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A link to the Attendance Affirmation/Evaluation will be in the thank you email that you will receive immediately following the program.

For CPE credits, attendees must participate until the end of the Q&A session and respond to five prompts during the program plus a single verification code. In addition, you must confirm your participation by completing and submitting an Attendance Affirmation/Evaluation after the webinar and include the final verification code on the Affirmation of Attendance portion of the form.

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TARGET VERSUS REGULATORY ALLOCATIONS

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Assistant Professor
West Virginia University
noel@noelpbrock.com

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REGULATORY (SAFE HARBOR) ALLOCATIONS
REGULATORY ALLOCATIONS

What are they?

- Establish an ordering (or layers) for allocating partnership profit and losses after considering regulatory allocations.

- Generally, profits are allocated first to offset prior years’ losses that eliminated the partners’ contributed capital and undistributed profits that were reflected in their capital accounts at the time such losses were allocated, and finally to reflect the manner in which the profits would be distributed if the partnership had cash available to distribute.

- Losses are generally allocated in the reverse order of profits.

- Liquidating distributions generally will be made in accordance with positive capital account balances.

- Allocating profits to “fill-up” waterfall layers
REGULATORY ALLOCATIONS

Common Issues/Considerations

➢ Often the waterfall provisions are in the distribution section of the agreement.

➢ There may be a different ways of sharing profits versus sharing losses.

➢ The allocations may be tied to target capital accounts even though they are layered allocations.
TARGETED ALLOCATIONS
TARGETED ALLOCATIONS

What are they?

- Specifies how cash will be distributed from operations and in liquidation of the partnership.
- Allocates profit/loss so that at the end of the taxable year, each partner’s capital account is equal to the amount that would be distributed to that partner in liquidation if all partnership assets were sold at their section 704(b) book value, less the partner’s share of minimum gain.
- They are distribution driven allocations that have the following characteristics:
  - Liquidation in accordance with the distribution provisions
  - “Plug” income so that capital accounts equal what a partner would receive upon a hypothetical liquidation if the assets of the partnership were sold for their section 704(b) value
TARGETED ALLOCATIONS

Common Issues/Considerations

- Targeted allocations won’t satisfy the substantial economic effect safe harbor because they don’t liquidate in accordance with capital account balances.
- If drafted properly, should be respected under the economic equivalence test or else are consistent with PIP
- Use of Qualified Income Offset provisions
- Impact of current tax distributions
- Impact on statutory allocations
- Impact of revaluation events

- Targeted allocations may create taxable capital shifts
PARTNERSHIP AGREEMENT PROVISIONS – ALLOCATIONS AND DISTRIBUTIONS

➢ Allocation Driven
  • Upon liquidation, distributions are made to the partners based on their capital account balances
  • Referred to as “allocation driven” because the allocations determine the capital accounts, which ultimately determine the economics
  • Sometimes referred to as “layer cake” allocations because there is often a waterfall – with multiple layers – in the allocation provisions

➢ Distribution Driven
  • Distributions are not based on capital accounts
  • Referred to as “distribution driven” because the allocations do not drive the economics
  • Therefore, partnership items must be allocated in such a way that they track the economics – i.e., the distributions drive the allocations
PARTNERSHIP AGREEMENT PROVISIONS – ALLOCATIONS AND DISTRIBUTIONS

Examples of Allocation Driven Agreements

- Safe Harbor Agreements
  - Agreements satisfying the test for “economic effect”
  - Agreements satisfying the “alternate test for economic effect”
- Non-Safe Harbor Agreements That Liquidate by Capital Accounts
  - Agreements that allocate income and loss on a non-section 704(b) basis – for example, agreements that allocate GAAP income and loss, or both realized and unrealized income and loss, determined on a FMV basis

Examples of Distribution Driven Agreements

- Targeted allocation agreements
- Any other agreement that does not provide for liquidation by capital accounts
EXAMPLE OF REGULATORY (SAFE HARBOR) AND TARGETED ALLOCATIONS
Layered allocations compute ending capital under the following formula:

\[
\text{beginning capital} + \text{contributions} + \text{income} - \text{distributions} - \text{loss} = \text{ending capital}
\]

Targeted allocations plug income under the following formula:

\[
\text{target ending capital} = \left( \text{beginning capital} + \text{contributions} - \text{distributions} - \text{loss} \right) + \text{income}
\]

or

\[
\text{target ending capital} = \left( \text{beginning capital} + \text{contributions} - \text{distributions} - \text{loss} \right) - \text{loss}
\]
REGULATORY (SAFE HARBOR) AND TARGETED ALLOCATIONS – CLASSIC 80/20 EXAMPLE

Common Issues/Considerations

- LP contributes $200 and GP contributes $0 to partnership
- Partnership buys two securities (1 and 2) for $100 each
- All distributions are made to LP until it gets its $200 back
- Then, distributions are made 80% to LP and 20% to GP
- In Year 2, the partnership sells 1 for $200 (gain of $100)
- Partnership distributes the $200 of proceeds to LP
REGULATORY ALLOCATION PROVISION

SECTION 1. ALLOCATIONS.

(a) **Net Income.** Net Income for any period will be allocated:

(I) **FIRST,** 100% TO THE LP UNTIL THE TOTAL NET INCOME ALLOCATED UNDER THIS SECTION 1(A)(I) EQUALS THE TOTAL NET LOSS ALLOCATED UNDER SECTION 1(B)(II), AND

(II) **SECOND,** 80% TO THE LP AND 20% TO THE GP.

(B) **Net Loss.** Net Loss for any period will be allocated:

(I) **First,** 80% TO THE LP AND 20% TO THE GP UNTIL THE TOTAL NET LOSS ALLOCATED UNDER THIS SECTION 1(B)(I) EQUALS THE TOTAL NET INCOME ALLOCATED UNDER SECTION 1(A)(II), AND

(II) **Second,** 100% TO THE LP.
### REGULATORY ALLOCATIONS – CAPITAL ACCOUNTS

<table>
<thead>
<tr>
<th></th>
<th>LP</th>
<th>GP</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Book</td>
<td>Tax</td>
</tr>
<tr>
<td>Contribution</td>
<td>200</td>
<td>200</td>
</tr>
<tr>
<td>Gain</td>
<td>80</td>
<td>80</td>
</tr>
<tr>
<td>Distribution</td>
<td>(200)</td>
<td>(200)</td>
</tr>
<tr>
<td>Total</td>
<td>80</td>
<td>80</td>
</tr>
</tbody>
</table>
“Except as otherwise provided in this Article, Profits and Losses (or items thereof) for any Fiscal Period shall be allocated among the Members in such manner that, as of the end of such Fiscal Period, the respective Capital Accounts of the Members shall be equal to the respective amounts that would be distributed to them, determined as if the Company were to (i) liquidate the assets of the Company for an amount equal to their Gross Asset Value and (ii) distribute the proceeds of liquidation pursuant to Section 10.3.”

Not all agreements have the “or items thereof” language

- Puts pressure on guaranteed payment determination
- Might make allocation fail economic effect equivalence and fall into PIP
SAMPLE TARGET ALLOCATION PROVISION LANGUAGE

Targeted allocations are computed under a 6-step process:

Step 1. Determine beginning capital for each partner
Step 2. Allocate contributions and distributions by partner
Step 3. Add Steps 1 and 2 to determine adjusted capital account for each partner
Step 4. Determine aggregate ending capital
Step 5. Allocate aggregate ending capital to the partners in accordance with the distribution provisions
Step 6. Subtract Step 3 from Step 5 to determine income for each partner
**TARGETED ALLOCATIONS – CAPITAL ACCOUNTS**

<table>
<thead>
<tr>
<th>Step</th>
<th>Description</th>
<th>LP</th>
<th>GP</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Determine Beg. Capital</td>
<td>200</td>
<td>0</td>
<td>200</td>
</tr>
<tr>
<td>2</td>
<td>Determine Contrib. and Dist.</td>
<td>(200)</td>
<td>0</td>
<td>(200)</td>
</tr>
<tr>
<td>3</td>
<td>Adjusted Capital</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>4</td>
<td>Determine Aggregate End. Capital</td>
<td></td>
<td></td>
<td>100</td>
</tr>
<tr>
<td>5</td>
<td>Allocate Ending Capital</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>1\textsuperscript{st} – Return Cap. to LP</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>2\textsuperscript{nd} – Return remainder 80/20</td>
<td>80</td>
<td>20</td>
<td>100</td>
</tr>
<tr>
<td></td>
<td>Total Ending Cap.</td>
<td>80</td>
<td>20</td>
<td>100</td>
</tr>
<tr>
<td>6</td>
<td>Taxable Income by Partner</td>
<td>80</td>
<td>20</td>
<td>100</td>
</tr>
</tbody>
</table>

*Note: Taxable Income by Partner is calculated by subtracting Step 3 from Step 5.*
BENEFITS AND DETRIMENTS OF TARGETED ALLOCATIONS

Lynn Fowler
lfowler@kilpatricktownsend.com
Why Do Targeted Allocations?

- **Primary Benefit - Certainty of Distributions**
  - Target allocations attempt to replicate “safe-harbor” allocations without requiring liquidating distributions to be in proportion to positive capital account balances
    - Safe harbor, Treas. Reg. § 1.704-1(b)(2)
  - If capital accounts don’t reflect parties’ economic deal, safe harbor allocations can alter the economics
Why Do Targeted Allocations?

- **Example: Preferred Returns**
  - A and B each contribute $500 to partnership P on 1/1 Year 1
  - B is entitled to a preferred return of 10% on unreturned capital
  - Next distributions go 1st to B to return its capital, then to A to return its capital
  - Remaining distributions split 60% to A and 40% to B
  - P invests capital in two assets, Asset 1 and Asset 2, investing $500 in each asset
  - P sells Asset 1 on 12/31 Year 1 for $700
  - P sells Asset 2 on 12/31 Year 2 for $500
  - P liquidates and distributes $1200 to A and B pursuant to partnership agreement
  - P engages in no other transactions
Why Do Targeted Allocations?

- Example: Preferred Returns
  - Capital Account Computation

<table>
<thead>
<tr>
<th></th>
<th>A</th>
<th>B</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beginning Capital</td>
<td>$500</td>
<td>$500</td>
<td>$1000</td>
</tr>
<tr>
<td>Year 1 Preferred Return Allocation</td>
<td>$0</td>
<td>$50</td>
<td>$50</td>
</tr>
<tr>
<td>Year 1 Residual Profit Allocation</td>
<td>$90</td>
<td>$60</td>
<td>$150</td>
</tr>
<tr>
<td>Year 2 Preferred Return Allocation</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>Year 2 Residual Profit Allocation</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>Ending Capital Account Balances</td>
<td>$590</td>
<td>$610</td>
<td>$1200</td>
</tr>
</tbody>
</table>
**Why Do Targeted Allocations?**

- **Example: Preferred Returns**
  - Distribution Waterfall

<table>
<thead>
<tr>
<th></th>
<th>A</th>
<th>B</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cumulative Preferred Return</td>
<td>$0</td>
<td>$100</td>
<td>$100</td>
</tr>
<tr>
<td>Return of B Capital</td>
<td>$0</td>
<td>$500</td>
<td>$500</td>
</tr>
<tr>
<td>Return of A Capital</td>
<td>$500</td>
<td>$0</td>
<td>$500</td>
</tr>
<tr>
<td>Residual Distributions</td>
<td>$60</td>
<td>$40</td>
<td>$100</td>
</tr>
<tr>
<td>Total Expected Distributions</td>
<td>$560</td>
<td>$640</td>
<td>$1200</td>
</tr>
</tbody>
</table>
Why Do Targeted Allocations?

- **Example: Preferred Returns**
  - Comparison of Capital Accounts to Distribution Waterfall

<table>
<thead>
<tr>
<th></th>
<th>A</th>
<th>B</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital Account Balance</td>
<td>$590</td>
<td>$610</td>
<td>$1200</td>
</tr>
<tr>
<td>Expected Distributions</td>
<td>$560</td>
<td>$640</td>
<td>$1200</td>
</tr>
<tr>
<td>Difference</td>
<td>$30</td>
<td>($30)</td>
<td>$0</td>
</tr>
</tbody>
</table>
Why Do Targeted Allocations?

- **Other Benefits**
  - Perceived ease of drafting
    - But puts pressure on drafter to draft distribution waterfall correctly
  - Less risk of surprise distribution result to parties
Issues with Targeted Allocations

- Tax Consequences of Distributions inconsistent with Capital Accounts
  - Comparison of Capital Accounts to Distribution Waterfall

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</tr>
<tr>
<td>Difference</td>
<td>$30</td>
<td>($30)</td>
<td>$0</td>
</tr>
</tbody>
</table>

- What are tax consequences to A and B of distribution pursuant to Waterfall?
  - Capital shift?
  - Guaranteed payment?
  - Distribution in excess of basis?
Issues with Targeted Allocations

- **Issues with Applying Allocations**
  - Targeted allocations require alternate calculations of actual capital account at BOY and target capital account at EOY:
  - Partnership return preparer must have systems in place to determine both amounts
Issues with Targeted Allocations

- **Issues with Respecting Special Allocations**
  - Many partnerships desire to specially allocate depreciate deductions separately from the general economic arrangement
    - Special allocations of gain from the sale of the depreciated property allocated to offset special allocations of depreciation
  - Example: P allocates items generally 50% to A and 50% to B. However, P allocates depreciation 80% to A and 20% to B. When P sells the partnership property, P allocates the gain 80% to A and 20% to B in an amount equal to prior depreciation deductions.
  - Are these respected as having *substantial* economic effect?
    - Substantiality test not met if allocations of depreciation are “reasonably expected” to be offset by subsequent allocations of income or gain
    - If safe harbor allocation method chosen, generally respected because value of property deemed to be equal to basis, so gain not reasonably expected to offset depreciation
      - Targeted allocation method does not meet safe harbor for economic effect, so can’t assume value = basis
Issues with Targeted Allocations

- **Issues with Fractions Rule**
  - Fractions Rule – IRC § 514(c)(9)(E)
    - Permits certain tax exempt partners to invest in leveraged real estate partnerships without realizing debt financed income
  - Fractions Rule requires that allocations have substantial economic effect within the meaning of IRC § 704(b)(2)
    - Targeted allocations do not meet safe harbor for economic effect
Issues with Targeted Allocations

- Issues with Allocations of Nonrecourse Deductions
  - Nonrecourse Deductions – cost recovery deductions when book value of partnership assets are less than nonrecourse debt secured by depreciated assets
  - Cannot have economic effect, so must be allocated in accordance with “partners interest in the partnership” – Treas. Reg. § 1.704-2(b)(1)
  - Certain allocations deemed to be in accordance with partners interest in the partnership – Treas. Reg. § 1.704-2(e)
    - Requires that partnership allocations generally meet safe harbor economic effect
    - Targeted allocations do not meet safe harbor for economic effect
Issues with Targeted Allocations

- **Issues with Allocations of Nonrecourse Debt**
  - Nonrecourse Debt – Debt for which no partner has economic risk of loss
  - IRC § 752(a) – partners include in the basis of their partnership interest allocable share of partnership debt
  - Partners include their share of partnership nonrecourse debt in proportion to their share of partnership profits – Treas. Reg. § 1.752-3(a)(3)
  - Partnership agreement may specify interest in partnership profits as long as it is consistent with allocations of significant item of income or gain that have substantial economic effect under IRC § 704(b)(2)
    - Targeted allocations do not meet safe harbor for economic effect
Allocations and Distributions - Pros and Cons

- **Allocation Driven (Safe Harbor)**
  - **Advantages**
    - Safe harbor, Treas. Reg. § 1.704-1(b)(2)
    - Fractions rule, § 514(c)(9)(E)
    - Allocations of nonrecourse deductions, Treas. Reg. § 1.704-2(b)(1)
    - Allocations of nonrecourse liabilities, Treas. Reg. § 1.752-2(a)
  - **Disadvantages**
    - Complex to draft properly
    - If wrong, interferes with deal economics

- **Distribution Driven (Targeted/Forced)**
  - **Advantages**
    - Easier to understand the economic deal
    - Easier to draft properly
  - **Disadvantages**
    - May produce unexpected tax results leaving allocations to accountants to determine with knowledge that they are often wrong
    - Allocations may be challenged
OVERVIEW OF OPERATING PARTNERSHIP AGREEMENTS – DISTRIBUTIVE SHARE

- **Section 704(a)** – determined by partnership agreement

- **Section 704(b)** – determined in accordance with partner’s interest in a partnership (“PIP”) if:
  - The partnership agreement does not provide partners’ distributive shares, or
  - Allocations in the partnership agreement lack substantial economic effect (“SEE”)
SUBSTANTIAL ECONOMIC EFFECT

Economic Effect

- Safe harbor - Treas. Reg. § 1.704-1(b)(2)(ii)(b) (The “Big Three”)
  - Maintenance of capital accounts under Treas. Reg. § 1.704-1(b)(2)(iv)
  - Liquidation of partner’s interest in accordance with positive capital account balances
  - Deficit Restoration Obligation (“DRO”) or Qualified Income Offset (“QIO”) (Alternate Test)

- Economic Effect Equivalence
  - Treas. Reg. § 1.704-1(b)(2)(ii)(i)
  - Allocations are deemed to have economic effect if, at the end of each year, a liquidation would produce the same economic effect as if the safe harbor had been satisfied, regardless of the economic performance of the partnership
SUBSTANTIAL ECONOMIC EFFECT

Substantiality

- Must be a reasonable possibility that the allocation will affect substantially the dollar amounts to be received from the partnership, independent of tax consequences.

- An allocation is not substantial if:
  - Overall tax effect for any partner is substantially diminished over the life of the partnership
  - There are shifting tax consequences
  - There transitory allocations
PARTNER’S INTEREST IN THE PARTNERSHIP

- If allocation fails to satisfy SEE safe harbor, partners’ distributive shares of partnership items determined in accordance with PIP.
  - PIP signifies the manner in which the partners have agreed to share the economic benefit or burden (if any) corresponding to the item being allocated. Reg. § 1.704-1(b)(3).
  - Takes into account all the facts and circumstances relating to the economic arrangement of the partners.
  - Factors include:
    - Relative contributions to the partnership
    - Interest in economic profits and losses
    - Interest in cash flow and other non-liquidating distributions
    - Rights of partners to distributions of capital on liquidation
TARGETED ALLOCATIONS: AGREEMENT DRAFTING BEST PRACTICES

Lynn Fowler
lfowler@kilpatricktownsend.com
Drafting the Targeted Allocation Provisions

- **Include 704(b) “Boilerplate”**
  - Computation of Capital Accounts
  - Definition of Capital Account
  - Definition of book “profits” and “losses”
  - Provisions for capital account revaluations and contributions at FMV
- **Nonrecourse Deduction Provisions**
  - Definitions of nonrecourse deductions and partner nonrecourse deductions
  - Definitions of minimum gain
  - Provisions for allocating nonrecourse deductions and partner nonrecourse deductions,
- **Negative capital account provisions**
  - Limitation on loss allocations
  - Qualified income offset—probably not necessary but good window dressing
  - Curative allocations—not necessary
Drafting the Targeted Allocation Provisions

- Two Important Definitions
  - Target Capital Account
    - The amount that any partner would receive if the partnership sold all of its assets at Book Value (or if greater, the amount of nonrecourse debt secured by such asset), paid all of liabilities, and distributed the remainder pursuant to the distribution formula
    - In other words, the amount that the parties have agreed to distribute to each partner if the partnership liquidated at Book Value
  - Partially Adjusted Capital Account
    - The partner’s Capital Account balance at the beginning of the year, adjusted for contributions to the partnership and distributions from the partnership during the fiscal year
Drafting the Targeted Allocation Provisions

- **Allocations**
  - Partnership Income allocated to any partner whose Partially Adjusted Capital Account is less than its Target Capital Account
  - Partnership Loss allocated to any partner whose Partially Adjusted Capital Account is greater than its Target Capital Account
Special Considerations

- **Targeted Allocations of Gross vs. Net Income or Loss**
  - In many cases, target allocations of net income not sufficient to create safe harbor result
Net vs. Gross Targeted Allocations?

- **Example: Preferred Returns**
  - A and B each contribute $500 to partnership P on 1/1 Year 1
  - B is entitled to a preferred return of 10% on unreturned capital
  - Next distributions go 1st to B to return its capital, then to A to return its capital
  - Remaining distributions split 60% to A and 40% to B

- P invests capital in land and leases for $300/year in Year 1 with $100/year in operating expenses
- Lease ends in April Year 2, with P earning $100 of rental income and $100 of operating expense
- P sells asset for $1000
- P liquidates and distributes $1200 to A and B pursuant to partnership agreement
- P engages in no other transactions
Net vs. Gross Targeted Allocations?

- **Example: Preferred Returns**  
  - Year 1 Capital Account Computation

<table>
<thead>
<tr>
<th></th>
<th>A</th>
<th>B</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beginning Capital</td>
<td>$500</td>
<td>$500</td>
<td>$1000</td>
</tr>
<tr>
<td>Year 1 Preferred Return Allocation</td>
<td>$0</td>
<td>$50</td>
<td>$50</td>
</tr>
<tr>
<td>Year 1 Residual Profit Allocation</td>
<td>$90</td>
<td>$60</td>
<td>$150</td>
</tr>
<tr>
<td>Ending Capital Account Balances</td>
<td>$590</td>
<td>$610</td>
<td>$1200</td>
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</tbody>
</table>
Net vs. Gross Targeted Allocations?

- **Example: Preferred Returns**
  - Year 2 Capital Account Computation – Net Income Only

<table>
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<tr>
<th></th>
<th>A</th>
<th>B</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beginning Capital Balances</td>
<td>$590</td>
<td>$610</td>
<td>$1200</td>
</tr>
<tr>
<td>Year 2 Preferred Return Allocation</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>Year 2 Residual Profit Allocation</td>
<td>$0</td>
<td>$0</td>
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</tr>
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<td>$590</td>
<td>$610</td>
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</tr>
</tbody>
</table>
Net vs. Gross Targeted Allocations?

- **Example: Preferred Returns**
  - Year 2 Capital Account Computation – Gross Income and Deductions

<table>
<thead>
<tr>
<th></th>
<th>A</th>
<th>B</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beginning Capital Balances</td>
<td>$590</td>
<td>$610</td>
<td>$1200</td>
</tr>
<tr>
<td>Year 2 Preferred Return Allocation</td>
<td>$0</td>
<td>$50</td>
<td>$50</td>
</tr>
<tr>
<td>Year 2 Residual Loss Allocation</td>
<td>($30)</td>
<td>($20)</td>
<td>($50)</td>
</tr>
<tr>
<td>Ending Capital Account Balances</td>
<td>$560</td>
<td>$640</td>
<td>$1200</td>
</tr>
</tbody>
</table>
Special Considerations

- **Targeted Allocations of Gross vs. Net Income or Loss**
  - Many partnership agreements apply targeted allocations on a gross basis
    - One-step approach—allocate net income/loss under targeted mechanism and only allocate gross income to the extent that net income/loss not sufficient to achieve safe harbor result
    - Two-step approach—allocate all items of gross income and gain alone under target approach (as if there were no items of deduction or loss); then allocate all items of deduction and loss under target approach
  - Two approaches could yield substantially different tax answers depending on tax character of income, gain, loss and deduction
**Special Considerations**

- **Varying Participation in Different Items**
  - In many cases, partners have different agreement on how they share operating income vs. how they share gain on exit
  - **Example:** P distributes operating income 50% to A (capital partner) and 50% to B (service partner with no capital contributions). P distributes sales proceeds 2/3 to A and 1/3 to B.
  - Partnership agreement should set up two targets, one to address liquidation with nothing but existing assets and operating income, and one to address sales of assets (tie to two different distribution waterfalls)
Trap to Avoid

- **Circularity**
  - Target capital account = amount distributed on liquidation of partnership
  - Target capital account should always refer to specific distribution formula for amount distributed on liquidation
  - Make sure that amount distributed on liquidation of partnership ≠ positive capital account balances, or you can’t compute target capital account