



---

Commonwealth of Massachusetts

Department of Revenue

---

General Instructions	2
Major Tax Changes	2
Specific Instructions	5
Table of Contents	back cover

# 2001 Massachusetts Partnership Return **Form 3**

---

Schedule 3K-1 and Instructions

# General Instructions

This booklet contains Form 3, Schedule 3K-1, and the instructions needed for completing your Massachusetts partnership return. The Massachusetts Schedule 3K-1 parallels federal Schedule K-1, which gathers information on each partner separately.

The instructions are divided into two sections designed to lead you through the form and answer your questions along the way.

The first section — **General Instructions** — answers commonly asked questions such as, “How Is a Partnership Taxed?”

The second section — **Specific Instructions** — provides information on each part of Form 3 and Schedule 3K-1.

## What are the Major Tax Changes for 2001?

### Tax Lowered on Wages, Salaries and Certain Other Items of Income

Legislation passed in 2000 resulting from a ballot initiative provides a reduction of the tax rate on wages, salaries, and certain other items of income that will be phased in over a three-year period starting with tax year 2001. This category of income includes such items as wages, salaries, other employee compensation, tips, pensions, partnership income, business income, rents, alimony, winnings and Massachusetts bank interest. The tax rate on this category of income is decreased from 5.85% to 5.6% for taxable year 2001. For taxable years beginning in 2002 the rate is reduced to 5.3%. For taxable years beginning in 2003 and thereafter, the rate is reduced to 5%.

### Tax Lowered on Interest and Dividends

Under a recent law change, the tax rate on dividends and interest (other than interest from Massachusetts banks) is the same as the tax rate on the category of income including wages, salaries, etc., that is more fully described above. The tax rate on dividends and interest is decreased from 5.85% to 5.6% for taxable year 2001; to 5.3% for 2002; and to 5% for 2003 and thereafter. 12% income continues to include short-term capital gains, as well as short- and long-term capital gains arising from the sale of collectibles, and pre-1996 installment sales classified as capital gain income for Massachusetts purposes.

### Lower Capital Gains Tax Rates Fully Phased In

Legislation passed in 1994 reduced the tax on gain from the sale of capital assets held for more than one year. For purposes of the law, holding periods will commence on January 1, 1995. The lower tax rates, ranging from 5% to 0%, have been gradually phased in over six years as holding periods increase from the commencement date.

Gains on the sale of capital assets (excluding collectibles) held for more than one year but not more than two years are taxed as 5% income, those held for more than two years but not more than three years are taxed as 4% income, those held for more than three years but not more than four years are taxed as 3% income, those held for more than four years but not more than five years are taxed as 2% income, those held for more than five years but not more than six years are taxed as 1% income, and those held for more than six years are taxed as 0% income. Deductions from these items of income include long-term capital losses, certain short-term capital losses, allowable deductions from your trade or business, and excess exemptions.

For a detailed explanation of the new law, see the Department’s Regulation on Capital Gains and Losses at 830 CMR 62.4.1.

### New Charitable Contributions Deduction

Beginning with tax year 2001, a deduction is allowed for certain charitable contributions paid on or after January 1, 2001. In general, the deduction is equal to the amount of the charitable contributions deduction allowed to the taxpayer under IRC sec. 170 as in effect on January 1, 1998. The amount of the Massachusetts deduction will be subject to all of the requirements, conditions and limitations imposed on the federal charitable contributions deduction. However, although individual taxpayers must itemize deductions in order to claim the charitable deduction on their federal income tax returns, they are not required to itemize on the federal return in order to claim the Massachusetts charitable deduction. To claim this deduction, see Schedule Y, line 9. For more information, see the Department’s proposed regulation, Deduction for Charitable Contributions.

### Credit for Building or Development of Low-Income Housing

Effective for tax years beginning on or after January 1, 2001, a new low-income housing credit is available to certain taxpayers that claim a federal low-income housing credit for the building or development of low-income housing under IRC sec. 42. The amount of credit a taxpayer can claim for a qualified Massachusetts project will be allocated by the Massachusetts Department of Housing and Community Development. A qualified Massachusetts project is a “qualified low-income housing project” as that term is defined in IRC sec. 42 if it is located in Massachusetts, meets the requirements of M.G.L. c. 62, sec. 6I and the owner enters into a regulatory agreement with the Department of Housing and Community Development.

### Federal Law Changes NOT Adopted by Massachusetts

• **Parking, T-Pass and Vanpool Fringe Benefits — IRC sec. 132(f).** Generally, Massachusetts follows the exclusion from an employee’s gross income for employer-provided parking, T-Pass, and vanpool benefits. However, two federal Acts subsequent to January 1, 1998, have created differences between the Massachusetts and federal treatment of this exclusion. The federal exclusion amounts for tax year 2001 are \$180 per month for employer-provided parking and \$65 per month for employer-provided vanpool and T-pass benefits combined. The Massachusetts exclusion amounts for tax year 2001 are \$185 per month for employer-provided parking and \$70 per month for employer-provided vanpool and T-pass benefits combined. Further, Massachusetts will not allow an exclusion for T-pass and vanpool benefits unless they are provided by an employer without charge to the employee. These differences will be reflected in the Form W-2 provided by your employer. See TIR 01-12.

• **Self-Employed Health Insurance Deduction — IRC sec. 162(l).** A federal and Massachusetts deduction is allowed for amounts paid for medical care insurance for a self-employed taxpayer and his or her spouse and dependents. For federal purposes the deduction will be 60% of the qualified insurance payments for the 2001 tax year. However, due to differences between the Internal Revenue Code as amended and in effect as of January 1, 1998, and the current year, only 50% of the qualified insurance payments are deductible for Massachusetts purposes for the 2001 tax year.

## Massachusetts Adopts the Current (post-1998 changes) U.S. Internal Revenue Code for Certain Federal Tax Provisions

The areas in which Massachusetts applies the current (which will include changes that have taken place after January 1, 1998) Internal Revenue Code consist of:

- exclusions of certain income derived from Roth IRAs as defined in IRC sec. 408A and Education IRAs as defined in IRC sec. 530;
- treatment of rollovers from a traditional to Roth IRAs;
- exclusion of gain from the sale of a principal residence provided by IRC sec. 121;
- deduction of trade or business expenses under IRC sec. 162(a); and
- the limitations provided by IRC secs. 274(m) & (n) for the deduction of certain travel, meals and entertainment expenses.

For more information, see TIRs 98-8 and 98-15.

### Corporate Trusts

Under recent legislation, certain dividends received by a resident beneficiary or shareholder of a corporate trust are subject to tax. However, where a taxpayer or the corporate trust also paid tax to another state (or certain other jurisdictions) on this income, he or she may be entitled to a credit for taxes paid to another jurisdiction. For more information, see Department Directive 00-9.

### When Must a Partnership File a Return?

A Massachusetts partnership return, Form 3, must be filed if the partnership meets either of the following criteria:

- has a usual place of business in Massachusetts; or
- receives federal gross income of more than \$100 during the taxable year.

### How Is a Partnership Taxed?

A partnership is not directly subject to income tax. Instead, each partner is taxed on the partner's share of the partnership income, whether distributed or not. Form 3 is a legally required informational return under Massachusetts General Laws, Ch. 62C, and subject to penalty for late filing.

### How Does Schedule 3K-1 Work?

Schedule 3K-1 is designed to allow the partnership to report each partner's distributive share of partnership income separately.

### Can Schedule 3K-1 Be Filed in an Alternative Format?

The Massachusetts Department of Revenue is now accepting Schedule 3K-1 by diskette. Form 3, however, must still be filed on paper. For a copy of the General Diskette Specifications and Record Layouts, you may visit the Department's website at [www.mass.gov/dor](http://www.mass.gov/dor).

### How Does Each Partner Report Partnership Income?

Each partner must report the partner's distributive share of each item of partnership income during the taxable year on the partner's Massachusetts tax return. The following table shows which return should be filed by each type of partner:

Type of partner	Form to file
Full-year resident individual . . . . .	1
Nonresident/part-year resident individual . . . . .	1-NR/PY
Trust or estate . . . . .	2
Domestic or foreign corporation . . . . .	355
Domestic or foreign corporation (part of a Massachusetts combined group) . . . . .	355C
Domestic or foreign S corporation . . . . .	355S
Corporate trust . . . . .	3F

Each **nonresident partner** must report the partner's distributive share of partnership income from any of the following categories:

- income derived from or connected with the partnership business carried on in Massachusetts;
- income from the ownership of any interest in real or tangible personal property located in Massachusetts; or
- interest, dividends, annuities and capital gains from property employed in the partnership business carried on in Massachusetts.

**Note:** A nonresident limited partner of a limited partnership engaged exclusively in buying, selling, dealing in or holding securities on its own behalf and not as a broker is not subject to tax on income from such partnership.

Qualified electing nonresident partners may file a composite tax return as defined in the nonresident regulation 830 CMR 62.5A.1(12)(f). A composite return is made on a Form 1-NR/PY with a composite Schedule E attached.

### What is Massachusetts Gross Income?

Massachusetts Gross Income is divided into three classes: Part B is taxed at 5.6%, Part A is taxed at 5.6% and 12% and Part C is taxed at 5%, 4%, 3%, 2% or 1%.

#### Part B income:

- Gross receipts from sales;
- Ordinary income or loss from other partnerships excluding all interest (other than interest from Massachusetts banks) and dividends;
- Ordinary income or loss from trusts and estates not subject to Massachusetts taxation;
- Royalty income or loss;
- Income from REMIC residual interest;
- Rental income or loss;
- Massachusetts bank interest; and
- Other income taxed at 5.6% (see Form 1 instructions).

#### Part A income:

- Interest other than from Massachusetts banks (taxed at 5.6%);
- Dividends (taxed at 5.6%);
- Short-term capital gains and losses (taxed at 12%);
- Gains and losses on the sale, exchange or involuntary conversion of property used in a trade or business and held for one year or less (taxed at 12%); and
- Long-term gains on collectibles and pre-1996 installment sales classified as capital gain income for Mass. purposes (taxed at 12%).

**Part C income:**

- Long-term capital gains and losses excluding long-term gains on collectibles; and
- Losses on the sale, exchange or involuntary conversion of property used in a trade or business and held for more than one year.

**Note:** Massachusetts gross income does **not** include interest on obligations of the U.S. or Mass. and its political sub-divisions.

**Are There Differences Between Massachusetts Tax Law and the Internal Revenue Code Provisions Affecting Partnerships?**

Yes. There are a number of differences between Massachusetts and U.S. personal income tax law. For Massachusetts tax purposes, a partnership is allowed only those expense deductions that an individually owned business is allowed. Deductions that are itemized by an individual on Schedule A of U.S. Form 1040, excluding charitable contributions, are not allowed. The deduction for a net operating loss carryover or carryback is not allowed to the partnership nor to an individual under Massachusetts income tax law. Explanations of these differences are provided in the appropriate lines and in the Forms 1 and 1-NR/PY instructions.

Form 3 and Schedule 3K-1 isolate income and deduction items in order to produce the correct Massachusetts partnership total as well as each partner's correct Massachusetts distributive share. These amounts sometimes differ from those reported on U.S. Form 1065, Schedule K-1.

**When and Where Must a Partnership Return Be Filed?**

A partnership return is due on or before the 15th day of the fourth month after the close of the partnership's taxable year, calendar or fiscal. If the partnership was dissolved or reorganized during the taxable year, Form 3 must be filed to reflect partnership activity as of the date of dissolution or reorganization.

Form 3 must be signed by one of the general partners. U.S. Form 1065 or Form 1065-B and all related schedules, including Schedule K-1 must be attached. A return without attached U.S. information is incomplete and subject to penalty.

The Massachusetts Department of Revenue is now accepting Schedule 3K-1 by diskette. Form 3, however, must still be filed on paper. For a copy of the General Diskette Specifications and Record Layouts, visit the Department's website at [www.mass.gov/dor](http://www.mass.gov/dor).

Mail partnership return to:

**Massachusetts Department of Revenue  
PO Box 7017  
Boston, MA 02204**

**What is the Penalty for Filing a Late Return?**

A \$5.00 per day penalty may be imposed for failure to file a partnership return on time.

# Specific Instructions

Certain lines are addressed in detail. Those lines without specific instructions are considered to be self-explanatory.

The Department of Revenue and the Internal Revenue Service maintain an extensive exchange program routinely sharing computer tapes and audit results. Discrepancies between income and deductions reported federally and on this return, except those allowed under state law, will be identified and may result in a state audit or further investigation.

## Electing Large Partnerships

If a partnership is filing U.S. Form 1065-B, U.S. Return of Income for Electing Large Partnerships, enter amounts from the lines on Form 1065-B corresponding to the line references from U.S. Form 1065. If there is no equivalent U.S. Form 1065-B line reference, enter the requested amount as if it had been reported on U.S. Form 1065.

## Part II. Partnership Income

If a partnership is made up entirely of **corporate partners**, the partnership need not complete Form 3, Part II. The partnership, however, must complete Form 3, Part I and, if applicable, Part III, and Schedule 3K-1, lines 22 through 29 (see instructions for Income Apportionment, Part III). The partnership must also attach U.S. Form 1065 and all schedules, including K-1s.

## Massachusetts Ordinary Income or Loss

### Line 1. Ordinary Income or Loss

Enter the total amount of ordinary income or loss from U.S. Form 1065, line 22.

### Line 2. Other Income or Loss

If reporting other income or loss from U.S. Form 1065, Schedule K, line 7, attach a statement and explain. If any income or loss from U.S. Form 1065, Schedule K, line 7 is granted capital gains treatment by the federal government, omit it here and include it in lines 18 through 23, as applicable.

### Line 3. State, Local and Foreign Income and Unincorporated Business Taxes or Excises

Enter total state, local and foreign income and unincorporated business taxes or excises. These taxes are deductible for U.S. tax purposes, but are not deductible in Massachusetts.

### Line 5. Section 1231 Gains or Losses

Enter any gains or losses from the sale, exchange or involuntary conversion of Section 1231 property included in line 4 above. These amounts should be included in lines 20, 21 and 23 as applicable.

### Line 7. Other Adjustments

Report and describe any other adjustments to Massachusetts partnership income and deductions not reported elsewhere on Form 3.

For Massachusetts tax purposes, a partnership is allowed only those expense deductions that an individually owned business is allowed. Deductions that are itemized by an individual on Schedule A of U.S. Form 1040 excluding, charitable contributions, are not allowed. The deduction for a net operating loss carryover or carryback is not allowed to the partnership nor to an individual under Massachusetts income tax law.

Also report the deductions for 10% of the costs of renovating a qualifying abandoned building located in an Economic Opportunity

Area. Attach a statement detailing the location and cost of renovating the qualifying abandoned building. The building must be designated as abandoned by the Economic Assistance Coordinating Council. For further information, contact the Massachusetts Office of Business Development, One Ashburton Place, Room 2101, Boston, MA 02108.

The partnership should also provide each partner with the amount of the partner's share of the deductible costs of renovating a qualifying abandoned building. Each partner should use this amount to complete Forms 1 or 1-NR/PY, Schedule E, Part II, line 4; Form 2; or Form 3F.

### Line 9. Net Income or Loss from Rental Real Estate Activity(ies)

Enter the net income or loss from rental real estate activity(ies) from U.S. Form 1065, Schedule K, line 2.

### Line 10. Net Income or Loss from Other Rental Activity(ies)

Enter the net income or loss from other rental activity(ies) from U.S. Form 1065, Schedule K, line 3c.

## U.S. Portfolio Income

### Line 11. U.S. Portfolio Income, Not Including Capital Gains

Add U.S. Form 1065, Schedule K, lines 4a, 4b, 4c and 4f and enter the total in line 11.

### Line 12. Interest on U.S. Debt Obligations

Enter the total amount of interest on U.S. debt obligations reported in line 11 which is taxable by the federal government, but is tax-exempt in Massachusetts.

### Line 13. 5.6% Interest from Massachusetts Banks

Enter the total amount of interest from Massachusetts banks included in line 11. Report any interest from Mass. savings accounts, savings share accounts and NOW accounts. Also report any interest from term and time deposits. Attach a statement listing bank sources and amounts.

### Line 14. Interest and Dividend Income

Enter the total amount of interest (other than interest from Massachusetts banks) and dividend income included in line 11. Do not include interest on U.S. debt obligations, which is taxable by the federal government, but is tax-exempt in Massachusetts. Attach a statement listing sources and amounts.

### Line 15. Non-Massachusetts State and Municipal Bond Interest

Enter the total amount of the partnership's non-Massachusetts state and municipal bond interest. This interest is taxable in Massachusetts, but not taxed by the federal government and thus not reported on U.S. Form 1065, Schedule K, line 4a.

### Line 16. Royalty Income

Enter the total amount of royalty income included in line 11.

### Line 17. Other Income

Enter the total amount of other income included in line 11 (from U.S. Form 1065, Schedule K, line 4f).

## Massachusetts Capital Gains and Losses

If the partnership had any other income or loss that is granted capital gains treatment by the federal government, include that amount in lines 18 through 24, as applicable.

### Line 18. Total Short-Term Capital Gains

Enter the total amount of short-term capital gains included in U.S. Form 1065, Schedule D, line 5.

### Line 19. Total Short-Term Capital Losses

Enter the total amount of short-term capital losses included in U.S. Form 1065, Schedule D, line 5.

### Line 20. Gain On the Sale, Exchange or Involuntary Conversion of Property Used in a Trade or Business and Held for One Year or Less

Enter from U.S. Form 4797 the amount of gain from the sale, exchange or involuntary conversion of property used in a trade or business and held for one year or less.

### Line 21. Loss On the Sale, Exchange or Involuntary Conversion of Property Used in a Trade or Business and Held for One Year or Less

Enter from U.S. Form 4797 the amount of loss from the sale, exchange or involuntary conversion of property used in a trade or business and held for one year or less.

### Line 22. Net Long-Term Capital Gain or Loss

Enter the net long-term gain or loss from U.S. Form 1065, Schedule K, line 4e(2).

### Line 23. Long-Term Section 1231 Gains and Losses

Enter the amount of gain or loss under IRC Section 1231 from U.S. Form 1065, Schedule K, line 6 from property held more than one year. Also, include any amounts included in U.S. Form 4797, Part II treated as capital gains or losses for Massachusetts purposes.

### Line 24. Long-Term Gains on Collectibles and Pre-1996 Installment Sales

Enter the amount of any long-term gain from collectibles held for more than one year and pre-1996 installment sales classified as capital gain income for Massachusetts purposes.

Collectibles are defined as any capital asset that is a collectible within the meaning of Internal Revenue Code section 408(m), as amended and in effect for the taxable year, including works of art, rugs, antiques, metals, gems, stamps, alcoholic beverages, certain coins, and any other items treated as collectibles for federal tax purposes.

### Line 25. Differences and Adjustments

Report any adjustments to Massachusetts capital gains and losses. Attach a complete statement explaining any such adjustments. For more information see Form 1, Schedule D instructions.

## Part III. Income Apportionment

Part III should be completed only if **all** three of the following conditions are met: (a) there is one or more corporate or nonresident individual partners; (b) there is any income from business activity or ownership of any interest in real or tangible property in another state; (c) such business activities provide the other state the jurisdiction to levy an income or franchise tax.

The total partnership income is apportioned using the three-factor formula provided in Massachusetts General Laws Ch. 63, sec. 38(c), except that the sales factor is single-weighted.

The partnership should provide each corporate partner or corporate trust partner with the applicable apportionment factors to be used in completing Schedule F of the applicable corporate form, or Form 3F, Schedule E.

### Line 26. Tangible Property

**26a.** For tax purposes, average value is based on original cost and is determined by averaging the property values at the beginning and end of the taxable year. If substantial changes occur during the taxable year, the Commissioner may require monthly averaging to properly reflect the average value of the property.

**26b.** Property rented is valued at eight times the annual rental rate less any sub-rentals received.

### Line 27. Payroll

Enter the total amount of wages, salaries, commissions or any other compensation paid to employees. An employee's compensation is apportioned to Massachusetts if **any** of the following apply:

- The employee's service is performed within Massachusetts;
- The employee's service is performed both in Massachusetts and in other state(s), but the non-Massachusetts service is secondary to the Massachusetts service;
- Part of the employee's service is performed in Massachusetts, and the service is controlled from a base of operations/place of control in Massachusetts; or
- Part of the employee's service is performed in Massachusetts and the base of operations/place of control of the service is not in a state in which some part of the service is performed, but the employee lives in Massachusetts.

### Line 28. Sales

For the sales factor, enter all gross receipts of the partnership with the exception of those receipts from interest, dividends and the sale or other disposition of securities.

**28a.** Sales of tangible personal property are assignable to Massachusetts if:

- The property is delivered or shipped to any buyer, including the U.S. Government, in Massachusetts; or
- The selling partnership is not taxable in the state of the buyer and the property is not sold by an agent or agencies chiefly situated at, connected with, or sent out from premises for the transaction of business owned or rented by the partnership outside Massachusetts. A buyer for this item includes the U.S. Government.

Sales of tangible personal property are **not** assignable to Massachusetts if:

- The property is shipped or delivered to a buyer in a foreign country; or
- The property is sold to any branch or instrumentality of the U.S. Government for resale to a foreign government.

**28b.** Sales of services, or other intangibles, are assigned to Massachusetts if the income-producing activity is performed in Massachusetts, or if the greater portion of the activity occurs in Massachusetts than in any other state based on performance cost.

**28c.** Rents from property located or used in Massachusetts are assigned to Massachusetts. Royalties are assigned to the state in which the property right is actually used by the lessee.

### **Line 30. Massachusetts Apportionment Percentage**

Any apportionment factor should not necessarily be considered in-applicable if its Massachusetts total (column A, lines 26c, 27a or 28e) is zero. If any of the apportionment totals for “Everywhere” (column B, lines 26c, 27a or 28e) are less than 3.33% of taxable net income, **do not** include that factor in your Massachusetts apportionment percentage.

Divide the total apportionment percentage in line 29 by either 3, 2 or 1, depending on the number of apportionment factors which apply. For example, if only the sales and payroll factors are applicable, divide by 2 instead of 3.

### **Lines 31 through 35. Resident and Nonresident Reconciliation**

The Massachusetts apportionment percentage (line 30) is applied only to the nonresident partners' share of each major income item. The total resident partners' shares are then added to reach the total amount of resident and nonresident partners' income attributable to Massachusetts. Finally, the corporate partners' share of each major income item is reported.

When completing line 32 exclude any income from unrelated business activities prior to apportionment, see 830 CMR 63.38.1, sections (3) and (4). Attach a statement and explain any adjustments.

## **Schedule 3K-1. Partner's Massachusetts Information**

### **Partner's Distributive Share**

A partner's distributive share of any item of income, loss, deduction or credit shall be determined by the partnership agreement. If the partnership agreement contains no special provisions with respect to the partner's distributive share of any item of income, loss, deduction or credit, such item shall be prorated in accordance with each partner's ratio of sharing income or losses of the partnership.

**a.** For a corporate partner skip to line 22.

**b.** For a nonresident partner eligible to apportion, enter in column B, lines 1 through 8 and 10 through 21, the amount of the partner's share of each applicable distributive share item multiplied by the apportionment percentage in Form 3, line 30.

Income should be apportioned if:

- There is one or more nonresident individual partners **and**;
- There is any income from business activity or ownership of any interest in real or tangible property in another state **and**;
- Such business activities provide the other state the jurisdiction to levy any income or franchise tax.

**Note:** For line 9, however, enter in column B the amount of the nonresident partner's distributive share without apportionment. For line 2, see instructions.

**c.** For all other partners, enter in column B, lines 1 through 21, the amount of the partner's share of each applicable distributive share item.

**d.** For lines 18 through 20 the partnership may provide each partner with a written breakdown of long-term capital gains and losses by the applicable holding periods of: more than one year but not more than two years; more than two years but not more than three years, more than three years but not more than four years; more than four years but not more than five years; more than five years but not more than six years; and more than six years.

**e.** A common trust fund under IRC Section 584 which has long-term capital gains and long-term capital losses must adjust the amount of capital gain reported to the partners.

First, gains and losses within each holding period are netted. For example, 5% gains are applied against 5% losses, 4% gains are applied against 4% losses, 3% gains are applied against 3% losses, 2% gains are applied against 2% losses, 1% gains are applied against 1% losses and 0% gains are applied against 0% losses. Then, any net losses within a particular holding period can be applied against net gains within other holding periods, beginning with the highest tax rate and applying any remaining losses against the next highest tax rate. For example, a 3% loss is first applied to 5% gains, any remaining loss is applied to 4% gains, any remaining loss is applied against 2% gains, any remaining loss then is applied against 1% gains, and any loss still remaining then is applied against 0% gains.

The excess, if any, of each class's net capital loss, reduced by any amount of such capital loss applied against other classes' net capital gain, shall be that class's capital loss in the succeeding taxable year.

Certain long-term capital losses may now be applied against short-term capital gains and then against interest (other than from Massachusetts banks) and dividend income.

Certain short-term capital losses may now be applied against long-term capital gains. This application is from the highest tax rate to the lowest. Unused losses can be carried forward as short-term losses in the succeeding tax year.

### **Line 1. Massachusetts Ordinary Income or Loss**

Enter the amount of the partner's share of the partnership's Massachusetts ordinary income or loss from Form 3, line 8. For a nonresident partner eligible to apportion, enter the amount of the partner's share of the partnership's Massachusetts ordinary income or loss multiplied by the apportionment percentage in Form 3, line 30.

### **Line 2. Guaranteed Payments to Partners (Deductible and Capitalized)**

Enter the guaranteed payments to each partner from U.S. Form 1065, Schedule K, line 5. For a nonresident partner eligible to apportion, if the payments are for services, the partnership should not apportion using the partnership's apportionment percentage, but should report payments related to services performed in Massachusetts. If the payments are not for services, use the partnership's Massachusetts apportionment percentage.

### **Line 3. Separately Stated Deductions**

Report and describe in line 3 any other expense that is deductible from income taxed at 5.6% and properly reportable on Massachusetts Forms 1 or 1-NR/PY, Part II; or Forms 2 or 3F, and that is not reported elsewhere on Schedule 3K-1. Examples of such deductions include charitable contributions, oil and gas depletion and the expense deduction for recovery property, IRC Section 179. An estate or trust may not elect to expense recovery property.

#### **Line 4. Total of Lines 1, 2 and 3**

Combine the amounts in lines 1, 2 and 3. The line 4 result includes each partner's share of the partnership's Massachusetts ordinary income and any guaranteed payments to the partner (deductible and capitalized).

The correct Massachusetts amount of the partner's share of ordinary income and guaranteed payments may differ from the comparable U.S. total reported on the partner's Form 1 or 1-NR/PY, Schedule E, Part II, line 1; Form 2, line 17; or Form 3F. Each partner should make adjustments in Form 1 or 1-NR/PY, Schedule E, Part II, line 2 and line 4, if applicable; Form 2, line 17; or Form 3F, to reflect the correct Massachusetts amount. Each partner should attach a statement with the partner's Massachusetts tax return and explain.

The partnership should provide each partner with the amount of the partner's share of any interest (other than interest from Massachusetts banks) and dividend income and 5.6% interest from Massachusetts banks included in line 4. Each partner should use these amounts to complete Form 1 or 1-NR/PY, Schedule E, Part II, lines 6 and 7; Form 2; or Form 3F.

#### **Line 5. Credits**

##### **Income Tax Paid to Other Jurisdictions**

Enter the partner's share of any tax due from the partnership to any other state, territory or possession of the United States, or the Dominion of Canada or any of its provinces on income taxable to the partner in Massachusetts and otherwise allowable as a credit to the individual. The partnership should also provide each such partner with the names of each taxing jurisdiction and the amount taxed.

This credit is available only to resident partners and may be taken on Form 1, line 29, Form 1-NY/PY, line 34 or where applicable, on Form 2, line 43. Where the credit is available, the partnership must also provide each resident partner with separately stated totals of 5.6%, 12%, 5, 4%, 3%, 2% and 1% income taxed by other jurisdictions to enable the partners to complete Schedule F.

**Note:** The amount in line 5 is **not** simply the partner's share of the amount reported on Form 3, line 3, because the credit for taxes paid to other jurisdictions does not include local income taxes paid or taxes paid to nations other than Canada.

##### **Lead Paint Credit**

Enter the partner's share of any credit due to the partnership for expenses incurred by the partnership for covering or removing lead paint on residential premises in Massachusetts. The partnership must provide each partner with a copy of a "Letter of Compliance" or a "Letter of Interim Control" issued by a licensed inspector.

##### **Economic Opportunity Area Credit**

Enter the partner's share of any Economic Opportunity Area Credit for qualifying property used in a Certified Project. Enter each partner's share of the credit, according to the partner's ownership share in line 5 of each partner's Schedule 3K-1.

This amount should then be used by each partner to complete Schedule EOA.

##### **Full Employment Credit**

Enter the partner's share of any Full Employment Credit, according to the partner's ownership share in line 5 of each partner's Schedule 3K-1.

This amount should then be used by each partner to complete Schedule FEC.

#### **Brownfields Credit**

Enter the partner's share of any Brownfields Credit, according to the partner's ownership share in line 5 of each partner's Schedule 3K-1.

This amount should then be used by each partner to complete Schedule BC.

#### **Low-Income Housing Credit**

See the Major Tax Law Changes for 2001 section on page 2 of the instructions for information on this credit.

Enter the partner's share of any Low-Income Housing Credit, according to the partner's ownership share in line 5 of each partner's Schedule 3K-1. A copy of the Eligibility Statement issued by the Department of Housing and Community Development must be attached to each partner's Schedule 3K-1.

This amount should then be used by each partner to complete their return.

For further information regarding this credit, contact the Department of Housing and Community Development, Division of Private Housing, at (617) 727-7827.

#### **Credit Recapture**

If the partnership is required to recapture any Economic Opportunity Area Credit or Brownfields Credit, enter the partner's share of any recapture as computed on Schedule H-2. This amount should then be used by each partner to complete their return.

#### **Line 6. Net Income or Loss from Rental Real Estate Activity(ies)**

Enter the partner's share of the partnership's net rental income or loss from real estate activity(ies) from Form 3, line 9.

The correct Massachusetts amount of the partner's share of net income or loss from rental real estate activity(ies) may differ from the comparable U.S. total reported on the partner's Form 1 or 1-NR/PY, Schedule E, Part II, line 1; Form 2, Schedule E, line 1; or Form 3F. Each partner should make adjustments in Form 1 or 1-NR/PY, Schedule E, Part II, line 2; Form 2, Schedule E, line 2; or Form 3F, to reflect the correct Massachusetts amount. Each partner should attach a statement with the partner's Massachusetts tax return and explain.

#### **Line 7. Net Income or Loss from Other Rental Activity(ies)**

Enter the partner's share of the partnership's net rental income or loss from other activity(ies) from Form 3, line 10.

The correct Massachusetts amount of the partner's share of net rental income or loss from other activity(ies) may differ from the comparable U.S. total reported on the partner's Form 1 or 1-NR/PY, Schedule E, Part II, line 1; Form 2, line 17; or Form 3F. Each partner should make adjustments in Form 1 or 1-NR/PY, Schedule E, Part II, line 2; Form 2, line 17; or Form 3F, to reflect the correct Massachusetts amount. Each partner should attach a statement with the partner's Massachusetts tax return and explain.

#### **Line 8. 5.6% Interest from Massachusetts Banks**

Enter the partner's share of the partnership's 5.6% interest from Massachusetts banks from Form 3, line 13. For a nonresident partner eligible to apportion, enter the partner's share of the partnership's 5.6% interest from Massachusetts banks multiplied by the apportionment percentage in Form 3, line 30.

Each partner should include the line 8 total in Form 1, line 5; Form 1-NR/PY, line 7; Form 2, line 16 or Form 3F.

Each nonresident partner whose income is apportioned should receive from the partnership the amount of the partner's pre-apportionment share of 5.6% interest from Massachusetts banks. Each nonresident individual whose income is apportioned should include this amount in Form 1-NR/PY, Schedule B, line 5. This amount should be used instead of any amount from Form 1-NR/PY, line 7 because the partner's full distributive share of such income is included in the U.S. amount reported in Schedule B, line 1. Each nonresident trust or estate whose income is apportioned should include its pre-apportionment share of 5.6% interest from Massachusetts banks in Form 2, Schedule B, line 6, instead of any amount from Form 2, line 16.

### **Line 9. Interest on U.S. Debt Obligations**

Enter the partner's share of the partnership's interest on U.S. debt obligations from Form 3, line 12. For a nonresident partner eligible to apportion, enter the partner's share **without** apportionment. This income is taxable by the federal government, but tax-exempt in Massachusetts.

Each partner should include the line 9 total in Form 1 or 1-NR/PY, Schedule B, line 6; Form 2, Schedule B, line 5; or Form 3F, Schedule B, line 7.

### **Line 10. Non-Massachusetts State and Municipal Bond Interest**

Enter the partner's share of the partnership's non-Massachusetts state and municipal bond interest from Form 3, line 15. For a nonresident partner eligible to apportion, enter the partner's distributive share of the partnership's non-Massachusetts state and municipal bond interest multiplied by the apportionment percentage in Form 3, line 30. This income is not taxed by the federal government, but is taxable in Massachusetts.

Each partner should include the line 10 total in Form 1, 1-NR/PY, 2 or 3F, Schedule B, line 3.

### **Line 11. Interest and Dividend Income**

Enter the partner's share of the partnership's interest (other than interest from Massachusetts banks) and dividend income from Form 3, line 14. For a nonresident partner eligible to apportion, enter the partner's distributive share of the partnership's interest (other than interest from Massachusetts banks) and dividend income multiplied by the apportionment percentage in Form 3, line 30.

The correct Massachusetts amount of the partner's share of interest (other than interest from Massachusetts banks) and dividend income may differ from the comparable U.S. total reported on the partner's Form 1, 1-NR/PY or 2, Schedule B, lines 1 and 2; or Form 3F. Each partner should make adjustments in Form 1 or 1-NR/PY, Schedule B, line 6; Form 2, Schedule B, line 8; or Form 3F, Schedule B, line 7 to reflect the correct Massachusetts amount. Each partner should attach a statement with the partner's Massachusetts tax return and explain.

### **Line 12. Royalty Income**

Enter the partner's share of the partnership's royalty income from Form 3, line 16.

For a nonresident partner eligible to apportion, enter the partner's distributive share of the partnership's royalty income from Form 3, line 16 multiplied by the apportionment percentage in Form 3, line 30.

The correct Massachusetts amount of the partner's share of royalty income may differ from the comparable U.S. total reported on Form 1 or 1-NR/PY, Schedule E, Part I, line 1a; Form 2, Schedule E, line

1a; or Form 3F. Each partner should make adjustments in Form 1, 1-NR/PY, Schedule E, Part I, line 2; or Form 2, Schedule E, line 2; or Form 3F, to reflect the correct Massachusetts amount. Each partner should attach a statement with the partner's Massachusetts tax return and explain.

### **Line 13. Other Income**

Enter the partner's share of the partnership's other income from Form 3, line 17. For a nonresident partner eligible to apportion, enter the partner's distributive share of the partnership's other income from Form 3, line 17 multiplied by the apportionment percentage in Form 3, line 30.

The correct Massachusetts amount of the partner's share of other income may differ from the comparable U.S. total reported on Form 1, 1-NR/PY, 2 or 3F. Each partner should make adjustments on the applicable lines of Form 1, 1-NR/PY, 2 or 3F, to reflect the correct Massachusetts amount. If any income reported to the partnership from a Real Estate Mortgage Investment Conduit (REMIC), in which the partnership is a residual interest holder, is reported in line 17, then any such adjustment should be made on Form 1 or 1-NR/PY, Schedule E, Part I, line 1b or Form 2, Schedule E, line 1b.

### **Line 14. Short-Term Capital Gains**

Enter the partner's share of the partnership's short-term capital gain from Form 3, line 18. For a nonresident partner eligible to apportion, enter the partner's share of the partnership's short-term capital gain multiplied by the apportionment percentage in Form 3, line 30.

The correct Massachusetts amount of the partner's share of short-term capital gain may differ from the comparable U.S. total reported on your Form 1, 1-NR/PY, 2 or 3F, Schedule B. Each partner should make adjustments in Form 1 or 1-NR/PY, Schedule B, line 8, or Form 2, Schedule B, line 11 or Form 3F, Schedule B, line 10, to reflect the correct Massachusetts amount. Each partner should attach a statement with the partner's Massachusetts tax return and explain any adjustments.

### **Line 15. Short-Term Capital Losses**

Enter the partner's share of the partnership's short-term capital loss from Form 3, line 19. For a nonresident partner eligible to apportion, enter the partner's share of the partnership's short-term capital loss multiplied by the apportionment percentage in Form 3, line 30.

The correct Massachusetts amount of the partner's share of short-term capital loss may differ from the comparable U.S. total reported on your Form 1, 1-NR/PY, 2 or Form 3F, Schedule B. Each partner should make adjustments in Form 1 or 1-NR/PY, Schedule B, line 14, or Form 2, Schedule B, line 17 or Form 3F, Schedule B, line 16, to reflect the correct Massachusetts amount. Each partner should attach a statement with the partner's Massachusetts tax return and explain any adjustments.

### **Line 16. Gain on the Sale, Exchange or Involuntary Conversion of Property Used in a Trade or Business and Held for One Year or Less**

Enter the partner's share of the partnership's gain on the sale, exchange or involuntary conversion of property used in a trade or business and held for one year or less from Form 3, line 20. For a nonresident partner eligible to apportion, enter the partner's share of the partnership's gain on the sale, exchange or involuntary conversion of property used in a trade or business and held for one year or less multiplied by the apportionment percentage in Form 3, line 30.

The correct Massachusetts amount of the partner's share of gain on the sale, exchange or involuntary conversion of property used in a trade or business and held for one year or less may differ from the comparable U.S. total reported on your Form 1, 1-NR/PY, 2 or 3F, Schedule B. Each partner should make adjustments in Form 1 or 1-NR/PY, Schedule B, line 10, or Form 2, Schedule B, line 13 or Form 3F, Schedule B, line 12, to reflect the correct Massachusetts amount. Each partner should attach a statement with the partner's Massachusetts tax return and explain any adjustments.

**Line 17. Loss on the Sale, Exchange or Involuntary Conversion of Property Used in a Trade or Business and Held for One Year or Less**

Enter the partner's share of the partnership's loss on the sale, exchange or involuntary conversion of property used in a trade or business and held for one year or less from Form 3, line 21. For a nonresident partner eligible to apportion, enter the partner's share of the partnership's loss on the sale, exchange or involuntary conversion of property used in a trade or business and held for one year or less multiplied by the apportionment percentage in Form 3, line 30.

The correct Massachusetts amount of the partner's share of loss on the sale, exchange or involuntary conversion of property used in a trade or business and held for one year or less may differ from the comparable U.S. total reported on your Form 1, 1-NR/PY, 2 or 3F, Schedule B. Each partner should make adjustments in Form 1 or 1-NR/PY, Schedule B, line 15, or Form 2, Schedule B, line 18 or Form 3F, Schedule B, line 17, to reflect the correct Massachusetts amount. Each partner should attach a statement with the partner's Massachusetts tax return and explain any adjustments.

**Line 18. Long-Term Capital Gain or Loss**

Enter the partner's share of the partnership's long-term capital gain or loss from Form 3, line 22. For a nonresident partner eligible to apportion, enter the partner's share of the partnership's long-term capital gain or loss multiplied by the apportionment percentage in Form 3, line 30.

The correct Massachusetts amount of the partner's share of long-term capital gain or loss may differ from the comparable U.S. total reported on your Form 1, 1-NR/PY, 2 or 3F, Schedule D. Each partner should make adjustments in Form 1 or 1-NR/PY, Schedule D, line 9, or Form 2, Schedule D, line 11 or Form 3F, Schedule D, line 6, to reflect the correct Massachusetts amount. Each partner should attach a statement with the partner's Massachusetts tax return and explain any adjustments.

**Line 19. Long-Term Section 1231 Gains or Losses**

Enter the partner's share of the partnership's long-term section 1231 gain or loss (not included in line 18) from Form 3, line 23. For a nonresident partner eligible to apportion, enter the partner's share of the partnership's long-term Section 1231 gain or loss multiplied by the apportionment percentage in Form 3, line 30.

The correct Massachusetts amount of the partner's share of long-term Section 1231 gain or loss may differ from the comparable U.S. total reported on your Form 1, 1-NR/PY, 2 or 3F, Schedule D. Each partner should make adjustments in Form 1 or 1-NR/PY, Schedule D, line 9, or Form 2, Schedule D, line 11 or Form 3F, Schedule D, line 6, to reflect the correct Massachusetts amount. Each partner should attach a statement with the partner's Massachusetts tax return and explain any adjustments.

**Line 20. Long-Term Gains on Collectibles and Pre-1996 Installment Sales**

Enter the partner's share of the partnership's long-term gains on collectibles and pre-1996 installment sales classified as capital gains for Massachusetts purposes from Form 3, line 24. For a nonresident partner eligible to apportion, enter the partner's share of the partnership's long-term gains on collectibles and pre-1996 installment sales multiplied by the apportionment percentage in Form 3, line 30.

The correct Massachusetts amount of the partner's share of long-term gains on collectibles and pre-1996 installment sales may differ from the comparable U.S. total reported on your Form 1, 1-NR/PY, 2 or 3F, Schedule D. Each partner should make adjustments in Form 1 or 1-NR/PY, Schedule D, line 9, or Form 2, Schedule D, line 11 or Form 3F, Schedule D, line 6. Each partner should report the correct Massachusetts amount in Form 1 or 1-NR/PY, Schedule D, line 11; Form 2, Schedule D, line 13 or Form 3F, Schedule D, line 8. Each partner should attach a statement with the partner's Massachusetts tax return and explain any adjustments.

**Corporate Partner Information  
For Corporate Partner Only**

Complete lines 22 through 24 for corporate partners only. For **all other** partners, **skip** to line 25. Lines 22 through 24 isolate income and deduction items where there are differences between Massachusetts and federal tax treatment. The information provided in lines 22 through 24 should be used by each corporate partner to complete Schedule E of the appropriate corporate return, supplementing other information on the corporate partner that is derived from U.S. Forms 1065 and 1120.

Provide each corporate partner with the apportionment factors in Form 3, lines 26 through 28 to assist each corporate partner in completing Schedule F of the appropriate corporate return. A corporate partner's distributive share of any item of income, loss, deduction or credit is determined by the partnership agreement. If the partnership agreement contains no provision with respect to the partner's distributive share of any item of income, loss, deduction or credit, such item shall be prorated in accordance with each partner's ratio of sharing income or losses of the partnership.

**Line 22. State and Municipal Bond Interest**

Enter the corporate partner's share of the partnership's state and municipal bond interest. This income is not reported in U.S. net income, but **is** taxable in Massachusetts. Each corporate partner should include the line 22 total in Form 355, 355C or 355S, Schedule E.

**Line 23. Foreign, State or Local Income, Franchise, Excise or Capital Stock Taxes**

Enter the corporate partner's share of the partnership's foreign, state or local income, franchise, excise or capital stock taxes. These taxes are deducted from U.S. net income, but not deductible in Massachusetts. Each corporate partner should include the amount in line 23 on Form 355, 355C or 355S, Schedule E.

**Line 24. Other Adjustments**

Enter each corporate partner's share of any other adjustments to Massachusetts partnership income that reflect differences between Massachusetts and federal tax treatment of corporate partner income and deductions. The partnership should also provide each corporate partner with the amount of the partner's share of the costs of renovating a qualifying abandoned building. Each corporate partner should use the line 24 amount in Form 355, 355C or 355S, Schedule E, line 8 and Schedule E, if applicable.

## **Reconciliation of Partner's Capital Account**

### **Lines 25 through 29. Reconciliation of Partner's Capital Account**

Lines 25 through 29 must be completed for each partner.

#### **Line 25. Balance at the Beginning of Year**

Enter each partner's capital amount at the beginning of the year.

#### **Line 26. Net Income for the Year**

Line 26a must include all income subject to taxation to resident and nonresident partners. Line 26b must include all line 26 income plus all income not subject to taxation and must reflect unallowable deductions.

#### **Line 29. Balance at the End of Year**

Enter the sum of lines 25, 26b and 27 less the amount in line 28.

## **Where to Get Forms and Publications**

To obtain Massachusetts forms and publications by phone, call the Department's main information lines at (617) 887-MDOR, or toll-free in Massachusetts at 1-800-392-6089. Please note that many forms and publications are available 24 hours a day by calling the Department's automated forms request system at the numbers listed above.

Many Massachusetts tax forms and publications are available via the Internet. The address for DOR's website is [www.mass.gov/dor](http://www.mass.gov/dor).

Certain forms and publications can be obtained through DOR's Fax on Demand system. For a complete Fax on Demand menu, please dial (617) 887-1900 using the handset and the keypad on your fax machine.

## **For General Tax Information**

Please call (617) 887-MDOR or toll-free in Mass. at 1-800-392-6089.

**For help in one of the following specific areas, please call the number listed below:**

- Certificates of Good Standing (617) 887-6550
- Installment sales (617) 887-6950
- Small Business Workshop (617) 887-6400
- Teletype (TTY): (617) 887-6140
- Vision-impaired taxpayers are welcome to make an appointment at any DOR office listed on this page to receive assistance in preparing their tax forms.

To report allegations of suspected misconduct or impropriety involving Department of Revenue employees, please call the Inspectional Services Division's Integrity Hot Line at 1-800-568-0085 or write to PO Box 9480, Boston, MA 02205-9480.

## **DOR Locations in Massachusetts**

19 Staniford Street

**Boston** 02204

(617) 887-MDOR

218 South Main Street

**Fall River** 02721

(508) 678-2844

1019 Iyanough Road

**Hyannis** 02601

(508) 771-2414

333 East Street

**Pittsfield** 01201

(413) 499-2206

436 Dwight Street

**Springfield** 01103

(413) 784-1000

40 Southbridge Street

**Worcester** 01608

(508) 792-7300

## **DOR Locations throughout the Country**

1355 Peachtree Street, NE

Suite 1280

**Atlanta, GA** 30309

(404) 874-2922

101 South First Street

4th Floor

**Burbank, CA** 91502

(818) 840-9059

150 North Michigan Avenue

Suite 2035

**Chicago, IL** 60601

(312) 899-9040

2603 Augusta Drive

Suite 1075

**Houston, TX** 77057

(713) 784-7225

1440 Broadway, 22nd floor

**New York, NY** 10018

(212) 768-2750

355 Fifth Avenue

Suite 1400

**Pittsburgh, PA** 15222

(412) 281-2776

# Contents

---

<b>General Instructions</b>	2
What Are the Major Tax Changes for 2001?	2
When Must a Partnership File a Return?	3
How Is a Partnership Taxed?	3
How Does Schedule 3K-1 Work?	3
Can Schedule 3K-1 Be Filed in an Alternative Format?	3
How Does Each Partner Report Partnership Income?	3
What Is Massachusetts Gross Income?	3
Are There Differences Between Massachusetts Tax Law and the Internal Revenue Code Provisions Affecting Partnerships?	4
When and Where Must a Partnership Return Be Filed?	4
What Is the Penalty for Filing a Late Return?	4
<b>Specific Instructions</b>	5
Electing Large Partnerships	5
Part II. Partnership Income	5
Massachusetts Ordinary Income or Loss	5
U.S. Portfolio Income	5
Massachusetts Capital Gains and Losses	6
Part III. Income Apportionment	6
Schedule 3K-1. Partner's Massachusetts Information	7
Partner's Distributive Share	7
Corporate Partner Information	10
Reconciliation of Partner's Capital Account	11

---

## Dear Taxpayer,

The Massachusetts Department of Revenue's website, [www.mass.gov/dor](http://www.mass.gov/dor) is a comprehensive resource, providing businesses with the information needed to meet their tax obligations and other business requirements, 24 hours a day, seven days a week.

At [www.mass.gov/dor](http://www.mass.gov/dor), business owners can register as employers or vendors (or update their records with DOR), report newly hired employees, file meals and room occupancy taxes and make corporate quarterly income tax payments online. Businesses will also find fill-in tax forms where information can be entered online and then printed out for filing, and free software for filing and paying withholding, sales and use taxes via personal computer. Also available are Massachusetts tax forms, helpful publications, and links to unemployment insurance, workers' compensation, and other business-related information.

The site also provides information on the Department's Small Business Workshops. Offered regularly at various locations across the Commonwealth, these free workshops cover numerous topics of importance to new businesses, including registration, income tax withholding, estimated taxes, filing deadlines, sales, use and meals taxes, new hire reporting, certificates and exemptions.

For further information, please visit [www.mass.gov/dor](http://www.mass.gov/dor) or call the Department's Customer Service Bureau at (617) 887-MDOR or toll-free in Massachusetts at (800) 392-6089.

Sincerely,



Bernard F. Crowley, Jr.  
Acting Commissioner