

# 2013

## Instructions for Form 1065-B

U.S. Return of Income for Electing Large  
Partnerships

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Volume 2 of 3



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Finally, in making partnership-level computations, any item of income, gain, loss, deduction, or credit attributable to a *disqualified person* is disregarded. For example, in computing the partnership's net income from oil and gas for purposes of determining the IDC preference to be reported to partners as part of the AMT adjustment, *disqualified persons'* distributive shares of the partnership's net income from oil and gas are not taken into account.

## **Extraterritorial Income Exclusion**

See Form 8873, Extraterritorial Income Exclusion, to determine whether the partnership qualifies for the exclusion and to figure the amount of the exclusion. If the partnership's foreign trading gross receipts do not exceed \$5 million and the partnership does not meet the foreign economic process requirements for the exclusion, it must report certain information to its partners. See the instructions below on how to report the exclusion on the partnership's return and the information it must report to its partners.

If applicable, the partnership must report the extraterritorial income exclusion on its return as follows.

1. If the partnership met the foreign economic process requirements explained in the Instructions for Form 8873, it can report the exclusion as a non-separately stated item on whichever of the following lines apply to that activity.

- Form 1065-B, Part I, line 5;
- Form 1065-B, Part I, line 23; or
- Form 8825, line 15.

In addition, the ELP must report, as an item of information using Code O1 in box 9 of Schedule K-1, the partner's distributive share of foreign trading gross receipts from Form 8873, line 15.

2. If the foreign trading gross receipts of the partnership for the tax year are \$5 million or less and the partnership did not meet the foreign economic process requirements, it cannot report the

extraterritorial income exclusion as a non-separately stated item on its return. Instead, the partnership must report the following separately stated items to the partners.

**Foreign trading gross receipts (Code O1).**

Using Code O1, enter in box 9 of Schedule K-1 the partner's distributive share of foreign trading gross receipts from the partnership's Form 8873, line 15.

Extraterritorial income exclusion (Code O2). Using Code O2, enter in box 9 of Schedule K-1 the partner's distributive share of the extraterritorial income exclusion from the partnership's Form 8873. For general partners only, identify the activity to which the exclusion relates. If the partnership is required to complete more than one Form 8873, combine the exclusions from line 52 and report a single exclusion amount in box 9.

**Note.** Upon request of a partner, the ELP should furnish a copy of the partnership's Form 8873 if that partner has a reduction for

international boycott operations, illegal bribes, kickbacks, etc.

## **Specific Instructions**

These instructions follow the line numbers on Form 1065-B. The accompanying schedules are discussed separately. Specific instructions for most of the lines are provided on the following pages. Lines that are not discussed in the instructions are self-explanatory.

Fill in all applicable lines and schedules. Enter any items specially allocated to the partners in the appropriate box of the applicable partner's Schedule K-1. Enter the total amount on the appropriate line of Schedule K. Do not enter separately stated amounts on the numbered lines on Form 1065-B, Parts I or II, on Form 1125-A, on Schedule D, or Form 8949.

File only one Form 1065-B for each partnership. Mark "Duplicate Copy" on any copy you give to a partner.

## **Name, Address, and Employer Identification Number**

**Name.** Enter the legal name of the ELP as it appears in the partnership agreement.

If the ELP has changed its name, check box G(2).

**Address.** Enter the address of the principal place of business or the principal office of the ELP. Include the suite, room, or other unit number after the street address. If the Post Office does not deliver mail to the street address and the partnership has a P.O. box, show the box number instead.

If the ELP receives its mail in care of a third party (such as an accountant or an attorney), enter on the street address line "C/O" followed by the third party's name and street address or P.O. box.

If the ELP's address is outside the United States or its possessions or territories, enter the information on the line for "City or town, state or province, country, and ZIP or foreign postal code" in the following order: city,

province or state, and the name of the foreign country. Follow the foreign country's practice in placing the postal code in the address. Do not abbreviate the country name.

If the ELP has had a change of address (including a change to an "in care of" address), check box G(3). If the partnership changes its mailing address or responsible party after filing its return, it can notify the IRS by filing Form 8822-B, Change of Address or Responsible Party — Business.

## **Items A and C**

Enter the applicable activity name and the code number from the list, *Codes for Principal Business Activity and Principal Product or Service*, near the end of the instructions.

For example, if, as its principal business activity, the ELP **(a)** purchases raw materials, **(b)** subcontracts out for labor to make a finished product from the raw materials, and **(c)** retains title to the goods, the ELP is considered to be a manufacturer and must enter "Manufacturer" in item A and enter in item C one of the codes (311110 through



339900) listed under "Manufacturing" on the list, *Codes for Principal Business Activity and Principal Product or Service*, near the end of the instructions.

## **Item F. Total Assets**

Enter the ELP's total assets at the end of the tax year, as determined by the accounting method regularly used in keeping the ELP's books and records. If there were no assets at the end of the tax year, enter "0."

## **Item J. Schedule M-3 (Form 1065)**

A partnership must complete Schedule M-3 (Form 1065), Net Income (Loss) Reconciliation for Certain Partnerships, instead of Schedule M-1, if any of the following apply.

1. The amount of total assets at the end of the tax year is \$10 million or more.
2. The amount of adjusted total assets for the tax year is \$10 million or more. Adjusted total assets is defined in the Instructions for Schedule M-3.

3. The amount of total receipts for the tax year is \$35 million or more.
4. An entity that is a reportable entity partner with respect to the partnership owns or is deemed to own, directly or indirectly, an interest of 50% or more in the partnership's capital, profit, or loss, on any day during the tax year of the partnership. Reportable entity partner is defined in the Instructions for Schedule M-3.

A partnership filing Form 1065-B that is not required to file Schedule M-3 may voluntarily file Schedule M-3 instead of Schedule M-1.

If you are filing Schedule M-3, check box J at the top of page 1 of Form 1065-B to indicate that Schedule M-3 is attached. See the Instructions for Schedule M-3 (Form 1065) for more information.

# **Part I. Taxable Income or Loss from Passive Loss Limitation Activities**

Report only amounts from passive loss limitation activities in Part I. See the earlier discussion of *Passive Loss Limitation Activities*. Do not report any tax-exempt interest income or income from the discharge of any indebtedness on lines 1a through 10. These amounts are accounted for separately by each partner and are reported in box 9 of Schedule K-1 (Form 1065-B). Income from discharge of indebtedness is also reported on line 8 of Schedule K, and tax-exempt interest income is reported on line 9 of Schedule K.

## **Income**

**Election to defer income from cancelled debt.** If the partnership elected to defer cancellations of debt (COD) income under section 108(i), the exclusions for COD under section 108(a)(1)(A), (B), (C), and (D) do not apply to the income from the COD for the tax year of the election and any later year. If the

partnership issued a debt instrument with original issue discount (OID) that is subject to section 108(i)(2) because of an election under section 108(i) to defer COD income, the deduction for all or a portion of the OID that accrues prior to the first tax year the COD is includible in income is deferred until the COD is includible in income. The amount of OID deferred is limited to the amount of COD income subject to the section 108(i) election. See section 108(i); Rev. Proc. 2009-37, 2009-36 I.R.B. 309; and Regulations section 1.108(i)-2 for more information.

**Special rule for filers of Form 8865.** Filers of Form 8865, Return of U.S. Persons With Regard to Certain Foreign Partnerships, had to file Form 1065 or Form 1065-B to make the section 108(i) election. These foreign partnerships also have an annual reporting requirement on Form 1065 or Form 1065-B for each tax year after the election until all items deferred under section 108(i) have been recognized. See Rev. Proc. 2009-37, 2009-36 I.R.B. 309 and Regulations section 1.108(i)-2 for details.

**Section 108(i) election and reporting by tiered partnerships.** A partnership that receives a Schedule K-1 from another partnership containing information relating to a section 108(i) election must report on the Schedule K-1 to its partners certain information relative to the section 108(i) election. See Rev. Proc. 2009-37, 2009-36 I.R.B. 309 and Regulations section 1.108(i)-2 for details.

## **Line 1a. Gross Receipts or Sales**

Enter the gross receipts or sales from all trade or business operations except those that must be reported on lines 6 through 10. For example, do not include gross receipts from farming on this line. Instead, show the net profit (loss) from farming on line 7. Also, do not include rental activity income or portfolio income.

**Advance payment.** In general, advance payments are reported in the year of receipt. To report income from long-term contracts, see section 460. For special rules for reporting certain advance payments for goods and long-term contracts, see Regulations

section 1.451-5. For permissible methods for reporting advance payments for services and most goods by an accrual method partnership, see Rev. Proc. 2004-34, 2004-22 I.R.B. 991, as clarified and modified by Rev. Proc. 2011-18, and modified by Rev. Proc. 2011-14, and clarified and modified by Rev. Proc. 2013-29, 2013-33 I.R.B. 141.

**Installment sales.** Generally, the installment method cannot be used for dealer dispositions of property. A “dealer disposition” is any disposition of:

- Personal property by a person who regularly sells or otherwise disposes of personal property of the same type on the installment plan or
- Real property held for sale to customers in the ordinary course of the taxpayer's trade or business.

**Exception.** These restrictions on using the installment method do not apply to dispositions of property used or produced in a farming business. See section 453(I) for details and exceptions.

For sales of timeshares and residential lots reported under the installment method, the ELP's income tax is increased by the interest payable under section 453(l)(3). In determining the amount of interest payable, the partnership is treated as subject to tax at a 35% rate. To report this addition to the tax, see the instructions for line 26.

Enter on line 1a the gross profit on collections from installment sales for any of the following.

- Dealer dispositions of property before March 1, 1986.
- Dispositions of property used or produced in the trade or business of farming.
- Dispositions of timeshares and residential lots reported under the installment method.

Attach a statement showing the following information for the current year and the 3 preceding years.

- Gross sales.
- Cost of goods sold.

- Gross profits.
- Percentage of gross profits to gross sales.
- Amount collected.
- Gross profit on amount collected.

### **Nonaccrual-experience method.**

Partnerships that qualify to use the nonaccrual-experience method (described earlier) should attach a statement showing total gross receipts, the amount not accrued as a result of the application of section 448(d)(5), and the net amount accrued. Enter the net amount on line 1a.

### **Line 2. Cost of Goods Sold**

If the partnership has a cost of goods sold deduction, complete and attach Form 1125-A, if applicable. Enter on Form 1065-B, page 1, line 2, the amount from Form 1125-A, line 8.

See Form 1125-A and its instructions.



## **Line 4. Net Rental Real Estate Income (Loss)**

Enter the net income or (loss) from rental real estate activities of the partnership from Form 8825. Attach this form to Form 1065-B. If the amount entered is from more than one activity, attach a statement identifying the amount from each activity.

## **Line 5. Net Income (Loss) From Other Rental Activities**

Enter the net income from rental activities other than rental real estate activities. See *Rental Activities*, earlier, and Pub. 925 for the definition of rental activities. Include on this line the gain or (loss) from line 17 of Form 4797 that is attributable to the sale, exchange, or involuntary conversion of an asset used in a rental activity other than a rental real estate activity. If the amount entered is from more than one activity, attach a statement identifying the amount from each activity.

## **Line 6. Ordinary Income (Loss) From Other Partnerships, Estates, and Trusts**

Enter the ordinary income or (loss) shown on Schedule K-1 (Form 1065, 1065-B, or 1041) or other ordinary income (loss) from a foreign partnership, estate, or trust. Be sure to show the partnership's, estate's, or trust's name, address, and EIN on a separate statement attached to this return. If the amount entered is from more than one source, identify the amount from each source.

Do not include rental activity income or (loss) from other partnerships, estates, or trusts on this line. Instead, report these amounts on line 20a of Form 8825 or line 5 of Form 1065-B, Part I.

Ordinary income or (loss) from another PTP is not reported on this line. Instead, report the amount separately on an attachment to line 15 of Schedule K and in box 9 of Schedule K-1.

Treat shares of other items separately reported on Schedule K-1 issued by the other

entity as if the items were realized or incurred by this partnership.

If there is a loss from another partnership, the amount of the loss that may be claimed is subject to the at-risk and basis limitations as appropriate.

If the tax year of your PTP does not coincide with the tax year of the other partnership, estate, or trust, include the ordinary income or (loss) from the other entity in the tax year in which the other entity's tax year ends.

## **Line 7. Net Farm Profit (Loss)**

Enter the partnership's net farm profit (loss) from Schedule F (Form 1040), Profit or Loss From Farming. Attach Schedule F (Form 1040) to Form 1065-B. In figuring the partnership's net farm profit (loss), include any section 179 expense deduction. Do not include on this line any farm profit or (loss) from other partnerships. Report those amounts on line 6.

For a special rule concerning the method of accounting for a farming partnership with a corporate partner and for other tax

information on farms, see Pub. 225, Farmer's Tax Guide.

## **Line 9. Net Gain (Loss) From Form 4797**

Include only the ordinary gains or (losses) from the sale, exchange, or involuntary conversion of assets used in a trade or business activity. Ordinary gains or losses from the sale, exchange, or involuntary conversion of rental activity assets are not reported on line 9. Instead, report them on line 19 of Form 8825 or line 5 of Form 1065-B, Part I.

An ELP that is a partner in another partnership must include on Form 4797, Sales of Business Property, its share of ordinary gains or (losses) from sales, exchanges, or involuntary conversions (other than casualties or thefts) of the other partnership's trade or business assets.

## **Line 10. Other Income (Loss)**

Enter trade or business income or (loss) that is not included on lines 1a through 9.

Examples of such income include the following.

- Interest income derived in the ordinary course of the partnership's trade or business, such as interest charged on receivable balances.
- Recoveries of bad debts deducted in prior years under the specific charge-off method.
- Taxable income from insurance proceeds.
- The amount included in income from line 2 of Form 6478, Biofuel Producer Credit.
- The amount included in income from line 8 of Form 8864, Biodiesel and Renewable Diesel Fuels Credit.
- All section 481 income adjustments resulting from changes in accounting methods. Show the computation of the section 481 adjustments on an attached statement.
- The amount of any deduction previously taken under section 179A that is subject to recapture. See Regulations section

1.179A-1 for details, including how to figure the recapture.

- The recapture amount for section 280F if the business use of listed property drops to 50% or less. To figure the recapture amount, the partnership must complete Part IV of Form 4797.
- Part or all of the proceeds received from certain employer-owned life insurance contracts issued after August 17, 2006. Partnerships that own one or more employer-owned life insurance contracts issued after this date must file Form 8925, Report of Employer-Owned Life Insurance Contracts. See section 101(j) for details.

Do not include items requiring separate computations that must be reported on Schedules K and K-1. See the instructions for Schedules K and K-1.

Do not report portfolio or rental activity income (loss) on this line.

## Deductions



*Report only trade or business activity deductions on lines 12 through 24.*

Do not report the following expenses on lines 12 through 24.

- Rental activity expenses. Report these expenses on Form 8825 or on an attached statement for line 5 of Form 1065-B, Part I.
- Deductions allocable to portfolio income. Report these deductions on page 2, Part II.
- Nondeductible expenses (for example, expenses connected with the production of tax-exempt income). Report nondeductible expenses on an attached statement for line 15 of Schedule K and in box 9 of Schedule K-1.
- Items the partnership must state separately that require separate computations by the partners. An example is foreign taxes paid. The distributive share of this expense is reported

separately to each partner on Schedule K-1, box 9.

## **Limitations on Deductions**

**Section 263A uniform capitalization rules.** The uniform capitalization rules of section 263A require partnerships to capitalize or include in inventory costs, certain costs incurred in connection with the following.

- The production of real property and tangible personal property held in inventory or held for sale in the ordinary course of business. Tangible personal property produced by a partnership includes a film, sound recording, videotape, book, or similar property.
- Real property or personal property (tangible and intangible) acquired for resale.
- The production of real property and tangible personal property by a partnership for use in its trade or business or in an activity engaged in for profit.



- The costs required to be capitalized under section 263A are not deductible until the property to which the costs relate is sold, used, or otherwise disposed of by the ELP.

***Exceptions.*** Section 263A does not apply to the following.

- Inventoriable items accounted for in the same manner as materials and supplies that are not incidental. See Form 1125-A and its instructions, for details.
- Personal property acquired for resale if the partnership's average annual gross receipts for the 3 prior tax years were \$10 million or less.
- Timber.
- Most property produced under a long-term contract.
- Certain property produced in a farming business.
- Geological and geophysical costs amortized under section 167(h).

- Research and experimental costs under section 174.
- Intangible drilling costs for oil, gas, and geothermal property.
- Mining exploration and development costs.

**Indirect costs.** ELPs subject to the uniform capitalization rules are required to capitalize not only direct costs but an allocable part of most indirect costs (including taxes) that benefit the assets produced or acquired for resale, or are incurred by reason of the performance of production or resale activities.

For inventory, some of the indirect costs that must be capitalized are the following.

- Administration expenses.
- Taxes.
- Depreciation.
- Insurance.
- Compensation paid to officers attributable to services.

- Rework labor.
- Contributions to pension, stock bonus, and certain profit-sharing, annuity, or deferred compensation plans.

Regulations section 1.263A-1(e)(3) specifies other indirect costs that relate to production or resale activities that must be capitalized and those that may be currently deductible.

Interest expense paid or incurred during the production period of designated property must be capitalized and is governed by special rules. For more details, see Regulations sections 1.263A-8 through 1.263A-15.

For more details on the uniform capitalization rules, see Regulations sections 1.263A-1 through 1.263A-3.

### **Transactions between related taxpayers.**

Generally, an accrual basis partnership can deduct business expenses and interest owed to a related party (including any partner) only in the tax year of the partnership that includes the day on which the payment is

includible in the income of the related party. See section 267 for details.

**Business start-up and organizational costs.** Generally, a partnership can elect to deduct up to \$5,000 of business start-up and organizational costs paid or incurred after October 22, 2004, in the year it begins business (unless the partnership elects to capitalize the full amount of such costs). The \$5,000 deduction is reduced (but not below zero) by the amount the total costs exceed \$50,000. If the total costs are \$55,000 or more, the deduction is reduced to zero. Any costs not deducted must be amortized as explained below. See sections 195(b) and 709(b).

***Time for making an election.*** The partnership generally elects to deduct start-up or organizational costs by claiming the deduction on its income tax return filed by the due date (including extensions) for the tax year in which the active trade or business begins. However, for start-up or organizational costs paid or incurred before September 9, 2008, the partnership may be

required to attach a statement to its return to elect to deduct such costs. See Temporary Regulations sections 1.195-1T and 1.709-1T (as in effect on July 7, 2008) for details. Also, see Regulations sections 1.195-1 and 1.709-1. If the partnership timely filed its return for the year without making an election, it can still make an election by filing an amended return within 6 months of the due date of the return (excluding extensions). Clearly indicate the election on the amended return and write "Filed pursuant to section 301.9100-2" at the top of the amended return. File the amended return at the same address the partnership filed its original return. The election applies when figuring income for the current tax year and all subsequent years.

The partnership can choose to forgo the elections above by clearly electing to capitalize its start-up or organizational costs on its tax return filed by the due date (including extensions) for the tax year in which the active trade or business begins.

The election to either amortize or capitalize start-up or organizational costs is irrevocable

and applies to all start-up and organizational costs that are related to the trade or business.

***Amortization.*** Any costs not deducted under the above rules must be amortized ratably over a 180-month period, beginning with the month the partnership begins business. See the Instructions for Form 4562 for details.

Report the deductible amount of these costs and any amortization on line 23 in Part I. For amortization that begins during the tax year, complete and attach Form 4562.

**Syndication costs.** Costs for issuing and marketing interests in the partnership, such as commissions, professional fees, and printing costs, must be capitalized. They cannot be depreciated or amortized. See the instructions for line 13 for the treatment of syndication fees paid to a partner.

**Reducing certain expenses for which credits are allowable.** The partnership may need to reduce the otherwise allowable deductions for expenses used to figure the credit. Do not reduce the amount of the

allowable deduction for any portion of the credit that was passed through to the ELP from another pass-through entity.

1. The work opportunity credit.
2. The credit for increasing research activities.
3. The disabled access credit.
4. The empowerment zone employment credit.
5. The Indian employment credit.
6. The credit for employer social security and Medicare taxes paid on certain employee tips.
7. The orphan drug credit.
8. Credit for small employer pension plan startup costs.
9. Credit for employer-provided childcare facilities and services.
10. The low sulfur diesel fuel production credit.
11. The mine rescue team training credit.

12. The credit for employer differential wage payments.

13. Credit for small employer health insurance premiums.

If the ELP has any of these credits, be sure to figure each current year credit before figuring the deductions for expenses on which the credit is based.

**Film and television production expenses.**

The partnership can elect to deduct certain costs of qualified film and television productions commencing before 2014. The deduction is subject to recapture under section 1245 if the election is voluntarily revoked or the production fails to meet the requirements for the deduction. See section 181 and the related regulations.

**Reforestation expenditures.** The ELP can elect to amortize over 84 months up to \$10,000 of qualified reforestation expenditures paid or incurred before October 23, 2004, from all qualified timber properties.

For qualified reforestation expenditures paid or incurred after October 22, 2004, the



partnership can elect to deduct up to \$10,000 for each qualifying timber property. If the partnership makes this election, it must amortize over 84 months any amount not deducted. See Notice 2006-47, 2006-20 I.R.B. 892, for details on making this election. Provide a description of the qualified timber property on an attached statement to Form 1065-B. If the partnership is electing to deduct amounts for more than one qualified timber property, provide a description and the amount for each property on the statement.

Report the deductible amount of these expenditures and any amortization deduction on line 23. For amortization that begins during the tax year, complete and attach Form 4562. See section 194 and Pub. 535 for more information.

## **Line 12. Salaries and Wages**

Enter the salaries and wages paid or incurred for the tax year, reduced by the amount of the following credit(s), if applicable:

- Form 5884, Work Opportunity Credit;

- Form 8844, Empowerment Zone Employment Credit;
- Form 8845, Indian Employment Credit;
- Form 8923, Mine Rescue Team Training Credit; and
- Form 8932, Credit for Employer Differential Wage Payments.

Do not reduce the amount of the allowable deduction for any portion of the credit that was passed through to the ELP from another pass-through entity. See the instructions for these forms for more information.

Do not include salaries and wages reported elsewhere on the return, such as amounts included in cost of goods sold, elective contributions to a section 401(k) cash or deferred arrangement, or amounts contributed under a salary reduction simplified employee plan (SEP) agreement or a SIMPLE IRA plan.

## **Line 13. Guaranteed Payments to Partners**

Deduct payments or credits to a partner for services or for the use of capital if the payments or credits are determined without regard to partnership income and are allocable to a trade or business activity. Also, include amounts paid during the tax year for insurance that constitutes medical care for a partner, a partner's spouse, a partner's dependents, or a partner's children under age 27 who are not dependents.

For information on how to treat the ELP's contribution to a partner's Health Savings Account (HSA), see Notice 2005-8, 2005-4 I.R.B. 368.

Do not include any payments and credits that should be capitalized. For example, although payments or credits to a partner for services rendered in syndicating a partnership may be guaranteed payments, they are not deductible as an expense. Instead, they should be charged to a capital account. They are capital expenditures. However, they

should be separately reported on Schedule K, line 7, and Schedule K-1, box 9.

Do not include distributive shares of partnership profits.

Report the guaranteed payments to the appropriate partners on Schedule K-1, box 9.

## **Line 14. Repairs and Maintenance**

Enter the costs of incidental repairs and maintenance that do not add to the value of the property or appreciably prolong its life, but only to the extent that such costs relate to a trade or business activity and are not claimed elsewhere on the return.

The cost of new buildings, machinery, or permanent improvements that increase the value of the property are not deductible. They are chargeable to capital accounts and can be depreciated or amortized.

## **Line 15. Bad Debts**

Enter the total debts that became worthless in whole or in part during the year, but only to the extent such debts relate to a trade or business activity. Report deductible

nonbusiness bad debts as a short-term capital loss on Schedule D.



*Cash method ELPs cannot take a bad debt deduction unless the amount was previously included in income.*

## **Line 16. Rent**

Enter rent paid on business property used in a trade or business activity. Do not deduct rent for a dwelling unit occupied by any partner for personal use.

If the partnership rented or leased a vehicle, enter the total annual rent or lease expense paid or incurred in the trade or business activities of the partnership. Also complete Part V of Form 4562, Depreciation and Amortization. If the partnership leased a vehicle for a term of 30 days or more, the deduction for vehicle lease expense may have to be reduced by an amount called the inclusion amount. You may have an inclusion amount if:

| <b>The lease term began:</b> | <b>And the vehicle's FMV on the first day of the lease exceeded:</b> |
|------------------------------|--|
|------------------------------|--|

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**Automobiles other than trucks and vans**

|   |          |
|---|----------|
| After 12/31/2012 and before 1/1/14. . . . . | \$19,000 |
| After 12/31/07 but before 1/1/13 . . .      | \$18,500 |
| After 12/31/06 but before 1/1/08 . . .      | \$15,500 |

**Trucks and Vans**

|  |          |
|--|----------|
| After 12/31/09 but before 1/1/14 . . . . . | \$19,000 |
| After 12/31/08 but before 1/1/10 . . . . . | \$18,500 |
| After 12/31/07 but before 1/1/09 . . . . . | \$19,000 |

The inclusion amount for lease terms beginning in 2014 will be published in the Internal Revenue Bulletin in early 2014.

See Pub. 463 for instructions on figuring the inclusion amount.

## **Line 17. Taxes and Licenses**

Enter taxes and licenses paid or incurred in the trade or business activities of the partnership if not reflected elsewhere on the return. Federal import duties and federal excise and stamp taxes are deductible only if paid or incurred in carrying on the trade or business of the partnership.

Do not deduct the following taxes on line 17.

- Taxes not imposed on the partnership.
- Federal income taxes or taxes reported elsewhere on the return.
- Section 901 foreign taxes. Report these taxes separately on Schedule K, line 14g, and Schedule K-1, box 9.
- Taxes allocable to a rental activity. Report these taxes on Form 8825. Report taxes allocable to a rental activity other than a rental real estate activity on Form 1065-B on an attachment to Part I, line 5.

- Taxes allocable to portfolio income. Report these taxes on Form 1065-B in Part II, line 8 or 11.
- Taxes paid or incurred for the production or collection of income, or for the management, conservation, or maintenance of property held to produce income. Also report these taxes on Form 1065-B in Part II, line 8 or 11.

See section 263A(a) for rules on capitalization of allocable costs (including taxes) for any property.

- Taxes, including state or local sales taxes, that are paid or incurred in connection with an acquisition or disposition of property. These taxes must be treated as a part of the cost of the acquired property or, in the case of a disposition, as a reduction in the amount realized on the disposition.
- Taxes assessed against local benefits that increase the value of the property assessed (such as for paving, etc.).
- a



## **Line 18. Interest**

Include only interest incurred in the trade or business activities of the ELP that is not claimed elsewhere on the return.

Do not deduct interest expense on the following.

- Debt required to be allocated to the production of designated property. Designated property includes real property, personal property that has a class life of 20 years or more, and other tangible property requiring more than 2 years (1 year in the case of property with a cost of more than \$1 million) to produce or construct. Interest that is allocable to designated property produced by a partnership for its own use or for sale must be capitalized. In addition, a partnership must also capitalize any interest on debt that is allocable to an asset used to produce designated property. See section 263A(f) and Regulations sections 1.263A-8 through 1.263A-15.

- Debt used to purchase rental property or debt used in a rental activity. Interest allocable to a rental real estate activity is reported on Form 8825 and is used in arriving at net income or (loss) from rental real estate activities on line 4. Interest allocable to a rental activity other than a rental real estate activity is used in arriving at net income or (loss) from a rental activity (other than a rental real estate activity). This net amount is reported on line 5.
- Debt used to buy property held for investment. Do not include interest expense that is clearly and directly allocable to interest, dividend, royalty, or annuity income not derived in the ordinary course of a trade or business. Interest paid or incurred on debt used to purchase or carry investment property is reported on line 7 of Part II. See the instructions for Form 4952, Investment Interest Expense Deduction, for more information on investment property.

Temporary Regulations section 1.163-8T gives rules for allocating interest expense among activities so that the limitations on passive activity losses, investment interest, and personal interest can be properly figured. Generally, interest expense is allocated in the same manner that debt is allocated. Debt is allocated by tracing disbursements of the debt proceeds to specific expenditures, as provided in the regulations.

Interest paid by an ELP to a partner for the use of capital should be entered on line 13 as guaranteed payments.

Prepaid interest can only be deducted over the period to which the prepayment applies.

**Note.** Additional limitations on interest deductions apply when the ELP is a policyholder or beneficiary with respect to a life insurance, endowment, or annuity contract issued after June 8, 1997. For details, see section 264. Attach a statement showing the computation of the deduction disallowed under section 264.

## **Line 19. Depreciation and Section 179 Expense Deduction**

Enter only the depreciation (including section 179 expense deduction) claimed on assets used in a trade or business activity. Enter on line 19b the depreciation (including section 179 expense deduction) included elsewhere on the return (for example, on page 1, line 2) that is attributable to assets used in trade or business activities. See the Instructions for Form 4562 or Pub. 946, *How To Depreciate Property*, to figure the amount of depreciation (including section 179 expense deduction) to enter on this line.

Complete and attach Form 4562 only if the ELP placed property in service during the tax year or claims depreciation on any car or other listed property.

## **Line 20. Depletion**

An ELP computes the deduction for oil and gas depletion at the partnership level. The deduction is computed under the assumptions that the partnership is the taxpayer and that it qualifies for the percentage depletion

deduction. In computing the depletion deduction, the 1,000-barrel-per-day limitation and the 65-percent-of-taxable-income limitation do not apply.

The amount of the depletion deduction is generally reported to each partner as a component of that partner's distributive share of taxable income or loss from passive loss limitation activities. However, the ELP must report information related to oil and gas activities to a partner who is a *disqualified person* in the same manner that it reports the information under the regular partnership tax law. See *Partnerships Holding Oil and Gas Properties* for more details.

If the ELP claims a deduction for timber depletion, complete and attach Form T (Timber), Forest Activities Schedule.

## **Line 21. Retirement Plans, etc.**

Enter the deductible contributions not claimed elsewhere on the return made by the partnership for its common-law employees under a qualified pension, profit-sharing,

annuity, or SEP or SIMPLE IRA plan, and under any other deferred compensation plan.

If the ELP contributes to an individual retirement arrangement (IRA) for employees, include the contribution in salaries and wages on Part I, line 12, or Form 1125-A, line 3, and not on line 21.

Employers who maintain a pension, profit-sharing, or other funded deferred compensation plan (other than a SEP or SIMPLE IRA), whether or not the plan is qualified under the Internal Revenue Code and whether or not a deduction is claimed for the current year, generally must file the applicable form listed below.

- Form 5500, Annual Return/Report of Employee Benefit Plan. File this form for a plan that is not a one-participant plan.
- Form 5500-EZ, Annual Return of One-Participant (Owners and Their Spouses) Retirement Plan. File this form for a plan that only covers one or more partners (or partners and their spouses).

Penalties may be assessed for failure to file these forms on time.

**Note.** Form 5500 and its schedules must be filed electronically using the Employee Retirement Income Security Act (ERISA) filing acceptance system (EFAST2). For more information, see the EFAST2 website at [www.efast.dol.gov](http://www.efast.dol.gov).

## **Line 22. Employee Benefit Programs**

Enter the ELP's contributions to employee benefit programs not claimed elsewhere on the return (for example, insurance, health, and welfare programs) that are not part of a pension, profit-sharing, etc., plan included on line 21.

Do not include amounts paid during the tax year for insurance that constitutes medical care for a partner, a partner's spouse, a partner's dependents, or a partner's children under age 27 who are not dependents. Instead, include these amounts on line 13 as guaranteed payments and on Schedule K, line 7, and Schedule K-1, box 9, of each partner on whose behalf the amounts were paid.

## Line 23. Other Deductions

Enter the total allowable trade or business deductions that are not deductible elsewhere in Part I of Form 1065-B. Attach a statement listing by type and amount each deduction included on this line. Examples of other deductions include the following.

- Amortization. See the Instructions for Form 4562 for more information. Complete and attach Form 4562 if the partnership is claiming amortization of costs that began during the tax year.
- Insurance premiums.
- Legal and professional fees.
- Supplies used and consumed in the business.
- Utilities.
- Certain business start-up expenditures and organizational expenditures that the partnership has elected to amortize or deduct. See Limitations on Deductions for more details.



- Film and television production expenses. See Limitations on Deductions for details.
- Reforestation expense deduction. See Limitations on Deductions for details.
- Endangered species recovery expenditures that were paid or incurred after December 31, 2008. See section 175 for details.
- Deduction for certain energy efficient commercial building property placed in service after December 31, 2005. See section 179D, Notice 2006-52, 2006-26 I.R.B. 1175, and Notice 2008-40, 2008-14 I.R.B. 725.
- Any negative net 481(a) adjustment.

Include on line 23 the deduction taken for amortization. Complete and attach Form 4562 if the ELP is claiming amortization of costs that begins during the tax year. The election to deduct intangible drilling costs under section 263(c) is made at the partnership level. An ELP also has the responsibility with respect to its partners who are not *disqualified persons* for making an election under section 59(e) to capitalize and amortize

certain specified intangible drilling costs. However, *disqualified persons* make their own separate section 59(e) elections. See *Partnerships Holding Oil and Gas Properties* for more information. See Pub. 535 for more information on amortization.

Also, see *Special Rules* below for limits on certain other deductions.

Do not deduct the following on line 23.

- Items that must be reported separately on Schedules K and K-1.
- Qualified expenditures to which an election under section 59(e) may apply.
- Fines or penalties paid to a government for violating any law. Report these expenses on Schedule K, line 15.
- Expenses allocable to tax-exempt income. Report these expenses on Schedule K, line 15.
- Any amount that is allocable to a class of exempt income. See section 265(b) for exceptions.

- Net operating losses. Only individuals and corporations may claim a net operating loss deduction.
- Amounts paid or incurred to participate or intervene in any political campaign on behalf of a candidate for public office, or to influence the general public regarding legislative matters, elections, or referendums.
- Expenses paid or incurred to influence federal or state legislation, or to influence the actions or positions of certain federal executive branch officials. However, certain in-house lobbying expenditures that do not exceed \$2,000 are deductible. See section 162(e) for more details.

## **Special Rules**

**Commercial revitalization deduction.** If the ELP constructed, purchased, or substantially rehabilitated a qualified building in a renewal community it may have qualified for either (a) a deduction of 50% of qualified capital expenditures in the year the building was placed in service or (b) amortization of

100% of the qualified capital expenditures over a 120-month period beginning with the month the building was placed in service. If the partnership elected to amortize these expenditures, complete and attach Form 4562. To qualify, the building must be nonresidential (as defined in section 168(e) (2)) and placed in service by the partnership. The partnership must be the original user of the building unless it is substantially rehabilitated. The amount of the qualified expenditures cannot exceed the lesser of \$10 million or the amount allocated to the building by the commercial revitalization agency of the state in which the building is located. Any remaining expenditures are depreciated over the regular depreciation recovery period. See section 1400I for details.

**Note.** The commercial revitalization deduction is not available for buildings placed in service after 2009.

***Rental real estate.*** Do not report this deduction on line 23 if the building is placed in service as rental real estate. A commercial revitalization deduction for rental real estate

is not deducted by the partnership but is passed through to the partners. Report this deduction on an attachment to line 15 of Schedule K and in box 9 of Schedule K-1 using Code Q.

**Travel, meals, and entertainment.** Subject to limitations and restrictions discussed below, a partnership can deduct ordinary and necessary travel, meals, and entertainment expenses paid or incurred in its trade or business. Also, special rules apply to deductions for gifts, skybox rentals, luxury water travel, convention expenses, and entertainment tickets. See section 274 and Pub. 463 for more details.

***Travel.*** The partnership cannot deduct travel expenses of any individual accompanying a partner or partnership employee, including a spouse or dependent of the partner or employee, unless:

- That individual is an employee of the partnership and

- His or her travel is for a bona fide business purpose and would otherwise be deductible by that individual.

***Meals and entertainment.*** Generally, the partnership can deduct only 50% of the amount otherwise allowable for meals and entertainment expenses paid or incurred in its trade or business. In addition (subject to exceptions under section 274(k)(2)):

- Meals must not be lavish or extravagant,
- A bona fide business discussion must occur during, immediately before, or immediately after the meal, and
- A partner or employee of the partnership must be present at the meal.

See section 274(n)(3) for a special rule that applies to expenses for meals consumed by individuals subject to the hours of service limits of the Department of Transportation.

***Membership dues.*** The ELP can deduct amounts paid or incurred for membership dues in civic or public service organizations, professional organizations, business leagues,

trade associations, chambers of commerce, boards of trade, and real estate boards. However, no deduction is allowed if a principal purpose of the organization is to entertain, or provide entertainment facilities for, members or their guests. In addition, the partnership cannot deduct membership dues in any club organized for business, pleasure, recreation, or other social purpose. This includes country clubs, golf and athletic clubs, airline and hotel clubs, and clubs operated to provide meals under conditions favorable to business discussion.

***Entertainment facilities.*** The ELP cannot deduct an expense paid or incurred for a facility (such as a yacht or hunting lodge) used for an activity usually considered entertainment, amusement, or recreation.

Generally, the ELP may be able to deduct otherwise nondeductible meals, travel, and entertainment expenses if the amounts are treated as compensation to the recipient and reported on Form W-2 for an employee or on Form 1099-MISC for an independent contractor.

## Line 26. Tax

**Net recapture taxes.** Recapture of the low-income housing credit under section 42(j) and investment credit under section 50 is imposed at the partnership level, and the amount of recapture is determined by assuming that the credit was fully utilized to reduce tax. The recapture of the qualifying therapeutic discovery project grant, under section 48D, is also imposed at the partnership level. Credit recapture does not result from any transfer of an interest in an ELP. Report partnership level recapture of low-income housing credit, investment credit, and qualifying therapeutic discovery project grant as follows.

1. Apply the recapture to reduce any current year credit of the same type.
2. Report any remaining recapture on line 26. The partnership is liable to pay any unapplied recapture amount. Complete Form 4255 for recapture of investment credit and qualifying therapeutic discovery project grant and Form 8611 for recapture of low-income housing



credit and check the appropriate box on line 26.

Report recapture of any other credit as a separately stated item in box 9 of Schedule K-1 using Code V.

**Interest on deferred tax attributable to installment sales of certain timeshares and residential lots.** For sales of timeshares and residential lots reported under the installment method, the ELP's income tax is increased by the interest payable under section 453(l)(3). In determining the amount of interest payable, the partnership is treated as subject to tax at a 35% rate. Report this amount on line 26 with the notation "Section 453(l)(3) interest." Attach a statement showing the computation.

**Interest on tax deferred under the installment method for certain nondealer installment obligations.** If an obligation arising from the disposition of property to which section 453A applies is outstanding at the close of the year, the partnership must include the interest due under section 453A(c). In determining the amount of

interest payable, the partnership is treated as subject to tax at a 35% rate. Report this amount on line 26 with the notation "Section 453A(c) interest." Attach a statement showing the computation.

## **Line 27**

Enter the total amounts from line 2 of Form 2439, Notice to Shareholder of Undistributed Long-Term Capital Gains, and line 17 of Form 4136, Credit for Federal Tax Paid on Fuels.

The credit for tax paid on undistributed capital gains of a RIC or a REIT and the refundable credit for fuel used for certain purposes are allowed to the ELP. They are not separately reported to partners.

## **Line 28**

You can e-file Form 1065-B and e-pay the balance due in a single step by authorizing an electronic funds withdrawal from your bank account when filing.

**Electronic deposit requirement.** ELPs must use electronic funds transfer to make all federal tax deposits (such as deposits of

employment tax, excise tax, and income tax). Forms 8109 and 8109-B, Federal Tax Deposit Coupon, cannot be used. Generally, electronic fund transfers are made using the Electronic Federal Tax Payment System (EFTPS). If you do not want to use EFTPS, you can arrange for your tax professional, financial institution, payroll service, or other trusted third party to make deposits on your behalf.

To get more information about EFTPS or to enroll in EFTPS, visit [www.eftps.gov](http://www.eftps.gov) or call 1-800-555-4477. Also see Publication 966, Electronic Federal Tax Payment System "A Guide To Getting Started."

## **Part II. Taxable Income or Loss From Other Activities**

Report in Part II only income or (loss) and deductions from activities not included in Part I (for example, portfolio income and deductions). See *Other Activities* for a definition of portfolio income.

## Line 1

Enter only taxable interest (not from passive loss limitation activities) on line 1.

Include interest income from the credit to holders of tax credit bonds. See the Instructions for Form 8912 for details.

**Schedule K-1.** Enter each partner's distributive share of interest income in box 5 of Schedule K-1. If the partnership is reporting interest income from clean renewable energy bonds, or Midwestern tax credit bonds, attach a statement to Schedule K-1 that shows each partner's distributive share of interest income from these credits. Partners need this information to properly adjust the basis of their interest in the partnership.

## Lines 2a Through 2c

Enter only taxable ordinary dividends on line 2a. On line 2b enter all qualified dividends from line 2a.

**Qualified dividends.** Except as provided below, qualified dividends are dividends

received after December 31, 2002, from domestic corporations and qualified foreign corporations.

***Exceptions.*** The following dividends are not qualified dividends.

- Dividends the ELP received on any share of stock held for less than 61 days during the 121-day period that began 60 days before the ex-dividend date. When determining the number of days the partnership held the stock, it cannot count certain days during which the partnership's risk of loss was diminished. The ex-dividend date is the first date following the declaration of a dividend on which the purchaser of a stock is not entitled to receive the next dividend payment. When counting the number of days the ELP held the stock, include the day the ELP disposed of the stock but not the day the ELP acquired it.
- Dividends attributable to periods totaling more than 366 days that the partnership received on any share of preferred stock held for less than 91 days during the 181-

day period that began 90 days before the ex-dividend date. When determining the number of days the partnership held the stock, do not count certain days during which the partnership's risk of loss was diminished. Preferred dividends attributable to periods totaling less than 367 days are subject to the 61-day holding period rule above.

- Dividends that relate to payments that the partnership is obligated to make with respect to short sales or positions in substantially similar or related property.
- Dividends paid by a regulated investment company that are not treated as qualified dividend income under section 854.
- Dividends paid by a real estate investment trust that are not treated as qualified dividend income under section 857(c).
- See Pub. 550 for more details.

***Qualified foreign corporation.*** A foreign corporation is a qualified foreign corporation if it is:

1. Incorporated in a possession of the United States or
2. Eligible for benefits of a comprehensive income tax treaty with the United States that the Secretary determines is satisfactory for this purpose and that includes an exchange of information program. See Notice 2006-101, 2006-47 I.R.B. 930, for details.

If the foreign corporation does not meet either 1 or 2, then it can be treated as a qualified foreign corporation for any dividend paid by the corporation if the stock associated with the dividend paid is readily tradable on an established securities market in the United States.

However, qualified dividends do not include dividends paid by a passive foreign investment company (defined in section 1297).

Report the qualified dividend on line 3 of Schedule K. See Pub. 550 and Notice 2006-3, 2006-3 I.R.B. 306, for more details.

## **Line 5**

Report and identify other income or (loss) on an attachment for line 5.

## **Line 7**

Investment interest is interest paid or accrued on debt properly allocable to property held for investment. Property held for investment includes property that produces income (unless derived in the ordinary course of a trade or business) from interest, dividends, annuities, or royalties, and gains from the disposition of property that produces those types of income or is held for investment. Investment interest does not include interest expense allocable to passive loss limitation activities.

To figure the deductible amount of investment interest, complete Form 4952. Enter the amount from line 8 of Form 4952.

## **Line 8**

Include state and local income taxes paid by the ELP that would be allowed as itemized deductions on any partners' income tax



returns if they were paid directly by the partner for the same purpose.

## **Line 9**

Enter contributions or gifts actually paid during the tax year to or for the use of charitable and governmental organizations described in section 170(c). The total amount claimed may not be more than 10% of the ELP's taxable income (total income minus deductions) figured without regard to the deduction for charitable contributions. The deduction for certain contributions of ordinary income and capital gain property is reduced under section 170(e).

**Substantiation requirements.** Generally, no deduction is allowed for any contribution of \$250 or more unless the partnership obtains a written acknowledgment from the charitable organization that shows the amount of cash contributed, describes any property contributed, and gives an estimate of the value of any goods or services provided in return for the contribution. The acknowledgment must be obtained by the due date (including extensions) of the ELP's return

or, if earlier, the date the partnership files its return. Do not attach the acknowledgment to the tax return, but keep it with the partnership's records. These rules apply in addition to the filing requirements for Form 8283, Noncash Charitable Contributions, discussed below.

**Contributions of property.** If the deduction claimed for noncash contributions exceeds \$500, complete Form 8283 and attach to Form 1065-B. See Pub. 526, Charitable Contributions, and Form 8283 for more information.

If the ELP made a qualified conservation contribution, under section 170(h), include the FMV of the underlying property before and after the donation, as well as the type of legal interest contributed, and describe the conservation purpose furthered by the donation.

***Conservation contributions of agricultural or livestock production property.*** Generally, conservation contributions of property used in (or available for) agricultural or livestock production made

by an ELP that is a qualified farmer or rancher (as defined in section 170(b)(1)(E) (v)) are not subject to the 10% taxable income limit. Instead, the deduction for these contributions is allowed to the extent it does not exceed the excess of the partnership's taxable income over the amount of allowable charitable contributions. The carryover period for conservation contributions of agricultural or livestock production property exceeding the taxable income limitation is 15 years.

***Charitable contributions of food***

***inventory.*** The deduction for the charitable contribution made before 2014 under section 170(e)(3) of qualified food inventory that was donated for the care of the ill, needy, and infants (see section 170(e)(3)(C)). To qualify for the deduction, the food must meet all the quality and labeling standards imposed by federal, state, and local laws and regulations. The amount of the charitable contribution for donated food inventory is the lesser of (a) the basis of the donated food plus one-half of the appreciation (gain if the donated food were sold at fair market value on the date of the

gift) or (b) twice the amount of basis of the donated food.

The ELP's deduction for food inventory contributions cannot exceed 10% of the ELP's aggregate net income for the tax year from the business activities from which the food inventory contribution was made (including your share of net income from another partnership or S corporation businesses that made food inventory contributions that were passed through to the ELP as a partner or shareholder).

***Contributions of used vehicles.*** Special rules apply to contributions of used motor vehicles, boats, or airplanes with a claimed value of more than \$500. See section 170(f)(12).

***Reduced deduction for contributions of certain property.*** For a charitable contribution of property, the ELP must reduce the contribution by the sum of:

- The ordinary income and short-term capital gain that would have resulted if the property were sold at its FMV and

- For certain contributions, the long-term capital gain that would have resulted if the property were sold at its FMV.

The reduction for the long-term capital gain applies to:

- Contributions of tangible personal property for use by an exempt organization for a purpose or function unrelated to the basis for its exemption,
- Contributions of any property to or for the use of certain private foundations except for stock for which market quotations are readily available (section 170(e)(5)), and
- Any patent or certain other intellectual property contributed after June 3, 2004. See section 170(e)(1)(B). However, the partnership can deduct certain qualified donee income from this property. See section 170(m).

**Nondeductible contributions.** Certain contributions made to an organization conducting lobbying activities are not deductible. See section 170(f)(9) for more details.

## **Lines 10a and 10b**

Enter on line 10a miscellaneous itemized deductions as defined in section 67(b). These deductions include expenses for the production or collection of income under section 212, such as investment advisory fees, subscriptions to investment advisory publications, and the cost of safe deposit boxes. Multiply line 10a by 30% (.30) and enter the result on line 10b. The remaining 70% of the amount on line 10a is not allowed as a deduction to the partnership or its partners.

## **Line 11**

Other allowable deductions include items such as:

- Real estate taxes and personal property taxes on investment property,
- Casualty and theft losses on income-producing property, and
- Any penalty on the early withdrawal of savings.

Attach a statement for line 11 listing the type and amount of each allowable deduction for which there is no separate line in Part II of Form 1065-B.

## **Schedule B. Other Information**

### **Question 1**

Check box 1f for any other type of entity and state the type.

### **Question 3**

The partnership must answer “Yes” if during the tax year:

- It owned an interest in another partnership (foreign or domestic) or
- It was the “tax owner” of a foreign disregarded entity (FDE) under Regulations sections 301.7701-2 and 301.7701-3. The tax owner of an FDE is the person that is treated as owning the assets and liabilities of the FDE for purposes of U.S. income tax law.

If the partnership answered “Yes” to this question, it must do the following.

1. Show each partnership's name, EIN (if any), and the country under whose laws the partnership was organized, on an attached statement, if the partnership directly or indirectly owned at least a 10% interest in any other foreign or domestic partnership (other than any partnership for which a Form 8865 is attached to the tax return).
2. Complete and attach Form 8858, Information Return of U.S. Persons With Respect To Foreign Disregarded Entities, for each FDE. For more information, see the Instructions for Form 8858.

**Note.** Clearly indicate whether each entity in the attached statement is a partnership or a disregarded entity.

## **Question 4. Foreign Partners**

Answer “Yes” if the ELP had any foreign partners (for purposes of section 1446) at any



time during the tax year. Otherwise, answer "No."

If the ELP had gross income effectively connected with a trade or business in the United States and foreign partners, it may be required to withhold tax under section 1446 on income allocable to foreign partners (without regard to distributions) and file Forms 8804, 8805, and 8813. See Regulations sections 1.1446-1 through 7 for more information.

## **Question 5**

Answer "Yes" if interests in the partnership are traded on an established securities market or are readily tradable on a secondary market (or its substantial equivalent).

## **Question 6**

Answer "Yes" if the ELP filed, or is required to file, a return under section 6111 to provide information on any reportable transaction by a material advisor. Use Form 8918, Material Advisor Disclosure Statement, to provide the

information. See the Instructions for Form 8918.

## **Question 7. Foreign Accounts**

Answer "Yes" if either 1 or 2 below applies to the ELP. Otherwise, check the "No" box.

1. At any time during the 2013 calendar year the partnership had an interest in or signature or other authority over a bank account, securities account, or other financial account in a foreign country (see FinCEN Form 114, Report of Foreign Bank and Financial Accounts (FBAR), formerly TD F 90-22.1) and
  - The combined value of the accounts was more than \$10,000 at any time during the calendar year and
  - The accounts were not with a U.S. military banking facility operated by a U.S. financial institution.
2. The ELP owns more than 50% of the stock in any corporation that would answer the question "Yes" based on item 1 above.

If you checked the “Yes” box for the question:

- Enter the name of the foreign country or countries. Attach a separate statement if more space is needed.
- File FinCEN Form 114 electronically at the FinCEN website,  
*[bsaefiling.fincen.treas.gov/main.html](https://bsaefiling.fincen.treas.gov/main.html)*.

## **Question 8**

The ELP may be required to file Form 3520, Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts, if:

- It directly or indirectly transferred property or money to a foreign trust. For this purpose, any U.S. person who created a foreign trust is considered a transferor.
- It is treated as the owner of any part of the assets of a foreign trust under the grantor trust rules.
- It received a distribution from a foreign trust.

For more information, see the Instructions for Form 3520.

**Note.** An owner of a foreign trust must ensure that the trust files an annual information return on Form 3520-A, Annual Information Return of Foreign Trust With a U.S. Owner.

## **Schedule D. Capital Gains and Losses**

### **Purpose of Schedule**

Use the Schedule D to report:

- Certain transactions the ELP does not have to report on Form 8949.
- The overall capital gains and losses from transactions listed on Form 8949.
- Capital gains from installment sales from Form 6252, Installment Sale Income.
- Capital gains and losses from like-kind exchange from Form 8824, Like-Kind Exchanges (and section 1043 conflict-of-interest sales).

- Partnership's share of net capital gains and losses, including specially allocated capital gains and losses, from partnerships, estates, and trusts.

Do not report on Schedule D capital gains (losses) specially allocated to any partners. Enter specially allocated capital gains (losses) directly on line 4a or 4b of Schedule K, or on an attached statement for line 15 of Schedule K and in box 3, 4, or 9 of Schedule K-1, whichever applies. See *How Income Is Shared Among Partners*, earlier.

**Note.** For more information, see Pub. 544, Sales and Other Dispositions of Assets, and Instructions for Form 8949. Do **not** report on Schedule D gains or losses from the sale or exchange of qualified preferred stock of the Federal National Mortgage Association (Fannie Mae) or the Federal Home Loan Mortgage Corporation (Freddie Mac). Instead, each partner's distributive share of such gains and losses must be reported as a separately stated item in box 9 of Schedule K-1 using Code V. See item 21, *Other information (Code V)*, for more information.

# What are Capital Assets?

Each item of property the partnership held (whether or not connected with its trade or business) is a capital asset except the following.

- Stock in trade or other property included in inventory or held mainly for sale to customers.
- Accounts or notes receivable acquired in the ordinary course of the trade or business for services rendered or from the sale of stock in trade or other property held mainly for sale to customers.
- Depreciable or real property used in the trade or business, even if it is fully depreciated.
- Certain copyrights; literary, musical, or artistic compositions; letters or memoranda; or similar property. See section 1221(a)(3).
- U.S. Government publications, including the Congressional Record, that the partnership received from the

Government, other than by purchase at the normal sales price, or that the partnership got from another taxpayer who had received it in a similar way, if the partnership's basis is determined by reference to the previous owner.

- Certain commodities derivative financial instruments held by a dealer. See section 1221(a)(6).
- Certain hedging transactions entered into in the normal course of the trade or business. See section 1221(a)(7).
- Supplies regularly used in the trade or business.

## **Overview of Large Partnership Provisions**

For ELPs, capital gains and losses generally are netted at the partnership level. A partner in a large partnership takes into account separately his distributive share of the partnership's net capital gain or net capital loss. Such net capital gain (loss) is treated as

long-term capital gain (loss). The 28% rate gain (loss) is treated in the same manner.

Any excess of net short-term capital gain over net long-term capital loss is not separately stated. Instead, it is consolidated with the partnership's other taxable income.

A partner's distributive share is divided between passive loss limitation activities and other activities. Capital gain (loss) is allocated to passive loss limitation activities to the extent that it is from sales and exchanges of property used in connection with a trade or business or rental activity. Any excess is allocated to other activities (that is, portfolio income).

Section 1231 gains are also netted at the partnership level. The net gain is generally treated as long-term capital gain. The net loss is treated as an ordinary loss and is included in computing the partnership's taxable income.

## **Items for Special Treatment**

- Use Form 4797, Sales of Business Property, to report **(a)** sales or exchanges



of property used in a trade or business, **(b)** sales or exchanges of depreciable or amortizable property, **(c)** sales or other dispositions of securities or commodities held in connection with a trading business, if the partnership made a mark-to-market election, **(d)** involuntary conversions (other than from casualties or thefts), and **(e)** the disposition of noncapital assets (other than inventory or property held primarily for sale to customers in the ordinary course of a trade or business).

- Use Form 4684, Casualties and Thefts, to report involuntary conversions of property due to a casualty or theft.
- Gains and losses from section 1256 contracts and straddles are reported on Form 6781, Gains and Losses From Section 1256 Contracts and Straddles.
- An exchange of business or investment property for property of a like kind is reported on Form 8824, Like-Kind Exchanges.

- Transactions by a securities dealer. See section 1236.
- See Pub. 550, Investment Income and Expenses, for information on bonds and other debt instruments.
- For certain real estate subdivided for sale that may be considered a capital asset, see section 1237.
- Gain on the sale of depreciable property to a more-than-50%-owned entity, or to a trust in which the partnership is a beneficiary, is treated as ordinary gain.
- For liquidating distributions from a corporation, see Pub. 550.
- See section 1248 for gain on the sale or exchange of stock in certain foreign corporations.
- For gain or loss on options to buy or sell, including closing transactions, see Pub. 550.
- Gain or loss from a short sale of property. See Pub. 550 for details.

- For undistributed capital gains from a RIC or a REIT, the partnership will receive information on Form 2439, Notice to Shareholder of Undistributed Long-Term Capital Gains.
- See section 84 for the transfer of property to a political organization if the FMV of the property exceeds the partnership's adjusted basis in such property.
- Any loss on the disposition of converted wetland or highly erodible cropland that is first used for farming after March 1, 1986, is reported as a long-term capital loss on Form 8949/Schedule D, but any gain on such a disposition is reported as ordinary income on Form 4797. See section 1257 for details.
- See Rev. Rul. 84-111, 1984-2 C.B. 88, for the transfer of partnership assets and liabilities to a newly formed corporation in exchange for all of its stock.
- See section 897 for the disposition of foreign investment in a U.S. real property interest.

- Any loss from a sale or exchange of property between the partnership and certain related persons is not allowed, except for distributions in a complete liquidation of a corporation. See sections 267 and 707(b) for details.
- Any loss from securities that are capital assets that become worthless during the year is treated as a loss from the sale or exchange of a capital asset on the last day of the tax year.
- Nonrecognition of gain on sale of stock to an employee stock ownership plan (ESOP) or an eligible cooperative. See section 1042 and Temporary Regulations section 1.1042-1T for rules under which the partnership can elect not to recognize gain from the sale of certain stock to an ESOP or an eligible cooperative.
- A nonbusiness bad debt must be treated as a short-term capital loss and can be deducted only in the year the debt becomes totally worthless. See Pub. 550 for more details.

- Any loss from a wash sale of stock or securities (including contracts or options to acquire or sell stock or securities) cannot be deducted unless the partnership is a dealer in stock or securities and the loss was sustained in a transaction made in the ordinary course of the partnership's trade or business. A wash sale occurs if the partnership acquires (by purchase or exchange), or has a contract or option to acquire, substantially identical stock or securities within 30 days before or after the date of the sale or exchange. See section 1091. Report a wash sale transaction on Form 8949, Part I or II (with the appropriate box checked), depending on how long the ELP owned the stock or securities. Enter "W" in column (f) and enter as a positive number in column (g) the amount of the loss not allowed. Complete all remaining columns. See the Instructions for Form 8949.
- Gain from installment sales. If the partnership sold property at a gain and it will receive a payment in a tax year after the year of sale, it generally must report

the sale on the installment method unless it elects not to. However, the installment method cannot be used to report sales of stock or securities traded on an established securities market. Use Form 6252 to report the sale on the installment method. Also use Form 6252 to report any payment received during the tax year from a sale made in an earlier year that was reported on the installment method.

- If the ELP wants to elect out of the installment method, it must report the full amount of the gain on a timely filed return (including extensions). If the partnership filed Form 1065-B on time, the election can be made on an amended return filed no later than 6 months after the due date (excluding extensions) of the original return. Write "See attached Form 8082 for AAR per IRC section 6251; Filed pursuant to section 301.9100-2" in the top margin of the amended return, and file it at the same address the original return was filed. See *Administrative Adjustment Requests*, earlier.

- A sale or other disposition of an interest in a partnership owning unrealized receivables or inventory items may result in ordinary gain or loss. See Pub. 541, Partnerships, for more details.
- Certain constructive ownership transactions. Gain in excess of the gain that would have been recognized if the partnership had held a financial asset directly during the term of a derivative contract must be treated as ordinary income. See section 1260 for details.

**Constructive sale treatment for certain appreciated positions.** Generally, the ELP must recognize gain (but not loss) on the date it enters into a constructive sale of any appreciated position in stock, a partnership interest, or certain debt instruments as if the position were disposed of at FMV on that date.

The ELP is treated as making a constructive sale of an appreciated position when it (or a related person, in some cases) does one of the following.

- Enters into a short sale of the same or substantially identical property (that is, a “short sale against the box”).
- Enters into an offsetting notional principal contract relating to the same or substantially identical property.
- Enters into a futures or forward contract to deliver the same or substantially identical property.
- Acquires the same or substantially identical property (if the appreciated position is a short sale, offsetting notional principal contract, or a futures or forward contract).

***Exception.*** Generally, constructive sale treatment does not apply if:

- The partnership closed the transaction before the end of the 30th day after the end of the year in which it was entered into,
- The partnership held the appreciated position to which the transaction relates



throughout the 60-day period starting on the date the transaction was closed, and

- At no time during that 60-day period was the partnership's risk of loss reduced by holding certain other positions.

For details and other exceptions to these rules, see Pub. 550.

### **Special rules for traders in securities.**

Traders in securities are engaged in the business of buying and selling securities for their own account. To be engaged in business as a trader in securities, the ELP must meet all the following conditions.

- The ELP must seek to profit from daily market movements in the prices of securities and not from dividends, interest, or capital appreciation.
- The ELP's trading activity must be substantial.
- The ELP must carry on the activity with continuity and regularity.

The following facts and circumstances should be considered in determining if an ELP's activity is a business.

- Typical holding periods for securities bought and sold.
- The frequency and dollar amount of the ELP's trades during the year.
- The extent to which the partners pursue the activity to produce income for a livelihood.
- The amount of time devoted to the activity.

Like an investor, a trader must report each sale of securities (taking into account commissions and any other costs of acquiring or disposing of the securities) on Form 8949/Schedule D or an attached statement containing all the same information for each sale in a similar format. However, if a trader made the mark-to-market election, each transaction is reported in Part II of Form 4797 instead of Form 8949/Schedule D. Regardless of whether a trader reports its gains and losses on Form 8949/Schedule D or Form

4797, the gain or loss from the disposition of securities is not taken into account when figuring net earnings from self-employment on Schedules K and K-1. See section 1402(i) for an exception that applies to section 1256 contracts.

The limitation on investment interest expense that applies to investors does not apply to interest paid or incurred in a trading business. A trader reports interest expense and other expenses (excluding commissions and other costs of acquiring or disposing of securities) from a trading business in Part I of Form 1065-B.

A trader also can hold securities for investment. The rules for investors generally will apply to those securities. Allocate interest and other expenses between the partnership's trading business and its investment securities. Investment interest expense is reported on line 7 of Part II, Form 1065-B.

**Rollover of gain from qualified stock.** If the partnership sold qualified small business stock (defined later) it held for more than 6 months, it can postpone gain if it purchased

other qualified small business stock during the 60-day period that began on the date of the sale. The partnership must recognize gain to the extent the sale proceeds exceed the cost of the replacement stock. Reduce the basis of the replacement stock by any postponed gain.

If the partnership chooses to postpone gain, report the sale on Form 8949, Part I or II (with the appropriate box checked), as it would be reported if the election was not made. Then enter "R" in column (f). Enter the amount of the postponed gain as a negative number (in parentheses) in column (g). See the Instructions for Form 8949.

Attach a statement to Form 1065-B that (a) identifies the replacement qualified small business stock, (b) shows the computation of the adjustment to the partnership's basis in the replacement stock for the amount of any postponed gain under section 1045, and (c) shows the dates on which the replacement stock was acquired by the ELP.



*The ELP also must separately state the amount of the gain rolled over on*

*qualified stock under section 1045 on an attachment to Form 1065-B, Schedule K, line 15. Each partner must determine if he or she qualifies for the rollover at the partner level or if he or she wants to opt out of the section 1045 election. Also, the partnership must separately state on that line any gain that would qualify for the section 1045 rollover at the partner level instead of the partnership level (because a partner was entitled to purchase replacement stock) and any gain on qualified stock that could qualify for an exclusion under section 1202.*

To be qualified small business stock, the stock must meet all of the following tests.

- It must be stock in a C corporation (that is, not S corporation stock).
- It must have been originally issued after August 10, 1993.
- As of the date the stock was issued, the corporation was a qualified small business. A qualified small business is a domestic C corporation with total gross assets of \$50 million or less (a) at all times after August

9, 1993, and before the stock was issued, and (b) immediately after the stock was issued. Gross assets include those of any predecessor of the corporation. All corporations that are members of the same parent-subsidary controlled group are treated as one corporation.

- The partnership must have acquired the stock at its original issue (either directly or through an underwriter), either in exchange for money or other property or as pay for services (other than as an underwriter) to the corporation. In certain cases, the partnership can meet the test if it acquired the stock from another person who met this test (such as by gift or inheritance) or through a conversion or exchange of qualified small business stock held by the partnership.
- During substantially all the time the partnership held the stock:
  1. The corporation was a C corporation,
  2. At least 80% of the value of the corporation's assets were used in the

active conduct of one or more qualified businesses (defined below), and

3. The issuing corporation was not a foreign corporation, domestic international sales corporation (DISC), former DISC, interest charge domestic international sales corporation (IC-DISC), former IC-DISC, corporation that has made (or that has a subsidiary that has made) a section 936 election, regulated investment company (RIC), real estate investment trust (REIT), real estate mortgage investment conduit (REMIC), financial asset securitization investment trust (FASIT), or cooperative.

**Note.** A specialized small business investment company (SSBIC) is treated as having met test 2 above.

A qualified business is any business other than the following.

- One involving services performed in the fields of health, law, engineering, architecture, accounting, actuarial science,

performing arts, consulting, athletics, financial services, or brokerage services.

- One whose principal asset is the reputation or skill of one or more employees.
- Any banking, insurance, financing, leasing, investing, or similar business.
- Any farming business (including raising or harvesting of trees).
- Any business involving the production of products for which percentage depletion can be claimed.
- Any business of operating a hotel, motel, restaurant, or similar business.

**Exclusion of gain from DC Zone assets.** If the ELP sold or exchanged a District of Columbia Enterprise Zone (DC Zone) asset that it held for more than 5 years, it may be able to exclude the qualified capital gain. The DC Zone asset must have been acquired after 1997, but before 2012, to qualify as an asset for which the partnership may be able to take



the exclusion. The sale or exchange of DC Zone capital assets include the following.

- Stock in a domestic corporation that was a DC Zone business.
- Interest in a partnership that was a DC Zone business.

Report the sale or exchange of property used in the partnership's DC Zone business on Form 4797.

***Gains not qualified for exclusion.*** The following gains do not qualify for the exclusion of gain from DC Zone assets.

- Gain on the sale of an interest in a partnership which is a DC Zone business attributable to unrecaptured section 1250 gain. See the instructions for line 15 of Schedule K for information on how to report unrecaptured section 1250 gain.
- Gain on the sale of an interest in a partnership or S corporation, which is a DC Zone business, attributable to real property or an intangible asset which is

not an integral part of the DC Zone business.

- Gain from a related-party transaction. See *Sales and Exchanges Between Related Persons* in Pub. 544.
- See section 1400B for more details on DC Zone assets and special rules.

***How to report.*** Report the sale or exchange on Form 8949, Part II (with the appropriate box checked), as it would be reported if the exclusion was not taken. Enter "X" in column (f) and enter the amount of the exclusion as a negative number (in parentheses) in column (g). See the Instructions for Form 8949.

**Undistributed long-term gains from a regulated investment company (RIC) or real estate investment trust (REIT).**

Report the partnership's share of long-term gains from Form 2439, Notice to Shareholder of Undistributed Long-Term Capital Gains, on Form 8949, Part II (with box F checked).

Enter "From Form 2439" in column (a). Enter the gain in column (h). Leave all other

columns blank. See the Instructions for Form 8949.

## **Specific Instructions**

Complete all necessary pages of Form(s) 8949 before completing lines 1b, 2, 3, 8b, 9, or 10 of Schedule D.

## **Rounding Off to Whole Dollars**

Cents can be rounded to whole dollars on the Schedule D. If cents are rounded to whole dollars, all amounts must be rounded. To round, drop cent amounts under 50 and increase cent amounts over 49 to the next dollar. For example, \$1.49 becomes \$1 and \$1.50 becomes \$2.

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

## **Lines 1a and 8a—Transaction Not Reported on Form 8949**

The partnership can report on line 1a (for short-term transactions) or line 8a (for long-

term transactions) the aggregate totals from any transactions (except sales of collectibles) for which:

- The partnership received a Form 1099-B (or substitute statement) that shows basis was reported to the IRS and does not show a nondeductible wash sale loss in box 5, and
- The partnership does not need to make any adjustments to the basis or type of gain or loss (short term or long term) reported on Form 1099-B (or substitute statement), or to its gain or loss. See *How To Complete Form 8949, Columns (f) and (g)*, in the Form 8949 instructions for details about possible adjustments to the partnership's gain or loss.

If the partnership chooses to report these transactions on lines 1a and 8a, do not report them on Form 8949.

Figure gain or loss on each line. Subtract the cost or other basis in column (e) from the proceeds (sales price) in column (d). Enter

the gain or loss in column (h). Enter negative amounts in parentheses.

***Example 1—basis reported to the IRS.***

The partnership received a Form 1099-B reporting the sale of stock held for 3 years and showing proceeds (in box 2a) of \$6,000 and cost or other basis (in box 3) of \$2,000. Box 6b is checked, meaning that basis was reported to the IRS. The partnership does not need to make any adjustments to the amounts reported on Form 1099-B or enter any codes. This was its only 2013 transaction. Instead of reporting this transaction on Form 8949, the partnership can enter \$6,000 in column (d), \$2,000 in column (e), and \$4,000 (\$6,000 – \$2,000) in column (h).

***Example 2—basis not reported to the***

***IRS.*** . The partnership received a Form 1099-B showing proceeds (in box 2a) of \$6,000 and cost or other basis (in box 3) of \$2,000. Box 6b is not checked, meaning that basis was not reported to the IRS. Do not report this transaction on line 1a or line 8a. Instead, report the transaction on Form 8949. Complete all necessary pages of Form 8949

before completing line 1b, 2, 3, 8b, 9, or 10 of Schedule D.

***Example 3—adjustment.*** The partnership received a Form 1099-B showing proceeds (in box 2a) of \$6,000 and cost or other basis (in box 3) of \$2,000. Box 6b is checked, meaning that basis was reported to the IRS. However, the basis shown in box 3 is incorrect. Do not report this transaction on line 1a or line 8a. Instead, report the transaction on Form 8949. See the instructions for Form 8949, columns (f), (g), and (h). Complete all necessary pages of Form 8949 before completing line 1b, 2, 3, 8b, 9, or 10 of Schedule D.

### **Lines 1b, 2, 3, 8b, 9, and 10, Column (h)—Transactions Reported on Form 8949**

Figure gain or loss on each line. First, subtract cost or other basis (column (e)) from proceeds/sales price (column (d)). Then combine the result with any adjustments in column (g). Enter the gain or loss in column (h). Enter negative amounts in parentheses.

**Example 1—gain.** Column (d) is \$6,000 and column (e) is \$2,000. Enter \$4,000 in column (h).

**Example 2—loss.** Column (d) is \$6,000 and column (e) is \$8,000. Enter (\$2,000) in column (h).

**Example 3—adjustment.** Column (d) is \$6,000, column (e) is \$2,000, and column (g) is (\$1,000). Enter \$3,000 ( $\$6,000 - \$2,000 - \$1,000$ ) in column (h).

## **Line 14—Capital Gains and Losses From Other Partnerships, Estates, and Trusts**

See the Schedule K-1 or other information supplied to the ELP by the other partnership, estate, or trust.

## **Part IV-Net Capital Gain (Loss) From Passive Loss Limitation Activities**

**Line 21.** Redetermine the amount on line 18 by taking into account only gains and losses from passive loss limitation activities.

# **Schedules K and K-1. Partners' Shares of Income, Credits, Deductions, etc.**

## **Purpose of Schedules**

The partners are liable for tax on their shares of the partnership income, whether or not distributed, and must include their shares on their tax returns.

**Schedule K** (page 4 of Form 1065-B) is a summary schedule of all the partners' shares of the partnership's income, credits, deductions, etc.

**Schedule K-1** (Form 1065-B) shows each partner's separate share. Attach a copy of each Schedule K-1 to the Form 1065-B filed with the IRS. Keep a copy with a copy of the partnership return as a part of the partnership's records and furnish a copy to each partner. If a partnership interest is held by a nominee on behalf of another person, the partnership may be required to furnish Schedule K-1 to the nominee. See Temporary



Regulations sections 1.6031(b)-1T and 1.6031(c)-1T for more information.

Give each partner a copy of either the Partner's Instructions for Schedule K-1 (Form 1065-B) or specific instructions for each item reported on the partner's Schedule K-1 (Form 1065-B).

## **Substitute Forms**

The partnership does not need IRS approval to use a substitute Schedule K-1 if it is an exact copy of the IRS schedule. The boxes must use the same numbers and titles and must be in the same order and format as on the comparable IRS Schedule K-1. The substitute schedule must include the OMB number. The partnership must provide each partner with the Partner's Instructions for Schedule K-1 (Form 1065-B) or other prepared specific instructions for each item reported on the partner's Schedule K-1.

The partnership must request IRS approval to use other substitute Schedules K-1. To request approval, write to Internal Revenue Service, Attention: Substitute Forms Program,

SE:W:CAR:MP:T:M:S, 1111 Constitution Avenue NW, IR-6526, Washington, DC 20224.

Each partner's information must be on a separate sheet of paper. Therefore, separate all continuously printed substitutes before you file them with the IRS.

The partnership may be subject to a penalty if it files Schedules K-1 that do not conform to the specifications discussed in Pub. 1167, General Rules and Specifications for Substitute Forms and Schedules.

## **How Income Is Shared Among Partners**

Generally, allocate shares of income, gain, loss, deduction, or credit among the partners according to the partnership agreement for sharing income or loss. However, partners can agree to allocate specific items in a ratio different from the ratio for sharing income or loss.

In determining the amounts required to be separately taken into account by a partner, those provisions of the large partnership rules

governing computation of taxable income are applied separately with respect to that partner by taking into account that partner's distributive share of the partnership's items of income, gain, loss, deduction, or credit. This rule permits partnerships to make otherwise valid special allocations of partnership items to partners.

Report the specially allocated items in the appropriate box of the applicable partner's Schedule K-1 and the total on the appropriate line of Schedule K, instead of on Parts I or II of Form 1065-B or Form 1125-A, or Schedules D. For example, specially allocated net capital gain from passive activities is entered in box 4a of Schedule K-1, and the total is entered on line 4a of Schedule K, along with any net capital gain from line 21 of Schedule D.

If a partner's interest changed during the year, see section 706(d) before determining each partner's distributive share of any item of income, gain, loss, deduction, etc. Income (loss) is allocated to a partner only for the part of the year in which that person is a

member of the partnership. The partnership will either allocate on a daily basis or divide the partnership year into segments and allocate income, loss, or special items in each segment among the persons who were partners during that segment. Partnerships that report their income on the cash basis must allocate interest expense, taxes, and any payment for services or for the use of property on a daily basis if there is any change in any partner's interest during the year.

Special rules on the allocation of income, gain, loss, and deductions generally apply if a partner contributes property to the partnership and the FMV of that property at the time of contribution differs from the contributing partner's adjusted tax basis. Under these rules, the partnership must use a reasonable method of making allocations of income, gain, loss, and deductions from the property so that the contributing partner receives the tax burdens and benefits of any built-in gain or loss (for example, precontribution appreciation or diminution of value of the contributed property).

See Regulations section 1.704-3 for details on how to make these allocations, including a description of specific allocation methods that are generally reasonable.

See *Dispositions of Contributed Property*, earlier, for special rules on the allocation of income, gain, loss, and deductions on the disposition of property contributed to the partnership by a partner.

If the partnership agreement does not provide for the partner's share of income, gain, loss, deduction, or credit, or if the allocation under the agreement does not have substantial economic effect, the partner's share is determined according to the partner's interest in the partnership. See Regulations section 1.704-1 for more information.

## **Specific Instructions for Schedules K and K-1**

Generally, the ELP is required to prepare and give a Schedule K-1 to each person who was a partner in the partnership at any time during the year.

However, if a foreign partnership meets each of the following four requirements, it is not required to file or provide Schedule K-1 for foreign partners (unless the foreign partner is a pass-through entity through which a U.S. person holds an interest in the foreign partnership).

- The partnership had no gross income effectively connected with the conduct of a trade or business within the United States during its tax year.
- All required Forms 1042 and 1042-S were filed by the partnership or another withholding agent as required by Regulations sections 1.1461-1(b) and (c).
- The tax liability of each partner for amounts reportable under Regulations sections 1.1461-1(b) and (c) has been fully satisfied by the withholding of tax at the source.
- The partnership is not a withholding foreign partnership as defined in Regulations section 1.1441-5(c)(2)(i).