form 1040), Self-Employment Tax.

This generally doesn't increase the total tax on the return, but it does give each spouse credit for social security earnings on which retirement benefits are based. However, this may not be true if either spouse exceeds the social security tax limitation.

For more information on qualified joint ventures, go to *IRS.gov/QJV*.

Partnership Agreement

The partnership agreement includes the original agreement and any modifications. The modifications must be agreed to by all partners or adopted in any other manner provided by the partnership agreement. The agreement or modifications can be oral or written.

Partners can modify the partnership agreement for a particular tax year after the close of the year but not later than the date for filing the partnership return for that year. This filing date doesn't include any extension of time.

If the partnership agreement or any modification is silent on any matter, the provisions of local law are treated as part of the agreement.

Terminating a Partnership

A partnership terminates when all its operations are discontinued and no part of any business, financial operation, or venture is continued by any of its partners in a partnership.

See section 1.708-1(b)(1) of the regulations for more information on the termination of a partnership. For special rules that apply to a merger, consolidation, or division of a partnership, see sections 1.708-1(c) and 1.708-1(d) of the regulations.

Date of termination. The partnership's tax year ends on the date of termination. The date of termination is the date the partnership completes the winding up of its affairs.

Short period return. If a partnership is terminated before the end of what would otherwise be its tax year, Form 1065 must be filed for the short period, which is the period from the beginning of the tax year through the date of termination. The return is due the 15th day of the 3rd month following the date of termination. See *Partnership Return (Form 1065)*, later, for information about filing Form 1065.

Conversion of partnership into LLC. The conversion of a partnership into an LLC classified as a partnership for federal tax purposes doesn't terminate the partnership. The conversion is not a sale, exchange, or liquidation of any partnership interest; the partnership's tax year doesn't close; and the LLC can continue to use the partnership's taxpayer identification number.

However, the conversion may change some of the partners' bases in their partnership interests if the partnership has recourse liabilities that become nonrecourse liabilities. Because the partners share recourse and nonrecourse liabilities differently, their bases must be adjusted to reflect the new sharing ratios. If a decrease in a partner's share of liabilities exceeds the partner's basis, he or she must recognize gain on the excess. For more information, see *Effect of Partnership Liabilities* under *Basis of Partner's Interest*, later.

The same rules apply if an LLC classified as a partnership is converted into a partnership.

Electronic Filing

Certain partnerships with more than 100 partners are required to file Form 1065, Schedules K-1, and related forms and schedules electronically. Other partnerships generally have the option to file electronically. For details about electronic filing, see the Instructions for Form 1065.

Exclusion From Partnership Rules

Certain partnerships that do not actively conduct a business can choose to be completely or partially excluded from being treated as partnerships for federal income tax purposes. All the partners must agree to make the choice, and the partners must be able to figure their own taxable income without figuring the partnership's income. However, the partners are not exempt from the rule that limits a partner's distributive share of partnership loss to the adjusted basis of the partner's partnership interest. Nor are they exempt from the requirement of a business purpose for adopting a tax year for the partnership that differs from its required tax year.

Investing partnership. An investing partnership can be excluded if the participants in the joint purchase, retention, sale, or exchange of investment property meet all the following requirements.

- They own the property as co-owners.
- They reserve the right separately to take or dispose of their shares of any property acquired or retained.
- They do not actively conduct business or irrevocably authorize some person acting in a representative capacity to purchase, sell, or exchange the investment property. Each separate participant can delegate authority to purchase, sell, or exchange his or her share of the investment property for the time being for his or her account, but not for a period of more than a year.

Operating agreement partnership. An operating agreement partnership group can be excluded if the participants in the joint production, extraction, or use of property meet all the following requirements.

- They own the property as co-owners, either in fee or under lease or other form of contract granting exclusive operating rights.
- They reserve the right separately to take in kind or dispose of their shares of any property produced, extracted, or used.
- They don't jointly sell services or the property produced or extracted. Each separate participant can delegate authority to sell his or her share of the property produced or extracted for the time being for his or her account, but not for a period of time in excess of the minimum needs of the industry, and in no event for more than 1 year.

However, this exclusion doesn't apply to an unincorporated organization one of whose principal purposes is cycling, manufacturing, or processing for persons who are not members of the organization.

Electing the exclusion. An eligible organization that wishes to be excluded from the partnership rules must make the election not later than the time for filing the partnership return for the first tax year for which exclusion is desired. This filing date includes any extension of time. See Regulations section 1.761-2(b) for the procedures to follow.

Partnership Return (Form 1065)

Every partnership that engages in a trade or business or has gross income must file an information return on Form 1065 showing its income, deductions, and other required information. The partnership return must show the names and addresses of each partner and each partner's distributive share of taxable income. The return must be signed by a partner. If an LLC is treated as a partnership, it must file Form 1065 and one of its members must sign the return.

A partnership is not considered to engage in a trade or business, and is not required to file a Form 1065, for any tax year in which it neither receives income nor pays or incurs any expenses treated as deductions or credits for federal income tax purposes.

See the Instructions for Form 1065 for more information about who must file Form 1065.

Partnership Distributions

Partnership distributions include the following.

- A withdrawal by a partner in anticipation of the current year's earnings.
- A distribution of the current year's or prior years' earnings not needed for working capital.
- A complete or partial liquidation of a partner's interest.

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- A distribution to all partners in a complete liquidation of the partnership.

A partnership distribution is not taken into account in determining the partner's distributive share of partnership income or loss. If any gain or loss from the distribution is recognized by the partner, it must be reported on his or her return for the tax year in which the distribution is received. Money or property withdrawn by a partner in anticipation of the current year's earnings is treated as a distribution received on the last day of the partnership's tax year.

Effect on partner's basis. A partner's adjusted basis in his or her partnership interest is decreased (but not below zero) by the money and adjusted basis of property distributed to the partner. See *Adjusted Basis* under *Basis of Partner's Interest*, later.

Effect on partnership. A partnership generally doesn't recognize any gain or loss because of distributions it makes to partners. The partnership may be able to elect to adjust the basis of its undistributed property.

Certain distributions treated as a sale or exchange. When a partnership distributes the following items, the distribution may be treated as a sale or exchange of property rather than a distribution.

- Unrealized receivables or substantially appreciated inventory items distributed in exchange for any part of the partner's interest in other partnership property, including money.
- Other property (including money) distributed in exchange for any part of a partner's interest in unrealized receivables or substantially appreciated inventory items.

See *Payments for Unrealized Receivables and Inventory Items* under *Disposition of Partner's Interest*, later.

This treatment doesn't apply to the following distributions.

- A distribution of property to the partner who contributed the property to the partnership.
- Payments made to a retiring partner or successor in interest of a deceased partner that are the partner's distributive share of partnership income or guaranteed payments.

Substantially appreciated inventory items. Inventory items of the partnership are considered to have appreciated substantially in value if, at the time of the distribution, their total fair market value is more than 120% of the partnership's adjusted basis for the property. However, if a principal purpose for acquiring inventory property is to avoid ordinary income treatment by reducing the appreciation to less than 120%, that property is excluded.

Partner's Gain or Loss

A partner generally recognizes gain on a partnership distribution only to the extent any money (and marketable securities treated as money) included in the distribution exceeds the adjusted basis of the partner's interest in the partnership. Any gain recognized is generally treated as capital gain from the sale of the partnership interest on the date of the distribution. If partnership property (other than marketable securities treated as money) is distributed to a partner, he or she generally doesn't recognize any gain until the sale or other disposition of the property.

For exceptions to these rules, see *Distribution of partner's debt* and *Net precontribution gain*, later. Also, see *Payments for Unrealized Receivables and Inventory Items* under *Disposition of Partner's Interest*, later.

Example. The adjusted basis of Jo's partnership interest is $14,000. She receives a distribution of $8,000 cash and land that has an adjusted basis of $2,000 and a fair market value of $3,000. Because the cash received doesn't exceed the basis of her partnership interest, Jo doesn't recognize any gain on the distribution. Any gain on the land will be recognized when she sells or otherwise disposes of it. The distribution decreases the adjusted basis of Jo's partnership interest to $4,000 [$14,000 – ($8,000 + $2,000)].

Qualified Opportunity Investment. If you held a qualified investment in a qualified opportunity fund (QOF) at any time during the year, you must file your return with Form 8997, Initial and Annual Statement of Qualified Opportunity Fund Investments, attached. See Form 8997 instructions.

Marketable securities treated as money. Generally, a marketable security distributed to a partner is treated as money in determining whether gain is recognized on the distribution. This treatment, however, doesn't generally apply if that partner contributed the security to the partnership or an investment partnership made the distribution to an eligible partner.

The amount treated as money is the security's fair market value when distributed, reduced (but not below zero) by the excess (if any) of:

1. The partner's distributive share of the gain that would be recognized had the partnership sold all its marketable securities at their fair market value immediately before the transaction resulting in the distribution, over
2. The partner's distributive share of the gain that would be recognized had the partnership sold all such securities it still held after the distribution at the fair market value in (1).

For more information, including the definition of marketable securities, see section 731(c) of the Internal Revenue Code.

Loss on distribution. A partner doesn't recognize loss on a partnership distribution unless all the following requirements are met.

- The adjusted basis of the partner's interest in the partnership exceeds the distribution.
- The partner's entire interest in the partnership is liquidated.
- The distribution is in money, unrealized receivables, or inventory items.

There are exceptions to these general rules. See the following discussions. Also, see *Liquidation at Partner's Retirement or Death* under *Disposition of Partner's Interest*, later.

Distribution of partner's debt. If a partnership acquires a partner's debt and extinguishes the debt by distributing it to the partner, the partner will recognize capital gain or loss to the extent the fair market value of the debt differs from the basis of the debt (determined under the rules discussed in *Partner's Basis for Distributed Property*, later).

The partner is treated as having satisfied the debt for its fair market value. If the issue price (adjusted for any premium or discount) of the debt exceeds its fair market value when distributed, the partner may have to include the excess amount in income as canceled debt.

Similarly, a deduction may be available to a corporate partner if the fair market value of the debt at the time of distribution exceeds its adjusted issue price.

Net precontribution gain. A partner generally must recognize gain on the distribution of property (other than money) if the partner contributed appreciated property to the partnership during the 7-year period before the distribution.

The gain recognized is the lesser of the following amounts.

1. The excess of:
   a. The fair market value of the property received in the distribution, over
   b. The adjusted basis of the partner's interest in the partnership immediately before the distribution, reduced (but not below zero) by any money received in the distribution.
2. The "net precontribution gain" of the partner. This is the net gain the partner would recognize if all the property contributed by the partner within 7 years of the distribution, and held by the partnership immediately before the distribution, were distributed to another partner, other than a partner who owns more than 50% of the partnership. For information about the distribution of contributed property to another partner, see *Contribution of Property* under *Transactions Between Partnership and Partners*, later.

The character of the gain is determined by reference to the character of the net precontribution gain. This gain is in addition to any gain the partner must recognize if the money distributed is more than his or her basis in the partnership.

For these rules, the term "money" includes marketable securities treated as money, as discussed earlier under *Marketable securities treated as money*.

Effect on basis. The adjusted basis of the partner's interest in the partnership is increased by any net precontribution gain recognized by the partner. Other than for purposes of determining the gain, the increase is treated as occurring immediately before the distribution. See *Basis of Partner's Interest*, later.

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The partnership must adjust its basis in any property the partner contributed within 7 years of the distribution to reflect any gain that partner recognizes under this rule.

Exceptions. Any part of a distribution that is property the partner previously contributed to the partnership is not taken into account in determining the amount of the excess distribution or the partner's net precontribution gain. For this purpose, the partner's previously contributed property doesn't include a contributed interest in an entity to the extent its value is due to property contributed to the entity after the interest was contributed to the partnership.

Recognition of gain under this rule also doesn't apply to a distribution of unrealized receivables or substantially appreciated inventory items if the distribution is treated as a sale or exchange, as discussed earlier under *Certain distributions treated as a sale or exchange*.

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Partner's Basis for Distributed Property

Unless there is a complete liquidation of a partner's interest, the basis of property (other than money) distributed to the partner by a partnership is its adjusted basis to the partnership immediately before the distribution. However, the basis of the property to the partner cannot be more than the adjusted basis of his or her interest in the partnership reduced by any money received in the same transaction.

Example 1. The adjusted basis of Emily's partnership interest is $30,000. She receives a distribution of property that has an adjusted basis of $20,000 to the partnership and $4,000 in cash. Her basis for the property is $20,000.

Example 2. The adjusted basis of Steve's partnership interest is $10,000. He receives a distribution of $4,000 cash and property that has an adjusted basis to the partnership of $8,000. His basis for the distributed property is limited to $6,000 ($10,000 – $4,000, the cash he receives).

Complete liquidation of partner's interest. The basis of property received in complete liquidation of a partner's interest is the adjusted basis of the partner's interest in the partnership reduced by any money distributed to the partner in the same transaction.

Partner's holding period. A partner's holding period for property distributed to the partner includes the period the property was held by the partnership. If the property was contributed to the partnership by a partner, then the period it was held by that partner is also included.

Basis divided among properties. If the basis of property received is the adjusted basis of the partner's interest in the partnership (reduced by money received in the same transaction), it must be divided among the properties distributed to the partner. For property distributed after August 5, 1997, allocate the basis using the following rules.

1. Allocate the basis first to unrealized receivables and inventory items included in the distribution by assigning a basis to each item equal to the partnership's adjusted basis in the item immediately before the distribution. If the total of these assigned bases exceeds the allocable basis, decrease the assigned bases by the amount of the excess.
2. Allocate any remaining basis to properties other than unrealized receivables and inventory items by assigning a basis to each property equal to the partnership's adjusted basis in the property immediately before the distribution. If the allocable basis exceeds the total of these assigned bases, increase the assigned bases by the amount of the excess. If the total of these assigned bases exceeds the allocable basis, decrease the assigned bases by the amount of the excess.

Allocating a basis increase. Allocate any basis increase required in rule (2) above first to properties with unrealized appreciation to the extent of the unrealized appreciation. If the basis increase is less than the total unrealized appreciation, allocate it among those properties in proportion to their respective amounts of unrealized appreciation. Allocate any remaining basis increase among all the properties in proportion to their respective fair market values.

Example. Eun's basis in her partnership interest is $55,000. In a distribution in liquidation of her entire interest, she receives properties A and B, neither of which is inventory or unrealized receivables. Property A has an adjusted basis to the partnership of $5,000 and a fair market value of $40,000. Property B has an adjusted basis to the partnership of $10,000 and a fair market value of $10,000.

To figure her basis in each property, Eun first assigns bases of $5,000 to property A and $10,000 to property B (their adjusted bases to the partnership). This leaves a $40,000 basis increase (the $55,000 allocable basis minus the $15,000 total of the assigned bases). She first allocates $35,000 to property A (its unrealized appreciation). The remaining $5,000 is allocated between the properties based on their fair market values. $4,000 ($40,000/$50,000) is allocated to property A and $1,000 ($10,000/$50,000) is allocated to property B. Eun's basis in property A is $44,000 ($5,000 + $35,000 + $4,000) and her basis in property B is $11,000 ($10,000 + $1,000).

Allocating a basis decrease. Use the following rules to allocate any basis decrease required in rule (1) or rule (2), earlier.

1. Allocate the basis decrease first to items with unrealized depreciation to the extent of the unrealized depreciation. If the basis decrease is less than the total unrealized depreciation, allocate it among those items in proportion to their respective amounts of unrealized depreciation.
2. Allocate any remaining basis decrease among all the items in proportion to their respective assigned basis amounts (as decreased in (1)).

Example. Armando's basis in his partnership interest is $20,000. In a distribution in liquidation of his entire interest, he receives properties C and D, neither of which is inventory or unrealized receivables. Property C has an adjusted basis to the partnership of $15,000 and a fair market value of $15,000. Property D has an adjusted basis to the partnership of $15,000 and a fair market value of $5,000.

To figure his basis in each property, Armando first assigns bases of $15,000 to property C and $15,000 to property D (their adjusted bases to the partnership). This leaves a $10,000 basis decrease (the $30,000 total of the assigned bases minus the $20,000 allocable basis). He allocates the entire $10,000 to property D (its unrealized depreciation). Armando's basis in property C is $15,000 and his basis in property D is $5,000 ($15,000 – $10,000).

Distributions before August 6, 1997. For property distributed before August 6, 1997, allocate the basis using the following rules.

1. Allocate the basis first to unrealized receivables and inventory items included in the distribution to the extent of the partnership's adjusted basis in those items. If the partnership's adjusted basis in those items exceeded the allocable basis, allocate the basis among the items in proportion to their adjusted bases to the partnership.
2. Allocate any remaining basis to other distributed properties in proportion to their adjusted bases to the partnership.

Partner's interest more than partnership basis. If the basis of a partner's interest to be divided in a complete liquidation of the partner's interest is more than the partnership's adjusted basis for the unrealized receivables and inventory items distributed, and if no other property is distributed to which the partner can apply the remaining basis, the partner has a capital loss to the extent of the remaining basis of the partnership interest.

Special adjustment to basis. A partner who acquired any part of his or her partnership interest in a sale or exchange or upon the death of another partner may be able to choose a special basis adjustment for property distributed by the partnership. To choose the special adjustment, the partner must have received the distribution within 2 years after acquiring the partnership interest. Also, the partnership must not have chosen the optional adjustment to basis when the partner acquired the partnership interest.

If a partner chooses this special basis adjustment, the partner's basis for the property distributed is the same as it would have been if the partnership had chosen the optional adjustment to basis. However, this assigned basis is not reduced by any depletion or depreciation that would have been allowed or allowable if the partnership had previously chosen the optional adjustment.

The choice must be made with the partner's tax return for the year of the distribution if the distribution includes any property subject to depreciation, depletion, or amortization. If the choice doesn't have to be made for the distribution year, it must be made with the return for the

first year in which the basis of the distributed property is pertinent in determining the partner's income tax.

A partner choosing this special basis adjustment must attach a statement to his or her tax return that the partner chooses under section 732(d) of the Internal Revenue Code to adjust the basis of property received in a distribution. The statement must show the computation of the special basis adjustment for the property distributed and list the properties to which the adjustment has been allocated.

Example. Chin Ho purchased a 25% interest in X partnership for $17,000 cash. At the time of the purchase, the partnership owned inventory having a basis to the partnership of $14,000 and a fair market value of $16,000. Thus, $4,000 of the $17,000 he paid was attributable to his share of inventory with a basis to the partnership of $3,500.

Within 2 years after acquiring his interest, Chin Ho withdrew from the partnership and for his entire interest received cash of $1,500, inventory with a basis to the partnership of $3,500, and other property with a basis of $6,000. The value of the inventory received was 25% of the value of all partnership inventory. (It is immaterial whether the inventory he received was on hand when he acquired his interest.)

Since the partnership from which Chin Ho withdrew didn't make the optional adjustment to basis, he chose to adjust the basis of the inventory received. His share of the partnership's basis for the inventory is increased by $500 (25% of the $2,000 difference between the $16,000 fair market value of the inventory and its $14,000 basis to the partnership at the time he acquired his interest). The adjustment applies only for purposes of determining his new basis in the inventory, and not for purposes of partnership gain or loss on disposition.

The total to be allocated among the properties Chin Ho received in the distribution is $15,500 ($17,000 basis of his interest – $1,500 cash received). His basis in the inventory items is $4,000 ($3,500 partnership basis + $500 special adjustment). The remaining $11,500 is allocated to his new basis for the other property he received.

Mandatory adjustment. A partner doesn't always have a choice of making this special adjustment to basis. The special adjustment to basis must be made for a distribution of property (whether or not within 2 years after the partnership interest was acquired) if all the following conditions existed when the partner received the partnership interest.

- The fair market value of all partnership property (other than money) was more than 110% of its adjusted basis to the partnership.
- If there had been a liquidation of the partner's interest immediately after it was acquired, an allocation of the basis of that interest under the general rules (discussed earlier under *Basis divided among properties*) would have decreased the basis of property that couldn't be depreciated, depleted, or amortized and increased the basis of property that could be.
- The optional basis adjustment, if it had been chosen by the partnership, would have changed the partner's basis for the property actually distributed.

Required statement. Generally, if a partner chooses a special basis adjustment and notifies the partnership, or if the partnership makes a distribution for which the special basis adjustment is mandatory, the partnership must provide a statement to the partner. The statement must provide information necessary for the partner to figure the special basis adjustment.

Marketable securities. A partner's basis in marketable securities received in a partnership distribution, as determined in the preceding discussions, is increased by any gain recognized by treating the securities as money. See *Marketable securities treated as money* under *Partner's Gain or Loss*, earlier. The basis increase is allocated among the securities in proportion to their respective amounts of unrealized appreciation before the basis increase.

Transactions Between Partnership and Partners

For certain transactions between a partner and his or her partnership, the partner is treated as not being a member of the partnership. These transactions include the following.

1. Performing services for, or transferring property to, a partnership if:
   a. There is a related allocation and distribution to a partner; and
   b. The entire transaction, when viewed together, is properly characterized as occurring between the partnership and a partner not acting in the capacity of a partner.
2. Transferring money or other property to a partnership if:
   a. There is a related transfer of money or other property by the partnership to the contributing partner or another partner, and
   b. The transfers together are properly characterized as a sale or exchange of property.

Payments by accrual basis partnership to cash basis partner. A partnership that uses an accrual method of accounting cannot deduct any business expense owed to a cash basis partner until the amount is paid. However, this rule doesn't apply to guaranteed payments made to a partner, which are generally deductible when accrued.

Guaranteed Payments

Guaranteed payments are those made by a partnership to a partner that are determined without regard to the partnership's income. A partnership treats guaranteed payments for services, or for the use of capital, as if they were made to a person who is not a partner. This treatment is for purposes of determining gross income and deductible business expenses only. For other tax purposes, guaranteed payments are treated as a partner's distributive share of ordinary income. Guaranteed payments are not subject to income tax withholding.

The partnership generally deducts guaranteed payments on Form 1065, line 10, as a business expense. They are also listed on Schedules K and K-1 of the partnership return. The individual partner reports guaranteed payments on Schedule E (Form 1040) as ordinary income, along with his or her distributive share of the partnership's other ordinary income.

Guaranteed payments made to partners for organizing the partnership or syndicating interests in the partnership are capital expenses. Generally, organizational and syndication expenses are not deductible by the partnership. However, a partnership can elect to deduct a portion of its organizational expenses and amortize the remaining expenses (see *Business start-up and organizational costs* in the *Instructions for Form 1065*). Organizational expenses (if the election is not made) and syndication expenses paid to partners must be reported on the partners' Schedules K-1 as guaranteed payments.

Minimum payment. If a partner is to receive a minimum payment from the partnership, the guaranteed payment is the amount by which the minimum payment is more than the partner's distributive share of the partnership income before taking into account the guaranteed payment.

Example. Under a partnership agreement, Divya is to receive 30% of the partnership income, but not less than $8,000. The partnership has net income of $20,000. Divya's share, without regard to the minimum guarantee, is $6,000 (30% × $20,000). The guaranteed payment that can be deducted by the partnership is $2,000 ($8,000 – $6,000). Divya's income from the partnership is $8,000, and the remaining $12,000 of partnership income will be reported by the other partners in proportion to their shares under the partnership agreement.

If the partnership net income had been $30,000, there would have been no guaranteed payment since her share, without regard to the guarantee, would have been greater than the guarantee.

Self-employed health insurance premiums. Premiums for health insurance paid by a partnership on behalf of a partner, for services as a partner, are treated as guaranteed payments. The partnership can deduct the payments as a business expense, and the partner must include them in gross income. However, if the partnership accounts for insurance paid for a partner as a reduction in distributions to the partner, the partnership cannot deduct the premiums.

A partner who qualifies can deduct 100% of the health insurance premiums paid by the partnership on his or her behalf as an adjustment to income. The partner cannot deduct the premiums for any calendar month, or part of a month, in which the partner is eligible to participate in any subsidized health plan maintained by any employer of the partner, the partner's spouse,

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the partner's dependents, or any children under age 27 who are not dependents. For more information on the self-employed health insurance deduction, see chapter 6 in Pub. 535.

Including payments in partner's income. Guaranteed payments are included in income in the partner's tax year in which the partnership's tax year ends.

Example 1. Under the terms of a partnership agreement, Erica is entitled to a fixed annual payment of $10,000 without regard to the income of the partnership. Her distributive share of the partnership income is 10%. The partnership has $50,000 of ordinary income after deducting the guaranteed payment. She must include ordinary income of $15,000 ($10,000 guaranteed payment + $5,000 ($50,000 × 10%) distributive share) on her individual income tax return for her tax year in which the partnership's tax year ends.

Example 2. Lamont is a calendar year taxpayer who is a partner in a partnership. The partnership uses a fiscal year that ended January 31, 2019. Lamont received guaranteed payments from the partnership from February 1, 2018, until December 31, 2018. He must include these guaranteed payments in income for 2019 and report them on his 2019 income tax return.

Payments resulting in loss. If guaranteed payments to a partner result in a partnership loss in which the partner shares, the partner must report the full amount of the guaranteed payments as ordinary income. The partner separately takes into account his or her distributive share of the partnership loss, to the extent of the adjusted basis of the partner's partnership interest.

Sale or Exchange of Property

Special rules apply to a sale or exchange of property between a partnership and certain persons.

Losses. Losses will not be allowed from a sale or exchange of property (other than an interest in the partnership) directly or indirectly between a partnership and a person whose direct or indirect interest in the capital or profits of the partnership is more than 50%.

If the sale or exchange is between two partnerships in which the same persons directly or indirectly own more than 50% of the capital or profits interests in each partnership, no deduction of a loss is allowed.

The basis of each partner's interest in the partnership is decreased (but not below zero) by the partner's share of the disallowed loss.

If the purchaser later sells the property, only the gain realized that is greater than the loss not allowed will be taxable. If any gain from the sale of the property is not recognized because of this rule, the basis of each partner's interest in the partnership is increased by the partner's share of that gain.

Gains. Gains are treated as ordinary income in a sale or exchange of property directly or indirectly between a person and a partnership, or between two partnerships, if both of the following tests are met.

- More than 50% of the capital or profits interest in the partnership(s) is directly or indirectly owned by the same person(s).
- The property in the hands of the transferee immediately after the transfer is not a capital asset. Property that is not a capital asset includes accounts receivable, inventory, stock-in-trade, and depreciable or real property used in a trade or business.

More than 50% ownership. To determine if there is more than 50% ownership in partnership capital or profits, the following rules apply.

1. An interest directly or indirectly owned by, or for, a corporation, partnership, estate, or trust is considered to be owned proportionately by, or for, its shareholders, partners, or beneficiaries.
2. An individual is considered to own the interest directly or indirectly owned by, or for, the individual's family. For this rule, "family" includes only brothers, sisters, half-brothers, half-sisters, spouses, ancestors, and lineal descendants.
3. If a person is considered to own an interest using rule (1), that person (the "constructive owner") is treated as if actually owning that interest when rules (1) and (2) are applied. However, if a person is considered to own an interest using rule (2), that person is not treated as actually owning that interest in reapplying rule (2) to make another person the constructive owner.

Example. Individuals A and B and Trust T are equal partners in Partnership ABT. A's husband, AH, is the sole beneficiary of Trust T. Trust T's partnership interest will be attributed to AH only for the purpose of further attributing the interest to A. As a result, A is a more-than-50% partner. This means that any deduction for losses on transactions between her and ABT will not be allowed, and gain from property that in the hands of the transferee is not a capital asset is treated as ordinary, rather than capital, gain.

More information. For more information on these special rules, see *Sales and Exchanges Between Related Persons* in chapter 2 of Pub. 544.

Contribution of Property

Usually, neither the partner nor the partnership recognizes a gain or loss when property is contributed to the partnership in exchange for a partnership interest. This applies whether a partnership is being formed or is already operating. The partnership's holding period for the property includes the partner's holding period.

The contribution of limited partnership interests in one partnership for limited partnership interests in another partnership qualifies as a tax-free contribution of property to the second partnership if the transaction is made for business purposes. The exchange is not subject to the rules explained later under *Disposition of Partner's Interest*.

Disguised sales. A contribution of money or other property to the partnership followed by a distribution of different property from the partnership to the partner is treated not as a contribution and distribution, but as a sale of property, if both of the following tests are met.

- The distribution wouldn't have been made but for the contribution.
- The partner's right to the distribution doesn't depend on the success of partnership operations.

All facts and circumstances are considered in determining if the contribution and distribution are more properly characterized as a sale. However, if the contribution and distribution occur within 2 years of each other, the transfers are presumed to be a sale unless the facts clearly indicate that the transfers are not a sale. If the contribution and distribution occur more than 2 years apart, the transfers are presumed not to be a sale unless the facts clearly indicate that the transfers are a sale.

Form 8275 required. A partner must attach Form 8275, Disclosure Statement, (or other statement) to his or her return if the partner contributes property to a partnership and, within 2 years (before or after the contribution), the partnership transfers money or other consideration to the partner. For exceptions to this requirement, see section 1.707-3(c)(2) of the regulations.

A partnership must attach Form 8275 (or other statement) to its return if it distributes property to a partner, and, within 2 years (before or after the distribution), the partner transfers money or other consideration to the partnership.

Form 8275 must include the following information.

- A caption identifying the statement as a disclosure under section 707 of the Internal Revenue Code.
- A description of the transferred property or money, including its value.
- A description of any relevant facts in determining if the transfers are properly viewed as a disguised sale. See Regulations section 1.707-3(b)(2) for a description of the facts and circumstances considered in determining if the transfers are a disguised sale.

Contribution to partnership treated as investment company. Gain is recognized when property is contributed (in exchange for an interest in the partnership) to a partnership that would be treated as an investment company if it were incorporated.

A partnership is generally treated as an investment company if over 80% of the value of its assets is held for investment and consists of certain readily marketable items. These items include money, stocks and other equity interests in a corporation, and interests in regulated investment companies and real estate investment trusts. For more information, see section 351(e)(1) of the Internal Revenue Code and the related regulations. Whether a partnership is treated as an investment company under this

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test is ordinarily determined immediately after the transfer of property.

This rule applies to limited partnerships and general partnerships, regardless of whether they are privately formed or publicly syndicated.

Contribution to foreign partnership. A domestic partnership that contributed property after August 5, 1997, to a foreign partnership in exchange for a partnership interest may have to file Form 8865, Return of U.S. Persons With Respect to Certain Foreign Partnerships, if either of the following applies.

1. Immediately after the contribution, the partnership owned, directly, indirectly, or by attribution, at least a 10% interest in the foreign partnership.
2. The fair market value of the property contributed to the foreign partnership, when added to other contributions of property made to the partnership during the preceding 12-month period, is greater than $100,000.

The partnership may also have to file Form 8865, even if no contributions are made during the tax year, if it owns a 10% or more interest in a foreign partnership at any time during the year. See the form instructions for more information.

Basis of contributed property. If a partner contributes property to a partnership, the partnership's basis for determining depreciation, depletion, gain, or loss for the property is the same as the partner's adjusted basis for the property when it was contributed, increased by any gain recognized by the partner at the time of contribution.

Allocations to account for built-in gain or loss. The fair market value of property at the time it is contributed may be different from the partner's adjusted basis. The partnership must allocate among the partners any income, deduction, gain, or loss on the property in a manner that will account for the difference. This rule also applies to contributions of accounts payable and other accrued but unpaid items of a cash basis partner.

The partnership can use different allocation methods for different items of contributed property. A single reasonable method must be consistently applied to each item, and the overall method or combination of methods must be reasonable. See section 1.704-3 of the regulations for allocation methods generally considered reasonable.

If the partnership sells contributed property and recognizes gain or loss, built-in gain or loss is allocated to the contributing partner. If contributed property is subject to depreciation or other cost recovery, the allocation of deductions for these items takes into account built-in gain or loss on the property. However, the total depreciation, depletion, gain, or loss allocated to partners cannot be more than the depreciation or depletion allowable to the partnership or the gain or loss realized by the partnership.

Example. Areta and Sofia formed an equal partnership. Areta contributed $10,000 in cash to the partnership and Sofia contributed depreciable property with a fair market value of $10,000 and an adjusted basis of $4,000. The partnership's basis for depreciation is limited to the adjusted basis of the property in Sofia's hands, $4,000.

In effect, Areta purchased an undivided one-half interest in the depreciable property with her contribution of $10,000. Assuming that the depreciation rate is 10% a year under the General Depreciation System (GDS), she would have been entitled to a depreciation deduction of $500 per year, based on her interest in the partnership, if the adjusted basis of the property equaled its fair market value when contributed. To simplify this example, the depreciation deductions are determined without regard to any first-year depreciation conventions.

However, since the partnership is allowed only $400 per year of depreciation (10% of $4,000), no more than $400 can be allocated between the partners. The entire $400 must be allocated to Areta.

Distribution of contributed property to another partner. If a partner contributes property to a partnership and the partnership distributes the property to another partner within 7 years of the contribution, the contributing partner must recognize gain or loss on the distribution.

The recognized gain or loss is the amount the contributing partner would have recognized if the property had been sold for its fair market value when it was distributed. This amount is the difference between the property's basis and its fair market value at the time of contribution. The character of the gain or loss will be the same as the character of the gain or loss that would have resulted if the partnership had sold the property to the distributee partner. Appropriate adjustments must be made to the adjusted basis of the contributing partner's partnership interest and to the adjusted basis of the property distributed to reflect the recognized gain or loss.

Disposition of certain contributed property. The following rules determine the character of the partnership's gain or loss on a disposition of certain types of contributed property.

1. ***Unrealized receivables.*** If the property was an unrealized receivable in the hands of the contributing partner, any gain or loss on its disposition by the partnership is ordinary income or loss. Unrealized receivables are defined later under *Payments for Unrealized Receivables and Inventory Items*. When reading the definition, substitute “partner” for “partnership.”
2. ***Inventory items.*** If the property was an inventory item in the hands of the contributing partner, any gain or loss on its disposition by the partnership within 5 years after the contribution is ordinary income or loss. Inventory items are defined later under *Payments for Unrealized Receivables and Inventory Items*.
3. ***Capital loss property.*** If the property was a capital asset in the contributing partner's hands, any loss on its disposition by the partnership within 5 years after the contribution is a capital loss. The capital loss is limited to the amount by which the partner's adjusted basis for the property exceeded the property's fair market value immediately before the contribution.
4. ***Substituted basis property.*** If the disposition of any of the property listed in (1), (2), or (3) is a nonrecognition transaction, these rules apply when the recipient of the property disposes of any substituted basis property (other than certain corporate stock) resulting from the transaction.

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Contribution of Services

A partner can acquire an interest in partnership capital or profits as compensation for services performed or to be performed.

Capital interest. A capital interest is an interest that would give the holder a share of the proceeds if the partnership's assets were sold at fair market value and the proceeds were distributed in a complete liquidation of the partnership. This determination generally is made at the time of receipt of the partnership interest. The fair market value of such an interest received by a partner as compensation for services must generally be included in the partner's gross income in the first tax year in which the partner can transfer the interest or the interest is not subject to a substantial risk of forfeiture. The capital interest transferred as compensation for services is subject to the rules for restricted property discussed under *Employee Compensation* in Pub. 525, Taxable and Nontaxable Income.

The fair market value of an interest in partnership capital transferred to a partner as payment for services to the partnership is a guaranteed payment, discussed earlier under *Guaranteed Payments*.

Profits interest. A profits interest is a partnership interest other than a capital interest. If a person receives a profits interest for providing services to, or for the benefit of, a partnership in a partner capacity or in anticipation of being a partner, the receipt of such an interest is not a taxable event for the partner or the partnership. However, this doesn't apply in the following situations.

- The profits interest relates to a substantially certain and predictable stream of income from partnership assets, such as income from high-quality debt securities or a high-quality net lease.
- Within 2 years of receipt, the partner disposes of the profits interest.
- The profits interest is a limited partnership interest in a publicly traded partnership.

A profits interest transferred as compensation for services is not subject to the rules for restricted property that apply to capital interests.

Basis of Partner's Interest

The basis of a partnership interest is the money plus the adjusted basis of any property the partner contributed. If the partner must recognize gain as a result of the contribution, this gain is included in the basis of his or her interest. Any increase in a partner's individual liabilities

because of an assumption of partnership liabilities is considered a contribution of money to the partnership by the partner.

Interest acquired by gift, etc. If a partner acquires an interest in a partnership by gift, inheritance, or under any circumstance other than by a contribution of money or property to the partnership, the partner's basis must be determined using the basis rules described in Pub. 551.

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Adjusted Basis

TIP *There is a worksheet for adjusting the basis of a partner's interest in the partnership in the Partner's Instructions for Schedule K-1 (Form 1065).*

The basis of an interest in a partnership is increased or decreased by certain items.

Increases. A partner's basis is increased by the following items.

- The partner's additional contributions to the partnership, including an increased share of, or assumption of, partnership liabilities.
- The partner's distributive share of taxable and nontaxable partnership income.
- The partner's distributive share of the excess of the deductions for depletion over the basis of the depletable property, unless the property is oil or gas wells whose basis has been allocated to partners.

Decreases. The partner's basis is decreased (but never below zero) by the following items.

- The money (including a decreased share of partnership liabilities or an assumption of the partner's individual liabilities by the partnership) and adjusted basis of property distributed to the partner by the partnership.
- The partner's distributive share of the partnership losses (including capital losses).
- The partner's distributive share of nondeductible partnership expenses that are not capital expenditures. This includes the partner's share of any section 179 expenses, even if the partner cannot deduct the entire amount on his or her individual income tax return.
- The partner's deduction for depletion for any partnership oil and gas wells, up to the proportionate share of the adjusted basis of the wells allocated to the partner.
- A partner's distributive share of foreign taxes paid or accrued by the partnership for tax years beginning after 2017.
- A partner's distributive share of the adjusted basis of a partnership's property donation to charity.

Note. If the property's fair market value exceeds its adjusted basis, a special rule provides that the basis limitation on partner losses does not apply to the extent of the partner's distributive share of the excess for tax years beginning after 2017.

Partner's liabilities assumed by partnership. If contributed property is subject to a debt or if a partner's liabilities are assumed by the partnership, the basis of that partner's interest is reduced (but not below zero) by the liability assumed by the other partners. This partner must reduce his or her basis because the assumption of the liability is treated as a distribution of money to that partner. The other partners' assumption of the liability is treated as a contribution by them of money to the partnership. See *Effect of Partnership Liabilities*, later.

Example 1. Ivan acquired a 20% interest in a partnership by contributing property that had an adjusted basis to him of $8,000 and a $4,000 mortgage. The partnership assumed payment of the mortgage. The basis of Ivan's interest is:

Adjusted basis of contributed property	$8,000
Minus: Part of mortgage assumed by other partners (80% (0.80) × $4,000)	3,200
Basis of Ivan's partnership interest	$4,800

Example 2. If, in *Example 1*, the contributed property had a $12,000 mortgage, the basis of Ivan's partnership interest would be zero. The $1,600 difference between the mortgage assumed by the other partners, $9,600 (80% × $12,000), and his basis of $8,000 would be treated as capital gain from the sale or exchange of a partnership interest. However, this gain wouldn't increase the basis of his partnership interest.

Book value of partner's interest. The adjusted basis of a partner's interest is determined without considering any amount shown in the partnership books as a capital, equity, or similar account.

Example. Enzo contributes to his partnership property that has an adjusted basis of $400 and a fair market value of $1,000. His partner contributes $1,000 cash. While each partner has increased his capital account by $1,000, which will be reflected in the partnership's books, the adjusted basis of Enzo's interest is only $400 and the adjusted basis of his partner's interest is $1,000.

When determined. The adjusted basis of a partner's partnership interest is ordinarily determined at the end of the partnership's tax year. However, if there has been a sale or exchange of all or part of the partner's interest or a liquidation of his or her entire interest in a partnership, the adjusted basis is determined on the date of sale, exchange, or liquidation.

Alternative rule for figuring adjusted basis. In certain cases, the adjusted basis of a partnership interest can be figured by using the partner's share of the adjusted basis of partnership property that would be distributed if the partnership terminated.

This alternative rule can be used in either of the following situations.

- The circumstances are such that the partner cannot practicably apply the general basis rules.
- It is, in the opinion of the IRS, reasonable to conclude that the result produced will not vary substantially from the result under the general basis rules.

Adjustments may be necessary in figuring the adjusted basis of a partnership interest under the alternative rule. For example, adjustments would be required to include in the partner's share of the adjusted basis of partnership property any significant discrepancies that resulted from contributed property, transfers of partnership interests, or distributions of property to the partners.

Effect of Partnership Liabilities

A partner's basis in a partnership interest includes the partner's share of a partnership liability only if, and to the extent that, the liability:

1. Creates or increases the partnership's basis in any of its assets;
2. Gives rise to a current deduction to the partnership; or
3. Is a nondeductible, noncapital expense of the partnership.

The term "assets" in (1) includes capitalized items allocable to future periods, such as organization expenses.

A partner's share of accrued but unpaid expenses or accounts payable of a cash basis partnership are not included in the adjusted basis of the partner's interest in the partnership.

Partner's basis increased. If a partner's share of partnership liabilities increases, or a partner's individual liabilities increase because he or she assumes partnership liabilities, this increase is treated as a contribution of money by the partner to the partnership.

Partner's basis decreased. If a partner's share of partnership liabilities decreases, or a partner's individual liabilities decrease because the partnership assumes his or her individual liabilities, this decrease is treated as a distribution of money to the partner by the partnership.

Assumption of liability. Generally, a partner or related person is considered to assume a partnership liability only to the extent that:

1. He or she is personally liable for it,
2. The creditor knows that the liability was assumed by the partner or related person,
3. The creditor can demand payment from the partner or related person, and
4. No other partner or person related to another partner will bear the economic risk of loss on that liability immediately after the assumption.

Related person. Related persons, for these purposes, includes all the following.

- An individual and his or her spouse, ancestors, and lineal descendants.
- An individual and a corporation if the individual directly or indirectly owns 80% or more in value of the outstanding stock of the corporation.
- Two corporations that are members of the same controlled group.
- A grantor and a fiduciary of any trust.
- Fiduciaries of two separate trusts if the same person is a grantor of both trusts.

- A fiduciary and a beneficiary of the same trust.
- A fiduciary and a beneficiary of two separate trusts if the same person is a grantor of both trusts.
- A fiduciary of a trust and a corporation if the trust or the grantor of the trust directly or indirectly owns 80% or more in value of the outstanding stock of the corporation.
- A person and a tax-exempt educational or charitable organization controlled directly or indirectly by the person or by members of the person's family.
- A corporation and a partnership if the same persons own 80% or more in value of the outstanding stock of the corporation and 80% or more of the capital or profits interest in the partnership.
- Two S corporations or an S corporation and a C corporation if the same persons own 80% or more in value of the outstanding stock of each corporation.
- An executor and a beneficiary of an estate.
- A partnership and a person owning, directly or indirectly, 80% or more of the capital or profits interest in the partnership.
- Two partnerships if the same persons directly or indirectly own 80% or more of the capital or profits interests.

Property subject to a liability. If property contributed to a partnership by a partner or distributed by the partnership to a partner is subject to a liability, the transferee is treated as having assumed the liability to the extent it doesn't exceed the fair market value of the property.

Partner's share of recourse liabilities. A partnership liability is a recourse liability to the extent that any partner or a related person, defined earlier under *Related person*, has an economic risk of loss for that liability. A partner's share of a recourse liability equals his or her economic risk of loss for that liability. A partner has an economic risk of loss if that partner or a related person would be obligated (whether by agreement or law) to make a net payment to the creditor or a contribution to the partnership with respect to the liability if the partnership were constructively liquidated. A partner who is the creditor for a liability that would otherwise be a nonrecourse liability of the partnership has an economic risk of loss in that liability.

Constructive liquidation. Generally, in a constructive liquidation, the following events are treated as occurring at the same time.

- All partnership liabilities become payable in full.
- All of the partnership's assets have a value of zero, except for property contributed to secure a liability.
- All property is disposed of by the partnership in a fully taxable transaction for no consideration except relief from liabilities for which the creditor's right to reimbursement is limited solely to one or more assets of the partnership.
- All items of income, gain, loss, or deduction are allocated to the partners.
- The partnership liquidates.

Example. Juan and Teresa form a cash basis general partnership with cash contributions of $20,000 each. Under the partnership agreement, they share all partnership profits and losses equally. The partnership borrows $60,000 and purchases depreciable business equipment. This debt is included in the partners' basis in the partnership because incurring it creates an additional $60,000 of basis in the partnership's depreciable property.

If neither partner has an economic risk of loss in the liability, it is a nonrecourse liability. Each partner's basis would include his or her share of the liability, $30,000.

If Teresa is required to pay the creditor if the partnership defaults, she has an economic risk of loss in the liability. Her basis in the partnership would be $80,000 ($20,000 + $60,000), while Juan's basis would be $20,000.

Limited partner. A limited partner generally has no obligation to contribute additional capital to the partnership and therefore doesn't have an economic risk of loss in partnership recourse liabilities. Thus, absent some other factor, such as the guarantee of a partnership liability by the limited partner or the limited partner making the loan to the partnership, a limited partner generally doesn't have a share of partnership recourse liabilities.

Partner's share of nonrecourse liabilities. A partnership liability is a nonrecourse liability if no partner or related person has an economic risk of loss for that liability. A partner's share of nonrecourse liabilities is generally proportionate to his or her share of partnership profits. However, this rule may not apply if the partnership has taken deductions attributable to nonrecourse liabilities or the partnership holds property that was contributed by a partner.

More information. For more information on the effect of partnership liabilities, including rules for limited partners and examples, see Regulations sections 1.752-1 through 1.752-5.

Disposition of Partner's Interest

The following discussions explain the treatment of gain or loss from the disposition of an interest in a partnership.

Abandoned or worthless partnership interest. A loss incurred from the abandonment or worthlessness of a partnership interest is an ordinary loss only if both of the following tests are met.

- The transaction is not a sale or exchange.
- The partner has not received an actual or deemed distribution from the partnership.

If the partner receives even a de minimis actual or deemed distribution, the entire loss generally is a capital loss. However, see *Payments for Unrealized Receivables and Inventory Items*, later.

For information on how to report an abandonment loss, see the Instructions for Form 4797. See Revenue Ruling 93-80 for more information on determining if a loss incurred on the abandonment or worthlessness of a partnership interest is a capital or an ordinary loss.

Partnership election to adjust basis of partnership property. Generally, a partnership's basis in its assets is not affected by a transfer of an interest in the partnership, whether by sale or exchange or because of the death of a partner. However, the partnership can elect to make an optional adjustment to basis in the year of transfer.

Sale, Exchange, or Other Transfer

The sale or exchange of a partner's interest in a partnership usually results in capital gain or loss. However, see *Payments for Unrealized Receivables and Inventory Items*, later, for certain exceptions. Gain or loss is the difference between the amount realized and the adjusted basis of the partner's interest in the partnership. If the selling partner is relieved of any partnership liabilities, that partner must include the liability relief as part of the amount realized for his or her interest.

Example 1. Kumar became a limited partner in the ABC Partnership by contributing $10,000 in cash on the formation of the partnership. The adjusted basis of his partnership interest at the end of the current year is $20,000, which includes his $15,000 share of partnership liabilities. The partnership has no unrealized receivables or inventory items. Kumar sells his interest in the partnership for $10,000 in cash. He had been paid his share of the partnership income for the tax year.

Kumar realizes $25,000 from the sale of his partnership interest ($10,000 cash payment + $15,000 liability relief). He reports $5,000 ($25,000 realized – $20,000 basis) as a capital gain.

Example 2. The facts are the same as in *Example 1*, except that Kumar withdraws from the partnership when the adjusted basis of his interest in the partnership is zero. He is considered to have received a distribution of $15,000, his relief of liability. He reports a capital gain of $15,000.

Installment reporting for sale of partnership interest. A partner who sells a partnership interest at a gain may be able to report the sale on the installment method. For requirements and other information on installment sales, see Pub. 537.

Part of the gain from the installment sale may be allocable to unrealized receivables or inventory items. See *Payments for Unrealized Receivables and Inventory Items* next. The gain allocable to unrealized receivables and inventory items must be reported in the year of sale. The gain allocable to the other assets can be reported under the installment method.

Payments for Unrealized Receivables and Inventory Items

If a partner receives money or property in exchange for any part of a partnership interest, the amount due to his or her share of the partnership's unrealized receivables or inventory items

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results in ordinary income or loss. This amount is treated as if it were received for the sale or exchange of property that is not a capital asset.

This treatment applies to the unrealized receivables part of payments to a retiring partner or successor in interest of a deceased partner only if that part is not treated as paid in exchange for partnership property. See *Liquidation at Partner's Retirement or Death*, later.

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Unrealized receivables. Unrealized receivables include any rights to payment not already included in income for the following items.

- Goods delivered or to be delivered to the extent the payment would be treated as received for property other than a capital asset.
- Services rendered or to be rendered.

These rights must have arisen under a contract or agreement that existed at the time of sale or distribution, even though the partnership may not be able to enforce payment until a later date. For example, unrealized receivables include accounts receivable of a cash method partnership and rights to payment for work or goods begun but incomplete at the time of the sale or distribution of the partner's share.

The basis for any unrealized receivables includes all costs or expenses for the receivables that were paid or accrued but not previously taken into account under the partnership's method of accounting.

Other items treated as unrealized receivables. Unrealized receivables include potential gain that would be ordinary income if the following partnership property were sold at its fair market value on the date of the payment.

- Mining property for which exploration expenses were deducted.
- Stock in a domestic international sales corporation (DISC).
- Certain farm land for which expenses for soil and water conservation or land clearing were deducted.
- Franchises, trademarks, or trade names.
- Oil, gas, or geothermal property for which intangible drilling and development costs were deducted.
- Stock of certain controlled foreign corporations.
- Market discount bonds and short-term obligations.
- Property subject to recapture of depreciation under sections 1245 and 1250 of the Internal Revenue Code. Depreciation recapture is discussed in chapter 3 of Pub. 544.

Determining gain or loss. The income or loss realized by a partner upon the sale or exchange of its interest in unrealized receivables and inventory items, discussed below, is the amount that would have been allocated to the partner if the partnership had sold all of its property for cash at fair market value, in a fully taxable transaction, immediately prior to the partner's transfer of interest in the partnership. Any gain or loss recognized that is attributable to the unrealized receivables and inventory items will be ordinary gain or loss.

Example. You are a partner in ABC Partnership. The adjusted basis of your partnership interest at the end of the current year is zero. Your share of potential ordinary income from partnership depreciable property is $5,000. The partnership has no other unrealized receivables or inventory items. You sell your interest in the partnership for $10,000 in cash and you report the entire amount as a gain since your adjusted basis in the partnership is zero. You report as ordinary income your $5,000 share of potential ordinary income from the partnership's depreciable property. The remaining $5,000 gain is a capital gain.

Inventory items. Inventory items are not limited to stock-in-trade of the partnership. They also include the following property.

- Property that would properly be included in the partnership's inventory if on hand at the end of the tax year or that is held primarily for sale to customers in the normal course of business.
- Property that, if sold or exchanged by the partnership, wouldn't be a capital asset or section 1231 property (real or depreciable business property held more than 1 year). For example, accounts receivable acquired for services or from the sale of inventory and unrealized receivables are inventory items.
- Property held by the partnership that would be considered inventory if held by the partner selling the partnership interest or receiving the distribution.

Notification required of partner. If a partner exchanges a partnership interest attributable to unrealized receivables or inventory for money or property, he or she must notify the partnership in writing. This must be done within 30 days of the transaction or, if earlier, by January 15 of the calendar year following the calendar year of the exchange. A partner may be subject to a $50 penalty for each failure to notify the partnership about such a transaction, unless the failure was due to reasonable cause and not willful neglect.

Information return required of partnership. When a partnership is notified of an exchange of partnership interests involving unrealized receivables or inventory items, the partnership must file Form 8308, Report of a Sale or Exchange of Certain Partnership Interests. Form 8308 is filed with Form 1065 for the tax year that includes the last day of the calendar year in which the exchange took place. If notified of an exchange after filing Form 1065, the partnership must file Form 8308 separately, within 30 days of the notification.

On Form 8308, the partnership provides its telephone number and states the date of the exchange and the names, addresses, and taxpayer identification numbers of the partnership filing the return and the transferee and transferor in the exchange. The partnership must provide a copy of Form 8308 (or a written statement with the same information) to each transferee and transferor by the later of January 31 following the end of the calendar year or 30 days after it receives notice of the exchange.

The partnership may be subject to a penalty for each failure to timely file Form 8308 and a penalty for each failure to furnish a copy of Form 8308 to a transferor or transferee, unless the failure is due to reasonable cause and not willful neglect. If the failure is intentional, a higher penalty may be imposed. See Internal Revenue Code sections 6722, 6723, and 6724 for details.

Statement required of partner. If a partner sells or exchanges any part of an interest in a partnership having unrealized receivables or inventory, he or she must file a statement with his or her tax return for the year in which the sale or exchange occurs. The statement must contain the following information.

- The date of the sale or exchange.
- The amount of any gain or loss attributable to the unrealized receivables or inventory.
- The amount of any gain or loss attributable to capital gain or loss on the sale of the partnership interest.

Partner's disposition of distributed unrealized receivables or inventory items. In general, any gain or loss on a sale or exchange of unrealized receivables or inventory items a partner received in a distribution is an ordinary gain or loss. For this purpose, inventory items do not include real or depreciable business property, even if they are not held more than 1 year.

Example. Oscar, a distributee partner, received his share of accounts receivable when his law firm dissolved. The partnership used the cash method of accounting, so the receivables had a basis of zero. If Oscar later collects the receivables or sells them, the amount he receives will be ordinary income.

Exception for inventory items held more than 5 years. If a distributee partner sells inventory items held for more than 5 years after the distribution, the type of gain or loss depends on how they are being used on the date sold. The gain or loss is capital gain or loss if the property is a capital asset in the partner's hands at the time sold.

Example. Marucia receives, through dissolution of her partnership, inventory that has a basis of $19,000. Within 5 years, she sells the inventory for $24,000. The $5,000 gain is taxed as ordinary income. If she had held the inventory for more than 5 years, her gain would have been capital gain, provided the inventory was a capital asset in her hands at the time of sale.

Substituted basis property. If a distributee partner disposes of unrealized receivables or inventory items in a nonrecognition transaction, ordinary gain or loss treatment applies to a later disposition of any substituted basis property resulting from the transaction.

Liquidation at Partner's Retirement or Death

Payments made by the partnership to a retiring partner or successor in interest of a deceased partner in return for the partner's entire interest in the partnership may have to be allocated between payments in liquidation of the partner's interest in partnership property and other payments. The partnership's payments include an assumption of the partner's share of partnership liabilities treated as a distribution of money.

For income tax purposes, a retiring partner or successor in interest of a deceased partner is treated as a partner until his or her interest in the partnership has been completely liquidated.

Liquidating payments. Payments made in liquidation of the interest of a retiring or deceased partner in exchange for his or her interest in partnership property are considered a distribution, not a distributive share or guaranteed payment that could give rise to a deduction (or its equivalent) for the partnership.

Unrealized receivables and goodwill. Payments made for the retiring or deceased partner's share of the partnership's unrealized receivables or goodwill are not treated as made in exchange for partnership property if both of the following tests are met.

- Capital is not a material income-producing factor for the partnership. Whether capital is a material income-producing factor is explained in the discussion under *Partnership Interests Created by Gift* near the beginning of this publication.
- The retiring or deceased partner was a general partner in the partnership.

However, this rule doesn't apply to payments for goodwill to the extent that the partnership agreement provides for a reasonable payment to a retiring partner for goodwill.

Unrealized receivables includes, to the extent not previously includible in income under the method of accounting used by the partnership, any rights (contractual or otherwise) to payment for (1) goods delivered, or to be delivered, to the extent the proceeds therefrom would be treated as amounts received from the sale or exchange of property other than a capital asset; or (2) services rendered, or to be rendered.

Partners' valuation. Generally, the partners' valuation of a partner's interest in partnership property in an arm's-length agreement will be treated as correct. If the valuation reflects only the partner's net interest in the property (total assets less liabilities), it must be adjusted so that both the value of, and the basis for, the partner's interest include the partner's share of partnership liabilities.

Gain or loss on distribution. Upon the receipt of the distribution, the retiring partner or successor in interest of a deceased partner will recognize gain only to the extent that any money (and marketable securities treated as money) distributed is more than the partner's adjusted basis in the partnership. The partner will recognize a loss only if the distribution is in money, unrealized receivables, and inventory items. No loss is recognized if any other property is received. See *Partner's Gain or Loss* under *Partnership Distributions*, earlier.

Other payments. Payments made by the partnership to a retiring partner or successor in interest of a deceased partner that are not made in exchange for an interest in partnership property are treated as distributive shares of partnership income or guaranteed payments. This rule applies regardless of the time over which the payments are to be made. It applies to payments made for the partner's share of unrealized receivables and goodwill not treated as a distribution.

If the amount is based on partnership income, the payment is taxable as a distributive share of partnership income. The payment retains the same character when reported by the recipient that it would have had if reported by the partnership.

If the amount is not based on partnership income, it is treated as a guaranteed payment. The recipient reports guaranteed payments as ordinary income. For additional information on guaranteed payments, see *Transactions Between Partnership and Partners*, earlier.

These payments are included in income by the recipient for his or her tax year that includes the end of the partnership tax year for which the payments are a distributive share or in which the partnership is entitled to deduct them as guaranteed payments.

Former partners who continue to make guaranteed periodic payments to satisfy the partnership's liability to a retired partner after the partnership is terminated can deduct the payments as a business expense in the year paid.

Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA)

TEFRA is the common acronym used for a set of consolidated examination, processing, and judicial procedures which determine the tax treatment of partnership items at the partnership level for partnerships and limited liability companies (LLCs) that file as partnerships. TEFRA created the unified partnership audit and litigation procedures (TEFRA partnership procedures) of Internal Revenue Code sections 6221 through 6234 (prior to the amendments by BBA). For additional information on TEFRA partnership procedures, see the January 2016 revision of Pub. 541.

CAUTION *The TEFRA partnership audit procedures were repealed and do not apply to tax years beginning after 2017. The Bipartisan Budget Act of 2015 (BBA) is effective for partnership tax years beginning after 2017.*

Bipartisan Budget Act of 2015 (BBA)

The BBA created a new centralized partnership audit regime effective for partnership tax years beginning after 2017. The new regime replaces the consolidated audit proceedings under TEFRA and the electing large partnership provisions. The new audit regime applies to all partnerships unless the partnership is an eligible partnership and elects out by making a valid election. See the Instructions for Form 1065.

Role of Partnership Representative

Under the centralized partnership audit regime, partnerships are required to designate a partnership representative. The partnership representative will have the sole authority to act on behalf of the partnership under the centralized partnership audit regime. The designated partnership representative is a partner or other person with substantial presence in the United States. If the designated partnership representative is an entity, the partnership must also appoint a designated individual to act on behalf of the entity partnership representative. The partnership must include information regarding the partnership representative and designated individual (if applicable) on Form 1065, Schedule B. For more information, see the Instructions for Form 1065.

Electing Out of the Centralized Partnership Audit Regime

A partnership can elect out of the centralized partnership audit regime for a tax year if the partnership is an eligible partnership that year. A partnership is an eligible partnership for a tax year if it has 100 or fewer eligible partners. A partner is an eligible partner if it is an individual, C corporation, foreign entity that would be treated as a C corporation if it was domestic, S corporation, or an estate of a deceased partner. The determination as to whether the partnership has 100 or fewer partners is made by adding the number of Schedules K-1 required to be issued by the partnership to the number of Schedules K-1 required to be issued by any partner that is an S corporation to its shareholders for the tax year of the S corporation ending with or within the partnership tax year. A partnership is not an eligible partnership if it is required to issue a Schedule K-1 to any of the following partners.

- A partnership.
- A trust.
- A foreign entity that would not be treated as a C corporation were it a domestic entity.
- A disregarded entity described in Regulations section 301.7701-2(c)(2)(i).
- An estate of an individual other than a deceased partner.
- Any person that holds an interest in the partnership on behalf of another person. See the Instructions for Form 1065 if electing out of the centralized partnership audit regime.

An annual election out of the centralized partnership audit regime must be made on the eligible partnership's timely filed return, including extensions, for the tax year to which the election applies. The election is made by including the following information on Schedule B-2 (Form 1065) and filing with the tax return.

- The name of each partner.
- The taxpayer identification number (TIN) of each partner.
- The federal tax classification for each partner.
- If an S corporation is a partner, provide the names, TINs, and federal tax classification of any shareholder of the S corporation for the tax year of the S corporation ending with or within the partnership's tax year.

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This annual election once made may not be revoked without the consent of the IRS. A partnership that elects out of the centralized partnership audit regime must notify each of its partners of the election within 30 days of making the election. By making the election out of the centralized partnership audit regime, you are affirming that all of the partners in the partnership meet the eligibility requirements under section 6221(b)(1)(C) of the Internal Revenue Code and you have provided all of the required information with the Form 1065.

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Amended Return

Rather than filing an amended return, a partnership that is subject to the centralized partnership audit regime must file either Form 8082, Notice of Inconsistent Treatment or Administrative Adjustment Request (AAR), or Form 1065-X, Amended Return or Administrative Adjustment Request (AAR), to request an administrative adjustment for an amount of one or more partnership-related items. The Form 8082 must be used if filing electronically.

AARs filed under the centralized partnership audit regime. Partnerships subject to the centralized partnership audit regime and filing an AAR that result in an imputed underpayment and any interest or penalties related to the imputed underpayment should report the imputed underpayment and any related interest and penalties on Form 1065 or 1065-X (as applicable). See the Instructions for Form 1065.

See the instructions for Form 8082 or 1065-X (as applicable) for the following.

- Information pertaining to certain modifications that are allowable for the partnership to include in its calculation of an AAR imputed underpayment.
- Information pertaining to the ability for the partnership to make an election under section 6227(b)(2) of the Internal Revenue Code to have the adjustments of the AAR taken into account by the reviewed year partners, rather than the partnership making an imputed underpayment.

Partner amended return filed as part of modification of the imputed underpayment during a BBA examination. Section 6225(c) of the Internal Revenue Code allows a BBA partnership under examination to request specific types of modifications of any imputed underpayment proposed by the IRS. One type of modification (under section 6225(c)(2) of the Internal Revenue Code) that may be requested is when one or more (reviewed year) partners file amended returns for the tax years of the partners which includes the end of the reviewed year of the BBA partnership under examination and for any tax year with respect to which tax attributes are affected. See the Instructions for Form 8980.

How To Sign Documents on Behalf of the Partnership

How To Sign Documents on Behalf of the Partnership

The following are examples of how a partnership representative (PR) should sign documents on behalf of the partnership. The manner in which the PR signs depends on whether the PR is an entity or an individual. If the PR is an entity, the designated individual (DI) signs in his or her capacity to act on behalf of that entity partnership representative.

Designated Partnership Representative (PR)	Signature as Partnership Representative (PR)	Example
Individual	Individual's signature	John Smith, PR
Entity	Designated individual's (DI) signature	Entity Name, PR, by John Smith, DI

How To Get Tax Help

If you have questions about a tax issue, need help preparing your tax return, or want to download free publications, forms, or instructions, go to *IRS.gov* and find resources that can help you right away.

Preparing and filing your tax return. After receiving all your wage and earnings statements (Form W-2, W-2G, 1099-R, 1099-MISC, 1099-NEC, etc.); unemployment compensation statements (by mail or in a digital format) or other government payment statements (Form 1099-G); and interest, dividend, and retirement statements from banks and investment firms (Forms 1099), you have several options to choose from to prepare and file your tax return. You can prepare the tax return yourself, see if you qualify for free tax preparation, or hire a tax professional to prepare your return.

Free options for tax preparation. Go to *IRS.gov* to see your options for preparing and filing your return online or in your local community, if you qualify, which include the following.

- **Free File.** This program lets you prepare and file your federal individual income tax return for free using brand-name tax-preparation-and-filing software or Free File fillable forms. However, state tax preparation may not be available through Free File. Go to *IRS.gov/FreeFile* to see if you qualify for free online federal tax preparation, e-filing, and direct deposit or payment options.
- **VITA.** The Volunteer Income Tax Assistance (VITA) program offers free tax help to people with low-to-moderate incomes, persons with disabilities, and limited-English-speaking taxpayers who need help preparing their own tax returns. Go to *IRS.gov/VITA*, download the free IRS2Go app, or call 800-906-9887 for information on free tax return preparation.
- **TCE.** The Tax Counseling for the Elderly (TCE) program offers free tax help for all taxpayers, particularly those who are 60 years of age and older. TCE volunteers specialize in answering questions about pensions and retirement-related issues unique to seniors. Go to *IRS.gov/TCE*, download the free IRS2Go app, or call 888-227-7669 for information on free tax return preparation.
- **MilTax.** Members of the U.S. Armed Forces and qualified veterans may use MilTax, a free tax service offered by the Department of Defense through Military OneSource.

  Also, the IRS offers Free Fillable Forms, which can be completed online and then filed electronically regardless of income.

Using online tools to help prepare your return. Go to *IRS.gov/Tools* for the following.

- The *Earned Income Tax Credit Assistant* (*IRS.gov/EITCAssistant*) determines if you're eligible for the earned income credit (EIC).
- The *Online EIN Application* (*IRS.gov/EIN*) helps you get an employer identification number (EIN).
- The *Tax Withholding Estimator* (*IRS.gov/W4app*) makes it easier for everyone to pay the correct amount of tax during the year. The tool is a convenient, online way to check and tailor your withholding. It's more user-friendly for taxpayers, including retirees and self-employed individuals. The features include the following.
  - Easy to understand language.
  - The ability to switch between screens, correct previous entries, and skip screens that don't apply.
  - Tips and links to help you determine if you qualify for tax credits and deductions.
  - A progress tracker.
  - A self-employment tax feature.
  - Automatic calculation of taxable social security benefits.
- The *First-Time Homebuyer Credit Account Look-up* (*IRS.gov/HomeBuyer*) tool provides information on your repayments and account balance.
- The *Sales Tax Deduction Calculator* (*IRS.gov/SalesTax*) figures the amount you can claim if you itemize deductions on Schedule A (Form 1040).

Getting answers to your tax questions. On IRS.gov, you can get up-to-date information on current events and changes in tax law.

- *IRS.gov/Help*: A variety of tools to help you get answers to some of the most common tax questions.
- *IRS.gov/ITA*: The Interactive Tax Assistant, a tool that will ask you questions on a number of tax law topics and provide answers.
- *IRS.gov/Forms*: Find forms, instructions, and publications. You will find details on 2020 tax changes and hundreds of interactive links to help you find answers to your questions.

- You may also be able to access tax law information in your electronic filing software.

Need someone to prepare your tax return? There are various types of tax return preparers, including tax preparers, enrolled agents, certified public accountants (CPAs), attorneys, and many others who don't have professional credentials. If you choose to have someone prepare your tax return, choose that preparer wisely. A paid tax preparer is:

- Primarily responsible for the overall substantive accuracy of your return,
- Required to sign the return, and
- Required to include their preparer tax identification number (PTIN).

Although the tax preparer always signs the return, you're ultimately responsible for providing all the information required for the preparer to accurately prepare your return. Anyone paid to prepare tax returns for others should have a thorough understanding of tax matters. For more information on how to choose a tax preparer, go to *Tips for Choosing a Tax Preparer* on IRS.gov.

Coronavirus. Go to *IRS.gov/Coronavirus* for links to information on the impact of the coronavirus, as well as tax relief available for individuals and families, small and large businesses, and tax-exempt organizations.

Tax reform. Tax reform legislation affects individuals, businesses, and tax-exempt and government entities. Go to *IRS.gov/TaxReform* for information and updates on how this legislation affects your taxes.

Employers can register to use Business Services Online. The Social Security Administration (SSA) offers online service at *SSA.gov/employer* for fast, free, and secure online W-2 filing options to CPAs, accountants, enrolled agents, and individuals who process Form W-2, Wage and Tax Statement, and Form W-2c, Corrected Wage and Tax Statement.

IRS social media. Go to *IRS.gov/SocialMedia* to see the various social media tools the IRS uses to share the latest information on tax changes, scam alerts, initiatives, products, and services. At the IRS, privacy and security are paramount. We use these tools to share public information with you. **Don't** post your SSN or other confidential information on social media sites. Always protect your identity when using any social networking site.

The following IRS YouTube channels provide short, informative videos on various tax-related topics in English, Spanish, and ASL.

- *Youtube.com/irsvideos*.
- *Youtube.com/irsvideosmultilingua*.
- *Youtube.com/irsvideosASL*.

Watching IRS videos. The IRS Video portal (*IRSVideos.gov*) contains video and audio presentations for individuals, small businesses, and tax professionals.

Online tax information in other languages. You can find information on *IRS.gov/MyLanguage* if English isn't your native language.

Free interpreter service. Multilingual assistance, provided by the IRS, is available at Taxpayer Assistance Centers (TACs) and other IRS offices. Over-the-phone interpreter service is accessible in more than 350 languages.

Getting tax forms and publications. Go to *IRS.gov/Forms* to view, download, or print all of the forms, instructions, and publications you may need. You can also download and view popular tax publications and instructions (including the Instructions for Forms 1040 and 1040-SR) on mobile devices as an eBook at *IRS.gov/eBooks*. Or you can go to *IRS.gov/OrderForms* to place an order.

Access your online account (individual taxpayers only). Go to *IRS.gov/Account* to securely access information about your federal tax account.

- View the amount you owe, pay online, or set up an online payment agreement.
- Access your tax records online.
- Review your payment history.
- Go to *IRS.gov/SecureAccess* to review the required identity authentication process.

Using direct deposit. The fastest way to receive a tax refund is to file electronically and choose direct deposit, which securely and electronically transfers your refund directly into your financial account. Direct deposit also avoids the possibility that your check could be lost, stolen, or returned undeliverable to the IRS. Eight in 10 taxpayers use direct deposit to receive their refunds. The IRS issues more than 90% of refunds in less than 21 days.

Getting a transcript of your return. The quickest way to get a copy of your tax transcript is to go to *IRS.gov/Transcripts*. Click on either "Get Transcript Online" or "Get Transcript by Mail" to order a free copy of your transcript. If you prefer, you can order your transcript by calling 800-908-9946.

Reporting and resolving your tax-related identity theft issues.

- Tax-related identity theft happens when someone steals your personal information to commit tax fraud. Your taxes can be affected if your SSN is used to file a fraudulent return or to claim a refund or credit.
- The IRS doesn't initiate contact with taxpayers by email, text messages, telephone calls, or social media channels to request personal or financial information. This includes requests for personal identification numbers (PINs), passwords, or similar information for credit cards, banks, or other financial accounts.
- Go to *IRS.gov/IdentityTheft*, the IRS Identity Theft Central webpage, for information on identity theft and data security protection for taxpayers, tax professionals, and businesses. If your SSN has been lost or stolen or you suspect you're a victim of tax-related identity theft, you can learn what steps you should take.
- Get an Identity Protection PIN (IP PIN). IP PINs are six-digit numbers assigned to eligible taxpayers to help prevent the misuse of their SSNs on fraudulent federal income tax returns. When you have an IP PIN, it prevents someone else from filing a tax return with your SSN. To learn more, go to *IRS.gov/IPPIN*.

Checking on the status of your refund.

- Go to *IRS.gov/Refunds*.
- The IRS can't issue refunds before mid-February 2021 for returns that claimed the EIC or the additional child tax credit (ACTC). This applies to the entire refund, not just the portion associated with these credits.
- Download the official IRS2Go app to your mobile device to check your refund status.
- Call the automated refund hotline at 800-829-1954.

Making a tax payment. The IRS uses the latest encryption technology to ensure your electronic payments are safe and secure. You can make electronic payments online, by phone, and from a mobile device using the IRS2Go app. Paying electronically is quick, easy, and faster than mailing in a check or money order. Go to *IRS.gov/Payments* for information on how to make a payment using any of the following options.

- *IRS Direct Pay*: Pay your individual tax bill or estimated tax payment directly from your checking or savings account at no cost to you.
- *Debit or Credit Card*: Choose an approved payment processor to pay online, by phone, or by mobile device.
- *Electronic Funds Withdrawal*: Offered only when filing your federal taxes using tax return preparation software or through a tax professional.
- *Electronic Federal Tax Payment System*: Best option for businesses. Enrollment is required.
- *Check or Money Order*: Mail your payment to the address listed on the notice or instructions.
- *Cash*: You may be able to pay your taxes with cash at a participating retail store.
- *Same-Day Wire*: You may be able to do same-day wire from your financial institution. Contact your financial institution for availability, cost, and cut-off times.

What if I can't pay now? Go to *IRS.gov/Payments* for more information about your options.

- Apply for an *online payment agreement* (*IRS.gov/OPA*) to meet your tax obligation in monthly installments if you can't pay your taxes in full today. Once you complete the online process, you will receive immediate notification of whether your agreement has been approved.
- Use the *Offer in Compromise Pre-Qualifier* to see if you can settle your tax debt for less than the full amount you owe. For more information on the Offer in Compromise program, go to *IRS.gov/OIC*.

Filing an amended return. You can now file Form 1040-X electronically with tax filing software to amend 2019 Forms 1040 and 1040-SR. To do so, you must have e-filed your original 2019 return. Amended returns for all prior years must be mailed. See *Tips for taxpayers who need to file an amended tax return* and go to

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IRS.gov/Form1040X for information and updates.

Checking the status of your amended return. Go to IRS.gov/WMAR to track the status of Form 1040-X amended returns. Please note that it can take up to 3 weeks from the date you filed your amended return for it to show up in our system, and processing it can take up to 16 weeks.

Understanding an IRS notice or letter you've received. Go to IRS.gov/Notices to find additional information about responding to an IRS notice or letter.

Contacting your local IRS office. Keep in mind, many questions can be answered on IRS.gov without visiting an IRS Taxpayer Assistance Center (TAC). Go to IRS.gov/LetUsHelp for the topics people ask about most. If you still need help, IRS TACs provide tax help when a tax issue can't be handled online or by phone. All TACs now provide service by appointment, so you'll know in advance that you can get the service you need without long wait times. Before you visit, go to IRS.gov/TACLocator to find the nearest TAC and to check hours, available services, and appointment options. Or, on the IRS2Go app, under the Stay Connected tab, choose the Contact Us option and click on "Local Offices."

The Taxpayer Advocate Service (TAS) Is Here To Help You

What Is TAS?

TAS is an ***independent*** organization within the IRS that helps taxpayers and protects taxpayer rights. Their job is to ensure that every taxpayer is treated fairly and that you know and understand your rights under the Taxpayer Bill of Rights.

How Can You Learn About Your Taxpayer Rights?

The Taxpayer Bill of Rights describes 10 basic rights that all taxpayers have when dealing with the IRS. Go to TaxpayerAdvocate.IRS.gov to help you understand what these rights mean to you and how they apply. These are ***your*** rights. Know them. Use them.

What Can TAS Do For You?

TAS can help you resolve problems that you can't resolve with the IRS. And their service is free. If you qualify for their assistance, you will be assigned to one advocate who will work with you throughout the process and will do everything possible to resolve your issue. TAS can help you if:

- Your problem is causing financial difficulty for you, your family, or your business;
- You face (or your business is facing) an immediate threat of adverse action; or
- You've tried repeatedly to contact the IRS but no one has responded, or the IRS hasn't responded by the date promised.

How Can You Reach TAS?

TAS has offices in every state, the District of Columbia, and Puerto Rico. Your local advocate's number is in your local directory and at TaxpayerAdvocate.IRS.gov/Contact-Us. You can also call them at 877-777-4778.

How Else Does TAS Help Taxpayers?

TAS works to resolve large-scale problems that affect many taxpayers. If you know of one of these broad issues, please report it to them at IRS.gov/SAMS.

TAS for Tax Professionals

TAS can provide a variety of information for tax professionals, including tax law updates and guidance, TAS programs, and ways to let TAS know about systemic problems you've seen in your practice.

Low Income Taxpayer Clinics (LITCs)

LITCs are independent from the IRS. LITCs represent individuals whose income is below a certain level and need to resolve tax problems with the IRS, such as audits, appeals, and tax collection disputes. In addition, clinics can provide information about taxpayer rights and responsibilities in different languages for individuals who speak English as a second language. Services are offered for free or a small fee for eligible taxpayers. To find a clinic near you, visit www.TaxpayerAdvocate.IRS.gov/about-us/Low-Income-Taxpayer-Clinics-LITC/ or see IRS Pub. 4134, Low Income Taxpayer Clinic List.

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To help us develop a more useful index, please let us know if you have ideas for index entries. See "Comments and Suggestions" in the "Introduction" for the ways you can reach us.

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