

IRS REPORTING REQUIREMENTS FOR FOREIGN PARTNERSHIPS

By Patrick W. Martin, Esq.
Procopio, Cory, Hargreaves & Savitch LLP

U.S. persons that own a controlling interest in a foreign partnership are subject to relatively new reporting requirements. Regulations issued under IRC §6046A and IRC §6038 outline the information requested and the U.S. persons who must file. The information requested under both sections can be filed using Form 8865 “**Return of U.S. Persons With Respect to Certain Foreign Partnerships**” and the accompanying schedules. Form 8865 is an information return that should accompany the timely filed income tax return for the year of the reportable event.

Section 6046A outlines the required information from U.S. Persons who acquire or dispose of an interest in a foreign partnership, or whose proportional interest in a foreign partnership changes substantially. Section 6038 involves information returns required of certain U.S. Persons with respect to controlled foreign partnerships.

IRC §6046A

Section 6046A of the Internal Revenue Code requires that a U.S. person with an interest in a foreign partnership file Form 8865 when they have a “reportable event” during the tax year.

Reportable events include acquisitions, dispositions and changes in proportional interests for U.S. persons of at least 10%. The 10% interest includes the capital interest in the partnership, the profit interest or the interest for allocation of deductions and losses. U.S. Persons refers to U.S. citizens and residents, domestic partnerships and corporations and domestic trusts and estates.

Acquisitions – When a U.S. Person initially acquires a 10% or greater interest in a foreign partnership. (An acquisition includes an increase in a person’s direct proportional interest).

Dispositions – When a U.S. Person who owns 10% or greater interest prior to the disposition and is left with less than 10% after the disposition. (A disposition includes a decrease in a person’s direct proportional interest).

Change in Proportional Interest – A U.S. Person’s interest in a foreign partnership is compared to the interest owned at the last reportable event. If that direct proportional interest has increased or decreased by at least a 10% interest, a reportable event has occurred. For U.S. Persons that owned a 10% or greater foreign partnership interest on December 31, 1999, transactions should be compared to that date to determine whether the first reportable event has occurred.

Proportional changes are caused by the withdrawal or addition of a partner, or by operation of the partnership agreement. The indirect acquisition of a foreign partnership interest is not considered a reportable event.

The informational return must contain the following information:

1. The name, address and taxpayer identification number of the U.S. person required to file the return.
2. If the U.S. person is treated as owning an interest in a foreign partnership by application of the attribution rules, information about the foreign and/or domestic persons who actually own the interest in the foreign partnership is required.
3. Information about all foreign entities that were owned by the foreign partnership, but who were disregarded as entities separate from their owners because there was a single owner that did not have limited liability.
4. For each reportable event, include the date and type of event, and the U.S. person’s direct percentage interest in the foreign partnership immediately before and immediately after the event.
5. The fair market value of the interest that was acquired or was disposed.
6. Information about foreign and domestic partnerships that the foreign partnership owned interests of at least 10% either directly or constructively during the partnership’s tax year ending with or within the year of the person filing Form 8865.
7. Any other information requested on Form 8865

Exempt Persons

Some transactions are exempt from the filing requirements of section 6046A due to the overlap of reporting requirements with section 6038B. If the acquisition of the partnership interest occurs as a result of a section 721 contribution, it is reported under section 6038B and will not have to be reported under 6046A, even if it constitutes a reportable event.

Trusts relating to state and local government employee retirement plans and partnerships that have validly elected to be excluded from the provisions of subchapter K of the Internal Revenue Code are exempt from the 6046A filing requirements.

IRC §6038

Section 6038 requires information returns to be filed by U.S. persons who have a controlling interest in foreign corporations and partnerships. U.S. persons affected by this requirement are those who are controlling 50% partners or controlling 10% partners.

Control is defined as ownership of at least 50% of the partnership interest, consisting either of the capital interest of the partnership, the profit interest or the interest in deduction and loss allocation. If there is no 50% controlling partner at any point during the tax year, all 10% controlling partners are required to file Form 8865. If at any point during the tax year, a U.S. person owned at least 10% of the partnership interest while the partnership was “controlled” by U.S. persons owning at least 10% , then all partners owning at least 10% are deemed “controlling 10% partners.”

A separate Form 8865 must be filed for each foreign partnership that a U.S. person is deemed in control. Constructive ownership provisions are applied to determine control. Interest will only be attributed from a non-resident if the person to whom the interest is attributed owns a direct or indirect interest in the partnership.

When there are multiple controlling 50% partners, only one partner is required to file the Form 8865. However, if any of the U.S. persons are controlling partners pursuant to their interest in capital or profits, the designated filing partner must also have an interest in capital or profits and not just an allocation of losses or deductions. When one Form 8865 is filed, information on all controlling partners is required to be included.

If a multiple controlling partner is not filing a separate Form 8865, they must file a statement entitled “Controlled Foreign Partnership Reporting” containing the following information:

1. A statement that the person qualified as a controlling partner, but is not submitting Form 8865 due to the multiple controlling partner exception.
2. The name, address and taxpayer identification number of the foreign partnership.
3. A representation that the filing has been or will be satisfied.
4. The name and address of the person filing the single return.
5. The Internal Revenue Service Center where the single return is required to be filed.
6. Any additional information requested in Form 8865.

Exempted Persons

U.S. persons that do not own a direct interest in a foreign partnership, but that are considered constructive owners are generally exempt from filing Form 8865 if the following requirements are met:

1. The U.S. person whose interest the indirect partner constructively owns must report all the information required under section 6038, unless that person is also an indirect constructive owner.
2. The indirect partner must file a statement titled “Controlled Foreign Partnership Reporting” containing the following information with their income tax return:
 - a. A representation that the indirect partner is exempt due to constructive ownership.
 - b. The names and addresses of the U.S. person whose interest the indirect partner constructively owns.
 - c. The names and addresses of the foreign partnership.
 - d. Any additional information that Form 8865 requires.

Trusts relating to state and local government employee retirement plans and partnerships that have validly elected to be excluded from the provisions of subchapter K of the Internal Revenue Code are exempt from the 6038 filing requirements.

The following information is required from controlling 50% partners and controlling 10% partners. Unlike the

exemptions under section 6046A, all 50% and 10% controlling partners must file Form 8865, unless specifically exempted by the instructions to the form.

1. A statement of the income, gain, losses, deductions and credits allocated to the direct interest in the partnership of the person reporting under section 6038;
2. If the U.S. person is treated as owning an interest in a foreign partnership by application of the attribution rules, information about the foreign and/or domestic persons who actually own the interest in the foreign partnership is required.
3. Information about all foreign entities that were owned by the foreign partnership, but who were disregarded as entities separate from their owners because there was a single owner that did not have limited liability.
4. A summary of the transactions that took place during the partnership's tax year between the partnership and the person filing the return, between the partnership and any other partnership of which the person filing the return is a controlling fifty-percent partner, and between the partnership and any corporation controlled by the person filing the return
5. Any other information that Form 8865 or its accompanying instructions require.

In addition to the above information, 50% controlling shareholders must also provide the following information as required by Form 8865:

1. A list of the names, addresses and tax identification numbers (if any) of each United States person that owned a direct interest of ten percent or more in the partnership during the partnership's tax year, and of each United States and foreign person whose interests in the partnership the controlling fifty-percent partner constructively owned during the partnership's tax year.
2. A list of transactions between the partnership and any U.S. person owning at the time of the transaction at least a 10-percent direct interest in the foreign partnership.
3. A statement of the aggregate of the partners' distributive shares of items of income, gain, losses, deductions and credits
4. A statement of income, gain, losses, deductions and credits allocated to each U.S. person holding a direct interest in the foreign partnership of ten percent or more.
5. Any other information Form 8865 or its accompanying instructions require controlling fifty-percent partners to submit.

Foreign Partnership Subject to Filing Requirements of Form 1065, pursuant to section 6031(e).

If the foreign partnership is required to file Form 1065, the U.S. partner must use a copy of the relevant part of Form 1065 to fill in Form 8865 and attach relevant schedules from 1065. Foreign partnerships are generally required to file Form 1065 if they have income that is effectively connected with a trade or business within the United States.

Schedules for Form 8865

Schedule A	Constructive Ownership of Partnership Interests
Schedule A-1	Certain Partners of Foreign Partnerships
Schedule A-2	Affiliation Schedule
Schedule B	Income Statement – Trade or Business Income
Schedule D	Capital Gains and Losses
Schedule K	Partners' Shares of Income, Credits, Deductions, etc.
Schedule L	Balance Sheets per Books
Schedule M	Balance Sheets for Interest Allocation
Schedule M-1	Reconciliation of Income (Loss) per books with Income (Loss) per return
Schedule M-2	Analysis of Partners' Capital Accounts
Schedule N	Transactions Between Controlled Foreign Partnership and Partners or Other Related Entities

Schedule K-1	Partner's Share of Income, Credits, Deductions, etc. (for direct partners)
Schedule O	Transfer of Property to a Foreign Partnership
Schedule P	Acquisitions, Dispositions and Changes of Interests in a Foreign Partnership

Patrick W. Martin is a U.S. lawyer licensed in California and Washington, D.C. and specializes in international tax and related international law-matters. Mr. Martin is the partner in charge of the international practice group of the Tax Team with the San Diego based law firm of Procopio, Cory, Hargreaves & Savitch LLP. He is the Immediate Past Chair of the International Tax Committee of the State Bar of California Taxation Section. He received his J.D. from the University of San Diego School of Law, has passed the Certified Public Accountant's exam, previously worked for the Internal Revenue Service, and studied postgraduate law studies in international business transactions at the Escuela Libre de Derecho, in Mexico City. Reach him at 619.515.3230 or pwm@procopio.com.