Abandonment Issues? They may work for you in 2014 year-end tax planning.

It runs counter to most investors to consider abandoning an asset, but with partnership interests, it might be the only way to recoup at least some of the investment in the form of tax losses. I will speak first to an issue I see often in the real estate context and then briefly cover other situations that could be equally beneficial.

If you have a real estate investment in which you are "passive" - either as a limited investor or an investor in for-rent real estate - that has not gone well you likely have the following scenario. You have received K-1's year after year with substantial losses, which you can't use because they are passive to you and therefore are suspended until you have passive income to offset or you dispose of the asset.

As a limited investor, your options are "limited" if the asset has marginal or no value (assets worth less than the debt against the property). There are no buyers for your interest and the sponsor of the deal will keep the partnership going as long as possible. This allows them to continue to collect fees and hope against hope that market forces will bail them out. However, they likely <u>can</u> use the passive losses to offset that management fee income and may be faced with "phantom" income if they sell the asset. The lender is predisposed to pretend and extend the loan to avoid having to take the property and deal with it on their own time and dime. A less than ideal but potentially practical solution is to abandon the asset.

An abandonment of a partnership interest is as straightforward as notifying the partnership that it has no value and you have chosen to relinquish the partnership interest. Obviously, you would not take this step unless you believe that statement to be true. The tax result will be to free up the suspended passive losses making them available to you currently to offset ordinary income (the holy grail of tax planning). If you have held the investment for some time, you will likely benefit by some of those losses offset not by your cash investment, but by capital gain, benefiting further from the tax rate arbitrage inherent in that result (capital gain offset by ordinary loss in equal amount). This results from the likely fact that much of the passive losses were funded by borrowed funds, and certainly have been if they exceed your cash investment in the deal.

If you have a partnership interest that you believe to be worthless and it does not fit the situation of passive interest in operating real estate described above, you may still be able to create an ordinary loss. One approach is to abandon the asset, claim that it is worthless, and treat it as such under Section 165 of the Internal Revenue Code. The ordinary treatment will hinge on if you are "at risk" for any partnership liabilities under the partnership tax rules. Failing that, holding the investment as worthless (not abandoned) might allow an ordinary deduction under section 165 even if you are "at risk" for partnership liabilities.

You should consult with your tax advisor before pursuing any of the concepts discussed above since the concepts and calculations are tricky. Don't ignore an asset that no longer has value; figure out a way to make it work for you. Better yet, identify those assets that might be deemed worthless and ask your tax advisor to quantify the tax benefit to you. Remember, if you intend to abandon a partnership interest, you must notify the partnership before year-end if you want the abandonment to benefit your 2014 tax return. To learn more about this tax planning opportunity, please contact Zane Dennis at zane@richeymay.com or 303-721-6131.