

Making a valid Sec. 754 Election Following a Transfer of a Partnership Interest

When there is a transfer of interest where a partner buys out another partner's interest or a part of the partner's interest, the new partner can receive additional depreciation expense under Internal Revenue Code section 754. The partnership has to prepare an election statement if it is the first time that there is a transfer of interest. The election statement must contain the name and address of the partnership making the election, a signature by one of the partners, and a declaration that the partnership elects under section 754 to apply the provisions of sections 734(b) and 743(b). Furthermore, a computation of the new partner's basis in order to compute the additional section 754 depreciation must also be attached to the partnership return. The election is a one-time election and is not revocable.

If the partnership fails to make the election, there are relief provisions in the Internal Revenue Code. The automatic relief provision under Reg. 301.9100-2, allows an automatic extension of 12 months from the original due date. This means that the partnership can file an original or amended return with the section 754 election attached. Furthermore, you must write at the top of the document "FILED PURSUANT TO REG. 301-9100-2". Finally, the return has to comply with all other requirements like attaching statements under code sections 734(b) and 743(b).

If the election wasn't made within the 12 month period, there is a relief provision under Reg. 301.9100-3(a). This relief will be granted if the partnership provides evidence that it acted reasonably and in good faith and that granting the extension will not prejudice the government's interests.

The partnership will be deemed to act reasonably and in good faith if the partnership did any of the following:

1. Requested relief before the IRS discovers the failure to make the election
2. Failed to make the election because of intervening events beyond the taxpayer's control.
3. Failed to make the election because, after exercising reasonable diligence, it was unaware of the necessity for the election
4. Reasonably relied on the IRS' written advice.
5. Reasonably relied on a qualified tax professional, and the tax professional failed to make, or, advise the taxpayer to make the election.

This relief provision involves writing a private letter ruling, which is subject to a user fee of \$ 9,800.

The private letter ruling must contain the following:

1. A sworn affidavit describing the following:
 - o a. The events that led to the failure to make a valid election and to the discovery of the failure

- o b. The existence of grounds for the extension
- 2. Stating whether the partnership's return for the tax year in which the election should have been made is being examined by the IRS or being considered by an appeals office or a federal court.
- 3. Copies of the tax return for the year in question, the election documents, and a copy of the tax return of who the section 754 election will affect.

The new partner must notify the partnership within 30 days of the transfer. The notice must contain the name, address and TIN of the transferee and the transferor, the date of the transfer, the amount of any liabilities assumed or taken subject to by the transferee, and the amount of any cash or fair market value of property that was delivered for the partnership interest. Also, it has to be signed under penalties of perjury.

Therefore, it is important the partnership is aware of the transfers of interest between parties in order to compute the section 754 election and the section 743(b) basis adjustment.