LESSON **9**

Tax Accounting for Partnership Operations

ASSIGNMENT

MN&W: ¶¶ 9.01-9.04

Code: §§ 446, 448, 701, 702, 703, 706

Regulations: Reg. §§ 1.702-1, 1.703-1, 1.706-1, 1.706-1T

QUESTIONS

1. Barbara, Bill, and Tom are partners in a partnership that is in the business of growing and selling orchids and other flowers. Barbara, Bill, and Tom, all expert gardeners, work long hours planting, maintaining, and harvesting the orchids and flowers, and share all partnership profits and losses equally (one third each). Assume in its 1999 taxable year, the partnership earns $380,000 of gross income from selling the flowers and orchids and incurs $80,000 of deductible expenses under § 162. In addition to the income and expenses from its business, the partnership also recognizes from the sale of investment assets a $40,000 long-term capital gain, a $10,000 long-term capital loss, a $120,000 short-term capital loss, and a $30,000 short-term capital gain. The partnership also received $60,000 of dividends and made a $30,000 charitable contribution.

   a. Compute the partnership's taxable income, and discuss the mechanism for taxing the partners.

b. Provide examples of elections that may be important to this partnership, and identify whether the partnership or the partners make those elections.

c. Explain how the computation of the partnership's taxable income changes if the partnership specially allocates $100,000 of gross income from operations to Barbara. All the other items are shared equally between the three partners.

d. Suppose in addition to the items above, the partnership recognizes $3,000,000 of gain from the sale of a Vincent Van Gogh original painting. The partnership purchased the painting many years ago at a nominal price. (At the time of the purchase, the partners and the seller believed the painting was a copy.) Although Barbara deals in antique art in her spare time, the partnership strictly held the painting for investment.

e. What method of accounting can be used by the partnership?

2. Assume general partnership *DEF* is a calendar-year taxpayer that has a C corporation as a partner and was formed on July 1, 1994, for valid business reasons. May *DEF* use the cash method of accounting for 1999? Assume *DEF*'s gross receipts were as follows:

1994: $2,000,000
1995: $4,000,000
1996: $5,500,000
1997: $5,000,000
1998: $5,200,000