



NORTHERN
TRUST

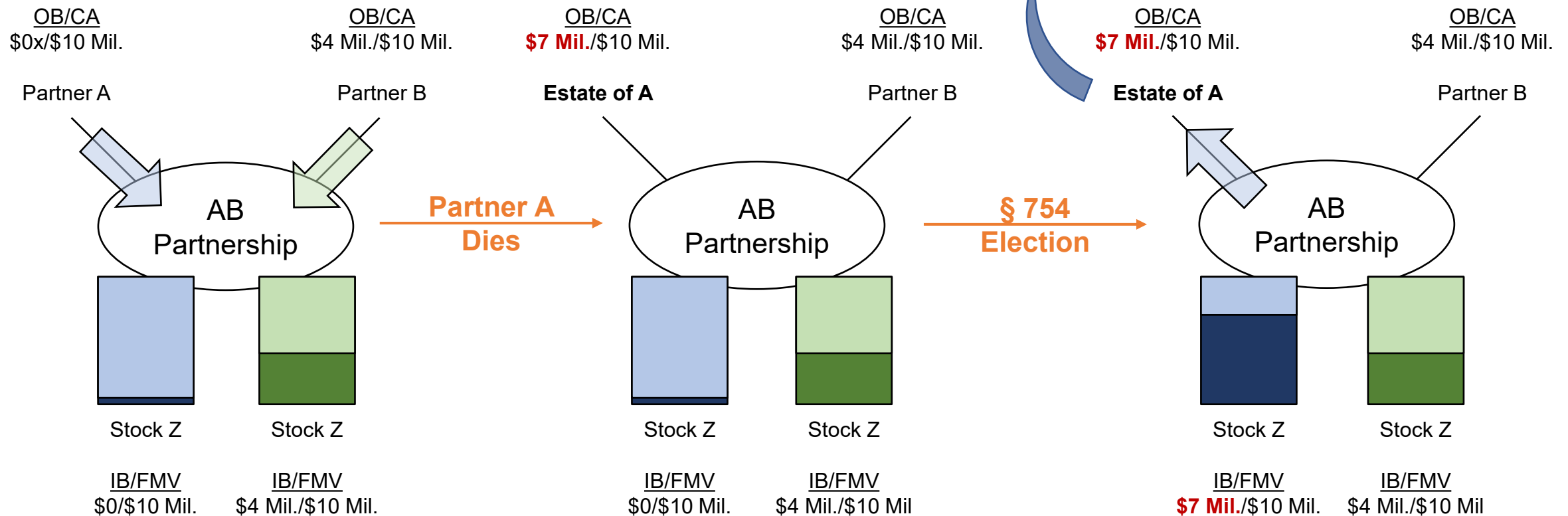
Practical Partnership Solutions to Common Client Situations

Paul S. Lee, J.D., LL.M.
Chief Tax Strategist
The Northern Trust Company
New York, New York

MAXIMIZING THE SECTION 1014 BASIS ADJUSTMENT

Inside Basis Adjustment at Death Is a Blunt Instrument

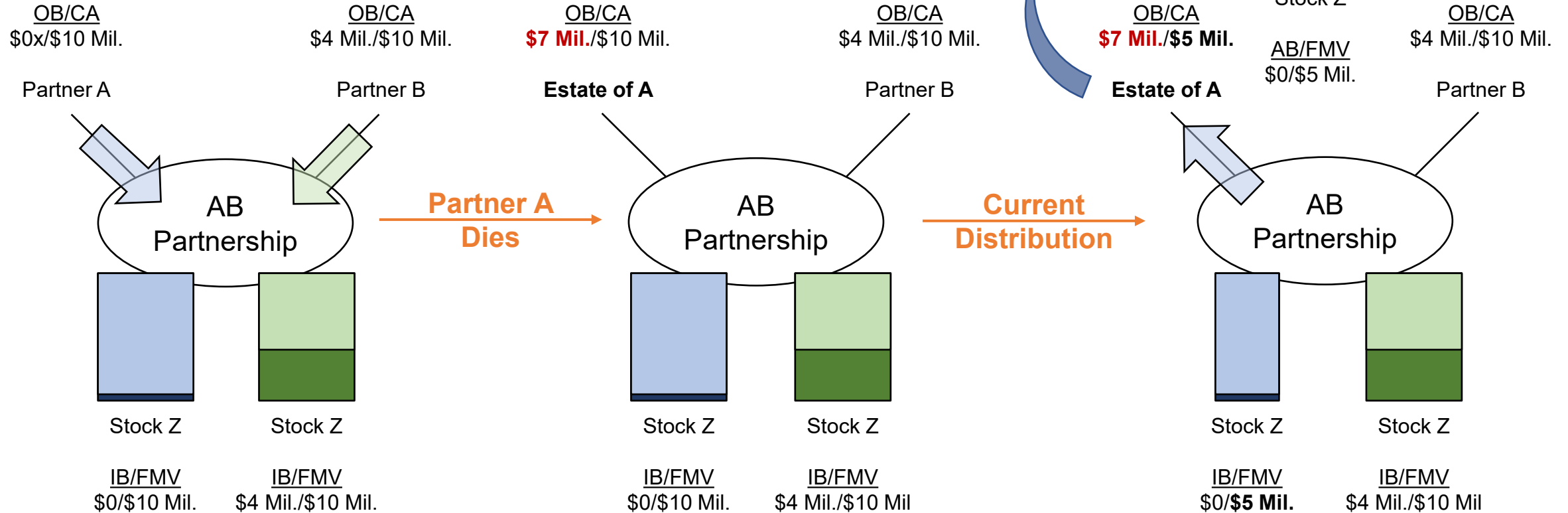
30%
Valuation
Discount



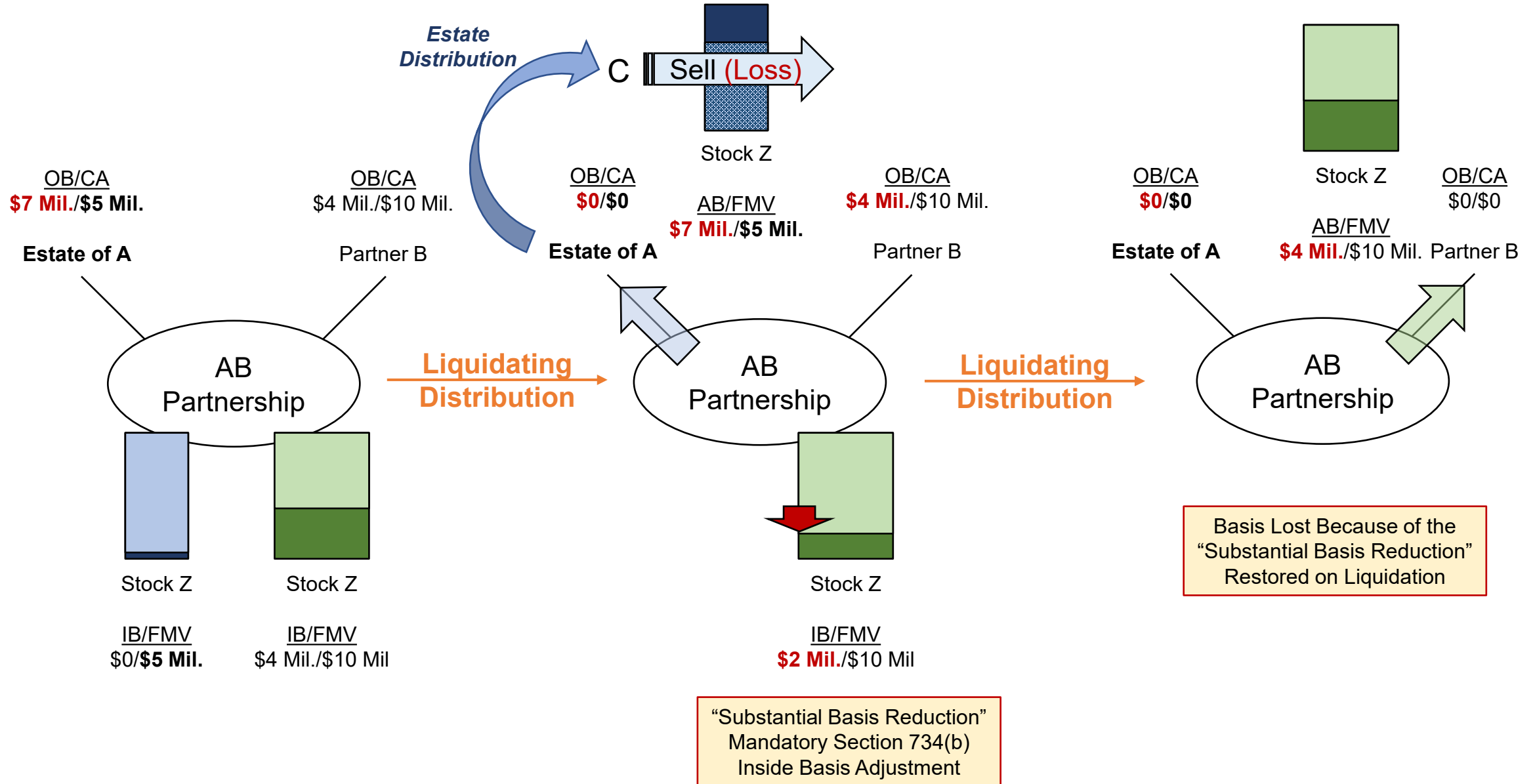
Section 743(b)
Inside Basis
Adjustment

No Section 754 Election: “Staggering Distributions”

30%
Valuation
Discount



No Section 754 Election: "Staggering" Distributions



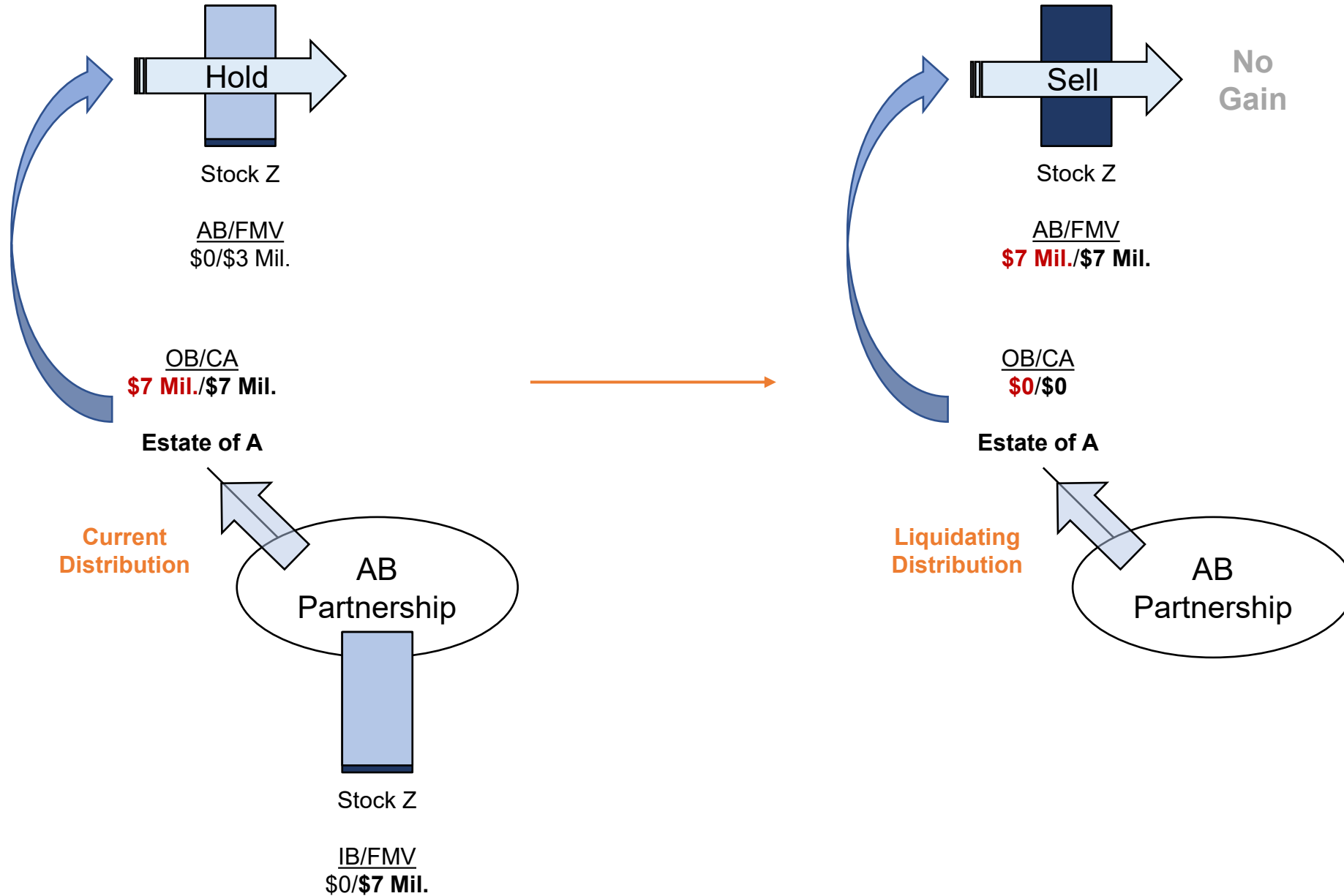
Inside Basis Adjustment v. “Staggering Distributions”

SUMMARY OF THE SECTION 743(b) INSIDE BASIS ADJUSTMENT	
Savings Due to \$5 Mil. Charitable Deduction @ 37.0% Rate	\$1,850,000
Unrecognized Gain of \$1.5 Mil. Due to Charitable Donation @ 23.8% Rate	\$357,000
\$1.5 Mil. Recognized Capital Gain Tax on \$5 Mil. Sale of Stock Z @ 23.8%	(\$357,000)
Total Net Tax Benefit	\$1,850,000
<i>After-Tax Amount Reinvested in Diversified Portfolio</i>	<i>\$4,643,000</i>
TOTAL ECONOMIC BENEFIT	\$6,493,000

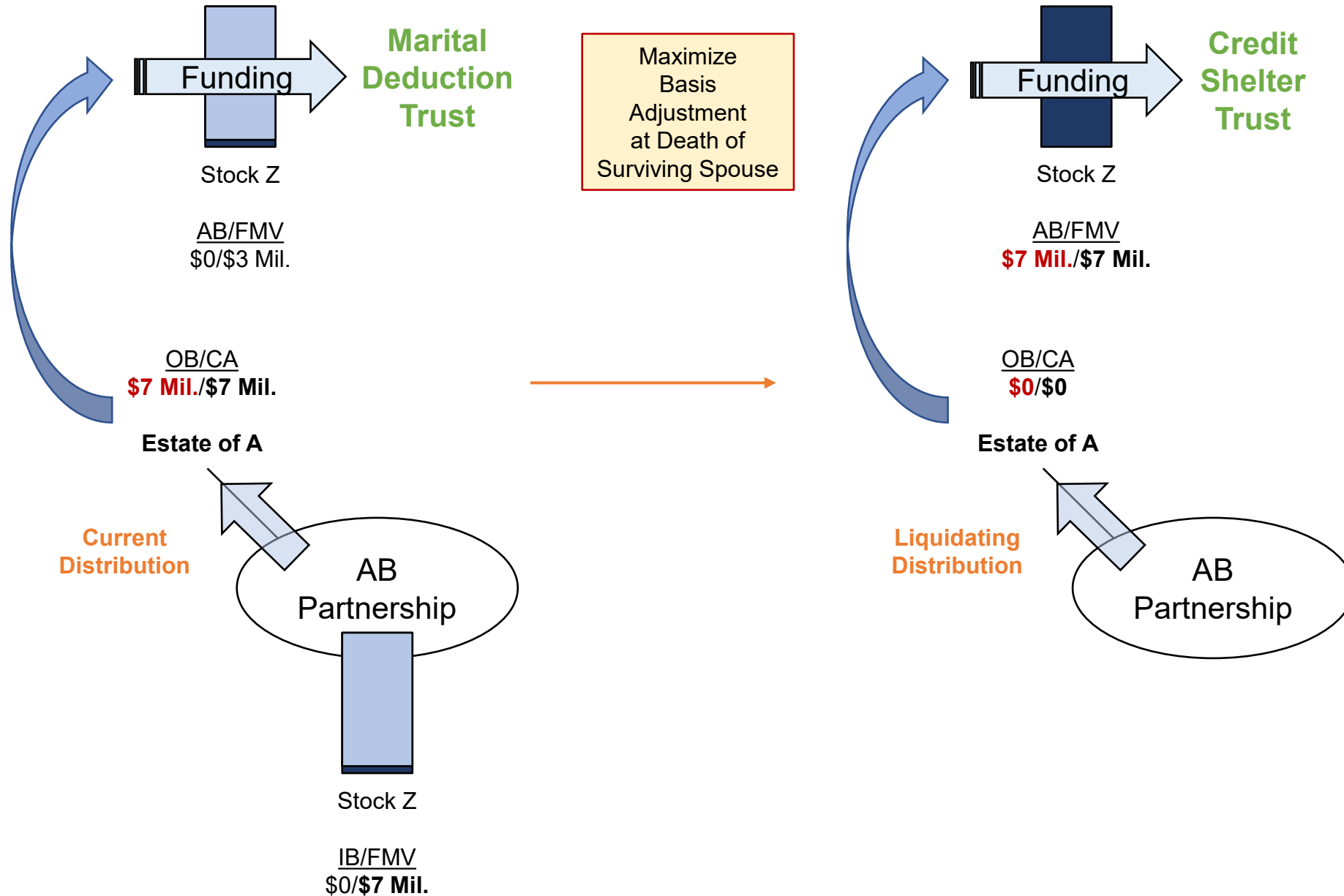
SUMMARY OF “STAGGERED DISTRIBUTIONS”	
Savings Due to \$5 Mil. Charitable Deduction @ 37.0% Rate	\$1,850,000
Unrecognized Gain of \$5 Mil. Due to Charitable Donation @ 23.8% Rate	\$1,190,000
Savings from (\$2 Mil.) Capital Loss on \$5 Mil. Sale of Stock Z @ 23.8%	\$476,000
Total Net Tax Benefit	\$3,516,000
<i>After-Tax Amount Reinvested in Diversified Portfolio</i>	<i>\$5,000,000</i>
TOTAL ECONOMIC BENEFIT	\$8,516,000

**+\$2,023,000
Economic
Benefit**

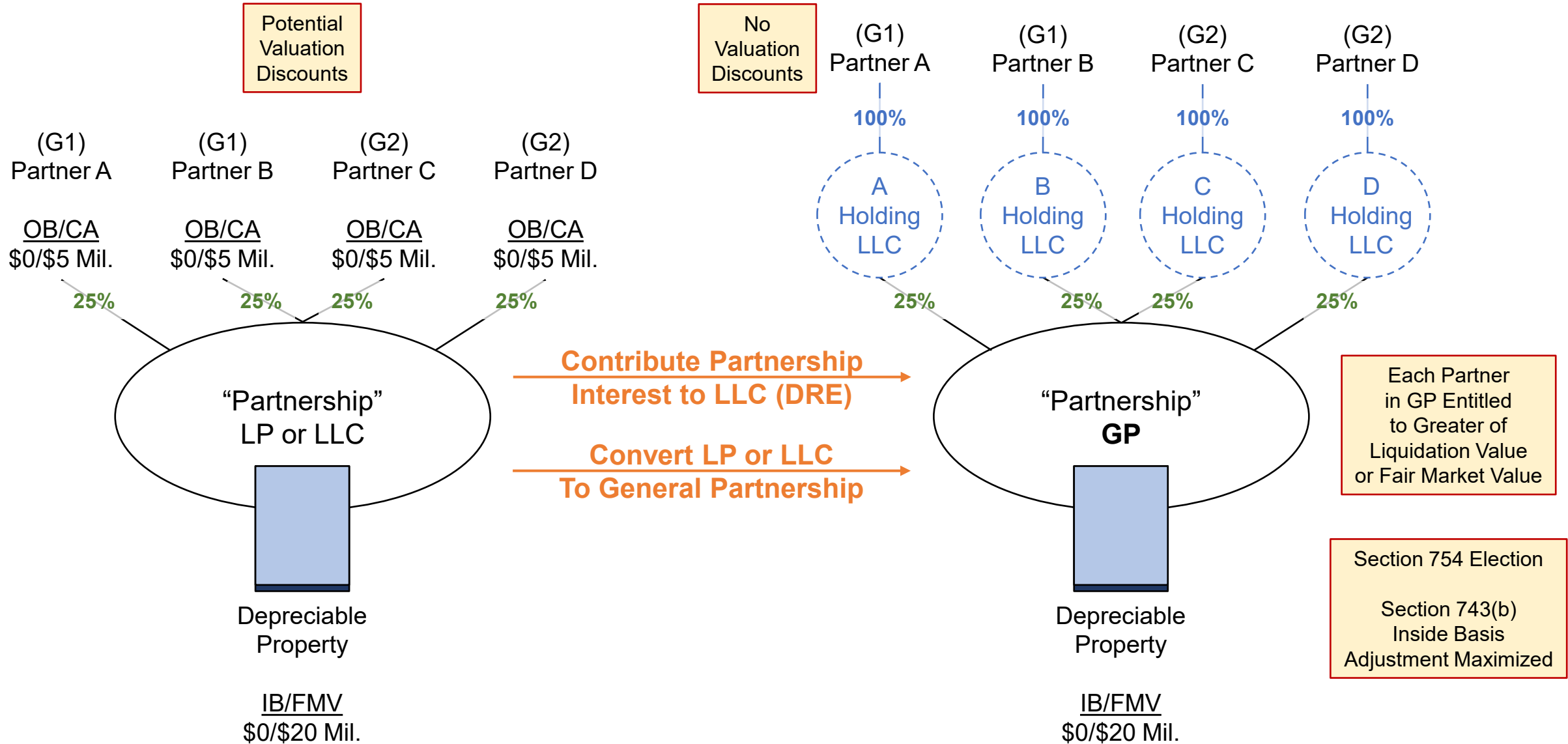
Other Applications for “Staggering Distributions”



Other Applications for “Staggering Distributions”

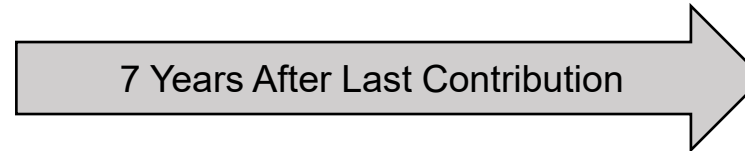
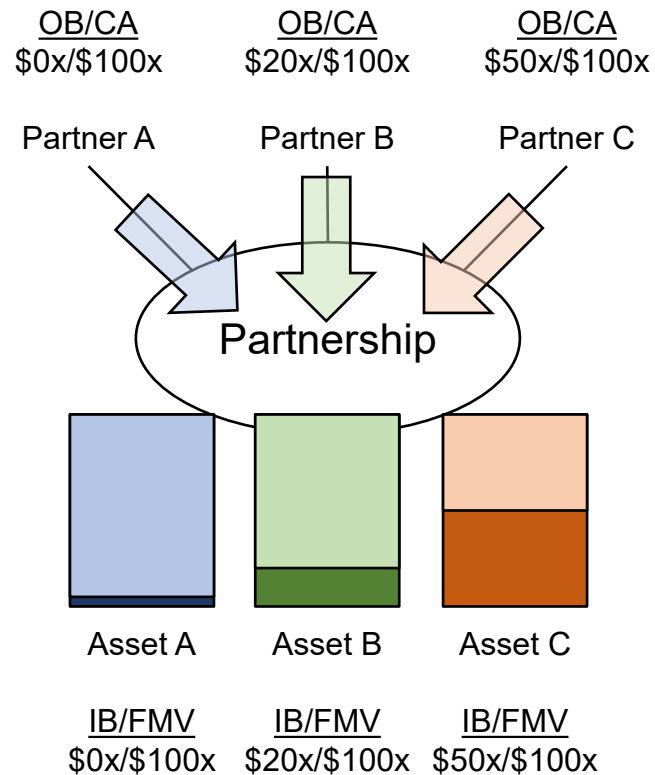


Eliminating Valuation Discounts on Pre-Existing Partnerships



TAX FREE EXCHANGES OF PROPERTY

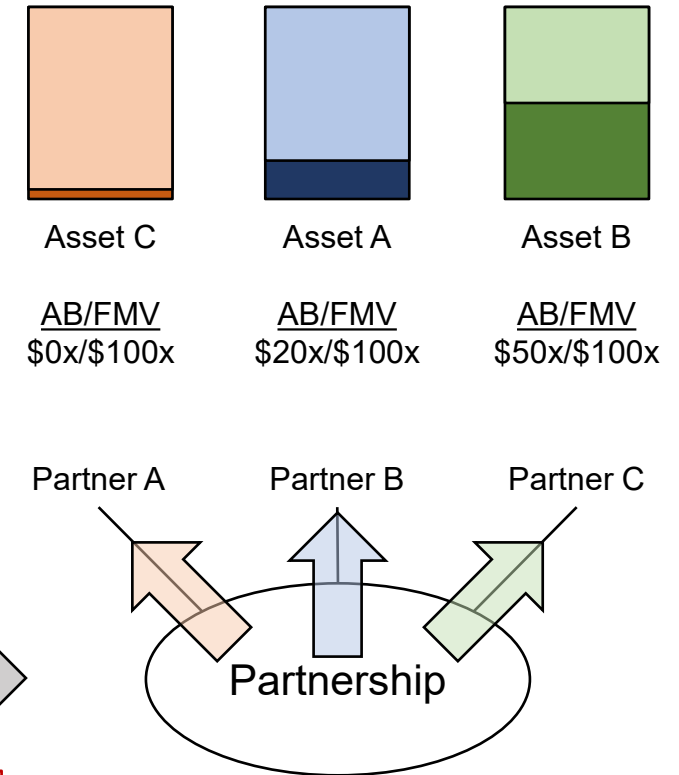
Avoiding the “Anti-Mixing Bowl” Rules



“Mixing Bowl” Transaction:

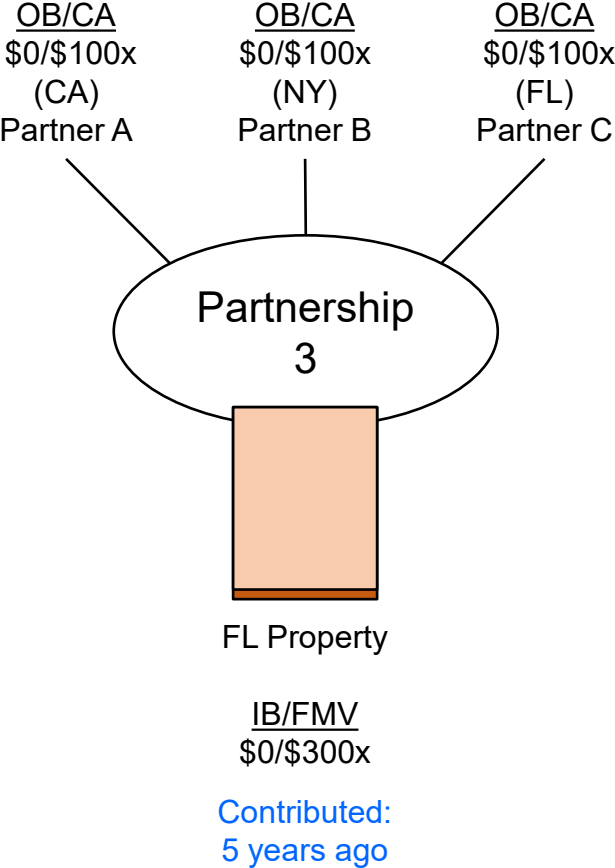
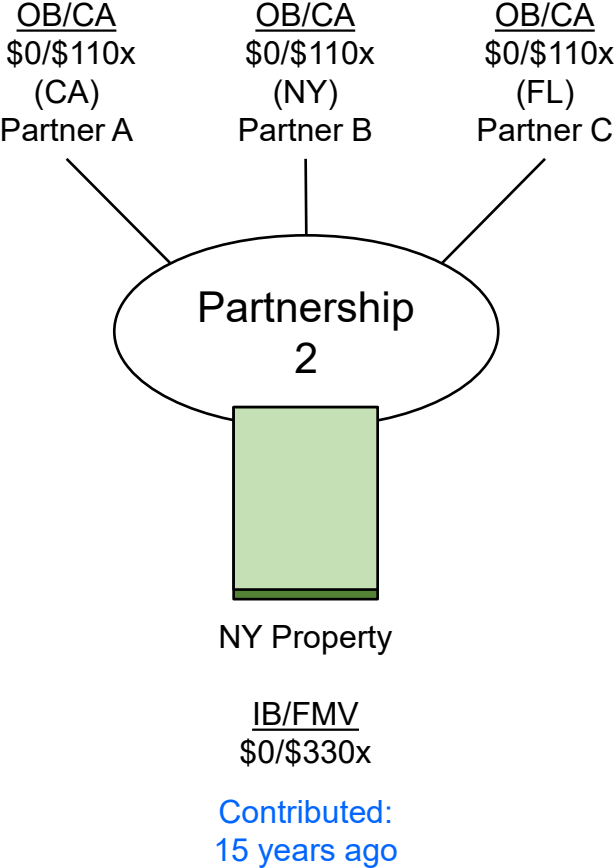
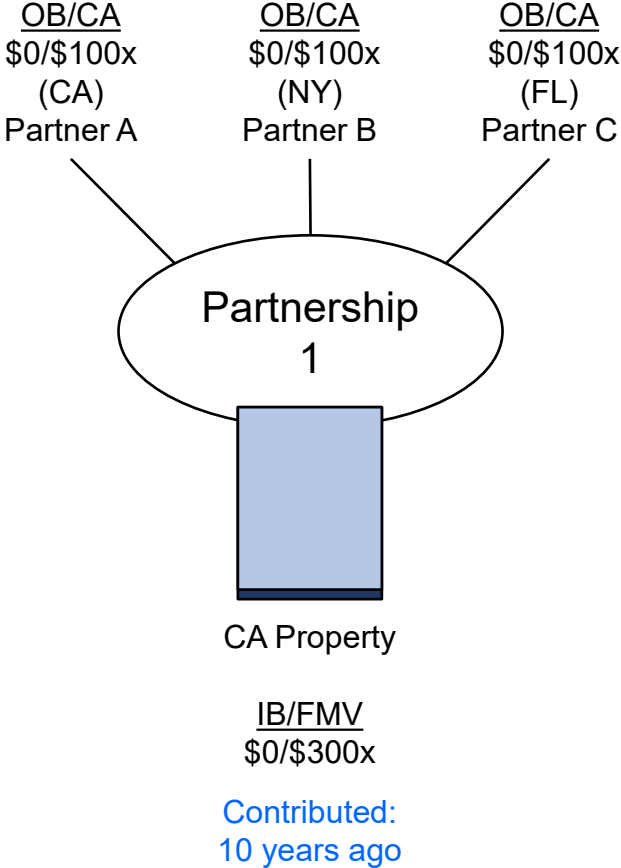
§ 704(c)(1)(B)
Contributed Property Is Distributed to Another Partner within 7 Years of Contribution

§ 737
Other Property Is Distributed to a Contributing Partner within 7 Years of the Contribution



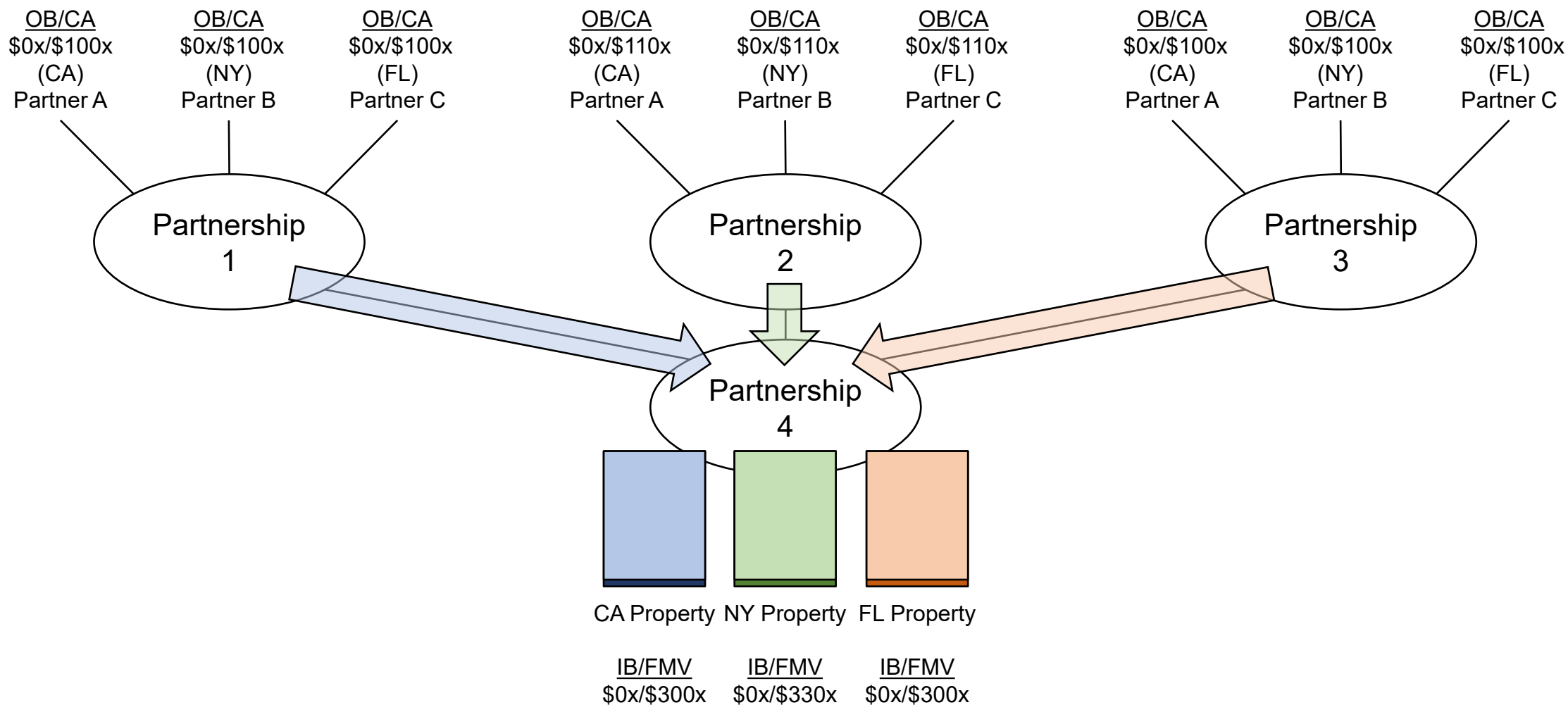
Swapping Interests in Different Properties

A wishes to own 100% of CA property
B wishes to own 100% of NY property
A wishes to own 100% of FL property

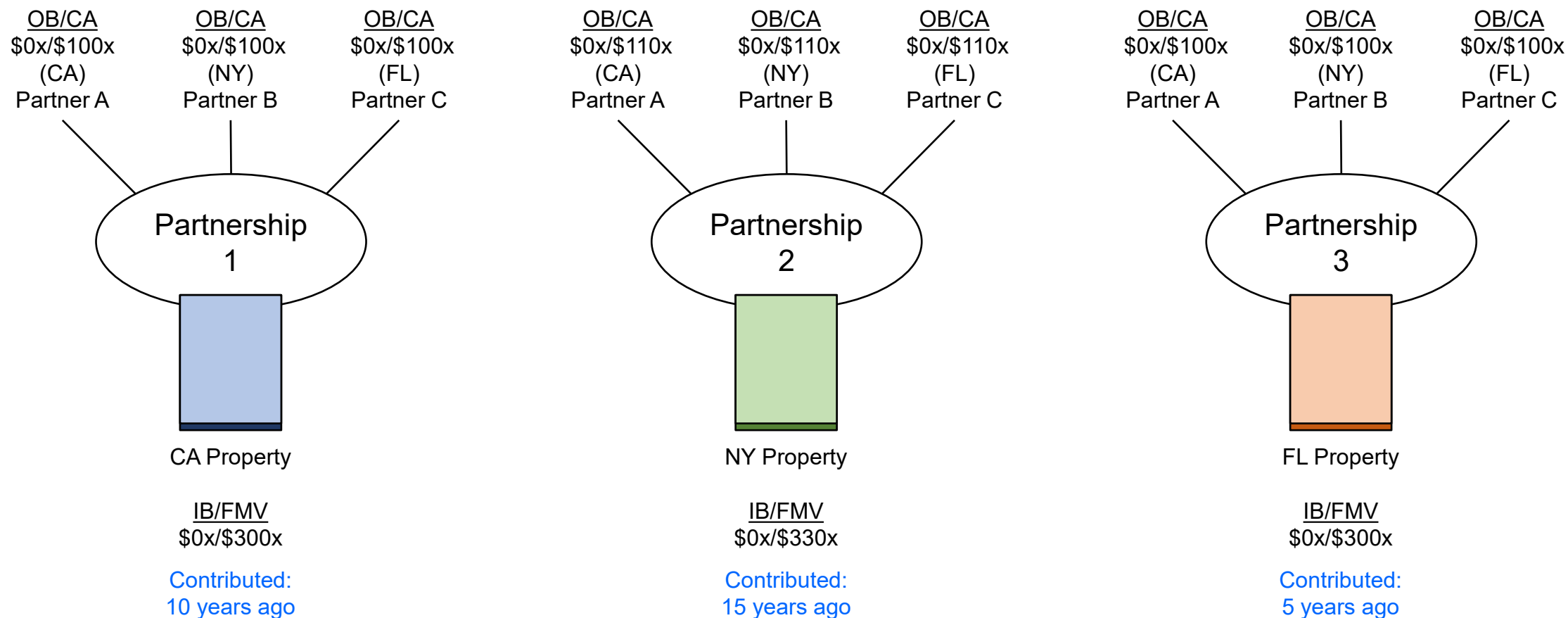


Common Mistake: Contribution to a New Partnership

Contribution to a newly-created partnership
Starts a **NEW** holding period for “mixing bowl” purposes

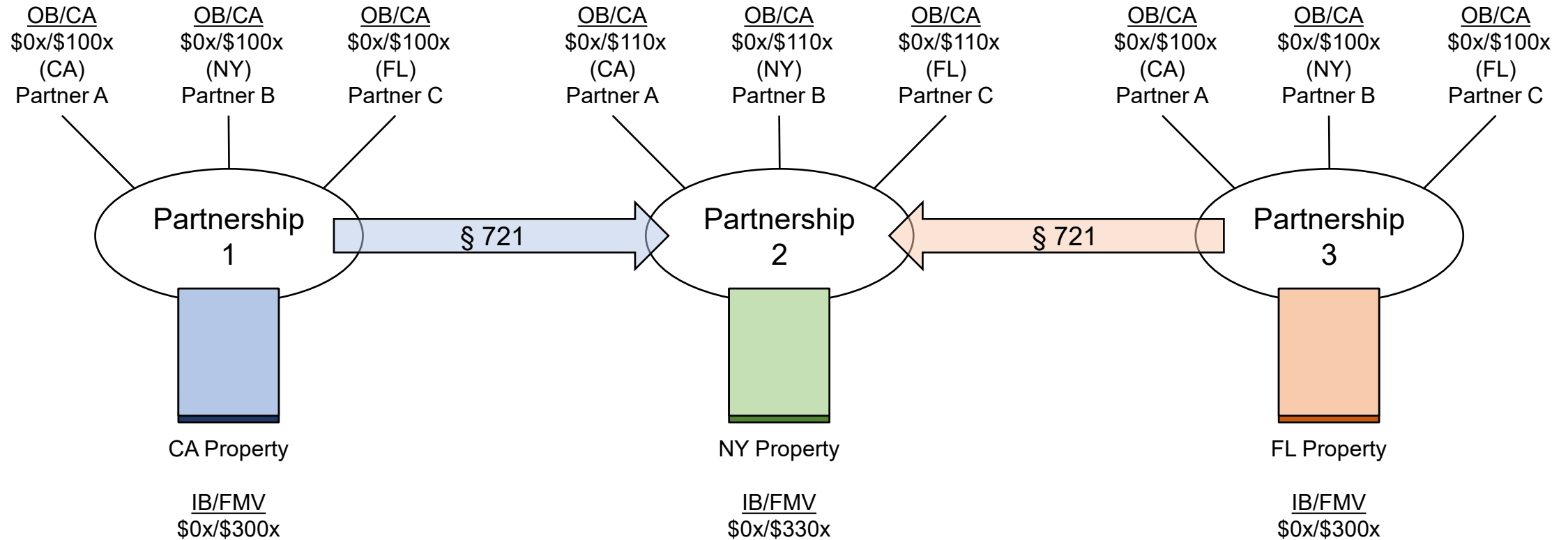


Swapping Interests in Different Properties

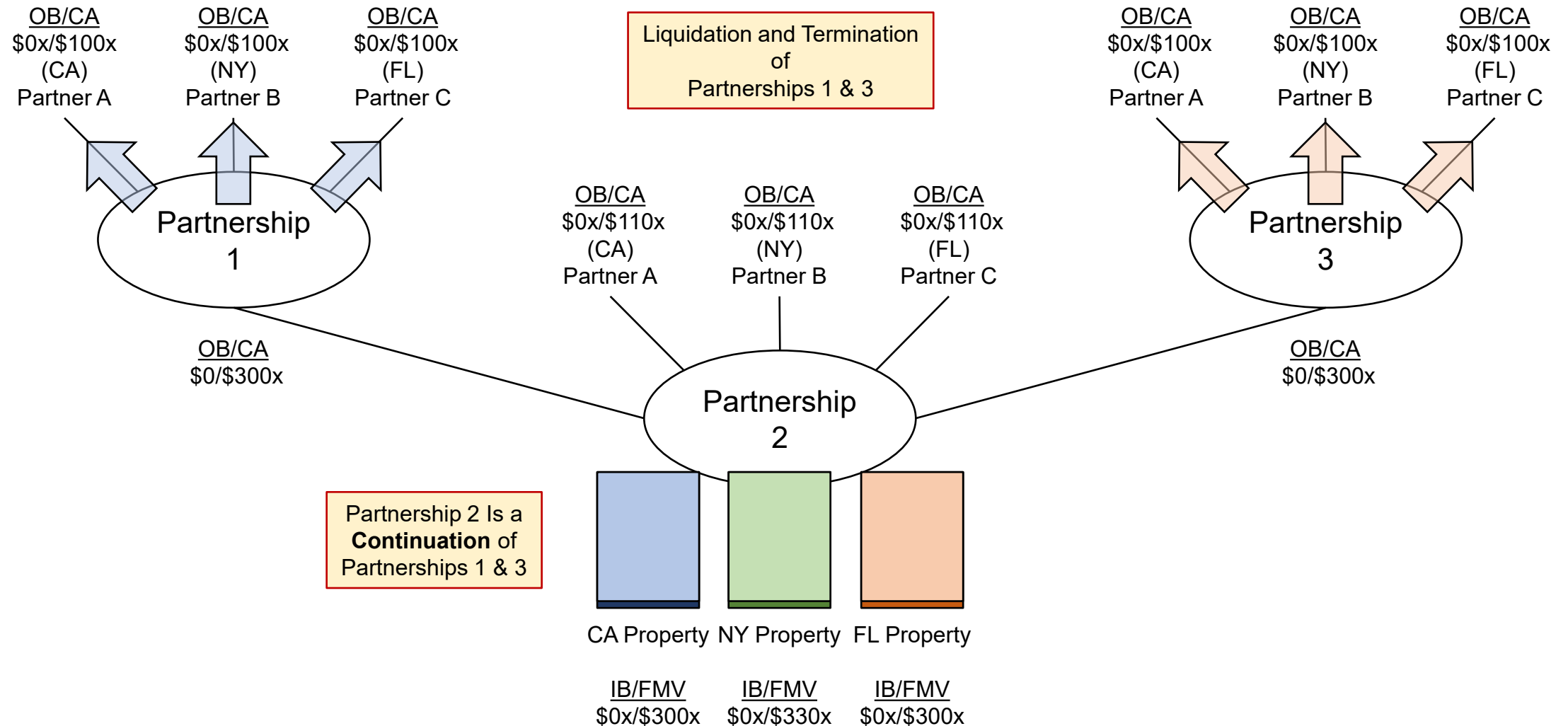


“Assets-Over” Merger Into an Existing Partnership

Partnerships 1 & 3 Contribute
All Assets and Liabilities to
Partnership 2 under Section 721 in
Exchange for Interests in Partnership 2



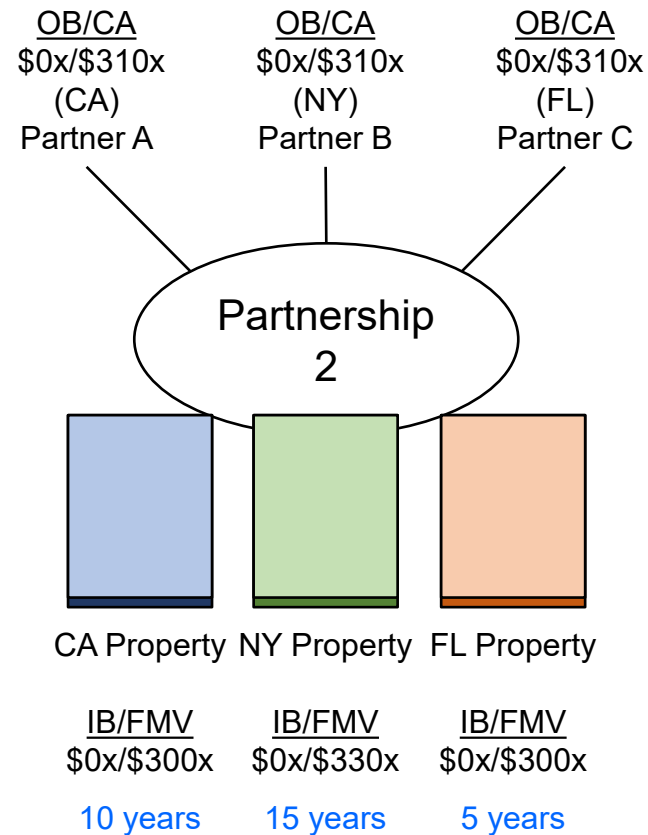
“Assets-Over” Merger Into an Existing Partnership



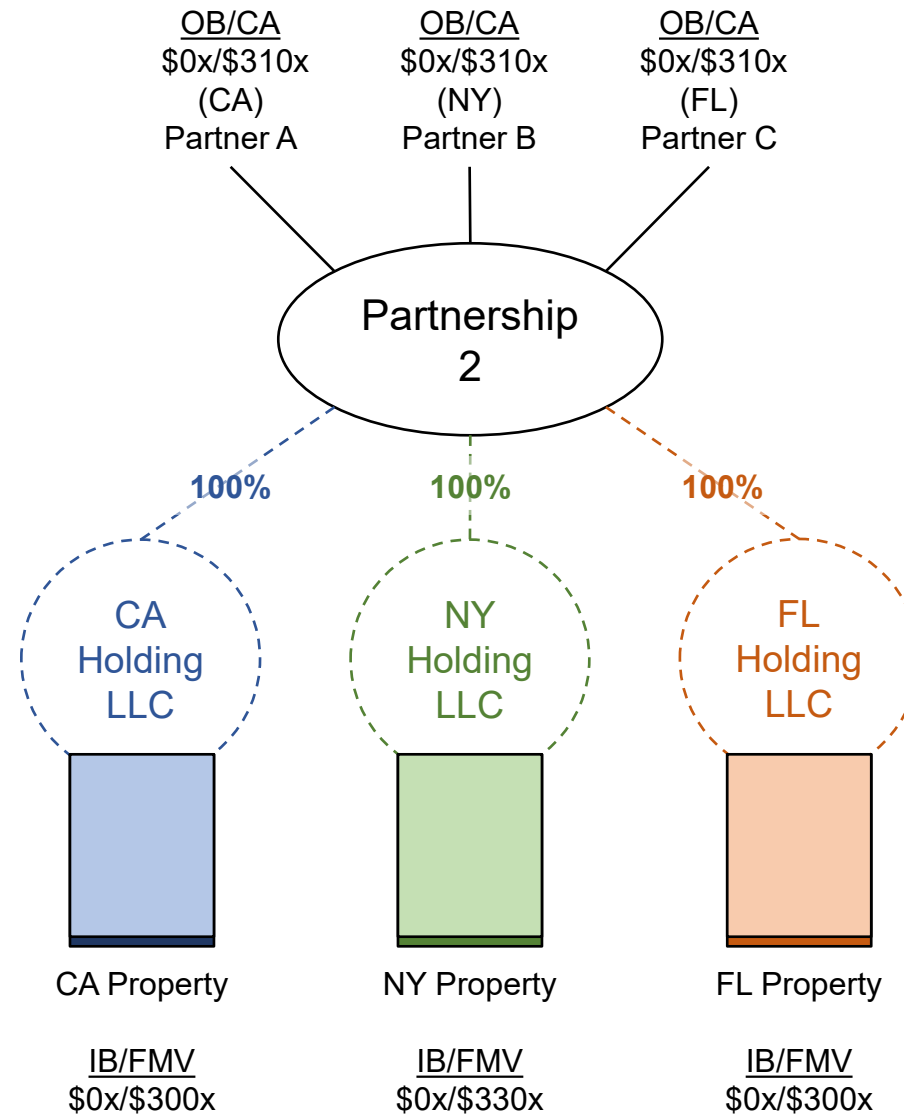
“Assets-Over” Merger Into an Existing Partnership

Transfers of Partnership Interest by Contributing Partner (Parents):

Transferees (A, B & C) stand in the shoes of the contributing partner for “mixing bowl” purposes



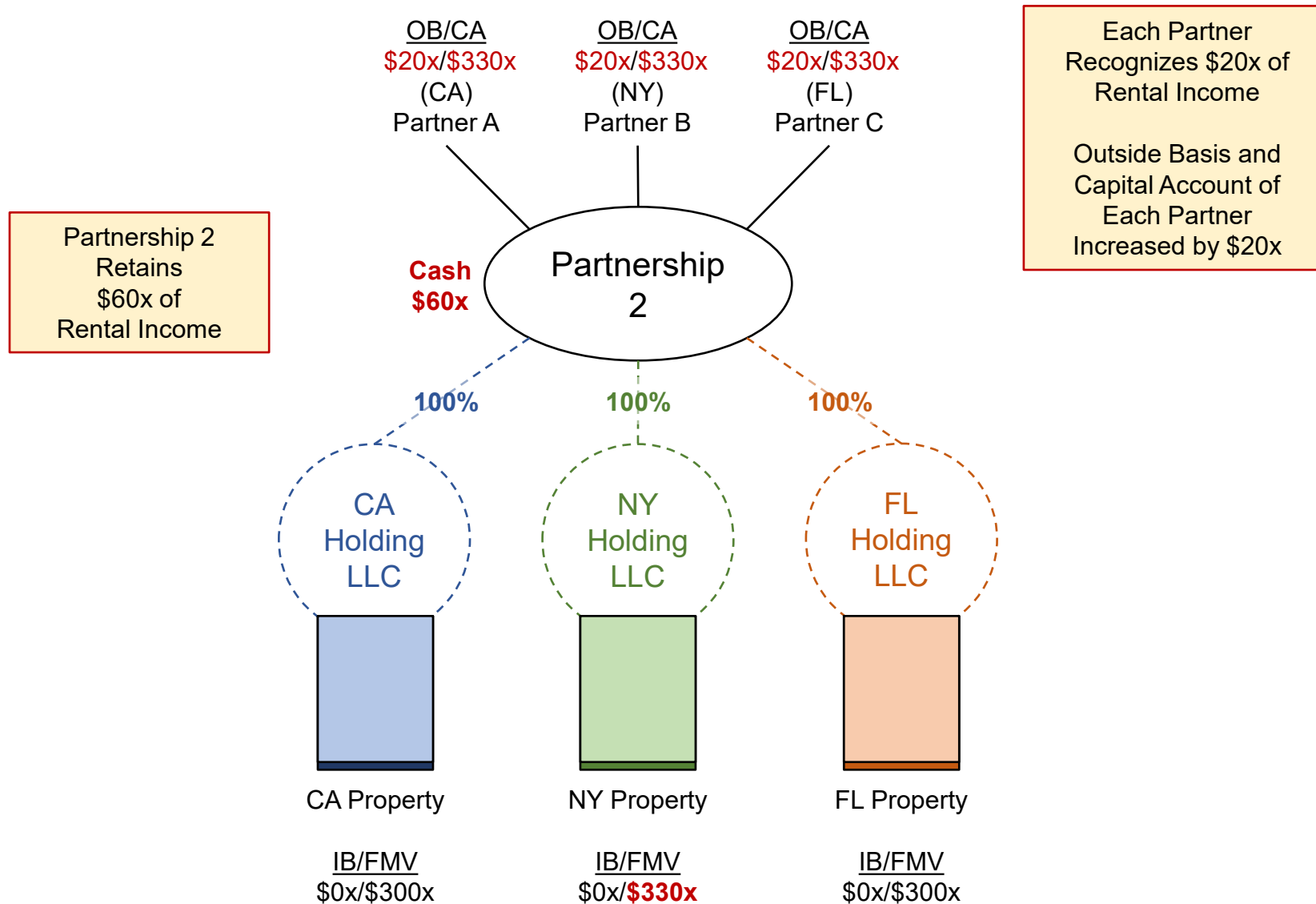
Holding Companies: Disregarded Entities



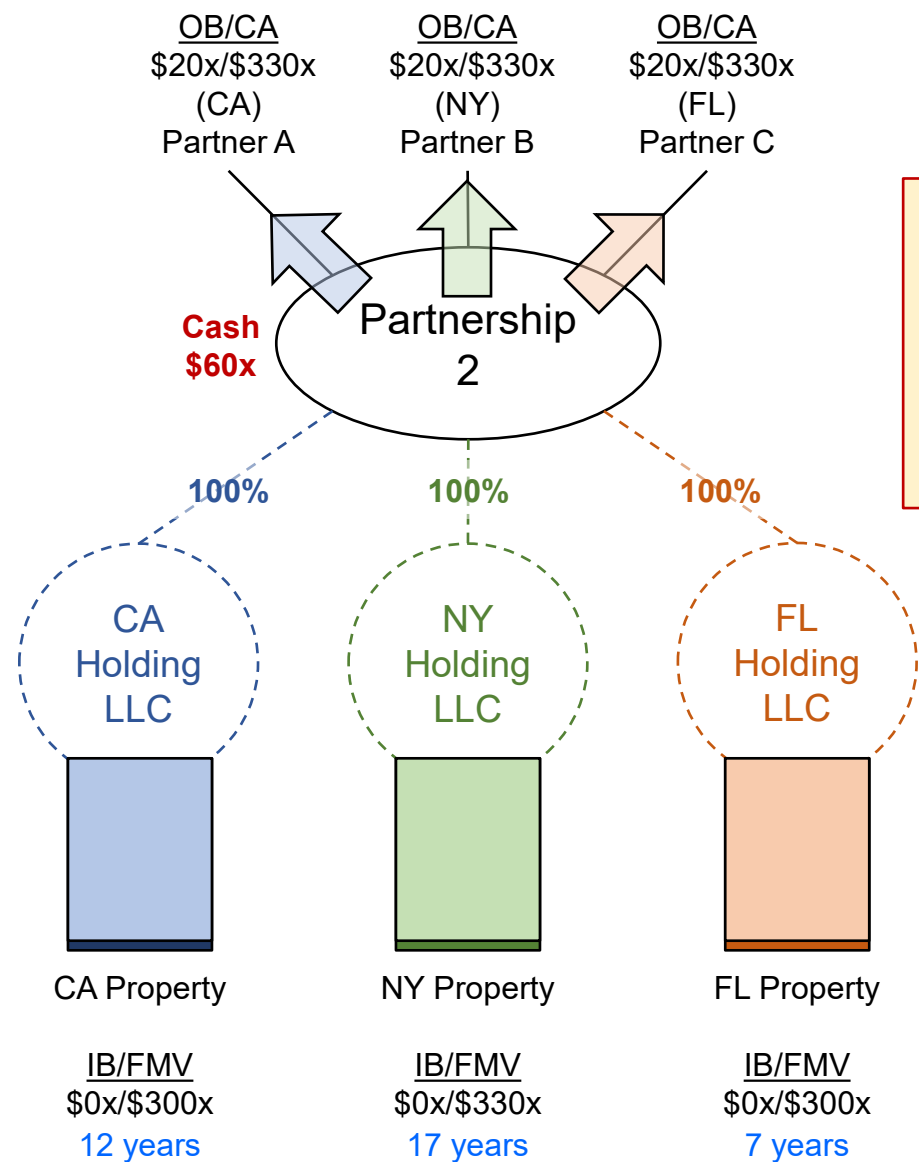
Disregarded LLCs Provide:

Limited Liability
&
Will Facilitate Transfers

Planning for Differences in Value



Separating the Property



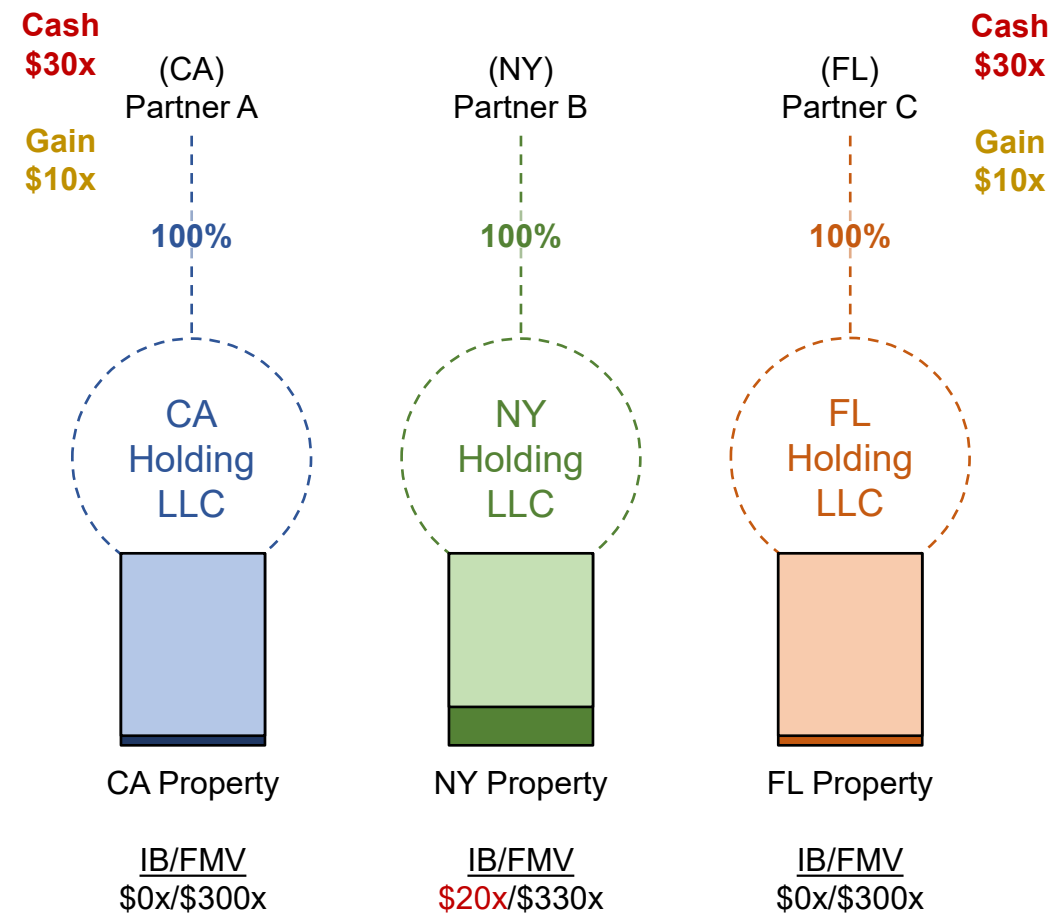
2 Years after the Merger:

Liquidate the Partnership.

Distribute the Holding Companies to A, B & C.

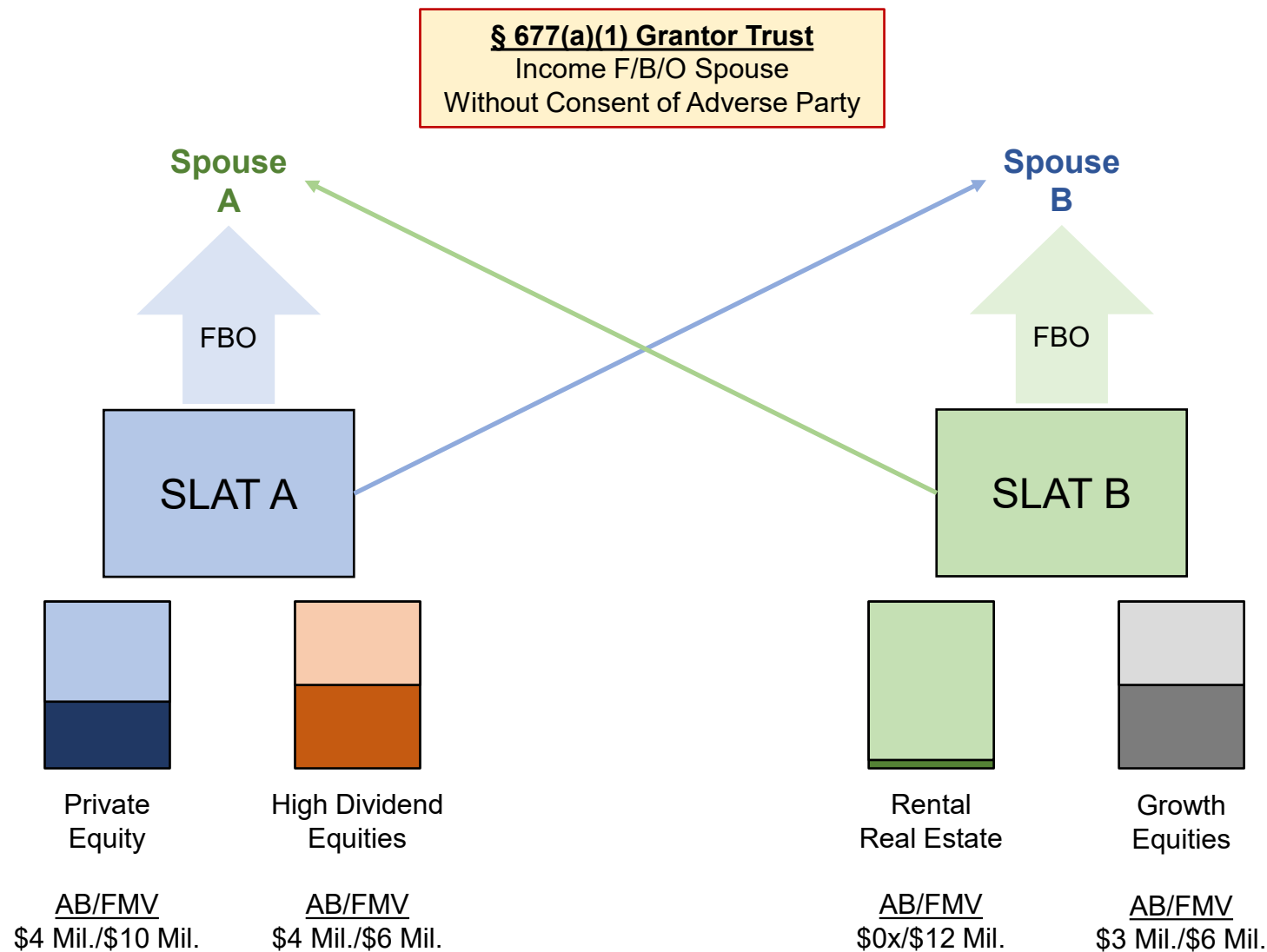
Distribute \$60x Cash Equally to Partners A and C.

Separation of the Properties

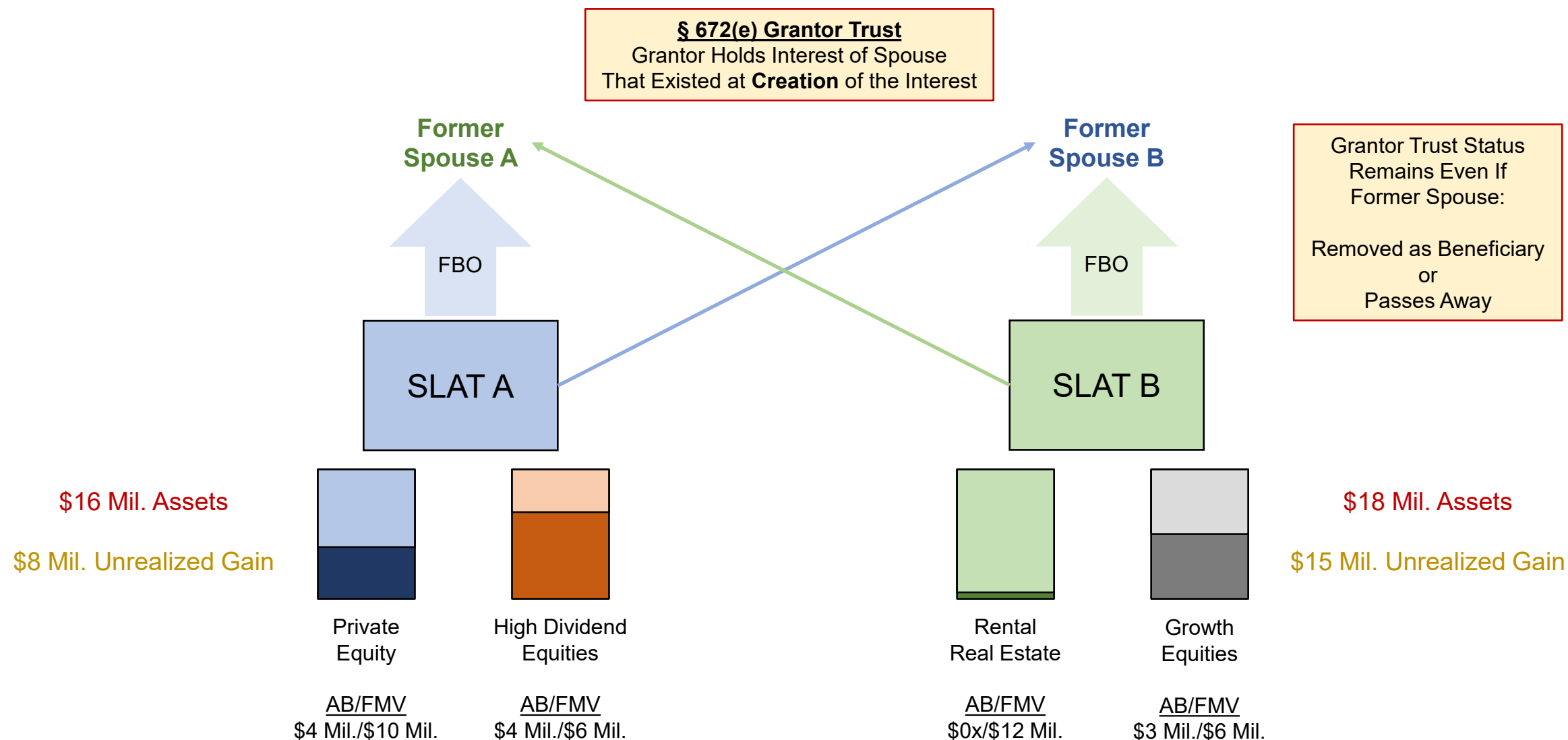


POST-DIVORCE SLAT PARTNERSHIP

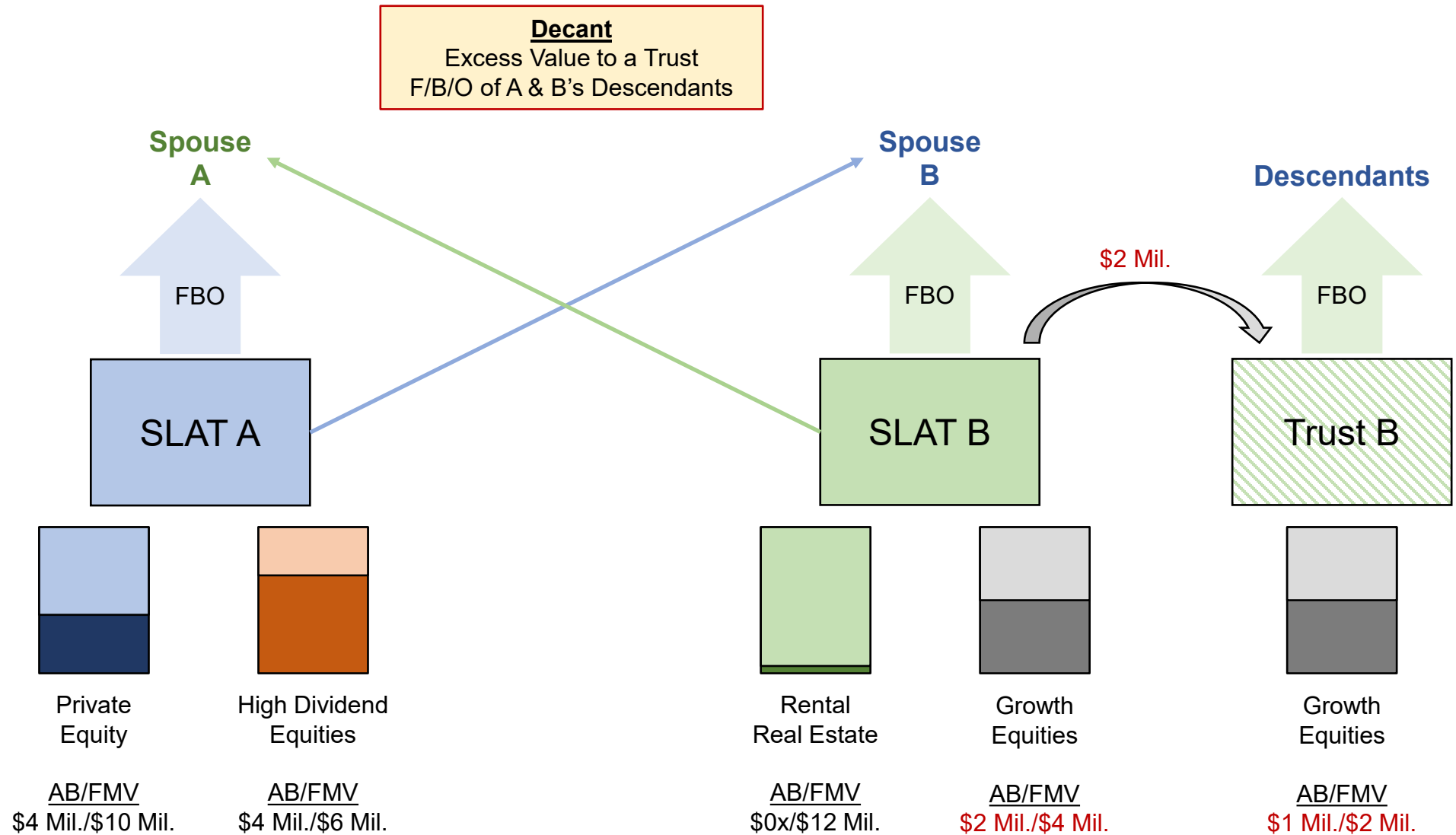
Spousal Lifetime Access Trusts Are Grantor Trusts



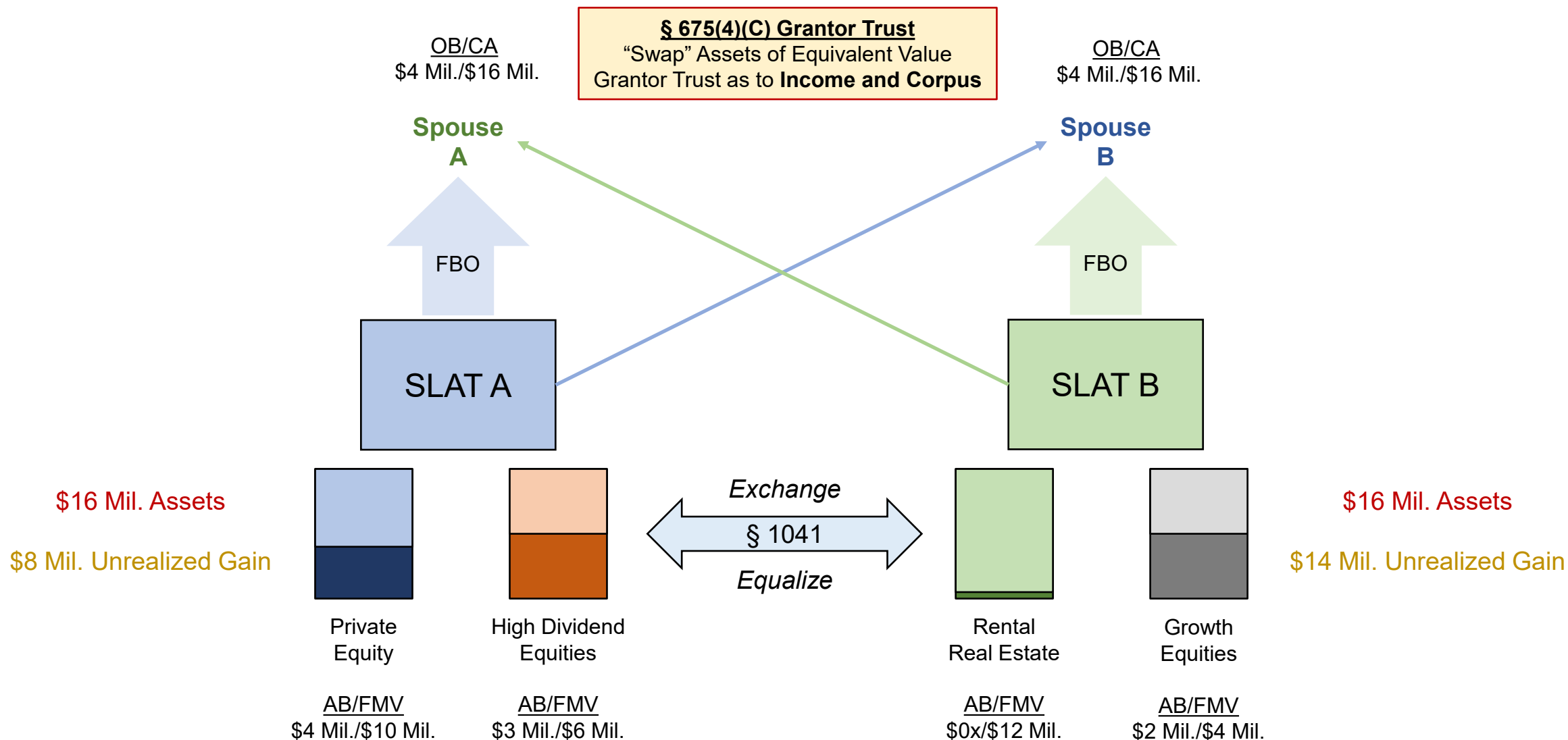
Spousal Lifetime Access Trusts Are Grantor Trusts After Divorce



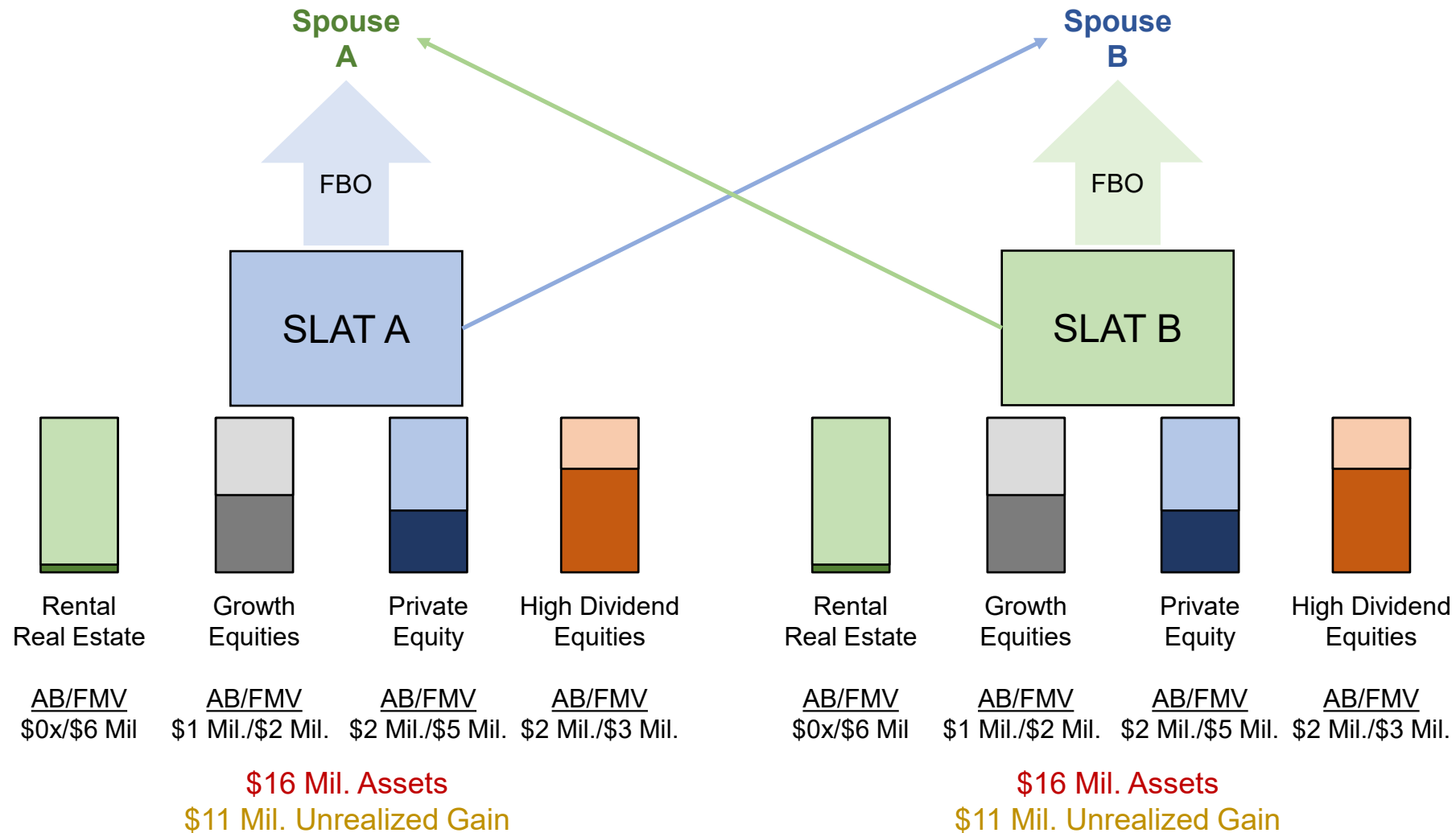
Equalize the Value of the Assets



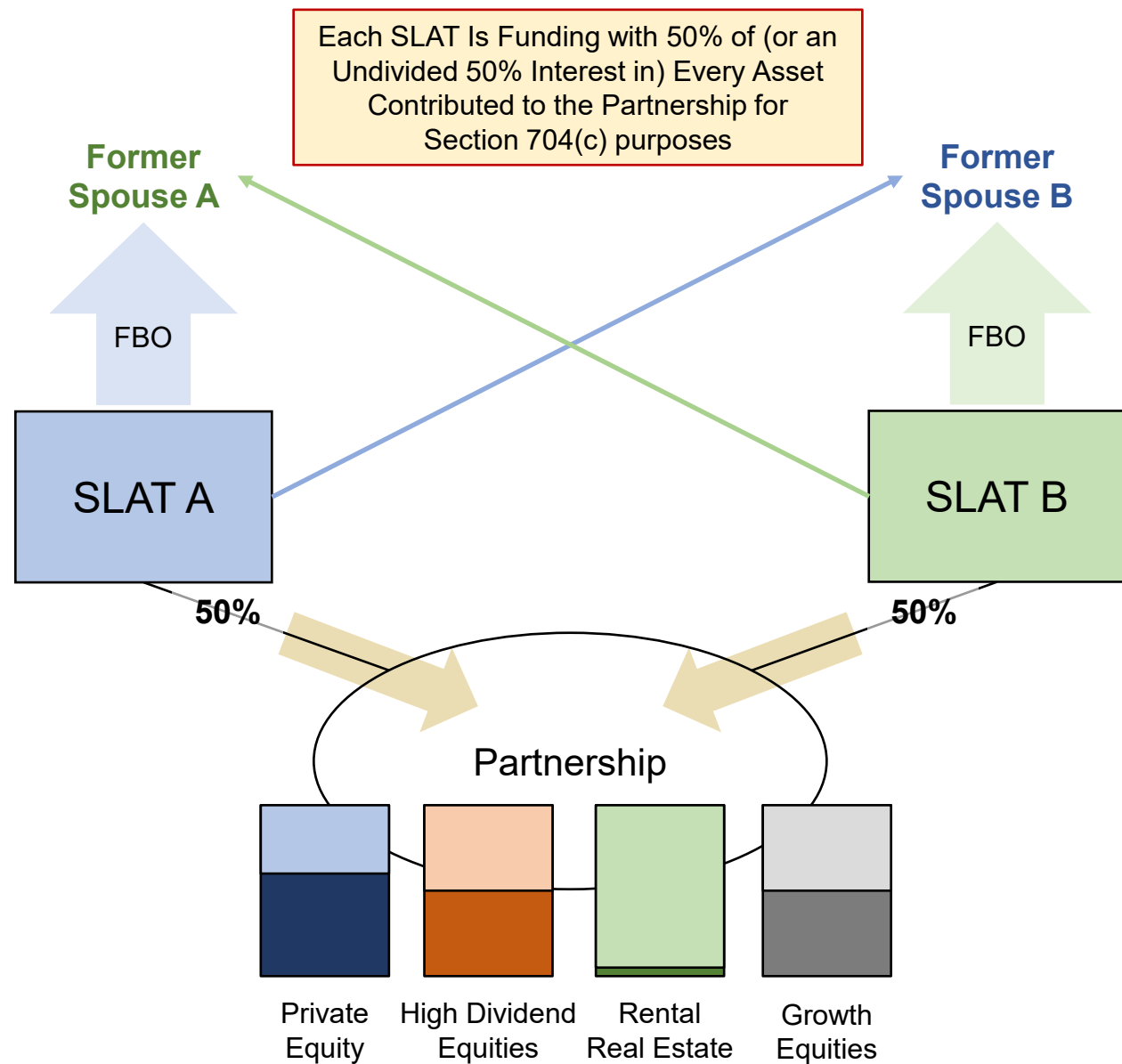
Exchange and Equalize Assets



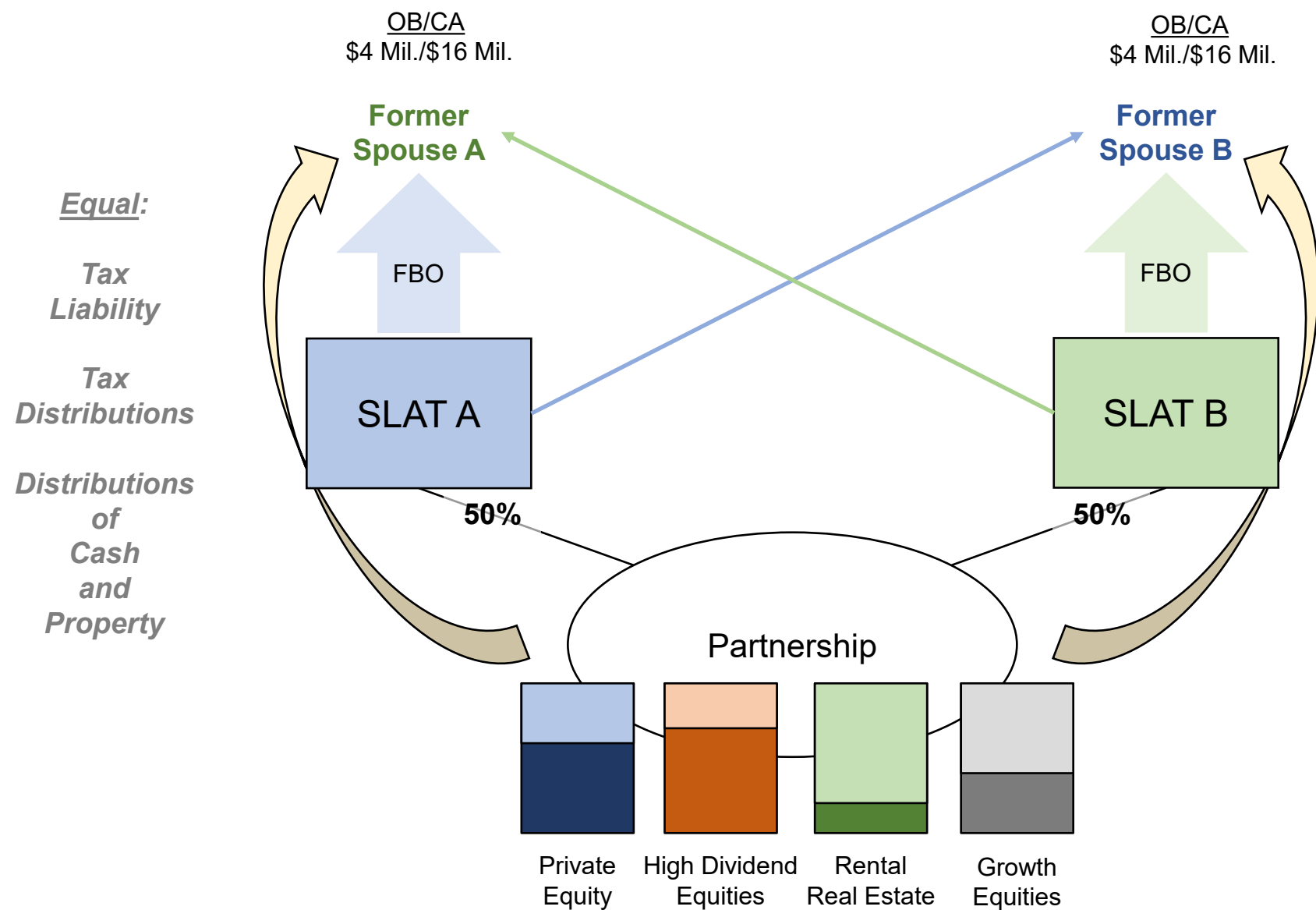
Exchange and Equalize Assets



Contribute Assets to a Partnership



Equal Allocations and Distributions



Additional Benefits:

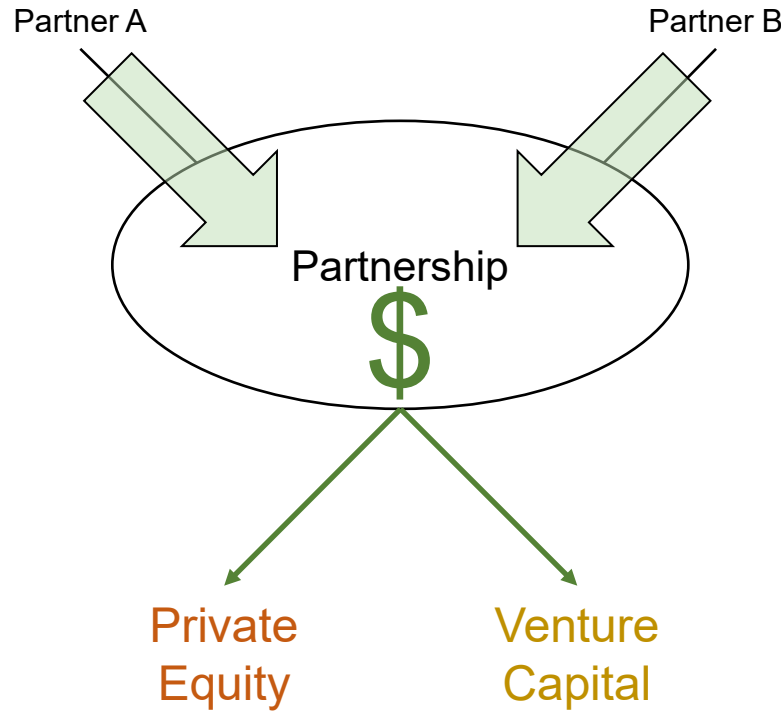
One or Both Former Spouses
Can Manage Assets and
Control Income Tax
Consequences

Ensures Access to an Equal
Amount of Assets

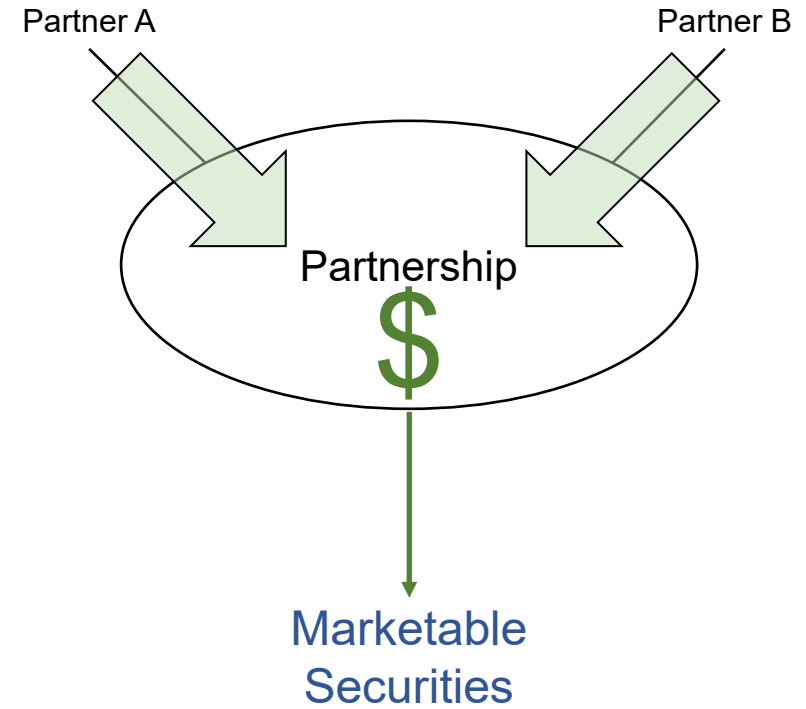
Property Can Be Distributed to
Each Former Spouse with No
“Mixing Bowl” Problems

MARKETABLE SECURITIES
PRIVATE EQUITY
VENTURE CAPITAL

Fund All Investments with Cash Through a Partnership



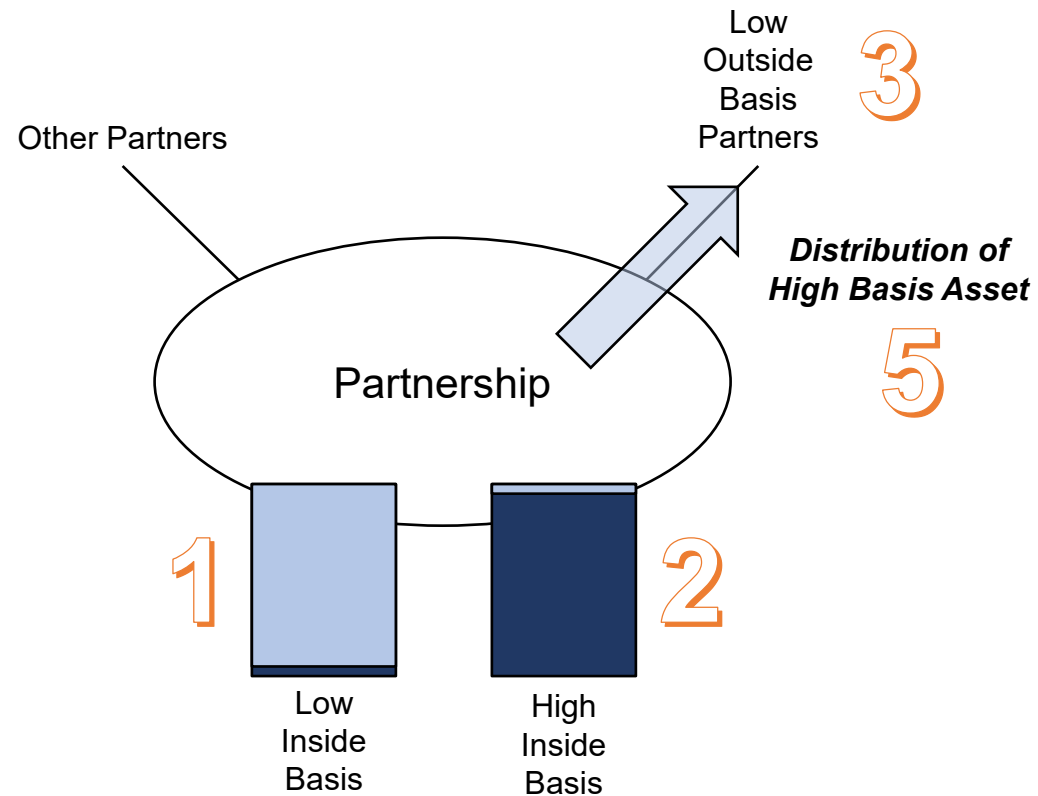
No Contributions of Property
No Section 704(c) Property
No "Mixing Bowl" Issues
No 7-Year Holding Period



§ 731(c)(3)(C)
Investment Partnership

Exception to Distributions of
Marketable Securities Treated as
Distributions of Cash

Elements of Basis Shifting



4

Partnership Property:

Purchased by the partnership

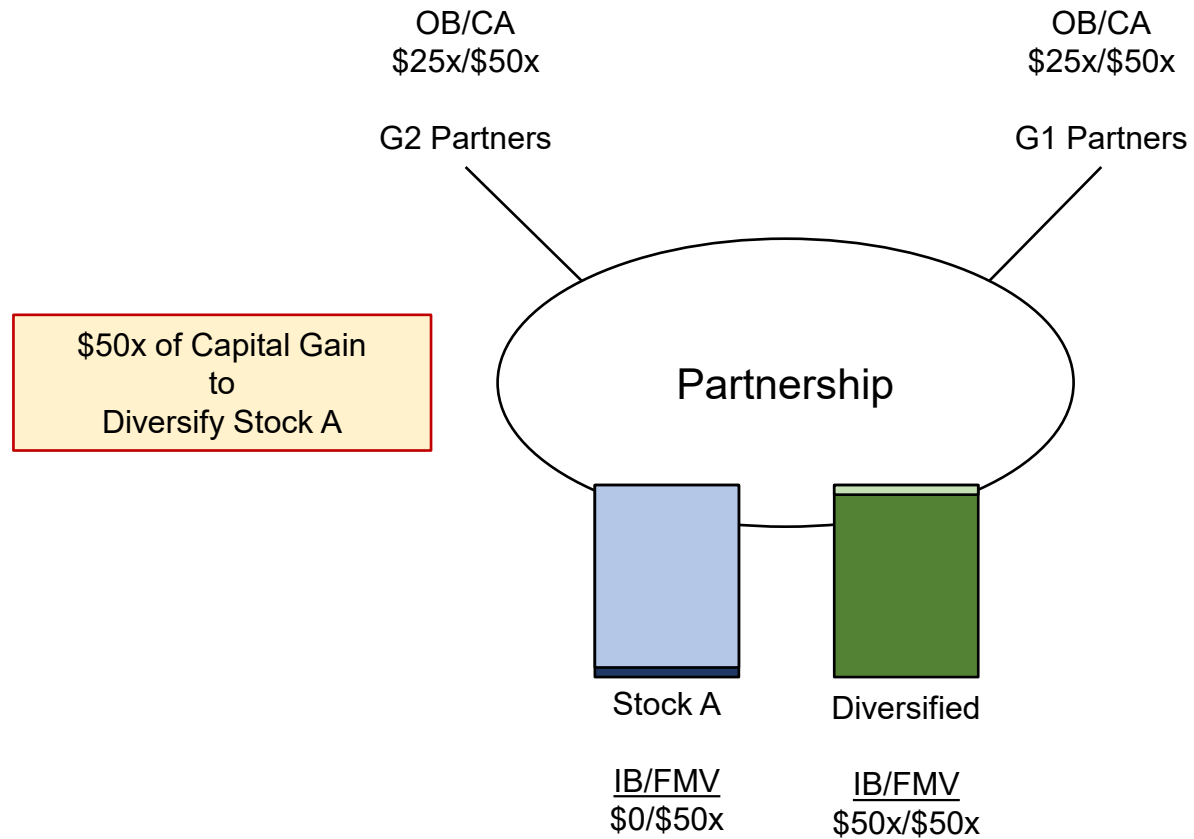
or

Contributed more than 7 years ago

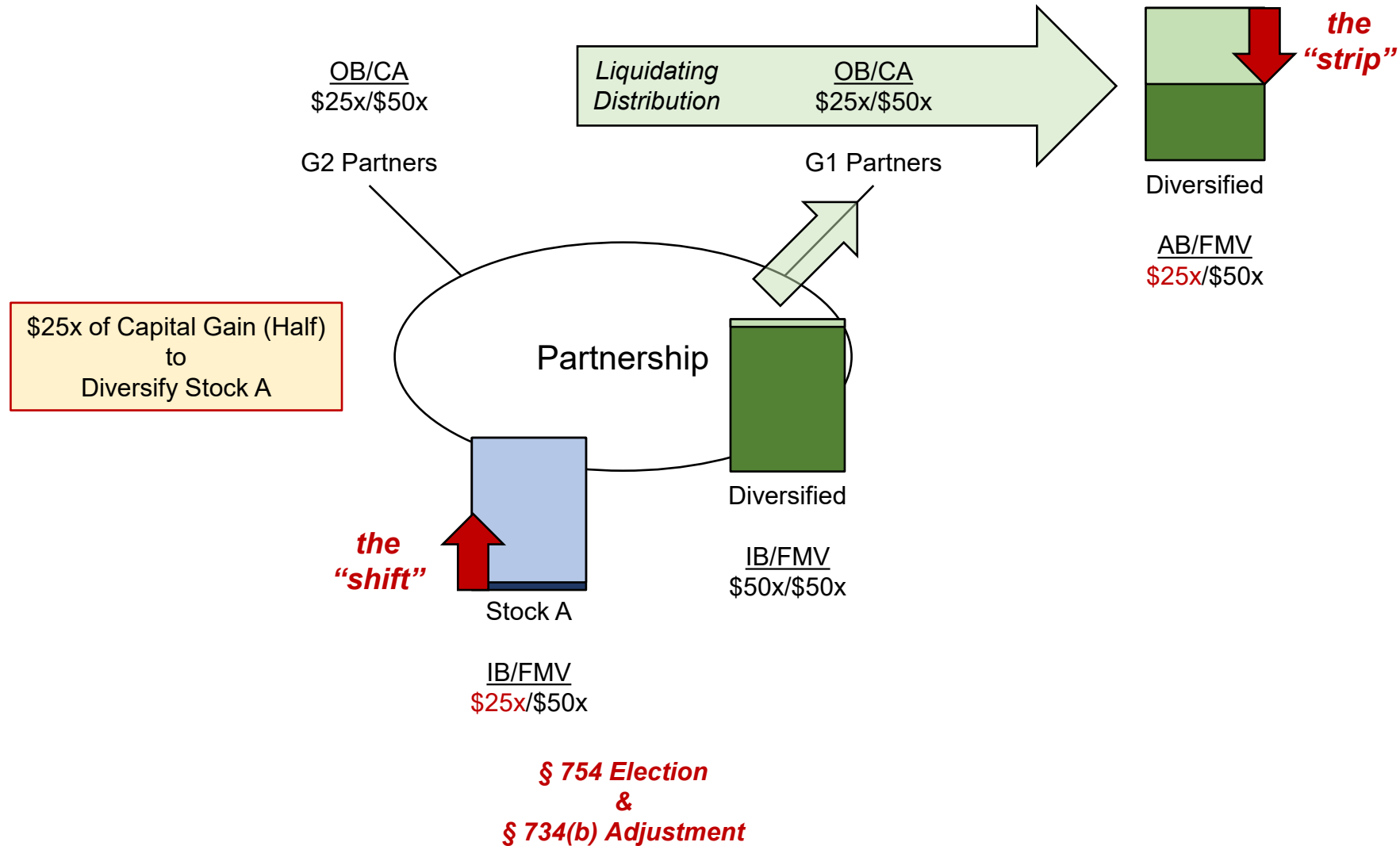
Section 754
Election

6

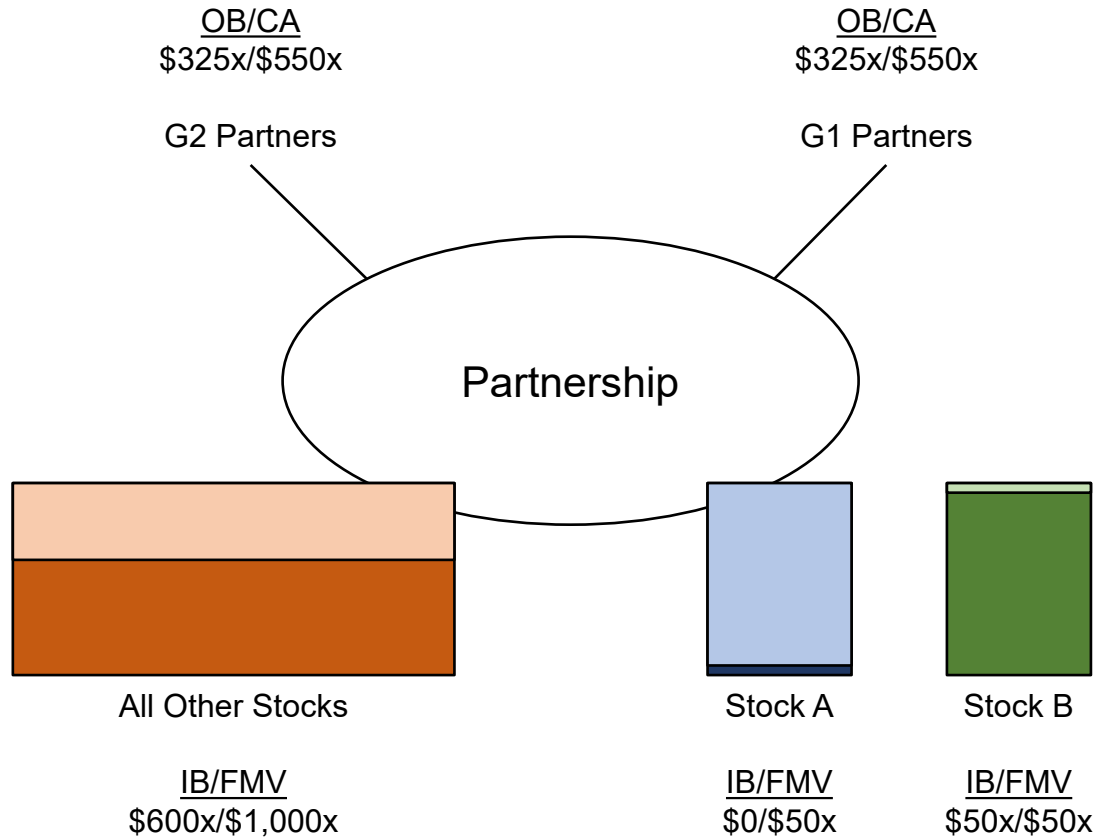
Common Simple Basis Shift Example



Common Simple Basis Shift Example



How to Be Surgical with Basis Shifting...



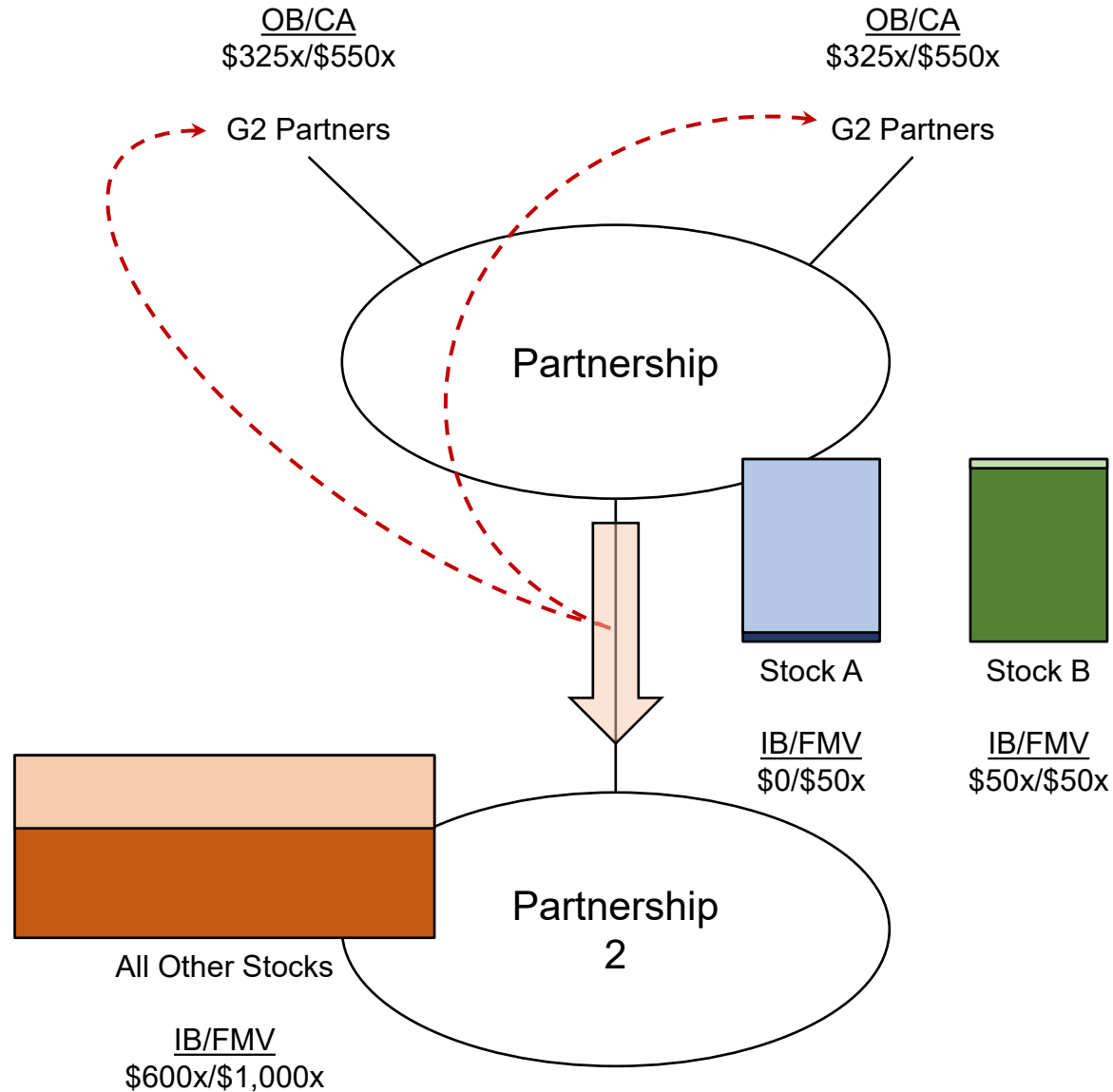
Generally, other assets in the partnership:

(i) Will Prevent a Basis “Strip”

(ii) Will Not Allow for an Efficient Basis “Shift”

(Inside Basis Adjustment under Section 734(b) Must Be Allocated Across All of the Partnership Assets)

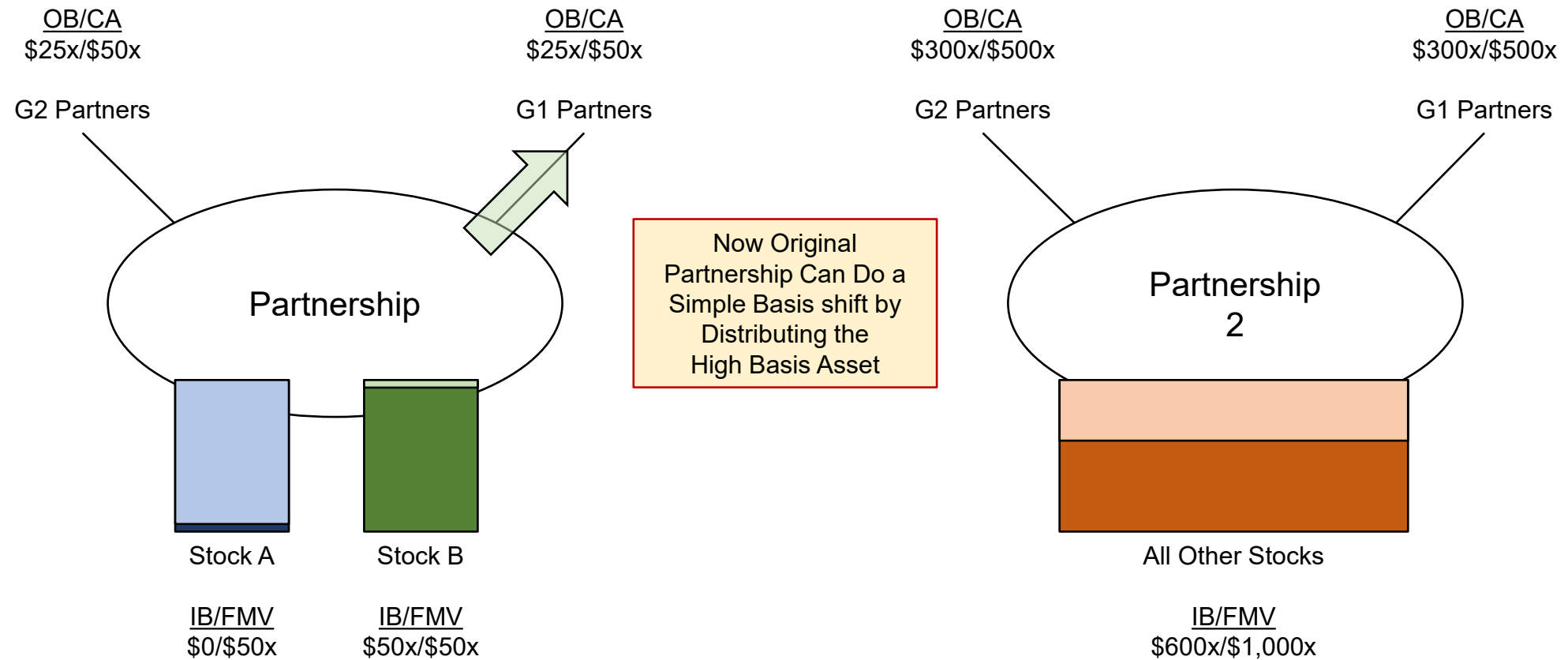
How to Be Surgical with Basis Shifting: Partnership Divisions



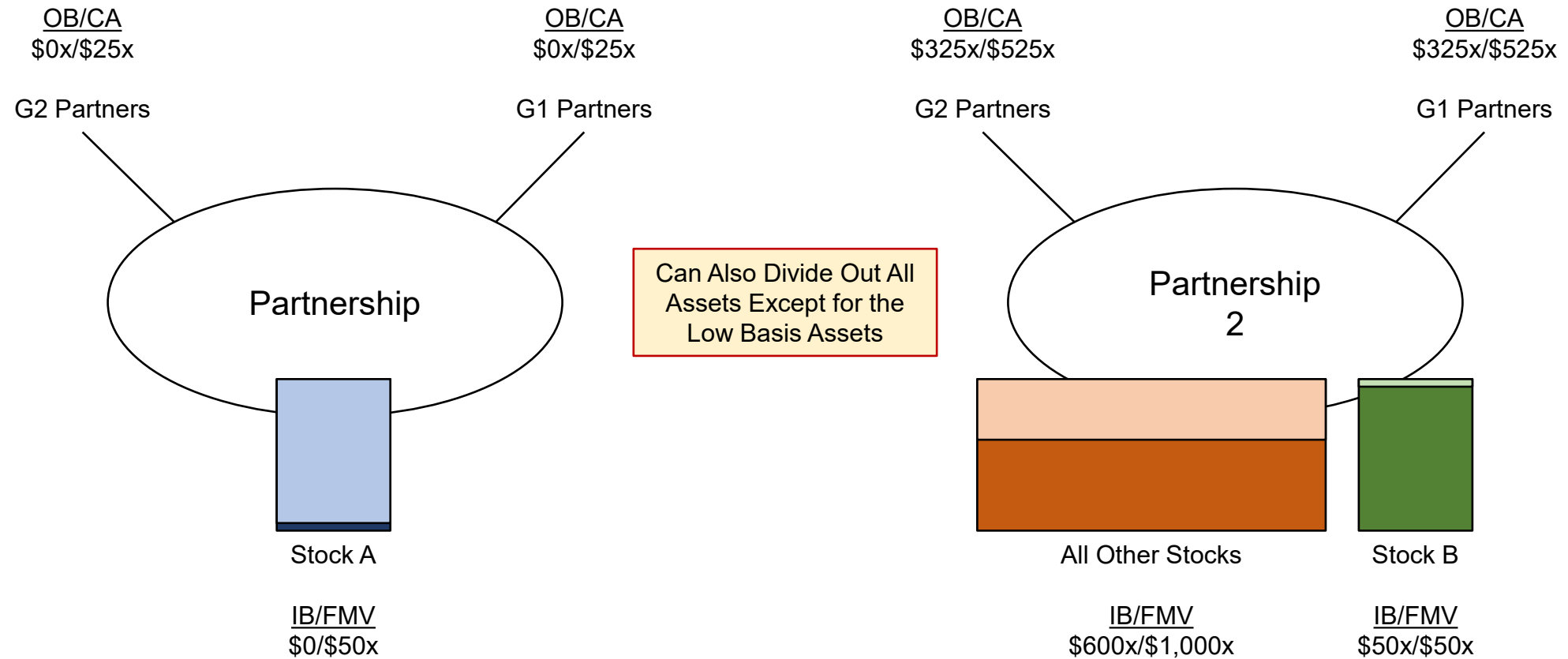
Pro Rata "Assets-Over" Division (Vertical Slice)

- (i) Contribution of "All Other Stocks" to Newly-Created Partnership/Disregarded Entity
- (ii) Distribution of Interests in the New Entity to the Partners of the Old Partnership

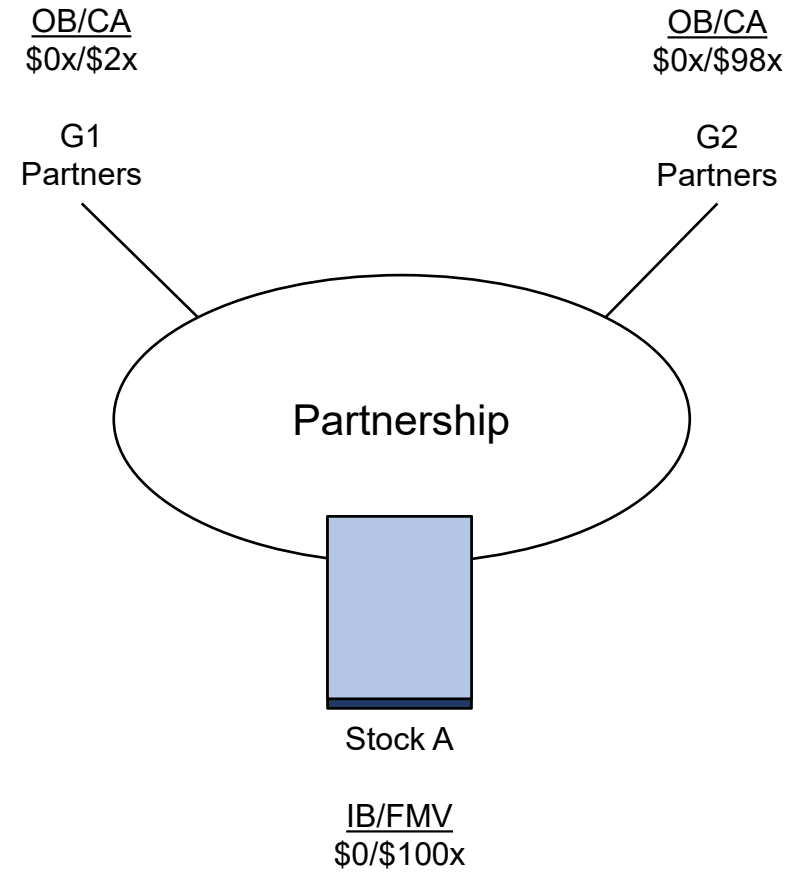
How to Be Surgical with Basis Shifting: Partnership Divisions



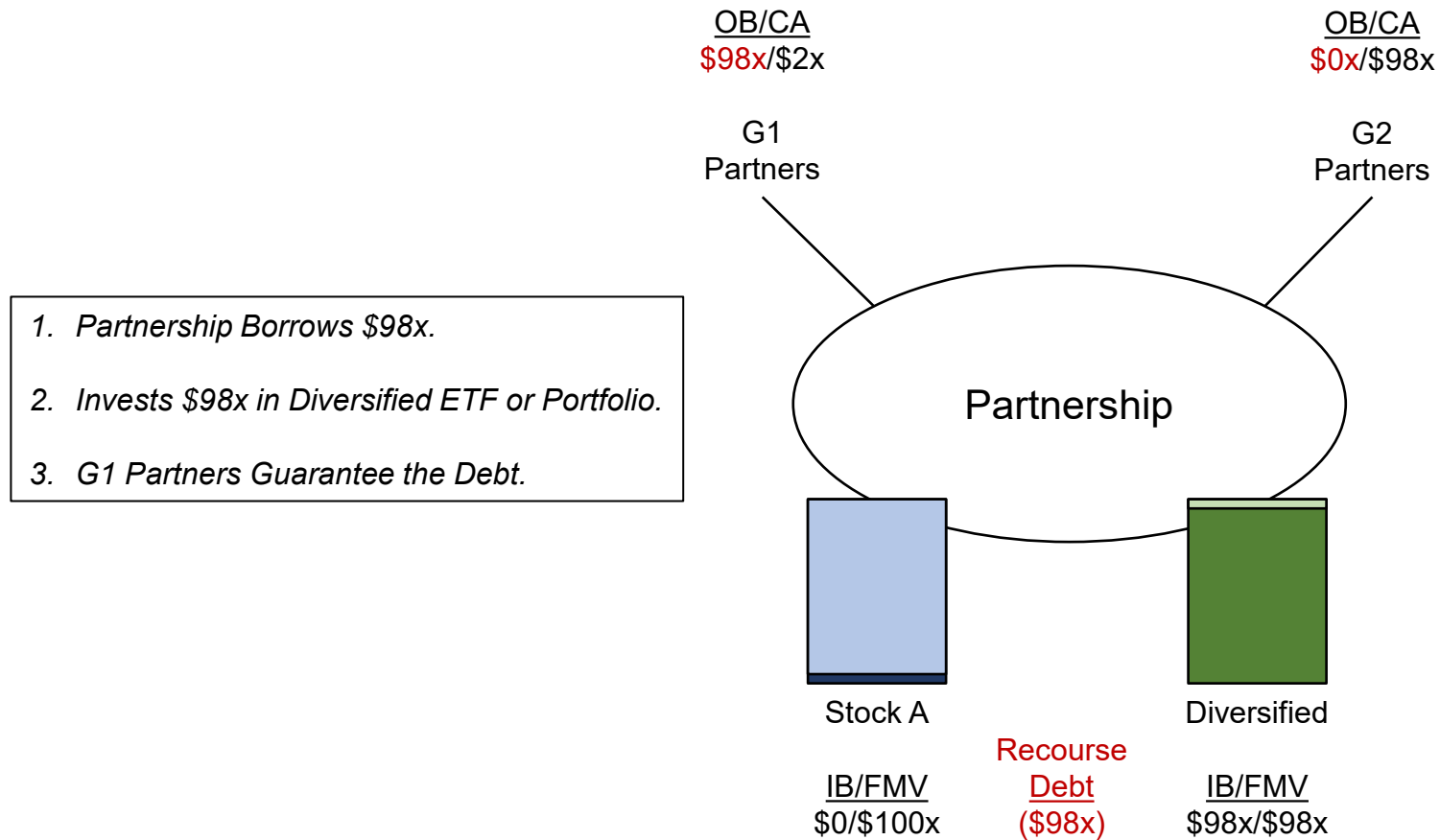
How to Be Surgical with Basis Shifting: Partnership Divisions



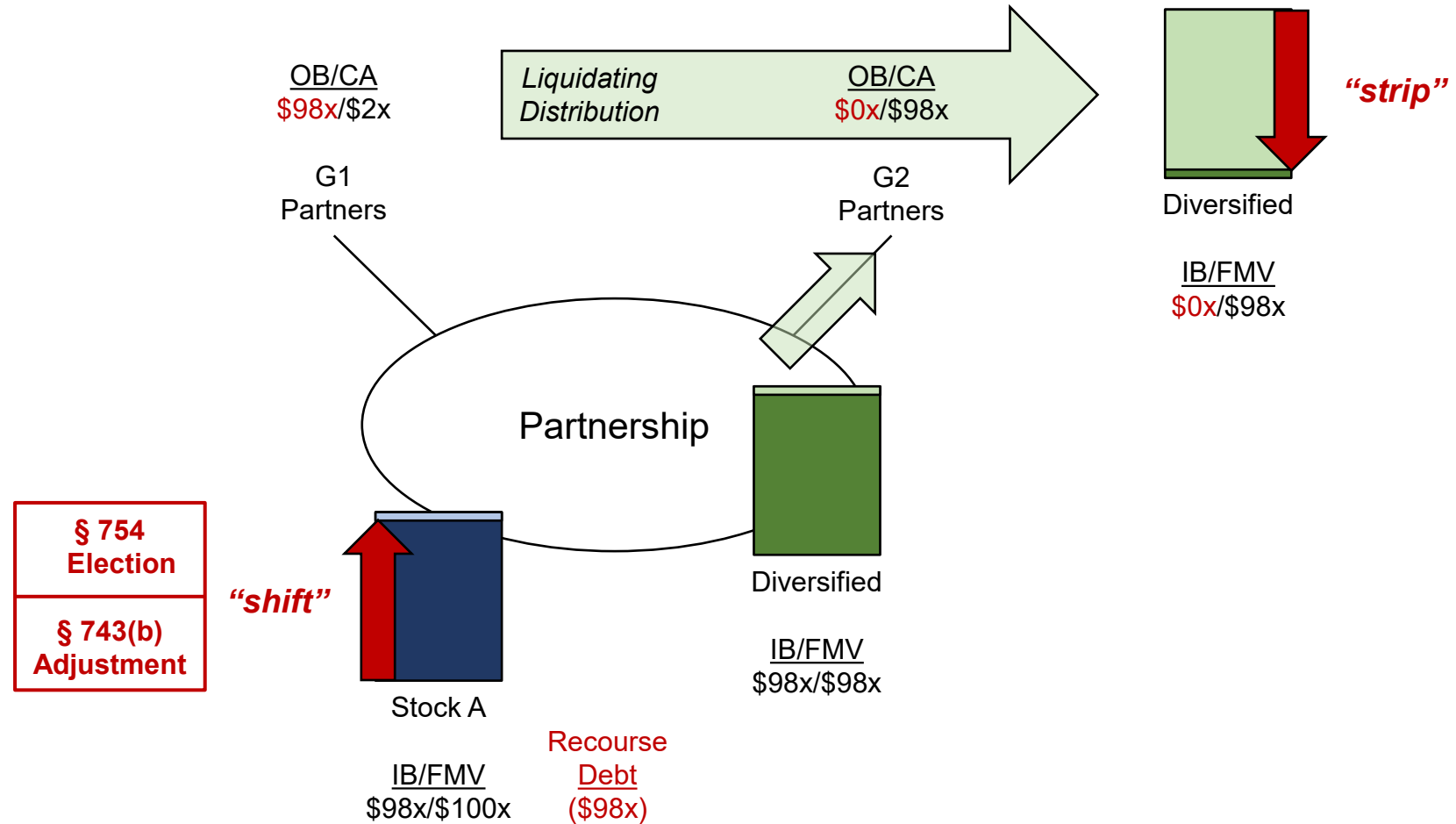
Basis Shifting with Just Low Basis Stock



Basis Shifting with Just Low Basis Stock: Leverage



Basis Shifting with Just Low Basis Stock: Liquidation



Basis Shifting with Just Low Basis Stock: Repay the Loan

OB/CA
\$1.96x/\$2x

G1
Partners

1. Sell \$98x of Stock A (\$96.04x of Basis).
2. Recognize \$1.96x of gain (OB of G1 Partners Increased to \$99.96x).
3. Repay \$98x to Lender (OB of G1 Partners Reduced to \$1.96x).

Partnership



Stock A

IB/FMV
\$1.96x/\$2x

Former
G2
Partners

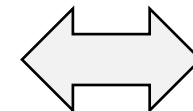


Diversified

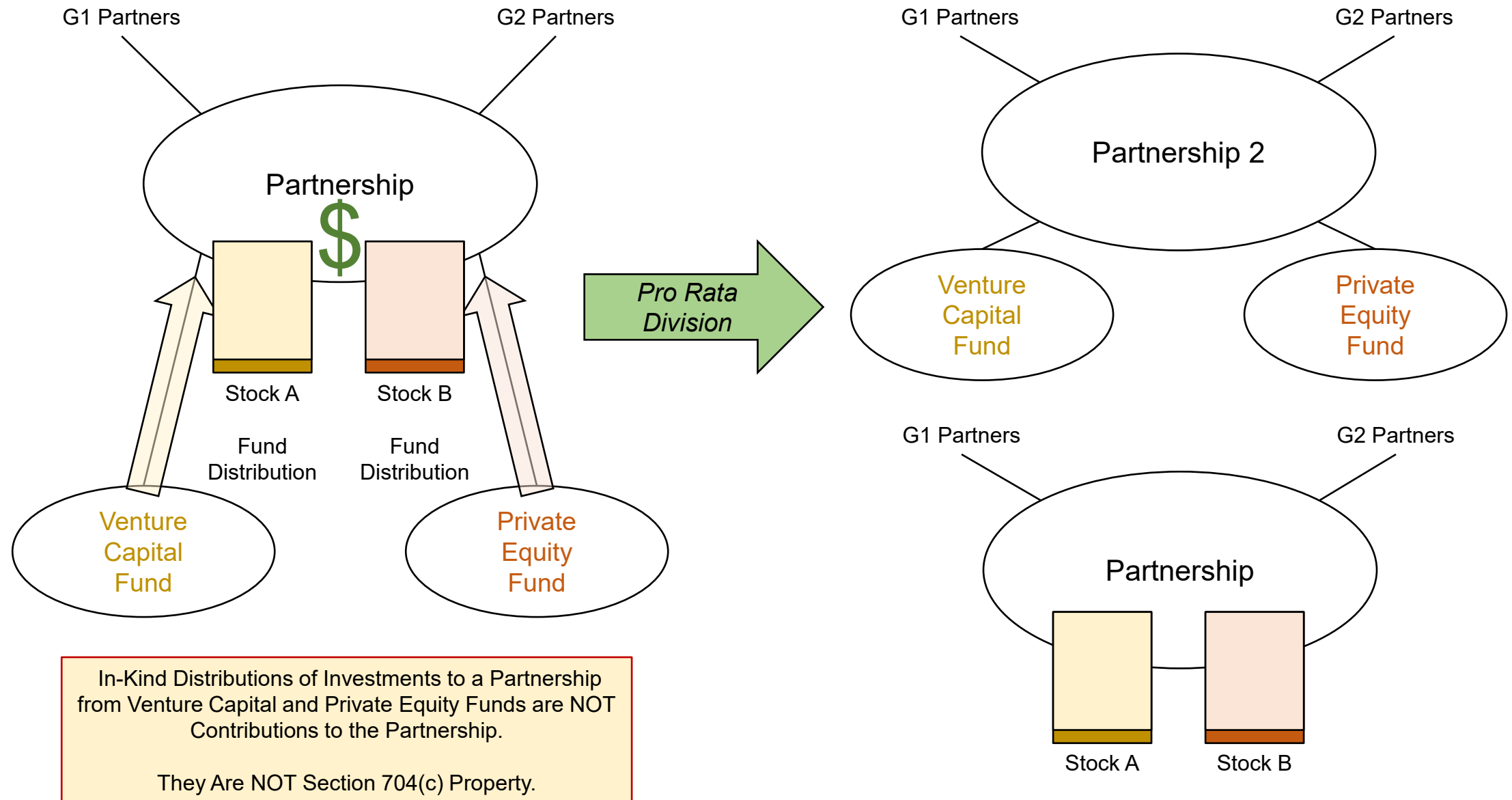
IB/FMV
\$0x/\$98x

This is essentially a personal exchange fund.

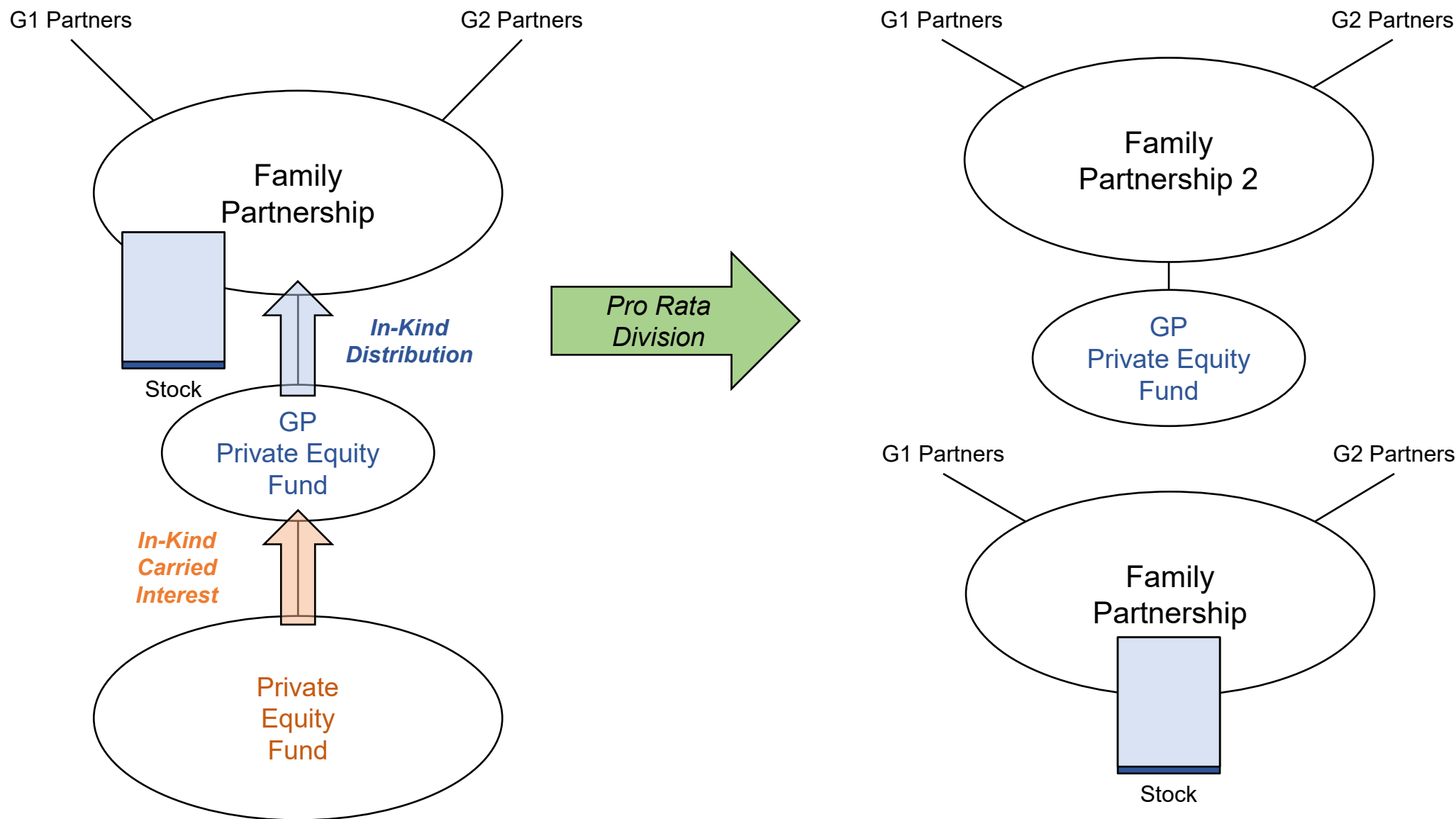
Can be used with tangible personal property
in lieu of a “like-kind” exchange.



Private Equity and Venture Capital Fund Investments

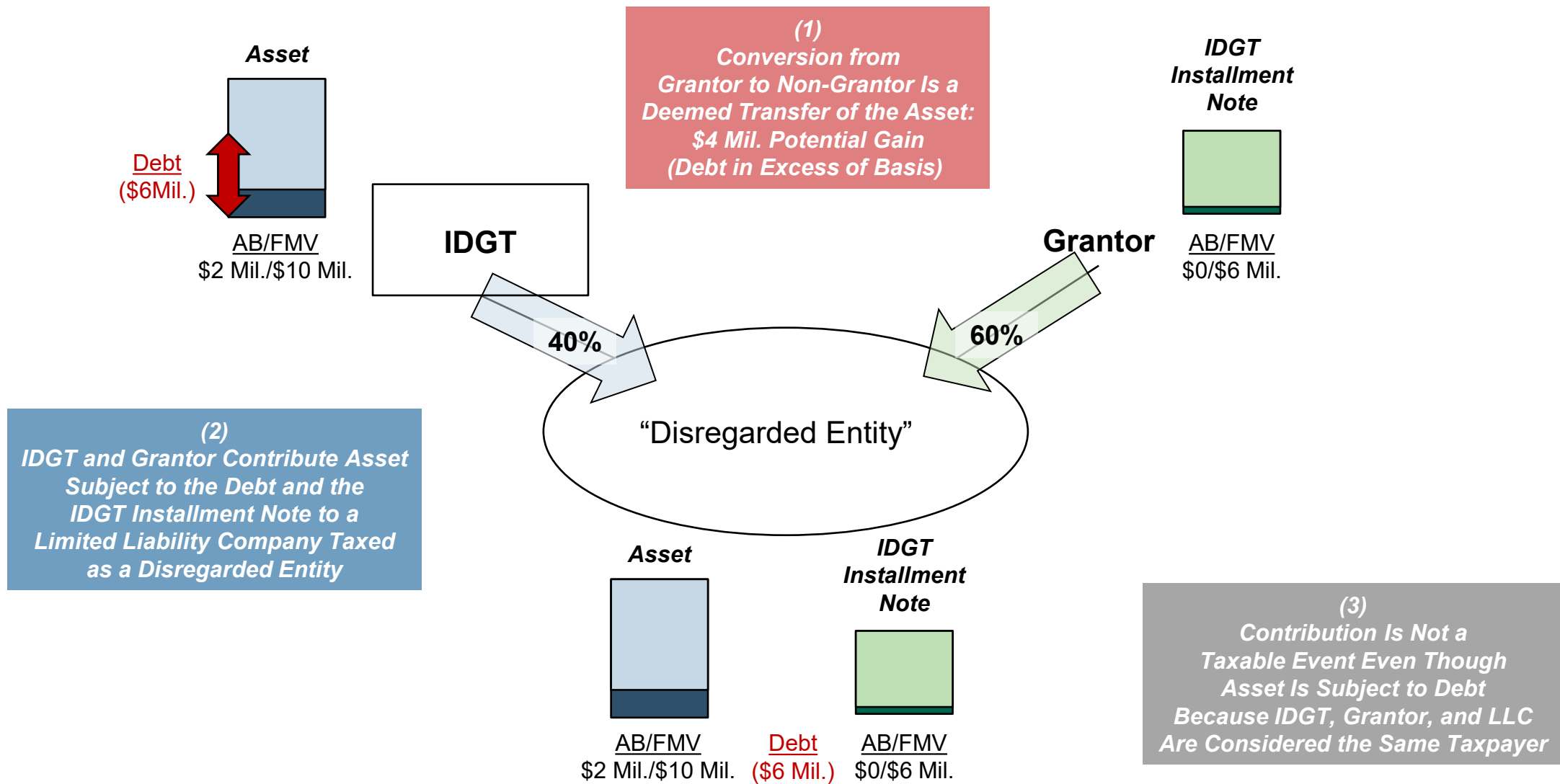


Carried Interest: In-Kind Distribution

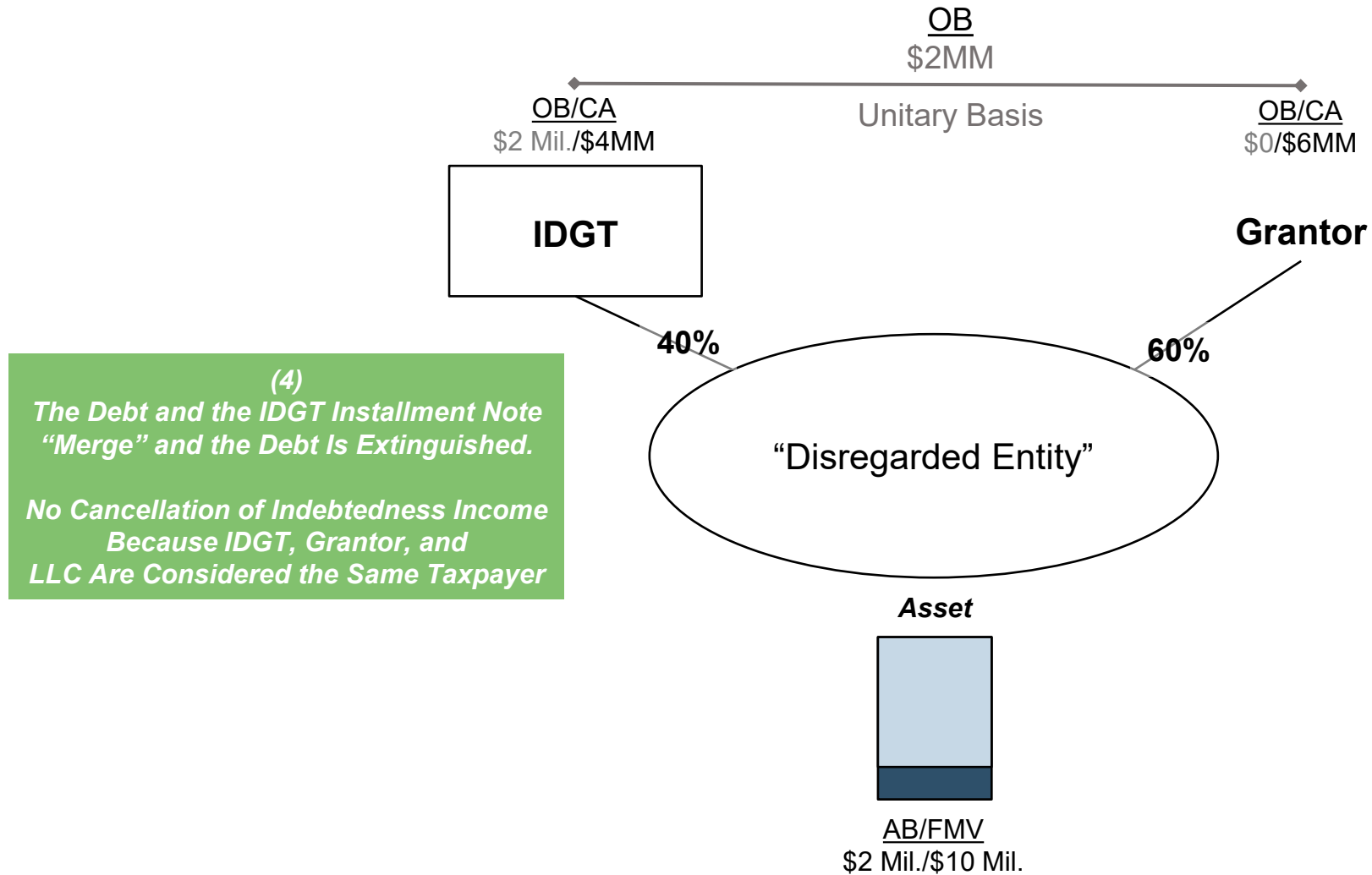


AVOIDING GAIN
UPON THE DEATH OF
THE GRANTOR

Making the Debt Disappear with a Disregarded Entity



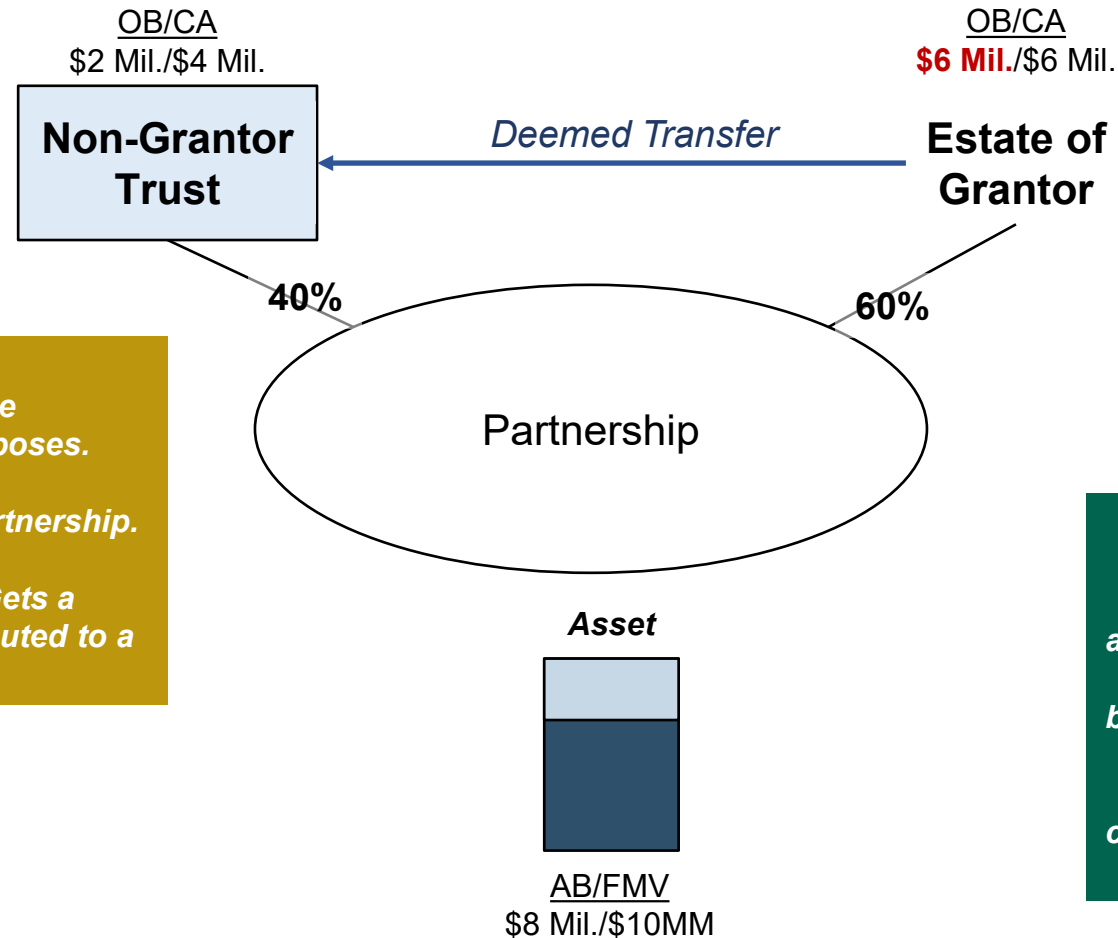
Debt “Merges” and Disappears: Non-Taxable Event



Death of Grantor Converts Disregarded Entity to a Partnership

Rev. Rul. 99-5

Conversion of Disregarded Entity to Partnership Created by Transfer of an LLC Interest to Another Taxpayer Treated as Purchase of Assets and Contribution to a New Partnership.



(5)
Grantor's Death Converts the LLC to a Partnership for Tax Purposes.

Treated as the Creation of a New Partnership.

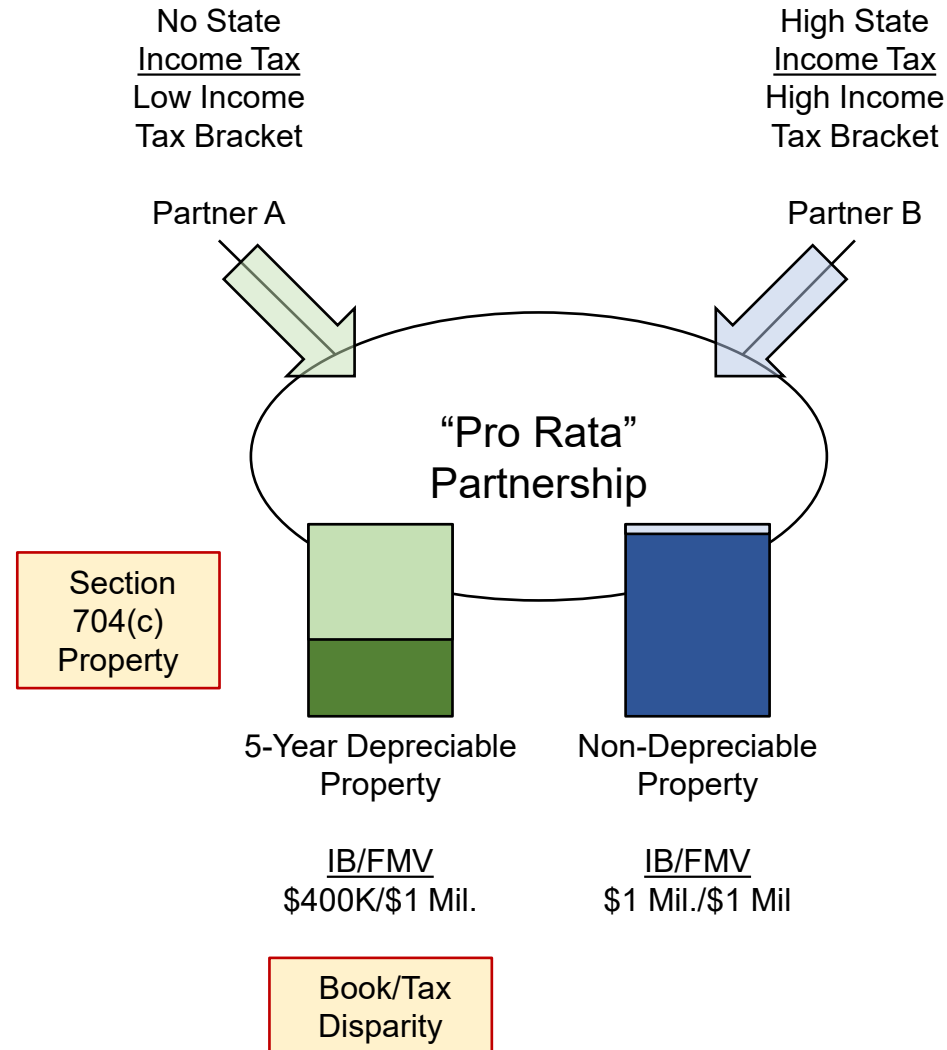
Grantor's Portion of the Asset Gets a "Step-Up" in Basis, and it is Contributed to a Newly-Formed Partnership.

(6) End Results:

- a) *No Gain at Grantor's Death.*
- b) *Asset Gets a Partial Basis Adjustment under Section 1014.*
- c) *No Installment Note Included in Grantor's Estate.*

ALLOCATING TAX ITEMS
DISPROPORTIONATELY
AMONG TAXPAYERS

Contribution of Depreciable Property



Section 704(c): Attempts to Avoid Shifts of Income

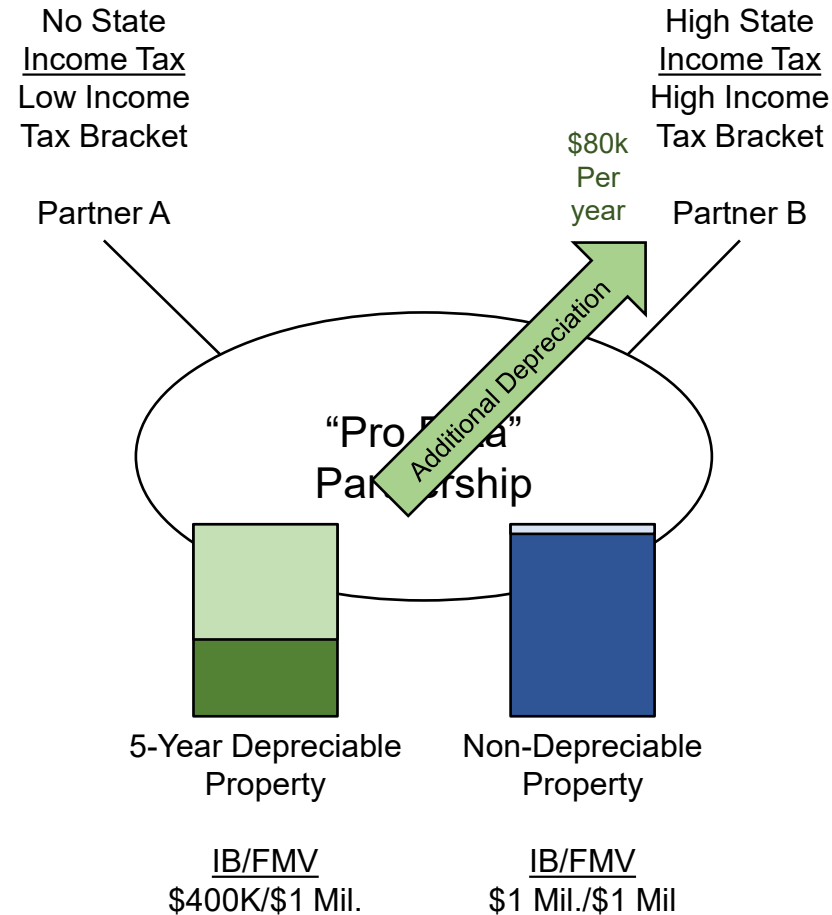
"BOOK" DEPRECIATION			
Adjusted Basis	Depreciation	Allocation to A	Allocation to B
\$1,000,000	\$200,000	\$100,000	\$100,000
\$800,000	\$200,000	\$100,000	\$100,000
\$600,000	\$200,000	\$100,000	\$100,000
\$400,000	\$200,000	\$100,000	\$100,000
\$200,000	\$200,000	\$100,000	\$100,000
Over 5 Years	\$1,000,000	\$500,000	\$500,000

"TAX" DEPRECIATION			
Adjusted Basis	Depreciation	Allocation to A	Allocation to B
\$400,000	\$80,000	\$40,000	\$40,000
\$320,000	\$80,000	\$40,000	\$40,000
\$240,000	\$80,000	\$40,000	\$40,000
\$160,000	\$80,000	\$40,000	\$40,000
\$80,000	\$80,000	\$40,000	\$40,000
Over 5 Years	\$400,000	\$200,000	\$200,000

Each year B has
\$60,000
LESS depreciation/
MORE taxable income

Section 704(c) assumes A is, in effect, disproportionately shifting taxable income to B because A has already enjoyed more of the depreciation prior to the contribution

“Traditional Method” of Resolving Book/Tax Disparities



“Ceiling Ruling” Limits the Traditional Method

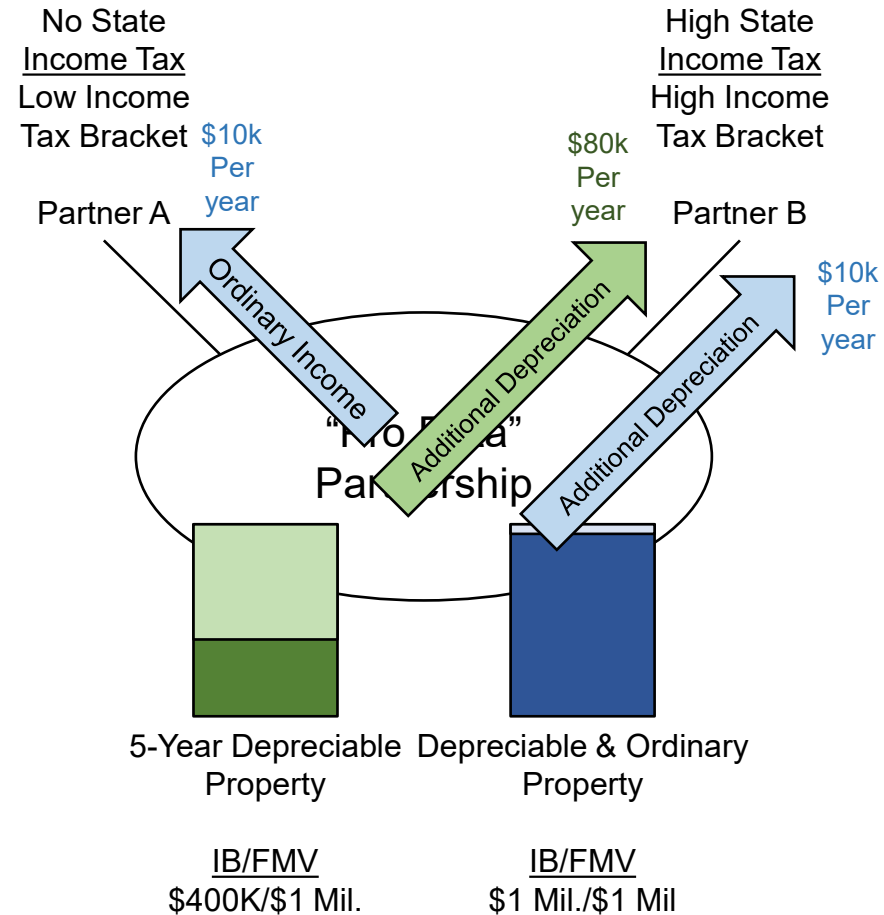
“BOOK” DEPRECIATION			
Adjusted Basis	Depreciation	Allocation to A	Allocation to B
\$1,000,000	\$200,000	\$100,000	\$100,000
\$800,000	\$200,000	\$100,000	\$100,000
\$600,000	\$200,000	\$100,000	\$100,000
\$400,000	\$200,000	\$100,000	\$100,000
\$200,000	\$200,000	\$100,000	\$100,000
Over 5 Years	\$1,000,000	\$500,000	\$500,000

“TAX” DEPRECIATION			
Adjusted Basis	Depreciation	Allocation to A	Allocation to B
\$400,000	\$80,000	\$0	\$80,000
\$320,000	\$80,000	\$0	\$80,000
\$240,000	\$80,000	\$0	\$80,000
\$160,000	\$80,000	\$0	\$80,000
\$80,000	\$80,000	\$0	\$80,000
Over 5 Years	\$400,000	\$0	\$400,000

Over 5 years
B is allocated
\$100,000
LESS depreciation/
MORE taxable income

“The total income, gain, loss, or deduction allocated to the partners for a taxable year with respect to a property cannot exceed the total partnership income, gain, or deduction with respect to that property for the taxable year (the ceiling rule).”
Treas. Reg. § 1.704-3(a)(1).

Traditional Method with “Curative” Allocations



Disclosures

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