

Introducing the New User-Friendly Schedule K-1 For Hedge Fund of Funds

BY KEN WOLOSOFF, CPA, JD, LLM

You have invested in an “Alternative Investment”. It is a hedge fund of funds. The partnership in which you invested has in turn invested in 20 or 30 other hedge funds in order to diversify over different strategies and asset classes and minimize risk.

Your hedge fund is required to aggregate all items of income and deduction from all of the underlying hedge funds and maintain the tax attributes reported by each underlying fund. Similarly, you must be provided with the same supplemental information reported on the Schedule K-1 of each underlying partnership. This might include, for example, passive and non-passive income and loss, investment interest expense deductible as an itemized deduction or as a non-passive deduction, net investment income, state sourced income, separate PTP loss information, investments in foreign corporations and foreign partnerships requiring disclosures, tax shelter reporting disclosure information, annual PFIC information, disposition of PFIC information and a dozen other footnotes giving additional information.

A hedge fund of funds Schedule K-1 can easily be 40 or more pages. As an investor, how do you know what to report, what is relevant, what does not apply to you, and where to find the items you must report?

We have consolidated and combined most of the important information and amounts to be reported on a single page, user-friendly, Schedule K-1 Summary which also tells you where to report this information on your individual return.

One of the challenges in preparing a fund of funds K-1 is that different underlying hedge funds, or their accounting firms, can put the same item in different places on a Schedule K-1. For example, you could have qualified dividend income shown on line 6B or alternatively on line 1, or alternatively on line 11F. The Summary K-1 indicates the combined total of qualified dividend income and also indicates that it consists of amounts from line 6B, line 1 and Line 11F. A note on the Summary K-1 indicates that you must see the Schedule K-1 footnotes for the amount of foreign qualified dividend income.



Another example would be that the Summary K-1 indicates the amount of non-passive income or loss reported throughout the Schedule K-1 on lines 1, 2, 3, 11A, 11F, 13J and 13W. However, if any underlying passive activity is from a Publicly Traded Partnership, it indicates that those items must be carved out from the total, separately reported and be subjected to separate passive loss limitations.

The Summary K-1 refers you to the Schedule K-1 footnotes for such items as:

- Foreign qualified dividend income
- State sourced income and withholding
- Tax exempt income by estate
- Effectively connected income for foreign partners
- Reportable transaction disclosure information
- Form 926 requirements for reporting a partner's share of transfers to foreign corporations
- PFIC information under IRC Secs. 1291-1296

There are some items reported in only one place on the face of the Schedule K-1 which do not require combinations. The Summary K-1 identifies these items.

Examples would include:

- Tax preference items
- Foreign source income and deductions
- Foreign taxes paid

All items on the Summary Schedule K-1 are footed and the total ties back to Total Income (Loss) in the capital reconciliation schedule following the Schedule K-1.

We can prepare a User-Friendly Summary K-1 for your Fund of Funds.

Please contact Ken at Kwolosoff@mwellp.com or 516-240-4285 for more information.

Cliff Feitzinger, CPA, researched and contributed to this article.

Enter Partnership Name

EIN: 99-9999999

Date:

Partner:

Tax ID:

User Friendly Fund of Hedge Funds K-1 Summary

Item	Consists of Amounts from K-1 Lines, Codes	Amount	Notes	Form 1040 Filers
Interest Income	5, 11F	151,057		Schedule B, part 1
Non-qualified dividend Income	6A, 11F	92,350		Schedule B, part 2
Qualified dividend income	1, 6B, 11F	337,172		Schedule B, part 2
Royalties	7	413		Schedule E, part 1
Short-term capital gain (Loss)	8, 11F	2,156,153		Schedule D, part 1
Long-term capital gain (Loss)	9A, 11F	3,872,800		Schedule D, part 2
Collectibles (28%) gain (loss) included in 9a amount		0		
Unrecaptured Section 1250 gain included in 9a amount		86		
Section 1231 gain (loss, passive)	10	-181		Form 4797, part 1, Line 2
Section 1256 contracts and straddles	11C	-234,709		Form 6781, part 1
Cancellation of debt (passive)	11E	0		Form 1040, line 21
PFIC income (loss)	11F	0	See footnote details	
Section 475 mark to market gain (loss)	1, 11F	0		Form 4797, part 2, line 10
Ordinary gain (loss) from disposition of PTP's	1	8,832		Form 4797, part 2, line 10
Section 179 deduction	12	0		Form 4562, line 6
Cash contributions (50%)	13A	14		Schedule A, line 16
Cash contributions (30%)	13B	0		Schedule A, line 16
Investment interest expense (Sch. A)	13H	174,310	Subject to limitation	Schedule A, line 14
Investment Interest expense (Sch. E)	1, 13H	512,568	Subject to limitation	Schedule E, part 2, column (h)
Deductions - royalty income	13I	161		Schedule E, part 1
Deductions - portfolio (2% floor)	13K	818,756	Subject to limitation	Schedule A, line 23
Deductions - portfolio (other)	13L	203		Schedule A, line 28
Foreign taxes paid	16L	12,180	Subject to limitation	Form 1116, part 2
Nonpassive income (loss) w/ U.S. Gov't interest in Box 1	1, 4, 11A, 11F, 13W	-459,976		Schedule E, part 2, column j (h)
Passive income (loss) (other than from Section 1231 in Line 10 and cancellation of debt income in Line 11E)	1, 2, 3, 11A, 11F, 13J, 13W	144,809	Subject to limitation	Schedule E, part 2, column g (f)
Taxable income (loss) (reflects foreign tax paid as a deduction)		4,550,528	Sum of above amounts	
Other Information:				
Investment income	1, 5, 6, 7 11A, 11F	457,726		
Investment expenses	13I, 13K, 13L	819,120		
Gross investment income (loss)	1, 5, 6, 7, 11A, 11F, 13W	129,848		Form 4952, line 4a
U.S. Government Interest (boxes 5 & 11F included above)	1, 5, 11F	979	State adjustment	
Cost to Carry U.S. Gov't Obligations		0	State adjustment	

Notes:

See Schedule K-1 for the following items:

- Self employment information (Line 14)
- Tax credits (Line 15)
- Foreign transactions (Line 16)
- AMT items (Line 17)
- Tax-exempt interest income (Line 18a)
- Nondeductible expenses (Line 18c)
- UBTI (Line 20V)

See Schedule K-1 footnotes for the following items:

- Publicly Traded Partnership information
- Section 199 information
- Foreign Qualified Dividend Income
- Effectively Connected Income for foreign partners
- Reportable Transaction Disclosure information
- Passive Foreign Investment Company (PFIC) information
- Form 926 Transfers to Foreign Corporations information
- State Sourced Income & Withholding
- Tax-exempt Interest Income by State

About Ken Wolosoff, CPA, JD, LLM

Ken is a tax partner with over fifteen years experience. He specializes in the area of financial services – Hedge Funds/Investment Partnerships, Broker/Dealers and Investment Advisors. His clients include high net worth individuals and family-owned businesses. Ken works hand-in-hand with his clients in structuring business transactions and in all aspects of tax planning. He is a member of the American Institute of Certified Public Accountants (AICPA), New York State Society of Certified Public Accountants (NYSSCPA), American Bar Association and New York State Bar Association. Ken can be reached at kwolosoff@mwellp.com.

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