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Reviewing Partnership Tax Returns

What Are You Missing?

Larry Tunnell, Ph.D., CPA; and Robert Ricketts, Ph.D., CPA

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By Larry Tunnell, Ph.D., CPA; and
Robert Ricketts, Ph.D., CPA

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Use of materials

This course manual accompanies all formats in which the course is offered, including self-study text, self-study online, group study, in-firm, and other formats, as applicable. Specific instructions for users of the various formats are included in this section.

CPAs are required to participate in continuing professional education (CPE) to maintain their professional competence and provide quality professional services. CPAs are responsible for complying with all applicable CPE requirements, rules, and regulations of state licensing bodies, other governmental entities, membership associations, and other professional organizations or bodies.

Professional standards for CPE programs are issued jointly by the American Institute of Certified Public Accountants (AICPA) and the National Association of State Boards of Accountancy (NASBA) to provide a framework for the development, presentation, measurement, and reporting of CPE programs. The Statement on Standards for CPE Programs (CPE standards) is available as part of AICPA *Professional Standards*, either in paperback or as an online subscription through the Association's Online Professional Library.

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Requirements for claiming and receiving CPE credit

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You must document your claims of CPE credit. Examples of acceptable evidence of completion include:

- For group and independent study programs, a certificate or other verification supplied by the CPE program sponsor
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- The exam for self-study in print format is located in the "Examination" section at the end of the course manual.

- You can find the course code number for both the self-study exam and the self-study evaluation in the examination's introductory material. You will complete the self-study exam and evaluation online at https://cpegrading.aicpa.org. You must provide the unique serial number printed on the inside front cover of this publication and you must achieve a minimum passing grade of at least 70% to qualify for CPE credit.
  - Upon achieving a passing grade, you will receive a certificate displaying the number of CPE credits earned based on a 50-minute learning segment, in compliance with CPE standards. The grading system provides a completion certificate online, which you may print or save as a PDF. The grading system maintains a transcript of your completed courses.
  - If you do not achieve a passing grade, the online grading system notifies you of this and also provides instructions for retaking the exam. You have three attempts to pass the exam. If you do not pass the exam in three attempts, please contact the Global Engagement Center at 1.888.777.7077 to obtain additional attempts.

Program evaluations

The information accumulated from participant evaluation forms is important in our continual efforts to provide high quality continuing education for the profession. When you participate in group study and other live presentations, please return your evaluation forms prior to departing your program sessions. When you participate in self-study, please complete the course evaluation online. Your comments are very important to us.

Customer service

For help and support, including information on refund claims and complaint resolutions, please call the Global Engagement Center at 1.888.777.7077, or visit the online help page at https://future.aicpa.org/cpe-learning.

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Chapter 1

Case One — Data Security Products

Learning objectives

- Calculate the balance in the partners' capital accounts and enter the results on Form 1065, *U.S. Return of Partnership Income*, and on the Schedule K-1s.
- Allocate self-employment income to the partners.
- Identify reporting requirements for partnerships and LLCs with respect to the qualified business income deduction.
- Identify the purposes of Schedules L, M-1, and M-2.

Data Security Products (DSP) is a Seattle, Washington, partnership with the following three partners:

Name	ID number
Frasier Corporation	75-8151512
4825 Linden Ave.	
Seattle, WA 98103	
Henry Yesler	454-66-3333
1750 Holman Rd., NW	
Seattle, WA 98117	
Dorothy (Lou) Graham	459-34-5939
1519 NW Market St.	
Seattle, WA 98107	

DSP was formed on January 1, 2021. Its federal identification number is 75-3185725 and its address is 1701 W. Dravus St., Seattle, WA 98199. The partners chose to use the calendar year as the partnership's taxable year. They contributed cash and land as follows to form the partnership:

Frasier:	Parkway Place land	
	Original cost and basis — Land	$300,000
	At date of contribution: Land's fair market value	800,000
	Outstanding mortgage balance	200,000
Henry:	$200,000 cash	
Dorothy:	$200,000 cash	

On January 1, 2021, they also purchased a building on Parkway Place situated next to the land that Frasier had contributed. The purchase price was $900,000 ($200,000 for the land and $700,000 for the building). $800,000 of the purchase price was financed with a mortgage. DSP will use the Parkway Place building to open a retail outlet for selling data security hardware and software. Henry will oversee store operations, and Dorothy will oversee the financial end of the business as well as building maintenance and management. Dorothy is the tax matters partner.

Henry and Dorothy are general partners of DSP; Frasier is a limited partner. Henry and Dorothy are guaranteed payments of $95,000 each per year for their efforts; Frasier is guaranteed a payment of $62,000 per year. Frasier, an FYE 10/31 C corporation, will own 60% of DSP profits and capital, and Henry and Dorothy each will be allocated and own, respectively, 20%. Henry and Dorothy each took a draw of $20,000 this year. Book depreciation on the equipment and building is equal to tax depreciation.

DSP financial statements

DSP has the following financial statements at December 31.

Account	Ending book balance sheet		Ending tax balance sheet	
Cash	$107,600		$107,600	
Accounts receivable	20,000		20,000	
Allowance for bad debts		6,000		6,000
Inventory	41,543		41,543	
Furniture, fixtures, and equipment	200,000		200,000	
Accumulated depreciation, FFE		28,580		28,580
Land	1,000,000		500,000	
Building	700,000		700,000	
Accumulated depreciation, building		24,394		24,394
Mortgage payable		1,000,000		1,000,000
Accounts payable		80,000		80,000
Capital, Frasier		582,101		82,101
Capital, Henry		174,034		174,034
Capital, Dorothy		174,034		174,034
Totals	$2,069,143	$2,069,143	$1,569,143	$1,569,143

Account	Book income statement	
Sales		766,500
Purchases	210,000	
Ending inventory	-41,543	
COGS	168,457	
Bad debt expense	6,000	
Insurance	12,000	
Employee wages	135,600	
Guaranteed payments	252,000	
Employee medical expenses	34,000	
Payroll taxes	27,800	
Charitable contributions	5,000	
Interest expense	61,000	
Property tax, building	27,200	
Property tax, F&F, inv.	14,300	
Depreciation expense, building	24,394	
Depreciation expense, equipment	28,580	−796,331
Net income		−29,831

Notes to accompany financial statements

DSP uses the accrual method of accounting for tax purposes.

There is no alternative minimum tax (AMT) adjustment for depreciation on the building. The partnership has chosen not to make the Section 179 election or take bonus depreciation with respect to the furniture, fixtures, and equipment acquired during the taxable year. The building and the equipment were all placed in service on January 1. The mortgages are both balloon mortgages due in a few years.

The partnership's bad debt expense under the specific charge-off method would be zero for the current year.

Data Security Products — 2021 tax return and accompanying forms and schedules

The partnership's 2021 Form 1065, *U.S. Return of Partnership Income*, along with the 2021 Schedules K-1 (Form 1065), *Partner's Share of Income, Deductions, Credits, etc.*, for each partner are reproduced on the following pages. The tax return and accompanying Schedules K-1 are followed by an explanation of the rationale and calculation of each figure reported on the return.

In reviewing the return, pay careful attention to the following items, which are discussed in more depth throughout the rest of this chapter:

- How are contributions of property booked by the partnership?
- How are the partners' capital accounts calculated and where are these balances reported?
- How is the partnership's fiscal year-end determined?
- How is self-employment income calculated, and which partners is it allocated to?
- How is depreciation calculated for various assets? How is it disclosed on the return?
- Is there a depreciation adjustment for AMT? How is it calculated?

Form **1065**

Department of the Treasury
Internal Revenue Service

U.S. Return of Partnership Income

For calendar year 2021, or tax year beginning ______________, ending ______________.

▶ **Go to *www.irs.gov/Form1065* for instructions and the latest information.**

OMB No. 1545-0123

2021

A Principal business activity: Retail	Name of partnership: Data Security Products	D Employer identification number: 75-3185725
B Principal product or service: Data security technology	Type or Print — Number, street, and room or suite no. If a P.O. box, see instructions: 1701 W. Dravus St.	E Date business started: 1/1/2021
C Business code number: 443142	City or town: Seattle; State: WA; ZIP code: 98199; Foreign country name; Foreign province/state/county; Foreign postal code	F Total assets (see instructions): $ 2,010,169

G Check applicable boxes: (1) [X] Initial return (2) [ ] Final return (3) [ ] Name change (4) [ ] Address change (5) [ ] Amended return

H Check accounting method: (1) [ ] Cash (2) [X] Accrual (3) [ ] Other (specify) ▶

I Number of Schedules K-1. Attach one for each person who was a partner at any time during the tax year. ▶ 3

J Check if Schedules C and M-3 are attached . . . ▶ [ ]

K Check if partnership: (1) [ ] Aggregated activities for section 465 at-risk purposes (2) [ ] Grouped activities for section 469 passive activity purposes

Caution: Include **only** trade or business income and expenses on lines 1a through 22 below. See instructions for more information.

Income	1a	Gross receipts or sales	1a	766,500		
	b	Returns and allowances	1b			
	c	Balance. Subtract line 1b from line 1a			1c	766,500
	2	Cost of goods sold (attach Form 1125-A)			2	168,457
	3	Gross profit. Subtract line 2 from line 1c			3	598,043
	4	Ordinary income (loss) from other partnerships, estates, and trusts (attach statement)			4	
	5	Net farm profit (loss) (attach Schedule F (Form 1040))			5	
	6	Net gain (loss) from Form 4797, Part II, line 17 (attach Form 4797)			6	
	7	Other income (loss) (attach statement)			7	
	8	**Total income (loss).** Combine lines 3 through 7			8	598,043
Deductions (see instructions for limitations)	9	Salaries and wages (other than to partners) (less employment credits)			9	135,600
	10	Guaranteed payments to partners			10	252,000
	11	Repairs and maintenance			11	
	12	Bad debts			12	
	13	Rent			13	
	14	Taxes and licenses			14	69,300
	15	Interest (see instructions)			15	61,000
	16a	Depreciation (if required, attach Form 4562)	16a	52,974		
	b	Less depreciation reported on Form 1125-A and elsewhere on return	16b		16c	52,974
	17	Depletion **(Do not deduct oil and gas depletion.)**			17	
	18	Retirement plans, etc.			18	
	19	Employee benefit programs			19	34,000
	20	Other deductions (attach statement)			20	12,000
	21	**Total deductions.** Add the amounts shown in the far right column for lines 9 through 20			21	616,874
	22	**Ordinary business income (loss).** Subtract line 21 from line 8			22	-18,831
Tax and Payment	23	Interest due under the look-back method—completed long-term contracts (attach Form 8697)			23	
	24	Interest due under the look-back method—income forecast method (attach Form 8866)			24	
	25	BBA AAR imputed underpayment (see instructions)			25	
	26	Other taxes (see instructions)			26	
	27	**Total balance due.** Add lines 23 through 26			27	0
	28	Payment (see instructions)			28	
	29	**Amount owed.** If line 28 is smaller than line 27, enter amount owed			29	
	30	**Overpayment.** If line 28 is larger than line 27, enter overpayment			30	

Sign Here

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than partner or limited liability company member) is based on all information of which preparer has any knowledge.

▶ Signature of partner or limited liability company member ▶ Date

May the IRS discuss this return with the preparer shown below? See instructions. [ ] Yes [ ] No

Paid Preparer Use Only

Print/Type preparer's name	Preparer's signature	Date	Check [ ] if self-employed	PTIN
Firm's name ▶			Firm's EIN ▶	
Firm's address ▶			Phone no.	
City	State		ZIP code	

For Paperwork Reduction Act Notice, see separate instructions. Form **1065** (2021)

HTA

Schedule B Other Information

		Yes	No
1	What type of entity is filing this return? Check the applicable box: **a** ☐ Domestic general partnership **b** ☒ Domestic limited partnership **c** ☐ Domestic limited liability company **d** ☐ Domestic limited liability partnership **e** ☐ Foreign partnership **f** ☐ Other ►		
2	At the end of the tax year:		
a	Did any foreign or domestic corporation, partnership (including any entity treated as a partnership), trust, or tax-exempt organization, or any foreign government own, directly or indirectly, an interest of 50% or more in the profit, loss, or capital of the partnership? For rules of constructive ownership, see instructions. If "Yes," attach Schedule B-1, Information on Partners Owning 50% or More of the Partnership	X	
b	Did any individual or estate own, directly or indirectly, an interest of 50% or more in the profit, loss, or capital of the partnership? For rules of constructive ownership, see instructions. If "Yes," attach Schedule B-1, Information on Partners Owning 50% or More of the Partnership		X
3	At the end of the tax year, did the partnership:		
a	Own directly 20% or more, or own, directly or indirectly, 50% or more of the total voting power of all classes of stock entitled to vote of any foreign or domestic corporation? For rules of constructive ownership, see instructions. If "Yes," complete (i) through (iv) below		X

(i) Name of Corporation	**(ii)** Employer Identification Number (if any)	**(iii)** Country of Incorporation	**(iv)** Percentage Owned in Voting Stock

		Yes	No
b	Own directly an interest of 20% or more, or own, directly or indirectly, an interest of 50% or more in the profit, loss, or capital in any foreign or domestic partnership (including an entity treated as a partnership) or in the beneficial interest of a trust? For rules of constructive ownership, see instructions. If "Yes," complete (i) through (v) below		X

(i) Name of Entity	**(ii)** Employer Identification Number (if any)	**(iii)** Type of Entity	**(iv)** Country of Organization	**(v)** Maximum Percentage Owned in Profit, Loss, or Capital

		Yes	No
4	Does the partnership satisfy **all four** of the following conditions?		
a	The partnership's total receipts for the tax year were less than $250,000.		
b	The partnership's total assets at the end of the tax year were less than $1 million.		
c	Schedules K-1 are filed with the return and furnished to the partners on or before the due date (including extensions) for the partnership return.		
d	The partnership is not filing and is not required to file Schedule M-3		X
	If "Yes," the partnership is not required to complete Schedules L, M-1, and M-2; item F on page 1 of Form 1065; or item L on Schedule K-1.		
5	Is this partnership a publicly traded partnership, as defined in section 469(k)(2)?		X
6	During the tax year, did the partnership have any debt that was canceled, was forgiven, or had the terms modified so as to reduce the principal amount of the debt?		X
7	Has this partnership filed, or is it required to file, Form 8918, Material Advisor Disclosure Statement, to provide information on any reportable transaction?		X
8	At any time during calendar year 2021, did the partnership have an interest in or a signature or other authority over a financial account in a foreign country (such as a bank account, securities account, or other financial account)? See instructions for exceptions and filing requirements for FinCEN Form 114, Report of Foreign Bank and Financial Accounts (FBAR). If "Yes," enter the name of the foreign country ►		X
9	At any time during the tax year, did the partnership receive a distribution from, or was it the grantor of, or transferor to, a foreign trust? If "Yes," the partnership may have to file Form 3520, Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts. See instructions		X
10a	Is the partnership making, or had it previously made (and not revoked), a section 754 election? See instructions for details regarding a section 754 election.		X
b	Did the partnership make for this tax year an optional basis adjustment under section 743(b) or 734(b)? If "Yes," attach a statement showing the computation and allocation of the basis adjustment. See instructions		X

Form **1065** (2021)

Schedule B **Other Information** *(continued)*

		Yes	No
c	Is the partnership required to adjust the basis of partnership assets under section 743(b) or 734(b) because of a substantial built-in loss (as defined under section 743(d)) or substantial basis reduction (as defined under section 734(d))? If "Yes," attach a statement showing the computation and allocation of the basis adjustment. See instructions		X
11	Check this box if, during the current or prior tax year, the partnership distributed any property received in a like-kind exchange or contributed such property to another entity (other than disregarded entities wholly owned by the partnership throughout the tax year) ▶ ☐		
12	At any time during the tax year, did the partnership distribute to any partner a tenancy-in-common or other undivided interest in partnership property?		X
13	If the partnership is required to file Form 8858, Information Return of U.S. Persons With Respect To Foreign Disregarded Entities (FDEs) and Foreign Branches (FBs), enter the number of Forms 8858 attached. See instructions ▶		
14	Does the partnership have any foreign partners? If "Yes," enter the number of Forms 8805, Foreign Partner's Information Statement of Section 1446 Withholding Tax, filed for this partnership. ▶ 0		X
15	Enter the number of Forms 8865, Return of U.S. Persons With Respect to Certain Foreign Partnerships, attached to this return. ▶ 0		
16a	Did you make any payments in 2021 that would require you to file Form(s) 1099? See instructions	X	
b	If "Yes," did you or will you file required Form(s) 1099?	X	
17	Enter the number of Forms 5471, Information Return of U.S. Persons With Respect To Certain Foreign Corporations, attached to this return. ▶ 0		
18	Enter the number of partners that are foreign governments under section 892. ▶ 0		
19	During the partnership's tax year, did the partnership make any payments that would require it to file Forms 1042 and 1042-S under chapter 3 (sections 1441 through 1464) or chapter 4 (sections 1471 through 1474)?		X
20	Was the partnership a specified domestic entity required to file Form 8938 for the tax year? See the Instructions for Form 8938		X
21	Is the partnership a section 721(c) partnership, as defined in Regulations section 1.721(c)-1(b)(14)?		X
22	During the tax year, did the partnership pay or accrue any interest or royalty for which one or more partners are not allowed a deduction under section 267A? See instructions		X
	If "Yes," enter the total amount of the disallowed deductions ▶ $		
23	Did the partnership have an election under section 163(j) for any real property trade or business or any farming business in effect during the tax year? See instructions		X
24	Does the partnership satisfy one or more of the following? See instructions		X
a	The partnership owns a pass-through entity with current, or prior year carryover, excess business interest expense.		
b	The partnership's aggregate average annual gross receipts (determined under section 448(c)) for the 3 tax years preceding the current tax year are more than $26 million and the partnership has business interest.		
c	The partnership is a tax shelter (see instructions) and the partnership has business interest expense. If "Yes" to any, complete and attach Form 8990.		
25	Is the partnership attaching Form 8996 to certify as a Qualified Opportunity Fund?		X
	If "Yes," enter the amount from Form 8996, line 15 ▶ $		
26	Enter the number of foreign partners subject to section 864(c)(8) as a result of transferring all or a portion of an interest in the partnership or of receiving a distribution from the partnership ▶ 0 Complete Schedule K-3 (Form 1065), Part XIII, for each foreign partner subject to section 864(c)(8) on a transfer or distribution.		
27	At any time during the tax year, were there any transfers between the partnership and its partners subject to the disclosure requirements of Regulations section 1.707-8?		X
28	Since December 22, 2017, did a foreign corporation directly or indirectly acquire substantially all of the properties constituting a trade or business of your partnership, and was the ownership percentage (by vote or value) for purposes of section 7874 greater than 50% (for example, the partners held more than 50% of the stock of the foreign corporation)? If "Yes," list the ownership percentage by vote and by value. See instructions. Percentage: By Vote By Value		X
29	Is the partnership electing out of the centralized partnership audit regime under section 6221(b)? See instructions.		X
	If "Yes," the partnership must complete Schedule B-2 (Form 1065). Enter the total from Schedule B-2, Part III, line 3 ▶ If "No," complete Designation of Partnership Representative below.		

Designation of Partnership Representative (see instructions)

Enter below the information for the partnership representative (PR) for the tax year covered by this return.

Name of PR ▶ Dorothy Graham

U.S. address of PR	1519 NW Market Street Seattle WA 98107	U.S. phone number of PR	
If the PR is an entity, name of the designated individual for the PR ▶			
U.S. address of designated individual		U.S. phone number of designated individual	

Form **1065** (2021)

Schedule K — Partners' Distributive Share Items

				Total amount
Income (Loss)	1	Ordinary business income (loss) (page 1, line 22)	1	-18,831
	2	Net rental real estate income (loss) (attach Form 8825)	2	
	3a	Other gross rental income (loss) — 3a		
	b	Expenses from other rental activities (attach statement) — 3b		
	c	Other net rental income (loss). Subtract line 3b from line 3a	3c	0
	4	Guaranteed payments: a Services 4a 252,000 b Capital 4b 0		
	c	Total. Add lines 4a and 4b	4c	252,000
	5	Interest income	5	
	6	Dividends and dividend equivalents: a Ordinary dividends	6a	
		b Qualified dividends 6b c Dividend equivalents 6c		
	7	Royalties	7	
	8	Net short-term capital gain (loss) (attach Schedule D (Form 1065))	8	
	9a	Net long-term capital gain (loss) (attach Schedule D (Form 1065))	9a	
	b	Collectibles (28%) gain (loss) — 9b		
	c	Unrecaptured section 1250 gain (attach statement) — 9c		
	10	Net section 1231 gain (loss) (attach Form 4797)	10	
	11	Other income (loss) (see instructions) Type ►	11	
Deductions	12	Section 179 deduction (attach Form 4562)	12	
	13a	Contributions	13a	5,000
	b	Investment interest expense	13b	
	c	Section 59(e)(2) expenditures: (1) Type ► (2) Amount ►	13c(2)	
	d	Other deductions (see instructions) Type ►	13d	
Self-Employment	14a	Net earnings (loss) from self-employment	14a	182,468
	b	Gross farming or fishing income	14b	
	c	Gross nonfarm income	14c	
Credits	15a	Low-income housing credit (section 42(j)(5))	15a	
	b	Low-income housing credit (other)	15b	
	c	Qualified rehabilitation expenditures (rental real estate) (attach Form 3468, if applicable)	15c	
	d	Other rental real estate credits (see instructions) Type ►	15d	
	e	Other rental credits (see instructions) Type ►	15e	
	f	Other credits (see instructions) Type ►	15f	
International Transactions	16	Attach Schedule K-2 (Form 1065), Partners' Distributive Share Items-International, and check this box to indicate that you are reporting items of international tax relevance ☐		
Alternative Minimum Tax (AMT) Items	17a	Post-1986 depreciation adjustment	17a	7,160
	b	Adjusted gain or loss	17b	
	c	Depletion (other than oil and gas)	17c	
	d	Oil, gas, and geothermal properties—gross income	17d	
	e	Oil, gas, and geothermal properties—deductions	17e	
	f	Other AMT items (attach statement)	17f	
Other Information	18a	Tax-exempt interest income	18a	
	b	Other tax-exempt income	18b	
	c	Nondeductible expenses	18c	6,000
	19a	Distributions of cash and marketable securities	19a	40,000
	b	Distributions of other property	19b	
	20a	Investment income	20a	
	b	Investment expenses	20b	
	c	Other items and amounts (attach statement)		
	21	Total foreign taxes paid or accrued	21	

Form 1065 (2021)

Analysis of Net Income (Loss)

1	Net income (loss). Combine Schedule K, lines 1 through 11. From the result, subtract the sum of Schedule K, lines 12 through 13d, and 21					1	228,169
2	Analysis by partner type:	(i) Corporate	(ii) Individual (active)	(iii) Individual (passive)	(iv) Partnership	(v) Exempt Organization	(vi) Nominee/Other
a	General partners	47,701	180,468				
b	Limited partners						

Schedule L — Balance Sheets per Books

		Beginning of tax year (a)	(b)	End of tax year (c)	(d)
	Assets				
1	Cash				107,600
2a	Trade notes and accounts receivable			20,000	
b	Less allowance for bad debts		0	6,000	14,000
3	Inventories				41,543
4	U.S. government obligations				
5	Tax-exempt securities				
6	Other current assets (attach statement)				
7a	Loans to partners (or persons related to partners)				
b	Mortgage and real estate loans				
8	Other investments (attach statement)				
9a	Buildings and other depreciable assets			900,000	
b	Less accumulated depreciation		0	52,974	847,026
10a	Depletable assets				
b	Less accumulated depletion		0		0
11	Land (net of any amortization)				1,000,000
12a	Intangible assets (amortizable only)				
b	Less accumulated amortization		0		0
13	Other assets (attach statement)				
14	Total assets		0		2,010,169
	Liabilities and Capital				
15	Accounts payable				80,000
16	Mortgages, notes, bonds payable in less than 1 year				
17	Other current liabilities (attach statement)				
18	All nonrecourse loans				1,000,000
19a	Loans from partners (or persons related to partners)				
b	Mortgages, notes, bonds payable in 1 year or more				
20	Other liabilities (attach statement)				
21	Partners' capital accounts				930,169
22	Total liabilities and capital		0		2,010,169

Schedule M-1 — Reconciliation of Income (Loss) per Books With Income (Loss) per Return

Note: The partnership may be required to file Schedule M-3. See instructions.

1	Net income (loss) per books	-29,831	6	Income recorded on books this year not included on Schedule K, lines 1 through 11 (itemize):	
2	Income included on Schedule K, lines 1, 2, 3c, 5, 6a, 7, 8, 9a, 10, and 11, not recorded on books this year (itemize):	0	a	Tax-exempt interest $	0
3	Guaranteed payments (other than health insurance)	252,000	7	Deductions included on Schedule K, lines 1 through 13d, and 21, not charged against book income this year (itemize):	
4	Expenses recorded on books this year not included on Schedule K, lines 1 through 13d, and 21 (itemize):	See Statement	a	Depreciation $	0
a	Depreciation $		8	Add lines 6 and 7	0
b	Travel and entertainment $	6,000	9	Income (loss) (Analysis of Net Income (Loss), line 1). Subtract line 8 from line 5	228,169
5	Add lines 1 through 4	228,169			

Schedule M-2 — Analysis of Partners' Capital Accounts

1	Balance at beginning of year		6	Distributions: a Cash	40,000
2	Capital contributed: a Cash	400,000		b Property	
	b Property	600,000	7	Other decreases (itemize):	
3	Net income (loss) (see instructions)	228,169		See Statement	258,000
4	Other increases (itemize):	0	8	Add lines 6 and 7	298,000
5	Add lines 1 through 4	1,228,169	9	Balance at end of year. Subtract line 8 from line 5	930,169

Form **1065** (2021)

Form **8453-PE**

Department of the Treasury
Internal Revenue Service

E-file Declaration for Form 1065

(For return of partnership income or administrative adjustment request)

▶ **File electronically with the partnership's return or administrative adjustment request .**
(Don't file paper copies.)
▶ **Go to *www.irs.gov/Form8453PE* for the latest information.**

For calendar year 2021, or tax year beginning , 2021, and ending , 20 .

OMB No. 1545-0123

2021

Name of partnership	Employer identification number
Data Security Products	75-3185725

Part I **Form 1065 Information** (whole dollars only)

1	Gross receipts or sales less returns and allowances (Form 1065, line 1c)	**1**	766,500
2	Gross profit (Form 1065, line 3)	**2**	598,043
3	Ordinary business income (loss) (Form 1065, line 22)	**3**	-18,831
4	Net rental real estate income (loss) (Form 1065, Schedule K, line 2)	**4**	
5	Other net rental income (loss) (Form 1065, Schedule K, line 3c)	**5**	

Part II **Declaration of Partner or Member or Partnership Representative** (see instructions)
Be sure to keep a copy of the partnership's Return of Partnership Income or AAR.

I declare under penalties of perjury:
1a. If this Form 1065 is transmitted as part of a return of partnership income, I'm a partner or member of the above partnership.
b. If this Form 1065 is transmitted as part of an administrative adjustment request (AAR), I'm the partnership representative (PR).
2. The information I've given my electronic return originator (ERO), transmitter, and/or intermediate service provider (ISP) and the amounts in Part I above agree with the amounts on the corresponding lines of the partnership's Form 1065.
3. To the best of my knowledge and belief, the partnership's corresponding return or AAR is true, correct, and complete.
4. I consent to my ERO, transmitter, and/or ISP sending the partnership's return or AAR, this declaration, and accompanying forms, schedules and statements to the IRS.
5. I consent to the IRS sending my ERO, transmitter, and/or ISP an acknowledgment of receipt of transmission and an indication of whether or not the partnership's return or AAR is accepted and, if rejected, the reason(s) for the rejection.
6. If the processing of the partnership's return or AAR is delayed, I authorize the IRS to disclose to my ERO, transmitter, and/or ISP the reason(s) for the delay.

Sign Here ▶ Signature of partner or member or PR | Date ▶ Title

Part III **Declaration of Electronic Return Originator (ERO) and Paid Preparer** (see instructions)

I declare that I've reviewed the above partnership's return or AAR and that the entries on Form 8453-PE are complete and correct to the best of my knowledge. If I'm only a collector, I'm not responsible for reviewing the return or AAR and only declare that this form accurately reflects the data on the return or AAR. The partner or member or PR will have signed this form before I submit the return or AAR. I'll give the partner or member or PR a copy of all forms and information to be filed with the IRS, and I've followed all other requirements in **Pub. 3112**, IRS *e-file* Application and Participation, and **Pub. 4163**, Modernized e-File (MeF) Information for Authorized IRS *e-file* Providers for Business Returns. If I'm also the Paid Preparer, under penalties of perjury, I declare that I've examined the above partnership's return or AAR and accompanying forms, schedules, and statements, and to the best of my knowledge and belief, they are true, correct, and complete. This Paid Preparer declaration is based on all information of which I've any knowledge.

ERO's Use Only					
ERO's signature ▶	Date	Check if also paid preparer ☐	Check if self-employed ☐	ERO's SSN or PTIN
Firm's name (or yours if self-employed), address, and ZIP code ▶			EIN	
			Phone no.	

Under penalties of perjury, I declare that I've examined the above partnership's return or AAR and accompanying forms, schedules, and statements, and to the best of my knowledge and belief, they are true, correct, and complete. This declaration is based on all information of which I've any knowledge.

Paid Preparer Use Only				
Print/Type preparer's name	Preparer's signature	Date	Check if self-employed ☐	PTIN
Firm's name ▶			Firm's EIN ▶	
Firm's address ▶			Phone no.	

For Privacy Act and Paperwork Reduction Act Notice, see instructions.
HTA

Form **8453-PE** (2021)

Form **1125-A**
(Rev. November 2018)
Department of the Treasury
Internal Revenue Service

Cost of Goods Sold

► **Attach to Form 1120, 1120-C, 1120-F, 1120S, or 1065.**
► **Go to *www.irs.gov/Form1125A* for the latest information.**

OMB No. 1545-0123

Name	Employer identification number
Data Security Products	75-3185725

1	Inventory at beginning of year	**1**	
2	Purchases	**2**	210,000
3	Cost of labor	**3**	
4	Additional section 263A costs (attach schedule)	**4**	
5	Other costs (attach schedule)	**5**	
6	**Total.** Add lines 1 through 5	**6**	210,000
7	Inventory at end of year	**7**	41,543
8	**Cost of goods sold.** Subtract line 7 from line 6. Enter here and on Form 1120, page 1, line 2 or the appropriate line of your tax return. See instructions	**8**	168,457

9a Check all methods used for valuing closing inventory:

(i) ☒ Cost
(ii) ☐ Lower of cost or market
(iii) ☐ Other (Specify method used and attach explanation.) ► ______

b Check if there was a writedown of subnormal goods ► ☐

c Check if the LIFO inventory method was adopted this tax year for any goods (if checked, attach Form 970) ► ☐

d If the LIFO inventory method was used for this tax year, enter amount of closing inventory computed under LIFO **9d** ______

e If property is produced or acquired for resale, do the rules of section 263A apply to the entity? See instructions ☐ Yes ☒ No

f Was there any change in determining quantities, cost, or valuations between opening and closing inventory? If "Yes," attach explanation ☐ Yes ☒ No

For Paperwork Reduction Act Notice, see instructions.
HTA

Form **1125-A** (Rev. 11-2018)

SCHEDULE B-1
(Form 1065)
(Rev. August 2019)
Department of the Treasury
Internal Revenue Service

Information on Partners Owning 50% or More of the Partnership

▶ **Attach to Form 1065.**
▶ **Go to *www.irs.gov/Form1065* for the latest information.**

OMB No. 1545-0123

Name of partnership	**Employer identification number (EIN)**
Data Security Products	75-3185725

Part I **Entities Owning 50% or More of the Partnership** (Form 1065, Schedule B, Question 2a (Question 3a for 2009 through 2017))

Complete columns (i) through (v) below for any foreign or domestic corporation, partnership (including any entity treated as a partnership), trust, tax-exempt organization, or any foreign government that owns, directly or indirectly, an interest of 50% or more in the profit, loss, or capital of the partnership (see instructions).

(i) Name of Entity	(ii) Employer Identification Number (if any)	(iii) Type of Entity	(iv) Country of Organization	(v) Maximum Percentage Owned in Profit, Loss, or Capital

Part II **Individuals or Estates Owning 50% or More of the Partnership** (Form 1065, Schedule B, Question 2b (Question 3b for 2009 through 2017))

Complete columns (i) through (iv) below for any individual or estate that owns, directly or indirectly, an interest of 50% or more in the profit, loss, or capital of the partnership (see instructions).

(i) Name of Individual or Estate	(ii) Identifying Number (if any)	(iii) Country of Citizenship (see instructions)	(iv) Maximum Percentage Owned in Profit, Loss, or Capital

For Paperwork Reduction Act Notice, see the Instructions for Form 1065. **Schedule B-1 (Form 1065) (Rev. 8-2019)**
HTA

651121

☐ Final K-1 ☐ Amended K-1 OMB No. 1545-0123

Schedule K-1 (Form 1065) **2021**

Department of the Treasury
Internal Revenue Service

For calendar year 2021, or tax year beginning ______ ending ______

Partner's Share of Income, Deductions, Credits, etc.

▶ **See back of form and separate instructions.**

Part I Information About the Partnership

A Partnership's employer identification number
75-3185725

B Partnership's name, address, city, state, and ZIP code
Data Security Products
1701 W. Dravus St.
Seattle, WA 98199

C IRS center where partnership filed return ▶ e-file

D ☐ Check if this is a publicly traded partnership (PTP)

Part II Information About the Partner

E Partner's SSN or TIN (Do not use TIN of a disregarded entity. See instructions.) Partner: 1
75-8151512

F Name, address, city, state, and ZIP code for partner entered in E. See instructions.
Frasier Corporation
4825 Linden Ave.
Seattle, WA 98103

G ☐ General partner or LLC member-manager ☒ Limited partner or other LLC member

H1 ☒ Domestic partner ☐ Foreign partner

H2 ☐ If the partner is a disregarded entity (DE), enter the partner's:
TIN ______ Name ______

I1 What type of entity is this partner? Corporation

I2 If this partner is a retirement plan (IRA/SEP/Keogh/etc.), check here ▶ ☐

J Partner's share of profit, loss, and capital (see instructions):

	Beginning	Ending
Profit		60.000000%
Loss		60.000000%
Capital		62.580134%

Check if decrease is due to sale or exchange of partnership interest . . . ▶ ☐

K Partner's share of liabilities:

	Beginning	Ending
Nonrecourse	$	$ 600,000
Qualified nonrecourse financing	$	$ 600,000
Recourse	$	$ 48,000

Check this box if Item K includes liability amounts from lower tier partnerships. ▶ ☐

L **Partner's Capital Account Analysis**

Beginning capital account	$
Capital contributed during the year	$ 600,000
Current year net income (loss)	$ -14,299
Other increase (decrease) (attach explanation)	$ -3,600
Withdrawals and distributions	$ ( )
Ending capital account	$ 582,101

M Did the partner contribute property with a built-in gain (loss)?
☒ **Yes** ☐ **No** If "Yes," attach statement. See instructions.

N **Partner's Share of Net Unrecognized Section 704(c) Gain or (Loss)**

Beginning	$
Ending	$ 500,000

Part III Partner's Share of Current Year Income, Deductions, Credits, and Other Items

1	Ordinary business income (loss)		-11,299
2	Net rental real estate income (loss)		
3	Other net rental income (loss)		
4a	Guaranteed payments for services		
4b	Guaranteed payments for capital		
4c	Total guaranteed payments		
5	Interest income		
6a	Ordinary dividends		
6b	Qualified dividends		
6c	Dividend equivalents		
7	Royalties		
8	Net short-term capital gain (loss)		
9a	Net long-term capital gain (loss)		
9b	Collectibles (28%) gain (loss)		
9c	Unrecaptured section 1250 gain		
10	Net section 1231 gain (loss)		
11	Other income (loss)		
12	Section 179 deduction		
13	Other deductions	G	3,000
14	Self-employment earnings (loss)	A	-7,432
15	Credits		
16	Schedule K-3 is attached if checked . . . . . . ▶ ☐		
17	Alternative minimum tax (AMT) items		
18	Tax-exempt income and nondeductible expenses	C	3,600
19	Distributions		
20	Other information	Z*	See Attached Stmt
21	Foreign taxes paid or accrued		

22 ☐ More than one activity for at-risk purposes*

23 ☐ More than one activity for passive activity purposes*

*See attached statement for additional information.

For IRS Use Only

For Paperwork Reduction Act Notice, see the Instructions for Form 1065. www.irs.gov/Form1065 **Schedule K-1 (Form 1065) 2021**
HTA

Frasier Corporation 75-8151512

K-1 Statement (Sch K-1, Form 1065)

Line 13 - Other Deductions

G	Code G - Contributions (100%)	G	3,000

Line 14 - Self-Employment

A	Code A - Net earnings (loss) from self-employment	A	-7,432

Line 18 - Tax-Exempt Income and Nondeductible Expenses

C	Code C - Nondeductible expenses	C	3,600

Line 20 - Other Information

Section 199A Information (Code Z)

	Non-SSTB	SSTB
Income Items		
Ordinary Income	-11,299	0
Deduction Items		
Contributions (100%)	3,000	0
Additional Information		
Section 199A W-2 wages	81,360	0
Section 199A unadjusted basis	540,000	0

651121

☐ Final K-1 ☐ Amended K-1 OMB No. 1545-0123

Schedule K-1 (Form 1065) **2021**

Department of the Treasury
Internal Revenue Service

For calendar year 2021, or tax year beginning ____ ending ____

Partner's Share of Income, Deductions, Credits, etc.

▶ **See back of form and separate instructions.**

Part I Information About the Partnership

A Partnership's employer identification number
75-3185725

B Partnership's name, address, city, state, and ZIP code
Data Security Products
1701 W. Dravus St.
Seattle, WA 98199

C IRS center where partnership filed return ▶ e-file

D ☐ Check if this is a publicly traded partnership (PTP)

Part II Information About the Partner

E Partner's SSN or TIN (Do not use TIN of a disregarded entity. See instructions.) Partner: 2
454-66-3333

F Name, address, city, state, and ZIP code for partner entered in E. See instructions.
Henry Yesler
1750 Holman Rd.
Seattle, WA 98117

G ☒ General partner or LLC member-manager ☐ Limited partner or other LLC member

H1 ☒ Domestic partner ☐ Foreign partner

H2 ☐ If the partner is a disregarded entity (DE), enter the partner's: TIN ____ Name ____

I1 What type of entity is this partner? Active Individual

I2 If this partner is a retirement plan (IRA/SEP/Keogh/etc.), check here ▶☐

J Partner's share of profit, loss, and capital (see instructions):

	Beginning	Ending
Profit		20.000000%
Loss		20.000000%
Capital		18.709933%

Check if decrease is due to sale or exchange of partnership interest . . . ▶☐

K Partner's share of liabilities:

	Beginning	Ending
Nonrecourse	$	$ 200,000
Qualified nonrecourse financing	$	$ 200,000
Recourse	$	$ 16,000

Check this box if Item K includes liability amounts from lower tier partnerships. ▶☐

L **Partner's Capital Account Analysis**

Beginning capital account	$
Capital contributed during the year	$ 200,000
Current year net income (loss)	$ -4,766
Other increase (decrease) (attach explanation)	$ -1,200
Withdrawals and distributions	$ (20,000)
Ending capital account	$ 174,034

M Did the partner contribute property with a built-in gain (loss)?
☐ Yes ☒ No If "Yes," attach statement. See instructions.

N **Partner's Share of Net Unrecognized Section 704(c) Gain or (Loss)**
Beginning . . . $
Ending . . . $

Part III Partner's Share of Current Year Income, Deductions, Credits, and Other Items

1	Ordinary business income (loss)	-3,766
2	Net rental real estate income (loss)	
3	Other net rental income (loss)	
4a	Guaranteed payments for services	
4b	Guaranteed payments for capital	
4c	Total guaranteed payments	
5	Interest income	
6a	Ordinary dividends	
6b	Qualified dividends	
6c	Dividend equivalents	
7	Royalties	
8	Net short-term capital gain (loss)	
9a	Net long-term capital gain (loss)	
9b	Collectibles (28%) gain (loss)	
9c	Unrecaptured section 1250 gain	
10	Net section 1231 gain (loss)	
11	Other income (loss)	
12	Section 179 deduction	
13	Other deductions	G 1,000
14	Self-employment earnings (loss)	A -3,766
15	Credits	
16	Schedule K-3 is attached if checked . . . ▶☐	
17	Alternative minimum tax (AMT) items	
18	Tax-exempt income and nondeductible expenses	C 1,200
19	Distributions	A 20,000
20	Other information	Z* See Attached Stmt
21	Foreign taxes paid or accrued	

22 ☐ More than one activity for at-risk purposes*
23 ☐ More than one activity for passive activity purposes*

*See attached statement for additional information.

For IRS Use Only

For Paperwork Reduction Act Notice, see the Instructions for Form 1065. www.irs.gov/Form1065 **Schedule K-1 (Form 1065) 2021**
HTA

Henry Yesler 454-66-3333

K-1 Statement (Sch K-1, Form 1065)

Line 13 - Other Deductions

G	Code G - Contributions (100%)	G	1,000

Line 14 - Self-Employment

A	Code A - Net earnings (loss) from self-employment	A	-3,766

Line 18 - Tax-Exempt Income and Nondeductible Expenses

C	Code C - Nondeductible expenses	C	1,200

Line 19 - Distributions

A	Code A - Cash and marketable securities	A	20,000

Line 20 - Other Information

Section 199A Information (Code Z)

	Non-SSTB	SSTB
Income Items		
Ordinary Income	-3,766	0
Deduction Items		
Contributions (100%)	1,000	0
Additional Information		
Section 199A W-2 wages	27,120	0
Section 199A unadjusted basis	180,000	0

651121

☐ Final K-1 ☐ Amended K-1 OMB No. 1545-0123

Schedule K-1 (Form 1065) **2021**

Department of the Treasury
Internal Revenue Service

For calendar year 2021, or tax year beginning ______ ending ______

Partner's Share of Income, Deductions, Credits, etc.

▶ **See back of form and separate instructions.**

Part I Information About the Partnership

A Partnership's employer identification number
75-3185725

B Partnership's name, address, city, state, and ZIP code
Data Security Products
1701 W. Dravus St.
Seattle, WA 98199

C IRS center where partnership filed return ▶ e-file

D ☐ Check if this is a publicly traded partnership (PTP)

Part II Information About the Partner

E Partner's SSN or TIN (Do not use TIN of a disregarded entity. See instructions.) Partner: 3
459-34-5939

F Name, address, city, state, and ZIP code for partner entered in E. See instructions.
Dorothy Graham
1519 NW Market Street
Seattle, WA 98107

G [X] General partner or LLC member-manager ☐ Limited partner or other LLC member

H1 [X] Domestic partner ☐ Foreign partner

H2 ☐ If the partner is a disregarded entity (DE), enter the partner's: TIN ______ Name ______

I1 What type of entity is this partner? Active Individual

I2 If this partner is a retirement plan (IRA/SEP/Keogh/etc.), check here ▶ ☐

J Partner's share of profit, loss, and capital (see instructions):

	Beginning	Ending
Profit		20.000000%
Loss		20.000000%
Capital		18.709933%

Check if decrease is due to sale or exchange of partnership interest . . . ▶ ☐

K Partner's share of liabilities:

	Beginning	Ending
Nonrecourse .	$	$ 200,000
Qualified nonrecourse financing	$	$ 200,000
Recourse . . .	$	$ 16,000

Check this box if Item K includes liability amounts from lower tier partnerships. ▶ ☐

L **Partner's Capital Account Analysis**

Beginning capital account	$
Capital contributed during the year . .	$ 200,000
Current year net income (loss)	$ -4,766
Other increase (decrease) (attach explanation)	$ -1,200
Withdrawals and distributions	$ (20,000)
Ending capital account	$ 174,034

M Did the partner contribute property with a built-in gain (loss)?
☐ **Yes** [X] **No** If "Yes," attach statement. See instructions.

N **Partner's Share of Net Unrecognized Section 704(c) Gain or (Loss)**
Beginning . . . . $
Ending . . . . $

Part III Partner's Share of Current Year Income, Deductions, Credits, and Other Items

1	Ordinary business income (loss)	-3,766	14	Self-employment earnings (loss)	
			A		-3,766
2	Net rental real estate income (loss)				
3	Other net rental income (loss)		15	Credits	
4a	Guaranteed payments for services				
4b	Guaranteed payments for capital		16	Schedule K-3 is attached if checked . . . . ▶ ☐	
4c	Total guaranteed payments		17	Alternative minimum tax (AMT) items	
5	Interest income				
6a	Ordinary dividends				
6b	Qualified dividends		18	Tax-exempt income and nondeductible expenses	
6c	Dividend equivalents		C		1,200
7	Royalties				
8	Net short-term capital gain (loss)				
			19	Distributions	
9a	Net long-term capital gain (loss)		A		20,000
9b	Collectibles (28%) gain (loss)				
			20	Other information	
9c	Unrecaptured section 1250 gain		Z*	See Attached Stmt	
10	Net section 1231 gain (loss)				
11	Other income (loss)				
12	Section 179 deduction		21	Foreign taxes paid or accrued	
13	Other deductions				
G		1,000			

22 ☐ More than one activity for at-risk purposes*
23 ☐ More than one activity for passive activity purposes*

*See attached statement for additional information.

For IRS Use Only

For Paperwork Reduction Act Notice, see the Instructions for Form 1065. www.irs.gov/Form1065 **Schedule K-1 (Form 1065) 2021**
HTA

Dorothy Graham 459-34-5939

K-1 Statement (Sch K-1, Form 1065)

Line 13 - Other Deductions

G	Code G - Contributions (100%)	**G**	1,000

Line 14 - Self-Employment

A	Code A - Net earnings (loss) from self-employment	**A**	-3,766

Line 18 - Tax-Exempt Income and Nondeductible Expenses

C	Code C - Nondeductible expenses	**C**	1,200

Line 19 - Distributions

A	Code A - Cash and marketable securities	**A**	20,000

Line 20 - Other Information

Section 199A Information (Code Z)

	Non-SSTB	SSTB
Income Items		
Ordinary Income	-3,766	0
Deduction Items		
Contributions (100%)	1,000	0
Additional Information		
Section 199A W-2 wages	27,120	0
Section 199A unadjusted basis	180,000	0

Form **4562**

Department of the Treasury
Internal Revenue Service (99)

Depreciation and Amortization
(Including Information on Listed Property)

► **Attach to your tax return.**

► **Go to *www.irs.gov/Form4562* for instructions and the latest information.**

OMB No. 1545-0172

2021

Attachment Sequence No. **179**

Name(s) shown on return	Business or activity to which this form relates	**Identifying number**
Data Security Products	1065 - Retail	75-3185725

Part I **Election To Expense Certain Property Under Section 179**

Note: If you have any listed property, complete Part V before you complete Part I.

1	Maximum amount (see instructions)	**1**	1,050,000
2	Total cost of section 179 property placed in service (see instructions)	**2**	200,000
3	Threshold cost of section 179 property before reduction in limitation (see instructions)	**3**	2,620,000
4	Reduction in limitation. Subtract line 3 from line 2. If zero or less, enter -0-	**4**	0
5	Dollar limitation for tax year. Subtract line 4 from line 1. If zero or less, enter -0-. If married filing separately, see instructions	**5**	1,050,000

6	**(a)** Description of property	**(b)** Cost (business use only)	**(c)** Elected cost
7	Listed property. Enter the amount from line 29	**7**	

8	Total elected cost of section 179 property. Add amounts in column (c), lines 6 and 7	**8**	0
9	Tentative deduction. Enter the **smaller** of line 5 or line 8	**9**	0
10	Carryover of disallowed deduction from line 13 of your 2020 Form 4562	**10**	
11	Business income limitation. Enter the smaller of business income (not less than zero) or line 5. See instructions	**11**	
12	Section 179 expense deduction. Add lines 9 and 10, but don't enter more than line 11	**12**	0
13	Carryover of disallowed deduction to 2022. Add lines 9 and 10, less line 12 ►	**13**	0

Note: Don't use Part II or Part III below for listed property. Instead, use Part V.

Part II **Special Depreciation Allowance and Other Depreciation (Don't** include listed property. See instructions.**)**

14	Special depreciation allowance for qualified property (other than listed property) placed in service during the tax year. See instructions	**14**	
15	Property subject to section 168(f)(1) election	**15**	
16	Other depreciation (including ACRS)	**16**	

Part III **MACRS Depreciation (Don't** include listed property. See instructions.**)**

Section A

17	MACRS deductions for assets placed in service in tax years beginning before 2021	**17**	
18	If you are electing to group any assets placed in service during the tax year into one or more general asset accounts, check here ► ☐		

Section B - Assets Placed in Service During 2021 Tax Year Using the General Depreciation System

(a) Classification of property	**(b)** Month and year placed in service	**(c)** Basis for depreciation (business/investment use only—see instructions)	**(d)** Recovery period	**(e)** Convention	**(f)** Method	**(g)** Depreciation deduction
19 a 3-year property						
b 5-year property						
c 7-year property		200,000	7	HY	200DB	28,580
d 10-year property						
e 15-year property						
f 20-year property						
g 25-year property			25 yrs.		S/L	
h Residential rental property	1/1/2021	700,000	27.5 yrs.	MM	S/L	24,394
			27.5 yrs.	MM	S/L	
i Nonresidential real property			39 yrs.	MM	S/L	
				MM	S/L	

Section C - Assets Placed in Service During 2021 Tax Year Using the Alternative Depreciation System

20 a Class life					S/L	
b 12-year			12 yrs.		S/L	
c 30-year			30 yrs.	MM	S/L	
d 40-year			40 yrs.	MM	S/L	

Part IV **Summary** (See instructions.)

21	Listed property. Enter amount from line 28	**21**	
22	**Total.** Add amounts from line 12, lines 14 through 17, lines 19 and 20 in column (g), and line 21. Enter here and on the appropriate lines of your return. Partnerships and S corporations—see instructions	**22**	52,974
23	For assets shown above and placed in service during the current year, enter the portion of the basis attributable to section 263A costs	**23**	

For Paperwork Reduction Act Notice, see separate instructions. Form 4562 (2021)

HTA

Line 20 (1065) - Other Deductions

1	Insurance	1	12,000
2	Total other deductions	2	12,000

Line 13a, Sch K (1065) - Contributions

G	Code G - Contributions (100%)	G	5,000
	Total contributions	13a	5,000

Line 19, Sch K (1065) - Distributions

			Adjusted Basis	Fair Market Value
A	Code A - Distributions of cash and marketable securities			
	Distributions of cash			40,000
	Total distributions of cash and marketable securities	A		40,000

Line 4, Sch M-1 (1065) - Expenses Recorded on Books not Included on Sch K

1	Bad debt expense	1	6,000
2	Total expenses on books not on Sch K	2	6,000

Line 7, Sch M-2 (1065) - Other Decreases

1	Guaranteed payments (other than health insurance)	1	252,000
2	Bad debt expense	2	6,000
3	Total other decreases	3	258,000

Summary of Unadjusted Basis of Qualified Property (4562)

12/31/2021

Summary of Qualified Property by Activity

	Activity	Unadjusted Cost or Basis
1	1065	900,000

Detail of Qualified Property

	Activity	Asset Description	Date In Service	Recovery Period	Years in Service	Total Cost or Basis	Business/Time Use Percent	Unadjusted Cost or Basis
2	1065	Building	1/1/2021	27.5	1	700,000	100.00%	700,000
3	1065	Equipment	1/2/2021	7.0	1	200,000	100.00%	200,000

Overview — Partnership tax return

The partnership tax return

Form 1065, *U.S. Return of Partnership Income*, must be filed annually by most entities classified as partnerships. Form 1065 is an information return only, summarizing the income, deductions, gains, losses, and the like from the entity's business and investment activities. The partnership generally does not pay tax on its income; rather that income or loss is "passed through" to the partners or members (for LLCs that are taxed as partnerships), who must add or subtract their shares of each item on the return when computing their own taxable incomes. Thus, the partners pay tax on the partnership's profits or receive any tax benefits associated with partnership items of loss and deduction.

Note. Certain publicly traded partnerships are treated as corporations and must file Form 1120, *U.S. Corporation Income Tax Return*, rather than Form 1065. See Section 7704 for the definition of "publicly traded partnerships."

A Schedule K-1 for each partner or LLC member is filed with Form 1065. A partner's Schedule K-1 summarizes her share of each item of income, gain, loss, deduction, and the like, reported on the Form 1065. Separate K-1s are filed for each partner or member; the amounts reported on each K-1 must add to the aggregate amounts reported on the Form 1065. These schedules are sent to both the IRS (as part of Form 1065) and to each partner or LLC member.

Form 1065 and accompanying Schedules K-1 must generally be filed by the 15^{th} day of the third month following the close of the partnership or LLC's taxable year. If this day falls on a Saturday or Sunday, the deadline is extended to the following Monday.

An automatic six-month extension to file the partnership tax return can be obtained by filing Form 7004, *Application for Automatic Extension of Time to File Certain Business Income Tax, Information, and Other Returns*. Form 7004 must be filed by the original due date of the partnership return.

Note that an extension of time to file the partnership tax return does not extend the filing period for any of the entity's partners or members, nor does it extend the time for payment of taxes by any of the partners. Partners wishing to extend the filing deadlines for their own tax returns must make separate requests of the IRS.

For partnerships or LLCs that maintain their books and records outside the United States and Puerto Rico, a two-month extension of time to file is automatically granted to the 15^{th} day of the 6^{th} month following the close of the partnership or LLC's taxable year.[1] The partnership or LLC is not required to file a form requesting this two-month extension; it is automatically granted to all eligible partnerships. Form 7004 may be filed by such partnerships requesting the automatic six-month extension of time to file, but

[1] Regulation Section 1.6081-5. This regulation might need to be updated by the IRS to correlate with the new due date of the Form 1065.

it must be noted that this six-month extension period includes the two-month extension granted to those partnerships maintaining their books and records outside the United States and Puerto Rico.

Knowledge check

1. Under Subchapter K, the partnership files Form 1065 reporting its income to the IRS. Regarding this, which statement is correct?
    a. The partners pay income tax on the portion of that taxable income that is distributed to them.
    b. The partnership pays tax only on that portion of income that is not distributed to the partners.
    c. The partners pay tax on their distributive shares of partnership income regardless of distributions.
    d. The partners pay tax only on the excess of distributions over their basis.

Aggregated versus separately stated items: Page 1 of Form 1065 versus Schedule K

In reporting its taxable income or loss to the IRS and its partners, Section 702 requires that the partnership segregate and report separately those items that might be subject to limitations or other special treatment on the tax returns of any of its partners. For example, the partnership is required to report separately the following items:

- Net ordinary income or loss from trade or business activities
- Net income or loss from rental real estate activities
- Net income or loss from other rental activities
- Long-term capital gains and losses
- Short-term capital gains and losses
- Section 1231 gains and losses (from the disposition of business-use assets)
- Charitable contributions
- Dividends
- Interest income
- Foreign taxes paid or accrued
- Any other items potentially subject to special treatment on a partner's tax return, such as intangible drilling costs, mining, and exploration expenditures

Thus, page 1 of Form 1065, used to report partnership or LLC taxable income, actually reports only the net *ordinary business* income or loss from partnership or LLC activities, which are not subject to special treatment by the partners. A complete summary of the partnership or LLC's items of income or loss is reported on Schedule K, which is attached to Form 1065. Schedule K summarizes the entity's items of income, loss, gain, or deduction from each of its activities and classifies those items into categories identified by the IRS as potentially subject to special treatment by the partners. The section following Schedule K (Analysis of Net Income [Loss]) actually summarizes the partnership or LLC's net income or loss from all sources and reports the type of partner (general or limited) the income or loss is allocated to. Each partner or member's share of each line item on Schedule K is reported to the IRS and to each partner or member in a corresponding box on Schedule K-1. A separate Schedule K-1 must be completed for each partner or member, with copies being sent to the IRS (as attachments to Form 1065) and to the individual partners or members. Each partner or member is required to receive only one Schedule K-1, reporting his individual share of each item of the entity's income or loss. As a practical matter, many partnerships and LLCs send a copy of Form 1065 and accompanying Schedule K to each partner or member. Specific requirements for completing these forms and schedules are discussed later in this chapter.

Knowledge check

2. Which item is ***not*** required to be separately stated on the partnership's tax return?
    a. Net income or loss from rental real estate activities.
    b. Salaries and wages paid to employees in the partnership's trade or business activities.
    c. Dividend income.
    d. Charitable contributions.

Maintenance of capital accounts

Because tax-basis capital accounts seldom reflect fair market values, regulations require the creation and maintenance of a separate set of investor capital accounts. These capital accounts are similar to the partnership's GAAP capital accounts with a few minor differences. They are intended to reflect, as accurately as possible, the economic interest that each partner or member has in the entity.

The regulations thus impose a set of accounting requirements to be followed in maintaining partner capital accounts. These requirements are generally straightforward: Property contributions are reflected in the partnership's Section 704(b) books at fair market value (net of liabilities) and partner allocations of book income, gain, loss, and deduction are added to or subtracted from individual partner capital accounts as allocations are made. The only notable departure from GAAP is that distributions of property must also be recorded at fair market value rather than remaining book value. As with contributions, distributions must also be recorded net of liabilities. As a result, the distribution of property by a partnership or LLC generally requires that either a gain or loss be recorded for Section 704(b) purposes.

Beginning in 2020, each partner's capital account balance as reported on their Schedule K-1 should be reported on the tax basis. Adding a partner's share of partnership liabilities to their tax basis capital account should result in the partner's basis in their partnership interest. The Section 704(b) capital account for each partner should still be maintained, but it is not required to be disclosed on the tax return.

Example 1-1

A and B form the AB Partnership with equal cash contributions of $50,000. The partnership borrows $200,000 and purchases two parcels of real estate at a total cost of $250,000. Immediately after the acquisition, the partnership's Section 704(b) balance sheet appears as follows:

Assets:	
Cash	$50,000
Parcel 1	40,000
Parcel 2	210,000
	$300,000
Liabilities:	$200,000
Capital A	50,000
Capital B	50,000
	$300,000

Over the next two years, the partnership reports total taxable income of $100,000, which it allocates equally between the two partners. At the end of year 2, Parcel 1 is distributed to A in a nonliquidating distribution. Assume that Parcel 1 is worth $120,000 at the date of distribution and that its tax basis to the partnership is still $40,000.

A's Section 704(b) capital account must be reduced by $120,000, the fair market value of Parcel 1. For the partnership's Section 704(b) books to remain in balance, the $80,000 appreciation in the value of Parcel 1 at the date of distribution must first be recorded as a gain and the partners' capital accounts increased accordingly. Thus, assuming the partners share partnership profits and losses equally, their capital accounts will be adjusted as follows:

	Capital, A	Capital, B
Beginning balance	$50,000	$50,000
Income, years 1 & 2	50,000	50,000
Gain on distribution of P1	40,000	40,000
Distribution of P1	(120,000)	0
Post-distribution balances	$20,000	$140,000

Although not required by the regulations, the partnership would be advised to revise the partners' profit- and loss-sharing ratios to reflect their new interests in partnership capital.

Key review point

Property contributed to the partnership will be initially included on the partnership Section 704(b) books at fair market value, rather than at the contributing partner's basis. The fair market value will be the book value, which generally is what will be reported on Schedule L. It is important to get an accurate idea of the fair market value of contributed property because this has a direct effect on the Section 704(b) capital account balance of the contributing partner.

Review check: Did the property contributed by Frasier get included on Schedule L at the correct amount?

Determination of tax year

Section 706(b)(1)(B) governs the determination of the partnership's taxable year. In general, the statute requires that the partnership's tax year conform to that used by its partners. Specifically, Section 706 requires determination of the partnership tax year according to the following requirements:

- *Majority interest rule*. A new partnership must adopt the same tax year as used by those partners owning aggregate interests exceeding 50% in profits and capital.
- *Principal partners rule*. If there are no majority interest partners, the partnership is required to adopt the same tax year as that of all those partners owning at least 5% interests in profits or capital (this is possible only if all greater-than-5% partners have the same tax year).
- *Other allowable year*. If neither of the aforementioned rules can be applied, the partnership generally must adopt as its taxable year the year that results in the least aggregate deferral of income to its partners. Aggregate deferral is measured by totaling, for all partners, the product of each partner's months of deferral of partnership income and that partner's percentage ownership. A partner's months of deferral are the number of months from the end of the partnership's taxable year to the end of the partner's taxable year (the months of partnership income that will not be recognized by the partner until the partner's following taxable year).

Example 1-2

A and B form equal partnership AB on January 1, Y1. Partner A has a tax year ending on June 30, whereas partner B's tax year ends on July 31. Because A and B each have a 50% interest in the partnership, neither the majority interest rule nor the principal partners rule apply. Thus, the partnership must use a June 30 tax year, because that year results in the least aggregate deferral of income for the partners:

6/30 Year-end				
Partner	Ptr yr. end	Partnership interest	Mo. deferral for 6/30 yr. end	Aggregate deferral
A	6/30	50%	0	0.0
B	7/31	50%	1	0.5
				0.5 months
7/31 Year-end				
Partner	Ptr yr. end	Partnership interest	Mo. deferral for 7/31 yr. end	Aggregate deferral
A	6/30	50%	11	5.5
B	7/31	50%	0	0.0
				5.5 months

Exceptions

There are two exceptions to the rules of Section 706(b)(1)(B). One exception allows partnerships to file Form 1128, *Application to Adopt, Change, or Retain a Tax Year*, to request to use another taxable year if they can show that they have a "natural business year." Generally, to qualify for this exception the partnership must show that the alternative year conforms to the partnership's natural business cycle. Under Revenue Procedure 2002-39 (2002-1 CB 1046), this can be done using one of three tests: (*a*) the annual business cycle test, (*b*) the seasonal business test, and (*c*) the 25% of gross receipts test.

Under the annual business cycle test, if the taxpayer's gross receipts from sales and services for the short period (ending with the proposed year-end) and the three immediately preceding taxable years indicate that the taxpayer has a peak and a non-peak period of business, the taxpayer's natural business year is deemed to end at, or soon after, the close of the highest peak period of business. Under a safe harbor rule, for this test, one month is deemed to be "soon after" the close of the highest peak period of business.

Under the seasonal business test, if the taxpayer's gross receipts from sales and services for the short period and the three immediately preceding taxable years indicate that the taxpayer's business is operational for only part of the year (for example, due to weather conditions) and, as a result, the taxpayer has insignificant gross receipts during the period the business is not operational, the taxpayer's natural business year is deemed to end at, or soon after, the operations end for the season. Under a safe harbor rule, for purposes of this test, an amount equal to less than 10% of the taxpayer's total gross receipts for the year will be deemed to be "insignificant" and one month will be deemed to be "soon after" the close of operations.

Under the 25% gross receipts test, a partnership may substantiate a natural business year by showing that gross receipts for the last two months of the requested year constitute 25% or more of its total gross receipts for such year. This requirement must be satisfied for the current year and the prior two years.[2]

The other exception to the rules of Section 706(b)(1)(B) allows a partnership to adopt, or to change to, an alternative tax year without showing a "natural business year." Under Sec. 444, however, to use the alternative year, the partnership must make required payments, which approximate the amount of the tax deferral for the alternative tax year. These payments must be made annually on May 15, accompanied by Form 8752, *Required Payment or Refund Under Section 7519*. The required payments for each year are determined by multiplying the partnership's deferral period income by the highest statutory individual tax rate plus 1%. Such amount must be paid to the IRS for the first year in which the alternative year is to be used. Additional payments must be made annually if the required prepayment increases over this initial amount by $500 or more.

Knowledge check

3. R and Q form equal partnership RQ on February 15. Partner R has a tax year ending on July 31, and partner Q's tax year ends on October 31. What taxable year must the partnership use?

    a. February 15.
    b. July 31.
    c. October 31.
    d. December 31.

[2] To substantiate a natural business year under the 25% gross receipts test, a taxpayer must have a 47-month history of gross receipts — 12 months for the current and two prior years plus 11 additional months to be used to compare the requested natural year with other potential tax years. Where more than one year qualifies as a natural business year under this test, the partnership must use the fiscal year with the highest percentage of gross receipts occurring in the final two months (that is, the "most natural" business year).

4. On February 1, Q and L form QL, an LLC choosing to be taxed as a partnership. The two investors have equal interests in the LLC's capital, profits, and losses. Q's tax year ends on January 31 and L has a tax year ending on March 31. What taxable year must the partnership use?

   a. December 31.
   b. January 31.
   c. March 31.
   d. February 1.

Review check: Can DSP use a calendar year as its taxable year? What are the effects if it cannot? Is depreciation affected?

Self-employment income of partners

Compensatory payments to partners often cause the partner to have to recognize self-employment income. The amount of self-employment income a partner must recognize depends on several factors, one of which is whether the partner is a general partner or a limited partner.

General partners

A general partner's self-employment income includes his distributive share (whether or not actually distributed) of non-separately stated income or loss from any trade or business carried on by the partnership.[3] As indicated previously, self-employment income of a general partner also includes guaranteed payments (even if made for the use of capital), as long as the partnership making the guaranteed payments is engaged in a trade or business.

Limited partners

The self-employment income of a limited partner does not include her distributive share of the limited partnership's non-separately stated income or loss but does include any guaranteed payments allocated to her, as long as they are in return for services rendered to the partnership and the partnership is engaged in a trade or business. Proposed regulations, explained later in this chapter, describe circumstances under which a partner will be treated as a limited partner for this purpose.[4] If a limited partner also holds a general partner interest in the same partnership, the distributive share received as a general partner is self-employment income, but the distributive share received as a limited partner is not.[5]

Similarly, guaranteed payments paid to an LLC member might be considered self-employment income, depending on the circumstances. Such payments to a wife from an LLC that she and her husband formed and owned were considered by the IRS and the Tax Court to be taxable self-employment income. The couple had originally reported the related payments as guaranteed payments on the LLC's returns and tried to characterize them as the wife's distributive share of partnership income after the IRS raised the self-employment tax issue. In addition, the facts indicated that the payments were for services the wife performed for the LLC (although such services were relatively small compared to her husband's). The services she provided included marketing advice, signing of documents, entering into contracts for the LLC, and allowing the LLC the use of her credit card and credit rating.[6]

[3] Reg. Section 1.1402(a)-1.
[4] IRC Section 1402(a)(13), Proposed Reg. Section 1.1402(a)-2(g) and (h).
[5] H. Rept. No 95-702 (PL 95-216), 12/20/77, p 11.
[6] *Lauren A. Howell* (2012), TC Memo 2012-303

A deduction of up to 20% of qualified business income (QBI) is allowed for certain taxpayers (discussion to follow later in these course materials). It should be noted that this deduction does not reduce taxable net earnings for self-employment tax purposes.

Example 1-3

The ABCD partnership has the following items of income:

Ordinary income from a trade or business	$100,000
Long-term capital gains	40,000
Dividend income	30,000

A, B, C, and D are equal partners, entitled to 25% shares of each item of partnership income or loss. A and B are general partners; the other partners are limited partners. A and C each receive a $10,000 guaranteed payment for services rendered; B and D each receive a $10,000 guaranteed payment for additional capital they have contributed. They each have the following self-employment income:

Partner	Self-employment income
A	$10,000 + .25 × ($100,000 – $40,000) = $25,000
B	Same as A, $25,000
C	$10,000
D	None

As a general partner, A will have self-employment income equal to A's guaranteed payment ($10,000) plus A's 25% share of the partnership's non-separately stated income (.25 × ($100,000 – $40,000 total guaranteed payments) = $15,000).

Because B is also a general partner, B's self-employment income is the same as A's, even though B's guaranteed payment is for capital contributed.

As a limited partner, C's self-employment income will not include her distributive share of the partnership's non-separately stated income but will include C's guaranteed payment because it is in return for services provided to the partnership.

Finally, as a limited partner whose guaranteed payment is a return on capital contributed, D will have no self-employment income.

Community property

Even if some portion of a partner's distributive share of the non-separately stated income or loss from a partnership is community income or loss under local community property laws (and thus taxable partly to their spouse), the entire distributive share is included in the net earnings from self-employment of the partner. No part of the distributive share will be included in the self-employment income of the partner's spouse.[7]

Key review point

Total self-employment income must be reported on Schedule K and must tie to the separate reporting of self-employment income for each of the partners on their Schedules K-1.

MACRS depreciation

Under MACRS you can use either the general depreciation system (GDS) or the alternative depreciation system (ADS) to depreciate property. The system you choose determines what depreciation method and recovery period you use. You generally must use GDS unless you are specifically required by law to use ADS or you elect to use ADS. The depreciation rates you use for a particular asset depend in part on the property classification the asset falls into. Following is a list of some of the property classifications under GDS and examples of the types of property included in each class.

- 3-year property:
  - Tractor units for over-the-road use
  - Any racehorse over two years old when placed in service
  - Any other horse (other than a racehorse) over 12 years old when placed in service
- 5-year property:
  - Automobiles, taxis, buses, and trucks
  - Computers and peripheral equipment
  - Office machinery (such as typewriters, calculators, and copiers)
  - Appliances, carpets, furniture, etc., used in a residential rental real estate activity
  - Certain geothermal, solar, and wind energy property
- 7-year property:
  - Office furniture and fixtures (such as desks, files, and safes)
  - Any property that does not have a class life and has not been designated by law as being in any other class
- 10-year property: Vessels, barges, tugs, and similar water transportation equipment
- 15-year property: Certain improvements made directly to land or added to it (such as shrubbery, fences, roads, sidewalks, and bridges)
- 20-year property: Farm buildings
- 27.5 S/L: Residential rental property
- 39 S/L: Nonresidential real property

[7] IRC Section 1402(a)(5)(B).

The allowable methods of depreciation for the different classes of property are as follows:

Method	Type of property
GDS using 200% DB	• Nonfarm 3-, 5-, 7-, and 10-year property
GDS using 150% DB	• All 15- and 20-year property Nonfarm 3-, 5-, 7-, and 10-year property
GDS using S/L	• Nonresidential real property • Residential rental property • All 3-, 5-, 7-, 10-, 15-, and 20-year property

Convention. *The midmonth convention.* Use this convention for nonresidential real property, residential rental property, and any railroad grading or tunnel bore. Under this convention, you treat all property placed in service or disposed of during a month as placed in service or disposed of at the midpoint of the month. This means that a one-half month of depreciation is allowed for the month the property is placed in service or disposed of.

The half-year convention. Under this convention, you treat all property placed in service or disposed of during a tax year as placed in service or disposed of at the midpoint of the year. This means that a one-half year of depreciation is allowed for the year the property is placed in service or disposed of. Most property that is not real estate will use the half-year convention.

Depreciation is calculated on Form 4562, *Depreciation and Amortization (Including Information on Listed Property)*, but could be included on the 1120s on page 1, line 14; on Form 1125-A; or on Form 8825, *Rental Real Estate Income and Expenses of a Partnership or an S Corporation*, line 14 (and then eventually on Schedule K).

Key review point

The depreciation method for the donated building should carry over to the partnership, so the relevant information will need to be received from the contributing partner.

Review check: Has the depreciation for the building been computed correctly? What if the first year is not a full calendar year?

Bonus depreciation

The Tax Cuts and Jobs Act (TCJA) of 2017 increased bonus depreciation to 100% of qualified property and expanded the definition of qualified property to include used property for tax years beginning in 2018. It also increased the Section 179 deduction limit to $1 million and made the net operating loss carryover period indefinite. The limit is indexed for inflation and is $1,050,000 in 2021 ($1,080,000 in 2022). The net effect of all these changes is to make it less likely that taxpayers will take MACRS depreciation on any asset, rather than simply expensing it. Section 461(l) of TCJA also reduced the allowable net operating loss deduction in a year to 80% of taxable income. This change will lead to circumstances in which there will be a greater present value of tax savings from taking MACRS depreciation than from expensing all eligible assets.

However, under the CARES Act passed in response to the coronavirus pandemic, the effective date of Section 461(l) has been retroactively postponed to tax years beginning after December 31, 2020. Because the effective date has been retroactively postponed, taxpayers can file amended returns for 2018 and 2019 claiming the full aggregate loss in the year incurred.

AMT depreciation adjustment

For regular MACRS, 5- or 7-year property is depreciable using the 200% declining balance method of depreciation, but for AMT purposes one can use only the 150% declining balance method. The difference is an AMT adjustment, which will go on line 17a of Schedule K, and in box 17 (code A) of each partner's Schedule K-1. The first-year percentage for 7-year property, from the IRS tables, is 14.29% for 200% DB, and 10.71% for 150% DB.

Review check: Has the AMT depreciation adjustment on the Form 1065, Schedule K, been computed correctly?

Section 199A QBI deduction

Beginning in 2018, the TCJA provisions allowed certain taxpayers a 20% QBI deduction for domestic trade or business income. However, taxpayers in service businesses will have their deduction phased out if the taxpayer's taxable income exceeds the 2021 threshold amounts of $164,900 for single or head of household, $164,925 for married filing separately, or $329,900 in the case of a joint return. Guaranteed payments do not qualify as either QBI or W-2 wages.

For taxpayers with taxable income in excess of the threshold amounts, the amount allowed as a deduction is equal to the *lesser of*

1. 20% of the taxpayer's QBI, or
2. the greater of
    a. 50% of the W-2 wages with respect to the qualified trade or business, or
    b. the sum of 25% of the W-2 wages with respect to the qualified trade or business plus 2.5% of the unadjusted basis, immediately after acquisition, of all qualified property.

Qualified property means tangible property subject to depreciation that is used in the production of QBI. The property must have been available for use at the close of the taxable year. Qualifying property cannot be fully depreciated before the end of the close of the taxable year. The depreciable period is defined as beginning on the date the property is first placed in service by the taxpayer and ending on the *later* of

1. 10 years after that date, or
2. the last day of the last full year in the applicable recovery period under Section 168 (MACRS).

The QBI deduction is calculated and taken at the taxpayer (partner) level, not the entity level. However, due to the way the deduction is calculated, partnerships (and other pass-through entities, for that matter) will be required to supply their partners with the information required to allow their partners to calculate their respective QBI deductions. To this end, they must disclose to partners their individual shares of QBI, W-2 wages, and qualified property in a statement labeled Code Z. These disclosures are made on Schedule K-1 in box 20.

Schedules L, M-1, M-2, and M-3

Before proceeding to a discussion of the specific requirements for reporting partnership or LLC income, deductions, gains and losses, it is instructive to discuss briefly the other major components of Form 1065 — the entity's balance sheets and reconciling schedules. Beginning and ending balance sheets are reported on Schedule L (page 5) of Form 1065. The balance sheets themselves are relatively straightforward. The primary question concerns which balance sheets should be reported. The tax law essentially requires partnerships to maintain at least two sets of books and records, one reflecting the tax basis of the partnership or LLC's assets, and measuring its income by reference to this tax basis, and the other reflecting the values, at the date of formation or contribution, of the entity's assets and measuring its income by reference to these amounts. The latter set of records is required under Section 704(b) and is used to determine each partner or member's economic interest in the partnership and its assets. Under Section 704(b), the partnership or LLC agreement must clearly tie each partner or member's rights to entity assets upon termination of such partner or member's interest in the partnership or LLC to his or her capital account on this balance sheet. Partnerships or LLCs whose agreements do not comply with this requirement are not allowed to make "special" allocations of items of income, gain, loss, or deduction to any partner or member. Although these balance sheets may not reflect the entity's taxable income, the IRS has made it clear in the instructions to Form 1065 that Schedule L should be prepared using GAAP or "book" values rather than tax basis.

Schedule M-1 on page five of Form 1065 reconciles the entity's book and taxable income. This schedule is relatively simple to complete, as it merely summarizes differences in the accounting methods used by the partnership or LLC for financial statement versus tax purposes. Examples of book or tax differences that might be reconciled here are depreciation, book gains and losses on distributions of assets, and meal and entertainment expenses.

Schedule M-2 reconciles the total book partner or member capital account balance from the beginning to the end of the year. Here, the change in capital is classified into changes resulting from partner or member contributions, withdrawals, and partnership or LLC income. The ending capital balance reported on this schedule should tie back to the end-of-year total reported on Schedule L. Thus, where the entity's book and tax records differ, the former should be used as the basis for completing Schedule M-2.

Partnerships and LLCs are not required to complete Schedules L, M-1, and M-2 if all of the following are satisfied: (*a*) total receipts are less than $250,000; (*b*) total assets are less than $1,000,000; (*c*) Schedules K-1 are filed with the partnership or LLC tax return and mailed to partners or members by the due date of the entity's tax return (including extensions); and (*d*) the partnership does not file or is not required to file Schedule M-3. Although "small" partnerships are excepted from completing these schedules, as well as from the requirement that each partner's or member's capital account be reconciled on the Schedule K-1 received by such partner or member, many partnerships and LLCs decide not to forgo reconciliation of the partners or members' capital accounts on Schedules K-1. Such information is often necessary in order for the individual partners or members, or their tax advisers, to calculate the individual partners or members' bases in their partnership or LLC interests.

Knowledge check

5. Schedule M-2 of Form 1065 is used to

    a. Reconcile changes in the partnership's capital balance on its tax basis balance sheet, as reported on Schedule L.
    b. Reconcile changes in the partnership's capital balance on its book balance sheet, as reported on Schedule L.
    c. Reconcile book income to tax basis income.
    d. Report all separately stated items.

Schedule M-3 of Form 1065 must be filed instead of Schedule M-1 if any one of the following is true:

- Total assets are equal to or greater than $10 million.
- Adjusted total assets (basically total assets plus distributions plus any other negative adjustments to capital from Schedule M-2) are equal to or greater than $10 million.
- Total receipts for the year equal or exceed $35 million.
- Any of the greater-than-50% partners of the partnership are themselves required to file Schedule M-3.

In fact, the very first section of the Schedule M-3 requires the disclosure of the reason the partnership is filing the M-3 and the name of all reportable entity partners.

Part I of Schedule M-3 is meant to make it easier for the IRS to establish what types of financial statements the partnership prepares and determine the partnership's share of income relative to the other entities that are in its consolidated group. It requires the disclosure of certain items related to the partnership's financial statements, such as whether the partnership filed SEC Form 10-K for the year, whether the partnership prepared a certified audited income statement for the year, and whether the partnership's income statement has been restated in the last five years. It also reconciles worldwide financial statement net income for any consolidated financial statement group in which the partnership might be included to the net income of the partnership per the income statement. It does this by

- beginning with worldwide consolidated net income for the consolidated group (line 4);
- removing the net income (loss) from nonincludible foreign and U.S. entities (lines 5 and 6);
- including the net income (loss) from U.S. and foreign "disregarded" entities (line 7);

- making adjustments to eliminate transactions between entities in the group and to reconcile the income statement period to the tax year (lines 8 and 9); and
- making other necessary reconciling adjustments (line 10).

Parts II and III of Schedule M-3 make it easier for the IRS to spot questionable items by requiring a reconciliation of book income or deductions to the related tax return income or deductions. Part II is designed to highlight the temporary and permanent differences between net income (loss) per the partnership's income statement and taxable income (broadly construed). To do that, Part II requires disclosures in the following four columns:

- A calculation of net income per the income statement (column a).
- Temporary differences (column b).
- Permanent differences (column c).
- A calculation of total taxable income (loss) from the partnership (column d). This amount should equal the amount on Form 1065, page 5, Analysis of Income, line 1.

A partnership does not have to disclose the information requested in columns *(a)* and *(d)* (calculations of book income and taxable income, respectively) in the first year it is required to file Schedule M-3, but it will have to disclose the information reported in those columns in any later year in which the partnership is required to file Schedule M-3. In addition, columns *(a)* and *(d)* are not required if Schedule M-3 is being filed voluntarily, unless the partnership was required to file Schedule M-3 in some prior year. If the partnership files Schedule M-3, it must always disclose columns *(b)* and *(c)* — temporary and permanent differences, respectively, between book and taxable income. Although all temporary and permanent differences are required to be disclosed, some specifically listed on Schedule M-3 are

- income (loss) from equity method foreign corporations;
- income (loss) from U.S. partnerships;
- mark-to-market income (loss);
- income recognition from long-term contracts; and
- original issue discount and other imputed interest.

Part III of Schedule M-3 is designed to highlight temporary and permanent differences only with respect to expense or deduction items. In Part III, book expenses are reported in column *(a)*, temporary differences in column *(b)*, permanent differences in column *(c)*, and deductions per the tax return in column *(d)*. The same requirements for disclosure of the information requested in these columns that apply in Part II also apply in Part III. Although all temporary and permanent differences in expenses must be disclosed, some specifically listed are

- state and local current income tax expense;
- meals and entertainment;
- fines and penalties;
- guaranteed payments;
- oil and gas depletion;
- depreciation; and
- bad debt expense.

Chapter 2

Case Two — Atlantic Traders

Learning objectives

- Recognize the tax treatment, both at the partner and the partnership level, of guaranteed payments to a partner.
- Calculate the amount of the guaranteed payment when the partner is to receive the lesser of a fixed dollar amount or a fixed percentage of partnership income.
- Identify and report Section 1202 gains on Form 1065.
- Calculate the ordinary loss to the partners from the sale of Section 1244 stock.
- Determine what type of transaction will qualify to be treated as an installment sale and how the transaction is disclosed by a partnership.

Atlantic Traders (AT) is a Florida partnership with the following three partners:

Name	SS number
Ray Charles	455-81-5151
4825 Ellis Rd. N.	
Jacksonville, FL 32254	
Leonard Skinner	454-66-3333
1750 Cleveland Rd.	
Jacksonville, FL 32209	
Luke Jackson	459-34-5939
1519 Carmen St.	
Jacksonville, FL 32206	

AT was formed on July 1, 2014, to buy and operate a business valuation service in the Buffett Building at 4823 W. State St., Jacksonville, FL 32202. Its federal identification number is 75-3185725.

Ray Charles is a general partner and manages the business valuation service. For his efforts, Ray is allocated 30% of the ordinary income from the business valuation service, but not less than $200,000. He also shares in 30% of the remaining income from the partnership. Over the years, the partnership has been very successful, and has retained a good deal of the profits from the business. Ray has been very successful at investing this excess cash and continues to do that this year. Ray is also the tax matters partner. Leonard and Luke, who are also general partners, are each allocated 35% of the remaining income. The mortgage on the real estate had to be individually guaranteed by the partners, so it is considered recourse debt.

Ray, Leonard, and Luke were distributed $106,580; $20,000; and $20,000, respectively.

During the year, AT had the following transactions (assume all amounts are net of commissions):

Transactions	Date purchased	Cost	Date sold	Sale price	Gain/loss	Character
Sold 1000 shares of Inception Corporation	7/20/2014	$102,730	6/26/2021	$393,840	$291,110	1202
Sold 5000 shares of Downer Corporation	6/12/2016	$568,040	8/3/2021	$201,000	($367,040)	1244
Sold 1000 acres of land, $400,000 mortgage, $900,000 this year, $700,000 next year	5/3/2015	$1,200,000	10/21/2021	$2,000,000	$800,000	LTCG, installment sale
Sold rare Spanish doubloons, held for investment	3/4/2017	$445,000	2/15/2021	$643,000	$198,000	STCG

In addition, AT received the following dividends:

- Received $30,000 of dividends from Intel Corp. (30,000 shares purchased on 5/13/2019)
- Received $11,000 of dividends from Grupo Aeromexico, a Mexican corporation. Assume that Grupo Aeromexico is considered a qualified foreign corporation due to the comprehensive tax treaty between the United States and Mexico. (20,000 shares purchased on 6/3/2018)

In addition to these transactions, AT bought $2.5 million of various stock issues.

AT financial statements

AT has the following financial statements at December 31.

	Beginning balance	Ending balance
Assets		
Cash	283,251	205,753
Furniture and equipment	240,000	240,000
Accumulated depreciation, equip	(70,000)	(100,000)
Investment land	1,815,445	615,445

	Beginning balance	Ending balance
Buffett Building	3,500,000	3,500,000
Accumulated depreciation, building	(624,466)	(714,209)
Land, Buffett Building	500,000	500,000
Stocks	1,670,770	3,500,000
Bonds	645,000	645,000
Other investments	445,000	0
Installment note receivable (Net of deferred gain)		350,000
Total	$8,405,000	$8,741,989
Liabilities and stockholders' equity		
Accounts payable	0	26,000
Mortgage payable	3,230,000	2,830,000
Capital, Ray	1,125,000	1,194,241
Capital, Leonard	2,025,000	2,345,874
Capital, Luke	2,025,000	2,345,874
Total	$8,405,000	$8,741,989

Income statement	Expenses /Losses	Revenue /Gains
Dividend income		$41,000
Interest income		47,000
Loss on sale of stock — 1244 stock	367,040	
Gain on the sale of stock		291,110
Gain on the sale of land		450,000
Gain on sale of doubloons		198,000
Sales		900,000
Insurance	12,000	
Employee wages	135,600	
Guaranteed payment to Ray	116,357	
Employee medical expenses	34,000	
Payroll taxes	27,800	
Interest expense	120,000	
Property tax	65,000	
Utilities	72,000	
Depreciation expense, F&F	30,000	
Depreciation expense, building	89,744	
Totals	1,069,541	1,927,110

The interest expense was on debt used to purchase the Buffett Building and land held for investment. The Buffett Building should be allocated 60% of the interest expense and property taxes, and the investment land should be allocated the other 40%.

Notes to accompany financial statements

AT uses the accrual method of accounting for tax purposes. AT’s book and tax balance sheets (and therefore partners’ capital accounts) are the same.

Assume that tax and book depreciation are the same. That is, the preceding depreciation numbers are the same as those that would be reported on Form 4562. Also, there is no AMT adjustment for depreciation on the building. The partnership has chosen not to make the Section 179 election or take bonus depreciation with respect to the equipment acquired during the taxable year.

Atlantic Traders — 2021 tax return and accompanying forms and schedules

The partnership’s 2021 Form 1065, *U.S. Return of Partnership Income*, along with 2021 Schedules K-1 (Form 1065), *Partner’s Share of Income, Deductions, Credits, etc.*, for each partner are reproduced on the following pages. The tax return and accompanying Schedules K-1 are followed by an explanation of the rationale and calculation of each figure reported on the return.

In reviewing the return, pay careful attention to the following items, which are discussed in more depth throughout the rest of this chapter:

- Are guaranteed payments treated correctly?
- Are Sections 1202 and 1244 gains and losses correctly treated?
- Is debt correctly allocated?

Form **1065** | **U.S. Return of Partnership Income** | OMB No. 1545-0123 | **2021**

Department of the Treasury
Internal Revenue Service

For calendar year 2021, or tax year beginning ______________, ending ________________.

► Go to *www.irs.gov/Form1065* for instructions and the latest information.

A Principal business activity: Services	Name of partnership: Atlantic Traders	**D** Employer identification number: 75-3185725
B Principal product or service: Valuation services	Number, street, and room or suite no. If a P.O. box, see instructions.: 4823 W. State Street	**E** Date business started: 6/1/2011
C Business code number: 541990	City or town: Jacksonville; State: FL; ZIP code: 32202; Foreign country name; Foreign province/state/county; Foreign postal code	**F** Total assets (see instructions): $ 8,741,989

Type or Print

G Check applicable boxes: (1) ☐ Initial return (2) ☐ Final return (3) ☐ Name change (4) ☐ Address change (5) ☐ Amended return

H Check accounting method: (1) ☐ Cash (2) ☒ Accrual (3) ☐ Other (specify) ►

I Number of Schedules K-1. Attach one for each person who was a partner at any time during the tax year. ► 3

J Check if Schedules C and M-3 are attached ► ☐

K Check if partnership: (1) ☐ Aggregated activities for section 465 at-risk purposes (2) ☐ Grouped activities for section 469 passive activity purposes

Caution: Include **only** trade or business income and expenses on lines 1a through 22 below. See instructions for more information.

Income	1a	Gross receipts or sales	1a	900,000		
	b	Returns and allowances	1b			
	c	Balance. Subtract line 1b from line 1a			1c	900,000
	2	Cost of goods sold (attach Form 1125-A)			2	
	3	Gross profit. Subtract line 2 from line 1c			3	900,000
	4	Ordinary income (loss) from other partnerships, estates, and trusts (attach statement)			4	
	5	Net farm profit (loss) (attach Schedule F (Form 1040))			5	
	6	Net gain (loss) from Form 4797, Part II, line 17 (attach Form 4797)			6	
	7	Other income (loss) (attach statement)			7	
	8	**Total income (loss).** Combine lines 3 through 7			8	900,000
Deductions (see instructions for limitations)	9	Salaries and wages (other than to partners) (less employment credits)			9	135,600
	10	Guaranteed payments to partners			10	116,357
	11	Repairs and maintenance			11	
	12	Bad debts			12	
	13	Rent			13	
	14	Taxes and licenses			14	66,800
	15	Interest (see instructions)			15	72,000
	16a	Depreciation (if required, attach Form 4562)	16a	119,744		
	b	Less depreciation reported on Form 1125-A and elsewhere on return	16b		16c	119,744
	17	Depletion **(Do not deduct oil and gas depletion.)**			17	
	18	Retirement plans, etc.			18	
	19	Employee benefit programs			19	34,000
	20	Other deductions (attach statement)			20	84,000
	21	**Total deductions.** Add the amounts shown in the far right column for lines 9 through 20			21	628,501
	22	**Ordinary business income (loss).** Subtract line 21 from line 8			22	271,499
Tax and Payment	23	Interest due under the look-back method—completed long-term contracts (attach Form 8697)			23	
	24	Interest due under the look-back method—income forecast method (attach Form 8866)			24	
	25	BBA AAR imputed underpayment (see instructions)			25	
	26	Other taxes (see instructions)			26	
	27	**Total balance due.** Add lines 23 through 26			27	0
	28	Payment (see instructions)			28	
	29	**Amount owed.** If line 28 is smaller than line 27, enter amount owed			29	
	30	**Overpayment.** If line 28 is larger than line 27, enter overpayment			30	

Sign Here

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than partner or limited liability company member) is based on all information of which preparer has any knowledge.

► Signature of partner or limited liability company member ► Date

May the IRS discuss this return with the preparer shown below? See instructions. ☐ Yes ☐ No

Paid Preparer Use Only

Print/Type preparer's name	Preparer's signature	Date	Check ☐ if self-employed	PTIN
Firm's name ►			Firm's EIN ►	
Firm's address ►			Phone no.	
City	State		ZIP code	

For Paperwork Reduction Act Notice, see separate instructions. Form **1065** (2021)

HTA

Schedule B Other Information

		Yes	No
1	What type of entity is filing this return? Check the applicable box: a [X] Domestic general partnership b [ ] Domestic limited partnership c [ ] Domestic limited liability company d [ ] Domestic limited liability partnership e [ ] Foreign partnership f [ ] Other ►		
2	At the end of the tax year:		
a	Did any foreign or domestic corporation, partnership (including any entity treated as a partnership), trust, or tax-exempt organization, or any foreign government own, directly or indirectly, an interest of 50% or more in the profit, loss, or capital of the partnership? For rules of constructive ownership, see instructions. If "Yes," attach Schedule B-1, Information on Partners Owning 50% or More of the Partnership		X
b	Did any individual or estate own, directly or indirectly, an interest of 50% or more in the profit, loss, or capital of the partnership? For rules of constructive ownership, see instructions. If "Yes," attach Schedule B-1, Information on Partners Owning 50% or More of the Partnership		X
3	At the end of the tax year, did the partnership:		
a	Own directly 20% or more, or own, directly or indirectly, 50% or more of the total voting power of all classes of stock entitled to vote of any foreign or domestic corporation? For rules of constructive ownership, see instructions. If "Yes," complete (i) through (iv) below		X

(i) Name of Corporation	(ii) Employer Identification Number (if any)	(iii) Country of Incorporation	(iv) Percentage Owned in Voting Stock

		Yes	No
b	Own directly an interest of 20% or more, or own, directly or indirectly, an interest of 50% or more in the profit, loss, or capital in any foreign or domestic partnership (including an entity treated as a partnership) or in the beneficial interest of a trust? For rules of constructive ownership, see instructions. If "Yes," complete (i) through (v) below		X

(i) Name of Entity	(ii) Employer Identification Number (if any)	(iii) Type of Entity	(iv) Country of Organization	(v) Maximum Percentage Owned in Profit, Loss, or Capital

		Yes	No
4	Does the partnership satisfy **all four** of the following conditions?		
a	The partnership's total receipts for the tax year were less than $250,000.		
b	The partnership's total assets at the end of the tax year were less than $1 million.		
c	Schedules K-1 are filed with the return and furnished to the partners on or before the due date (including extensions) for the partnership return.		
d	The partnership is not filing and is not required to file Schedule M-3		X
	If "Yes," the partnership is not required to complete Schedules L, M-1, and M-2; item F on page 1 of Form 1065; or item L on Schedule K-1.		
5	Is this partnership a publicly traded partnership, as defined in section 469(k)(2)?		X
6	During the tax year, did the partnership have any debt that was canceled, was forgiven, or had the terms modified so as to reduce the principal amount of the debt?		X
7	Has this partnership filed, or is it required to file, Form 8918, Material Advisor Disclosure Statement, to provide information on any reportable transaction?		X
8	At any time during calendar year 2021, did the partnership have an interest in or a signature or other authority over a financial account in a foreign country (such as a bank account, securities account, or other financial account)? See instructions for exceptions and filing requirements for FinCEN Form 114, Report of Foreign Bank and Financial Accounts (FBAR). If "Yes," enter the name of the foreign country ►		X
9	At any time during the tax year, did the partnership receive a distribution from, or was it the grantor of, or transferor to, a foreign trust? If "Yes," the partnership may have to file Form 3520, Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts. See instructions		X
10a	Is the partnership making, or had it previously made (and not revoked), a section 754 election? See instructions for details regarding a section 754 election.		X
b	Did the partnership make for this tax year an optional basis adjustment under section 743(b) or 734(b)? If "Yes," attach a statement showing the computation and allocation of the basis adjustment. See instructions		X

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Schedule B Other Information *(continued)*

		Yes	No
c	Is the partnership required to adjust the basis of partnership assets under section 743(b) or 734(b) because of a substantial built-in loss (as defined under section 743(d)) or substantial basis reduction (as defined under section 734(d))? If "Yes," attach a statement showing the computation and allocation of the basis adjustment. See instructions		X
11	Check this box if, during the current or prior tax year, the partnership distributed any property received in a like-kind exchange or contributed such property to another entity (other than disregarded entities wholly owned by the partnership throughout the tax year) . . . ▶ ☐		
12	At any time during the tax year, did the partnership distribute to any partner a tenancy-in-common or other undivided interest in partnership property?		X
13	If the partnership is required to file Form 8858, Information Return of U.S. Persons With Respect To Foreign Disregarded Entities (FDEs) and Foreign Branches (FBs), enter the number of Forms 8858 attached. See instructions . . . ▶		
14	Does the partnership have any foreign partners? If "Yes," enter the number of Forms 8805, Foreign Partner's Information Statement of Section 1446 Withholding Tax, filed for this partnership. . ▶ 0		X
15	Enter the number of Forms 8865, Return of U.S. Persons With Respect to Certain Foreign Partnerships, attached to this return. . . . ▶ 0		
16a	Did you make any payments in 2021 that would require you to file Form(s) 1099? See instructions	X	
b	If "Yes," did you or will you file required Form(s) 1099?	X	
17	Enter the number of Forms 5471, Information Return of U.S. Persons With Respect To Certain Foreign Corporations, attached to this return. . . . ▶ 0		
18	Enter the number of partners that are foreign governments under section 892. . . . ▶ 0		
19	During the partnership's tax year, did the partnership make any payments that would require it to file Forms 1042 and 1042-S under chapter 3 (sections 1441 through 1464) or chapter 4 (sections 1471 through 1474)?		X
20	Was the partnership a specified domestic entity required to file Form 8938 for the tax year? See the Instructions for Form 8938		X
21	Is the partnership a section 721(c) partnership, as defined in Regulations section 1.721(c)-1(b)(14)?		X
22	During the tax year, did the partnership pay or accrue any interest or royalty for which one or more partners are not allowed a deduction under section 267A? See instructions		X
	If "Yes," enter the total amount of the disallowed deductions . . . ▶ $		
23	Did the partnership have an election under section 163(j) for any real property trade or business or any farming business in effect during the tax year? See instructions		X
24	Does the partnership satisfy one or more of the following? See instructions		X
a	The partnership owns a pass-through entity with current, or prior year carryover, excess business interest expense.		
b	The partnership's aggregate average annual gross receipts (determined under section 448(c)) for the 3 tax years preceding the current tax year are more than $26 million and the partnership has business interest.		
c	The partnership is a tax shelter (see instructions) and the partnership has business interest expense. If "Yes" to any, complete and attach Form 8990.		
25	Is the partnership attaching Form 8996 to certify as a Qualified Opportunity Fund?		X
	If "Yes," enter the amount from Form 8996, line 15 . . . ▶ $		
26	Enter the number of foreign partners subject to section 864(c)(8) as a result of transferring all or a portion of an interest in the partnership or of receiving a distribution from the partnership . . . ▶ Complete Schedule K-3 (Form 1065), Part XIII, for each foreign partner subject to section 864(c)(8) on a transfer or distribution.		
27	At any time during the tax year, were there any transfers between the partnership and its partners subject to the disclosure requirements of Regulations section 1.707-8?		X
28	Since December 22, 2017, did a foreign corporation directly or indirectly acquire substantially all of the properties constituting a trade or business of your partnership, and was the ownership percentage (by vote or value) for purposes of section 7874 greater than 50% (for example, the partners held more than 50% of the stock of the foreign corporation)? If "Yes," list the ownership percentage by vote and by value. See instructions. Percentage: By Vote By Value		
29	Is the partnership electing out of the centralized partnership audit regime under section 6221(b)? See instructions.		X
	If "Yes," the partnership must complete Schedule B-2 (Form 1065). Enter the total from Schedule B-2, Part III, line 3 ▶ If "No," complete Designation of Partnership Representative below.		

Designation of Partnership Representative (see instructions)

Enter below the information for the partnership representative (PR) for the tax year covered by this return.

Name of PR ▶ Ray Charles

U.S. address of PR	4825 Ellis Rd. Jacksonville FL 32254	U.S. phone number of PR	
If the PR is an entity, name of the designated individual for the PR ▶			
U.S. address of designated individual		U.S. phone number of designated individual	

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Schedule K Partners' Distributive Share Items

						Total amount
Income (Loss)	1	Ordinary business income (loss) (page 1, line 22)			1	271,499
	2	Net rental real estate income (loss) (attach Form 8825)			2	
	3a	Other gross rental income (loss)	3a			
	b	Expenses from other rental activities (attach statement)	3b			
	c	Other net rental income (loss). Subtract line 3b from line 3a			3c	0
	4	Guaranteed payments: a Services 4a 116,357 b Capital	4b	0		
	c	Total. Add lines 4a and 4b			4c	116,357
	5	Interest income			5	47,000
	6	Dividends and dividend equivalents: a Ordinary dividends			6a	41,000
	b	Qualified dividends 6b 41,000 c Dividend equivalents	6c			
	7	Royalties			7	
	8	Net short-term capital gain (loss) (attach Schedule D (Form 1065))			8	
	9a	Net long-term capital gain (loss) (attach Schedule D (Form 1065))			9a	526,515
	b	Collectibles (28%) gain (loss)	9b	198,000		
	c	Unrecaptured section 1250 gain (attach statement)	9c			
	10	Net section 1231 gain (loss) (attach Form 4797)			10	
	11	Other income (loss) (see instructions) Type ► See Attached Statement			11	45,555
Deductions	12	Section 179 deduction (attach Form 4562)			12	
	13a	Contributions			13a	
	b	Investment interest expense			13b	48,000
	c	Section 59(e)(2) expenditures: (1) Type ► (2) Amount ►			13c(2)	
	d	Other deductions (see instructions) Type ► Code L-Ded-port (other)			13d	26,000
Self-Employment	14a	Net earnings (loss) from self-employment			14a	387,856
	b	Gross farming or fishing income			14b	
	c	Gross nonfarm income			14c	
Credits	15a	Low-income housing credit (section 42(j)(5))			15a	
	b	Low-income housing credit (other)			15b	
	c	Qualified rehabilitation expenditures (rental real estate) (attach Form 3468, if applicable)			15c	
	d	Other rental real estate credits (see instructions) Type ►			15d	
	e	Other rental credits (see instructions) Type ►			15e	
	f	Other credits (see instructions) Type ►			15f	
International Transactions	16	Attach Schedule K-2 (Form 1065), Partners' Distributive Share Items-International, and check this box to indicate that you are reporting items of international tax relevance ☐				
Alternative Minimum Tax (AMT) Items	17a	Post-1986 depreciation adjustment			17a	
	b	Adjusted gain or loss			17b	
	c	Depletion (other than oil and gas)			17c	
	d	Oil, gas, and geothermal properties—gross income			17d	
	e	Oil, gas, and geothermal properties—deductions			17e	
	f	Other AMT items (attach statement)			17f	
Other Information	18a	Tax-exempt interest income			18a	
	b	Other tax-exempt income			18b	
	c	Nondeductible expenses			18c	
	19a	Distributions of cash and marketable securities			19a	146,580
	b	Distributions of other property			19b	
	20a	Investment income			20a	88,000
	b	Investment expenses			20b	26,000
	c	Other items and amounts (attach statement)				
	21	Total foreign taxes paid or accrued			21	

Form **1065** (2021)

Analysis of Net Income (Loss)

1	Net income (loss). Combine Schedule K, lines 1 through 11. From the result, subtract the sum of Schedule K, lines 12 through 13d, and 21					1	973,926
2	Analysis by partner type:	(i) Corporate	(ii) Individual (active)	(iii) Individual (passive)	(iv) Partnership	(v) Exempt Organization	(vi) Nominee/Other
a	General partners		973,926				
b	Limited partners						

Schedule L Balance Sheets per Books

	Assets	Beginning of tax year (a)	Beginning of tax year (b)	End of tax year (c)	End of tax year (d)
1	Cash		283,251		205,753
2a	Trade notes and accounts receivable				
b	Less allowance for bad debts		0		0
3	Inventories				
4	U.S. government obligations				
5	Tax-exempt securities				
6	Other current assets (attach statement)				
7a	Loans to partners (or persons related to partners)				
b	Mortgage and real estate loans				
8	Other investments (attach statement)		2,760,770		4,495,000
9a	Buildings and other depreciable assets	3,740,000		3,740,000	
b	Less accumulated depreciation	694,466	3,045,534	814,209	2,925,791
10a	Depletable assets				
b	Less accumulated depletion		0		0
11	Land (net of any amortization)		2,315,445		1,115,445
12a	Intangible assets (amortizable only)				
b	Less accumulated amortization		0		0
13	Other assets (attach statement)				
14	Total assets		8,405,000		8,741,989
	Liabilities and Capital				
15	Accounts payable				26,000
16	Mortgages, notes, bonds payable in less than 1 year				
17	Other current liabilities (attach statement)				
18	All nonrecourse loans				
19a	Loans from partners (or persons related to partners)				
b	Mortgages, notes, bonds payable in 1 year or more		3,230,000		2,830,000
20	Other liabilities (attach statement)				
21	Partners' capital accounts		5,175,000		5,885,989
22	Total liabilities and capital		8,405,000		8,741,989

Schedule M-1 Reconciliation of Income (Loss) per Books With Income (Loss) per Return

Note: The partnership may be required to file Schedule M-3. See instructions.

1	Net income (loss) per books	857,569	6	Income recorded on books this year not included on Schedule K, lines 1 through 11 (itemize):	
2	Income included on Schedule K, lines 1, 2, 3c, 5, 6a, 7, 8, 9a, 10, and 11, not recorded on books this year (itemize):	0	a	Tax-exempt interest $	0
3	Guaranteed payments (other than health insurance)	116,357	7	Deductions included on Schedule K, lines 1 through 13d, and 21, not charged against book income this year (itemize):	
4	Expenses recorded on books this year not included on Schedule K, lines 1 through 13d, and 21 (itemize):		a	Depreciation $	0
a	Depreciation $		8	Add lines 6 and 7	0
b	Travel and entertainment $	0	9	Income (loss) (Analysis of Net Income (Loss), line 1). Subtract line 8 from line 5	973,926
5	Add lines 1 through 4	973,926			

Schedule M-2 Analysis of Partners' Capital Accounts

1	Balance at beginning of year	5,175,000	6	Distributions: a Cash	146,580
2	Capital contributed: a Cash			b Property	
	b Property		7	Other decreases (itemize):	
3	Net income (loss) (see instructions)	973,926		See Statement	116,357
4	Other increases (itemize):	0	8	Add lines 6 and 7	262,937
5	Add lines 1 through 4	6,148,926	9	Balance at end of year. Subtract line 8 from line 5	5,885,989

Form 1065 (2021)

Form **8453-PE**

Department of the Treasury
Internal Revenue Service

E-file Declaration for Form 1065

(For return of partnership income or administrative adjustment request)

▶ **File electronically with the partnership's return or administrative adjustment request . (Don't file paper copies.)**

▶ **Go to *www.irs.gov/Form8453PE* for the latest information.**

For calendar year 2021, or tax year beginning , 2021, and ending , 20 .

OMB No. 1545-0123

2021

Name of partnership	**Employer identification number**
Atlantic Traders	75-3185725

Part I Form 1065 Information (whole dollars only)

1	Gross receipts or sales less returns and allowances (Form 1065, line 1c)	**1**	900,000
2	Gross profit (Form 1065, line 3)	**2**	900,000
3	Ordinary business income (loss) (Form 1065, line 22)	**3**	271,499
4	Net rental real estate income (loss) (Form 1065, Schedule K, line 2)	**4**	
5	Other net rental income (loss) (Form 1065, Schedule K, line 3c)	**5**	

Part II Declaration of Partner or Member or Partnership Representative (see instructions)

Be sure to keep a copy of the partnership's Return of Partnership Income or AAR.

I declare under penalties of perjury:
1a. If this Form 1065 is transmitted as part of a return of partnership income, I'm a partner or member of the above partnership.
b. If this Form 1065 is transmitted as part of an administrative adjustment request (AAR), I'm the partnership representative (PR).
2. The information I've given my electronic return originator (ERO), transmitter, and/or intermediate service provider (ISP) and the amounts in Part I above agree with the amounts on the corresponding lines of the partnership's Form 1065.
3. To the best of my knowledge and belief, the partnership's corresponding return or AAR is true, correct, and complete.
4. I consent to my ERO, transmitter, and/or ISP sending the partnership's return or AAR, this declaration, and accompanying forms, schedules and statements to the IRS.
5. I consent to the IRS sending my ERO, transmitter, and/or ISP an acknowledgment of receipt of transmission and an indication of whether or not the partnership's return or AAR is accepted and, if rejected, the reason(s) for the rejection.
6. If the processing of the partnership's return or AAR is delayed, I authorize the IRS to disclose to my ERO, transmitter, and/or ISP the reason(s) for the delay.

Sign Here ▶ Signature of partner or member or PR | Date ▶ | Title

Part III Declaration of Electronic Return Originator (ERO) and Paid Preparer (see instructions)

I declare that I've reviewed the above partnership's return or AAR and that the entries on Form 8453-PE are complete and correct to the best of my knowledge. If I'm only a collector, I'm not responsible for reviewing the return or AAR and only declare that this form accurately reflects the data on the return or AAR. The partner or member or PR will have signed this form before I submit the return or AAR. I'll give the partner or member or PR a copy of all forms and information to be filed with the IRS, and I've followed all other requirements in **Pub. 3112**, IRS *e-file* Application and Participation, and **Pub. 4163**, Modernized e-File (MeF) Information for Authorized IRS *e-file* Providers for Business Returns. If I'm also the Paid Preparer, under penalties of perjury, I declare that I've examined the above partnership's return or AAR and accompanying forms, schedules, and statements, and to the best of my knowledge and belief, they are true, correct, and complete. This Paid Preparer declaration is based on all information of which I've any knowledge.

ERO's Use Only					
	ERO's signature ▶	Date	Check if also paid preparer ☐	Check if self-employed ☐	ERO's SSN or PTIN
	Firm's name (or yours if self-employed), address, and ZIP code ▶			EIN	
				Phone no.	

Under penalties of perjury, I declare that I've examined the above partnership's return or AAR and accompanying forms, schedules, and statements, and to the best of my knowledge and belief, they are true, correct, and complete. This declaration is based on all information of which I've any knowledge.

Paid Preparer Use Only					
	Print/Type preparer's name	Preparer's signature	Date	Check if self-employed ☐	PTIN
	Firm's name ▶			Firm's EIN ▶	
	Firm's address ▶			Phone no.	

For Privacy Act and Paperwork Reduction Act Notice, see instructions. Form **8453-PE** (2021)

HTA

Form **1125-A** (Rev. November 2018) Department of the Treasury Internal Revenue Service

Cost of Goods Sold

▶ **Attach to Form 1120, 1120-C, 1120-F, 1120S, or 1065.**
▶ **Go to *www.irs.gov/Form1125A* for the latest information.**

OMB No. 1545-0123

Name	Employer identification number
Atlantic Traders	75-3185725

1	Inventory at beginning of year	**1**	
2	Purchases	**2**	
3	Cost of labor	**3**	
4	Additional section 263A costs (attach schedule)	**4**	
5	Other costs (attach schedule)	**5**	
6	**Total.** Add lines 1 through 5	**6**	0
7	Inventory at end of year	**7**	
8	**Cost of goods sold.** Subtract line 7 from line 6. Enter here and on Form 1120, page 1, line 2 or the appropriate line of your tax return. See instructions	**8**	0

9a Check all methods used for valuing closing inventory:

(i) ☐ Cost

(ii) ☐ Lower of cost or market

(iii) ☐ Other (Specify method used and attach explanation.) ▶

b Check if there was a writedown of subnormal goods ▶ ☐

c Check if the LIFO inventory method was adopted this tax year for any goods (if checked, attach Form 970) ▶ ☐

d If the LIFO inventory method was used for this tax year, enter amount of closing inventory computed under LIFO **9d**

e If property is produced or acquired for resale, do the rules of section 263A apply to the entity? See instructions ☐ Yes ☐ No

f Was there any change in determining quantities, cost, or valuations between opening and closing inventory? If "Yes," attach explanation ☐ Yes ☐ No

For Paperwork Reduction Act Notice, see instructions. HTA Form **1125-A** (Rev. 11-2018)

Name(s) shown on return. Name and SSN or taxpayer identification no. not required if shown on other side	**Social security number or taxpayer identification number**
Atlantic Traders	75-3185725

Before you check Box D, E, or F below, see whether you received any Form(s) 1099-B or substitute statement(s) from your broker. A substitute statement will have the same information as Form 1099-B. Either will show whether your basis (usually your cost) was reported to the IRS by your broker and may even tell you which box to check.

Part II **Long-Term.** Transactions involving capital assets you held more than 1 year are generally long-term (see instructions). For short-term transactions, see page 1.

Note: You may aggregate all long-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS and for which no adjustments or codes are required. Enter the totals directly on Schedule D, line 8a; you aren't required to report these transactions on Form 8949 (see instructions).

You *must* check Box D, E, *or* F below. Check only one box. If more than one box applies for your long-term transactions, complete a separate Form 8949, page 2, for each applicable box. If you have more long-term transactions than will fit on this page for one or more of the boxes, complete as many forms with the same box checked as you need.

- [X] **(D)** Long-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS (see **Note** above)
- [ ] **(E)** Long-term transactions reported on Form(s) 1099-B showing basis **wasn't** reported to the IRS
- [ ] **(F)** Long-term transactions not reported to you on Form 1099-B

1 **(a)** Description of property (Example: 100 sh. XYZ Co.)	**(b)** Date acquired (Mo., day, yr.)	**(c)** Date sold or disposed of (Mo., day, yr.)	**(d)** Proceeds (sales price) (see instructions)	**(e)** Cost or other basis. See the **Note** below and see *Column (e)* in the separate instructions	**Adjustment, if any, to gain or loss.** If you enter an amount in column (g), enter a code in column (f). **See the separate instructions.** **(f)** Code(s) from instructions	**(g)** Amount of adjustment	**(h)** **Gain or (loss).** Subtract column (e) from column (d) and combine the result with column (g)
10000 shares Inception Corporation stock	7/20/2014	6/26/2021	393,840	102,730	Q	-145,555	145,555
5000 shares Downer Corporation stock	6/12/2016	8/3/2021	201,000	568,040	S	100,000	-267,040
2 **Totals.** Add the amounts in columns (d), (e), (g), and (h) (subtract negative amounts). Enter each total here and include on your Schedule D, **line 8b** (if **Box D** above is checked), **line 9** (if **Box E** above is checked), or **line 10** (if **Box F** above is checked) ►			594,840	670,770		-45,555	-121,485

Note: If you checked Box D above but the basis reported to the IRS was incorrect, enter in column (e) the basis as reported to the IRS, and enter an adjustment in column (g) to correct the basis. See *Column (g)* in the separate instructions for how to figure the amount of the adjustment.

Name(s) shown on return. Name and SSN or taxpayer identification no. not required if shown on other side	**Social security number or taxpayer identification number**
Atlantic Traders	75-3185725

Before you check Box D, E, or F below, see whether you received any Form(s) 1099-B or substitute statement(s) from your broker. A substitute statement will have the same information as Form 1099-B. Either will show whether your basis (usually your cost) was reported to the IRS by your broker and may even tell you which box to check.

Part II **Long-Term.** Transactions involving capital assets you held more than 1 year are generally long-term (see instructions). For short-term transactions, see page 1.

Note: You may aggregate all long-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS and for which no adjustments or codes are required. Enter the totals directly on Schedule D, line 8a; you aren't required to report these transactions on Form 8949 (see instructions).

You *must* check Box D, E, *or* F below. Check only one box. If more than one box applies for your long-term transactions, complete a separate Form 8949, page 2, for each applicable box. If you have more long-term transactions than will fit on this page for one or more of the boxes, complete as many forms with the same box checked as you need.

☐ **(D)** Long-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS (see **Note** above)
☐ **(E)** Long-term transactions reported on Form(s) 1099-B showing basis **wasn't** reported to the IRS
☒ **(F)** Long-term transactions not reported to you on Form 1099-B

1 **(a)** Description of property (Example: 100 sh. XYZ Co.)	**(b)** Date acquired (Mo., day, yr.)	**(c)** Date sold or disposed of (Mo., day, yr.)	**(d)** Proceeds (sales price) (see instructions)	**(e)** Cost or other basis. See the **Note** below and see *Column (e)* in the separate instructions	Adjustment, if any, to gain or loss. If you enter an amount in column (g), enter a code in column (f). **See the separate instructions.** **(f)** Code(s) from instructions	**(g)** Amount of adjustment	**(h)** **Gain or (loss).** Subtract column (e) from column (d) and combine the result with column (g)
Spanish doubloons	3/4/2017	2/15/2021	643,000	445,000	C		198,000
2 Totals. Add the amounts in columns (d), (e), (g), and (h) (subtract negative amounts). Enter each total here and include on your Schedule D, **line 8b** (if **Box D** above is checked), **line 9** (if **Box E** above is checked), or **line 10** (if **Box F** above is checked) ►			643,000	445,000		0	198,000

Note: If you checked Box D above but the basis reported to the IRS was incorrect, enter in column (e) the basis as reported to the IRS, and enter an adjustment in column (g) to correct the basis. See *Column (g)* in the separate instructions for how to figure the amount of the adjustment.

Form **8949** (2021)

SCHEDULE D (Form 1065)

Department of the Treasury
Internal Revenue Service

Capital Gains and Losses

▶ Attach to Form 1065 or Form 8865.
▶ Use Form 8949 to list your transactions for lines 1b, 2, 3, 8b, 9, and 10.
▶ Go to *www.irs.gov/Form1065* for instructions and the latest information.

OMB No. 1545-0123

2021

Name of partnership: Atlantic Traders

Employer identification number: 75-3185725

Did the partnership dispose of any investment(s) in a qualified opportunity fund during the tax year? . . . . ▶ ☐ Yes ☒ No
If "Yes," attach Form 8949 and see its instructions for additional requirements for reporting your gain or loss.

Part I Short-Term Capital Gains and Losses—Generally Assets Held One Year or Less (see instructions)

See instructions for how to figure the amounts to enter on the lines below. This form may be easier to complete if you round off cents to whole dollars.	(d) Proceeds (sales price)	(e) Cost (or other basis)	(g) Adjustments to gain or loss from Form(s) 8949, Part I, line 2, column (g)	(h) Gain or (loss) Subtract column (e) from column (d) and combine the result with column (g)
1a Totals for all short-term transactions reported on Form 1099-B for which basis was reported to the IRS and for which you have no adjustments (see instructions). However, if you choose to report all these transactions on Form 8949, leave this line blank and go to line 1b . .				0
1b Totals for all transactions reported on Form(s) 8949 with **Box A** checked . . .				0
2 Totals for all transactions reported on Form(s) 8949 with **Box B** checked . . .				0
3 Totals for all transactions reported on Form(s) 8949 with **Box C** checked . . .				0

4 Short-term capital gain from installment sales from Form 6252, line 26 or 37 . . .	4	
5 Short-term capital gain or (loss) from like-kind exchanges from Form 8824 . . .	5	
6 Partnership's share of net short-term capital gain (loss), including specially allocated short-term capital gains (losses), from other partnerships, estates, and trusts . . .	6	
7 **Net short-term capital gain or (loss).** Combine lines 1a through 6 in column (h). Enter here and on Form 1065, Schedule K, line 8 or 11; or Form 8865, Schedule K, line 8 or 11 . . .	7	0

Part II Long-Term Capital Gains and Losses—Generally Assets Held More Than One Year (see instructions)

See instructions for how to figure the amounts to enter on the lines below. This form may be easier to complete if you round off cents to whole dollars.	(d) Proceeds (sales price)	(e) Cost (or other basis)	(g) Adjustments to gain or loss from Form(s) 8949, Part II, line 2, column (g)	(h) Gain or (loss) Subtract column (e) from column (d) and combine the result with column (g)
8a Totals for all long-term transactions reported on Form 1099-B for which basis was reported to the IRS and for which you have no adjustments (see instructions). However, if you choose to report all these transactions on Form 8949, leave this line blank and go to line 8b . .				0
8b Totals for all transactions reported on Form(s) 8949 with **Box D** checked . . .	594,840	670,770	-45,555	-121,485
9 Totals for all transactions reported on Form(s) 8949 with **Box E** checked . . .				0
10 Totals for all transactions reported on Form(s) 8949 with **Box F** checked . . .	643,000	445,000		198,000

11 Long-term capital gain from installment sales from Form 6252, line 26 or 37 . . .	11	450,000
12 Long-term capital gain or (loss) from like-kind exchanges from Form 8824 . . .	12	
13 Partnership's share of net long-term capital gain (loss), including specially allocated long-term capital gains (losses), from other partnerships, estates, and trusts . . .	13	
14 Capital gain distributions (see instructions). . . .	14	
15 **Net long-term capital gain or (loss).** Combine lines 8a through 14 in column (h). Enter here and on Form 1065, Schedule K, line 9a or 11; or Form 8865, Schedule K, line 9a or 11 . . .	15	526,515

For Paperwork Reduction Act Notice, see the Instructions for Form 1065.
HTA

Schedule D (Form 1065) 2021

651121

☐ Final K-1 ☐ Amended K-1 OMB No. 1545-0123

Schedule K-1 (Form 1065) **2021**

Department of the Treasury
Internal Revenue Service

For calendar year 2021, or tax year beginning ______ ending ______

Partner's Share of Income, Deductions, Credits, etc.

▶ See back of form and separate instructions.

Part I Information About the Partnership

A Partnership's employer identification number
75-3185725

B Partnership's name, address, city, state, and ZIP code
Atlantic Traders
4823 W. State Street
Jacksonville, FL 32202

C IRS center where partnership filed return ▶ e-file

D ☐ Check if this is a publicly traded partnership (PTP)

Part II Information About the Partner

E Partner's SSN or TIN (Do not use TIN of a disregarded entity. See instructions.) Partner: 1
455-81-5151

F Name, address, city, state, and ZIP code for partner entered in E. See instructions.
Ray Charles
4825 Ellis Rd.
Jacksonville, FL 32254

G [X] General partner or LLC member-manager ☐ Limited partner or other LLC member

H1 [X] Domestic partner ☐ Foreign partner

H2 ☐ If the partner is a disregarded entity (DE), enter the partner's: TIN ______ Name ______

I1 What type of entity is this partner? Active Individual

I2 If this partner is a retirement plan (IRA/SEP/Keogh/etc.), check here ▶ ☐

J Partner's share of profit, loss, and capital (see instructions):

	Beginning	Ending
Profit	30.000000%	30.000000%
Loss	30.000000%	30.000000%
Capital	30.000000%	30.000000%

Check if decrease is due to sale or exchange of partnership interest . . . ▶ ☐

K Partner's share of liabilities:

	Beginning	Ending
Nonrecourse . . $	1,396,500	$ 1,428,356
Qualified nonrecourse financing . . . . $	1,396,500	$ 1,428,356
Recourse . . . $		$ 7,800

Check this box if Item K includes liability amounts from lower tier partnerships. ▶ ☐

L Partner's Capital Account Analysis

Beginning capital account	$
Capital contributed during the year . .	$
Current year net income (loss)	$ 175,822
Other increase (decrease) (attach explanation)	$
Withdrawals and distributions	$ (106,580)
Ending capital account	$ 69,242

M Did the partner contribute property with a built-in gain (loss)?
☐ Yes [X] No If "Yes," attach statement. See instructions.

N Partner's Share of Net Unrecognized Section 704(c) Gain or (Loss)
Beginning . . . . $
Ending . . . . $

Part III Partner's Share of Current Year Income, Deductions, Credits, and Other Items

1	Ordinary business income (loss)		
2	Net rental real estate income (loss)		
3	Other net rental income (loss)		
4a	Guaranteed payments for services		116,357
4b	Guaranteed payments for capital		
4c	Total guaranteed payments		116,357
5	Interest income		14,100
6a	Ordinary dividends		12,300
6b	Qualified dividends		12,300
6c	Dividend equivalents		
7	Royalties		
8	Net short-term capital gain (loss)		
9a	Net long-term capital gain (loss)		157,955
9b	Collectibles (28%) gain (loss)		59,400
9c	Unrecaptured section 1250 gain		
10	Net section 1231 gain (loss)		
11	Other income (loss)	I*	13,667
12	Section 179 deduction		
13	Other deductions	H	14,400
		L	7,800

14	Self-employment earnings (loss)	A	116,357
15	Credits		
16	Schedule K-3 is attached if checked . . . . ▶ ☐		
17	Alternative minimum tax (AMT) items		
18	Tax-exempt income and nondeductible expenses		
19	Distributions	A	106,580
20	Other information	A	26,400
		B	7,800
		Z*	See Attached Stmt
21	Foreign taxes paid or accrued		

22 ☐ More than one activity for at-risk purposes*
23 ☐ More than one activity for passive activity purposes*

*See attached statement for additional information.

For IRS Use Only

Ray Charles 455-81-5151

K-1 Statement (Sch K-1, Form 1065)

Line 11 - Other Income (Loss)

I	Code I - Other income (loss)		
	Gain from the sale or exchange of qualified small business stock		43,667
	Long-Term Gain eligible for section 1045 rollover (replacement stock not purchased by the partnership)		-30,000
	Code I - Total other income (loss)	I	13,667

Line 13 - Other Deductions

H	Code H - Investment interest expense	H	14,400
L	Code L - Deductions-portfolio (other)		
	Property taxes		7,800
	Code L - Total deductions-portfolio (other)	L	7,800

Line 14 - Self-Employment

A	Code A - Net earnings (loss) from self-employment	A	116,357

Line 19 - Distributions

A	Code A - Cash and marketable securities	A	106,580

Line 20 - Other Information

A	Code A - Investment income	A	26,400
B	Code B - Investment expenses	B	7,800

Section 199A Information (Code Z)

Income Items	Non-SSTB	SSTB
Ordinary Income	116,357	0
Additional Information		
Section 199A W-2 wages	40,680	0
Section 199A unadjusted basis	1,456,633	0

Section 1202 Sales (Sch K1 (1065)) - Required Statement

Information for Partner 1: Ray Charles 455-81-5151

	Name of qualified small business that issued the stock	Date Acquired	Date Sold	Sales Price	Adjusted Basis
1	Inception Corporation	7/20/2014	6/26/2021	118,152	30,819

Line 20, Code P, Section 453A(c) Information (Sch K1 (1065))

75-3185725
Atlantic Traders

Ray Charles 455-81-5151

1	Description of property: 4 - 1000 acres of land		
2	Date acquired: 5/3/2015		
3	Date property sold: 10/21/2021		
4	Selling price, including mortgages and other debts, less mortgages, debts and other liabilities the buyer assumed or took the property subject to:		
	a Selling price including mortgages and other debts	**4a**	2,000,000
	b Mortgages, debts, and other liabilities the buyer assumed or took the property	**4b**	400,000
	c Subtract line 4b from line 4a	**4c**	1,600,000
5	Gross profit	**5**	800,000
6	Gross profit percentage	**6**	0.500000
7	Contract price less (4) above, plus payments received during the year (not including interest) whether stated or unstated	**7**	900,000
8	Payments received in prior years, not including interest whether stated or unstated	**8**	0
9	Installment sale income	**9**	450,000
10	Character of the income - capital or ordinary:	**10**	Capital
11	**a** Schedule K deferred obligation (Line 4c less Lines 7 and 8)	**11a**	700,000
	b Partner's share of the deferred obligation (Line 11a multiplied by partner's profit percentage)	**11b**	210,000

This data is provided to support the calculation of Section 453A(c) interest charge for installment sale obligations. See IRC Section 453A and report any required interest on Form 1040, Sch 2, Line 15. Note that this summary does not include installment sales reported on the Section 179 Disposition sheet.

651121

☐ Final K-1 ☐ Amended K-1 OMB No. 1545-0123

Schedule K-1 (Form 1065) **2021**

Department of the Treasury
Internal Revenue Service

For calendar year 2021, or tax year beginning ______ ending ______

Partner's Share of Income, Deductions, Credits, etc.

▶ **See back of form and separate instructions.**

Part I Information About the Partnership

A Partnership's employer identification number
75-3185725

B Partnership's name, address, city, state, and ZIP code
Atlantic Traders
4823 W. State Street
Jacksonville, FL 32202

C IRS center where partnership filed return ▶ e-file

D ☐ Check if this is a publicly traded partnership (PTP)

Part II Information About the Partner

E Partner's SSN or TIN (Do not use TIN of a disregarded entity. See instructions.) Partner: 2
454-66-3333

F Name, address, city, state, and ZIP code for partner entered in E. See instructions.
Leonard Skinner
1750 Cleveland Rd.
Jacksonville, FL 32209

G ☒ General partner or LLC member-manager ☐ Limited partner or other LLC member

H1 ☒ Domestic partner ☐ Foreign partner

H2 ☐ If the partner is a disregarded entity (DE), enter the partner's: TIN ______ Name ______

I1 What type of entity is this partner? Active Individual

I2 If this partner is a retirement plan (IRA/SEP/Keogh/etc.), check here ▶ ☐

J Partner's share of profit, loss, and capital (see instructions):

	Beginning	Ending
Profit	35.000000%	35.000000%
Loss	35.000000%	35.000000%
Capital	35.000000%	35.000000%

Check if decrease is due to sale or exchange of partnership interest . . . ▶ ☐

K Partner's share of liabilities:

	Beginning	Ending
Nonrecourse . . $	916,750	$ 713,822
Qualified nonrecourse financing . . . . $	916,750	$ 713,822
Recourse . . . $		$ 9,100

Check this box if Item K includes liability amounts from lower tier partnerships. ▶ ☐

L **Partner's Capital Account Analysis**

Beginning capital account . . . . . $	
Capital contributed during the year . . $	
Current year net income (loss) . . . . $	340,874
Other increase (decrease) (attach explanation) $	
Withdrawals and distributions . . . . $	(20,000)
Ending capital account . . . . . . $	320,874

M Did the partner contribute property with a built-in gain (loss)?
☐ **Yes** ☒ **No** If "Yes," attach statement. See instructions.

N **Partner's Share of Net Unrecognized Section 704(c) Gain or (Loss)**
Beginning . . . . $ ______
Ending . . . . $ ______

Part III Partner's Share of Current Year Income, Deductions, Credits, and Other Items

1	Ordinary business income (loss)		135,750
2	Net rental real estate income (loss)		
3	Other net rental income (loss)		
4a	Guaranteed payments for services		
4b	Guaranteed payments for capital		
4c	Total guaranteed payments		
5	Interest income		16,450
6a	Ordinary dividends		14,350
6b	Qualified dividends		14,350
6c	Dividend equivalents		
7	Royalties		
8	Net short-term capital gain (loss)		
9a	Net long-term capital gain (loss)		184,280
9b	Collectibles (28%) gain (loss)		69,300
9c	Unrecaptured section 1250 gain		
10	Net section 1231 gain (loss)		
11	Other income (loss)	I*	15,944
12	Section 179 deduction		
13	Other deductions	H	16,800
		L	9,100
14	Self-employment earnings (loss)	A	135,750
15	Credits		
16	Schedule K-3 is attached if checked . . . . ▶ ☐		
17	Alternative minimum tax (AMT) items		
18	Tax-exempt income and nondeductible expenses		
19	Distributions	A	20,000
20	Other information	A	30,800
		B	9,100
		Z*	See Attached Stmt
21	Foreign taxes paid or accrued		

22 ☐ More than one activity for at-risk purposes*
23 ☐ More than one activity for passive activity purposes*

*See attached statement for additional information.

For IRS Use Only

For Paperwork Reduction Act Notice, see the Instructions for Form 1065. www.irs.gov/Form1065 **Schedule K-1 (Form 1065) 2021**
HTA

Leonard Skinner 454-66-3333

K-1 Statement (Sch K-1, Form 1065)

Line 11 - Other Income (Loss)

I	Code I - Other income (loss)		
	Gain from the sale or exchange of qualified small business stock		50,944
	Long-Term Gain eligible for section 1045 rollover (replacement stock not purchased by the partnership)		-35,000
	Code I - Total other income (loss)	**I**	15,944

Line 13 - Other Deductions

H	Code H - Investment interest expense	**H**	16,800
L	Code L - Deductions-portfolio (other)		
	Property taxes		9,100
	Code L - Total deductions-portfolio (other)	**L**	9,100

Line 14 - Self-Employment

A	Code A - Net earnings (loss) from self-employment	**A**	135,750

Line 19 - Distributions

A	Code A - Cash and marketable securities	**A**	20,000

Line 20 - Other Information

A	Code A - Investment income	**A**	30,800
B	Code B - Investment expenses	**B**	9,100

Section 199A Information (Code Z)

Income Items	**Non-SSTB**	**SSTB**
Ordinary Income	135,750	0
Additional Information		
Section 199A W-2 wages	47,460	0
Section 199A unadjusted basis	1,699,406	0

Section 1202 Sales (Sch K1 (1065)) - Required Statement

Information for Partner 2: Leonard Skinner 454-66-3333

	Name of qualified small business that issued the stock	Date Acquired	Date Sold	Sales Price	Adjusted Basis
1	Inception Corporation	7/20/2014	6/26/2021	137,844	35,956

Line 20, Code P, Section 453A(c) Information (Sch K1 (1065))

75-3185725
Atlantic Traders

Leonard Skinner 454-66-3333

1	Description of property: 4 - 1000 acres of land		
2	Date acquired: 5/3/2015		
3	Date property sold: 10/21/2021		
4	Selling price, including mortgages and other debts, less mortgages, debts and other liabilities the buyer assumed or took the property subject to:		
	a Selling price including mortgages and other debts	**4a**	2,000,000
	b Mortgages, debts, and other liabilities the buyer assumed or took the property	**4b**	400,000
	c Subtract line 4b from line 4a	**4c**	1,600,000
5	Gross profit	**5**	800,000
6	Gross profit percentage	**6**	0.500000
7	Contract price less (4) above, plus payments received during the year (not including interest) whether stated or unstated	**7**	900,000
8	Payments received in prior years, not including interest whether stated or unstated	**8**	0
9	Installment sale income	**9**	450,000
10	Character of the income - capital or ordinary:	**10**	Capital
11	**a** Schedule K deferred obligation (Line 4c less Lines 7 and 8)	**11a**	700,000
	b Partner's share of the deferred obligation (Line 11a multiplied by partner's profit percentage)	**11b**	245,000

This data is provided to support the calculation of Section 453A(c) interest charge for installment sale obligations.
See IRC Section 453A and report any required interest on Form 1040, Sch 2, Line 15. Note that this summary does not include installment sales reported on the Section 179 Disposition sheet.

651121

☐ Final K-1 ☐ Amended K-1 OMB No. 1545-0123

Schedule K-1 (Form 1065) **2021**

Department of the Treasury
Internal Revenue Service

For calendar year 2021, or tax year beginning ______ ending ______

Partner's Share of Income, Deductions, Credits, etc.

▶ See back of form and separate instructions.

Part I Information About the Partnership

A Partnership's employer identification number
75-3185725

B Partnership's name, address, city, state, and ZIP code
Atlantic Traders
4823 W. State Street
Jacksonville, FL 32202

C IRS center where partnership filed return ▶ e-file

D ☐ Check if this is a publicly traded partnership (PTP)

Part II Information About the Partner

E Partner's SSN or TIN (Do not use TIN of a disregarded entity. See instructions.) Partner: 3
459-34-5939

F Name, address, city, state, and ZIP code for partner entered in E. See instructions.
Luke Jackson
1519 Carmen Street
Jacksonville, FL 32206

G ☒ General partner or LLC member-manager ☐ Limited partner or other LLC member

H1 ☒ Domestic partner ☐ Foreign partner

H2 ☐ If the partner is a disregarded entity (DE), enter the partner's:
TIN ______ Name ______

I1 What type of entity is this partner? Active Individual

I2 If this partner is a retirement plan (IRA/SEP/Keogh/etc.), check here ▶ ☐

J Partner's share of profit, loss, and capital (see instructions):

	Beginning	Ending
Profit	35.000000%	35.000000%
Loss	35.000000%	35.000000%
Capital	35.000000%	35.000000%

Check if decrease is due to sale or exchange of partnership interest . . . ▶ ☐

K Partner's share of liabilities:

	Beginning	Ending
Nonrecourse	$ 916,750	$ 713,822
Qualified nonrecourse financing	$ 916,750	$ 713,822
Recourse	$	$ 9,100

Check this box if Item K includes liability amounts from lower tier partnerships. ▶ ☐

L **Partner's Capital Account Analysis**

Beginning capital account	$
Capital contributed during the year	$
Current year net income (loss)	$ 340,873
Other increase (decrease) (attach explanation)	$
Withdrawals and distributions	$ (20,000)
Ending capital account	$ 320,873

M Did the partner contribute property with a built-in gain (loss)?
☐ Yes ☒ No If "Yes," attach statement. See instructions.

N **Partner's Share of Net Unrecognized Section 704(c) Gain or (Loss)**
Beginning . . . $
Ending . . . $

Part III Partner's Share of Current Year Income, Deductions, Credits, and Other Items

1	Ordinary business income (loss)		135,749
2	Net rental real estate income (loss)		
3	Other net rental income (loss)		
4a	Guaranteed payments for services		
4b	Guaranteed payments for capital		
4c	Total guaranteed payments		
5	Interest income		16,450
6a	Ordinary dividends		14,350
6b	Qualified dividends		14,350
6c	Dividend equivalents		
7	Royalties		
8	Net short-term capital gain (loss)		
9a	Net long-term capital gain (loss)		184,280
9b	Collectibles (28%) gain (loss)		69,300
9c	Unrecaptured section 1250 gain		
10	Net section 1231 gain (loss)		
11	Other income (loss)	I*	15,944
12	Section 179 deduction		
13	Other deductions	H	16,800
		L	9,100
14	Self-employment earnings (loss)	A	135,749
15	Credits		
16	Schedule K-3 is attached if checked . . . . . . ▶ ☐		
17	Alternative minimum tax (AMT) items		
18	Tax-exempt income and nondeductible expenses		
19	Distributions	A	20,000
20	Other information	A	30,800
		B	9,100
		Z*	See Attached Stmt
21	Foreign taxes paid or accrued		

22 ☐ More than one activity for at-risk purposes*
23 ☐ More than one activity for passive activity purposes*

*See attached statement for additional information.

For IRS Use Only

For Paperwork Reduction Act Notice, see the Instructions for Form 1065. www.irs.gov/Form1065 **Schedule K-1 (Form 1065) 2021**
HTA

Luke Jackson 459-34-5939

K-1 Statement (Sch K-1, Form 1065)

Line 11 - Other Income (Loss)

I	Code I - Other income (loss)		
	Gain from the sale or exchange of qualified small business stock		50,944
	Long-Term Gain eligible for section 1045 rollover (replacement stock not purchased by the partnership)		-35,000
	Code I - Total other income (loss)	I	15,944

Line 13 - Other Deductions

H	Code H - Investment interest expense	H	16,800
L	Code L - Deductions-portfolio (other)		
	Property taxes		9,100
	Code L - Total deductions-portfolio (other)	L	9,100

Line 14 - Self-Employment

A	Code A - Net earnings (loss) from self-employment	A	135,749

Line 19 - Distributions

A	Code A - Cash and marketable securities	A	20,000

Line 20 - Other Information

A	Code A - Investment income	A	30,800
B	Code B - Investment expenses	B	9,100

Section 199A Information (Code Z)

Income Items	Non-SSTB	SSTB
Ordinary Income	135,749	0
Additional Information		
Section 199A W-2 wages	47,460	0
Section 199A unadjusted basis	1,699,406	0

Section 1202 Sales (Sch K1 (1065)) - Required Statement

Information for Partner 3: Luke Jackson 459-34-5939

	Name of qualified small business that issued the stock	Date Acquired	Date Sold	Sales Price	Adjusted Basis
1	Inception Corporation	7/20/2014	6/26/2021	137,844	35,956

Line 20, Code P, Section 453A(c) Information (Sch K1 (1065))

75-3185725
Atlantic Traders

Luke Jackson 459-34-5939

1	Description of property: 4 - 1000 acres of land		
2	Date acquired: 5/3/2015		
3	Date property sold: 10/21/2021		
4	Selling price, including mortgages and other debts, less mortgages, debts and other liabilities the buyer assumed or took the property subject to:		
	a Selling price including mortgages and other debts	4a	2,000,000
	b Mortgages, debts, and other liabilities the buyer assumed or took the property	4b	400,000
	c Subtract line 4b from line 4a	4c	1,600,000
5	Gross profit	5	800,000
6	Gross profit percentage	6	0.500000
7	Contract price less (4) above, plus payments received during the year (not including interest) whether stated or unstated	7	900,000
8	Payments received in prior years, not including interest whether stated or unstated	8	0
9	Installment sale income	9	450,000
10	Character of the income - capital or ordinary:	10	Capital
11	a Schedule K deferred obligation (Line 4c less Lines 7 and 8)	11a	700,000
	b Partner's share of the deferred obligation (Line 11a multiplied by partner's profit percentage)	11b	245,000

This data is provided to support the calculation of Section 453A(c) interest charge for installment sale obligations. See IRC Section 453A and report any required interest on Form 1040, Sch 2, Line 15. Note that this summary does not include installment sales reported on the Section 179 Disposition sheet.

Form **6252**

Department of the Treasury
Internal Revenue Service

Installment Sale Income

▶ Attach to your tax return.

▶ Use a separate form for each sale or other disposition of property on the installment method.

▶ Go to *www.irs.gov/Form6252* for the latest information.

OMB No. 1545-0228

2021

Attachment Sequence No. **67**

Name(s) shown on return: Atlantic Traders

Identifying number: 75-3185725

1 Description of property ▶ 4 - 1000 acres of land

2a Date acquired (mm/dd/yyyy) ▶ 05/03/2015 **b** Date sold (mm/dd/yyyy) ▶ 10/21/2021

3 Was the property sold to a related party (see instructions) after May 14, 1980? If "No," skip line 4 ☐ Yes ☒ No

4 Was the property you sold to a related party a marketable security? If "Yes," complete Part III. If "No," complete Part III for the year of sale and the 2 years after the year of sale ☐ Yes ☐ No

Part I Gross Profit and Contract Price. Complete this part for all years of the installment agreement.

5	Selling price including mortgages and other debts. **Don't** include interest, whether stated or unstated			5	2,000,000
6	Mortgages, debts, and other liabilities the buyer assumed or took the property subject to (see instructions)	6	400,000		
7	Subtract line 6 from line 5	7	1,600,000		
8	Cost or other basis of property sold	8	1,200,000		
9	Depreciation allowed or allowable	9			
10	Adjusted basis. Subtract line 9 from line 8	10	1,200,000		
11	Commissions and other expenses of sale	11			
12	Income recapture from Form 4797, Part III (see instructions)	12			
13	Add lines 10, 11, and 12			13	1,200,000
14	Subtract line 13 from line 5. If zero or less, **don't** complete the rest of this form. See instructions			14	800,000
15	If the property described on line 1 above was your main home, enter the amount of your excluded gain. See instructions. Otherwise, enter -0-			15	0
16	**Gross profit.** Subtract line 15 from line 14			16	800,000
17	Subtract line 13 from line 6. If zero or less, enter -0-			17	0
18	**Contract price.** Add line 7 and line 17			18	1,600,000

Part II Installment Sale Income. Complete this part for all years of the installment agreement.

19	Gross profit percentage (expressed as a decimal amount). Divide line 16 by line 18. (For years after the year of sale, see instructions.)			19	0.500000
20	If this is the year of sale, enter the amount from line 17. Otherwise, enter -0-			20	0
21	Payments received during year (see instructions). **Don't** include interest, whether stated or unstated			21	900,000
22	Add lines 20 and 21			22	900,000
23	Payments received in prior years (see instructions). **Don't** include interest, whether stated or unstated	23			
24	**Installment sale income.** Multiply line 22 by line 19			24	450,000
25	Enter the part of line 24 that is ordinary income under the recapture rules. See instructions			25	
26	Subtract line 25 from line 24. Enter here and on Schedule D or Form 4797. See instructions			26	450,000

Part III Related Party Installment Sale Income. Don't complete if you received the final payment this tax year.

27 Name, address, and taxpayer identifying number of related party ▶

28 Did the related party resell or dispose of the property ("second disposition") during this tax year? ☐ Yes ☐ No

29 **If the answer to question 28 is "Yes," complete lines 30 through 37 below unless one of the following conditions is met. Check the box that applies.**

- **a** ☐ The second disposition was more than 2 years after the first disposition (other than dispositions of marketable securities). If this box is checked, enter the date of disposition (mm/dd/yyyy) ▶
- **b** ☐ The first disposition was a sale or exchange of stock to the issuing corporation.
- **c** ☐ The second disposition was an involuntary conversion and the threat of conversion occurred after the first disposition.
- **d** ☐ The second disposition occurred after the death of the original seller or buyer.
- **e** ☐ It can be established to the satisfaction of the IRS that tax avoidance wasn't a principal purpose for either of the dispositions. If this box is checked, attach an explanation. See instructions.

30	Selling price of property sold by related party (see instructions)	30	
31	Enter contract price from line 18 for year of first sale	31	
32	Enter the **smaller** of line 30 or line 31	32	
33	Total payments received by the end of your 2021 tax year (see instructions)	33	
34	Subtract line 33 from line 32. If zero or less, enter -0-	34	0
35	Multiply line 34 by the gross profit percentage on line 19 for year of first sale	35	0
36	Enter the part of line 35 that is ordinary income under the recapture rules. See instructions	36	
37	Subtract line 36 from line 35. Enter here and on Schedule D or Form 4797. See instructions	37	0

For Paperwork Reduction Act Notice, see page 4. Form **6252** (2021)

HTA

Form **4562**

Department of the Treasury
Internal Revenue Service (99)

Depreciation and Amortization
(Including Information on Listed Property)

► Attach to your tax return.

► Go to *www.irs.gov/Form4562* for instructions and the latest information.

OMB No. 1545-0172

2021

Attachment Sequence No. **179**

Name(s) shown on return	Business or activity to which this form relates	**Identifying number**
Atlantic Traders	1065 - Services	75-3185725

Part I **Election To Expense Certain Property Under Section 179**

Note: If you have any listed property, complete Part V before you complete Part I.

1	Maximum amount (see instructions)	1	
2	Total cost of section 179 property placed in service (see instructions)	2	
3	Threshold cost of section 179 property before reduction in limitation (see instructions)	3	
4	Reduction in limitation. Subtract line 3 from line 2. If zero or less, enter -0-	4	0
5	Dollar limitation for tax year. Subtract line 4 from line 1. If zero or less, enter -0-. If married filing separately, see instructions	5	0

6 (a) Description of property	(b) Cost (business use only)	(c) Elected cost
7 Listed property. Enter the amount from line 29	7	

8	Total elected cost of section 179 property. Add amounts in column (c), lines 6 and 7	8	0
9	Tentative deduction. Enter the **smaller** of line 5 or line 8	9	0
10	Carryover of disallowed deduction from line 13 of your 2020 Form 4562	10	
11	Business income limitation. Enter the smaller of business income (not less than zero) or line 5. See instructions	11	
12	Section 179 expense deduction. Add lines 9 and 10, but don't enter more than line 11	12	0
13	Carryover of disallowed deduction to 2022. Add lines 9 and 10, less line 12 ►	13	0

Note: Don't use Part II or Part III below for listed property. Instead, use Part V.

Part II **Special Depreciation Allowance and Other Depreciation (Don't** include listed property. See instructions.)

14	Special depreciation allowance for qualified property (other than listed property) placed in service during the tax year. See instructions	14	
15	Property subject to section 168(f)(1) election	15	
16	Other depreciation (including ACRS)	16	

Part III **MACRS Depreciation (Don't** include listed property. See instructions.)

Section A

17	MACRS deductions for assets placed in service in tax years beginning before 2021	17	119,744
18	If you are electing to group any assets placed in service during the tax year into one or more general asset accounts, check here ► ☐		

Section B - Assets Placed in Service During 2021 Tax Year Using the General Depreciation System

(a) Classification of property	(b) Month and year placed in service	(c) Basis for depreciation (business/investment use only—see instructions)	(d) Recovery period	(e) Convention	(f) Method	(g) Depreciation deduction
19 a 3-year property						
b 5-year property						
c 7-year property						
d 10-year property						
e 15-year property						
f 20-year property						
g 25-year property			25 yrs.		S/L	
h Residential rental property			27.5 yrs.	MM	S/L	
			27.5 yrs.	MM	S/L	
i Nonresidential real property			39 yrs.	MM	S/L	
				MM	S/L	

Section C - Assets Placed in Service During 2021 Tax Year Using the Alternative Depreciation System

(a) Classification of property	(b) Month and year placed in service	(c) Basis for depreciation	(d) Recovery period	(e) Convention	(f) Method	(g) Depreciation deduction
20 a Class life					S/L	
b 12-year			12 yrs.		S/L	
c 30-year			30 yrs.	MM	S/L	
d 40-year			40 yrs.	MM	S/L	

Part IV **Summary** (See instructions.)

21	Listed property. Enter amount from line 28	21	
22	**Total.** Add amounts from line 12, lines 14 through 17, lines 19 and 20 in column (g), and line 21. Enter here and on the appropriate lines of your return. Partnerships and S corporations—see instructions	22	119,744
23	For assets shown above and placed in service during the current year, enter the portion of the basis attributable to section 263A costs	23	

For Paperwork Reduction Act Notice, see separate instructions. Form 4562 (2021)

HTA

Line 20 (1065) - Other Deductions

1	Insurance	1	12,000
2	Telephone	2	72,000
3	Total other deductions	3	84,000

Line 11, Sch K (1065) - Other Income (Loss)

I	Code I - Other income (loss)		
	Gain from the sale or exchange of qualified small business stock		145,555
	Loss from sale of section 1244 stock		-100,000
	Total Code I - Other income (loss)	I	45,555
	Total other income (loss)	11	45,555

Line 13d, Sch K (1065) - Other Deductions

L	Code L - Deductions-portfolio (other)		
	Property taxes		26,000
	Total Code L - Deductions-portfolio (other)	L	26,000
	Total other deductions	13d	26,000

Line 19, Sch K (1065) - Distributions

		Adjusted Basis		Fair Market Value
A	Code A - Distributions of cash and marketable securities			
	Distributions of cash			146,580
	Total distributions of cash and marketable securities		A	146,580

Line 20c, Sch K (1065) - Other Information

P	Code P - Section 453A(c) information	P	700,000

Line 8, Sch L (1065) - Other Investments

			Beginning	Ending
1	Installment note receivable (net of deferred gain)	1		350,000
2	Stocks	2	1,670,770	3,500,000
3	Bonds	3	645,000	645,000
4	Spanish doubloons	4	445,000	
5	Total other investments	5	2,760,770	4,495,000

Line 7, Sch M-2 (1065) - Other Decreases

1	Guaranteed payments (other than health insurance)	1	116,357
2	Total other decreases	2	116,357

Guaranteed payments to partners

Payments where a partner provides services or capital to a partnership in his capacity as a partner and receives payments that are not dependent on the income of the partnership are called *guaranteed payments*.[1] On the other hand, if payments to a partner for services are dependent on partnership income and the partner is acting in his capacity as a partner, the payments should be treated as a distributive share of partnership income.

Example 2-1

Partner A agrees to actively manage the business of the ABC partnership on a full-time basis; the other partners are not involved in the day-to-day management of the business. Under these circumstances, A might negotiate a fixed payment for her services from the partnership, similar in amount to the salary an employee might receive. Because the services being performed are an integral part of the business, but are not dependent on partnership income, the payments involved would be treated as guaranteed payments.

Another situation where such payments would be called for is when one partner contributes more capital than the other partners but is given the same proportional share of partnership income as the others. To compensate the partner for the extra capital contributed, the partnership could pay him fixed payments, similar in amount to interest, instead of allocating a larger share of partnership income.

Usually, a guaranteed payment will be fixed in amount, but it does not have to be. The IRS has taken the position that under certain circumstances even a contingent payment for services, the amount of which is determined by reference to an item of partnership gross income (for example, percentage of rents collected), can be characterized as a guaranteed payment. Such a payment would be a guaranteed payment if, on the basis of all of the facts and circumstances, the payment is compensation rather than a share of partnership profits. According to the IRS, whether a payment is compensation or a share of partnership profits depends on the reasonableness of the payment for the services provided and whether the method used to determine the amount of the payment would have been appropriate to use to compensate an unrelated party for the services.[2] Before the IRS issued its ruling on the matter, the Tax Court ruled that a payment that was dependent on the gross rentals from shopping centers was not a guaranteed payment.[3]

[1] IRC Section 707(c).
[2] *Rev. Rul. 81-300*, 1981-2 CB 143.
[3] *Pratt, Edward v. Com.*, 64 TC 203 (1975), aff'd on other issue, 39 AFTR 2d 77-1258, 550 F2d 1023, 77-1 USTC Par. 9347 (1977, CA5).

Knowledge check

1. Partner L of the LMN Partnership agrees to actively manage the partnership in return for a $6,000 distribution from the partnership each month. How should the $6,000 monthly payment be treated by LMN?

    a. As a guaranteed payment to L.
    b. As a distributive share of income to L.
    c. As a payment to one not acting as a partner.
    d. As a guaranteed payment, but only after subtracting L's share of the partnership's deduction of the payment.

Tax treatment of guaranteed payments

Character of income and deduction

Guaranteed payments are treated as ordinary income by the partner who receives them and are not treated as a share of partnership income.[4] In general, the partnership is entitled to an ordinary deduction for such payments, although they must be capitalized in situations where the services provided by the partner are more properly characterized as capital expenditures by the partnership (for example, organization or defense-of-title expenses).

Example 2-2

The ABC Company is a partnership equally owned by A, B, and C. Assume that the income and deductions of ABC are allocated equally between the three partners. ABC has the following items of income, gain, and expense for the year:

Operating business income	$120,000
Long-term capital gain	24,000
Tax-exempt interest	48,000
Total	$192,000

[4] Regulation Section 1.707-1(c).

Example 2-2 (continued)

Because C manages the partnership's operations, she receives a guaranteed payment of $90,000 from ABC during the year. The income of the partnership will be allocated as follows:

	Total	C	A and B (each)
Ordinary taxable income	$30,000*	$10,000	$10,000
Guaranteed payment (ordinary)	90,000	90,000	
Long-term capital gain	24,000	8,000	8,000
Tax-exempt interest	48,000	16,000	16,000
Total	$192,000	$124,000	$34,000

*($120,000 operating business income - $90,000 deduction for guaranteed payment = $30,000).

C will recognize a total of $100,000 of ordinary income, consisting of the $90,000 guaranteed payment she receives and her $10,000 share of the $30,000 ordinary income of the partnership.

Knowledge check

2. Partner G of the equal GHI Partnership is paid a $30,000 guaranteed payment for managerial services rendered in operating the partnership. Before the guaranteed payment, the partnership has taxable income of $75,000. What is G's total income from the partnership?

   a. $30,000.
   b. $45,000.
   c. $55,000.
   d. $25,000.

Minimum guaranteed payments

At times, a partner may want to be guaranteed some minimum level of compensation while remaining allowed to share in any partnership income that might occur in excess of this amount. For example, she might request that she be allocated 25% of partnership profits, but not less than a fixed dollar amount of $100,000. In that case, the guaranteed payment is the excess, if any, of the amount received by the partner over what would have been her share of partnership income (calculated before subtracting the guaranteed payment).[5]

[5] Reg. Sec. 1.707-1(c), Ex (2); Rev. Rul. 69-180, 1969-1 C.B. 183.

Example 2-3

Partner A manages the business of the ABCD Partnership. According to the partnership agreement, partner A will be allocated the greater of $200,000 or 25% of partnership income each year. The other partners each receive one-third of the partnership's income or loss after making the required allocation to A.

Assume that during the current year the partnership reports net ordinary trade or business income of $500,000. Further assume that it has no other items of income or loss. Under the terms of the partnership agreement, A will be allocated a total of $200,000 from the partnership because $200,000 is greater than 25% of the partnership's $500,000 net income.

Absent this guarantee, A would have been allocated a distributive share of partnership income of only $125,000 (25% of the partnership's $500,000 in operating profits). Of the total amount distributed to A, therefore, $75,000 will be classified as a guaranteed payment (the $200,000 received over the $125,000 A would have received absent the guarantee).

A's total ordinary income from the partnership will be $200,000, consisting of A's $75,000 guaranteed payment and a $125,000 share of partnership income. The other partners will each be allocated $100,000 of ordinary income [($500,000 - $200,000) ÷ 3].

Knowledge check

3. Partner X of the XYZ Partnership manages the business of the partnership. In return for these services, X has negotiated an agreement with XYZ that he will be allocated 40% of partnership income, but not less than $80,000. The partnership has income of $150,000. How much is X's guaranteed payment?

    a. $20,000.
    b. $32,000.
    c. $80,000.
    d. $150,000.

Key review point

AT's ordinary income from the valuation service will be $387,856. Ray's guaranteed payment is shown to be $116,357. Have Ray's and the other partners' shares of ordinary income been computed correctly? Have the distributions to Ray been accounted for correctly?

Qualified business income deduction

Beginning in 2018, the Tax Cuts and Jobs Act (TCJA) provides for a 20% qualified business income (QBI) deduction for domestic trade or business income; however, if the deduction is based on QBI from a specialized service trade or business (SSTB), it may be limited or phased out completely. The deduction begins to phase out if the taxpayer's 2021 taxable income exceeds the threshold amounts of $164,900 for single and head of household; $164,925 for married filing separately; and $329,800 for married filing joint returns. The thresholds for 2022 are $170,050 for single, head of household, and married filing separately, and $340,100 for married filing jointly. The phase-out range for single filers is $50,000 and $100,000 for joint filers. Guaranteed payments qualify neither as QBI nor as W-2 wages for purposes of calculating the deduction when the taxpayer’s deduction is subject to phase-out.

For taxpayers with taxable income in excess of the threshold amounts, the amount allowed as a deduction is equal to the *lesser of*

- 20% of the taxpayer’s QBI, or
- the greater of
  - 50% of W-2 wages with respect to the qualified trade or business, or
  - the sum of 25% of W-2 wages with respect to the qualified trade or business plus 2.5% of the unadjusted basis, immediately after acquisition, of all qualified property.

Qualified property means tangible property subject to depreciation used in the production of QBI. The property must have been available for use at the close of the taxable year. Qualifying property cannot be fully depreciated before the end of the close of the taxable year.

The QBI deduction is calculated and taken at the partner level — not the entity level. Due to the way the deduction is calculated, however, partnerships (and other pass-through entities, for that matter) are required to supply the partners with the information they require to calculate their respective QBI deductions. To this end, they must disclose to partners, using Code Z, their individual shares of QBI, W-2 wages, and qualified property. These disclosures are made on Schedules K-1 in Box 20.

Key review point

Ray’s guaranteed payment does not qualify as QBI, but all other income allocated to the partners from the valuation business does qualify as QBI. All of the wages are allocated to the valuation business. The partnership will be required to supply the partners with the information they need to calculate their respective QBI deductions. Therefore, they must disclose to the partners, under Code Z, their individual shares of QBI, W-2 wages, and qualified property. Qualified property includes only depreciable property, so the land under the Buffett Building would be excluded, as would all the other non-depreciable assets. These disclosures are made on Schedules K-1 in Box 20.

Allocation of recourse liabilities

General rules: "Constructive liquidation"

Partnership recourse liabilities are allocated among general partners in accordance with the way those partners bear the economic risk of loss for those liabilities. Partners bear the economic risk of loss for a liability to the extent they would be required to make a net contribution to the lender, or to the partnership, in the event of a partnership constructive liquidation. In this hypothetical constructive liquidation scenario, all the partnership's assets (including money) are sold for no consideration, and the partnership is liquidated without paying any of its outstanding liabilities. The losses recognized in the deemed sale are then allocated to the partners in accordance with their loss-sharing ratios and their capital accounts are analyzed to determine each partner's potential personal liability.

This hypothetical liquidation determines each partner's economic risk for partnership liabilities in a manner quite similar to the determination of his economic interest in partnership items of income and loss under Section 704(b). In fact, it follows the rationale under Section 704(b) — the hypothetical book losses are allocated to the partners as provided in the partnership agreement and recorded in their capital accounts. Those partners with deficits in their capital accounts following this hypothetical transaction would be obligated to restore those deficits under Section 704(b). Restoration of deficit capital accounts would be required for the partnership to pay its creditors. Thus, their shares of the partnership's recourse liabilities are equal to the deficit balances they would be required to repay in the hypothetical worst-case scenario reflected in the constructive liquidation.

Example 2-4

A and B form a general partnership with cash contributions of $50,000 each. The partners agree to share all items of income and loss equally. The partnership borrows $90,000 on a recourse note and purchases a shopping center for $190,000. A constructive liquidation of the partnership, in which all partnership assets are assumed to become worthless, and all liabilities payable in full, would yield the following partner capital accounts:

	A	B
Beginning capital	$ 50,000	$ 50,000
Loss on shopping center	(95,000)	(95,000)
Hypothetical capital balance	$ (45,000)	$ (45,000)

Because A and B would each be required by law to make a net contribution of $45,000 to the partnership, they share risk of loss for the partnership recourse debt equally.

Knowledge check

4. Which capital accounts do the regulations look to in determining the partners' shares of partnership recourse debts in a hypothetical constructive liquidation?

    a. Section 704(b) book capital accounts.
    b. The capital accounts under GAAP.
    c. The tax capital accounts.
    d. The hypothetical capital accounts.

Limited partners

Because limited partners typically cannot be obligated to make payments to the partnership or to the partnership's creditors beyond their initial contributions, the regulations generally prevent them from sharing in partnership recourse debts; however, where a limited partner is required to restore a deficit in her capital account, this obligation will entitle her to a share of partnership recourse debts. Similarly, where a limited partner obtains his partnership interest in exchange for cash and a promissory note obligating him to make additional contributions in the future, he will be entitled to share in partnership recourse debts to the extent of the outstanding balance of the promissory note.

Book versus tax capital accounts

The regulations under Section 752 are corollaries of earlier regulations issued under Section 704(b). The Section 704(b) regulations, governing partnership accounting generally, form the foundation on which the liability sharing regulations are based. Thus, it is important to recognize that the hypothetical capital account calculations required in the constructive liquidation process are based on the partners' book capital accounts under Section 704(b). (However, the partner's capital account balance shown on Schedule K-1 must be calculated using the tax basis.)

Example 2-5

Q and L form a partnership with contributions of property and/or cash, as follows:
Q contributes real estate with a fair market value of $750,000 and a tax basis of $450,000; this real estate is unencumbered by liabilities of any kind. L contributes cash of $750,000.
The partnership borrows $500,000 against the real estate contributed by Q to construct an office building. The loan is a recourse loan for which Q and L, as general partners, each assume joint and several liabilities. Q and L agree to share in partnership capital, profits, and losses equally. A constructive liquidation immediately after the partnership incurs the liability would yield the following results:

Example 2-5 (continued)

	Q	L
Beginning capital balances	$ 750,000	$ 750,000
Hypothetical loss	(1,000,000)	(1,000,000)
Hypothetical capital balance	$ (250,000)	$ (250,000)

Note that the hypothetical loss allocated between the two partners is the amount of the book loss that would result if the partnership disposed of all its assets for no consideration. Where the partnership has only recourse liabilities outstanding, the hypothetical loss will be equal to the aggregate book value of the partnership's assets. In this case, the partnership would lose $2 million. Allocating this loss equally among the two partners leaves each with a $250,000 deficit balance in their hypothetical capital accounts. These reflect the amounts each partner would be required to pay the partnership in order to allow the partnership to pay its creditors. Because each partner would owe $250,000, they share the $500,000 partnership recourse liability equally.

Key review point

Accounts payable of an accrual basis taxpayer should be treated as a recourse debt. To allocate the total recourse debt (including accounts payable) of $2,856,000, the $8,741,988 of loss on the hypothetical sale of all assets for $0 would be allocated to the partners' capital accounts. The resulting negative account balances give the appropriate allocation of the recourse debt to the different partners as reported in Part II, item K, on their respective K-1s. (Difference due to rounding.)

	Ending balance	Loss	Balance after loss
Capital, Ray	$1,194,241	($2,622,597)	($1,428,356)
Capital, Leonard	2,345,874	(3,059,697)	(713,823)
Capital, Luke	2,345,874	(3,059,697)	(713,823)
Total	$5,885,989	($8,741,990)	($2,856,000)

Capital gains and losses

Most property owned and used for personal purposes or investment are *capital assets*. For example, a personal house, furniture, car, stocks, and bonds are capital assets. A capital asset is any property except (among other items):

- Inventory
- Accounts or notes receivable for services rendered
  - in the ordinary course of a trade or business and
  - as an employee
- Depreciable property used in a trade or business
- Real estate used in a trade or business
- Supplies regularly used in a trade or business

Partnerships use Form 8949 to report the sale or exchange of a capital asset not reported on another form or schedule. Use Schedule D to figure the overall gain or loss from transactions reported on Form 8949 and to report a capital loss carryover from the previous tax year to the current tax year.

The tax treatment of a capital gain or loss depends on how long the asset is owned before it is sold or exchanged. If the holding period of a capital asset is one year or less, the gain or loss from its disposition is short-term. A short-term capital loss should be reported in Part I of Form 8949 and or Schedule D, as applicable. If the holding period of a capital asset is longer than one year, the gain or loss from its disposition is long-term. In such a case, report the long-term capital loss in Part II of Form 8949 and/or Schedule D, as applicable. If a Form 1099B (or substitute statement) is received for a stock sale, box 2 may help determine whether the gain or loss is short- or long-term.

The tax rates that apply to a net capital gain are generally lower than the tax rates that apply to other income. These lower rates are called the maximum capital gains rates. The term *net capital gain* means the amount by which net long-term capital gain for the year is more than net short-term capital loss. For 2021, maximum tax rates for capital gains for individuals are 0%, 15%, 20%, 25%, and 28%, depending on the type of capital asset involved.

The following chart summarizes the capital gains tax rates in effect for 2021 based on taxable income:

Tax rate	Married filing jointly and surviving spouse	Head of household	Single	Married filing separately
0%	Up to $80,800	Up to $54,100	Up to $40,400	Up to $40,400
15%	Over $80,800 but not over $501,600	Over $54,100 but not over $473,750	Over $40,400 but not over $445,850	Over $40,400 but not over $250,800
20%	Over $501,600	Over $473,750	Over $445,850	Over $250,800

Individuals should use the Qualified Dividends and Capital Gain Worksheet in the Instructions for Form 1040, or the Schedule D Tax Worksheet in the Instructions for Schedule D (Form 1040) (whichever applies) to figure their tax if they have qualified dividends or net capital gain.

Key review point

Sometimes adjustments are needed to be made to capital gains and losses as computed on Form 8949. Codes are provided for the different types of adjustments; these codes should be entered in Form 8949 column (f). The adjustment amount itself should be entered in column (g). Some common codes, along with the type of adjustment they correspond to, are:

- B — Form 1099-B (or substitute statement) to show an incorrect basis in box 1e
- H — To show the exclusion from sale or exchange of a principal residence
- Q — Exclusion of part of the gain on the sale of qualified small business stock
- W — Nondeductible loss from a wash sale
- S — Loss from Section 1244 stock in excess of the ordinary loss allowed
- C — Disposition of collectibles

Dividends

Ordinary dividends are the most common type of distribution from a corporation or a mutual fund. They are paid out of earnings and profits and are generally taxed the same as ordinary income. This means they are not capital gains. It can be assumed that any dividend received on common or preferred stock is an ordinary dividend unless the paying corporation or mutual fund indicates otherwise. Ordinary dividends will be shown in box 1a of Form 1099-DIV.

Qualified dividends are the ordinary dividends subject to the same 0%, 15%, or 20% maximum tax rate that applies to net capital gain. They should be shown in box 1b of the Form 1099-DIV.

The maximum rate of tax on qualified dividends is

- 0% on any amount that otherwise would be taxed at a 10% or 15% rate,
- 15% on any amount that otherwise would be taxed at rates greater than 15% but less than 39.6%, and
- 20% on any amount that otherwise would be taxed at a 39.6% rate.

To qualify for the maximum rate, all the following requirements must be met:

- The dividends must have been paid by a U.S. corporation or a qualified foreign corporation. A qualified foreign corporation includes any foreign corporation that is eligible for benefits of a comprehensive income tax treaty with the United States that the IRS determines is satisfactory for purposes of the qualified dividend rules and that includes an exchange-of-information program.
- The dividends are not any of the following types of unqualified distributions (among others listed):
  - Capital gain distributions
  - Dividends paid on deposits with mutual savings banks, cooperative banks, credit unions, U.S. building and loan associations, U.S. savings and loan associations, federal savings and loan associations, and similar financial institutions (report these amounts as interest income)
  - Dividends from a corporation that is a tax-exempt organization or farmer's cooperative during the corporation's tax year in which the dividends were paid or during the corporation's previous tax year
- The required holding period of the stock is met.

To be qualified, the stock must be held for more than 60 days during the 121-day period that begins 60 days before the ex-dividend date. The ex-dividend date is the first date following the declaration of a dividend on which the buyer of a stock is not entitled to receive the next dividend payment. When counting the number of days the stock was held, include the day of disposition, but not the day of acquisition. In the case of preferred stock, the stock must have been held more than 90 days during the 181-day period that begins 90 days before the ex-dividend date if the dividends are due to periods totaling more than 366 days. If the preferred dividends are due to periods totaling less than 367 days, the 60-out-of-121-day holding period applies.

Ordinary dividends, including any qualified dividends, should be reported on Schedule K, line 6a, and Schedule K-1, box 6a. Qualified dividends should be reported on Schedule K, line 6b, and on Schedule K-1, box 6b.

Foreign income and Schedules K-2 and K-3

Beginning with the 2021 tax year, partnerships with foreign source income might have to complete Schedules K-2 and K-3, which replace, supplement, or clarify the following:

1. Former line 16, "Partners' Distributive Share Items, Foreign Transactions," of Schedule K, Form 1065
2. Line 16, "Foreign Transactions," of Schedule K-1 (Form 1065)
3. Certain amounts formerly reported on Form 1065, Schedule K, line 20c, "Other items and amounts," and Schedule K-1, Part III, line 20, "Other information"

The new schedules assist partnerships in providing the information necessary for the partners to complete their returns if they have foreign income or operations. For example, the new Schedule K-3 provides information necessary for corporate and individual partners to figure their foreign tax credit on Form 1118, *Foreign Tax Credit—Corporations*, and Form 1116, *Foreign Tax Credit (Individual, Estate or Trust)*, respectively. Schedule K-2 is used to report items of international tax relevance from the operation of the partnership, and would provide partnership-level information similar to that which would otherwise go on Schedule K of Form 1065. Schedule K-3 is generally used to report to partners their share of the items reported on Schedule K-2. Partners must include the information reported on Schedule K-3 on their tax or information returns.

Since some of the partners might need to know that the $11,000 dividend from Grupo Aeromexico to Atlantic Traders is foreign source income, Schedules K-2 and K-3 should have been filed with the relevant information included.

Collectibles

Gain or loss from the sale of collectibles is subject to a maximum tax rate of 28%. *Collectibles gain or loss* is the gain or loss from the sale or trade of a work of art, rug, antique, metal (such as gold, silver, and platinum bullion), gem, stamp, coin, or alcoholic beverage; to qualify, the previous items must have been held more than one year. Collectibles gain includes gain from the sale of an interest in a partnership, S corporation, or trust due to unrealized appreciation of collectibles held by the partnership, S corporation, or trust.

Collectibles gains and losses should be reported on Schedule K, line 9b, and Schedule K-1, box 9b.

Section 1202 stock sales

Section 1202 allows the exclusion of a portion of the eligible gain on the sale or exchange of qualified small business (QSB) stock. The Section 1202 exclusion applies only to QSB stock held for more than five years.

If the QSB stock was acquired on or before February 17, 2009, up to 50% of the qualified gain can be excluded; however, up to 60% of the qualified gain on certain empowerment-zone business stock can be excluded.

If the QSB stock was acquired after February 17, 2009, and before September 28, 2010, up to 75% of the qualified gain can be excluded.

If the QSB stock was acquired after September 27, 2010, up to 100% of the qualified gain can be excluded.

Any gain that is not excluded is subject to a tax rate of 28%, rather than a possibly more favorable long-term capital gain rate.

To be QSB stock, the stock must meet all following tests:

1. It must be stock in a C corporation (that is, not S corporation stock).
2. It must have been originally issued after August 10, 1993.
3. As of the date the stock was issued, the corporation was a domestic C corporation with total gross assets of $50 million or less *(a)* at all times after August 9, 1993, and before the stock was issued, and *(b)* immediately after the stock was issued.
4. The stock must have been acquired at its original issue (either directly or through an underwriter), either in exchange for money or other property (other than stock) or as pay for services (other than as an underwriter) to the corporation.
5. During substantially all the time the stock was held: a. the corporation was a C corporation; b. at least 80% of the value of the corporation's assets were used in the active conduct of one or more qualified businesses (defined later in the text); and c. the corporation wasn't a foreign corporation, domestic international sales corporation (DISC), former DISC, regulated investment company, real estate investment trust, real estate mortgage investment conduit (REMIC), financial asset securitization investment trust (FASIT), cooperative, or a corporation that has made (or that has a subsidiary that has made) a Section 936 election.

The Section 1202 exclusion applies only to QSB stock held by the partnership for more than five years. Corporate partners aren't eligible for the Section 1202 exclusion. Additional limitations apply at the partner level. Report the gain on Form 8949 with code Q in column (f), and a negative adjustment for all of the excluded portion of the gain in column (g). Report each partner's share of Section 1202 gain that is eligible for exclusion on Schedule K, line 11, and on Schedule K-1, box 11, code I. Each partner will determine if he or she qualifies for the Section 1202 exclusion. Report on an attached statement to Schedule K-1 for each sale or exchange *(a)* the name of the corporation that issued the QSB stock, *(b)* the partner's share of the partnership's adjusted basis and sales price of the QSB stock, and *(c)* the dates the QSB stock was bought and sold.

Section 1244 stock

An ordinary loss, rather than a capital loss, can be deducted on a loss on the sale, trade, or worthlessness of Section 1244 stock. The amount that can be deducted as an ordinary loss is limited to $50,000 each year for a single individual or one who is married filing separately. On a joint return, the limit is $100,000, even if only one spouse has this type of loss. If the loss, for example, is $110,000 and the taxpayer's spouse has no loss, $100,000 can be deducted on a joint return. The remaining $10,000 is a capital loss.

Section 1244 (small business) stock is stock issued for money or property (other than stock and securities) in a domestic small business corporation. To qualify, during its five most recent tax years before the loss, this corporation must have derived more than 50% of its gross receipts from other than royalties, rents, dividends, interest, annuities, and gains from sales and trades of stocks or securities. If the corporation was in existence for at least one year, but less than five years, the 50% test applies to the tax years ending before the loss. If the corporation was in existence less than one year, the 50% test applies to the entire period the corporation was in existence before the day of the loss. If, however, the corporation's deductions (other than the net operating loss and dividends-received deductions) were more than its gross income during this period, this 50% test does not apply.

The corporation must have been largely an operating company for ordinary loss treatment to apply. If the stock was issued before July 19, 1984, the stock must be common stock. If issued after July 18, 1984, the stock may be either common or preferred.

The taxpayer must be the original owner of the stock to be allowed ordinary loss treatment. To claim a deductible loss on stock issued to a partnership, the taxpayer must have been a partner when the stock was issued and have remained so until the time of the loss. If a partnership distributes Section 1244 stock to a partner, the partner cannot treat any later loss on that stock as an ordinary loss. A partner's distributive share of the partnership Section 1244 loss would be added to any individual Section 1244 stock loss they might have before applying the ordinary loss limit.

The ordinary loss limitation is applied at the partner level, not the partnership level, so all Section 1244 losses of a partnership should be passed through to the partners without limitation. It is not entirely clear from the instructions how a Section 1244 loss should be reported by a partnership. The loss should first be reported on Form 8949 as follows: Complete columns (a), (b), and (c) normally. In column (d), enter the entire sales price of the stock sold. In column (e), enter the entire basis of the stock sold. Enter "S" in column (f). In column (g), enter the entire loss for this transaction. Enter it as a positive number.

At the partnership level, it is not clear that the loss is ordinary; because that determination is made at the partner level, it does not seem appropriate to include it on Form 4797 under "Ordinary Gains and Losses", line 10, as would be the case for individuals. The more appropriate treatment is to treat it in a manner similar to Section 1202 gains and report Section 1244 losses in their entirety on line 11 of Schedule K and in box 11 of Schedule K-1, code I. Each partner can then determine if she qualifies for the Section 1244 ordinary loss deduction, and to what extent. To make that determination, each partner will need certain information — a statement should be attached to Schedule K-1 for each sale or exchange indicating *(a)* the name of the corporation that issued the Section 1244 stock, *(b)* the partner's share of the partnership's adjusted basis and sales price of the Section 1244 stock, and *(c)* the dates the Section 1244 stock was bought and sold.

Investment interest expense

Interest paid on money borrowed to buy property held for investment is investment interest and is deductible. (It should be noted, however, that interest incurred to produce tax-exempt income can't be deducted.) The deduction for investment interest expense is generally limited to net investment income. Net investment income is computed by subtracting investment expenses (other than interest expense) from investment income. Investment income generally includes gross income from property held for investment. Property held for investment includes property that produces interest, dividends, annuities, or royalties not derived in the ordinary course of a trade or business. It also includes property that produces gain or loss (not derived in the ordinary course of a trade or business) from the sale or trade of property producing these types of income or held for investment (other than an interest in a passive activity). Investment property also includes an interest in a trade or business activity in which the taxpayer did not materially participate (other than a passive activity).

Investment income does not include qualified dividends or net capital gain unless the taxpayer chooses to include them. Taxpayers can elect to include all or part of qualified dividends in investment income by completing Form 4952, line 4g, according to its instructions. If, however, the election is made to include any qualified dividends in investment income, the amount of qualified dividends eligible for the lower capital gains tax rates must be reduced by the same amount.

Similar rules apply for net capital gains. Investment income generally does not include net capital gain from disposing of investment property (including capital gain distributions from mutual funds); however, an election to include all or part of net capital gain in investment income can be made by completing Form 4952, line 4g, according to its instructions. If this election is made, the amount of net capital gain eligible for the lower capital gains tax rates must be reduced by the same amount.

The amount of investment interest that is not deducted because of the net investment income limit can be carried over to subsequent tax years. The interest carried over is treated as investment interest paid or accrued in that next year.

To determine investment interest expense of a partner, S corporation shareholder, or beneficiary, combine the taxpayer's share of investment interest from a partnership, S corporation, estate, or trust with their other investment interest. The taxpayer's share of net investment income from a partnership, S corporation, estate, or trust should also be combined with their other net investment income for purposes of calculating the investment interest expense limitation.

Interest expense associated with a trade or business that is a passive activity to the taxpayer is not considered to be investment interest expense; however, interest expense associated with portfolio activity is considered investment interest expense, even if it is incurred by a partnership or S corporation in which the taxpayer does not materially participate.

Investment interest expense should be reported on line 13b of Schedule K and in box 13, code H, of Schedule K-1. Investment income and investment expenses other than interest are reported on lines 20a and 20b, respectively. This information is needed by partners to determine the investment interest expense limitation. It should be noted that investment expenses for this purpose include only otherwise deductible items. Because miscellaneous deductions are no longer deductible, much of what were investment expenses before 2018 no longer fall in that category.

Other investment expenses

Before 2018, investment expenses such as investment adviser fees and safe-deposit box rentals were treated as miscellaneous itemized deductions and were deductible to the extent that they, along with other miscellaneous expenses, exceeded 2% of adjusted gross income. These miscellaneous expenses are no longer deductible. Investment interest expense is still deductible to the extent not limited by net investment income; state and local taxes are still deductible, but the deduction is limited to $10,000.

The $10,000 aggregate limitation rule doesn't apply to: (1) foreign income, war profits, and excess profits taxes; (2) state and local and foreign real property taxes; and (3) state and local personal property taxes if those taxes are paid or accrued in carrying on a trade or business or in an activity described in Section 212. It thus appears that the property tax passed through to the partners would not be subject to the $10,000 aggregate limit. Any nondeductible expenses should be included on line 18(c) and Box 18, code C, of Schedules K and K-1, respectively.

Passive activity loss limitation

In general, Section 469 limits the amount of losses, deductions, and credits that partners can claim from “passive activities.” The passive activity rules provide that losses and credits from passive activities can generally be applied only against income and tax (respectively) from passive activities. Thus, passive losses can't be applied against income from “active” activities (salaries, wages, professional fees, or a business in which the partner materially participates) or against “portfolio income.”

The primary standard for determining whether an activity is passive is the level of participation required of the taxpayer with regard to the activity. Specifically, a passive activity is one in which the taxpayer does not “materially participate” during the taxable year. In addition, most rental activities are deemed to be passive regardless of the taxpayer's level of participation, though there is a rather significant exception for taxpayers who are engaged primarily in the real estate business.[6]

Material participation

The regulations establish a number of tests under which taxpayers may be deemed to have "materially participated in an activity." Satisfaction of any one of the following tests constitutes material participation:

1. The taxpayer's participation in the activity exceeded 500 hours (during the tax year).
2. The taxpayer's participation constituted substantially all the participation in the activity, including the participation of individuals who did not own any interest in the activity (for example, a part-time business with no or very few employees).
3. The taxpayer's participation exceeded 100 hours during the tax year, and was at least as much as any other person's participation in the activity — again, including people who did not own an interest in the activity (for example, a part-time business with a minimum level of employees).
4. The activity is a "significant participation activity" defined as follows, where participation in all significant participation activities during the year exceeds 500 hours.
5. The taxpayer materially participated in the activity for any 5 of the preceding 10 taxable years (for example, a retiree or variable-participation activity).
6. The activity is a personal service activity (involving personal services in the fields of health, veterinary services, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, or any other trade or business in which capital is not a material income-producing factor), and the taxpayer has materially participated in it for any three preceding taxable years (for example, a recent retiree).
7. The facts and circumstances support that the taxpayer participated in the activity on a "regular, continuous, and substantial basis" during the taxable year.[7]

A significant participation activity is one in which the individual participates for more than 100 hours during the year but does not meet any of the other tests for material participation.

Example 2-6

Robert has a full-time job as an architect. In addition, he and a friend have started a fledgling home improvement business that they operate after regular working hours and on weekends. The business is organized as an LLC, owned 50% each by Robert and his friend. During the current year, Robert and his partner each worked about 160 hours during this taxable year making home improvements. Their income was not sufficient to offset their costs (primarily tools and materials) and they incurred a loss for the year. Because Robert and his friend each worked more than 100 hours, and both worked the same amount of time, their home improvement business is not a passive activity; therefore, they may deduct their loss without limitation.

[6] Section 469(c)(3). The code also provides that working interests in oil and gas properties are *not* passive activities whether or not the taxpayer materially participates.
[7] Reg. Sec. 1.469-5T(a).

A partner or LLC member cannot be deemed to have materially participated in an activity under test 7 unless she participated in the activity for more than 100 hours during the year.[8] Participation in managing the activity does not count in determining material participation under this test if

- any other person received compensation for managing the activity, or
- any other person spent more hours during the tax year managing the activity (regardless of whether the individual was compensated for such management services).

Limited partners generally are not treated as material participants in the activity conducted by the partnership. This rule does not apply, however, if the limited partner (or LLC member treated as a limited partner) satisfies the requirements of tests 1, 5, or 6. These exceptions are meant to prohibit profitable activities from being classified as passive, thereby allowing the taxpayer to deduct passive losses from other sources.[9]

The rule also does not apply if the taxpayer owns interests as both a limited and general partner in the same activity. A limited partner who also holds a general partner interest during the entire year in the same activity is not treated as holding a limited partnership interest.[10]

The passive activity limitations do not apply to the partnership. Instead, they apply to each partner's share of any income or loss and credit attributable to a passive activity. Because the treatment of each partner's share of partnership income or loss and credit depends on the nature of the activity that generated it, the partnership must report income or loss and credits separately for each activity.

If the partnership has more than one activity, it must report information for each activity on an attachment to Schedules K and K-1. Generally, passive activities include (*a*) activities that involve the conduct of a trade or business if the partner doesn't materially participate in the activity, and (*b*) all rental activities, regardless of the partner's participation. The level of each partner's participation in an activity must be determined by the partner.

Generally, portfolio income includes all gross income, other than income derived in the ordinary course of a trade or business, that is attributable to interest; dividends; royalties; income from a real estate investment trust, a regulated investment company, a real estate mortgage investment conduit, a common trust fund, a controlled foreign corporation, a qualified electing fund, or a cooperative; income from the disposition of property that produces income of a type defined as portfolio income; and income from the disposition of property held for investment. Solely for purposes of the preceding paragraph, gross income derived in the ordinary course of a trade or business includes (and portfolio income, therefore, does not include) the following types of income:

- Interest income on loans and investments made in the ordinary course of a trade or business of lending money
- Interest on accounts receivable arising from the performance of services or the sale of property in the ordinary course of a trade or business of performing such services or selling such property, but only if credit is customarily offered to customers of the business

[8] Reg. Sec. 1.469-5T(b)(2)(iii).
[9] Reg. Sec. 1.469-5T(e)(2).
[10] Reg. Sec. 1.469-5T(e)(3)(ii).

- Income from investments made in the ordinary course of a trade or business of furnishing insurance or annuity contracts or reinsuring risks underwritten by insurance companies
- Income or gain derived in the ordinary course of an activity of trading or dealing in any property if such activity constitutes a trade or business (unless the dealer held the property for investment at any time before such income or gain is recognized)

Passive income and related deductions should be reported on the appropriate lines of Schedule K rather than on page 1 of Form 1065.

Key review point

If the partnership's activities do not rise to the level of a trade or business, then expenses associated with the investing activities would generally not be deductible. Investment interest expense and property taxes allocable to the investment land would, however, still be deductible to a certain extent. Given the apparent low level of participation by Leonard and Luke, they should consider converting AT to either a limited partnership or an LLC to provide themselves some limited liability.

Installment sales

An installment sale is a sale of property where at least one payment is received after the tax year of the sale. The rules for installment sales do not apply if the installment method is elected out of, or the transaction is one for which the installment method may not apply. The installment sales method can't be used for the following:

- *Sale of inventory*. The regular sale of inventory of personal property does not qualify as an installment sale.
- *Dealer sales*. Sales of personal property by a person who regularly sells or otherwise disposes of the same type of personal property on the installment plan are not installment sales. This rule also applies to real property held for sale to customers in the ordinary course of a trade or business.
- *Stock or securities*. The installment method can't be used to report gain from the sale of stock or securities traded on an established securities market. The entire gain must be reported on the sale in the year in which the trade date falls.

An installment obligation is a buyer's obligation to make future payments and can be in the form of a deed of trust, note, land contract, mortgage, or other evidence of the buyer's debt.

If a sale results in a loss, the installment method can't be used. If the loss is on an installment sale of business or investment property, the loss can be deducted only in the tax year of sale. If an installment sale calls for payments in a later year and the sales contract provides for little or no interest, unstated interest might have to be recognized, even if there is a loss.

Each payment on an installment sale usually consists of the following three parts:

- Interest income
- Return of the adjusted basis in the property
- Gain on the sale

For each payment that is received, both the interest and the gain on the sale must be included in income. The return of the basis in the property is nontaxable.

Gross profit is the total gain reported on the installment method. To figure the gross profit, subtract the adjusted basis for installment sale purposes from the selling price. If the property sold was a principal residence, subtract from the gross profit any gain excluded. The selling price is the total cost of the property to the buyer and includes any of the following:

- Any money to be received by the seller
- The FMV of any property to be received by the seller
- Any existing mortgage or other debt the buyer pays, assumes, or takes
- Any selling expenses the buyer pays

The adjusted basis for installment sale purposes is the total of the following three items:

- Adjusted basis (generally its cost, less depreciation and casualty losses)
- Selling expenses
- Depreciation recapture

A certain percentage of each payment (after subtracting interest) received by the seller is reported as installment sale income. This percentage is called the *gross profit percentage* and is figured by dividing the gross profit from the sale by the contract price. The gross profit percentage generally remains the same for each payment the seller receives.

The contract price equals

- the selling price, minus
- the mortgages, debts, and other liabilities assumed or taken by the buyer, plus
- the amount by which the mortgages, debts, and other liabilities assumed or taken by the buyer exceed the adjusted basis of the seller for installment sale purposes.

Example. The Dillon Company, a partnership, sells property (cost = $32,000) for a sales price of $80,000. Selling expenses are $4,000. Part of the sales price is the assumption by the buyer of a liability of $15,000. The contract price is therefore $65,000, and the gross profit is $44,000 ($80,000 - $32,000 - $4,000). The gross profit percentage is 67.692% ($44,000 ÷ $65,000). After subtracting interest, Dillon reports 67.7% of each payment, including the down payment, as installment sale income from the sale for the tax year the corporation receives the payment. The remainder (balance) of each payment is the tax-free return of its adjusted basis. If Dillon receives $25,000 the first year and $40,000 the next, its installment sale income in the first year will be $16,923 ($25,000 × 67.692%), and in the second year will be $27,077 ($40,000 × 67.692%).

Review check: Was the recognized installment sale gain computed correctly?

Chapter 3

Case Three — Agricultural Pump & Service, LLC

Learning objectives

- Analyze the consequences when a new partner joins the partnership.
- Make appopriate allocations of book and tax income following the entry of a new partner to a partnership.
- Compute book depreciation expense following the revaluation of a partnership's assets.
- Properly allocate depreciation expense among the contributing and non-contributing partners under Section 704(c).

Facts

Agricultural Pump & Service, LLC, was formed on February 1, 2017, by Sylvia and her brother, Ed. Sylvia and Ed each contributed cash in exchange for 50% interests in the company. The company used the cash to purchase a building and manufacturing equipment, which was placed in service on March 1, 2017. The company manufactures, installs, and services water pumps and irrigation systems throughout the midwestern United States.

On April 30, 2021, Sylvia's son, Bobby, joined the LLC as a one-third member. At the date Bobby joined, all members agreed that the equity value of the LLC was $4,400,000. Bobby contributed a group of assets with an aggregate FMV of $2,200,000 for a one-third interest in the company. Bobby contributed a large metal workshop on 5 acres for an interest in the LLC. Because the value of the building and land was insufficient for a one-third interest in the company, he also added $250,000 cash and a note payable to the LLC for $750,000. The building was purchased and placed in service on March 1, 2011. Bobby contributed it to the LLC on April 30, 2021.

In total, Bobby contributed the following assets to the LLC:

Contributed Assets	Basis	FMV
Cash	$250,000	$250,000
Note payable to LLC	750,000	750,000
Building	830,000	925,000
Accumulated depreciation	(204,839)	n/a
Land	170,000	275,000
Total	**$1,795,161**	**$2,200,000**

The LLC was very profitable this year and paid its three members $250,000 in guaranteed payments. Guaranteed payments were made to the members as follows:

Sylvia	$97,222
Ed	97,222
Bobby	55,556
Total	250,000

In addition, at the end of the year, the LLC distributed $150,000 to each LLC member. Rather than distributing cash to Bobby, it forgave $150,000 of the note payable he contributed to the LLC in exchange for his one-third interest.

Because the LLC was originally formed with cash contributions from its members, it had no Section 704(c) property prior to Bobby's entry. Under terms of the LLC agreement, all items of income, gain, loss, and deduction are shared in proportion to the LLC members' interests in capital.

Agricultural Pump & Service is treated as a partnership for federal income tax purposes. During 2021, it had the following three members:

Name	SS number
Sylvia Planer	444-11-5151
1409 N. Plum Street	
Hutchinson, KS 67501	
Ed O'Donald	454-66-3333
3501 N. Waldron Street	
Hutchinson, KS 67502	
Bobby Planer	459-34-5939
5712 N. Monroe Street	
Hutchinson, KS 67502	

The company's financial statements are presented on the following pages.

Agricultural Pump & Service financial statements

The LLC's book and tax balance sheets at the beginning of the year were as follows:

	Beginning balance sheet	
	Tax	Book
Cash	$87,820	$87,820
Accounts receivable	100,000	100,000
Inventories	1,737,500	1,737,500
Building	2,925,000	2,925,000
Accumulated depreciation, building	(284,374)	(284,374)
Equipment (7-yr)	3,630,000	3,630,000

	Beginning balance sheet	
	Tax	Book
Accumulated depreciation, equipment	(2,495,788)	(2,495,788)
Land	900,000	900,000
Organization/start-up costs	15,000	15,000
Accumulated amortization	(8,000)	(8,000)
	$6,607,158	**$6,607,158**
Accounts payable	58,000	58,000
Long-term debt (recourse)	3,025,000	3,025,000
Capital, Sylvia	1,762,079	1,762,079
Capital, Ed	1,762,079	1,762,079
Totals	**$6,607,158**	**$6,607,158**

There were no differences in the LLC's book and tax balance sheets because Sylvia and Ed each contributed cash to form the company. However, at the date of Bobby's entry, the members agreed that the building was worth $4,000,000, of which $1,000,000 was attributable to the land. The members valued the equipment at $1,200,000. The remainder of the premium Bobby paid to join the LLC was attributable to Goodwill.

The LLC's financial statements at December 31, 2021 were as follows:

	Ending balance sheet		Income statement	
	Tax	Book	Tax	Book
Cash	$392,290	$392,290		
Accounts receivable	109,368	109,368		
Inventories	1,929,985	1,929,985		
Other current assets	291,766	291,766		
Note receivable	600,000	600,000		
Building	2,925,000	3,000,000		
Accumulated depreciation, building	(359,374)	(57,300)		
Building (new)	830,000	925,000		
Accumulated depreciation, building	(219,027)	(20,994)		
Equipment (7-yr)	3,630,000	1,200,000		
Accumulated depreciation, equipment	(2,819,947)	(252,600)		
Land	900,000	1,000,000		
Land (new)	170,000	275,000		

	Ending balance sheet		Income statement	
	Tax	Book	Tax	Book
Organization costs	15,000	7,000		
Accumulated amortization	(9,000)			
Goodwill		66,472		
Total Assets	$8,386,061	$9,465,987		
Accounts payable	53,465	53,465		
Long-term debt (recourse)	3,025,000	3,025,000		
Capital, Sylvia	1,788,228	2,129,174		
Capital, Ed	1,788,228	2,129,174		
Capital, Bobby	1,731,141	2,129,174		
Total Liabilities and Capital	$8,386,061	$9,465,987		
Sales			8,965,000	8,965,000
Cost of goods sold			(6,065,000)	(6,065,000)
Insurance			60,000	(60,000)
Employee wages			1,425,000	(1,425,000)
Guaranteed payments			250,000	(250,000)
Supplies			34,000	(34,000)
Payroll taxes			110,000	(110,000)
Interest expense			138,376	(138,376)
Property tax, land			30,000	(30,000)
Depreciation expense			413,347	463,946
Amortization, org/start-up expense			1,000	0*
*Intangibles are not depreciated for book.				

Agricultural Pump & Service: 2021 tax return and accompanying forms and schedules

The partnership's 2021 tax return and accompanying Schedules K-1 are followed by an explanation of the rationale and calculation of key figures reported on the return. Ignore any odd character fonts that appear throughout, due to incompatibility between the tax software and the printer used to prepare this return.

In reviewing the return, pay careful attention to the following items, which are discussed in more depth throughout the rest of this chapter:

- How does Bobby's entry to the LLC affect the LLC for tax purposes?
- Does Bobby's contribution of appreciated property to the LLC trigger Section 704(c)?
- Is the LLC entitled to revalue its assets under Section 704(b) following Bobby's entry into the LLC?

- How did the LLC report the revalued assets following Bobby's admission to the LLC? What about the partners' capital accounts?
- How does the LLC calculate book and tax depreciation among the members?
- Does the revaluation require special allocations under Section 704(c)?

Form 1065 U.S. Return of Partnership Income

Form **1065** — Department of the Treasury, Internal Revenue Service

For calendar year 2021, or tax year beginning ____________, 2021, ending ____________, 20____.

▶ Go to *www.irs.gov/Form1065* for instructions and the latest information.

OMB No. 1545-0123 — **2021**

A Principal business activity: Mfg, Install, Repair	Name of partnership: Agricultural Pump & Service, LLC	**D** Employer identification number: 75-9876543
B Principal product or service: Pumps, Irrigation Eq	Number, street, and room or suite no. If a P.O. box, see instructions.: 1840 N Plum Street	**E** Date business started: 03/01/2017
C Business code number: 115110	City or town, state or province, country, and ZIP or foreign postal code: Hutchinson, KS 67502	**F** Total assets (see instructions): $ 9,465,987

Type or Print

G Check applicable boxes: (1) ☐ Initial return (2) ☐ Final return (3) ☐ Name change (4) ☐ Address change (5) ☐ Amended return

H Check accounting method: (1) ☑ Cash (2) ☐ Accrual (3) ☐ Other (specify) ▶

I Number of Schedules K-1. Attach one for each person who was a partner at any time during the tax year ▶

J Check if Schedules C and M-3 are attached . . . ▶ ☑

K Check if partnership: (1) ☐ Aggregated activities for section 465 at-risk purposes (2) ☐ Grouped activities for section 469 passive activity purposes

Caution: Include **only** trade or business income and expenses on lines 1a through 22 below. See instructions for more information.

Income	1a	Gross receipts or sales	1a	8,965,000		
	b	Returns and allowances	1b			
	c	Balance. Subtract line 1b from line 1a			1c	8,965,000
	2	Cost of goods sold (attach Form 1125-A)			2	6,065,000
	3	Gross profit. Subtract line 2 from line 1c			3	2,900,000
	4	Ordinary income (loss) from other partnerships, estates, and trusts (attach statement)			4	
	5	Net farm profit (loss) (attach Schedule F (Form 1040))			5	
	6	Net gain (loss) from Form 4797, Part II, line 17 (attach Form 4797)			6	
	7	Other income (loss) (attach statement)			7	
	8	**Total income (loss).** Combine lines 3 through 7			8	2,900,000
Deductions (see instructions for limitations)	9	Salaries and wages (other than to partners) (less employment credits)			9	1,425,000
	10	Guaranteed payments to partners			10	250,000
	11	Repairs and maintenance			11	
	12	Bad debts			12	
	13	Rent			13	
	14	Taxes and licenses			14	140,000
	15	Interest (see instructions)			15	138,375
	16a	Depreciation (if required, attach Form 4562)	16a	414,347		
	b	Less depreciation reported on Form 1125-A and elsewhere on return	16b	414,347	16c	0
	17	Depletion **(Do not deduct oil and gas depletion.)**			17	
	18	Retirement plans, etc.			18	
	19	Employee benefit programs			19	
	20	Other deductions (attach statement)			20	94,000
	21	**Total deductions.** Add the amounts shown in the far right column for lines 9 through 20			21	2,047,375
	22	**Ordinary business income (loss).** Subtract line 21 from line 8			22	852,625
Tax and Payment	23	Interest due under the look-back method—completed long-term contracts (attach Form 8697)			23	0
	24	Interest due under the look-back method—income forecast method (attach Form 8866)			24	0
	25	BBA AAR imputed underpayment (see instructions)			25	0
	26	Other taxes (see instructions)			26	0
	27	**Total balance due.** Add lines 23 through 26			27	0
	28	Payment (see instructions)			28	0
	29	**Amount owed.** If line 28 is smaller than line 27, enter amount owed			29	0
	30	**Overpayment.** If line 28 is larger than line 27, enter overpayment			30	0

Sign Here

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than partner or limited liability company member) is based on all information of which preparer has any knowledge.

▶ Signature of partner or limited liability company member ▶ Date

May the IRS discuss this return with the preparer shown below? See instructions. ☐ Yes ☐ No

Paid Preparer Use Only

Print/Type preparer's name	Preparer's signature	Date	Check ☐ if self-employed	PTIN
Firm's name ▶			Firm's EIN ▶	
Firm's address ▶			Phone no.	

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 11390Z Form **1065** (2021)

Schedule B Other Information

		Yes	No
1	What type of entity is filing this return? Check the applicable box:		
a	☐ Domestic general partnership **b** ☐ Domestic limited partnership		
c	☑ Domestic limited liability company **d** ☐ Domestic limited liability partnership		
e	☐ Foreign partnership **f** ☐ Other ▶		
2	At the end of the tax year:		
a	Did any foreign or domestic corporation, partnership (including any entity treated as a partnership), trust, or tax-exempt organization, or any foreign government own, directly or indirectly, an interest of 50% or more in the profit, loss, or capital of the partnership? For rules of constructive ownership, see instructions. If "Yes," attach Schedule B-1, Information on Partners Owning 50% or More of the Partnership		✔
b	Did any individual or estate own, directly or indirectly, an interest of 50% or more in the profit, loss, or capital of the partnership? For rules of constructive ownership, see instructions. If "Yes," attach Schedule B-1, Information on Partners Owning 50% or More of the Partnership		✔
3	At the end of the tax year, did the partnership:		
a	Own directly 20% or more, or own, directly or indirectly, 50% or more of the total voting power of all classes of stock entitled to vote of any foreign or domestic corporation? For rules of constructive ownership, see instructions. If "Yes," complete (i) through (iv) below		✔

(i) Name of Corporation	(ii) Employer Identification Number (if any)	(iii) Country of Incorporation	(iv) Percentage Owned in Voting Stock

		Yes	No
b	Own directly an interest of 20% or more, or own, directly or indirectly, an interest of 50% or more in the profit, loss, or capital in any foreign or domestic partnership (including an entity treated as a partnership) or in the beneficial interest of a trust? For rules of constructive ownership, see instructions. If "Yes," complete (i) through (v) below		✔

(i) Name of Entity	(ii) Employer Identification Number (if any)	(iii) Type of Entity	(iv) Country of Organization	(v) Maximum Percentage Owned in Profit, Loss, or Capital

		Yes	No
4	Does the partnership satisfy **all four** of the following conditions?		
a	The partnership's total receipts for the tax year were less than $250,000.		
b	The partnership's total assets at the end of the tax year were less than $1 million.		
c	Schedules K-1 are filed with the return and furnished to the partners on or before the due date (including extensions) for the partnership return.		
d	The partnership is not filing and is not required to file Schedule M-3		✔
	If "Yes," the partnership is not required to complete Schedules L, M-1, and M-2; item F on page 1 of Form 1065; or item L on Schedule K-1.		
5	Is this partnership a publicly traded partnership, as defined in section 469(k)(2)?		✔
6	During the tax year, did the partnership have any debt that was canceled, was forgiven, or had the terms modified so as to reduce the principal amount of the debt?		✔
7	Has this partnership filed, or is it required to file, Form 8918, Material Advisor Disclosure Statement, to provide information on any reportable transaction?		✔
8	At any time during calendar year 2021, did the partnership have an interest in or a signature or other authority over a financial account in a foreign country (such as a bank account, securities account, or other financial account)? See instructions for exceptions and filing requirements for FinCEN Form 114, Report of Foreign Bank and Financial Accounts (FBAR). If "Yes," enter the name of the foreign country ▶		✔
9	At any time during the tax year, did the partnership receive a distribution from, or was it the grantor of, or transferor to, a foreign trust? If "Yes," the partnership may have to file Form 3520, Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts. See instructions		✔
10a	Is the partnership making, or had it previously made (and not revoked), a section 754 election?		✔
	See instructions for details regarding a section 754 election.		
b	Did the partnership make for this tax year an optional basis adjustment under section 743(b) or 734(b)? If "Yes," attach a statement showing the computation and allocation of the basis adjustment. See instructions		✔

Schedule B **Other Information** *(continued)*

		Yes	No
c	Is the partnership required to adjust the basis of partnership assets under section 743(b) or 734(b) because of a substantial built-in loss (as defined under section 743(d)) or substantial basis reduction (as defined under section 734(d))? If "Yes," attach a statement showing the computation and allocation of the basis adjustment. See instructions		✔
11	Check this box if, during the current or prior tax year, the partnership distributed any property received in a like-kind exchange or contributed such property to another entity (other than disregarded entities wholly owned by the partnership throughout the tax year) . . . ▶ ☐		
12	At any time during the tax year, did the partnership distribute to any partner a tenancy-in-common or other undivided interest in partnership property?		✔
13	If the partnership is required to file Form 8858, Information Return of U.S. Persons With Respect To Foreign Disregarded Entities (FDEs) and Foreign Branches (FBs), enter the number of Forms 8858 attached. See instructions . . . ▶		
14	Does the partnership have any foreign partners? If "Yes," enter the number of Forms 8805, Foreign Partner's Information Statement of Section 1446 Withholding Tax, filed for this partnership . . . ▶		✔
15	Enter the number of Forms 8865, Return of U.S. Persons With Respect to Certain Foreign Partnerships, attached to this return . . . ▶		
16a	Did you make any payments in 2021 that would require you to file Form(s) 1099? See instructions		✔
b	If "Yes," did you or will you file required Form(s) 1099?		✔
17	Enter the number of Forms 5471, Information Return of U.S. Persons With Respect To Certain Foreign Corporations, attached to this return . . . ▶		
18	Enter the number of partners that are foreign governments under section 892 . . . ▶		
19	During the partnership's tax year, did the partnership make any payments that would require it to file Forms 1042 and 1042-S under chapter 3 (sections 1441 through 1464) or chapter 4 (sections 1471 through 1474)?		✔
20	Was the partnership a specified domestic entity required to file Form 8938 for the tax year? See the Instructions for Form 8938		✔
21	Is the partnership a section 721(c) partnership, as defined in Regulations section 1.721(c)-1(b)(14)?		✔
22	During the tax year, did the partnership pay or accrue any interest or royalty for which one or more partners are not allowed a deduction under section 267A? See instructions		✔
	If "Yes," enter the total amount of the disallowed deductions . . . ▶ $		
23	Did the partnership have an election under section 163(j) for any real property trade or business or any farming business in effect during the tax year? See instructions		✔
24	Does the partnership satisfy one or more of the following? See instructions		✔
a	The partnership owns a pass-through entity with current, or prior year carryover, excess business interest expense.		
b	The partnership's aggregate average annual gross receipts (determined under section 448(c)) for the 3 tax years preceding the current tax year are more than $26 million and the partnership has business interest.		
c	The partnership is a tax shelter (see instructions) and the partnership has business interest expense. If "Yes" to any, complete and attach Form 8990.		
25	Is the partnership attaching Form 8996 to certify as a Qualified Opportunity Fund?		✔
	If "Yes," enter the amount from Form 8996, line 15 . . . ▶ $		
26	Enter the number of foreign partners subject to section 864(c)(8) as a result of transferring all or a portion of an interest in the partnership or of receiving a distribution from the partnership . . . ▶ Complete Schedule K-3 (Form 1065), Part XIII, for each foreign partner subject to section 864(c)(8) on a transfer or distribution.		
27	At any time during the tax year, were there any transfers between the partnership and its partners subject to the disclosure requirements of Regulations section 1.707-8?		✔
28	Since December 22, 2017, did a foreign corporation directly or indirectly acquire substantially all of the properties constituting a trade or business of your partnership, and was the ownership percentage (by vote or value) for purposes of section 7874 greater than 50% (for example, the partners held more than 50% of the stock of the foreign corporation)? If "Yes," list the ownership percentage by vote and by value. See instructions. Percentage: By Vote By Value		✔
29	Is the partnership electing out of the centralized partnership audit regime under section 6221(b)? See instructions.		✔
	If "Yes," the partnership must complete Schedule B-2 (Form 1065). Enter the total from Schedule B-2, Part III, line 3 ▶ If "No," complete Designation of Partnership Representative below.		

Designation of Partnership Representative (see instructions)

Enter below the information for the partnership representative (PR) for the tax year covered by this return.

Name of PR ▶ Sylvia Planer

U.S. address of PR	1409 Plum Street Hutchinson, KS 67501	U.S. phone number of PR	
If the PR is an entity, name of the designated individual for the PR ▶			
U.S. address of designated individual		U.S. phone number of designated individual	

Form **1065** (2021)

Schedule K Partners' Distributive Share Items

				Total amount
Income (Loss)	1	Ordinary business income (loss) (page 1, line 22)	1	852,624
	2	Net rental real estate income (loss) (attach Form 8825)	2	
	3a	Other gross rental income (loss) — 3a		
	b	Expenses from other rental activities (attach statement) — 3b		
	c	Other net rental income (loss). Subtract line 3b from line 3a	3c	
	4	Guaranteed payments: a Services 4a ___ b Capital 4b ___		
		c Total. Add lines 4a and 4b	4c	250,000
	5	Interest income	5	
	6	Dividends and dividend equivalents: a Ordinary dividends	6a	
		b Qualified dividends 6b ___ c Dividend equivalents 6c ___		
	7	Royalties	7	
	8	Net short-term capital gain (loss) (attach Schedule D (Form 1065))	8	
	9a	Net long-term capital gain (loss) (attach Schedule D (Form 1065))	9a	
	b	Collectibles (28%) gain (loss) — 9b		
	c	Unrecaptured section 1250 gain (attach statement) — 9c		
	10	Net section 1231 gain (loss) (attach Form 4797)	10	
	11	Other income (loss) (see instructions) Type ▶	11	
Deductions	12	Section 179 deduction (attach Form 4562)	12	
	13a	Contributions	13a	
	b	Investment interest expense	13b	
	c	Section 59(e)(2) expenditures: (1) Type ▶ ___ (2) Amount ▶	13c(2)	
	d	Other deductions (see instructions) Type ▶ Depreciation & Amortization	13d	414,347
Self-Employment	14a	Net earnings (loss) from self-employment	14a	688,277
	b	Gross farming or fishing income	14b	
	c	Gross nonfarm income	14c	
Credits	15a	Low-income housing credit (section 42(j)(5))	15a	
	b	Low-income housing credit (other)	15b	
	c	Qualified rehabilitation expenditures (rental real estate) (attach Form 3468, if applicable)	15c	
	d	Other rental real estate credits (see instructions) Type ▶	15d	
	e	Other rental credits (see instructions) Type ▶	15e	
	f	Other credits (see instructions) Type ▶	15f	
International Transactions	16	Attach Schedule K-2 (Form 1065), Partners' Distributive Share Items-International, and check this box to indicate that you are reporting items of international tax relevance ☐		
Alternative Minimum Tax (AMT) Items	17a	Post-1986 depreciation adjustment	17a	
	b	Adjusted gain or loss	17b	
	c	Depletion (other than oil and gas)	17c	
	d	Oil, gas, and geothermal properties—gross income	17d	
	e	Oil, gas, and geothermal properties—deductions	17e	
	f	Other AMT items (attach statement)	17f	
Other Information	18a	Tax-exempt interest income	18a	
	b	Other tax-exempt income	18b	
	c	Nondeductible expenses	18c	
	19a	Distributions of cash and marketable securities	19a	
	b	Distributions of other property	19b	450,000
	20a	Investment income	20a	
	b	Investment expenses	20b	
	c	Other items and amounts (attach statement)		
	21	Total foreign taxes paid or accrued	21	

Form 1065 (2021)

Analysis of Net Income (Loss)

1	Net income (loss). Combine Schedule K, lines 1 through 11. From the result, subtract the sum of Schedule K, lines 12 through 13d, and 21					1	
2	Analysis by partner type:	(i) Corporate	(ii) Individual (active)	(iii) Individual (passive)	(iv) Partnership	(v) Exempt Organization	(vi) Nominee/Other
a	General partners		688,277				
b	Limited partners						

Schedule L Balance Sheets per Books

	Assets	Beginning of tax year (a)	(b)	End of tax year (c)	(d)
1	Cash		87,820		392,290
2a	Trade notes and accounts receivable	100,000		109,368	
b	Less allowance for bad debts	0	100,000	0	109,368
3	Inventories		1,737,500		1,929,985
4	U.S. government obligations				
5	Tax-exempt securities				
6	Other current assets (attach statement)		0		291,766
7a	Loans to partners (or persons related to partners)		0		600,000
b	Mortgage and real estate loans				
8	Other investments (attach statement)				
9a	Buildings and other depreciable assets	6,555,000		5,125,000	
b	Less accumulated depreciation	2,780,162	3,744,838	330,893	4,794,107
10a	Depletable assets				
b	Less accumulated depletion				
11	Land (net of any amortization)		900,000		1,275,000
12a	Intangible assets (amortizable only)	15,000		7,000	
b	Less accumulated amortization	8,000	7,000	0	7,000
13	Other assets (attach statement)				66,472
14	Total assets		6,607,158		9,465,987
	Liabilities and Capital				
15	Accounts payable		58,000		53,465
16	Mortgages, notes, bonds payable in less than 1 year				
17	Other current liabilities (attach statement)				
18	All nonrecourse loans				
19a	Loans from partners (or persons related to partners)				
b	Mortgages, notes, bonds payable in 1 year or more		3,025,000		3,025,000
20	Other liabilities (attach statement)				
21	Partners' capital accounts		3,524,158		6,387,522
22	Total liabilities and capital		6,607,158		9,465,987

Schedule M-1 Reconciliation of Income (Loss) per Books With Income (Loss) per Return

Note: The partnership may be required to file Schedule M-3. See instructions.

1	Net income (loss) per books	388,678	6	Income recorded on books this year not included on Schedule K, lines 1 through 11 (itemize):	
2	Income included on Schedule K, lines 1, 2, 3c, 5, 6a, 7, 8, 9a, 10, and 11, not recorded on books this year (itemize):		a	Tax-exempt interest $	
3	Guaranteed payments (other than health insurance)	250,000	7	Deductions included on Schedule K, lines 1 through 13d, and 21, not charged against book income this year (itemize):	
4	Expenses recorded on books this year not included on Schedule K, lines 1 through 13d, and 21 (itemize):		a	Depreciation $ Amortization	1,000
a	Depreciation $ 50,599		8	Add lines 6 and 7	1,000
b	Travel and entertainment $	50,599	9	Income (loss) (Analysis of Net Income (Loss), line 1). Subtract line 8 from line 5	688,277
5	Add lines 1 through 4	689,277			

Schedule M-2 Analysis of Partners' Capital Accounts

1	Balance at beginning of year	3,524,158	6	Distributions: a Cash	450,000
2	Capital contributed: a Cash	250,000		b Property	
	b Property	1,950,000	7	Other decreases (itemize):	
3	Net income (loss) (see instructions)	388,678			
4	Other increases (itemize): revaluation	724,687	8	Add lines 6 and 7	450,000
5	Add lines 1 through 4	6,837,523	9	Balance at end of year. Subtract line 8 from line 5	6,387,523

Form **1065** (2021)

Form **1125-A** (Rev. November 2018) Department of the Treasury Internal Revenue Service

Cost of Goods Sold

► Attach to Form 1120, 1120-C, 1120-F, 1120S, or 1065.
► Go to *www.irs.gov/Form1125A* for the latest information.

OMB No. 1545-0123

Name	Employer identification number
Agricultural Pump & Service, LLC	75-9876543

1	Inventory at beginning of year	1	1,737,500
2	Purchases	2	6,257,485
3	Cost of labor	3	0
4	Additional section 263A costs (attach schedule)	4	0
5	Other costs (attach schedule)	5	7,994,985
6	**Total.** Add lines 1 through 5	6	
7	Inventory at end of year	7	1,929,985
8	**Cost of goods sold.** Subtract line 7 from line 6. Enter here and on Form 1120, page 1, line 2 or the appropriate line of your tax return. See instructions	8	6,065,985

9a Check all methods used for valuing closing inventory:
- *(i)* ☑ Cost
- *(ii)* ☐ Lower of cost or market
- *(iii)* ☐ Other (Specify method used and attach explanation.) ►

b Check if there was a writedown of subnormal goods ► ☐

c Check if the LIFO inventory method was adopted this tax year for any goods (if checked, attach Form 970) ► ☐

d If the LIFO inventory method was used for this tax year, enter amount of closing inventory computed under LIFO **9d**

e If property is produced or acquired for resale, do the rules of section 263A apply to the entity? See instructions ☐ Yes ☑ No

f Was there any change in determining quantities, cost, or valuations between opening and closing inventory? If "Yes," attach explanation ☐ Yes ☑ No

Section references are to the Internal Revenue Code unless otherwise noted.

What's New

Small business taxpayers. For tax years beginning after December 31, 2017, the following apply.

- A small business taxpayer (defined below), may use a method of accounting for inventories that either: (1) treats inventories as nonincidental materials and supplies, or (2) conforms to the taxpayer's financial accounting treatment of inventories.
- A small business taxpayer is not required to capitalize costs under section 263A.

General Instructions

Purpose of Form

Use Form 1125-A to calculate and deduct cost of goods sold for certain entities.

Who Must File

Filers of Form 1120, 1120-C, 1120-F, 1120S, or 1065, must complete and attach Form 1125-A if the applicable entity reports a deduction for cost of goods sold.

Inventories

Generally, inventories are required at the beginning and end of each tax year if the production, purchase, or sale of merchandise is an income-producing factor. See Regulations section 1.471-1. If inventories are required, you generally must use an accrual method of accounting for sales and purchases of inventory items.

Exception for certain taxpayers. A small business taxpayer (defined below), can adopt or change its accounting method to account for inventories in the same manner as material and supplies that are non-incidental, or conform to its treatment of inventories in an applicable financial statement (as defined in section 451(b)(3)), or if it does not have an applicable financial statement, the method of accounting used in its books and records prepared in accordance with its accounting procedures. See section 471(c)(3).

A small business taxpayer claiming exemption from the requirement to keep inventories is changing its method of accounting for purposes of section 481. For additional guidance on this method of accounting, see Pub. 538, Accounting Periods and Methods. For guidance on changing to this method of accounting, see Form 3115 and the Instructions for Form 3115.

Small business taxpayer. A small business taxpayer is a taxpayer that (a) has average annual gross receipts of $25 million or less (indexed for inflation) for the 3 prior tax years, and (b) is not a tax shelter (as defined in section 448(d)(3)). See Pub. 538.

Uniform capitalization rules. The uniform capitalization rules of section 263A generally require you to capitalize, or include in inventory, certain costs incurred in connection with the following.

- The production of real property and tangible personal property held in inventory or held for sale in the ordinary course of business.
- Real property or personal property (tangible and intangible) acquired for resale.
- The production of real property and tangible personal property for use in its trade or business or in an activity engaged in for profit.

A small business taxpayer (defined above) is not required to capitalize costs under section 263A. See section 263A(i).

See the discussion on section 263A uniform capitalization rules in the instructions for your tax return before completing Form 1125-A. Also see Regulations sections 1.263A-1 through 1.263A-3. See Regulations section 1.263A-4 for rules for property produced in a farming business.

For Paperwork Reduction Act Notice, see instructions. Cat. No. 55988R Form **1125-A** (Rev. 11-2018)

Specific Instructions

Line 1. Inventory at Beginning of Year

If you are changing your method of accounting for the current tax year, you must refigure last year's closing inventory using the new method of accounting. Enter the result on line 1. If there is a difference between last year's closing inventory and the refigured amount, attach an explanation and take it into account when figuring any section 481(a) adjustment.

Line 2. Purchases

Reduce purchases by items withdrawn for personal use. For a partnership, the cost of these items should be shown on Schedule K and Schedule K-1 as distributions to partners.

Line 4. Additional Section 263A Costs

If you elected a simplified method of accounting, enter on line 4 the balance of section 263A costs paid or incurred during the tax year not includible on lines 2, 3, and 5.

If you elected the simplified production method, additional section 263A costs are generally those costs, other than interest, that were not capitalized under your method of accounting immediately prior to the effective date of section 263A, but are now required to be capitalized under section 263A. For details, see Regulations section 1.263A-2(b).

If you elected the simplified resale method, additional section 263A costs are generally those costs incurred with respect to the following categories.

- Off-site storage or warehousing.
- Purchasing.
- Handling, such as processing, assembling, repackaging, and transporting.
- General and administrative costs (mixed service costs).

Line 5. Other Costs

Enter on line 5 any costs paid or incurred during the tax year not entered on lines 2 through 4. Attach a statement listing details of the costs.

Special Rules for Cooperatives

Cooperatives are allowed to deduct certain per-unit retain allocations. Include these costs on line 5. Attach a statement listing details of per-unit retain allocations paid in:

- Qualified per-unit retain certificates,
- Money or other property (except nonqualified per-unit certificates), and
- Nonqualified per-unit retain certificates redeemed this year.

Per-unit retain allocations. A cooperative is allowed to deduct from its taxable income amounts paid during the payment period for the tax year as per-unit retain allocations to the extent paid in money, qualified per-unit retain certificates, or other property with respect to marketing occurring during the tax year. A per-unit retain allocation is any allocation from a cooperative to a patron for products marketed for him without reference to the cooperative net earnings. A qualified per-unit retain certificate is any per-unit retain certificate that the distributee has agreed to take into account at its stated dollar amount.

Nonqualified per-unit retain certificates redeemed this year. Include the amount paid in money or other property (except amounts already included as per-unit retain certificates) to patrons to redeem nonqualified per-unit retain certificates. No deduction is allowed at the time of issuance for a nonqualified per-unit retain certificate. However, the cooperative may take a deduction in the year the certificate is redeemed, subject to the stated dollar amount of the certificate. See section 1383. Also see the instructions for Form 1120-C, line 30h, for a special rule for figuring the cooperative's tax in the year of redemption of a nonqualified per-unit retain certificate.

Line 7. Inventory at End of Year

See Regulations sections 1.263A-1 through 1.263A-3 for details on figuring the amount of additional section 263A costs to be included in ending inventory.

Line 8. Cost of Goods Sold

Enter the amount from line 8 on your tax return as follows. Filers of Form 1120, 1120-C, 1120S, and 1065, enter cost of goods sold on page 1, line 2. Filers of Form 1120-F, enter cost of goods sold on Section II, line 2.

Lines 9a Through 9f. Inventory Valuation Methods

Inventories can be valued at:

- Cost,
- Cost or market value (whichever is lower), or
- Any other method approved by the IRS that conforms to the requirements of the applicable regulations cited below.

Filers that use erroneous valuation methods must change to a method permitted for federal income tax purposes. Use Form 3115 to make this change. See the Instructions for Form 3115. Also see Pub. 538.

Line 9a. Method of valuing closing inventory. On line 9a, check the method(s) used for valuing inventories. Under lower of cost or market, the term “market” (for normal goods) means the current bid price prevailing on the inventory valuation date for the particular merchandise in the volume usually purchased by the filer. For a manufacturer, market applies to the basic elements of cost—raw materials, labor, and burden. If section 263A applies, the basic elements of cost must reflect the current bid price of all direct costs and all indirect costs properly allocable to goods on hand at the inventory date.

Inventory may be valued below cost when the merchandise is unsalable at normal prices or unusable in the normal way because the goods are subnormal due to damage, imperfections, shopwear, change of style, odd or broken lots, or other similar causes, including second-hand goods taken in exchange. The goods may be valued at the bona fide selling price, minus the direct cost of disposition (but not less than scrap value). Bona fide selling price means actual offering of goods during a period ending not later than 30 days after inventory date.

Lines 9c and 9d. LIFO method. If this is the first year the Last-in, First-out (LIFO) inventory method was either adopted or extended to inventory goods not previously valued under the LIFO method provided in section 472, attach Form 970, Application To Use LIFO Inventory Method, or a statement with the information required by Form 970. Check the LIFO box on line 9c. On line 9d, enter the amount of total closing inventories computed under section 472. Estimates are acceptable.

If you changed or extended your inventory method to LIFO and had to write up the opening inventory to cost in the year of election, report the effect of the write-up as other income, on your applicable return, proportionately over a 3-year period that begins with the year of the LIFO election.

Note: Entities using the LIFO method that make an S corporation election or transfer LIFO inventory to an S corporation in a nonrecognition transaction may be subject to an additional tax attributable to the LIFO recapture amount. See the instructions for Form 1120, Schedule J, line 11.

Line 9e. If property is produced or acquired for resale and the rules of section 263A apply to the corporation, cooperative, partnership, or other applicable entity, check the "Yes" box on line 9e.

Paperwork Reduction Act Notice. We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by section 6103.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated burden for business taxpayers filing this form is approved under OMB control number 1545-0123 and is included in the estimates shown in the instructions for their business income tax return.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. See the instructions for the tax return with which this form is filed.

SCHEDULE B-1 (Form 1065)
(Rev. August 2019)
Department of the Treasury
Internal Revenue Service

Information on Partners Owning 50% or More of the Partnership

► Attach to Form 1065.
► Go to *www.irs.gov/Form1065* for the latest information.

OMB No. 1545-0123

Name of partnership	Employer identification number (EIN)
Agricultural Pump & Service, LLC	75-9876543

Part I **Entities Owning 50% or More of the Partnership** (Form 1065, Schedule B, Question 2a (Question 3a for 2009 through 2017))

Complete columns (i) through (v) below for any foreign or domestic corporation, partnership (including any entity treated as a partnership), trust, tax-exempt organization, or any foreign government that owns, directly or indirectly, an interest of 50% or more in the profit, loss, or capital of the partnership (see instructions).

(i) Name of Entity	(ii) Employer Identification Number (if any)	(iii) Type of Entity	(iv) Country of Organization	(v) Maximum Percentage Owned in Profit, Loss, or Capital

Part II **Individuals or Estates Owning 50% or More of the Partnership** (Form 1065, Schedule B, Question 2b (Question 3b for 2009 through 2017))

Complete columns (i) through (iv) below for any individual or estate that owns, directly or indirectly, an interest of 50% or more in the profit, loss, or capital of the partnership (see instructions).

(i) Name of Individual or Estate	(ii) Identifying Number (if any)	(iii) Country of Citizenship (see instructions)	(iv) Maximum Percentage Owned in Profit, Loss, or Capital
Sylvia Planer	444-11-5151	United States	66%
Bobby Planer	459-34-5939	United States	66%

For Paperwork Reduction Act Notice, see the Instructions for Form 1065. Cat. No. 49842K **Schedule B-1 (Form 1065) (Rev. 8-2019)**

General Instructions

Section references are to the Internal Revenue Code unless otherwise noted.

Future Developments

For the latest information about developments related to Schedule B-1 (Form 1065) and its instructions, such as legislation enacted after the form and instructions were published, go to *www.irs.gov/Form1065*.

Purpose of Form

Use Schedule B-1 (Form 1065) to provide the information applicable to certain entities, individuals, and estates that own, directly or indirectly, an interest of 50% or more in the profit, loss, or capital of the partnership.

Who Must File

Schedule B-1 (Form 1065) must be filed by all partnerships that answer "Yes" to question 2a or question 2b (question 3a or question 3b for 2009 through 2017) on Form 1065, Schedule B. Attach Schedule B-1 to Form 1065.

Specific Instructions

Part I

Complete Part I if the partnership answered "Yes" to Form 1065, Schedule B, question 2a (question 3a for 2009 through 2017). List each corporation, partnership, trust, tax-exempt organization, or foreign government owning, directly or indirectly, an interest of 50% or more in the profit, loss, or capital of the partnership at the end of the tax year. Enter the name, EIN, type of entity (corporation, partnership, trust, tax-exempt organization, or foreign government), country of organization, and the maximum percentage interests owned, directly or indirectly, in the profit, loss, or capital of the partnership. For an affiliated group filing a consolidated tax return, list the parent corporation rather than the subsidiary members. List the entity owner of a disregarded entity rather than the disregarded entity. If the owner of a disregarded entity is an individual rather than an entity, list the individual in Part II. In the case of a tax-exempt organization, enter "tax-exempt organization" in column (iii).

Example 1. Corporation A owns, directly, an interest of 50% in the profit, loss, or capital of Partnership B. Corporation A also owns, directly, an interest of 15% in the profit, loss, or capital of Partnership C. Partnership B owns, directly, an interest of 70% in the profit, loss, or capital of Partnership C. Therefore, Corporation A owns, directly or indirectly, an interest of 50% in the profit, loss, or capital of Partnership C (15% directly and 35% indirectly through Partnership B). On Partnership C's Form 1065, it must answer "Yes" to question 2a (question 3a for 2009 through 2017) of Schedule B. Partnership C must also complete Part I of Schedule B-1. In Part I, Partnership C must identify Corporation A, which includes entering "50%" in column (v) (its maximum percentage owned). It also must identify Partnership B, and enter "70%" in column (v).

Part II

Complete Part II if the partnership answered "Yes" to Form 1065, Schedule B, question 2b (question 3b for 2009 through 2017). List each individual or estate owning, directly or indirectly, an interest of 50% or more in the profit, loss, or capital of the partnership at the end of the tax year. Enter the name, social security or employer identification number, country of citizenship (for an estate, the citizenship of the decedent), and the maximum percentage interests owned, directly or indirectly, in the profit, loss, or capital of the partnership.

Example 2. A owns, directly, 50% of the profit, loss, or capital of Partnership X. B, the daughter of A, does not own, directly, any interest in X and does not own, indirectly, any interest in X through any entity (corporation, partnership, trust, or estate). Because family attribution rules apply only when an individual (in this example, B) owns a direct interest in the partnership or an indirect interest through another entity, A's interest in Partnership X is not attributable to B. On Partnership X's Form 1065, it must answer "Yes" to question 2b (question 3b for 2009 through 2017) of Schedule B. Partnership X must also complete Part II of Schedule B-1. In Part II, Partnership X must identify A, which includes entering "50%" in column (iv). Partnership X will **not** identify B in Part II.

651121

☐ Final K-1 ☐ Amended K-1

OMB No. 1545-0123

Schedule K-1 (Form 1065) **2021**

Department of the Treasury
Internal Revenue Service

For calendar year 2021, or tax year

beginning / / 2021 ending / /

Partner's Share of Income, Deductions, Credits, etc.

▶ See back of form and separate instructions.

Part I Information About the Partnership

A Partnership's employer identification number
75-9876543

B Partnership's name, address, city, state, and ZIP code
Agricultural Pump & Service, LLC
1840 N Plum Street
Hutchinson, KS 67502

C IRS center where partnership filed return ▶ e-file

D ☐ Check if this is a publicly traded partnership (PTP)

Part II Information About the Partner

E Partner's SSN or TIN (Do not use TIN of a disregarded entity. See instructions.)
459-34-5939

F Name, address, city, state, and ZIP code for partner entered in E. See instructions.
Bobby Planer
1501 Mayflower
Hutchinson, KS 67502

G ☒ General partner or LLC member-manager ☐ Limited partner or other LLC member

H1 ☒ Domestic partner ☐ Foreign partner

H2 ☐ If the partner is a disregarded entity (DE), enter the partner's:
TIN ________ Name ________

I1 What type of entity is this partner? Active Individual

I2 If this partner is a retirement plan (IRA/SEP/Keogh/etc.), check here ▶ ☐

J Partner's share of profit, loss, and capital (see instructions):

	Beginning	Ending
Profit	0 %	33 %
Loss	0 %	33 %
Capital	0 %	33 %

Check if decrease is due to sale or exchange of partnership interest . ▶ ☐

K Partner's share of liabilities:

	Beginning	Ending
Nonrecourse . . .	$	$
Qualified nonrecourse financing	$	$
Recourse	$ 0	$ 1,026,155

Check this box if Item K includes liability amounts from lower tier partnerships ▶ ☐

L **Partner's Capital Account Analysis**

Beginning capital account	$
Capital contributed during the year . .	$ 1,795,161
Current year net income (loss)	$ 85,980
Other increase (decrease) (attach explanation)	$
Withdrawals and distributions	$ (150,000)
Ending capital account	$ 1,731,141

M Did the partner contribute property with a built-in gain (loss)?
☐ **Yes** ☐ **No** If "Yes," attach statement. See instructions.

N **Partner's Share of Net Unrecognized Section 704(c) Gain or (Loss)**

Beginning	$ 0
Ending	$ 2,129,174

Part III Partner's Share of Current Year Income, Deductions, Credits, and Other Items

1	Ordinary business income (loss)	189,472
2	Net rental real estate income (loss)	
3	Other net rental income (loss)	
4a	Guaranteed payments for services	55,556
4b	Guaranteed payments for capital	
4c	Total guaranteed payments	55,556
5	Interest income	
6a	Ordinary dividends	
6b	Qualified dividends	
6c	Dividend equivalents	
7	Royalties	
8	Net short-term capital gain (loss)	
9a	Net long-term capital gain (loss)	
9b	Collectibles (28%) gain (loss)	
9c	Unrecaptured section 1250 gain	
10	Net section 1231 gain (loss)	
11	Other income (loss)	
12	Section 179 deduction	
13	Other deductions	W 103,492
14	Self-employment earnings (loss)	A 141,536
15	Credits	
16	Schedule K-3 is attached if checked . . . . . ▶ ☐	
17	Alternative minimum tax (AMT) items	
18	Tax-exempt income and nondeductible expenses	
19	Distributions	A 150,000
20	Other information	
21	Foreign taxes paid or accrued	

22 ☐ More than one activity for at-risk purposes*

23 ☐ More than one activity for passive activity purposes*

*See attached statement for additional information.

For IRS Use Only

For Paperwork Reduction Act Notice, see the Instructions for Form 1065. www.irs.gov/Form1065 Cat. No. 11394R **Schedule K-1 (Form 1065) 2021**

651121

☐ Final K-1 ☐ Amended K-1

OMB No. 1545-0123

Schedule K-1 (Form 1065) **2021**

Department of the Treasury
Internal Revenue Service

For calendar year 2021, or tax year

beginning / / 2021 ending / /

Partner's Share of Income, Deductions, Credits, etc. ▶ See back of form and separate instructions.

Part I Information About the Partnership

A Partnership's employer identification number
75-9876543

B Partnership's name, address, city, state, and ZIP code
Agricultural Pump & Service, LLC
1840 N Plum Street
Hutchinson, KS 67502

C IRS center where partnership filed return ▶ e-file

D ☐ Check if this is a publicly traded partnership (PTP)

Part II Information About the Partner

E Partner's SSN or TIN (Do not use TIN of a disregarded entity. See instructions.)
454-66-3333

F Name, address, city, state, and ZIP code for partner entered in E. See instructions.
Ed O'Donald
3501 N Waldron Street
Hutchinson, KS 67502

G ☒ General partner or LLC member-manager ☐ Limited partner or other LLC member

H1 ☒ Domestic partner ☐ Foreign partner

H2 ☐ If the partner is a disregarded entity (DE), enter the partner's:
TIN ______ Name ______

I1 What type of entity is this partner? Active Individual

I2 If this partner is a retirement plan (IRA/SEP/Keogh/etc.), check here ▶ ☐

J Partner's share of profit, loss, and capital (see instructions):

	Beginning	Ending
Profit	50 %	33 %
Loss	50 %	33 %
Capital	50 %	33 %

Check if decrease is due to sale or exchange of partnership interest . ▶ ☐

K Partner's share of liabilities:

	Beginning	Ending
Nonrecourse . . .	$	$
Qualified nonrecourse financing	$	$
Recourse	$ 1,541,500	$ 1,026,155

Check this box if Item K includes liability amounts from lower tier partnerships ▶ ☐

L Partner's Capital Account Analysis

Beginning capital account	$ 1,762,079
Capital contributed during the year . .	$
Current year net income (loss)	$ 176,649
Other increase (decrease) (attach explanation)	$
Withdrawals and distributions	$ (150,000)
Ending capital account	$ 1,788,728

M Did the partner contribute property with a built-in gain (loss)?
☐ Yes ☒ No If "Yes," attach statement. See instructions.

N Partner's Share of Net Unrecognized Section 704(c) Gain or (Loss)

Beginning	$ 0
Ending	$ 339,884

Part III Partner's Share of Current Year Income, Deductions, Credits, and Other Items

1	Ordinary business income (loss)	351,576	14	Self-employment earnings (loss)	A 273,871
2	Net rental real estate income (loss)				
3	Other net rental income (loss)		15	Credits	
4a	Guaranteed payments for services	97,222			
4b	Guaranteed payments for capital		16	Schedule K-3 is attached if checked . . . . . ▶ ☐	
4c	Total guaranteed payments	97,222	17	Alternative minimum tax (AMT) items	
5	Interest income				
6a	Ordinary dividends				
6b	Qualified dividends		18	Tax-exempt income and nondeductible expenses	
6c	Dividend equivalents				
7	Royalties				
8	Net short-term capital gain (loss)		19	Distributions	A 150,000
9a	Net long-term capital gain (loss)				
9b	Collectibles (28%) gain (loss)		20	Other information	
9c	Unrecaptured section 1250 gain				
10	Net section 1231 gain (loss)				
11	Other income (loss)				
12	Section 179 deduction		21	Foreign taxes paid or accrued	
13	Other deductions	W 154,927			

22 ☐ More than one activity for at-risk purposes*
23 ☐ More than one activity for passive activity purposes*
*See attached statement for additional information.

For IRS Use Only

For Paperwork Reduction Act Notice, see the Instructions for Form 1065. www.irs.gov/Form1065 Cat. No. 11394R Schedule K-1 (Form 1065) 2021

651121

☐ Final K-1 ☐ Amended K-1

OMB No. 1545-0123

Schedule K-1 (Form 1065) **2021**

Department of the Treasury
Internal Revenue Service

For calendar year 2021, or tax year

beginning / / 2021 ending / /

Partner's Share of Income, Deductions, Credits, etc.

▶ See back of form and separate instructions.

Part I Information About the Partnership

A Partnership's employer identification number
75-9876543

B Partnership's name, address, city, state, and ZIP code
Agricultural Pump & Service, LLC
1840 N Plum Street
Hutchinson, KS 67502

C IRS center where partnership filed return ▶ e-file

D ☐ Check if this is a publicly traded partnership (PTP)

Part II Information About the Partner

E Partner's SSN or TIN (Do not use TIN of a disregarded entity. See instructions.)
444-11-5151

F Name, address, city, state, and ZIP code for partner entered in E. See instructions.
Sylvia Planer
1408 N Plum Street
Hutchinson, KS 67502

G ☒ General partner or LLC member-manager ☐ Limited partner or other LLC member

H1 ☒ Domestic partner ☐ Foreign partner

H2 ☐ If the partner is a disregarded entity (DE), enter the partner's:
TIN ______ Name ______

I1 What type of entity is this partner? Active Individual

I2 If this partner is a retirement plan (IRA/SEP/Keogh/etc.), check here ▶ ☐

J Partner's share of profit, loss, and capital (see instructions):

	Beginning	Ending
Profit	50 %	33 %
Loss	50 %	33 %
Capital	50 %	33 %

Check if decrease is due to sale or exchange of partnership interest . ▶ ☐

K Partner's share of liabilities:

	Beginning	Ending
Nonrecourse	$	$
Qualified nonrecourse financing	$	$
Recourse	$ 1,541,500	$ 1,026,155

Check this box if Item K includes liability amounts from lower tier partnerships ▶ ☐

L Partner's Capital Account Analysis

Beginning capital account	$ 1,762,079
Capital contributed during the year	$
Current year net income (loss)	$ 176,649
Other increase (decrease) (attach explanation)	$
Withdrawals and distributions	$ (150,000)
Ending capital account	$ 1,788,728

M Did the partner contribute property with a built-in gain (loss)?
☐ Yes ☒ No If "Yes," attach statement. See instructions.

N Partner's Share of Net Unrecognized Section 704(c) Gain or (Loss)

Beginning	$ 0
Ending	$ 339,884

Part III Partner's Share of Current Year Income, Deductions, Credits, and Other Items

1	Ordinary business income (loss)	351,576
2	Net rental real estate income (loss)	
3	Other net rental income (loss)	
4a	Guaranteed payments for services	97,222
4b	Guaranteed payments for capital	
4c	Total guaranteed payments	97,222
5	Interest income	
6a	Ordinary dividends	
6b	Qualified dividends	
6c	Dividend equivalents	
7	Royalties	
8	Net short-term capital gain (loss)	
9a	Net long-term capital gain (loss)	
9b	Collectibles (28%) gain (loss)	
9c	Unrecaptured section 1250 gain	
10	Net section 1231 gain (loss)	
11	Other income (loss)	
12	Section 179 deduction	
13	Other deductions	W 154,927
14	Self-employment earnings (loss)	A 273,871
15	Credits	
16	Schedule K-3 is attached if checked . . . . ▶ ☐	
17	Alternative minimum tax (AMT) items	
18	Tax-exempt income and nondeductible expenses	
19	Distributions	A 150,000
20	Other information	
21	Foreign taxes paid or accrued	

22 ☐ More than one activity for at-risk purposes*

23 ☐ More than one activity for passive activity purposes*

*See attached statement for additional information.

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Form **4562**

Department of the Treasury
Internal Revenue Service (99)

Depreciation and Amortization
(Including Information on Listed Property)

▶ Attach to your tax return.
▶ Go to *www.irs.gov/Form4562* for instructions and the latest information.

OMB No. 1545-0172
2021
Attachment Sequence No. 179

Name(s) shown on return	Business or activity to which this form relates	Identifying number
Agricultural Pump & Service	Manufacture, Installation & Repair Irrigation Equipment	75-9876543

Part I Election To Expense Certain Property Under Section 179
Note: If you have any listed property, complete Part V before you complete Part I.

1	Maximum amount (see instructions)	1	
2	Total cost of section 179 property placed in service (see instructions)	2	
3	Threshold cost of section 179 property before reduction in limitation (see instructions)	3	
4	Reduction in limitation. Subtract line 3 from line 2. If zero or less, enter -0-	4	
5	Dollar limitation for tax year. Subtract line 4 from line 1. If zero or less, enter -0-. If married filing separately, see instructions	5	

6	(a) Description of property	(b) Cost (business use only)	(c) Elected cost
7	Listed property. Enter the amount from line 29	7	

8	Total elected cost of section 179 property. Add amounts in column (c), lines 6 and 7	8	
9	Tentative deduction. Enter the **smaller** of line 5 or line 8	9	
10	Carryover of disallowed deduction from line 13 of your 2020 Form 4562	10	
11	Business income limitation. Enter the smaller of business income (not less than zero) or line 5. See instructions	11	
12	Section 179 expense deduction. Add lines 9 and 10, but don't enter more than line 11	12	
13	Carryover of disallowed deduction to 2022. Add lines 9 and 10, less line 12 ▶ 13		

Note: Don't use Part II or Part III below for listed property. Instead, use Part V.

Part II Special Depreciation Allowance and Other Depreciation (Don't include listed property. See instructions.)

14	Special depreciation allowance for qualified property (other than listed property) placed in service during the tax year. See instructions	14	
15	Property subject to section 168(f)(1) election	15	
16	Other depreciation (including ACRS)	16	

Part III MACRS Depreciation (Don't include listed property. See instructions.)

Section A

17	MACRS deductions for assets placed in service in tax years beginning before 2021	17	
18	If you are electing to group any assets placed in service during the tax year into one or more general asset accounts, check here ▶ ☐		

Section B—Assets Placed in Service During 2021 Tax Year Using the General Depreciation System

(a) Classification of property	(b) Month and year placed in service	(c) Basis for depreciation (business/investment use only—see instructions)	(d) Recovery period	(e) Convention	(f) Method	(g) Depreciation deduction
19a 3-year property						
b 5-year property						
c 7-year property		3,630,000	7	mid-year	MACRS	324,159
d 10-year property						
e 15-year property						
f 20-year property						
g 25-year property			25 yrs.		S/L	
h Residential rental			27.5 yrs.	MM	S/L	
property			27.5 yrs.	MM	S/L	
i Nonresidential real	3/1/2017	2,925,000	39 yrs.	MM	S/L	75,000
property	5/1/2021	830,000		MM	S/L	14,188

Section C—Assets Placed in Service During 2021 Tax Year Using the Alternative Depreciation System

(a) Classification of property	(b)	(c)	(d)	(e)	(f)	(g)
20a Class life					S/L	
b 12-year			12 yrs.		S/L	
c 30-year			30 yrs.	MM	S/L	
d 40-year			40 yrs.	MM	S/L	

Part IV Summary (See instructions.)

21	Listed property. Enter amount from line 28	21	
22	**Total.** Add amounts from line 12, lines 14 through 17, lines 19 and 20 in column (g), and line 21. Enter here and on the appropriate lines of your return. Partnerships and S corporations—see instructions	22	413,347
23	For assets shown above and placed in service during the current year, enter the portion of the basis attributable to section 263A costs	23	

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Part V Listed Property (Include automobiles, certain other vehicles, certain aircraft, and property used for entertainment, recreation, or amusement.)

Note: For any vehicle for which you are using the standard mileage rate or deducting lease expense, complete **only** 24a, 24b, columns (a) through (c) of Section A, all of Section B, and Section C if applicable.

Section A—Depreciation and Other Information (Caution: See the instructions for limits for passenger automobiles.**)**

24a Do you have evidence to support the business/investment use claimed? ☐ **Yes** ☐ **No** **24b** If "Yes," is the evidence written? ☐ **Yes** ☐ **No**

(a) Type of property (list vehicles first)	(b) Date placed in service	(c) Business/ investment use percentage	(d) Cost or other basis	(e) Basis for depreciation (business/investment use only)	(f) Recovery period	(g) Method/ Convention	(h) Depreciation deduction	(i) Elected section 179 cost
25 Special depreciation allowance for qualified listed property placed in service during the tax year and used more than 50% in a qualified business use. See instructions .						**25**		
26 Property used more than 50% in a qualified business use:								
		%						
		%						
		%						
27 Property used 50% or less in a qualified business use:								
		%				S/L –		
		%				S/L –		
		%				S/L –		
28 Add amounts in column (h), lines 25 through 27. Enter here and on line 21, page 1 .						**28**		
29 Add amounts in column (i), line 26. Enter here and on line 7, page 1							**29**	

Section B—Information on Use of Vehicles

Complete this section for vehicles used by a sole proprietor, partner, or other "more than 5% owner," or related person. If you provided vehicles to your employees, first answer the questions in Section C to see if you meet an exception to completing this section for those vehicles.

	(a) Vehicle 1		(b) Vehicle 2		(c) Vehicle 3		(d) Vehicle 4		(e) Vehicle 5		(f) Vehicle 6	
30 Total business/investment miles driven during the year (**don't** include commuting miles) .												
31 Total commuting miles driven during the year												
32 Total other personal (noncommuting) miles driven												
33 Total miles driven during the year. Add lines 30 through 32												
	Yes	**No**	**Yes**	**No**	**Yes**	**No**	**Yes**	**No**	**Yes**	**No**	**Yes**	**No**
34 Was the vehicle available for personal use during off-duty hours?												
35 Was the vehicle used primarily by a more than 5% owner or related person? . .												
36 Is another vehicle available for personal use?												

Section C—Questions for Employers Who Provide Vehicles for Use by Their Employees

Answer these questions to determine if you meet an exception to completing Section B for vehicles used by employees who **aren't** more than 5% owners or related persons. See instructions.

	Yes	**No**
37 Do you maintain a written policy statement that prohibits all personal use of vehicles, including commuting, by your employees?		
38 Do you maintain a written policy statement that prohibits personal use of vehicles, except commuting, by your employees? See the instructions for vehicles used by corporate officers, directors, or 1% or more owners . .		
39 Do you treat all use of vehicles by employees as personal use?		
40 Do you provide more than five vehicles to your employees, obtain information from your employees about the use of the vehicles, and retain the information received?		
41 Do you meet the requirements concerning qualified automobile demonstration use? See instructions.		
Note: If your answer to 37, 38, 39, 40, or 41 is "Yes," don't complete Section B for the covered vehicles.		

Part VI Amortization

(a) Description of costs	(b) Date amortization begins	(c) Amortizable amount	(d) Code section	(e) Amortization period or percentage	(f) Amortization for this year
42 Amortization of costs that begins during your 2021 tax year (see instructions):					
43 Amortization of costs that began before your 2021 tax year				**43**	
44 **Total.** Add amounts in column (f). See the instructions for where to report				**44**	

Form **4562** (2021)

Admission of a new partner to a partnership

Section 721

The general rule of Section 721 provides that neither gain nor loss will be recognized by either the contributing partner or to the partnership upon the contribution of property to a partnership in exchange for an interest in partnership. The partner takes a tax basis in her partnership interest equal to the aggregate tax basis of the assets contributed (Section 722) and the partnership takes a carryover basis in the assets contributed (Section 723).The basis rules of Sections 722 and 723 ensure that gain or loss not recognized under Section 721 is not excluded from taxation forever, but is merely deferred until either the partner disposes of her interest in the partnership or the partnership disposes of the contributed asset(s).

Example 3-1

Q, L, and R form an equal partnership. Q and L contribute $400,000 cash each and R contributes real estate with a fair value of $400,000 and a tax basis of $225,000. No gain is recognized by any partner or by the partnership itself. Q and L will take a tax basis in their partnership interests of $400,000 each. Although R's partnership interest is worth $400,000, her tax basis in that interest is only $225,000, the tax basis of the asset contributed to the partnership in exchange for that interest. The partnership's initial balance sheet will be as follows:

	Tax basis	704(b) book value
Cash	$800,000	$800,000
Real estate	225,000	400,000
Total assets	$1,025,000	$1,200,000
Capital, Q	$400,000	$400,000
Capital, L	400,000	400,000
Capital, R	225,000	400,000
Total capital	$1,025,000	$1,200,000

Example 3-1 (continued)

In the current case, Bobby's entry as a one-third member of the LLC will be a nontaxable event. His basis in his interest will be equal to the aggregate tax basis of the assets contributed, $1,795,161, increased by his share of the LLC's liabilities. Bobby's tax basis in his membership interest is not reported on either the LLC's tax return or on the members' Schedules K-1.

The allocation of liabilities is governed by Section 752; that topic is covered in another chapter. Here, Agricultural Pump & Service has only recourse liabilities and all items of book income, gain, loss, or expense are shared equally. The LLC's recourse liabilities will be allocated equally, as are all other book items. The equal allocation of liabilities is indicated on the members' Schedules K-1.

Revaluing the LLC's assets under Section 704(b)

The book balance sheet

When Bobby joined the LLC, the property he contributed was recorded in the LLC's book (Section 704(b)) balance sheet at fair market value under Reg. Sec. 1.704-1(b)(2)(iv)(c). Recall that the LLC agreement allocates all items of LLC income, gain, expense, and loss in accordance with the investors' interests in capital. Because Bobby's capital balance reflects the fair market value of the properties he contributed in exchange for his interest, and the original investors reflect the value of the assets they contributed several years ago, the three "equal" investors now have different capital balances. This problem can be alleviated if the LLC opts to revalue all its assets on its book balance sheet.

Reg. Sec. 1.704-1(b)(2)(iv)(i) allows a partnership or LLC to revalue all of its assets on its book balance sheet under the following four situations:

1. The contribution of property (including cash) to a partnership or LLC in exchange for an interest therein
2. The distribution of property (including cash) to a partner or LLC member in exchange for an interest therein
3. Admission of a partner or member to the partnership or LLC in exchange for services
4. Under "generally accepted industry accounting practices" where substantially all of the partnership's property (excluding money) is stock, securities, commodities, options, warrants, futures, or similar instruments that are readily traded on an established securities market

Although the decision to revalue is optional, the regulations presume that the partnership or LLC will revalue its assets in these circumstances. If it does not, then the partnership/LLC agreement must provide for effectively the same results as if the election had been made. (Reg. Sec. 1.704-1(b)(5), Example 14(iv)). Otherwise, the regulations caution, there may be other tax ramifications outside of the allocation arena, such as a gift or compensation. (Reg. Sec. 1.704-1(b)(2)(iv)(f).

Restating the LLC balance sheet

For book purposes only, the LLC is treated as selling its assets for their fair market values and recording gain or loss accordingly. The gain or loss is then allocated among the partners/members in accordance with their interests in profit or loss.

Example 3-2

JD Partners, an equal two-person partnership, had assets with an aggregate value of $7,600,000 when R joined the partnership as an equal one-third partner. The aggregate tax basis of the assets was $4,800,000. The LLC revalued its assets as of the date R joined the partnership.

The revaluation will increase the book value of the partnership's assets to their fair market values. The revaluation will trigger a *book* gain of $2,800,000. This gain will be allocated to J and D equally in accordance with their interests in the partnership. R is not allocated gain because the revaluation occurs just prior to her entry to the partnership.

The book gain will increase the partners' book capital accounts to reflect their shares of the value of the partnership's assets. It will also balance the book balance sheet — the increase in value of the assets will be matched by an equal increase in partnership capital. Note that we are talking solely about the book balance sheet. No taxable income is recognized in connection with the revaluation of the partnership's books.

Goodwill

To the extent that the incoming partner/member contributes an amount for her interest that exceeds her share of the fair market value of the entity's net tangible assets, the excess is recorded as goodwill. Note that the excess amount paid by the incoming member is for only that portion to which she has an interest — the full value of the asset must be recorded on the book balance sheet.

Example 3-3

G contributed property and cash with a fair market value of $1,250,000 to an existing partnership in exchange for a 20% interest in partnership capital, profit, and loss. The partnership opted to revalue its assets in connection with G's entry. G's share of the fair value of the partnership's tangible and financial assets (accounts receivable, etc.), net of liabilities is $1,200,000. The $50,000 excess of the value of G's contribution over her $1,200,000 share of the partnership's net tangible and financial assets is assigned to goodwill. If G's 20% share of the value of the partnership's goodwill is $50,000, the total value of partnership goodwill must be $120,000 ($50,000 ÷ 20%). Accordingly, the partnership's revalued balance sheet will include $120,000 for goodwill.

Note that the partnership has no tax basis in goodwill. It takes a carryover, rather than FMV, *tax basis* in the assets received from G and generally will not have goodwill on its tax balance sheet. Because it has no tax basis in the goodwill, it will not claim amortization expense for tax purposes. Because the book value of depreciable/amortizable assets must be depreciated/amortized at the same rate as the tax basis, and the tax basis is zero, the partnership will not amortize the goodwill for book purposes. This issue will be discussed in more depth later in this course.

Key review point

In this case, Agricultural Pump & Supply will increase the *book* value of its assets and capital. The balance sheets reported on Schedule L are the LLC's *book* balance sheets. Prior to Bobby's entry, the book and tax balance sheets were the same because the original two members paid cash for their interests. Bobby's entry triggered a revaluation of the LLC's assets with the result that the book and tax balance sheets will no longer be the same. The focus of the current discussion is on the book balance sheet, which is the balance sheet required to be reported on Schedule L. *The LLC's tax balance sheet, which is used to determine the tax basis capital accounts reconciled on Schedule K-1, is not affected by the Sec. 704(b) revaluation following Bobby's entry as an LLC member.*

The transition from the beginning book balance sheet to the ending book balance sheet is a three-stage affair: 1) the balance sheet is adjusted for operations from January 1, 2021, through April 30, 2021; 2) the markup of book assets (and member capital accounts) to fair market value upon Bobby's entry; and 3) LLC operations from May 1, 2021, through December 31, 2021.

After this process, the following several items should be noted in reporting the revalued assets on the LLC's ending book balance sheet:

- The depreciable assets were "booked up" to fair market value as of May 1, 2021. In the process, accumulated depreciation was wiped out; accumulated depreciation on the ending book balance sheet consists of book depreciation expense for the 8 months following Bobby's entry to the LLC.
- The note receivable from Bobby is reported as a loan to a partner.
- In this case, the note receivable is reduced at year-end and treated as a distribution to Bobby as discussed in the case facts.
- The revaluation created goodwill on the LLC's book balance sheet; because there is no tax basis in this intangible, it cannot be amortized for either tax or book, as discussed later in this chapter.
- Because Schedule L reports the book balance sheet and Form 4562 necessarily uses the original tax basis of depreciable assets to compute tax depreciation, the total depreciable assets reported on Schedule L will not tie to the total cost of those assets reported on Form 4562. The different cost amounts can be summarized as follows:

	Tax cost	Section 704(b) values
Equipment	$3,630,000	$1,200,000
Building 1	2,925,000	3,000,000
Building 2	830,000	925,000
Totals	$7,385,000	$5,125,000

Note that the tax cost used to depreciate these properties ties to Form 4562 and the total Section 704(b) value ties to Schedule L. This is a common source of confusion on Form 1065 when the book and tax values of a partnership or LLC's assets are not equal, as will be the case when the entity has chosen to revalue its assets following the entry of a new partner/member.

The increase in the book value of assets is run through the LLC members' capital accounts. Because the revaluation is triggered by Bobby's entry to the partnership, the adjustments are made to Sylvia's and Ed's capital accounts only. This will bring their book capital accounts up to the fair market values at the date of Bobby's entry. From that date forward, the three members share in LLC profits equally. These profit allocations and the distributions paid to the members are reflected in the members' capital balances. As indicated on the ending balance sheet provided in the case facts, the three members will all have equal book capital accounts on the ending balance sheet reported on Schedule L reflecting their equal interests in the LLC.

Finally, Schedule M-2 provides a reconciliation of member capital. All items in the reconciliation are straightforward except for the revaluation gain reported on line 4. This item is *not* a plug figure. It is computed as follows:

Beginning member capital (1,762,079 * 2)	$3,524,158
Operating income 1/1–4/30:	
Income before depreciation, 1/1–4/30	284,208
Depreciation, 1/1–4/30	(133,053)
Balance before revaluation	3,675,313
Revalued capital (2,200,000 × 2)	4,400,000
Difference (book gain on revaluation)	$ 724,687

Effect of revaluation on book value of assets

As noted previously, the premium Bobby paid to join the LLC should be reflected (in this case) in the depreciable assets and goodwill. The tax bases and values of the fixed assets as of the date Bobby joined the LLC are summarized in the following table:

	Building	Equipment	Land	Totals
Cost	$2,295,000	$3,630,000	$900,000	$7,455,000
Accumulated depreciation, 1/1/2021	(284,374)	(2,495,000)	0	(2,780,162)
Depreciation, Jan.–Apr. 2021	(25,000)	(108,053)	0	(133,053)
Adjusted basis	2,615,626	1,026,159	900,000	4,541,785
FMV	3,000,000	1,200,000	1,000,000	5,200,000
Sec. 704(b) "book-up"	384,374	173,841	100,000	658,215

Thus, $658,215 of the book-up increases the book value of the building, land, and equipment. The remaining $66,472 ($724,687 from above, less $658,215) is recorded as goodwill (using the residual method under Sec. 1060).

Tax capital is reported on Schedule K-1, whereas book capital is reported on Schedule L

The Schedule K-1s received by the LLC members report their shares of *taxable* income, loss, gain, deduction, etc. Consistent with the focus of the Schedule K-1 on tax consequences to the LLC members/partners, the K-1s include a section reconciling their *tax basis* capital accounts and their shares of partnership/LLC liabilities. These amounts, combined with the Sec. 704(c) gain attributable to each partner/member, are used to determine their tax bases in their interests in the partnership or LLC. On the LLC K-1s, the beginning and ending capital balances reported for each member tie to the tax balance sheets presented at the beginning of this chapter. The tax basis balance sheet must be maintained whenever there are book-tax differences in one or more partnership/LLC assets so that the Schedule K-1s can be properly prepared.

Computing depreciation

Tax depreciation

When a partner contributes depreciable property to a partnership in exchange for an interest in capital, profit, and loss, the partnership is deemed to "step into the shoes" of the contributing partner with respect to computing tax depreciation. This means that, rather than treating the property as newly acquired and starting depreciation in the year of contribution, the partnership computes tax depreciation as if it had acquired the property on the date and at the same price as the contributing partner paid to acquire the property. Because the property is not treated as newly acquired, neither the first- or last-year conventions apply. The total tax depreciation on the property is computed as if it did not change hands. Because it does change hands, the full year's tax depreciation is allocated between the contributor and the partnership/LLC based on the number of days it was owned by each.

Knowledge check

1. On May 30, Q contributed residential realty to an existing partnership in exchange for a 20% interest in capital, profits, and losses. The property was originally purchased for $550,000 and is valued at $687,500 at the date of contribution. How much tax depreciation will be reported on the partnership's tax return for the year of the contribution? Choose the closest answer.

   a. $20,000.
   b. $11,667.
   c. $8,333.
   d. $14,557.

Book depreciation

Section 704(c) will not work if a partnership is free to choose different depreciation methods, or different depreciable lives for book and tax. For example, nonresidential real estate contributed by a partner might be treated as new residential real estate for book, such that the book depreciation deductions would be spread over 39 years beginning with the year of the contribution, and for the tax the property would continue to be depreciated using its original purchase date and depreciable life. This would reduce each year's book depreciation, and therefore the allocations to non-contributing partners, thereby minimizing the special allocations required under Section 704(c). To prevent this type of abuse, Regs. Sec. 1.704-1(b)(2)(iv)(g)(3) require that book depreciation and other cost recovery deductions be calculated at the same *rate* used in computing tax depreciation for each item of partnership property, no matter how it is acquired by the partnership (i.e., whether or not it is subject to Section 704(c)).

Knowledge check

2. Carlton contributed nonresidential real property to Wildfire LLC in exchange for a 25% interest in capital, profit, and loss. The property was acquired 10 years ago for $3,750,000 and is worth $5,000,000. Its remaining tax basis is $2,832,532. It has 29 years, 5½ months left in its depreciable life for tax purposes. (Assume the land on which the building sits was acquired in a separate transaction for a separate price.) What is the LLC's approximate book depreciation deduction with respect to this property for the first full year after its contribution to the LLC?

    a. $169,724.
    b. $14,144.
    c. $96,150.
    d. $128,200.

3. What is the LLC's tax depreciation deduction for this property for the first full year after its contribution to the LLC?

    a. $136,350.
    b. $96,150.
    c. $128,200.
    d. $169,724.

Key review point

Bobby contributed land with a tax basis of $170,000 and FMV of $275,000 and a building with a tax basis of $625,161 ($830,000 - 204,839) and FMV of $925,000. The total built-in gain inherent in these properties was $105,000 (land) and $299,839 (building). The built-in gain inherent in the land will be realized and allocated to Bobby if and when the land is sold. In contrast, a portion of the built-in gain inherent in the building must be recognized by Bobby each year as the building is depreciated.

Tax depreciation on the building will equal 21,282 for 2021. One-third (4 months ÷12 months) applies to the period before Bobby joined the LLC. Thus, the LLC's depreciation deduction with respect to the building contributed by Bobby is $14,188.

To compute book depreciation for 2021, the LLC must apply the ratio of tax depreciation over tax basis to the book value of the property. The book value of the property is equal to its $925,000 value at the date that Bobby contributed it to the partnership. Thus, book depreciation expense is equal to $20,993 [(14,188 ÷ 626,161) × 925,000].

Note that tax depreciation is deducted on the tax return, and book depreciation is reported as accumulated depreciation on Schedule L.

Special allocations required under Section 704(c)

Section 704(c) applies whenever a partner contributes property to a partnership with a fair market value that differs from its tax basis. When property with a built-in gain or loss is contributed to the partnership, tax gains and losses, and depreciation and depletion with respect to the contributed property will differ from the amounts recorded for “book” purposes under Section 704(b). Under Section 704(c), the partnership must allocate tax gain from the subsequent disposition of such property to the contributing partner(s) to the extent of the original difference between value and basis. To the extent the gain recognized upon sale of the property exceeds the built-in gain at the date of contribution, such excess is allocated among the partners in accordance with the partnership agreement.

Practitioners should be aware that Section 704(c) is mandatory, and requires that the partnership or LLC make special allocations of tax gain, loss, depreciation, and amortization in a manner that prevents the contributing partner from shifting built-in gain or loss on contributed property to other partners or LLC members.

Knowledge check

4. Lloyd contributed non-depreciable real estate to a new partnership in exchange for a 25% interest in capital, profit, and loss. The remaining 75% interest in capital, profit, and loss is owned equally by his three partners. The tax basis of the real estate in Lloyd’s hands was $120,000 and its value was $200,000 at the date of contribution to the partnership. In a subsequent year, the partnership sold the real estate for $300,000, recognizing a gain of $180,000 for tax purposes. How much of the gain will be allocated to Lloyd?

    a. $45,000.
    b. $80,000.
    c. $125,000.
    d. $105,000.

In contrast, if the property is depreciable, tax depreciation during the period prior to disposition must be allocated away from the contributing partner in a manner that protects the non-contributors from the built-in gain.

The general approach under Section 704(c) is to tie tax depreciation allocations to non-contributing partners to the allocation of book depreciation. This means that tax depreciation is allocated in the following three steps:

1. The partnership/LLC allocates book depreciation among the partners in accordance with its partnership/membership agreement.
2. The partnership allocates tax depreciation to the non-contributing partners to the extent of their allocations of book depreciation.
3. The remaining tax depreciation is allocated to the contributing partner/member.

Example 3-4

On January 1, 2021, J, D, and R form the equal JDR partnership to develop and manage commercial real estate. J and D contribute $450,000 cash in exchange for their one-third interests in the partnership. R contributes depreciable property with a tax basis of $325,000 and a fair value of $450,000. The property has 10 years remaining in its depreciable life and is depreciated using the straight-line method. The property contributed by D is Section 704(c) property, with a built-in gain of $125,000. Under Section 704(c), the partnership first allocates book depreciation among the partners. Tax deductions follow the book deductions for J and D:

	J		D		R	
	Book	Tax	Book	Tax	Book	Tax
1. Book depreciation	$15,000		$15,000		$15,000	
2.Tax depreciation, J & D		15,000		15,000		
3. Tax depreciation, R						2,500

Note that R's book capital account will be reduced by $15,000 each year to record depreciation expense on the property she contributed. Because her book capital account represents the amount she is entitled to receive at liquidation, each year she is relinquishing a claim to $15,000 of partnership assets. However, she is allowed a tax deduction for only $2,500. Over the 10-year depreciable life of the property, she will relinquish rights to $150,000 in partnership assets and claim a corresponding tax deduction of only $25,000. The result of these unbalanced allocations is that R will bear the tax burden on the $125,000 built-in gain inherent in the property at the rate of $12,500 per year over the next 10 years.

The regulations under Section 704(c) provide alternative allocation rules in the event that total tax depreciation is not sufficient to cover the full book depreciation allocations made to the non-contributing partners. In such cases, the partnership can remedy the shortfall by allocating depreciation expense on other assets away from the contributing partner to make up for the shortfall that otherwise would be borne by the non-contributors. This approach, called the "curative" allocations method, is authorized in Regs. Sec. 1-704-3(c)(1). Alternatively, the partnership can simply allocate negative depreciation to the contributing partner so that the non-contributors can be allocated tax depreciation equal to their shares of book depreciation. The negative depreciation allocated to the contributing partner has the same effect as an allocation of ordinary income so that (s)he bears the tax burden of the built-in gain. This method, the "remedial" allocations method, is authorized by Regs. Sec. 1.704-3(d)(1).

Key review point

As noted earlier, book depreciation on the building contributed by Bobby for 2021 is $20,993 and tax depreciation is $14,188. Book and tax depreciation should be allocated as follows:

	Sylvia (S)		Ed (E)		Bobby (B)	
	Book	Tax	Book	Tax	Book	Tax
1. Book depreciation	$6,998		$6,998		$6,998	
2.Tax depreciation, S & E		6,998		6,998		
3. Tax depreciation, B						192
Totals	$6,998	$6,998	$6,998	$6,998	$6,998	$192

Note the effect of Section 704(c) — Sylvia and Ed are allocated the same amount of depreciation for tax as they are for book. Bobby, in contrast, receives only a small amount of tax depreciation, and his book capital account — and thus the amount he is entitled to receive upon liquidation of his interest in the LLC — is reduced by $6,998. He has effectively recognized $6,806 of the built-in gain inherent in the building at the date he contributed it to the LLC ($6,998 - 192).

The allocations of tax depreciation are reflected on the LLC members' Schedules K-1. Because there are other depreciable properties, we cannot determine whether the amounts reported on the members' K-1s are accurate until we review the tax depreciation allocations for the other properties.

Revaluation of assets triggers Section 704(c)

Reg. Sec. 1.704-3(a)(6) require that the principles of Section 704(c) be applied when partnerships revalue property. In such cases, all partners whose Section 704(b) capital accounts are restated are treated as contributors from that point forward, and future tax allocations must reflect the differences between the book and tax values of partnership assets resulting from the revaluation.

Example 3-5

A and B are equal partners in the AB partnership. At January 1, the partnership had the following balance sheets:

Assets	Book and tax basis	FMV
Land	$800,000	$1,000,000
Capital		
Capital, A	$400,000	$500,000
Capital, B	400,000	500,000
	$800,000	$1,000,000

The partnership admits new partner C as a one-third partner in exchange for a $500,000 cash contribution. To ensure that the partners' book capital accounts reflect the true sharing arrangements between the partners, the partnership elects to "book up" its sole asset (land) to its fair market value of $1,000,000 at the date of C's admission.

This revaluation causes A's and B's book capital accounts to be increased to $500,000 each, so that the new partnership balance sheets are as follows:

Assets	Tax basis	Book value
Cash	$500,000	$500,000
Land	800,000	1,000,000
	$1,300,000	$1,500,000
Capital		
Capital, A	$500,000	$500,000
Capital, B	400,000	500,000
Capital, C	400,000	500,000
	$1,300,000	$1,500,000

For purposes of Section 704(c), the land is now treated as contributed property (contributed by partners A and B to "new" partnership ABC). Accordingly, upon a subsequent sale of the land for $1,150,000, partners A and B will each be required to recognize their $100,000 shares of the built-in gain inherent in the property before C's admission to the partnership, plus their one-third shares ($50,000) of the post-admission gain.

Key review point

Prior to Bobby's entry, the LLC had one amortizable asset (capitalized start-up costs) and two depreciable assets on its balance sheet (7-year equipment purchased in 2017, and 39-year nonresidential realty, purchased in March 2017).

Amortization, like depreciation, must be allocated in accordance with Section 704(c). As illustrated previously, that allocation begins with an allocation of book amortization among the LLC members. This asset is not amortized on the book balance sheet following Bobby's entry. Thus, Bobby's book allocation of amortization is zero, and he is allocated none of the tax amortization. The remaining tax amortization ($1,000) will therefore be allocated equally between the two original LLC members ($500 each).

Tax depreciation is allocated in the same manner. First, we must calculate tax depreciation:

Asset	Cost	Rate	2021 depreciation	4 mo.	8 mo.
Equipment	3,630,000	8.93%	324,159	108,053	216,106
Building	2,925,000	2.56%	75,000	25,000	50,000

Depreciation rates can be obtained from IRS tax depreciation tables for 7-year and 39-year property respectively.

As of April 30, 2021, these assets were revalued to reflect their fair market values. To compute book depreciation, we must first determine the tax basis, net of depreciation, of the assets at the date of revaluation. On the beginning balance sheet, the accumulated depreciation for each asset was $2,495,788 (equipment) and $284,374 (building). Accounting for 4 months' depreciation, at the date of revaluation, the net tax basis of the assets was as follows:

	Equipment	Building
Original cost	$3,630,000	$2,925,000
Accumulated depr, BOY	(2,495,788)	(284,374)
Depreciation through Apr	(108,053)	(25,000)
Net tax basis, 4/30	$1,026,159	$2,615,626

Book depreciation on the equipment, from May 1 through December 31, is thus equal to 21.05% (216,106 ÷ 1,026,159) × $1,200,000 fair value of the equipment as of May 1, 2021 = $252,600.

Book depreciation on the building, from May 1 through December 31, will equal 1.91%; (50,000 ÷ 2,615,626) × $3,000,000 fair value of the building = $57,300.

Allocation of tax depreciation:

	Sylvia (S)		Ed (E)		Bobby (B)	
Depreciation	Book	Tax	Book	Tax	Book	Tax
Equipment						
Book, Jan 1–Apr. 30	$54,026		$54,027		0	
Book, May 1–Dec. 31	84,200		84,200		84,200	
Tax, Jan 1–Apr. 30		$54,026		$54,027		0
Tax, May–Dec., Bobby						84,200
Tax, May–Dec., remainder		65,953		65,953		
Total, Book	$138,226		$138,226		$84,200	
Total, Tax		**$119,979**		**$119,979**		**$84,200**
Building (old)						
Book, Jan. 1–Apr. 30	$12,500		$12,500		0	
Book, May 1–Dec. 31	19,100		19,100		19,100	
Tax, Jan. 1–Apr. 30		12,500		12,500		0
Tax, May–Dec., Bobby						19,100
Tax, May–Dec., remainder		15,450		15,450		
Total, Book	31,600		31,600		19,100	
Total, Tax		**27,950**		**27,950**		**19,100**

Adding these totals to those with respect to the building contributed to the LLC by Bobby yields total tax depreciation to each member as follows:

	Sylvia (S)		Ed (E)		Bobby (B)	
Depreciation	Book	Tax	Book	Tax	Book	Tax
New building	6,998	6,998	6,998	6,998	6,998	192
Old building	31,600	27,950	31,600	27,950	19,100	19,100
Equipment	138,226	119,979	138,226	119,979	84,200	84,200
Totals	176,824	**154,927**	176,825	**154,927**	110,298	**103,492**

The bolded amounts tie to the tax depreciation numbers reported on the LLC members' Schedules K-1, so we can be comfortable that total allocations of tax depreciation are consistent with the requirements of Section 704(c).

Key review point

The excess of book over tax depreciation and amortization for the members as summarized reduces the built-in gains in both the assets revalued under Section 704(b) and the assets contributed by Bobby for his one-third interest in the partnership. The built-in gains on the LLC's assets as of the date of Bobby's entry — and the associated Section 704(b) revaluation — and as of December 31, 2021, can be summarized as follows:

	704(b) revalued assets	Assets contributed by Bobby
Beginning balance, unrecognized 704(c) gain/loss	724,687	404,839
Excess of book depreciation/amortization over tax	43,920	6,806
Ending balance, unrecognized 704(c) gain/loss	679,767	398,033

The tax software often does not reliably make allocations under Section 704(c). Where the software does not accurately make Section 704(c) allocations, the practitioner must either input depreciation allocation ratios to reflect the proper allocations from the working papers or override the figures on the tax return with the proper numbers from the working papers.

Chapter 4

Case Four — Rocky Mountain Properties, LLC

Learning objectives

- Apply the provisions of Section 737 and make associated adjustments to the basis of property retained by the partnership.
- Determine the tax basis of distributed property in the hands of the recipient partner.
- Calculate the required basis adjustments under Section 734(b) when a partnership distributes property to a partner in liquidation of his interest.
- Allocate the Section 734(b) adjustment, if any, among properties retained by the partnership following a distribution of property.
- Allocate nonrecourse liabilities among the partners in a partnership.

Facts

Rocky Mountain Properties, LLC, was formed in 2015 by three unrelated investors: Bob Cantu, Chelsea Zook, and Amelia Martinez. All three members were involved in management of the LLC. Bob contributed raw land with a tax basis of $250,000 and an FMV of $500,000 in exchange for a 40% interest in the company. Chelsea and Amelia each contributed $375,000 cash in exchange for 30% interests. The company used the cash and a $1 million nonrecourse loan to construct a strip shopping center on the land contributed by Bob. Three years later, the shopping center had appreciated considerably in value. The company borrowed another $1.5 million on a nonrecourse loan secured by the strip mall to purchase a second rental retail property. In 2020, it purchased a third property for $2.3 million, using a combination of debt and earnings from its original two properties.

In 2021, due to a combination of factors, Bob decided to leave the LLC. On April 1, the LLC distributed Property 3 — the recently purchased retail center — to Bob in complete liquidation of his interest in the company. As previously noted, this property was acquired by the LLC by purchase in 2020. Bob took the property subject to a $2 million nonrecourse liability that was secured by it and surrendered his shares in the LLC. Chelsea and Amelia became equal "partners" in the LLC on April 1 and have continued to manage the existing properties while evaluating other properties as potential investments for the LLC. As of the end of 2021, they had not invested in any new projects.

During 2021, Rocky Mountain Properties had the following three partners:

Name	SS number
Bob Cantu	444-11-5151
1409 West 46th Avenue	
Denver, CO 80211	
Amelia Martinez	454-66-3333
3501 West Kentucky Avenue	
Denver, CO 80219	
Chelsea Zook	459-34-5939
5712 Evans Avenue	
Denver, CO 80210	

The company's beginning balance sheet as of January 1, 2021, follows:

	Beginning balance sheet	
	Tax	Book
Cash and equivalents	$202,125	202,125
Property 1 (constructed on land contributed by Bob)	1,750,000	1,750,000
Accumulated depreciation, Property 1	(233,708)	(233,708)

	Beginning balance sheet	
	Tax	Book
Property 2 (acquired)	1,950,000	1,950,000
Accumulated depreciation, Property 2	(122,917)	(122,917)
Property 3 (acquired)	2,028,000	2,028,000
Accumulated depreciation, Property 3	(45,500)	(45,500)
Land, Property 1	250,000	500,000
Land, Property 2	200,000	200,000
Land, Property 3	272,000	272,000
Total Assets	**$6,250,000**	**$6,500,000**
NR 1 (secured by Property 1)	2,500,000	2,500,000
NR 2 (secured by Property 3)	2,000,000	2,000,000
Capital, Bob	550,000	800,000
Capital, Amelia	600,000	600,000
Capital, Chelsea	600,000	600,000
Totals	**$6,250,000**	**$6,500,000**

Note that this balance sheet is the Section 704(b) balance sheet. The only difference between the company's book and tax balance sheets is the value of the land on which property 1 was constructed. Its fair value at the date of contribution, which is its book value for purposes of Section 704(b), was $500,000. Its tax basis to Bob was only $250,000, which is the LLC's tax basis, and therefore the amount that would be included on the tax balance sheet. Bob's capital account on the tax balance sheet would be only $550,000.

The ending balance sheet and the income statement are summarized as follows:

	Ending balance sheet		Income statement	
	Tax	Book	Tax	Book
Cash and equivalents	$403,525	$403,525		
Property 1 (constructed on land contributed by Bob)	1,750,000	1,750,000		
Sec. 734(b) adjustment, Property 1	(215,161)	(215,161)		
Accumulated depreciation, Property 1	(278,580)	(278,580)		
Property 2 (acquired)	1,950,000	1,950,000		
Sec. 734(b) adjustment, Property 2	(259,787)	(259,787)		

	Ending balance sheet		Income statement	
Accumulated depreciation, Property 2	(172,917)	(172,917)		
Land, Property 1	500,000	500,000		
Sec. 734(b) adjustment, Land Property 1	(73,087)	(73,087)		
Land, Property 2	200,000	200,000		
Sec. 734(b) adjustment, Land Property 2	(29,269)	(29,269)		
	$3,774,724	$3,774,724		
Nonrecourse mortgage, Property 1	2,425,000	2,425,000		
Capital, Amelia	674,862	674,862		
Capital, Chelsea	674,862	674,862		
Totals	$3,774,724	$3,774,724		
Gross rents — Property 1			275,000	275,000
Gross rents — Property 2			370,000	370,000
Gross rents — Property 3			113,000	113,000
Total Revenues			$758,000	$758,000
Advertising — Property 1			7,200	7,200
Advertising — Property 2			6,500	6,500
Advertising — Property 3			2,200	2,200
Insurance — Property 1			6,000	6,000
Insurance — Property 2			8,000	8,000
Insurance — Property 3			2,500	2,500
Interest expense, NR 1 (secured by P1)			125,000	125,000
Interest expense, NR 2 (secured by P3)			30,000	30,000
Repairs — Property 1			60,000	60,000
Repairs — Property 2			25,000	25,000
Taxes — Property 1			24,000	24,000
Taxes — Property 2			32,000	32,000
Taxes — Property 3			12,000	12,000
Utilities — Property 1			9,000	9,000
Utilities — Property 2			18,000	18,000
Utilities — Property 3			5,000	5,000
Wages, Salaries — Property 1			36,000	36,000
Wages, Salaries — Property 2			42,000	42,000
Wages, Salaries — Property 3			12,000	12,000

	Ending balance sheet		Income statement	
Depreciation expense — Property 1			44,872	44,872
Depreciation expense — Property 2			50,000	50,000
Depreciation expense — Property 3			15,167	15,167
Miscellaneous — Property 1			5,700	5,700
Miscellaneous — Property 2			10,100	10,100
Miscellaneous — Property 3			3,400	3,400
Total expenses			$591,639	$591,639

The unfiled 2021 tax return for Rocky Mountain Properties is reprinted on the following pages for your review. In reviewing the return, you should consider the following issues, which are addressed in more detail in the remainder of this chapter:

- Will Bob be required to recognize the built-in gain inherent in the land he originally contributed to the LLC upon receipt of the liquidating distribution from the LLC? If so, how will that affect the LLC and Bob for tax purposes?
- Should the LLC have recognized any gain or loss in connection with the distribution of appreciated property to Bob in redemption of his shares in the LLC?
- What will be Bob's tax basis in the property received from the LLC in the liquidating distribution? What will be the LLC's tax basis in its remaining properties?
- How should the LLC compute depreciation expense on the property distributed to Bob in April? What about the other properties retained by the LLC?
- How should the LLC allocate nonrecourse liabilities among the members?

Form **1065** | Department of the Treasury Internal Revenue Service

U.S. Return of Partnership Income

For calendar year 2021, or tax year beginning ____________, 2021, ending ____________, 20____.

► Go to *www.irs.gov/Form1065* for instructions and the latest information.

OMB No. 1545-0123

2021

A Principal business activity: Realty Investment	Name of partnership: Rocky Mountain Properties, LLC	**D** Employer identification number: 75-1245678
B Principal product or service: Rental Properties	Number, street, and room or suite no. If a P.O. box, see instructions.: 601 Main Street	**E** Date business started: 07/01/2014
C Business code number: 531110	City or town, state or province, country, and ZIP or foreign postal code: Denver, CO 80210	**F** Total assets (see instructions): $ 3,774,724

Type or Print

G Check applicable boxes: (1) ☐ Initial return (2) ☐ Final return (3) ☐ Name change (4) ☐ Address change (5) ☐ Amended return

H Check accounting method: (1) ☑ Cash (2) ☐ Accrual (3) ☐ Other (specify) ►

I Number of Schedules K-1. Attach one for each person who was a partner at any time during the tax year ►

J Check if Schedules C and M-3 are attached ► ☐

K Check if partnership: (1) ☐ Aggregated activities for section 465 at-risk purposes (2) ☐ Grouped activities for section 469 passive activity purposes

Caution: Include **only** trade or business income and expenses on lines 1a through 22 below. See instructions for more information.

Income	1a	Gross receipts or sales	1a	
	b	Returns and allowances	1b	
	c	Balance. Subtract line 1b from line 1a	1c	0
	2	Cost of goods sold (attach Form 1125-A)	2	
	3	Gross profit. Subtract line 2 from line 1c	3	0
	4	Ordinary income (loss) from other partnerships, estates, and trusts (attach statement)	4	
	5	Net farm profit (loss) (attach Schedule F (Form 1040))	5	
	6	Net gain (loss) from Form 4797, Part II, line 17 (attach Form 4797)	6	
	7	Other income (loss) (attach statement)	7	
	8	**Total income (loss).** Combine lines 3 through 7	8	0
Deductions (see instructions for limitations)	9	Salaries and wages (other than to partners) (less employment credits)	9	
	10	Guaranteed payments to partners	10	
	11	Repairs and maintenance	11	
	12	Bad debts	12	
	13	Rent	13	
	14	Taxes and licenses	14	
	15	Interest (see instructions)	15	
	16a	Depreciation (if required, attach Form 4562)	16a	
	b	Less depreciation reported on Form 1125-A and elsewhere on return	16b	
			16c	
	17	Depletion **(Do not deduct oil and gas depletion.)**	17	
	18	Retirement plans, etc.	18	
	19	Employee benefit programs	19	
	20	Other deductions (attach statement)	20	
	21	**Total deductions.** Add the amounts shown in the far right column for lines 9 through 20	21	0
	22	**Ordinary business income (loss).** Subtract line 21 from line 8	22	0
Tax and Payment	23	Interest due under the look-back method—completed long-term contracts (attach Form 8697)	23	
	24	Interest due under the look-back method—income forecast method (attach Form 8866)	24	
	25	BBA AAR imputed underpayment (see instructions)	25	
	26	Other taxes (see instructions)	26	
	27	**Total balance due.** Add lines 23 through 26	27	0
	28	Payment (see instructions)	28	0
	29	**Amount owed.** If line 28 is smaller than line 27, enter amount owed	29	0
	30	**Overpayment.** If line 28 is larger than line 27, enter overpayment	30	0

Sign Here

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than partner or limited liability company member) is based on all information of which preparer has any knowledge.

► Signature of partner or limited liability company member ► Date

May the IRS discuss this return with the preparer shown below? See instructions. ☐ Yes ☐ No

Paid Preparer Use Only

Print/Type preparer's name	Preparer's signature	Date	Check ☐ if self-employed	PTIN
Firm's name ►			Firm's EIN ►	
Firm's address ►			Phone no.	

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 11390Z Form **1065** (2021)

Schedule B Other Information

		Yes	No
1	What type of entity is filing this return? Check the applicable box:		
	a ☐ Domestic general partnership b ☐ Domestic limited partnership		
	c ☑ Domestic limited liability company d ☐ Domestic limited liability partnership		
	e ☐ Foreign partnership f ☐ Other ▶		
2	At the end of the tax year:		
a	Did any foreign or domestic corporation, partnership (including any entity treated as a partnership), trust, or tax-exempt organization, or any foreign government own, directly or indirectly, an interest of 50% or more in the profit, loss, or capital of the partnership? For rules of constructive ownership, see instructions. If "Yes," attach Schedule B-1, Information on Partners Owning 50% or More of the Partnership		✔
b	Did any individual or estate own, directly or indirectly, an interest of 50% or more in the profit, loss, or capital of the partnership? For rules of constructive ownership, see instructions. If "Yes," attach Schedule B-1, Information on Partners Owning 50% or More of the Partnership		✔
3	At the end of the tax year, did the partnership:		
a	Own directly 20% or more, or own, directly or indirectly, 50% or more of the total voting power of all classes of stock entitled to vote of any foreign or domestic corporation? For rules of constructive ownership, see instructions. If "Yes," complete (i) through (iv) below		✔

(i) Name of Corporation	(ii) Employer Identification Number (if any)	(iii) Country of Incorporation	(iv) Percentage Owned in Voting Stock

		Yes	No
b	Own directly an interest of 20% or more, or own, directly or indirectly, an interest of 50% or more in the profit, loss, or capital in any foreign or domestic partnership (including an entity treated as a partnership) or in the beneficial interest of a trust? For rules of constructive ownership, see instructions. If "Yes," complete (i) through (v) below		✔

(i) Name of Entity	(ii) Employer Identification Number (if any)	(iii) Type of Entity	(iv) Country of Organization	(v) Maximum Percentage Owned in Profit, Loss, or Capital

		Yes	No
4	Does the partnership satisfy **all four** of the following conditions?		
a	The partnership's total receipts for the tax year were less than $250,000.		
b	The partnership's total assets at the end of the tax year were less than $1 million.		
c	Schedules K-1 are filed with the return and furnished to the partners on or before the due date (including extensions) for the partnership return.		
d	The partnership is not filing and is not required to file Schedule M-3		✔
	If "Yes," the partnership is not required to complete Schedules L, M-1, and M-2; item F on page 1 of Form 1065; or item L on Schedule K-1.		
5	Is this partnership a publicly traded partnership, as defined in section 469(k)(2)?		✔
6	During the tax year, did the partnership have any debt that was canceled, was forgiven, or had the terms modified so as to reduce the principal amount of the debt?		✔
7	Has this partnership filed, or is it required to file, Form 8918, Material Advisor Disclosure Statement, to provide information on any reportable transaction?		✔
8	At any time during calendar year 2021, did the partnership have an interest in or a signature or other authority over a financial account in a foreign country (such as a bank account, securities account, or other financial account)? See instructions for exceptions and filing requirements for FinCEN Form 114, Report of Foreign Bank and Financial Accounts (FBAR). If "Yes," enter the name of the foreign country ▶		✔
9	At any time during the tax year, did the partnership receive a distribution from, or was it the grantor of, or transferor to, a foreign trust? If "Yes," the partnership may have to file Form 3520, Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts. See instructions		✔
10a	Is the partnership making, or had it previously made (and not revoked), a section 754 election? See instructions for details regarding a section 754 election.		✔
b	Did the partnership make for this tax year an optional basis adjustment under section 743(b) or 734(b)? If "Yes," attach a statement showing the computation and allocation of the basis adjustment. See instructions		✔

Form **1065** (2021)

Schedule B **Other Information** *(continued)*

		Yes	No
c	Is the partnership required to adjust the basis of partnership assets under section 743(b) or 734(b) because of a substantial built-in loss (as defined under section 743(d)) or substantial basis reduction (as defined under section 734(d))? If "Yes," attach a statement showing the computation and allocation of the basis adjustment. See instructions	✔	
11	Check this box if, during the current or prior tax year, the partnership distributed any property received in a like-kind exchange or contributed such property to another entity (other than disregarded entities wholly owned by the partnership throughout the tax year) . . . ▶ ☐		
12	At any time during the tax year, did the partnership distribute to any partner a tenancy-in-common or other undivided interest in partnership property?	✔	
13	If the partnership is required to file Form 8858, Information Return of U.S. Persons With Respect To Foreign Disregarded Entities (FDEs) and Foreign Branches (FBs), enter the number of Forms 8858 attached. See instructions . . . ▶		
14	Does the partnership have any foreign partners? If "Yes," enter the number of Forms 8805, Foreign Partner's Information Statement of Section 1446 Withholding Tax, filed for this partnership . . . ▶		✔
15	Enter the number of Forms 8865, Return of U.S. Persons With Respect to Certain Foreign Partnerships, attached to this return . . . ▶		
16a	Did you make any payments in 2021 that would require you to file Form(s) 1099? See instructions		✔
b	If "Yes," did you or will you file required Form(s) 1099?		✔
17	Enter the number of Forms 5471, Information Return of U.S. Persons With Respect To Certain Foreign Corporations, attached to this return . . . ▶		
18	Enter the number of partners that are foreign governments under section 892 . . . ▶		
19	During the partnership's tax year, did the partnership make any payments that would require it to file Forms 1042 and 1042-S under chapter 3 (sections 1441 through 1464) or chapter 4 (sections 1471 through 1474)?		✔
20	Was the partnership a specified domestic entity required to file Form 8938 for the tax year? See the Instructions for Form 8938		✔
21	Is the partnership a section 721(c) partnership, as defined in Regulations section 1.721(c)-1(b)(14)?		✔
22	During the tax year, did the partnership pay or accrue any interest or royalty for which one or more partners are not allowed a deduction under section 267A? See instructions		✔
	If "Yes," enter the total amount of the disallowed deductions . . . ▶ $		
23	Did the partnership have an election under section 163(j) for any real property trade or business or any farming business in effect during the tax year? See instructions		✔
24	Does the partnership satisfy one or more of the following? See instructions		✔
a	The partnership owns a pass-through entity with current, or prior year carryover, excess business interest expense.		
b	The partnership's aggregate average annual gross receipts (determined under section 448(c)) for the 3 tax years preceding the current tax year are more than $26 million and the partnership has business interest.		
c	The partnership is a tax shelter (see instructions) and the partnership has business interest expense. If "Yes" to any, complete and attach Form 8990.		
25	Is the partnership attaching Form 8996 to certify as a Qualified Opportunity Fund?		✔
	If "Yes," enter the amount from Form 8996, line 15 . . . ▶ $		
26	Enter the number of foreign partners subject to section 864(c)(8) as a result of transferring all or a portion of an interest in the partnership or of receiving a distribution from the partnership . . . ▶ Complete Schedule K-3 (Form 1065), Part XIII, for each foreign partner subject to section 864(c)(8) on a transfer or distribution.		
27	At any time during the tax year, were there any transfers between the partnership and its partners subject to the disclosure requirements of Regulations section 1.707-8?		✔
28	Since December 22, 2017, did a foreign corporation directly or indirectly acquire substantially all of the properties constituting a trade or business of your partnership, and was the ownership percentage (by vote or value) for purposes of section 7874 greater than 50% (for example, the partners held more than 50% of the stock of the foreign corporation)? If "Yes," list the ownership percentage by vote and by value. See instructions. Percentage: By Vote By Value		✔
29	Is the partnership electing out of the centralized partnership audit regime under section 6221(b)? See instructions.		✔
	If "Yes," the partnership must complete Schedule B-2 (Form 1065). Enter the total from Schedule B-2, Part III, line 3 ▶ If "No," complete Designation of Partnership Representative below.		

Designation of Partnership Representative (see instructions)

Enter below the information for the partnership representative (PR) for the tax year covered by this return.

Name of PR ▶ Amelia Martinez

U.S. address of PR	3501 Kentucky Ave Denver CO 80219	U.S. phone number of PR	
If the PR is an entity, name of the designated individual for the PR ▶			
U.S. address of designated individual		U.S. phone number of designated individual	

Form **1065** (2021)

Schedule K Partners' Distributive Share Items

					Total amount
Income (Loss)	1	Ordinary business income (loss) (page 1, line 22)		1	
	2	Net rental real estate income (loss) (attach Form 8825)		2	166,361
	3a	Other gross rental income (loss)	3a		
	b	Expenses from other rental activities (attach statement)	3b		
	c	Other net rental income (loss). Subtract line 3b from line 3a		3c	0
	4	Guaranteed payments: **a** Services 4a 250,000 **b** Capital	4b		
		c Total. Add lines 4a and 4b		4c	
	5	Interest income		5	
	6	Dividends and dividend equivalents: **a** Ordinary dividends		6a	
		b Qualified dividends 6b **c** Dividend equivalents	6c		
	7	Royalties		7	
	8	Net short-term capital gain (loss) (attach Schedule D (Form 1065))		8	
	9a	Net long-term capital gain (loss) (attach Schedule D (Form 1065))		9a	
	b	Collectibles (28%) gain (loss)	9b		
	c	Unrecaptured section 1250 gain (attach statement)	9c		
	10	Net section 1231 gain (loss) (attach Form 4797)		10	250,000
	11	Other income (loss) (see instructions) Type ▶		11	
Deductions	12	Section 179 deduction (attach Form 4562)		12	
	13a	Contributions		13a	
	b	Investment interest expense		13b	
	c	Section 59(e)(2) expenditures: **(1)** Type ▶ **(2)** Amount ▶		13c(2)	
	d	Other deductions (see instructions) Type ▶		13d	
Self-Employment	14a	Net earnings (loss) from self-employment		14a	
	b	Gross farming or fishing income		14b	
	c	Gross nonfarm income		14c	
Credits	15a	Low-income housing credit (section 42(j)(5))		15a	
	b	Low-income housing credit (other)		15b	
	c	Qualified rehabilitation expenditures (rental real estate) (attach Form 3468, if applicable)		15c	
	d	Other rental real estate credits (see instructions) Type ▶		15d	
	e	Other rental credits (see instructions) Type ▶		15e	
	f	Other credits (see instructions) Type ▶		15f	
International Transactions	16	Attach Schedule K-2 (Form 1065), Partners' Distributive Share Items-International, and check this box to indicate that you are reporting items of international tax relevance ☐			
Alternative Minimum Tax (AMT) Items	17a	Post-1986 depreciation adjustment		17a	
	b	Adjusted gain or loss		17b	
	c	Depletion (other than oil and gas)		17c	
	d	Oil, gas, and geothermal properties—gross income		17d	
	e	Oil, gas, and geothermal properties—deductions		17e	
	f	Other AMT items (attach statement)		17f	
Other Information	18a	Tax-exempt interest income		18a	
	b	Other tax-exempt income		18b	
	c	Nondeductible expenses		18c	
	19a	Distributions of cash and marketable securities		19a	
	b	Distributions of other property		19b	2,239,333
	20a	Investment income		20a	
	b	Investment expenses		20b	
	c	Other items and amounts (attach statement)			
	21	Total foreign taxes paid or accrued		21	

Form **1065** (2021)

Analysis of Net Income (Loss)

1	Net income (loss). Combine Schedule K, lines 1 through 11. From the result, subtract the sum of Schedule K, lines 12 through 13d, and 21					1	416,361
2	Analysis by partner type:	(i) Corporate	(ii) Individual (active)	(iii) Individual (passive)	(iv) Partnership	(v) Exempt Organization	(vi) Nominee/Other
a	General partners						
b	Limited partners		416,361				

Schedule L — Balance Sheets per Books

	Assets	Beginning of tax year (a)	(b)	End of tax year (c)	(d)
1	Cash		202,125		403,525
2a	Trade notes and accounts receivable				
b	Less allowance for bad debts				
3	Inventories				
4	U.S. government obligations				
5	Tax-exempt securities				
6	Other current assets (attach statement)				
7a	Loans to partners (or persons related to partners)				
b	Mortgage and real estate loans				
8	Other investments (attach statement)				
9a	Buildings and other depreciable assets	5,728,000		3,225,052	
b	Less accumulated depreciation	402,125	5,325,875	451,497	2,773,555
10a	Depletable assets				
b	Less accumulated depletion				
11	Land (net of any amortization)		972,000		597,644
12a	Intangible assets (amortizable only)				
b	Less accumulated amortization				
13	Other assets (attach statement)				
14	Total assets		6,500,000		3,774,724
	Liabilities and Capital				
15	Accounts payable				
16	Mortgages, notes, bonds payable in less than 1 year				
17	Other current liabilities (attach statement)				
18	All nonrecourse loans		4,500,000		2,425,000
19a	Loans from partners (or persons related to partners)				
b	Mortgages, notes, bonds payable in 1 year or more				
20	Other liabilities (attach statement)				
21	Partners' capital accounts		2,000,000		1,349,724
22	Total liabilities and capital		6,500,000		3,774,724

Schedule M-1 — Reconciliation of Income (Loss) per Books With Income (Loss) per Return

Note: The partnership may be required to file Schedule M-3. See instructions.

1	Net income (loss) per books	166,361	6	Income recorded on books this year not included on Schedule K, lines 1 through 11 (itemize):	
2	Income included on Schedule K, lines 1, 2, 3c, 5, 6a, 7, 8, 9a, 10, and 11, not recorded on books this year (itemize):	250,000	a	Tax-exempt interest $	
3	Guaranteed payments (other than health insurance)		7	Deductions included on Schedule K, lines 1 through 13d, and 21, not charged against book income this year (itemize):	
4	Expenses recorded on books this year not included on Schedule K, lines 1 through 13d, and 21 (itemize):		a	Depreciation $	
a	Depreciation $		8	Add lines 6 and 7	
b	Travel and entertainment $		9	Income (loss) (Analysis of Net Income (Loss), line 1). Subtract line 8 from line 5	416,361
5	Add lines 1 through 4	416,361			

Schedule M-2 — Analysis of Partners' Capital Accounts

1	Balance at beginning of year	2,000,000	6	Distributions: a Cash	
2	Capital contributed: a Cash			b Property	2,239,333
	b Property		7	Other decreases (itemize):	
3	Net income (loss) (see instructions)	166,361			577,304
4	Other increases (itemize):	2,000,000	8	Add lines 6 and 7	2,816,637
5	Add lines 1 through 4	4,166,361	9	Balance at end of year. Subtract line 8 from line 5	1,349,724

Form **1065** (2021)

SCHEDULE B-1 (Form 1065)
(Rev. August 2019)
Department of the Treasury
Internal Revenue Service

Information on Partners Owning 50% or More of the Partnership

► Attach to Form 1065.
► Go to *www.irs.gov/Form1065* for the latest information.

OMB No. 1545-0123

Name of partnership: Rocky Mountain Properties, LLC

Employer identification number (EIN): 75-1245678

Part I **Entities Owning 50% or More of the Partnership** (Form 1065, Schedule B, Question 2a (Question 3a for 2009 through 2017))

Complete columns (i) through (v) below for any foreign or domestic corporation, partnership (including any entity treated as a partnership), trust, tax-exempt organization, or any foreign government that owns, directly or indirectly, an interest of 50% or more in the profit, loss, or capital of the partnership (see instructions).

(i) Name of Entity	(ii) Employer Identification Number (if any)	(iii) Type of Entity	(iv) Country of Organization	(v) Maximum Percentage Owned in Profit, Loss, or Capital

Part II **Individuals or Estates Owning 50% or More of the Partnership** (Form 1065, Schedule B, Question 2b (Question 3b for 2009 through 2017))

Complete columns (i) through (iv) below for any individual or estate that owns, directly or indirectly, an interest of 50% or more in the profit, loss, or capital of the partnership (see instructions).

(i) Name of Individual or Estate	(ii) Identifying Number (if any)	(iii) Country of Citizenship (see instructions)	(iv) Maximum Percentage Owned in Profit, Loss, or Capital
Amelia Martinez	454-66-3333	United States	50%
Chelsea Zook	459-34-5939	United States	50%

For Paperwork Reduction Act Notice, see the Instructions for Form 1065. Cat. No. 49842K **Schedule B-1 (Form 1065) (Rev. 8-2019)**

General Instructions

Section references are to the Internal Revenue Code unless otherwise noted.

Future Developments

For the latest information about developments related to Schedule B-1 (Form 1065) and its instructions, such as legislation enacted after the form and instructions were published, go to *www.irs.gov/Form1065*.

Purpose of Form

Use Schedule B-1 (Form 1065) to provide the information applicable to certain entities, individuals, and estates that own, directly or indirectly, an interest of 50% or more in the profit, loss, or capital of the partnership.

Who Must File

Schedule B-1 (Form 1065) must be filed by all partnerships that answer "Yes" to question 2a or question 2b (question 3a or question 3b for 2009 through 2017) on Form 1065, Schedule B. Attach Schedule B-1 to Form 1065.

Specific Instructions

Part I

Complete Part I if the partnership answered "Yes" to Form 1065, Schedule B, question 2a (question 3a for 2009 through 2017). List each corporation, partnership, trust, tax-exempt organization, or foreign government owning, directly or indirectly, an interest of 50% or more in the profit, loss, or capital of the partnership at the end of the tax year. Enter the name, EIN, type of entity (corporation, partnership, trust, tax-exempt organization, or foreign government), country of organization, and the maximum percentage interests owned, directly or indirectly, in the profit, loss, or capital of the partnership. For an affiliated group filing a consolidated tax return, list the parent corporation rather than the subsidiary members. List the entity owner of a disregarded entity rather than the disregarded entity. If the owner of a disregarded entity is an individual rather than an entity, list the individual in Part II. In the case of a tax-exempt organization, enter "tax-exempt organization" in column (iii).

Example 1. Corporation A owns, directly, an interest of 50% in the profit, loss, or capital of Partnership B. Corporation A also owns, directly, an interest of 15% in the profit, loss, or capital of Partnership C. Partnership B owns, directly, an interest of 70% in the profit, loss, or capital of Partnership C. Therefore, Corporation A owns, directly or indirectly, an interest of 50% in the profit, loss, or capital of Partnership C (15% directly and 35% indirectly through Partnership B). On Partnership C's Form 1065, it must answer "Yes" to question 2a (question 3a for 2009 through 2017) of Schedule B. Partnership C must also complete Part I of Schedule B-1. In Part I, Partnership C must identify Corporation A, which includes entering "50%" in column (v) (its maximum percentage owned). It also must identify Partnership B, and enter "70%" in column (v).

Part II

Complete Part II if the partnership answered "Yes" to Form 1065, Schedule B, question 2b (question 3b for 2009 through 2017). List each individual or estate owning, directly or indirectly, an interest of 50% or more in the profit, loss, or capital of the partnership at the end of the tax year. Enter the name, social security or employer identification number, country of citizenship (for an estate, the citizenship of the decedent), and the maximum percentage interests owned, directly or indirectly, in the profit, loss, or capital of the partnership.

Example 2. A owns, directly, 50% of the profit, loss, or capital of Partnership X. B, the daughter of A, does not own, directly, any interest in X and does not own, indirectly, any interest in X through any entity (corporation, partnership, trust, or estate). Because family attribution rules apply only when an individual (in this example, B) owns a direct interest in the partnership or an indirect interest through another entity, A's interest in Partnership X is not attributable to B. On Partnership X's Form 1065, it must answer "Yes" to question 2b (question 3b for 2009 through 2017) of Schedule B. Partnership X must also complete Part II of Schedule B-1. In Part II, Partnership X must identify A, which includes entering "50%" in column (iv). Partnership X will **not** identify B in Part II.

651121

☐ Final K-1 ☐ Amended K-1 OMB No. 1545-0123

Schedule K-1 (Form 1065) **2021**

Department of the Treasury
Internal Revenue Service

For calendar year 2021, or tax year

beginning / / 2021 ending / /

Partner's Share of Income, Deductions, Credits, etc.

► See back of form and separate instructions.

Part I Information About the Partnership

A Partnership's employer identification number
75-1245678

B Partnership's name, address, city, state, and ZIP code
Rocky Mountain Properties, LLC
601 Main Street
Denver CO 80210

C IRS center where partnership filed return ►

D ☐ Check if this is a publicly traded partnership (PTP)

Part II Information About the Partner

E Partner's SSN or TIN (Do not use TIN of a disregarded entity. See instructions.)
454-66-3333

F Name, address, city, state, and ZIP code for partner entered in E. See instructions.
Amelia Martinez
3501 W Kentucky Ave
Denver CO 80219

G ☒ General partner or LLC member-manager ☐ Limited partner or other LLC member

H1 ☒ Domestic partner ☐ Foreign partner

H2 ☐ If the partner is a disregarded entity (DE), enter the partner's:
TIN ______ Name ______

I1 What type of entity is this partner? ______

I2 If this partner is a retirement plan (IRA/SEP/Keogh/etc.), check here ► ☐

J Partner's share of profit, loss, and capital (see instructions):

	Beginning	Ending
Profit	30 %	50 %
Loss	30 %	50 %
Capital	30 %	50 %

Check if decrease is due to sale or exchange of partnership interest . ► ☐

K Partner's share of liabilities:

	Beginning	Ending
Nonrecourse . . .	$ 2,028,000	$ 0
Qualified nonrecourse financing	$ 1,275,000	$ 1,212,500
Recourse	$	$

Check this box if Item K includes liability amounts from lower tier partnerships ► ☐

L Partner's Capital Account Analysis

Beginning capital account	$ 600,000
Capital contributed during the year . .	$ 0
Current year net income (loss)	$ 74,862
Other increase (decrease) (attach explanation)	$
Withdrawals and distributions	$ ( )
Ending capital account	$ 674,862

M Did the partner contribute property with a built-in gain (loss)?
☐ Yes ☐ No If "Yes," attach statement. See instructions.

N Partner's Share of Net Unrecognized Section 704(c) Gain or (Loss)

Beginning	$ 0
Ending	$ 0

Part III Partner's Share of Current Year Income, Deductions, Credits, and Other Items

1	Ordinary business income (loss)	
2	Net rental real estate income (loss)	74,862
3	Other net rental income (loss)	
4a	Guaranteed payments for services	
4b	Guaranteed payments for capital	
4c	Total guaranteed payments	
5	Interest income	
6a	Ordinary dividends	
6b	Qualified dividends	
6c	Dividend equivalents	
7	Royalties	
8	Net short-term capital gain (loss)	
9a	Net long-term capital gain (loss)	
9b	Collectibles (28%) gain (loss)	
9c	Unrecaptured section 1250 gain	
10	Net section 1231 gain (loss)	
11	Other income (loss)	
12	Section 179 deduction	
13	Other deductions	
14	Self-employment earnings (loss)	
15	Credits	
16	Schedule K-3 is attached if checked . . . . . ► ☐	
17	Alternative minimum tax (AMT) items	
18	Tax-exempt income and nondeductible expenses	
19	Distributions	
20	Other information	
21	Foreign taxes paid or accrued	

22 ☐ More than one activity for at-risk purposes*
23 ☐ More than one activity for passive activity purposes*

*See attached statement for additional information.

For IRS Use Only

For Paperwork Reduction Act Notice, see the Instructions for Form 1065. www.irs.gov/Form1065 Cat. No. 11394R **Schedule K-1 (Form 1065) 2021**

651121

☐ Final K-1 ☐ Amended K-1

OMB No. 1545-0123

Schedule K-1 (Form 1065) **2021**

Department of the Treasury
Internal Revenue Service

For calendar year 2021, or tax year

beginning / / 2021 ending / /

Partner's Share of Income, Deductions, Credits, etc.

► See back of form and separate instructions.

Part I Information About the Partnership

A Partnership's employer identification number
75-1245678

B Partnership's name, address, city, state, and ZIP code
Rocky Mountain Properties, LLC
601 Main Street
Denver CO 80210

C IRS center where partnership filed return ►

D ☐ Check if this is a publicly traded partnership (PTP)

Part II Information About the Partner

E Partner's SSN or TIN (Do not use TIN of a disregarded entity. See instructions.)
444-11-5151

F Name, address, city, state, and ZIP code for partner entered in E. See instructions.
Bob Cantu
1409 W 46th Ave
Denver CO 80219

G ☒ General partner or LLC member-manager ☐ Limited partner or other LLC member

H1 ☒ Domestic partner ☐ Foreign partner

H2 ☐ If the partner is a disregarded entity (DE), enter the partner's:
TIN ______ Name ______

I1 What type of entity is this partner? ______

I2 If this partner is a retirement plan (IRA/SEP/Keogh/etc.), check here ► ☐

J Partner's share of profit, loss, and capital (see instructions):

	Beginning	Ending
Profit	30 %	0 %
Loss	30 %	0 %
Capital	30 %	0 %

Check if decrease is due to sale or exchange of partnership interest . ► ☐

K Partner's share of liabilities:

	Beginning	Ending
Nonrecourse . . .	$ 0	$ 0
Qualified nonrecourse financing	$ 1,950,000	$ 0
Recourse	$	$

Check this box if Item K includes liability amounts from lower tier partnerships ► ☐

L **Partner's Capital Account Analysis**

Beginning capital account	$ 550,000
Capital contributed during the year . .	$ 2,000,000
Current year net income (loss)	$ 266,636
Other increase (decrease) (attach explanation)	$ [Sec. 743(b)] (577,303)
Withdrawals and distributions	$ (2,239,333)
Ending capital account	$ 0

M Did the partner contribute property with a built-in gain (loss)?
☐ **Yes** ☐ **No** If "Yes," attach statement. See instructions.

N **Partner's Share of Net Unrecognized Section 704(c) Gain or (Loss)**

Beginning	$ 250,000
Ending	$ 0

Part III Partner's Share of Current Year Income, Deductions, Credits, and Other Items

1	Ordinary business income (loss)	
2	Net rental real estate income (loss)	16,636
3	Other net rental income (loss)	
4a	Guaranteed payments for services	
4b	Guaranteed payments for capital	
4c	Total guaranteed payments	
5	Interest income	
6a	Ordinary dividends	
6b	Qualified dividends	
6c	Dividend equivalents	
7	Royalties	
8	Net short-term capital gain (loss)	
9a	Net long-term capital gain (loss)	
9b	Collectibles (28%) gain (loss)	
9c	Unrecaptured section 1250 gain	
10	Net section 1231 gain (loss)	250,000
11	Other income (loss)	
12	Section 179 deduction	
13	Other deductions	
14	Self-employment earnings (loss)	
15	Credits	
16	Schedule K-3 is attached if checked . . . . . ► ☐	
17	Alternative minimum tax (AMT) items	
18	Tax-exempt income and nondeductible expenses	
19	Distributions	2,239,333
20	Other information	
21	Foreign taxes paid or accrued	

22 ☐ More than one activity for at-risk purposes*
23 ☐ More than one activity for passive activity purposes*

*See attached statement for additional information.

For IRS Use Only

For Paperwork Reduction Act Notice, see the Instructions for Form 1065. www.irs.gov/Form1065 Cat. No. 11394R **Schedule K-1 (Form 1065) 2021**

651121

☐ Final K-1 ☐ Amended K-1

OMB No. 1545-0123

Schedule K-1 (Form 1065) **2021**

Department of the Treasury
Internal Revenue Service

For calendar year 2021, or tax year

beginning / / 2021 ending / /

Partner's Share of Income, Deductions, Credits, etc.

▶ See back of form and separate instructions.

Part I Information About the Partnership

A Partnership's employer identification number
75-1245678

B Partnership's name, address, city, state, and ZIP code
Rocky Mountain Properties, LLC
601 Main Street
Denver CO 80210

C IRS center where partnership filed return ▶

D ☐ Check if this is a publicly traded partnership (PTP)

Part II Information About the Partner

E Partner's SSN or TIN (Do not use TIN of a disregarded entity. See instructions.)
459-34-5939

F Name, address, city, state, and ZIP code for partner entered in E. See instructions.
Chelsea Zook
5712 Evans Avenue
Denver CO 80210

G ☒ General partner or LLC member-manager ☐ Limited partner or other LLC member

H1 ☒ Domestic partner ☐ Foreign partner

H2 ☐ If the partner is a disregarded entity (DE), enter the partner's:
TIN ______ Name ______

I1 What type of entity is this partner? ______

I2 If this partner is a retirement plan (IRA/SEP/Keogh/etc.), check here ▶ ☐

J Partner's share of profit, loss, and capital (see instructions):

	Beginning	Ending
Profit	30 %	50 %
Loss	30 %	50 %
Capital	30 %	50 %

Check if decrease is due to sale or exchange of partnership interest . ▶ ☐

K Partner's share of liabilities:

	Beginning	Ending
Nonrecourse	$ 2,028,000	$ 0
Qualified nonrecourse financing	$ 1,275,000	$ 1,212,500
Recourse	$	$

Check this box if Item K includes liability amounts from lower tier partnerships ▶ ☐

L Partner's Capital Account Analysis

Beginning capital account	$ 600,000
Capital contributed during the year	$ 0
Current year net income (loss)	$ 74,862
Other increase (decrease) (attach explanation)	$
Withdrawals and distributions	$ ( )
Ending capital account	$ 674,862

M Did the partner contribute property with a built-in gain (loss)?
☐ Yes ☐ No If "Yes," attach statement. See instructions.

N Partner's Share of Net Unrecognized Section 704(c) Gain or (Loss)

Beginning	$ 0
Ending	$ 0

Part III Partner's Share of Current Year Income, Deductions, Credits, and Other Items

1	Ordinary business income (loss)	
2	Net rental real estate income (loss)	74,862
3	Other net rental income (loss)	
4a	Guaranteed payments for services	
4b	Guaranteed payments for capital	
4c	Total guaranteed payments	
5	Interest income	
6a	Ordinary dividends	
6b	Qualified dividends	
6c	Dividend equivalents	
7	Royalties	
8	Net short-term capital gain (loss)	
9a	Net long-term capital gain (loss)	
9b	Collectibles (28%) gain (loss)	
9c	Unrecaptured section 1250 gain	
10	Net section 1231 gain (loss)	
11	Other income (loss)	
12	Section 179 deduction	
13	Other deductions	
14	Self-employment earnings (loss)	
15	Credits	
16	Schedule K-3 is attached if checked . . . . ▶ ☐	
17	Alternative minimum tax (AMT) items	
18	Tax-exempt income and nondeductible expenses	
19	Distributions	
20	Other information	
21	Foreign taxes paid or accrued	

22 ☐ More than one activity for at-risk purposes*

23 ☐ More than one activity for passive activity purposes*

*See attached statement for additional information.

For IRS Use Only

For Paperwork Reduction Act Notice, see the Instructions for Form 1065. www.irs.gov/Form1065 Cat. No. 11394R **Schedule K-1 (Form 1065) 2021**

Form **8825** (Rev. November 2018) Department of the Treasury Internal Revenue Service

Rental Real Estate Income and Expenses of a Partnership or an S Corporation

▶ Attach to Form 1065 or Form 1120S.

▶ Go to *www.irs.gov/Form8825* for the latest information.

OMB No. 1545-0123

Name	Employer identification number
Rocky Mountain Properties, LLC	75-1245678

1 Show the type and address of each property. For each rental real estate property listed, report the number of days rented at fair rental value and days with personal use. See instructions. See page 2 to list additional properties.

	Physical address of each property—street, city, state, ZIP code	Type—Enter code 1–8; see page 2 for list	Fair Rental Days	Personal Use Days
A	Property 1 Denver CO 8210	4	365	0
B	Property 2 Denver CO 8210	4	365	0
C	Property 3 Denver CO 8210	4	69	0
D				

		Properties A	Properties B	Properties C	Properties D
Rental Real Estate Income					
2 Gross rents	2	275,000	370,000	110,000	
Rental Real Estate Expenses					
3 Advertising	3	7,200	6,500	2,200	
4 Auto and travel	4				
5 Cleaning and maintenance	5				
6 Commissions	6				
7 Insurance	7	6,000	8,000	2,500	
8 Legal and other professional fees	8				
9 Interest (see instructions)	9	125,000		30,000	
10 Repairs	10	60,000	25,000		
11 Taxes	11	24,000	32,000	12,000	
12 Utilities	12	9,000	18,000	5,000	
13 Wages and salaries	13	36,000	42,000	12,000	
14 Depreciation (see instructions)	14	44,872	50,000	15,167	
15 Other (list) ▶ miscellaneous	15	5,700	7,100	3,400	
16 Total expenses for each property. Add lines 3 through 15	16	317,772	188,600	82,267	
17 Income or (loss) from each property. Subtract line 16 from line 2	17	-42,772	181,400	27,733	

18a Total gross rents. Add gross rents from line 2, columns A through H	18a	785,000
b Total expenses. Add total expenses from line 16, columns A through H	18b	(589,639)
19 Net gain (loss) from Form 4797, Part II, line 17, from the disposition of property from rental real estate activities	19	
20a Net income (loss) from rental real estate activities from partnerships, estates, and trusts in which this partnership or S corporation is a partner or beneficiary (from Schedule K-1)	20a	

b Identify below the partnerships, estates, or trusts from which net income (loss) is shown on line 20a. Attach a schedule if more space is needed.

(1) Name **(2)** Employer identification number

21 Net rental real estate income (loss). Combine lines 18a through 20a. Enter the result here and on: • **Form 1065 or 1120S:** Schedule K, line 2	21	166,361

For Paperwork Reduction Act Notice, see instructions. Cat. No. 10136Z Form **8825** (Rev. 11-2018)

1 Show the type and address of each property. For each rental real estate property listed, report the number of days rented at fair rental value and days with personal use. See instructions.

	Physical address of each property—street, city, state, ZIP code	Type—Enter code 1–8; see below for list	Fair Rental Days	Personal Use Days
E				
F				
G				
H				

		Properties E	Properties F	Properties G	Properties H
Rental Real Estate Income					
2 Gross rents	**2**				
Rental Real Estate Expenses					
3 Advertising	**3**				
4 Auto and travel	**4**				
5 Cleaning and maintenance	**5**				
6 Commissions	**6**				
7 Insurance	**7**				
8 Legal and other professional fees	**8**				
9 Interest (see instructions)	**9**				
10 Repairs	**10**				
11 Taxes	**11**				
12 Utilities	**12**				
13 Wages and salaries	**13**				
14 Depreciation (see instructions)	**14**				
15 Other (list) ▶	**15**				
16 Total expenses for each property. Add lines 3 through 15	**16**				
17 Income or (loss) from each property. Subtract line 16 from line 2	**17**				

Allowable Codes for Type of Property

1—Single Family Residence
2—Multi-Family Residence
3—Vacation or Short-Term Rental
4—Commercial
5—Land
6—Royalties
7—Self-Rental
8—Other (include description with the code on Form 8825 or on a separate statement)

General Instructions

Section references are to the Internal Revenue Code.

Future Developments

For the latest information about developments related to Form 8825 and its instructions, such as legislation enacted after they were published, go to *www.irs.gov/Form8825*.

Which Version To Use

Use this November 2018 revision of Form 8825 for tax years beginning in 2018 or later, until a later revision is issued. Use prior revisions of this form for earlier tax years. All revisions are available at *www.irs.gov/Form8825*.

What's New

• The Tax Reform Act of 2017 amended section 163(j) to reflect a limitation on business interest expense. For tax years beginning after December 31, 2017, business interest expense may be limited for certain taxpayers. See the instructions for line 9.

• The Bipartisan Budget Act of 2015 repealed the electing large partnership rules for tax years beginning after 2017. As a result, the references to Form 1065-B, U.S. Return of Income for Electing Large Partnerships, were removed.

Purpose of Form

Partnerships and S corporations use Form 8825 to report income and deductible expenses from rental real estate activities, including net income (loss) from rental real estate activities that flow through from partnerships, estates, or trusts.

Before completing this form, be sure to read the following.

• *Passive Activity Limitations* in the instructions for Form 1065 or Form 1120S, especially for the definition of "rental activity."

• *Extraterritorial Income Exclusion* in the instructions for Form 1065 or 1120S.

Specific Instructions

Form 8825 provides space for up to eight properties. If there are more than eight properties, attach additional Forms 8825.

The number of columns to be used for reporting income and expenses on this form may differ from the number of rental real estate activities the partnership or S corporation has for purposes of the passive activity limitations. For example, a partnership owns two apartment buildings, each located in a different city. For purposes of the passive activity limitations, the partnership grouped both buildings into a single activity. Although the partnership has only one rental real estate activity for purposes of the passive activity limitations, it must report the income and deductions for each building in separate columns.

However, if the partnership or S corporation has more than one rental real estate activity for purposes of the passive activity limitations, attach a statement to Schedule K that reports the net income (loss) for each separate activity. Also, attach a statement to each Schedule K-1 that reports each partner's or shareholder's share of the net income (loss) by separate activity. See *Passive Activity Reporting Requirements* in the instructions for Form 1065 or Form 1120S for additional information that must be provided for each activity.

Complete lines 1 through 17 for each property. But complete lines 18a through 21 on only one Form 8825. The figures on lines 18a and 18b should be the combined totals for all forms.

Do not report on Form 8825 any of the following.

• Income or deductions from a trade or business activity or a rental activity other than rental real estate. These items are reported elsewhere.

• Portfolio income or deductions.

• Section 179 expense deduction.

• Other items that must be reported separately to the partners or shareholders.

• Commercial revitalization deductions.

Line 1. For each property, give the street address, city or town, and zip code. If the property is located outside the United States, give the postal code and country. Specify the type of property by entering one of the following codes in the "Type" column.

Codes

1—Single Family Residence

2—Multi-Family Residence

3—Vacation or Short-Term Rental

4—Commercial

5—Land

6—Royalties

7—Self-Rental

8—Other (include description with the code on Form 8825 or on a separate statement)

For each property, enter the number of days rented at fair rental value and days with personal use. For details, see section 280A.

Line 9. Your interest expense may be limited. See the instructions for Form 8990, Business Interest Expense Limitation Under Section 163(j), for more information.

Line 14. The partnership or S corporation may claim a depreciation deduction each year for rental property (except for land, which is not depreciable). If the partnership or S corporation placed property in service during the current tax year or claimed depreciation on any vehicle or other listed property, complete and attach Form 4562, Depreciation and Amortization. See Form 4562 and its instructions to figure the depreciation deduction.

Paperwork Reduction Act Notice. We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by section 6103.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated burden for business taxpayers filing this form is approved under OMB control number 1545-0123 and is included in the estimates shown in the instructions for their business income tax return.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. See the instructions for the tax return with which this form is filed.

Form **8453-PE**

Department of the Treasury
Internal Revenue Service

E-file Declaration for Form 1065

(For return of partnership income or administrative adjustment request)

► **File electronically with the partnership's return or administrative adjustment request.**
(Don't file paper copies.)

► **Go to *www.irs.gov/Form8453PE* for the latest information.**

OMB No. 1545-0123

2021

For calendar year 2021, or tax year beginning , 2021, and ending , 20 .

Name of partnership	Employer identification number
Rocky Mountain Properties, LLC	75-1245678

Part I **Form 1065 Information** (whole dollars only)

1	Gross receipts or sales less returns and allowances (Form 1065, line 1c)	1	
2	Gross profit (Form 1065, line 3)	2	
3	Ordinary business income (loss) (Form 1065, line 22)	3	
4	Net rental real estate income (loss) (Form 1065, Schedule K, line 2)	4	166,361
5	Other net rental income (loss) (Form 1065, Schedule K, line 3c)	5	

Part II **Declaration of Partner or Member or Partnership Representative** (see instructions)
Be sure to keep a copy of the partnership's Return of Partnership Income or AAR.

I declare under penalties of perjury:
1a. If this Form 1065 is transmitted as part of a return of partnership income, I'm a partner or member of the above partnership.
b. If this Form 1065 is transmitted as part of an administrative adjustment request (AAR), I'm the partnership representative (PR).
2. The information I've given my electronic return originator (ERO), transmitter, and/or intermediate service provider (ISP) and the amounts in Part I above agree with the amounts on the corresponding lines of the partnership's Form 1065.
3. To the best of my knowledge and belief, the partnership's corresponding return or AAR is true, correct, and complete.
4. I consent to my ERO, transmitter, and/or ISP sending the partnership's return or AAR, this declaration, and accompanying forms, schedules and statements to the IRS.
5. I consent to the IRS sending my ERO, transmitter, and/or ISP an acknowledgment of receipt of transmission and an indication of whether or not the partnership's return or AAR is accepted and, if rejected, the reason(s) for the rejection.
6. If the processing of the partnership's return or AAR is delayed, I authorize the IRS to disclose to my ERO, transmitter, and/or ISP the reason(s) for the delay.

Sign Here ► Signature of partner or member or PR | Date ► | Title

Part III **Declaration of Electronic Return Originator (ERO) and Paid Preparer** (see instructions)

I declare that I've reviewed the above partnership's return or AAR and that the entries on Form 8453-PE are complete and correct to the best of my knowledge. If I'm only a collector, I'm not responsible for reviewing the return or AAR and only declare that this form accurately reflects the data on the return or AAR. The partner or member or PR will have signed this form before I submit the return or AAR. I'll give the partner or member or PR a copy of all forms and information to be filed with the IRS, and I've followed all other requirements in **Pub. 3112,** IRS *e-file* Application and Participation, and **Pub. 4163,** Modernized e-File (MeF) Information for Authorized IRS *e-file* Providers for Business Returns. If I'm also the Paid Preparer, under penalties of perjury, I declare that I've examined the above partnership's return or AAR and accompanying forms, schedules, and statements, and to the best of my knowledge and belief, they are true, correct, and complete. This Paid Preparer declaration is based on all information of which I've any knowledge.

ERO's Use Only	ERO's signature ►	Date	Check if also paid preparer ☐	Check if self-employed ☐	ERO's SSN or PTIN
	Firm's name (or yours if self-employed), address, and ZIP code ►			EIN	
				Phone no.	

Under penalties of perjury, I declare that I've examined the above partnership's return or AAR and accompanying forms, schedules, and statements, and to the best of my knowledge and belief, they are true, correct, and complete. This declaration is based on all information of which I've any knowledge.

Paid Preparer Use Only	Print/Type preparer's name	Preparer's signature	Date	Check if self-employed ☐	PTIN
	Firm's name ►			Firm's EIN ►	
	Firm's address ►			Phone no.	

For Privacy Act and Paperwork Reduction Act Notice, see instructions. Cat. No. 48316Z Form **8453-PE** (2021)

General Instructions

Future Developments

For the latest information about developments related to Form 8453-PE and its instructions, such as legislation enacted after they were published, go to *www.irs.gov/Form8453PE.*

Purpose of Form

Use Form 8453-PE to:

- Authenticate an electronic Form 1065, U.S. Return of Partnership Income, as part of return or AAR;
- Authorize the electronic return originator (ERO), if any, to transmit via a third-party transmitter; and
- Authorize the intermediate service provider (ISP) to transmit via a third-party transmitter if you're filing online (not using an ERO).

TIP *Instead of filing Form 8453-PE, a partner or member filing a partnership's return or AAR through an ERO can sign the return or AAR using a personal identification number (PIN). For details, see Form 8879-PE, E-file* Authorization for Form 1065.

Who Must File

If you're filing a 2021 Form 1065 through an ISP and/or transmitter and you're not using an ERO, you must file Form 8453-PE with your electronically filed return or AAR. An ERO can use either Form 8453-PE or Form 8879-PE to obtain authorization to file the partnership's Form 1065.

When and Where To File

File Form 8453-PE with the partnership's electronically filed return or AAR. Use a scanner to create a Portable Document Format (PDF) file of the completed form. Your tax preparation software will allow you to transmit this PDF file with the return or AAR.

Specific Instructions

Name. Print or type the partnership's name in the space provided.

Employer identification number (EIN). Enter the partnership's EIN in the space provided.

Part II—Declaration of Partner or Member or PR

If the Form 1065 is being transmitted and filed as part of a partnership return, then the declaration must be signed by a partner or member.

If the Form 1065 is being transmitted and filed as part of a partnership AAR, then the declaration must be signed by the PR; or designated individual, if the partnership representative is an entity.

If the ERO makes changes to the electronic return or AAR after Form 8453-PE has been signed by the partner or member or PR, whether it was before it was transmitted or if the return or AAR was rejected after transmission, the ERO must have the partner or member or PR complete and sign a corrected Form 8453-PE if either:

- The total income (loss) on Form 1065, line 8, differs from the amount on the electronic return or AAR by more than $150; or
- The ordinary business income (loss) on Form 1065, line 22, differs from the amount on the electronic return or AAR by more than $100.

Part III—Declaration of Electronic Return Originator (ERO) and Paid Preparer

Note: If the return or AAR is filed online through an ISP and/or transmitter (not using an ERO), don't complete Part III.

If the partnership's return or AAR is filed through an ERO, the IRS requires the ERO's signature. A paid preparer, if any, must sign Form 8453-PE in the space for Paid Preparer Use Only. But if the paid preparer is also the ERO, don't complete the paid preparer section. Instead, check the box labeled "Check if also paid preparer."

Use of PTIN

Paid preparers. Anyone who's paid to prepare the partnership's return or AAR must enter their PTIN in Part III. For information on applying for and receiving a PTIN, see Form W-12, IRS Paid Preparer Tax Identification Number (PTIN) Application and Renewal, or visit *www.irs.gov/PTIN.*

EROs who aren't paid preparers. Only EROs who aren't also the paid preparer of the return or AAR have the option to enter their PTIN or their social security number in the "ERO's Use Only" section of Part III. For information on applying for and receiving a PTIN, see Form W-12, IRS Paid Preparer Tax Identification Number (PTIN) Application and Renewal, or visit *www.irs.gov/PTIN*.

Privacy Act and Paperwork Reduction Act Notice. We ask for the information on this form to carry out the Internal Revenue laws of the United States. You're required to give us the information. We need it to ensure that you're complying with these laws and to allow us to figure and collect the right amount of tax. Internal Revenue Code section 6109 requires EROs to provide their identifying numbers on the return.

You aren't required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by Internal Revenue Code section 6103.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated burden for business taxpayers filing this form is approved under OMB control number 1545-0123 and is included in the estimates shown in the instructions for their business income tax return.

Comments. You can send us comments from *www.irs.gov/FormComments.* Or you can write to the Internal Revenue Service, Tax Forms and Publications Division, 1111 Constitution Ave. NW, IR-6526, Washington, DC 20224. **Don't send the form to this office.**

Form **4797**

Department of the Treasury
Internal Revenue Service

Sales of Business Property

(Also Involuntary Conversions and Recapture Amounts Under Sections 179 and 280F(b)(2))

► Attach to your tax return.

► Go to *www.irs.gov/Form4797* for instructions and the latest information.

OMB No. 1545-0184

2021

Attachment Sequence No. 27

Name(s) shown on return	Identifying number
Rocky Mountain Properties, LLC	75-1245678

1a	Enter the gross proceeds from sales or exchanges reported to you for 2021 on Form(s) 1099-B or 1099-S (or substitute statement) that you are including on line 2, 10, or 20. See instructions	**1a**	
b	Enter the total amount of gain that you are including on lines 2, 10, and 24 due to the partial dispositions of MACRS assets	**1b**	
c	Enter the total amount of loss that you are including on lines 2 and 10 due to the partial dispositions of MACRS assets	**1c**	

Part I Sales or Exchanges of Property Used in a Trade or Business and Involuntary Conversions From Other Than Casualty or Theft—Most Property Held More Than 1 Year (see instructions)

2 (a) Description of property	(b) Date acquired (mo., day, yr.)	(c) Date sold (mo., day, yr.)	(d) Gross sales price	(e) Depreciation allowed or allowable since acquisition	(f) Cost or other basis, plus improvements and expense of sale	(g) Gain or (loss) Subtract (f) from the sum of (d) and (e)
Land 1	07/01/2015	04/01/2021	500,000	0	250,000	250,000

3	Gain, if any, from Form 4684, line 39	**3**	
4	Section 1231 gain from installment sales from Form 6252, line 26 or 37	**4**	
5	Section 1231 gain or (loss) from like-kind exchanges from Form 8824	**5**	
6	Gain, if any, from line 32, from other than casualty or theft	**6**	
7	Combine lines 2 through 6. Enter the gain or (loss) here and on the appropriate line as follows	**7**	250,000
	Partnerships and S corporations. Report the gain or (loss) following the instructions for Form 1065, Schedule K, line 10, or Form 1120-S, Schedule K, line 9. Skip lines 8, 9, 11, and 12 below.		
	Individuals, partners, S corporation shareholders, and all others. If line 7 is zero or a loss, enter the amount from line 7 on line 11 below and skip lines 8 and 9. If line 7 is a gain and you didn't have any prior year section 1231 losses, or they were recaptured in an earlier year, enter the gain from line 7 as a long-term capital gain on the Schedule D filed with your return and skip lines 8, 9, 11, and 12 below.		
8	Nonrecaptured net section 1231 losses from prior years. See instructions	**8**	
9	Subtract line 8 from line 7. If zero or less, enter -0-. If line 9 is zero, enter the gain from line 7 on line 12 below. If line 9 is more than zero, enter the amount from line 8 on line 12 below and enter the gain from line 9 as a long-term capital gain on the Schedule D filed with your return. See instructions	**9**	

Part II Ordinary Gains and Losses (see instructions)

10 Ordinary gains and losses not included on lines 11 through 16 (include property held 1 year or less):

11	Loss, if any, from line 7	**11**	( )
12	Gain, if any, from line 7 or amount from line 8, if applicable	**12**	
13	Gain, if any, from line 31	**13**	
14	Net gain or (loss) from Form 4684, lines 31 and 38a	**14**	
15	Ordinary gain from installment sales from Form 6252, line 25 or 36	**15**	
16	Ordinary gain or (loss) from like-kind exchanges from Form 8824	**16**	
17	Combine lines 10 through 16	**17**	
18	For all except individual returns, enter the amount from line 17 on the appropriate line of your return and skip lines a and b below. For individual returns, complete lines a and b below.		
a	If the loss on line 11 includes a loss from Form 4684, line 35, column (b)(ii), enter that part of the loss here. Enter the loss from income-producing property on Schedule A (Form 1040), line 16. (Do not include any loss on property used as an employee.) Identify as from "Form 4797, line 18a." See instructions	**18a**	
b	Redetermine the gain or (loss) on line 17 excluding the loss, if any, on line 18a. Enter here and on Schedule 1 (Form 1040), Part I, line 4	**18b**	

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 13086I Form **4797** (2021)

Part III Gain From Disposition of Property Under Sections 1245, 1250, 1252, 1254, and 1255 (see instructions)

19	(a) Description of section 1245, 1250, 1252, 1254, or 1255 property:	(b) Date acquired (mo., day, yr.)	(c) Date sold (mo., day, yr.)
A			
B			
C			
D			

	These columns relate to the properties on lines 19A through 19D. ▶		Property A	Property B	Property C	Property D
20	Gross sales price (**Note:** *See line 1a before completing.*)	20				
21	Cost or other basis plus expense of sale	21				
22	Depreciation (or depletion) allowed or allowable	22				
23	Adjusted basis. Subtract line 22 from line 21	23				
24	Total gain. Subtract line 23 from line 20	24				
25	**If section 1245 property:**					
a	Depreciation allowed or allowable from line 22	25a				
b	Enter the **smaller** of line 24 or 25a	25b				
26	**If section 1250 property:** If straight line depreciation was used, enter -0- on line 26g, except for a corporation subject to section 291.					
a	Additional depreciation after 1975. See instructions	26a				
b	Applicable percentage multiplied by the **smaller** of line 24 or line 26a. See instructions	26b				
c	Subtract line 26a from line 24. If residential rental property **or** line 24 isn't more than line 26a, skip lines 26d and 26e	26c				
d	Additional depreciation after 1969 and before 1976	26d				
e	Enter the **smaller** of line 26c or 26d	26e				
f	Section 291 amount (corporations only)	26f				
g	Add lines 26b, 26e, and 26f	26g				
27	**If section 1252 property:** Skip this section if you didn't dispose of farmland or if this form is being completed for a partnership.					
a	Soil, water, and land clearing expenses	27a				
b	Line 27a multiplied by applicable percentage. See instructions	27b				
c	Enter the **smaller** of line 24 or 27b	27c				
28	**If section 1254 property:**					
a	Intangible drilling and development costs, expenditures for development of mines and other natural deposits, mining exploration costs, and depletion. See instructions	28a				
b	Enter the **smaller** of line 24 or 28a	28b				
29	**If section 1255 property:**					
a	Applicable percentage of payments excluded from income under section 126. See instructions	29a				
b	Enter the **smaller** of line 24 or 29a. See instructions	29b				

Summary of Part III Gains. Complete property columns A through D through line 29b before going to line 30.

30	Total gains for all properties. Add property columns A through D, line 24	30	
31	Add property columns A through D, lines 25b, 26g, 27c, 28b, and 29b. Enter here and on line 13	31	
32	Subtract line 31 from line 30. Enter the portion from casualty or theft on Form 4684, line 33. Enter the portion from other than casualty or theft on Form 4797, line 6	32	

Part IV Recapture Amounts Under Sections 179 and 280F(b)(2) When Business Use Drops to 50% or Less (see instructions)

			(a) Section 179	(b) Section 280F(b)(2)
33	Section 179 expense deduction or depreciation allowable in prior years	33		
34	Recomputed depreciation. See instructions	34		
35	Recapture amount. Subtract line 34 from line 33. See the instructions for where to report	35		

Form **4797** (2021)

Form **4562**

Department of the Treasury
Internal Revenue Service (99)

Depreciation and Amortization

(Including Information on Listed Property)

▶ Attach to your tax return.

▶ Go to *www.irs.gov/Form4562* for instructions and the latest information.

OMB No. 1545-0172

2021

Attachment Sequence No. 179

Name(s) shown on return	Business or activity to which this form relates	Identifying number
Rocky Mountain Properties, LLC	1065-Real Estate Investment	75-1245678

Part I **Election To Expense Certain Property Under Section 179**

Note: If you have any listed property, complete Part V before you complete Part I.

1	Maximum amount (see instructions)	1	
2	Total cost of section 179 property placed in service (see instructions)	2	
3	Threshold cost of section 179 property before reduction in limitation (see instructions)	3	
4	Reduction in limitation. Subtract line 3 from line 2. If zero or less, enter -0-	4	
5	Dollar limitation for tax year. Subtract line 4 from line 1. If zero or less, enter -0-. If married filing separately, see instructions	5	

6 (a) Description of property	(b) Cost (business use only)	(c) Elected cost
7 Listed property. Enter the amount from line 29	7	

8	Total elected cost of section 179 property. Add amounts in column (c), lines 6 and 7	8	
9	Tentative deduction. Enter the **smaller** of line 5 or line 8	9	
10	Carryover of disallowed deduction from line 13 of your 2020 Form 4562	10	
11	Business income limitation. Enter the smaller of business income (not less than zero) or line 5. See instructions	11	
12	Section 179 expense deduction. Add lines 9 and 10, but don't enter more than line 11	12	
13	Carryover of disallowed deduction to 2022. Add lines 9 and 10, less line 12 ▶ 13		

Note: Don't use Part II or Part III below for listed property. Instead, use Part V.

Part II **Special Depreciation Allowance and Other Depreciation (Don't** include listed property. See instructions.)

14	Special depreciation allowance for qualified property (other than listed property) placed in service during the tax year. See instructions	14	
15	Property subject to section 168(f)(1) election	15	
16	Other depreciation (including ACRS)	16	

Part III **MACRS Depreciation (Don't** include listed property. See instructions.)

Section A

17	MACRS deductions for assets placed in service in tax years beginning before 2021	17	110,039
18	If you are electing to group any assets placed in service during the tax year into one or more general asset accounts, check here ▶ ☐		

Section B—Assets Placed in Service During 2021 Tax Year Using the General Depreciation System

(a) Classification of property	(b) Month and year placed in service	(c) Basis for depreciation (business/investment use only—see instructions)	(d) Recovery period	(e) Convention	(f) Method	(g) Depreciation deduction
19a 3-year property						
b 5-year property						
c 7-year property						
d 10-year property						
e 15-year property						
f 20-year property						
g 25-year property			25 yrs.		S/L	
h Residential rental property			27.5 yrs.	MM	S/L	
			27.5 yrs.	MM	S/L	
i Nonresidential real property			39 yrs.	MM	S/L	
				MM	S/L	

Section C—Assets Placed in Service During 2021 Tax Year Using the Alternative Depreciation System

(a) Classification of property	(b) Month and year placed in service	(c) Basis for depreciation	(d) Recovery period	(e) Convention	(f) Method	(g) Depreciation deduction
20a Class life					S/L	
b 12-year			12 yrs.		S/L	
c 30-year			30 yrs.	MM	S/L	
d 40-year			40 yrs.	MM	S/L	

Part IV **Summary** (See instructions.)

21	Listed property. Enter amount from line 28	21	
22	**Total.** Add amounts from line 12, lines 14 through 17, lines 19 and 20 in column (g), and line 21. Enter here and on the appropriate lines of your return. Partnerships and S corporations—see instructions	22	110,039
23	For assets shown above and placed in service during the current year, enter the portion of the basis attributable to section 263A costs	23	

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 12906N Form **4562** (2021)

Part V Listed Property (Include automobiles, certain other vehicles, certain aircraft, and property used for entertainment, recreation, or amusement.)

Note: For any vehicle for which you are using the standard mileage rate or deducting lease expense, complete **only** 24a, 24b, columns (a) through (c) of Section A, all of Section B, and Section C if applicable.

Section A—Depreciation and Other Information (Caution: See the instructions for limits for passenger automobiles.**)**

24a Do you have evidence to support the business/investment use claimed? ☐ **Yes** ☐ **No** **24b** If "Yes," is the evidence written? ☐ **Yes** ☐ **No**

(a) Type of property (list vehicles first)	(b) Date placed in service	(c) Business/ investment use percentage	(d) Cost or other basis	(e) Basis for depreciation (business/investment use only)	(f) Recovery period	(g) Method/ Convention	(h) Depreciation deduction	(i) Elected section 179 cost
25 Special depreciation allowance for qualified listed property placed in service during the tax year and used more than 50% in a qualified business use. See instructions						**25**		
26 Property used more than 50% in a qualified business use:								
		%						
		%						
		%						
27 Property used 50% or less in a qualified business use:								
		%				S/L –		
		%				S/L –		
		%				S/L –		
28 Add amounts in column (h), lines 25 through 27. Enter here and on line 21, page 1						**28**		
29 Add amounts in column (i), line 26. Enter here and on line 7, page 1							**29**	

Section B—Information on Use of Vehicles

Complete this section for vehicles used by a sole proprietor, partner, or other "more than 5% owner," or related person. If you provided vehicles to your employees, first answer the questions in Section C to see if you meet an exception to completing this section for those vehicles.

	(a) Vehicle 1		(b) Vehicle 2		(c) Vehicle 3		(d) Vehicle 4		(e) Vehicle 5		(f) Vehicle 6	
30 Total business/investment miles driven during the year (**don't** include commuting miles)												
31 Total commuting miles driven during the year												
32 Total other personal (noncommuting) miles driven												
33 Total miles driven during the year. Add lines 30 through 32												
	Yes	**No**	**Yes**	**No**	**Yes**	**No**	**Yes**	**No**	**Yes**	**No**	**Yes**	**No**
34 Was the vehicle available for personal use during off-duty hours?												
35 Was the vehicle used primarily by a more than 5% owner or related person?												
36 Is another vehicle available for personal use?												

Section C—Questions for Employers Who Provide Vehicles for Use by Their Employees

Answer these questions to determine if you meet an exception to completing Section B for vehicles used by employees who **aren't** more than 5% owners or related persons. See instructions.

	Yes	No
37 Do you maintain a written policy statement that prohibits all personal use of vehicles, including commuting, by your employees?		
38 Do you maintain a written policy statement that prohibits personal use of vehicles, except commuting, by your employees? See the instructions for vehicles used by corporate officers, directors, or 1% or more owners		
39 Do you treat all use of vehicles by employees as personal use?		
40 Do you provide more than five vehicles to your employees, obtain information from your employees about the use of the vehicles, and retain the information received?		
41 Do you meet the requirements concerning qualified automobile demonstration use? See instructions.		
Note: If your answer to 37, 38, 39, 40, or 41 is "Yes," don't complete Section B for the covered vehicles.		

Part VI Amortization

(a) Description of costs	(b) Date amortization begins	(c) Amortizable amount	(d) Code section	(e) Amortization period or percentage	(f) Amortization for this year
42 Amortization of costs that begins during your 2021 tax year (see instructions):					
Business start-up costs	2017	15,000		15 years	1,000
43 Amortization of costs that began before your 2021 tax year				**43**	
44 **Total.** Add amounts in column (f). See the instructions for where to report				**44**	1,000

Form **4562** (2021)

Distribution of appreciated property by the LLC to a member

General

Distributions are treated very differently under subchapter K compared with subchapter S. Although both a partnership/LLC and an S corporation are pass-through entities, they are subject to very different rules regarding distributions from the entity to its members. Distributions of appreciated property by either a regular corporation or an S corporation are fully taxable to both the entity and the recipient shareholder. The general framework for appreciated property distributions by corporations is provided in Section 311(b). Under that framework, the transaction is akin to the sale of such property for its FMV followed by a distribution to the shareholder of the net proceeds from the deemed sale.

Under subchapter K, in contrast, distributions of appreciated property by the partnership to a partner are generally tax-free to both the entity and the distributee-partner. If the distribution is in complete liquidation of the partner's interest, as in this case, the partner's basis in property received is generally equal to his outside basis in the partnership interest, reduced by any cash included in the distribution.[1] This "substitute" basis rule applies regardless of the partnership or LLC's tax basis in the distributed property. Thus, most of the time, the partner's tax basis in property received in a liquidating distribution will differ from the partnership's tax basis in the distributed property. We will address how to account for such differences later in this chapter.

Example 4-1

Rebecca's outside basis in her partnership interest is $25,000. In complete liquidation of that interest, she receives property with an aggregate FMV of $50,000 and an aggregate basis to the partnership of $17,000. Under Section 732(b), Rebecca's aggregate basis in the assets received will be $25,000, notwithstanding the fact that the aggregate basis of these properties to the partnership was only $17,000. (Had the partnership's basis in the distributed properties been $37,000, Rebecca would still take an aggregate basis of $25,000.)

[1] Section 732(b). If the partner/member receives more than one property, she takes an aggregate basis in the properties received equal to the outside basis of the partnership interest.

The rationale for the substitute basis requirement of Section 732(b) is that the partner’s remaining outside basis in the partnership interest must be zero after the distribution, because the partnership interest no longer exists. Thus, the entire pre-distribution outside basis must be assigned to the property or properties received in the liquidating distribution.

Distributions to “contributing” partners — Section 737

A significant exception to the nonrecognition rules generally applicable to partnership distributions is found in Sections 704(c)(1)(B) and 737. Under Section 704(c)(1)(B), “built-in gain” attributable to the contribution of appreciated property to the partnership must be recognized upon a *disposition* by the partnership of the contributed property. For this purpose, the term disposition includes a distribution of Section 704(c) property (“contributed” property) to any partner *other than the contributor*. Upon such a distribution, any remaining built-in gain inherent in the contributed property must be recognized by the contributing partner.

One way to subvert this rule would be for the contributing partner to leave the partnership before the contributed property is sold, exchanged, or otherwise disposed of. Section 737 blocks this strategy. Under Section 737, a “contributing” partner will recognize any remaining built-in gain inherent in contributed property upon the receipt of any distribution from the LLC or partnership, other than the contributed asset(s), to the extent that the value of the distribution exceeds the partner/member’s tax basis in the partnership/LLC interest. This provision applies whether the distribution is received in partial or full liquidation of the partner/member’s interest in the entity.

Section 737 prevents the contributing partner from shifting the built-in gain inherent in contributed property to other partners by liquidating his interest in the partnership prior to the partnership's distribution or other disposition of the contributed property. If the contributing partner is no longer a partner when the contributed property is sold or distributed, she could not be required to recognize any gain under the provisions of subchapter K. Thus, the remaining partners in the partnership would recognize the contributing partner's built-in gain upon any subsequent disposition. Section 737 closes this loophole by forcing the contributing partner to recognize some or all of the built-in gain upon the receipt of a distribution from the partnership of property with an FMV greater than the partner’s tax basis in the partnership interest.

Section 737 applies to all distributions received by the contributor within seven years of the contribution of appreciated or depreciated property to the partnership or LLC.

Example 4-2

Margaret acquired a one-third interest in MNO, LLC, in exchange for the contribution of property (tract 1) with an FMV of $60,000 and a tax basis of $25,000. The LLC elected to be treated as a partnership for federal income tax purposes. In its first year of operations, the LLC's income just equaled its expenses. At the end of that year, the LLC distributed another property (tract 2) to Margaret, reducing her interest in the LLC from one-third to one-fifth. The property received by Margaret was valued at $30,000. Under Section 737, Margaret will recognize $5,000 of the built-in gain inherent in tract 1 upon receipt of tract 2. The gain recognized is equal to the excess of the value of tract 2 ($30,000) over Margaret's tax basis in her interest in the LLC ($25,000, the basis of the property she contributed to the LLC in exchange for that interest). **Note:** This example assumes that the LLC has no debt and that Margaret received no other distributions from the LLC.

Note that the gain triggered by Section 737 will not exceed the remaining built-in gain subject to the provisions of Section 704(c). Thus, in example 4-2, had the value of tract 2 been $90,000 rather than $30,000, Margaret would have recognized only $35,000 gain under Section 737, although the value of tract 2 exceeded her basis in her partnership interest by $65,000. Because she is still a member of the LLC, she will recognize the remaining built-in gain inherent in tract 1 when it is sold or otherwise disposed of by the LLC.

Key review point

Rocky Mountain Properties distributed a retail center to Bob Cantu in complete liquidation of his interest. Bob had originally acquired his interest in the LLC six years earlier in exchange for appreciated land. The land contributed by Bob was not part of the retail center he received in liquidation of his interest. Thus, Bob will be required to recognize the built-in gain inherent in the land upon receipt of the distribution. The gain should be reported on the partnership's 2021 Form 1065 and allocated entirely to Bob. It is properly reported on line 10 of Bob's Schedule K-1. Note that this gain, taxed to Bob, will also increase the LLC's tax basis in the land originally contributed by Bob, but retained by the LLC after his departure.

Effect of Section 737 on tax basis

Any gain recognized by a contributing partner/member under Section 737 increases her basis in her partnership interest. Moreover, the increase in the basis of the partnership interest is deemed to occur immediately *before* the distribution. Thus, the effect of the gain on the partner's tax basis in the partnership interest is accounted for before the effect of the distribution on that basis. Note that to the extent that the recognized gain increases the partner's tax basis in the partnership interest, it may also increase the partner's tax basis in the distributed property (because the basis of the property received may not exceed the partner's tax basis in the partnership interest). However, this is an incidental effect that applies only in situations where the tax basis of the distributed property is limited to the partner's tax basis in the partnership interest.

In addition, it must be emphasized that any gain recognized under Section 737 also increases the partnership's tax basis in the property originally contributed by the partner receiving the distribution of other property from the partnership. This is necessary to prevent the built-in gain inherent in the contributed property from being shifted to other partners. For example, in the current case, Bob Cantu contributed appreciated property (land) to Rocky Mountain Properties to acquire his interest in the LLC. After receipt of the retail center, he is no longer a member of the LLC. He recognized the built-in gain inherent in the land upon receipt of the retail center under Section 737. The LLC now needs to increase the tax basis of the land to eliminate the built-in gain or the other partners will have to recognize it on the future disposition of the land. Because Bob has already recognized the gain, requiring the other partners to later recognize it again would be double-counting. Thus, Section 737 contains a mechanism allowing the partnership to increase its tax basis of the land by the amount of Bob's Section 737 gain.

Knowledge check

1. Karen contributed a tract of land with a tax basis of $125,000 and an FMV of $360,000 to an LLC, KLO. Within seven years, she received a distribution from the partnership of a different tract of real estate valued at $230,000 with a tax basis of $175,000. At the time she received the distribution, her tax basis in her interest in KLO was $145,000. How much gain must she recognize under Section 737?

    a. $30,000.
    b. $105,000.
    c. $85,000.
    d. $55,000.

2. What will be KLO's tax basis in the land contributed by Karen?

    a. $125,000.
    b. $230,000.
    c. $180,000.
    d. $210,000.

Key review point

The LLC's tax basis in the land contributed by Bob is increased by the gain allocated to Bob under Section 737. Thus, the LLC's tax basis in the land will be increased to its Section 704(b) book value, which was the value of the land at the date it was contributed by Bob. With the distribution to Bob, the LLC's tax and book balance sheets are identical. Although the LLC could elect to revalue its assets, there is no need to do so as the remaining members' capital accounts are equal, consistent with their 50% interests in the remaining LLC assets.

Although not reported on the tax return, it is important to determine Bob's tax basis in property 3. This determination is, of course, important to Bob. But it is also important to the LLC because it will be required to adjust the tax basis of its remaining assets to the extent that Bob's tax basis in property 3 differs from the LLC's basis in that asset immediately prior to its distribution to Bob. This adjustment is discussed in the next segment. Because this is a liquidating distribution, Bob will take a tax basis in property 3 equal to his tax basis in his interest in the LLC just before receipt of the liquidating distribution.

Bob's tax basis in his LLC interest at the beginning of the year is equal to his $550,000 capital balance on the tax balance sheet plus his share of LLC liabilities. As will be illustrated later in the chapter, his share of the LLC's liabilities prior to his departure from the LLC is $1,950,000. Thus, his tax basis on January 1, 2021, was $2,500,000. This basis is adjusted as follows in determining his tax basis in the distributed property:

Beginning tax basis in LLC interest	$2,500,000
Share of LLC income prior to liquidation of his interest	16,637
Share of LLC Section 1231 gain (attributable to Sec. 737)	250,000
Assumption of $2,000,000 liability on property 3	2,000,000
Reduction in share of LLC liabilities	(1,950,000)
Tax basis in LLC interest just prior to receipt of property 3	2,816,637

This will be Bob's tax basis in the property (property 3) received in the liquidating distribution from the LLC.

Section 737 creates a significant exception to the general partnership rule that distributions are nontaxable. They also introduce a considerable level of complexity to the taxation of partnerships and LLCs. Although the treatment of distributions under subchapter K remains more "taxpayer friendly" than that of subchapters C and S, it is also far more complex. The benefits of proper planning are accordingly much larger, as are the potential traps for the unwary.

Section 734(b) — Adjusting the basis of remaining partnership assets following a distribution of property by the partnership

General

Partnerships offer more flexibility in tax planning than any other form of business. One area that exemplifies this flexibility is the ability of the partnership to adjust the basis of partnership assets to reflect the economic reality of certain transactions between the partnership and one or more of its partners, and even between two or more partners outside the partnership.

These basis adjustments are made under either Section 734 or Section 743, depending on the nature of the transaction that triggers them. Generally, basis adjustments are required only if the partnership makes or has previously made an election under Section 754. However, where the basis adjustment is "substantial," as defined in Section 734(d), the IRC requires that it be made whether or not the partnership has a Section 754 election in effect. Section 734(d) provides that a *substantial basis adjustment* is one that is greater than $250,000.

Basis adjustments under Section 743(b), following the sale of an interest in the partnership, were illustrated in the Agricultural Pump & Service case in chapter 3. The current case involves the distribution of appreciated property in liquidation of a partner's interest in the partnership. In such cases, the partner takes a substitute basis in the property received equal to his or her tax basis in the partnership interest being liquidated. The partnership's tax basis in the distributed property is not considered in determining the liquidating partner's basis in such property; indeed, the partner's tax basis will generally differ from the partnership's basis, sometimes by a considerable amount.

Increase or decrease in basis of assets distributed in complete liquidation of a partner's interest

The provisions of Section 734(b) are triggered when a distribution results in a stepped-up or stepped-down basis in the distributed property in the hands of the distributee-partner, though no gain or loss is recognized.[2] For example, under Section 732(b), a partner receiving a property distribution in complete liquidation of his or her partnership interest takes a basis in the property received equal to the remaining basis in his partnership interest (after reduction for any cash received in the distribution), regardless of the basis the partnership had in the distributed property.

[2] Section 734(b)(1)(B) and (b)(2)(B).

If the partnership's basis in the distributed property differs from this amount, as will generally be the case, the total of the gain recognized by the distributee-partner on a subsequent sale of the distributed assets and the gain recognized within the partnership on the sale of undistributed assets will differ from the total gain that would have been recognized if the distributee-partner remained a partner and all assets were sold within the partnership. A Section 734(b) adjustment will avoid this problem. The amount of the adjustment is measured by the difference between the basis of the distributed property to the partnership and its basis in the hands of the recipient partner.

Key review point

As determined previously, Bob will take a basis in property 3 of $2,816,637. The LLC's tax basis in property 3, including the land, is calculated as follows:

Cost of the land	$272,000
Cost of the building	2,028,000
Accumulated depreciation, Jan. 1, 2021	(45,500)
Depreciation expense, 3.5 months	(15,167)
LLC tax basis in property 3, including land	2,239,333

Bob's tax basis in the property is $577,304 higher than the LLC's tax basis in the property. The LLC's basis adjustment under Section 734(b) will therefore be negative $577,304. It must reduce its tax basis in its remaining properties by this amount.

Note also that the Section 734(b) adjustment is necessary to balance the LLC balance sheet. Bob's tax basis in the interest is higher than the tax basis of property 3, including land. This excess will remain in his capital account, yet he is no longer a member of the LLC. To solve this problem, the LLC will have to reduce his capital account by the same amount as it reduces the tax basis of its assets. This reduction is reflected in the capital account analysis (Section L) on Bob's K-1. The $2,000,000 capital contribution listed in this analysis reflects the liability assumed by Bob in connection with receipt of property 3.

Key review point

Note that Section 734(a) requires that the basis adjustment calculated under Section 734(b) be applied if either the partnership has a Section 754 election in effect OR the adjustment calculated under Section 734(b) is "substantial." Section 734(d) defines a *substantial* adjustment as one in excess of $250,000. Thus, Rocky Mountain Properties must make the Section 734(b) adjustment whether or not it has previously made an election under Section 754.

Allocating the adjustment amount among partnership properties

Assuming the partnership makes a Section 754 election or already has one in effect, the partnership must adjust the tax basis of its remaining assets following a distribution in which the recipient takes a different tax basis in the distributed property than the partnership had. This allocation must be made in a manner that will reduce the difference between the fair market value and the adjusted basis of the partnership properties.

The allocation of a Section 734(b) adjustment is made to assets of the same character as those that gave rise to the adjustment. For this purpose, all assets of the partnership are classified as either capital gain assets or ordinary income assets.

Where, as in the case of Rocky Mountain Properties, the adjustment is the result of a distribution in which the basis of the property distributed was increased or decreased, the adjustment must be made to property of a similar character to the distributed property from which the adjustment arose.[3] Any increase in the basis of property distributed (for example, from a liquidating distribution where the inside basis of distributed property is less than the partner's outside basis) will result in a decrease in the basis of partnership property of the same class as the property whose basis was increased as part of the distribution. Any decrease in the basis of property distributed (for example, from a distribution where the inside basis of distributed property is greater than the partner's outside basis) will result in an increase in the basis of partnership property of the same class as the property whose basis was increased as part of the distribution. This approach attempts to preserve not only the amount, but also the character, of the gain or loss to be recognized by the other partners.

Once the character of the asset is determined, the adjustment should be made in the following manner:

1. An increase in basis will be made first to assets that have appreciated, to the extent of their appreciation, and any remaining increase will be allocated according to the relative FMV of the properties in that class of property.
2. A decrease in basis must first be allocated to depreciated assets to the extent of their depreciation, and any further decrease would be allocated to property of the same class in proportion to the relative adjusted basis of the properties in that class.

Where an increase or decrease in the basis of undistributed property cannot be made because the partnership owns no property of the same character or because the basis of all the property of the same character has been reduced to zero, the adjustment will be made when the partnership subsequently acquires property of a like character to which an adjustment can be made.

[3] Regulation Section 1.755-1(b)(1)(i).

Example 4-3

The ABC Partnership has the following balance sheets:

	Basis	FMV
Cash	$ 20,000	$ 20,000
Property 1	50,000	40,000
Property 2	10,000	60,000
Property 3	55,000	60,000
	$ 135,000	$ 180,000
Capital, A	$ 45,000	$ 60,000
Capital, B	45,000	60,000
Capital, C	45,000	60,000
	$ 135,000	$ 180,000

Assume the partnership distributes property 3 to partner B in complete liquidation of her partnership interest. Under Section 731, partner B will recognize no gain or loss on the distribution. Under Section 732, she will take a substitute basis in the property equal to her basis in her partnership interest immediately prior to the distribution (reduced by any cash received in the distribution). Thus, B's basis in property 1 will be $60,000, a step-down of ($10,000) in the basis of this asset. The partnership's balance sheets immediately after the distribution will be as follows:

	Basis	FMV
Cash	$ 20,000	$ 20,000
Property 1	50,000	40,000
Property 2	10,000	60,000
	$ 80,000	$ 120,000
Capital, A	$ 45,000	$ 60,000
Capital, C	45,000	60,000
	$ 90,000	$ 120,000

Example 4-3 (continued)

Upon a subsequent sale of property 3, B will recognize a $15,000 gain. Upon a subsequent sale of properties 1 and 2, the partnership will recognize a net $40,000 gain. Thus, the total gain to be recognized upon sale of the properties has increased by $10,000 as a result of the distribution to B. If a Section 754 election is in effect, Section 734(b) requires the partnership to increase its basis in remaining assets by $10,000 to reflect the step-up in the basis of property 3 resulting from the distribution to B. Because Property 2 is the only property that has appreciated in value, the positive Section 734(b) adjustment will be allocated entirely to Property 2. The partnership's post-distribution, post-adjustment balance sheet would then appear as follows:

	Basis	FMV
Cash	$ 20,000	$ 20,000
Property 1	50,000	40,000
Property 2	20,000	60,000
	$ 90,000	$ 120,000
Capital, A	$ 45,000	$ 60,000
Capital, C	45,000	60,000
	$ 90,000	$ 120,000

Now the sale of the partnership's remaining asset will trigger a $30,000 gain, which will be shared equally by each of the remaining partners. The net result is that each partner will recognize $15,000 gain upon the future sale of the properties they own (either directly or through the partnership). This is the intent of Section 734(b).

Key review point

Rocky Mountain Properties must allocate the $577,304 negative basis adjustment among remaining properties in the same class. This would include properties 1 and 2 and associated land. Assume that none of these properties has basis in excess of value. In such cases, the negative adjustment is allocated among the four assets in proportion to their tax bases. Making the adjustment at year-end, the remaining tax bases of the four assets, and the associated allocation of the negative Section 734(b) adjustment, would proceed as follows:

	Adjusted tax basis	Percent of total	Section 734(b) adj.
Property 1	$1,471,420	37.27%	($215,161)
Property 2	1,777,083	45.00%	(259,787)
Land — property 1	500,000*	12.66%	(73,087)
Land — property 2	200,000	5.07%	(29,269)
	$3,948,503	100%	($577,304)

* Basis has already been increased by the Section 737 gain recognized by Bob.

These figures tie to those in the ending balance sheet presented at the beginning of this chapter.

Note that the basis adjustment in this case has been allocated at the end of the year (that is, as of December 31, 2021). The regulations under Section 734(b) do not address the timing of the adjustments. An earlier adjustment would complicate the computation of depreciation and would require special allocations of depreciation expense because Bob would be entitled to 40% of the depreciation calculated for the first three months of the year and none for the remainder. Chelsea and Amelia would be allocated 30% each of the first three months' depreciation and 50% each of the last nine months' depreciation. It is not clear whether the midmonth convention would be applicable in the case of a negative basis adjustment because this is neither an addition nor a disposition of property. The midmonth convention presumably does apply to the depreciation of property 3, which was distributed to Bob on April 1. Thus, the LLC would claim 3.5 months' depreciation on property 3 on Form 1065 and Bob would claim 8.5 months on his individual tax return. Accounting for the basis adjustment at the end of the year, as is done in this tax return, will affect the depreciation calculations for 2022 and beyond, but not for 2021.

Allocation of nonrecourse debts

Conceptual difficulties in allocating nonrecourse liabilities

As discussed, nonrecourse liabilities are those liabilities for which no partner or LLC member (or related person) bears personal risk of loss. In the event of default by the entity, the lender can foreclose upon any property serving as collateral for the loan but has no further recourse against either the partnership or LLC or any partner therein. If the lender is itself a partner or LLC member or is related to a partner or member, then at least one partner bears personal risk of loss and the liability. Although structured as a nonrecourse loan, it will be treated as a recourse loan for purposes of Section 752 (subject to the *de minimis* exceptions of Regs. Sec. 1.752-2(d)). Similarly, if the loan is guaranteed by one or more partners, then it will not be treated as a nonrecourse loan under Section 752.

Nonrecourse liabilities create interesting problems from a tax policy standpoint. Although none of the partners has any personal obligation to repay them, the lender would not make a loan that it did not expect to be repaid, so the indebtedness is real. It therefore is included in each partner's tax basis. The question then becomes how to allocate the debt (and the related tax basis) among the partners. An evaluation of the partners' economic risks is irrelevant to the question — none of them has any economic risk. Thus, the question becomes how the partners will share in the repayment of the loan. Historically, Section 752 has looked to the partners' interests in partnership profits to answer this question.

Nonrecourse liabilities allocated by reference to partners' profits interests

If they are to be repaid at all, partnership nonrecourse liabilities will essentially be paid from partnership profits. If the partnership is not profitable, it will be more likely to default on the loan. Thus, the regulations provide that nonrecourse liabilities are to be allocated in accordance with the partners' profit-sharing ratios. The regulations do, however, give priority to certain kinds of partnership profits over others. In particular, because partnership minimum gain is used in the Section 704(b) regulations as a mechanism for restoring deficit capital balances, the Section 752 regulations look first to minimum gain to guide the allocation of partnership liabilities.

Minimum gain

Partnership minimum gain is the gain that will be recognized by the partnership upon a disposition of property encumbered by a nonrecourse debt, even if the property becomes worthless. Because the satisfaction of nonrecourse debt in exchange for the encumbered property (for example, as in foreclosure) is treated as a sale or exchange, the minimum sales price that can be realized from the disposition of any property is the amount of the outstanding nonrecourse debt encumbering that property. Thus, where the book value (in other words, Section 704(b) value) of the property falls below the outstanding principal balance of the nonrecourse mortgage, the minimum amount of gain that would be recognized upon disposition of such property is the difference between the basis of the property and the remaining principal. More gain could be recognized, but never less.

Example 4-4

Partnership GH owns real estate acquired several years ago with a remaining tax basis of $500,000. The property is encumbered by a $750,000 nonrecourse mortgage incurred to finance acquisition of the property. The lender has no recourse against the partnership. Should the partnership default on its loan payments, the lender has the right to foreclose upon the property, taking it in complete satisfaction of the outstanding debt balance. In effect, in the event that the partnership becomes unwilling or unable to make payments on its loan, it will transfer the property to the lender in satisfaction of the loan.

Thus, for tax purposes, foreclosure will be treated by the partnership as a taxable sale of the property; even if the property becomes completely worthless, the partnership will merely transfer it to the lender in satisfaction of the remaining unpaid balance of the nonrecourse loan.

This feature of the loan agreement effectively creates a minimum selling price for the partnership. Regardless of economic circumstances, it can sell its property to the lender for this minimum sales price. Sale at this price would generate a gain, in this case, of $250,000. This gain, the minimum amount that can be triggered for tax purposes, is known as the *minimum gain*.

Knowledge check

3. J Dean Properties is a partnership that owns real property with a tax basis and book value of $800,000. The property is encumbered by an $850,000 nonrecourse mortgage. The fair market value of the property is $1 million. What is the minimum gain associated with the property?

   a. $150,000.
   b. $50,000.
   c. $0.
   d. $200,000.

Under the Section 704(b) regulations, the existence of partnership minimum gain allows partners' capital accounts to fall below zero even in the absence of any requirement on their parts to make additional capital contributions to restore these deficit balances. As long as the deficits do not exceed the partners' shares of partnership minimum gain, any deficit in their capital accounts can be made up, or restored, with an allocation of minimum gain. This allocation has tax consequences in that it increases the partner's taxable income. These consequences give the underlying loss allocations economic effect under the Section 704(b) regulations. Following the same rationale, the regulations under Section 752 look to the allocation of minimum gain to support the allocation of the underlying nonrecourse debt associated with that minimum gain.

Example 4-5

A and B form a limited partnership to acquire a shopping center. A, the general partner, contributes $20,000, and B, the limited partner, contributes $180,000 to the partnership. The partnership borrows $1,800,000 on a nonrecourse loan and purchases the shopping center for $2,000,000. The partners agree to share losses 10% to A and 90% to B. Partnership income is to be shared equally. The partnership agreement complies with the requirements of Section 704(b). Minimum gain is to be shared 10/90 in order to substantiate the loss-sharing arrangement. In each of its first three years, the partnership's revenues just offset its operating expenses, giving it net income of $0 before depreciation. Its annual depreciation deduction of $90,000 results in a ($90,000) annual tax loss, yielding the following partner capital accounts:

	A	B
Beginning capital	$ 20,000	$ 180,000
Loss in years 1 and 2	(18,000)	(162,000)
Capital, end of year 2	$ 2,000	$ 18,000
Year 3 loss	(9,000)	(81,000)
Capital, end of year 3	$ (7,000)	$ (63,000)

At the end of years 1 and 2, there is no partnership minimum gain, so the nonrecourse liability is allocated equally between the partners in accordance with their general profit-sharing ratios. At the end of year 3, however, partnership minimum gain is $70,000 (basis = 2,000,000 - 270,000 = 1,730,000; principal amount of loan = $1,800,000). Thus, the first $70,000 of the nonrecourse loan is allocated 10% to A and 90% to B in accordance with the partners' interests in partnership minimum gain. The remaining nonrecourse liability of $1,730,000 (1,800,000 - 70,000) is allocated equally. At the end of year 3, A's share of partnership nonrecourse debt is $872,000 ($7,000 share of partnership minimum gain plus $865,000 share of the excess) and B's share is $928,000 ($63,000 + $865,000).

Tax versus book minimum gain

Profit allocations under Section 704(c) also take priority over other profits in some cases. Where partnership property is encumbered by a nonrecourse debt, and the exchange of such property in full satisfaction of the note would generate a gain that would be allocated to one or more partners under Section 704(c), the nonrecourse liability attached to the property also will be allocated in this way. That is, where minimum gain would be allocated under Section 704(c) to one or more partners, the allocation of the nonrecourse liability follows the allocations of the minimum gain, to the extent of the minimum gain.

Example 4-6

J and K form a general partnership to provide residential property to renters. J contributes $100,000 to the partnership that it uses to acquire residential property. K contributes an apartment building valued at $175,000. The basis of the contributed building is $50,000 and it is subject to a nonrecourse debt of $75,000. The partners share all profits and losses equally. The $75,000 nonrecourse loan, however, is not shared equally by the partners. The first $25,000 of such loan is allocated to K, because K would be allocated $25,000 of partnership gain under Section 704(c) if the partnership disposed of the apartment building in full satisfaction of the nonrecourse liability.[4] The remainder of the nonrecourse liability is allocated between the partners in proportion to their equal interests in partnership profits. Thus, J's share of the $75,000 nonrecourse liability is $25,000 (½ of 50,000) and K's share is $50,000 [$25,000 + ½ of (50,000)].

Knowledge check

4. Q Lynn Properties is a partnership that owns real property with a tax basis of $750,000 and a book value of $800,000. The property is encumbered by a $900,000 nonrecourse mortgage. The fair market value of the property is $1 million. What is the tax and book minimum gain associated with the property?

    a. Tax minimum gain, $50,000; book minimum gain, $100,000.
    b. Tax minimum gain, $50,000; book minimum gain, $200,000.
    c. Tax minimum gain, 0; book minimum gain, $150,000.
    d. Tax minimum gain, $150,000; book minimum gain, $100,000.

Other partnership profits

In summary, each partner's share of partnership nonrecourse debts will be equal to the sum of

1. the partner's share of partnership minimum gain under Section 704(b);
2. the amount of any partnership Section 704(c) minimum gain that would be allocated to such partner; and
3. the partner's proportionate share of any remaining nonrecourse liabilities determined by reference to her interest in general partnership profits.

If the property serving as collateral for the loan is not Section 704(c) property (in other words, property contributed to the partnership by a partner), there will be no Section 704(c) minimum gain — all minimum gain in such cases will be Section 704(b) minimum gain. Nonrecourse liabilities are generally allocated on a liability-by-liability basis, so that an accurate measurement of book and tax minimum gain, and the partners' interests therein, can be determined. The separately computed amounts are then added together to determine each partner's aggregate share of partnership nonrecourse liabilities.

[4] Note that there is no Section 704(b) gain in this problem.

Key review point

In the current case, Rocky Mountain Properties must allocate the nonrecourse liabilities at two different points in time. First, it must allocate the liabilities as of March 31, 2021, the day before Bob's interest is liquidated. This allocation is necessary so that Bob can accurately compute his tax basis in the LLC interest (because that basis, after adjustment for the change in liabilities, becomes his tax basis in property 3 received in the liquidating distribution). The allocation of the LLC's nonrecourse liabilities as of March 31 is as follows:

	Bob	Amelia	Chelsea	Total
NR 1 (secured by property 1): 704(c) min gain	$250,000	0	0	$250,000
704(b) min gain: (2,500,000-250,000-1,766,292)	193,484	145,112	145,112	483,708
Remainder	706,516	529,888	529,888	1,766,292
Total allocation NR 1	$1,150,000	$675,000	$675,000	$2,500,000
NR 2 (secured by P3): 704(c) min gain	0	0	0	0
704(b) min gain:	0	0	0	0
Remainder	800,000	600,000	600,000	2,000,000
Total allocation NR 2	$800,000	$600,000	$600,000	$2,000,000
Total share of LLC's NR liabilities	**$1,950,000**	**$1,275,000**	**$1,275,000**	**$4,500,000**

Note that we used this allocation of the NR liabilities in computing Bob's tax basis in his interest in the LLC earlier in this chapter.

The allocation of liabilities at year-end is much easier. Amelia and Chelsea are each 50% members, and the LLC makes no special allocations. Thus, the minimum gain is shared in the same 50:50 ratio as the rest of the partnership's income and the total NR debt is shared in this same ratio. NR 2 is not allocated as it was distributed to Bob and was no longer on the LLC's balance sheet at year-end.

Tax Glossary

401(k) plan. A qualified retirement plan to which contributions from salary are made from pre-tax dollars.

accelerated depreciation. Computation of depreciation to provide greater deductions in earlier years of equipment and other business or investment property.

accounting method. Rules applied in determining when and how to report income and expenses on tax returns.

accrual method. Method of accounting that reports income when it is earned, disregarding when it may be received, and expense when incurred, disregarding when it is actually paid.

acquisition debt. Mortgage taken to buy, hold, or substantially improve main or second home that serves as security.

active participation. Rental real estate activity involving property management at a level that permits deduction of losses.

adjusted basis. Basis in property increased by some expenses (for example, by capital improvements) or decreased by some tax benefit (for example, by depreciation).

adjusted gross income (AGI). Gross income minus above-the-line deductions (such as deductions other than itemized deductions, the standard deduction, and personal and dependency exemptions).

alimony. Payments for the support or maintenance of one's spouse pursuant to a judicial decree or written agreement related to divorce or separation.

alternative minimum tax (AMT). System comparing the tax results with and without the benefit of tax preference items for the purpose of preventing tax avoidance.

amortization. Write-off of an intangible asset's cost over a number of years.

applicable federal rate (AFR). An interest rate determined by reference to the average market yield on U.S. government obligations. Used in Sec. 7872 to determine the treatment of loans with below-market interest rates.

at-risk rules. Limits on tax losses to business activities in which an individual taxpayer has an economic stake.

backup withholding. Withholding for federal taxes on certain types of income (such as interest or dividend payments) by a payor that has not received required taxpayer identification number (TIN) information.

bad debt. Uncollectible debt deductible as an ordinary loss if associated with a business and otherwise deductible as short-term capital loss.

basis. Amount determined by a taxpayer's investment in property for purposes of determining gain or loss on the sale of property or in computing depreciation.

cafeteria plan. Written plan allowing employees to choose among two or more benefits (consisting of cash and qualified benefits) and to pay for the benefits with pretax dollars. Must conform to Sec. 125 requirements.

capital asset. Investments (such as stocks, bonds, and mutual funds) and personal property (such as home).

capital gain/loss. Profit (net of losses) on the sale or exchange of a capital asset or Sec. 1231 property, subject to favorable tax rates, and loss on such sales or exchanges (net of gains) deductible against $3,000 of ordinary income.

capitalization. Addition of cost or expense to the basis of property.

carryovers (carryforwards) and carrybacks. Tax deductions and credits not fully used in one year are chargeable against prior or future tax years to reduce taxable income or taxes payable.

Conservation Reserve Program (CRP). A voluntary program for soil, water, and wildlife conservation, wetland establishment and restoration and reforestation, administered by the U.S. Department of Agriculture.

credit. Amount subtracted from income tax liability.

deduction. Expense subtracted in computing adjusted gross income.

defined benefit plan. Qualified retirement plan basing annual contributions on targeted benefit amounts.

defined contribution plan. Qualified retirement plan with annual contributions based on a percentage of compensation.

depletion. Deduction for the extent a natural resource is used.

depreciation. Proportionate deduction based on the cost of business or investment property with a useful life (or recovery period) greater than one year.

earned income. Wages, bonuses, vacation pay, and other remuneration, including self-employment income, for services rendered.

earned income credit. Refundable credit available to low-income individuals.

employee stock ownership plan (ESOP). Defined contribution plan that is a stock bonus plan or a combined stock bonus and money purchase plan designed to invest primarily in qualifying employer securities.

estimated tax. Quarterly payments of income tax liability by individuals, corporations, trusts, and estates.

exemption. A deduction against net income based on taxpayer status (such as single, head of household, married filing jointly or separately, trusts, and estates).

fair market value. The price that would be agreed upon by a willing seller and willing buyer, established by markets for publicly-traded stocks, or determined by appraisal.

fiscal year. A 12-month taxable period ending on any date other than December 31.

foreign tax. Income tax paid to a foreign country and deductible or creditable, at the taxpayer's election, against U.S. income tax.

gift. Transfer of money or property without expectation of anything in return, and excludable from income by the recipient. A gift may still be affected by the unified estate and gift transfer tax applicable to the gift's maker.

goodwill. A business asset, intangible in nature, adding a value beyond the business's tangible assets.

gross income. Income from any and all sources, after any exclusions and before any deductions are taken into consideration.

half-year convention. A depreciation rule assuming property other than real estate is placed in service in the middle of the tax year.

head-of-household. An unmarried individual who provides and maintains a household for a qualifying dependent and therefore is subject to distinct tax rates.

health savings account (HSA). A trust operated exclusively for purposes of paying qualified medical expenses of the account beneficiary and thus providing for deductible contributions, tax-deferred earnings, and exclusion of tax on any monies withdrawn for medical purposes.

holding period. The period of time a taxpayer holds onto property, therefore affecting tax treatment on its disposition.

imputed interest. Income deemed attributable to deferred-payment transfers, such as below-market loans, for which no interest or unrealistically low interest is charged.

incentive stock option (ISO). An option to purchase stock in connection with an individual's employment, which defers tax liability until all of the stock acquired by means of the option is sold or exchanged.

income in respect of a decedent (IRD). Income earned by a person, but not paid until after his or her death.

independent contractor. A self-employed individual whose work method or time is not controlled by an employer.

indexing. Adjustments in deductions, credits, exemptions and exclusions, plan contributions, AGI limits, and so on, to reflect annual inflation figures.

individual retirement account (IRA). Tax-exempt trust created or organized in the U.S. for the exclusive benefit of an individual or the individual's beneficiaries.

information returns. Statements of income and other items recognizable for tax purposes provided to the IRS and the taxpayer. Form W-2 and forms in the 1099 series, as well as Schedules K-1, are the prominent examples.

installment method. Tax accounting method for reporting gain on a sale over the period of tax years during which payments are made, such as, over the payment period specified in an installment sale agreement.

intangible property. Items such as patents, copyrights, and goodwill.

inventory. Goods held for sale to customers, including materials used in the production of those goods.

involuntary conversion. A forced disposition (for example, casualty, theft, condemnation) for which deferral of gain may be available.

jeopardy. For tax purposes, a determination that payment of a tax deficiency may be assessed immediately as the most viable means of ensuring its payment.

Keogh plan. A qualified retirement plan available to self-employed persons.

key employee. Officers, employees, and officers defined by the Internal Revenue Code for purposes of determining whether a plan is "top heavy."

Kiddie tax. Application of parents' maximum tax rate to unearned income of their child under age 19. Full-time students under 24 are also subject to the kiddie tax.

lien. A charge upon property after a tax assessment has been made and until tax liability is satisfied.

like-kind exchange. Tax-free exchange of business or investment property for property that is similar or related in service or use.

listed property. Items subject to special restrictions on depreciation (for example, cars, computers, cell phones).

lump-sum distribution. Distribution of an individual's entire interest in a qualified retirement plan within one tax year.

marginal tax rate. The highest tax bracket applicable to an individual's income.

material participation. The measurement of an individual's involvement in business operations for purposes of the passive activity loss rules.

mid-month convention. Assumption, for purposes of computing depreciation, that all real property is placed in service in the middle of the month.

mid-quarter convention. Assumption, for purposes of computing depreciation, that all property other than real property is placed in service in the middle of the quarter, when the basis of property placed in service in the final quarter exceeds a statutory percentage of the basis of all property placed in service during the year.

minimum distribution. A retirement plan distribution, based on life expectancies, that an individual must take after age 70½ in order to avoid tax penalties.

minimum funding requirements. Associated with defined benefit plans and certain other plans, such as money purchase plans, assuring the plan has enough assets to satisfy its current and anticipated liabilities.

miscellaneous itemized deduction. Deductions for certain expenses (for example, unreimbursed employee expenses) limited to only the amount by which they exceed 2 percent of adjusted gross income.

money purchase plan. Defined contribution plan in which the contributions by the employer are mandatory and established other than by reference to the employer's profits.

net operating loss (NOL). A business or casualty loss for which amounts exceeding the allowable deduction in the current tax year may be carried back two years to reduce previous tax liability and forward 20 years to cover any remaining unused loss deduction.

nonresident alien. An individual who is neither a citizen nor a resident of the United States. Nonresidents are taxed on U.S. source income.

original issue discount (OID). The excess of face value over issue price set by a purchase agreement.

passive activity loss (PAL). Losses allowable only to the extent of income derived each year (such as by means of carryover) from rental property or business activities in which the taxpayer does not materially participate.

passive foreign investment company (PFIC). A foreign based corporation subject to strict tax rules which covers the treatment of investments in Sections 1291 through 1297.

pass-through entities. Partnerships, LLCs, LLPs, S corporations, and trusts and estates whose income or loss is reported by the partner, member, shareholder, or beneficiary.

personal holding company (PHC). A corporation, usually closely-held, that exists to hold investments such as stocks, bonds, or personal service contracts and to time distributions of income in a manner that limits the owner(s) tax liability.

qualified subchapter S trust (QSST). A trust that qualifies specific requirements for eligibility as an S corporation shareholder.

real estate investment trust (REIT). A form of investment in which a trust holds real estate or mortgages and distributes income, in whole or in part, to the beneficiaries (such as investors).

real estate mortgage investment conduit (REMIC). Treated as a partnership, investors purchase interests in this entity which holds a fixed pool of mortgages.

realized gain or loss. The difference between property's basis and the amount received upon its sale or exchange.

recapture. The amount of a prior deduction or credit recognized as income or affecting its characterization (capital gain vs. ordinary income) when the property giving rise to the deduction or credit is disposed of.

recognized gain or loss. The amount of realized gain or loss that must be included in taxable income.

regulated investment company (RIC). A corporation serving as a mutual fund that acts as investment agents for shareholders and customarily dealing in government and corporate securities.

reorganization. Restructuring of corporations under specific Internal Revenue Code rules so as to result in nonrecognition of gain.

resident alien. An individual who is a permanent resident, has substantial presence, or, under specific election rules is taxed as a U.S. citizen.

Roth IRA. Form of individual retirement account that produces, subject to holding period requirements, nontaxable earnings.

S corporation. A corporation that, upon satisfying requirements concerning its ownership, may elect to act as a pass-through entity.

Saver's credit. Term commonly used to describe Sec. 25B credit for qualified contributions to a retirement plan or via elective deferrals.

Sec. 1231 property. Depreciable business property eligible for capital gains treatment.

Sec. 1244 stock. Closely held stock whose sale may produce an ordinary, rather than capital, loss (subject to caps).

split-dollar life insurance. Arrangement between an employer and employee under which the life insurance policy benefits are contractually split, and the costs (premiums) are also split.

statutory employee. An insurance agent or other specified worker who is subject to social security taxes on wages but eligible to claim deductions available to the self-employed.

stock bonus plan. A plan established and maintained to provide benefits similar to those of a profit-sharing plan, except the benefits must be distributable in stock of the employer company.

tax preference items. Tax benefits deemed includable for purposes of the alternative minimum tax.

tax shelter. A tax-favored investment, typically in the form of a partnership or joint venture, that is subject to scrutiny as tax-avoidance device.

tentative tax. Income tax liability before taking into account certain credits, and AMT liability over the regular tax liability.

transportation expense. The cost of transportation from one point to another.

travel expense. Transportation, meals, and lodging costs incurred away from home and for trade or business purposes.

unearned income. Income from investments (such as interest, dividends, and capital gains).

uniform capitalization rules (UNICAP). Rules requiring capitalization of property used in a business or income-producing activity (such as items used in producing inventory) and to certain property acquired for resale.

unrelated business income (UBIT). Exempt organization income produced by activities beyond the organization's exempt purposes and therefore taxable.

wash sale. Sale of securities preceded or followed within 30 days by a purchase of substantially identical securities. Recognition of any loss on the sale is disallowed.

Reviewing Partnership Tax Returns: What Are You Missing?

By Larry Tunnell, Ph.D., CPA; and
Robert Ricketts, Ph.D., CPA

Solutions

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Solutions

Case One — Data Security Products

Knowledge check solutions

1.

   a. Incorrect. The partners pay tax on their distributive shares of partnership income, regardless of distributions actually received.
   b. Incorrect. The partnership does not pay tax on income or distributions.
   c. Correct. The partners, not the partnership, pay income tax on the partnership's income, whether or not such income is distributed to them.
   d. Incorrect. Although the partners may pay tax on distributions in excess of their basis, they will also pay tax on their distributive shares of partnership income.

2.

   a. Incorrect. Net income or loss from rental real estate activities must be separately stated on the partnership tax return.
   b. Correct. Income and expenses from partnership trade or business activities are summarized on page 1 of Form 1065.
   c. Incorrect. Dividend income must be separately stated on the partnership tax return.
   d. Incorrect. Charitable contributions must be separately stated.

3.

   a. Incorrect. The February 15 partnership year-end would create a greater deferral period for the partners than would a July 31 year-end.
   b. Correct. The partnership must use the taxable year ending July 31 that minimizes the aggregate tax deferral for its partners.
   c. Incorrect. The partnership cannot choose the taxable year ending October 31.
   d. Incorrect. December 31 is a year-end that would be used by the individual partners when preparing their personal income tax returns. The partnership must use the taxable year ending July 31, because it has the least aggregate deferral.

4.

   a. Incorrect. A December 31 year-end does not minimize the aggregate deferral of income for the LLC’s members.
   b. Correct. A January 31 year-end minimizes the aggregate deferral of income for the LLC’s members.
   c. Incorrect. A March 31 year-end would result in a higher aggregate deferral of income for the LLC’s members.
   d. Incorrect. Because the two principal partners or members have different year-ends, the LLC must choose the tax year that minimizes the aggregate deferral of income for its members.

5.

   a. Incorrect. Schedule M-2 reconciles book capital balances, not tax balances.
   b. Correct. Schedule M-2 reconciles beginning and ending balances in the partnership’s book capital account, as reported on Schedule L.
   c. Incorrect. Schedule M-1 reconciles book and tax income.
   d. Incorrect. Schedule K reports all separately stated items for the partnership.

Case Two — Atlantic Traders

Knowledge check solutions

1.

   a. Correct. Because the services are integral to the business, they are in his role as a partner; they are not dependent on the income of the partnership and are therefore treated as a guaranteed payment.
   b. Incorrect. The payments are not dependent on the income of the partnership, so they are not a distributive share.
   c. Incorrect. Because the services are integral to the business, they are in his role as a partner.
   d. Incorrect. The $6,000 monthly payments are each treated as a guaranteed payment to L in their entirety.

2.

a. Incorrect. G will recognize the guaranteed payment and a share of partnership income.
b. Correct. G will have to recognize the $30,000 guaranteed payment and his one-third share of the partnership income after deducting the guaranteed payment (⅓ × ($75,000 - $30,000) = $15,000).
c. Incorrect. G will have to recognize the $30,000 guaranteed payment and his one-third share of the partnership income after deducting the guaranteed payment.
d. Incorrect. This figure represents G's share of the total income from the partnership; it neglects to include G's share of the guaranteed payments.

3.

a. Correct. X's guaranteed payment is the excess of the actual payment ($80,000) over X's distributive share ($150,000 × 40% = $60,000).
b. Incorrect. This figure represents 40% of $80,000 and is contrary to the agreement between X and the XYZ partnership.
c. Incorrect. X's guaranteed payment is the excess of the actual payment over X's distributive share.
d. Incorrect. This represents the partnership's total income and ignores the partner's agreement and distributive share.

4.

a. Correct. The regulations are based on the theoretical framework established in Section 704(b).
b. Incorrect. The regulations look to the economic obligations each partner would have (if any) in the hypothetical event that all the partnership's assets become worthless.
c. Incorrect. The tax capital accounts do not reflect the partners' economic arrangements with the partnership.
d. Incorrect. The liquidation is hypothetical, but is based on actual capital accounts.

Case Three — Agricultural Pump & Service, LLC

Knowledge check solutions

1.

   a. Incorrect. This is an entire year's depreciation on the realty. The partnership can deduct depreciation only from June through December.
   b. Correct. The partnership will deduct 7 months' depreciation on the realty and Q will deduct 5 months' of depreciation.
   c. Incorrect. This is the amount of depreciation Q will deduct.
   d. Incorrect. The partnership will step into Q's shoes and calculate depreciation based upon Q's original purchase price, not the fair market value of the property on the date it was contributed to the partnership.

2.

   a. Correct. Book depreciation must equal the same percentage of the book value of the property ($5,000,000) as the tax depreciation comprises of the tax basis of the property *at the date of contribution*. The tax depreciation rate for nonresidential property (39 year life) is 2.564% (from the IRS tables). The original tax basis is $3,750,000 × 2.564% = $96,150 tax depreciation. The tax basis at date of contribution is $2,832,532. ($96,150 ÷ $2,832,532) × $5,000,000 book value = $169,724 book depreciation.
   b. Incorrect. This is the monthly depreciation.
   c. Incorrect. This is the tax depreciation deduction.
   d. Incorrect. Book depreciation must equal the same percentage of the book value of the property ($5,000,000) as the tax depreciation comprises of the tax basis of the property *at the date of contribution*. This amount is based upon the tax basis of the original purchaser.

3.

   a. Incorrect. Residential property is computed over 27.5 years. This is nonresidential property.
   b. Correct. Tax depreciation of nonresidential realty is computed using the straight-line method over 39 years. Per the IRS depreciation tables, that rate is 2.564%.
   c. Incorrect. Depreciation expense is computed by reference to the original cost of the realty rather than the fair market value at the date of contribution.
   d. Incorrect. The original cost must be depreciated straight-line over 39 years.

4.

a. Incorrect. The built-in gain inherent in the property must be allocated to Lloyd.
b. Incorrect. Lloyd shares in the post-contribution gain in addition the built-in gain.
c. Incorrect. The built-in gain must be subtracted from the total gain and then added to Lloyd's 25% allocation..
d. Correct. Lloyd will be allocated the $80,000 built-in gain, plus 25% of the remaining $100,000.

Case Four — Rocky Mountain Properties, LLC

Knowledge check solutions

1.

a. Incorrect. This is the difference between the tax basis of the distributed property and Karen's tax basis in her partnership interest.
b. Incorrect. Karen's tax basis has increased by $20,000 since the date of her contribution to the partnership.
c. Correct. Karen must recognize her built-in gain to the extent that the value of the property received exceeds the tax basis of her interest in the partnership.
d. Incorrect. This is the difference between the FMV of the property received in the distribution and its tax basis to the partnership.

2.

a. Incorrect. The basis of the land is increased by the gain recognized by Karen under Section 737.
b. Incorrect. Karen's Section 737 gain was less than $105,000.
c. Incorrect. Karen's Section 737 gain was more than $85,000.
d. Correct. Karen recognized an $85,000 gain under Section 737. The partnership may increase its tax basis in the land by that amount.

3.

a. Incorrect. The value of the property is not relevant in measuring the minimum gain.
b. Correct. The principal balance of the nonrecourse mortgage exceeds the tax basis of the property by $50,000.
c. Incorrect. The basis of the property collateralizing the nonrecourse mortgage is lower than the principal of that mortgage. There is minimum gain.
d. Incorrect. This is the inherent gain in the property, not the minimum gain.

4.

a. Correct. The tax minimum gain is equal to the excess of book value over tax basis, and the book minimum gain is the excess of the principal of the nonrecourse liability over the book value of the property.
b. Incorrect. The FMV of the property is not relevant in determining the amount of the book minimum gain.
c. Incorrect. The total minimum gain is $150,000, but a portion of this is tax minimum gain.
d. Incorrect. The total minimum gain is $150,000, but a portion of this is book minimum gain.

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