

Investment Interest Expense Deduction
▶ Attach to Form N-11, N-15, or N-40

Name(s) as shown on return

Social security number or employer identification number

Part I Total Investment Interest Expense

1	Investment interest expense paid or accrued in 2012. See Instructions	1		
2	Disallowed investment interest expense from 2011 Form N-158, line 7.....	2		
3	Total investment interest expense. Add lines 1 and 2.....	3		

Part II Net Investment Income

4a	Gross income from property held for investment (excluding any net gain from the disposition of property held for investment).....	4a		
b	Net gain from the disposition of property held for investment	4b		
c	Enter the smaller of line 4b or your net capital gain from the disposition of property held for investment.....	4c		
d	Line 4b minus line 4c.....	4d		
e	Enter the amount from line 4c that you elect to include in investment income. See Instructions	4e		
f	Investment income. Add lines 4a, 4d, and 4e.....	4f		
5	Investment expenses. See Instructions	5		
6	Net investment income. Line 4f minus line 5. If zero or less, enter -0-	6		

Part III Investment Interest Expense Deduction

7	Disallowed investment interest expense to be carried forward to 2013. Line 3 minus line 6. If zero or less, enter -0-	7		
8	Investment interest expense deduction. Enter the smaller of line 3 or line 6. See Instructions.....	8		

General Instructions

Section references are to the Internal Revenue Code unless otherwise noted.

Note

Section 265 (with respect to the nondeductibility of expenses and interest relating to tax-exempt income) shall be operative; except that it shall not apply to expenses and interest for royalties and other income derived from any patents, copyrights, and trade secrets by an individual or a qualified high technology business as defined in section 235-7.3, Hawaii Revised Statutes. Such expenses shall be deductible.

Purpose of Form

Interest expense paid by an individual, estate, or a trust on a loan that is allocable to property held for investment (defined below) may not be fully deductible in the current year. Form N-158 is used to figure the amount of investment interest expense deductible for the current year and the amount, if any, to carry forward to future years.

For more information, get federal Publication 550, Investment Income and Expenses.

Who Must File

If you are an individual, estate, or a trust, and you claim a deduction for investment interest expense, you must complete and attach Form N-158 to your tax return, unless **all** of the following apply:

- Your investment interest expense is not more than your investment income from interest and ordinary dividends.
- You have no other deductible investment expenses.
- You have no disallowed investment interest expense from 2011.

Allocation of Interest Expense

If you paid or accrued interest on a loan and used the loan proceeds for more than one purpose, you may have to allocate the interest. This is necessary because different rules apply to investment interest, personal interest, trade or business interest, home mortgage interest, and passive activity interest. See federal Publication 535, Business Expenses.

Specific Instructions

Part I — Total Investment Interest Expense

Line 1

Enter the investment interest paid or accrued during the tax year, regardless of when you incurred the indebtedness. Investment interest is interest paid or accrued on a loan (or part of a loan) that is allocable to property held for investment (as defined later).

Include investment interest expense reported to you on Schedule K-1 from a partnership or an S corporation. Include amortization of bond premium on taxable bonds purchased after October 22, 1986, but before January 1, 1988, unless you elected to offset amortizable bond premium against the interest payments on the bond. A taxable bond is a bond on which the interest is includible in gross income.

Investment interest expense **does not** include the following:

- Home mortgage interest.
- Interest expense that is properly allocable to a

passive activity. Generally, a passive activity is any business activity in which you **do not** materially participate and any rental activity. See the separate instructions for federal Form 8582, Passive Activity Loss Limitations, for more details.

- Any interest expense that is capitalized, such as construction interest subject to section 263A.
- Interest expense related to tax-exempt interest income under section 265.
- Interest expense, disallowed under section 264, on indebtedness with respect to life insurance, endowment, or annuity contracts issued after June 8, 1997, even if the proceeds were used to purchase any property held for investment.

Property Held for Investment. Property held for investment includes property that produces income, **not** derived in the ordinary course of a trade or business, from interest, dividends, annuities, or royalties. It also includes property that produces gain or loss, **not** derived in the ordinary course of a trade or business, from the disposition of property that produces these types of income or is held for investment. However, it does not include an interest in a passive activity.

Exception. A working interest in an oil or gas property that you held directly or through an entity that did **not** limit your liability is property held for investment, but only if you did not materially participate in the activity.

Part II — Net Investment Income

Line 4a

Gross income from property held for investment to be entered on line 4a includes income (unless derived in the ordinary course of a trade or business) from:

- Interest,
- Ordinary dividends (except Alaska Permanent Fund dividends),
- Annuities, and
- Royalties.

Include investment income reported to you on Schedule K-1 from a partnership or an S corporation. Also include net investment income from an estate or a trust.

Also include on line 4a (or 4b, if applicable) net passive income from a passive activity of a publicly traded partnership (as defined in section 469(k)(2)). See Notice 88-75, 1988-2 C.B. 386, for details.

Net income from certain passive activities, such as rental of substantially nondepreciable property, may have to be recharacterized and included on line 4a. See federal Publication 925, Passive Activity and At-Risk Rules, or Regulations section 1.469-2(f)(10) for details.

If you are filing Form N-814, Parents' Election To Report Child's Interest and Dividends, part or all of your child's income may be included on line 4a. See Form N-814 for details.

Caution: Do not include on line 4a any net gain from the disposition of property held for investment. Instead, enter this amount on line 4b.

Line 4b

Net gain from the disposition of property held for investment is the excess, if any, of total gains over total losses from the disposition of property held for investment. When figuring this amount, include capital gain distributions from mutual funds and capital loss carryovers.

Line 4c

Net capital gain from the disposition of property held for investment is the excess, if any, of net long-term capital gain over net short-term capital loss from the disposition of property held for investment. Capital gain distributions from mutual funds are treated as long-term capital gains.

Line 4e

Net capital gain from the disposition of property held for investment is excluded from investment income. However, you may elect to include in investment income all or part of the net capital gain from the disposition of property held for investment.

To make the election, enter on line 4e the amount you elect to include in investment income.

If you make an entry on line 4e and you are using an alternative tax on your capital gains (or Part VI of Schedule D (Form N-40)), you must also reduce the amount of net capital gain eligible for the 7.25% maximum capital gains rate by the amount on this line. Therefore, you should consider the effect on your tax using the maximum capital gains tax rate before making an entry on this line.

Line 5

See **Note** on page 1.

Investment expenses are your allowed deductions, other than interest expense, directly connected with the production of investment income. For example, depreciation or depletion allowed on assets that produce investment income is an investment expense.

Include investment expenses reported to you on Schedule K-1 from a partnership or an S corporation.

Investment expenses **do not** include any deductions taken into account in determining your income or loss from a passive activity.

If you have investment expenses that are included as a miscellaneous itemized deduction on line 23 of the Itemized Deductions Worksheet in the Form N-11 Instructions, on line 26 of the Itemized Deductions Worksheet - For Nonresidents in the Form N-15 Instructions, or on line 47 of the Itemized Deductions Worksheet - For Part-Year Residents in the Form N-15 Instructions, the 2% adjusted gross income limitation on line 26 of the Itemized Deductions Worksheet in the Form N-11 Instructions, on line 30 of the Itemized Deductions Worksheet - For Nonresidents in the Form N-15 Instructions, or on line 55 of the Itemized Deductions Worksheet - For Part-Year Residents in the Form N-15 Instructions may reduce the amount you must include on Form N-158, line 5.

Include on Form N-158, line 5, only the smaller of:

- The investment expenses included on line 23 of the Itemized Deductions Worksheet in the Form N-11 Instructions, on line 26 of the Itemized Deductions Worksheet - For Nonresidents in the Form N-15 Instructions, or on line 47 of the Itemized Deductions Worksheet - For Part-Year Residents in the Form N-15 Instructions, or
- The total on line 27 of the Itemized Deductions Worksheet in the Form N-11 Instructions, on line 31 of the Itemized Deductions Worksheet - For Nonresidents in the Form N-15 Instructions, or on line 56 of the Itemized Deductions Worksheet - For Part-Year Residents in the Form N-15 Instructions

Example. Assume line 23 of the Itemized Deductions Worksheet in the Form N-11 Instructions includes investment expenses of \$3,000, and line 27 of the Itemized Deductions Worksheet is \$1,300 after the 2% adjusted gross income limitation. Investment expenses from the Itemized Deductions Worksheet of \$1,300 are used to figure the amount of investment expenses for line 5. If investment expenses of \$800 were included on line 23 and line 27 of the Itemized Deductions Worksheet was \$1,300, investment expenses from the Itemized Deductions Worksheet of \$800 would be used.

Part III — Investment Interest Expense Deduction

Line 8

You may deduct the amount on line 8 as investment interest expense.

Individuals. Generally, enter the amount from line 8 (excluding any amount included on federal Form 6198, line 4 – see below) on line 14 of the Itemized Deductions Worksheet in the Form N-11 Instructions, on line 15 of the Itemized Deductions Worksheet - For Nonresidents in the Form N-15 Instructions, or on line 23 of the Itemized Deduction Worksheet - For Part-Year Residents in the Form N-15 Instructions, even if all or part of it is attributable to a partnership or an S corporation. However, if any portion of this amount is attributable to royalties, enter that part of the interest expense on federal Schedule E. Also, if any portion is attributable to a trade or business that is not a passive activity, enter that part of the interest expense on the schedule where you report other expenses for that trade or business.

Estates and Trusts. Enter the amount from line 8 (excluding any amount included on federal Form 6198, line 4 – see below) on Form N-40, line 10.

Federal Form 6198. If any portion of the deductible investment interest expense is attributable to an activity for which you are not at risk, you must also use federal Form 6198, At-Risk Limitations, to figure your deductible investment interest expense. Enter the portion attributable to the at-risk activity on federal Form 6198, line 4. See federal Form 6198 and its instructions for more details, especially the instructions for line 4 of that form.