Accredited Business Advisor (ABA) Part 2

Preparatory Course

NSA ©2020

NSA 75 Years
National Society of Accountants

TABLE OF CONTENTS

1 Property Law

2 Contracts

3 Uniform Commercial Code (UCC)

4 Agency

5 Partnerships

6 Corporations

7 Trusts

8 Limited Liability Corporations and Limited Liability Partnerships

9 Cost-Volume-Profit Relationships

10 Department Analysis

11 Time Value of Money

12 Capital Budgeting

13 Capital Investment Analysis

14 Budgeting

15 Managerial Decisions

16 The Cash Budget

17 Internal Control Systems

18 Evaluating Investment/Business Opportunities

19 Employee Benefits

20 Preliminaries of the Federal Income Tax Return

21 Wages, Interest, Dividends, Distributions, Social Security Benefits, and Capital Gains or Losses

22 Other Income

23 Deductions from Gross Income

24 Standard Deduction, Itemized Deductions, and Qualified Business Income Deduction

25 Tax Computation and Other Taxes

26 Tax Credits

27 Filing Returns, Paying Taxes, Obtaining Refunds, and Other Matters

28 Taxation of Partnerships

29 Tax Deferral and Investment

30 S Corporations

31 Corporate Taxation

32 Income Taxation of Trusts and Estates

33 Estate Tax, Gift Tax, and Generation-Skipping Transfer Tax (GSTT)

34 Tax-Exempt Organizations

35 Affordable Care Act

36 Ethics and Professional Conduct

Chapter 28

TAXATION OF PARTNERSHIPS

LEARNING OBJECTIVES

After reviewing this chapter, you should be able to:

- Distinguish the "aggregate" theory of partnership taxation from the "entity" approach used for other business forms
- Determine the tax consequences of formation of a partnership to the partner and the partnership
- Identify when a partner may recognize gain for receipt of an interest in exchange for the performance of services
- Identify the reporting requirements for a partnership, including filing obligations and tax election issues
- Identify the key elements used to determine a partner's basis in the partnership interest
- Identify the partnership capital account reporting available to the partnership, including both required methods and other methods that may also be useful for other purposes
- Distinguish the tax consequences of a guaranteed payment and a distribution for both the partnership and the partner
- Identify the options available to a partnership when adopting accounting methods and periods
- Distinguish recourse liabilities from nonrecourse liabilities
- Determine partners' shares of recourse and nonrecourse liabilities
- Determine partners' shares of income and loss of the partnership, both by agreement and special considerations applicable to built-in gains and losses
- Determine the tax consequences of distributions of money and property from the partnership to the partners

the transferee's deduction, determined using the allocation method described in this paragraph, is prorated for the number of months remaining in the transferee's tax year.

If real property is transferred, the transferee's deduction for the year of the transfer is determined using the disposition rules of Regulations Section 1.168-2(a)(3). That is, the transferee is entitled to cost recovery deductions prorated through the end of the month preceding the month of transfer. This produces a result similar to that described earlier for personal property.

If the partnership's first year is a short tax year, any otherwise allowable cost recovery deductions must be prorated by the ratio that the number of months in the short year bears to 12.

Holding Period of Partnership Interest

A partner's basis in a partnership interest acquired by contribution of money or property is a substituted basis. That is, the partner substitutes the basis that he or she had in the property transferred for the basis of the partnership interest. Tax advisors often fail to distinguish a carryover basis from a substituted basis, but the distinction is important with respect to determination of holding period.

Section 1223(1) provides that when the basis of property acquired by the taxpayer is the same, in whole or in part, as the basis of property transferred in exchange for that property, then the holding period of the new property shall include the holding period of the property exchanged if the property exchanged is a capital or a Section 1231 asset.

If an interest is acquired in exchange for property that is not either a capital or a Section 1231 asset, the holding period begins on the date of acquisition of the interest.

If an interest is acquired in exchange for a transfer of capital assets (or Section 1231 assets) and other property, the partner presumably has a split holding period for the acquired interest. In Revenue Ruling 84-53, the IRS ruled that a partner has just one interest in the partnership, even if both limited and general partnership interests are held by that partner. Thus, a sale of all or a portion of a partner's interest before the more than one year holding period of Section 1222 is satisfied may result in both long-term and short-term capital gain.

Transfers of assets to the partnership on an ongoing basis may create multiple holding periods for the partner's interest.

Holding Period of Contributed Assets to the Partnership

Section 1223(2) states that if property is acquired in an exchange, and the basis of the property so acquired is the same, in whole or in part, as the basis of such property to the transferor, then the holding period shall include the holding period of the transferor. This is a carryover basis, not a substituted basis, provision and allows the holding period to include the transferor's holding period regardless of the nature of the property transferred.

Because Section 723 states that the partnership's basis in contributed assets is equal to the basis of such assets to the contributing partner, increased by any gain recognized under Section 721(b), the partnership has a carryover basis and is entitled to include the holding period of the contributing partner when determining its holding period. This is true regardless of the character of the assets contributed.

an HSA are tax-free when used to pay qualified medical expenses. When an HSA distribution is used for any other purpose, it is taxable as ordinary income and subject to a 20% tax penalty unless the distribution is received:

- While the account holder is disabled,
- Following the account holder's death, or
- By the account holder after reaching the eligibility age for Medicare.

TRANSFERS, ROLLOVERS, AND EXCHANGES MAINTAIN TAX UMBRELLA

Investors change employers from time to time. To help ensure the protection against unwanted taxation remains in place, they may roll over qualified plan and IRA funds as shown in the following chart:

From These Plans	To These Plans
Qualified plan (before-tax contributions only)	• Another qualified plan • A Section 403(b) tax-sheltered annuity • A Section 457 governmental plan (that agrees to a separate arrangement for eligible retirement plan funds) • A traditional IRA • A Roth IRA
Qualified plan (after-tax contributions)	• A defined contribution plan (provided the plan has separate arrangements for after-tax contributions and transfer is direct trustee-to-trustee) • A traditional IRA • A Roth IRA
Eligible Section 457 governmental plan	• A qualified plan • A Section 403(b) tax-sheltered annuity • Another Section 457 governmental plan • A traditional IRA • A Roth IRA
Section 403(b) tax-sheltered annuity	• A qualified plan • Another Section 403(b) tax-sheltered annuity • A Section 457 governmental plan (that agrees to separately arrange for eligible retirement plan funds) • A traditional IRA • A Roth IRA
Section 403(b) tax-sheltered annuity (after-tax contributions)	• A defined contribution plan (provided the plan separately arranges for after-tax contributions and transfer is direct trust-ee-to-trustee) • A traditional IRA • A Roth IRA
Section 403(b) tax-sheltered annuity (designated Roth arrangements)	• Another 403(b) plan that accepts Roth rollovers • A Roth IRA
Traditional IRA (deductible contributions only)	• A qualified plan • A Section 403(b) tax-sheltered annuity • A Section 457 governmental plan (that agrees to separately arrange for eligible retirement plan funds) • Another traditional IRA

competent practitioner would under similar circumstances due to a lack of knowledge or a lack of independence standpoint, the licensee may have breached his duty of exercising reasonable care.

EXAMPLES

Examples of a tax practitioner's common-law duty include:

- Duty to perform an engagement with the same care, skill, and competency as any other reasonably competent accountant would under similar circumstances
- Duty to maintain independence and objectivity during the engagement
- Duty to properly supervise personnel during the course of the engagement
- Duty to be diligent in reviewing the client's information and determining proper accounting or tax treatment
- Duty of due diligence/further inquiry

The court found in *Brockhouse v. U.S.*[11] that preparer penalties under Code Sec. 6694(a) were warranted when a CPA failed to pursue additional factual inquiry when facts presented by the taxpayer suggested additional information was necessary in order to properly calculate the client's tax liability. The court stated that "this due diligence requirement means that a preparer must act as a reasonable, prudent person with respect to the information supplied to the preparer."

The third criterion of negligence, *proximate cause*, includes two elements: (1) cause in fact and (2) foreseeability.[12] In *In re: Sun Point Securities Inc*., the issue of proximate cause was discussed at length, stating "[n]egligent acts are only a *cause in fact* of harm if they are a substantial factor in bringing about the harm, without which no harm would have occurred." *Foreseeability* requires that a person of ordinary intelligence should have anticipated the danger created by a negligent act or omission.[13]

EXAMPLE

Jean, a tax professional, does not report certain income items on her client's tax return due to the fact that her client, Cliff, had deliberately hidden this information from her. The IRS audits Cliff and assesses an additional tax liability of $100,000 plus penalties and interest due to this omission. Cliff sues Jean as a result. He will not prevail because she properly reported the income items of which she was aware and so did not breach her duty to Cliff.

Potential Duty Owed Through Privity

The concept of privity means that a client may have standing to sue a tax practitioner because of the direct contractual relationship between the client and its service provider. If a state's common law requires the plaintiff to have privity with the defendant, then that may prevent a non-client from suing a tax practitioner. It should be noted that not all states' common law require privity, which makes it easier for non-clients to sue an accounting firm. Non-privity states permit non-clients to sue if the plaintiff's reliance on the practitioner's work is foreseeable. These jurisdictions have rules that failure to disclose facts in non-privity states can be treated as the equivalent of a misrepresentation of fact.

11 749 F.2d 1248 (7th Cir 1984).

12 *Greenstein, Logan & Co. v. Burgess Mktg., Inc.*, 744 S.W.2d 170, 186 (Tex. Ct. App. 1987), writ denied.

13 *Doe v. Boys Clubs of Greater Dallas, Inc.*, 907 S.W.2d 472, 478 (Tex. 1995).

REVIEW QUESTIONS

1. Al and Bob form an equal partnership. Al contributes $10,000 in cash. Bob contributes Section 1231 property with a basis of $5,000 and a fair market value of $10,000. Bob has held the contributed property for 2 years. What is Bob's basis in his partnership interest, and when does his holding period begin?

a. $10,000 basis; holding period begins at date of transfer

b. $5,000 basis; holding period begins at the date of transfer

c. $10,000 basis; holding period begins 2 years before the transfer

d. $5,000 basis; holding period begins 2 years before the transfer

2. Maureen acquired a 40 percent interest in a partnership by contributing property that had an adjusted basis to her of $30,000 and a fair market value of $50,000. The property was subject to a $40,000 mortgage, which was assumed by the partnership. Following the contribution, Maureen's share of the liability is reduced to 40 percent. What is the adjusted basis of Maureen's partnership interest taking into consideration all of these facts?

a. $30,000

b. $24,000

c. $16,000

d. $6,000

3. Which of the following may be considered a "guaranteed payment" to a partner?

a. Payment of a fixed $50,000 each year

b. Payment of the first $25,000 in profits

c. Payment of a preference return of 8% of unreturned capital, with a cumulative feature for unpaid amounts

d. Payment of $35,000 to a partner for rent of a building

4. If the partnership income is not distributed to a partner as earned, the amount of undistributed income:

a. Increases the partner's basis

b. Decreases the partner's basis

c. Does not affect the partner's basis

d. Is not currently taxable

ANSWERS TO REVIEW QUESTIONS

1. a. *Incorrect.* It is true that you do not have to provide any reason for requesting a filing extension.

b. *Correct.* A filing extension only extends the time to *file* the return; it does not provide an extension of time to *pay* taxes, which are due by April 15.

c. *Incorrect.* An extension request must be filed by April 15.

d. *Incorrect.* The extension period for an individual income tax return is 6 months.

2. a. *Correct.* There is no cost to taxpayers who use the Fillable Forms option from the IRS website to file electronically.

b. *Incorrect.* While there is no cost to printing out IRS forms, there is a postage fee for mailing the form through the U.S. Postal Service or an IRS-approved private delivery service.

c. *Incorrect.* Whether the software is on a computer or in the cloud, there's a charge for the software.

d. *Incorrect.* This entails professional fees for return preparation and filing.

3. a. *Incorrect.* The return is not valid without a signature.

b. *Incorrect.* A taxpayer must include the date that the return is signed.

c. *Correct.* Whether to include a phone number and/or email address is optional and does not affect the processing of the return.

d. *Incorrect.* While instructions to the return indicate that this entry is required, it does not appear that the nature of the entry affects the processing of the return.

4. a. *Incorrect.* The third-party designee does not have the authority to receive a refund check on behalf of a taxpayer.

b. *Incorrect.* The third-party designee cannot bind the taxpayer to additional liability.

c. *Incorrect.* The third-party designee is not authorized to represent the taxpayer before the IRS merely through this designation.

d. *Correct.* The third-party designee has the right to give the IRS missing information.

ABOUT THE AUTHORS

Allison McLeod

Professor McLeod is currently a full-time Senior Lecturer at the University of North Texas, teaching classes in Corporate Income Taxes, Individual Taxes, Tax Research, Ethics and Financial Accounting. She also practices law part-time with the Dallas firm Grable Martin Fulton and taught as an adjunct professor at the University of North Texas College of Law. Prior to Professor McLeod going into academia, she worked for 18 years in industry and in a Big Four accounting firm. Professor McLeod earned a law degree from Baylor School of Law, and an LL.M. degree in Taxation from Southern Methodist School of Law. She has been a licensed CPA since 1993 and has been licensed to practice law since 1992. Professor McLeod has enjoyed teaching live ethics course to CPAs since 2011 and is the owner of www.cpaethicsonline.com, which offers on-line self-study courses to CPAs.

Barbara Weltman

Barbara Weltman, JD, has written extensively on a wide variety of tax, small business, and financial planning matters for both professionals and the general public. The Wall Street Journal called her “the guru of small business taxes.” She is the co-author, along with Sidney Kess, of CCH’s Individual and Small Business Tax Planning Guide and CCH’s Retirement Planning Guide and a number of self-study programs for CCH. She is publisher of Big Ideas for Small ¬Business®, maintains a small business information Web site at www.barbaraweltman.com, and is the host of Build Your Business Radio. Ms. Weltman is a graduate of Brooklyn Law School.

Gary Cokins

Gary Cokins is an internationally recognized expert, speaker, and author in performance improvement systems and advanced cost management.

Gary received a BS degree with honors (Tau Beta Pi; Alpha Pi Mu) in Industrial Engineering/Operations Research from Cornell University in 1971. He was two year varsity football letterman. He received his MBA with honors (Beta Gamma Sigma) from Northwestern University's Kellogg School of Management in 1974.

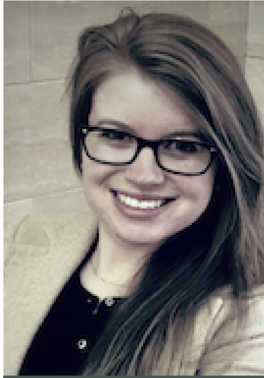
Gary began his career as a strategic planner with FMC Corporation and subsequently served as Financial Controller and Operations Manager with FMC's Link-Belt division. In 1981 Gary began his management consulting career first with Deloitte Consulting. Next with KPMG, Gary was trained on activity-based costing (ABC) by Harvard Business School Professors Robert S. Kaplan and Robin Cooper. With KPMG working with Dr. David Norton, Gary was also involved with initial research that led to the development of the Balanced Scorecard. Prior to joining SAS, Gary headed the National Cost Management Consulting Services for Electronic Data Systems (EDS). In 1996 Gary joined ABC Technologies that was acquired in 2002 by SAS, a leading provider of enterprise performance management and business analytics software headquartered in Cary, North Carolina. At SAS he was a principal consultant and retired in 2012.

Mr. Cokins has participated and served on committees including: CAM-I, the Supply Chain Council, the International Federation of Accountants (IFAC), the Institute of Management Accountants, the AICPA, and the American Association of Accountants (AAA).

James R. Hamill

Dr. Hamill is the Director of Tax Practice at Reynolds, Hix & Co., P.A., in Albuquerque, New Mexico. He is the author of more than 36 CPE courses and more than 100 articles in professional tax journals and writes a weekly column on tax issues for the Albuquerque Journal. He has lectured on structuring tax

transactions throughout the country for international CPA firms, State CPA Societies, and numerous other organizations. He has developed and instructed webinars on a variety of tax topics over the past 10 years. He is a CPA in New Mexico, a past Chair of the New Mexico Society of CPAs, and has 30 years of experience in tax practice.

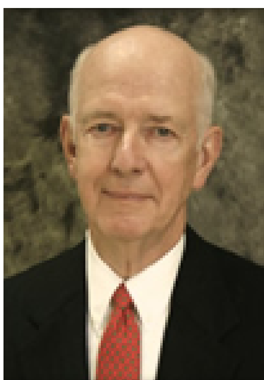


Klaralee Charlton

Klaralee Charlton is a Shareholder with Katz, Look & Onorato, P.C. She practices fiduciary tax, estate administration, and business transactional law. As part of her practice, Ms. Charlton guides clients through the process of administering a loved one's estate including the collection, valuation, management and transfer of assets including financial accounts, real estate, and business interests with a focus on minimizing estate and income tax liability. She also works closely with trustees of ongoing trusts to ensure compliance and prepares clients' fiduciary income tax returns annually.

Klaralee has written and lectured on topics including estate and gift tax, fiduciary income tax reporting and U.S. regulations governing the valuation of small family businesses. She is an active member of the Colorado Bar Association, Tax Section and the Greater Denver Tax Counsel Association.

She earned her J.D. in 2011 from the University of Utah, S.J. Quinney College of Law, her LL.M. in Tax Law from the University of Denver in 2013, and her B.A. in political science in 2009 from Bryn Mawr College. She is admitted to practice in both Colorado and Montana.



Paul J. Winn

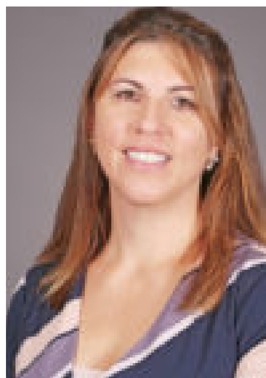
Paul J. Winn, CLU, ChFC has over thirty years experience in the life insurance and investment industry. As well as fifteen years as a financial writer, editor, and trainer. Paul has worked for Mutual Life Insurance Company of New York, Security Mutual Life Insurance Company, Principal Financial Group, and the Maryland Financial Corporation.

Paul is a Published book author, writer & editor of major mutual life insurance company's agent-training "university", and the creator of more than 100 training courses in computer-based training, print and scripted classroom formats.

Paul Jorgensen

Paul has over 25 years of legal practice and business experience. Paul founded and currently heads The Jorgensen Law Firm PLLC, a Washington D.C. intellectual property and contract law firm. Prior to this, Paul was intellectual property and contract counsel at Patton Boggs LLP, Senior Intellectual Property Counsel at Choice Hotels International, Inc., and an associate with Venable, Baetjer, Howard & Civiletti. Through this experience, Paul has helped individual, organization and corporate clients with their domestic and international trademark, copyright, trade name, trade secret and domain name matters, and has designed and negotiated hundreds of successful contracts and licenses.

Paul teaches several different courses to lawyers and non-lawyers aimed at demystifying legal structures and writing. He teaches regularly at the Dubai Chamber of Commerce, the American Law Institute CLE, myLawCLE, Georgetown University, Georgetown University Law Center, the International Trademark Association, Rossdale CLE, Strafford Publications and numerous other professional groups.



Tara Lamphier

Tara Lamphier is a CPA at Muto, Vollucci & Company in Rhode Island wth 10 years of experience. Prior to becoming a CPA, Tara was a Senior Accountant at Levine, Katz, Nannis & Solomon for five year. She has conducted technial review, course updates, and written NASBA compliant review and exam questions for several self-study CPE course providers. Tara has a Bachelor of Business Administration from Bryant University.