

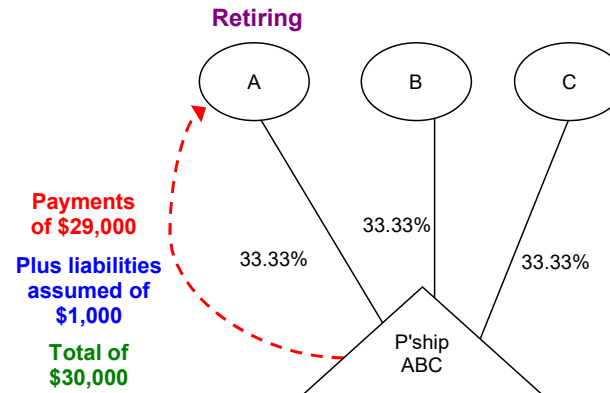
**Reg. 1.736-1(b)(7),
Example 1**

**Retiring Partner, Fixed Amount,
No Payment for Goodwill**

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<u>Assets</u>	<u>Adj. basis per books</u>	<u>Market value</u>	A's 1/3 Share of Value	
Cash	13,000	13,000	4,333	
Unrealized receivables	0	30,000		(cannot be 736(b), see 1.736-1(a)(3))
Capital and section 1231 assets	20,000	23,000	7,667	
Total	33,000	66,000	12,000	Sec. 736(b)

<u>Liabilities & Capital</u>			A's 1/3 Share for Basis	
Liabilities	3,000	3,000	1,000	
Capital:				
A	10,000	21,000	10,000	
B	10,000	21,000		
C	10,000	21,000		
Total	33,000	66,000	11,000	
Capital gain from partnership distributions			1,000	
Total proceeds to be received (over 3 years)			30,000	
Less 736(b) payments			(12,000)	
Total 736(a)(2) payments (considered as guaranteed pmts.)			18,000	Sec. 736(a)(2)



	<u>736(a)(2)</u>	<u>736(b)</u>	Cap. gain if no election	Cap. gain if 1.736- 1(b)(6) election
Year 1 pmt.s (cash of 9,000 & liab.s ass. 1,000)	10,000	6,000	4,000	333
Year 2 pmt.s (cash)	10,000	6,000	4,000	333
Year 3 pmt.s (cash)	10,000	6,000	4,000	1,000
Total	30,000	18,000	12,000	

Partnership ABC is a personal service partnership and its balance sheet is as shown above. Partner A retires from the partnership in accordance with an agreement whereby his share of liabilities (\$1,000) is assumed. In addition he is to receive \$9,000 in the year of retirement plus \$10,000 in each of the two succeeding years. Thus, the total that A receives for his partnership interest is \$30,000 (\$29,000 in cash and \$1,000 in liabilities assumed). Under the agreement terminating A's interest, the value of A's interest in section 736(b) partnership property is \$12,000 (one-third of \$36,000, the sum of \$13,000 cash and \$23,000, the fair market value of capital and section 1231 assets). A's share in unrealized receivables is not included in his interest in partnership property described in section 736(b). Since the basis of A's interest is \$11,000 (\$10,000 plus \$1,000, his share of partnership liabilities), he will realize a capital gain of \$1,000 (\$12,000 minus \$11,000) from the disposition of his interest in partnership property. The remaining \$18,000 (\$30,000 minus \$12,000) will constitute payments under section 736(a)(2) which are taxable to A as guaranteed payments under section 707(c). The payment for the first year is \$10,000, consisting of \$9,000 in cash, plus \$1,000 in liability assumed (section 752(b)). Thus, unless the partners agree otherwise under Reg. 1.736-1(b)(5)(iii), each annual payment of \$10,000 will be allocated as follows: \$6,000 (18,000/30,000 of \$10,000) is a section 736(a)(2) payment and \$4,000 (12,000/30,000 of \$10,000) is a payment for an interest in section 736(b) partnership property. (The partnership may deduct the \$6,000 guaranteed payment made to A in each of the 3 years.) The gain on the payments for partnership property will be determined under section 731, as provided in Reg. 1.736-1(b)(6). A will treat only \$4,000 of each payment as a distribution in a series in liquidation of his entire interest and, under section 731, will have a capital gain of \$1,000 when the last payment is made. However, if A so elects, as provided in Reg. 1.736-1(b)(6), he may treat such gain as follows: Of each \$4,000 payment attributable to A's interest in partnership property, \$333 is capital gain (one-third of the total capital gain of \$1,000), and \$3,667 is a return of capital.