Irs form 1065 sch m-3

Per IRS Instructions for Schedule M-3 (Form 1065) Net Income (Loss) Reconciliation for Certain Partnerships, on page 1: Who Must File Any entity that files Form 1065 must file Schedule M-3 (Form 1065) if any of the following is true. The amount of total assets at the end of the tax year reported on Schedule L, line 14, column (d), is equal to $10 million or more. The amount of adjusted total assets for the tax year is equal to $10 million or more. See Total Assets and Adjusted Total Assets, later. The amount of total receipts for the tax year is equal to $35 million or more. Total receipts is defined in the instructions for Codes for Principal Business Activity and Principal Product or Service in the Instructions for Form 1065. An entity that is a reportable entity partner with respect to the partnership (as defined under these instructions) owns or is deemed to own, directly or indirectly, an interest of 50% or more in the partnership's capital, profit, or loss on any day during the tax year of the partnership. A common trust fund or foreign partnership must file Schedule M-3 if it meets any of the tests discussed above. Note. All references to a U.S. partnership in these instructions refer to any entity required to file Schedule M-3 (Form 1065), where appropriate. Partnerships not required to file Schedule M-3 may voluntarily file Schedule M-3. Note that any link in the information above is updated each year automatically and will take you to the most recent version of the document at the time it is accessed. Instructions for Schedule M-3 (Form 1065) - Introductory Material General Instructions Specific Instructions Item D. Reportable Entity Partner Part I. Financial Information and Net Income (Loss) Reconciliation Parts II and III Part II. Reconciliation of Net Income (Loss) per Income Statement of Partnership With Income (Loss) per Return Lines 1 Through 9. Additional Information for Each Entity Line 1. Income (Loss) From Equity Method Foreign Corporations Line 2. Gross Foreign Dividends Not Previously Taxed Line 3. Subpart F, QEF, and Similar Income Inclusions Line 4. Gross Foreign Distributions Previously Taxed Line 5. Income (Loss) From Equity Method U.S. Corporations Line 6. U.S. Dividends Line 7. Income (Loss) From U.S. Partnerships, and Line 8. Income (Loss) From Foreign Partnerships Line 9. Income (Loss) From Other Pass-Through Entities Line 10. Items Relating to Reportable Transactions Line 11. Interest Income Line 12. Total Accrual to Cash Adjustment Line 13. Hedging Transactions Line 14. Mark-to-Market Income (Loss) Traders in securities or commodities. Line 15. Cost of Goods Sold Line 16. Sale Versus Lease (for Sellers and/or Lessors) Line 17. Section 481(a) Adjustments Line 18. Unearned/Deferred Revenue Line 19. Income Recognition From Long-Term Contracts Line 20. Original Issue Discount and Other Imputed Interest Line 21a. Income Statement Gain/Loss on Sale, Exchange, Abandonment, Worthlessness, or Other Disposition of Assets Other Than Inventory and Pass-Through Entities Line 21b. Gross Capital Gains From Schedule D, Excluding Amounts From Pass-Through Entities Line 21c. Gross Capital Losses From Schedule D, Excluding Amounts From Pass-Through Entities, Abandonment Losses, and Worthless Stock Losses Line 21d. Net Gain/Loss Reported on Form 4797, Line 17, Excluding Amounts From Pass-Through Entities, Abandonment Losses, and Worthless Stock Losses Line 21e. Abandonment Losses Line 21f. Worthless Stock Losses Line 21g. Other Gain/Loss on Disposition of Assets Other Than Inventory Line 22. Other Income (Loss) Items With Differences Line 23. Total Income (Loss) Items Line 24. Total Expense/ Deduction Items Line 25. Other Items With No Differences Part III. Reconciliation of Net Income (Loss) per Income Statement of Partnership With Income (Loss) per Return— Expense/Deduction Items Section references are to the Internal Revenue Code unless otherwise noted. For the latest information about developments related to Schedule M-3 (Form 1065) and its instructions, such as legislation enacted after they were published, go to IRS.gov/Form1065. Schedule M-3, Part I, asks certain questions about the partnership's financial statements and reconciles financial statement net income (loss) for the consolidated financial statement group to income (loss) per the income statement for the partnership. Schedule M-3, Parts II and III, reconcile financial statement net income (loss) for the partnership (per Schedule M-3, Part I, line 11) to line 1 of the Analysis of Net Income (Loss) found on Form 1065. If the partnership is required to file (or voluntarily files) Schedule M-3 (Form 1065), the partnership must file Form 1065 and all attachments and schedules, including Schedule M-3 (Form 1065), at the following address. Department of the Treasury Internal Revenue Service Center Ogden, UT 84201-0011 Any entity that files Form 1065 must file Schedule M-3 (Form 1065) if any of the following is true. The amount of total assets at the end of the tax year reported on Schedule L, line 14, column (d), is equal to $10 million or more. The amount of adjusted total assets for the tax year is equal to $10 million or more. See Total Assets and Adjusted Total Assets, later. The amount of total receipts for the tax year is equal to $35 million or more. Total receipts is defined in the instructions for Codes for Principal Business Activity and Principal Product or Service in the Instructions for Form 1065. An entity that is a reportable entity partner with respect to the partnership (as defined under these instructions) owns or is deemed to own, directly or indirectly, an interest of 50% or more in the partnership's capital, profit, or loss on any day during the tax year of the partnership. A common trust fund or foreign partnership must file Schedule M-3 if it meets any of the tests discussed above. All references to a U.S. partnership in these instructions refer to any entity required to file Schedule M-3 (Form 1065), where appropriate. Partnerships not required to file Schedule M-3 may voluntarily file Schedule M-3. Form 1065 filers that are required to file Schedule M-3 (Form 1065) and have at least $50 million total assets at the end of the tax year must complete Schedule M-3 (Form 1065) entirely. Form 1065 filers that (a) are required to file Schedule M-3 (Form 1065) and have less than $50 million total assets at the end of the tax year, or (b) aren't required to file Schedule M-3 (Form 1065) and voluntarily file Schedule M-3 (Form 1065) must either (i) complete Schedule M-3 (Form 1065) entirely, or (ii) complete Schedule M-3 (Form 1065) through Part I and complete Schedule M-1 instead of completing Parts II and III of Schedule M-3 (Form 1065). If the filer chooses to complete Schedule M-1 instead of completing Parts II and III of Schedule M-3 (Form 1065), line 1 of Schedule M-1 must equal line 11 of Part I of Schedule M-3 (Form 1065). For any part of Schedule M-3 (Form 1065) that is completed, all columns must be completed, all applicable questions must be answered, all numerical data requested must be provided, and any statement required to support a line item must be attached and provide the information required for that line item. Any partnership required to file Schedule M-3 must check all boxes above Part I that apply for the reason(s) for which the Schedule M-3 is required to be filed. A partnership not required to file Schedule M-3, but that is doing so voluntarily, should check box E above Part I. The partnership should figure its adjusted total assets using the Adjusted Total Assets Worksheet, later. For purposes of determining for Schedule M-3 whether the partnership's adjusted total assets (under these instructions) equal $10 million or more, the partnership's total assets at the end of the tax year must be determined on an overall accrual method of accounting unless both of the following apply: (a) the tax return of the partnership is prepared using an overall cash method of accounting, and (b) the partnership doesn't prepare financial statements using, and isn't included in financial statements prepared on, an accrual basis. See Part I. Financial Information and Net Income (Loss) Reconciliation regarding non-tax-basis income statements and related non-tax-basis balance sheets to be used in the preparation of Schedule M-3 and the related non-tax-basis balance sheets to be used in the preparation of Schedule L. In the case of a partnership year ending because of a section 708 termination, the total assets of the partnership at the end of the year for determining the requirement to file Schedule M-3 are determined immediately before the section 708 termination and any actual or deemed contribution or distribution of the partnership assets under the provisions of section 708 are taken into account. Example 1. U.S. partnership A, a limited liability company (LLC), owns 60% of the income and capital of U.S. partnership B, also an LLC. For its tax year ending December 31, 2019, A prepares non-tax-basis GAAP (generally accepted accounting principles) consolidated financial statements with B that report total assets at the end of the year of $12 million. A files Form 1065 and reports on its non-tax-basis unconsolidated GAAP Schedule L total assets at the end of the year of $7 million. The $7 million total includes $3 million for its investment in B under the equity method of accounting. The amount of total liabilities at the end of the year reported to A's partners on Schedules K-1 is $5 million. A made distributions of $1 million during the year reflected on Schedule M-2, line 6. The amount of A's adjusted total assets is $8 million for the tax year. A has total receipts for the tax year of $15 million. A has no reportable entity partners (as defined under Reportable Entity Partner Reporting Responsibilities, later). A isn't required to file Schedule M-3 under any of the four tests discussed earlier. A may voluntarily file Schedule M-3 for the tax year. If A doesn't file Schedule M-3, it must complete Schedule M-1. If A files Schedule M-3, it must either (i) complete Schedule M-3 entirely, or (ii) complete Schedule M-3 through Part I and complete Schedule M-1 instead of completing Parts II and III of Schedule M-3. Same facts as in Example 1.1 except that A has total receipts for 2019 of $40 million. A must file Schedule M-3 for 2019 and either (i) complete Schedule M-3 entirely, [illegible]

name, EIN (if applicable), and net income (loss) included on line 4a that is removed on this line 5 for each separate nonincludible foreign entity. Also state the total assets and total liabilities for each such separate nonincludible foreign entity and include those assets and liabilities amounts in the total assets and total liabilities reported on Part I, line 12b. The amounts of income (loss) detailed on the supporting statement should be reported for each separate nonincludible foreign entity without regard to the effect of consolidation or elimination entries. If there are consolidation or elimination entries relating to nonincludible foreign entities whose income (loss) is reported on the attached statement that aren't reportable on line 8, the net amounts of all such consolidation and elimination entries must be reported on a separate line on the attached statement, so that the separate financial accounting income (loss) of each nonincludible foreign entity remains separately stated. For example, if the net income (after consolidation and elimination entries) of a nonincludible foreign sub-consolidated group is being reported on line 5a, the attached supporting statement should report the income (loss) of each separate nonincludible foreign legal entity from each such entity's own financial accounting net income statement or books and records, and any consolidation or elimination entries (for intercompany dividends, minority interests, etc.) not reportable on line 8 should be reported on the attached supporting statement as a net amount on a line separate and apart from lines that report each nonincludible foreign entity's separate net income (loss). Remove the financial statement net income (line 6a) or loss (line 6b) of each U.S. entity that is included on line 4a and isn't an includible entity in the partnership return (nonincludible U.S. entity). In addition, on line 8, adjust for consolidation eliminations and correct for minority interest and intercompany dividends between any nonincludible U.S. entity and any includible entity. Don't remove in Part I the financial statement net income (loss) of any nonincludible U.S. entity accounted for on line 4a using the equity method. Attach a supporting statement that provides the name, EIN (if applicable), and net income (loss) included on line 4a that is removed on line 6a or 6b for each separate nonincludible U.S. entity. Also state the total assets and total liabilities for each such separate nonincludible U.S. entity and include those assets and liabilities amounts in the total assets and total liabilities reported on Part I, line 12c. The amounts of income (loss) detailed on the supporting statement should be reported for each separate nonincludible U.S. entity without regard to the effect of consolidation or elimination entries. If there are consolidation or elimination entries relating to nonincludible U.S. entities whose income (loss) is reported on the attached statement that aren't reportable on line 8, the net amounts of all such consolidation and elimination entries must be reported on a separate line on the attached statement, so that the separate financial accounting income (loss) of each nonincludible U.S. entity remains separately stated. For example, if the net income (after consolidation and elimination entries) of a nonincludible U.S. sub-consolidated group is being reported on line 6a, the attached supporting statement should report the income (loss) of each separate nonincludible U.S. legal entity from each such entity's own financial accounting net income statement or books and records, and any consolidation or elimination entries (for intercompany dividends, minority interests, etc.) not reportable on line 8 should be reported on the attached supporting statement as a net amount on a line separate and apart from lines that report each nonincludible U.S. entity's separate net income (loss). Include on line 7a or 7b the financial net income or (loss) of each disregarded entity in the U.S. tax return that isn't included in the consolidated financial group, and therefore not included in the income reported on line 4a, but that is included on line 11. Include on line 7a the financial income or (loss) of any foreign disregarded entity that isn't included in the income reported on line 4a but that is included on line 11 (other foreign disregarded entities). Include on line 7b the financial income or (loss) of any U.S. disregarded entity that isn't included in the income reported on line 4a but that is included on line 11 (other U.S. disregarded entities). In addition, on line 8, adjust for consolidation eliminations and correct for minority interest and intercompany dividends for any other disregarded entity. Attach a supporting statement that provides the name, EIN, and net income (loss) per the financial statement or books and records included on line 7a or 7b for each separate foreign or U.S. disregarded entity. Also state the total assets and total liabilities for each such separate included entity and include those assets and liabilities amounts in the total assets and total liabilities reported on Part I, line 12d. The amounts of income (loss) detailed on the supporting statement should be reported for each separate other disregarded entity without regard to the effect of consolidation or elimination entries solely between or among the entities listed. If there are consolidation or elimination entries relating to such separate other disregarded entities whose income (loss) is reported on the attached statement that aren't reportable on line 8, the net amounts of all such consolidation and elimination entries must be reported on a separate line on the attached statement, so that the separate financial accounting income (loss) of each separate other disregarded entity remains separately stated. For example, if the net income (after consolidation and elimination entries) of a sub-consolidated group of other foreign disregarded entities is being reported on line 7a, the attached supporting statement should report the income (loss) of each separate other foreign disregarded entity from each disregarded entity's own financial accounting net income statement or books and records, and any consolidation or elimination entries (for intercompany dividends, minority interests, etc.) not reportable on line 8 should be reported on the attached supporting statement as a net amount on a line separate and apart from lines that report each other foreign disregarded entity's separate net income (loss). Adjustments on line 8 to reverse certain financial accounting consolidation or elimination entries are necessary to ensure that transactions between includible entities and nonincludible U.S. or foreign entities aren't eliminated, in order to report the correct total amount on line 11. Also, additional consolidation entries and elimination entries may be necessary on line 8 related to transactions between includible entities that are in the consolidated financial statement group and other includible entities that aren't in the consolidated financial statement group but that are reported on line 7a or 7b in order to report the correct total amount on line 11. Include on line 8 the total of the following: (a) amounts of any adjustments to consolidation entries and elimination entries that are contained in the amount reported on line 4a, required as a result of removing amounts on line 5 or 6; and (b) amounts of any additional consolidation entries and elimination entries that are required as a result of including amounts on line 7a or 7b. This is necessary in order that the consolidation entries and intercompany elimination entries included in the amount reported on line 11 are only those applicable to the financial net income (loss) of includible entities for the financial statement period. For example, adjustments must be reported on line 8 to remove minority interest and to reverse the elimination of intercompany dividends included on line 4a that relate to the net income of entities removed on line 5 or 6 because the income to which the consolidation or elimination entries relate has been removed. Also, for example, consolidation or elimination entries must be reported on line 8 to eliminate any intercompany dividends between entities whose income is included on line 7a or 7b and other entities included in the U.S. income tax return. If an entity owner of an interest in another entity (a) accounts for the interest in the other entity in the owner's separate general ledger on the equity method, and (b) fully consolidates the other entity in the owner's consolidated financial statements, but that entity isn't includible in the owner's Form 1065, then, as part of reversing all consolidation and elimination entries for the nonincludible entity, the owner must reverse on line 8 the elimination of the equity income inclusion from the other entity. If the owner doesn't account for the other entity on the equity method on its own general ledger, it won't have eliminated the equity income for consolidated financial statement purposes, and therefore will have no elimination of equity income to reverse. The attached supporting statement for line 8 must identify the type (for example, minority interest, intercompany dividends, etc.) and amount of consolidation or elimination entries reported, as well as the names of the entities to which they pertain. It isn't necessary, but it is permitted, to report on line 8 intercompany eliminations that net to zero, such as intercompany interest income and expense. Include on line 9 any adjustments necessary to the income (loss) of the partnership to reconcile differences between the partnership's income statement period reported on line 2 and the partnership's tax year. Attach a statement describing the adjustment. Include on line 10 any other adjustments to reconcile net income (loss) on line 4a through line 9, with net income (loss) of the partnership reported on line 11. For any adjustment reported on line 10, attach a supporting statement with an explanation of each net adjustment included on line 10. Report on line 11 the net income (loss) per the income statement (or books and records, if applicable) of the partnership. Amounts reported in column (a) of Parts II and III must be reported on the same accounting method as is used to report the amount of net income (loss) per income statement of the partnership on line 11. Don't, in any event, report on line 11 the net income of entities other than the partnership filing Form 1065 for the tax year. For example, it isn't permissible to remove the income of nonincludible entities on lines 5 and/or 6, above, then to add back such income on lines 7 through 10, such that the amount reported on line 11 includes the net income of entities not includible in the U.S. income tax return. A principal purpose of Schedule M-3 is to report on line 11 only the financial accounting net income of only the partnership (including any other includible entities) filing Form 1065. Whether or not the partnership prepares financial statements, line 11 must include all items that impact the net income (loss) of the partnership even if they aren't recorded in the profit and loss accounts in the partnership's general ledger, including, for example, all post-closing adjusting entries (including workpaper adjustments) and dividend income or other income received from nonincludible entities. If the partnership prepares unconsolidated financial statements using the same accounting method used to determine worldwide consolidated net income (loss) for Part I, line 4, and if it uses the equity method for investments, the amount reported on Part I, line 11, will equal the amount of the unconsolidated net income (loss) reported on the unconsolidated financial statements. See Examples 5.3, 5.4, and 5.5 below. Example 5. U.S. partnership P owns 60% of corporation DS1 which is fully consolidated in P's financial statements. P doesn't account for DS1 in P's separate general ledger on the equity method. DS1 has net income of $100 (before minority interests) and pays dividends of $50, of which P receives $30. The dividend is eliminated in the consolidated financial statements. In its financial statements, P consolidates DS1 and includes $60 of net income ($100 less the minority interest of $40) on line 4a. P must remove the $100 net income of DS1 on line 6a. P must reverse on line 8 the elimination of the $40 minority interest net income of DS1. In addition, P reverses its elimination of the $30 intercompany dividend in its financial statements on line 8. The net result is that P includes the $30 dividend from DS1 on line 11 and on Part II, line 6, column (a). P's dividend income included on the tax return from DS1 must be reported on Part II, line 6, column (d). U.S. partnership C owns 60% of the capital and profits interests in U.S. LLC N. C doesn't account for N in C's separate general ledger on the equity method. N has net income of $100 (before minority interests) and makes no distributions during the tax year. C treats N as a corporation for financial statement purposes and as a partnership for U.S. income tax purposes. In its financial statements, C consolidates N and includes $60 of net income ($100 less the minority interest of $40) on line 4a. C must remove the $100 net income of N on line 6a. C must reverse on line 8 the elimination of the $40 minority interest net income of N. The result is that C includes no income for N either on line 11 or on Part II, line 7, column (a). C's taxable income from N must be reported by C on Part II, line 7, column (d). U.S. partnership P owns 60% of corporation DS1, which is fully consolidated in P's financial statements. P accounts for DS1 in P's separate general ledger on the equity method. DS1 has net income of $100 (before minority interests) and pays dividends of $50, of which P receives $30. The dividend reduces P's investment in DS1 for equity method reporting on P's separate general ledger where P includes its 60% equity share of DS1 income, which is $60. In its financial statements, P eliminates the DS1 equity method income of $60 and consolidates DS1, including $60 of net income ($100 less the minority interest of $40) on line 4a. P must remove the $100 net income of DS1 on line 6a. P must reverse on line 8 the elimination of the $40 minority interest net income of DS1 and the elimination of the $60 of DS1 equity income. The net result is that P includes the $60 of equity method income from DS1 on line 11 and on Part II, line 5, column (a). P's dividend income on the tax return from its investment in DS1 must be reported on Part II, line 6, column (d). U.S. partnership C owns 60% of the capital and profits interests in U.S. LLC N. C accounts for N in C's separate general ledger on the equity method. N has net income of $100 (before minority interests) and makes no distributions during the tax year. C treats N as a corporation for financial statement purposes and as a partnership for U.S. income tax purposes. For equity method reporting on C's separate general ledger, C includes its 60% equity share of N income, which is $60. In its financial statements, C eliminates the $60 of N equity method income and consolidates N, including $60 of net income ($100 less the minority interest of $40) on line 4a. C must remove the $100 net income of N on line 6a. C must reverse on line 8 the elimination of the $40 minority interest net income of N and the elimination of the $60 of N equity method income. The result is that C includes the $60 of equity method income for N on line 11 and on Part II, line 7, column (a). C's taxable income from N must be reported by C on Part II, line 7, column (d). U.S. partnership C owns 60% of the capital and profits interests in U.S. LLC N. C accounts for N in C's separate general ledger on the equity method. N has net income of $100 (before minority interests) and pays a $50 cash distribution, of which C receives $30. The distribution reduces C's investment in N for equity method reporting on C's separate general ledger. C treats N as a corporation for financial statement purposes and as a partnership for U.S. income tax purposes. For equity method reporting on C's separate general ledger, C includes its 60% equity share of N income, which is $60. In its financial statements, C eliminates the $60 of N equity method income, consolidates N, and includes $60 of net income ($100 less the minority interest of $40) on line 4a. C must remove the $100 net income of N on line 6a. C must reverse on line 8 the elimination of the $40 minority interest net income of N and the elimination of the $60 of N equity method income. The result is that C includes the $60 of equity method income for N on line 11 and on Part II, line 7, column (a). C's taxable income from N must be reported by C on Part II, line 7, column (d). U.S. partnership P owns 100% of the stock of U.S. LLC Q, a disregarded entity. Q is included in P's federal income tax return, even though Q isn't included in P's consolidated financial statements on either a consolidated basis or on the equity method. Q has 2019 net income of $100 after taking into account its $40 interest payment to P. P has net income of $1,040 after recognition of the interest income from Q. Because Q is a disregarded entity, 100% of the net income of both P and Q must be reported on P's Form 1065 and the intercompany interest income and expense must be removed by consolidation elimination entries. P must report its financial statement net income of $1,040 on line 4a and reports Q's net income of $100 on line 7b as a U.S. disregarded entity not included on line 4a, but included on line 11. Then, in order to reflect the full consolidation of the financial accounting net income of P and Q on line 11, the following consolidation and elimination entry is reported on line 8: offsetting entries to remove the $40 of interest income received from Q included by P on line 4a, and to remove the $40 of interest expense of Q included in line 7b for a net change of zero. The result is that line 11 reports $1,140: $1,040 from line 4a, and $100 from line 7. Stated another way, line 11 includes the entire $1,000 net income of P, measured before recognition of the intercompany interest income from Q and the consolidation of Q operations, plus the entire $140 net income of Q, measured before interest expense to P. P isn't required to include on the attached supporting statement for line 8 the offsetting adjustment to the intercompany elimination of interest income and interest expense (though it is permitted to do so). Line 12 must be completed by all partnerships that file Schedule M-3. Report on lines 12a, 12b, 12c, and 12d the total amounts (not just the partnership's share) of assets and liabilities of entities included or removed on Part I, lines 4, 5, 6, and 7. All assets and liabilities reported on Part I, lines 12a through 12d, must be reported as positive amounts. On line 12a, enter the worldwide consolidated total assets and total liabilities of all of the entities included in completing Part I, line 4. On line 12b, enter the total assets and total liabilities of the entities removed in completing Part I, line 5. On line 12c, enter the total assets and total liabilities of the entities removed in completing Part I, line 6. On line 12d, enter the total assets and total liabilities of the entities included in completing Part I, line 7. A schedule or statement may be attached to any line even if none is required. For each line item in Parts II and III, report in column (a) the amount of net income (loss) included on Part I, line 11, and report in column (d) the amount included on line 1 of the Analysis of Net Income (Loss) found on Form 1065. Note. Part II, line 26, column (a), must equal Part I, line 11, and column (d) must equal line 1 of the Analysis of Net Income (Loss) found on Form 1065. Thus, column (d) on Part II and Part III must include certain of the separately stated items on Schedule K. For any item of income, gain, loss, expense, or deduction for which there is a difference between columns (a) and (d), the portion of the difference that is temporary must be entered in column (b) and the portion of the difference that is permanent must be entered in column (c). If financial statements are prepared by the partnership under GAAP, differences that are treated as temporary under GAAP must be reported in column (b) and differences that are permanent (that is, not temporary) for GAAP must be reported in column (c). Generally, under GAAP, a temporary difference affects (creates, increases, or decreases) a deferred tax asset or liability. If the partnership doesn't prepare financial statements, or the financial statements aren't prepared under GAAP, report in column (b) any difference that the partnership believes will reverse in a future tax year (that is, have an opposite effect on taxable income in a future tax year (or years) due to the difference in timing of recognition for financial accounting and U.S. income tax purposes) or is the reversal of such a difference that arose in a prior tax year. Report in column (c) any difference that the partnership believes won't reverse in a future tax year (and isn't the reversal of such a difference that arose in a prior tax year). If the partnership is unable to determine whether a difference between column (a) and column (d) for an item will reverse in a future tax year or is the reversal of a difference that arose in a prior tax year, report the difference for that item in column (c). Example 6. At the end of Partnership A's first tax year, December 31, 2019, it wasn't required to file Schedule M-3 for any reason. A may elect to file Schedule M-3 instead of completing Schedule M-1. If A elects to file Schedule M-3, it must either (i) complete Schedule M-3 entirely, or (ii) complete Schedule M-3 through Part I and complete Schedule M-1 instead of completing Parts II and III of Schedule M-3. If A elects to complete Schedule M-3 entirely, it must complete all columns of Parts II and III. If A completes Schedule M-3 through Part I and completes Schedule M-1 instead of completing Parts II and III of Schedule M-3, line 11 of Part I of Schedule M-3 must equal line 1 of Schedule M-1. If an amount is attributable to a reportable transaction described in Regulations section 1.6011-4(b), the amount must be reported in columns (a), (b), (c), and (d), as applicable, of Part II, line 10, Items relating to reportable transactions, regardless of whether the amount would otherwise be reported on Schedule M-3, Part II or Part III. Thus, if a taxpayer files Form 8886, Reportable Transaction Disclosure Statement, the amounts attributable to that reportable transaction must be reported on Part II, line 10. A partnership is required to report in column (a) of Parts II and III the amount of any item specifically listed on Schedule M-3 that is in any manner included in the partnership's current year financial statement net income (loss) or in an income or expense account maintained in the partnership's books and records, even if there is no difference between that amount and the amount included in net income (loss) for tax purposes unless (a) otherwise instructed in these instructions, or (b) the amount is attributable to a reportable transaction described in Regulations section 1.6011-4(b) and is therefore reported on Part II, line 10. For example, with the exception of interest income reflected on a Schedule K-1 received by the partnership as a result of the partnership's investment in a partnership or other pass-through entity, all interest income included on Part I, line 11, whether from unconsolidated affiliated entities, third parties, banks, or other entities, whether from foreign or domestic sources, whether taxable or exempt from tax, and whether classified as some other type of income for U.S. income tax purposes (such as dividends), must be included on Part II, line 11, column (a). Likewise, all fines and penalties included on Part I, line 11, paid to a government or other authority for the violation of any law for which fines or penalties are assessed must be included on Part III, line 7, column (a), regardless of the government authority that imposed the fines or penalties, regardless of whether the fines or penalties are civil or criminal, and regardless of the classification, nomenclature, or terminology attached to the fines or penalties by the imposing authority in its actions or documents. If a partnership would be required to report in column (a) of Parts II and III the amount of any item specifically listed on Schedule M-3 in accordance with the preceding paragraph, except that the partnership has capitalized the item of income or expense and reports the amount in its financial statement balance sheet or in asset and liability accounts maintained in the partnership's books and records, the partnership must report the proper tax treatment of the item in columns (b), (c), and (d), as applicable. Furthermore, in applying the two preceding paragraphs, a partnership is required to report in column (a) of Parts II and III the amount of any item specifically listed on Schedule M-3 that is included in the partnership's financial statements or exists in the partnership's books and records, regardless of the nomenclature associated with that item in the financial statements or books and records. Accurate completion of Schedule M-3 requires reporting amounts according to the substantive nature of the specific line items included in Schedule M-3 and consistent reporting of all transactions of like substantive nature that occurred during the tax year. For example, all expense amounts that are included in the financial statements or exist in the books and records that represent some form of “Bad debt expense” must be reported on Part III, line 26, in column (a), regardless of whether the amounts are recorded or stated under different nomenclature in the financial statements or the books and records such as “Provision for doubtful accounts,” “Expense for uncollectible notes receivable,” or “Impairment of trade accounts receivable.” Likewise, as stated in the preceding paragraph, all fines and penalties must be included on Part III, line 7, column (a), regardless of the terminology or nomenclature attached to them by the partnership in its books and records or financial statements. With limited exceptions, Part II includes lines for specific items of income, gain, or loss (income items). (See lines 1 through 21.) If an income item is described on lines 1 through 21, report the amount of the item on the applicable line, regardless of whether there is a difference for the item. If there is a difference for the income item, or only a portion of the income item has a difference and a portion of the item doesn't have a difference, and the item isn't described on lines 1 through 21, report and describe the entire amount of the item on line 22. With limited exceptions, Part III includes lines for specific items of expense or deduction (expense items). (See lines 1 through 29.) If an expense item is described on lines 1 through 29, report the amount of the item on the applicable line, regardless of whether there is a difference for the item. If there is a difference for the expense item, or only a portion of the expense item has a difference and a portion of the item doesn't have a difference and the item isn't described on lines 1 through 29, report and describe the entire amount of the item on line 30. If there is no difference between the financial accounting amount and the amount reported for tax purposes of an entire item of income, loss, expense, or deduction and the item isn't described or included on Part II, lines 1 through 22, or Part III, lines 1 through 30, report the entire amount of the item in columns (a) and (d) of Part II, line 25. Separately stated and adequately disclosed. Each difference reported in Parts II and III must be separately stated and adequately disclosed. In general, a difference is adequately disclosed if the difference is labeled in a manner that clearly identifies the item or transaction from which the difference arises. For further guidance about adequate disclosure, see Regulations section 1.6662-4(f). If a specific item of income, gain, loss, expense, or deduction is described on Part II, lines 7 through 21, or Part III, lines 1 through 29, and the line doesn't indicate to “attach schedule” or “attach details,” and the specific instructions for the line don't call for an attachment of a schedule or explanation, then the item is considered separately stated and adequately disclosed if the item is reported on the applicable line and the amount(s) of the item(s) is reported in the applicable columns of the applicable line. See the instructions for Part II, lines 1 through 9, for specific additional information required to be provided for these particular lines. Except as otherwise provided, differences for the same item must be combined or netted together and reported as one amount on the applicable line of Schedule M-3. However, differences for separate items must not be combined or netted together. Each item (and corresponding amount attributable to that item) must be separately stated and adequately disclosed on the applicable line of Schedule M-3 or any statement required to be attached, even if the amounts are below a certain dollar amount. Required statements for Part II, line 22, and Part III, line 30. A separate statement must be attached to Schedule M-3 (Form 1065) that includes a detailed description of each item and adjustment entered on Part II, line 22, and Part III, line 30. The description for each amount entered in column (a) must be readily identifiable to the name of the account in the financial statements or books and records of the taxpayer, under which the amount in column (a) was recorded in the accounting records. Also, the description for each amount entered in column (a) must include detailed information supporting each adjustment reported in columns (b) and (c), including how the adjustment is identified in the accounting records. The entire description is considered the tax description for the amount reported in column (d) for each item reported on Part II, line 22, or Part III, line 30. Each description should adequately describe all four columns of Part II, line 22, or Part III, line 30. If additional information is required to provide an acceptable description, provide a supporting statement. Example 7. Partnership B prepares GAAP financial statements. In prior years, B acquired intellectual property (IP) and goodwill. The IP is amortizable for both U.S. income tax and financial statement purposes. In 2019, B's annual amortization expense for IP is $9,000 for U.S. income tax purposes and $6,000 for financial statement purposes. The goodwill isn't amortizable for U.S. income tax purposes and is subject to impairment for financial statement purposes. In 2019, B records an impairment charge on the goodwill of $5,000. B must report the amortization attributable to the IP on Part III, line 21, and report $6,000 in column (a), a temporary difference of $3,000 in column (b), and $9,000 in column (d). B must report the goodwill impairment on Part III, line 19, and report $5,000 in column (a), a permanent difference of ($5,000) in column (c), and $0 in column (d). Example 8. Partnership C is a calendar year partnership that files and entirely completes Schedule M-3 for its 2019 tax year. C placed in service 10 depreciable fixed assets in a previous tax year. C's total depreciation expense for its 2019 tax year for five of the assets is $50,000 for income statement purposes and $70,000 for U.S. income tax purposes. C's total annual depreciation expense for its 2019 tax year for the other five assets is $40,000 for income statement purposes and $30,000 for U.S. income tax purposes. C treats the differences between financial statement and U.S. income tax depreciation expense as giving rise to temporary differences that will reverse in future years. C must combine all of its depreciation adjustments. Accordingly, C must report on Part III, line 25, for its 2019 tax year income statement depreciation expense of $90,000 in column (a), a temporary difference of $10,000 in column (b), and U.S. income tax depreciation expense of $100,000 in column (d). Example 9. Partnership D is a calendar year partnership that files and entirely completes Schedule M-3 for its 2019 tax year. On December 31, 2019, D establishes three reserve accounts in the amount of $100,000 for each account. One reserve account is an allowance for accounts receivable that are estimated to be uncollectible. The second reserve is an estimate of coupons outstanding that may have to be paid. The third reserve is an estimate of future warranty expenses. In its financial statements, D treats the three reserve accounts as giving rise to temporary differences that will reverse in future years. The three reserves are expenses in D's 2019 financial statements but aren't deductions for U.S. income tax purposes in 2019. D must not combine the Schedule M-3 differences for the three reserve accounts. D must report the amounts attributable to the allowance for uncollectible accounts receivable on Part III, line 26, Bad debt expense, and must separately state and adequately disclose the amounts attributable to each of the other two reserves, coupons outstanding, and warranty costs, on a required, attached statement that supports the amounts on Part III, line 30. D must also provide a description for each reserve that meets the requirements for Part III, line 30, discussed earlier under Required statements for Part II, line 22, and Part III, line 30. In this example, an acceptable description for warranty costs would be “Future Warranty Expense Reserve.” There is no need to add the title of the reserve account to the description if the account name for the amount in column (a) is already part of the adjustment description. Example 10. Partnership E is a calendar year partnership that files and entirely completes Schedule M-3 for its 2019 tax year. On January 2, 2019, E establishes an allowance for uncollectible accounts receivable (bad debt reserve) of $100,000. During 2019, E increases the reserve by $250,000 for additional accounts receivable that may become uncollectible. Additionally, during 2019, E decreases the reserve by $75,000 for accounts receivable that were discharged in bankruptcy during 2019. The balance in the reserve account on December 31, 2019, is $275,000. The $100,000 amount to establish the reserve account and the $250,000 to increase the reserve account are expenses on E's 2019 financial statements but aren't deductions for U.S. income tax purposes in 2019. However, the $75,000 decrease to the reserve is deductible for U.S. income tax purposes in 2019. In its financial statements, E treats the reserve account as giving rise to a temporary difference that will reverse in future tax years. E must report on Part III, line 26, Bad debt expense, for its 2019 tax year income statement bad debt expense of $350,000 in column (a), a temporary difference of ($275,000) in column (b), and U.S. income tax bad debt expense of $75,000 in column (d). Example 11. During 2019, partnership F had $100 of meals expenses, $100 of entertainment expenses, and therefore deducted $200 on its income statement. For federal income tax purposes, the $100 of meals expenses is subject to section 274(n) (50% allowance) and the $100 of entertainment expenses is subject to section 274(a) (0% allowance). F must report on Part III, line 6: $200 in column (a), $150 in column (c), and $50 in column (d). F must report all of its meals and entertainment expenses only on this line whether there is a difference or not because meals and entertainment expenses are specifically described. For any item reported on lines 1 or 3 through 5, attach a supporting statement that provides the name of the entity for which the item is reported, the entity's EIN (if applicable), the type of entity (corporation, partnership, etc.), and the item amounts for columns (a) through (d). See the instructions for lines 2 and 6 through 9 for the specific information required for those particular lines. Report on line 1, column (a), the financial income (loss) included on Part I, line 11, for any foreign corporation accounted for on the equity method and remove such amount in column (b) or (c), as applicable. Report the amount of dividends received and other taxable amounts received or includible from foreign corporations on lines 2 through 4, as applicable. Except as otherwise provided in this paragraph, report on line 2, column (d), the amount (before any withholding tax) of any foreign dividends included on line 1 of the Analysis of Net Income (Loss) found on Form 1065, and report on line 2, column (a), the amount of dividends from any foreign corporation included on Part I, line 11. Don't report on line 2 any amounts that must be reported on line 3 or dividends that were previously taxed and must be reported on line 4. (See the instructions below for lines 3 and 4.) Report withholding taxes on Part III, line 30, Other expense/deduction items with differences, or line 25, Other items with no differences, as applicable. For any dividends reported on line 2 that are received on a class of voting stock of which the partnership directly or indirectly owned 10% or more of the outstanding shares of that class at any time during the tax year, report on an attached supporting statement for line 2: (a) the name of the dividend payer, (b) the payer's EIN (if applicable), (c) the class of voting stock on which the dividend was paid, (d) the percentage of the class directly or indirectly owned, and (e) the amounts for columns (a) through (d). Report on line 3, column (d), the amount included in taxable income under section 951 (relating to Subpart F), gains or other income inclusions resulting from elections under sections 1291(d)(2) and 1298(b)(1), and any amount included in taxable income pursuant to section 1293 (relating to QEFs). See Form 5471, Information Return of U.S. Persons With Respect to Certain Foreign Corporations, and Form 8621, Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund, for more information. Also include on line 3 passive foreign investment company mark-to-market gains and losses under section 1296. Don't report such gains and losses on line 14. Report on line 4, column (a), any distributions received from foreign corporations that were included on Part I, line 11, and that were previously taxed for U.S. income tax purposes. For example, include in column (a) amounts that are excluded from taxable income under sections 959 and 1293(c). Remove such amounts in column (b) or (c), as applicable. Report the full amount of the distribution before any withholding tax. Report withholding taxes on Part III, line 30, Other expense/deduction items with differences, or line 25, Other items with no differences, as applicable. Since previously taxed foreign distributions aren't currently taxable, line 4, column (d), is shaded. (Also, see the instructions above for line 2.) Report on line 5, column (a), the financial income (loss) included on Part I, line 11, for any U.S. corporation accounted for on the equity method and remove such amount in column (b) or (c), as applicable. Report on line 6 the amount of dividends received from any U.S. corporations. Report on line 6, column (a), the amount of dividends included on Part I, line 11, that were received from any U.S. corporation. Report on line 6, column (d), the amount of any U.S. dividends included in taxable income on line 1 of the Analysis of Net Income (Loss) found on Form 1065. For any dividends reported on line 6 that are received on classes of voting stock in which the partnership directly or indirectly owned 10% or more of the outstanding shares of that class at any time during the tax year, report on an attached supporting statement for line 6: (1) the name of the dividend payer, (2) the payer's EIN (if applicable), (3) the class of voting stock on which the dividend was paid, (4) the percentage of the class directly or indirectly owned, and (5) the amounts for columns (a) through (d). For any interest owned by the partnership that is treated as an investment in a partnership for U.S. income tax purposes (other than an interest in a disregarded entity), report amounts on line 7 or 8, as described below. In column (a), the sum of the partnership's distributive share of income or loss from a U.S. or foreign partnership that is included on Part I, line 11. In column (b) or (c), as applicable, the sum of all differences, if any, attributable to the partnership's distributive share of income or loss from a U.S. or foreign partnership. In column (d), the sum of all amounts of income, gain, loss, or deduction attributable to the partnership's distributive share of income or loss from a U.S. or foreign partnership (that is, the sum of all amounts reportable on the partnership's Schedule(s) K-1 received from the partnership (if applicable)), without regard to any limitations computed at the partner level (for example, limitations on utilization of charitable contributions, capital losses, and interest expense). For each partnership reported on line 7 or 8, attach a supporting statement that provides the name, EIN (if applicable), end of year profit-sharing percentage (if applicable), end of year loss-sharing percentage (if applicable), and the amount reported in column (a), (b), (c), or (d) of line 7 or 8, as applicable. Example 12. U.S. partnership H is a calendar year partnership that files and entirely completes Schedule M-3 for its 2019 tax year. H has an investment in a U.S. partnership USP. H prepares financial statements in accordance with GAAP. For its 2019 tax year, H's financial statement net income includes $10,000 of income attributable to its share of USP's net income. H's Schedule K-1 from USP reports $5,000 of ordinary income, $7,000 of long-term capital gains, $4,000 of charitable contributions, and $200 of section 179 expense. H must report on line 7 $10,000 in column (a), a permanent difference of ($2,200) in column (c), and $7,800 in column (d). For any interest in a pass-through entity (other than an interest in a partnership reportable on line 7 or 8, as applicable) owned by the U.S. partnership (other than an interest in a disregarded entity), report the following on line 9. In column (a), the sum of the partnership's distributive share of income or loss from the pass-through entity that is included on Part I, line 11. In column (b) or (c), as applicable, the sum of all differences, if any, attributable to the pass-through entity. In column (d), the sum of all taxable amounts of income, gain, loss, or deduction reportable on the partnership's Schedule(s) K-1 received from the pass-through entity (if applicable). For each pass-through entity reported on line 9, attach a supporting statement that provides that entity's name, EIN (if applicable), the partnership's end of year profit-sharing percentage (if applicable), the partnership's end of year loss-sharing percentage (if applicable), and the amounts reported by the partnership in column (a), (b), (c), or (d) of line 9, as applicable. Any amounts attributable to any reportable transactions (as described in Regulations section 1.6011-4) must be included on line 10 regardless of whether the difference, or differences, would otherwise be reported elsewhere in Part II or Part III. Thus, if a taxpayer files Form 8886 for any reportable transaction described in Regulations section 1.6011-4, the amounts attributable to that reportable transaction must be reported on line 10. In addition, all income and expense amounts attributable to a reportable transaction must be reported on line 10, columns (a) and (d), even if there is no difference between the financial statement amounts and the tax return amounts. Each difference attributable to a reportable transaction must be separately stated and adequately disclosed. A partnership will be considered to have separately stated and adequately disclosed a reportable transaction on line 10 if the partnership sequentially numbers each Form 8886 and lists by statement number (shown on line A of Form 8886) on the supporting statement for line 10 each sequentially numbered reportable transaction and the amounts required for line 10, columns (a) through (d). Instead of satisfying the requirements of the preceding paragraph, a partnership will be considered to have separately stated and adequately disclosed a reportable transaction if the partnership attaches a supporting statement that provides the following for each reportable transaction. A description of the reportable transaction disclosed on Form 8886 for which amounts are reported on line 10. The name and reportable transaction or tax shelter registration number, if applicable, as reported on lines 1a and 1c, respectively, of Form 8886. The type of reportable transaction (that is, listed transaction, confidential transaction, transaction with contractual protection, etc.) as reported on line 2 of Form 8886. If a transaction is a listed transaction described in Regulations section 1.6011-4(b)(2), the description must also include the published guidance number shown on line 3 of Form 8886. In addition, if the reportable transaction involves an investment in the transaction through another entity such as a partnership, the description must include the name and EIN (if applicable) of that entity as reported on line 5 of Form 8886. Example 13. Partnership J is a calendar year partnership that files and entirely completes Schedule M-3 for its 2019 tax year. J incurred seven different abandonment losses during its 2019 tax year. One loss of $12 million results from a reportable transaction described in Regulations section 1.6011-4(b)(5), another loss of $5 million results from a reportable transaction described in Regulations section 1.6011-4(b)(4), and the remaining five abandonment losses aren't reportable transactions. J discloses the reportable transactions giving rise to the $12 million and $5 million losses on separate Forms 8886 and sequentially numbers them X1 and X2, respectively. J must separately state and adequately disclose the $12 million and $5 million losses on line 10. The $12 million loss and the $5 million loss will be adequately disclosed if J attaches a supporting statement for line 10 that lists each of the sequentially numbered forms, Form 8886-X1 and Form 8886-X2, and with respect to each reportable transaction reports the appropriate amounts required for line 10, columns (a) through (d). Alternatively, J's disclosures will be adequate if the description provided for each loss on the supporting statement includes the names and reportable transaction or tax shelter registration numbers, if any, disclosed on the applicable Form 8886, identifies the type of reportable transaction for the loss, and reports the appropriate amounts required for line 10, columns (a) through (d). J must report the losses attributable to the other five abandonment losses on line 21e, regardless of whether a difference exists for any or all of those abandonment losses. Example 14. Partnership K is a calendar year partnership that files and entirely completes Schedule M-3 for its 2019 tax year. K enters into a transaction with contractual protection that is a reportable transaction described in Regulations section 1.6011-4(b)(4). This reportable transaction is the only reportable transaction for K's 2019 tax year and results in a $7 million capital loss for both financial accounting purposes and U.S. income tax purposes. Although the transaction doesn't result in a difference, K is required to report on line 10 the following amounts: ($7 million) in column (a), $0 in columns (b) and (c), and ($7 million) in column (d). The transaction will be adequately disclosed if K attaches a supporting statement for line 10 that (a) sequentially numbers the Form 8886 and refers to the sequentially numbered Form 8886-X1, and (b) reports the applicable amounts required for line 10, columns (a) through (d). Alternatively, the transaction will be adequately disclosed if the supporting statement for line 10 includes a description of the transaction, the name and reportable transaction number, if any, and the type of reportable transaction disclosed on Form 8886. Attach Form 8916-A, Supplemental Attachment to Schedule M-3. Complete Part II and enter the amounts shown on line 6, columns (a) through (d), on Schedule M-3, line 11, columns (a) through (d), as applicable. An entity that (a) is required to file a Schedule M-3 and has less than $50 million in total assets at the end of the tax year, or (b) isn't required to file a Schedule M-3 and voluntarily files a Schedule M-3, isn't required to file Form 8916-A but may voluntarily do so. Report on line 11, column (a), the total amount of interest income included on Part I, line 11, and report on line 11, column (d), the total amount of interest income included on line 1 of the Analysis of Net Income (Loss) found on Form 1065 that isn't required to be reported elsewhere on Schedule M-3. In column (b) or (c), as applicable, adjust for any amounts treated for U.S. income tax purposes as interest income that are treated as some other form of income for financial accounting purposes, or vice versa. For example, adjustments to interest income resulting from adjustments made in accordance with the instructions for line 16, Sale versus lease, should be made in columns (b) and (c) of line 11. Don't report on line 11 amounts reported in accordance with the instructions for lines 7, 8, 9, 10, and 20. This line is completed by a partnership that prepares financial statements (or books and records, if permitted) using an overall accrual method of accounting and uses an overall cash method of accounting for U.S. income tax purposes (or vice versa). With the exception of amounts required to be reported on line 10, the partnership must report on line 12, a single amount net of all adjustments attributable solely to the use of the different overall methods of accounting (for example, adjustments related to accounts receivable, accounts payable, compensation, accrued liabilities, etc.), regardless of whether a separate line on Schedule M-3 corresponds to an item within the accrual to cash reconciliation. Differences not attributable to the use of the different overall methods of accounting must be reported on the appropriate lines of Schedule M-3 (for example, a depreciation difference must be reported on Part III, line 25). Example 15. Partnership L is a calendar year partnership that files and entirely completes Schedule M-3 for its 2019 tax year. L prepares financial statements in accordance with GAAP using an overall accrual method of accounting. L uses an overall cash method of accounting for U.S. income tax purposes. L's financial statements for the year ending December 31, 2019, report accounts receivable of $35,000, an allowance for bad debts of $10,000, and accounts payable of $17,000 related to 2019 acquisition and reorganization legal and accounting fees. In addition, for L's year ending December 31, 2019, L reported financial statement depreciation expense of $15,000 and depreciation for U.S. income tax purposes of $25,000. For L's 2019 tax year using an overall cash method of accounting, L doesn't recognize the $35,000 of revenue attributable to the accounts receivable, can't deduct the $10,000 allowance for bad debt, and can't deduct the $17,000 of accounts payable. In its financial statements, L treats both the difference in overall accounting methods used for financial statement and U.S. income tax purposes and the difference in depreciation expense as temporary differences. L must combine all adjustments attributable to the differences related to the overall accounting methods on line 12. As a result, L must report on line 12 $8,000 in column (a) ($35,000 – $10,000 – $17,000), ($8,000) in column (b), and $0 in column (d). L must not report the accrual to cash adjustment attributable to the legal and accounting fees on Part III, line 18, Current year acquisition/reorganization legal and accounting fees. Because the difference in depreciation expense doesn't relate to the use of the cash or accrual method of accounting, L must report the depreciation difference on Part III, line 25, Depreciation, and report $15,000 in column (a), $10,000 in column (b), and $25,000 in column (d). Report on line 13, column (a), the net gain or loss from hedging transactions on Part I, line 11. Report in column (d) the amount of taxable income from hedging transactions as defined in section 1221(b)(2). Use columns (b) and (c) to report all differences caused by treating hedging transactions differently for financial accounting purposes and for U.S. income tax purposes. For example, if a portion of a hedge is considered ineffective under GAAP but is still a valid hedge under section 1221(b)(2), the difference must be reported on line 13. The hedge of a capital asset, which isn't a valid hedge for U.S. income tax purposes but may be considered a hedge for GAAP purposes, must also be reported here. Report hedging gains and losses computed under the mark-to-market method of accounting on line 13 and not on line 14. Report any gain or loss from inventory hedging transactions on line 13 and not on line 15. Report on line 14 any amount representing the mark-to-market income or loss for any securities held by a dealer in securities, a dealer in commodities having made a valid election under section 475(e), or a trader in securities or commodities having made a valid election under section 475(f). "Securities" for these purposes are securities described in section 475(c)(2) and commodities described in section 475(e)(2). Securities described in section 475(c)(2)(E) do not include contracts to which section 1256(a) applies. Report hedging gains and losses computed under the mark-to-market method of accounting on line 13, Hedging transactions, and not on line 14. Report on line 15 any amounts deducted as part of cost of goods sold during the tax year, regardless of whether the amounts would otherwise be reported elsewhere in Part II or Part III. However, don't report the items mentioned in the next paragraph on line 15. Examples of amounts that must be included on line 15 are amounts attributable to inventory valuation, such as amounts attributable to cost-flow assumptions, additional costs required to be capitalized (including depreciation) such as section 263A costs, inventory shrinkage accruals, inventory obsolescence reserves, and lower of cost or market (LCM) write-downs. The entries in columns (a) and (d) are negative amounts. Don't report the following on line 15 or on Form 8916-A. Amounts reportable on line 10. Any gain or loss from inventory hedging transactions reportable on line 13. Amounts reportable on line 16. Amounts reportable on line 19. Mark-to-market income or (loss) associated with the inventories of dealers in securities under section 475 reportable on line 14. Section 481(a) adjustments related to cost of goods sold or inventory valuation reportable on line 17. Fines and penalties reportable on Part III, line 7. Judgments, damages, awards, and similar costs, reportable on Part III, line 8. Amounts included on Part III, line 28, Purchase versus lease. Example 16. Partnership C is a calendar year partnership that files and entirely completes Schedule M-3 for its 2019 tax year. C placed in service 10 depreciable fixed assets in a previous tax year. C's total depreciation expense for its 2019 tax year for five of the assets is $50,000 for financial accounting purposes and $70,000 for U.S. income tax purposes. C's total annual depreciation expense for its 2019 tax year for the other five assets is $40,000 for financial accounting purposes and $30,000 for U.S. income tax purposes. In addition, C incurs $200 of meal expenses that C deducts in computing net income for financial accounting purposes. All $200 of the meal expenses is subject to the 50% limitation under section 274(n). In its financial statements, C treats the $50,000 depreciation and $100 of the meals as other costs in computing cost of goods sold. C must include on Form 8916-A and on line 15, in column (a), the $50,000 of depreciation and $100 of meals. C must also include a temporary difference of $20,000 in column (b), a permanent difference of ($50) in column (c), and $70,050 in column (d) ($70,000 depreciation and $50 meals). In addition, C must report on Part III, line 25, for its 2019 tax year income statement, depreciation expense of $40,000 in column (a), a temporary difference of ($10,000) in column (b), and $30,000 in column (d); and on Part III, line 6, meals and entertainment expense of $100 in column (a), a permanent difference of ($50) in column (c), and $50 in column (d). All other cost of goods sold items would be added to the amounts included on line 15, detailed in this example, and reported on Form 8916-A and on line 15 in the appropriate columns. Asset transfer transactions with periodic payments characterized for financial accounting purposes as either a sale or a lease may, under some circumstances, be characterized as the opposite for tax purposes. If the transaction is treated as a lease, the seller/lessor reports the periodic payments as gross rental income and also reports depreciation expense or deduction. If the transaction is treated as a sale, the seller/lessor reports gross profit (sale price less cost of goods sold) from the sale of assets and reports the periodic payments as payments of principal and interest income. On line 16, column (a), report the gross profit or gross rental income for financial accounting purposes for all sale or lease transactions that must be given the opposite characterization for tax purposes. On line 16, column (d), report the gross profit or gross rental income for federal income tax purposes. Interest income amounts for such transactions must be reported on line 11 in column (a) or (d), as applicable. Depreciation expense for such transactions must be reported on Part III, line 25, in column (a) or (d), as applicable. Use columns (b) and (c) of lines 11 and 16, and Part III, line 25, as applicable, to report the differences between columns (a) and (d). Example 17. M is a calendar year partnership that files and entirely completes Schedule M-3 for its 2019 tax year. M sells and leases property to customers. For financial accounting purposes, M accounts for each transaction as a sale. For U.S. income tax purposes, each of M's transactions must be treated as a lease. In its financial statements, M treats the difference in the financial accounting and the U.S. income tax treatment of these transactions as temporary. During 2019, M reports in its financial statements $1,000 of sales and $700 of cost of goods sold with respect to 2019 lease transactions. M receives periodic payments of $500 in 2019 with respect to these 2019 transactions and similar transactions from prior years and treats $400 as principal and $100 as interest income. For financial accounting purposes, M reports gross profit of $300 ($1,000 − $700) and interest income of $100 from these transactions. For U.S. income tax purposes, M reports $500 of gross rental income (the periodic payments) and (based on other facts) $200 of depreciation deduction on the property. On its 2019 Schedule M-3, M must report on line 11 $100 in column (a), ($100) in column (b), and $0 in column (d). In addition, M must report on line 16 $300 of gross profit in column (a), $200 in column (b), and $500 of gross rental income in column (d). Lastly, M must report on Part III, line 25, $200 in columns (b) and (d). With the exception of a section 481(a) adjustment that is required to be reported on Part I, line 10, for reportable transactions, any difference between an income or expense item attributable to an authorized (or unauthorized) change in method of accounting made for U.S. income tax purposes that results in a section 481(a) adjustment must be reported on line 17, regardless of whether a separate line for that income or expense item exists in Part II or Part III. Example 18. Partnership N is a calendar year partnership that files and entirely completes Schedule M-3 for its 2019 tax year. N was depreciating certain fixed assets over an erroneous recovery period and, effective for its 2019 tax year, N receives IRS consent to change its method of accounting for the depreciable fixed assets and begins using the proper recovery period. The change in method of accounting results in a positive section 481(a) adjustment of $100,000 that is required to be spread over 4 tax years, beginning with the 2019 tax year. In its financial statements, N treats the section 481(a) adjustment as a temporary difference. N must report on line 17 $25,000 in columns (b) and (d) for its 2019 tax year and each of the subsequent 3 tax years (unless N is otherwise required to recognize the remainder of the section 481(a) adjustment earlier). N must not report the section 481(a) adjustment on Part III, line 25. Report on line 18, column (a), amounts of revenues included on Part I, line 11, that were deferred from a prior financial accounting year. Report on line 18, column (d), amounts of revenues recognizable for U.S. income tax purposes in the current tax year that are recognized for financial accounting purposes in a different year. Also report on line 18, column (d), any amount of revenues reported on line 18, column (a), that are recognizable for U.S. income tax purposes in the current tax year. Use columns (b) and (c) of line 18, as applicable, to report differences between columns (a) and (d). Line 18 must not be used to report income recognized from long-term contracts. Instead, use line 19. Report on line 19 the amount of net income or loss for financial statement purposes (or books and records, if applicable) or U.S. income tax purposes for any contract accounted for under a long-term contract method of accounting. Report on line 20 any amounts of original issue discount (OID) and other imputed interest. The term "original issue discount and other imputed interest" includes, but isn't limited to: The excess of a debt instrument's stated redemption price at maturity over its issue price, as determined under section 1273; Amounts that are imputed interest on a deferred sales contract under section 483; Amounts treated as interest or OID under the stripped bond rules under section 1286; and Amounts treated as OID under the below-market interest rate rules under section 7872. Report on line 21a, column (a), all gains and losses on the disposition of assets except for (a) gains and losses on the disposition of inventory, and (b) gains and losses allocated to the partnership from a pass-through entity (for example, on Schedule K-1) that are included in the net income (loss) of the partnership reported on Part I, line 11. Reverse the amount reported in column (a) in column (b) or (c), as applicable. The corresponding gains and losses for U.S. income tax purposes are reported on lines 21b through 21g, as applicable. Report on line 21b gross capital gains reported on Schedule D, Capital Gains and Losses, excluding capital gains from pass-through entities, which must be reported on line 7, 8, or 9, as applicable. Report on line 21c gross capital losses reported on Schedule D, excluding capital losses from (a) pass-through entities, which must be reported on line 7, 8, or 9, as applicable; (b) abandonment losses, which must be reported on line 21e; and (c) worthless stock losses, which must be reported on line 21f. Report on line 21d the net gain or loss reported on line 17 of Form 4797, excluding amounts from (a) pass-through entities, which must be reported on line 7, 8, or 9, as applicable; (b) abandonment losses, which must be reported on line 21e; and (c) worthless stock losses, which must be reported on line 21f. Traders in securities or commodities that have made a valid election under section 475(f) to use the mark-to-market method to account for securities or commodities, see the instructions for Part II, line 14, earlier. Report on line 21e any abandonment losses, regardless of whether the loss is characterized as an ordinary loss or a capital loss. Report on line 21f any worthless stock loss, regardless of whether the loss is characterized as an ordinary loss or a capital loss. Attach a statement that separately states and adequately discloses each transaction that gives rise to a worthless stock loss and the amount of each loss. Report on line 21g any gains or losses from the sale or exchange of property other than inventory that aren't reported on lines 21b through 21f. Separately state and adequately disclose on line 22 all items of income (loss) with differences that aren't otherwise listed on lines 1 through 21. Attach a statement that describes and itemizes the type of income (loss) and the amount of each item and provides a description that states the income (loss) name for book purposes for the amount recorded in column (a) and describes the adjustment being recorded in column (b) or (c). The entire description completes the tax description for the amount included in column (d) for each item separately stated on this line. The attached statement should have five columns. The first column has the description for the next four columns. The second column is Column (a), Income (Loss) per Income Statement. The third column is Column (b), Temporary Difference. The fourth column is Column (c), Permanent Difference. The fifth column is Column (d), Income (Loss) per Tax Return. For every item listed on the attached statement for line 22, columns (a) + (b) + (c) must equal column (d). Each item with amounts in columns (a), (b), (c), and (d) will be totaled and included as one line on line 22. A partnership should include tax-exempt income from forgiven Paycheck Protection Program (PPP) loans on line 22, column (c), as a negative number if it was included on line 22 in column (a) as Income per Income Statement. If any "comprehensive income," as defined by Statement of Financial Accounting Standards (SFAS) No. 130, is reported on this line, describe the item(s) in detail. Examples of sufficiently detailed descriptions include "Foreign currency translation adjustments—comprehensive income" and "Gains and losses on available-for-sale securities—comprehensive income." Combine lines 1 through 22 and enter the total on line 23. Line 15, Cost of goods sold, columns (a) and (d), are negative amounts that will affect the totals entered on line 23. Report on line 24, columns (a) through (d), as applicable, the negative of the amounts reported on Part III, line 31, columns (a) through (d). For example, if Part III, line 31, column (a), reflects an amount of $1 million, then report on line 24, column (a), ($1,000,000). Similarly, if Part III, line 31, column (b), reflects an amount of ($50,000), then report on line 24, column (b), $50,000. If there is no difference between the financial accounting amount and the taxable amount of an entire item of income, gain, loss, expense, or deduction and the item isn't described or included on lines 1 through 22, or Part III, lines 1 through 30, report the entire amount of the item in columns (a) and (d) of line 25. If an item of income, loss, expense, or deduction has a difference and a portion of the item doesn't have a difference, report the entire item on one line (that is, both the portion with a difference and the portion without a difference) on the applicable line of lines 1 through 22 of Part II, or Part III, lines 1 through 30. See Example 11, earlier. Expense amounts that reduce financial income must be reported on Part III, but if reported on Part II, line 24, must be the negative of the amounts reported on Part III, line 31. If the partnership doesn't distinguish between current and deferred income tax expense in its financial statements (or its books and records, if applicable), report income tax expense as current income tax expense using lines 1 and 3, as applicable. Report on lines 5 any amounts for expenses that are reflected as expense for financial accounting purposes (column (a)) or deducted in the U.S. income tax return (column (d)) other than amounts reportable elsewhere on Schedule M-3, Parts II and III. Examples of amounts reportable on line 5 include expense/deduction items attributable to options to acquire capital interest units, profits interest units, and other rights to acquire partnership equity, regardless of whether such payments are made to employees or nonemployees, or as payment for property or compensation for services. Report on line 6, column (a), any amounts paid or accrued by the partnership during the tax year for meals, beverages, and entertainment that are accounted for in financial accounting income, regardless of the classification, nomenclature, or terminology used for such amounts, and regardless of how or where such amounts are classified in the partnership's financial income statement or income and expense accounts maintained in the partnership's books and records. Report only amounts not otherwise reportable elsewhere on Schedule M-3, Parts II and III (for example, Part II, line 15). Report on line 7 any fines or similar penalties paid to a government or other authority for the violation of any law for which fines or penalties are assessed. All fines and penalties expensed in financial accounting income (paid or accrued) must be included on line 7, column (a), regardless of the government or other authority that imposed the fines or penalties, regardless of whether the fines and penalties are civil or criminal, regardless of the classification, nomenclature, or terminology used for the fines or penalties by the imposing authority in its actions or documents, and regardless of how or where the fines or penalties are classified in the partnership's financial income statement or the income and expense accounts maintained in the partnership's books and records. See sections 162(f) and 162(g) for additional guidance. Report on line 7, column (d), any such amounts described in the preceding paragraph that are includible in taxable income, regardless of the financial accounting period in which such amounts were or are included in financial accounting net income. Complete columns (b) and (c), as appropriate. Don't report on line 7 amounts required to be reported in accordance with the instructions for line 8. Don't report on line 7 amounts recovered from insurers or any other indemnitors for any judgments, damages, awards, or similar costs described above. Include on line 9, column (a), the amount of any estimated or actual judgments, damages, awards, settlements, and similar costs, however named or classified, included in financial accounting income, regardless of whether the amount deducted was attributable to an estimate of future anticipated payments or actual payments. Also report on line 8, column (a), the reversal of any overaccrual of any amount described in this paragraph. Report on line 8, column (d), any such amounts described in the preceding paragraph that are includible in taxable income, regardless of the financial accounting period in which such amounts were or are included in financial accounting net income. Complete columns (b) and (c), as appropriate. Don't report on line 8 amounts required to be reported in accordance with the instructions for line 7. Don't report on line 8 amounts recovered from insurers or any other indemnitors for any judgments, damages, awards, or similar costs described above. Report on line 9, column (a), the amount of guaranteed payments expensed in the partnership's financial statements. Report on line 9, column (d), the amount of guaranteed payments deductions. The net amount of the deduction reported in column (d) is the amount reported as a deduction from Form 1065, page 1, line 10, reduced by the amount reported as income on Form 1065, Schedule K, line 4. The net amount of the guaranteed payments reported in column (d) will be zero if no guaranteed payments are capitalized and all are deducted on Form 1065, page 1, line 10, or a negative amount (reported in parentheses) if any of the guaranteed payments are capitalized by the partnership. Generally, if guaranteed payments are capitalized for financial accounting purposes, the amount of guaranteed payments reported in column (c) is a permanent difference equal to the amount of guaranteed payment income reported on Form 1065, Schedule K, line 4. If no guaranteed payment expense is recognized for financial accounting purposes, the amount reported in column (a) is zero. Any amount of guaranteed payments capitalized for tax purposes on Form 1065, page 1, but not capitalized for financial accounting purposes, will generally be reported as a negative temporary difference amount in column (b). Example 19. AZ is a calendar year partnership that files and entirely completes Schedule M-3 for its 2019 tax year. AZ has total income in 2019 of $5,000 for both financial accounting and tax accounting purposes before taking into account guaranteed payments expense or deductions. Partner A is paid a deductible guaranteed payment of $3,000 for services rendered to the partnership during the tax year. Partner Z is paid a $1,000 guaranteed payment, which is capitalized to land for tax accounting. Both guaranteed payments, in the total amount of $4,000, are expensed as incurred for financial accounting purposes in arriving at net financial accounting income. There are no other expenses or deductions for financial accounting or tax accounting purposes. The amount shown on Part I, line 11, Net income (loss) per income statement of the partnership, is $1,000 ($5,000 − $3,000 − $1,000 = $1,000). The amount shown on line 9, column (a), is ($4,000), the amount of guaranteed payments expenses for financial accounting purposes. The amount shown on line 9, column (d), is ($1,000), the net amount deducted after taking into consideration the $4,000 of total guaranteed payments allocated to the partners as income on Schedule K, netted against $3,000 deducted on Form 1065, page 1, line 10. The amount reported on line 9, column (b), is a temporary difference of ($1,000), the negative of the amount of guaranteed payments capitalized for Form 1065, page 1. The amount reported on line 9, column (c), is a permanent difference of ($4,000), equal to the guaranteed payment income shown on Form 1065, Schedule K, line 4, expressed as a negative amount. Part II, line 23, reports $5,000 in column (a), $0 in column (b), $0 in column (c), and $5,000 in column (d). Part II, line 24, reports ($4,000) in column (a), $1,000 in column (b), $4,000 in column (c), and $1,000 in column (d). Part II, line 26, reports $1,000 in column (a), $1,000 in column (b), $4,000 in column (c), and $6,000 in column (d). Same facts as in Example 19.1, except that no guaranteed payments expense is recognized for financial accounting purposes. The amount shown on Part I, line 11, is $5,000. On line 9, AZ reports $0 in column (a), ($1,000) in column (b), $0 in column (c), and ($1,000) in column (d). Part III, line 23, reports $0 in column (a), $1,000 in column (b), $0 in column (c), and $1,000 in column (d). Part II, line 25, AZ reports $5,000 in column (a), $1,000 in column (b), $0 in column (c), and $6,000 in column (d). Report on line 10 any amounts attributable to the partnership's pension plans, profit-sharing plans, and any other retirement plans. Report on line 11 any amounts attributable to other post-retirement benefits not otherwise includible on line 10 (for example, retiree health and life insurance coverage, dental coverage, etc.). Report on line 12, column (a), any compensation expense included in the net income (loss) amount reported on Part I, line 11, that isn't deductible for U.S. income tax purposes in the current tax year and that wasn't reported elsewhere on Schedule M-3, column (a). Report on line 12, column (d), any compensation deductible in the current tax year that wasn't included in the net income (loss) amount reported on Part I, line 11, or the current tax year and that isn't reportable elsewhere on Schedule M-3, including any compensation deductions deferred in a prior tax year. For example, report originations and reversals of deferred compensation subject to section 409A on line 12. Report on line 14 any charitable contribution of intangible property, for example, contributions of: Intellectual property, patents (including any amounts of additional contributions allowable by the donee subsequent to the year of donation), copyrights, trademarks; Securities (including stocks and their derivatives, stock options, and bonds); Conservation easements (including scenic easements or air rights); Railroad rights of way; Mineral rights; and Other intangible property. Include on line 15, column (a), organizational expenses, as defined in Regulations section 1.709-2(a). Report on line 15, column (d), the amount of organizational expense deducted per section 709(b). Include on line 16 syndication expenses, as defined in Regulations section 1.709-2(b). Report on line 17 any investment banking fees paid or incurred in connection with a taxable or tax-free acquisition of property (for example, ownership interests or assets) or a tax-free reorganization not otherwise reportable on Schedule M-3 (for example, Part II, line 15 or 16). Report on this line any investment banking fees paid or incurred at any stage of the acquisition or reorganization process, including, for example, fees paid or incurred to evaluate whether to investigate an acquisition, fees to conduct an actual investigation, and fees to consummate the acquisition or reorganization. Report on line 18 any legal and accounting fees paid or incurred in connection with a taxable or tax-free acquisition of property (for example, ownership interests or assets) or a tax-free reorganization not otherwise reportable on Schedule M-3 (for example, Part II, line 15 or 16). Report on this line any legal and accounting fees paid or incurred at any stage of the acquisition or reorganization process, including, for example, fees paid or incurred to evaluate whether to investigate an acquisition, fees to conduct an actual investigation, and fees to consummate the acquisition or reorganization. Report on line 19 amortization of goodwill or amounts attributable to the impairment of goodwill. Report on line 20 amortization of acquisition, reorganization, and start-up costs. For purposes of columns (b), (c), and (d), include amounts deductible under section 167 or 195. Report on line 21 any amortization or impairment write-offs not otherwise includible on Schedule M-3. When using this line to figure amounts on other tax forms or worksheets, this line should be considered to be zero. Form 1065 filers report on line 23a, column (a), any oil and gas depletion included on Part I, line 11. Report on line 23b any depletion expense/deduction other than oil and gas that isn't required to be reported elsewhere on Schedule M-3 (for example, on Part II, line 7, 8, 9, or 15). Intangible drilling and development costs (IDC) are costs of developing oil, gas, or geothermal wells. Report on line 24, column (a), the total amount of intangible drilling and development costs (or such equivalent costs as classified in the partnership's financial statements) included on Part I, line 11, and report on line 24, column (d), the total amount of IDC paid or incurred during the current tax year under section 263(c) and Regulations section 1.612-4. Report on line 25 any depreciation expense/deduction that isn't required to be reported elsewhere on Schedule M-3 (for example, on Part II, line 7, 8, 9, or 15). Report on line 26, column (a), any amounts attributable to an allowance for uncollectible accounts receivable or actual write-offs of accounts receivable included on Part I, line 11. Report in column (d) the amount of bad debt expense deduction for federal income tax purposes under section 166. Attach Form 8916-A. Complete Part III and enter the amounts shown on line 5, columns (a) through (d), on Schedule M-3, line 27, columns (a) through (d), as applicable. An entity that (a) is required to file a Schedule M-3 and has less than $50 million in total assets at the end of the tax year, or (b) isn't required to file a Schedule M-3 and voluntarily files a Schedule M-3, isn't required to file Form 8916-A but may voluntarily do so. Report on line 27, column (a), the total amount of interest expense included on Part I, line 11, and report on line 27, column (d), the total amount of interest deduction included on line 1 of the Analysis of Net Income (Loss) on Form 1065 that isn't reported elsewhere on Schedule M-3. In column (b) or (c), as applicable, adjust for any amounts treated for U.S. income tax purposes as interest deduction that are treated as some other form of expense for financial accounting purposes, or vice versa. For example, adjustments to interest expense/deduction resulting from adjustments made in accordance with the instructions for line 28 should be made in columns (b) and (c), as applicable, of line 27. Don't report on Form 8916-A and on line 27 amounts reported in accordance with the instructions for (a) Part II, lines 7, 8, and 9, Income (loss) from U.S. partnerships, foreign partnerships, and other pass-through entities; and (b) Part III, line 10, Items relating to reportable transactions. Also see the instructions for Part II, line 16, for sellers and/or lessors. Asset transfer transactions with periodic payments characterized for financial accounting purposes as either a purchase or a lease may, under some circumstances, be characterized as the opposite for tax purposes. If a transaction is treated as a lease, the purchaser/lessee reports the periodic payments as rental expense. If the transaction is treated as a purchase, the purchaser/lessee reports the periodic payments as payments of principal and interest and also reports depreciation expense or deduction with respect to the purchased asset. Report in column (a) gross rent expense for a lease for financial accounting purposes but a sale for U.S. income tax purposes. Report in column (d) gross rental deductions for a transaction treated as a lease for U.S. income tax purposes but as a purchase for financial accounting purposes. Report interest expense or deduction amounts for such transactions on line 27, in column (a) or (d), as applicable. Report depreciation expense or deduction amounts for such transactions on line 25, in column (a) or (d), as applicable. Use columns (b) and (c) of lines 25, 27, and 28, as applicable, to report the differences between columns (a) and (d) for such recharacterized transactions. Example 20. X is a calendar year U.S. partnership that files and entirely completes Schedule M-3 for its 2019 tax year. X acquired property in a transaction that, for financial accounting purposes, X treats as a lease. Because of its terms, the transaction is treated for U.S. income tax purposes as a purchase, and X must treat the periodic payments it makes partially as a payment of principal and partially as a payment of interest. In its financial statements, X treats the difference between the financial accounting and U.S. income tax treatment of this transaction as a temporary difference. During 2019, X reports in its financial statements $1,000 of gross rental expense that, for U.S. income tax purposes, is recharacterized as a $700 payment of principal and a $300 payment of interest, accompanied by a depreciation deduction of $1,200 (based on other facts). On its 2019 Schedule M-3, X must report the following on line 28: column (a), $1,000, its financial accounting gross rental expense; column (b), ($1,000); and column (d), $0. On line 27, X reports $0 in column (a) and $300 in columns (b) and (d) for the interest deduction. On line 25, X reports $0 in column (a) and $1,200 in columns (b) and (d) for the depreciation deduction. Report in column (a) the amount of expenses included in net income reported on Part I, line 11, that are related to research and development expenses. Report in column (d) the amount of deductions included on page 1 of the return and/or separately reported on Schedule K of the return that are recognized under section 174 research and experimental expenditures consistent with the partnership's adopted method of accounting for such expenditures. In column (b) or (c), as applicable, include any adjustments for any amounts treated for U.S. income tax purposes as research or experimental expenditures that are treated as some other form of expense for financial accounting purposes, or vice versa. Report any difference in timing recognition in column (b). Example 21. Partnership X is a calendar year taxpayer that files and entirely completes Schedule M-3 for its 2019 tax year. During 2019, X incurred $100,000 of research and development costs that X recognized as an expense in its financial statements. Also, X incurred $20,000 in attorney fees in obtaining a patent application that X capitalized and amortized in its financial statements. X recognized $2,000 of amortization deduction. In compliance with its adopted method of accounting under section 174, X deducts research and experimental expenditures for U.S. income tax purposes. Accordingly, X must report $100,000 in column (a), $20,000 in column (b), and $120,000 in column (d). X must also report $2,000 in column (a), ($2,000) in column (b), and $0 in column (d) on Part III, line 21. Assume the same facts as Example 21.1, except X elected to capitalize and amortize its research and expenditures over 60 months with respect to all its research programs for U.S. tax purposes. X first realized benefits from such expenditures on August 1. Accordingly, X must report $100,000 in column (a), a temporary difference of ($90,000) (that is, $100,000 – $10,000) in column (b), and $10,000 (that is, $120,000/60 months, times 5 months) in column (d). Partnership X is a calendar year taxpayer that files and entirely completes Schedule M-3 for its 2019 tax year. X adopted the current expense method for research and experimental expenditures for U.S. income tax purposes. During 2019, X incurred $50,000 of research and development costs that X recognized as an expense in its financial statements. Also, X undertook to develop a new machine for its business. X expended $30,000 on the project of which $10,000 represents actual costs of material, labor, and component cost to construct the machine, and $20,000 represents research costs not attributable to the machine itself. X capitalized all costs of $30,000 related to the machine and recognized $6,000 of depreciation expense in its financial statements. X's depreciation expense on the $10,000 of costs related to the machine itself was $2,000 for U.S. income tax purposes. Accordingly, X must report $50,000 in column (a), $20,000 (research costs that aren't attributable to the machine itself) in column (b), and $70,000 in column (d). X must also report $6,000 in column (a), ($4,000) in column (b), and $2,000 in column (c) on Part III, line 25. Partnership X is a calendar year taxpayer that files and entirely completes Schedule M-3 for its 2019 tax year. During 2019, X incurred $10,000 of research and development costs related to social sciences that it recognized as an expense in its financial statements. X adopted the current expense method for research and experimental expenditures for U.S. income tax purposes. Because such costs aren't allowable costs under section 174, X must report $10,000 in column (a), permanent difference ($10,000) in column (c), and $0 in column (d). If such costs are otherwise deductible for U.S. income tax purposes, X must report this item of expense on Part III, line 30. Partnership X is a calendar year taxpayer that files and entirely completes Schedule M-3 for its 2019 tax year. During 2019, X paid $75,000 to acquire or in-license intangible assets under a collaborative arrangement with another company that X recognized as a research and development expense in its financial statements. X adopted the current expense method for research and experimental expenditures for U.S. income tax purposes. Because payments made to acquire rights to a product or technology are excluded costs from the definition of research and experimental expenditures, X must report $75,000 in column (a), ($75,000) in column (c), and $0 in column (d). X must report any amortization otherwise allowable related to the payments on Part III, line 21. Separately state and adequately disclose on line 30 all items of expense/deduction that aren't otherwise listed on lines 1 through 29. Attach a statement that describes and itemizes the type of expense/deduction and the amount of each item, and provides a description that states the expense/deduction name for book purposes for the amount recorded in column (a) and describes the adjustment being recorded in column (b) or (c). The entire description completes the tax description for the amount included in column (d) for each item separately stated on this line. The amount of details attached to the return for line 30 must separately state and adequately disclose the nature and amount of the expense related to each reserve and/or contingent liability. The appropriate level of disclosure depends upon each taxpayer's operational activity and the nature of its accounting records. For example, if a partnership's net income amount reported in the income statement includes anticipated expenses for a discontinued operation as a single amount, and its general ledger or other books, records, and workpapers provide details for the anticipated expenses under more explanatory and defined categories such as employee termination costs, lease cancellation costs, loss on sale of equipment, etc., a supporting statement that lists those categories of expenses and their details will satisfy the requirement to separately state and adequately disclose the employee termination costs, it isn't required that an anticipated termination cost amount be listed for each employee, or that each asset (or category of asset) be listed along with the anticipated loss on disposition. The attached statement should have five columns. The first column has the description for the next four columns; the second column is Column (a), Expense per Income Statement; the third column is Column (b), Temporary Difference; the fourth column is Column (c), Permanent Difference; and the fifth column is Column (d), Deduction per Tax Return. For every item listed on the attached statement for line 30, columns (a) + (b) + (c) must equal column (d). Each item with amounts in columns (a), (b), (c), and (d) will be totaled and included as one line on line 30 of the face of the schedule. Reserves and contingent liabilities. Report on line 30 amounts related to the change in each reserve or contingent liability that isn't required to be reported elsewhere on Schedule M-3. Report on line 30, column (a), expenses included in net income reported on Part I, line 11, that are related to reserves and contingent liabilities. Report on line 30, column (d), amounts related to liabilities for reserves and contingent liabilities that are deductible in the current tax year for U.S. income tax purposes. Examples of items that must be reported on line 30 include warranty reserves, restructuring reserves, reserves for discontinued operations, and reserves for acquisitions and dispositions. Only report on line 30 items that aren't required to be reported elsewhere on Schedule M-3, Parts II and III. For example, the expense for a reserve for inventory obsolescence must be reported on Part II, line 15. Example 22. Partnership Q is a calendar year partnership that files and entirely completes Schedule M-3 for its 2019 tax year. On July 1 of each year, Q has a fixed liability for its annual insurance premiums that provides a 12-month coverage period beginning July 1 through June 30. In addition, Q historically prepays 12 months of advertising expense on July 1. On July 1, 2019, Q prepays its insurance premium of $500,000 and advertising expenses of $800,000. For financial accounting purposes, Q capitalizes and amortizes the prepaid insurance and advertising over 12 months. For U.S. income tax purposes, Q deducts the insurance premium when paid and amortizes the advertising over the 12-month period. In its financial statements, Q treats the differences attributable to the financial statement treatment and U.S. income tax treatment of the prepaid insurance and advertising as temporary differences. Q also has a legal expense reserve where $300,000 was expensed for financial accounting purposes and a ($100,000) temporary difference was calculated to arrive at the income tax deduction of $200,000. The statement attached to Q's return for Part III, line 30, must be separately stated and adequately disclosed as follows: Enter on Part II, line 24, columns (a) through (d), as applicable, positive amounts from line 31 as negative (in parentheses) and negative amounts as positive. For example, if line 31, column (a), reflects an amount of $1 million, then report on Part II, line 24, column (a), ($1,000,000). Similarly, if line 31, column (b), reflects an amount of ($50,000), then report on Part II, line 24, column (b), $50,000.

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