

## **Business Tax Administrative Rule 600.18-1**

### **Partnership Basis Adjustments**

For both the City of Portland Business License Tax and the Multnomah County Business Income Tax, tax is assessed at the entity level per Portland City Code 7.02.110 (A) and Multnomah County Code 12.110 (A). Partnerships that acquire assets have basis in the assets (partnership basis), while the partners have basis in their individual interest in the partnership (partner basis). Sales of partnership interests can create disparity between partnership and transferee partner basis. IRS Section 754 allows some remedy for this disparity at the partnership level by allowing the partnership to increase its basis and related depreciation. However, this allowance is allocated (through Schedule K and K-1) to only the involved partner(s). While the form of the Section 754 election is a partnership transaction, in substance it is deemed to be a partner-level transaction because it relates directly to the calculation of transferee partner basis.

A deduction for the step up in basis for partnership assets related to an Internal Revenue Code (IRC) Section 754 election (which allows IRC Section 743 adjustments) is not allowed for the City of Portland Business License Tax or the Multnomah County Business Income Tax. The stepped-up basis applies to the transferee individual partner(s) only and is reflected on the partner's Schedule K-1, regardless of the fact that it may have also been reported on Schedule K of the partnership's return. IRS Form 1065 instructions for tax year 2017 (subject to change) state the adjustments must be on an attached statement to Schedule K-1 using the codes for Other Income or Other Deductions.

Example 1: Individuals A, B, and C form Partnership Z as equal partners (each owning 33.3%). The partnership purchases a building for \$600,000. Over the next five years, the partnership has depreciated the building by \$60,000 and now has a remaining basis of \$540,000. This depreciation deduction was used to reduce the City/County taxable income of Partnership Z. Each of the three partners now has a basis of \$180,000.

Individual A then sells their interest in Partnership Z to Individual D for \$500,000. The gain on the sale of the partnership interest recognized by Individual A of \$320,000 would generally not be subject to the City of Portland Business License Tax or the Multnomah County Business Income Tax as it is the investment income of an individual. Individual D now has a \$500,000 depreciable basis in the building through their partnership interest. If Partnership Z makes an IRC Section 754 election, Individual D may take an additional depreciation deduction on their federal tax return based on the increase in the "transferee partner basis" of Individual D's purchased asset. However, this deduction is not allowed on the City/County tax return of Partnership Z.

Example 2: Corporation A and B form Partnership Z as equal partners (each owning 50%). Corporation C bought its interest (50%) in Partnership Z solely from Corporation A. Corporation C does business in the City of Portland in addition to its ownership percentage in Partnership Z. Corporation C sells its interest in Partnership Z three years later. Corporation C can include its stepped-up basis in determining the reportable gain from the sale of the interest in

Partnership Z when determining City/County taxable income because Partnership Z did not get to claim any of the additional depreciation from Corporation C's stepped-up basis.

XX-XX-2018

Thomas Lannom

---

Date

---

Director, Revenue Division

Adopted XX-XX-2018

DRAFT