

2010

Instructions for Schedule P (Form 1120-F)



Department of the Treasury
Internal Revenue Service

List of Foreign Partner Interests in Partnerships

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

General Instructions

Purpose of Schedule

Schedule P (Form 1120-F) is used to identify and reconcile the foreign corporation's directly held partnership interests with the distributive shares of partnership effectively connected income (ECI) and the foreign corporation's effectively connected outside tax basis in each interest. Part I is used to identify all partnership interests the foreign corporation directly owns that give rise to a distributive share of income or loss that is effectively connected with a trade or business within the United States of the foreign corporation. Part II is used to reconcile the foreign corporation's distributive share of ECI and allocable expenses with the total income and expenses reported to it on Schedule K-1 (Form 1065), Partner's Share of Income, Deductions, Credits, etc. Part III is used as follows: The corporation's outside basis in its directly-held partnership interests that include ECI in the corporation's distributive share is apportioned between ECI and non-ECI under Regulations section 1.884-1(d)(3) to determine the average value treated as a U.S. asset for interest expense allocation purposes under Regulations section 1.882-5. The apportionment of the outside basis to ECI as of the current and prior tax year end is also taken into account in determining the average apportioned value included in the corporation's U.S. assets for purposes of computing the branch profits tax. The U.S. assets, and partner share of booked liabilities and interest expense of the partnership are also coordinated with the interest expense allocation computations filed with Form 1120-F on Schedule I (Form 1120-F).

Who Must Complete Schedule P

A foreign corporation that is directly or indirectly engaged in trade or business within the United States is required to file Schedule P (Form 1120-F) for all directly-owned partnership interests that have ECI included in its distributive share of income reported to the corporation on Schedule K-1 (Form 1065). If the foreign

corporation treats any of its distributive share of partnership net income or loss from a partnership that is not engaged in trade or business within the United States as ECI with another trade or business of the corporation, the corporation's entire distributive share of items of income and expense must also be reconciled between ECI and non-ECI and reported on Schedule P.

A foreign corporation may be engaged in a trade or business within the United States either directly through its own non-partnership related activities or indirectly through the activities of one or more partnerships in which the corporation owns a partnership interest. In addition, if a corporation owns an interest in a partnership that is itself deemed engaged in trade or business within the United States as a result of the partnership's own directly or indirectly owned interest in another partnership ("lower tier partnership"), the corporation is also treated as engaged in trade or business as a result of its direct and indirect ownership of such interests. See section 875(1). The foreign corporation's distributive share of income from a domestic partnership and certain foreign partnership interests is reported to the partner on Schedule K-1 (Form 1065), together with the corporation's allocable share of partnership liabilities. If the partnership is engaged in trade or business directly or indirectly through a lower-tier partnership and has ECI to report in the distributive share of a foreign partner, it is responsible for making quarterly installment payments of withholding tax under section 1446 on the foreign partner's distributive share of estimated ECI under section 1446 and reporting the amounts to the foreign partner for the tax year on Form 8805, Foreign Partner's Information Statement of Section 1446 Withholding Tax. If a partnership is required to report ECI on Form 8805 to a foreign corporate partner, the corporation must reconcile its entire distributive share of income and expenses reported on Schedule K-1 (Form 1065) from such partnership, rather than the information on Form 8805, on Schedule P (Form 1120-F).

Exceptions from Filing Schedule P

Do not file Schedule P if the corporation does not have any ECI with respect to its

combined distributive shares of income from all directly owned partnership interests. A foreign corporation that has ECI reported to it from a partnership is not required to file Schedule P (Form 1120-F) if none of the corporation's business profits including its ECI from the partnership are attributable to a U.S. permanent establishment pursuant to an applicable income tax treaty and the corporation files a protective tax return under Regulations section 1.882-4(a)(3)(vi).

Protective election on Schedule P. See *Protective election* on page 4 for instructions for making a protective partnership outside basis apportionment election with a protective return.

When and Where To File

Attach Schedule P (Form 1120-F) to the foreign corporation's Form 1120-F income tax return. See the Instructions for Form 1120-F for the time, place, and manner for filing the foreign corporation's income tax return.

Other Forms and Schedules Related to Schedule P

Form 1120-F, Section II. Gross ECI includible in the corporation's distributive share is reportable on Form 1120-F, Section II, lines 3 through 10, in the applicable category of income. Expenses (other than interest expense) that are deductions allocated and apportioned on Schedule P (Form 1120-F) to the partner's ECI are also reported on Form 1120-F, Section II.

Schedule I (Form 1120-F). Interest expense reportable on Schedule P is includible in the corporation's interest expense allocation computation under Regulations section 1.882-5. The corporation's distributive share of interest expense that is directly allocable to effectively connected income under Regulations section 1.882-5(a)(1)(ii)(B) is reported on Schedule P, line 14b, and on Schedule I (Form 1120-F), line 22. The corporation's distributive share of interest expense that is included in the taxpayer's three-step allocation formula is reported on Schedule P, line 14c, and the total from line 14c is reported on Schedule I (Form 1120-F), line 9, column (b). The average value of partnership liabilities the corporation includes in the determination

of its outside basis for which the corporation also receives a distributive share of interest expense is reported on Schedule P (Form 1120-F), line 17 (Total column), and on Schedule I (Form 1120-F), line 8, column (b). The average value of partnership liabilities reported on Schedule P (Form 1120-F) and Schedule I (Form 1120-F) does not include the partnership liabilities that give rise to directly allocable interest expense under Regulations section 1.882-5(a)(1)(ii)(B), reportable on Schedule P (Form 1120-F), line 14b. The average value of the partner's outside basis apportioned to ECI is reported on Schedule P (Form 1120-F), line 19, and as a U.S. asset on Schedule I (Form 1120-F), line 5, column (b).

Schedule H (Form 1120-F), Part I, Part II, and Part IV. The corporation's distributive share of non-interest expenses included on Schedule P, lines 4 and 5 is also included in the corporation's overall allocation and apportionment of expenses on Schedule H (Form 1120-F), Part IV, lines 38a through 41, if the partnership books constitute set(s) of books that are also reportable on Form 1120-F, Schedule L or the partnership interest is recorded on Schedule L books of the corporation's own separate trade or business within the United States. If the partnership interest is not reported on Schedule L, the distributive share of partnership expenses allocable to the corporation's distributive share of ECI is included on Schedule H (Form 1120-F) in Parts I and II. See the Instructions for Schedule H (Form 1120-F).

Schedule M-3 (Form 1120-F), Part II. The corporation's distributive share of partnership income or loss may be reported on Schedule M-3 (Form 1120-F), Part II, line 9 (domestic partnerships) and line 10 (foreign partnerships) in accordance with the corporation's reporting on its applicable financial statements for Schedule M-3 (Form 1120-F) purposes. See the Instructions for Schedule M-3 (Form 1120-F), Part II, lines 9 and 10 for the specific reporting requirements.

Part I – List of Foreign Partner Interests in Partnerships

In Part I, list the name, address, and Employer Identification Number of each directly owned partnership interest that has effectively connected income included in the partner's distributive share on Schedule K-1 (Form 1065). Also include in the list of partnership interests any interest in a partnership that is not engaged in trade or business within the United States if the corporation treats some or all of its distributive share as ECI with a separate trade or business of its own within the United States. **Do not report on Schedule P** any indirectly owned partnership interests (lower-tier partnership interests) that have income effectively connected with the lower-tier

partnership's own trade or business within the United States unless the corporation also owns a direct interest in the lower-tier partnership. The corporation's distributive share of ECI earned through lower-tier partnership interests is includable on the Schedule K-1 (Form 1065) reportable to the corporation by the partnership in which the corporation owns a direct interest, whether or not the directly owned partnership is itself directly engaged in trade or business within the United States.

Schedule P (Form 1120-F) accommodates reporting for four directly-owned partnership interests. Complete a separate line in Part I, and the corresponding columns in Parts II and III, for each directly owned partnership interest. If the corporation directly owns more than four partnership interests which are required to be reported on Schedule P (Form 1120-F), report the required information for those additional partnership interests on attached separate sheets using the same size and format as shown on the schedule. Also, in the "Totals" column of Parts II and III, for each line item, enter the sum for all directly owned partnership interests, including those interests reported on attached sheets.

Entities treated as partnerships for tax purposes include Limited Liability Partnerships (LLPs) and Limited Liability Companies (LLCs) that are not classified as corporations for federal income tax purposes and may be domestic or foreign. Do not include any interest in any entity treated as a disregarded entity as described under Regulations section 301.7701-2(c)(2).

Column (d). With respect to each partnership interest, check the "Yes" box if the foreign corporation's distributive share is ECI, or treated as ECI, in whole or in part, with a U.S. trade or business determined under section 875. Accordingly, with respect to each partnership interest, check the "Yes" box if the foreign corporation is engaged in a U.S. trade or business indirectly through the activities of the partnership. Check the "No" box if the foreign corporation has applied ECI principles solely at the partner level and not as a result of the partnership's activities.

Part II – Foreign Partner Income and Expenses: Reconciliation to Schedule K-1 (Form 1065)

Part II reconciles the partner's ECI and non-ECI to its Schedule K-1 (Form 1065) distributive share from each partnership listed in Part I. The Schedule K-1 lines are grouped for reconciliation of their income and expense in the following manner:

- Schedule P, lines 1 through 5: ECI and non-ECI reconciliation of income and

non-interest expenses from Schedule K-1 (Form 1065), lines 1 through 3.

- Schedule P, lines 6 through 9: Reconciliation of other income and other non-interest expenses from Schedule K-1 (Form 1065).
- Schedule P, lines 10 and 11: Total gross income and total gross ECI from Schedule K-1 (Form 1065).
- Schedule P, lines 12 through 14: Reconciliation of **total interest expense from Schedule K-1 (Form 1065).**

Note. If you are reconciling the foreign corporation's distributive share of ECI and allocable expenses with the total income and expenses reported to the corporation on Schedule K-1 (Form 1065-B), the relevant information will be located in box 9 of the Schedule K-1 (Form 1065-B) or in an attachment for box 9. Specifically, the lines on Schedule K-1 (Form 1065) noted throughout these instructions correspond to the box 9 information on Schedule K-1 (Form 1065-B) as follows:

- Schedule K-1 (Form 1065), line 1 corresponds to the information reported on Schedule K-1 (Form 1065-B), box 9 using code A1.
- Schedule K-1 (Form 1065), line 2 corresponds to the information reported on Schedule K-1 (Form 1065-B), box 9 using code B1.
- Schedule K-1 (Form 1065), line 3 corresponds to the information reported on Schedule K-1 (Form 1065-B), box 9 using code C1.

Also note that other interest expense reported on Schedule K-1 (Form 1065), lines 13 and 18 corresponds to the information reported on Schedule K-1 (Form 1065-B), box 9 using code M-2 (nondeductible expenses) and/or code U (other information).

Lines 1 Through 5. ECI and Non-ECI Reconciliation of Income and Non-Interest Expenses

Line 1. Enter on line 1 the combined total income (loss) from Schedule K-1 (Form 1065), Part III, line 1, Ordinary business income (loss); line 2, Net rental real estate income (loss); and line 3, Other net rental income (loss). Enter the combined amount in the column in Part II which corresponds to the line in Part I on which the partnership is listed. The amount entered on line 1 is grouped into its gross income and gross expense components for allocation and apportionment to ECI and non-ECI under sections 864(c) and 882(c). The gross income apportionments are shown on line 3, and the allocation and apportionments of non-interest expenses are determined under Regulations sections 1.861-8 and 1.861-17 and Temporary Regulations section 1.861-8T(c). See Regulations section 1.861-17 for the allocation and ECI apportionment treatment of research and experimentation expenditures that are included in trade or business income on line 1 or 3, Schedule K-1, and which

are also reportable on Schedule P (Form 1120-F), lines 4 and 5.

Lines 2 and 3. Gross income. Enter on line 2 the total gross income included in Schedule P (Form 1120-F), line 1. On line 3, enter the amount of ECI included in the gross income reported on line 2. If all of the gross income reported on line 2 is ECI, then report the same number on line 3.

Note. Line 3 may exceed line 2 if losses included in line 2 are non-ECI and the income and gains are ECI.

Lines 4 and 5. Non-interest expense. Enter on line 4 the total amount of non-interest expense included on line 1. On line 5, enter the amount of non-interest expense included on line 1 that is allocated and apportioned to gross ECI. Include on line 4 (and line 5 if applicable), guaranteed payments made by the partnership that are included in the combined net income (loss) reported on line 1. Interest expense included in line 1 is subject to allocation under Regulations section 1.882-5 and is reported in a separate grouping of the corporation's distributive share of all interest expense on Schedule P (Form 1120-F), line 12.

Lines 6 Through 9. Other Gross Income and Other Non-Interest Expenses

Other gross income. Enter on line 6 all other gross income from Schedule K-1 (Form 1065) that is not included on lines 1 through 3 of the Schedule K-1 (and is not reportable on line 2 of Schedule P). On line 7, enter the amount of gross income from line 6 that is allocated and apportioned to ECI.

Note. The amount on line 7 may exceed the amount on line 6 if losses included on line 6 are allocated to non-ECI and other gross income and gains are allocated to ECI.

Other non-interest expense. Enter on line 8 all other non-interest expense from Schedule K-1 (Form 1065) that is not included on lines 1 through 3 of the Schedule K-1 (and is not reportable on lines 4 and 5 of Schedule P). On line 9, enter the amount of non-interest expense from line 8 that is allocated and apportioned to ECI. Include on line 8 (and line 9 if applicable) guaranteed payments made by the partnership that are not included on lines 4 and 5.

Lines 10 and 11. Summary of Gross Income

Line 10. Total Gross Income. Enter on line 10 the sum of the gross income amounts entered on line 2 and line 6. The amount on line 10 is the total gross income from Schedule K-1 (Form 1065).

Line 11. Total Gross Effectively Connected Income. Enter on line 11 the sum of the ECI amounts entered on lines 3 and 7. The amount on line 11 is the total gross ECI from Schedule K-1 (Form 1065).

Lines 12 Through 14. Interest Expense Reconciliation

Enter on line 12 the amount of interest expense included in the net income (loss) on lines 1 through 3 of Schedule K-1 (Form 1065) and in the net income (loss) reported on line 1 of Schedule P (Form 1120-F). On line 13, enter the sum of the other interest expense reported on Schedule K-1 (Form 1065), lines 13 and 18.

Note. If interest expense is included on any line of Schedule K-1 (Form 1065) other than lines 1, 2, 3, 13, or 18, attach a schedule indicating the line the interest is included on and reclassify the interest expense reported on such other line to Schedule K-1 (Form 1065), line 13 or line 18, as appropriate, for purposes of reporting the reclassified amount on line 13 of Schedule P. The reclassification will require an adjustment to such other line to prevent double counting of total expenses.

Line 14a. Total interest expense. Add lines 12 and 13 and enter the result on line 14a. This amount is the corporation's total distributive share of interest expense from Schedule K-1 (Form 1065) that is subject to allocation under Regulations section 1.882-5.

Line 14b. Direct interest expense allocation. On line 14b, enter the amount of interest expense included in line 14a that is directly allocable to ECI under Regulations section 1.882-5(a)(1)(ii)(B) and the applicable requirements of Temporary Regulations section 1.861-10T(b) or (c). The amount entered on line 14b is also included on Schedule I (Form 1120-F), line 22.

Line 14c. U.S.-booked interest expense of the partnership. Subtract line 14b from line 14a and enter the amount on line 14c. This amount constitutes the book interest expense of the partnership that is includible in the three-step formula under Regulations section 1.882-5(d) or 1.882-5(e). The amount on line 14c ("Totals" column) is also required to be reported on Schedule I (Form 1120-F), line 9, column (b). The line 14c amount is also taken into account on Form 1120-F, Section III, Part II, line 8 in determining the corporation's branch interest under Regulations section 1.884-4(b).

Part III – Foreign Partner's Average Outside Basis Under Regulations Sections 1.882-5(b) and 1.884-1(d)(3)

Report in Part III the corporation's outside basis for each partnership interest identified in Part I of this Schedule P (Form 1120-F) for purposes of determining the amount the corporation includes as a U.S. asset in Step 1 of the interest expense allocation under Regulations section 1.882-5. The corporation's outside basis in its

partnership interests reported on Schedule P is determined and adjusted under the rules applicable to the determination of the corporation's outside basis in the partnership for branch profits tax purposes under Regulations section 1.884-1(d)(3), except that the amounts entered on lines 15 through 19 are the average values rather than the determination dates used under the section 884 regulations for branch profits tax purposes. If the corporation is not exempt from the branch profits tax under an applicable income tax treaty, attach a schedule showing the determination of the corporation's outside basis in accordance with the requirements of lines 15 through 19 for an averaging period that shows the apportioned outside basis for the beginning and ending determination dates of the corporation's tax year.

Line 15. Section 705 Outside Basis. Enter on line 15 the corporation's average value of the outside basis (otherwise determined under section 705) of the partnership in the column which corresponds to the line in Part I on which the partnership interest is listed. The average value is determined using the most frequent averaging period for which data is reasonably available. See Regulations sections 1.882-5(b)(3) and 1.882-5(c)(2)(iv).

Line 16. Partner Liabilities Included in the Corporation's Outside Basis. The corporation's outside basis reported on line 15 is adjusted on line 16 to conform the amount of liabilities the corporation includes in the determination of its outside basis to the proportionate amount of the corporation's distributive share of interest expense with respect to the partnership's liabilities. This adjustment is made only for purposes of determining the corporation's outside basis included in the interest expense allocation and branch profits tax computations. The adjustment is not made for other federal income tax purposes such as for determining the corporation's gain or loss from disposition of the partnership interest.

Line 16a. Adjustment for directly allocable interest. The outside basis is reduced by the average amount of liabilities that give rise to directly allocable interest expense in accordance with Regulations section 1.882-5(a)(1)(ii)(B). Enter the portion of the partnership liability that is subject to the direct interest expense allocation rules under Temporary Regulations section 1.861-10T(b) or (c) and is subject to exclusion from the determination of the corporation's average U.S. asset values under Regulations section 1.882-5. See Temporary Regulations section 1.861-10T(d).

Line 16b. Enter the average amount of the corporation's share of all other partnership liabilities it otherwise takes into account under section 752 in determining its outside basis in its partnership interest.

Line 16c. Add lines 16a and 16b and enter the result on line 16c. This is the corporation's combined average total share of partnership liabilities for the year.

Line 17. Enter the corporation's average partnership liabilities, or portion thereof, for the year for which the corporation receives a distributive share of interest expense for the year. See Regulations section 1.884-1(d)(3)(vi). Also, enter this line 17 amount on Schedule I (Form 1120-F), line 8, column (b), to the extent applicable in determining the corporation's interest expense deduction under Regulations section 1.882-5.

Line 18. Partner's Adjusted Average Outside Basis in Partnership. Add lines 16d and 17 and enter the amount on line 18. The amount reported on line 18 is the corporation's adjusted outside basis that is eligible for apportionment between ECI and non-ECI.

Line 19. Partner's Outside Basis Allocable to ECI. Enter on line 19 the corporation's average outside basis reported on line 18 that is apportioned to ECI. Also enter this line 19 amount on Schedule I (Form 1120-F), line 5, column (b). See Regulations section 1.884-1(d)(3)(i) for the elective requirements for apportioning outside basis on the mandatory proportionate income or asset method. For purposes of determining the proportion of the partnership interest that is a U.S. asset, a foreign corporation may elect separately for each partnership interest to use either the asset method or the income method described in Regulations sections 1.884-1(d)(3)(ii) and (iii). If the corporation does not timely elect either method in the first year the corporation has a distributive share of ECI from the partnership, the Director of Field Operations may make the election on behalf of the corporation. See Regulations section 1.884-1(d)(3)(v) and the instructions for line 20 below.

Note. The required timely-filed election under Regulations section 1.884-1(d)(3)(iv) for apportioning outside basis between ECI and non-ECI also applies to lower-tier partnership interests that are not required to be identified and reconciled to Schedule K-1 (Form 1065) on this Schedule P (Form 1120-F).

Line 20. Outside Basis Election Method. Enter "income" or "asset" on line 20 to indicate the elective outside basis apportionment method used to determine the amount of the corporation's outside basis in its partnership interests apportioned to ECI and reported on line 19. The allocation method is subject to a five-year minimum period election that must be made in the first year the partner has a distributive share of ECI included in the income reported on Schedule K-1 (Form 1065). The elective method chosen must be used for both branch profits tax and interest expense allocation purposes during the same five-year minimum period.

Asset method. In general, a partner's interest in a partnership shall be treated as a U.S. asset in the same proportion that the sum of the partner's proportionate share of the adjusted bases of all partnership assets as of the determination date, bears to the sum of the partner's proportionate share of the adjusted bases of all partnership assets as of the determination date. The proportion of U.S. assets to total assets of the partnership is determined as if the partnership were a foreign corporation engaged in trade or business within the United States. Generally, a partner's proportionate share of a partnership asset is the same as its proportionate share of all items of income, gain, loss, and deduction that may be generated by the asset. See Regulations section 1.884-1(d)(3)(ii)(B) for non-uniform treatment of certain partnership items.

Income method. Under the income method, a partner's interest in a partnership shall be treated as a U.S. asset in the same proportion that its distributive share of partnership ECI for the partnership's tax year that ends with or within the partner's tax year bears to its distributive share of all partnership income for that tax year.

Protective election. If the corporation files a protective tax return under Regulations section 1.882-4(a)(3)(vi), and the partnership is not engaged in trade or business within the United States or does not have business profits attributable to a U.S. permanent establishment, the corporation need not file Schedule P and report its distributive share of income and expenses with its Form 1120-F. However, if it is later determined that the corporation's distributive share of partnership income is ECI with a trade or business of the corporation, the corporation will have failed to make a timely income method or asset method election with respect to such partnership for outside basis apportionment purposes if no other election disclosure is made. To preserve the right to allocate and apportion its outside basis under a chosen method, the corporation may make a protective election by filing Schedule P (Form 1120-F) and completing Part I and line 20 with the protective return filing on Form 1120-F. The protective election is effective only for a year in which a Schedule P (Form 1120-F) protective election attachment is also the first year in which the corporation's distributive share is in fact ECI with a trade or business of the corporation within the United States. The corporation need not complete Part II or Part III, lines 15 through 19 with the protective election.