(C) Tax Analysts 2011. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

Taxation of Noncompensatory Capital Shifts

By Brad Martinson

Brad Martinson

Brad Martinson is a partner in the corporate section of Rutan & Tucker, Costa Mesa, Calif., specializing in tax law. He represents domestic and foreign corporations, partnerships, and joint ventures involved in mergers and acquisitions, and assists in restructurings of financially troubled corporations and partnerships. He can be reached at BMartinson@rutan.com.

This article analyzes the federal income tax consequences of actual noncompensatory capital shifts between partners in a partnership, a situation for which there is a dearth of guidance. It addresses the consequences of capital shifts that occur on abandonment of a partnership interest, exit by a partner in a section 736 setting, and the forfeiture of a profits interest by a terminated employee.

A few years ago, I was asked to analyze the income tax consequences of an employee's termination from an investment-fund management company that was classified as a partnership for tax purposes. Before termination, the employee held a profits interest in the management company that was fully vested but subject to complete forfeiture on termination for cause. The employee was terminated for cause, and as a result his profits interest was forfeited for no consideration. The capital account he left behind was transferred to the remaining partners. At issue was whether the remaining partners recognized current income as a result of this capital "shift."

On researching the issue, I was surprised by the lack of guidance on capital shifts in a noncompensatory setting. This lack of guidance is especially notable because, since my initial research, capital shifts (or at least the potential for capital shifts) have arisen quite often in the deals that cross my desk. Unfortunately, no new guidance has been issued since this initial project, so we are left to speculate on the proper income tax treatment of noncompensatory capital shifts. This article is intended to further that speculation by first briefly summarizing the existing guidance and then discussing my view of the likely income tax consequences of actual noncompensatory capital shifts, including the one described above.

A. Capital Account Rules

Before starting the discussion, it is important to note that this article assumes the reader has a working knowledge of the section 704(b) capital account rules. Nevertheless, two concepts need to be addressed briefly because they are core concepts that influence this discussion.

The first concept is the general idea that section 704(b) book capital accounts[1] are intended to represent the partners' economic interests in the partnership. Under reg. section 1.704-1(b)(i), allocations of income, gain, loss, deduction, or credit to a partner under a partnership agreement will be disallowed unless the allocation has "substantial economic effect" or is in accordance with the partners' interests in the partnership. For an allocation to satisfy the economic effect portion of the determination, the allocation must be consistent with the underlying economic arrangement of the partners.[2]

The economic effect test can be satisfied if (1) partners' capital accounts are maintained in accordance with the requirements of reg. section 1.704-1(b)(2),[3] (2) liquidating distributions are made to the partners in accordance with their respective positive capital account balances, and (3) each partner with a deficit capital account balance following liquidation of his interest in the partnership is unconditionally obligated to restore the deficit to the partnership.[4] The goal of these requirements is to have capital accounts that accurately reflect the partners' economic interests in the partnership and

[1]References to "capital accounts" in this article mean section 704(b) book capital accounts.

[2]Reg. section 1.704-1(b)(2)(ii)(a).

[3]Meaning, generally, that a partner's capital account is increased by capital contributions made by the partner and his allocable share of income and gain, and decreased by distributions to the partner and his allocable share of loss and deduction.

[4]Reg. section 1.704-1(b)(2)(ii)(*b*). Requirement (iii) of this section can be satisfied in the alternative through a "qualified income offset" as described in reg. section 1.704-1(b)(2)(ii)(*d*).

track their business deal.[5] Thus, in concept, a transfer of capital account balances from one partner to another would affect each partner's economics in the partnership, and could be considered equivalent to the transfer of money from one partner to the other.

The second concept is that the section 704(b) regulations provide a partnership with an opportunity to adjust capital accounts on the occurrence of some events to reflect the then-current FMV of the partnership's assets, including intangible assets such as goodwill. This adjustment is known in partnership tax parlance as a capital account book up or book down. Under reg. section 1.704-1(b)(2)(iv)(f), the partnership may, but is not required to, book up or book down capital accounts in connection with:

> (i) a contribution of money or other property (other than a de minimis amount) to the partnership by a new or existing partner as consideration for an interest in the partnership;
>
> (ii) the liquidation of the partnership or a distribution of money or other property (other than a de minimis amount) by the partnership to a retiring or continuing partner as consideration for an interest in the partnership; or
>
> (iii) the grant of an interest in the partnership (other than a de minimis interest) as consideration for the provision of services to or for the benefit of the partnership by an existing partner acting in a partner capacity, or by a new partner acting in a partner capacity or in anticipation of being a partner.

B. Guidance on Capital Shifts

There is limited guidance in the code and regulations regarding capital shifts. The regulations under section 721 discuss the treatment of compensatory capital shifts, providing that to the extent any partner gives up any part of his right to be repaid his contributions in favor of another partner as compensation for services, the FMV of the interest in partnership capital transferred to the compensated partner constitutes income under section 61.[6] Importantly, the regulations note that the timing of income recognition depends on the facts and circumstances, including any substantial restrictions or conditions on the compensated partner's right to withdraw or dispose of the interest.[7]

Case law on capital shifts is similarly limited. The leading case is *Lehman v. Commissioner*, 19 T.C. 659 (1953), in which a $10,000 credit to the taxpayers' capital accounts transferred from the capital accounts of other partners was treated as income to the taxpayers in the year of the transfer. The taxpayers argued that any gain resulting from the capital shift should be postponed until dissolution of the partnership, and should be capital gain. The Tax Court disagreed, holding that the capital shift was the equivalent of a taxable transfer of $10,000 in cash to the taxpayer at the time of the capital shift, followed by a $10,000 contribution to the partnership.[8] Although it is not entirely clear, the capital shift in *Lehman* likely arose in a compensatory setting, so its authority in a noncompensatory setting is somewhat limited.

Absent specific guidance, the general income inclusion rules of section 61 must be considered. Under section 61, gross income means ''all income from whatever source derived,'' which the Supreme Court has interpreted to include any ''undeniable accessions to wealth, clearly realized, over which taxpayers have complete dominion.''[9] This general gross income concept must be interpreted together with general income recognition principles, under which taxpayers realize income only on the occurrence of a specific realization event and are not otherwise taxed merely for the appreciation in value of assets.[10]

C. General Analysis of Capital Shift Taxation

Based on the current guidance, I believe a noncompensatory transfer of all or a portion of a capital account by one partner to another may constitute taxable income to the recipient partner. A capital shift may be an undeniable accession to wealth under the capital accounting rules, because a transfer to or from a partner's capital account is intended to have a true economic impact on that partner.

Moreover, a capital shift is not a nontaxable appreciation in the value of assets. The increase in value of a transferee partner's partnership interest arising from a capital shift is not attributable to appreciation in an investment in the traditional

---

[5]IRS, ''Partnership — Audit Technique Guide,'' ch. 1 (Mar. 2008).

[6]Reg. section 1.721-1(b)(1).

[7]*Id.* There are also recently issued proposed regulations under section 721 on noncompensatory partnership options that touch on capital shifts but are not particularly instructive for purposes of this discussion.

[8]The Tenth Circuit in *Farris v. Commissioner*, 222 F.2d 320 (10th Cir. 1955), agreed with the *Lehman* court, saying that ''it was the same as though the other partners had paid them $10,000 in cash to be placed in their capital account.''

[9]*Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426 (1955).

[10]*See, e.g., Eisner v. Macomber*, 252 U.S. 189 (1919).

(C) Tax Analysts 2011. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

sense, but rather from the actual transfer. Under the *Lehman* court's principles, this actual transfer may be considered equivalent to a transfer of cash to the transferee at the time of the capital shift, followed by a contribution to the partnership. This transfer, I would argue, is generally a specific realization event for section 61 purposes. There are some circumstances, however, in which a capital shift arguably is not a realization event for a recipient partner. See Part D.3 for one example.

These conclusions, however, do not lead to a capital shift being per se taxable at the time of the shift. Instead, it seems appropriate to apply the principles of section 61 and the section 721 regulations, which defer income recognition until the taxpayer has ''complete dominion'' over the accession to wealth (under section 61), or when the facts and circumstances warrant inclusion (under the section 721 regulations).

Thus, a partner to whom capital is shifted should recognize income as a result of the capital shift only if and when the facts and circumstances indicate the taxpayer has complete dominion over the shifted capital.

D. Examples and Analysis

1. Abandonment of a partnership interest. A noncompensatory capital shift may arise on the abandonment of a partnership interest. In most cases, a partner would abandon a partnership interest only if it were worthless, and in that case, although there might technically be a capital shift, the FMV of the partnership capital shifted would be zero.[11] There are, however, circumstances in which a partner may elect to abandon a partnership interest that has actual value because it is economically efficient on an after-tax basis.

The key to this analysis is that the abandonment of a partnership interest may produce an ordinary loss. When a partner abandons his partnership interest for no consideration and is not relieved of any partnership liabilities, the loss is an ordinary loss because there is no sale or exchange of property giving rise to capital gain or loss treatment.[12] The amount of the loss is equal to the abandoning partner's tax basis in his interest immediately before the abandonment.[13]

Having an opportunity to recognize ordinary loss, a partner may choose to abandon a partnership interest and recognize the ordinary loss rather than being redeemed out of the partnership and recognizing a capital loss. Importantly, when a partner abandons a partnership interest with actual value, the abandoned capital account will be shifted to the remaining partners.

> **Example (Abandonment):** A invests $220,000 for a 20 percent interest in XYZ, an entity classified as a partnership for tax purposes. MAJ owns 60 percent and MIN owns the remaining 20 percent. XYZ's operating agreement provides that the company may be liquidated on majority vote and that there are significant limitations on the transfer and redemption of interests. XYZ is an operating company and has no debt. Following A's investment, XYZ's business lagged, and as a result, A received no distributions and was allocated $120,000 in operating losses. Moreover, because of lost customer contracts, supplier issues, etc., the value of XYZ has decreased from $1.1 million at the time of A's investment to $50,000. A's tax basis in his XYZ interest is $100,000.
>
> A now wants out of this investment. MAJ has told A that A will be permitted to have his interest redeemed for $10,000, which is the FMV of his interest. If A chooses redemption, A would receive $10,000 in cash and have a $90,000 capital loss, which we will assume is worth approximately $1,050 per year during the carryover period.[14] All told, we will assume that the redemption choice results in a net after-tax present value to A of $15,000.
>
> Alternatively, A could elect to simply abandon his XYZ interest. By doing so, A would forfeit the redemption proceeds of $10,000, but would be entitled to an ordinary loss equal to his tax basis of $100,000. That ordinary loss is worth $35,000 to A.[15]

In this example, it is clear that A should simply abandon his XYZ interest. A's decision, however,

---

[11]Interestingly, the abandonment of a partnership interest is technically not an event that permits a partnership to book down the partners' capital accounts under reg. section 1.704-1(b)(2)(iv)(*f*). It seems justifiable to me, however, for a partnership to assert that the abandonment of a partnership interest is the functional equivalent of liquidating that partnership interest.

[12]*Citron v. Commissioner*, 97 T.C. 200 (1991); *Echols v. Commissioner*, 950 F.2d 209 (5th Cir. 1991).

[13]Reg. section 1.165-1(c).

[14]This figure assumes that A has no capital gains, and uses $3,000 of capital losses each year to offset ordinary income, and that the applicable federal income tax rate is 35 percent.

[15]This figure assumes that the abandonment loss is not a nonbusiness loss that would be a miscellaneous itemized deduction limited for regular income tax purposes and added back for alternative minimum tax purposes.

(C) Tax Analysts 2011. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

may have income tax consequences to the remaining partners in XYZ because A's capital account of $10,000 will be shifted to those partners. At issue is whether that capital shift results in current income for the remaining partners.

Clearly, both MAJ and MIN realized an accession to wealth as a result of this transaction. Before the abandonment, the values of MAJ's and MIN's interests in XYZ were $30,000 and $10,000,[16] respectively, and following the abandonment those values were $37,500 and $12,500, respectively.[17] However, in my view, MAJ and MIN should recognize income as a result of this capital shift only if and when the facts and circumstances indicate that they have complete dominion over the shifted capital.

I would argue that the facts and circumstances of this example indicate that MAJ currently has complete dominion over the shifted capital account. MAJ has voting control and can therefore unilaterally elect to liquidate XYZ and receive a liquidating distribution of assets equaling its capital account balance, which would, post-abandonment, include the value attributable to A's shifted capital. Therefore, based on the general principles of section 61, it is arguable that MAJ should recognize current income equal to its share of the shifted capital.

But, it seems proper not to treat MIN as recognizing current income because the facts and circumstances do not indicate that MIN currently has complete dominion over its shifted capital. MIN is simply a minority member who cannot force a liquidation and whose ability to redeem or transfer its interest at a value reflecting the shifted capital is substantially limited.

I recognize that under the *Lehman* court's principles, MIN, as well as MAJ, may be treated as though it received cash at the time of the capital shift and then made a subsequent contribution to XYZ. If those principles are applied here, both MIN and MAJ would have taxable income as a result of the receipt of cash. That cannot be the correct answer in this case, however, because MIN had far from complete dominion over that cash following the deemed contribution because of its substantially limited rights under the XYZ partnership agreement. Therefore, in my view, *Lehman* principles should not be applied to MIN, and MIN should not be required to recognize current income as a result of the capital shift.[18]

2. Section 736 payments. Section 736 governs the treatment of payments to retiring or deceased partners in liquidation of their partnership interests. The rules in section 736 are confusing and convoluted, and a full discussion of the complexities of section 736 is beyond the scope of this article. I must, however, briefly describe the differing tax treatment of section 736(a) and (b) payments.

A payment to a retiring or deceased partner made under section 736(a) is considered to be either a distributive share of partnership income if the amount of the payment is determined with regard to the income of the partnership or a guaranteed payment if the amount is determined without regard to the income of the partnership. A section 736(b) payment is treated as being made in exchange for the partner's interest in partnership property, and is considered to be a distribution by the partnership and not a distributive share or guaranteed payment under section 736(a). Thus, section 736(a) payments generally produce ordinary income for a retiring or deceased partner, and section 736(b) payments trigger capital gains to the extent they exceed the partner's tax basis in his interest.[19] Moreover, section 736(a) payments do not reduce the retiring or deceased partner's capital account,[20] whereas section 736(b) payments are distributions that do reduce the recipient's capital account.

> **Example (Section 736):** A, B, and C are equal partners in ABC, an entity classified as a partnership for income tax purposes. The ABC partnership agreement provides that if a partner withdraws for any reason, he is entitled to receive a series of payments over the three-year period following withdrawal that are equal to 50 percent (in year 1), 40 percent (in year 2) and 30 percent (in year 3) of the distributions the partner would have received during such year (the Withdrawal Payments). C withdraws and becomes entitled to Withdrawal Payments in years 2-4, which end up totaling $800. Immediately before C's withdrawal (and after a book-up), C has a capital

[16]Presumably, the true FMV of MAJ's and MIN's interests would factor in control premiums and minority discounts, but valuation discussions are beyond the scope of this article.

[17]Following A's abandonment, MAJ's and MIN's interests in XYZ would be 75 and 25 percent, respectively.

[18]Note that MIN will not be completely exempted from recognizing income or gain as a result of this transfer. Assuming (Footnote continued in next column.) MIN ultimately receives the amount of the shifted capital (through liquidation, transfer, or redemption), MIN will have gain equal to the amount of the shifted capital because MIN's tax basis was not increased as a result of the capital shift. Therefore, MIN's tax consequences from the capital shift are simply deferred.

[19]Except to the extent ordinary income is recognized on the distribution under section 751.

[20]The recipient either receives a corresponding income allocation, which increases his capital account and offsets the reduction attributable to the distribution, or a guaranteed payment that by definition has no effect on the recipient's capital account.

(C) Tax Analysts 2011. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

account balance of $1,000. ABC properly treats the Withdrawal Payments as being section 736(b) payments. Therefore, ABC allocates no income to C in years 2-4, and the Withdrawal Payments are reflected as distributions on ABC's Forms 1065 and K-1 issued to C for years 2-4. As a result, C's capital account is reduced by the amount of the Withdrawal Payments, resulting in a final capital account of $200.

As is evidenced by this example, a withdrawing partner receiving section 736(b) payments will have a residual capital account balance to the extent those payments are less than that partner's capital account before retirement or death.[21] At issue is whether that residual capital account, when it is shifted to the remaining partners, results in current income for those partners. In my view, it does not.

It is slightly unsettling that there is no statute, regulation, court opinion, or ruling affirmatively stating that income is not recognized as a result of this type of capital shift, including under the general income recognition principles of section 61. Nevertheless, one can take comfort in that neither the statutory language of section 736 nor the applicable Treasury regulations discuss any potential taxable capital shift triggered by payments in liquidation of a partner's interest, and no cases or rulings indicate that a taxable shift would occur. Moreover, the legislative history discussing the first enacted version of section 736 indicates that no income should be recognized:

> The amounts paid for the capital interest of the withdrawing partner are treated in the same manner as a distribution. The remaining partners, of course, are allowed no deductions for such payments. *Essentially, these payments represent a purchase by the remaining partners of the withdrawing partner's capital interest in the partnership*.[22]

In effect, Congress says that payments under section 736 should be treated as being made in exchange for the withdrawing partner's capital account. Therefore, section 736 essentially provides a mechanism for the remaining partners (through the partnership) to buy out a withdrawing partner's interest without requiring an immediate cash outlay equal to the withdrawing partner's capital account balance (or other negotiated price). Section 736 implicitly assumes that the purchase price for this exchange will be negotiated on an arm's-length basis, and to the extent the payments received by the withdrawing partner are less than his capital account balance, he simply made a poor business deal and the remaining partners got a good deal. Obviously, the remaining partners should not recognize current income as a result of purchasing property on an arm's-length basis at a discount.

3. Forfeiture for cause. The final example is the situation described at the beginning of this article. To recap, an employee (E) was terminated for cause from an investment-fund management company that was classified as a partnership for tax purposes. Before termination, E held a profits interest in the management company that was fully vested, but subject to complete forfeiture on termination for cause. As a result of this termination, E's profits interest was forfeited for no consideration. The capital account E forfeited was transferred to the remaining partners. To expand on this example, let's suppose that the founder of the business (Founder) has majority control of the partnership and all other partners have minority interests. Let's suppose that the minority partners can have their interests redeemed at a formula-based redemption price prescribed in the partnership's operating agreement equal to their partnership percentage multiplied by some percentage of current and prior years' earnings. Transfers of partnership interests by the minority partners are not permitted without Founder approval. Allocations of profits (including profits arising from a book-up) are allocated pro rata among the partners in accordance with their percentage interests. Finally, under the partnership's operating agreement, liquidating distributions are made in accordance with positive capital account balances.

I will address two different scenarios in this example:

> *Scenario 1* — During the period E held his profits interest, E received tax distributions only, and his share of undistributed profits was invested in the investment fund.
>
> *Scenario 2* — During the period E held his profits interest, E received distributions equal to his share of profits, which generally had the effect of zeroing out his capital account on an ongoing basis. However, shortly before E's termination and forfeiture, a new profits interest was issued to another employee, and all the existing partners' (including E's) capital accounts were booked up. As a result, E's

[21]A similar result would occur if the partnership is entitled to make section 736(a) payments because in that scenario either C would have received income allocations equal to its Withdrawal Payments (and capital account reductions equal to the Withdrawal Payments) or the Withdrawal Payments would have been treated as guaranteed payments, which by definition do not affect capital accounts. In either case, C's final capital account balance following all Withdrawal Payments and allocations would have remained at $1,000. *See supra* note 20.

[22]H.R. Rep. No. 83-1337, at 71-72 (emphasis added).

(C) Tax Analysts 2011. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

capital account reflected his percentage-interest share of the deemed profits arising from the book-up. In this case, E's booked-up capital account balance was largely attributable to the goodwill of the investment-fund management business.

Analysis re: Scenario 1 — In this scenario, a capital account reflecting the value of an actual investment in the managed investment fund has been transferred to the remaining partners. In my view, an analysis similar to the analysis under the Abandonment example above should be applied.

Thus, regarding the Founder, the question is whether the facts and circumstances indicate that he has complete dominion over the shifted capital. As in the Abandonment example, I would argue that he does; the Founder has majority control over the partnership and therefore can effect a liquidation of the partnership at any time. Moreover, because he is the controlling member of the manager of the investment fund, presumably he could effectuate a redemption for cash of the investment giving rise to E's shifted capital. As a result, and because liquidating distributions are made in accordance with positive capital account balances, the Founder could cause a liquidation of the partnership that would result in him receiving a liquidating distribution of cash in an amount that includes his share of the shifted capital. In my view, these are facts and circumstances that suggest current and complete dominion over the shifted capital. Therefore, I believe the Founder should recognize current income equal to his share of the shifted capital.

Unlike in the Abandonment example, the minority partners here have an unlimited right to have their interests redeemed. Therefore, some of the substantial limitations that caused MIN not to recognize current income in the Abandonment example do not apply here. I would argue, however, that the minority partners should not be required to recognize current income as a result of the capital shift here because under the partnership agreement they have no current ability to realize the actual value of the shifted capital. The partnership agreement provides a formulaic redemption price based on an earnings multiple, and the result of that formula is not tied to capital account balances, but rather to the partnership's earnings. Thus, the redemption price of a minority partner's interest immediately before the capital shift and immediately after the capital shift would not change.[23] Also, the minority partners have no right to cause a liquidation of the partnership. Taken together, the capital shift had no current economic impact on any minority partner because the minority partners must wait until liquidation (or sale with majority partner approval) before receiving any value attributable to the shifted capital. Stated differently, the minority partners currently do not have complete dominion over the shifted capital. As a result, the minority partners should not be required to recognize current income as a result of the capital shift.

Analysis re: Scenario 2 — Nothing has changed from Scenario 1 to Scenario 2 other than the type of asset comprising E's capital account, the former being an interest in an investment fund, and the latter being goodwill. Therefore, if we were to treat all amounts in a capital account consistently, regardless of their nature, the result in Scenario 2 for the Founder should be identical to that in Scenario 1. In both cases the Founder should be treated as recognizing current income as a result of the capital shift.

Scenario 2, however, presents a situation that merits a distinction between a capital account balance attributable to goodwill and a balance attributable to tangible, immediately realizable assets. This distinction cannot be found in the code or regulations but, I argue, should be applied on a policy basis in the capital shift context.

Here, E's capital account was booked up before the issuance of a profits interest to a new partner. The goal of a book-up in this circumstance is to ensure that the pre-issuance partners share in the pre-issuance value of the business. The pre-issuance partners will ensure that their booked-up capital accounts include the value of the partnership's goodwill because the aggregate balance of all booked-up capital accounts should equal the *total* value of the partnership's business. This, however, is where capital accounts start looking more like an accounting fiction than a true reflection of the economic value of a partner's interest in the partnership, because goodwill is highly theoretical, hard to value, and generally realizable only on some liquidity event, like a sale to a third party. Thus, although it is important to ensure that goodwill is included in capital accounts to prevent the new profits-interest partner from sharing in goodwill that arose before he received his interest, it is also important to understand that the portion of capital account balances that is attributable to goodwill is speculative and typically not immediately realizable.

Therefore, when the capital attributable to goodwill is shifted, even the Founder, with his power over and control of the partnership, cannot currently realize the value of that capital. The Founder has no ability to monetize goodwill on his own;

[23]In effect, the minority partners have a right to receive section 736 payments on redemption, which should not trigger capital shift income.

(C) Tax Analysts 2011. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

although the Founder has the right to liquidate the partnership, he has no ability to convert goodwill to cash absent a sale of the goodwill, which is an event over which he does not have complete dominion. Thus, in my view, no partner, including the Founder, has had a realization event for section 61 purposes and therefore no partner should recognize current income as a result of this capital shift.

Applied more generally, it seems to be good policy to conclude that no partner should recognize income as a result of a capital shift to the extent the shifted capital is attributable to goodwill. Again, no authority explicitly supports this proposition. To try to avoid this situation altogether, the partnership agreement can provide that all goodwill, on liquidation, will be distributed to the principal(s)/founder(s), if appropriate for that deal. In many cases it would be the principal(s)/founder(s), and not the minority partners, who could capitalize on the name brand, customer relationships, and other components of goodwill if they were to ever start a new venture. The partnership agreement could also provide that any allocations of deemed profits attributable to goodwill (as a result of a book-up) should be allocated solely to the principal(s)/founder(s). With these two provisions included in the partnership agreement, the capital account of any minority partner would not include a goodwill component, and the capital shift concerns that come into play in Scenario 2 would never arise if any minority partner's capital is shifted to other partners.

(C) Tax Analysts 2011. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.