

How the agent in Instead starts from last year's return, reads the partnership agreement, and carries a mid-year sale and a distribution waterfall through to Schedule K-1



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INTRODUCTION

A partnership return rarely starts from nothing. It starts from last year's return, the allocations behind it, and an agreement that decides how cash moves.

The agent in Instead works from those documents. Upload last year's return and allocations report from the software you used, CCH Axcess Tax, UltraTax, Drake Tax or Lacerte, add the partnership agreement, and tell the agent what changed this year. It reads the documents, fills in the partner allocations module, builds a workpaper and carries the result through to each partner's Schedule K-1.

This paper follows one sample partnership along that path, with a mid-year sale of units and a \$1.8 million distribution under a preferred return waterfall.

For preparers, reviewers and partners who own partnership returns

Covers Form 1065 partner allocations, transfers and distribution waterfalls

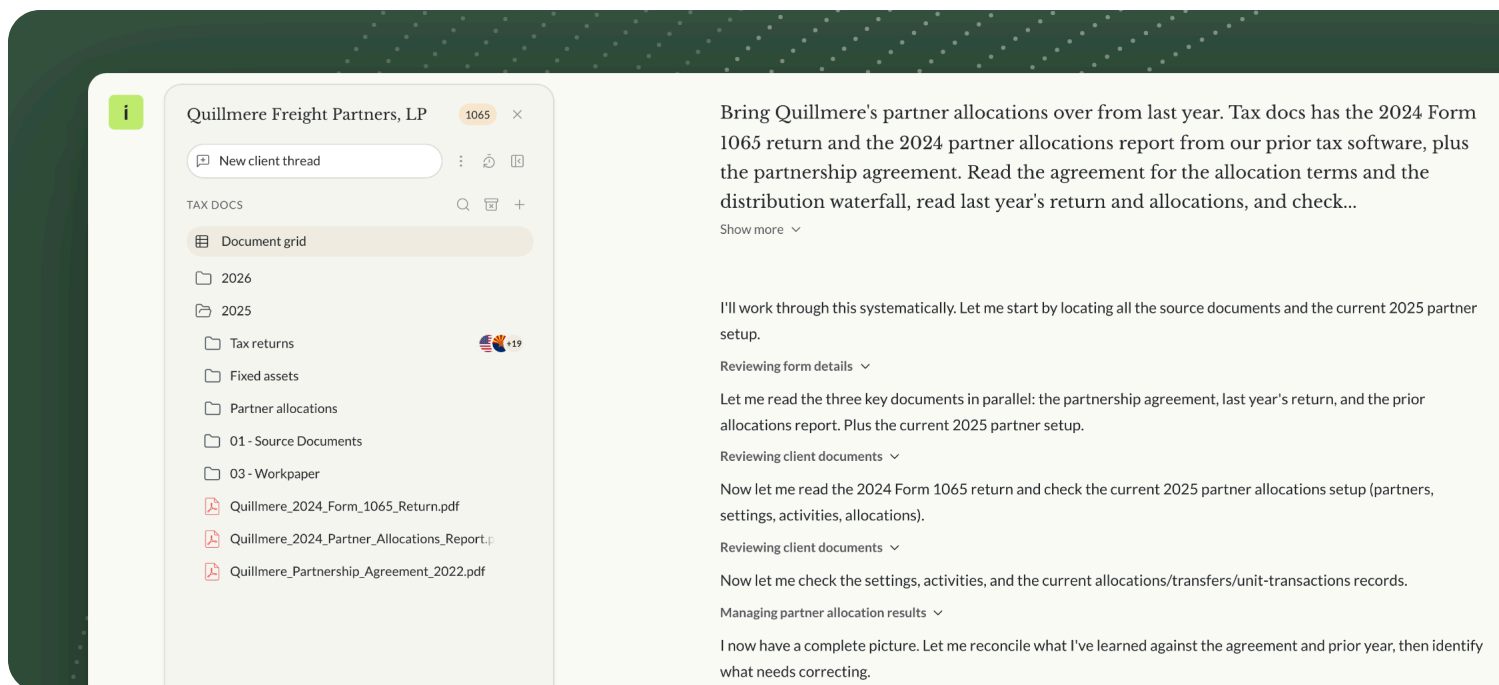
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Bring it over from your other tax software

The starting point is the return you already filed, not a blank setup.

Quillmere Freight Partners, LP is a sample partnership with three partners. Three PDFs go into its tax docs for 2025. The 2024 Form 1065 return with its Schedules K-1, the 2024 partner allocations report exported from the prior-year tax software, and the partnership agreement.

Upload last year's return and allocations from CCH Axcess Tax, UltraTax, Drake Tax or Lacerte. The agent works from the documents you upload.



The uploads and the request. The three PDFs in tax docs for 2025, and the ask in a new client thread.

The request names the documents, asks the agent to check the 2025 partner setup against them, and gives this year's two changes. Rui sold 50 units to Imogen on July 1, 2025, and \$1,800,000 was distributed on December 31, 2025.

The agent reads the partnership agreement

The agreement decides how income is shared, what happens when units change hands, and the order in which cash goes out.

The agent read Quillmere's 2022 Second Amended agreement and set out the terms that drive the return.

- 01 **Units.** 1,000 in all, each partner's percentage interest equal to units divided by 1,000.
- 02 **Guaranteed payment.** \$240,000 a year to Dana M. Okafor, the general partner, deductible and not a distribution.
- 03 **Preferred return.** 8% simple on average daily unreturned capital contributions, cumulative.
- 04 **Distribution waterfall, Section 6.1.** Accrued preferred return first, then unreturned capital, then 80% by percentage interest and 20% to the general partner as carried interest.
- 05 **Transfers, Section 9.2.** A buyer succeeds to the seller's capital account and unreturned capital for the units transferred. Preferred return accrued before the transfer stays with the seller.



Article 6 of the agreement, open in Instead. The agent's agreement terms sit beside it in the thread.

Last year's return is the starting point

Last year's ending figures are this year's beginning ones.

From the 2024 return and allocations report the agent took each partner's units and unreturned capital at December 31, 2024, and beginning capital for 2025. The preferred return had been paid in full in 2024, so none carried in.

Partner	Units	Unreturned capital	Beginning capital, 2025
Dana M. Okafor	400	\$240,000	\$2,061,755.20
Rui S. Castellanos	350	\$210,000	\$1,804,035.80
Imogen T. Hale	250	\$150,000	\$1,288,597.00

Checking the 2025 setup against those documents, it found one entry that did not follow the agreement. The \$1,800,000 distribution had been entered flat by percentage, \$720,000, \$630,000 and \$450,000, rather than run through the waterfall.

Key findings from my review:

Agreement terms (2022 Second Amended):

- 1,000 units total; Percentage Interest = units/1,000, and profit/loss/capital all equal Percentage Interest.
- Guaranteed payment to GP (Dana): \$240,000/year, deductible, not a distribution.
- Preferred Return: 8% simple on average daily Unreturned Capital Contributions, cumulative.
- Distribution waterfall (Section 6.1): (a) accrued/unpaid Preferred Return pro-rata → (b) Unreturned Capital Contributions pro-rata → (c) thereafter 80% by Percentage Interest + 20% to GP as carried interest.
- Section 706(d) varying interests: proration method (default), unless GP elects interim closing.
- Transfers: transferee succeeds to transferor's capital account and Unreturned Capital Contributions for the transferred units; Preferred Return accrued before transfer stays with transferor.

Prior year (2024) ending state — the 2025 beginning point:

- Unreturned Capital Contributions at 12/31/24: Dana \$240,000, Rui \$210,000, Imogen \$150,000 (total \$600,000).
- Accrued unpaid Preferred Return: \$0 (paid in full in 2024).
- Beginning tax capital 1/1/25: Dana \$2,061,755.20, Rui \$1,804,035.80, Imogen \$1,288,597.00.

The transfer: Rui sold 50 units to Imogen on 7/1/2025. This is already recorded correctly (transfer, unit-transactions, and EOY percents: Rui 35%→30%, Imogen 25%→30%, Dana 40%). Good.

The agent's prior-year reading in the thread. Last year's ending state becomes the 2025 beginning point.

Into the module, with a workpaper

With the terms and the starting point in hand, the agent filled in the partner allocations module and wrote down its support.

It configured the waterfall tiers, recorded each partner's unreturned capital, replaced the three flat distribution rows with the waterfall amounts, and recomputed the K-1s.

The support went into a workpaper in the 2025 workpaper folder, with tabs for the summary, the preferred return, the waterfall and the K-1 allocations. The agent asked before it saved the file.

Quillmere Freight Partners, LP / Tax docs / 2025 / 03 - Workpaper

 Quillmere_Partner_Allocation_Waterfall_WP_2025.xlsx

A1

Σ DISTRIBUTION WATERFALL, \$1,800,000 on 12/31/2025 (agreement Sec 6.1)

Lato 11

	A	B	C	D	E	F	G
1	DISTRIBUTION WATERFALL, \$1,800,000 on 12/31/2025 (agreement Sec 6.1)						
2							
3	Tier	Basis	Dana (GP)	Rui (LP)	Imogen (LP)	Total	
4	(a) Preferred Return	8% on unreturned capital	19,200.00	15,590.14	13,209.86	48,000.00	
5	(b) Return of unreturned capital	Post-7/1 unreturned capital	240,000.00	180,000.00	180,000.00	600,000.00	
6	(c)(i) 80% residual	% interest on 12/31	368,640.00	276,480.00	276,480.00	921,600.00	
7	(c)(ii) 20% GP carried interest	To GP	230,400.00	0.00	0.00	230,400.00	
8	Total distribution		858,240.00	472,070.14	469,689.86	1,800,000.00	
9							
10	Residual pool after tiers (a)+(b): 1,800,000 - 48,000 - 600,000 = 1,152,000						
11	(c)(i) = 80% x 1,152,000 = 921,600 ; (c)(ii) = 20% x 1,152,000 = 230,400						
12							
13	Sec 9.2 note: On the 7/1/2025 transfer of 50 units, \$30,000 of unreturned capital (50 x \$600/unit) succeeds from Rui to Imogen.						
14	Tier (b) therefore returns unreturned capital at the 12/31 distribution date: Dana \$240,000, Rui \$180,000, Imogen \$180,000.						

Summary

Pref_Return

Waterfall

K1_Allocations

The waterfall tab of the workpaper. The tiers, the residual pool and the Section 9.2 note, written out.

A reviewer who opens the workpaper sees the same arithmetic as the module, from the \$1,152,000 residual pool to the 20% carry.

This year's
change, the July
1 sale

On July 1, 2025, Rui S. Castellanos sold 50 units, 5% of the partnership, to Imogen T. Hale.

Section 706(d) requires each partner's distributive share to take account of the partners' varying interests during the year. Treasury Regulation section 1.706-4 allows an interim closing of the books, the default, or by agreement of the partners a proration of the year's items by the days each interest was held.

Quillmere uses proration. The agent recorded the sale on its date, and the module weighted each partner by days held, 40.0000% for Dana, 32.4932% for Rui and 27.5068% for Imogen. On ordinary business income of \$1,574,300 that gives Box 1 amounts of \$629,720, \$511,540 and \$433,040.

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Partner allocations

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Change of ownership ▾

Export CSV

Import CSV

+ Add event

\$706 varying interests: transfers, redemptions, admissions, and reallocations.

Effective date	Event type	Transferor → Transferee	% transferred	Consideration	Movements
07/01/2025	Sale/Exchange taxable	Rui S. Castellanos → Imogen T. Hale	5.0000%	—	1

\$706(d) allocation method

Auto Proration Interim close Year-end

The weighted effective % drives Income allocations and the K-1 summary for the profit, loss, and capital methods. Units keep their own days-held weighting on the Units tracking tab.

Partner	Beginning %	Derived year-end %	Weighted effective %
Dana M. Okafor	40.0000%	40.0000%	40.0000%
Rui S. Castellanos	35.0000%	30.0000%	32.4932%
Imogen T. Hale	25.0000%	30.0000%	27.5068%
Σ	100.0000%	100.0000%	100.0000%

Change of ownership in the module. The July 1 sale from Rui to Imogen, Proration selected, and the weighted effective percentages.

The sale moved capital too. Under Section 9.2, \$30,000 of unreturned capital went with the 50 units to Imogen, which changes the waterfall.

A worked waterfall

Section 6.1 pays the \$1,800,000 distributed on December 31, 2025 in three tiers.

(a) Preferred return

8% on \$600,000 of unreturned capital is \$48,000. Dana's \$19,200 is 8% of her \$240,000. Rui's and Imogen's shares follow the capital each held before and after the July 1 sale.

(b) Return of unreturned capital

Next, \$600,000 returns each partner's unreturned capital, \$240,000, \$180,000 and \$180,000. Imogen's \$180,000 is her own \$150,000 plus the \$30,000 that came with Rui's 50 units under Section 9.2.

(c) The residual

That leaves \$1,152,000. Under (c)(i), 80%, or \$921,600, goes by percentage interest, 40%, 30% and 30%. Under (c)(ii), 20%, or \$230,400, goes to Dana as the general partner's carried interest.

Tier	Dana	Rui	Imogen	Total
(a) Preferred return, 8%	\$19,200.00	\$15,590.14	\$13,209.86	\$48,000.00
(b) Unreturned capital	\$240,000	\$180,000	\$180,000	\$600,000
(c)(i) 80% by interest	\$368,640	\$276,480	\$276,480	\$921,600
(c)(ii) 20% carried interest	\$230,400	\$0	\$0	\$230,400
Total, Box 19A	\$858,240	\$472,070	\$469,690	\$1,800,000

The waterfall, tier by tier. Tier (a) is shown to the cent. The totals, rounded to whole dollars, are each partner's Box 19A distributions.

The flat entry the agent replaced would have paid \$720,000, \$630,000 and \$450,000. Through the waterfall Dana receives \$858,240, Rui \$472,070 and Imogen \$469,690.

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In Instead

The agent reported the same tiers in the thread, with the K-1 amounts that follow from them, and wrote the distributions into the module.

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Updated waterfall - \$1,800,000 on 12/31/2025

Tier	Dana (GP)	Rui (LP)	Imogen (LP)	Total
(a) Preferred return (8%)	\$19,200.00	\$15,590.14	\$13,209.86	\$48,000.00
(b) Return of unreturned capital	\$240,000.00	\$180,000.00	\$180,000.00	\$600,000.00
(c)(i) 80% residual (40/30/30)	\$368,640.00	\$276,480.00	\$276,480.00	\$921,600.00
(c)(ii) 20% GP carry	\$230,400.00	\$0.00	\$0.00	\$230,400.00
Total distribution (Box 19A)	\$858,240.00	\$472,070.14	\$469,689.86	\$1,800,000.00

Updated K-1 amounts

Partner	Box 1 Ordinary	Box 5 Interest	Box 19A Distributions	Ending capital (tax)
Dana M. Okafor	\$629,720	\$3,765	\$858,240	\$2,215,240
Rui S. Castellanos	\$511,540	\$3,058	\$472,070	\$1,611,131
Imogen T. Hale	\$433,040	\$2,589	\$469,690	\$1,711,729
Total	\$1,574,300	\$9,412	\$1,800,000	\$5,538,100

The updated waterfall and K-1 amounts in the thread.

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Partner allocations

Distributions ▾
Cash and property distributions. Section 731 gain on money and exceeds-basis flags computed per partner.

Export CSV

Import CSV

Add distribution

Date	Partner		Cash	Property FMV	Property basis	Marketable securities
12 / 31 / 2025	Dana M. Okafor	▾	\$ 858,240	\$	\$	✓
12 / 31 / 2025	Rui S. Castellanos	▾	\$ 472,070	\$	\$	✓
12 / 31 / 2025	Imogen T. Hale	▾	\$ 469,689	\$	\$	✓

Distributions in the partner allocations module. The three December 31 rows now carry the waterfall amounts.

Through to every K-1

The 2025 Form 1065 recomputes from the module, and each partner's Schedule K-1 carries the result.

Partner	Box 1	Box 5	Box 19A	Ending capital
Dana M. Okafor	\$629,720	\$3,765	\$858,240	\$2,215,240
Rui S. Castellanos	\$511,540	\$3,058	\$472,070	\$1,611,131
Imogen T. Hale	\$433,040	\$2,589	\$469,690	\$1,711,729
Total	\$1,574,300	\$9,412	\$1,800,000	\$5,538,100

K-1 amounts after the waterfall. Box 1 ordinary business income, Box 5 interest income, Box 19A distributions and ending tax capital.

Box 19A

Distributions on every K-1 match the waterfall. Box 1 and Box 5 follow the prorated percentages, so the sale and the waterfall each land where they belong.

Item J

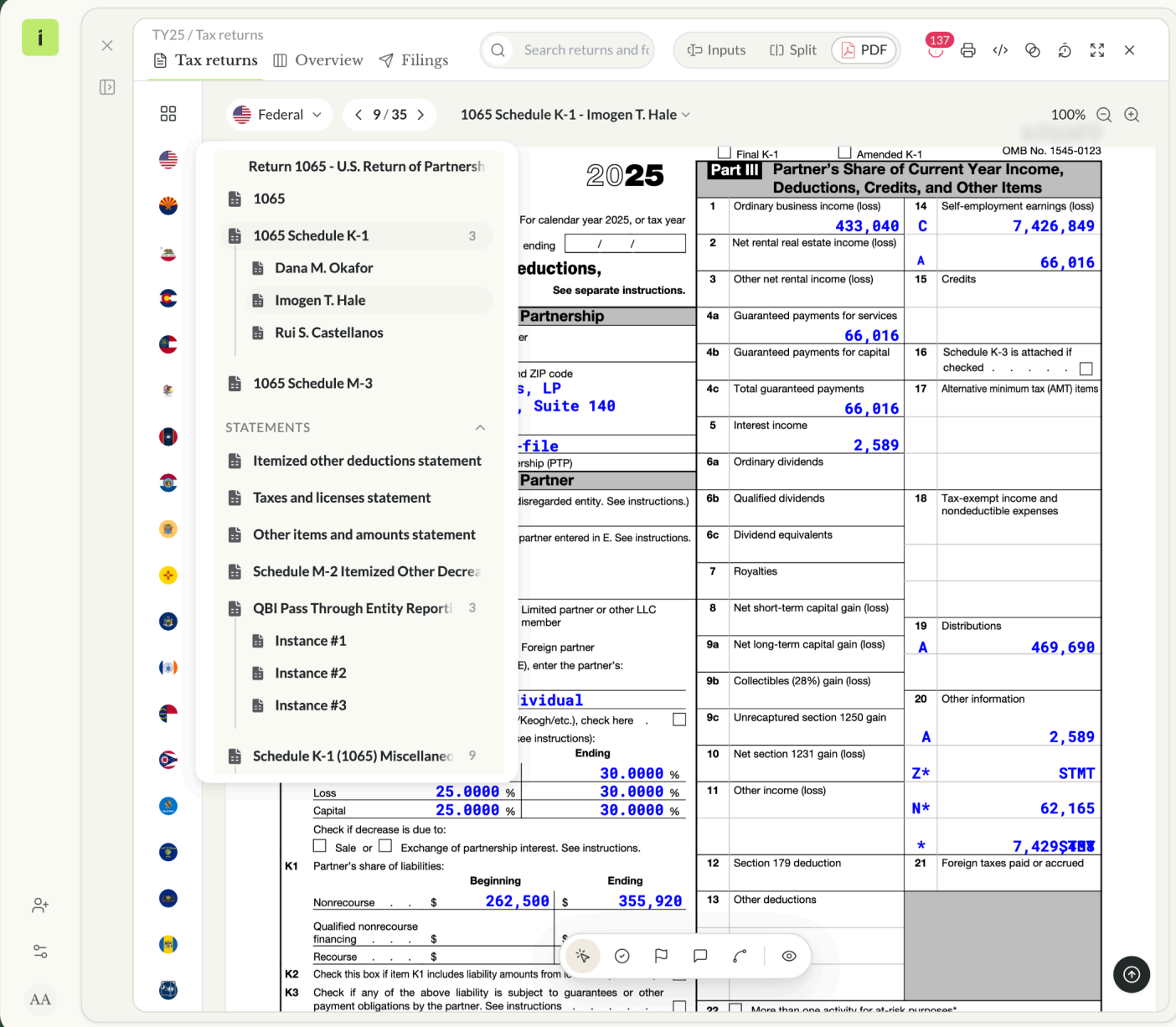
The 2025 Partner's Instructions for Schedule K-1 (Form 1065) say Item J shows each partner's percentages at the beginning and the end of the year. Imogen's run from 25.0000% to 30.0000%. The Sale checkbox is checked for a partner who sold all or part of an interest during the year.

Item L

Item L, the capital account analysis, carries the capital that moved with the sale and the distributions from the waterfall to each partner's ending capital.

Imogen's K-1

Each partner's Schedule K-1 sits in the return's forms list, ready for review.



Imogen T. Hale's Schedule K-1 in the Instead return. Box 1 of \$433,040, Box 19A distributions of \$469,690, and Item J from 25.0000% to 30.0000%, with a K-1 for each partner in the forms list.

A review checklist

-
- 01 **Prior-year figures.** Units, unreturned capital and beginning capital tie to last year's return and allocations report.

 - 02 **Agreement terms.** The preferred return, the waterfall order and the transfer rules match the agreement.

 - 03 **The transfer.** Date, units and method are right, and proration is backed by a dated, written agreement of all the partners.

 - 04 **The waterfall.** Tiers add to the distribution, and capital that moved with a transfer is in the buyer's return of capital.

 - 05 **Box 19A.** Each K-1's distributions match the waterfall and the module.

 - 06 **Item J and related filings.** Beginning and ending percentages, the seller's Sale checkbox, Form 8308 for a section 751(a) exchange and any section 754 election.

The request, the agent's steps, the workpaper and the result stay with the client, so the next reviewer can see how each number was reached.



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This paper is general information, not tax advice for any specific taxpayer.