

**Reg. 1.736-1(b)(7),
Example 3**

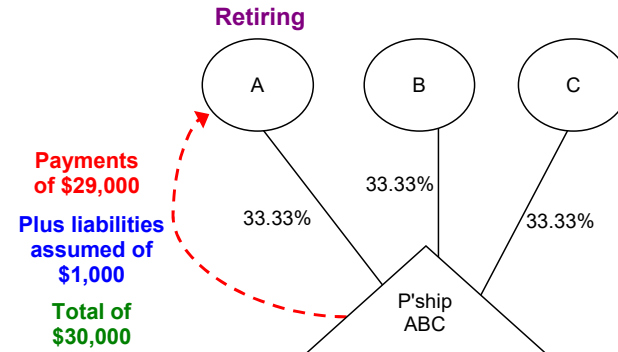
**Retiring Partner, Fixed Amount, &
Payment for Goodwill**

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Assets	Adj. basis per books	Market value	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))
Goodwill	0	9,000	3,000
Capital and section 1231 assets	20,000	23,000	7,667
Total	33,000	75,000	15,000 Sec. 736(b)

Liabilities & Capital			A's 1/3 Share for Basis
Liabilities	3,000	3,000	1,000
Capital:			
A	10,000	24,000	10,000
B	10,000	24,000	
C	10,000	24,000	
Total	33,000	75,000	11,000

Capital gain from partnership distributions	4,000	
Total proceeds to be received (over 3 years)	30,000	
Less 736(b) payments	(15,000)	
Total 736(a)(2) payments (considered as guaranteed pmts.)	15,000	Sec. 736(a)(2)



	736(a)(2)	736(b)	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	5,000	5,000	1,333
Year 2 pmt.s (cash)	10,000	5,000	5,000	1,333
Year 3 pmt.s (cash)	10,000	5,000	5,000	4,000
Total	30,000	15,000	15,000	

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 \$15,000 (one-third of \$45,000, the sum of \$13,000 cash, plus \$23,000, the value of capital and section 1231 assets, plus \$9,000 good will). 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 \$4,000 (\$15,000 minus \$11,000) from the disposition of his interest in partnership property. The remaining \$15,000 (\$30,000 minus \$15,000) 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: \$5,000 (15,000/30,000 of \$10,000) is a section 736(a)(2) payment and \$5,000 (15,000/30,000 of \$10,000) is a payment for an interest in section 736(b) partnership property. (The partnership may deduct the \$5,000 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 \$5,000 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 \$4,000 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 \$5,000 payment attributable to A's interest in partnership property, \$1,333 is capital gain (one-third of the total capital gain of \$4,000), and \$3,667 is a return of capital.