

# 2009

# Partner's Instructions for Schedule K-1 (Form 1065)

## Partner's Share of Income, Deductions, Credits, etc. (For Partner's Use Only)

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

### General Instructions

#### Purpose of Schedule K-1

The partnership uses Schedule K-1 to report your share of the partnership's income, deductions, credits, etc. Keep it for your records. Do not file it with your tax return. The partnership has filed a copy with the IRS.

Although the partnership generally is not subject to income tax, you are liable for tax on your share of the partnership income, whether or not distributed. Include your share on your tax return if a return is required. Use these instructions to help you report the items shown on Schedule K-1 on your tax return.

The amount of loss and deduction you may claim on your tax return may be less than the amount reported on Schedule K-1. It is the partner's responsibility to consider and apply any applicable limitations. See *Limitations on Losses, Deductions, and Credits* beginning on page 2 for more information.

#### Inconsistent Treatment of Items

Generally, you must report partnership items shown on your Schedule K-1 (and any attached schedules) the same way that the partnership treated the items on its return. This rule does not apply if your partnership is within the "small partnership exception" and does not elect to have the tax treatment of partnership items determined at the partnership level.

If the treatment on your original or amended return is inconsistent with the partnership's treatment, or if the partnership was required to but has not filed a return, you must file Form 8082, *Notice of Inconsistent Treatment or Administrative Adjustment Request (AAR)*, with your original or amended return to identify and explain any inconsistency (or to note that a partnership return has not been filed).

If you are required to file Form 8082 but do not do so, you may be subject to the accuracy-related penalty. This penalty is in addition to any tax that results from making your amount or treatment of the item consistent with that shown on the partnership's return. Any deficiency that results from making the amounts consistent may be assessed immediately.

#### Errors

If you believe the partnership has made an error on your Schedule K-1, notify the partnership and ask for a corrected Schedule K-1. Do not change any items on your copy of Schedule K-1. Be sure that the partnership sends a copy of the corrected Schedule K-1 to the IRS. If you are a partner in a partnership that does not meet the small partnership exception and you report any partnership item on your return in a manner different from the way the partnership reported it, you must file Form 8082.

#### Sale or Exchange of Partnership Interest

Generally, a partner who sells or exchanges a partnership interest in a section 751(a) exchange must notify the partnership, in writing, within 30 days of the exchange (or, if earlier, by January 15 of the calendar year following the calendar year in which the exchange occurred). A "section 751(a) exchange" is any sale or exchange of a partnership interest in which any money or other property received by the partner in exchange for that partner's interest is attributable to unrealized receivables (as defined in section 751(c)) or inventory items (as defined in section 751(d)).

The written notice to the partnership must include the names and addresses of both parties to the exchange, the identifying numbers of the transferor and (if known) of the transferee, and the exchange date.

An exception to this rule is made for sales or exchanges of publicly traded partnership interests for which a broker is required to file Form 1099-B, *Proceeds From Broker and Barter Exchange Transactions*.

If a partner is required to notify the partnership of a section 751(a) exchange but does not do so, a \$50 penalty may be imposed for each such failure. However, no penalty will be imposed if the partner can show that the failure was due to reasonable cause and not willful neglect.

#### Nominee Reporting

Any person who holds, directly or indirectly, an interest in a partnership as a nominee for another person must furnish a written statement to the partnership by the last day of the month following the end of the partnership's tax year. This statement must include the name, address, and identifying number of the nominee and such other person, description of the partnership interest held as nominee for that person,

and other information required by Temporary Regulations section 1.6031(c)-1T. A nominee that fails to furnish this statement must furnish to the person for whom the nominee holds the partnership interest a copy of Schedule K-1 and related information within 30 days of receiving it from the partnership.

A nominee who fails to furnish when due all the information required by Temporary Regulations section 1.6031(c)-1T, or who furnishes incorrect information, is subject to a \$50 penalty for each statement for which a failure occurs. The maximum penalty is \$100,000 for all such failures during a calendar year. If the nominee intentionally disregards the requirement to report correct information, each \$50 penalty increases to \$100 or, if greater, 10% of the aggregate amount of items required to be reported, and the \$100,000 maximum does not apply.

#### International Boycotts

Every partnership that had operations in, or related to, a boycotting country, company, or a national of a country must file Form 5713, *International Boycott Report*.

If the partnership cooperated with an international boycott, it must give you a copy of its Form 5713. You must file your own Form 5713 to report the partnership's activities and any other boycott operations that you may have. You may lose certain tax benefits if the partnership participated in, or cooperated with, an international boycott. See Form 5713 and its instructions for more information.

#### Definitions

##### General Partner

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

##### Limited Partner

A limited partner is a partner in a partnership formed under a state limited partnership law, whose personal liability for partnership debts is limited to the amount of money or other property that the partner contributed or is required to contribute to the partnership. Some members of other entities, such as domestic or foreign business trusts or limited liability companies that are classified as partnerships, may be treated as limited partners for certain purposes. See, for example, Temporary Regulations section 1.469-5T(e)(3), which treats all members with limited liability as limited partners for purposes of section 469(h)(2).

## Nonrecourse Loans

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

## Elections

Generally, the partnership decides how to figure taxable income from its operations. However, certain elections are made by you separately on your income tax return and not by the partnership. These elections are made under the following code sections.

- Section 59(e) (deduction of certain qualified expenditures ratably over the period of time specified in that section). For details, see the instructions for code J in box 13.
- Section 108(b)(5) (income from the discharge of indebtedness). This does not include the section 108(i) election.
- Section 263A(d) (preproductive expenses). See the instructions for code P in box 13.
- Section 617 (deduction and recapture of certain mining exploration expenditures).
- Section 901 (foreign tax credit).

## Additional Information

For more information on the treatment of partnership income, deductions, credits, etc., see Pub. 535, Business Expenses.

To get forms and publications, see the instructions for your tax return or visit the IRS website at [www.irs.gov](http://www.irs.gov).

## Limitations on Losses, Deductions, and Credits

There are three potential limitations on partnership losses that you can deduct on your return. These limitations and the order in which you must apply them are as follows: the basis rules, the at-risk limitations, and the passive activity limitations. These limitations are discussed below.

Other limitations may apply to specific deductions (for example, the section 179 expense deduction). Generally, specific limitations apply before the basis, at-risk, and passive loss limitations.

## Basis Rules

Generally, you may not claim your share of a partnership loss (including a capital loss) to the extent that it is greater than the adjusted basis of your partnership interest at the end of the partnership's tax year. Any losses and deductions not allowed this year because of the basis limit can be carried forward indefinitely and deducted in a later year subject to the basis limit for that year.

The partnership is not responsible for keeping the information needed to figure the basis of your partnership interest. Although the partnership does provide an analysis of the changes to your capital account in item L of Schedule K-1, that information is based on the partnership's books and records and cannot be used to figure your basis.

You can figure the adjusted basis of your partnership interest by adding items that increase your basis and then subtracting items that decrease your basis.

Use the worksheet below to figure the basis of your interest in the partnership.

For more details on the basis rules, see Pub. 541, Partnerships.

## At-Risk Limitations

Generally, if you have (a) a loss or other deduction from any activity carried on as a trade or business or for the production of income by the partnership and (b) amounts in the activity for which you are not at risk, you will have to complete Form 6198, At-Risk Limitations, to figure your allowable loss.

The at-risk rules generally limit the amount of loss and other deductions that you can claim to the amount you could actually lose in the activity. These losses

and deductions include a loss on the disposition of assets and the section 179 expense deduction. However, if you acquired your partnership interest before 1987, the at-risk rules do not apply to losses from an activity of holding real property placed in service before 1987 by the partnership. The activity of holding mineral property does not qualify for this exception. The partnership should identify on an attachment to Schedule K-1 any losses that are not subject to the at-risk limitations.

Generally, you are not at risk for amounts such as the following.

- Nonrecourse loans used to finance the activity, to acquire property used in the

### Worksheet for Adjusting the Basis of a Partner's Interest in the Partnership

Keep for Your Records



1. Your adjusted basis at the end of the prior year. Do not enter less than zero. Enter -0- if this is your first tax year . . . . .	1. _____
Increases:	
2. Money and your adjusted basis in property contributed to the partnership less the associated liabilities (but not less than zero) . . . . .	2. _____
3. Your increased share of or assumption of partnership liabilities (Subtract your share of liabilities shown in item K of your 2008 Schedule K-1 from your share of liabilities shown in item K of your 2009 Schedule K-1 and add the amount of any partnership liabilities you assumed during the tax year) (but not less than zero) . . . . .	3. _____
4. Your share of the partnership's income or gain (including tax-exempt income) reduced by any amount included in interest income with respect to the credit to holders of clean renewable energy bonds, Gulf tax credit bonds, and Midwestern tax credit bonds . . . . .	4. _____
5. Any gain recognized this year on contributions of property. Do not include gain from transfer of liabilities . . . . .	5. _____
6. Your share of the excess of the deductions for depletion (other than oil and gas depletion) over the basis of the property subject to depletion . . . . .	6. _____
Decreases:	
7. Withdrawals and distributions of money and the adjusted basis of property distributed to you from the partnership. Do not include the amount of property distributions included in the partner's income (taxable income) . . . . .	7. _____
<b>Caution:</b> A distribution may be taxable if the amount exceeds your adjusted basis of your partnership interest immediately before the distribution.	
8. Your decreased share of partnership liabilities and any decrease in your individual liabilities because they were assumed by the partnership. (Subtract your share of liabilities shown in item K of your 2009 Schedule K-1 from your share of liabilities shown in item K of your 2008 Schedule K-1 and add the amount of your individual liabilities that the partnership assumed during the tax year) (but not less than zero) . . . . .	8. _____
9. Your share of the partnership's nondeductible expenses that are not capital expenditures . . . . .	9. _____
10. Your share of the partnership's losses and deductions (including capital losses). However, include your share of the partnership's section 179 expense deduction for this year even if you cannot deduct all of it because of limitations . . . . .	10. _____
11. The amount of your deduction for depletion of any partnership oil and gas property, not to exceed your allocable share of the adjusted basis of that property . . . . .	11. _____
12. Your adjusted basis in the partnership at end of this tax year. (Add lines 1 through 6 and subtract lines 7 through 11 from the total. If zero or less, enter -0-.) . . . . .	12. <u>0.00</u>

**Caution:** The deduction for your share of the partnership's losses and deductions is limited to your adjusted basis in your partnership interest. If you entered zero on line 12 and the amount figured for line 12 was less than zero, a portion of your share of the partnership losses and deductions may not be deductible. (See *Basis Rules* above for more information.)

activity, or to acquire your interest in the activity, that are not secured by your own property (other than the property used in the activity). See the instructions for item K on page 5 for the exception for qualified nonrecourse financing secured by real property.

- Cash, property, or borrowed amounts used in the activity (or contributed to the activity, or used to acquire your interest in the activity) that are protected against loss by a guarantee, stop-loss agreement, or other similar arrangement (excluding casualty insurance and insurance against tort liability).
- Amounts borrowed for use in the activity from a person who has an interest in the activity, other than as a creditor, or who is related, under section 465(b)(3), to a person (other than you) having such an interest.

You should get a separate statement of income, expenses, etc., for each activity from the partnership.

## Passive Activity Limitations

Section 469 provides rules that limit the deduction of certain losses and credits. These rules apply to partners who:

- Are individuals, estates, trusts, closely held corporations, or personal service corporations and
- Have a passive activity loss or credit for the tax year.

Generally, passive activities include the following.

1. Trade or business activities in which you did not materially participate and
2. Activities that meet the definition of rental activities under Temporary Regulations section 1.469-1T(e)(3) and Regulations section 1.469-1(e)(3).

Passive activities do not include:

1. Trade or business activities in which you materially participated.
2. Rental real estate activities in which you materially participated if you were a **real estate professional** for the tax year. You were a real estate professional only if you met both of the following conditions.
  - a. More than half of the personal services you performed in trades or businesses were performed in real property trades or businesses in which you materially participated and
  - b. You performed more than 750 hours of services in real property trades or businesses in which you materially participated.

**Note.** For a closely held C corporation (defined in section 465(a)(1)(B)), the above conditions are treated as met if more than 50% of the corporation's gross receipts were from real property trades or businesses in which the corporation materially participated.

For purposes of this rule, each interest in rental real estate is a separate activity, unless you elect to treat all interests in rental real estate as one activity. For details on making this election, see the Instructions for Schedule E (Form 1040).

If you are married filing jointly, either you or your spouse must separately meet both of the above conditions, without taking into account services performed by the other spouse.

A real property trade or business is any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business. Services you performed as an employee are not treated as performed in a real property trade or business unless you owned more than 5% of the stock (or more than 5% of the capital or profits interest) in the employer.

3. Working interests in oil or gas wells if you were a general partner.

4. The rental of a dwelling unit any partner used for personal purposes during the year for more than the greater of 14 days or 10% of the number of days that the residence was rented at fair rental value.

5. Activities of trading personal property for the account of owners of interests in the activities.

If you are an individual, an estate, or a trust, and you have a passive activity loss or credit, use Form 8582, Passive Activity Loss Limitations, to figure your allowable passive losses and Form 8582-CR, Passive Activity Credit Limitations, to figure your allowable passive credits. For a corporation, use Form 8810, Corporate Passive Activity Loss and Credit Limitations. See the instructions for these forms for details.

If the partnership had more than one activity, it will attach a statement to your Schedule K-1 that identifies each activity (trade or business activity, rental real estate activity, rental activity other than rental real estate, etc.) and specifies the income (loss), deductions, and credits from each activity.

**Material participation.** You must determine if you materially participated (a) in each trade or business activity held through the partnership and (b) if you were a real estate professional (defined above), in each rental real estate activity held through the partnership. All determinations of material participation are based on your participation during the partnership's tax year.

Material participation standards for partners who are individuals are listed below. Special rules apply to certain retired or disabled farmers and to the surviving spouses of farmers. See the Instructions for Form 8582 for details.

Corporations should refer to the Instructions for Form 8810 for the material participation standards that apply to them.

**Individuals (other than limited partners).** If you are an individual (either a general partner or a limited partner who owned a general partnership interest at all times during the tax year), you materially participated in an activity only if one or more of the following apply.

1. You participated in the activity for more than 500 hours during the tax year.
2. Your participation in the activity for the tax year constituted substantially all the participation in the activity of all individuals (including individuals who are not owners of interests in the activity).
3. You participated in the activity for more than 100 hours during the tax year, and your participation in the activity for the tax year was not less than the participation in the activity of any other individual (including individuals who were not owners of interests in the activity) for the tax year.

4. The activity was a significant participation activity for the tax year, and you participated in all significant participation activities (including activities outside the partnership) during the year for more than 500 hours. A significant participation activity is any trade or business activity in which you participated for more than 100 hours during the year and in which you did not materially participate under any of the material participation tests (other than this test).

5. You materially participated in the activity for any 5 tax years (whether or not consecutive) during the 10 tax years that immediately precede the tax year.

6. The activity was a personal service activity and you materially participated in the activity for any 3 tax years (whether or not consecutive) preceding the tax year. A personal service activity involves the performance of personal services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, or any other trade or business in which capital is not a material income-producing factor.

7. Based on all the facts and circumstances, you participated in the activity on a regular, continuous, and substantial basis during the tax year.

**Limited partners.** If you are a limited partner, you do not materially participate in an activity unless you meet one of the tests in paragraphs 1, 5, or 6 above.

**Work counted toward material participation.** Generally, any work that you or your spouse does in connection with an activity held through a partnership (where you own your partnership interest at the time the work is done) is counted toward material participation. However, work in connection with the activity is not counted toward material participation if either of the following applies.

1. The work is not the type of work that owners of the activity would usually do and one of the principal purposes of the work that you or your spouse does is to avoid the passive loss or credit limitations.

2. You do the work in your capacity as an investor and you are not directly involved in the day-to-day operations of the activity. Examples of work done as an investor that would not count toward material participation include:

- a. Studying and reviewing financial statements or reports on operations of the activity,
- b. Preparing or compiling summaries or analyses of the finances or operations of the activity for your own use, and
- c. Monitoring the finances or operations of the activity in a non-managerial capacity.

**Effect of determination.** Income (loss), deductions, and credits from an activity are nonpassive if you determine that:

- You materially participated in a trade or business activity of the partnership or
- You were a real estate professional (defined earlier) in a rental real estate activity of the partnership.

If you determine that you did not materially participate in a trade or business activity of the partnership or if you have income (loss), deductions, or credits from a rental activity of the partnership (other than

a rental real estate activity in which you materially participated as a real estate professional), the amounts from that activity are passive. Report passive income (losses), deductions, and credits as follows.

1. If you have an overall gain (the excess of income over deductions and losses, including any prior year unallowed loss) from a passive activity, report the income, deductions, and losses from the activity as indicated in these instructions.

2. If you have an overall loss (the excess of deductions and losses, including any prior year unallowed loss, over income) or credits from a passive activity, report the income, deductions, losses, and credits from all passive activities using the Instructions for Form 8582 or Form 8582-CR (or Form 8810), to see if your deductions, losses, and credits are limited under the passive activity rules.

**Publicly traded partnerships.** The passive activity limitations are applied separately for items (other than the low-income housing credit and the rehabilitation credit) from each publicly traded partnership (PTP). Thus, a net passive loss from a PTP may not be deducted from other passive income. Instead, a passive loss from a PTP is suspended and carried forward to be applied against passive income from the same PTP in later years. If the partner's entire interest in the PTP is completely disposed of, any unused losses are allowed in full in the year of disposition.

If you have an overall gain from a PTP, the net gain is nonpassive income. In addition, the nonpassive income is included in investment income to figure your investment interest expense deduction.

Do not report passive income, gains, or losses from a PTP on Form 8582. Instead, use the following rules to figure and report on the proper form or schedule your income, gains, and losses from passive activities that you held through each PTP you owned during the tax year.

1. Combine any current year income, gains and losses, and any prior year unallowed losses to see if you have an overall gain or loss from the PTP. Include only the same types of income and losses you would include in your net income or loss from a non-PTP passive activity. See Pub. 925, Passive Activity and At-Risk Rules, for more details.

2. If you have an overall gain, the net gain portion (total gain minus total losses) is nonpassive income. On the form or schedule you normally use, report the net gain portion as nonpassive income and the remaining income and the total losses as passive income and loss. To the left of the entry space, enter "From PTP." It is important to identify the nonpassive income because the nonpassive portion is included in modified adjusted gross income for purposes of figuring on Form 8582 the "special allowance" for active participation in a non-PTP rental real estate activity. In addition, the nonpassive income is included in investment income when figuring your investment interest expense deduction on Form 4952.

**Example.** If you have Schedule E (Form 1040) income of \$8,000, and a Form 4797 prior year unallowed loss of \$3,500 from the

passive activities of a particular PTP, you have a \$4,500 overall gain (\$8,000 – \$3,500). On Schedule E (Form 1040), line 28, report the \$4,500 net gain as nonpassive income in column (j). In column (g), report the remaining Schedule E (Form 1040) gain of \$3,500 (\$8,000 – \$4,500). On the appropriate line of Form 4797, report the prior year unallowed loss of \$3,500. Be sure to enter "From PTP" to the left of each entry space.

3. If you have an overall loss (but did not dispose of your entire interest in the PTP to an unrelated person in a fully taxable transaction during the year), the losses are allowed to the extent of the income, and the excess loss is carried forward to use in a future year when you have income to offset it. Report as a passive loss on the schedule or form you normally use the portion of the loss equal to the income. Report the income as passive income on the form or schedule you normally use.

**Example.** You have a Schedule E (Form 1040) loss of \$12,000 (current year losses plus prior year unallowed losses) and a Form 4797 gain of \$7,200. Report the \$7,200 gain on the appropriate line of Form 4797. On Schedule E (Form 1040), line 28, report \$7,200 of the losses as a passive loss in column (f). Carry forward to 2010 the unallowed loss of \$4,800 (\$12,000 – \$7,200).

If you have unallowed losses from more than one activity of the PTP or from the same activity of the PTP that must be reported on different forms, you must allocate the unallowed losses on a *pro rata* basis to figure the amount allowed from each activity or on each form.

**TIP** *To allocate and keep a record of the unallowed losses, use Worksheets 5, 6, and 7 of Form 8582. List each activity of the PTP in Worksheet 5. Enter the overall loss from each activity in column (a). Complete column (b) of Worksheet 5 according to its instructions. Multiply the total unallowed loss from the PTP by each ratio in column (b) and enter the result in column (c) of Worksheet 5. Then, complete Worksheet 6 if all the loss from the same activity is to be reported on one form or schedule. Use Worksheet 7 instead of Worksheet 6 if you have more than one loss to be reported on different forms or schedules for the same activity. Enter the net loss plus any prior year unallowed losses in column (a) of Worksheet 6 (or Worksheet 7 if applicable). The losses in column (c) of Worksheet 6 (column (e) of Worksheet 7) are the allowed losses to report on the forms or schedules. Report both these losses and any income from the PTP on the forms and schedules you normally use.*

4. If you have an overall loss and you disposed of your entire interest in the PTP to an unrelated person in a fully taxable transaction during the year, your losses (including prior year unallowed losses) allocable to the activity for the year are not limited by the passive loss rules. A fully taxable transaction is one in which you recognize all your realized gain or loss. Report the income and losses on the forms and schedules you normally use.

**Note.** For rules on the disposition of an entire interest reported using the installment method, see the Instructions for Form 8582.

**Special allowance for a rental real estate activity.** If you actively participated in a rental real estate activity, you may be able to deduct up to \$25,000 of the loss from the activity from nonpassive income. This "special allowance" is an exception to the general rule disallowing losses in excess of income from passive activities. The special allowance is not available if you were married, file a separate return for the year, and did not live apart from your spouse at all times during the year.

Only individuals, qualifying estates, and qualifying revocable trusts that made a section 645 election can actively participate in a rental real estate activity. Estates (other than qualifying estates), trusts (other than qualifying revocable trusts that made a section 645 election), and corporations cannot actively participate. Limited partners cannot actively participate unless future regulations provide an exception.

You are not considered to actively participate in a rental real estate activity if, at any time during the tax year, your interest (including your spouse's interest) in the activity was less than 10% (by value) of all interests in the activity.

Active participation is a less stringent requirement than material participation. You may be treated as actively participating if you participated, for example, in making management decisions or arranging for others to provide services (such as repairs) in a significant and bona fide sense. Management decisions that can count as active participation include approving new tenants, deciding rental terms, approving capital or repair expenditures, and other similar decisions.

An estate is a qualifying estate if the decedent would have satisfied the active participation requirement for the activity for the tax year the decedent died. A qualifying estate is treated as actively participating for tax years ending less than 2 years after the date of the decedent's death.

**Modified adjusted gross income limitation.** The maximum special allowance that single individuals and married individuals filing a joint return can qualify for is \$25,000. The maximum is \$12,500 for married individuals who file separate returns and who lived apart at all times during the year. The maximum special allowance for which an estate can qualify is \$25,000 reduced by the special allowance for which the surviving spouse qualifies.

If your modified adjusted gross income (defined below) is \$100,000 or less (\$50,000 or less if married filing separately), your loss is deductible up to the maximum special allowance referred to in the preceding paragraph. If your modified adjusted gross income is more than \$100,000 (more than \$50,000 if married filing separately), the special allowance is limited to 50% of the difference between \$150,000 (\$75,000 if married filing separately) and your modified adjusted gross income. When modified adjusted gross income is \$150,000 or more (\$75,000 or more if married filing separately), there is no special allowance.

