



Calculation of Partnership Income

Course #33052A

Taxes

2 Credit Hours

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CALCULATION OF PARTNERSHIP INCOME

This course explores the elections available at both the partnership level and the individual partner level. It explains how a partnership may make entity-level elections (such as opting out of the centralized partnership audit regime or making a § 754 basis adjustment election) and how partners may make their own elections or treatment choices. The course clarifies who must make each election, when it must be filed, and how it impacts partnership and partner tax treatment.

LEARNING ASSIGNMENTS AND OBJECTIVES

As a result of studying each assignment, you should be able to meet the objectives listed below each individual assignment.

SUBJECTS

Calculation of Partnership Income

Study the course materials

Complete the review questions at the end of each chapter

Answer the exam questions 1 to 10

Objectives:

- Identify the elections available at the partnership level and those available at the partner level.

NOTICE

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EXAM OUTLINE

- **TEST FORMAT:** The final exam for this course consists of 10 multiple-choice questions and is based specifically on the information covered in the course materials.
- **ACCESS FINAL EXAM:** Log in to your account and click Take Exam. A copy of the final exam is provided at the end of these course materials for your convenience, however you must submit your answers online to receive credit for the course.
- **LICENSE RENEWAL INFORMATION:** This course qualifies for **2** CPE hours.
- **PROCESSING:** You will receive the score for your final exam immediately after it is submitted. A score of 70% or better is required to pass.
- **CERTIFICATE OF COMPLETION:** Will be available in your account to view online or print. If you do not pass an exam, it can be retaken free of charge.

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CHAPTER 1: CALCULATION OF PARTNERSHIP INCOME

Chapter Objective

After completing this chapter, you should be able to:

- Identify the elections available at the partnership level and those available at the partner level.

¶401 INTRODUCTION

Generally, in computing its taxable income, the partnership takes into account the same items of income and deduction during the year as does an individual. The partnership, however, must separately state the net amounts of certain items of income and deductions enumerated in Code Sec. 702(a). These separately stated amounts are items that could be subject to special limitations or treatment when recognized by the partners. Any special treatment for a certain type of income, deduction, or credit is generally applied at the partner level and is computed based on the partner's overall tax situation, including income, deductions, and credits from other sources. Code Sec. 702(a) requires that the partnership separately state its net amounts from the following sources:

- Long-term capital gains and losses.
- Short-term capital gains and losses.
- Code Sec. 1231 gains and losses.
- Charitable contributions.
- Dividends that are taxed as net capital gains or are eligible for the dividends received deduction.¹
- Income taxes paid to foreign countries.
- Other items required by the regulations.

Examples of items the regulations add are the following:

- Recoveries of bad debts and taxes.
- Gains and losses from wagering.
- Nonbusiness "production of income" expenses.
- Medical and dental expenses.
- Alimony payments.

¹. Code Sec. 243.

- Intangible drilling and development costs.
- Items specially allocated.
- Any amount that, if separately taken into account by any partner, would result in an income tax liability for that partner different from that which would result if that partner did not take the item separately into account.² Some examples of these items are income from rental real estate activities, oil and gas depletion, recapture of Code Sec. 179 expense deductions, and qualified business income.

Administrative pronouncements and case law add other types of income and deductions that must be separately stated. In preparing the partnership's tax return, these separately stated items are listed on Schedule K of Form 1065, *U.S. Return of Partnership Income*, and each partner's share is listed on the partner's Schedule K-1, *Partner's Share of Income, Deductions, Credits, etc.* The remaining amounts of income and deduction that are not separately stated are taken into account by simply netting them on line one of Form 1065, Schedule K.

Example 4-1

EXAMPLE

The equal AB partnership has the following items of income and deductions for its taxable year:

Gross rents		\$250,000
Depreciation	\$100,000	
Maintenance expenses	40,000	
Property taxes	10,000	
Insurance	5,000	
Property management fees	30,000	
		<u>(185,000)</u>
Net rental income		\$65,000
Gains from selling investment land		<u>40,000</u>
Partnership's business or investment income		\$105,000
Charitable deductions		\$10,000

The partnership's business or investment income is \$105,000, but this net amount never appears on its tax return. The partnership must separately state its net rental income of \$65,000 because this is per se passive income from nonreal estate operations,³ and each partner's passive losses from other sources are deductible only to the extent of his *(continued)*

2. Reg. § 1.702-1(a)(8)(i), (ii).

3. Code Sec. 469(c)(7).

Example 4-1 (continued)



total passive income from all sources. The capital gains of \$40,000 must also be separately stated because a partner's capital losses are deductible only to the extent of his capital gains from all sources (plus \$3,000 for individuals). The partnership's charitable contributions are not deductible by the partnership but must be stated separately because each individual partner can deduct these amounts only if his total charitable contributions do not exceed the percentages of adjusted gross income specified in Code Sec. 170.

S Corporation Observation



An S corporation calculates and presents its taxable income in the same manner as does a partnership.⁴

¶402 BOTH ENTITY AND AGGREGATE RULES APPLY

The computation and treatment of partnership taxable income at times treats the partnership as an entity separate from its owners and at times treats the partnership as a joint ownership through a tenancy-in-common of individuals. For example, there is no income tax imposed on the partnership, but the income of the partnership is taxed to the partners. In this case the partnership is treated as an aggregate of a group of individual partners. However, the combined net income for the partnership is computed and reported by the partnership on Form 1065, and in this respect the partnership is treated as an entity separate from the partners.

Partnerships are treated as entities for purposes of making most elections (such as choice of accounting methods) that affect the computation of pass-through items, and for certain procedural purposes.⁵ Partnerships are treated similar to tenants-in-common or as an aggregation of individual owners for other purposes. For example, the Code Sec. 469 passive loss limits and the Code Sec. 465 at-risk limits apply at the partner level. In some situations, there is a choice whether to use an entity rule or an aggregate rule. For example, a purchaser of a partnership interest has a new cost basis in his or her interest, but not a cost basis in his or her share of the assets. This rule has an entity approach. However, the partner receives a cost basis in his or her share of the assets if a Code Sec. 754 election is in effect. This is in essence an election to use an aggregate approach.

4. Code Sec. 1366(a).

5. See Code Secs. 703(b), 6221, et. seq.