

## CAUTION

This revised version of the Partner's Instructions for 2004 Schedule 3K-1 was posted on the Internet on February 28, 2005. This version clarifies that a nonresident or part-year resident partner of a partnership whose entire income is derived from business transacted, property located, or services performed in Wisconsin reports on his or her Wisconsin income tax return the amounts under Wisconsin law from Schedule 3K-1, column d. **Exception:** Intangible income, such as interest and dividends, passed through to a partner who is a nonresident of Wisconsin is not subject to Wisconsin income tax.

# Partner's Instructions for 2004 Schedule 3K-1

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## General Instructions

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**Items to Note** – Schedule 3K-1 now contains a separate column that shows the amounts reportable to Wisconsin by a nonresident or part-year resident of Wisconsin who is a partner in a partnership that does business in and outside Wisconsin. Use the amounts from column d, or column e, if appropriate, when filling out Wisconsin Form 1NPR, Wisconsin income tax return for nonresidents and part-year residents.

For 2004, increases in taxable income for state and local government bond interest must be reported on line 5. See the line 5 instructions.

**Purpose of Schedule 3K-1** – Similar to federal Schedule K-1, the partnership uses Schedule 3K-1 to report your share of the partnership's income, deductions, credits, etc., for Wisconsin purposes. **Please keep it for your records. Do not** file it with your tax return unless you are claiming a tax credit passed through from the partnership or you are filing an amended return based on an amended Schedule 3K-1.

Although the partnership may have to pay a recycling surcharge, you are liable for Wisconsin franchise or income tax on your share of the partnership income, whether or not distributed, and you must include your share on your Wisconsin franchise or income tax return if a return is required.

The amount of loss and deduction that you may claim on your Wisconsin return may be less than the amount reported on Schedule 3K-1. **It is the partner's responsibility to consider and apply any applicable limitations.**

**Inconsistent Treatment of Items** – Generally, you must report partnership items shown on your Schedule 3K-1 and any attached schedules the same way that the partnership treated the items on its return. If your treatment is (or may be) inconsistent with the partnership's treatment, attach a statement to your return to identify and explain any inconsistency.

**Errors** – If you believe the partnership has made an error on your Schedule 3K-1, notify the partnership and ask for a corrected Schedule 3K-1. Don't change any items on your copy. Be sure that the partnership sends a copy of the corrected Schedule 3K-1 to the Wisconsin Department of Revenue.

**Elections** – 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 tax return and not by the partnership. These include elections under Internal Revenue Code section 59(e)(2), relating to the deduction of certain qualified expenditures ratably over the period of time specified in that section.

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## Limitations on Losses, Deductions, and Credits

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

**Note:** *Other limitations may apply to specific deductions, such as the section 179 expense deduction. These limitations on specific deductions generally apply before the basis, at-risk, and passive loss limitations.*

**Basis Rules** – Generally, you may **not** claim your share of a partnership loss (including a capital loss) to the extent that it is greater than the adjusted basis of your partnership interest at the end of the partnership's taxable year.

You compute the Wisconsin adjusted 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 include:*

- Money and your adjusted basis in property contributed to the partnership.
- Your share of the increase in the partnership's liabilities.
- Your share of the partnership's income as computed under Wisconsin law.

*Items that decrease your basis, but not below zero, include:*

- Money and the adjusted basis of property distributed to you.
- Your share of the decrease in the partnership's liabilities.
- Your share of the partnership's losses as computed under Wisconsin law.
- Your share of the partnership's section 179 expense deduction.
- Your share of the partnership's nondeductible expenses.
- Your share of the supplement to the federal historic rehabilitation tax credit computed.

**Note:** When figuring the Wisconsin adjusted basis in a multistate partnership, use your share of the total partnership amounts, as computed under Wisconsin law, rather than just the income, losses, and deductions attributable to Wisconsin activities.

**At-Risk Limitations** – For federal purposes, if you have (1) a loss or other deduction from any activity carried on as a trade or business or for the production of income by the partnership, and (2) amounts in the activity for which you aren't at risk, you generally will have to figure the allowable loss. The at-risk rules generally limit the amount of loss (including loss on disposition of assets) and other deductions (such as the section 179 expense deduction) that you can claim to the amount you could actually lose in the activity. The at-risk rules also apply for Wisconsin purposes.

**Passive Activity Limitations** – Internal Revenue Code section 469 provides rules that limit the deduction of certain losses. The rules apply to partners who are individuals, estates, trusts, closely held corporations, or personal service corporations and have a passive activity loss for the taxable year. Passive activities include trade or business activities in which you didn't materially participate and rental activities, as defined in the federal regulations. Rental real estate activities in which you materially participated are not passive activities if you meet certain eligibility requirements. The partnership will identify separately each activity that may be passive to you. You must determine whether your losses are limited by the passive activity rules.

The passive activity loss limits also apply for Wisconsin purposes. However, if there are differences between your federal and Wisconsin income, you may have to recompute the amount of passive activity loss deductible for Wisconsin.

There are three types of differences between federal and Wisconsin income: Schedule I adjustments, those resulting from making different elections for federal and Wisconsin purposes, and modifications to federal adjusted gross income prescribed in section 71.05(6) to (12), (19), and (20), Wisconsin Statutes.

A Schedule I adjustment may arise if a provision of the Internal Revenue Code doesn't apply for Wisconsin or if a federal law change becomes effective at a different time for Wisconsin than for federal purposes. Modifications to federal adjusted gross income include the addition of state and local government bond interest income and the subtraction of the 60% capital gain deduction.

For differences resulting from Schedule I adjustments or different elections, you must recompute the passive activity loss limits for Wisconsin. However, you may not recompute the loss limits for modifications. The partnership should tell you the reason for any adjustment in column c so that you will know whether you must recompute the passive activity loss limits.

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## Specific Instructions

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**Lines 1 through 13 and 16** – The entries on these lines show your share of the federal amount, adjustment, and amount reportable under Wisconsin law for each of the items. For nonresident and part-year resident partners of multistate partnerships, the entries also show your share of the amount attributed to Wisconsin. These amounts don't take into account limitations on losses or other items that may have to be adjusted because of (1) the adjusted basis of your partnership interest, (2) the at-risk limitations, or (3) the passive activity limitations. If your share items aren't affected by any of the limitations, you should have reported the federal amounts on your federal income tax return. If any of the limitations apply, you should have adjusted the federal amounts for the limitations before entering them on your federal return.

For additional information about the taxation of non-resident and part-year resident partners, see the 2004 Form 3 instructions beginning on page 8.

If the amount under Wisconsin law for any share item on lines 1 through 13 and 16 differs from the federal amount, you must account for this difference on your Wisconsin franchise or income tax return. How you account for the difference depends on the share item, the reason for the difference, and the return you are filing.

**Individuals, Estates, and Trusts** – If the difference arises because a provision of the Internal Revenue Code doesn't apply for Wisconsin or a federal law change becomes effective for Wisconsin at a different time, you must complete Wisconsin Schedule I (Schedule B for estates and trusts) before filling in your Wisconsin income tax return. If the difference results from the partnership making different elections for federal and Wisconsin purposes, you must recompute the federal adjusted gross income that you report on your Wisconsin return. Finally, if the difference is a modification allowed in computing Wisconsin adjusted gross income, the treatment depends on which share item is affected and the return you are filing.

*Lines 1, 2, 3, 4, 6, 7, 11, 12, and 19:*

- If you are filing Form 1, account for any modification to one of these share items by combining the amount from Schedule 3K-1, column c, with any other Wisconsin modification and entering the total on the appropriate line of Form 1.
- If you are filing Form 1NPR, include in column B on the appropriate line of Form 1NPR, along with any other Wisconsin income or loss, the Wisconsin amount from column d or e, as appropriate, of any share item reported on one of these lines.
- If you are filing Form 2, account for any modification to one of these share items by entering the amount from Schedule 3K-1, column c, on Form 2, Schedule A.

*Lines 5 and 17a.* Interest income that is exempt from federal income taxes but taxable by Wisconsin, such as state and local government bond interest, is shown as an **addition** on line 5, column c.

- If you are filing Form 1, combine the amount from Schedule 3K-1, column c, with any other interest modification and enter the total on the appropriate line of Form 1.
- If you are filing Form 1NPR, include in column B on Form 1NPR, along with any other Wisconsin interest income, the Wisconsin source amount of interest income from Schedule 3K-1, column e.
- If you are filing Form 2, account for any modification by entering the amount from Schedule 3K-1, column c, on Form 2, Schedule A.

**Note:** Modifications for state and local government bond interest that is taxable by Wisconsin are also shown as **subtractions** on Schedule 3K-1, line 17a, column c.

*Lines 8 and 9:* Enter the Wisconsin amounts from column d (column d or e, as appropriate, for non-

residents and part-year residents) of these share items on the appropriate lines of Wisconsin Schedule WD (Schedule WD (Form 2) for estates and trusts).

*Line 10:* If the federal and Wisconsin amounts differ, see the instructions for Part II of Wisconsin Schedule T and recompute a federal Form 4797 as instructed.

*Lines 13 and 19:* If the Wisconsin amount of charitable contributions or the amount of any other itemized deduction differs from the federal amount, adjust the deduction items from federal Schedule A when figuring the Wisconsin itemized deduction credit (Form 1, Schedule 1, or Form 1NPR, Schedule 1). Increase or decrease, as appropriate, the amount from federal Schedule A by the amount on Schedule 3K-1, column c.

**Partnerships** – If you are filing Form 3, account for any difference between the Wisconsin and federal amount of a share item that is allowable in computing Wisconsin net income by entering the amount from Schedule 3K-1, column c, on the appropriate line of Form 3, Schedule 3K, column c.

**Corporations** – If you are filing Form 4 or 5, account for any difference between the Wisconsin and federal amount of a share item that is allowable in computing Wisconsin net income by entering the amount from Schedule 3K-1, column c, on Form 4 or 5, Schedule V or W, as appropriate.

**Tax-Option (S) Corporations** – If you are filing Form 5S, account for any difference between the Wisconsin and federal amount of a share item by entering the amount from Schedule 3K-1, column c, on the appropriate line of Form 5S, Schedule 5K, column c.

**Line 14a – Individuals, estates, and trusts** enter the amount from line 14a, column d or e, on Wisconsin Schedule MS.

**Partnerships** enter the amount from line 14a, column d, on the worksheet on Wisconsin Schedule 3Z.

**Corporations and tax-option (S) corporations** enter the amount from line 14a, column d, on Wisconsin Schedule Z-1.

**Line 14b** – Enter the amount from line 14b, column d or e, on Wisconsin Schedule DI.

**Lines 14c through 14e** – Enter the amounts from lines 14c, 14d, and 14e, column d or e, on the appropriate lines on Wisconsin Schedule DC.

**Line 14f** – Enter the amount from line 14f, column d or e, on the appropriate line on Wisconsin Schedule TC.

**Line 14g** – Enter the amount from line 14g, column d or e, on the appropriate line on Wisconsin Schedule HR.

**Note:** The historic rehabilitation credit reduces the Wisconsin basis of your partnership interest.

**Line 15** – Enter the total amount from line 15, column d or e, as appropriate, on the "Net income tax paid to another state" line (Form 1, line 45, or Form 1NPR, line 68). **If you claim this credit you must attach a copy of Schedule 3K-1 to the Form 1 or Form 1NPR that you file with the Department.**

**Line 16 – Individuals, estates, and trusts** enter the net amount from column c of line 16 on Wisconsin Schedule MT, line 8. If you are a nonresident of Wisconsin for any part of the partnership's taxable year, enter the difference between column b and column d or e, as appropriate on Schedule MT, line 8.

**Partnerships and tax-option (S) corporations** enter the amounts from column c on the appropriate lines of Schedule 3K or Schedule 5K, column c.

**Corporations** may disregard this line.

**Lines 17a through 17c** – Differences in the amount of income that is exempt for federal and Wisconsin purposes are shown on lines 17a and 17b, column c. Increases or decreases in the amount of nondeductible expenses are shown on line 17c, column c. Use the amount from column d when computing the Wisconsin basis of your partnership interest.

**Partnerships and tax-option (S) corporations** enter the amounts from column c on the appropriate lines of Schedule 3K or Schedule 5K, column c.

**Line 18** – Reduce the Wisconsin basis of your partnership interest by the Wisconsin distributions shown on line 18, column d. If these distributions exceed the Wisconsin basis of your partnership interest and you were a Wisconsin resident when you received the distributions, treat the excess as a gain from the sale or exchange of property. Enter any Wisconsin gain on the appropriate line of Wisconsin Schedule WD.

**Line 19** – If applicable, the partnership has provided supplemental information or has listed in the space provided, or on attached schedules, your share of items not included on lines 1 through 18. This listing should include the federal amount, adjustment, amount under Wisconsin law, and Wisconsin source amount, if applicable, for each item. Account for any other share items listed on line 19 as necessary to include the taxable or deductible amount of each item as computed under Wisconsin law in your Wisconsin income.

**Individuals, Estates, and Trusts** – If interest income from United States government obligations is listed, you must make an adjustment on your Wisconsin return since this income is taxable for federal income tax purposes, but not for Wisconsin purposes. If you are filing Form 1, subtract this interest income on Form 1, line 7. If you are filing Form 1NPR, don't include this interest income on Form 1NPR, line 2, column B. If you are filing Form 2, subtract the United States government interest on Schedule A, line 8.

**Line 20 – Individuals** combine the amount from column d or e, as appropriate, with your gross income from other sources (if any) that is reportable to Wisconsin to determine whether you must file a Wisconsin income tax return. See the instructions for Form 1 or Form 1NPR for information about the filing requirements.

**Part IV – Partnerships, corporations, and tax-option (S) corporations** include your share of the numerator and denominator of the partnership's apportionment factors in the numerator and denominator of your apportionment factors.