

2013

Instructions for Form 1065-B

U.S. Return of Income for Electing Large
Partnerships

Volume 1 of 3



Instruction 1065-B (Rev. 2013) Catalog Number 61644U
Department of the Treasury **Internal Revenue Service** www.irs.gov



Visit the Accessibility
Page on IRS.gov

Section references are to the Internal Revenue Code unless otherwise noted.

Contents

Topic	Regular Page	Large Print Page
What's New	1	7
Photographs of Missing Children	1	8
Contacting Your Taxpayer Advocate	1	8
How To Get Forms and Publications	1	9
General Instructions	2	11
Purpose of Form	2	11
Electing Large Partnership (ELP) Status	2	12
Definitions	2	14
Termination of the Partnership	2	18
Electronic Filing	2	18
When To File	3	21
Where To File	3	24
Who Must Sign	3	25

Interest and Penalties	4	28
Accounting Methods	4	32
Accounting Periods	5	38
Rounding Off to Whole Dollars	5	41
Recordkeeping	5	41
Administrative Adjustment Requests	5	42
Other Forms, Returns, And Statements That May Be Required	6	45
Assembling the Return	8	49
Overview	8	50
Separately Stated Items	8	51
Limitations	8	54
Elections Made by the Partnership	9	56
Effect of Section 743(b) Basis Adjustment on Partnership Items	9	60
Elections Made by Each Partner	9	61
Partner's Dealings With Partnership	9	62
Contributions to the Partnership	9	62

Dispositions of Contributed Property	10	63
Recognition of Precontribution Gain on Certain Partnership Distributions Unrealized	10	65
Receivables and Inventory Items	10	66
Activities of Electing Large Partnerships (ELPs)	10	67
Special Reporting Requirements	11	79
Extraterritorial Income Exclusion	14	101
Specific Instructions	14	104
Part I. Taxable Income or Loss from Passive Loss Limitation Activities	15	109
Part II. Taxable Income or Loss From Other Activities	20	157
Schedule B. Other Information	22	169
Schedule D. Capital Gains and Losses	22	174

Schedules K and K-1. Partners' Shares of Income, Credits, Deductions, etc.	25	202
Specific Instructions for Schedules K and K-1	26	207
Analysis of Net Income (Loss)	36	293
Schedule L. Balance Sheets per Books	36	295
Schedule M-1. Reconciliation of Income (Loss) per Books With Income (Loss) per Return	37	301
Schedule M-2. Analysis of Partners' Capital Accounts	37	303
Codes for Principal Business Activity and Principal Product or Service	39	309
Index	42	312

Future Developments

For the latest information about developments related to Form 1065-B, its schedules, and its instructions, such as legislation enacted after they were published, go to www.irs.gov/form1065b.

What's New

For 2013, certain transactions may be combined and the totals reported on line 1a or 8a of Schedule D without completing Form 8949, Sales and Other Dispositions of Capital Assets. For additional information, see the instructions for Lines 1a and 8a—Transactions Not Reported on Form 8949.

- **Schedule K-1 (Form 1065-B).** New code U has been added to box 9 of Schedule K-1. Code U is used to report information related to the net investment income tax. Former Code U (*Other information*) is now code V.
- **Regulations section 1.1411-10(g) election.** The partnership can elect to include section 951 inclusions and section 1293 inclusions in net investment income for purposes of section 1411 in the same tax year as the amounts are included in income for chapter 1 purposes. See Regulations section 1.1411-10(g) under Elections Made by the Partnership for more information.

Photographs of Missing Children

The Internal Revenue Service is a proud partner with the National Center for Missing and Exploited Children. Photographs of missing children selected by the Center may appear in instructions on pages that would otherwise be blank. You can help bring these children home by looking at the photographs and calling 1-800-THE-LOST (1-800-843-5678) if you recognize a child.

Contacting Your Taxpayer Advocate

The Taxpayer Advocate Service (TAS) is your voice at the IRS. TAS's job is to ensure that every taxpayer is treated fairly and that you know and understand your rights. TAS offers free help to guide you through the often-confusing process of resolving tax problems that you haven't been able to solve on your own. Remember, the worst thing you can do is nothing at all.

As a taxpayer, you have rights that the IRS must abide by in its dealings with you. TAS online tax toolkit at www.TaxpayerAdvocate.irs.gov can help you understand these rights.

If you think TAS can help you, call your local advocate, whose number is in your local directory and on our website at www.irs.gov/advocate. You can call our toll-free number at 1-877-777-4778. If you have access to TTY/TDD equipment, you can call 1-800-829-4059. You can also access the IRS through relay services such as the Federal Relay Service at www.gsa.gov.fedrelay.

TAS also handles large-scale, systemic problems that affect many taxpayers. If you know of one of these broad issues, please report it to us through our [*Systemic Advocacy Management System*](#).

How To Get Forms and Publications

Internet. You can access the IRS website at IRS.gov 24 hours a day, 7 days a week to:

- *E-file* your return. Find out about commercial tax preparation and *e-file* services available free to eligible taxpayers;
- Download forms, including talking tax forms, instructions, and publications;
- Use the online Internal Revenue Code, regulations, or other official guidance;
- Get information on starting and operating a small business;
- Order IRS products online;
- Research your tax questions online;
- Search publications online by topic or keyword;
- View Internal Revenue Bulletins (IRBs) published in the last few years;
- and Sign up to receive local and national tax news by email.

By phone and in person. You can order forms and publications by calling 1-800-TAX-Form (1-800-829-3676). If you have access to TTY/TDD equipment, you can call 1-800-

829-4059 to ask tax questions or to order forms and publications. You can also access the IRS through relay services such as the Federal Relay Service at www.gsa.gov/fedrelay. Additionally, you can get most forms and publications at your local IRS office.

General Instructions

Purpose of Form

Form 1065-B is an information return used to report the income, gains, losses, deductions, etc., from the operation of an electing large partnership (as defined in section 775). An electing large partnership (ELP) may be required to pay certain taxes, such as recapture of the investment credit under section 50, but generally it “passes through” any profits or losses to its partners. Partners must include these ELP items on their income tax or information returns.

A regular partnership is required to separately report to each partner the partner's distributive share of any item of income, gain, loss, deduction, or credit that if separately

taken into account by any partner would result in an income tax liability for that partner different from that which would result if the item was not taken into account separately. Unlike a regular partnership, an ELP combines most items at the partnership level and passes through net amounts to partners. These ELP rules override the regular partnership tax rules to the extent they are inconsistent with the regular partnership tax rules.

Electing Large Partnership (ELP) Status

A partnership chooses electing large partnership (ELP) status by filing Form 1065-B instead of Form 1065. The election applies to the tax year for which it was made and all later tax years. This election cannot be revoked without IRS consent.

To make the election, the partnership must have had 100 or more partners during the preceding tax year. Thus, a partnership cannot make the election for its first tax year. The number of partners is determined by

counting only persons directly holding partnership interests, including persons holding through nominees. Service partners are not counted as partners for this purpose. Service partners are those partners who perform substantial services in connection with the partnership's activities or who have performed such services in the past.

Service partnerships are not eligible to make the election if substantially all of the partners are:

- Individuals performing substantial services in connection with the partnership's activities.
- Personal service corporations with the owner-employees performing the services.
- Retired partners who had performed the services.
- Spouses of partners performing or who had performed the services.

In addition, commodity partnerships are not eligible to make the election. Commodity partnerships have as their principal activity

the buying and selling of commodities (other than inventory described in section 1221(a)(1)) or options, futures, or forwards relating to commodities.

Once a partnership has made an election by filing Form 1065-B, this treatment on the return will bind the partnership and all of its partners. The IRS, however, is not bound by the treatment on the return. To the extent provided in future regulations, a partnership may cease to be treated as an electing large partnership for a tax year in which the number of its partners falls below 100.

Definitions

Partnership

A partnership is the relationship between two or more persons who join to carry on a trade or business, with each person contributing money, property, labor, or skill and each expecting to share in the profits and losses of the business whether or not a formal partnership agreement is made.

The term “partnership” includes a limited partnership, syndicate, group, pool, joint venture, or other unincorporated organization, through or by which any business, financial operation, or venture is carried on, that is not, within the meaning of the regulations under section 7701, a corporation, trust, estate, or sole proprietorship.

Foreign Partnership

A foreign partnership is a partnership that is not created or organized in the United States or under the law of the United States or of any state. See Notice 2010-41 for information on when a domestic partnership will be classified as foreign.

General Partner

A general partner is a partner who is personally liable for partnership debts.

General Partnership

A general partnership is composed only of general partners.

Limited Partner

A limited partner is a partner in a partnership formed under a state limited partnership law, whose personal liability for partnership debts is limited to the amount of money or other property that the partner contributed or is required to contribute to the partnership. Some members of other entities, such as domestic or foreign business trusts or limited liability companies that are classified as partnerships, may be treated as limited partners for certain purposes.

Limited Partnership

A limited partnership is formed under a state limited partnership law and composed of at least one general partner and one or more limited partners.

Limited Liability Partnership

A limited liability partnership (LLP) is formed under a state limited liability partnership law. Generally, a partner in an LLP is not personally liable for the debts of the LLP or any other partner, nor is a partner liable for

the acts or omissions of any other partner, solely by reason of being a partner.

Limited Liability Company

A limited liability company (LLC) is an entity formed under state law by filing articles of organization as an LLC. Unlike a partnership, none of the members of an LLC are personally liable for its debts. An LLC may be classified for federal income tax purposes as a partnership, a corporation, or an entity disregarded as an entity separate from its owner by applying the rules in Regulations section 301.7701-3. See Form 8832, Entity Classification Election, for more details.

Note. A domestic LLC with at least two members that does not file Form 8832 is classified as a partnership for federal income tax purposes.

Nonrecourse Loans

Nonrecourse loans are those liabilities of the partnership for which no partner or related person bears the economic risk of loss.

Termination of the Partnership

An ELP terminates when all its operations are discontinued and no part of any business, financial operation, or venture is continued by any of its partners in a partnership. Unlike other partnerships, an ELP does not terminate on the sale or exchange of 50% or more of the partnership interests within a 12-month period. The ELP's tax year ends on the date of termination which is the date the ELP winds up its affairs.

Special rules apply in the case of a merger, consolidation, or division of a partnership. See Regulations section 1.708-1 for details.

Electronic Filing

Generally, electing large partnerships are required to file electronically. However, the requirement to file electronically does not apply to certain returns, including:

- Bankruptcy returns,
- Returns with precomputed penalty and interest.

See Rev. Proc. 2012-17 for the requirements for furnishing substitute Schedule K-1, Partner's Share of Income, Deductions, Credits, etc. electronically.

For more details on electronic filing using the Modernized e-file system, see:

- Publication 3112, IRS *e-file* Application and Participation;
- Publication 4163, Modernized e-File (MeF) Information for Authorized IRS *e-file* Providers for Business Returns;
- Publication 4164, Modernized e-File (MeF) Guide for Software Developers and Transmitters;
- Form 8453-B, U.S. Electing Large Partnership Declaration for an IRS *e-file* Return; and
- Form 8879-B, IRS *e-file* Signature Authorization for Form 1065-B.

For More Information on Filing Electronically

- Call the Electronic Filing Section at the Ogden Service Center at 1-866-255-0654 or
- Visit www.irs.gov/efile.

Electronic Filing Waiver

The IRS may waive the electronic filing rules if the partnership demonstrates that a hardship would result if it were required to file its return electronically. A partnership interested in requesting a waiver of the mandatory electronic filing requirement must file a written request, and request one in the manner prescribed by the Ogden Submission Processing Center (OSPC).

- All written requests for waivers should be mailed to:

Internal Revenue Service Ogden
Submission Processing Center e-file Team,
Mail Stop 1057 Ogden, UT 84201
Attn: Form 1065 e-File Waiver Request

- Waiver requests can also be faxed to 1-877-477-0575.
- Contact OSPC at 1-866-255-0654 for questions regarding the waiver procedures of process.

When To File

Generally, a domestic partnership must file Form 1065-B by the 15th day of the 4th month following the date its tax year ended as shown at the top of Form 1065-B.

For partnerships that keep their records and books of account outside the United States and Puerto Rico, an extension of time to file and pay is granted to the 15th day of the 6th month following the close of the tax year. Do not file Form 7004, Application for Automatic Extension of Time To File Certain Business Income Tax, Information, and Other Returns, if the partnership is taking this 2-month extension of time to file and pay. Attach a statement to the partnership's tax return stating that the partnership qualifies for the extension of time to file and pay. If the partnership is unable to file its return within

the 2-month period, use Form 7004 to request an additional 4-month extension.

If the due date falls on a Saturday, Sunday, or legal holiday, file by the next day that is not a Saturday, Sunday, or legal holiday.



Unlike regular partnerships, an electing large partnership is required to furnish Schedules K-1 to its partners by the first March 15 following the close of the partnership's tax year.

Private Delivery Services

The partnership can use certain private delivery services designated by the IRS to meet the “timely mailing as timely filing/paying” rule for Form 1065-B. These private delivery services include only the following.

- DHL Express (DHL): DHL Same Day Service.
- Federal Express (FedEx): FedEx Priority Overnight, FedEx Standard Overnight, FedEx 2Day, FedEx International Priority, and FedEx International First.

- United Parcel Service (UPS): UPS Next Day Air, UPS Next Day Air Saver, UPS 2nd Day Air, UPS 2nd Day Air A.M., UPS Worldwide Express Plus, and UPS Worldwide Express.

For the IRS mailing address to use if you are using a private delivery service, go to [IRS.gov](https://www.irs.gov) and enter “private delivery service” in the search box.

The private delivery service can tell you how to get written proof of the mailing date.



Private delivery services cannot deliver items to P.O. boxes. You must use the U.S. Postal Service to mail any item to an IRS P.O. box address.

Extension

If you need more time to file a partnership return, file Form 7004 to request a 6-month extension of time to file. File Form 7004 by the regular due date of the partnership return. Form 7004 can be electronically filed. This extension runs concurrently with the 2-month extension granted to partnerships that

keep their record and books of account outside the United States and Puerto Rico.

Period Covered

Form 1065-B is an information return for calendar year 2013 and fiscal years beginning in 2013 and ending in 2014. If the return is for a fiscal year or a short tax year, fill in the tax year space at the top of the form.

The 2013 Form may also be used if:

1. The partnership has a tax year of less than 12 months that begins and ends in 2014 and
2. The 2014 Form 1065-B is not available by the time the partnership is required to file its return.

However, the partnership must show its 2014 tax year on the 2013 Form 1065-B and incorporate any tax law changes that are effective for tax years beginning after 2013.

Where To File

If the partnership's principal business, office, or agency is located in the United States,

then file the return at: Department of the Treasury, Internal Revenue Service Center, Ogden, UT 84201-0007.

If the partnership's principal business, office, or agency is located in a foreign country or U.S. possession, then file the return at: Internal Revenue Service Center, P.O. Box 409101, Ogden, UT 84409.

Who Must Sign

General Partner or LLC Member Manager

Form 1065-B is not considered to be a return unless it is signed. One general partner or LLC member manager must sign the return. When a return is made for a partnership by a receiver, trustee, or assignee, the fiduciary must sign the return, instead of the general partner or LLC member manager. Returns and forms signed by a receiver or trustee in bankruptcy on behalf of a partnership must be accompanied by a copy of the order or instructions of the court authorizing signing of the return or form.

Paid Preparer's Information

If a partner or an employee of the ELP completes Form 1065-B, the paid preparer's space should remain blank. In addition, anyone who prepares Form 1065-B but does not charge the partnership should not complete this section.

Generally, anyone who is paid to prepare the partnership return must:

- Sign the return, in the space provided for the preparer's signature;
- Fill in the other blanks in the "Paid Preparer Use Only" area of the return (a paid preparer cannot use a social security number in the "Paid Preparer Use Only" box. The paid preparer must use a preparer tax identification number (PTIN)); and
- Give the ELP a copy of the return in addition to the copy to be filed with the IRS.

Note. A paid preparer may sign original returns or amended returns by rubber stamp,

mechanical device, or computer software program.

Paid Preparer Authorization

If the ELP wants to allow the paid preparer to discuss its 2013 Form 1065-B with the IRS, check the “Yes” box in the signature area of the return. The authorization applies only to the individual whose signature appears in the “Paid Preparer Use Only” section of its return. It does not apply to the firm, if any, shown in the section.

If the “Yes” box is checked, the ELP is authorizing the IRS to call the paid preparer to answer any questions that may arise during the processing of its return. The partnership is also authorizing the paid preparer to:

- Give the IRS any information that is missing from its return,
- Call the IRS for information about the processing of its return, and

- Respond to certain IRS notices that the partnership has shared with the preparer about math errors and return preparation.

The partnership is not authorizing the paid preparer to receive any refund check, bind the partnership to anything, or otherwise represent the partnership before the IRS. If the ELP wants to expand the paid preparer's authorization, see Pub. 947, Practice Before the IRS and Power of Attorney.

The authorization cannot be revoked. However, the authorization will automatically end no later than the due date (excluding extensions) for filing the 2014 return.

Interest and Penalties

Interest

Interest is charged on taxes not paid by the due date, even if an extension of time to file is granted. Interest is also charged from the due date (including extensions) to the date of payment on the failure to file penalty, the accuracy-related penalty, the reportable transaction underpayment penalty, and the

fraud penalty. The interest charged is figured at a rate determined under section 6621.

Late Filing of Return

A penalty is assessed against the partnership if it is required to file a partnership return and it **(a)** fails to file the return by the due date, including extensions, or **(b)** files a return that fails to show all the information required, unless such failure is due to reasonable cause.

If the partnership receives a notice about a penalty after it files the return, the partnership may send the IRS an explanation and the Service will determine if the explanation meets reasonable-cause criteria. **Do not** attach an explanation when filing the return.

The penalty is \$195 for each month or part of a month (for a maximum of 12 months) the failure continues, multiplied by the total number of persons who were partners in the partnership during any part of the partnership's tax year for which the return is due.

If tax is due (regardless of when the return was required to be filed), the penalty is the amount stated above plus 5% of the unpaid tax for each month or part of a month the return is late, up to a maximum of 25% of the unpaid tax. If the return is more than 60 days late, the minimum penalty is \$135 or the balance of the tax due on the return, whichever is smaller.

Late Payment of Tax

An ELP that does not pay the tax when due generally may have to pay a penalty of $\frac{1}{2}$ of 1% for each month or part of a month the tax is not paid, up to a maximum of 25% of the unpaid tax. The penalty will not be imposed if the partnership can show that failure to pay on time was due to reasonable cause.

Failure To Furnish Information Timely

For each failure to furnish Schedule K-1 to a partner when due and each failure to include on Schedule K-1 all the information required to be shown (or the inclusion of incorrect information), a \$100 penalty may be imposed

with respect to each Schedule K-1 for which a failure occurs. The maximum penalty is \$1.5 million for all such failures during a calendar year. If the requirement to report correct information is intentionally disregarded, each \$100 penalty is increased to \$250 or, if greater, 10% of the aggregate amount of items required to be reported, and the \$1.5 million maximum does not apply.

Trust Fund Recovery Penalty

This penalty may apply if certain excise, income, social security, and Medicare taxes that must be collected or withheld are not collected or withheld, or these taxes are not paid. These taxes are generally reported on:

- Form 720, Quarterly Federal Excise Tax Return;
- Form 941, Employer's QUARTERLY Federal Tax Return;
- Form 943, Employer's Annual Federal Tax Return for Agricultural Employees;
- Form 944, Employer's Annual Federal Tax Return; or

- Form 945, Annual Return of Withheld Federal Income Tax.

The trust fund recovery penalty may be imposed on all persons who are determined by the IRS to have been responsible for collecting, accounting for, and paying over these taxes, and who acted willfully in not doing so. The penalty is equal to the unpaid trust fund tax. See the Instructions for Form 720; Pub. 15, (Circular E), Employer's Tax Guide; or Pub. 51, (Circular A), Agricultural Employer's Tax Guide, for more details, including the definition of a responsible person.

Accounting Methods

An accounting method is a set of rules used to determine when and how income and expenditures are reported. Figure ordinary income using the method of accounting regularly used in keeping the ELP's books and records. In all cases, the method used must clearly show taxable income. Generally, permissible methods include:

- Cash,

- Accrual, or
- Any other method authorized by the

Internal Revenue Code. Generally, a partnership may not use the cash method of accounting if **(a)** it has at least one corporate partner, average annual gross receipts of more than \$5 million, and it is not a farming business or **(b)** it is a tax shelter (as defined in section 448(d)(3)). See section 448 for details.

Accrual method. If inventories are required, an accrual method of accounting must be used for sales and purchases of merchandise. However, qualifying taxpayers and eligible businesses of qualifying small business taxpayers are excepted from using an accrual method and may account for inventorable items as materials and supplies that are not incidental. For more details, see Form 1125-A and its instructions.

Under the accrual method, an amount is includible in income when:

1. All the events have occurred that fix the right to receive the income, which is the earliest of the date:
 - a. Payment is earned through the required performance,
 - b. Payment is due to the taxpayer, or
 - c. Payment is received by the taxpayer and
2. The amount can be determined with reasonable accuracy. See Regulations section 1.451-1(a) for details.

Generally, an accrual basis taxpayer can deduct accrued expenses in the tax year in which:

- All events that determine the liability have occurred,
- The amount of the liability can be figured with reasonable accuracy, and
- Economic performance takes place with respect to the expense.

For property and service liabilities, for example, economic performance occurs as

the property or service is provided. There are special economic performance rules for certain items, including recurring expenses. See section 461(h) and the related regulations for the rules for determining when economic performance takes place.

Nonaccrual-experience method. Accrual method partnerships are not required to accrue certain amounts to be received from the performance of services that, on the basis of their experience, will not be collected, if:

- The services are in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting or
- The partnership's average annual gross receipts for the 3 prior tax years does not exceed \$5 million.

This provision does not apply to any amount if interest is required to be paid on the amount or if there is any penalty for failure to timely pay the amount. For information, see section 448(d)(5) and Regulations section

1.448-2. For reporting requirements, see the instructions for line 1a.

Percentage of completion method. Long-term contracts (except for certain real property construction contracts) must generally be accounted for using the percentage of completion method described in section 460. See section 460 and the underlying regulations for rules on long-term contracts.

Mark-to-market accounting. Dealers in securities must use the mark-to-market accounting method described in section 475. Under this method, any security that is inventory to the dealer must be included in inventory at its fair market value (FMV). Any security that is not inventory and that is held at the close of the tax year is treated as sold at its FMV on the last business day of the tax year, and any gain or loss must be taken into account in determining gross income. The gain or loss taken into account is generally treated as ordinary gain or loss. For details, including exceptions, see section 475, the

related regulations, and Rev. Rul. 97-39, 1997-39 I.R.B. 4.

Traders in securities or commodities, and dealers in commodities, can elect to use the mark-to-market accounting method. To make the election, the partnership must file a statement describing the election, the first tax year the election is to be effective, and, in the case of an election for traders in securities or commodities, the trade or business for which the election is made. The statement must be filed by the due date (not including extensions) of the partnership return for the tax year immediately preceding the election year and attached to that return, or if applicable, to a request for an extension of time to file that return. For more details, see Rev. Proc. 99-17, 1999-7 I.R.B. 52, as superseded in part by Rev. Proc. 99-49, and sections 475(e) and (f).

Change in accounting method. Generally, the ELP must get IRS consent to change its method of accounting used to report income (for income as a whole or for any material item). To do so, it must file Form 3115,

Application for Change in Accounting Method.
See Form 3115.

Section 481(a) adjustment. The ELP may have to make an adjustment to prevent amounts of income or expenses from being duplicated or omitted. This is called a section 481(a) adjustment. The section 481(a) adjustment period is generally 1 year for a net negative adjustment and 4 years for a net positive adjustment. However, in some instances, a partnership can elect to modify the section 481(a) adjustment period. The partnership must complete the appropriate lines of Form 3115 to make the election. See the Instructions for Form 3115.

Include any net positive section 481(a) adjustment on Form 1065-B, Part I, line 10. If the net section 481(a) adjustment is negative, report it on Form 1065-B, Part I, line 23.

Accounting Periods

An ELP is generally required to have one of the following tax years.

1. The tax year of a majority of its partners (majority tax year).
2. If there is no majority tax year, then the tax year common to all of the ELP's principal partners (partners with an interest of 5% or more in the partnership profits or capital).
3. If there is neither a majority tax year nor a tax year common to all principal partners, then the tax year that results in the least aggregate deferral of income.

Note. In determining the tax year of a partnership under 1, 2, or 3 above, the tax years of certain tax-exempt and foreign partners are disregarded. See Regulations section 1.706-1(b) for more details.

4. Some other tax year, if:
 - a. The ELP can establish that there is a business purpose for the tax year; or
 - b. The ELP elects under section 444 to have a tax year other than a required tax year by filing Form 8716, Election To Have a Tax Year Other Than a

Required Tax Year. For a partnership to have this election in effect, it must make the payments required by section 7519 and file Form 8752, Required Payment or Refund Under Section 7519.

A section 444 election ends if a partnership changes its accounting period to its required tax year or some other permitted year or it is penalized for willfully failing to comply with the requirements of section 7519. If the termination results in a short tax year, type or legibly print at the top of the first page of Form 1065-B for the short tax year, "SECTION 444 ELECTION TERMINATED"; or

- c. The partnership elects to use a 52-53 week tax year that ends with reference to either its required tax year or a tax year elected under section 444.

Change of tax year. To change its tax year or to adopt or retain a tax year other than its required tax year, the partnership must file Form 1128, Application To Adopt, Change, or Retain a Tax Year, unless the partnership is making an election under section 444.

Note. The tax year of a common trust fund must be the calendar year.

Rounding Off to Whole Dollars

The partnership can round off cents to whole dollars on its return and schedules. If the partnership does round to whole dollars, it must round all amounts. To round, drop amounts under 50 cents and increase amounts from 50 to 99 cents to the next dollar (for example, \$1.39 becomes \$1 and \$2.50 becomes \$3).

If two or more amounts must be added to figure the amount to enter on a line, include cents when adding the amounts and round off only the total.

Recordkeeping

The ELP must keep its records as long as they may be needed for the administration of any provision of the Internal Revenue Code. The partnership usually must keep records that support an item of income, deduction, or credit on the partnership return for 3 years from the date the return is due or is filed,

whichever is later. It also must keep records that verify its basis in property for as long as they are needed to figure the basis of the original or replacement property.

The ELP should also keep copies of all returns it has filed. They help in preparing future returns and in making computations when filing an amended return.

Administrative Adjustment Requests

The procedures to follow when filing an amended partnership return depend on whether the amended return is filed electronically or on paper. The rules for determining when a return must be filed electronically (see Electronic filing, above) also apply to amended returns.

Electronically filed amended returns. To correct an error on a Form 1065-B already filed, file Form 8082, Notice of Inconsistent Treatment or Administrative Adjustment Request (AAR). Generally, an adjustment to a partnership item requested on Form 8082 will flow through to the partners and be taken

into account in determining the amount of the same item for the partnership tax year in which the IRS allows the adjustment. If the income, deductions, credits, or other information provided to any partner on Schedule K-1 are incorrect under section 704 in the partner's distributive share of any partnership item shown on Form 1065-B, file an amended Schedule K-1 (Form 1065-B) for that partner with the Form 8082. Also give a copy of the amended Schedule K-1 to that partner. See the Form 8082 instructions for details on how to file the amended Form 1065-B.

Paper filed amended returns. Use Form 1065X, Amended Return or Administrative Adjustment Request (AAR) to file the amended return or administrative adjustment request. See Form 1065X, and its separate instructions, for information on completing and filing the form.

A change to the partnership's federal return may affect its state return. This includes changes made as a result of an IRS

examination. For more information, contact the state tax agency for the state in which the partnership return was filed.

Other Forms, Returns, And Statements That May Be Required

Form, Return, or Statement	Use this to—
W-2 and W-3—Wage and Tax Statement; and Transmittal of Wage and Tax Statements	Report wages, tips, other compensation, and withheld income, social security and Medicare taxes for employees.
720—Quarterly Federal Excise Tax Return	Report and pay environmental taxes, communications and air transportation taxes, fuel taxes, manufacturers taxes, ship passenger tax, and certain other excise taxes. Also, see <i>Trust Fund Recovery Penalty</i> , earlier.
940—Employer's Annual Federal Unemployment (FUTA) Tax Return	Report and pay FUTA tax.
941—Employer's QUARTERLY Federal Tax Return	Report quarterly income tax withheld on wages and employer and employee social security and Medicare taxes. Also, see <i>Trust Fund Recovery Penalty</i> , earlier.
943—Employer's Annual Federal Tax Return for Agricultural Employees	Report income tax withheld and employer and employee social security and Medicare taxes on farmworkers. Also, see <i>Trust Fund Recovery Penalty</i> , earlier.
944—Employer's Annual Federal Tax Return	File annual Form 944 instead of filing quarterly Forms 941 if the IRS notified you in writing.
945—Annual Return of Withheld Federal Income Tax	Report income tax withheld from nonpayroll payments, including pensions, annuities, individual retirement accounts (IRAs), gambling winnings, and backup withholding. Also, see <i>Trust Fund Recovery Penalty</i> , earlier.
1042 and 1042-S—Annual Withholding Tax Return for U.S. Source Income of Foreign Persons; and Foreign Person's U.S. Source Income Subject to Withholding	Report and send withheld tax on payments or distributions made to nonresident alien individuals, foreign partnerships, or foreign corporations to the extent these payments or distributions constitute gross income from sources within the United States that is not effectively connected with a U.S. trade or business. A domestic partnership must also withhold tax on a foreign partner's distributive share of such income, including amounts that are not actually distributed. Withholding on amounts not previously distributed to a foreign partner must be made and paid over by the earlier of: <ul style="list-style-type: none">• The date on which Schedule K-1 is sent to that partner or• The 15th day of the 3rd month after the end of the partnership's tax year. For more details, see sections 1441 and 1442 and Pub. 515, Withholding of Tax on Nonresident Aliens and Foreign Entities.
1042-T—Annual Summary and Transmittal of Forms 1042-S	Transmit paper Forms 1042-S to the IRS.
1065X—Amended Return or Administrative Adjustment Request (AAR)	Use Form 1065X to correct a previously filed partnership return or to make an Administrative Adjustment Request for a previously filed return.
1096—Annual Summary and Transmittal of U.S. Information Returns	Transmit paper Forms 1097, 1098, 1099, 3921, 3922, 5498, and W-2G to the IRS.
1097-BTC—Bond Tax Credit	Report tax credits to bond holders and tax credits passed to another person.
1098—Mortgage Interest Statement	Report the receipt from any individual of \$600 or more of mortgage interest (including certain points) in the course of the partnership's trade or business.
1099-A, B, C, INT, K, LTC, MISC, OID, R, S, and SA Important. Every partnership must file Forms 1099-MISC if, in the course of its trade or business, it makes payments of rents, commissions, or other fixed or determinable income (see section 6041) totaling \$600 or more to any one person during the calendar year.	Report the following: <ul style="list-style-type: none">• Acquisitions or abandonments of secured property;• Proceeds from broker and barter exchange transactions;• Cancellation of debts;• Interest payments;• Payment card and third-party network payments;• Payments of long-term care and accelerated death benefits;• Miscellaneous income payments;• Original issue discount;• Distributions from pensions, annuities, retirement or profit-sharing plans, IRAs, insurance contracts, etc.;• Proceeds from real estate transactions; and• Distributions from an HSA, Archer MSA, or Medicare Advantage MSA.

Form, Return, or Statement	Use this to—
5471 —Information Return of U.S. Persons With Respect To Certain Foreign Corporations	Report information with respect to certain foreign corporations. A domestic partnership may have to file Form 5471 if it: <ul style="list-style-type: none">• Controls a foreign corporation;• Acquires, disposes of, or owns 10% or more in value of the outstanding stock of a foreign corporation; or• Owns stock in a corporation that is a controlled foreign corporation for an uninterrupted period of 30 days or more during any tax year of the foreign corporation, and it owned that stock on the last day of that year.
5713 —International Boycott Report	Report operations in, or related to, a “boycotting” country, company, or national of a country and to figure the loss of certain tax benefits. The partnership must give each partner a copy of the Form 5713 filed by the partnership if there has been participation in, or cooperation with, an international boycott.
8275 —Disclosure Statement	Disclose items or positions, except those contrary to a regulation, that are not otherwise adequately disclosed on a tax return. The disclosure is made to avoid the parts of the accuracy-related penalty imposed for disregard of rules or substantial understatement of tax. Also use Form 8275 for disclosures relating to preparer penalties for understatements due to unrealistic positions or disregard of rules.
8275-R —Regulation Disclosure Statement	Disclose any item on a tax return for which a position has been taken that is contrary to Treasury regulations.
8288 and 8288-A —U.S. Withholding Tax Return for Dispositions by Foreign Persons of U.S. Real Property Interests; and Statement of Withholding on Dispositions by Foreign Persons of U.S. Real Property Interests	Report and send withheld tax on the sale of U.S. real property by a foreign person. See section 1445 and the related regulations for additional information.
8300 —Report of Cash Payments Over \$10,000 Received in a Trade or Business	Report the receipt of more than \$10,000 in cash or foreign currency in one transaction or a series of related transactions.
8308 —Report of a Sale or Exchange of Certain Partnership Interests	Report the sale or exchange by a partner of all or part of a partnership interest where any money or other property received in exchange for the interest is attributable to unrealized receivables or inventory items.
8594 —Asset Acquisition Statement Under Section 1060	Report a sale of assets if goodwill or going concern value attaches, or could attach, to such assets. Both the seller and buyer of a group of assets that makes up a trade or business must use this form.
8621 —Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund	Report ownership interest in a passive foreign investment company.
8697 —Interest Computation Under the Look-Back Method for Completed Long-Term Contracts	Figure the interest due or to be refunded under the look-back method of section 460(b)(2) on certain long-term contracts that are accounted for under either the percentage of completion-capitalized cost method or the percentage of completion method.
8804 , 8805 , and 8813 —Annual Return for Partnership Withholding Tax (Section 1446); Foreign Partner's Information Statement of Section 1446 Withholding Tax; and Partnership Withholding Tax Payment Voucher (Section 1446)	Figure and report the withholding tax on the distributive shares of any effectively connected gross income for foreign partners. This is done on Forms 8804 and 8805. Use Form 8813 to send installment payments of withheld tax based on effectively connected taxable income allocable to foreign partners. Exception. <i>Publicly traded partnerships do not file these forms. They must instead withhold tax on distributions to foreign partners and report and send payments using Forms 1042 and 1042-S. See Regulations section 1.1446-4 for more information.</i>
8832 —Entity Classification Election	See <i>Entity Classification Election</i> , later.
8865 —Return of U.S. Person With Respect to Certain Foreign Partnerships	Report the information required under section 6038 (reporting with respect to controlled foreign partnerships), section 6038B (reporting of transfers to foreign partnerships), or section 6046A (reporting of acquisitions, dispositions, and changes in foreign partnership interests). See Form 8865 and its instructions for more details.
8866 —Interest Computation Under the Look-Back Method for Property Depreciated Under the Income Forecast Method	Figure the interest due or to be refunded under the look-back method of section 167(g)(2) for certain property placed in service after September 13, 1995, depreciated under the income forecast method.
8876 —Excise Tax on Structured Settlement Factoring Transactions	Report and pay the 40% excise tax imposed under section 5891.
8886 —Reportable Transaction Disclosure Statement	Disclose information for each reportable transaction in which the partnership participated. Form 8886 must be filed for each tax year the partnership participated in the reportable transaction. The partnership may have to pay a penalty if it is required to file Form 8886 and does not do so. The following are reportable transactions. <ul style="list-style-type: none">• Any listed transaction, which is a transaction that is the same as or substantially similar to one of the types of transactions that the IRS has determined to be a tax avoidance transaction and identified by notice, regulation, or other published guidance as a listed transaction.• Any transaction offered under conditions of confidentiality for which the partnership (or a related party) paid an advisor a fee of at least \$50,000 (\$250,000 for partnerships if all partners are corporations).• Certain transactions for which the partnership (or a related party) has contractual protection against disallowance of the tax benefits.• Certain transactions resulting in a loss of at least \$2 million in any single tax year or \$4 million in any combination of tax years (if all partners are corporations, see Regulations section 1.6011-4(b)(5)(i)(B)).• Any transaction identified by the IRS by notice, regulation, or other published guidance as a “transaction of interest.” See Notice 2009-55, 2009-31 I.R.B. 170. See Regulations section 1.6011-4, the Instructions for Form 8886, and the instructions for line 15 of Schedule K for more information.

Form, Return, or Statement	Use this to—
8918—Material Advisor Disclosure Statement	Material advisors to any reportable transaction must disclose certain information about the reportable transaction by filing Form 8918 with the IRS.
8925—Report of Employer-Owned Life Insurance Contracts	Report the number of employees covered by employer-owned life insurance contracts issued after August 17, 2006, and the total amount of employer-owned life insurance in force on those employees at the end of the tax year.
8938—Statement of Specified Foreign Financial Assets	Report the ownership of specified foreign financial assets if the total value of those assets is more than the applicable reporting threshold.
Statement of section 743(b) basis adjustments	<p>Report the adjustment of bases under section 743(b). If the partnership is required to adjust the bases of partnership properties under section 743(b) because of a section 754 election or because of a substantial built-in loss as defined in section 743(d) on the sale or exchange of a partnership interest or on the death of a partner, the partnership must attach a statement to its return for the year of the transfer. The statement must list:</p> <ol style="list-style-type: none">1. The name and identifying number of the transferee partner,2. The computation of the adjustment, and3. The partnership properties to which the adjustment has been allocated.

This page is intentionally left blank

Assembling the Return

When submitting Form 1065-B, organize the pages of the return in the following order.

- Pages 1-5,
- Schedule F (Form 1040), Profit or Loss From Farming (if required),
- Form 8825, Rental Real Estate Income and Expenses of a Partnership or an S Corporation (if required),
- Form 1125-A, Cost of Goods Sold (if required),
- Form 8941, Credit for Small Employer Health Insurance Premiums (if required),
- Any other schedules in alphabetical order, and
- Any other forms in numerical order.

Complete every applicable entry space on Form 1065-B and Schedule K-1. Do not enter "See attached" instead of completing the entry spaces. Penalties may be assessed if the partnership files an incomplete return. If you need more space on the forms or

schedules, attach separate sheets and place them at the end of the return using the same size and format as on the printed forms.

Show the totals on the printed forms. Also be sure to put the partnership's name and EIN on each supporting statement or attachment.

Overview

The taxable income of an ELP is computed in the same manner as that of an individual, except that the items described below are separately stated and certain modifications are made. These modifications include not allowing the deduction for personal exemptions, the net operating loss deduction, and certain itemized deductions. Other itemized deductions are modified.

The netting of capital gains and losses occurs at the partnership level. Such net capital gain (loss) is treated as long-term capital gain (loss). Any excess of net short-term capital gain over net long-term capital loss is consolidated with the partnership's other taxable income and is not separately reported.

General credits are separately reported to partners as a single item. They are taken into account by partners as a current year general business credit. General credits are those credits that are not separately reported. The refundable credit for federal tax paid on fuels and the refund or credit for tax paid on undistributed capital gains of a regulated investment company (RIC) or a real estate investment trust (REIT) are taken by the partnership and thus are not separately reported to partners. The partnership also recaptures the investment credit under section 50 and low-income housing credit under section 42(j).

Separately Stated Items

Partners must take into account separately (under section 772(a)) their distributive shares of the following items (whether or not they are actually distributed).

- Taxable income (loss) from passive loss limitation activities.
- Taxable income (loss) from other activities (for example, portfolio income (loss)).

- Net capital gain (loss) allocable to passive loss limitation activities.
- Net capital gain (loss) allocable to other activities.
- 28% rate gain (loss) allocable to passive loss limitation activities.
- 28% rate gain (loss) allocable to other activities.
- Qualified dividends.
- Tax-exempt interest income.
- Extraterritorial income exclusion and foreign trading gross receipts.
- Net alternative minimum tax (AMT) adjustment separately computed for passive loss limitation activities.
- Net AMT adjustment separately computed for other activities.
- General credits.
- Low-income housing credit.
- Rehabilitation credit from rental real estate activities.

- Creditable foreign taxes and foreign source items. Other items of income, gain, loss, deduction, or credit, to the extent the IRS determines separate treatment is appropriate. Examples of such items include the domestic production activity deduction and gains on sales of qualified small business stock (information required for a section 1202 exclusion or section 1045 rollover).

Note. For electing large partnerships, the term passive loss limitation activities includes trade or business, rental real estate, and other rental activities. Partnership items from passive loss limitation activities allocated to limited partners are treated as being from passive activities and subject to the passive activity limitations. However, general partners may have materially or actively participated in some or all of these passive loss limitation activities. Each general partner must determine if any partnership items from these activities are subject to the passive activity limitations. To allow each general partner to correctly apply the passive activity limitations, the partnership must report

income or loss and credits separately for each trade or business activity, rental real estate activity, rental activity other than rental real estate, and other activities (for example, portfolio income). See the discussion on *Passive Loss Limitation Activities*, later.

The character of any item separately stated to the partners is based on its character to the partnership. The items are treated as incurred by the partnership, similar to the character rule for other partnerships under section 702(b).

Limitations

Most limitations and other provisions affecting taxable income or credit are applied at the partnership level except for:

- Section 68—Overall itemized deduction limitation,
- Sections 49 and 465—At-risk limitations, and
- Section 469—Passive loss limitations.

Miscellaneous itemized deductions. The limitation on miscellaneous itemized

deductions is applied at the partnership level. However, instead of the 2% floor, 70% of the partnership's total miscellaneous itemized deductions are disallowed.

Charitable contributions. Another limitation that is applied at the partnership level is the deduction for charitable contributions. The deduction is limited to 10% of the partnership's taxable income (before the charitable contribution deduction).

Entity Classification Election

Use Form 8832, Entity Classification Election, to make a change in classification. Except for certain business entities always classified as a corporation, a business entity with at least two members may choose to be classified either as a partnership or an association taxable as a corporation. A domestic eligible entity with at least two members that does not file Form 8832 is classified under the default rules as a partnership. However, a foreign eligible entity with at least two members is classified under the default rules as a partnership only if at least one member does not have limited liability. File Form 8832

only if the entity does not want to be classified under these default rules or if it wants to change its classification.



Attach a copy of Form 8832 to the partnership's federal tax return for the tax year of the election.

Elections Made by the Partnership

All elections, other than the exceptions listed under *Elections Made by Each Partner*, affecting the computation of taxable income or any credit are made by the partnership. For example, it chooses the accounting method and depreciation methods it will use. The partnership also makes elections under the following sections.

1. Section 179 (election to expense certain property).
2. Section 1033 (involuntary conversions).
3. Section 754 (manner of electing optional adjustment to basis of partnership property).

There are no changes to the optional basis adjustment provisions as a result of the ELP rules. Under section 754, a partnership can elect to adjust the basis of partnership property when property is distributed or when a partnership interest is transferred. Once an election is made under section 754, it applies both to all distributions and to all transfers made during the tax year and in all subsequent tax years unless the election is revoked. See Regulations section 1.754-1(c).

This election must be made in a statement that is filed with the partnership's timely filed return (including any extension) for the tax year during which the distribution or transfer occurs. The statement must include:

- The name and address of the partnership,
- A declaration that the partnership elects under section 754 to apply the provisions of section 734(b) and section 743(b), and
- The signature of a partner authorized to sign the partnership return.

The partnership can get an automatic 12-month extension to make the section 754

election provided corrective action is taken within 12 months of the original deadline for making the election. For details, see Regulations section 301.9100-2.

See section 754 and the related regulations for more information.

If there is a distribution of property consisting of an interest in another partnership, see section 734(b).

The partnership is required to attach a statement for any section 743(b) basis adjustments.

4. Regulations section 1.1411-10(g) (section 1411 election with respect to CFCs and QEFs).

A domestic partnership that directly or indirectly owns stock of a controlled foreign corporation (CFC) (within the meaning of section 953(c)(1)(B) or section 957(a)) or a passive foreign investment company (within the meaning of section 1297(a)) that the domestic partnership treats as a qualified electing fund (QEF) under section 1293 may make the election provided in Regulations

section 1.1411-10(g) for a tax year that begins before January 1, 2014, if all of its partners consent to the election. This election must be made on an entity-by-entity basis, and applies only to the particular CFCs and QEFs for which an election is made. In general, for purposes of section 1411, if an election is in effect for a CFC or QEF, the amounts included in income under section 951 and section 1293 derived from the CFC or QEF are included in net investment income, and distributions described in section 959(d) or section 1293(c) are excluded from net investment income. An election that is made under Regulations section 1.1411-10(g) cannot be revoked. For more information regarding this election, see Regulations section 1.1411-10(g).

The election must be made in a statement that is filed with the partnership's original or amended return for the tax year in which the election is made. An election is made. An election can be made on an amended return only if the tax year for which the election is made, and all tax years affected by the election, are not closed by the period of

limitations on assessments under section 6501. The statement must include:

- The name and EIN of the partnership making the election,
- A declaration that all of its partners consent to each election made in the statement,
- A declaration that the partnership elects under Regulations section 1.411-10(g) to apply the rules in Regulations section 1.1411-10(g) to the CFCs and QEFs identified in the statement, and
- The following information with respect to each CFC and QEF for which an election is made: (i) the name of the CFC or QEF; and (ii) either the EIN of the CFC or QEF, or, if the CFC or QEF does not have an EIN, the reference ID number of the CFC or QEF.

Effect of Section 743(b) Basis Adjustment on Partnership Items

If the basis of partnership property has been adjusted for a transferee partner under

section 743(b), the partnership must adjust the transferee's distributive share of the items of partnership income, deduction, gain, or loss in accordance with Regulations section 1.743-1(j)(3) and (4). These adjustments must be reported on Schedule K and the transferee partner's Schedule K-1. Report the adjustments on an attached statement to Schedule K-1 using the codes for *Other Income* or *Other Deductions*. Identify the partnership item being adjusted and the amount of the adjustment. If the adjustments are to partnership items from more than one trade or business, report the adjustments separately for each activity. Section 743(b) adjustments do not affect the transferee's capital account.

Elections Made by Each Partner

Elections under the following sections are made by each partner separately on the partner's tax return.

1. Section 108 (income from discharge of indebtedness). This does not include the section 108(i) election. If an

electing large partnership has income from the discharge of any indebtedness, this is reported separately to each partner.

2. Section 901 (foreign tax credit).

Partner's Dealings With Partnership

If a partner engages in a transaction with his or her partnership, other than in his or her capacity as a partner, the partner is treated as not being a member of the partnership for that transaction. Special rules apply to sales or exchanges of property between partnerships and certain persons, as explained in Pub. 541, Partnerships.

Contributions to the Partnership

Generally, no gain or (loss) is recognized to the partnership or any of the partners when property is contributed to the partnership in exchange for an interest in the partnership. This rule does not apply to any gain realized on a transfer of property to a partnership that would be treated as an investment company

(within the meaning of section 351) if the partnership were incorporated. If, as a result of a transfer of property to a partnership, there is a direct or indirect transfer of money or other property to the transferring partner, the partner may have to recognize gain on the exchange.

The basis to the ELP of property contributed by a partner is the adjusted basis in the hands of the partner at the time it was contributed, plus any gain recognized (under section 721(b)) by the partner at that time. See section 723 for more information.

Dispositions of Contributed Property

Generally, if the partnership disposes of property contributed to the partnership by a partner, income, gain, loss, and deductions from that property must be allocated among the partners to take into account the difference between the property's basis and its FMV at the time of the contribution. However, if the adjusted basis of the contributed property exceeds its FMV at the

time of the contribution, the built-in loss can only be taken into account by the contributing partner. For all other partners, the basis of the property in the hands of the partnership is treated as equal to its FMV at the time of the contribution (see section 704(c)(1)(C)).

For property contributed to the ELP, the contributing partner must recognize gain or loss on a distribution of the property to another partner within 7 years of its being contributed. The gain or loss is equal to the amount that the contributing partner should have recognized if the property had been sold for its FMV when distributed, because of the difference between the property's basis and its FMV at the time of contribution.

See section 704(c) for details and other rules on dispositions of contributed property. See section 724 for the character of any gain or (loss) recognized on the disposition of unrealized receivables, inventory items, or capital loss property contributed to the partnership by a partner.

Recognition of Precontribution Gain on Certain Partnership Distributions

A partner who contributes appreciated property to the partnership must include in income any precontribution gain to the extent the FMV of other property (other than money) distributed to the partner by the partnership exceeds the adjusted basis of his or her partnership interest just before the distribution. Precontribution gain is the net gain, if any, that would have been recognized under section 704(c)(1)(B) if the partnership had distributed to another partner all the property that had been contributed to the partnership by the distributee partner within 7 years of the distribution and that was held by the partnership just before the distribution.

Appropriate basis adjustments are to be made to the adjusted basis of the distributee partner's interest in the partnership and the partnership's basis in the contributed property to reflect the gain recognized by the partner.

For more details and exceptions, see Pub. 541.

Unrealized Receivables and Inventory Items

Generally, if a partner sells or exchanges a partnership interest and unrealized receivables or inventory items are involved, the transferor partner must notify the partnership, in writing, within 30 days of the exchange. The partnership must then file Form 8308, Report of a Sale or Exchange of Certain Partnership Interests.

If a partnership distributes unrealized receivables or substantially appreciated inventory items in exchange for all or part of a partner's interest in other partnership property (including money), treat the transaction as a sale or exchange between the partner and the partnership. Treat the partnership gain or (loss) as ordinary income or (loss). The income or (loss) is specially allocated only to partners other than the distributee partner.

If a partnership gives other property (including money) for all or part of that partner's interest in the partnership's unrealized receivables or substantially appreciated inventory items, treat the transaction as a sale or exchange of the property.

See Rev. Rul. 84-102, 1984-2 C.B. 119, for information on the tax consequences that result when a new partner joins a partnership that has liabilities and unrealized receivables. Also see Pub. 541 for more information on unrealized receivables and inventory items.

Activities of Electing Large Partnerships (ELPs)

The activities of an ELP are reported as either:

- Passive loss limitation activities, including trade or business, real estate rental, and other rental activities or
- Other activities, including portfolio or investment activities.

Passive Loss Limitation Activities

The term *passive loss limitation activity* means any activity involving the conduct of a trade or business (including any activity treated as a trade or business under section 469(c)(5) or (6)), or any rental activity.

A limited partner's share of an ELP's taxable income or loss from these activities is treated as income or loss from the conduct of a single passive trade or business activity. Thus, an ELP does not have to report items from multiple activities separately to limited partners.

However, if a partner holds an interest in an ELP other than as a limited partner, the distributive share of items from each activity is accounted for separately under the passive activity rules of section 469. Thus, for example, passive loss limitation activity income or loss is not treated as passive income with respect to the general partnership interest of a partner who materially participates in the partnership's trade or business activities. For general

partners, the partnership does have to report items for each activity separately.

Trade or Business Activities

A trade or business activity is an activity (other than a rental activity or an activity treated as incidental to an activity of holding property for investment) that:

- Involves the conduct of a trade or business (within the meaning of section 162),
- Is conducted in anticipation of starting a trade or business, or
- Involves research or experimental expenditures deductible under section 174 (or that would be if you chose to deduct rather than capitalize them).

Rental Activities

Generally, except as noted below, if the gross income from an activity consists of amounts paid principally for the use of real or personal tangible property held by the partnership, the activity is a rental activity.

There are several exceptions to this general rule. Under these exceptions, an activity involving the use of real or personal tangible property is not a rental activity if any of the following apply.

- The average period of customer use (defined below) for such property is 7 days or less.
- The average period of customer use for such property is 30 days or less and significant personal services (defined below) are provided by or on behalf of the partnership.
- Extraordinary personal services (defined below) are provided by or on behalf of the partnership.
- The rental of such property is treated as incidental to a nonrental activity of the partnership under Temporary Regulations section 1.469-1T(e)(3)(vi) and Regulations section 1.469-1(e)(3)(vi)(D).
- The partnership customarily makes the property available during defined business

hours for nonexclusive use by various customers.

- The partnership provides property for use in a nonrental activity of a partnership or joint venture in its capacity as an owner of an interest in such partnership or joint venture. Whether the partnership provides property used in an activity of another partnership or of a joint venture in the partnership's capacity as an owner of an interest in the partnership or joint venture is determined on the basis of all the facts and circumstances.

In addition, a guaranteed payment described in section 707(c) is never income from a rental activity.

Average period of customer use. Figure the average period of customer use for a class of property by dividing the total number of days in all rental periods by the number of rentals during the tax year. If the activity involves renting more than one class of property, multiply the average period of customer use of each class by the ratio of the gross rental income from that class to the

activity's total gross rental income. The activity's average period of customer use equals the sum of these class-by-class average periods weighted by gross income. See Regulations section 1.469-1(e)(3)(iii).

Significant personal services. Personal services include only services performed by individuals. To determine if personal services are significant personal services, consider all the relevant facts and circumstances.

Relevant facts and circumstances include:

- How often the services are provided,
- The type and amount of labor required to perform the services, and
- The value of the services in relation to the amount charged for use of the property.

The following services are not considered in determining whether personal services are significant.

- Services necessary to permit the lawful use of the rental property.
- Services performed in connection with improvements or repairs to the rental

property that extend the useful life of the property substantially beyond the average rental period.

- Services provided in connection with the use of any improved real property that are similar to those commonly provided in connection with long-term rentals of high-grade commercial or residential property. Examples include cleaning and maintenance of common areas, routine repairs, trash collection, elevator service, and security at entrances.

Extraordinary personal services. Services provided in connection with making rental property available for customer use are extraordinary personal services only if the services are performed by individuals and the customers' use of the rental property is incidental to their receipt of the services.

For example, a patient's use of a hospital room generally is incidental to the care received from the hospital's medical staff. Similarly, a student's use of a dormitory room in a boarding school is incidental to the

personal services provided by the school's teaching staff.

Rental activity incidental to a nonrental activity. An activity is not a rental activity if the rental of the property is incidental to a nonrental activity, such as the activity of holding property for investment, a trade or business activity, or the activity of dealing in property.

Rental of property is incidental to an activity of holding property for investment if both of the following apply.

- The main purpose for holding the property is to realize a gain from the appreciation of the property.
- The gross rental income from such property for the tax year is less than 2% of the smaller of the property's unadjusted basis or its FMV.

Rental of property is incidental to a trade or business activity if all of the following apply.

- The partnership owns an interest in the trade or business at all times during the year.
- The rental property was mainly used in the trade or business activity during the tax year or during at least 2 of the 5 preceding tax years.
- The gross rental income from the property for the tax year is less than 2% of the smaller of the property's unadjusted basis or its FMV.

The sale or exchange of property that is both rented and sold or exchanged during the tax year (where the gain or loss is recognized) is treated as incidental to the activity of dealing in property if, at the time of the sale or exchange, the property was held primarily for sale to customers in the ordinary course of the partnership's trade or business.

See Temporary Regulations section 1.469-1T(e)(3) and Regulations section 1.469-1(e)(3) for more information on the definition of rental activities for purposes of the passive activity limitations.

In reporting the partnership's income or losses and credits from rental activities, the partnership must separately report rental real estate activities and rental activities other than rental real estate activities.

Partners who actively participate in a rental real estate activity may be able to deduct part or all of their rental real estate losses (and the deduction equivalent of rental real estate credits) against income (or tax) from nonpassive activities. The combined amount of rental real estate losses and the deduction equivalent of rental real estate credits from all sources (including rental real estate activities not held through the partnership) that can be claimed is limited to \$25,000. This \$25,000 amount is generally reduced for high-income partners.

Self-Charged Interest

Certain self-charged interest income and expense may be treated as passive activity gross income and passive activity deductions if the loan proceeds are used in a passive activity. Generally, self-charged interest income and deductions result from loans

between the partnership and its partners. It also includes loans between the partnership and another partnership if each owner in the borrowing entity has the same proportional ownership interest in the lending entity. The partnership can elect not to apply these rules to self-charged interest income.

The self-charged interest rules do not apply to a partner's interest in a partnership if the partnership makes an election under Regulations section 1.469-7(g) to avoid the application of these rules. To make the election, the partnership must attach to its original or amended partnership return, a statement that includes the name, address, and EIN of the partnership and a declaration that the election is being made under Regulations section 1.469-7(g). The election will apply to the tax year in which it was made and all subsequent tax years. Once made, the election may only be revoked with the consent of the IRS. For more details on the self-charged interest rules, see Regulations section 1.469-7.

Other Activities

The term *other activities* means activities other than passive loss limitation activities. This is income or expenses connected with property held for investment, that is, portfolio income. Generally, portfolio income includes all gross income, other than income derived in the ordinary course of a trade or business, that is attributable to interest; dividends; royalties; income from a real estate investment trust, a regulated investment company, a real estate mortgage investment conduit, a common trust fund, a controlled foreign corporation, a qualified electing fund, or a cooperative; income from the disposition of property that produces income of a type defined as portfolio income; and income from the disposition of property held for investment. Portfolio income is reported separately and is reduced by portfolio deductions, allocable investment interest expense, and nonbusiness deductions. See *Self-Charged Interest*, earlier, for an exception.

Special Reporting Requirements

General Partners

Passive Activity Reporting Requirements

To allow general partners to correctly apply the passive activity loss and credit limitation rules, any partnership that carries on more than one activity must do the following.

1. Provide a statement for each activity conducted through the partnership that identifies the type of activity conducted (trade or business, rental real estate, rental activity other than rental real estate, or investment). See *Grouping Activities*, discussed later.
2. On the statement for each activity, provide a statement detailing the net income or (loss), credits, and all items required to be separately stated under section 772(a) from each trade or business activity, from each rental real estate activity, from each rental

activity other than a rental real estate activity, and from investments.

3. Identify the net income or (loss) and credits from each oil or gas well drilled or operated under a working interest that any partner (other than a partner whose only interest in the partnership during the year is as a limited partner) holds through the partnership. Further, if any partner had an interest as a general partner in the partnership during less than the entire year, the partnership must identify both the disqualified deductions from each well that the partner must treat as passive activity deductions, and the ratable portion of the gross income from each well that the partner must treat as passive activity gross income.
4. Identify the net income or (loss) and the partner's share of partnership interest expense from each activity of renting a dwelling unit that any partner uses for personal purposes during the year for more than the

greater of 14 days or 10% of the number of days that the residence is rented at fair rental value.

5. Identify the net income or (loss) and the partner's share of partnership interest expense from each activity of trading personal property conducted through the partnership. For this purpose, personal property means property that is actively traded such as stocks, bonds, and other securities. See Temporary Regulations section 1.469-1T(e)(6).
6. For any gain or (loss) from the disposition of an interest in an activity or of an interest in property used in an activity (including dispositions before 1987 from which gain is being recognized after 1986):
 - a. Identify the activity in which the property was used at the time of disposition.
 - b. If the property was used in more than one activity during the 12 months

preceding the disposition, identify the activities in which the property was used and the adjusted basis allocated to each activity.

- c. For gains only, if the property was substantially appreciated at the time of the disposition and the applicable holding period specified in Regulations section 1.469-2(c) (2)(iii)(A) was not satisfied, identify the amount of the nonpassive gain and indicate whether the gain is investment income under Regulations section 1.469-2(c)(2)(iii)(F).
- 7. Specify the amount of gross portfolio income, the interest expense properly allocable to portfolio income, and expenses other than interest expense that are clearly and directly allocable to portfolio income.
- 8. Identify separately any of the following types of payments to partners.

- a. Payments to a partner for services other than in the partner's capacity as a partner under section 707(a).
 - b. Guaranteed payments to a partner for services under section 707(c).
 - c. Guaranteed payments for use of capital.
 - d. If section 736(a)(2) payments are made for unrealized receivables or for goodwill, the amount of the payments and the activities to which the payments are attributable.
 - e. If section 736(b) payments are made, the amount of the payments and the activities to which the payments are attributable.
9. Identify the ratable portion of any section 481 adjustment (whether a net positive or a net negative adjustment) allocable to each partnership activity.
10. Identify the amount of gross income from each oil or gas property of the partnership.

11. Identify any gross income from sources specifically excluded from passive activity gross income, including the following.
 - a. Income from intangible property if the partner is an individual whose personal efforts significantly contributed to the creation of the property.
 - b. Income from state, local, or foreign income tax refunds.
 - c. Income from a covenant not to compete if the partner is an individual who contributed the covenant to the partnership.
12. Identify any deductions that are not passive activity deductions.
13. If the partnership makes a full or partial disposition of its interest in another entity, identify the gain (loss) allocable to each activity conducted through the entity, and the gain allocable to a passive activity that would have been recharacterized as

nonpassive gain had the partnership disposed of its interest in property used in the activity (because the property was substantially appreciated at the time of the disposition, and the gain represented more than 10% of the partner's total gain from the disposition).

14. Identify the following items from activities that may be subject to the recharacterization rules under Temporary Regulations section 1.469-2T(f) and Regulations section 1.469-2(f).
 - a. Net income from an activity of renting substantially nondepreciable property.
 - b. The smaller of equity-financed interest income or net passive income from an equity-financed lending activity.
 - c. Net rental activity income from property developed (by the partner or the partnership), rented, and sold

within 12 months after the rental of the property commenced.

- d. Net rental activity income from the rental of property by the partnership to a trade or business activity in which the partner had an interest (either directly or indirectly).
 - e. Net royalty income from intangible property if the partner acquired the partner's interest in the partnership after the partnership created the intangible property or performed substantial services, or incurred substantial costs in developing or marketing the intangible property.
15. Identify separately the credits from each activity conducted by or through the partnership.
16. Identify the partner's distributive share of the partnership's self-charged interest income or expense (see *Self-Charged Interest*, discussed previously).

- a. **Loans between a partner and the partnership.** Identify the lending or borrowing partner's share of the self-charged interest income or expense. If the partner made the loan to the ELP, also identify the activity in which the loan proceeds were used. If the proceeds were used in more than one activity, allocate the interest to each activity based on the amount of the proceeds used in each activity.
- b. **Loans between the partnership and another partnership or an S corporation.** If the partnership's partners have the same proportional ownership interest in the partnership and the other partnership or S corporation, identify each partner's share of the interest income or expense from the loan. If the ELP was the borrower, also identify the activity in which the loan proceeds were used. If the loan proceeds were

used in more than one activity,
allocate the interest to each
activity based on the amount of the
proceeds used in each activity.

For more information on passive activities,
see Pub. 925, Passive Activity and At-Risk
Rules.

Net Investment Income Tax Reporting Requirements

Note. The information described in this
section should be given directly to the partner
and should not be reported by the partnership
to the IRS.

To allow partners to correctly figure the net
investment income tax where a partner
disposes of an interest in the partnership
during the tax year, the partnership may be
required to provide the partner with certain
information. The net investment income tax is
a tax imposed on an individual, trust, or
estate's net investment income. Net
investment income includes the net gains or
losses from the sale of an interest in the
partnership. A partner who is actively

involved in one or more of the partnership or lower tier pass-through entities' trades or businesses (other than trading in financial instruments or commodities) can reduce the amount of the gain or loss from the sale of the partnership interest or lower tier pass-through entity included in its net investment income. However, to figure its net investment income, the active partner needs certain information from the partnership.

Generally, the partnership must provide certain information to the partner if the partnership knows, or has reason to know, the following.

1. The partner disposed of an interest in the partnership.
2. The partner materially participates (within the meaning of the passive activity loss rules (section 469)) in one or more of the trades or businesses (within the meaning of section 162) of the partnership or a lower tier pass-through entity (other than trading in financial instruments or commodities).

3. The partner does not qualify for the optional simplified reporting method for figuring its net investment income associated with the disposition of the interest. For more information, see the Instructions for Form 8960, Line 5c.

Information to be provided to partner.

Generally, the partnership must provide the partner with its distributive share of the net gain and loss from the deemed sale for fair market value of the partnership's property, other than property that relates to the trades or businesses in which the partner materially participates, as determined under the passive activity loss rules applicable to the transfer of an interest in a pass-through entity. For more information, see the Instructions for Form 8960, Line 5c.

Note: If a partner, who qualifies for the optional simplified reporting method, prefers to determine net gain or loss under the general calculation, the partnership may, but is not obligated to, provide the information to the partner at that partner's request.

Grouping Activities

Generally, one or more trade or business activities or rental activities may be treated as a single activity if the activities make up an appropriate economic unit for the measurement of gain or loss under the passive activity rules. Whether activities make up an appropriate economic unit depends on all the relevant facts and circumstances. The factors given the greatest weight in determining whether activities make up an appropriate economic unit are:

- Similarities and differences in types of trades or businesses,
- The extent of common control,
- The extent of common ownership,
- Geographical location, and
- Reliance between or among the activities.

Example. The ELP has a significant ownership interest in a bakery and a movie theater in Baltimore and a bakery and a movie theater in Philadelphia. Depending on the relevant facts and circumstances, there

may be more than one reasonable method for grouping the ELP's activities. For instance, the following groupings may or may not be permissible.

- A single activity.
- A movie theater activity and a bakery activity.
- A Baltimore activity and a Philadelphia activity.
- Four separate activities.

Once the ELP chooses a grouping under these rules, it must continue using that grouping in later tax years unless a material change in the facts and circumstances makes it clearly inappropriate. The IRS may regroup the ELP's activities if the partnership's grouping fails to reflect one or more appropriate economic units and one of the primary purposes of the grouping is to avoid the passive activity limitations.

Limitation on grouping certain activities.
The following activities may not be grouped together.

1. A rental activity with a trade or business activity unless the activities being grouped together make up an appropriate economic unit and
 - a. The rental activity is insubstantial relative to the trade or business activity or vice versa or
 - b. Each owner of the trade or business activity has the same proportionate ownership interest in the rental activity. If so, the portion of the rental activity involving the rental of property to be used in the trade or business activity may be grouped with the trade or business activity.
2. An activity involving the rental of real property with an activity involving the rental of personal property (except personal property provided in connection with the real property or vice versa).
3. Any activity with another activity in a different type of business and in which the ELP holds an interest as a limited partner or as a limited entrepreneur (as

defined in section 464(e)(2)) if that other activity engages in holding, producing, or distributing motion picture films or videotapes; farming; leasing section 1245 property; or exploring for or exploiting oil and gas resources or geothermal deposits.

Activities conducted through other partnerships. Once a partnership determines its activities under these rules, the partnership as a partner can use these rules to group those activities with:

- Each other,
- Activities conducted directly by the partnership, or
- Activities conducted through other partnerships.

A partner cannot treat as separate activities those activities grouped together by a partnership.

Tax-Exempt Partners

A tax-exempt partner is subject to tax on its distributive share of partnership income to

the extent that the partnership activity is an unrelated business for the partner. Therefore, partnership items must be separately reported to tax-exempt partners to allow them to compute income from an unrelated business.

Publicly Traded Partnerships (PTPs)

For ELPs, the requirement that the passive loss rules be separately applied to each PTP continues to apply.

Partnerships Holding Residual Interests in Real Estate Mortgage Investment Conduits (REMICs)

For purposes of the excise tax on partnerships holding residual interests in REMICs, all interests in an electing large partnership are treated as held by disqualified organizations. Therefore, an ELP holding a residual interest in a REMIC is subject to an annual tax equal to 35% of the excess inclusions. The amount that is subject to tax is excluded from partnership income. To report and pay this tax, file Form 8831, Excise Taxes on Excess Inclusions of REMIC Residual Interests.

Partnerships Holding Oil and Gas Properties

Partnerships holding oil and gas properties generally follow the same simplified reporting rules as other ELPs. However, certain partners are treated as *disqualified persons*, and special rules apply.

Computing depletion. Depletion is generally computed at the partnership level. The 1,000-barrel-per-day-limitation on depletion does not apply. Depletion is also computed without regard to the 65-percent-of-taxable-income limitation and the depletion basis adjustment. The depletion deduction is computed with the assumptions that the partnership is the taxpayer and that it qualifies for the percentage depletion deduction. This deduction is reported to partners (other than disqualified persons) as part of their share of the taxable income (loss) from passive loss limitation activities.

Disqualified persons. Two categories of taxpayers are defined as *disqualified persons*.

- Certain retailers and refiners who do not qualify for the section 613A percentage depletion deduction. See sections 613A(d)(2) and (4).
- Any other person whose average daily production of domestic crude oil and natural gas exceeds 500 barrels for its tax year in which the partnership's tax year ends. See section 776(b) for more details.

A disqualified person must notify the partnership of its status as such.

Reporting to disqualified persons. An ELP reports information related to oil and gas activities to a *disqualified person* in box 9 of Schedule K-1 (Form 1065-B) providing the same information as required for other partnerships. This information may be provided in an attached statement if additional space is required. However, the simplified rules do apply to a *disqualified person's* share of items not related to oil and gas activities.

Other reporting requirements. Unlike other partnerships, the election to deduct

intangible drilling and development costs (IDCs) is made at the partnership level, and the partnership can pass through a full deduction of IDCs to its partners who are not *disqualified persons*. Also, an ELP (and not the partners) makes the section 59(e) election to capitalize and amortize certain specific IDCs for its partners who are not *disqualified persons*. However, partners who are *disqualified persons* are permitted to make their own separate section 59(e) election.

A single AMT adjustment (under either corporate or noncorporate rules) is made and reported to partners who are not *disqualified persons*. This separately reported item is affected by the limitation on the repeal of the tax preference for excess IDCs. For purposes of computing this limitation, the partnership is treated as the taxpayer. Thus, the limitation on repeal of the IDC preference is applied at the partnership level and is based on the cumulative reduction in the partnership's alternative minimum taxable income resulting from repeal of that preference.