

## Waveland Schedule K-1 Tax Guide For Individual Taxpayers

### 2011 Schedule K-1 (Form 1065)

The purpose of this guide is to explain where various items from the investor Form K-1 should be reported on an individual tax return.

**The following is provided for general information and is not intended to be, nor should it be considered tax advice. Federal and state tax laws related to partnership tax reporting are extremely complex and are subject to interpretation by tax professionals. Before preparing any tax filing we recommend that you consult your tax advisor or refer to the appropriate federal and state tax laws.**

### Income and Deductions Reported on Schedule K-1 (Limited partner or other LLC member)

**Investor invests as an investor limited partner and the investment is considered a passive activity. Portfolio income (interest, royalties etc.) is not considered passive income and reported separately. The forms referenced here are for those filing individual Federal returns; all other taxpayers including trusts corporations and LLC's need to consult your tax advisor for the proper tax reporting forms.**

| Line (Box) # | Line Description  | Reported on Individual Return  |
|--------------|---|--|
|              | <b>Income and Expense Items</b>   |  |
| 1            | Ordinary business income (loss)<br><b>Note 1</b>  | Form 8582 to determine any passive loss limitations; Sch. E, p.2, Part II, line 28, col. (f) if loss or col. (g) if income <b>Note 2</b> |
| 5            | Interest income   | Schedule B   |
| 10           | Net section 1231 gain (loss)  | From 4797, Part 1 and then to Sch. D, p.1, Part II, line 11  |
| 13 J         | Intangible drilling costs, Section 59 (e)(2) expenditures <b>Note 3</b>   | Sched. E, p.2, Part II, line 28, cols. (f) through (g) <b>Note 2</b>   |
| 20 T         | References attached statement that contains cost depletion and allowable depletion by property<br><b>Note 4</b> | Sched. E, p.2, Part II, line 28, cols. (f) through (g) <b>Note 2</b>   |

## Other Items Reported on Schedule K-1

| Line (Box) # | Line Description  | Reported on Individual Return                           |
|--------------|---|---|
| 13 U         | Qualified Production Activities income  | Form 8903, consult your tax advisor                     |
| 14 A         | Net earnings (loss) from self-employment  | Form SE <b>Note 5</b>                                   |
| 17 A-F       | Amounts necessary to complete Alternative Minimum Tax (“AMT”) computations on Form 6251 | Form 6251, consult your tax advisor                     |
| 18 A         | Tax exempt interest income  | Check state requirements                                |
| 19 A         | Distributions, cash and marketable securities   | Informational   |
| 20 A         | Investment income   | Form 4952, only if claiming investment interest expense |

**Note 1** For oil and gas activities this line item contains oil and gas revenues, dry hole expenses, production taxes, lease operating expenses including workovers, depreciation, amortization and general and administrative expenses. It does not include interest income, intangible drilling costs, depletion or capital (§1231) gains and losses.

**Note 2** Form 8582 needs to be completed with all passive investments to determine if there is a passive activity loss limitation. If no limitation the amounts can be recorded on the appropriate line on Sch. E, p.2, Part II. If there is a limitation, follow the instructions for Form 8582.

**Note 3** This assumes that each investor deducts their share of intangible drilling costs. However, a taxpayer can elect to capitalize all or a portion of intangible drilling costs (“IDC”) and amortize over 60 months with a properly filed 59(e) election. The portion capitalized and amortized will not be subject to the alternative minimum tax (“AMT”) preference calculation. We would advise consulting your personal tax advisor before making such election.

**Note 4** The investor share of allowable depletion (greater of cost or percentage depletion) is computed at the partnership level without regard to any limitation that may apply to you. However, depletion is subject to certain limitations and we recommend that you consult with your personal tax advisor to determine if any such limitations apply.

**Note 5** The amount for self-employment income reported in box 14 A only applies to investor general partners. Consult your personal tax advisor about including any amounts from 13 J (IDC) as well as depletion in computing total income or (loss) from self-employment as these items have not been accounted for in box 14 A. There would be no self-employment income reported for an investor limited partner or after an investor general partner is converted to an investor limited partner. **There were a number of partnerships in which investor general partners were converted to investor limited partners in 2011. On these partnerships all of the income is considered non-passive, post conversion loss would be considered passive. The portion prior to conversion is included in self employment income. Please see footnotes on your respective K-1 for additional details.**

### **Other Notes**

In addition, certain supporting schedules attached to the K-1 contain certain information referenced above including income (loss) allocation and IDC deductions between states for state tax purposes. Any state tax withholding information is also included.

The K-1 notes also include the investor share of bonus depreciation as this may be treated differently for state income tax reporting.

For those investors with Oklahoma source income a Form 500-B is attached to the K-1 that has the investor share of Oklahoma state tax withheld during 2011.

While no income was derived from Pennsylvania, New Jersey, and New York sources, resident partner presence within these states necessitated a return being filed in accordance with state law. Resident Partners in Pennsylvania, New Jersey, and New York, please note that state adjustments to federal income (i.e. intangible drilling costs and depletion) have not been taken into account in the amounts reported to you in the K-1 notes.