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E*ZINES
December 2000 Vol. 2

Tax (International, Federal, State, & Local)
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REGULATIONS FINALIZED ON SALES AND EXCHANGES OF INTERESTS IN PARTNERSHIPS, S CORPORATIONS AND TRUSTS

Effective for transfers on or after September 21, 2000 of interests in S corporations, trusts and partnerships, the portion of individual sellers' gains attributable to collectibles held for more than one year will be taxed at a 28% rate, in accordance with regulations recently finalized by the Internal Revenue Service. The term "collectibles" includes all works of art, antiques, gems, metals, stamp and coin collections and alcoholic beverages, among other items.

Also, a selling partner's gain on the disposition of his partnership interest equal to the amount of straight line depreciation gain which would have been taxed to him if the partnership had sold its depreciable real property improvements, will be treated as gain subject to the 25% federal individual tax rate in the same manner as if the partnership had sold the asset.

The Internal Revenue Service, however, exempted redemption transactions from the 28% and 25% rates, so that if an interest in a partnership is redeemed, the gain which otherwise would have been collectibles gain or straight line depreciation recapture gain will be taxed at the maximum federal 20% rate for partnership interests held for more than one year. However, taxpayers should be aware that a capital contribution by one partner to a partnership followed by a redemption of another partner will usually be treated as the purchase of a partnership interest rather than a redemption of a partnership interest.

In a separate set of regulations (also applicable to dispositions on or after September 21, 2000), if a partner makes a capital contribution to a partnership or acquires an additional interest in a partnership and, within 12 months from the latest acquisition or contribution, he disposes of his partnership interest, a portion of his capital gain on the sale of his partnership interest will be treated as short term capital gain. That portion is calculated generally as that fraction of his entire capital gain the numerator of which is the value of the interest purchased or contributed within 12 months prior to the sale or redemption and the denominator of which is the fair market value of his interest immediately after the most recent capital contribution or purchase. Of course, the portion of a selling partner's gain which is ordinary income as a result of depreciation recapture or other ordinary income type assets of the partnership will continue to be ordinary income. Only the remaining portion of the gain which is capital gain is affected by these new regulations.

These regulations, however, do provide certain exceptions for publicly traded partnerships where the interests are divided into units. Gains are calculated on a unit-by-unit basis.

Also, these regulations permit the netting of cash contributions and distributions within the 12 months prior to the sale by treating all cash distributions as if they were received immediately before the sale or exchange.

Given these new regulations, tax planning prior to a sale or redemption of a partnership interest is crucial to avoid the higher tax rates which could be experienced.

Remember that these legal principles may change and vary widely in their application to specific factual circumstances. You should consult with counsel about your individual circumstances. For further information regarding these issues, contact:

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