

DISTRIBUTIONS IN ACCORDANCE WITH CAPITAL ACCOUNTS (TREAS REG 1.704-1(B)(2)(IV))

What's the business deal? Get LP to a target? (like original capital contribution?) Get GP to a certain percentage? Share residuals at a certain rate?

Often the “deal” is GP gets a high percentage (e.g., 80%) of proceeds, and the LP to get the balance, regardless of where their capital accounts are at the time of the sale.

- But distributions have to be made in accordance with capital accounts
- So, if the LP has a large capital account, it may get most of the money
- What to do when the numbers don't add up?

DISCUSSION

Capital accounts are increased by:

- Capital contributions
- Allocations of income (or gross profit)

Capital accounts are decreased by:

- Distributions
- Allocations of losses
- Non deductible items

In a sale and liquidation scenario, you started at zero and must end at zero

THE GOOD

Capital Accounts Pre Sale			
		GP	LP
Ending Capital Account Prior to Sale	\$	(25,000)	\$ (575,000)

THE GOOD

THE SALE

Sales Price			\$ 8,450,000
Fixed Assets	\$ 7,600,000		
Less Acc. Depreciation	(4,750,000)	\$ 2,850,000	
Land		100,000	
Basis			<u>2,950,000</u>
Gain (Loss) on Sale			\$ 5,500,000

THE GOOD

THE SALE APPLIED

		GP	LP
Ending Capital Account Prior to Sale		\$ (25,000)	\$ (575,000)
Allocation of Sale proceeds:	\$ 5,500,000		
Negative Capital Accounts		25,000	575,000
To Equal terminal distributions		4,719,635	180,365
Reallocation to Pay LP Exit Taxes (Assume 35%)		(309,615)	309,615
Capital Account Before Liquidating Distribution		4,410,020	489,980

THE GOOD CASH TO DISTRIBUTE

Sales Price		\$ 8,450,000
Mortgage		- 3,450,000
Transaction Costs		<u>- 100,000</u>
		3,550,000
Cash to distribute		\$ 4,900,000

THE GOOD -- 90/10

Capital Accounts Pre Sale		GP	LP
Ending Capital Account Prior to Sale		\$ (25,000)	\$ (575,000)
Allocation of Sale proceeds:	\$ 5,500,000		
Negative Capital Accounts		25,000	575,000
Equal to terminal distributions		4,719,635	180,365
Exit Tax Reallocation	35%	(309,615)	309,615
Capital Account Before Liquidating Distribution		4,410,020	489,980
Cash to Distribute	\$ 4,900,000		
Fund Reserves			
Credit Adjusters			
Exit Tax Distribution			(309,615)
Deferred Developer Fee			
Other Affiliate Loans			
90% to GP and 10% to LP		(4,410,020)	(180,365)
Terminal Capital Account		\$ -	\$ -
Cash Received		\$ 4,410,020	\$ 489,980
		90%	10%

THE NOT-SO-GOOD

Capital Accounts Pre Sale				
		GP	LP	
Ending Capital Account Prior to Sale		\$ (1,000,000)	\$ 2,300,000	

THE NOT-SO-GOOD

Sales Price			\$ 11,300,000	
Fixed Assets	\$ 11,500,000			
Less Accumulated Depreciation	(4,800,000)	\$ 6,700,000		
Land		1,700,000		
Basis			8,400,000	
Gain (Loss) on Sale			\$ 2,900,000	

THE NOT-SO-GOOD

Capital Accounts Pre Sale			
		GP	LP
Ending Capital Account Prior to Sale		\$ (1,000,000)	\$ 2,300,000
Allocation of Sale proceeds:	\$ 2,900,000		
Negative Capital Accounts		1,000,000	-
Equal to terminal distributions		1,900,000	-
Exit Tax Reallocation	35%	-	-
Capital Account Before Liquidating Distribution		1,900,000	2,300,000

THE NOT-SO-GOOD

Sales Price			\$ 11,300,000	
First Mortgage		\$ 6,750,000		
Second Mortgage		250,000	7,000,000	
Transaction Costs			100,000	
			7,100,000	
Cash to distribute			\$ 4,200,000	

THE NOT-SO-GOOD

		GP	LP
Ending Capital Account Prior to Sale		\$ (1,000,000)	\$ 2,300,000
Allocation of Sale proceeds:	\$ 2,900,000		
Negative Capital Accounts		1,000,000	-
Equal to terminal distributions		1,900,000	-
Exit Tax Reallocation	35%	-	-
Capital Account Before Liquidating Distribution		1,900,000	2,300,000
Cash to Distribute	\$ 4,200,000		
Fund Reserves			
Credit Adjusters			
Exit Tax Distribution		-	-
Deferred Developer Fee			
Other Affiliate Loans			
90% to GP and 10% to LP		(1,900,000)	(2,300,000)
Terminal Capital Account		\$ -	\$ -
Cash Received		\$ 1,900,000	\$ 2,300,000
		45%	55%

THE UGLY

Capital Accounts Pre Sale

		GP	LP
Ending Capital Account Prior to Sale		\$ (450,000)	\$ (1,500,000)

THE UGLY

Sales Price			\$ 8,800,000
Fixed Assets	\$ 14,000,000		
Less Accumulated Depreciation	(7,800,000)	\$ 6,200,000	
Land		600,000	
Basis			6,800,000
Gain (Loss) on Sale			\$ 2,000,000

THE UGLY

		GP	LP
Ending Capital Account Prior to Sale		\$ (450,000)	\$ (1,500,000)
Allocation of Sale proceeds:	\$ 2,000,000		
Negative Capital Accounts		450,000	1,500,000
Equal to terminal distributions		50,000	-
Exit Tax Reallocation	35%	(807,692)	807,692
Capital Account Before Liquidating Distribution		(757,692)	807,692

THE UGLY

Sales Price			\$ 8,800,000
First Mortgage		\$ 7,635,000	
Second Mortgage(s)		1,015,000	8,650,000
Transaction Costs			100,000
			8,750,000
Cash to distribute			\$ 50,000

THE UGLY

		GP	LP
Ending Capital Account Prior to Sale		\$ (450,000)	\$ (1,500,000)
Allocation of Sale proceeds:	\$ 2,000,000		
Negative Capital Accounts		450,000	1,500,000
Equal to terminal distributions		50,000	-
Exit Tax Reallocation	35%	(807,692)	807,692
Capital Account Before Liquidating Distribution		(757,692)	807,692
Cash to Distribute	\$ 50,000		
Fund Reserves			
Credit Adjusters			
Exit Tax Distribution			(807,692)
Deferred Developer Fee			
Other Affiliate Loans			
90% to GP and 10% to LP		-	-
Terminal Capital Account		\$ (757,692)	\$ -
Cash Received		\$ -	\$ 807,692
		0%	1615%

THANK YOU!

Questions?



Charlie Rhuda (Charlie.Rhuda@novoco.com)

Novogradac & Company LLP