Warren & Selbert

Simple as ABC.

Minimum Gain

Code section 1.704-2 defines the computation of Partnership Minimum Gain (PMG) required in a partnership encumbered with non-recourse debt obligations secured by assets rather than guaranteed directly by the partners. The concept of minimum gain is simple: track the sum of asset deductions taken by partners while the liquidation risk is borne instead by the lenders. The computation and the rules for subsequent income allocation, however, represent one of the more challenging aspects of partnership tax law.

When the adjusted tax basis of an asset is less than the outstanding non-recourse debt obligation at the end of the fiscal year, a PMG balance will be equal to the amount of that difference. As the PMG balance increases from the prior year, the partnership is deemed to have allocated non-recourse deductions to its partners. Aside from maintaining the calculation of the PMG balance and allocating a share of the change in PMG to each partner, no other action is required in years with an increasing PMG balance.

However, as the PMG balance decreases, each partner is required to show a minimum amount of positive taxable income from the partnership that is at least equal to their share of the PMG reduction amount. This is referred to as the Minimum Gain Chargeback (MGCB). The rationale for the MGCB is that since the partners are no longer being allocated additional non-recourse deductions, they must show the IRS that they are incurring a compensatory amount of positive income to justify the amount of riskless deductions that they took in earlier years. In the event that the partnership is not showing positive income in years where the PMG balance is decreasing, then the amount of MGCB must be carried forward until the partnership is profitable.

Because the IRS requires recapture of minimum gain upon liquidation, each partner is deemed as bearing the responsibility for their share of PMG in their capital account. Similarly, a partner's share of PMG is also including the first "tier" of the share of liabilities in their outside basis calculation.

PMG can also affect a partner's income statement and balance sheet. Waterfall agreements in the partnership LLC documents will require that the partner's share of PMG be allocated gain first in the event of a liquidation event. This can be especially important in the calculation of Hypothetical Liquidation Book Value (HLBV) calculations that are often used to determine pre-tax book income in a partner's financial statements.

*In **ABC**, the PSHIP/MINGAIN report displays the calculation of each partner's share of minimum gain. The PSHIP/MGCB report identifies the amount of income allocation adjustment that is necessary to meet the IRS's MGCB rules. The PSHIP/LIABS report details the impact of PMG on each partner's outside basis.*