Question 1 of 3

Exhibits: "YR 5 K-1 for Sven Nordstrom.pdf"

Sven Nordstrom is a 50% general partner of the Swedish Materials Partnership (SMP), a domestic partnership. The basis of his partnership interest on January 1, Year 5 was $55,000, which included his $25,000 share of liabilities. SMP has been profitable in previous years, but in Year 5, the partnership suffered a slowdown in business. Sven's Year 5 Schedule K-1 from the partnership is provided as an exhibit.

Task 1
Determine the amount, if any, of the ordinary business loss that is deductible on Sven's Year 5 personal tax return considering his basis and the at-risk amount. In Columns B and C, enter all amounts as positive, whole values. If a response is zero, enter a zero (0). If applicable, indicate in Column C the amount of any suspended loss related to the amount in Column B.

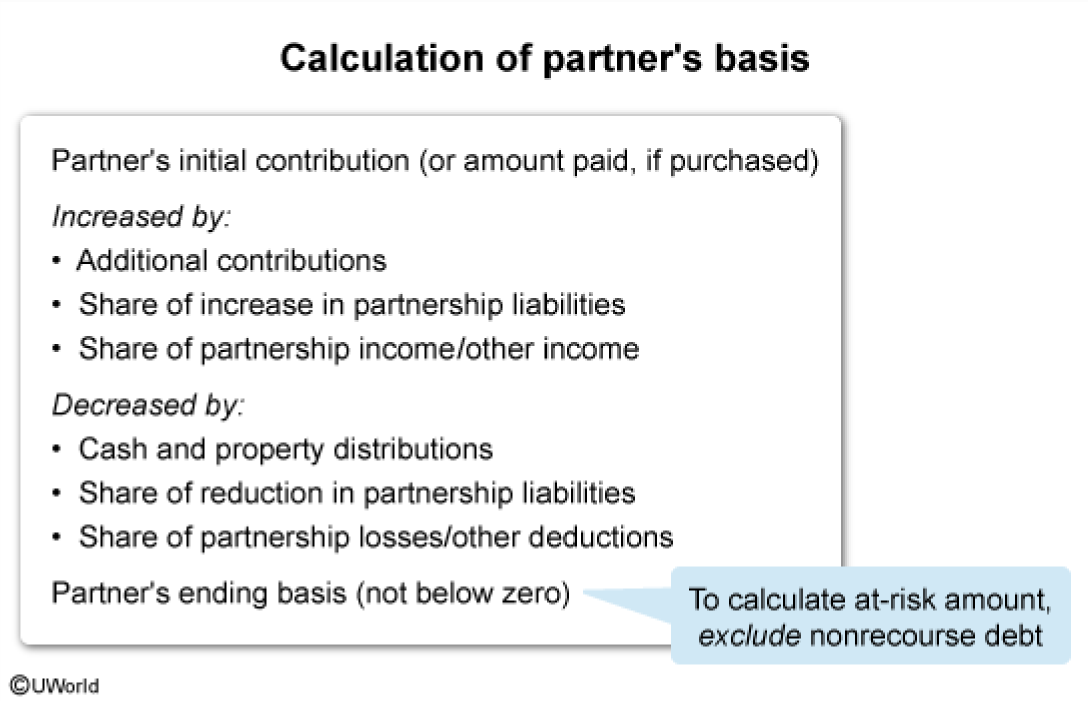
	A	B	C
1	**Requirement**	**Amount deductible**	**Amount suspended**
2	What amount of the ordinary business loss can Sven deduct considering only his basis?	123	123
3	What amount of ordinary business loss can Sven deduct after applying the at-risk rules?	123	123

Task 2
Assume Sven is a limited partner (instead of a general partner) and the parentship is considered a passive activity. Sven has passive income from other sources of $16,500 for Year 5. Use any applicable information from the K-1 exhibit. In Columns B and C, enter all amounts as positive, whole values. If a response is zero, enter a zero (0). If applicable, indicate in Column C the amount of any suspended loss related to the amount in Column B.

	A	B	C
1	**Scenario**	**Amount deductible**	**Amount suspended**
2	What amount of the ordinary business loss can Sven deduct considering only his basis?	123	123

3	What amount of ordinary business loss can Sven deduct after applying the at-risk rules?	123	123
4	What is the total amount of the ordinary business loss that Sven can deduct considering all limitations?	123	123

Explanation



Background

A partner's **basis** in a partnership (P/S) is adjusted every tax year for the pass-through items from the P/S. Each partner has an *outside tax basis* for their interest in a P/S that is used to determine the *deductibility of P/S losses* and the *treatment of distributions*. Items affecting basis are applied in a special order to arrive at the ending basis balance and to ensure the proper tax treatment of distributions and P/S losses (ie, increases to basis are applied before distributions and other decreases).

As a flow-through entity, a P/S cannot claim a net operating loss (NOL). Therefore, when a P/S incurs a business operating loss, it is distributed to the owners (partners). However, a partner's **deduction** for their share of the **loss** is **limited** by **basis**, **at-risk**, and **passive** activity rules.

The amount of debt included in the at-risk amount depends on whether the partner is a general or limited partner. Because the **general partners** may ultimately be responsible for P/S debt, their **basis** is **increased** by their pro rata distributive share of **all P/S debt**, *recourse* and *nonrecourse*. A **limited** partner's basis is increased for their pro rata share of only **nonrecourse debt**.

At-risk rules prevent partners from deducting losses greater than the amount of their personal liability (ie, economic risk of loss from **recourse** debt) in the P/S. Therefore, a partner's at-risk amount generally is equal to the taxpayer's **basis excluding** any P/S **nonrecourse debt** (ie, *no personal liability* such as a note payable secured by collateral).

Note: To determine the amount of P/S liabilities to include in a partner's basis, check to see if their basis includes their share of liabilities at the beginning of year (as in this scenario). If included, then only adjust the basis for the increase or decrease in liabilities during the year to arrive at ending basis.

The *limitations* on the deductibility of a business operating loss are applied as follows:

- First, since **basis** may **never** fall below **zero**, the deductible loss is limited by **basis**.
- Next, the loss is limited by the **at-risk amount**. The deductible loss may **not** exceed the taxpayer's **at-risk amount**.
- Finally, if the activity is a **passive activity**, the loss deduction is further limited to **passive income from other passive activities**.
- Any losses suspended (ie, not currently deductible) based on these limitations are *carried forward* indefinitely to future years until the partner has sufficient basis, at-risk amount, or passive income (or until the P/S interest is disposed).

A *guaranteed payment* for services is an expense in the calculation of the business operating loss of the P/S and therefore, does *not* affect a partner's basis. Instead, the amount is reported as income by the partner who performed the services. Distributions decrease a partner's basis, but not below zero.

A passive activity is any activity in which the taxpayer does **not** materially participate (ie, a limited partner). Losses or expenses generated by a passive activity are deductible only to the extent of any passive gains/income. Any unused passive activity losses are suspended and carried forward to future years to offset passive income generated in those years.

Task 1

	A	B	C
1	**Scenario**	**Amount deductible**	**Amount suspended**

2	What amount of the ordinary business loss can Sven deduct considering only his basis?	$54,050	$12,950
3	What amount of ordinary business loss can Sven deduct after applying the at-risk rules?	$49,050	$5,000

Row 2: Ordinary business loss limited by basis

Sven's basis must be adjusted for his pro rata share (ie, 50%) of Year 5's items from the P/S as reported on the Schedule K-1 exhibit. This includes the ordinary business loss, the increase in liabilities, interest income, dividends, and the net short-term capital gain. Guaranteed payments reported on the K-1 do *not* affect basis but the $8,000 distribution does. However, since the $8,000 distribution is considered *before* the P/S loss, Sven has sufficient basis to offset the distribution.

Because the beginning basis already included $25,000 of the debt ($3,000 nonrecourse + $22,000 recourse), only the *$5,000 increase in debt* ($2,000 nonrecourse + $3,000 recourse) is needed as an *adjustment* to basis. The increase is the difference between the beginning and ending debt balances reported on the K-1, Box K. Accordingly, the ending basis is $0 as shown below. The **suspended loss** due to *lack of basis* of **$12,950** ($67,000 – $54,050) is carried forward until there is sufficient basis.

Beginning basis (given)	$55,000
Increase in nonrecourse liabilities (K-1, Box K) ($5,000 – $3,000)	2,000
Increase in recourse liabilities (K-1, Box K) ($25,000 – $22,000)	3,000
Interest income (K-1, Box 5)	500
Qualified dividend income (K-1, Box 6b)	250
Net short-term capital gain (K-1, Box 8)	1,300
Basis before distribution	$62,050
Less distribution (K-1, Box 19)	(8,000)
Basis before ordinary business loss	$54,050
Loss limited by basis	**(54,050)**
Ending basis	$0

Row 3: Ordinary business loss limited by the at-risk amount

The at-risk amount represents what a partner is at-risk of losing if the investment becomes worthless. A taxpayer is *not* considered at-risk with respect to borrowed amounts if the taxpayer is not personally liable for the repayment of the debt (ie, nonrecourse debt).

Sven's basis *before* the ordinary business loss in the table above is $54,050. However, that amount includes *nonrecourse* debt. Therefore, to determine his at-risk amount, Sven must exclude his total share of the nonrecourse debt at the end of year from his basis, which is

$5,000 (K-1, Box K). Sven's **at-risk amount is $49,050** ($54,050 – $5,000). Accordingly, the $67,000 loss that was limited to $54,050 by basis is now further limited to **$49,050** due to the at-risk rules. The unused **$5,000 loss is suspended** under the *at-risk limitation* and carried forward.

Recap

P/S loss	$67,000	
Limited by basis	(54,050)	
Suspended loss due to basis		$12,950
Limited by basis	$54,050	
At-risk amount	(49,050)	
Suspended due to at-risk		5,000
Total loss suspended		$17,950

To double check: $67,000 total loss – **$49,050** deductible loss = **$17,950** suspended loss

Task 2

	A	B	C
1	**Scenario**	**Amount deductible**	**Amount suspended**
2	What amount of the ordinary business loss can Sven deduct considering only his basis?	$29,050	$37,950
3	What amount of ordinary business loss can Sven deduct after applying the at-risk rules?	$24,050	$5,000
4	What is the total amount of the ordinary business loss that Sven can deduct considering all limitations?	$16,500	$7,550

Row 2: Ordinary business loss limited by basis

A **limited** partner's basis is **increased** for their pro rata share of *only* **nonrecourse debt**. Therefore, Sven's basis will change. The beginning basis will now *exclude* the *recourse debt* and *no increase* will be made for the additional *recourse debt* during the year. A revised basis schedule is provided below. Because the recourse debt is excluded, the $67,000 loss is limited to **$29,050** and the ending basis is $0. The **suspended loss** due to *lack of basis* of **$37,950** ($67,000 – $29,050) is carried forward until there is sufficient basis.

Beginning basis ($55,000 – $22,000 recourse debt K-1, Box K)	$33,000
Increase in nonrecourse liabilities (K-1, Box K) ($5,000 – $3,000)	2,000

Interest income (K-1, Box 5)	500
Qualified dividend income (K-1, Box 6b)	250
Net short-term capital gain (K-1, Box 8)	1,300
Basis before distribution	$37,050
Less distribution (K-1, Box 19)	(8,000)
Basis before ordinary business loss	$29,050
Loss limited by basis	**(29,050)**
Ending basis	$0

Shortcut: *To arrive at the $29,050 new basis before ordinary business loss, start with $54,050 basis after the distribution from Task 1 and deduct the total $25,000 of recourse debt ($54,050 – $25,000 = $29,050). To determine the suspended loss, add the total $25,000 recourse debt to the $12,950 suspended loss in Task 1 ($12,950 + $25,000 = $37,950).*

Row 3: Ordinary business loss limited by the at-risk amount

Next, the $29,050 from above is further limited by the *at-risk limitation*. Sven must exclude his total share of the nonrecourse debt at the end of year from his basis, which is $5,000 (K-1, Box K), making his **at-risk amount $24,050** ($29,050 – $5,000). The unused **$5,000 loss** is **suspended** under the *at-risk limitation* and carried forward.

Row 4: Ordinary business loss limited by passive income

The last limitation when there is a loss from a passive activity is passive income. Here, Sven has passive income of $16,500. Although his at-risk amount of $24,050 is sufficient to offset the passive income, the loss **deductible** is **limited** to **passive income** (ie, **$16,500**). The **unused loss** of **$7,550** ($24,050 – $16,500) is a *suspended passive loss* and carried forward to be used against future passive income.

Recap

P/S loss	$67,000	
Limited by basis	(29,050)	
Suspended loss due to basis		$37,950
Limited by basis	$29,050	
At-risk amount	(24,050)	
Suspended due to at-risk		5,000
Limited by at-risk	$24,050	
Limited by passive income	(16,500)	
Suspended by passive income		7,550
Total loss suspended		$50,500

To double check: $67,000 total loss – **$16,500** deductible loss = **$50,500** suspended loss

Question 2 of 3

Exhibits: "Exhibit 1-Becker Brewing Company (BBC), LLC K-1.pdf"

Bert Becker, single, is a 40% member in the Becker Brewing Company (BBC), LLC, a domestic partnership. The outside basis of his partnership interest on January 1, Year 4, was $33,500, which included his $10,500 share of liabilities. Bert also has a 70% interest as a general partner in the MaryJane Partnership.

Bert needs your help in handling the tax implications of his involvement in these two entities for Year 4. Assume that the excess business loss deduction limitation for Year 4 is $305,000.

Task 1

Determine the amount, if any, of the ordinary business loss that is deductible on Bert's Year 4 personal tax return for BBC considering his basis and at-risk amount. Use any applicable information from the *BBC K-1 exhibit* above. In column B, select the correct amount from the list.

	A	B
1	**Requirement**	**Amount deductible**
2	What amount of ordinary business loss can Bert deduct considering only his basis?	
3	What amount of ordinary business loss can Bert deduct after applying the at-risk rules?	

Task 2

Assume Bert is a limited partner (instead of a general partner) and the partnership is considered a passive activity. Bert has no passive income from other sources for Year 4. Use any applicable information from the *BBC K-1 exhibit* above. In column B, select the correct amount from the list.

	A	B
1	**Requirement**	**Amount deductible**
2	What amount of ordinary business loss can Bert deduct considering only his basis?	

3	What amount of ordinary business loss can Bert deduct after applying the at-risk rules?	
4	What amount of the ordinary business loss can Bert deduct considering the passive-activity loss rules?	

Available Options for 'Amount deductible':

1. $40,000
2. $35,000
3. $30,000
4. $28,000
5. $23,000
6. $10,000
7. $0

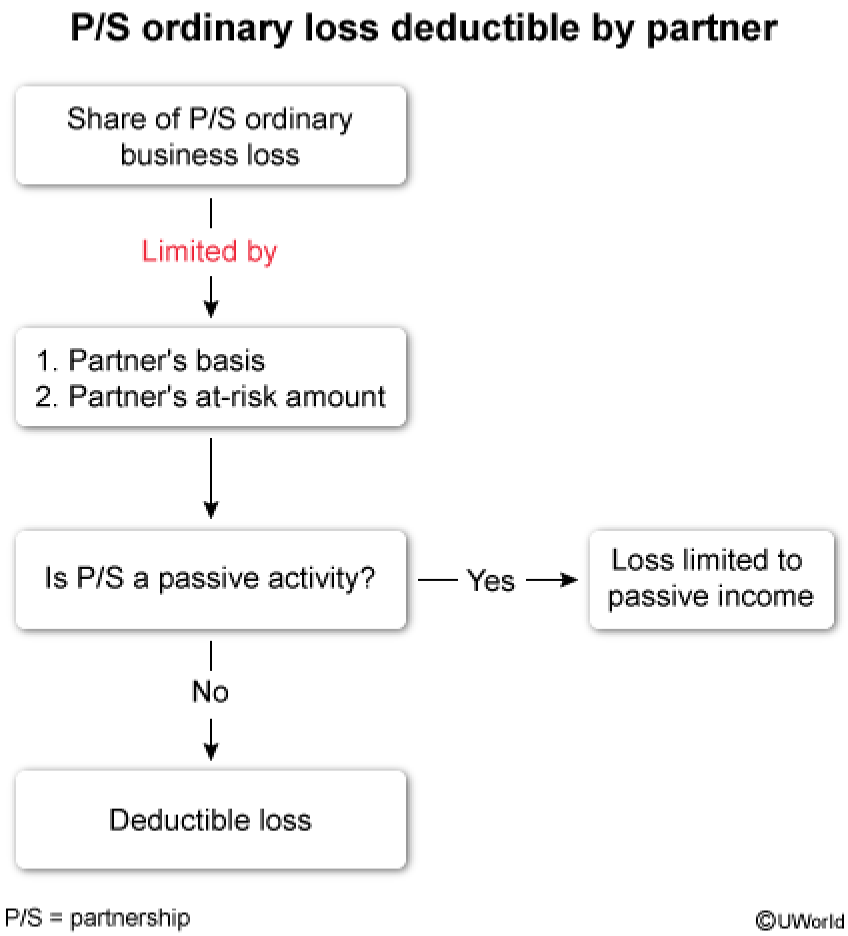
Task 3

Assume that MaryJane Partnership reports a $280,000 ordinary business loss on Bert's K-1 for Year 4. Bert's outside basis and at-risk amount in MaryJane at the end of Year 4 are both $300,000. Considering both BBC and MaryJane, enter the amount of ordinary business loss that Bert can deduct considering all limitations and assuming that Bert is a general partner in both partnerships. Enter the amount as a positive, whole value. If the response is zero, enter a zero (0).

	A	B
1	**Requirement**	**Amount deductible**
2	What amount of the ordinary business loss can Bert deduct considering all limitations?	123

Explanation

Background information



Partnerships (P/S) cannot claim a net operating loss (NOL). Therefore, when a P/S incurs a business operating loss, it is distributed to the owners (ie, partners, members). However, an owner's share of the **ordinary business loss** is **deductible** only if it passes three hurdles: the partner's **outside tax basis**, **at-risk amount**, and **passive activity** limitations.

- First, losses **may not** reduce the *partner's basis* in the P/S (ie, outside basis) below *zero*.
- Next, losses are further limited by the partner's *at-risk* amount. Generally, a partner's basis includes their share of P/S debt. However, because some partners may *not* be personally liable for P/S debt, the at-risk rules **prevent** partners from **deducting losses greater** than the amount of their **personal liability** in the P/S.
- Finally, *if* the activity is a passive activity, losses are further **limited** to the partner's *passive income*.

In addition, *individual taxpayers* are subject to an overall **excess business loss limitation**, which is designed to limit the amount of loss deducted annually on an individual's tax return.

Since a partner's basis may **never fall below zero**, a deductible loss is first limited by basis. The calculation of a partner's basis each tax year includes adjusting for each partner's share of P/S income/losses and changes in its share of P/S liabilities, additional contributions made, and distributions received. Items affecting basis are applied in a special order to arrive at the ending basis and to ensure the proper tax treatment of distributions and P/S losses (ie, increases to basis are applied before distributions and other decreases).

The amount of debt included in the basis amount depends on whether the partner is a general partner or a limited partner. Because **general partners** are ultimately responsible for P/S debt, their **basis** is **increased** by their pro rata distributive share of **all P/S debt**, recourse and nonrecourse. A **limited** partner's basis is increased for their pro rata share of only **nonrecourse debt**.

A partner's at-risk amount is generally equal to the taxpayer's **basis**, **excluding** any P/S **nonrecourse debt** (eg, a P/S note payable secured by collateral means no personal liability for the partner).

Note: To determine the amount of P/S liabilities to include in a partner's basis, evaluate whether their basis includes their share of liabilities at the beginning of the year (as in this scenario). If included, then adjust only the basis for the increase or decrease in liabilities during the year to arrive at the ending basis.

A passive activity is any activity in which the taxpayer does **not** materially participate (ie, is a limited partner). Losses or expenses generated by a passive activity are deductible only to the extent of any passive gains/income.

Task 1

	A	*B*
1	**Requirement**	**Amount deductible**
2	What amount of ordinary business loss can Bert deduct considering only his basis?	$35,000
3	What amount of ordinary business loss can Bert deduct after applying the at-risk rules?	$30,000

Row 2: Ordinary business loss limited by basis

Bert's basis must be adjusted for his pro rata share (ie, 40%) of Year 4's items from the P/S as reported on the *BBC K-1 exhibit*. This includes only the ordinary business loss of $40,000 and the increase in liabilities since no other items were reported.

Because the beginning basis ($33,500—given information) already included his $10,500 share of the debt ($4,000 nonrecourse + $6,500 recourse), only the $1,500 increase in debt ($1,000 nonrecourse + $500 recourse) is needed as an adjustment to basis at the end of the year before considering the loss. The increase is the difference between the beginning and ending debt balances reported on K-1, Box K. Therefore, Bert's $40,000 reported business loss is limited by basis to **$35,000** ($33,500 beginning basis + $1,500 increase in debt), and his ending basis after subtracting the loss is zero.

Row 3: Ordinary business loss limited by the at-risk amount

A taxpayer is *not* considered at-risk with respect to borrowed amounts if the taxpayer is not personally liable for the repayment of the debt (ie, nonrecourse debt). Bert must exclude his total share of the nonrecourse debt ($5,000—K-1, Box K) from his basis at year end. Bert's at-risk amount is **$30,000** ($35,000 − $5,000). Accordingly, the $40,000 loss that was limited to $35,000 by basis is now further limited to **$30,000** due to the at-risk rules.

Task 2

	A	*B*
1	**Requirement**	**Amount deductible**
2	What amount of ordinary business loss can Bert deduct considering only his basis?	$28,000
3	What amount of ordinary business loss can Bert deduct after applying the at-risk rules?	$23,000
4	What amount of ordinary business loss can Bert deduct considering the passive-activity loss rules?	$0

Row 2: Ordinary business loss limited by basis

A **limited** partner's basis is **increased** for their pro rata share of *only* **nonrecourse debt**. Therefore, Bert's beginning basis will change. The beginning basis will now *exclude* the *recourse debt* ($6,500—K-1, Box K) or $27,000 ($33,500 − $6,500), and *no increase* will be made for the additional recourse debt during the year. Assuming Bert is now a limited partner, the basis limitation is **$28,000** ($27,000 + $1,000) of additional nonrecourse debt, per the K-1. Bert's basis after applying the basis limitation is zero.

Shortcut: *To arrive at the $28,000 new basis before ordinary business loss, start with the $35,000 basis limitation from Task 1 and deduct the total $7,000 of recourse debt per the K-1 at year end ($35,000 − $7,000 = **$28,000**).*

Row 3: Ordinary business loss limited by the at-risk amount

Next, the $28,000 from above is further limited by the *at-risk limitation*. Bert must exclude his total share of the nonrecourse debt at year end from his basis, which is $5,000 (K-1, Box K), making his **at-risk amount $23,000** ($28,000 − $5,000).

Row 4: Ordinary business loss limited by passive income

A taxpayer can deduct passive losses only to the extent of passive income. Since Bert has **no passive income**, the $40,000 passive loss is *suspended* and carried forward to be used against future passive income.

Task 3

	A	B
1	**Requirement**	**Amount deductible**
2	What amount of the ordinary business loss can Bert deduct considering all limitations?	$305,000

Row 2: Ordinary business loss limited by the excess business loss limitation

In addition to the above loss limitations, business losses are limited to **$305,000** (given information above). Any remaining loss can be carried forward as part of the taxpayer's net operating loss.

Activity	**Loss**
BBC, LLC after applying basis limitation	($30,000)
MaryJane Partnership (not limited by basis or at-risk amount)	(280,000)
Total business losses	(310,000)
Excess business loss limitation	305,000

Excess loss	($5,000)

Question 3 of 3

Sam "The Daredevil" Risky owns several business activities in year 20XX involving skydiving and bungee jumping. Recently, Sam purchased an interest in Houdini Escape Fun, an S corporation. The information below was obtained from Sam's year 20XX K-1's.

Kenosha Skydiving Thrills – Ordinary business income	$8,300
Beware Bungee Jumping – Ordinary business income	$10,200
Houdini Escape Fun – Ordinary business loss	$(19,500)

Sam purchased his interest in Houdini Escape Fun for $7,500 on April 1, 20XX. Sam is a material participant in the skydiving and bungee jumping activities, but he is **not** a material participant in Houdini Escape Fun.

Enter the appropriate values in the cells below. Enter all values as positive numbers. If a value is zero, enter a zero (0).

	A	B
1	A	B
2	What is Sam's gross income that he must report from the activities listed above?	123
3	Assuming that Sam is **not** a material participant in any of the activities, what is the gross income that he must report?	123
4	What is Sam's ending basis in Houdini Escape Fun?	123

Explanation

Sam's Gross Income

Kenosha Skydiving Thrills – Ordinary business income	$8,300	Active
Beware Bungee Jumping – Ordinary business income	$10,200	Active
Gross Income	$18,500	

Sam is not a material participant in Houdini Escape Fun and, therefore, it is a passive activity. Houdini generated a passive activity loss for Sam which is not deductible. Passive activity losses can only offset passive activity income.

Sam's Gross Income if Sam is not a material participant in any activity:

Kenosha Skydiving Thrills – Ordinary business income	$8,300	Passive
Beware Bungee Jumping – Ordinary business income	$10,200	Passive
Houdini Escape Fun – Ordinary business loss	($7,500)	Passive - limited to basis
Gross Income	$11,000	

Sam has a passive interest in all activities; therefore, the passive loss from Houdini can offset the passive income from Kenosha Skydiving and Beware Bungee. However, Sam can deduct a loss only to the extent that he has basis in that particular activity. Sam's deductible passive loss in Houdini is limited to his basis of $7,500, his original contribution to the activity. The remaining $12,000 loss from Houdini will carry forward as a suspended loss.

Sam's ending basis:

Beginning basis	$7,500	
Houdini Escape Fun – Ordinary business loss	-7,500	Passive - limited to basis
Ending basis	$0	

Sam can deduct a loss only to the extent that he has basis in that particular activity. Sam's deductible passive loss in Houdini is limited to his basis of $7,500, his original contribution to the activity. This reduces his basis in the Houdini stock to zero. The remaining $12,000 loss from Houdini will carry forward as a suspended loss.