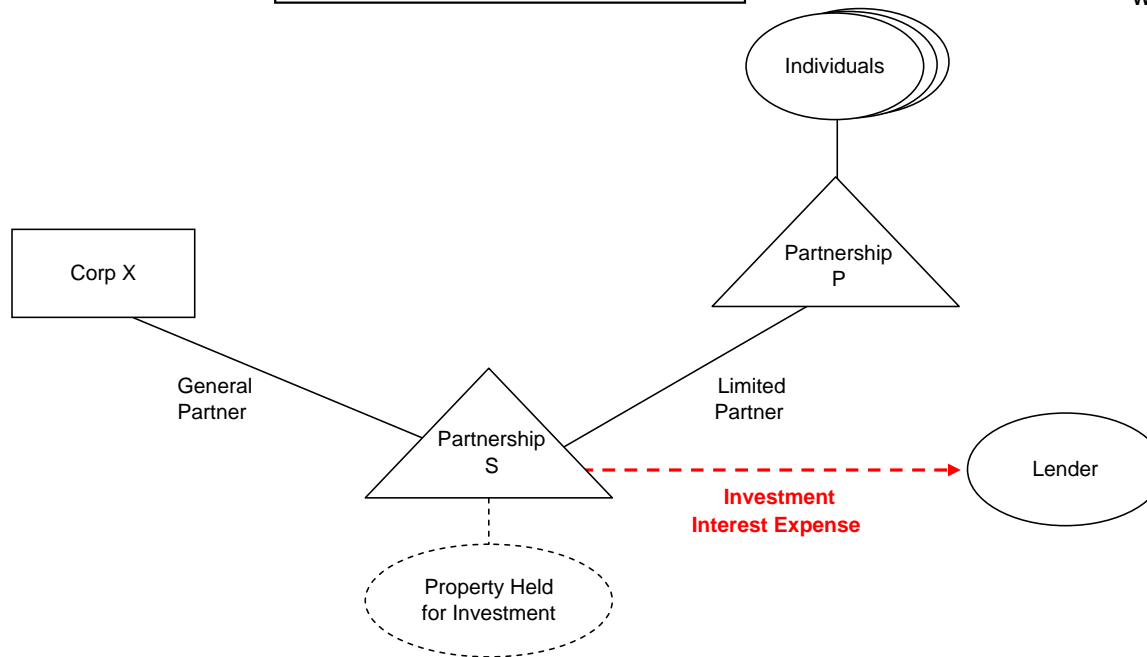


**Separate Statement of Items  
for Tiered Partnerships**



S, a limited partnership, engages in construction activities. X, a corporation, is the sole general partner of S. P, a limited partnership, is the sole limited partner of S. The partners of P are all individuals, S and P are classified as partnerships under section 7701(a)(2). In the taxable year in question, S paid interest expense on indebtedness incurred to purchase property held for investment within the meaning of section 163(d)(3)(D), S did not separately state the investment interest expense or the investment income in informing its partners of their distributive share of income, gain, loss, deduction, or credit on schedule K-1 (Form 1065) (Partner’s Share of Income, Credits, Deductions, etc.) for the taxable year.

The limitation on investment interest expense under section 163(d) does not apply to corporations. Under section 701, a partnership is not subject to the income tax. Because S has only a corporation and a partnership as partners, the tax liability of S’s partners cannot be affected by the section 163(d) limitation. However, P, the limited partner of S, has partners that are individuals. The tax liability of these individual partners of P may be affected by the section 163(d) limitation, and they therefore need a separate statement of their distributive share of investment income and investment interest expenses of S and P. See Rev. Rul. 84-131, 1984-2 C.B. 37. The fact that an item flows through an intermediate partnership does not change the character of the item. Therefore, in order to give effect to section 702(a)(8) and section 1.702-1(a)(8)(ii), S and P must separately state investment interest expense and investment income under section 703 .