

2023 Supplemental Problem Set

The following problem will take the user through the lifecycle of J & L Custom Cakes, LLC. John and Lisa were two competing specialty cake shops located in Milwaukee, WI. They determined they could be more profitable if they joined forces and became partners rather than competitors. They formed an LLC in which to operate their business. In addition, they wish to be taxed as a partnership. Based upon the assets and cash they have to contribute, John will own $\frac{1}{3}$ of the LLC and Lisa will own $\frac{2}{3}$.

The various situations which follow require various computations to determine basis and ownership of the LLC at different times during the lifecycle. Tables have been included to assist you in these calculations.

SITUATION 1. J & L CUSTOM CAKES, LLC FORMATION, JANUARY 1, 20x1

J & L Custom Cakes, LLC was formed January 1, 20x1 when John and Lisa contributed their respective assets to the new business organization. Following are the basis and FMV figures for their respective contributions. In addition to the contributions shown on the depreciation schedule below, the members also made these contributions.

Assets of John	FMV	Assets of Lisa	FMV
Mixer	\$ 1,300	Oven	\$ 1,500
Cash register	400	Stove	600
Display case	600	Computer	1,000
Goodwill	40,000	Printer	500
Cash	3,700	Office furnishings	1,000
200 Shares ABC Corp (Stock basis \$1,000)	4,000	Delivery van	13,000
Total assets	\$50,000	Kitchen equipment	2,000
		Building	198,000
		Land	11,500
		Goodwill	5,000
		Cash	300
		Accounts receivable	15,000
		Bakery supplies	600
		Total assets	\$250,000
		Mortgage on building	(150,000)
		Net contribution	\$100,000

20x0 Depreciation Schedule

Assets of John	Acquisition Date	Cost	§179	Basis	Life	Method	Prior	Remaining Basis
Mixer	01/02/15	\$1,500		\$1,500	7	MACRS	\$ 214	\$1,286
Cash register	01/02/15	600		600	7	MACRS	86	514
Display case	01/02/11	800		800	7	MACRS	115	685
Goodwill	01/01/14	5,000		5,000	15	SL	500	4,500
Total assets		\$7,900		\$7,900			\$915	\$6,985

Assets of Lisa	Acquisition Date	Cost	§179	Basis	Life	Method	Prior	Remaining Basis
Building	06/19/07	\$185,000		\$185,000	39	MACRS	\$40,521	\$144,479
Lot	06/16/07	5,000		5,000		ND	0	5,000
Oven	07/23/14	2,800		2,800	7	MACRS	1,086	1,714
Stove	07/23/14	1,000		1,000	7	MACRS	388	612
Computer	11/30/15	1,500		1,500	5	MACRS	225	1,275
Printer	11/30/15	600		600	5	MACRS	120	480
Office furnishings	02/01/15	2,000		2,000	7	MACRS	286	1,714
Delivery van	11/30/15	15,000	3,260	11,740	5	MACRS	0	11,740
Kitchen equipment	07/01/08	4,000		4,000	7	MACRS	4,000	0
Goodwill		0		0			0	0
Total assets		\$216,900		\$213,640			\$46,626	\$167,014

Complete Table A to show the initial contributions of Lisa and John, their bases and capital account calculations at the time of contribution on January 1, 20x1.

Situation 1, Table A
J & L Custom Cakes, LLC
Contributions on January 1, 20x1

John	Basis	FMV
Cash	\$ 3,700	\$ 3,700
Accounts receivable	0	0
Bakery supplies	0	0
200 shares stock ABC Corp.	1,000	4,000
Equipment & vehicle	2,485	2,300
Building	0	0
Land	0	0
Goodwill	4,500	40,000
Total assets	\$ 11,685	\$ 50,000
Loans	0	0
Net worth or capital account	\$ 11,685	\$ 50,000
Lisa		
Cash	\$ 300	\$ 300
Accounts receivable	0	15,000
Bakery supplies	0	600
Stock ABC Corp.	0	0
Equipment & vehicle	17,535	19,600
Building	144,479	198,000
Land	5,000	11,500
Goodwill	0	5,000
Total assets	\$167,314	\$250,000
Loans	(150,000)	(150,000)
Net worth or capital account	\$ 17,314	\$100,000

Complete Table B showing the merger of the two contributors' assets and liabilities to form the LLC balance sheet.

Situation 1, Table B
Opening Balance Sheet, J & L Custom Cakes, LLC
January 1, 20x1, $\frac{1}{3}$ John - $\frac{2}{3}$ Lisa Ownership

Assets	John		Lisa		LLC	
	Basis	FMV	Basis	FMV	Basis	FMV
Cash	\$ 3,700	\$ 3,700	\$ 300	\$ 300		
Accounts receivable	0	0	0	15,000		
Bakery supplies	0	0	0	600		
Stock ABC Corp.	1,000	4,000	0	0		
Equipment & vehicle	2,485	2,300	17,535	19,600		
Building	0	0	144,479	198,000		
Land	0	0	5,000	11,500		
Goodwill	4,500	40,000	0	5,000		
Total assets	\$11,685	\$50,000	\$167,314	\$250,000		
Liabilities and Capital						
Loans	\$ 0	\$ 0	\$150,000	\$150,000		
Capital	11,685	50,000	17,314	100,000		
Total liabilities and capital	\$11,685	\$50,000	\$167,314	\$250,000	\$178,999	\$300,000

Complete Table C to determine the beginning basis of the LLC interest for each member.

Situation 1, Table C
Basis Computation of Member's Interest at Formation
J & L Custom Cakes, LLC January 1, 20x1, 1/3 John - 2/3 Lisa Ownership

	John	Lisa
Basis of member's interest at beginning of the year	_____	_____
Add:		
1. Cash contributed	_____	_____
2. Property contributed	_____	_____
3. Increase in long-term notes and/or mortgage liabilities	_____	_____
4. Increase in short-term notes	_____	_____
5. Increase in accounts payable	_____	_____
6. Salary and/or interest	_____	_____
7. Ordinary income	_____	_____
8. Capital gain	_____	_____
9. Non-taxable receipts	_____	_____
10. Excess of depletion deduction over the basis of the depletable property	_____	_____
11. Member's share of liability contributed by other members ¹	=====	=====
Total	_____	_____
Subtract:		
12. Decrease in long-term notes and/or mortgage liabilities	_____	_____
13. Decrease in short-term and/or mortgage liabilities	_____	_____
14. Decrease in accounts payable	_____	_____
15. Non-deductible expense	_____	_____
16. Draws ²	_____	_____
17. Other deductions ³	_____	_____
18. Liability assumed by other members contributed by this member	=====	=====
Total	_____	_____
Basis of member's interest end of year prior to the taking of any ordinary and/or capital losses	_____	_____
Less share of LLC's debt	=====	=====
Capital account (line L, Schedule K-1)	\$ 11,685	\$ 17,314

¹ Liabilities that are carried to the partnership by any of the partners.

² Draw represents all items withdrawn from the partnership including salary and interest, ordinary income, cash, and property.

³ Reduction for IRC §179 deduction.

SITUATION 2. TAX PREPARATION OF J & L CUSTOM CAKES, LLC

Lisa owns $\frac{2}{3}$ of the LLC and John owns $\frac{1}{3}$. All income and allocations are shared $\frac{2}{3}-\frac{1}{3}$, except that each member receives a guaranteed payment of \$30,000 per year. LLC assets at the start of the LLC include accounts receivable, vehicles, bakery equipment, land and buildings and some inventory. To conserve energy, the members decide to sell the oven and stove and rent new ones. The gross sales include the accounts receivable that were collected in 20x1. There are \$10,000 of accounts receivable at the end of the year and \$400 of bakery supplies. Assume the FMV of the other assets remain the same. Following is a cash flow worksheet:

Situation 2, Table A Cash Reconciliation for J & L Custom Cakes, LLC, 20x1

Cash Inflow		
Cash on hand, January 1, 20x1	\$ 4,000	
Gross sales	210,000	
Interest income	100	
Sale of oven	1,500	
Operating loan borrowed	15,000	
Sale of 100 Shares ABC Corp.	2,000	
Sale of stove	600	
Cash available	\$233,200	\$233,200
Cash Outflow		
Salaries and wages	\$ 25,000	
Guaranteed payments to members	60,000	
Equipment rent	3,500	
Interest: mortgage \$7,500 + other \$600	8,100	
Taxes	3,500	
Repairs	600	
Utilities	2,500	
Other	56,000	
Telephone system purchase on April 23, 20x1	1,800	
Principal payment: mortgage \$11,000 + other \$15,000	26,000	
LLC draws	45,000	
Cash outflow	\$232,000	(\$232,000)
Cash on hand December 31, 20x1		\$ 1,200

Tax Return Amounts

Form 1065, page 1

Gross sales	\$210,000
Gain on oven and stove	107
Operating deductions	(159,200)
Depreciation	(9,588)
	\$ 41,319

Form 1065, page 3

Interest income	\$ 100
Gain on sale of stock	1,500
Total	\$ 1,600
IRC §179 deduction	\$ 750

20x1 Depreciation Schedule

Assets of John	Acquisition Date	Cost	§179	Basis	Life	Method	Prior	Remaining Basis	20x1 Depreciation
Mixer	01/02/15	\$1,500		\$1,500	7	MACRS	\$ 214	\$1,286	\$ 367
Cash register	01/02/15	600		600	7	MACRS	86	514	147
Display case	01/02/11	800		800	7	MACRS	115	685	196
Goodwill	01/01/14	5,000		5,000	15	SL	500	4,500	333
Total assets		\$7,900		\$7,900			\$915	\$6,985	\$1,043

Assets of Lisa	Acquisition Date	Cost	§179	Basis	Life	Method	Prior	Remaining Basis	20x1 Depreciation
Building	06/19/07	\$185,000		\$185,000	39	MACRS	\$40,521	\$144,479	\$4,743
Lot	06/16/07	5,000		5,000		ND	0	5,000	0
Oven	07/23/14	2,800		2,800	7	MACRS	1,086	1,714	245
Stove	07/23/14	1,000		1,000	7	MACRS	388	612	88
Computer	11/30/15	1,500		1,500	5	MACRS	225	1,275	480
Printer	11/30/15	600		600	5	MACRS	120	480	192
Office furnishings	02/01/15	2,000		2,000	7	MACRS	286	1,714	490
Delivery van	11/30/15	15,000	3,260	11,740	5	MACRS	0	11,740	2,157
Kitchen equipment	07/01/08	4,000		4,000	7	MACRS	4,000	0	0
Total assets		\$216,900		\$213,640			\$46,626	\$167,014	\$8,395

Assets of J & L	Acquisition Date	Cost	§179	Basis	Life	Method	Prior	Remaining Basis	20x1 Depreciation
Telephone system	4/23/06	1,800	750	1,050	7	MACRS	0	1,050	150
Grand Total		\$226,600		\$222,590			\$47,541	\$175,049	\$9,588

Complete the balance sheet for December 31.

Situation 2, Table B
Ending Balance Sheet December 31, 20x1

Assets	Basis		FMV	
Cash	_____		_____	
Accounts receivable	_____		_____	
Bakery supplies	_____		_____	
Stock, ABC Corp.	_____		_____	
Equipment & vehicle	_____		_____	
Building	_____		_____	
Land	_____		_____	
Goodwill	=====		=====	
Total Assets	_____	_____	_____	_____
Liabilities				
Operating loan	_____		_____	
Mortgage	=====		=====	
Total liabilities	_____	=====	_____	=====
Net worth or capital account	_____	_____	=====	_____
Total liabilities and net worth	\$165,168		\$289,700	

Compute the inside and outside basis for both John and Lisa.

Situation 2, Table C
Year-end Capital Account Adjustments J & L Custom Cakes, LLC, 20x1

	John		Lisa	
	Tax Basis	Book or FMV	Tax Basis	Book or FMV
Beginning capital account	_____	_____	_____	_____
Capital contributions	_____	_____	_____	_____
Current year increase (decrease)	_____	_____	_____	_____
Capital withdrawals	=====	=====	=====	=====
Ending capital account	\$ 10,741	\$ 49,056	\$ 15,427	\$ 98,113

Situation 2, Table D
Basis Computation of Member's Interest for Year 20x1
J & L Custom Cakes, LLC December 31, 20x1, $\frac{1}{3}$ John – $\frac{2}{3}$ Lisa Ownership

	John	Lisa
Basis of member's interest at beginning of the year	_____	_____
Add:		
1. Cash contributed	_____	_____
2. Property contributed	_____	_____
3. Increase in long-term notes and/or mortgage liabilities	_____	_____
4. Increase in short-term notes	_____	_____
5. Increase in accounts payable	_____	_____
6. Salary and/or interest	_____	_____
7. Ordinary income	_____	_____
8. Capital gain	_____	_____
9. Non-taxable receipts	_____	_____
10. Excess of depletion deduction over the basis of the depletable property	_____	_____
11. Member's share of liability contributed by other members ¹	=====	=====
Total	_____	_____
Subtract:		
12. Decrease in long-term notes and/or mortgage liabilities	_____	_____
13. Decrease in short-term and/or mortgage liabilities	_____	_____
14. Decrease in accounts payable	_____	_____
15. Non-deductible expense	_____	_____
16. Draws ²	_____	_____
17. Other deductions ³	_____	_____
18. Liability assumed by other members contributed by this member	=====	=====
Total	_____	_____
Basis of member's interest end of year prior to the taking of any ordinary and/or capital losses	_____	_____
Less share of LLC's debt	=====	=====
Capital account (line L, Schedule K-1)	\$10,741	\$15,427

¹ Liabilities that are carried to the partnership by any of the partners.

² Draw represents all items withdrawn from the partnership including salary and interest, ordinary income, cash, and property.

³ Reduction for IRC §179 deduction.

SITUATION 3. J & L CUSTOM CAKES, LLC WITH SPECIAL ALLOCATIONS ON CONTRIBUTED PROPERTY

J & L Custom Cakes, LLC has the same contributions on January 1, 20x1, but income and depreciation are allocated according to the contributing member.

**Situation 3, Table A
Member Contributions
J & L Custom Cakes, LLC, January 1, 20x1**

	John's Contributions				
	Basis	FMV	Built-in Gain/Loss	Book Depreciation	Tax Depreciation
Accounts receivable	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Bakery supplies	0	0	0	0	0
Stock	1,000	4,000	3,000	0	0
Mixer	1,286	1,300	14	108	367
Cash register	514	400	(114)	100	147
Display case	685	600	(85)	75	196
Building	0	0	0	0	0
Land	0	0	0	0	0
Goodwill	4,500	40,000	35,500	333	333
Total	\$ 7,985	\$ 46,300	\$ 38,315	\$ 616	\$ 1,043

	Lisa's Contributions				
	Basis	FMV	Built-in Gain/Loss	Book Depreciation	Tax Depreciation
Accounts receivable	\$ 0	\$ 15,000	\$ 15,000	\$ 0	\$ 0
Bakery supplies	0	600	600	0	0
Stock	0	0	0	0	0
Oven	1,714	1,500	(214)	54	245
Stove	612	600	(12)	21	88
Computer	1,275	1,000	(275)	333	480
Printer	480	500	20	167	192
Office furnishings	1,714	1,000	(714)	200	490
Delivery van	11,740	13,000	1,260	1,600	2,157
Kitchen equipment	0	2,000	2,000	200	0
Building	144,479	198,000	53,521	6,600	4,743
Land	5,000	11,500	6,500	0	0
Goodwill	0	5,000	5,000	2,667	0
Total	\$167,014	\$249,700	\$ 82,686	\$ 11,842	\$ 8,395

In order to determine the special depreciation allocations under IRC §704(c) use the following table.

Situation 3, Table B
Depreciation Allocation for Contributed Property
J & L Custom Cakes, LLC, December 31, 20x1

Depreciation Allocation for Property Contributed by John				
	Book Depreciation	Tax Depreciation	Allocation to Lisa	Remainder for John
Equipment (5 Yr)	\$ 0	\$ 0	_____	_____
Equipment (7 Yr) ¹	283	710	_____	_____
Buildings	0	0	_____	_____
Goodwill	<u>333</u>	<u>333</u>	_____	_____
Total John	\$ 616	\$ 1,043	_____	_____

Depreciation Allocation for Property Contributed by Lisa				
	Book Depreciation	Tax Depreciation	Allocation to John	Remainder for Lisa
Equipment (5 Yr) ¹	\$ 2,100	\$ 2,829	_____	_____
Equipment (7 Yr)	475	823	_____	_____
Buildings	6,600	4,743	_____	_____
Goodwill	<u>2,667</u>	<u>0</u>	_____	_____
Total Lisa	\$ 11,842	\$ 8,395	_____	_____

¹ Because the book depreciation is less than the tax depreciation, depreciation is allocated according to the capital ratios.

\$5,000 of the sales were accounts receivable contributed by Lisa. Since they have zero basis, the entire \$5,000 is allocated to Lisa. The gain on the sale of the oven and stove, contributed by Lisa was \$107. The gain is allocated to her. The bakery supplies were used and not sold, so there is no income to allocate. One-half of the ABC Corporation stock was sold at a gain of \$1,500. Since the stock was contributed by John, the gain is allocated to him. The balance of the profit (\$45,650) for the year is split $\frac{1}{3} - \frac{2}{3}$ as is the interest income of \$100 and the \$179 deduction of \$750.

SITUATION 4. SALE OF LLC ASSETS AND DISTRIBUTION OF CASH

After the end of the operating year, John and Lisa decided to dissolve their business by selling all assets and distributing the cash. Their balance sheet and FMV of assets at the time of sale were the same as the year-end balance sheet.

Calculate the gain on the asset sale.

Situation 4, Table A
Sale of LLC Assets Followed by Cash Distribution

Assets	Basis	FMV	Gain on Sale	
			Amount	Type
Cash	\$ 1,200	\$ 1,200		
Accounts receivable	0	10,000		
Bakery supplies	0	400		
Stock ABC Corp.	500	2,000		
Equipment & vehicle	14,565	21,600		
Building	139,736	198,000		
Land	5,000	11,500		
Goodwill	<u>4,167</u>	<u>45,000</u>		
Total Assets	\$165,168	\$289,700		
Liabilities				
Operating loan	\$ 0	\$ 0		
Mortgage	<u>139,000</u>	<u>139,000</u>		
Total liabilities	\$139,000	\$139,000		
Net worth or capital account	<u>\$ 26,168</u>	<u>\$150,700</u>		
Total liabilities and net worth	\$165,168	\$289,700		

¹ A portion of the goodwill gain will qualify as §1245 recapture.

OI=ordinary income; CG=capital gain; DR=depreciation recapture

Use the following table to determine the gain on the distribution of cash after the assets are sold and the mortgage is repaid.

Situation 4, Table B
Distribution of Cash in J & L Custom Cakes, LLC on Dissolution
Form 1065, Schedule M

	Beginning	+	Ordinary	+	=	Ending
	Capital		Income		Capital Gain	Capital
LLC						
Cash in LLC after sale						
Less payment of liabilities						
Cash available for distribution						
Ending capital account (basis)						
Gain on distribution of cash						

Calculate the entries which will appear on the LLCs Schedule M.

Situation 4, Table C
Schedule M Transactions for J & L Custom Cakes,
LLC Showing Final Sale and Distribution of Cash Only
Form 1065, Schedule M

	Beginning	+	Ordinary	+	Other	–	=	Remaining
	Capital		Income		Income			Basis
John								
Lisa								
Total								

Gain or Loss

John must report a _____ of _____ on his tax return.

Lisa must report a _____ of _____ on her tax return.

SITUATION 5. PROPORTIONATE DISTRIBUTION OF ASSETS, FOLLOWED BY A SALE

After the end of the first operating year, John and Lisa decide to dissolve the LLC by distributing the assets and debts to each of the members on a pro rata basis, and then selling the assets. Calculate their respective shares of the FMV of each of the classes of assets.

Situation 5, Table A
Allocation of LLC FMV in J & L Custom Cakes, LLC
to John and Lisa on Dissolution, January 1, 20x2

Assets	FMV	John's 1/3 Share FMV	Lisa's 2/3 Share FMV
Cash	\$ 1,200	_____	_____
Accounts receivable	10,000	_____	_____
Bakery supplies	400	_____	_____
Stock ABC Corp.	2,000	_____	_____
Equipment & vehicle	21,600	_____	_____
Building	198,000	_____	_____
Land	11,500	_____	_____
Goodwill	<u>45,000</u>	_____	=====
Total assets	\$289,700	_____	_____
Liabilities			
Operating loan	\$ 0	_____	_____
Mortgage	<u>139,000</u>	_____	=====
Total Liabilities	\$139,000	_____	_____
Net worth or capital account	<u>150,700</u>	_____	=====
Total liabilities and net worth	\$289,700	_____	_____

Next, allocate each member's basis between cash, unrealized receivables, and inventory.

Situation 5, Table B
Allocation of Basis in J & L Custom Cakes, LLC
on Dissolution

John's basis = capital account	\$ 10,741	+	Share of liabilities	\$ 46,333	=	\$ 57,074
Lisa's basis = capital account	15,427	+	Share of liabilities	92,667	=	108,094
LLC basis = capital account	\$ 26,168	+	Liabilities	\$ 139,000	=	\$ 165,168

	LLC Basis		John's Basis		Lisa's Basis
Total basis					
Less cash received					
Balance					

Unrealized receivables and substantially appreciated inventory

	LLC Basis		John's Basis		Lisa's Basis
Accounts receivable					
Bakery supplies					
Depreciation recapture					
Subtotal UR & SAI					
Adjusted basis for allocation					

Determine the basis for the other assets which are distributed to Lisa under procedures outlined in IRC §732(c).

Situation 5, Table C
Determining Basis for Lisa on Distribution of Other
Property from J & L Custom Cakes, LLC

	1	2	3	4	5	6	7
Assets	Share of LLC Basis	Share of FMV	Unrealized Depreciation	Share of Adjusted Basis	Percentage of Basis	Reduction	Substitute Basis
Stock ABC Corp.	\$ 334	\$ 1,334					
Equipment & vehicle	9,710	14,400		0			
Building	93,158	132,000					
Land	3,334	7,666					
Goodwill	2,778	30,000					
Total assets	\$ 109,314	\$ 185,400		\$ 99,604	100.00%		

Lisa's remaining outside basis for allocation is \$107,294, which is less than her share of the LLC's inside basis of \$109,314. Therefore, she reduces the basis of assets received by \$2,020, as none of the assets have an FMV less than the LLC basis. The decrease is allocated in the same percentage as that of Lisa.

An exception applies to assets that require depreciation recapture. The unrealized depreciation is \$0 if the FMV is greater than the share of LLC basis.

Determine the basis of the other assets which are distributed to John under procedures outlined in IRC §732(c).

Situation 5, Table D
Determining Basis for John on Distribution of Other
Property from J & L Custom Cakes, LLC

Assets	1	2	3	4	5	6
	Share of LLC Basis	Share of FMV	Unrealized Appreciation	Percent Unrealized Appreciation	Allocation	Substitute Basis
Stock ABC Corp.	\$ 167	\$ 667	_____	_____	_____	_____
Equipment & vehicle	4,855	7,200	0	0.00%	_____	_____
Building	46,579	66,000	_____	_____	_____	_____
Land	1,667	3,833	_____	_____	_____	_____
Goodwill	<u>1,389</u>	<u>15,000</u>	_____	_____	_____	_____
Total assets	\$ 54,657	\$ 92,700	_____	_____	_____	_____

Determine the sales results for John and Lisa in the tables below.

John's remaining outside basis for allocation is \$56,674, which is greater than his \$54,657 share of the LLC basis. He is first allocated his share of the LLC inside basis. Next, he is allocated the additional \$2,017 (\$56,674 – \$54,657) which is prorated by the percentage of unrealized appreciation.

No unrealized appreciation is allocated to depreciation recapture items.

Situation 5, Table E
Determining Gain for John on Sale of his
1/3 Share of LLC Assets after a Prorated Distribution

Assets	Adjusted Basis	FMV	John's Gain	Type
Cash	_____	\$ 400	_____	_____
Accounts receivable	_____	3,333	_____	_____
Bakery supplies	_____	133	_____	_____
Stock ABC Corp.	_____	667	_____	_____
Equipment & vehicle	_____	7,200	_____	_____
Building	_____	66,000	_____	_____
Land	_____	3,833	_____	_____
Goodwill	_____	<u>15,000</u>	_____	_____
Total assets	_____	\$ 96,566	_____	_____

Ol=ordinary income; CG=capital gain; DR=depreciation recapture

Situation 5, Table F
Determining Gain for Lisa on Sale of her
 $\frac{2}{3}$ Share of LLC Assets after a Prorated Distribution

Assets	Adjusted Basis	FMV	Lisa's Gain	Type
Cash	_____	\$ 800	_____	_____
Accounts receivable	_____	6,667	_____	_____
Bakery supplies	_____	267	_____	_____
Stock ABC Corp.	_____	1,333	_____	_____
Equipment & vehicle	_____	14,400	_____	_____
Building	_____	132,000	_____	_____
Land	_____	7,667	_____	_____
Goodwill	=====	30,000	_____	_____
Total assets	_____	\$193,134	_____	_____

Ol=ordinary income; CG=capital gain; DR=depreciation recapture

Use the following table to compare the results from Situation 4 to Situation 5.

Situation 5, Table G
Comparison of Sales of Assets within the
LLC (Situation 4) and Distribution of Assets
with Sale Outside the LLC (Situation 5)

	Situation 4 Sale by the LLC	Situation 5 Sale by the Individuals
John		
IRC §1231 gain	_____	_____
Depreciation recapture	_____	_____
Ordinary income	_____	_____
Capital gain on distribution	_____	=====
Net gain	_____	_____
Lisa		
IRC §1231 gain	_____	_____
Depreciation recapture	_____	_____
Ordinary income	_____	_____
Capital gain on distribution	_____	=====
Net gain	_____	_____

SITUATION 6. PROPORTIONATE DISTRIBUTION OF ASSETS, EACH MEMBER TAKING SPECIFIC ASSETS

John and Lisa decide to dissolve their LLC as in Situation 5. When assets and liabilities are distributed, each member takes specific assets. John wants the equipment and Lisa wants the delivery van, land, building and inventory. To prevent the deemed sale of §751 property between the members and the LLC, they carefully allocate the §751 property so that John receives $\frac{1}{3}$ of the property and Lisa receives $\frac{2}{3}$. They accomplish this by each first selecting the assets with potential depreciation recapture associated with them and then dividing the accounts receivable in such a way that John receives his share and Lisa her share. Because there is not enough asset value to allow Lisa to receive all of the land and building, they decide to give John an undivided 20% interest and Lisa an undivided 15% interest. The cash is divided $\frac{1}{3}-\frac{2}{3}$ and the goodwill is split in an amount to make each member receive enough FMV to balance to their respective share of FMV as determined in Table A.

If they take assets they contributed, the pre-contribution gain from depreciation recapture does not have to be allocated according to their capital share.¹ However, post-contribution depreciation must be allocated.

If they decide to accept specific liabilities in other than a $\frac{1}{3}-\frac{2}{3}$ ratio, then adjustments to their basis for the acceptance of each member's share of LLC liabilities and individual assumption of specific liabilities are made prior to Step 1 in Table C.

Use Table A to indicate the IRC §751 assets and non-IRC §751 assets.

Situation 6, Table A
Allocation of LLC FMV Between
Capital Assets and §751 Property

Assets	LLCFMV	IRC §751 Asset	Capital or Other than IRC §751 Asset
Cash	\$ 1,200	\$ 0	\$ 1,200
Accounts receivable	10,000	10,000	0
Bakery supplies	400	400	0
Stock ABC Corp.	2,000	0	2,000
Equipment & vehicle	21,600	7,035	14,565
Building	198,000	0	198,000
Land	11,500	0	11,500
Goodwill	45,000	0	45,000
Total assets	<u>\$289,700</u>	<u>\$ 17,435</u>	<u>\$272,265</u>
John's $\frac{1}{3}$ share	\$ 96,567	\$ 5,812	\$ 90,755
Lisa's $\frac{2}{3}$ share	\$ 193,133	11,623	\$ 181,510

¹ IRC §704(c)

Use Table B to allocate the assets between John and Lisa.

Situation 6, Table B
Allocation of LLC FMV in J & L Custom Cakes, LLC to
John and Lisa in a Proportionate Specific Allocation

Assets	LLC FMV	John		Lisa	
		FMV	\$751 Property	FMV	\$751 Property
Cash	\$ 1,200	\$ 400	\$ 0	\$ 800	\$ 0
Accounts receivable	10,000	2,194	2,194	7,806	7,806
Bakery supplies	400	0	0	400	400
Stock ABC Corp.	2,000	2,000	0	0	0
Equipment & vehicle	21,600	8,600	3,618	13,000	3,417
Building	198,000	39,600	0	158,400	0
Land	11,500	1,725	0	9,775	0
Goodwill	45,000	42,048	0	2,952	0
Total assets	\$289,700	\$96,567	\$ 5,812	\$193,133	\$11,623

Using Table C, determine the remaining basis of the assets after allocations for cash, unrealized receivables, and inventory.

Allocate the basis to the remaining assets of each member by using Tables D & E.

Situation 6, Table C
Allocation of Basis and FMV in J & L Custom Cakes,
LLC to John and Lisa on Dissolution, January 1, 20x2

John's basis = capital account	\$ 10,741	+	Share of liabilities	\$ 46,333	=	\$ 57,074	
Lisa's basis = capital account	15,427	+	Share of liabilities	92,667	=	108,093	
LLC Basis = capital account	\$ 26,168	+	Liabilities	\$139,000	=	\$165,168	
			John			Lisa	
	LLC Basis		FMV	Basis		FMV	Basis
Step 1. Total basis	\$165,168		\$96,567	\$ 57,074		\$193,133	\$108,093
Less cash	(1,200)		(400)	(400)		(800)	(800)
Balance	\$163,968		\$96,167	\$ 56,674		\$192,333	\$107,293
Step 2. Unrealized receivables and substantially appreciated inventory.							
Accounts receivable	\$ 0		\$ 2,194	\$ 0		\$ 7,806	\$ 0
Bakery supplies	0		0	0		400	0
Depreciation recapture	0		3,618	0		3,417	0
Subtotal	\$ 0		\$ 5,812	\$ 0		\$11,623	\$ 0
Remaining FMV & basis for allocation	\$163,968		\$90,355	\$ 56,674		\$180,710	\$107,293

Situation 6, Table D
Allocation of Basis and FMV of Other Property in J & L
Custom Cakes, LLC to Lisa on Dissolution

	1	2	3	4	5	6	7
Assets	Share of LLC Basis	Share of FMV	Unrealized Depreciation	Share Adjusted Basis	Percent Adjusted Basis	Reduction	Substitute Basis
Equipment & vehicle	\$ 9,583	\$ 13,000	\$ 0	\$ 9,583	_____	_____	_____
Building	111,789	158,400	0	111,789	_____	_____	_____
Land	4,000	9,775	0	4,000	_____	_____	_____
Goodwill	273	2,952	0	273	_____	_____	_____
Total	\$125,645	\$184,127	\$ 0	\$125,645	100.00%	\$ (18,351)	_____

Situation 6, Table E
Allocation of Basis and FMV of Other Property in J & L
Custom Cakes, LLC to John on Dissolution

	1	2	3	4	5	6
Assets	Share of LLC Basis	Share of FMV	Unrealized Appreciation	Percent Unrealized Appreciation	Allocation	Substitute Basis
Stock ABC Corp.	\$ 500	\$ 2,000	\$ 1,500	_____	_____	_____
Equipment & vehicle	4,982	8,600	0	_____	_____	_____
Building	27,947	39,600	11,653	_____	_____	_____
Land	1,000	1,725	725	_____	_____	_____
Goodwill	3,894	42,048	38,154	_____	_____	_____
Total	\$ 38,323	\$ 93,973	\$ 52,032	100.00%	\$ 18,351	_____

Because John received all of the equipment and vehicles, the basis of each item of equipment must be determined using Table F.

SITUATION 7. SALE OF A PARTIAL OR TOTAL INTEREST — LLC NOT TERMINATED

On January 1, 20x2, Lisa decides to sell half of her $\frac{2}{3}$ interest in J & L Custom Cakes, LLC to Gabe. This forms a new equal $\frac{1}{3}$ LLC of John, Lisa and Gabe. Since only $\frac{1}{3}$ of the member interest is being sold, the LLC does not terminate.

Use Table A to allocate the bases of the LLC assets between John and Lisa.

Situation 7, Table A
Allocation of Basis in J & L Custom Cakes, LLC to Lisa on January 1, 20x2
(See Situation 5 for details of this transaction)

John's basis = capital account	\$ 10,741	+	Share of liabilities	\$ 46,333	=	\$ 57,074
Lisa's basis = capital account	15,427	+	Share of liabilities	92,667	=	108,093
LLC basis = capital account	<u>\$ 26,168</u>	+	Liabilities	<u>\$139,000</u>	=	<u>\$165,168</u>

	LLC Basis	John's Basis	Lisa's Basis
Total basis	\$165,168	\$ 57,074	\$108,093
less cash	(1,200)	(400)	(800)
Balance	\$163,968	\$ 56,674	\$107,293

Unrealized receivables and substantially appreciated inventory

	LLC Basis	John's Basis	Lisa's Basis
Accounts receivable	\$ 0	\$ 0	\$ 0
Bakery supplies	0	0	0
Depreciation recapture	<u>0</u>	<u>0</u>	<u>0</u>
Subtotal UR & SAI	\$ 0	\$ 0	\$ 0
Adjusted basis for allocation	\$163,968	\$ 56,674	\$107,293
Stock ABC Corp.	\$ 500	\$ 195	\$ 327
Equipment & vehicle	14,565	4,855	9,710
Building	139,736	47,677	91,268
Land	5,000	1,789	3,266
Goodwill	<u>4,167</u>	<u>2,158</u>	<u>2,722</u>
Total	\$163,968	\$ 56,674	\$107,293

Use Table B to show the sale of $\frac{1}{2}$ of Lisa's share to Gabe.

Situation 7, Table B
Sale of $\frac{1}{2}$ of Lisa's J & L Custom Cakes, LLC Interest to Gabe

Assets	Lisa's $\frac{2}{3}$ Share		Sale of $\frac{1}{2}$ of Lisa's Share to Gabe		Gain to Lisa
	Adjusted Basis	FMV	Adjusted Basis	FMV	
Cash	\$ 800	\$ 800	_____	_____	_____
Accounts receivable	0	6,667	_____	_____	_____
Bakery supplies	0	267	_____	_____	_____
Stock ABC Corp.	327	1,333	_____	_____	_____
Equipment & vehicle	9,710	14,400	_____	_____	_____
Building	91,268	132,000	_____	_____	_____
Land	3,266	7,667	_____	_____	_____
Goodwill	<u>2,722</u>	_____	=====	=====	=====
Total assets	\$108,093	\$193,134	_____	_____	_____
Liabilities and capital					
Liabilities	\$92,667	\$92,667	_____	_____	_____
Capital	<u>15,427</u>	<u>100,467</u>	_____	=====	_____
Total	\$108,093	\$193,134	_____	_____	_____

OI=ordinary income; CG=capital gain; DR=depreciation recapture

Calculate Lisa's gain by using Table C.

Situation 7, Table C
**Sale of $\frac{1}{2}$ of Lisa's Interest in J
 & L Custom Cakes, LLC to Gabe**
Calculation of Profit and Allocation of Gain

Cash or notes received by Lisa	_____
Liabilities assumed by Gabe ($\frac{1}{3}$ of \$139,000)	_____
Amount realized	_____
Lisa's basis in the $\frac{1}{2}$ interest	=====
Lisa's total gain	_____
Lisa's ordinary income and depreciation recapture (Table C) Part II, Form 4797	=====
Lisa's capital gain (Table C) Part II Schedule D	_____

Allocate the basis of the LLC property under IRC §743(b) for Gabe using Tables D & E.

Situation 7, Table D
Allocation of Basis of LLC Property under IRC §743(b) for Gabe

	Partnership Assets		
	Adjusted Basis	FMV	Difference
IRC §§1221 and 1231 property			
Stock ABC Corp.	\$ 500	\$ 2,000	\$ 1,500
Equipment	14,565	21,600	7,035
Buildings	139,736	198,000	58,264
Land	5,000	11,500	6,500
Goodwill	<u>4,167</u>	<u>45,000</u>	<u>40,833</u>
Total	\$163,968	\$278,100	\$114,132
Other property			
Cash	\$ 1,200	\$ 1,200	\$ 0
Accounts receivable	0	10,000	10,000
Bakery supplies	<u>0</u>	<u>400</u>	<u>400</u>
Total	\$ 1,200	\$11,600	\$10,400
Total assets	\$165,168	\$289,700	\$124,532

Situation 7, Table E

Calculation of Special Allocation for Gabe after Purchase of Lisa's LLC Interest

Cash paid	_____
Liabilities assumed	=====
Gabe's outside basis	_____
Gabe's inside basis = 1/3 of LLC adjusted basis	_____
Amount of adjustment	\$ 41,511

	Difference between FMV and LLC Basis	Percent		Member Adjustment	Amount of Adjustment
Step 1					
A) Capital assets	_____	_____	x	_____	_____
B) Other property	=====	_____	x	_____	=====
Total adjustment	_____	_____			_____
Step 2					
A) IRC §§ 1221 and 1231 property					
Stock ABC Corp.	_____	_____	x	_____	_____
Equipment & vehicle	_____	_____	x	_____	_____
Building	_____	_____	x	_____	_____
Land	_____	_____	x	_____	_____
Goodwill	=====	_____	x	_____	=====
Total adjustment	\$ 114,132	_____			\$ 38,044
B) Other Property					
Accounts receivable	_____	_____	x	_____	_____
Bakery supplies	=====	_____	x	_____	=====
Total	\$ 10,400	_____			\$ 3,467
Total					\$ 41,511

SITUATION 8. SALE OF A TOTAL LLC INTEREST WITH LLC TERMINATED

On January 1, 20x2, Lisa decides to sell her total interest in the J & L Custom Cakes, LLC to John and Gabe, who become equal members. As in **Situation 7**, the first step is to allocate the basis of the selling member's LLC interest to the LLC assets (**Table 8A**) to determine the classification of Lisa's gain.

Use Table A to determine Lisa's bases in the assets of the LLC.

Situation 8, Table A
Allocation of Basis in J & L Custom Cakes, LLC to Lisa on January 1, 20x2
(See Situation 5 for details of this transaction)

John's basis = capital account	\$ 10,741	+	Share of liabilities	\$ 46,333	=	\$ 57,074
Lisa's basis = capital account	15,427	+	Share of liabilities	92,667	=	108,093
LLC basis = capital account	\$ 26,168	+	Liabilities	\$139,000	=	\$165,168
	LLC Basis		John's Basis			Lisa's Basis
Total basis	\$165,168		\$ 57,074			\$108,093
less cash	(1,200)		(400)			(800)
Balance	\$163,968		\$ 56,674			\$107,293
Unrealized receivables and substantially appreciated inventory						
	LLC Basis		John's Basis			Lisa's Basis
Accounts receivable	\$ 0		\$ 0			\$ 0
Bakery supplies	0		0			0
Depreciation recapture	<u>0</u>		<u>0</u>			<u>0</u>
Subtotal UR & SAI	\$ 0		\$ 0			\$ 0
Adjusted basis for allocation	\$163,968		\$ 56,674			\$107,293
Stock ABC Corp.	\$ 500		\$ 195			\$ 327
Equipment & vehicles	14,565		4,855			9,710
Building	139,736		47,677			91,268
Land	5,000		1,789			3,266
Goodwill	<u>4,167</u>		<u>2,158</u>			<u>2,722</u>
	\$163,968		\$ 56,674			\$107,293

Since Lisa has a greater than 50% interest in J & L Custom Cakes, LLC, the sale of her interest terminates the LLC. The sale requires allocation of Lisa's basis of her share of the assets as in **Situation 5, Table B**. Lisa sells $\frac{1}{4}$ of her interest to John. Use Table B to determine Lisa's gain on the $\frac{1}{4}$ interest.

Situation 8, Table B
Sale of Lisa's $\frac{2}{3}$ Interest in
J & L Custom Cakes, LLC — Sale of 25% of Lisa's Interest to John

Assets	Lisa's $\frac{2}{3}$ Share		Sale of 25% of Lisa's Share to John		Gain to Lisa
	Adjusted Basis	FMV	Adjusted Basis	FMV	
Cash	\$ 800	\$ 800			
Accounts receivable	0	6,667			
Bakery supplies	0	267			
Stock ABC Corp.	327	1,333			
Equipment & vehicle	9,710	14,400			
Building	91,268	132,000			
Land	3,266	7,667			
Goodwill	<u>2,722</u>	<u>30,000</u>			
Total assets	\$108,093	\$193,134			\$ 21,260
Liabilities and capital					
Liabilities	\$92,667	\$92,667			
Capital	<u>15,427</u>	<u>100,467</u>			
Total	\$108,093	\$193,134			

OI=ordinary income; CG=capital gain; DR=depreciation recapture

Use Table C below to determine the gain on the $\frac{3}{4}$ interest sold to Gabe.

Situation 8, Table C
Sale of Lisa's $\frac{2}{3}$ Interest in J & L Custom Cakes, LLC
 — Sale of 75% of Lisa's Interest to Gabe

Assets	Lisa's $\frac{2}{3}$ Share		Sale of 75% of Lisa's Share to Gabe		Gain to Lisa
	Adjusted Basis	FMV	Adjusted Basis	FMV	
Cash	\$ 800	\$ 800	_____	_____	_____
Accounts receivable	0	6,667	_____	_____	_____
Bakery supplies	0	267	_____	_____	_____
Shares ABC Corp.	327	1,333	_____	_____	_____
Equipment & vehicle	9,710	14,400	_____	_____	_____
Building	91,268	132,000	_____	_____	_____
Land	3,266	7,667	_____	_____	_____
Goodwill	<u>2,722</u>	<u>30,000</u>	_____	_____	_____
Total assets	\$108,093	_____	_____	_____	\$ 63,780
Liabilities and capital					
Liabilities	\$ 92,667	\$ 92,667	_____	_____	_____
Capital	<u>15,247</u>	<u>100,467</u>	_____	_____	_____
Total	\$108,094	\$193,134	_____	_____	_____

OI=ordinary income; CG=capital gain; DR=depreciation recapture

Table D is used to show Lisa's total gain from the sale.

Situation 8, Table D
Taxable Gain from Sale of Lisa's Former LLC
 Interest- 25% to John and 75% to Lisa

Assets	Gain to Lisa Sale to John	Gain to Lisa Sale to Gabe	Total Gain
Cash	_____	_____	_____
Accounts receivable	_____	_____	_____
Bakery supplies	_____	_____	_____
Stock ABC Corp.	_____	_____	_____
Equipment & vehicle	_____	_____	_____
Building	_____	_____	_____
Land	_____	_____	_____
Goodwill	_____	_____	_____
Total	_____	_____	_____

Assume John and Gabe want to make an IRC §743(b) election. Use Tables E to begin the process.

Situation 8, Table E
Allocation of Basis of LLC Property
under IRC §743(b) for John and Gabe

	Adjusted Basis	FMV	Difference
IRC §§1221 and 1231 property			
Stock ABC Corp.	\$ 500	\$ 2,000	\$ 1,500
Equipment & vehicle	14,565	21,600	7,035
Building	139,736	198,000	58,264
Land	5,000	11,500	6,500
Goodwill	<u>4,167</u>	<u>45,000</u>	<u>40,833</u>
Total	\$163,968	\$278,100	\$114,132
Other property			
Cash	\$ 1,200	\$ 1,200	\$ 0
Accounts receivable	0	10,000	10,000
Bakery supplies	<u>0</u>	<u>400</u>	<u>400</u>
Total	\$ 1,200	\$ 11,600	\$ 10,400
Total assets	\$165,168	\$289,700	\$124,532

Use Table F to determine the amount of Gabe's adjustment.

Situation 8, Table F
Calculation of Special Allocation for Gabe after Purchase of a 50% LLC Interest from Lisa

50% of J & L Custom Cakes, LLC				
	Gabe's Outside Basis	Gabe's Share of Inside Basis		Difference
IRC §§1221 and 1231 property				
Stock ABC Corp.	_____	_____		_____
Equipment & vehicle	_____	_____		_____
Building	_____	_____		_____
Land	_____	_____		_____
Goodwill	=====	=====		=====
Total				
Cash	_____	_____		_____
Accounts receivable	_____	_____		_____
Bakery supplies	_____	_____		_____
Total	=====	=====		=====
	_____	_____		_____
Total assets	\$144,850	\$ 82,585		\$ 62,265
	Difference between FMV and LLC Basis	Percent	Member Adjustment	Amount of Adjustment
Step 1				
A) Capital assets	\$114,132	91.65%	×	_____
B) Other property	10,400	8.35%	×	_____
Total adjustment	\$124,532	100.00%		\$124,530
				\$ 62,265
Step 2				
A) IRC §§1221 and 1231 property				
Stock ABC Corp.	\$ 1,500	1.31%	×	_____
Equipment & vehicle	7,035	6.16%	×	_____
Building	58,264	51.05%	×	_____
Land	6,500	5.70%	×	_____
Goodwill	40,833	35.78%	×	=====
Total adjustment	\$114,132	100.00%		_____
B) Other Property				
Cash	\$ 0	0.00%	×	_____
Accounts receivable	10,000	96.15%	×	_____
Bakery supplies	400	3.85%	×	=====
Total	\$10,400	100.00%		_____
Total	\$124,532			_____

Next, use Table G to recombine Gabe's $\frac{1}{2}$ of his LLC basis with his special basis allocation.

Situation 8, Table G
Recombination of Gabe's $\frac{1}{2}$ of the LLC Basis from J
& L Custom Cakes, LLC and His Special Allocation

Asset	LLC Basis	50% of Basis	Special Allocation	New Basis Allocation
Cash	\$ 1,200	_____	_____	_____
Accounts receivable	0	_____	_____	_____
Bakery supplies	0	_____	_____	_____
Stock ABC Corp.	500	_____	_____	_____
Equipment & vehicle	14,565	_____	_____	_____
Building	139,736	_____	_____	_____
Land	5,000	_____	_____	_____
Goodwill	<u>4,167</u>	_____	_____	_____
Total assets	\$165,168	_____	\$ 62,265	\$144,850

Table H can be used to determine the amount of John's adjustment.

Situation 8, Table H
Calculation of Special Allocation for John after Purchase of a 1/6 LLC Interest from Lisa

50% of J & L Custom Cakes, LLC					
	John's Outside Basis	John's Share of Inside Basis		Difference	
IRC §§1221 and 1231 property					
Stock ABC Corp.	\$ 333	\$ 83		\$ 250	
Equipment & vehicle	3,600	2,428		1,172	
Building	33,000	23,289		9,711	
Land	1,917	833		1,084	
Goodwill	<u>7,500</u>	<u>695</u>		<u>6,805</u>	
Total	\$ 46,350	\$ 27,328		\$ 19,022	
Cash	\$ 200	\$ 200		\$ 0	
Accounts receivable	1,667	0		1,667	
Bakery supplies	<u>67</u>	<u>0</u>		<u>67</u>	
Total	\$ 1,933	\$ 200		\$ 1,733	
Total assets	\$ 48,283	\$ 27,528		\$ 20,755	
	Difference between FMV and LLC Basis	Percent		Member Adjustment	Amount of Adjustment
Step 1					
A) Capital assets	\$114,132	91.65%	×	\$ 20,755	\$ 19,022
B) Other property	<u>10,400</u>	<u>8.35%</u>	×	20,755	<u>1,733</u>
Total adjustment	124,532	100.00%			\$ 20,755
Step 2					
A) IRC §§1221 and 1231 property					
Stock ABC Corp.	\$ 1,500	1.31%	×	\$ 19,022	\$ 250
Equipment & vehicle	7,035	6.16%	×	19,022	1,173
Building	58,264	51.05%	×	19,022	9,711
Land	6,500	5.70%	×	19,022	1,083
Goodwill	<u>40,833</u>	<u>35.78%</u>	×	19,022	<u>6,806</u>
Total adjustment	\$114,132	100.00%			\$ 19,022
B) Other Property					
Accounts receivable	\$ 10,000	96.15%	×	\$ 1,733	\$ 1,667
Bakery supplies	<u>400</u>	<u>3.85%</u>	×	1,733	<u>67</u>
Total	\$ 10,400	100.00%			\$ 1,733
Total	\$124,532				\$ 20,755

John's new basis allocation can be determined using Table I.

Situation 8, Table I
Recombination of John's $\frac{1}{3}$ Interest in J & L
Custom Cakes, LLC with the Purchase From Lisa

Assets	LLC Basis	Purchased 16.7% Basis	+	Special Allocation	+	John's $\frac{1}{3}$ Interest	=	New Basis Allocation
Cash	\$ 1,200	_____		_____		_____		_____
Accounts receivable	0	_____		_____		_____		_____
Bakery supplies	0	_____		_____		_____		_____
Stock ABC Corp.	500	_____		_____		_____		_____
Equipment & vehicle	14,565	_____		_____		_____		_____
Building	139,736	_____		_____		_____		_____
Land	5,000	_____		_____		_____		_____
Goodwill	4,167	_____		_____		_____		_____
Total assets	\$165,168	\$27,528		\$20,755		\$55,057		\$103,340

Finally, John and Gabe's basis can be recombined.

Situation 8, Table J
Recombination of John's and Gabe's Basis in
Assets Distributed from J & L Custom Cakes, LLC

Asset	John's Basis	Gabe's Basis	J & L Custom Cakes, LLC
Cash	_____	_____	_____
Accounts receivable	_____	_____	_____
Bakery supplies	_____	_____	_____
Stock ABC Corp.	_____	_____	_____
Equipment & vehicle	_____	_____	_____
Building	_____	_____	_____
Land	_____	_____	_____
Goodwill	_____	_____	_____
Total assets	\$103,342	\$144,850	\$248,192

**SITUATION 9. SALE OF AN LLC INTEREST WITH
THE §754 ELECTION NOT MADE FOR THE NEW MEMBER INTERESTS**

Use the same scenario as **Situation 8**, except no §754 election is in effect. Therefore, the outside basis for the $\frac{1}{6}$ share purchased by John is not recognized by a special allocation of the difference between John's additional share of the inside basis and his outside basis. If the §754 election were made, he could receive an additional \$20,755 of basis applied to the share of the assets purchased as in **Situation 8, Table H**. For Gabe, the difference is \$62,265. (**Situation 8, Table F**).

Situation 9, Table A
Difference in Assets' Basis Between Making and Not Making the
§754 Election for J & L Custom Cakes, LLC Members

Assets	754 Election Made	754 Election Not Made	Difference in Basis
Cash	_____	\$ 1,200	_____
Accounts receivable	_____	0	_____
Bakery supplies	_____	0	_____
Stock ABC Corp.	_____	500	_____
Equipment & vehicle	_____	14,565	_____
Building	_____	139,736	_____
Land	_____	5,000	_____
Goodwill	_____	4,167	_____
Total basis	_____	\$165,168	\$83,022

**SITUATION 10. COMPLETE WITHDRAWAL (LIQUIDATION)
OF A MEMBER WITH A SINGLE PAYMENT**

On January 1, Lisa decides to withdraw from J & L Custom Cakes, LLC. Use the same balance sheet as January 1, 20x2 from **Situation 7, Table A**, which shows the outcome after Lisa sold 1/2 of her LLC interest to Gabe.

The decision is made to liquidate Lisa's remaining interest rather than John and Gabe purchasing Lisa's interest as in **Situation 8**.

Use Table A to calculate Lisa's and John's bases.

Situation 10, Table A
Allocation of Basis in J & L Custom Cakes, LLC to Lisa on January 1, 20x2

John's basis = capital account	\$ 10,741	+	Share of liabilities	46,333	=	\$ 57,074
Lisa's Basis = capital account	15,427	+	Share of liabilities	92,667	=	108,093
LLC Basis = capital account	\$ 26,168	+	Liabilities	\$139,000	=	\$165,168

	LLC Basis	John's Basis	Lisa's Basis
Total basis	\$165,168	\$ 57,074	\$108,093
less cash	(1,200)	(400)	(800)
Balance	\$163,968	\$ 56,674	\$107,293

Unrealized receivables and substantially appreciated inventory

	LLC Basis	John's Basis	Lisa's Basis
Accounts receivable	\$ 0	\$ 0	\$ 0
Bakery supplies	0	0	0
Depreciation recapture	0	0	0
Subtotal UR & SAI	\$ 0	\$ 0	\$ 0
Adj. basis for allocation	\$163,968	\$ 56,674	\$107,293
Stock ABC Corp.	\$ 500	\$ 195	\$ 327
Equipment & vehicle	14,565	4,855	9,710
Building	139,736	47,677	91,268
Land	5,000	1,789	3,266
Goodwill	4,167	2,158	2,722
Total	\$163,968	\$ 56,674	\$107,293

For liquidations after August 5, 1997, all LLC liquidations require an allocation of ordinary income property for the liquidated member since there is no longer a test for appreciated inventory. Therefore, Lisa's LLC interest must be allocated to her share. Use Table B for this calculation.

Use Table B to show the gain on the respective classes of property.

Situation 10, Table B
Liquidation of Lisa's Remaining $\frac{1}{3}$ Interest in J & L Custom Cakes, LLC

Assets	Lisa's $\frac{2}{3}$ Share		Liquidation of Lisa's $\frac{1}{3}$ Share		Gain to Lisa's	
	Adjusted Basis	FMV	Adjusted Basis	FMV		
Cash	\$ 800	\$ 800	_____	_____	_____	_____
Accounts receivable	0	6,667	_____	_____	_____	_____
Bakery supplies	0	267	_____	_____	_____	_____
Stock ABC Corp.	327	1,333	_____	_____	_____	_____
Equipment & vehicle	9,710	14,400	_____	_____	_____	_____
Building	91,268	132,000	_____	_____	_____	_____
Land	3,266	7,667	_____	_____	_____	_____
Goodwill	<u>2,722</u>	<u>30,000</u>	_____	_____	_____	_____
Total assets	\$108,093	\$193,134	\$ 54,047	\$ 96,569	\$ 42,522	
Liabilities and capital						
Liabilities	\$ 92,667	\$ 92,667	_____	_____		
Capital	<u>15,427</u>	<u>100,467</u>	_____	_____		
Total	\$108,093	\$193,134	_____	_____		

OI = ordinary income; CG = capital gain; DR = depreciation recapture

Liquidation differs from a sale. Complete **Table C** to show a classification of the liquidation payments into the following three categories:

1. §736(b) payments for capital gain property,
2. §736(b) payments for ordinary income property, and
3. §736(a) payments for other.

Situation 10, Table C
Classification of Liquidation Payments for Lisa on
Liquidation of her LLC Interest with a Single Cash Payment

Type of Property	Adjusted Basis of Interest	FMV of Lisa's Interest ¹	Gain
IRC §736(b) payments for capital gain property			
Cash	\$ 400	\$ 400	\$ 0
Stock ABC Corp.	164	667	503
Equipment & vehicle	4,855	4,855	0
Building	45,634	66,000	20,366
Land	1,633	3,834	2,201
Goodwill	1,361	15,000	13,639
Total	<u>\$ 54,047</u>	<u>\$ 90,756</u>	<u>\$ 36,709</u>
IRC §736(b) payments for substantially appreciated inventory			
Accounts receivable	\$ 0	\$ 3,334	\$ 3,334
Bakery supplies	0	134	134
Depreciation recapture	0	2,345	2,345
Total	<u>\$ 0</u>	<u>\$ 5,813</u>	<u>\$ 5,813</u>
IRC §736(a) other payments, including unrealized receivables			
Other	0	0	0
Total	<u>\$ 54,047</u>	<u>\$ 96,569</u>	<u>\$ 42,522</u>

¹ Depreciation recapture is treated as an unrealized receivable. However, in a liquidation it is considered to be property, which like an installment sale, must be reported as ordinary income in the year of sale.

The calculation of total gain and determination of where the items are reported can be shown in **Table D**.

Situation 10, Table D
Calculation of Profit for Lisa in
Complete Liquidation of her LLC Interest

Liquidation payment, January 1, 20x2	
Lisa's liabilities assumed	
Amount realized	
Lisa's basis	
Lisa's total gain	

If the LLC made a §754 election, you can use **Tables E and F** indicate the adjustments the LLC makes based on the same procedure as in **Situation 7, Tables D and E**.

Situation 10, Table E
Allocation of Basis of LLC Property Under IRC §743(b) for the LLC

	LLC Assets		
	Adjusted Basis	FMV	Difference
IRC §§1221 and 1231 property			
Stock ABC Corp.	\$ 500	\$ 2,000	\$ 1,500
Equipment & vehicle	14,565	21,600	7,035
Building	139,736	198,000	58,264
Land	5,000	11,500	6,500
Goodwill	4,167	45,000	40,833
Total	\$163,968	\$278,100	\$114,132
Other property			
Cash	\$ 1,200	\$ 1,200	\$ 0
Accounts receivable	0	10,000	10,000
Bakery supplies	0	400	400
Total	\$ 1,200	\$11,600	\$10,400
Total assets	\$165,168	\$289,700	\$124,532

Situation 10, Table F
Calculation of Special Allocation After Liquidation
of Lisa's Interest by J & L Custom Cakes, LLC

	Difference between FMV and LLC Basis	Percent		Member Adjustment	Amount of Adjustment
Step 1					
A) Capital assets	_____	_____	×	_____	_____
B) Other property	=====	_____	×	_____	=====
Total adjustment	_____	_____			_____
Step 2					
A) IRC §§1221 and 1231 property					
Stock ABC Corp.	_____	_____	×	_____	_____
Equipment & vehicle	_____	_____	×	_____	_____
Building	_____	_____	×	_____	_____
Land	_____	_____	×	_____	_____
Goodwill	=====	_____	×	_____	=====
Total adjustment	_____	_____			_____
B) Other property					
Accounts receivable	_____	_____	×	_____	_____
Bakery supplies	=====	_____	×	_____	=====
Total	_____	_____			_____
Total	_____				\$41,511

The exception is that only §736(b) payments are allocated. Since §736(b) payments are made by the LLC, the basis adjustments are added directly to the balance sheet and can be shown in **Table G**. Or, they are maintained as a separate schedule to be allocated to the LLC in the same manner as the special allocation to Gabe as shown in **Situation 7**. Assume the LLC borrows \$50,000 to provide enough cash to make the payment to Lisa.

Situation 10, Table G
Balance Sheet Adjustments for Liquidation Payment
for Appreciated Inventory and IRC §754 Election

Assets	Opening Balance	+	Adjustments	=	Balance After Adjustments
Cash	\$ 1,200		For loan <u>(50,236)^a</u>		<u> </u>
Accounts receivable	\$ 0		<u> </u>		<u> </u>
Bakery supplies	0		<u> </u>		<u> </u>
Stock ABC Corp.	500		<u> </u>		<u> </u>
Equipment & vehicle	14,565		<u> </u>		<u> </u>
Building	139,736		<u> </u>		<u> </u>
Land	5,000		<u> </u>		<u> </u>
Goodwill	<u>4,167</u>		<u> </u>		<u> </u>
Total assets	\$165,168		\$ 41,274		<u> </u>
Liabilities and capital					
Liabilities	\$139,000		Increase \$ 50,000		<u> </u>
Capital	26,168		<u>(50,236)^b</u> 41,510 ^c		<u> </u>
Total	\$165,168		\$ 41,274		<u> </u>

^a Liquidation payment.

^b Addition to basis.

^c Cash distribution to Lisa: net reduction in cash that reduces the total adjustment on the balance sheet from \$41,511 to \$41,274.

**SITUATION 11. COMPLETE WITHDRAWAL (LIQUIDATION)
OF A MEMBER WITH A SERIES OF FIXED PAYMENTS**

Instead of taking all the cash at once, Lisa and the LLC agree to a series of fixed payments from the LLC. In this situation, the two parties know the financial commitment in advance. The total payments are greater than in **Situation 10** to reflect the time value of money.

Lisa and the LLC agree on a series of 10 payments of \$10,000 each, with a down payment of an additional \$25,000.

First, use the basis of Lisa's LLC interest to allocated to her share of the assets, and show in shown in **Table A**.

Situation 11, Table A
Allocation of Basis in J & L Custom Cakes, LLC to Lisa on January 1, 20x2

John's basis = capital account	\$ 10,741	+	Share of liabilities	\$ 46,333	=	\$ 57,074
Lisa's basis = capital account	15,427	+	Share of liabilities	92,667	=	108,093
LLC Basis = capital account	\$ 26,168	+	Liabilities	\$139,000	=	\$165,168
	LLC Basis		John's Basis			Lisa's Basis
Total basis	\$165,168		\$ 57,074			\$108,093
less cash	(1,200)		(400)			(800)
Balance	\$163,968		\$ 56,674			\$107,293
Unrealized receivables and substantially appreciated inventory						
	LLC Basis		John's Basis			Lisa's Basis
Accounts receivable	\$ 0		\$ 0			\$ 0
Bakery supplies	0		0			0
Depreciation recapture	0		0			0
Subtotal UR & SAI	\$ 0		\$ 0			\$ 0
Adjusted basis for allocation	\$163,968		\$ 56,674			\$107,293
Stock ABC Corp.	\$ 500		\$ 195			\$ 327
Equipment & vehicle	14,565		4,855			9,710
Building	139,736		47,677			91,268
Land	5,000		1,789			3,266
Goodwill	4,167		2,158			2,722
Total	\$163,968		\$ 56,674			\$107,293

Complete **Table B** to show the reportable gain for property, which is allocated for §736(b) liquidation purposes.

Situation 11, Table B
Liquidation of Lisa's Remaining $\frac{1}{3}$ Interest in J & L Custom Cakes, LLC

Assets	Lisa's $\frac{2}{3}$ Share		Liquidation of Lisa's $\frac{1}{3}$ Share		Gain to Lisa	
	Adjusted Basis	FMV	Adjusted Basis	FMV		
Cash	\$ 800	\$ 800	\$ 400	\$ 400	\$ 0	
Accounts receivable	0	6,667	0	3,334	3,334	OI
Bakery supplies	0	267	0	134	134	OI
Stock ABC Corp.	327	1,333	164	667	503	CG
Equipment & vehicle	9,710	14,400	4,855	7,200	2,345	DR
Building	91,268	132,000	45,634	66,000	20,366	CG
Land	3,266	7,667	1,633	3,834	2,201	CG
Goodwill	<u>2,722</u>	30,000	<u>1,361</u>	15,000	<u>13,639</u>	CG
Total assets	\$108,093	\$193,134	\$54,047	\$96,569	\$42,522	
Liabilities and capital						
Liabilities	\$ 92,667	\$ 92,667	\$ 46,333	\$ 46,333		
Capital	<u>15,427</u>	<u>100,467</u>	<u>7,714</u>	<u>50,236</u>		
Total	\$108,093	\$193,134	\$54,047	\$96,569		

OI = ordinary income; CG = capital gain; DR = depreciation recapture

Use Table C to classify Lisa's liquidation payments.

Situation 11, Table C
Classification of Liquidation Payments for
Lisa on Liquidation of her LLC Interest

Type of Property	Adjusted Basis of Interest	FMV of Lisa's Interest ¹	Gain
IRC §736(b) payments for capital gain property			
Cash	\$ 400	\$ 400	\$ 0
Stock ABC Corp.	164	667	503
Equipment & vehicle	4,855	4,855	0
Building	45,634	66,000	20,366
Land	1,633	3,834	2,201
Goodwill	1,361	15,000	13,639
Total	\$ 54,047	\$ 90,756	\$ 36,709
IRC §736(b) payments for substantially appreciated inventory			
Accounts receivable	\$ 0	\$ 3,334	\$ 3,334
Bakery supplies	0	134	134
Depreciation recapture	0	2,345	2,345
Total	\$ 0	\$ 5,813	\$ 5,813
IRC §736(a) other payments, including unrealized receivables			
Other	0	74,764	74,764
Total	\$ 54,047	\$171,333	\$117,286

¹ Depreciation recapture is treated as an unrealized receivable. However, in a liquidation it is considered to be property, which like an installment sale, must be reported as ordinary income in the year of sale.

Complete **Table D** to show the calculation of gain for Lisa.

Situation 11, Table D
Calculation of Gain for Lisa for Fixed Liquidation Payments
(Fixed Liquidation Payments of \$10,000 for 10 Years)

Liquidation payments (10 × \$10,000) + \$25,000 down payment	
Lisa's liabilities assumed by the LLC	
Amount realized	
Lisa's basis	
Lisa's total gain	
Payments received:	
20x2: cash distribution	
20x2: liabilities assumed by LLC	
Amount realized in 20x2	

Use Table E to calculate the allocation of payments between various types of income. Remember that in year 1 Lisa must also report the debt which was assumed.

Each annual payment is split between IRC § 736(b) portion and IRC §736(a) portion by calculating the ratio of the total IRC §736 (b) payments to the total amount received.

$$\text{\$736(b)\%} = \frac{\text{Total \text{\$736(b) payments}}}{\text{Amount Realized}} = \frac{\text{\$96,569}}{\text{\$171,333}} = 56.363339\%$$

The 20x2 §736(b) payment is $56.363339\% \times \$81,333 = \$45,842$

The ordinary IRC §736(b) gain is reported first and then the IRC §736(b) basis which is \$40,029 (\$45,842 IRC §736(b) less \$5,813 ordinary gain). This reduces Lisa’s basis from \$54,047 to \$14,018 to be recovered in a future year or years. If the first year payment is not sufficient to cover the ordinary gain, the additional ordinary gain is still reported and then added to basis for future year’s recovery before capital gain.

20x2 IRC §736(b) payment	\$ 45,842
Less IRC §736(b) SAI (ordinary gain)	(5,813)
Balance	<u>\$ 40,029</u>
Basis in IRC §736(b) property	54,047
Basis left to recover	<u>\$ 14,018</u>

The 20x2 IRC §736(a) payment is \$35,491 or (\$81,333 – \$45,842).

The 20X3 payment of \$10,000 is \$5,636 IRC §736(b) fully used to reduce basis.

The IRC §736(a) is \$10,000 – \$5,636 or \$4,364.

The LLC reporting is as follows:

- The §736(b) cash payment is reported annually as a distribution on Schedule M, Form 1065.
- The LLC reports a guaranteed payment on Form 1065 equivalent to the §736(a) payment.
- If the LLC makes a §754 election, the LLC increases its basis each year in property by the annual §736(b) gain on property reported by Lisa. This is the same as **Situation 10, Tables E and F**.

Gain is reported by Lisa as follows:

- The §736(b) payment for capital gain property is reported on Lisa’s Schedule D, Part II.
- The §736(b) payment for substantially appreciated inventory is reported on Lisa’s Form 4797, Part II.
- The §736(a) payment is reported as a guaranteed payment on her Schedule K-1 and then Schedule E.

Table E is the liquidation schedule for the annual reporting of the liquidation payments made to Lisa. The first year is confusing because the liability assumption of \$46,333 must be reported in Year 1.

Lisa's beginning basis is \$54,047, which is reflected by a capital account of \$7,713 and share of liabilities of \$46,333. Since the §736(a) payment of \$35,491 exceeds the actual cash withdrawal of \$35,000, the difference is added to Lisa's beginning capital account. The ending capital account is verified by deducting the §736(b) basis reduction from Lisa's beginning basis (\$54,047 – \$40,029 = 14,108). Following is a summary of the annual reporting in **Table E**.

- Year 20x3** Ordinary gain of \$4,364 and no capital gain with an allocation.
- Year 4** No capital gain reported by Lisa and no step up in basis for the members.
- Year 5** \$2,891 of capital gain (\$5,636 of §736(b) payment – \$2,745 remaining basis).
- Year 6–11** \$5,636 of capital gain reported by Lisa allocated annually by the LLC.

Situation 11, Table E

Liquidation Schedule for Fixed Payments Made to Lisa By J & L Custom Cakes, LLC

Year	Payment	736(a)	736(b)	Lisa's Beginning Capital	Basis Change	Lisa's Ending Capital	Capital Gain
20x2	\$ 35,000 46,333	\$ 35,491	\$ 5,813 OI 40,029	\$ 7,713	\$ 491	\$ 14,017	
20x3	10,000	4,364	5,636	14,017	(5,636)	8,381	
20x4	10,000	4,364	5,636	8,381	(5,636)	2,745	
20x5	10,000	4,364	5,636	2,745	(2,745)	0	\$ 2,891
20x6	10,000	4,364	5,636	0	0	0	5,636
20x7	10,000	4,364	5,636	0	0	0	5,636
20x8	10,000	4,364	5,636	0	0	0	5,636
20x9	10,000	4,364	5,636	0	0	0	5,636
20x10	10,000	4,364	5,636	0	0	0	5,636
20x11	<u>10,000</u>	<u>4,364</u>	<u>5,636</u>	0	0	0	<u>5,636</u>
Total	\$171,333	\$74,767	\$96,566				\$36,707

If the LLC makes a §754 election, it can step up its basis in its assets as in **Situation 10**. However, since payments are being made over a period of time, the adjustments can only be made in the year of, and to the extent of, the gain reported by Lisa. This means a separate adjustment is made each year taxable gain is reported by Lisa.

Complete Tables F, G, and H to show this allocation.

Situation 11, Table F
Allocation of Basis of LLC Property Under IRC §743(b) for the LLC

	LLC Assets		Difference
	Adjusted Basis	FMV	
IRC §§1221 and 1231 property			
Stock ABC Corp.	\$ 500	\$ 2,000	\$ 1,500
Equipment & vehicle	14,565	21,600	7,035
Building	139,736	198,000	58,264
Land	5,000	11,500	6,500
Goodwill	4,167	<u>45,000</u>	<u>40,833</u>
Total	\$163,968	\$278,100	\$114,132
Other property			
Cash	\$ 1,200	\$ 1,200	\$ 0
Accounts receivable	0	10,000	10,000
Bakery supplies	0	<u>400</u>	<u>400</u>
Total	\$ 1,200	\$11,600	\$10,400
Total assets	\$165,168	\$289,700	\$124,532

Situation 11, Table G
Calculation of Special Allocation After Liquidation
of Lisa's Interest by J & L Custom Cakes, LLC

	Difference between FMV and LLC Basis	Percent		Member Adjustment	Amount of Adjustment
Step 1					
A) Capital assets	\$114,132	91.65%	×	_____	_____
B) Other property	<u>10,400</u>	<u>8.35%</u>	×	_____	_____
Total adjustment	\$124,532	100.00%			_____
Step 2					
A) IRC §§1221 and 1231 property					
Stock ABC Corp.	\$ 1,500	1.31%	×	_____	_____
Equipment & vehicle	7,035	6.16%	×	_____	_____
Building	58,264	51.05%	×	_____	_____
Land	6,500	5.70%	×	_____	_____
Goodwill	<u>40,833</u>	<u>35.78%</u>	×	_____	_____
Total adjustment	\$114,132	100.00%			_____
B) Other property					
Accounts receivable	\$ 10,000	96.15%	×	_____	_____
Bakery supplies	<u>400</u>	<u>3.85%</u>	×	_____	_____
Total	\$ 10,400	100.00%			_____
Total	\$124,532				_____

^a The adjustment equals the gain reported by Lisa on the IRC §736(b) payments in year 20x5 of \$2,891.

The above adjustments are allocated to the LLC balance sheet in year 20x5.

Situation 11, Table H
Balance Sheet Adjustments for Liquidation Payment
for Appreciated Inventory and IRC §754 Election

Assets	Opening Balance	+	Adjustments	=	Balance After Adjustments
Cash	\$ 1,200		_____		_____
Accounts receivable	0		_____		_____
Bakery supplies	0		_____		_____
Stock ABC Corp.	500		_____		_____
Equipment & vehicle	14,565		_____		_____
Building	139,736		_____		_____
Land	5,000		_____		_____
Goodwill	<u>4,167</u>		<u>_____</u>		<u>_____</u>
Total assets	\$165,168		\$ 2,891		_____
Liabilities and capital					
Liabilities	\$139,000		_____		_____
Capital	<u>26,168</u>		<u>_____</u>		<u>_____</u>
Total	\$165,168		\$ 2,891		_____

SITUATION 12. COMPLETE WITHDRAWAL (LIQUIDATION) OF A MEMBER WITH A SERIES OF PAYMENTS NOT FIXED IN ADVANCE

The calculation of the amount realized cannot be determined in advance. Therefore, there is no split of each annual payment as in Situation 11. Instead, the order of tax reporting is:

1. §736(b) depreciation recapture
2. §736(b) ordinary gain for substantially appreciated inventory
3. §736(b) recovery of basis
4. §736(b) capital gain

The balance is all §736(a) payments.

Lisa and the LLC choose variable payments which are 20% of the net income per year for 10 years. In Year 1, the net profit is \$60,000.

Use the following table to determine the basis reduction in the first year.

20x1 Payment received (cash)	_____
Liabilities assumed	=====
Amount realized	_____
First allocation to recapture	=====
Balance	_____
Recovery of IRC §736(b) ordinary gain	_____
Balance reduces basis	_____

SITUATION 13. TERMINATION OF THE LLC

Lisa, in J & L Custom Cakes, LLC, to which Gabe had been added on January 1, 20x1, dies on June 30, 20x1. The remaining members are John and Gabe. They feel they cannot purchase Lisa's interest and therefore decide to terminate the business. Lisa's estate receives a step-up in basis on her share of LLC assets as of June 30 (i.e., the date of her death). The accounts receivable do not receive a step-up in basis because they are an IRD item in addition to Lisa's share of LLC net income to June 30.

After six months of operation, the LLC balance sheet is the same as at the time Gabe purchased his interest. Complete Table A to show the FMV of Lisa's interest in the LLC and her basis of the assets in the estate.

Situation 13, Table A
Basis for Lisa's Estate in J & L Custom Cakes, LLC

Assets	FMV of Lisa's LLC Interest	Basis for Lisa's Estate
Cash	\$ 400	_____
Accounts receivable	3,334	_____
Bakery supplies	134	_____
Stock ABC Corp.	667	_____
Equipment & vehicle	7,200	_____
Building	66,000	_____
Land	3,834	_____
Goodwill	<u>15,000</u>	_____
Total assets	\$ 96,569	_____
Liabilities and capital		
Liabilities	\$ 46,333	_____
Capital	<u>50,236</u>	_____
Total	\$ 96,569	_____

Complete Tables B and C to show the adjustments to be made for Lisa's estate's interest.

Situation 13, Table D
Allocation of Basis of LLC Property under IRC §743(b) for Lisa's Estate

	LLC Assets		
	Adjusted Basis	FMV	Difference
IRC §§1221 and 1231 property			
Stock ABC Corp.	\$ 500	\$ 2,000	\$ 1,500
Equipment & vehicle	14,565	21,600	7,035
Building	139,736	198,000	58,264
Land	5,000	11,500	6,500
Goodwill	4,167	45,000	40,833
Total	\$163,968	\$278,100	\$114,132
Other property			
Cash	\$ 1,200	\$ 1,200	\$ 0
Accounts receivable ^a	0	0	0
Bakery supplies	0	400	400
Total	\$ 1,200	\$ 1,600	\$ 400
Total assets	\$165,168	\$279,700	\$114,532

^aSince the accounts receivable is an "income in respect of decedent" item and will not receive a step-up in basis, it is not included in the allocation process.

Situation 13, Table C
Calculation of Special Allocation for Lisa's Estate

	Difference between FMV and LLC Basis	Percent		Member Adjustment	Amount of Adjustment
Step 1					
A) Capital assets	\$114,132	99.65%	×	\$ 38,177	\$ 38,044
B) Other property	400	0.35%	×	38,177	133
Total adjustment	\$114,532	100.00%			\$ 38,177
Step 2					
A) IRC §§1221 and 1231 property					
Stock ABC Corp.	\$ 1,500	1.31%	×	\$ 38,044	\$ 500
Equipment & vehicle	7,035	6.16%	×	38,044	2,345
Building	58,264	51.05%	×	38,044	19,421
Land	6,500	5.70%	×	38,044	2,167
Goodwill	40,833	35.78%	×	38,044	13,611
Total adjustment	\$114,132	100.00%			\$ 38,044
B) Other property					
Accounts receivable	\$ 0	0.00%	×	\$ 133	\$ 0
Bakery supplies	400	100.00%	×	133	133
Total	\$ 400	100.00%			\$ 133
Total	\$114,532				\$ 38,177

The adjusted items are specially allocated to Lisa's estate as the assets are sold. Complete **Table D** to illustrate the potential gain.

Situation 13, Table D
Gain for Lisa's Estate on Sale of J & K Custom Cakes, LLC Assets

Assets	LLCFMV	LLC Basis	LLC Gain	Lisa's Estate Share	Lisa's Estate Special Basis	Gain for Estate
Cash	\$ 1,200	\$ 1,200	\$ 0	_____	_____	_____
Accounts receivable	10,000	0	10,000	_____	_____	_____
Bakery supplies	400	0	400	_____	_____	_____
Stock ABC Corp.	2,000	500	1,500	_____	_____	_____
Equipment & vehicle	21,600	14,565	7,035	_____	_____	_____
Building	198,000	139,736	58,264	_____	_____	_____
Land	11,500	5,000	6,500	_____	_____	_____
Goodwill	45,000	4,167	40,833	_____	_____	_____
Total assets	\$289,700	\$165,168	\$124,532	_____	_____	_____

SITUATION 14. SUCCESSOR IN INTEREST CONTINUES IN LLC

Use the same facts as **Situation 13**. Lisa's widower continues to participate in the LLC, assuming Lisa's LLC interest after death as her successor in interest.

The LLC year closes for Lisa on June 30. Her net earnings for the first half of the year are allocated to her final return. The net earnings for the last half of the year are allocated to the successor in interest. As of July 1, the successor in interest receives a step-up in basis of his LLC interest except for the IRD items which are allocated to him as a normal part of the LLC operations. If a §754 election was made, or is made with the 20x2 LLC return, he has a step-up in basis of LLC assets as in **Situation 13, Tables A, B and C**. The application of the special basis adjustment establishes a special depreciation account for the depreciable assets and a special holding account for the IRD items.

There is no depreciation recapture or gain on inventory items except to the degree sales exceed his share of inventory declared at death. The basis for Lisa's successor in interest begins at its FMV on July 1, 20x1, less IRD items, or \$93,235 plus a special basis addition of \$38,177. The LLC balance sheet remains unchanged and continues to carry Lisa's old capital account of \$54,047 as adjusted.

In the year of death, two Schedules K-1 are prepared allocating a portion of the LLC interest to Lisa's for the first half of the year and a portion to her widower, estate or successor in interest for the second half.

SITUATION 15. SALE OF A DECEASED MEMBER'S INTEREST

Use the same facts as **Situation 13**. John and Gabe carry life insurance on Lisa under a **cross-purchase arrangement** where John and Gabe receive the insurance proceeds and use it to buy Lisa's LLC interest from the estate or her successor in interest.

For the estate, the reporting is the same as **Situation 13**. The LLC allocates on a Schedule K-1 any IRD items to the estate. IRD is the first half-year share of net income and accounts receivable. If the LLC made or makes a §754 election in its 20x2 return, the LLC makes the same basis adjustment to Lisa's estate as in **Situation 13, Tables A, B and C** if the estate continues in the LLC for a time before the buyout. However, if the buyout is immediate, the FMV and allocation of basis in **Situation 13, Table A** are sufficient. There is no depreciation recapture or ordinary income on the sale of the LLC assets to John and Gabe other than the IRD items.

John and Gabe have a new basis in this share of the LLC interest they purchase from the estate. The basis equals the purchase price. The purchase price is

$$\text{\$50,236 (price paid)} + \text{\$46,333 (debts assumed)} = \text{\$96,569.}$$

However, since a greater than 50% interest in the LLC is transferred within a 12-month period, the LLC is terminated.

The procedure is the same as in **Situation 8**, where John and Gabe purchase Lisa's interest directly. For John, the first step is to allocate the outside basis of his share of the LLC basis and then the special allocation for the share purchased as in **Situation 8, Table I**. For Gabe, the starting point is his $\frac{1}{3}$ share of the common LLC basis ($\frac{1}{3}$ of \$165,168) plus his special basis adjustment from **Situation 7, Table E**. This is added to his share of the LLC basis of his purchase of the $\frac{1}{2}$ of Lisa's estate's remaining interest plus the same special allocation for this purchase as John (**Situation 8, Table H**). The basis for John and Gabe are combined in **Table C** to show the total basis available for deductions. Part of the deductions is taken on the LLC books and part is a special allocation taken separately on the members Schedules K-1.

Complete Tables A, B, and C.

Situation 15, Table A
Adjusted Basis for John on his $\frac{1}{2}$ Share of J & L Custom Cakes, LLC Assets

Assets	Basis of John's $\frac{1}{3}$ Interest	Purchased 16.7% Basis	Special Allocation	John's New Basis
Cash	\$ 400	\$ 200	\$ 0	\$ 600
Accounts receivable	0	0	1,667	1,667
Bakery supplies	0	0	67	67
Stock ABC Corp.	195	83	250	528
Equipment & vehicle	4,855	2,428	1,172	8,455
Building	47,677	23,289	9,711	80,677
Land	1,789	833	1,084	3,706
Goodwill	2,158	695	6,805	9,658
Total	\$ 57,074	\$ 27,528	\$ 20,756	\$ 105,358

Situation 15, Table B
Re-Combination of Gabe's Basis in Two Separate Purchases of
Part of Lisa's Interest In J & L Custom Cakes, LLC

Assets	Gabe's 1/3 of LLC Basis	Gabe's Adjust for 1/3 Interest	Gabe's Purchase 16.7% of LLC Basis	Adjustment for 16.7%	Gabe's Total Basis
Cash	\$ 400	\$ 0	\$ 200	\$ 0	\$ 600
Accounts receivable	0	3,333	0	1,667	5,000
Bakery supplies	0	133	0	67	200
Stock ABC Corp.	167	500	83	250	1,000
Equipment & vehicle	4,855	2,345	2,428	1,172	10,800
Building	46,579	19,421	23,289	9,711	99,000
Land	1,667	2,167	833	1,084	5,751
Goodwill	1,389	13,611	695	6,805	22,500
Total	\$ 55,057	\$ 41,511	\$ 27,528	\$ 20,755	\$144,851

Situation 15, Table C
Combination of John's and Gabe's Basis in J & L Custom Cakes, LLC
to Show the Total Basis Available for John and Gabe

Assets	John's Basis	Gabe's Basis	Total Basis
Cash	_____	_____	_____
Accounts receivable	_____	_____	_____
Bakery supplies	_____	_____	_____
Stock ABC Corp.	_____	_____	_____
Equipment & vehicle	_____	_____	_____
Building	_____	_____	_____
Land	_____	_____	_____
Goodwill	_____	_____	_____
Total	\$105,358	\$144,851	\$250,209

SITUATION 16. LLC PURCHASES DECEASED MEMBER'S INTEREST

Use the same facts as **Situation 13**, except that J & L Custom Cakes LLC carried a \$100,000 insurance policy on Lisa, payable to the LLC with a binding agreement that the surviving members are to use the proceeds to purchase the deceased member's LLC interest.

The FMV of Lisa's estate's LLC interest is \$96,569. This is composed of \$50,236 of equity and \$46,333 of assumed debt. The liquidation payment for Lisa's estate's LLC interest is \$50,236.

Liquidation payment July 1, 20x1	_____
Lisa's liabilities assumed	=====
Amount realized	_____
Lisa's estate's basis (from situation 13A)	_____
Gain	_____

The \$96,569 amount received is a §736(b) payment for property with no gain to be reported. The \$3,334 of gain is a §736(a) payment reported by the LLC on a Schedule K-1 as a guaranteed payment. \$46,902 is reported by the LLC as a withdrawal by Lisa's estate (\$50,236 total payments – \$3,334 guaranteed payment).

For the estate, the reporting is similar to **Situation 10**. The LLC allocates on a Schedule K-1 the two IRD items to the estate. IRD is the first half-year share of net income and accounts receivable. The LLC is not terminated in a liquidation distribution in contrast to the sale to John and Gabe in **Situation 15**. The gain in **Table 16A**, except the \$3,334 accounts receivable (an IRD), are offset by the step up in basis shown in **Table 13A**.

If the LLC made, or makes a §754 election in its 20x2 return, it receives a special basis adjustment similar to the §736(b) step-up in basis shown in **Situation 10, Tables F and G**. These calculations are shown in **Situation 16, Tables B and C**. The special adjustment is the difference between Lisa's remaining LLC basis (\$54,046) and the FMV of the assets which receive a stepped-up basis (\$93,235). This special basis adjustment is \$39,189. The application of the special basis adjustment is to establish a special depreciation account for the depreciable assets, a holding account for the land, and a special holding account for ordinary income items to be allocated when they are sold or used.

Situation 16, Table A
Classification of Liquidation Payments for
Lisa on Liquidation of her LLC Interest

Type of Property	Adjusted Basis of Lisa's Interest	FMV of Lisa's Interest	Gain
IRC §736(b) payments for capital gain property			
Cash	\$ 400	\$ 400	\$ 0
Stock ABC Corp.	164	667	503
Equipment & vehicle	4,855	4,855	0
Building	45,634	66,000	20,366
Land	1,633	3,834	2,201
Goodwill	1,361	15,000	13,639
Total	<u>\$ 54,047</u>	<u>\$ 90,756</u>	<u>\$ 36,709</u>
IRC §736(b) payments for substantially appreciated inventory			
Accounts receivable	\$ 0	\$ 3,334	\$ 3,334
Bakery supplies	0	134	134
Depreciation recapture ^a	0	2,345	2,345
Total	<u>\$ 0</u>	<u>\$ 5,813</u>	<u>\$ 5,813</u>
IRC §736(a) other payments, including unrealized receivables			
Other	0	0	0
Total	<u>\$ 54,047</u>	<u>\$ 96,569</u>	<u>\$ 42,522</u>

^a Depreciation recapture is treated as an unrealized receivable but in a liquidation is considered to be property, which like an installment sale, must be reported as ordinary income in the year of sale.

Situation 16, Table B
Allocation of Basis of LLC Property Under IRC §743(b) for
J & L Custom Cakes, LLC's Purchase from Lisa's Estate

	LLC Assets		Difference
	Adjusted Basis	FMV	
IRC §§1221 and 1231 property			
Stock ABC Corp.	\$ 500	\$ 2,000	\$ 1,500
Equipment & vehicle	14,565	21,600	7,035
Building	139,736	198,000	58,264
Land	5,000	11,500	6,500
Goodwill	<u>4,167</u>	<u>45,000</u>	<u>40,833</u>
Total	\$163,968	\$278,100	\$114,132
Other property			
Cash	\$ 1,200	\$ 1,200	\$ 0
Accounts receivable	0	0	0
Office supplies	<u>0</u>	<u>400</u>	<u>400</u>
Total	\$ 1,200	\$ 1,600	\$ 400
Total assets	\$165,168	\$279,700	\$114,532

Situation 16, Table C
Calculation of Special Allocation for J & L Custom
Cakes, LLC after Liquidation of Lisa's Estate LLC Interest

	Difference between FMV and LLC Basis	Percent	Member Adjustment	Amount of Adjustment
Step 1				
A) Capital assets	\$114,132	99.65% ×	\$ 39,188 ^a	\$ 39,051
B) Other property	<u>400</u>	<u>0.35%</u> ×	39,188	<u>137</u>
Total adjustment	\$114,532	100.00%		\$39,188
Step 2				
A) IRC §§1221 and 1231 property				
Stock ABC Corp.	\$ 1,500	1.31% ×	\$ 39,051	\$ 511
Equipment & vehicle	7,035	6.16% ×	39,051	2,406
Building	58,264	51.05% ×	39,051	19,936
Land	6,500	5.70% ×	39,051	2,226
Goodwill	<u>40,833</u>	<u>35.78%</u> ×	39,051	<u>13,972</u>
Total adjustment	\$114,132	100.00%		\$ 39,051
B) Other property				
Accounts receivable	\$ 0	0.00% ×	\$ 137	\$ 0
Bakery supplies	<u>400</u>	<u>100.00%</u> ×	137	<u>137</u>
Total	\$ 400	100.00%		\$ 137
Total	\$114,532			\$ 39,188

^a The adjustment equals the difference between Lisa's estate's outside basis of \$93,235 and Lisa's basis of her LLC interest of \$54,047.

Situation 16, Table D

IRC §754 Balance Sheet Adjustments for Liquidation Payment for Liquidation of Lisa's Estate

Assets	Opening Balance	+	Adjustments	=	Balance After Adjustments
Cash	_____		Insurance	\$100,000 (50,236) ^a	_____
Accounts receivable	_____			_____	_____
Bakery supplies	_____			_____	_____
Stock ABC Corp.	_____			_____	_____
Equipment & vehicle	_____			_____	_____
Building	_____			_____	_____
Land	_____			_____	_____
Goodwill	=====			=====	=====
Total assets	_____			\$ 88,952	_____
Liabilities and capital					
Liabilities	_____			\$ 0	_____
			Insurance	100,000	
Capital	_____			(50,236) ^b	_____
				39,188 ^c	_____
Total	_____			\$ 88,952	_____

^a Liquidation payment.

^b Addition to basis.

^c Cash distribution to Lisa: net increase in cash that reduces the total adjustment on the balance sheet from _____ to _____.