

## Partnership Basis

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### Chad asks:

I recently formed a LLC with my brother as equal partners. I contributed land worth \$5,000 and my brother contributed \$4,000 of cash and his old computer, which we agreed was worth the other \$1,000 he needed to make us equal partners. Now our accountant is telling us that we aren't equal partners, how can this be?

### My reply:

I'm glad to hear you have an accountant because partnership taxation is a very complex area. This is something your accountant should have explained to you, when he or she told you that you weren't "equal partners". Since he or she didn't automatically explain this to you; you should have felt comfortable enough to ask him or her right then. If you're not comfortable talking to your advisor it may be time to find a new one.

Now to your question. You most likely have a partnership agreement that says that you and your brother will be sharing equally in the capital and profits of your partnership and therefore you believe you are equal partners - and you are. However partnership taxation is anything but straight forward.

Partnership taxation has what is called "inside basis" and "outside basis". "Inside basis" refers to the partnership's tax basis in its assets. "Outside basis" refers to the partners' tax basis in their partnership interest.

The land that you contributed may have been worth \$5,000, but your basis in that land (close to what it cost you to buy it), prior to contributing it to the partnership, was probably much less. Whatever your basis was in the land that you contributed is now your basis in your partnership interest.

Your brother contributed cash plus his computer. His basis in his partnership interest will be the amount of cash he contributed \$4,000 plus his basis in his computer (not what it was worth to the partnership, which you said was \$1,000, but generally his original cost, which was probably higher).

As I said previously stated, partnership taxation is a very complex area and I have simplified the rules to give you my best guess as to why your basis in your partnership interests are different even though you both contributed the same value to the partnership and intend on being equal partners in the profits.

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**Gina L. Gwozdz** is a CPA who has chosen to specialize in taxes. Visit her website at <http://GLGcpa.com> to view more Tax Tip Articles.