

REAL ESTATE



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Q We are partners in a real estate partnership. The property has appreciated significantly in value and the general partner has suggested that we borrow against the equity and make distributions to the partners. Are there any tax consequences to us or the partnership if we do this?

A What the general partner is suggesting is known as a “debt-financed” distribution. This can be done, tax-free, as long as the distributions do not exceed the partner’s basis in the partnership interest. However, the ability to deduct interest on this loan may be limited. Generally, the partnership may deduct interest on debt used to fund the partnership’s business operations (i.e. operating expenses). But, interest incurred on proceeds used to finance distributions to partners are not deductible at the partnership level. Instead, the interest is separately stated on Schedule K-1 and deductibility depends on what the partner did with the proceeds.