



## Instructions for Form 8865

### Return of U.S. Persons With Respect to Certain Foreign Partnerships

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

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Schedule K	13	more than \$1 million but less than or	
Schedule K-1	13	equal to \$10 million may be able to adopt	
Specific Instructions (Schedules		or change to the cash method of	
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Income (Loss)	13	partnerships prohibited from using the	
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more details, including change in accounting method requirements, see Notice 2001-76, 2001-52 I.R.B. 614.

## General Instructions

### Purpose of Form

Use Form 8865 to report the information required under section 6038 (reporting with respect to controlled foreign partnerships), section 6038B (reporting of transfers to foreign partnerships), or section 6046A (reporting of acquisitions, dispositions, and changes in foreign partnership interests).

### Who Must File

A U.S. person qualifying under one or more of the **Categories of Filers** below must complete and file Form 8865. These instructions and the **Filer Categories - Required Information** chart on page 2 explain the information, statements, and schedules required for each category of filer. If you qualify under more than one category for a particular foreign partnership, you must submit all the items required for all categories under which you qualify. For example, if you qualify as a Category 2 and a Category 3 filer, you must submit all the schedules required of Category 2 filers (page 1 of Form 8865, Schedules A, A-2, N, and K-1) plus any additional schedules that Category 3 filers are required to submit (Schedules A-1 and O).

Complete a **separate** Form 8865 and the applicable schedules for **each** foreign partnership for which you qualify under at least one of the categories of filers.

File the 2001 Form 8865 with your income tax return for your tax year beginning in 2001.

### Categories of Filers

**Category 1 filer.** A Category 1 filer is a U.S. person who controlled the foreign partnership at any time during the partnership's tax year. Control of a partnership is ownership of more than a 50% interest in the partnership. See the definition of 50% interest on page 4. There may be more than one Category 1 filer for a partnership for a particular partnership tax year.

**Category 2 filer.** A Category 2 filer is a U.S. person who at any time during the tax year of the foreign partnership owned a 10% or greater interest in the partnership while the partnership was controlled by U.S. persons owning at

Filer Categories – Required Information	Category 1	Category 2	Category 3	Category 4
Identifying information—(page 1 of Form 8865)	✓	✓	✓	✓
Schedule A—Constructive Ownership of Partnership Interest	✓	✓	✓	✓
Schedule A-1—Certain Partners of Foreign Partnership	✓		✓	
Schedule A-2—Affiliation Schedule	✓	✓	✓	✓
Schedule B—Income Statement—Trade or Business Income	✓			
Schedule D—Capital Gains and Losses	✓			
Schedule K—Partners’ Shares of Income, Credits, Deductions, etc.	✓			
Schedule L—Balance Sheets per Books	✓			
Schedule M—Balance Sheets for Interest Allocation	✓			
Schedule M-1—Reconciliation of Income (Loss) per Books With Income (Loss) per Return	✓			
Schedule M-2—Analysis of Partners’ Capital Accounts	✓			
Schedule N—Transactions Between Controlled Foreign Partnership and Partners or Other Related Entities	✓	✓		
Separate Schedule K-1—Partner’s Share of Income, Credits, Deductions, etc. (direct partners only)	✓	✓		
Separate Schedule O—Transfer of Property to a Foreign Partnership			✓	
Separate Schedule P—Acquisitions, Dispositions, and Changes of Interests in a Foreign Partnership				✓

least 10% interests. However, if the foreign partnership had a Category 1 filer at any time during that tax year, no person will be considered a Category 2 filer. See the definition of a 10% interest on page 4.

**Category 3 filer.** A Category 3 filer is a U.S. person who contributed property during that person’s tax year to a foreign partnership in exchange for an interest in the partnership (a section 721 transfer), if that person either:

1. Owned directly or constructively at least a 10% interest in the foreign partnership immediately after the contribution, or
2. The value of the property contributed (when added to the value of any other property contributed to the partnership by such person, or any related person, during the 12-month period ending on the date of transfer) exceeds \$100,000.

If a domestic partnership contributes property to a foreign partnership, the domestic partnership’s partners are considered to have transferred a proportionate share of the contributed property to the foreign partnership. If a foreign partnership contributes property to another foreign partnership, the partners of the contributing foreign partnership are not considered to have transferred a

proportionate share of the contributed property.

Category 3 also includes a U.S. person that previously transferred appreciated property to the partnership and was required to report that transfer under section 6038B, if the foreign partnership disposed of such property while the U.S. person remained a direct or indirect partner in the partnership.

**Category 4 filer.** A Category 4 filer is a U.S. person that had a reportable event under section 6046A during that person’s tax year. There are three categories of reportable events under section 6046A: acquisitions, dispositions, and changes in proportional interests.

**Acquisitions.** A U.S. person that acquires a foreign partnership interest has a reportable event if:

- The person did not own a 10% or greater direct interest in the partnership and as a result of the acquisition the person owns a 10% or greater direct interest in the partnership (e.g., from 9% to 10%). For purposes of this rule, an acquisition includes an increase in a person’s direct proportional interest (see definition of change in proportional interest on page 4); or
- Compared to the person’s direct interest when the person last had a reportable event, after the acquisition the

person’s direct interest has increased by at least a 10% interest (e.g., from 11% to 21%).

**Dispositions.** A U.S. person that disposes of a foreign partnership interest has a reportable event if:

- The person owned a 10% or greater direct interest in the partnership before the disposition and as a result of the disposition the person owns less than a 10% direct interest (e.g., from 10% to 8%). For purposes of this rule, a disposition includes a decrease in a person’s direct proportional interest; or
- Compared to the person’s direct interest when the person last had a reportable event, after the disposition the person’s direct interest has decreased by at least a 10% interest (e.g., from 21% to 11%).

**Changes in proportional interests.**

A U.S. person has a reportable event if compared to the person’s direct proportional interest the last time the person had a reportable event, the person’s direct proportional interest has increased or decreased by at least the equivalent of a 10% interest in the partnership.

**Special rule for a partnership interest owned on December 31, 1999.** If the U.S. person owned at least a 10% direct interest in the foreign partnership

on December 31, 1999, then comparisons should be made to the person's direct interest on December 31, 1999. Once the person has a reportable event after December 31, 1999, future comparisons should be made by reference to the last reportable event.

## Exceptions to Filing

**Multiple Category 1 filers.** If during the tax year of the partnership there is more than one Category 1 filer, instead of each Category 1 filer submitting a separate Form 8865, only one Form 8865 from one Category 1 filer is required. A person that is a Category 1 filer by reason of an interest in losses or deductions may not file the single Form 8865 if another U.S. person is a Category 1 filer by reason of an interest in capital or profits; only the latter may file the return. The U.S. person that files the Form 8865 must complete Item E on page 1 of the form.

The single Form 8865 to be filed must contain all of the information that would have been required if each Category 1 filer had filed a separate Form 8865. Specifically, a separate Schedule N and Schedule K-1 must be attached to the Form 8865 for each Category 1 filer. Also, questions B, C, and D on page 1 and Schedule A on page 2 of Form 8865 must be completed for each Category 1 filer not filing the form on a separate statement to be attached to the single Form 8865.

A Category 1 filer not filing Form 8865 must attach a statement entitled "Controlled Foreign Partnership Reporting" to that person's income tax return.

The statement must include the following information:

- A statement that the person qualified as a Category 1 filer, but is not submitting Form 8865 under the multiple Category 1 filers exception.
- The name, address, and identifying number (if any) of the foreign partnership of which the person qualified as a Category 1 filer.
- A statement that the filing requirement has been or will be satisfied.
- The name and address of the person filing Form 8865 for this partnership.
- The Internal Revenue Service Center where the Form 8865 must be filed.



*A U.S. person who qualifies for this exception to the Category 1 filing requirement would still have to file a separate Form 8865 if that person is also subject to the filing requirements of Category 3 or 4. This separate Form 8865 would have to include all the information required for a Category 3 or 4 filer in addition to the Controlled Foreign Partnership Reporting statement.*

**Constructive owners.** See the definition of constructive ownership on page 4. A Category 1 or 2 filer that does not own a direct interest in the partnership and that is required to file this form solely because of constructive ownership from a U.S.

person(s) is not required to file Form 8865 if:

1. Form 8865 if filed by the U.S. person(s) through which the indirect partner constructively owns an interest in the foreign partnership,
2. The U.S. person through which the indirect partner constructively owns an interest in the foreign partnership is also a constructive owner and meets all the requirements of this constructive ownership filing exception, or
3. Form 8865 is filed for the foreign partnership by another Category 1 filer under the multiple Category 1 filers exception.

To qualify for the constructive ownership filing exception, the indirect partner must file with its income tax return a statement entitled "Controlled Foreign Partnership Reporting."

This statement must contain the following information:

1. A statement that the indirect partner was required to file Form 8865, but is not doing so under the constructive owners exception;
2. The names and addresses of the U.S. persons whose interests the indirect partner constructively owns; and
3. The name and address of the foreign partnership for which the indirect partner would have had to have filed Form 8865 but for this exception.

**Members of an affiliated group of corporations filing a consolidated return.** If one or more members of an affiliated group of corporations filing a consolidated return qualify as Category 1 or 2 filers for a particular foreign partnership, the common parent corporation may file one Form 8865 on behalf of all of the members of the group required to report. Except for group members who also qualify under the constructive owners exception, the Form 8865 must contain all the information that would have been required to be submitted if each group member filed its own Form 8865.

**Exception for certain trusts.** Trusts relating to state and local government employee retirement plans are not required to file Form 8865.

**Exception for certain Category 4 filers.** If you qualify as a Category 3 and 4 filer because you contributed property to a foreign partnership in exchange for a 10% or greater interest in that partnership, you are not required to report this transaction under both Category 3 and 4 filing requirements. If you properly report the contribution of property under the Category 3 rules, you are not required to report it as a Category 4 filer. However, the acquisition will count as a reportable event to determine if a later change in your partnership interest qualifies as a reportable event under Category 4.

**Example.** Partner A does not own an interest in FPS, a foreign partnership. Partner A transfers property to FPS in

exchange for a 15% direct interest in FPS. Partner A qualifies as a Category 3 filer because he transferred property to a foreign partnership and owned at least a 10% interest in FPS immediately after the contribution. Partner A is also a Category 4 filer because he did not own a 10% or greater direct interest in FPS and as a result of the acquisition of the FPS interest now owns a 10% or greater direct interest in FPS. If Partner A properly reports the contribution on Form 8865 as a Category 3 filer, Partner A is not required to report his acquisition of the 15% interest in FPS as a Category 4 filer.

## Relief for Category 1 and 2 Filers When the Foreign Partnership Files Form 1065 or Form 1065-B

If a foreign partnership files **Form 1065**, U.S. Return of Partnership Income, or **Form 1065-B**, U.S. Return of Income for Electing Large Partnerships, for its tax year, Category 1 and 2 filers must use a copy of the completed Form 1065 or 1065-B schedules in place of the equivalent schedules of Form 8865.

The following Form 1065/1065-B schedules are equivalent to the following Form 8865 schedules:

Forms 1065/ 1065-B	Form 8865
Page 1 (Parts I and II of Form 1065-B)	Schedule B
Schedule D	Schedule D
Schedule K	Schedule K
Schedule L	Schedule L
Schedule M-1	Schedule M-1
Schedule M-2	Schedule M-2
Schedule K-1	Schedule K-1

**Example.** Partner A is a Category 1 filer with respect to FPS, a foreign partnership during the FPS 2001 tax year. FPS completes and files a Form 1065 for its 2001 tax year. Instead of completing Schedules B, D, K, L, M-1, M-2, and K-1 of Form 8865, Partner A must attach to its Form 8865 page 1 of Form 1065 and Form 1065 Schedules D, K, L, M-1, M-2, and K-1 (including the Schedules K-1 for Partner A and all other U.S. persons owning 10% or greater direct interests in FPS). Partner A also must complete the following items and schedules on Form 8865:

- The first page,
- Schedule A,
- Schedule A-1,
- Schedule A-2,
- Schedule M, and
- Schedule N.

**Example.** Partner A is a Category 2 filer with respect to FPS, a foreign partnership. If FPS completes and files a Form 1065 for its 2001 tax year, Partner A must file with Form 8865 the Schedule K-1 (Form 1065) that it receives from the partnership instead of Schedule K-1 (Form 8865). Partner A also must

complete the following items and schedules on Form 8865:

- The first page,
- Schedule A,
- Schedule A-2, and
- Schedule N.

## When and Where To File

Attach Form 8865 to your income tax return (or, if applicable, partnership or exempt organization return) and file both by the due date (including extensions) for that return. If you do not have to file an income tax return, you must file Form 8865 separately with the IRS at the time and place you would be required to file an income tax return (or, if applicable, a partnership or exempt organization return). See below for penalties that may apply if you do not file Form 8865 on time.

## Definitions

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

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

A joint undertaking merely to share expenses is not a partnership. Mere co-ownership of property that is maintained and leased or rented is not a partnership. However, if the co-owners provide services to the tenants, a partnership exists.

**Foreign partnership.** A foreign partnership is a partnership that is not created or organized in the United States or under the law of the United States or of any state.

**50% interest.** A 50% interest in a partnership is an interest equal to 50% of the capital interest in the partnership, an interest equal to 50% of the profits interest in the partnership, or an interest to which 50% of the deductions or losses of the partnership are allocated. For purposes of determining a 50% interest, the constructive ownership rules below apply.

**10% interest.** A 10% interest in a partnership is an interest equal to 10% of the capital interest in the partnership, an interest equal to 10% of the profits interest in the partnership, or an interest to which 10% of the deductions or losses of the partnership are allocated. For purposes of determining a 10% interest, the constructive ownership rules below apply.

**Constructive ownership.** For purposes of determining an interest in a partnership, the constructive ownership

rules of section 267(c) (excluding section 267(c)(3)) apply, taking into account that such rules refer to corporations and not to partnerships. Generally, an interest owned directly or indirectly by or for a corporation, partnership, estate, or trust shall be considered as being owned proportionately by its owners.

Also, an individual is considered to own an interest owned directly or indirectly by or for his family. The family of an individual includes only that individual’s spouse, brothers, sisters, ancestors, and lineal descendants. An interest will be attributed from a nonresident alien individual under the family attribution rules only if the person to whom the interest is attributed owns a direct or indirect interest in the foreign partnership under section 267(c)(1) or (5).

**U.S. person.** A U.S. person is a citizen or resident of the United States, a domestic partnership, a domestic corporation, and any estate or trust that is not foreign.

**Control of a corporation.** Control of a corporation is ownership of stock possessing more than 50% of the total combined voting power, or more than 50% of the total value of shares of all classes of stock of the corporation. For rules concerning indirect ownership and attribution, see Regulations section 1.6038-2(c).

**Change in a proportional interest.** A partner’s proportional interest in a foreign partnership can change as a result of changes in other partners’ interests, for example, when another partner withdraws from the partnership. A partner’s proportional interest can also change, for example, by operation of the partnership agreement (e.g., if the partnership agreement provides that a partner’s interest in profits will change on a set date or when the partnership has earned a specified amount of profits, then the partner’s proportional interest changes when the set date or specified amount of profits is reached).

## Penalties

**Failure to timely submit all information required of Category 1 and 2 filers.**

• A \$10,000 penalty is imposed for each tax year of each foreign partnership for failure to furnish the required information within the time prescribed. If the information is not filed within 90 days after the IRS has mailed a notice of the failure to the U.S. person, an additional \$10,000 penalty (per foreign partnership) is charged for each 30-day period, or fraction thereof, during which the failure continues after the 90-day period has expired. The additional penalty is limited to a maximum of \$50,000 for each failure.

• Any person who fails to furnish all of the information required within the time prescribed, will be subject to a reduction of 10% of the foreign taxes available for credit under sections 901, 902, and 960. If the failure continues 90 days or more after the date the IRS mails notice of the

failure, an additional 5% reduction is made for each 3-month period, or fraction thereof, during which the failure continues after the 90-day period has expired. See section 6038(c)(2) for limits on the amount of this penalty.

• Criminal penalties under sections 7203, 7206, and 7207 may apply for failure to file or for filing false or fraudulent information.

Additionally, any person that does file under the constructive owners exception may be subject to these penalties if all the requirements of the exception are not met. Any person required to file Form 8865 who does not file under the multiple Category 1 filers exception, may be subject to the above penalties if the other person does not file a correct and complete form and schedules. See **Exceptions to Filing** on page 3.

**Failure to file information required of Category 3 filers.** Any person that fails to properly report a contribution to a foreign partnership that is required to be reported under section 6038B and the regulations under that section (Form 8865, page 1, and Schedules A, A-1, A-2, and O), is subject to a penalty equal to 10% of the fair market value (FMV) of the property contributed. This penalty is subject to a \$100,000 limit, unless the failure is due to intentional disregard. In addition, the transferor must recognize gain on the contribution as if the contributed property had been sold for FMV.

**Failure to file information required of Category 4 filers.** Any person who fails to properly report all the information requested by section 6046A (Form 8865, page 1, and Schedules A, A-2, and P), is subject to a \$10,000 penalty. If the failure continues for more than 90 days after the IRS mails notice of the failure, an additional \$10,000 penalty will apply for each 30-day period (or fraction thereof) during which the failure continues after the 90-day period has expired. The additional penalty shall not exceed \$50,000.

**Treaty-based return positions.** File **Form 8833**, Treaty-Based Return Position Disclosure Under Section 6114 or 7701(b), to report a return position that a treaty of the United States (such as an income tax treaty, an estate and gift tax treaty, or a friendship, commerce, and navigation treaty):

- Overrides or modifies any provision of the Internal Revenue Code and
- Causes (or potentially causes) a reduction of any tax incurred at any time.

Failure to make such a report may result in a \$1,000 penalty (\$10,000 in the case of a C corporation). See section 6712.

## Corrections to Form 8865

If you file a Form 8865 containing incomplete or incorrect information, file a corrected Form 8865 with an amended tax return following the instructions for the return with which you originally filed Form

8865. Write “corrected” at the top of the form and attach a statement identifying and explaining the changes.

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## Specific Instructions

**Important:** Fill in all applicable lines and sections. All information must be in English. All amounts must be stated in U.S. dollars.

If the information required in a given section exceeds the space provided within that section, **do not** write “see attached” in the section and attach all of the information on additional sheets. Instead, complete all entry spaces in the section and attach separate sheets to provide the remaining information, using the same size and format as the printed forms.

## General Information

All categories of filers must complete all questions on page 1 with three exceptions. Complete Item E only if, in addition to filing the form on your own behalf, you are reporting information about other Category 1 filers under the multiple Category 1 filing exception, or are reporting information about members of your affiliated group of corporations under the consolidated return exception. See **Exceptions to Filing** on page 3. Answer Items G8 and G9 only if you are a Category 1 filer.

## Tax Year

Enter in the space below the title of Form 8865 the tax year of the foreign partnership that ended with or within the tax year of the person filing this form. Category 1 or 2 filers must report information for the tax year of the foreign partnership that ends with or within their tax years. A Category 3 or 4 filer must report on Schedules O or P, respectively, transactions that occurred during that filer’s tax year (rather than during the partnership’s tax year).

## Identifying Numbers and Addresses

Enter the identifying number of the person filing this return. Use an employer identification number (EIN) to identify partnerships, corporations, and estates or trusts. For individuals, use a social security number (SSN) or individual taxpayer identification number (ITIN).

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 U.S. person has a P.O. box, show the box number instead.

**Foreign address.** Enter the information in the following order: city, province or state, and country. Follow the country’s practice for entering the postal code, if any. Do not abbreviate the country name.

## Item A—Category of Filer

Check the box for each category that describes the person filing the form. If more than one category applies, check all

boxes that apply. See **Categories of Filers** on page 1.

## Item C

Enter the filer’s share of nonrecourse liabilities, partnership-level qualified nonrecourse financing, and other liabilities. Nonrecourse liabilities are those liabilities of the partnership for which no partner bears the economic risk of loss. The extent to which a partner bears the economic risk is determined under the rules of Regulations section 1.752-2.

“Qualified nonrecourse financing” generally includes financing for which no one is personally liable for repayment that is borrowed for use in an activity of holding real property and that is:

- Lent or guaranteed by a Federal, state, or local government or
- Borrowed from a qualified person.

See section 465 for more information on qualified nonrecourse financing.

## Item D—Identification of Common Parent

If the person filing the form is a member of a consolidated group, but not the parent, list the name, address, and EIN of the filer’s common parent.

## Item E

**Information about certain partners.** If you are reporting information about other persons under the multiple Category 1 filers exception, or are reporting information about members of your affiliated group of corporations under the consolidated return exception (see **Exceptions to Filing** on page 3), identify each such person in Item E. List their names, addresses, and identifying numbers. Also indicate for each person whether such person is a Category 1 filer or Category 2 filer, and whether such person constructively owned an interest in the foreign partnership during the tax year of the partnership listed at the top of page 1 of Form 8865. See **Constructive ownership** on page 4.

## Item F6

**Category 1, 2, 3, and 4 filers in a partnership that filed Form 1065 or 1065-B.** Enter the business code shown in Item C of the Form 1065 or 1065-B filed by the partnership.

**Category 1, 2, 3, and 4 filers in a partnership that did not file Form 1065 or 1065-B.** Enter the applicable business code from the list beginning on page 25. If the information necessary to apply the total receipts test is not available, pick a principal business activity code using the information you have about the partnership.

## Item F8

Enter the foreign partnership’s functional currency and exchange rate (the rate used to convert the functional currency to U.S. dollars). See sections 985 through 989 and the regulations thereunder. If the partnership had more than one qualified business unit (QBU), attach a statement

identifying each QBU, its country of operation, and its functional currency. See Regulations section 1.989(a)-1(b) for the definition of a QBU.

**Hyperinflationary exception.** A partnership that has a hyperinflationary currency as its functional currency is subject to special rules set forth in Regulations section 1.985-3. Under these rules, a partnership must use the U.S. dollar as its functional currency.

## Item G2

If the foreign partnership was required to file Form 1065 or Form 1065-B for the partnership’s tax year listed at the top of page 1 (Form 8865), check the applicable box and enter the IRS Service Center where the form was or will be filed. Also check the applicable box(es) if the foreign partnership was required to file **Form 8804**, Annual Return for Partnership Withholding Tax (Section 1446), or **Form 1042**, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons (for the calendar year ending within or with the foreign partnership’s tax year).

## Item G6

Enter the number of foreign disregarded entities owned by the partnership during the partnership’s tax year. A disregarded entity is an entity that is disregarded as separate from its owner under Regulations section 301.7701-3(a). See **Form 8832**, Entity Classification Election, for more information. On an attached schedule, list the name and EIN of each foreign disregarded entity, identify the country or countries in which each disregarded entity conducts operations, and identify how the disregarded entity is classified in the foreign country.

## Question G8—Separate Units

Only Category 1 filers are required to answer question G8.

Indicate whether the partnership owned any interest in a separate unit. In general, a separate unit is:

1. A foreign branch that is owned either directly by a domestic corporation or indirectly by a domestic corporation through ownership of a partnership or trust interest,
2. An interest in a partnership, or
3. An interest in a trust.

See Regulations section 1.1503-2(c)(3) and (4) for more information on separate units. Attach a schedule identifying each separate unit and its country of operation.

## Question G9

Only answer question G9 if you are a Category 1 filer.

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## Schedule A—Constructive Ownership of Partnership Interest

All Category 1, 2, 3, and 4 filers must complete Schedule A. Check box **a** if the person filing the return owns a direct

interest in the foreign partnership. Check box **b** if the person filing the return constructively owns an interest in the foreign partnership. See **Constructive ownership** on page 4.

Category 1 and 2 filers must list the persons (U.S. and foreign) whose interests in the foreign partnership they constructively owned during the partnership tax year for which this form is being completed.

Category 3 and 4 filers must list the persons (U.S. and foreign) whose interests in the foreign partnership they constructively owned during the filer's tax year during which the reportable transfer or "reportable event" occurred.

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## Schedule A-1—Certain Partners of Foreign Partnership

All Category 1 and certain Category 3 filers must complete Schedule A-1. Any person already listed on Schedule A is not required to be listed again on Schedule A-1.

**Category 1 filers.** Category 1 filers must list all U.S. persons who owned at least a 10% direct interest in the foreign partnership during the partnership's tax year listed at the top of page 1 of Form 8865.

**Category 3 filers.** Category 3 filers must list **(a)** each U.S. person that owned a 10% or greater direct interest in the foreign partnership during the Category 3 filer's tax year and **(b)** any other person related to the Category 3 filer that was a direct partner in the foreign partnership during that tax year. See Regulations section 1.6038B-2(i)(4) for the definition of a related person.

**Exception.** Category 3 filers who transferred solely cash and did not own a 10% or greater interest in the transferee partnership after the transfer are not required to complete Schedule A-1.

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## Schedule A-2—Affiliation Schedule

All Category 1, 2, 3, and 4 filers must complete Schedule A-2. List on Schedule A-2 all partnerships (foreign or domestic) in which the foreign partnership owned a direct interest, or a 10% indirect interest (under the rules of section 267(c)(1) and (5)) during the partnership tax year listed at the top of page 1, Form 8865. Only Category 1 filers must complete the ordinary income or loss column. In that column, report the foreign partnership's share of ordinary income (even if not received) or loss from partnerships in which the foreign partnership owns a direct interest. The total amount of ordinary income or loss from each partnership must also be included on line 4 of Schedule B.

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## Schedule B—Income Statement—Trade or Business Income

**Important:** *If the foreign partnership filed Form 1065 or 1065-B, do not complete Schedule B on Form 8865. Instead, attach to Form 8865 a copy of page 1 from Form 1065, or Parts I and II of Form 1065-B.*

All Category 1 filers must complete Schedule B and also report the amounts on Schedules K and K-1.

### Income



*Report only trade or business activity income on lines 1a through 8. Do not report rental activity income or portfolio income on these lines. Rental activity income and portfolio income are reported on Schedules K and K-1. Rental real estate activities are also reported on Form 8825, Rental Real Estate Income and Expenses of a Partnership or an S Corporation.*

Do not include any tax-exempt income on lines 1a through 7. A partner in a partnership that receives any tax-exempt income other than interest, or holds any property or engages in any activity that produces tax-exempt income reports the amount of this income on line 20 of Schedules K and K-1.

Report tax-exempt interest income, including exempt-interest dividends received by the partnership as a shareholder in a mutual fund or other regulated investment company, on line 19 of Schedules K and K-1.

See **Deductions** on page 7 for information on how to report expenses related to tax-exempt income.

If the partnership has had debt discharged resulting from a title 11 bankruptcy proceeding or while insolvent, see **Form 982**, Reduction of Tax Attributes Due to Discharge of Indebtedness, and **Pub. 908**, Bankruptcy Tax Guide.

### 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 4 through 7. For example, do not include gross receipts from farming on this line. Instead, show the net profit (loss) from farming on line 5. Also, do not include on line 1a rental activity income or portfolio income.

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 by an accrual method partnership, see Rev. Proc. 71-21, 1971-2 C.B. 549.

**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 any disposition of real property held for sale to customers in the ordinary course of the taxpayer's trade or business. The disposition of property used or produced in a farming business is not included as a dealer disposition. See section 453(l) for details and exceptions.

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 schedule 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.

### Line 2—Cost of Goods Sold

Generally, inventories are required at the beginning and end of each tax year if the production, purchase, or sale of merchandise is an income-producing factor. See Regulations section 1.471-1.

However, a foreign partnership may account for inventory items in the same manner as materials and supplies that are not incidental if **(a)** its average annual gross receipts for the 3 prior tax years are \$1 million or less and **(b)** its business is not a tax shelter (as defined in section 448(d)(3)). In addition, for tax years ending on or after December 31, 2001, this rule applies to an eligible business of a qualifying small business taxpayer. A **qualifying small business taxpayer** includes a partnership with average annual gross receipts of more than \$1 million but less than or equal to \$10 million and that is not prohibited from using the cash method under section 448. For more details, including the definition of an eligible business, see Notice 2001-76, 2001-52 I.R.B. 614.

Under this accounting method, inventory costs for raw materials purchased for use in producing finished goods or merchandise purchased for resale are deductible in the year the finished goods or merchandise are sold (but not before the year the partnership paid for the raw materials or merchandise, if it is also using the cash method). See Rev. Proc. 2001-10, 2001-2 I.R.B. 272 and **Pub. 538**, Accounting Periods and Methods, for details.

## Cost of Goods Sold Worksheet

**Form 8865**  
(keep for your records)

1. Inventory at start of year . . . . .	1. _____
2. Purchases . . . . .	2. _____
3. Cost of labor . . . . .	3. _____
4. Other costs . . . . .	4. _____
5. Total . . . . .	5. _____
6. Inventory at end of year . . . . .	6. _____
7. <b>Cost of goods sold.</b> Subtract line 6 from line 5. Enter the result here and on page 2, line 2, Schedule B . . . . .	7. _____

### Cost of Goods Sold Worksheet

**Instructions.** All filers not using the cash method of accounting should see **Section 263A uniform capitalization rules** on page 8 before completing the worksheet.

**Line 2—Purchases.** Reduce purchases by items withdrawn for personal use. The cost of these items should be shown on line 23 of Schedules K and K-1 as distributions to partners.

**Line 4—Other Costs.** Enter on line 4 any costs paid or incurred during the tax year not entered on lines 2 and 3.

### Line 4—Ordinary Income (Loss) From Other Partnerships, Estates, and Trusts

Enter the ordinary income (loss) shown on Schedule K-1 (Form 1065) or Schedule K-1 (Form 1041), or other ordinary income (loss) from a foreign partnership, estate, or trust. 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 portfolio income or rental activity income (loss) from other partnerships, estates, or trusts on this line. Instead, report these amounts on the applicable lines of Schedules K and K-1, or on line 20a of Form 8825 if the amount is from a rental real estate activity.

Ordinary income or loss from another partnership that is a publicly traded partnership is not reported on this line. Instead, report the amount separately on line 7 of Schedules K and 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 partnership does not coincide with the tax year of the other partnership, estate, or trust, include the ordinary income (loss) from the other entity in the tax year in which the other entity's tax year ends.

### Line 5—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 8865. **Do not** include on this line any farm profit (loss) from other partnerships. Report those amounts on line 4.

Also report the partnership's fishing income on this line.

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.

**Note:** *Farm partnerships that are not required to use an accrual method should not capitalize the expenses of raising any plant with a preproductive period of more than 2 years. Instead, state them separately on an attachment to Schedule K, line 24, and on Schedule K-1, line 25, Supplemental Information. See Regulations section 1.263A-4 for more information.*

### Line 6—Net Gain (Loss) From Form 4797

 *Include only 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 reported separately on line 19 of Form 8825 or line 3 of Schedules K and K-1, generally as a part of the net income (loss) from the rental activity.*

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

Do not include any recapture of section 179 expense deduction. See the instructions for Schedule K-1, line 25, Supplemental Information, item 4, and the Instructions for Form 4797 for more information.

### Line 7—Other Income (Loss)

Enter on line 7 trade or business income (loss) that is not included on lines 1a

through 6. Examples of such income include:

1. Interest income derived in the ordinary course of the partnership's trade or business, such as interest charged on receivable balances.
2. Recoveries of bad debts deducted in earlier years under the specific charge-off method.
3. Taxable income from insurance proceeds.
4. The amount of credit figured on **Form 6478**, Credit for Alcohol Used as Fuel.

5. All section 481 income adjustments resulting from changes in accounting methods. Show the computation of the section 481 adjustments on an attached schedule.


6. The amount of any deduction previously taken under section 179A that is subject to recapture. See **Pub. 535**, Business Expenses, for details, including how to figure the recapture.

7. The recapture amount for section 280F if the business use of listed property drops to 50% or less. To figure the recapture amount, complete Part IV of Form 4797.

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 later in these instructions.

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

### Deductions

 Report **only** trade or business activity deductions on lines 9 through 21.

**Do not** report the following expenses on lines 9 through 21:

- Rental activity expenses. Report these expenses on Form 8825 or line 3b of Schedule K.
- Deductions allocable to portfolio income. Report these deductions on line 10 of Schedules K and K-1.
- Nondeductible expenses (e.g., expenses connected with the production of tax-exempt income). Report nondeductible expenses on line 21 of Schedules K and K-1.
- Qualified expenditures to which an election under section 59(e) may apply. The instructions for lines 18a and 18b of Schedules K and K-1 explain how to report these amounts.
- Items that require separate computations by the partners. Examples include expenses incurred for the production of income instead of in a trade or business, charitable contributions, foreign taxes paid, intangible drilling and development costs, soil and water conservation expenditures, amortizable basis of reforestation expenditures, and exploration expenditures. The distributive shares of these expenses are reported separately on Schedule K-1.

## 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 production of real and tangible personal property held in inventory or held for sale in the ordinary course of business.
- 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 partnership.

**Exceptions.** Section 263A does not apply to:

- Inventory of a partnership that accounts for inventories in the same manner as materials and supplies that are not incidental.
- 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. See the note at the end of the instructions for line 5 on page 7.

Report the following costs separately for purposes of determinations under section 59(e):

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

### **Tangible personal property**

produced by a partnership includes a film, sound recording, videotape, book, or similar property.

Partnerships subject to the 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:

- 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 may 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 expenses.** Business start-up expenses must be capitalized. If the partnership files Form 1065 or 1065-B, it may elect to amortize them over a period of not less than 60 months. See Pub. 535 and Regulations section 1.195-1.

**Organization costs.** Amounts paid or incurred to organize a partnership are capital expenditures. They are not deductible as a current expense.

If the partnership files Form 1065 or 1065-B, it may elect to amortize organization expenses over a period of 60 or more months, beginning with the month in which the partnership begins business. See the instructions for line 10 for the treatment of organization expenses paid to a partner. See Pub. 535 for more information.

**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 10 for the treatment of syndication fees paid to a partner.

**Reducing certain expenses for which credits are allowable.** For each of the following credits, the partnership must reduce the otherwise allowable deductions for expenses used to figure the credit by the amount of the current year credit:

1. The work opportunity credit.
2. The welfare-to-work credit.
3. The credit for increasing research activities.
4. The enhanced oil recovery credit.
5. The disabled access credit.
6. The empowerment zone employment credit.
7. The Indian employment credit.
8. The credit for employer social security and Medicare taxes paid on certain employee tips.
9. The orphan drug credit.

If the partnership has any of these credits, figure each current year credit

before figuring the deductions for expenses on which the credit is based.

## Line 9—Salaries and Wages

Enter on line 9 the salaries and wages paid or incurred for the tax year, reduced by any applicable employment credits from **Form 5884**, Work Opportunity Credit, **Form 8861**, Welfare-to-Work Credit, **Form 8844**, Empowerment Zone Employment Credit, and **Form 8845**, Indian Employment Credit. 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 SEP agreement or a SIMPLE IRA plan.

## Line 10—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 on line 10 amounts paid during the tax year for insurance that constitutes medical care for a partner, a partner's spouse, or a partner's dependents.

Do not include any payments and credits that should be capitalized. For example, although payments or credits to a partner for services rendered in organizing or syndicating a partnership may be guaranteed payments, they are not deductible on line 10. They are capital expenditures. However, they should be separately reported on Schedules K and K-1, line 5.

Do not include distributive shares of partnership profits.

Report the guaranteed payments to the appropriate partners on Schedule K-1, line 5.

## Line 11—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.

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

## Line 12—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 partnerships cannot take a bad debt deduction unless the amount was previously included in income.*

**Line 13—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:

The lease term began:	And the vehicle's fair market value on the first day of the lease exceeded:
After 12/31/98 . . . . .	\$15,500
After 12/31/96 but before 1/1/99 . . . . .	\$15,800
After 12/31/94 but before 1/1/97 . . . . .	\$15,500

If the lease term began before January 1, 1995, see **Pub. 463**, Travel, Entertainment, Gift, and Car Expenses, to find out if the partnership has an inclusion amount.

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

**Line 14—Taxes and Licenses**

Enter taxes and licenses paid or incurred in the trade or business activities of the partnership if not reflected in cost of goods sold. 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 14:

- State and local sales taxes paid or incurred in connection with the acquisition or disposition of business property. These taxes must be added to the cost of the property, or, in the case of a disposition, subtracted from the amount realized.
- Taxes assessed against local benefits to the extent that they increase the value of the property assessed, such as for paving, etc.
- Federal income taxes or taxes reported elsewhere on the return.
- Section 901 foreign taxes. See Schedules K and K-1, line 17g.
- Taxes allocable to a rental activity. Taxes allocable to a rental real estate activity are reported on Form 8825. Taxes allocable to a rental activity other than a rental real estate activity are reported on line 3b of Schedule K.

- Taxes allocable to portfolio income. These taxes are reported on line 10 of Schedules K and K-1.
- Taxes paid or incurred for the production or collection of income, or for the management, conservation, or maintenance of property held to produce income. Report these taxes separately on line 11 of Schedules K and K-1.

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

**Line 15—Interest**

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

Do not deduct interest expense on 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. A partner may be required to capitalize interest that was incurred by the partner for the partnership's production expenditures. Similarly, a partner may have to capitalize interest that was incurred by the partnership for the partner's own production expenditures. The information required by the partner to properly capitalize interest for this purpose must be provided by the partnership in an attachment to Schedule K-1. See section 263A(f) and Regulations sections 1.263A-8 through 1.263A-15.

Do not include interest expense on 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 (loss) from rental real estate activities on line 2 of Schedules K and K-1. Interest allocable to a rental activity other than a rental real estate activity is included on line 3b of Schedule K and is used in arriving at net income (loss) from a rental activity (other than a rental real estate activity). This net amount is reported on line 3c of Schedule K and line 3 of Schedule K-1.

Do not include interest expense on 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 14a of Schedules K and K-1. See the instructions for line 14a of Schedules

K and K-1 and **Form 4952**, Investment Interest Expense Deduction, for more information on investment property.

Do not include interest on debt proceeds allocated to distributions made to partners during the tax year. Instead, report such interest on line 11 of Schedules K and K-1. To determine the amount to allocate to distributions to partners, see Notice 89-35, 1989-1 C.B. 675.

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 a partnership to a partner for the use of capital should be entered on line 10 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 partnership 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 16—Depreciation**

On line 16a, enter **only** the depreciation claimed on assets used in a trade or business activity. Enter on line 16b the depreciation reported elsewhere on the return 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 to enter on this line.

For depreciation, you must complete and attach Form 4562 only if the partnership placed property in service during the tax year or claims depreciation on any car or other listed property.

**Line 17—Depletion**

If the partnership claims a deduction for timber depletion, complete and attach **Form T**, Forest Activities Schedules.

 *Do not deduct depletion for oil and gas properties. The partner figures depletion on oil and gas properties. See the instructions for Schedule K-1, line 25, item 3.*

**Line 18—Retirement Plans, etc.**

Do not deduct payments for partners to retirement or deferred compensation plans including IRAs, qualified plans, and simplified employee pension (SEP) and SIMPLE IRA plans on this line. These amounts are reported on Schedule K-1, line 11, and are deducted by the partners on their own returns.

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 partnership contributes to an individual retirement arrangement (IRA) for employees, include the contribution in salaries and wages on Schedule B, line 9, or Schedule B, line 2, and not on line 18.

### Line 19—Employee Benefit Programs

Enter the partnership's contributions to employee benefit programs not claimed elsewhere on the return (e.g., insurance, health, and welfare programs) that are not part of a pension, profit-sharing, etc., plan included on line 18.

Do not include amounts paid during the tax year for insurance that constitutes medical care for a partner, a partner's spouse, or a partner's dependents. Instead, include these amounts on line 10 as guaranteed payments and on Schedule K, lines 5 and 11. Also report these amounts on the Schedule K-1, lines 5 and 11. See **General Instructions for Schedules K and K-1** on page 13 for the filing requirements for Schedule K-1.

### Line 20—Other Deductions

Attach your own schedule listing by type and amount all allowable deductions related to a trade or business activity **only** for which there is no separate line on Schedule B. Enter the total on this line. Examples of other deductions include:

- Amortization (except as noted below)—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.
- Part of the cost of qualified clean-fuel vehicle property and qualified clean-fuel vehicle refueling property. For more details, see section 179A.

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

**Do not** deduct on line 20:

- Items that must be reported separately on Schedules K and K-1.
- Qualified expenditures to which an election under section 59(e) may apply. See the instructions on page 19 for lines 18a and 18b of Schedule K-1 for details on treatment of these items.
- Amortization of reforestation expenditures under section 194. The partnership can elect to amortize up to \$10,000 of qualified reforestation expenditures paid or incurred during the tax year. However, the amortization is not deducted by the partnership but the amortizable basis is instead separately allocated among the partners. See the

instructions on page 21 for Schedule K-1, line 25, item 21, and Pub. 535 for more details.

- Fines or penalties paid to a government for violating any law. Report these expenses on Schedule K, line 21.
- Expenses allocable to tax-exempt income. Report these expenses on Schedule K, line 21.
- 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. Report these expenses on Schedule K, line 21.
- 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

#### 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. 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. 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 partnership may deduct amounts paid or incurred for membership dues in civic or public service organizations, professional organizations (such as bar and medical associations), 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 may not 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 partnership 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.

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

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## Schedule D—Capital Gains and Losses

**Important:** *If the foreign partnership filed Form 1065 or 1065-B, do not complete Schedule D on Form 8865. Instead, attach to Form 8865 a copy of the Schedule D from Form 1065 or 1065-B.*

All Category 1 filers must complete Schedule D to report sales or exchanges of capital assets, capital gain distributions, and nonbusiness bad debts.

### Purpose of Schedule

Do not report on Schedule D capital gains (losses) specially allocated to any partner. Use Schedule D (Form 8865) to report sales or exchanges of capital assets, capital gain distributions, and nonbusiness bad debts.

Enter capital gains (losses) specially allocated to the partnership as a partner in other partnerships and from estates and trusts on Schedule D, line 4 or 9, whichever applies. Enter capital gains (losses) of the partnership that are specially allocated to partners directly on line 4d, 4e(1), 4e(2), 4e(3), or 7 of Schedules K and K-1, whichever applies.

**Note:** *For more information, see Pub. 544, Sales and Other Dispositions of Assets.*

### 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:

- 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 used in the trade or business.

### 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 (see section 475 and its regulations for details), (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.
- Bonds and other debt instruments. See **Pub. 550**, Investment Income and Expenses.
- 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.
- Liquidating distributions from a corporation. See **Pub. 550** for details.
- Gain on the sale or exchange of stock in certain foreign corporations. See section 1248.
- Gain or loss on options to buy or sell, including closing transactions. See **Pub. 550** for details.
- Gain or loss from a short sale of property. See **Pub. 550** for details.

- Transfer of property to a political organization if the fair market value of the property exceeds the partnership's adjusted basis in such property. See section 84.
- Any loss on the disposition of converted wetland or highly erodible cropland that is first used for farming after March, 1986, is reported as a long-term capital loss on Schedule D, but any gain on such a disposition is reported as ordinary income on Form 4797. See section 1257 for details.
- Transfer of partnership assets and liabilities to a newly formed corporation in exchange for all of its stock. See *Rev. Rul. 84-111, 1984-2 C.B. 88*.
- Disposition of foreign investment in a U.S. real property interest. See section 897.
- 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 section 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.
- Gain from the sale or exchange of stock in a collapsible corporation is not a capital gain. See section 341.
- 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 may 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. For each bad debt, enter the name of the debtor and "schedule attached" in column (a) of line 1 and the amount of the bad debt as a loss in column (f). Also attach a statement of facts to support each bad debt deduction.
- 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 for more information.
- 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 includes the full amount of the gain in its income in the year of sale. However, the installment method may not be used to report sales of stock or securities traded on an established

- securities market. Use **Form 6252**, Installment Sale Income, 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.
- A sale or other disposition of an interest in a partnership owning unrealized receivables or inventory items may result in an 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.

### 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 partnership must seek to **profit from daily market movements** in the prices of securities and not from dividends, interest, or capital appreciation.
  - The partnership's trading activity must be **substantial**.
  - The partnership must carry on the activity with **continuity and regularity**.
- The following facts and circumstances should be considered in determining if a partnership's activity is a business:
- Typical holding periods for securities bought and sold.
  - The frequency and dollar amount of the partnership'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 Schedule D or on an attached statement containing all the same information for each sale in a similar format. However, if a trader used the mark-to-market accounting method (see section 475 and its regulations for details), each transaction is reported in Part II of **Form 4797** instead of Schedule D. Regardless of whether a trader reports its gains and losses on 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 on Schedule B of Form 8865.

A trader also may 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 14a of Schedules K and K-1.

### Constructive Sale Treatment for Certain Appreciated Positions

Generally, a partnership would 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 fair market value on that date.

A partnership 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 the 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.

### Rollover of Gain From Qualified Stock



*Separately state on Form 8865, Schedule K, line 7 (and not on Schedule D) 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 the 50% 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-subsidiary 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 may meet the test if it acquired the stock from another person who met this test (such as by gift or at death) or through a conversion or exchange of qualified business stock by the holder.

- During substantially all of 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 was used in the active conduct of one or more qualified businesses (defined below), and
3. The 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 the 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.

### Specific Instructions (Schedule D)

#### Columns (b) and (c)—Date Acquired and Date Sold

Use the trade dates for date acquired and date sold for stocks and bonds traded on an exchange or over-the-counter market.

#### Column (d)—Sales Price

Enter in this column either the gross sales price or the net sales price from the sale. On sales of stocks and bonds, report the gross amount as reported to the partnership by the partnership's broker on **Form 1099-B**, Proceeds From Broker and Barter Exchange Transactions, or similar statement. However, if the broker advised the partnership that gross proceeds (gross sales price) less commissions and option premiums were reported to the IRS, enter that net amount in column (d).

#### Column (e)—Cost or Other Basis

In general, the cost or other basis is the cost of the property plus purchase commissions and improvements and minus depreciation, amortization, and depletion. If the partnership got the property in a tax-free exchange, involuntary conversion, or wash sale of stock, it may not be able to use the actual cash cost as the basis. If the partnership does not use cash cost, attach an explanation of the basis.

If the partnership sold stock, adjust the basis by subtracting all the stock-related nontaxable distributions received before the sale. This includes nontaxable distributions from utility company stock and mutual funds. Also adjust the basis for any stock splits or stock dividends.

If a charitable contribution deduction is passed through to a partner because of a bargain sale of property to a charitable organization, the adjusted basis for determining gain from the sale is an amount that has the same ratio to the adjusted basis as the amount realized has to the fair market value.

See section 852(f) for the treatment of certain load charges incurred in acquiring stock in a mutual fund with a reinvestment right.

If the gross sales price is reported in column (d), increase the cost or other basis by any expense of sale, such as broker's fees, commissions, or option premiums, before making an entry in column (e).

For more details, see **Pub. 551**, Basis of Assets.

#### Column (f)—Gain or (Loss)

Make a separate entry in this column for each transaction reported on lines 1 and 6 and any other line(s) that applies to the partnership. For lines 1 and 6, subtract the amount in column (e) from the amount in column (d). Enter negative amounts in parentheses.

## Column (g)—28% Rate Gain or (Loss)

Enter in column (g) **only** the amount, if any, from Part II, column (f), that is from collectibles gains and losses. A **collectibles gain or loss** is any long-term gain or deductible long-term loss from the sale or exchange of a collectible that is a capital asset.

**Collectibles** include works of art, rugs, antiques, metals (such as gold, silver, and platinum bullion), gems, stamps, coins, alcoholic beverages, and certain other tangible property.

Also include gain (but not loss) from the sale or exchange of an interest in a partnership or trust held for more than 1 year and attributable to unrealized appreciation of collectibles. For details, see Regulations section 1.1(h)-1. Also attach the statement required under Regulations section 1.1(h)-1(e).

## Lines 4 and 9—Capital Gains and Losses From Other Partnerships, Estates, and Trusts

Enter capital gains (losses) specially allocated to the partnership as a partner in other partnerships and from estates and trusts on Schedule D, line 4 or 9, whichever applies.

## Line 10—Capital Gain Distributions

On line 10, column (f), report as the **total** amount of **(a)** capital gain distributions and **(b)** the partnership's share of undistributed capital gains from a RIC or REIT. On line 10, column (g), report the 28% rate gain portion of these amounts. Report the partnership's share of taxes paid on undistributed capital gains by a RIC or REIT on a statement attached to Form 8865 for Schedule K, line 24 (and the partner's share in the line 25 Supplemental Information space of Schedule K-1).

## General Instructions for Schedules K and K-1—Partners' Shares of Income, Credits, Deductions, Etc.

**Important:** *If the foreign partnership filed Form 1065 or 1065-B, do not complete Schedules K and K-1 on Form 8865. Instead, attach to Form 8865 a copy of the Schedules K and K-1 from Form 1065 or 1065-B.*

### Schedule K

Schedule K is a summary schedule of all of the partners' shares of the partnership income, credits, deductions, etc. Only Category 1 filers must complete Schedule K.

### Schedule K-1

Schedule K-1 is used to report a specific partner's share of the partnership income, credits, deductions, etc.

All Category 1 and 2 filers must complete Schedule K-1 for any direct interest they hold in the partnership. A Category 1 or 2 filer that does not own a direct interest is not required to complete Schedule K-1.

Category 1 filers must also complete Schedule K-1 for each U.S. person that directly owns a 10% or greater direct interest in the partnership.

On Schedule K-1, provide the partner's beginning and year-end percentage interest in partnership profits, capital, deductions, or losses. These percentages should include any interest constructively owned by the filer.

Lines 1 through 23 are the same for both Schedule K and Schedule K-1. However, Schedule K-1 contains information about a particular partner's distributive share, rather than information about the partnership as a whole. Complete lines 1 through 25 for any direct interest that partner owns in the partnership.

**Example.** Partner A owns a 45% direct interest in foreign partnership (FPS). Partner A also owns 100% of the stock of a domestic corporation (DC), which owns a 10% direct interest in FPS. Therefore, Partner A is considered to own a 55% interest in FPS and is thus a Category 1 filer. When Partner A completes Schedule K-1 for itself, Partner A must report the distributive share of items allocated to Partner A's direct interest of 45% but not any items allocated to DC's 10% interest. When Partner A completes Schedule K-1 for DC (which Partner A must do because DC owns a direct 10% interest), Partner A must report on DC's Schedule K-1 only items allocated to DC's direct 10% interest.

Although the partnership is not subject to income tax, the partners are liable for tax on their shares of the partnership income, whether or not distributed, and must include their share of such items on their tax returns. Allocations of income, gains, losses, deductions, or credits among the partners generally should be made according to the partnership agreement. See section 704 and the regulations thereunder.

## Specific Instructions (Schedules K and K-1, Except as Noted)

**Note:** *Generally, Schedules K and K-1 on Form 8865 and Form 1065 are the same. If more guidance is needed to complete Schedules K and K-1 of Form 8865, refer to the Form 1065 instructions.*

### Special Allocations

An item is specially allocated if it is allocated to a partner in a ratio different from the ratio for sharing income or loss generally.

Report specially allocated ordinary gain (loss) on Schedules K and K-1, line 7. Report other specially allocated items on the applicable lines of the partner's Schedule K-1, with the total amount on the applicable line of Schedule K. For example, specially allocated long-term capital gain is entered on line 4e(1) of the partner's Schedule K-1, and the total is entered on line 4e(1) of Schedule K, along with any net long-term capital gain (or loss) from line 12 column (f), of Schedule D.

## Income (Loss)

### Line 1—Ordinary Income (Loss) From Trade or Business Activities

Enter the amount from Schedule B, line 22. Enter the income (loss) without reference to **(a)** the basis of the partners' interests in the partnership, **(b)** the partners' at-risk limitations, or **(c)** the passive activity limitations. These limitations, if applicable, are determined at the partner level.

If the partnership has more than one trade or business activity, identify on an attachment to Schedule K-1 the amount from each separate activity.

Line 1 should not include rental activity income (loss) or portfolio income (loss).

### Line 2—Net Income (Loss) From Rental Real Estate Activities

Enter the net income (loss) from rental real estate activities of the partnership from Form 8825. Attach this form to Form 8865. If the partnership has more than one rental real estate activity, identify on an attachment to Schedule K-1 the amount attributable to each activity.

### Line 3—Net Income (Loss) From Other Rental Activities

On Schedule K, line 3a, enter gross income from rental activities other than those reported on Form 8825. See **Pub. 925, Passive Activity and At-Risk Rules**, for a definition of rental activities. Include on line 3a, the gain (loss) from line 18 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.

On line 3b of Schedule K, enter the deductible expenses of the activity. Attach a schedule of these expenses to Form 8865.

Enter the net income (loss) on line 3c of Schedule K. Enter the partner's share on line 3 of Schedule K-1.

If the partnership has more than one rental activity reported on line 3, identify on an attachment to Schedule K-1 the amount from each activity.

### Lines 4a Through 4f—Portfolio Income (Loss)

Enter portfolio income (loss) on lines 4a through 4f.

Do not reduce portfolio income by deductions allocable to it. Report such deductions (other than interest expense)

on line 10 of Schedules K and K-1. Interest expense allocable to portfolio income is generally investment interest expense and is reported on line 14a of Schedules K and K-1.

**Lines 4a and 4b.** Enter only taxable interest and ordinary dividends on these lines. Taxable interest is interest from all sources except interest exempt from tax and interest on tax-free covenant bonds.

**Lines 4d, 4e(1), 4e(2), and 4e(3).** Enter on line 4d of Schedule K the gain or loss (that is portfolio income (loss) from line 5 of Schedule D plus any short-term capital gain (loss) that is specially allocated to partners. Report a partner's share on line 4d of Schedule K-1.

Enter on line 4e(1) the gain or loss that is portfolio income (loss) from line 12 of Schedule D plus any long-term capital gain (loss) that is specially allocated to partners. Enter on line 4e(2) the gain or loss from line 11 of Schedule D plus any 28% rate gain (loss) that is included on line 12 of Schedule D. Enter on line 4e(3) the gains (not losses) from the disposition of assets (excluding property that could qualify for section 1202 gain) held more than 5 years that are portfolio income included on line 12 of Schedule D.

If any gain or loss from lines 5, 11, and 12 of Schedule D is not portfolio income (e.g., gain or loss from the disposition of nondepreciable personal property used in a trade or business), do not report this income or loss on lines 4d and 4e(1) through 4e(3). Instead, report it on line 7 of Schedules K and K-1. If the partnership had a gain from such property held more than 5 years, show the total of all such gains on an attachment to Schedule K-1. Indicate on the statement that the shareholder should include this amount on line 4 of the worksheet for line 29 of Schedule D (Form 1040).

If the income or loss is attributable to more than one activity, report the income or loss amount separately for each activity on an attachment to Schedule K-1 and identify the activity to which the income or loss relates.



*If any gain or loss from lines 5, 11, and 12 of Schedule D is from the disposition of nondepreciable personal property used in a trade or business, it may not be treated as portfolio income. Report such gain or loss on line 7 of Schedules K and K-1. If the partnership had a gain from such property held more than 5 years, show the total of all such gains on an attachment to Schedule K-1. Indicate on the statement that the partner should include this amount on line 4 of the worksheet for line 29 of Schedule D (Form 1040). If the gain or loss is attributable to more than one activity, report the gain or loss amount separately for each trade or business activity on an attachment to Schedule K-1 and identify the activity to which the gain or loss relates.*

**Line 4f.** Report and identify other portfolio income or loss on an attachment for line 4f.

For example, income reported to the partnership from a real estate mortgage investment conduit (REMIC), in which the partnership is a residual interest holder, would be reported on an attachment for line 4f. If the partnership holds a residual interest in a REMIC, report on the attachment for line 4f the partner's share of the following:

- Taxable income (net loss) from the REMIC (line 1b of **Schedules Q (Form 1066)**, Quarterly Notice to Residual Interest Holder of REMIC Taxable Income or Net Loss Allocation).
- Excess inclusion (line 2c of Schedules Q (Form 1066)).
- Section 212 expenses (line 3b of Schedules Q (Form 1066)). Do not report these section 212 expenses on line 10 of Schedules K and K-1.

Because Schedule Q (Form 1066) is a quarterly statement, you must follow the Schedule Q instructions to figure the amounts to report to the partner for the partnership's tax year.

### Line 5—Guaranteed Payments to Partners

Guaranteed payments to partners include:

- Payments for salaries, health insurance, and interest deducted by the partnership and reported on Schedule B, line 10; Form 8825; or on Schedule K, line 3b; and
- Payments the partnership must capitalize. See the Instructions for Schedule B, line 10.

Generally, amounts reported on line 5 are not considered to be related to a passive activity. For example, guaranteed payments for personal services paid to a partner would not be passive activity income. Likewise, interest paid to any partner is not passive activity income.

### Line 6—Net Section 1231 Gain (Loss) (Other Than Due to Casualty or Theft)

Enter on line 6 the net section 1231 gain (loss) from Form 4797, line 7. Do not include specially allocated ordinary gains and losses or net gains or losses from involuntary conversions due to casualties or thefts on this line. Instead, report them on line 7. If the partnership has more than one activity, attach a statement to Schedule K-1 that identifies the activity to which the section 1231 gain (loss) relates.

Attach a statement to each Schedule K-1 indicating the aggregate amount of all gains from section 1231 property held more than 5 years. Do not include any gain attributable to straight-line depreciation from section 1250 property. Indicate on the statement that this amount should be included in the partner's computation of qualified 5-year gain only if the amount on the partner's Form 4797, line 7, is more than zero. Do not include any unrecaptured section 1250 gain.

### Line 7—Other Income (Loss)

Use line 7 to report other items of income, gain, or loss not included on lines 1 through 6. If the partnership has more than one activity, identify on an attachment the amount and the activity to which each amount relates.

- Include the following items on line 7:
- Gains from the disposition of farm recapture property (see Form 4797) and other items to which section 1252 applies.
  - Gains from the disposition of an interest in oil, gas, geothermal, or other mineral properties (section 1254).
  - Any net gain or loss from section 1256 contracts from **Form 6781**, Gains and Losses From Section 1256 Contracts and Straddles.
  - Recoveries of tax benefit items (section 111).
  - Gambling gains and losses subject to the limitations in section 165(d).
  - Any income, gain, or loss to the partnership under section 751(b).
  - Specially allocated ordinary gain (loss).
  - Net gain (loss) from involuntary conversions due to casualty or theft. The amount for this line is shown on **Form 4684**, Casualties and Thefts, line 38a, 38b, or 39.

The partner's share must be entered on Schedule K-1. If there was a gain (loss) from a casualty or theft to property not used in a trade or business or for income-producing purposes, do not complete Form 4684 for this type of casualty or theft. Instead, the partner will complete his or her own Form 4684.

- Gain from the sale or exchange of qualified small business stock that is eligible for the 50% section 1202 exclusion. The section 1202 exclusion applies only to qualified small business stock issued after August 10, 1993, and held by the partnership for more than 5 years. Corporate partners are not eligible for the section 1202 exclusion. Additional limitations apply at the partner level. Report the partner's share of section 1202 gain on Schedule K-1. The partner will determine if he or she qualifies for the section 1202 exclusion. Report on an attachment to Schedule K-1 for each sale or exchange the name of the corporation that issued the stock, the partner's share of the partnership's adjusted basis and sales price of the stock, and the dates the stock was bought and sold.
- Gain eligible for section 1045 rollover (replacement stock not purchased by the partnership). Include only gain from the sale or exchange of qualified small business stock the partnership held for more than 6 months but that **was not** deferred by the partnership under section 1045. A partner (other than a corporation) may be eligible to defer his or her distributive share of this gain under section 1045 if he or she purchases other qualified small business stock during the 60-day period that began on the date the stock was sold by the partnership. Additional limitations apply at the partner level. Report on an attachment to

Schedule K-1 for each sale or exchange the name of the corporation that issued the stock, the partner's share of the partnership's adjusted basis and sales price of the stock, and the dates the stock was bought and sold.

## Deductions

### Line 8—Charitable Contributions

Enter the total amount of charitable contributions made by the partnership during its tax year on Schedule K. Enter the partner's distributive share on Schedule K-1. On an attachment to Schedules K and K-1, show separately the dollar amount of contributions subject to each of the 50%, 30%, and 20% of adjusted gross income limits. For additional information, see **Pub. 526**, Charitable Contributions.

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

If the partnership made a qualified conservation contribution, include the FMV of the underlying property before and after the donation and describe the conservation purpose furthered by the donation.

### Line 9—Section 179 Expense Deduction

If the partnership files Form 1065 or 1065-B, it may elect to expense part of the cost of certain tangible property the partnership purchased this year for use in its trade or business or certain rental activities. See **Pub. 946**, How to Depreciate Property, for a definition of what kind of property qualifies for the section 179 expense deduction and the Instructions for Form 4562 for limitations on the amount of the section 179 expense deduction.

If the foreign partnership received a Schedule K-1 from another partnership reporting a section 179 expense deduction, complete lines 6 through 13 of Form 4562. Report the eligible partners' distributive shares of the amount on line 12 of Form 4562 on Schedule K-1, line 9. An estate or trust is not an eligible partner.

See the instructions for line 25 of Schedule K-1, item 4, for any recapture of a section 179 amount.

### Line 10—Deductions Related to Portfolio Income

Enter on line 10 and attach an itemized list of the deductions clearly and directly allocable to portfolio income (other than interest expense and section 212 expenses from a REMIC). Interest expense related to portfolio income is investment interest expense and is reported on line 14a of Schedules K and K-1. Section 212 expenses from the partnership's interest in a REMIC are reported on an attachment for line 4f of Schedules K and K-1.

No deduction is allowable under section 212 for expenses allocable to a convention, seminar, or similar meeting.

### Line 11—Other Deductions

Use line 11 to report deductions not included on lines 8, 9, 10, 17g, and 18b. On an attachment, identify the deduction and amount and, if the partnership has more than one activity, the activity to which the deduction relates.

Examples of items to be reported on an attachment to line 11 include:

- Amounts paid by the partnership that would be allowed as itemized deductions on any of the partners' income tax returns if they were paid directly by a partner for the same purpose. However, do not enter expenses related to portfolio income or investment interest expense on this line.

If there was a loss from an involuntary conversion due to casualty or theft of income-producing property, include in the total amount for this line the relevant amount from Form 4684, line 32.

- Any penalty on early withdrawal of savings.
- Soil and water conservation expenditures (section 175).
- Contributions to a capital construction fund.
- Any amounts paid during the tax year for health insurance coverage for a partner (including that partner's spouse and dependents). For 2001, a partner may be allowed to deduct up to 60% of such amounts on Form 1040, line 28.
- Payments for a partner to an IRA, qualified plan, simplified employee pension (SEP) or a SIMPLE IRA plan. If a qualified plan is a defined benefit plan, a partner's distributive share of payments is determined in the same manner as his or her distributive share of partnership taxable income. For a defined benefit plan, attach to the Schedule K-1 a statement showing the amount of benefit accrued for the tax year.
- Interest expense allocated to debt-financed distributions. See Notice 89-35 for more information.
- Interest paid or accrued on debt properly allocable to each general partner's share of a working interest in any oil or gas property (if the partner's liability is not limited).

## Credits

### Line 12a—Low-Income Housing Credit

Section 42 provides a credit that may be claimed by owners of low-income residential rental buildings. If the partners are eligible to take the low-income housing credit, complete and attach **Form 8586**, Low-Income Housing Credit; **Form 8609**, Low-Income Housing Credit Allocation Certification; and **Schedule A (Form 8609)**, Annual Statement, to Form 8865.

Report on line 12a(1) the total low-income housing credit for property with respect to which a partnership is to


be treated under section 42(j)(5) as the taxpayer to which the low-income housing credit was allowed. Report any other low-income housing credit on line 12a(2).

If part or all of the credit reported on line 12a(1) or 12a(2) is attributable to additions to qualified basis of property placed in service before 1990, report on an attachment to Schedules K and K-1 the amount of the credit on each line that is attributable to property placed in service **(a)** before 1990 and **(b)** after 1989.

### Line 12b—Qualified Rehabilitation Expenditures Related to Rental Real Estate Activities

Enter total qualified rehabilitation expenditures related to rental real estate activities of the partnership. Also complete the applicable lines of **Form 3468**, Investment Credit, that apply to qualified rehabilitation expenditures for property related to rental real estate activities of the partnership for which income or loss is reported on line 2 of Schedule K. See Form 3468 for details on qualified rehabilitation expenditures. Attach Form 3468 to Form 8865.

For line 12b of Schedule K-1, enter the partner's distributive share of the expenditures. On the dotted line to the left of the entry space for line 12b, enter the line number of Form 3468 on which the partner should report the expenditures. If there is more than one type of expenditure, or the expenditures are from more than one rental real estate activity, report this information separately for each expenditure or activity on an attachment to Schedules K and K-1.

 *Qualified rehabilitation expenditures for property not related to rental real estate activities must be listed separately on line 25 of Schedule K-1.*

### Line 12c—Credits (Other Than Credits Shown on Lines 12a and 12b) Related to Rental Real Estate Activities

Report any information that the partners need to figure credits related to a rental real estate activity, other than the low-income housing credit and qualified rehabilitation expenditures. On the dotted line to the left of the entry space for line 12c (or in the margin), identify the type of credit. If there is more than one type of credit or the credit is from more than one activity, report this information separately for each credit or activity on an attachment to Schedules K and K-1.

### Line 12d—Credits Related to Other Rental Activities

Use this line to report information that the partners need to figure credits related to a rental activity other than a rental real estate activity. On the dotted line to the left of the entry space for line 12d, identify the type of credit. If there is more than one type of credit or the credit is from more than one activity, report this

information separately for each credit or activity on an attachment to Schedules K and K-1.

### Line 13—Other Credits

Enter on line 13 any other credit, except credits or expenditures shown or listed for lines 12a through 12d of Schedules K and K-1. On the dotted line to the left of the entry space for line 13, identify the type of credit. If there is more than one type of credit or the credit is from more than one activity, report this information separately for each credit or activity on an attachment to Schedules K and K-1. The credits to be reported on line 13 and other required attachments are as follows:

- Credit for backup withholding on dividends, interest, or patronage dividends.
- Nonconventional source fuel credit. The credit is figured at the partnership level and then is apportioned to the partners based on their distributive shares of partnership income attributable to sales of qualified fuels. Attach a separate schedule to the return to show the computation of the credit. See section 29 for more information.
- Qualified electric vehicle credit (Form 8834).
- Unused credits from cooperatives. The unused credits are apportioned to persons who were partners in the partnership on the last day of the partnership's tax year.
- Work opportunity credit (Form 5884). This credit is apportioned among the partners according to their interest in the partnership at the time the wages on which the credit is figured were paid or accrued.
- Welfare-to-work credit (Form 8861). This credit is apportioned in the same manner as the work opportunity credit.
- Credit for alcohol used as fuel (Form 6478). This credit is apportioned to persons who were partners on the last day of the partnership's tax year. The credit must be included in income on line 7 of Schedule B.

If this credit includes the small ethanol producer credit, identify on a statement attached to each Schedule K-1 (a) the amount of the small producer credit included in the total credit allocated to the partner, (b) the number of gallons of qualified ethanol fuel production allocated to the partner, and (c) the partner's share in gallons of the partnership's productive capacity for alcohol.

- Credit for increasing research activities (Form 6765).
- Enhanced oil recovery credit (Form 8830).
- Disabled access credit (Form 8826).
- Renewable electricity production credit (Form 8835).
- Empowerment zone employment credit (Form 8844).
- Indian employment credit (Form 8845).
- Credit for employer social security and Medicare taxes paid on certain employee tips (Form 8846).
- Orphan drug credit (Form 8820).

- New markets credit (Form 8874).
- Credit for contributions to selected community development corporations (Form 8847).
- General credits from an electing large partnership.

See the instructions for line 25, item 13 of Schedule K-1 to report expenditures qualifying for the (a) rehabilitation credit not related to rental real estate activities, (b) energy credit, or (c) reforestation credit.

### Investment Interest

Lines 14a through 14b(2) must be completed for all partners.

#### Line 14a—Interest Expense on Investment Debts

Include on this line 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.

Property held for investment also includes a general partner's share of a working interest in any oil or gas property for which the partner's liability is not limited and in which the partner did not materially participate. However, the level of a partner's participation in an activity is determined by the partner and not by the partnership. As a result, interest allocable to a general partner's share of a working interest in any oil or gas property (if the partner's liability is not limited) should not be reported on line 14a. Instead, report this interest on line 11.

Investment interest does not include interest expense allocable to a passive activity.

The amount on line 14a will be deducted (after applying the investment interest expense limitations of section 163(d)) by individual partners on Schedule A (Form 1040), line 13.

For more information, see **Form 4952**, Investment Interest Expense Deduction.

#### Lines 14b(1) and 14b(2)—Investment Income and Expenses

Enter on line 14b(1) only the investment income included on lines 4a, 4b, 4c, and 4f of Schedules K and K-1. Do not include other portfolio gains or losses on this line.

Enter on line 14b(2) only the investment expense included on line 10 of Schedules K and K-1.

If there are other items of investment income or expense included in the amounts reported separately on Schedule K-1 (such as net short-term capital gain or loss, net long-term capital gain or loss, and other portfolio gains or losses), attach a schedule to Schedule K-1 identifying these amounts.

Investment income includes gross income from property held for investment, the excess of net gain from the

disposition of property held for investment over net capital gain from the disposition of property held for investment, and any net capital gain from the disposition of property held for investment that a partner elects to include in investment income under section 163(d)(4)(B)(iii). Generally, investment income and investment expenses do not include any income or expenses from a passive activity.

Property subject to a net lease is not treated as investment property because it is subject to the passive loss rules. Do not reduce investment income by losses from passive activities.

Investment expenses are deductible expenses (other than interest) directly connected with the production of investment income. See the Form 4952 instructions for more information on investment income and expenses.

#### Lines 15a Through 15c—Self-Employment

**Note:** If the partnership is an options dealer or a commodities dealer, see section 1402(i) before completing lines 15a, 15b, and 15c, to determine the amount of any adjustment that may have to be made to the amounts shown on the **Worksheet for Figuring Net Earnings (Loss) From Self-Employment** on page 17. If the partnership is engaged solely in the operation of a group investment program, earnings from the operation are not self-employment earnings for either general or limited partners.

**General partners.** General partners' net earnings (loss) from self-employment do not include:

- Dividends on any shares of stock and interest on any bonds, debentures, notes, etc., unless the dividends or interest are received in the course of a trade or business, such as a dealer in stocks or securities or interest on notes or accounts receivable.
- Rentals from real estate, except rentals of real estate held for sale to customers in the course of a trade or business as a real estate dealer or payments for rooms or space when significant services are provided.
- Royalty income, except royalty income received in the course of a trade or business.

See the instructions for **Schedule SE (Form 1040)**, Self-Employment Tax, for more information.

**Limited partners.** Generally, a limited partner's share of partnership income (loss) is not included in net earnings (loss) from self-employment. Limited partners treat as self-employment earnings only guaranteed payments for services they actually rendered to, or on behalf of, the partnership to the extent that those payments are payment for those services.

#### Line 15a—Net Earnings (Loss) From Self-Employment

**Schedule K.** Enter on line 15a the amount from line 5 of the worksheet.



**Schedule K-1.** Do not complete this line for any partner that is an estate, trust, corporation, exempt organization, or IRA.

Enter on line 15a of Schedule K-1 each individual general partner's share of the amount shown on line 5 of the worksheet and each individual limited partner's share of the amount shown on line 4c of the worksheet.

**Line 15b—Gross Farming or Fishing Income**

Enter the partnership's gross farming or fishing income from self-employment. Individual partners need this amount to figure net earnings from self-employment under the farm optional method in Section B, Part II of Schedule SE (Form 1040).

**Line 15c—Gross Nonfarm Income**

Enter the partnership's gross nonfarm income from self-employment. Individual partners need this amount to figure net earnings from self-employment under the nonfarm optional method in Section B, Part II of Schedule SE (Form 1040).

**Worksheet Instructions**

**Line 1b.** Include on line 1b any part of the net income (loss) from rental real estate activities from Schedule K, line 2, that is from:

1. Rentals of real estate held for sale to customers in the course of a trade or business as a real estate dealer or
2. Rentals for which services were rendered to the occupants (other than services usually or customarily rendered for the rental of space for occupancy only). The supplying of maid service is such a service; but the furnishing of heat and light, the cleaning of public entrances, exits, stairways and lobbies, trash collection, etc., are not considered services rendered to the occupants.

**Lines 3b and 4b.** Allocate the amounts on these lines in the same way line 22 of Schedule B is allocated to these particular partners.

**Line 4a.** Include in the amount on line 4a any guaranteed payments to partners reported on Schedules K and K-1, line 5, and derived from a trade or business as defined in section 1402(c). Also include other ordinary income and expense items (other than expense items subject to separate limitations at the partner level) reported on Schedules K and K-1 that are used to figure self-employment earnings under section 1402.

**Adjustments and Tax Preference Items**

Lines 16a through 16e must be completed for all partners except certain small corporations exempt from the alternative minimum tax (AMT) under section 55(e).

Enter items of income and deductions that are adjustments or tax preference items for the AMT. See **Form 6251**, Alternative Minimum Tax—Individuals; **Form 4626**, Alternative Minimum Tax—Corporations; or Schedule I of **Form 1041**, U.S. Income Tax Return for Estates and Trusts, to determine the amounts to enter and for other information.

Do not include as a tax preference item any qualified expenditures to which an election under section 59(e) may apply. Instead, report these expenditures on lines 18a and 18b. Because these expenditures are subject to an election by a partner, the partnership cannot figure the amount of any tax preference related to them.

**Line 16a—Depreciation Adjustment on Property Placed in Service After 1986**

Figure the adjustment for line 16a based only on tangible property placed in service after 1986 (and tangible property placed in service after July 31, 1986, and before 1987 for which the partnership elected to use the general depreciation system). **Do not** make an adjustment for motion picture films, videotapes, sound recordings, certain public utility property (as defined in section 168(f)(2)), property depreciated under the unit-of-production method (or any other method not expressed in a term of years), or qualified Indian reservation property.

For property placed in service **before 1999**, refigure depreciation for the AMT as follows (using the same convention used for the regular tax):

- For section 1250 property (generally, residential rental and nonresidential real property), use the straight line method over 40 years.
- For tangible property (other than section 1250 property) depreciated using the straight line method for the regular tax, use the straight line method over the property's class life. Use 12 years if the property has no class life.
- For any tangible property, use the 150% declining balance method, switching to the straight line method the first tax year it gives a larger deduction, over the property's AMT class life. Use 12 years if the property has no class life.

**Note:** See *Pub. 946* for a table of class lives.

For property placed in service **after 1998**, refigure depreciation for the AMT **only** for property depreciated for the regular tax using the 200% declining balance method. For the AMT, use the

**Worksheet for Figuring Net Earnings (Loss) From Self-Employment**

<b>1a</b> Ordinary income (loss) (Schedule K, line 1) . . . . .	<b>1a</b>		
<b>b</b> Net income (loss) from <b>certain</b> rental real estate activities (see instructions) . . . . .	<b>1b</b>		
<b>c</b> Net income (loss) from other rental activities (Schedule K, line 3c) . . . . .	<b>1c</b>		
<b>d</b> Net loss from Form 4797, Part II, line 18, included on line 1a above. Enter as a positive amount . . . . .	<b>1d</b>		
<b>e</b> Combine lines 1a through 1d . . . . .	<b>1e</b>		
<b>2</b> Net gain from Form 4797, Part II, line 18, included on line 1a above . . . . .	<b>2</b>		
<b>3a</b> Subtract line 2 from line 1e. If line 1e is a loss, increase the loss on line 1e by the amount on line 2 . . . . .	<b>3a</b>		
<b>b</b> Part of line 3a allocated to limited partners, estates, trusts, corporations, exempt organizations, and IRAs . . . . .	<b>3b</b>		
<b>c</b> Subtract line 3b from line 3a. If line 3a is a loss, reduce the loss on line 3a by the amount on line 3b. Include each individual general partner's share on line 15a of Schedule K-1 . . . . .			<b>3c</b>
<b>4a</b> Guaranteed payments to partners (Schedule K, line 5) derived from a trade or business as defined in section 1402(c) (see instructions) . . . . .	<b>4a</b>		
<b>b</b> Part of line 4a allocated to individual limited partners for <b>other than</b> services and to estates, trusts, corporations, exempt organizations, and IRAs . . . . .	<b>4b</b>		
<b>c</b> Subtract line 4b from line 4a. Include each individual general partner's share and each individual limited partner's share on line 15a of Schedule K-1 . . . . .			<b>4c</b>
<b>5</b> Net earnings (loss) from self-employment. Combine lines 3c and 4c. Enter here and on Schedule K, line 15a			<b>5</b>

150% declining balance method, switching to the straight line method the first tax year it gives a larger deduction, and the same convention and recovery period used for the regular tax.

Figure the adjustment by subtracting the AMT deduction for depreciation from the regular tax deduction and enter the result on line 14a. If the AMT deduction is more than the regular tax deduction, enter the difference as a negative amount. Depreciation capitalized to inventory must also be refigured using the AMT rules. Include on this line the current year adjustment to income, if any, resulting from the difference.

#### **Line 16b—Adjusted Gain or Loss**

If the partnership disposed of any tangible property placed in service after 1986 (or after July 31, 1986, if an election was made to use the general depreciation system), or if it disposed of a certified pollution control facility placed in service after 1986, refigure the gain or loss from the disposition using the adjusted basis for the AMT. The property's adjusted basis for the AMT is its cost or other basis minus all depreciation or amortization deductions allowed or allowable for the AMT during the current tax year and previous tax years. Enter on this line the difference between the regular tax gain (or loss) and the AMT gain (or loss). If the AMT gain is less than the regular tax gain, **or** the AMT loss is more than the regular tax loss, **or** there is an AMT loss and a regular tax gain, enter the difference as a negative amount.

If any part of the adjustment is allocable to net short-term capital gain (loss), net long-term capital gain (loss), or net section 1231 gain (loss), attach a schedule that identifies the amount of the adjustment allocable to each type of gain or loss. For a net long-term capital gain (loss), also identify the amount of the adjustment that is 28% rate gain (loss). For a net section 1231 gain (loss), also identify the amount of adjustment that is unrecaptured section 1250 gain.

No schedule is required if the adjustment is allocable solely to ordinary gain (loss).

#### **Line 16c—Depletion (Other Than Oil and Gas)**

Do not include any depletion on oil and gas wells. The partners must figure their depletion deductions and preference items separately.

Refigure the depletion deduction under section 611 for mines, wells (other than oil and gas wells), and other natural deposits for the AMT. Percentage depletion is limited to 50% of the taxable income from the property as figured under section 613(a), using only income and deductions allowed for the AMT. Also, the deduction is limited to the property's adjusted basis at the end of the year, as refigured for the AMT. Figure this limit separately for each property. When refiguring the property's adjusted basis,

take into account any AMT adjustments made this year or in previous years that affect basis (other than the current year's depletion).

Enter the difference between the regular tax and AMT deduction. If the AMT deduction is greater, enter the difference as a negative amount.

#### **Lines 16d(1) and 16d(2)**

Enter only the income and deductions for oil, gas, and geothermal properties that are used to figure the partnership's ordinary income or loss (line 22 of Schedule B). If there are items of income or deduction for oil, gas, and geothermal properties included in the amounts required to be passed through separately to the partners on Schedule K-1 (items not reported on line 1 of Schedule K-1), attach a schedule identifying these amounts.

Figure the amount for lines 16d(1) and (2) separately for oil and gas properties that are not geothermal deposits and for all properties that are geothermal deposits.

Attach a schedule that shows the separate amounts that are included in the computation of the amounts on lines 16d(1) and (2).

**Line 16d(1)—Gross income from oil, gas, and geothermal properties.** Enter the aggregate amount of gross income (within the meaning of section 613(a)) from all oil, gas, and geothermal properties that was received or accrued during the tax year and included on Schedule B.

**Line 16d(2)—Deductions allocable to oil, gas, and geothermal properties.** Enter the amount of any deductions allowed for the AMT that are allocable to oil, gas, and geothermal properties.

#### **Line 16e—Other Adjustments and Tax Preference Items**

Attach a schedule to each required Schedule K-1 that shows the partner's share of other items not shown on lines 16a through 16d(2) that are adjustments or tax preference items or that the partner would need to complete Form 6251, Form 4626, or Schedule I of Form 1041. See these forms and their instructions to determine the amount to enter.

Other adjustments and tax preference items or information the partner would need include the following:

- Accelerated depreciation of real property under pre-1987 rules.
- Accelerated depreciation of leased personal property under pre-1987 rules.
- Long-term contracts entered into after February 28, 1986. Except for certain home construction contracts, the taxable income from these contracts must be figured using the percentage of completion method of accounting for the AMT.
- Losses from tax shelter farm activities. No loss from any tax shelter farm activity is allowed for the AMT.

- Any information needed by certain corporate partners to compute the adjusted current earnings (ACE) adjustment.

Schedules K and K-1 have the same line numbers for lines 1 through 23.

#### **Foreign Taxes**

Lines 17a through 17h must be completed if the partnership has foreign income, deductions, or losses or has paid or accrued foreign taxes. See **Pub. 514**, Foreign Tax Credit for Individuals, for more information.

#### **Line 17a—Name of Foreign Country or U.S. Possession**

Enter the name of the foreign country or U.S. possession from which the partnership had income or to which the partnership paid or accrued taxes. If the partnership had income from, or paid or accrued taxes to, **more than one** foreign country or U.S. possession, enter "**See attached**" and attach a schedule for each country for lines 17a through 17h.

#### **Line 17b—Gross Income From All Sources**

Enter the partnership's gross income from all sources, including all U.S. and foreign source income.

#### **Line 17c—Gross Income Sourced at Partner Level**

Enter the total gross income of the partnership that is required to be sourced at the partner level. This includes income from the sale of most personal property other than inventory, depreciable property, and certain intangible property. See **Pub. 514** and section 865 for details. Attach a schedule showing the following information:

- The amount of this gross income (without regard to its source) in each category identified in the instructions for line 17d, including each of the listed categories.
- Specifically identify gains on the sale of personal property other than inventory, depreciable property, and certain intangible property on which a foreign tax of 10% or more was paid or accrued. Also list losses on the sale of such property if the foreign country would have imposed a 10% or higher tax had the sale resulted in a gain. See **Sales or Exchanges of Certain Personal Property** in **Pub. 514** and section 865.
- Specify the net foreign source capital gain or loss within each separate limitation category shown on page 19 in the instructions for line 17d(2). Also, in the case of noncorporate partners, separately identify the net foreign source gains or losses within each separate limitation category that are 28% rate gains or losses, unrecaptured section 1250 gains, and qualified 5-year gains.

#### **Line 17d—Foreign Gross Income Sourced at Partnership Level**

Separately report gross income from sources outside the United States by category of income as follows. For

partnership and corporate partners only, attach a schedule identifying the total amount of foreign gross income in each category of income attributable to foreign branches. See Pub. 514 for information on the categories of income.

**Line 17d(1).** Passive foreign source income.

**Line 17d(2).** Attach a schedule showing the amount of foreign source income included in each of the following listed categories of income:

- Financial services income;
- High withholding tax interest;
- Shipping income;
- Dividends from each noncontrolled section 902 corporation;
- Dividends from a DISC, a former DISC, an IC-DISC, or a former IC-DISC;
- Distributions from a foreign sales corporation (FSC) or a former FSC;
- Section 901(j) income; and
- Certain income re-sourced by treaty.

**Line 17d(3).** General limitation foreign source income (all other foreign source income).

### Line 17e—Deductions Allocated and Apportioned at Partner Level

Enter on line 17e(1) the partnership's total interest expense (including interest equivalents under Temporary Regulations section 1.861-9T(b)). Do not include interest directly allocable under Temporary Regulations section 1.861-10T to income from a specific property. This type of interest is allocated and apportioned at the partnership level and is included on lines 17f(1) through (3). On line 17e(2), enter the total of all other deductions or losses that are required to be allocated at the partner level. For example, include on line 17e(2) research and experimental expenditures (see Regulations section 1.861-17(f)).

### Line 17f—Deductions Allocated and Apportioned at Partnership Level to Foreign Source Income

Separately report partnership deductions that are apportioned at the partnership level to (1) passive foreign source income, (2) each of the listed foreign categories of income, and (3) general limitation foreign source income (see the instructions for line 17d). See Pub. 514 for more information.

For partnership and corporate partners only, attach a schedule identifying the total amount of deductions apportioned to each category of income shown in the instructions for line 17d that are attributable to foreign branches.

### Line 17g—Total Foreign Taxes

Enter in U.S. dollars the total foreign taxes (described in section 901 or section 903) that were paid or accrued by the partnership (according to its method of accounting for such taxes). Translate these amounts into U.S. dollars by using the applicable exchange rate (see Pub. 514).

Attach a schedule reporting the following information:

1. The total amount of foreign taxes (including foreign taxes on income sourced at the partner level) relating to each category of income (see instructions for line 17d).

2. The dates on which the taxes were paid or accrued, the exchange rates used, and the amounts in both foreign currency and U.S. dollars, for:

- Taxes withheld at source on interest.
- Taxes withheld at source on dividends.
- Taxes withheld at source on rents and royalties.
- Other foreign taxes paid or accrued.

### Line 17h—Reduction in Taxes Available for Credit

Enter the total reductions in taxes available for credit.

Attach a schedule showing the reductions for:

- Taxes on foreign mineral income (section 901(e)).
- Taxes on foreign oil and gas extraction income (section 907(a)).
- Taxes attributable to boycott operations (section 908).
- Failure to timely file (or furnish all of the information required on) Forms 5471 and 8865.
- Any other items (specify).

### Other

#### Lines 18a and 18b

Do not deduct or include qualified expenditures for intangible drilling and development costs as adjustments or tax preference items on Schedule K-1. Instead, enter on line 18a the type of expenditures claimed on line 18b. Enter on line 18b the qualified expenditures paid or incurred during the tax year to which an election under section 59(e) may apply. Enter this amount on each required Schedule K-1 whether or not any partner makes an election under section 59(e). If the expenditures are for intangible drilling and development costs, enter the month in which the expenditures were paid or incurred (after the type of expenditure on line 18a). If there is more than one type of expenditure included in the total shown on line 18b (or intangible drilling and development costs were paid or incurred for more than 1 month), report this information separately for each type of expenditure (or month) on an attachment to Schedules K and K-1.

The term "qualified expenditures" includes only the following types of expenditures paid or incurred during the tax year:

- Circulation expenditures.
- Research and experimental expenditures.
- Intangible drilling and development costs.

- Mining exploration and development costs.

### Line 19—Tax-Exempt Interest Income

Enter on line 19 tax-exempt interest income, including any exempt-interest dividends received from a mutual fund or other regulated investment company. Individual partners must report this information on line 8b of Form 1040. The adjusted basis of the partner's interest is increased by the amount shown on this line under section 705(a)(1)(B).

### Line 20—Other Tax-Exempt Income

Enter on line 20 all income of the partnership exempt from tax other than tax-exempt interest (e.g., life insurance proceeds). The adjusted basis of the partner's interest is increased by the amount shown on this line under section 705(a)(1)(B).

### Line 21—Nondeductible Expenses

Enter on line 21 nondeductible expenses paid or incurred by the partnership. Do not include separately stated deductions shown elsewhere on Schedules K and K-1, capital expenditures, or items the deduction for which is deferred to a later tax year. The adjusted basis of the partner's interest is decreased by the amount shown on this line under section 705(a)(2)(B).

### Line 22—Distributions of Money (Cash and Marketable Securities)

Enter on line 22 the total distributions to the partner(s) of cash and marketable securities that are treated as money under section 731(c)(1). Generally, marketable securities are valued at FMV on the date of distribution. However, the value of marketable securities does not include the distributee partner's share of the gain on the securities distributed to that partner. See section 731(c)(3)(B) for details.

If the amount on line 22 includes marketable securities treated as money, state separately on an attachment to Schedules K and K-1 (a) the partnership's adjusted basis of those securities immediately before the distribution and (b) the FMV of those securities on the date of distribution (excluding the distributee partner's share of the gain on the securities distributed to that partner).

### Line 23—Distributions of Property Other Than Money

Enter on line 23 the total distributions to the partner(s) of property not included on line 22. In computing the amount of the distribution, use the adjusted basis of the property to the partnership immediately before the distribution. In addition, attach a statement showing the adjusted basis and FMV of each property distributed.

## Line 24 (Schedule K Only)

Attach a statement to report the partnership's total income, expenditures, or other information for the items listed under **Line 25 (Schedule K-1 Only)—Supplemental Information** below.

## Lines 24a and 24b (Schedule K-1 Only)—Recapture of Low-Income Housing Credit

If recapture of part or all of the low-income housing credit is required because: **(a)** prior year qualified basis of a building decreased, or **(b)** the partnership disposed of a building or part of its interest in a building, see **Form 8611, Recapture of Low-Income Housing Credit**. The instructions for Form 8611 indicate when the form is completed and what information is provided to partners when recapture is required.

If a partner's ownership interest in a building decreased because of a transaction at the partner level, attach the necessary information for the partner to figure the recapture.

Report on line 24a the total low-income housing credit recapture with respect to a partnership treated under section 42(j)(5) as the taxpayer to which the low-income housing credit was allowed. Report any other low-income housing credit recapture on line 24b.

If the partnership filed **Form 8693, Low-Income Housing Credit Disposition Bond**, to avoid recapture of the low-income housing credit, no entry should be made on line 24 of Schedule K-1.

See Form 8586, Form 8611, and section 42 for more information.

## Line 25 (Schedule K-1 Only)—Supplemental Information

Enter in the line 25 Supplemental Information space of Schedule K-1, or on an attached schedule if more space is needed, the partner's share of any information requested on lines 1 through 24b that must be reported in detail, and items 1 through 23 below. Identify the applicable line number next to the information entered in the Supplemental Information space. Show income or gains as a positive number. Show losses in parentheses.

**1.** Taxes paid on undistributed capital gains by a regulated investment company (RIC) or a real estate investment trust (REIT). As a shareholder of a RIC or a REIT, the partnership will receive notice on **Form 2439, Notice to Shareholder of Undistributed Long-Term Capital Gains**, of the amount of tax paid on undistributed capital gains.

**2.** The number of gallons of each fuel sold or used during the tax year for a nontaxable use qualifying for the credit for taxes paid on fuels, types of use, and the applicable credit per gallon. See **Form 4136, Credit for Federal Tax Paid on Fuels**, for details.

**3.** The partner's share of gross income from each property, share of production for the tax year, etc., needed to figure the partner's depletion deduction for oil and gas wells. The partnership should also allocate to the partner(s) a proportionate share of the adjusted basis of each partnership oil or gas property. The allocation of the basis of each property is made as specified in section 613A(c)(7)(D).

The partnership cannot deduct depletion on oil and gas wells. The partner must determine the allowable amount to report on his or her return. See Pub. 535 for more information.

**4.** Recapture of section 179 expense deduction. For property placed in service after 1986, the section 179 expense deduction is recaptured at any time the business use of the property drops to 50% or less. Enter the amount that was originally passed through to the partners and the partnership's tax year in which the amount was passed through. State whether the recapture amount was caused by the disposition of the section 179 property. Do not include this amount in the partnership's income.

**5.** Recapture of certain mining exploration expenditures (section 617).

**6.** Any information or statements a partner needs to comply with section 6111 (registration of tax shelters) or section 6662(d)(2)(B)(ii) (regarding adequate disclosure of items that may cause an understatement of income tax).

**7.** The partner's share of preproductive period farm expenses, if the partnership is not required to use the accrual method of accounting. See Regulations section 1.263A-4.

**8.** Any information a partner needs to figure the interest due under section 453(l)(3). If the partnership previously had elected to report the disposition of certain timeshares and residential lots on the installment method, the partner's tax liability must be increased by the partner's allocable share of the interest on tax attributable to the installment payments received during the tax year.

**9.** Any information a partner needs to figure interest due under section 453A(c). If an obligation arising from the disposition of property to which section 453A applies is outstanding at the close of the year, report the partner's allocable share of the outstanding installment obligation to which section 453A(b) applies.

**10.** For closely held partnerships (as defined in section 460(b)(4)), state the information a partner needs to figure the partner's allocable share of any interest due or to be refunded under the look-back method of section 460(b)(2) on certain long-term contracts that are accounted for under either the percentage of completion—capitalized cost method or the percentage of completion method. Also attach the information specified in the instructions for Form 8697, Part II,

lines 1 and 3, for each tax year in which such a long-term contract is completed.

**11.** Any information a partner needs relating to interest expense that the partner is required to capitalize. A partner may be required to capitalize interest expense incurred by the partner for the partnership's production expenditures. Similarly, a partner may have to capitalize interest that was incurred by the partnership for the partner's own production expenditures. See Regulations sections 1.263A-8 through 1.263A-15 for more information.

**12.** Any information a partner that is a tax-exempt organization may need to figure its share of unrelated business taxable income under section 512(a)(1) (but excluding any modifications required by paragraphs (8) through (15) of section 512(b)). Partners are required to notify the partnership of their tax-exempt status. See **Form 990-T, Exempt Organization Business Income Tax Return**, for more information.

**13.** Expenditures qualifying for the **(a)** rehabilitation credit not related to rental real estate activities, **(b)** energy credit, or **(c)** reforestation credit. Complete and attach Form 3468. See Form 3468 and the related instructions for information on eligible property and the lines on Form 3468 to complete. Attach to each Schedule K-1 a separate schedule in a format similar to that shown on Form 3468 detailing the partner's share of qualified expenditures. Also indicate the lines of Form 3468 on which the partners should report these amounts.

**14.** Recapture of investment credit. Complete and attach **Form 4255, Recapture of Investment Credit**, when investment credit property is disposed of, or it no longer qualifies for the credit, before the end of the recapture period or the useful life applicable to the property. State the type of property at the top of Form 4255 and complete lines 2, 4, and 5, whether or not any partner is subject to recapture of the credit. Attach to each Schedule K-1 a separate schedule providing the information the partnership is required to show on Form 4255, but list only the partner's distributive share of the cost of the property subject to recapture. Also indicate the lines of Form 4255 on which the partners should report these amounts.

**15.** Any information a partner may need to figure the recapture of the qualified electric vehicle credit. See Pub. 535 for more information.

**16.** Any information a partner may need to figure recapture of the Indian employment credit. Generally, if a partnership terminates a qualified employee less than 1 year after the date of initial employment, any Indian employment credit allowed for a prior tax year by reason of wages paid or incurred to that employee must be recaptured. For details, see section 45A(d).

**17.** Nonqualified withdrawals by the partnership from a capital construction fund.

**18.** Unrecaptured section 1250 gain. Figure this amount for each section 1250 property in Part III of Form 4797 (except property for which gain is reported using the installment method on Form 6252) for which you had an entry in Part I of Form 4797 by subtracting line 26g of Form 4797 from the **smaller** of line 22 or line 24 of Form 4797. Figure the total of these amounts for all section 1250 properties. Generally, the result is the partnership's unrecaptured section 1250 gain. However, if the partnership is reporting gain on the installment method for a section 1250 property held more than 1 year, see the next paragraph to figure the unrecaptured section 1250 gain on that property. Report the partner's distributive share of the total amount as "Unrecaptured section 1250 gain."

The total unrecaptured section 1250 gain for an installment sale of section 1250 property held more than 1 year is figured for the year of the sale in a manner similar to that used in the preceding paragraph. However, the total unrecaptured section 1250 gain must be allocated to the installment payments received from the sale. To do so, the partnership generally must treat the gain allocable to each installment payment as unrecaptured section 1250 gain until all such gain has been used in full. Figure the unrecaptured section 1250 gain for installment payments received during the tax year as the **smaller of (a)** the amount from line 26 or line 37 of Form 6252 (whichever applies) or **(b)** the total unrecaptured section 1250 gain for the sale reduced by all gain reported in prior

years (excluding section 1250 ordinary income recapture). However, if the partnership chose not to treat all of the gain from payments received after May 6, 1997, and before August 24, 1999, as unrecaptured section 1250 gain, use only the amount the partnership chose to treat as unrecaptured section 1250 gain for those payments to reduce the total unrecaptured section 1250 gain remaining to be reported for the sale.

If the partnership received a Schedule K-1 or Form 1099-DIV from an estate, a trust, a REIT, or a mutual fund (or other regulated investment company) reporting "unrecaptured section 1250 gain," **do not** add it to the partnership's own unrecaptured section 1250 gain. Instead, report it as a separate amount. For example, if the partnership received a Form 1099-DIV from a REIT with unrecaptured section 1250 gain, report it as "Unrecaptured section 1250 gain from a REIT."

Also report as a separate amount any gain from the sale or exchange of an interest in another partnership attributable to unrecaptured section 1250 gain. See Regulations section 1.1(h)-1 and attach the statement required under Regulations section 1.1(h)-1(e).

**19.** If the partnership is a closely held partnership (as defined in section 460(b)(4)) and it depreciated certain property placed in service after September 13, 1995, under the income forecast method, it must attach to Form 1065 the information specified in the instructions for Form 8866, line 2, for the

3rd and 10th tax years beginning after the tax year the property was placed in service. It must also report the line 2 amounts to its partners. See the instructions for Form 8866 for more details.

**20.** Any information a partner that is a publicly traded partnership may need to determine if it meets the 90% qualifying income test of section 7704(c)(2). Partners are required to notify the partnership of their status as a publicly traded partnership.

**21.** Amortization of reforestation expenditures. Report the amortizable basis and year in which the amortization began for the current year and the 7 preceding years. For limits that may apply, see section 194 and Pub. 535.

**22.** Any information needed by a partner to figure the interest due under section 1260(b). If any portion of a constructive ownership transaction was open in any prior year, the partner's tax liability must be increased by the partner's pro rata share of interest due on any deferral of gain recognition. See section 1260(b) for details, including how to figure the interest.

**23.** Any other information a partner may need to file his or her return that is not shown anywhere else on Schedule K-1. For example, if one of the partners is a pension plan, that partner may need special information to properly file its tax return.

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## Schedule L—Balance Sheets per Books

**Important:** If the foreign partnership filed Form 1065 or 1065-B, **do not** complete Schedule L on Form 8865. Instead, attach to Form 8865 a copy of the Schedule L from Form 1065 or 1065-B.

Only Category 1 filers are required to complete Schedule L. If you answered “Yes” to question G9 on page 1 of Form 8865, you do not have to complete Schedule L. Schedule L requires balance sheets prepared and translated into U.S. dollars in accordance with U.S. generally accepted accounting principles (GAAP).

**Exception.** If the partnership or any qualified business unit of the partnership uses the dollar approximate separate transactions method (DASTM), Schedule L should reflect the tax balance sheets prepared and translated into U.S. dollars according to Regulations section 1.985-3(d).

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## Schedule M—Balance Sheets for Interest Allocation

All Category 1 filers must complete Schedule M. Schedule M should reflect the book values of the partnership’s assets as described in Temporary Regulations sections 1.861-9T(g)(2) and 1.861-12T. Assets should be characterized as U.S. assets or foreign assets in one or more separate limitation categories as provided in Temporary Regulations sections 1.861-9T(g)(3) and 1.861-12T. The balance sheets should be prepared in U.S. dollars under Temporary Regulations section 1.861-9T(g)(2)(ii).

**Exception.** If the partnership or any qualified business unit of the partnership uses DASTM, Schedule M should reflect the tax balance sheet prepared in U.S. dollars under Regulations section 1.985-3(d). See Temporary Regulations section 1.861-9T(g)(2)(ii)(A)(2) for more information on DASTM.

**Line 2.** Enter the partnership’s foreign assets according to the following income limitation categories:

- Passive income category.
- Listed categories (attach a statement classifying foreign assets by the categories listed in the instructions for line 17c).
- General limitation income category.

See the instructions for line 17 of Schedule K and section 904(d) for more information.

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## Schedule M-1—Reconciliation of Income (Loss) per Books With Income (Loss) per Return

**Important:** If the foreign partnership filed Form 1065 or 1065-B, **do not** complete Schedule M-1 on Form 8865. Instead, attach to Form 8865 a copy of the Schedule M-1 from Form 1065 or 1065-B.

Only Category 1 filers are required to complete Schedule M-1. If you answered “Yes” to question G9 on page 1 of Form 8865, you do not have to complete Schedule M-1.

**Line 3—Guaranteed payments.** Include on this line guaranteed payments shown on Schedule K, line 5 (other than amounts paid for insurance that constitutes medical care for a partner, a partner’s spouse, and a partner’s dependents).

### Line 4b—Travel and Entertainment

Include on this line:

- The part of the cost of meals and entertainment not allowed under section 274(n).
- Expenses for the use of an entertainment facility.
- The part of business gifts over \$25.
- Expenses of an individual allocable to conventions on cruise ships over \$2,000.
- Employee achievement awards over \$400.
- The part of the cost of entertainment tickets that exceeds face value (also subject to 50% disallowance).
- The part of the cost of skyboxes that exceeds the face value of nonluxury box seat tickets.
- The part of the cost of luxury water travel not allowed under section 274(m).
- Expenses for travel as a form of education.
- Nondeductible club dues.
- Other travel and entertainment expenses not allowed as a deduction.

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## Schedule M-2—Analysis of Partners’ Capital Accounts

**Important:** If the foreign partnership filed Form 1065 or 1065-B, **do not** complete Schedule M-2 on Form 8865. Instead, attach to Form 8865 a copy of the Schedule M-2 from Form 1065 or 1065-B.

Only Category 1 filers are required to complete Schedule M-2. If you answered “Yes” to question G9 on page 1 of Form 8865, you do not have to complete Schedule M-2. Show what caused the changes in the direct partners’ capital accounts during the partnership’s tax year as reflected on the partnership’s books and records. All items must be reported in U.S. dollars.

Though not required to, you may use the rules in Regulations section 1.704-1(b)(2)(iv) to determine the partners’ capital accounts in Schedule M-2. If the beginning and ending capital accounts reported under these rules differ from the amounts reported on Schedule L, attach a statement reconciling any differences.

**Line 2—Capital contributed during year.** Include on line 2 the amount of money and property contributed by each partner to the partnership as reflected on the partnership’s books and records.

**Line 3—Net income (loss) per books.** Enter on line 3 the partnership’s net income (loss) shown on the partnership’s books, from Schedule M-1, line 1.

**Line 6—Distributions.**

**Line 6a—Cash.** Enter the total amount of money distributed to each partner by the partnership.

**Line 6b—Property.** Enter the total amount of property distributed to each partner by the partnership as reflected on the partnership’s books and records.

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## Schedule N—Transactions Between Controlled Foreign Partnership and Partners or Other Related Entities

All Category 1 filers must complete all of Schedule N and report all transactions of the foreign partnership during the tax year of the partnership listed on the top of page 1 of Form 8865. A Category 1 filer filing a Form 8865 for other Category 1 filers under the multiple Category 1 filers exception must complete a Schedule N for itself and a separate Schedule N for each Category 1 filer not filing Form 8865.

All Category 2 filers are required to complete columns (a), (b), and (c) of Schedule N. Category 2 filers do not have to complete column (d).

**Column (a).** Use column (a) to report transactions between the foreign partnership and the person filing the Form 8865.

**Column (d).** Use column (d) to report transactions between the foreign partnership and any U.S. person with a 10% or more direct interest in the foreign partnership. If such person also qualifies under column (b), do not report transactions between the foreign partnership and that person under column (d). Report the transactions only under column (b).

**Lines 6 and 16.** Enter distributions received from other partnerships and distributions from the foreign partnership for which this form is being completed.

**Lines 20 and 21.** Enter the largest outstanding balances during the year of gross amounts borrowed from, and gross amounts lent to, the related parties described in columns (a) through (d). Do

not enter aggregate cash flows, year-end loan balances, average balances, or net balances. Do not include open account balances resulting from sales and purchases reported under other items listed on Schedule N that arise and are collected in full in the ordinary course of business.

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## Schedule O—Transfer of Property to a Foreign Partnership

**Note:** Every Category 3 filer must complete Schedule O.

### Part I—Transfers Reportable Under Section 6038B

Part I is used to report the transfer of property to a foreign partnership. Provide the information required in columns (a) through (g) with respect to each contribution of property to the foreign partnership that must be reported. If you contributed property with a FMV greater than its tax basis (appreciated property), or intangible property, provide the information required in columns (a) through (g) separately with respect to each item of property transferred (except to the extent you are allowed to aggregate the property under Regulations section 1.704-3(e)(2), (3), and (4)). Provide a general description of each such item of property in the **Supplemental information required to be reported** section. For all other property contributed, aggregate by the categories listed in Part I.

**Column (a).** Enter the date of the transfer. If the transfer was composed of a series of transactions over multiple dates, enter the date the transfer was completed.

**Column (b).** Enter the number of items of property transferred.

**Column (c).** Enter the FMV of the property contributed (measured as of the date of the transfer).

**Column (d).** Enter your adjusted basis in the property contributed on the date of the transfer. See sections 1011 through 1016 for more information on the determination of adjusted basis.

**Column (e).** If you contributed appreciated property, enter the method (traditional, traditional with curative allocations, or remedial) used by the partnership to make section 704(c) allocations with respect to each item of such property. See Regulations section 1.704-3(b), (c), and (d) for more information on these allocation methods.

**Column (f).** Enter the amount of gain, if any, recognized on the transfer. See sections 721(b) and 904(f)(3).

**Column (g).** Enter your percentage interest in the partnership immediately after the transfer. To the extent your percentage interest in the partnership differs among capital, profits, losses, or

deductions, enter “See Below” and state the different percentages.

**Supplemental information required to be reported.** Enter any information required to be reported in Part I in greater detail. Identify the applicable column number next to the information entered in this section. In addition, if you contributed property to a foreign partnership as part of a wider transaction, briefly describe the entire transaction.

### Part II—Dispositions Reportable Under Section 6038B

Use Part II to report certain dispositions by a foreign partnership of property. If you were required to report a transfer of appreciated property to the partnership, and the partnership disposes of the property while you are still a direct or constructive partner, you must report that disposition in Part II. If the partnership disposes of the property in a nonrecognition transaction and receives in exchange substituted basis property, report the subsequent disposition of the substituted basis property in the same manner as provided for the contributed property. See section 7701(a)(42) for the definition of substituted basis property and Regulations section 1.704-3(a)(8) for more information.

**Column (a).** Provide a brief description of the property disposed of by the partnership. If you are reporting the disposition of substituted basis property received by the partnership in a nonrecognition transaction in exchange for appreciated property contributed by you, enter “See Attached.” Attach a schedule providing brief descriptions of both the property contributed by you to the partnership and the substituted basis property received by the partnership in exchange for that property.

**Column (b).** Enter the date that you transferred this property to the partnership. If you are reporting the disposition of substituted basis property received by the partnership in a nonrecognition transaction in exchange for property previously contributed by you, enter “See Attached.” Attach a schedule showing both the date you transferred the appreciated property to the partnership and the date the partnership exchanged the property for substituted basis property in a nonrecognition transaction. See Regulations section 1.6038B-2.

**Column (c).** Enter the date that the partnership disposed of the property.

**Column (d).** Briefly describe how the partnership disposed of the property (e.g., by sale or exchange).

**Column (e).** Enter the amount of gain, if any, recognized by the partnership on the disposition of property.

**Column (f).** Enter the amount of depreciation recapture, if any, recognized by the partnership on the disposition of property. See Regulations section 1.1245-1(e) and 1.1250-1(f).

**Column (g).** Enter the amount of gain from column (e) allocated to you.

**Column (h).** Enter the amount of depreciation recapture from column (f) allocated to you. See Regulations sections 1.1245-1(e) and 1.1250-1(f). If you recognize any section 1254 recapture on the partnership’s disposition of natural resource recapture property, enter “See Attached” and attach a schedule calculating the amount of recapture. See Regulations section 1.1254-5.

### Part III—Gain Recognition Under Section 904(f)(3) or (f)(5)(F)

If gain recognition was required with respect to any transfer reported in Part I under section 904(f)(3) and (f)(5)(F), attach a schedule identifying the transfer and the amount of gain recognized.

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## Schedule P—Acquisitions, Dispositions, and Changes of Interests in a Foreign Partnership

Use Schedule P to report the acquisition, disposition, and change of interest in a foreign partnership. Every Category 4 filer must complete Schedule P.

### Part I—Acquisitions

Part I is completed by Category 4 filers required to report an acquisition of an interest in a foreign partnership. See the **Categories of Filers** beginning on page 1 for more details about which types of acquisitions must be reported.

**Column (a).** If you acquired the interest in the foreign partnership by purchase, gift, inheritance, or in a distribution from a trust, estate, partnership, or corporation, enter the name, address, and identifying number (if any), of the person from whom you acquired the interest.

**Column (b).** Enter the date of the acquisition. If the acquisition was composed of a series of transactions over multiple dates, enter the date the acquisition was completed.

**Column (c).** Enter the FMV of the interest you acquired in the partnership (measured as of the date of acquisition).

**Column (d).** Enter your basis in the partnership interest that you acquired (measured as of the date of acquisition). See sections 722 and 742.

**Columns (e) and (f).** Enter your total direct percentage interest in the partnership both before and immediately after the acquisition. To the extent your direct percentage interest in the partnership differs among capital, profits, losses, or deductions, enter “See Below” and state the different percentages in Part IV.

### Part II—Dispositions

This section is completed by U.S. persons who are Category 4 filers because they disposed of an interest in a foreign

partnership. See **Categories of Filers** beginning on page 1 for more details about what types of dispositions must be reported. For each disposition reported in Part II, indicate in Part IV whether a statement is required by Regulations section 1.751-1(a)(3) to be filed with respect to the disposition.

**Column (a).** Unless you disposed of the interest by withdrawing, in whole or in part, from the partnership, enter the name, address, and identifying number (if any) of the person to whom you transferred the interest in the foreign partnership.

**Column (b).** Enter the date of the disposition. If the disposition was composed of a series of transactions over multiple dates, enter the date the disposition was completed.

**Column (c).** Enter the FMV of the interest you disposed of in the partnership (measured as of the date of disposition). If you recognized gain or loss on the disposition, state the amount of gain or loss in Part IV. See section 741.

**Column (d).** Enter your adjusted basis in the partnership interest disposed of immediately before the disposition. See section 705.

**Columns (e) and (f).** Enter your total direct percentage interest in the partnership both before and immediately after the disposition. To the extent your percentage interest in the partnership differs among capital, profits, losses, or deductions, enter "See Below" and state the different percentages in Part IV.

### Part III—Change in Proportional Interest

This section is completed by U.S. persons who are Category 4 filers because their direct proportional interest in the foreign

partnership changed. See **Category of Filers** beginning on page 1 for more details about which changes in proportional interest must be reported.

**Column (a).** Briefly describe the event that caused your interest in the partnership to change (e.g., the admission of a new partner).

**Column (b).** Enter the date of the change. If the change resulted from a series of transactions over multiple dates, enter the date the change was completed.

**Column (c).** Enter the FMV of your interest in the partnership immediately before the change.

**Column (d).** Enter your basis in your partnership interest immediately before the change.

**Columns (e) and (f).** Enter your direct percentage interest in the partnership both before and immediately after the change. To the extent your percentage interest in the partnership differs among capital, profits, losses, or deductions, enter "See Below" and state the different percentages in Part IV.

### Part IV—Supplemental Information Required To Be Reported

Enter any information asked for in Part I, Part II, or Part III that must be reported in detail. Identify the applicable part number and column next to the information entered in Part IV.

**Paperwork Reduction Act Notice.** We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by section 6103.

The time needed to complete and file this form and related schedules will vary depending on individual circumstances. The estimated average times are:

Form	Recordkeeping	Learning about the law or the form	Preparing, copying, assembling and sending the form to the IRS
8865	96 hr., 45 min.	21 hr., 32 min.	36 hr., 5 min.
Schedule K-1 (Form 8865)	30 hr., 36 min.	9 hr., 39 min.	17 hr., 45 min.
Schedule O (Form 8865)	13 hr., 9 min.	2 hr., 22 min.	2 hr., 42 min.
Schedule P (Form 8865)	5 hr., 15 min.	30 min.	36 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form and related schedules simpler, we would be happy to hear from you. See the instructions for the tax return with which this form is filed. If you do not have to file a tax return, see the instructions for the return you would be required to file.



# Codes for Principal Business Activity and Principal Product or Service

This list of Principal Business Activities and their associated codes is designed to classify an enterprise by the type of activity in which it is engaged to facilitate the administration of the Internal Revenue Code. These Principal Business Activity Codes are based on the North American Industry Classification System.

Using the list of activities and codes below, determine from which activity the business derives the largest percentage of its "total receipts." Total receipts is defined as the sum of gross receipts or sales (Schedule B, line 1a), all other income (Schedule B, lines 4 through 7), income (receipts only) reported on Schedule K, lines 3a and 4a through 4f, and income (receipts only) reported on Form 8825, lines 2, 19, and 20a. If the business purchases raw materials and

supplies them to a subcontractor to produce the finished product, but retains title to the product, the business is considered a manufacturer and must use one of the manufacturing codes (311110-339900).

Once the Principal Business Activity is determined, enter the six-digit code from the list below on page 1, item F6. Also enter a brief description of the business activity in item F7.

Agriculture, Forestry, Fishing and Hunting	Code	Code	Code
<b>Code</b>	<b>Heavy Construction</b>	321900 Other Wood Product Mfg	<b>Machinery Manufacturing</b>
<b>Crop Production</b>	234100 Highway, Street, Bridge, & Tunnel Construction	<b>Paper Manufacturing</b>	333100 Agriculture, Construction, & Mining Machinery Mfg
111100 Oilseed & Grain Farming	234900 Other Heavy Construction	322100 Pulp, Paper, & Paperboard Mills	333200 Industrial Machinery Mfg
111210 Vegetable & Melon Farming (including potatoes & yams)	<b>Special Trade Contractors</b>	322200 Converted Paper Product Mfg	333310 Commercial & Service Industry Machinery Mfg
111300 Fruit & Tree Nut Farming	235110 Plumbing, Heating, & Air-Conditioning Contractors	<b>Printing and Related Support Activities</b>	333410 Ventilation, Heating, Air-Conditioning, & Commercial Refrigeration Equipment Mfg
111400 Greenhouse, Nursery, & Floriculture Production	235210 Painting & Wall Covering Contractors	323100 Printing & Related Support Activities	333510 Metalworking Machinery Mfg
111900 Other Crop Farming (including tobacco, cotton, sugarcane, hay, peanut, sugar beet & all other crop farming)	235310 Electrical Contractors	<b>Petroleum and Coal Products Manufacturing</b>	333610 Engine, Turbine & Power Transmission Equipment Mfg
<b>Animal Production</b>	235400 Masonry, Drywall, Insulation, & Tile Contractors	324110 Petroleum Refineries (including integrated)	333900 Other General Purpose Machinery Mfg
112111 Beef Cattle Ranching & Farming	235500 Carpentry & Floor Contractors	324120 Asphalt Paving, Roofing, & Saturated Materials Mfg	<b>Computer and Electronic Product Manufacturing</b>
112112 Cattle Feedlots	235610 Roofing, Siding, & Sheet Metal Contractors	324190 Other Petroleum & Coal Products Mfg	334110 Computer & Peripheral Equipment Mfg
112120 Dairy Cattle & Milk Production	235710 Concrete Contractors	<b>Chemical Manufacturing</b>	334200 Communications Equipment Mfg
112210 Hog & Pig Farming	235810 Water Well Drilling Contractors	325100 Basic Chemical Mfg	334310 Audio & Video Equipment Mfg
112300 Poultry & Egg Production	235900 Other Special Trade Contractors	325200 Resin, Synthetic Rubber, & Artificial & Synthetic Fibers & Filaments Mfg	334410 Semiconductor & Other Electronic Component Mfg
112400 Sheep & Goat Farming	<b>Manufacturing</b>	325300 Pesticide, Fertilizer, & Other Agricultural Chemical Mfg	334500 Navigational, Measuring, Electromedical, & Control Instruments Mfg
112510 Animal Aquaculture (including shellfish & finfish farms & hatcheries)	<b>Food Manufacturing</b>	325410 Pharmaceutical & Medicine Mfg	334610 Manufacturing & Reproducing Magnetic & Optical Media
112900 Other Animal Production	311110 Animal Food Mfg	325500 Paint, Coating, & Adhesive Mfg	<b>Electrical Equipment, Appliance, and Component Manufacturing</b>
<b>Forestry and Logging</b>	311200 Grain & Oilseed Milling	325600 Soap, Cleaning Compound, & Toilet Preparation Mfg	335100 Electric Lighting Equipment Mfg
113110 Timber Tract Operations	311300 Sugar & Confectionery Product Mfg	325900 Other Chemical Product & Preparation Mfg	335200 Household Appliance Mfg
113210 Forest Nurseries & Gathering of Forest Products	311400 Fruit & Vegetable Preserving & Specialty Food Mfg	<b>Plastics and Rubber Products Manufacturing</b>	335310 Electrical Equipment Mfg
113310 Logging	311500 Dairy Product Mfg	326100 Plastics Product Mfg	335900 Other Electrical Equipment & Component Mfg
<b>Fishing, Hunting and Trapping</b>	311610 Animal Slaughtering & Processing	326200 Rubber Product Mfg	<b>Transportation Equipment Manufacturing</b>
114110 Fishing	311710 Seafood Product Preparation & Packaging	327100 Clay Product & Refractory Mfg	336100 Motor Vehicle Mfg
114210 Hunting & Trapping	311800 Bakeries & Tortilla Mfg	327210 Glass & Glass Product Mfg	336210 Motor Vehicle Body & Trailer Mfg
<b>Support Activities for Agriculture and Forestry</b>	311900 Other Food Mfg (including coffee, tea, flavorings & seasonings)	327300 Cement & Concrete Product Mfg	336300 Motor Vehicle Parts Mfg
115110 Support Activities for Crop Production (including cotton ginning, soil preparation, planting, & cultivating)	<b>Beverage and Tobacco Product Manufacturing</b>	327400 Lime & Gypsum Product Mfg	336410 Aerospace Product & Parts Mfg
115210 Support Activities for Animal Production	312110 Soft Drink & Ice Mfg	327900 Other Nonmetallic Mineral Product Mfg	336510 Railroad Rolling Stock Mfg
115310 Support Activities For Forestry	312120 Breweries	<b>Primary Metal Manufacturing</b>	336610 Ship & Boat Building
<b>Mining</b>	312130 Wineries	331110 Iron & Steel Mills & Ferroalloy Mfg	336990 Other Transportation Equipment Mfg
211110 Oil & Gas Extraction	312140 Distilleries	331200 Steel Product Mfg from Purchased Steel	<b>Furniture and Related Product Manufacturing</b>
212110 Coal Mining	312200 Tobacco Manufacturing	331310 Alumina & Aluminum Production & Processing	337000 Furniture & Related Product Manufacturing
212200 Metal Ore Mining	<b>Textile Mills and Textile Product Mills</b>	331400 Nonferrous Metal (except Aluminum) Production & Processing	<b>Miscellaneous Manufacturing</b>
212310 Stone Mining & Quarrying	313000 Textile Mills	331500 Foundries	339900 Other Miscellaneous Manufacturing
212320 Sand, Gravel, Clay, & Ceramic & Refractory Minerals Mining & Quarrying	314000 Textile Product Mills	<b>Fabricated Metal Product Manufacturing</b>	<b>Wholesale Trade</b>
212390 Other Nonmetallic Mineral Mining & Quarrying	<b>Apparel Manufacturing</b>	332110 Forging & Stamping	<b>Wholesale Trade, Durable Goods</b>
213110 Support Activities for Mining	315100 Apparel Knitting Mills	332210 Cutlery & Handtool Mfg	421100 Motor Vehicle & Motor Vehicle Parts & Supplies Wholesalers
<b>Utilities</b>	315210 Cut & Sew Apparel Contractors	332300 Architectural & Structural Metals Mfg	421200 Furniture & Home Furnishing Wholesalers
221100 Electric Power Generation, Transmission & Distribution	315220 Men's & Boys' Cut & Sew Apparel Mfg	332400 Boiler, Tank, & Shipping Container Mfg	421300 Lumber & Other Construction Materials Wholesalers
221210 Natural Gas Distribution	315230 Women's & Girls' Cut & Sew Apparel Mfg	332510 Hardware Mfg	421400 Professional & Commercial Equipment & Supplies Wholesalers
221300 Water, Sewage & Other Systems	315290 Other Cut & Sew Apparel Mfg	332610 Spring & Wire Product Mfg	421500 Metal & Mineral (except Petroleum) Wholesalers
<b>Construction</b>	315990 Apparel Accessories & Other Apparel Mfg	332700 Machine Shops; Turned Product; & Screw, Nut, & Bolt Mfg	421600 Electrical Goods Wholesalers
<b>Building, Developing, and General Contracting</b>	<b>Leather and Allied Product Manufacturing</b>	332810 Coating, Engraving, Heat Treating, & Allied Activities	
233110 Land Subdivision & Land Development	316110 Leather & Hide Tanning & Finishing	332900 Other Fabricated Metal Product Mfg	
233200 Residential Building Construction	316210 Footwear Mfg (including rubber & plastics)		
233300 Nonresidential Building Construction	316990 Other Leather & Allied Product Mfg		
	<b>Wood Product Manufacturing</b>		
	321110 Sawmills & Wood Preservation		
	321210 Veneer, Plywood, & Engineered Wood Product Mfg		

<p><b>Code</b></p> <p>421700 Hardware, &amp; Plumbing &amp; Heating Equipment &amp; Supplies Wholesalers</p> <p>421800 Machinery, Equipment, &amp; Supplies Wholesalers</p> <p>421910 Sporting &amp; Recreational Goods &amp; Supplies Wholesalers</p> <p>421920 Toy &amp; Hobby Goods &amp; Supplies Wholesalers</p> <p>421930 Recyclable Material Wholesalers</p> <p>421940 Jewelry, Watch, Precious Stone, &amp; Precious Metal Wholesalers</p> <p>421990 Other Miscellaneous Durable Goods Wholesalers</p> <p><b>Wholesale Trade, Nondurable Goods</b></p> <p>422100 Paper &amp; Paper Product Wholesalers</p> <p>422210 Drugs &amp; Druggists' Sundries Wholesalers</p> <p>422300 Apparel, Piece Goods, &amp; Notions Wholesalers</p> <p>422400 Grocery &amp; Related Product Wholesalers</p> <p>422500 Farm Product Raw Material Wholesalers</p> <p>422600 Chemical &amp; Allied Products Wholesalers</p> <p>422700 Petroleum &amp; Petroleum Products Wholesalers</p> <p>422800 Beer, Wine, &amp; Distilled Alcoholic Beverage Wholesalers</p> <p>422910 Farm Supplies Wholesalers</p> <p>422920 Book, Periodical, &amp; Newspaper Wholesalers</p> <p>422930 Flower, Nursery Stock, &amp; Florists' Supplies Wholesalers</p> <p>422940 Tobacco &amp; Tobacco Product Wholesalers</p> <p>422950 Paint, Varnish, &amp; Supplies Wholesalers</p> <p>422990 Other Miscellaneous Nondurable Goods Wholesalers</p> <p><b>Retail Trade</b></p> <p><b>Motor Vehicle and Parts Dealers</b></p> <p>441110 New Car Dealers</p> <p>441120 Used Car Dealers</p> <p>441210 Recreational Vehicle Dealers</p> <p>441221 Motorcycle Dealers</p> <p>441222 Boat Dealers</p> <p>441229 All Other Motor Vehicle Dealers</p> <p>441300 Automotive Parts, Accessories, &amp; Tire Stores</p> <p><b>Furniture and Home Furnishings Stores</b></p> <p>442110 Furniture Stores</p> <p>442210 Floor Covering Stores</p> <p>442291 Window Treatment Stores</p> <p>442299 All Other Home Furnishings Stores</p> <p><b>Electronics and Appliance Stores</b></p> <p>443111 Household Appliance Stores</p> <p>443112 Radio, Television, &amp; Other Electronics Stores</p> <p>443120 Computer &amp; 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