Form 8865: Reporting Foreign Partnership Income
Navigating Rules for Allocable Share of Foreign Income

WEDNESDAY, NOVEMBER 5, 2014, 1:00-2:50 pm Eastern

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Form 8865: Foreign Partnership Income

November 5, 2014

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Today’s Program

*International Information Reporting Overview*
*Charles Kolstad*

*Filling Out Form 8865*
*Alison Dougherty*

Considerations in Preparing Form 8865
*Charles Kolstad*
International Information Reporting

- US business now have extensive international business operations
- To assure compliance with US tax rules, the IRS has adopted a large number of information reporting forms
  - Form 5471 (Foreign Corporations)
  - Form 8858 (Disregarded Foreign Entities)
  - Form 8865 (Foreign Partnerships)
  - FinCEN Form 114 (Foreign Financial Accounts)
International Information Reporting

- The IRS is now aggressively enforcing the international information reporting requirements
- International examiners assigned more often to tax audits
- Increasingly difficult to avoid penalties for late filed information returns
- 2014 Offshore Voluntary Disclosure Program
International Information Reporting

• Failure to file the required forms can have several adverse effects:
• Significant monetary penalties for failure to file Form 8865 on a timely basis
• Possible IRS argument that the income tax return is incomplete if the necessary information returns are not attached
  • Statute of limitations does not start to run if income tax return is incomplete
  • Section 6501(c)(8) – Statute of limitations does not expire until 3 years after Form 8865 is provided to the IRS
• Deutsche Bank case
Prerequisite to Filing Form 8865
Foreign Partnership Classification

- Form 8865 must be filed to report certain interests in a foreign partnership
  - Actual general or limited foreign partnership
  - Check the box foreign partnership
  - Foreign LLPs
    - Different treatment from US LLPs/LLCs
    - Classified as a corporation under the default classification rules under Regulation 301.7701-3 unless at least one member has unlimited liability (file Form 5471 not Form 8865)
Prerequisite to Filing Form 8865
Foreign Default Classification Rule

• Certain foreign entities are on the per se list of foreign corporations under the Section 7701 regulations

• All other foreign entities can elect their classification for US tax purposes
  • File Form 8802 to elect entity classification

• Foreign eligible entity default classification will be as a foreign corporation if it has more than one owner and at least one owner does not have unlimited liability
Charles K. Kolstad
Of Counsel Venable LLP

Charles Kolstad focuses his practice on international tax, corporate, and partnership matters. He assists clients in tax and corporate planning relating to the acquisition, disposition and restructuring of businesses, corporations and partnerships both domestically and internationally.

He has advised numerous clients, accountants and business managers on dealing with unreported foreign financial accounts and foreign trusts, as well as the reporting requirements for U.S. tax payers with international business operations. Charles also advises foreign individuals moving to the U.S. on pre-immigration, income, gift and estate tax planning opportunities.
Slide Intentionally Left Blank
Form 8865
Return of U.S. Persons with Respect to Certain Foreign Partnerships

Alison N. Dougherty

November 5, 2014
Form 8865 Foreign Partnership Reporting
Form 8865 Foreign Partnership Reporting

• Form 8865 reporting requirement applies to U.S. persons who own an interest in a foreign partnership.

• U.S. person is a U.S. individual who is a U.S. citizen or resident, U.S. partnership, U.S. corporation and any estate or trust that is not foreign. See I.R.C. Section 7701(a)(30).

• U.S. resident is an individual who holds a U.S. green card, meets the substantial presence test or makes the first year election under I.R.C. Section 7701(b).
Form 8865 Foreign Partnership Reporting

What is a foreign partnership?

• Partnership
  – Relationship between two or more persons
  – Purpose to carry on a trade or business
  – Each person contributes money, property or services
  – Each person expects to share in the profits and losses of the business
  – Limited partnership, syndicate, group, pool, joint venture, or other unincorporated organization
    • Business, financial operation or venture is carried on
    • Not within definition of corporation, trust, estate or sole proprietorship under I.R.C. Section 7701

• Foreign partnership – any partnership not created or organized in the United States or under the laws of the United States or any state
Foreign Partnership Based on Check-the-Box Election

- Foreign eligible entity that is classified as a foreign partnership with Form 8832 check-the-box election in effect
- Foreign eligible entity is a foreign company that is not on the per se list of foreign corporations.
Foreign Partnership Based on Foreign Default Classification Rule

• Foreign eligible entity default classification as foreign partnership with more than one owner and at least one owner does not have limited liability
Form 8865 Foreign Partnership Reporting
Applicable Authority

- I.R.C. Section 6038 and U.S. Treas. Reg. Section 1.6038-3 reporting with respect to controlled foreign partnerships
- I.R.C. Section 6038B and U.S. Treas. Reg. Section 1.6038B-2 reporting of transfers to foreign partnerships
- I.R.C. Section 6046A and U.S. Treas. Reg. Section 1.6046A-1 reporting of acquisitions, dispositions and changes in foreign partnership interests
Form 8865 – Foreign Partnership Interests for Category 1 and 2 Filers

• 50% or 10% interest is an interest in the capital, profits, deductions or losses of the foreign partnership
Form 8865 – Constructive Ownership

• Attribution from entities, estates and trusts - Interest owned directly or indirectly by or for a corporation, partnership, estate or trust is considered as being owned proportionately by its owners, partners or beneficiaries
• Attribution from family members – An individual is considered to own an interest owned directly or indirectly by or for his or her family including spouse, brothers, sisters, ancestors and lineal descendants
Form 8865 – Constructive Ownership

• Attribution from family members who are nonresident alien individuals – An individual is considered to own an interest that is owned directly or indirectly by a nonresident alien family member if the individual also owns an interest directly or indirectly not taking into account the interest of the nonresident alien family member.
Form 8865 – Category 1 Filer

• Category 1 Filer – U.S. person who controlled a foreign partnership at any time during the partnership’s tax year

• Control means owning more than a 50% interest in the partnership.
Form 8865 – Category 2 Filer

• Category 2 Filer – U.S. person who at any time during the foreign partnership’s tax year owned a 10% or greater interest while the partnership was controlled by U.S. persons each owning at least 10% interests.

• If partnership has Category 1 filer then no person is considered a Category 2 filer.
• Category 3 Filer – U.S. person who contributed property during that person’s tax year to a foreign partnership in exchange for a partnership interest and:
  1. owned directly or constructively at least a 10% interest immediately after the contribution, or
  2. The value of property contributed exceeds $100,000 taking into account the value of all property contributed by the person or any related person during the 12 month period ending on the date of the transfer.
Form 8865 – Category 3 Filer

• Category 3 Filer – Also includes:
  
  1. U.S. person that previously transferred appreciated property to the partnership;
  2. U.S. person was required to report the prior transfer as a Category 3 filer; and
  3. Foreign partnership disposed of such property while the U.S. person was a direct or indirect partner in the partnership
Form 8865 – Category 3 Filer

• Category 3 Filer – U.S. partners in U.S. partnerships
  1. U.S. partnership transfers property to a foreign partnership
  2. U.S. partnership’s partners are considered to have transferred their proportionate share of the property to the foreign partnership
  3. If U.S. partnership files Form 8865 to report the transfer, the U.S. partners are not required to file
Form 8865 – Category 3 Filer

- Category 3 Filer – Indirect transfers through foreign partnerships
  2. Preamble to the regulation states that “if a foreign partnership transfers property to another foreign partnership, a U.S. person that is a partner of the transferor partnership is not required to report that transfer until such time as the IRS and Treasury implement rules requiring such reporting.” T.D. 8817 (2/5/1999).
Form 8865 – Category 4 Filer

• Category 4 Filer – U.S. person who had a reportable event during that person’s tax year including:
  1. Acquiring an interest that results in a 10% or greater direct interest in the foreign partnership;
  2. Disposing of an interest that results in a decrease of the direct interest below 10%; or
  3. 10% increase or decrease in direct proportional ownership interest since last reportable event.
Form 8865 Filing Exceptions

1. Multiple Category 1 filers
2. Constructive owners
3. Members of affiliated group of corporations filing consolidated return
4. Certain trusts
5. Certain Category 4 filers
6. Relief for Category 1 and 2 filers when foreign partnership files Form 1065 or 1065-B
• Constructive Category 1 or 2 filer – Not required to file Form 8865 if no direct interest and:

1. U.S. person through which the interest is constructively owned files Form 8865;
2. U.S. person through which the interest is constructively owned is also a constructive owner and meets the requirements for the constructive ownership exception; or
3. Form 8865 is filed by another Category 1 filer under multiple filers exception.
Form 8865 Constructive Ownership Exception

• Indirect partner must file statement with U.S. Federal tax return.
  1. Controlled Foreign Partnership Reporting statement
  2. Indirect partner is required to filed Form 8865 but is not filing under the constructive ownership exception.
  3. Name and address of U.S. persons whose interests the indirect partner constructively owns
  4. Name and address of foreign partnership
  5. Other requirements for statement if indirect partner is a domestic corporation
# Form 8865 Filing Requirements for Filer Categories

<table>
<thead>
<tr>
<th>Filing Requirements for Categories of Filers</th>
<th>Category of Filers</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>1</td>
</tr>
<tr>
<td>Identifying Information— (page 1 of Form 8865)</td>
<td>✓</td>
</tr>
<tr>
<td>Schedule A—Construcive Ownership of Partnership Interest</td>
<td>✓</td>
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<tr>
<td>Schedule A-1—Certain Partners of Foreign Partnership</td>
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</tr>
<tr>
<td>Schedule A-2—Affiliation Schedule</td>
<td>✓</td>
</tr>
<tr>
<td>Schedule B—Income Statement—Trade or Business Income</td>
<td>✓</td>
</tr>
<tr>
<td>Schedule K—Partners’ Distributive Share Items</td>
<td>✓</td>
</tr>
<tr>
<td>Schedule L—Balance Sheets per Books</td>
<td>✓</td>
</tr>
<tr>
<td>Schedule M—Balance Sheets for Interest Allocation</td>
<td>✓</td>
</tr>
<tr>
<td>Schedule M-1—Reconciliation of Income (Loss) per Books With Income (Loss) per Return</td>
<td>✓</td>
</tr>
<tr>
<td>Schedule M-2—Analysis of Partners’ Capital Accounts</td>
<td>✓</td>
</tr>
<tr>
<td>Schedule N—Transactions Between Controlled Foreign Partnership and Partners or Other Related Entities</td>
<td>✓</td>
</tr>
<tr>
<td>Schedule D— Schedule D (Form 1066), Capital Gains and Losses</td>
<td>✓</td>
</tr>
<tr>
<td>Schedule K-1—Partner's Share of Income, Deductions, Credits, etc. (direct partners only)</td>
<td>✓</td>
</tr>
<tr>
<td>Schedule O—Transfer of Property to a Foreign Partnership</td>
<td>✓</td>
</tr>
<tr>
<td>Schedule P—Acquisitions, Dispositions, and Changes of Interests in a Foreign Partnership</td>
<td>✓</td>
</tr>
</tbody>
</table>
Form 8865 Page One

- Foreign partnership’s tax year
- Filer information
- Filer category
- Filer’s tax year
- Filer’s share of partnership liabilities
- Information about other partners – multiple Category 1 filers exception and consolidated returns exception
- Foreign partnership information
- Reference ID required if no FEIN
- Date of formation
- Principal business activity and code list in Form 8865 instructions
- Functional currency and exchange rate
- U.S. and foreign agents, U.S. filing requirements, custody of books
- Special allocations, Form 8858 for disregarded entities, classification in foreign country, separate units
- Exception for filing Schedules L, M-1 and M-2 if gross receipts less than $250,000 and assets less than $1 million at end of the tax year
- Signature block – sign only if filing separately from tax return
Form 8865 Page Two
Schedule A – Direct or constructive ownership interest
Schedule A-1
- Category 1 filer – List each U.S. person who owned 10% direct interest
- Category 3 filer – List each U.S. person who owned 10% direct interest
- Category 3 filer – List any direct partner related to the Category 3 filer
- Category 3 filer – Schedule A-1 not required if only transferred cash and did not own 10% after the transfer

Schedule A-2 – All filers must list all U.S. or foreign partnerships in which foreign partnership owned a direct interest or 10% indirect interest.
Schedule A-2 – Category 1 filer must provide foreign partnership’s share of ordinary income or loss from direct interest in other partnership.
Follow instructions for Form 1065 Income and Deductions

Trade or business income

Do not report rental activity income or portfolio income

Translation of foreign currency into US dollars based on divide by convention at average exchange rate for the year


www.oanda.com currency converter
Form 8865
Reporting Periods for Category 1 and 2 Filers

• Form 8865 reporting required for the foreign partnership’s tax year that ends with or within the U.S. person’s tax year per U.S. Treas. Reg. Sec. 1.6038-3(f).

• Same rules apply to determine required tax year end of foreign partnership as for U.S. partnerships under I.R.C. Section 706.
Form 8865
Foreign Partnership Tax Year End

• I.R.C. Section 706 – Partnership’s tax year determined by reference to partners
  – Majority interest tax year
  – Tax year of all principal partners
  – 12/31 calendar year tax year
  – Other tax year end if business purpose established without deferral of income to partners
At issue for Category 1 filer required to report taxable income and Schedule K-1 on Form 8865 and Category 2 filer required to report Schedule K-1

Theoretically calculation of book income or loss of foreign partnership should be consistent with U.S. GAAP

Tax accounting method for foreign partnership should follow same rules for U.S. partnerships

Cash method prohibited for foreign partnership with C corporation partner unless meet $5 mil. gross receipts test per I.R.C. Section 448
Form 8865 Page Three Schedule K
• Only Category 1 filers complete Schedule K
• Schedule K is a summary of all partners’ distributive shares of income, gain, loss, deductions and credits
• Line 1 ordinary trade or business income from the income statement
• Rental activity income or loss and portfolio items reflected on Schedule K
• Schedule K is the same on Form 8865 as Form 1065
<table>
<thead>
<tr>
<th>Item</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Cash</td>
</tr>
<tr>
<td>2a</td>
<td>Trade notes and accounts receivable</td>
</tr>
<tr>
<td>2b</td>
<td>Cash balance due from customers</td>
</tr>
<tr>
<td>2c</td>
<td>Less allowance for bad debts</td>
</tr>
<tr>
<td>3</td>
<td>Inventories</td>
</tr>
<tr>
<td>4</td>
<td>U.S. government obligations</td>
</tr>
<tr>
<td>5</td>
<td>Tax-exempt securities</td>
</tr>
<tr>
<td>6</td>
<td>Other current assets (attach statement)</td>
</tr>
<tr>
<td>7a</td>
<td>Loans to partners (or persons related to partners)</td>
</tr>
<tr>
<td>7b</td>
<td>Mortgages and real estate loans</td>
</tr>
<tr>
<td>7c</td>
<td>Other investments (attach statement)</td>
</tr>
<tr>
<td>7d</td>
<td>Depletions and other depreciations</td>
</tr>
<tr>
<td>7e</td>
<td>Loss on sale of assets</td>
</tr>
<tr>
<td>7f</td>
<td>Less accumulated depreciation</td>
</tr>
<tr>
<td>8</td>
<td>Other current assets (attach statement)</td>
</tr>
<tr>
<td>9</td>
<td>Intangible assets (attach statement)</td>
</tr>
<tr>
<td>10</td>
<td>Intangible assets (attach statement)</td>
</tr>
<tr>
<td>11</td>
<td>Outstanding obligations</td>
</tr>
<tr>
<td>12</td>
<td>Investments in unconsolidated entities</td>
</tr>
<tr>
<td>13</td>
<td>Other assets (attach statement)</td>
</tr>
</tbody>
</table>

**Balance Sheet**

<table>
<thead>
<tr>
<th>Item</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>15</td>
<td>Accounts payable</td>
</tr>
<tr>
<td>16</td>
<td>Notes receivable</td>
</tr>
<tr>
<td>17</td>
<td>Other current liabilities (attach statement)</td>
</tr>
<tr>
<td>18</td>
<td>All notes payable (attach statement)</td>
</tr>
<tr>
<td>19</td>
<td>Notes payable due from partners</td>
</tr>
<tr>
<td>20</td>
<td>Less mortgages, notes, and other receivables due from partners</td>
</tr>
<tr>
<td>21</td>
<td>Partners' capital accounts</td>
</tr>
<tr>
<td>22</td>
<td>Total liabilities and capital</td>
</tr>
</tbody>
</table>

**Schedule L Balance Sheet**
Only Category 1 filers complete Schedule L

Foreign partnership’s balance sheet is prepared and translated from foreign currency into U.S. dollars in accordance with U.S. GAAP

Convert the balance sheet from foreign currency to U.S. dollars based on the divide by convention with the 12/31 year end exchange rate


http://www.fms.treas.gov/intn.html

www.oanda.com currency converter
Form 8865 Page Five Schedules M, M-1 & M-2

<table>
<thead>
<tr>
<th>Schedule M</th>
<th>Balance Sheet for Interest Allocation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Total U.S. assets</td>
</tr>
<tr>
<td>2</td>
<td>Total foreign assets</td>
</tr>
<tr>
<td>a</td>
<td>Positive category</td>
</tr>
<tr>
<td>b</td>
<td>General category</td>
</tr>
<tr>
<td>c</td>
<td>Other (attach statement)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Schedule M-1</th>
<th>Recomputation of Income (Loss) per Books With Income (Loss) per Return. (Not required if Item [6], page 5, is answered “Yes.”)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Net income (loss) per books</td>
</tr>
<tr>
<td>2</td>
<td>Income included on Schedule K, Items 2, 3, 4, 5, 6, 7, 8, 9, 11, and 11 not recorded on books this year (if any)</td>
</tr>
<tr>
<td>3</td>
<td>Qualified payments other than health insurance</td>
</tr>
<tr>
<td>4</td>
<td>Depreciation and depletion of depreciable property (including depreciation and depletion of depreciable property)</td>
</tr>
<tr>
<td></td>
<td>Add lines 1 through 4</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Schedule M-2</th>
<th>Analysis of Partners' Capital Accounts. (Not required if Item 7, page 5, is answered “Yes.”)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Capital contributed by a limited partner</td>
</tr>
<tr>
<td>2</td>
<td>Capital contributed by a general partner</td>
</tr>
<tr>
<td>3</td>
<td>Net income (loss) per books</td>
</tr>
<tr>
<td>4</td>
<td>Other increases (decreases)</td>
</tr>
<tr>
<td></td>
<td>Add lines 1 through 4</td>
</tr>
</tbody>
</table>

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• Only Category 1 filers complete Schedule M
• Schedule M is prepared in US dollars
• Schedule M reflects book value of the foreign partnership’s assets
• Assets are separated into U.S. and foreign assets
• Assets are identified as passive, general or other limitation category per Temp. Treas. Reg. Section 1.861-9T(g)(3) and 1.861-12T.
• Only Category 1 filers complete Schedule M-1
• Schedule M-3 is not required with Form 8865
• Schedule M-1 is a reconciliation of book net income per financial statements to taxable income per return
• Schedule M-1 reflects book to tax differences based on the partnership’s method of accounting
• Different book to tax differences depending on cash or accrual method of accounting for tax
• Only Category 1 filers complete Schedule M-2
• Schedule M-2 is a reconciliation of beginning to ending capital
• Schedule M-2 for partnership is similar to a retained earnings reconciliation for a corporation
• Schedule M-2 reflects increases or decreases to beginning capital for partners’ capital contributions, net income or loss per books, distributions and other adjustments for the year
Form 8865 Page Six Schedule N

<p>| Transactions Between Controlled Foreign Partnership and Partners or Other Related Entities |
|---------------------------------|---------------------------------|---------------------------------|---------------------------------|---------------------------------|---------------------------------|</p>
<table>
<thead>
<tr>
<th>1 Name of foreign partnership</th>
<th>2 Persons devoting fulltime effort to transaction (if any)</th>
<th>3 Percentage ownership (if any)</th>
<th>4 Percentage of gross income or other income or loss distributable by the partnership</th>
<th>5 Amount distributable from the return</th>
<th>6 Amounts included in income of persons within scope of section 871(e) or included in income of persons filing form 8865</th>
</tr>
</thead>
<tbody>
<tr>
<td>11 Purchase of property other than inventory</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>12 Purchase of property rights (patents, trademarks, etc.)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>13 Compensation paid for technical, managerial, engineering, construction, or like services</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>14 Commissions paid</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>15 Rent, royalties, and license fees paid</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>18 Other</td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Add lines 1 through 18</td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>20 Amounts borrowed (net of the maximum loan balance during the year, see instructions)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>21 Amounts issued (net of the maximum loan balance during the year, see instructions)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
• Schedule N must be completed by Category 1 and 2 filers
• Schedule N reports transactions between a controlled foreign partnership and partners or other related parties
• Schedule N reports transactions between the foreign partnership and:
  1. The U.S. filer of the Form 8865
  2. Any U.S. corporation or partnership controlling or controlled by the U.S. filer
  3. Any other foreign corporation or partnership controlling or controlled by the U.S. filer
  4. Any other U.S. person with a 10% or more direct interest in the foreign partnership
• IRS looks at Schedule N to identify transfer pricing issues
Form 8865 Schedule D
Form 8865 Schedule D

• Only Category 1 filers complete Schedule D
• Schedule D Capital Gains and Losses from Form 1065
• Schedule D reports the foreign partnership’s sales or exchanges of capital assets, capital gain distributions and nonbusiness bad debts.
Form 8865 Schedule K-1

Schedule K-1
(Form 8865)
Department of the Treasury
Internal Revenue Service

Part I
Partner's Share of Current Year Income, Deductions, Credits, and Other Items

<table>
<thead>
<tr>
<th>Item</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Ordinary business income (loss)</td>
</tr>
<tr>
<td>2</td>
<td>Interest income</td>
</tr>
<tr>
<td>3</td>
<td>Short-term capital gain (loss)</td>
</tr>
<tr>
<td>4</td>
<td>Selling transactions</td>
</tr>
<tr>
<td>5</td>
<td>Business expenses</td>
</tr>
<tr>
<td>6</td>
<td>Royalties</td>
</tr>
<tr>
<td>7</td>
<td>Other income/expense</td>
</tr>
</tbody>
</table>

Part II
Information About the Partnership

<table>
<thead>
<tr>
<th>Item</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>Partnership's employer identification number</td>
</tr>
<tr>
<td>B</td>
<td>Partner's name, address, city, state, and ZIP code</td>
</tr>
</tbody>
</table>

Part III
Information About the Partner

<table>
<thead>
<tr>
<th>Item</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>G</td>
<td>Partner's tax identification number</td>
</tr>
</tbody>
</table>

Part IV
Partnership's Interest in Property, Debt, and Indebtedness (as reported on Form 1065, Schedule K-1)

<table>
<thead>
<tr>
<th>Item</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>H</td>
<td>% of partnership</td>
</tr>
<tr>
<td>I</td>
<td>Beginning balance</td>
</tr>
<tr>
<td>J</td>
<td>Ending balance</td>
</tr>
</tbody>
</table>

Part V
Partnership's Capital Account Balances (as reported on Form 1065, Schedule K-1)

<table>
<thead>
<tr>
<th>Item</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>Beginning capital account balance</td>
</tr>
<tr>
<td>B</td>
<td>Capital contributed during the year</td>
</tr>
<tr>
<td>C</td>
<td>Current year balance change</td>
</tr>
<tr>
<td>D</td>
<td>Withdrawals and contributions</td>
</tr>
<tr>
<td>E</td>
<td>Ending capital account balance</td>
</tr>
</tbody>
</table>

Part VI
Other Information

<table>
<thead>
<tr>
<th>Item</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>14</td>
<td>Self-employment earnings (loss)</td>
</tr>
</tbody>
</table>

For new investors: see instructions for Parts III, IV, and V.

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Form 8865 Schedule K-1

• Category 1 and 2 filers complete Schedule K-1 for any direct interest in the foreign partnership
• Category 1 filers complete Schedule K-1 for each U.S. person that owns 10% or greater direct interest
• Schedule K-1 reflects beginning and ending ownership percentages including constructive interests of the filer
• Schedule K-1 items of partner’s share of partnership income, gain, loss, deduction and credit reported on lines 1-20 for direct interest
Form 8865 Schedule K-1

• U.S. partner is liable for U.S. tax on Schedule K-1 items from foreign partnership.

• U.S. partner claims deduction on U.S. Federal tax return for losses to extent of outside basis and at-risk basis in the foreign partnership interest same as U.S. partnerships.
Form 8865 Schedule O

<table>
<thead>
<tr>
<th>Part I</th>
<th>Transfers Reportable Under Section 6038B</th>
</tr>
</thead>
<tbody>
<tr>
<td>Item of property</td>
<td>Number of items or original basis</td>
</tr>
<tr>
<td>Cash</td>
<td></td>
</tr>
<tr>
<td>Stock, notes</td>
<td></td>
</tr>
<tr>
<td>Tangible personal property</td>
<td></td>
</tr>
<tr>
<td>Intellectual property</td>
<td></td>
</tr>
<tr>
<td>Other property</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Part II</th>
<th>Dispositions Reportable Under Section 6038B</th>
</tr>
</thead>
<tbody>
<tr>
<td>Item of property</td>
<td>Number of items or original basis</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Part III</th>
<th>Dispositions Subject to Gain Recognition Under Section 6038A</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

For Information Reporting Notice, see instructions for Form 8865.

Schedule O (Form 8865) 2012
Form 8865 Schedule O

- Only Category 3 filers complete Schedule O.
- Schedule O reports Transfers of Property to a Foreign Partnership.
- Reportable transfers include cash, securities, tangible and intangible property.
- Report dispositions of property by foreign partnership of appreciated property that filer contributed to partnership.
- Report dispositions of property in a nonrecognition transaction for which the foreign partnership received substituted basis property.
Form 8865 Schedule P

### SCHEDULE P

**Acquisitions, Dispositions, and Changes of Interests in a Foreign Partnership**

#### Part I: Acquisitions

<table>
<thead>
<tr>
<th>Name of foreign partnership</th>
<th>Date of acquisition</th>
<th>% of interest acquired</th>
<th>% of interest after acquisition</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

#### Part II: Dispositions

<table>
<thead>
<tr>
<th>Name of foreign partnership</th>
<th>Date of disposition</th>
<th>% of interest disposed</th>
<th>% of interest before disposition</th>
<th>% of interest after disposition</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

#### Part III: Change in Proportional Interest

<table>
<thead>
<tr>
<th>Description of change</th>
<th>Date of change</th>
<th>% of interest before change</th>
<th>% of interest after change</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

#### Part IV: Supplemental Information Required To Be Reported (see instructions)

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For Paperwork Reduction Act Notice, see the instructions for Form 8865.

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47
Form 8865 Schedule P

• Only Category 4 filers complete Schedule P
• Schedule P reports acquisitions, dispositions and changes of interests in a foreign partnership
• Report acquisitions that increase interest to 10% or greater
• Report dispositions that decrease interest below 10%
• Report increase or decrease of 10%
• Report date of acquisition or disposition, basis and FMV of interest, % before and after transaction
Form 8865 Filing Requirements and Penalties

• Form 8865 Filing requirements
  – Form 8865 is attached to the U.S. filer’s annual U.S. Federal tax return
  – Due by the due date including extensions of the U.S. person’s tax return
  – If U.S. person does not file a return, Form 8865 must be filed separately

• Form 8865 Penalties
  – $10,000 for each failure to file (continued failure may result in penalty increasing to $50,000)
  – Reduction of 10% of foreign taxes available for credit (continued failure may result in additional reductions)
  – Category 3 failure to file penalty 10% of fair market value of property transferred up to $100,000 unless failure due to intentional disregard
  – Category 3 failure to file penalty also includes tax on gain as if property transferred was sold at fair market value
  – Criminal penalties for filing false or fraudulent information
  – Statute of limitations does not begin to run until Form 8865 is filed
Form 8865 Foreign Partnership Reporting
Check-the-Box Elections

• Deemed liquidation of foreign corporation and deemed contribution of assets and liabilities to new foreign partnership

• Tax year end and accounting method

• Final Form 5471 Category 3 filing and first year Form 8865 filing

• Form 8865 Schedule O reporting - how to calculate value and basis of contributed assets
How to resolve prior year delinquencies depends on whether the taxable income from the foreign partnership was reported on the U.S. partner’s U.S. Federal tax return.

All taxable income was reported with non-willful failure to file - Amend the prior year U.S. Federal tax return and attach the Form 8865 with a reasonable cause statement

Not all taxable income was reported with non-willful failure to file – Consider IRS Streamlined Domestic Offshore filing procedure with 5% penalty

Not all taxable income was reported with willful or intentional failure to file – Consider IRS Offshore Voluntary Disclosure Program

Consider impact of failure to file FinCEN Form 114 (f/k/a TD F 90-22.1) Foreign Bank Account Reports to report U.S. partner’s financial interest in or signature authority over foreign accounts owned by the foreign partnership
Form 8865 Foreign Partnership Reporting and Form 8938 Report of Specified Foreign Financial Assets

- Form 8938 Report of Specified Foreign Financial Assets – Take into account value of foreign partnership interest for filing threshold
  1. Single living in United States - $50,000 at 12/31 or $75,000 at any time during calendar year
  2. Married filing jointly living in United States - $100,000 at 12/31 or $150,000 at any time during calendar year
- If filing Form 8865, still must attach Form 8938 if within filing threshold
- If not filing Form 8865, must report information regarding foreign partnership on Form 8938 if within filing threshold
Form 8865 Foreign Partnership Reporting

Questions and comments

Conclusion

Thank you
Alison N. Dougherty is a Senior Manager with Aronson LLC. She has extensive experience assisting clients with U.S. tax reporting and compliance for offshore assets and foreign accounts. She specializes in international tax compliance, planning and structuring as a subject matter leader of Aronson’s international tax practice. Her responsibilities include U.S. Federal and multi-state tax compliance for C corporations, S corporations, partnerships and individuals. She also provides transactional tax planning and structuring services.

Alison completed the LL.M. in Securities and Financial Regulation in 2004 with academic distinction at Georgetown University Law Center. She completed the LL.M. in Taxation in 2000 and the Juris Doctor in 1999 at the University of Denver College of Law. She completed the Bachelor of Arts in Foreign Language in 1995 at Virginia Commonwealth University.
CONSIDERATIONS IN PREPARING FORM 8865
Form 8865 Basic Considerations

A. Form 8865 reporting is predicated on the presence of a foreign partnership.

Thus:

1. The threshold issue - Is the entity the U.S. person needs to report on a partnership?

B. Once it is ascertained that the entity is a partnership:

1. The Subchapter K substantive rules should be considered to determine the US person’s Form 8865 reporting obligations.

2. Issues to consider, for instance, would include: What if a foreign partnership is deemed to have undergone a technical termination? Subsequent to a technical termination, do the U.S. partners have Form 8865, Cat. 3 and Cat. 4 filing obligations? What is the annual accounting period that needs to be reported on the Form 8865 by the U.S. partners subsequent to the partnership’s technical termination?
C. Whether a US partner of a foreign partnership needs to file a Form 8865 is contingent upon its share in the foreign partnership’s capital, profits, income or losses/deduction.

1. Treas. Reg. Sec. 6038-3(b)(5) requires that the determination whether one is a Cat.1 or Cat. 2 filer is made annually “by reference to the agreement of the partners relating to such interests during that tax year.”

D. Issues to consider in determining a U.S. person’s ownership interest in a partnership may include:

1. Is the determination to be made on the sharing of book profits/losses or tax-basis profits/losses?

2. What if the entity’s partnership status resulted from a “check-the-box” election to treat an eligible foreign entity as a partnership for US tax purposes? In this case, there is no partnership agreement to refer to.
Form 8865 - Cat. 1 Filing: Exception for Multiple Cat. 1 Filers

A. Two considerations regarding the multiple Cat. 1 filers exception to a Form 8865, Cat. 1 filing:

1. Only a Cat. 1 capital/profits partner is permitted to file on behalf of other Cat. 1 partners. A Cat. 1 loss/deductions partner may not file on behalf of another Cat. 1 capital/profits partner. See Treas. Reg. Sec.1.6038-3(3)(c)(1)(i).

2. One should be cautious in relying upon the multiple Cat. 1 filers exception for if the Cat. 1 partner agreeing to file properly the Form 8865, Cat. 1 filing fails to do so, all the other non-filing Cat. 1 partners are deemed not to have complied with their respective Form 8865, Cat. 1 filing obligations even though they expressly indicated that they relied upon the multiple Cat. 1 filers exception.
Form 8865 – Cat. 3 Filing

A. The Form 8865, Cat. 3 filing requirements apply to certain dispositions by the foreign partnerships also. Under Treas. Reg. Sec. 6038B-2(a)(4), a Form 8865, Cat. 3 filing will generally be triggered, if a Cat. 3 partner:

1. Previously transferred appreciated property to the foreign partnership;

2. Such transfer was subject to Form 8865, Cat. 3 filing; and

3. The foreign partnership subsequently disposes of the transferred property while the Cat. 3 partner remained a partner.
Form 8865 – Cat. 3 Filing (Cont.)

B. Form 8865, Cat. 3 filing’s 10% partnership interest threshold:

1. The at least 10% partnership interest threshold required to trigger a Form 8865, Cat. 3 filing is defined by reference to Code Sec. 6038 and the regulations thereunder. See Treas. Reg. Sec. 1.6038B-2(a)(1)(i).

2. Thus, the Form 8865, Cat. 1 and Cat. 2 filings requirements apply to a Form 8865, Cat. 3 filing also.
C. Under the Form 8865, Cat. 3 filing rules, if a U.S. person:

1. Is a partner in a U.S. partnership and the U.S. partnership properly reports a transfer of property to a foreign partnership, then the U.S. partner need not undertake a Form 8865, Cat. 3 filing as to such an indirect transfer. See Treas. Reg. Sec. 1.6038B-2(a)(2).
2. Is a partner in a foreign partnership and the foreign partnership transfers property to another foreign partnership, then the U.S. partner is currently not required to file a Form 8865, Cat. 3 filing with respect to such an indirect transfer. Although the provision of Treas. Reg. Sec. 1.6038B-2(a)(3) dealing with “indirect transfer through a foreign partnership” states that it is “reserved,” this regulation’s preamble expressly states that “if a foreign partnership transfers property to another foreign partnership, a U.S. person that is a partner of the transferor partnership is not required to report that transfer until such time the IRS and Treasury implement rules requiring such reporting.” See TD 8817 (2/5/1999).
Form 8865 – Cat. 4 Filing

A. The two attributes of Form 8865, Cat. 4 filings are:
   1. Direct ownership interest in a foreign partnership; and
   2. Presence of a “reportable event” (as defined in the Code Sec. 6046A regulations).

B. What constitutes interest in a foreign partnership for purposes of Form 8865, Cat. 4 filing?
   1. The “reportable event” threshold of at least 10% interest in a foreign partnership is defined by reference to Code Sec. 6038. See 6046A(d) and Treas. Reg. Sec. 1.6046A-1(b)(4).
   2. Thus, the rules determining what constitutes ownership interest in a foreign partnership applicable to Form 8865 Cat. 1 and Cat. 2 filings apply to a Form 8865, Cat. 4 filing also.
C. The “reportable event” concept:

1. Due to the definition of a “reportable event,” any transfer, no matter how small, could potentially trigger a Form 8865, Cat. 4 filing.

2. A U.S. partner may experience a “reportable event” even though:
   a. It has not acquired or disposed of its partnership interest; or
   b. The terms of the partnership agreement were not altered.

See Treas. Reg. Sec. 1.6046AA-1(b)(3) stating that “a partner’s proportional interest in a foreign partnership may change for a number of reasons, for example, the change may be caused by changes in other partners’ interests resulting from a partner withdrawing from the partnership. A proportional change may also occur by operation of the partnership agreement, for example, 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 and one of those events occurs.”
Form 8865 – Reporting Periods

A. Cat. 1 and Cat. 2 filers:

1. Must undertake their Form 8865 reporting for the foreign partnership’s tax year that ends with or within the US person’s tax year. See Treas. Reg. Sec. 1.6038-3(f).

2. Should pay attention to reporting period issues if the foreign partnership’s and its U.S. partners do not have the same annual accounting period (what needs to be reported on the Form 8865 for which year?). Reporting period issues will be especially thorny in cases of tiered flow-through entities with differing tax years.
Form 8865 – Reporting Periods (Cont.)

B. Cat. 3 filers:

1. Need to file the Form 8865 for Code Sec. 721 contributions or certain dispositions by the foreign partnership occurring within the Cat. 3 filer’s tax year. See Treas. Reg. Sec. 1.6038B-2(a)(5).

C. Cat. 4 filers:

1. Must file Form 8865 for a “reportable event” taking place within the Cat. 4 filer’s tax year. See Treas. Reg. Sec. 1.6046A-1(d).