**Title:** Breaking Up is So Hard to Do (Part 3 of 3)

**Subtitle:** So, we've had our ups, and we've had our downs. Hopefully by now, you can gauge the&nbsp;commitment that is made when establishing a business entity, and how breaking up that&nbsp;commitment--regardless of the context--is seldom clear-cut, and often frustrating.

**Meta Description:** Breaking Up is So Hard to Do (Part 3 of 3)

**Date:** 0-2-2012

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I have written about exit strategies and the consequent problems when facing taxes on assets. I have also elaborated on certain situations where a partnership can be taxed.  In the last installment, I would like to discuss some strategies for avoiding gain recognition when distributing assets, and some of the unexpected results that become apparent.

Strategies for avoiding gain recognition upon distribution generally consist of waiting seven years, transfer of partnership interests to a grantor trust, or distributing the property to the partner who contributed it.  Nestled with the rules are some interesting and painful surprises.

Investment Partnerships – Notwithstanding the three sections, those entities meeting the definition of an investment partnership have their own escape hatches to recognition upon distribution of a security. Investment partnerships are not engaged in a trade or business, and consist primarily (90% or more) of investment securities.  There are four exceptions to immediate recognition upon distribution of a security  and they apply when : (1) the security was contributed by the partner receiving the security; (2) the security was not a marketable security when acquired by the distributing partnership plus additional conditions are met; (3) the partnership acquired the security in a non-recognition transaction plus additional conditions are met; or (4) the partnership is an investment partnership and the partner is an eligible partner.

A surprise occurs when the interests transferred by parent have built-in-gain as part of the legacy.  Unexpected results occur when a parent transfers interests to her 3 children and Child#1 wants to be cashed out.  Thus, the distribution to Child1 causes all the others to recognize gain.  If one did not love their sibling before, the transaction, they will love them even less once the consequences are known.

The final surprise to most, but not all, readers is that relief from indebtedness is treated as a  cash distribution.  Exit strategies may not garner much attention at the time of contribution, but they can have a dramatic impact upon one’s net worth.

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