

## 2017 LONE STAR FUNDS – HUDCO INVESTMENTS

### SCHEDULE K-1 FREQUENTLY ASKED QUESTIONS

#### INTRODUCTION

Any advice included in this written communication is not intended or written to be used, and it cannot be used by the taxpayer, for the purpose of avoiding any penalties that may be imposed by any governmental taxing authority or agency.

If you have questions about the information reported, please contact our Tax Department at 214-754-8400, Monday through Friday, 8 AM to 5 PM, Central Time.

The Lone Star Funds, collectively, are privately held partnerships and generally not subject to U.S. federal or state income tax. Instead, each partner is required to report an allocable share of our items of income, gain, loss, deduction or tax credit in the partners' income tax return. We have provided a Schedule K-1 to assist you in reporting your allocable share of partnership items in your U.S. federal income tax return. If you have any questions regarding how this information should be reported in your return, please contact your tax advisor.

#### IMPORTANT NOTICE

**The enclosed information is provided for your general guidance. This information is not intended to be tax advice. The tax information discussed in this attachment and reflected on the schedules provided to you is based on existing U.S. federal and state laws and regulations. Before undertaking any tax filing, we suggest you consult your tax advisor.**

#### FREQUENTLY ASKED QUESTIONS AND ANSWERS

- Q. Why do I receive a Schedule K-1 rather than a Form 1099?
- A. Form 1099 is generally used to report interest and dividend income. Partnerships are required to file a Schedule K-1, which separately reports many different items of income, gain, loss, deduction and credit.
- Q. Are the cash distributions I received from Lone Star Funds taxable?
- A. You are required to report in your tax return only those items of income, gain, loss, deduction or tax credit as reflected on your Schedule K-1. In general, cash distributions received from Lone Star Funds are not taxable. However, if you receive a cash distribution that exceeds your tax basis, you must recognize the excess as additional taxable income.

- Q. Why is the amount of cash I received different than the amount of income I must report on my income tax return?
- A. The amount of your taxable income will not correspond to the amount of cash distributed to you during the year. A portion of cash you receive may be a return of capital. In addition, the Fund may incur taxable income and not distribute cash to investors. The amount you are required to include in your income tax return is your share of income and related items, allocated based on your ownership of the Lone Star Fund in which you owned an interest during 2017 and reported on your Schedule K-1.
- Q. Does the Schedule K-1 show my tax basis in the partnership interest I own?
- A. No. However, the Ending Capital Account amount under Partner's Capital Account Analysis in the Schedule K-1 may provide an approximation of your ending tax basis for all partnership interests owned at December 31, 2017.
- Q. Why does "Capital Contributed during the year" and "Withdrawals & Distributions" on Schedule K-1, Part II, L not match the contribution/distribution notices I have received?
- A. Timing differences may exist between the contribution/distribution notices you have received and Schedule K-1, Part II, L due to the timing of capital calls, if distributions were used to pay the capital calls and if the Hudco has finalized investor ownership percentages.
- Q. If the partnership in which I invest owns an interest in a Real Estate Investment Trust (REIT), what is the source of the REIT distributions included on my Schedule K-1?
- A. The source of these distributions is the sale of REIT shares or distributions of operating earnings or financing proceeds. Any gains reported on Schedule K-1, Line 8 or Line 9a are related to sale of REIT shares.
- Q. Why did I receive a State Allocation and Apportionment Schedule with amounts in both the allocation and apportionment sections?
- A. States do not all use the same methodology to determine state taxable income. We provide both allocation and apportionment amounts so that you have sufficient information to compute your state taxable income.

- Q. Why did I receive a footnote with the information necessary to file a Form 8621 Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund?
- A. Form 8621 elections allow a U.S. investor to include their pro rata share of a lower tier foreign entity's capital gain in their income this year. Without this election, the amounts would be reported as ordinary dividend income. Although your Schedule K-1s have been prepared as if the elections have been made, you will need to file the elections with your tax return.
- Q. Is Lone Star Funds subject to the Tax Shelter Regulations?
- A. Yes. Lone Star Funds is subject to the rules regarding reportable transactions under the Tax Shelter Regulations. If the Fund in which you invest participated in a reportable transaction, such as a currency translation loss, and certain ownership thresholds are met, you will be provided with a footnote with the information necessary to file a Form 8886. Partners should consult their tax advisors concerning any possible disclosure obligation with respect to their interest in Lone Star Funds.
- Q. Why did I receive a footnote with the information necessary to file a Form 926 Return by a U.S. Transferor of Property to a Foreign Corporation?
- A. Form 926 is generally used by a United States person to report contributions to a foreign corporation that exceed \$100,000, or if their direct or indirect ownership in the foreign corporation exceeds certain thresholds.
- Q. Why did I receive a footnote with information necessary to file a Form 8938 Statement of Specified Foreign Financial Assets?
- A. Form 8938 is the form on which U.S. taxpayers must report their ownership in specified foreign financial assets if the total interest in the foreign financial assets exceeds specified thresholds. Your interest in a foreign domiciled Hudco is a foreign financial asset which must be disclosed on Form 8938.
- Q. Are any amounts reported on my Schedule K-1 subject to the net investment income tax?
- A. Form 8960 is the form on which U.S. individuals, estates and trusts report net investment income tax. You should consult your tax advisor regarding whether amounts reported on your Schedule K-1 are subject to net investment income tax.

- Q. Why did I receive a Form 1042-S Foreign Person's U.S. Source Income subject to Withholding?
- A. U.S. Internal Revenue Service regulations require the partnership in which you invest to report on certain types of income earned from U.S. sources, such as dividends and interest paid from U.S. payors. Form 1042-S is prepared and filed with the U.S. Internal Revenue Service. The partnership is required to furnish you with a copy of Form 1042-S, evidencing the amount of tax withheld, if any, on your behalf. You are being furnished a Form 1042-S for all of your U.S. source dividends and interest. If you file a U.S. tax return you should attach a copy of Form 1042-S to your tax return.
- Q. Why is the Debt Service Footnote included in the partner footnotes section?
- A. The interest expense amount reported in the Debt Service Footnote does not represent interest expense incurred by the partnership in which you invest. This amount represents interest that you paid during the tax year on your debt to facilitate your investment in the Hudco partnership.
- Q. Why did I receive a FinCEN Report 114 – Report of Foreign Bank and Financial Accounts Template?
- A. Certain U.S. persons who have signature authority over any financial accounts in a foreign country are required to file the FinCEN Report 114. We have provided you with information for all Lone Star and/or Hudson accounts in which you have signature authority. The report must be electronically filed through the Financial Crimes Enforcement Network's BSA E-Filing System. The report must be received on or before April 15. Filers that do not meet the April 15 filing deadline are granted an automatic extension until October 15.
- Q. What should I do if the ownership, address, or other partner identifying information on my Schedule K-1 is incorrect?
- A. Corrections may be made by writing to us at the below listed email address. After receiving the corrections, we will update our records for future Schedule K-1s.

[PartnerReporting@Hudson-Advisors.com](mailto:PartnerReporting@Hudson-Advisors.com)

**IMPORTANT NOTICE:** The information in the enclosed tax package is provided by the Partnership to assist you in preparing your personal tax return. The information reflects the application of various assumptions and conventions, as disclosed by the Partnership. It is anticipated that the Partnership may provide disclosures of certain of these assumptions and conventions in the preparation of the Partnership return as warranted to the Internal Revenue Service and/or other taxing authorities. We suggest that you refer to the appropriate federal and state income tax laws and instructions, and that you consult your tax advisor with any questions. You should discuss with your tax advisor whether the treatment of any items in the enclosed tax package may subject you and/or your tax advisor to a penalty imposed by a taxing authority and the need to adequately disclose any items in order to avoid such penalty.