

Partner's Share of Income, Deductions, Credits, etc.

For calendar year 1998 or fiscal year beginning month \_\_\_ day \_\_\_ year 1998, and ending month \_\_\_ day \_\_\_ year \_\_\_

Partner's identifying number, Partnership's FEIN, Secretary of State file number, Partner's name, address, state and ZIP Code, Partnership's name, address, state and ZIP Code

A Is this partner a: (1) general partner; or (2) limited partner?
B What type of entity is this partner?
C Is this partner a foreign partner?
D Enter partner's percentage (without regard to special allocations) of:
Profit sharing
Loss sharing
Ownership of capital

E Partner's share of liabilities:
Nonrecourse
Qualified nonrecourse financing
Other
F Tax shelter registration number
G (1) Check here if this is a publicly traded partnership as defined in IRC Section 469(k)(2)
(2) Check here if this is an investment partnership (R&TC Section 17955 and 23040.1)
H Check here if this is:
(1) a final Schedule K-1 (565)
(2) an amended Schedule K-1 (565)
I Is this partner a nonresident of California?

J Analysis of partner's capital account:
Table with 5 columns: (a) Capital account at beginning of year, (b) Capital contributed during year, (c) Partner's share of line 3, line 4 and line 7 Form 565, Schedule M-2, (d) Withdrawals and distributions, (e) Capital account at end of year (combine column (a) through column (d))

Caution: Refer to Partner's Instructions for Schedule K-1 (565) before entering information from this schedule on your tax return.

Main table with 5 columns: (a) Distributive share item, (b) Amount from federal Schedule K-1 (1065), (c) Adjustments, (d) Total amounts using California law (Combine col. (b) and col. (c)), (e) California source amounts and credits. Rows include Income (Loss) and Deductions.

	(a) Distributive share item	(b) Amount from federal Schedule K-1 (1065)	(c) Adjustments	(d) Total amounts using California law (Combine col. (b) and col. (c))	(e) California source amounts and credits
Investment Interest	12 a Interest expense on investment debts . . . . .				
	b (1) Investment income included on lines 4a, 4b, 4c and 4e . . . . .				
	(2) Investment expenses included on line 10 . . . . .				
Credits	13 a (1) Withholding on partnership allocated to all partners . . . . .				
	(2) Partnership withholding on nonresident partners . . . . .				
	(3) Total withholding (equals amount on Form 592-B if calendar year partnership)				
	b Low-income housing credit . . . . .				
	c Credits other than line 13b related to rental real estate activities. Attach schedule.				
d Credits related to other rental activities. See instructions. Attach schedule . . . . .					
14 Other credits. Attach required schedules or statements. . . . .					
Adjustments and Tax Preference Items	15 a Depreciation adjustment on property placed in service after 1986 . . . . .				
	b Adjusted gain or loss . . . . .				
	c Depletion (other than oil and gas) . . . . .				
	d (1) Gross income from oil, gas and geothermal properties . . . . .				
	(2) Deductions allocable to oil, gas and geothermal properties . . . . .				
e Other adjustments and tax preference items. Attach schedule . . . . .					
Other	16 a Total expenditures to which an IRC Section 59(e) election may apply . . . . .				
	b Type of expenditures _____				
	17 Tax-exempt interest income . . . . .				
	18 Other tax-exempt income . . . . .				
	19 Nondeductible expenses . . . . .				
	20 Distributions of money (cash and marketable securities) . . . . .				
	21 Distributions of property other than money				
22 Supplemental information required to be reported separately to each partner. Attach additional schedules. See instructions. \$ _____					

**Table 1** — Partner's share of nonbusiness income from intangibles (source of income is dependent on residence or commercial domicile of the partner):

Interest	\$ _____	Sec 1231 Gains/Losses	\$ _____	Capital Gains/Losses	\$ _____
Dividends	\$ _____	Royalties	\$ _____	Other	\$ _____

FOR USE BY APPORTIONING UNITARY PARTNERS ONLY — See instructions.

**Table 2** — Partner's share of distributive items.

- A. Partner's share of the partnership's business income. See instructions. \$ \_\_\_\_\_
- B. Partner's share of nonbusiness income from real and tangible property sourced or allocable to California.
- |                       |          |                 |          |
|-----------------------|----------|-----------------|----------|
| Capital Gains/Losses  | \$ _____ | Rents/Royalties | \$ _____ |
| Sec 1231 Gains/Losses | \$ _____ | Other           | \$ _____ |

C. Partner's share of the property, payroll and sales:

Factors	Total within and outside California	Total within California
Property: Beginning	\$ _____	\$ _____
Ending	\$ _____	\$ _____
Payroll	\$ _____	\$ _____
Sales	\$ _____	\$ _____

# Partner's Instructions for Schedule K-1 (565)

## General Information

### A Purpose

The partnership uses Schedule K-1 (565) to report your distributive share of the partnership's income, deductions, credits, etc. Please keep this schedule for your records. Do not file it with your tax return. The partnership has filed a copy with the Franchise Tax Board (FTB).

**Although the partnership is not subject to income tax, you are subject to tax on your share of the partnership income, whether or not distributed.**

The amount of loss and deduction you may claim on your tax return may be less than the amount reported on Schedule K-1 (565). Generally, the amount of loss and deduction you may claim is limited to your basis in the partnership and the amount for which you are considered at-risk. If you have losses, deductions or credits from a passive activity, you must also apply the passive activity rules. It is the partner's responsibility to consider and apply any applicable limitations. See Specific Instructions C, Loss Limitations.

You should read the federal Schedule K-1 (1065) instructions before completing your tax return with this Schedule K-1 (565) information.

For more information on the treatment of partnership income, deductions, credits, etc., get the following federal publications: Publication 541, Tax Information on Partnerships, and Publication 535, Business Expenses.

Any information returns required for federal purposes under Internal Revenue Code (IRC) Sections 6038, 6038A and 6038B are also required for California purposes. Attach the information returns to the partner's California return when filed. If the information returns are not provided, penalties may be imposed under R&TC Sections 19141.2 and 19141.5.

### B Definitions

#### General Partner

An individual or entity owning interest in a partnership who is personally liable for partnership debts and who is authorized to act on behalf of the partnership.

#### Limited Partner

An individual or entity owning interest in a partnership whose potential 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.

#### Nonrecourse Loans

Liabilities of the partnership for which none of the partners have assumed any personal liability.

#### Qualified Nonrecourse Financing

Any 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 loaned or guaranteed by a federal, state or local government or borrowed from a "qualified" person.

#### California Business Situs

The place at which intangible personal property is employed as capital in California; or the place where the property is located if possession and control of the property is localized in connection with the taxpayer's business that is within the state, so that substantial use or value attaches to the property. The term is generally used in reference to:

- The income of nonresidents from intangible personal property, such as shares of corporate stocks, bonds, notes, bank deposits and other indebtedness; or
- The income of nonresidents from rents or royalties for the use of, or for the privilege of using in this state, patents, copyrights, secret processes, formulas, goodwill, trademarks, trade brands, franchises and other like property.

#### Apportionment

The process by which business income from a trade or business conducted in two or more states (an apportioning trade or business) is divided between taxing jurisdictions. The apportionment percentage is determined by reference to the California property, payroll and sales factors of the apportioning trade or business.

#### Unitary

A method of taxation by which all of the activities comprising a single trade or business are viewed as a single unit, regardless of whether those activities are conducted by divisions of a single entity or by commonly owned or controlled entities. For further information about unitary business principles, get FTB Pub. 1061, Guidelines for Corporations Filing a Combined Report.

#### Elections

The choice of a particular accounting method for tax reporting purposes. Generally, the partnership decides how to figure taxable income from its operations. For example, it chooses the accounting method and depreciation methods it will use.

However, certain elections are made by you separately on your individual income tax return and not by the partnership. These elections are made under the following IRC Sections, to which California Revenue and Taxation Code (R&TC) conforms:

- IRC Section 108(b)(5) (income from discharge of indebtedness); and
- IRC Section 617 (deduction and recapture of certain mining exploration expenditures, paid or incurred).

#### Additional Definitions

For definitions of a partnership, general partnership, limited partnership, limited liability partnership, etc., see the instructions for Form 565, Partnership Return of Income, and the instructions for federal Form 1065, U.S. Partnership Return of Income.

### C Reporting Information from Columns (d) and (e)

If the partnership income is from activities both within and outside California, the partnership will complete Schedule R, Apportionment and Allocation of Income, to determine the partnership income from California sources. As indicated on Schedule K-1 (565), resident partners will use only the information in column (c) and column (d) to report their share of the partnership's income or loss.

Nonresident, corporate and other entity partners must report their share of income apportioned or allocated to California as indicated on Schedule K-1 (565). Special rules apply if a partner and the partnership engage in a unitary business. See Title 18, Cal. Code Reg. Sections 17951 and 25137-1 for more information. Also see General Information E, Unitary Partners. Nonresident, corporate, and other entity partners (other than partners that are unitary with the partnership) will use the information in columns (c), (d) and (e) to report their distributive share of income (losses) or credits. Residents, part-year residents and some nonresidents may qualify for a credit for taxes paid to other states on income that is apportioned or allocated to a state other than California. For more information get Schedule S, Other State Tax Credit.

Nonapportioning partnerships do not need to fill out column (e) on Schedule K-1 (565) if the partner is a resident and the "No" box is checked on Question I. However, the final determination of residency is made at the partner level. If the partnership is uncertain as to the residency status of the partner, it should fill out column (e) for that partner.

### D Income Not from a Trade Or Business of the Partnership (Nonbusiness Income)

If the partnership has income that is not from a trade or business (nonbusiness income), the source of that nonbusiness intangible income will be determined at the partner level. However, nonbusiness income from real or tangible property

## Schedule K-1 (565) Instructions

located in California, such as rents, royalties, gains or losses is California source income (Title 18 Cal., Code Reg. Section 17951-3 and R&TC Sections 25124 and 25125). This information should be included on the appropriate line of column (e), as well as in Table 2, Part B, if the partnership believes it is unitary with the partner, or if the partnership is uncertain whether it is unitary with the partner. Non-unitary partners should ignore the information in Table 2 and use column (e).

The source of income from all nonbusiness intangibles will depend on whether the partner is required to apportion its income and whether the partner is a corporation. In most cases, income from nonbusiness intangible property is sourced at the residence or commercial domicile of the partner.

However, for individuals, estates, trusts and S corporations that are not required to apportion income, income from nonbusiness intangibles will have a California source if the intangible has acquired a California business situs. For example, a nonresident pledges stocks, bonds or other intangible personal property in California. This pledge is security for the payment of debt, taxes, or other liabilities incurred for a business in the state. The pledged property will acquire a business situs in California. Another example is a nonresident who maintains an office and bank account in California for the business activities in the state. The bank account will acquire a business situs in California. See Title 18, Cal. Code Reg. Section 17951-2 and R&TC Section 17952. If the intangible income is determined to have a business situs by the partnership, the intangible income will be included in column (e).

If the partner is an apportioning taxpayer or a corporation, Title 18, Cal. Code Reg. Sections 17951-4 and 25137-1 require that nonbusiness income from intangibles be allocated in accordance with the rules of R&TC Sections 25126 and 25127.

Because the source of intangible nonbusiness income is dependent upon the status of the individual partner, that income is not included in column (e) and is entered only in Table 1. The partner must determine the source of such income by applying the rules described above.

## E Unitary Partners (This section generally applies to apportioning partnerships only.)

**Note:** The following rules apply not only to corporations, but to individuals or other entities that conduct a trade or business that is unitary with the partnership's trade or business (see Title 18, Cal. Code Reg. Section 17951, incorporating the provisions of Section 25137 and regulations thereunder).

Unitary partners cannot use the California source information reflected in column (e). Such partners must use the information in Table 1 and Table 2 as described below.

The partner's distributive share of partnership items is determined by applying the partnership rules in R&TC Sections 17851 through 17858. The determination of the portion of the distributive share of business and nonbusiness income that has its source in this state or that is includible in the partner's business income subject to apportionment is made in accordance with Title 18, Cal. Code Reg. Section 25137-1 if the partner, or the partnership, or both, have income from sources within and outside this state. The partner, in computing net income for its tax accounting period, must include its distributive share of partnership items referred to above for any partnership taxable year ending within or with the partner's tax accounting period.

### Distributive Items of Business Income

#### Apportionment of Business Income – Unitary Business —

If the partnership's activities and the partner's activities constitute a unitary business under established standards (other than ownership requirements), the combined business income of this single trade or business apportioned to California is determined by combining the partner's distributive share of the partnership's apportionment factors with the factors of the partner for any partnership year ending within the partner's tax accounting period. Combined business income is then apportioned by using a 3 or 4 factor formula consisting of

property, payroll and a single or double-weighted sales factor of the partner. Use of a 3 factor formula depends upon whether combined gross business receipts (partner's share of the partnership's gross business receipts plus the partner's own gross business receipts) are more than 50% from agricultural, extractive, savings and loans, banking or financial business activities.

If you are a partner that is unitary with a partnership, use Table 2 to compute your factors, applying the rules shown below (see Title 18, Cal. Code Reg. Section 25137-1 for examples). Partners that are unitary with the partnership should perform the following steps:

1. Combine your distributive share of the partnership's business income with your own business income to determine total business income.
2. Compute property, payroll and sales factors by combining the partnership's factors from Table 2, Part C, with your own factors as explained below.
3. Apply the apportionment factor determined in Step 2 to the total business income determined in Step 1 to arrive at business income apportioned to this state.

#### 1. Unitary Partner's Computation of Property Factor

Use Schedule R to compute the numerator and the denominator of the property factor. Adjust factors in accordance with Title 18, Cal. Code Reg. Sections 25130 and 25131. Also apply the following special rules:

- A. Include in the denominator of your property factor your distributive share of the partnership's beginning and ending balances of real and tangible property (owned or rented) and used during the tax accounting period in the regular course of business. See Table 2, Part C.
- B. Include in the numerator of your property factor the value of such property that is described in 1A above that is located in California. See Table 2, Part C.
- C. See Title 18, Cal. Code Reg. Section 25137-1(f)(1)(B) for examples of how to avoid duplication of the value of property that is rented by the partner to the partnership or vice versa.

#### 2. Unitary Partner's Computation of Payroll Factor

Use Schedule R to compute the numerator and the denominator of the payroll factor in accordance with Title 18, Cal. Code Reg. Sections 25132 and 25133. Apply the following special rules:

- A. Include in the denominator of your payroll factor your distributive share of the partnership's payroll used to produce business income. See Table 2, Part C; and
- B. Include in the numerator any such payroll described in 2A that is applicable to California. See Table 2, Part C.

#### 3. Unitary Partner's Computation of the Sales Factor

Compute the numerator and denominator of the sales factor in accordance with Title 18, Cal. Code Reg. Sections 25134 to 25136. Apply the following special rules:

- A. Include in the denominator of the sales factor your distributive share of the partnership's sales that give rise to business income. See Table 2, Part C;
- B. Include in the numerator of your sales factor the amount of such sales described in 3A attributable to California; and
- C. Eliminate intercompany sales as follows:
  - Sales by the partner to the partnership to the extent of the partner's interest in the partnership; or
  - Sales by the partnership to the partner not to exceed the partner's interest in all partnership sales (see Title 18, Cal. Code Reg. Section 25137-1(f)(3)).

#### Distributive Items of Nonbusiness Income for a Unitary Partner

Income in Table 2, Part B, is from a California source under R&TC Sections 25124 and 25125. Because Schedule K-1 (565), column (e) data is not utilized by a unitary partner, unitary partners must make certain to separately include such items as California source income.

## Specific Instructions

### A Questions and Items

The partnership completes the questions and items on the Schedule K-1 (565) for all partners. For more information, see the federal instructions for Schedule K-1 (1065).

### B Schedule K-1 (565)

**Important Note to Partners:** If your Schedule K-1 (565) reports losses and/or deductions, you must first apply the basis, at-risk and the passive activity loss limitations before such losses/deductions can be deducted on your return. See Specific Instructions C, Loss Limitations. Also, see IRC Section 705(a) for information on how to compute basis. If your return is ever examined, you may be required to provide your computations and the supporting documents for your partnership interest.

If you are an individual partner, the amounts in column (c), Adjustments, and column (d), Total amounts using California law, that are from nonpassive activities must be reported on the appropriate California form or schedule; i.e., Schedule D, California Capital Gain or Loss Adjustment, Schedule D-1, Sales of Business Property, Schedule CA (540), California Adjustments — Residents, or Schedule CA (540NR), California Adjustments — Nonresidents or Part-Year Residents.

Amounts in column (e), California source amounts and credits, that are from passive activities must be reported on form FTB 3801, Passive Activity Loss Limitations, or form FTB 3802, Corporate Passive Activity Loss and Credit Limitations. Use the related worksheets to figure any passive loss limitations. If the partnership knows that you are a California resident it may leave column (e) blank. California residents are subject to tax on their entire taxable income shown in column (d) (R&TC Section 17041).

If you are not an individual partner, report the amounts as instructed on your tax return.

If you have losses, deductions, credits, etc., from a prior year that were not deductible or usable because of certain limitations they may be taken into account in determining your net income, loss, etc., for this year. However, do not combine the prior-year amounts with any amounts shown on this Schedule K-1 (565) to get a net figure. Instead, report the amounts on an attached schedule, statement or form on a year-by-year basis. See the federal instructions for Schedule K-1 (1065) for more information.

### C Loss Limitations

The amounts shown on line 1 through line 3 of your Schedule K-1 (565) reflect your distributive share of income from the partnership's business or rental operations. If you have losses from the partnership, you should be aware that there are three potential limitations imposed on losses which you may deduct on your tax return. These limitations and the order in which they must be applied are as follows:

- Basis rules (IRC Section 704);
- At-risk rules (IRC Section 465); and
- Passive loss rules (IRC Section 469)

Each of these limitations are discussed separately below.

**Note:** Other limitations may apply to specific deductions such as the investment interest expense deduction. These limitations on specific deductions generally apply before the basis, at-risk and passive loss limitations.

#### Basis Rules

Generally, California tax law is the same as federal tax law concerning basis limitations. You may not claim your share of a partnership loss (including a capital loss) that is greater than the adjusted basis of your partnership interest at the end of the partnership's taxable year.

The partnership is not responsible for keeping the information needed to compute the basis of your partnership interest. Although the partnership does provides you with an analysis of the changes to your capital account on your Schedule K-1

(565), Item J, that information is based on the partnership's books and records and should not be used to compute your basis.

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

Items that increase your basis are:

- Money and the adjusted basis of property you contributed to the partnership;
- Your distributive share of the partnership's income; and
- Your distributive share of the increase in the liabilities of the partnership (and/or your individual liabilities caused by your assumption of partnership liabilities).

Items that decrease your basis, but not below zero, are:

- Money and the adjusted basis of property distributed to you;
- Your share of the partnership's losses; and
- Your share of the decrease in the liabilities of the partnership (and/or your individual liabilities assumed by the partnership).

This is not a complete list of items and factors that determine basis. Get federal Publication 541 for a complete discussion of how to determine the basis of your partnership interest.

#### At-Risk Rules

The at-risk rules generally limit the amount of loss, (including loss on disposition of assets) and other deductions (such as IRC Section 179, R&TC Sections 17266, 17267.2, 17267.6 and 17268 deduction) that you can claim to the amount you could actually lose in the activity.

If you have: (1) a loss or other deduction from an activity carried on as a trade or business or for the production of income by the partnership; and (2) amounts in the activity for which you are not at-risk, you will have to complete federal Form 6198, At-Risk Limitations, to figure the allowable loss to report on your return. Complete federal Form 6198 using California amounts.

See the federal instructions for Schedule K-1 (1065), At-Risk Limitations, and federal publication 925, Passive Activity and At-Risk Rules, for more information.

#### Passive Loss Rules

IRC Section 469 limits the deduction of certain losses and credits. California law is the same as this federal provision. These rules apply to partners who have a passive activity loss or credit for the taxable year.

For California purposes, the passive loss limitations apply to:

1. Individuals;
2. Estates;
3. Trusts (other than grantor trusts);
4. Closely held corporations; and
5. S Corporations.

Even though the passive loss rules do not apply to grantor trusts, partnerships, and limited liability companies, they do apply to the owners of these entities.

A passive activity is generally a trade or business activity in which the partner does not materially participate or a rental real estate activity in which the partner does not actively participate. A partnership may have more than one activity. Each partner must apply the passive activity loss limitations on an activity by activity basis.

Individuals, estates and trusts and S corporations must complete form FTB 3801, to calculate the allowable passive losses, and form FTB 3801-CR, Passive Activity Credit Limitations, to calculate the allowable passive credits. Corporations must complete form FTB 3802.

The amounts reported on Schedule K-1 (565), line 1 and line 14 are normally passive activity income (loss) or credits from the trade or business of the partnership if you are a limited partner, or if you are a general partner who did not materially participate in the trade or business activities of the partnership. The amounts reported on Schedule K-1 (565), line 2, line 3 and line 13b are from rental activities of the partnership and are passive activity income (loss) or credits to

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all partners. There is an exception to this rule for losses incurred by qualified investors in qualified low-income housing projects. The partnership will identify any of these qualified amounts on an attachment for line 2.

The passive loss rules apply separately to the items attributable to each publicly traded partnership (PTP) that is not treated as a corporation under IRC Section 7704. Thus, partners who do not materially participate in the operations of a PTP are allowed to deduct their share of the PTP's losses only to the extent of passive income from the same PTP or when the entire interest is sold (IRC Section 469(k)). See the instructions for form FTB 3801 and form FTB 3802 for the rules to calculate and report income, gains and losses from passive activities that you held through each PTP you owned during the tax year.

See the federal instructions for Schedule K-1 (1065), Passive Activity Limitations, and federal publication 925 for more information.

## D Investment Partnership Income

If you are a nonresident individual, the amounts in column (e) will generally not be taxable by California (R&TC Section 17955). However, nonresident individuals will be taxed on their distributive share of California source income from an investment partnership if the income from the qualifying investment securities is interrelated with:

- Any other business activity of the nonresident partner; or
- Any other entity in which the nonresident partner owns an interest that is separate and distinct from the investment activity of the partnership and that is conducted in California.

If you are a corporate partner, the amounts in column (e) will also generally not be taxable in California provided the income from the partnership is the corporation's only California source income. However, if the corporation:

- Participates in the management of the investment activities of the partnership or is engaged in a unitary business with another corporation, or partnership that participates in the management of the investment activities of the partnership; or
- Has income attributable to sources within California other than income from the investment partnership;

Then the corporation will be taxable on its distributive share of California source income of the partnership. See R&TC Section 23040.1 for more details.

## Specific Line Instructions

Enter the difference between federal and California amounts from column (c) on Schedule CA (540), if you are a resident; or on Schedule CA (540NR), if you are a nonresident. Also, if you are a nonresident, enter California source amounts from the Schedule K-1 (565), column (e), on your Schedule CA (540NR), column E.

If the box for Item G(1) is checked, the partnership is a publicly traded partnership (PTP) as defined in IRC Section 469(d)(2). Follow the instructions for form FTB 3801 or form FTB 3802 for reporting income, gains and losses from PTPs.

If the box for Item G(2) is checked, the partnership is an investment partnership as defined in R&TC Sections 17955 and 23040.1. If you are a nonresident individual, the amounts in column (e) will generally not be taxable in California. See Specific Instructions D, Investment Partnership Income, for additional information.

**Note to Nonresident Partners:** The specific line instructions below that instruct you to enter information from Schedule K-1 (565), column (d), on other forms, apply to resident partners. When the instructions make reference to column (d), nonresident partners should take information from columns (c), (d) and (e) and apply the information to the appropriate line relating to computation of total income and income from California sources.

## A Income (Loss)

### Line 1 – Ordinary Income (Loss) from Trade or Business Activities

The amount reported on line 1, column (d), is your share of the ordinary income (loss) from the trade or business activities of the partnership. For individual partners, where you report this amount on Form 540 or Form 540NR depends on whether or not this amount is a passive activity to you.

If, in addition to this passive activity income, you have a passive activity loss from this partnership or from any other source, report the income on form FTB 3801 or form FTB 3802. If a loss is reported on line 1, column (d), report the loss on the applicable line of form FTB 3801 or form FTB 3802 to determine how much of the loss is allowable.

**Note:** If the partnership has income from activities both within and outside California, the amount nonresidents or corporate partners must report on their tax returns is a function of the partnership's apportionment percentage and allocation of income. Reporting instructions are included in the information provided by the partnership. See also Title 18, Cal. Code Reg. Sections 17951-4 and 25137-1 for more information. Also see General Information E, Unitary Partners.

### Line 2 – Income (Loss) from Rental Real Estate Activities

Generally, the income (loss) reported on line 2, column (d), is a passive activity amount to all partners. However, the loss limitations of IRC Section 469 do not apply to qualified investors in qualified low-income housing projects. If applicable, the partnership will attach a schedule for line 2 to identify such amounts. You will have to report the California adjustment amount from column (c) on Schedule CA (540 or 540NR).

Use the following instructions to determine where to enter the line 2 amount.

- If you have a loss on line 2, column (d) (other than a qualified low-income housing project loss), enter the loss on the applicable line of form FTB 3801 or form FTB 3802 to determine how much of the loss is allowable. Your share of the loss may be eligible for the special \$25,000 allowance for rental real estate losses. Get the instructions for form FTB 3801 or form FTB 3802 for more information.

See the federal Specific Instructions for line 2, item 1 and item 2 for more information.

**Note:** If you are a qualified investor reporting a qualified low-income housing project loss, report any California adjustment amount from column (c) on Schedule CA (540 or 540NR).

- If you have only income on line 2, column (d), and no other passive losses, enter any California adjustment amount from column (c) on Schedule CA (540 or 540NR). However, if in addition to this passive activity income, you have a passive activity loss from this partnership or from any other source, report the line 2, column (d), income on the applicable line of form FTB 3801 or form FTB 3802.

### Line 3 – Income (Loss) from Other Rental Activities

The amount on line 3, column (d) is a passive activity amount for all partners.

- If line 3, column (d) is a loss, report the loss on the applicable line of form FTB 3801 or form FTB 3802.
- If only income is reported on line 3, column (d), and you have no other passive losses, report the California adjustment from column (c) on Schedule CA (540 or 540NR). However, if in addition to this passive activity income, you have a passive activity loss from this partnership or from any other source, report the line 3 income on the applicable line of form FTB 3801 or form FTB 3802.

Line 4a  
through

### Line 4e – Portfolio Income (Loss)

Portfolio income (loss) referred to as "portfolio" in these instructions is generally not subject to the passive activity limitations of IRC Section 469. Portfolio income includes interest, dividend and royalty income and gain or loss on the

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sale of property held for investment. If you have amounts on Schedule K-1 (565), line 4a through line 4e, report these amounts as follows:

- Line 4a, column (c) — Report on Schedule CA (540 or 540NR), line 8, column B or line 8, column C, whichever is applicable;
- Line 4b, column (c) — Report on Schedule CA (540 or 540NR), line 9, column B or line 9, column C, whichever is applicable;
- Line 4c, column (c) — Report on Schedule CA (540 or 540NR), line 17, column B or line 17, column C, whichever is applicable;
- Line 4d, column (d) — Report on Schedule D; and
- Line 4e, column (d) — Report on applicable schedule.

**Caution:** Generally, amounts reported on line 4d and line 4e are gains or losses attributable to the disposition of property held for investment and are, therefore, classified as portfolio income (loss). If, however, an amount reported on line 4d or line 4e, column (d) is a passive activity amount, the partnership should identify the amount.

The partnership uses line 4e, column (d), to report portfolio income other than interest, dividend, royalty and capital gain (loss) income. The partnership should attach a schedule to Schedule K-1 (565) to tell you what kind of portfolio income is reported on line 4e, column (d). An example of portfolio income that could be reported on line 4e, column (d), is from a real estate mortgage investment conduit (REMIC) in which the partnership is a residual interest holder.

If the partnership has a residual interest in a REMIC, it will report your share of REMIC taxable income (net loss) on the schedule. Report the adjustment amount from column (c) on Schedule CA (540 or 540NR). The partnership will also report your share of "excess inclusion" and your share of IRC Section 212 expenses. If you itemize your deductions on federal Schedule A (1040), you may deduct these IRC Section 212 expenses as a miscellaneous deduction.

### Line 5 – Guaranteed Payments to Partners

Amounts on this line are not normally part of a passive activity. If there is an amount on Schedule K-1 (565), line 5, column (c), enter this amount on Schedule CA (540 or 540NR), line 21, column B or line 21, column C, whichever is applicable.

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

If the amount on line 6 relates to rental activity, the IRC Section 1231 gain (loss) is a passive activity amount. If the amount relates to a trade or business activity and you are a limited partner, the IRC Section 1231 gain (loss) is a passive activity amount.

- If the amount is not a passive activity amount to you, report it on Schedule D-1, line 2, column (g) or column (h), whichever is applicable. You do not have to complete column (b) through column (f). Write "From Schedule K-1 (565)" across these columns.
- If a gain is reported on line 6, column (d), and it is a passive activity amount to you, report the gain on Schedule D-1, line 2, column (h), and be sure to see "Passive Loss Limitations" in the instructions for Schedule D-1.
- If a loss is reported on line 6, column (d), and it is a passive activity amount to you, see "Passive Loss Limitations" in the instructions for Schedule D-1. You must use form FTB 3801 to determine how much of the loss is allowed on Schedule D-1.

### Line 7 – Other Income (Loss)

Amounts reported on this line are other items of income (loss) not included on line 1 through line 6. The partnership should give you a description for each of these items.

Use the instructions below to:

- Report income or gain (not losses) from passive activities, or
- Report income, gain or losses from all other passive activities.

If you have losses from passive activities, or a combination of income, gains and losses from passive activities, you must first complete form FTB 3801 or FTB 3802 to determine if any of your losses are limited by the passive loss rules. Use the instructions below to report passive income and losses after the passive loss limitations have been computed.

Line 7 items may include:

- Partnership gains from disposition of farm recapture property (get Schedule D-1) and other items to which IRC Section 1252 applies;
- Recoveries of bad debts, prior taxes and delinquency amounts (IRC Section 111). Report the amount from line 7, column (c), on Schedule CA (540 or 540NR), line 21f, column B or line 21f, column C, whichever is applicable;
- Gains and losses from wagering (IRC Section 165(d)). Report the amount from line 7, column (c), on Schedule CA (540 or 540NR), line 21f, column B or line 21f, column C, whichever is applicable;
- Any income, gain or (loss) to the partnership under IRC Section 751. Report this amount on Schedule D-1, line 10;
- Specially allocated ordinary gain or (loss). Report this amount on Schedule D-1, line 10;
- Net gain or (loss) from involuntary conversions due to casualty or theft. The partnership will give you a schedule that shows the California amounts to be entered on federal Form 4684, Casualties and Thefts, Section B, Part II, line 34, column (b)(i), column (b)(ii) and column (c); and
- Eligible gain from the sale or exchange of qualified small business stock (as defined in R&TC Section 18152.5 and issued after August 10, 1993 but before January 1, 1999). Also, the name of the corporation that issued the stock and the adjusted basis of that stock should be reported on the attachment to Schedules K (565) and K-1 (565). Any differences between IRC Section 1202 and R&TC Section 18152.5 should be included on line 7, column (c).

## B Deductions

### Line 8 – Charitable Contributions

The partnership will provide a schedule that shows which contributions were subject to the 50%, 30% and 20% limitations. For further information, see the instructions for federal Form 1040.

If there is an amount on Schedule K-1 (565), line 8, column (c), enter this amount on Schedule CA (540 or 540NR), line 38.

### Line 9 – Expense Deduction for Recovery Property

The maximum amount of expense deduction for recovery property for California purposes R&TC 17255 (IRC Section 179 deduction) that you can claim for all sources is \$16,000. The \$16,000 limit is reduced if the total cost of IRC Section 179 property placed in service during the year exceeds \$200,000.

The partnership will provide information on your share of the IRC Section 179 deduction and of the cost of the partnership's IRC Section 179 property so that you can compute this limitation. Your IRC Section 179 deduction is also limited to your taxable income from all of your trades or businesses. See form FTB 3885A, Depreciation and Amortization Adjustments – Individuals, and get federal Publication 534, Depreciating Property Placed In Service Before 1987, for more information.

If the IRC Section 179 deduction is a passive activity amount, report it on the applicable line of form FTB 3801. If it is not a passive activity amount and there is an amount on Schedule K-1 (565), line 9, column (c), enter this amount on Schedule CA (540 or 540NR), line 21f, column B or line 21f, column C, whichever is applicable.

Refer to R&TC Sections 17266, 17267.2, 17267.6 and 17268 on how to figure the expense deduction for recovery property in an economic development area.

### Line 10 – Deductions Related to Portfolio Income

Amounts entered on this line are the deductions that are clearly and directly allocable to portfolio income (other than investment interest expense and expenses from a REMIC). If you have an

## Schedule K-1 (565) Instructions

amount on Schedule K-1 (565), line 10, column (c), enter this amount on Schedule CA (540 or 540NR), line 21f, column B or column C, as applicable. If any of the line 10 amount should not be reported on Schedule CA (540 or 540NR), the partnership should identify that amount for you.

### Line 11 – Other Deductions

Amounts on this line are deductions not included on line 8 through line 10. If there is an amount on Schedule K-1 (565), line 11, column (c), enter this amount on the applicable line of Schedule CA (540 or 540NR).

See the federal instructions for Schedule K-1 (1065), line 11, for examples of other deductions. Also see FTB Pub. 1001 for differences between federal and California tax law for certain deductions.

## C Investment Interest

If the partnership paid or accrued interest on debts it incurred to buy or hold investment property, the amount of interest you can deduct may be limited.

For more information and the special provisions that apply to investment interest expense, get form FTB 3526, Investment Interest Expense Deduction, and federal Publication 550, Investment Income and Expenses.

### Line 12a – Interest Expense on Investment Debts

Enter the amount from column (d) on form FTB 3526 along with your investment interest expense from any other sources. Form FTB 3526 will help you determine how much of your total investment interest is deductible.

### Line 12b(1)

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### Line 12b(2) – Investment Income and Investment Expenses

Use the column (d) amounts to determine the amount to enter on form FTB 3526, line 1.

**Caution:** The amounts shown on line 12b(1) and line 12b(2) include only investment income and expenses included on lines 4a, 4b, 4c, 4e and line 10 of this Schedule K-1 (565). The partnership should attach a schedule that shows the amount of any investment income and expenses included in any other lines of this Schedule K-1 (565). Use these amounts, if any, to adjust line 12b(1) and line 12b(2) to determine your total investment income and total investment expenses from this partnership.

Combine these totals with investment income and expenses from all other sources to determine the amount to enter on form FTB 3526, line 1.

## D Credits

If you have credits that are passive activity credits to you, you must complete form FTB 3801-CR (or form FTB 3802 for corporations) in addition to the credit forms referenced. Get the instructions for form FTB 3801-CR (or form FTB 3802) for more information.

### Line 13a(1) – Withholding on Partnership Allocated to All Partners

If taxes were withheld from payments to the partnership by another entity, this withholding is allocated to all partners according to their respective interests in the partnership. Your share is entered on line 13a(1).

### Line 13a(2) – Partnership Withholding on Nonresident Partners

If taxes were withheld-at-source on you as a domestic or foreign nonresident partner, the amount of the withholding is entered on line 13a(2).

### Line 13a(3) – Total Withholding

Add together the amounts (if any) on line 13a(1) and line 13a(2) to get the total amount of withholding credit you have for the partnership year. If taxes were withheld by the partnership or if there is a pass-through withholding credit from another entity, the partnership must provide you a completed Form 592-B, Nonresident Withholding Tax Statement. You must attach Form 592-B to the front of your California income

or franchise tax return to claim the amount withheld, even if you are a resident. The amount shown on the Form 592-B should be claimed on:

- Form 540, California Resident Income Tax Return, line 38, or;
- Form 540NR, California Nonresident or Part-Year Resident Income Tax Return, line 47, or;
- Form 541, California Fiduciary Income Tax Return, line 28, or;
- Form 109, California Exempt Organization Business Income Tax Return, line 22, or;
- Form 100, California Corporation Franchise or Income Tax Return, line 35, or;
- Form 100S, California S Corporation Franchise or Income Tax Return, line 35.

Schedule K-1 (565) may not be used to claim the withholding credit. If the partnership is not on a calendar year, the amount on line 13a(3) may not match the amount on Form 592-B because of the difference in accounting periods.

### Line 13b – Low-Income Housing Credit

Your share of the partnership's low-income housing credit is shown on line 13b, column (d). Any allowable credit is entered on form FTB 3521, Low-Income Housing Credit. The passive activity credit limitations of IRC Section 469, however, may limit the amount of credit you take. Credits from passive activities are generally limited to tax attributable to passive activities.

**Caution:** You cannot claim the low-income housing credit on any qualified low-income housing project for which any person was allowed any benefit under IRC Section 502 of the Tax Reform Act of 1986.

### Line 13c – Other Credits Related to Rental Real Estate Activities

If applicable, the partnership will use this line, through an attached schedule, to give you the information you need to compute credits related to rental real estate activities other than the low-income housing credit.

### Line 13d – Credits Related to Other Rental Activities

If applicable, the partnership will use this line, through an attached schedule, to give you the information you need to compute credits related to rental activities other than rental real estate activities.

### Line 14 – Other Credits

If applicable, the partnership will use this line, through an attached schedule, to give you the information you need to compute credits related to a trade or business activity.

Credits that may be reported on line 14 (depending on the type of activity they relate to) include:

- Community Development Financial Institution Deposits credit. Use credit code 209.
- Disabled Access for Eligible Small Business credit — get form FTB 3548.
- Donated Agricultural Products Transportation credit — get form FTB 3547.
- Employer Child Care Program/Contribution credit — get form FTB 3501.
- Enhanced Oil Recovery credit — get form FTB 3546.
- Enterprise Zone (EZ) Hiring & Sales or Use Tax credits — get form FTB 3805Z.
- Farmworker Housing Credit-Construction credit. Use credit code 207.
- Farmworker Housing Credit-Loan. Use credit code 208.
- Local Agency Military Base Recovery Area (LAMBRA) Hiring & Sales or Use Tax credits — get form FTB 3807.
- Manufacturers' Investment credit — get form FTB 3535.
- Prison Inmate Labor credit — get form FTB 3507.
- Research credit — get form FTB 3523.
- Rice Straw credit. Use credit code 206.
- Salmon and Steelhead Trout Habitat Restoration credit. Use credit code 200.
- Manufacturing Enhancement Area (MEA) Hiring credit — get form FTB 3808.

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- Targeted Tax Area (TTA) Hiring and Sales or Use Tax credits – get form FTB 3809.

**Note:** The passive activity limitations of IRC Section 469 may limit the amount of credits on line 13b, line 13c, line 13d and line 14. Line 13b, line 13c and line 13d credits are related to the rental activities of the partnership. Line 14 credits are related to the trade or business activities of the partnership. In general, passive activity credits, as defined in R&TC Section 17561, from passive activities are limited to tax attributable to passive activities for California purposes. Credits that may be limited under the passive activity credit rules are the:

- Research credit; and
- Low-income housing credit.

You may be able to use the low-income housing credit, and other credits generated from rental activities, against tax on other income. See form FTB 3801-CR, Passive Activity Credit Limitations, for more information.

The partnership has included on line 14 your distributive share of net income taxes paid to other states by the partnership. Subject to the limitations of R&TC Section 18006, partners may claim a credit against their individual tax for net income taxes paid by the partnership to another state. The amount of tax paid is required to be supported by a copy of the return filed with the other state and evidence of the payment of the tax. Get Schedule S, Other State Tax Credit, for more information.

## E Adjustments and Tax Preference Items

Line 15a through Line 15e col. (d)

– Use the information reported on line 15a through line 15e, column (d) as well as your adjustments and tax preference items from other sources to complete Schedule P (540), Alternative Minimum Tax and Credit Limitations — Residents; Schedule P (540NR), Alternative Minimum Tax and Credit Limitations — Nonresidents or Part Year Residents; Schedule P (541), Alternative Minimum Tax and Credit Limitations — Fiduciaries; or Schedule P (100), Alternative Minimum Tax and Credit Limitations — Corporations. For additional information, see the federal instructions for Schedule K-1 (1065), Adjustments and Tax Preference Items, line 16a through line 16e.

## F Other

Line 16 through Line 19

– See the federal instructions for Schedule K-1 (1065), Other, line 18 through line 21. The partnership should give you a description and the amount of your share for each item applicable to California in this category.

**Line 22** – The partnership will provide supplemental information required to be reported to you on this line. If the partnership is claiming tax benefits from an EZ, LARZ, LAMBRA, MEA or TTA it will give you the business income and business capital gains and losses apportioned to the EZ, LARZ, LAMBRA, MEA or TTA on this line. Get form FTB 3805Z, FTB 3806, FTB 3807, FTB 3808 or FTB 3809 to claim any applicable credit.

The partnership may have provided an amount showing your proportionate interest in the partnership's aggregate gross receipts, less returns and allowances on this line. A qualified taxpayer may exclude income, positive and negative adjustments and preference items attributable to any trade or business from alternative minimum taxable income. A "qualified taxpayer" is defined as an individual, estate or trust that:

- Is the owner of, or has an ownership interest in a trade or business; **and**
- Has aggregate gross receipts, less returns and allowances, of less than \$1,000,000 during the taxable year from all trades or businesses in which the taxpayer is an owner or has an ownership interest. In the case of an ownership interest, you should include only your proportional share of aggregate gross receipts of any trade or business from a

partnership, limited liability company (LLC), S corporation, regulated investment company (RIC), real estate investment trust (REIT) or real estate mortgage investment conduit (REMIC).

You need to add your share of the aggregate gross receipts from this partnership to your aggregate gross receipts from all other trades or businesses in which you hold an interest to determine if you are a qualified taxpayer.

For purposes of R&TC Section 17062(b)(4), "aggregate gross receipts, less returns and allowances" means the sum of:

- The gross receipts of the trades or businesses which the taxpayer owns;
- The proportionate interest of the gross receipts of the trades or businesses which the taxpayer owns; or
- The proportional interest of pass-through entities gross receipts in which the taxpayer holds an interest. "Gross receipts" means the sum of the gross receipts from the production of business income, as defined in subdivision (a) of R&TC Section 25120, and the gross receipts from the production of nonbusiness income, as defined in subdivision (d) of R&TC Section 25120.

For purposes of this section "pass-through entity" means a partnership (as defined by R&TC Section 17008), an S corporation, a RIC, a REIT, and a REMIC. See R&TC Section 17062 for more information.

See the federal instructions for Schedule K-1 (1065), line 25, for examples of supplemental information to be reported here. Also, see FTB Pub. 1001 for a listing of items of nonconformity for individuals.

## G Table 1

Generally, nonbusiness interest and dividends are sourced to the state of residence for nonapportioning individuals. Nonapportioning means doing business entirely within California. For more information regarding the sourcing of intangibles, see R&TC Section 17952.

For apportioning partners, nonbusiness interest and dividends generally are allocable to California if the taxpayer's commercial domicile is California. For information regarding sourcing of intangibles for apportioning taxpayers, see R&TC Sections 24126 and 25127.

The income data contained in Table 1 is not reflected in column (e) of Schedule K-1 (565). For additional information, see General Information D, Income Not from a Trade or Business of the Partnership.

## H Table 2

The final determination of unity is made at the partner's level.

If the partner and the partnership are engaged in a single unitary business or if the partnership is uncertain as to whether it is unitary with the partner, the partnership will furnish the information in Table 2.

The partner's share of the partnership's business income is entered on Table 2, Part A. The partner then adds that income to its own business income and apportions the combined business income using the revised factor described below.

Table 2, Part B reflects the partner's share of nonbusiness income from real and tangible property wholly sourced or allocable to California. This is added to apportioned business income and nonbusiness intangible income allocated to California and becomes a part of California taxable income. For more information on sourcing intangibles, see R&TC Sections 25124 and 25125 and Title 18, Cal. Code Reg. Sections 17951-1, 17951-2 and 17951-3.

The partner's share of the partnership's property, payroll and sales factors is in Table 2, Part C. The partner combines its apportionment factors with the apportionment factors of the partnership and uses the revised factor to compute its business income apportioned to California. For further information, see General Information D, Income Not from a Trade or Business of the Partnership.