Section 736 - Payments to a Retiring Partner or a Deceased Partner's Successor in Interest

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Dated July 27, 2011

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Start

Liq'n of Entire Int. in P'ship

Were payments made to a retiring partner or to a deceased partner's successor in interest in liquidation of such partner's entire interest in the partnership?

No → N/A: Section 736 does not apply. Reg. 1.736-1(a)(1)(i)

Yes → Reg. 1.736-1(a)(1)(i), Sec. 761(d), Reg. 1.761-1(d), Holman v. Commr., 66 T.C. 809 (1976), affd, 564 F.2d 283 (9th Cir. 1977), Milliken v. Commr., 72 T.C. 256 (1979), aff'd in unpub. opin. (1st Cir. 1979)

Continue as Partner

Did the estate or other successor in interest of a deceased partner continues as a partner in its own right under local law?

Yes → N/A

No → Reg. 1.736-1(a)(1)(i)

Pmts by P'ship

Were payments made by the partnership (rather than by the partners)?

No → N/A

Yes → Reg. 1.736-1(a)(1)(i)

For P'ship Property

Were the payments made in exchange for the withdrawing "partner's interest in partnership property"? Generally, the valuation placed by the partners upon a partner's interest in partnership property in an arm's length agreement will be regarded as correct. If such valuation reflects only the partner's net interest in the property (i.e., total assets less liabilities), it must be adjusted so that both the value of the partner's interest in property and the basis for his interest take into account the partner's share of partnership liabilities.

No → 736(a) Payments

Yes → Sec. 736(b)(1), Reg. 1.736-1(b)(1), Rev. Rul. 75-154, Wallis v. Commr., T.C. Memo. 2009-243, aff'd 11th Cir. 2010, Quirk Est. v. Commr., 928 F. 2d 751 (6th Cir. 1991), Champlin v. Commr., T.C. Memo 1977-196

736(a) Payments

The payments are treated as payments under section 736(a).

With Regard to Inc. of the P'ship

Were the payments to the withdrawing partner determined with regard to the income of the partnership?

Yes → Treat as Distributive Share

No → Sec. 736(a)(1) & (2), Reg. 1.736-1(a)(3) → Treat as Guaranteed Payments

Treat as Distributive Share

The payments made in liquidation of the interest of the withdrawing partner are considered as a distributive share to the recipient of partnership income. These payments are taken into account under section 702 in the income of the withdrawing partner and thus reduce the amount of the distributive shares of the remaining partners. The payments are included in the income of the recipient for his taxable year with or within which ends the partnership taxable year for which the payment is a distributive share. The withdrawing partner is regarded as a partner until the entire interest of the withdrawing partner is liquidated.

Sec. 736(a)(1), Reg. 1.736-1(a)(1)(ii), (a)(3), (4), (5), & (6)
Rev. Rul. 75-154, Rev. Rul. 83-155

Treat as Guaranteed Payments

The payments made in liquidation of the interest of the withdrawing partner are considered as a guaranteed payment described in section 707(c). These payments are deductible by the partnership under section 162(a) and are taxable as ordinary income to the recipient under section 61(a). The payments are included in the income of the recipient for his taxable year in which the partnership is entitled to deduct such amount as a guaranteed payment. The withdrawing partner is regarded as a partner until the entire interest of the withdrawing partner is liquidated.

Rev. Rul. 75-154, Rev. Rul. 83-155

Gen'l Partner

Was the retiring or deceased partner a general partner in the partnership?

Yes → Capital P'ship

No → Sec. 736(b)(3)(B)

Capital P'ship

Was capital a material income-producing factor for the partnership?

No → Unrealized Receivables

Yes → Sec. 736(b)(3)(A)

Unrealized Receivables

Were the payments to the withdrawing partner for his/her interest in unrealized receivables of the partnership in excess of their partnership basis, including any special basis adjustment for them to which such partner is entitled?

No → Apprec'd Good Will

Yes → Sec. 736(b)(2)(A), Reg. 1.736-1(b)(2)

Apprec'd Good Will

Were the payments to the withdrawing partner for his/her interest in the partner's share of good will of the partnership in excess of its partnership basis, including any special basis adjustments for it to which such partner is entitled?

No → Sec. 736(b)(2)(B), Reg. 1.736-1(b)(3)

Yes → Stated Good Will

Stated Good Will

Did the partnership agreement provide for a reasonable payment with respect to good will ("stated good will")? Generally, the valuation placed upon good will by an arm's length agreement of the partners, whether specific in amount or determined by a formula, is regarded as correct.

No → 736(b) Payments

Yes → Sec. 736(b)(2)(B), Reg. 1.736-1(b)(3), Smith v. Commr., 37 T.C. 1033 (1962), aff'd, 313 F.2d 16 (10th Cir. 1962), Commr. v. Jackson Investment Co., 346 F.2d 187 (9th Cir. 1965), Spector v. Commr., 641 F.2d 376 (5th Cir 1981), Jacobs v. Commr., T.C. Memo 1974-196

736(b) Payments

The payments are considered as made in exchange for such partner's interest in partnership property and are treated as payments under section 736(b).

Reg. 1.736-1(b)(4)

Inventory

Were the payments to the withdrawing partner for his/her interest in inventory?

Yes → 751(b) May Apply

No → Reg. 1.736-1(b)(4) → Liq'n Distrib'n

751(b) May Apply

Payments for an interest in substantially appreciated inventory items, as defined in section 751(d), are subject to the rules provided in section 751(b) and Reg. 1.751-1(b). The partnership basis in inventory items as to a deceased partner's successor in interest does not change because of the death of the partner unless the partnership has elected the optional basis adjustment under section 754. But see Reg. 1.751-1(b)(3)(iii).

Reg. 1.736-1(b)(4)

Liq'n Distrib'n

The payments are considered as a distribution by the partnership in complete liquidation under sections 731, 732, and where applicable, 751. The payments are taken into account by the recipient for his/her taxable year in which such payments are made. The withdrawing partner is regarded as a partner until the entire interest of the withdrawing partner is liquidated.

Sec. 736(b), Reg. 1.736-1(a)(2), (5) & (6)

Annual Payments

The preceding boxes determined the portion of the total section 736 payments that will be considered section 736(a) payments and 736(b) payments. However, typically section 736 payments are made to the withdrawing partner over multiple years. Consequently, the payments received in each year must be allocated between section 736(a) and section 736(b). The following boxes determine how the annual allocation between section 736(a) and section 736(b) should be made.

Reg. 1.736-1(b)(5)

Agreed Upon Allocation

Have all the remaining partners and the withdrawing partner or his/her successor in interest agreed to an allocation of each annual payment between section 736(a) and (b), provided that the total amount allocated to property under section 736(b) does not exceed the fair market value of such property at the date of death or retirement?

Yes → Reg. 1.736-1(b)(5)(iii) → Alloc. As Agreed

No → Fixed Amount Fixed Years

Alloc. As Agreed

Allocate each annual payment between section 736(a) and (b) as agreed.

Reg. 1.736-1(b)(5)(iii)

Fixed Amount Fixed Years

Was a fixed amount (whether or not supplemented by any additional amounts) to be received over a fixed number of years?

Yes → Pro Rata Allocation

No → Reg. 1.736-1(b)(5)(i) → 736(b) First

736(b) First

The payments received by the retiring partner or deceased partner's successor in interest are first treated as payments in exchange for his/her interest in partnership property under section 736(b) to the extent of the value of that interest and, thereafter, as payments under section 736(a).

Reg. 1.736-1(b)(5)(ii)

Pro Rata Allocation

Allocate each fixed agreed payment pro rata between section 736(a) and 736(b) in the same ratio as all fixed agreed payments for the fixed number of years are treated as section 736(a) and 736(b) payments. If the amount received in a year is less than the fixed agreed payments for that year, a special "catch-up" rule accelerates the section 736(b) portion in future years.

Reg. 1.736-1(b)(5)(i)

736(b) Pmts Fixed Sum

Were the total of section 736(b) payments a fixed sum?

Yes → Proportionate Gain Election

No → Reg. 1.736-1(b)(6) → Basis First

Proportionate Gain Election

Has the retiring partner or a deceased partner's successor in interest elected (in his/her tax return for the first taxable year for which he/she receives such payments), to report and to measure the amount of any gain or loss by the difference between (i) the amount treated as a distribution under section 736(b) in that year, and (ii) the portion of the adjusted basis of the partner for his partnership interest attributable to such distribution (i.e., the amount which bears the same proportion to the partner's total adjusted basis for his partnership interest as the amount distributed under section 736(b) in that year bears to the total amount to be distributed under section 736(b))?

Reg. 1.736-1(b)(6)

No → Basis First

Yes → Alloc. Gain Proportionately

Basis First

Gains or Loss with respect to section 736(b) payments are determined under section 731 (generally no gain until distributions exceed basis).

Reg. 1.736-1(b)(6)

Alloc. Gain Proportionately

Allocate gain related to section 736(b) payments between the years as described in the preceding box.

Reg. 1.736-1(b)(6)

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