



# Sunrise Series

Reviewing Your K-1  
Draft Package

January 14, 2020

# Notice

The following information is not intended to be “written advice concerning one or more Federal tax matters” subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

# Agenda

- 2019 Changes to Form 1065 & Schedule K-1
- Tax Reform: Year Two Considerations
- Current Developments & Items on the Horizon



# 2019 Changes to Form 1065 & Schedule K-1



# Form 1065

2019 Changes to Form 1065 & Schedule K-1

# Updated Form 1065 & Schedule K-1

**On December 26, the IRS released the final version of Form 1065, Schedule K-1, and related instructions for the 2019 tax year**

- Form 1065 draft was released on September 30
- Various drafts of Schedule K-1 were released on: September 30, October 18, November 8, and December 9
- Draft instructions were released for the Form 1065 on October 29 and the draft Schedule K-1 instructions were released the following day. These draft instructions were updated a few times prior to finalization at the end of December.

# Overview of Key Changes

**The draft forms and instructions outlined a number of key changes to the Form 1065 and Schedule K-1 that may require significant work to prepare for the next filing season:**

- Required use of tax basis capital for the capital account schedule on Schedule K-1 for partnerships
- Disclosure of additional information related to section 704(c) amounts of the partnership
- Disclosures of additional information related to section 743(b) basis adjustments and current year income, gain, loss, and deduction
- Guaranteed payments will have to be separately presented as either a guaranteed payment for the use of capital or guaranteed payments for services
- Additional information on the existence of multiple activities for section 465 “at-risk” and section 469 “passive activity” purposes

***But see Notice 2019-66...***

# Notice 2019-66

## **Notice 2019-66 provided welcome relief from some of the significant reporting changes**

- Released on December 9, 2019
- Tax Basis Capital Accounts:
  - Requirement to report each partner's share of partnership capital using the tax basis method will not be effective until 2020
  - For 2019, partnerships must report capital accounts consistent with 2018 reporting requirements, including negative tax capital accounts reported on a partner-by-partner basis
- Section 704(c) Reporting
  - Defines “net unrecognized section 704(c) gain or loss” for purposes of the new reporting requirement and allows partnerships to make determinations in a reasonable manner consistent with prior years for 2019 and thereafter until further notice
    - Clarifies that such amount is the sum of all unrecognized gains or losses under section 704(c), including section 704(c) gains and losses arising from revaluations of partnership property
  - Exempts PTPs from reporting section 704(c) gain or loss until further notice



# Notice 2019-66 (cont'd)

## **Notice 2019-66 provided welcome relief from some of the significant reporting changes**

- Section 465 Reporting
  - Requirement added by the 2019 draft instructions to report information about separate section 465 at-risk activities will not be effective until 2020
  - Do not have to report anything more than was required to be filed on 2018 return
    - Must still comply, however, with Form 6198 which requires partnerships to furnish their partners with a separate statement of income, expenses, and deductions for each at-risk and not-at-risk activity
- Provides relief from certain reporting penalties

# Form 1065

## Page 1

### — NEW Item K Check Boxes

- Aggregated activities for section 465 at-risk purposes
- Grouped activities for section 469 passive activity purposes

Form <b>1065</b>		<b>U.S. Return of Partnership Income</b>		OMB No. 1545-0123
Department of the Treasury Internal Revenue Service		For calendar year 2019, or tax year beginning _____, 2019, ending _____, 20____.		<b>2019</b>
		► Go to <a href="http://www.irs.gov/Form1065">www.irs.gov/Form1065</a> for instructions and the latest information.		
<b>A</b> Principal business activity	<b>Type or Print</b>	Name of partnership	<b>D</b> Employer identification number	
<b>B</b> Principal product or service		Number, street, and room or suite no. If a P.O. box, see instructions.	<b>E</b> Date business started	
<b>C</b> Business code number		City or town, state or province, country, and ZIP or foreign postal code	<b>F</b> Total assets (see instructions)  \$	
<b>G</b> Check applicable boxes: (1) <input type="checkbox"/> Initial return (2) <input type="checkbox"/> Final return (3) <input type="checkbox"/> Name change (4) <input type="checkbox"/> Address change (5) <input type="checkbox"/> Amended return <b>H</b> Check accounting method: (1) <input type="checkbox"/> Cash (2) <input type="checkbox"/> Accrual (3) <input type="checkbox"/> Other (specify) ► _____ <b>I</b> Number of Schedules K-1. Attach one for each person who was a partner at any time during the tax year ► _____ <b>J</b> Check if Schedules C and M-3 are attached . . . . . ► <input type="checkbox"/> <b>K</b> Check if partnership: (1) <input type="checkbox"/> Aggregated activities for section 465 at-risk purposes (2) <input type="checkbox"/> Grouped activities for section 469 passive activity purposes				

# Form 1065 (cont'd)

## Page 3 Schedule B “Other Information”

### — **UPDATE** Question 24 – section 163(j) Question

- Re-worded question regarding section 163(j) which will presumably remove filing requirement for partnerships with investment-only items.
- Updated gross receipts test from \$25M to \$26M for inflation

<b>24</b>	Does the partnership satisfy one or more of the following? See instructions . . . . .		
<b>a</b>	The partnership owns a pass-through entity with current, or prior year carryover, excess business interest expense.		
<b>b</b>	The partnership's aggregate average annual gross receipts (determined under section 448(c)) for the 3 tax years preceding the current tax year are more than <u>\$26 million</u> and the partnership has business interest.		
<b>c</b>	The partnership is a tax shelter (see instructions) and the partnership has business interest expense. If "Yes" to any, complete and attach Form 8990.		

### — **REMOVED** Partnership Representative EIN/SSN lines

<b>Designation of Partnership Representative</b> (see instructions) Enter below the information for the partnership representative (PR) for the tax year covered by this return.	
Name of PR ▶	
U.S. address of PR ▶	U.S. phone number of PR ▶
If the PR is an entity, name of the designated individual for the PR ▶	
U.S. address of designated individual ▶	U.S. phone number of designated individual ▶

# Form 1065 (cont'd)

## Page 3 Schedule B “Other Information”

### — **NEW** Question 27 – section 864(c)(8)

- Disclose number of foreign partners subject to section 864(c)(8)

<b>27</b>	Enter the number of foreign partners subject to section 864(c)(8) as a result of transferring all or a portion of an interest in the partnership or of receiving a distribution from the partnership . . . . . ▶		
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### — **NEW** Question 28 – disguised sale

- Check the box if disguised sale disclosure included

<b>28</b>	At any time during the tax year, were there any transfers between the partnership and its partners subject to the disclosure requirements of Regulations section 1.707-8? . . . . .		
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# Form 1065 (cont'd)

## Page 4 Schedule K

- **NEW** Guaranteed payment lines
  - Breakout of guaranteed payments for services and for capital

Schedule K		Partners' Distributive Share Items		Total amount		
(Loss)	1	Ordinary business income (loss) (page 1, line 22)		1		
	2	Net rental real estate income (loss) (attach Form 8825)		2		
	3a	Other gross rental income (loss)	3a			
	b	Expenses from other rental activities (attach statement)	3b			
	c	Other net rental income (loss). Subtract line 3b from line 3a		3c		
	4	Guaranteed payments: a Services	4a	b Capital	4b	
	c	Total. Add lines 4a and 4b		4c		
5	Interest income		5			

- **REMOVED** GILTI reporting lines

Foreign Transactions	16a	Name of country or U.S. possession ▶		
	b	Gross income from all sources	16b	
	c	Gross income sourced at partner level	16c	
		Foreign gross income sourced at partnership level		
	d	Reserved for future use ▶	e	Foreign branch category ▶
	f	Passive category ▶	g	General category ▶
		Deductions allocated and apportioned at partner level	h	Other (attach statement) ▶
	i	Interest expense ▶	j	Other ▶
		Deductions allocated and apportioned at partnership level to foreign source income		
	k	Reserved for future use ▶	l	Foreign branch category ▶
	m	Passive category ▶	n	General category ▶
		o	Other (attach statement) ▶	
	p	Total foreign taxes (check one): ▶ Paid <input type="checkbox"/> Accrued <input type="checkbox"/>	16p	
q	Reduction in taxes available for credit (attach statement)	16q		
r	Other foreign tax information (attach statement)			

# Form 1065 (cont'd)

## Item K, Liability Reconciliation

- Schedule K-1, Item K Liabilities are required to be reported on a tax basis
- **NEW** Form 1065 instructions state that if the liabilities on Schedule K-1 do not equal the total liabilities on Schedule L, attach a reconciliation

Part II Information About the Partner	
<b>K</b> Partner's share of liabilities:	
	<div>BeginningEnding</div>
Nonrecourse . . . \$	\$
Qualified nonrecourse financing . . . \$	\$
Recourse . . . \$	\$
<input type="checkbox"/> Check this box if Item K includes liability amounts from lower tier partnerships.	

# Schedule K-1

## Item E / Item H2 Partner Information

### — **UPDATE** Disregarded Entity Reporting

- Added note that TIN of DRE should not be used in Item E (not a new requirement)
- Added DRE checkbox and line to put EIN/Name of DRE partner

## Item J Partner's Share of Profits, Loss, Capital

- ### — **NEW** Check box if decrease from beginning to ending is due to sale/exchange of a partnership interest whether or not the sale or exchange is taxable

## Item K Partner's Share of Liabilities

- ### — **NEW** Check box if liabilities reported include amounts from an LTP

Part II Information About the Partner													
E	Partner's SSN or TIN (Do not use TIN of a disregarded entity. See inst.)												
F	Name, address, city, state, and ZIP code for partner entered in E. See instructions.												
G	<input type="checkbox"/> General partner or LLC member-manager <input type="checkbox"/> Limited partner or other LLC member												
H1	<input type="checkbox"/> Domestic partner <input type="checkbox"/> Foreign partner												
H2	<input type="checkbox"/> If the partner is a disregarded entity (DE), enter the partner's: TIN _____ Name _____												
I1	What type of entity is this partner? _____												
I2	If this partner is a retirement plan (IRA/SEP/Keogh/etc.), check here <input type="checkbox"/>												
J	Partner's share of profit, loss, and capital (see instructions): <table border="1"><thead><tr><th></th><th>Beginning</th><th>Ending</th></tr></thead><tbody><tr><td>Profit</td><td>%</td><td>%</td></tr><tr><td>Loss</td><td>%</td><td>%</td></tr><tr><td>Capital</td><td>%</td><td>%</td></tr></tbody></table> <input type="checkbox"/> Check if decrease is due to sale or exchange of partnership interest		Beginning	Ending	Profit	%	%	Loss	%	%	Capital	%	%
	Beginning	Ending											
Profit	%	%											
Loss	%	%											
Capital	%	%											
K	Partner's share of liabilities: <table border="1"><thead><tr><th></th><th>Beginning</th><th>Ending</th></tr></thead><tbody><tr><td>Nonrecourse . . . \$</td><td></td><td>\$</td></tr><tr><td>Qualified nonrecourse financing . . . \$</td><td></td><td>\$</td></tr><tr><td>Recourse . . . \$</td><td></td><td>\$</td></tr></tbody></table> <input type="checkbox"/> Check this box if Item K includes liability amounts from lower tier partnerships.		Beginning	Ending	Nonrecourse . . . \$		\$	Qualified nonrecourse financing . . . \$		\$	Recourse . . . \$		\$
	Beginning	Ending											
Nonrecourse . . . \$		\$											
Qualified nonrecourse financing . . . \$		\$											
Recourse . . . \$		\$											

# Schedule K-1 (cont'd)

## Item L Partner's Capital Account

- **UPDATE** Capital Account Reporting
  - Mandatory reporting on **Tax Basis Capital**
    - **Delayed until 2020**

## Item N Share of Unrecognized Gains (Loss)

- **NEW** Section 704(c) Reporting
  - Partner's share of net unrecognized section 704(c) gain or (loss)

L		Partner's Capital Account Analysis
	Beginning capital account	. . . \$ _____
	Capital contributed during the year	. . . \$ _____
	Current year net income (loss)	. . . \$ _____
	Other increase (decrease) (attach explanation)	\$ _____
	Withdrawals & distributions	. . . \$ ( _____ )
	Ending capital account	. . . \$ _____
M	Did the partner contribute property with a built-in gain or loss? <input type="checkbox"/> Yes <input type="checkbox"/> No If "Yes," attach statement. See instructions.	
N Partner's Share of Net Unrecognized Section 704(c) Gain or (Loss)		
	Beginning	. . . . . \$ _____
	Ending	. . . . . \$ _____



# Schedule K-1 (cont'd)

## Line 4 Partner's Guaranteed Payment

- **NEW** Guaranteed payment lines
  - Breakout of guaranteed payments for services and for capital

## Line 21 / Line 22 Multiple Activities

- **NEW** Check boxes for more than one activity for at-risk purposes (section 465) and more than one activity for passive activity purposes (section 469)
  - Includes \* indicating additional information may be requested

Part III Partner's Share of Current Year Income, Deductions, Credits, and Other Items			
1	Ordinary business income (loss)	15	Credits
2	Net rental real estate income (loss)		
3	Other net rental income (loss)	16	Foreign transactions
4a	Guaranteed payments for services		
4b	Guaranteed payments for capital		
4c	Total guaranteed payments		

21	<input type="checkbox"/>	More than one activity for at-risk purposes*
22	<input type="checkbox"/>	More than one activity for passive activity purposes*
*See attached statement for additional information.		

# Schedule K-1 (cont'd)

## Updates to codes used for Schedule K-1

- **NEW** Line 11F – Section 743(b) positive adjustments
- **NEW** Line 13V – Section 743(b) negative adjustments
- **UPDATE** Line 20Z – Section 199A information
  - Removed separate line reporting:
    - Line 20AA - Section 199A W-2 wages
    - Line 20AB - Section 199A unadjusted basis
    - Line 20AC - Section 199A REIT dividends
    - Line 20AD - Section 199A PTP income
- **NEW** Line 20AA – Section 704(c) information
- **NEW** Line 20AB – Section 751 gain/(loss)
- **NEW** Line 20AC – Section 1(h)(5) gain/(loss)
- **NEW** Line 20AD – Deemed section 1250 unrecaptured gain



# Tax Basis Capital Accounts

2019 Changes to Form 1065 & Schedule K-1

# Tax Basis Capital Accounts

**Beginning in 2020 capital accounts will be required to be reported on a tax basis**

- Why is the IRS now requiring tax basis capital?
- What is “tax basis capital”?

*From the draft Schedule K-1...*

L Partner's Capital Account Analysis	
	Tax Basis Capital
Beginning capital account . . . .	\$ _____
Capital contributed during the year . . .	\$ _____
Current year net income (loss) . . . .	\$ _____
Other increase (decrease) (attach explanation)	\$ _____
Withdrawals & distributions . . . .	\$ ( _____ )
Ending capital account . . . .	\$ _____

# Tax Basis Capital Accounts (cont'd)

## Generally speaking...

- Each partner has a single tax basis capital account
- Tax basis capital accounts are **increased** for:
  - Money and net tax basis of contributed property;
  - Distributive share of partnership taxable income and gain.
    - Both taxable and tax-exempt income.
- Tax basis capital accounts are **decreased** for:
  - Money and net tax basis of property distributed;
  - Distributive share of partnership taxable losses and deductions.
    - Including nondeductible, non-capitalizable expenditures.

# Tax Basis Capital Accounts (cont'd)

## The basic tax basis capital definition seems simple, however...

- Historically, it has been unclear whether certain items should be included or excluded from the calculation of tax basis capital accounts
  - Section 743(b) adjustments
  - Section 704(c)(1)(C)
  - Syndication costs
  
- Historically, it has also been unclear how certain items should impact tax basis capital accounts
  - Section 734(b) adjustments
  - “Hanging” negative capital accounts
  
- In addition to tax basis capital being undefined, there has been conflicting guidance
  - Earlier versions of the draft Form 1065 instructions
  - Prior Year FAQs

# Tax Basis Capital Accounts (cont'd)

## Earlier versions of the Draft Form 1065 Instructions:

- Tax basis capital means:
  - The amount of cash plus the tax basis of property contributed to a partnership by a partner minus the amount of cash plus the tax basis of property distributed to a partner by the partnership net of liabilities assumed or taken subject to in connection with such contribution or distribution; plus
  - The partner's cumulative share of partnership taxable income and tax-exempt income; minus
  - The partner's cumulative share of taxable loss and nondeductible, noncapital expenditures
- The instructions also provided that section 743(b) basis adjustments do not affect the transferee's tax basis capital account
  - Note, this instruction was removed in the final version of the Form 1065 instructions to be consistent with the 2018 instructions.

# Tax Basis Capital Accounts (cont'd)

## Tax Basis Capital Account FAQs

- Published April 5, 2019
- Provided formula for calculating tax basis that included section 743(b) basis adjustments
- Also provided a safe harbor approach
  - A partnership may calculate tax basis capital by subtracting a partner's allocable share of liabilities under section 752 from partner's outside basis
  - This would include a partner's section 743(b) basis adjustment
  - Presumably requires the partnership to request outside tax basis from its partners
  - Will the safe harbor still be available for 2020 returns? Will there be a new safe harbor?



# Tax Basis Capital Accounts (cont'd)

## **Practical considerations in calculating tax basis capital accounts:**

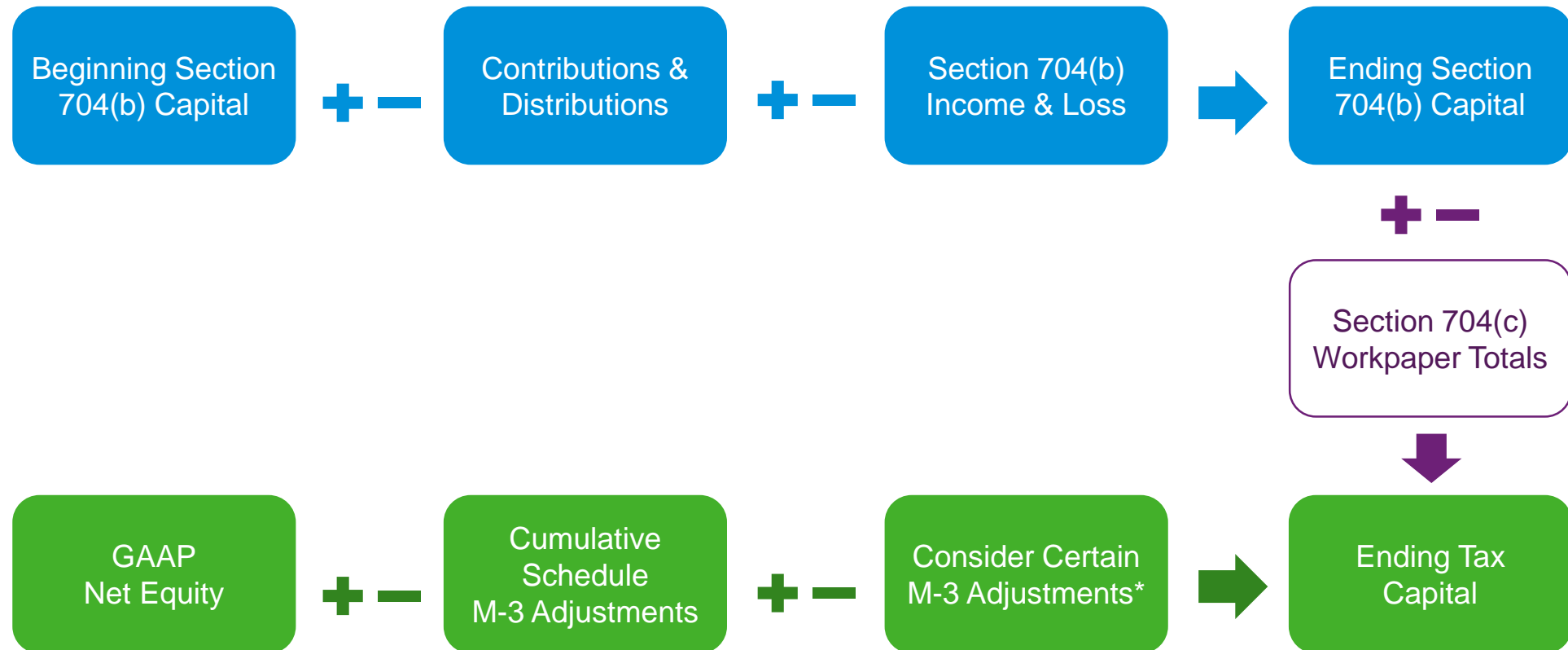
- What if the partnership has never tracked tax basis capital accounts?
  - What if the partnership has been in business for 50 years?
- Is it reasonable to use an estimate as a starting point?
- Will the IRS provide any potentially reasonable methods for situations where tax basis capital accounts have not been tracked / cannot be reasonably tracked (or possibility of disclosure)?
  - Previously Taxed Capital – Reg. section 1.743-1(d)(1)
  - Section 704(b) capital account less section 704(c) gain
  - Partner's outside basis, less liabilities, less section 743(b) adjustments

# Tax Basis Capital Accounts (cont'd)

## Best Practices

- Reconcile aggregate tax basis capital accounts to tax basis balance sheet
- Reconcile the difference between aggregate section 704(b) capital and aggregate tax capital to aggregate section 704(c) amounts
- Reconcile the difference between each partner's section 704(b) capital account and tax basis capital account to each partner's share of remaining section 704(c) amounts
  - Note, however, that the difference between a partner's section 704(b) capital account and their tax capital does not always equal their remaining share of section 704(c) gain or loss
  - Consider the cumulative impact of ceiling rule limitations and how section 734(b) adjustments have been reflected in the tax basis capital accounts

# Partnership Health Check



\*For example, Schedule M-3 adjustments for guaranteed payment income, non-taxable/non-deductible amounts, and section 743(b) adjustments



# Net Unrecognized Section 704(c) Gain or Loss

2019 Changes to Form 1065 & Schedule K-1

# Net Unrecognized Section 704(c) Gain or Loss

## New reporting for section 704(c):

- Item N – Partner's share of net unrecognized section 704(c) gain or loss
- Line 20AA – Section 704(c) information

## What is net unrecognized section 704(c) gain or loss?

- Forward section 704(c)
- Section 704(c)(1)(C)
- Reverse layers (book-ups/downs)

N		Partner's Share of Net Unrecognized Section 704(c) Gain or (Loss)									
	Beginning	.	.	.	.	.	.	.	.	.	\$
	Ending	.	.	.	.	.	.	.	.	.	\$

# Section 704(c) Gain or Loss – Item N

## Per Form 1065 Instructions:

- Solely for purposes of completing item N, the section 704(c) gain or loss is the partner's share of the net (net means aggregate or sum) of all unrecognized section 704(c) gain or loss in partnership property, including section 704(c) gain or loss arising from revaluations of partnership property. See Notice 2019-66 for more information.
- Notice 2019-66 allows taxpayers to resolve section 704(c) issues in a reasonable manner, consistent with prior years' practice for purposes of applying section 704(c) to partners.

## Relevance of information?

- Potentially would allow the IRS to get an estimate of a partner's section 704(b) capital account balance
  - $\text{Tax Basis Capital Account} + \text{Net Unrecognized Section 704(c) Gain/(Loss)} = \text{Section 704(b) Capital Account}$

# Section 704(c) Gain or Loss – Line 20AA

## Per Form 1065 / Schedule K-1 Instructions:

- Form 1065 Instructions: If the partner received any section 704(c) income or deduction items that are included in any line item of Schedule K-1, include the net section 704(c) adjustment
  - Defined as the “net of all outstanding built-in gains and built-in losses on section 704(c) property held by the partnership as of the end of the tax year”
- Schedule K-1 Instructions: report the net income or loss effect of all section 704(c) allocations for the partner

## What does this mean?

- There is an apparent disconnect in the instructions for Form 1065 and Schedule K-1 and additional guidance may be required



# Section 743(b) Reporting

2019 Changes to Form 1065 & Schedule K-1



# Historic Reporting of Section 743(b)

## Historically, section 743(b) reporting has been inconsistent

- Previous Schedule K-1 instructions provided that the section 743(b) adjustment should be reported using the codes for Line 11 or Line 13
  - There were no specific codes on Line 11 or Line 13 for section 743(b) adjustments
- Regulations indicate that the partnership first computes partnership taxable income under section 703(a) and allocates it to the partners; the items allocated to the partner with the section 743(b) adjustment are then adjusted for the 743(b) utilization.
- As a result, historic reporting typically followed one of three presentations:
  1. Line 11 or Line 13
  2. Using the impacted line (e.g., Line 1 if depreciation, Line 9a if adjustment to capital gain)
  3. Line 20 – informational footnote only

# Line Item Reporting for Section 743(b)

## **New Schedule K-1 provides specific lines for the impact of section 743(b) adjustments**

- Line 11F: Other income (loss): Section 743(b) positive adjustments
  - “deduction or loss resulting from your total net section 743(b) basis adjustments”
- Line 13V: Other Deductions: Section 743(b) negative adjustments
  - “income or gain resulting from your total net section 743(b) basis adjustments”
- Line 20AH: Other: includes net section 743(b) adjustment for partners with basis adjustments
  - “attach a statement on line 20, code AH, showing each section 743(b) basis adjustment making up the total and identify the asset to which it relates”
  - Detail reported likely should align with section 743(b) statement groupings

## **Considerations:**

- Very likely to require change to current presentation
- Clarifies that section 743(b) adjustments will affect the taxable income/(loss) amount reported on the Form 1065



# At-Risk & Passive Activity Reporting

2019 Changes to Form 1065 & Schedule K-1

# Loss Limitations: Reporting Requirements

## Reporting requirements

### — Form 1065

- Whether partnership aggregated activities for section 465 purposes
- Whether partnership grouped activities for section 469 purposes

### — Schedule K-1

- Whether the partnership has more than one activity for section 465 purposes
- Whether the partnership has more than one activity for section 469 purposes
- Attached statement for additional information

**K** Check if partnership: (1) ☐ Aggregated activities for section 465 at-risk purposes (2) ☐ Grouped activities for section 469 passive activity purposes

21 ☐ More than one activity for at-risk purposes\*

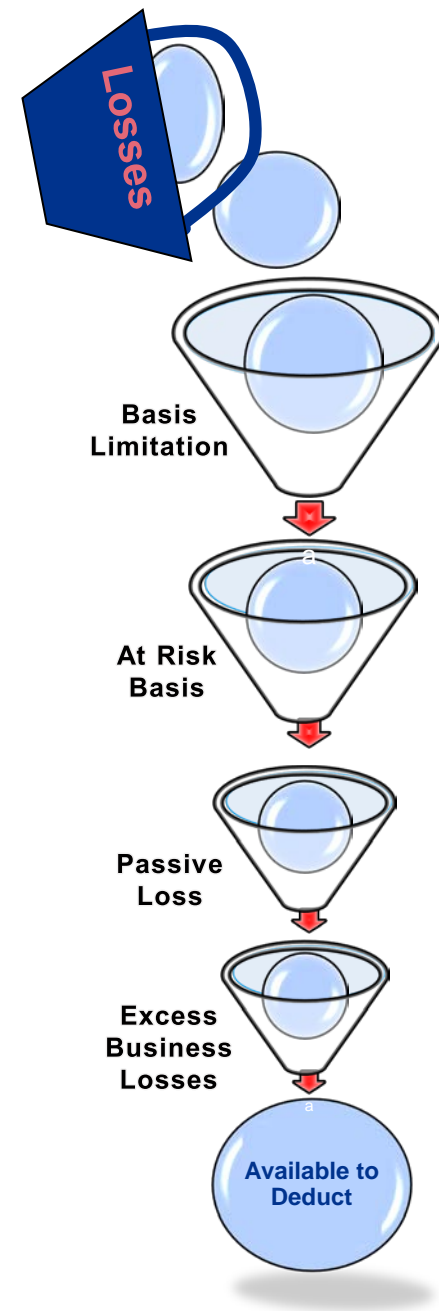
22 ☐ More than one activity for passive activity purposes\*

# Loss Limitations: Generally

**Partnership will report the full amount of losses allocated to a partner on Schedule K-1**

**Partner must then apply applicable loss limitation before deduction the losses on his/her return:**

- Basis limitation under section 704(d)
  - Applies to all partners
- At-risk limitations under section 465
  - Limits losses from an activity to amount at risk
  - Partnership & S corporation may have more than one activity
- Passive activity loss limitations under section 469
  - Limits losses from passive activities to passive income from all sources
- Excess businesses losses under section 461(l)
  - Excess business losses of a non-corporate taxpayer are not allowed as a deduction in the current year, but instead are carried over as a net operating loss



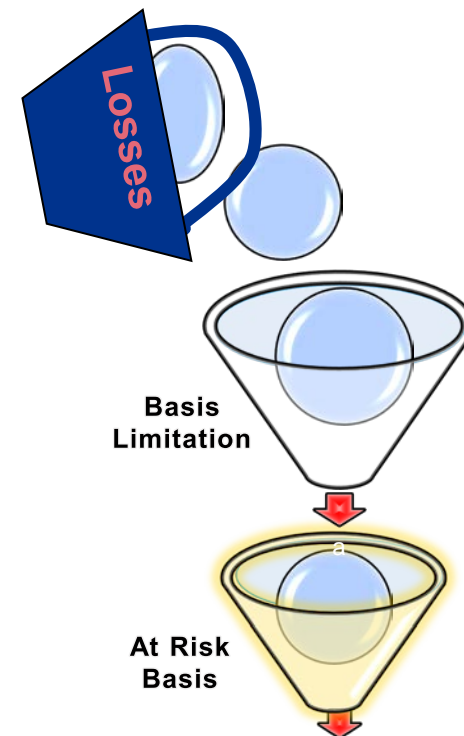
# At Risk Limitation

**At-risk rules limit the partner or shareholder's loss to the amount the taxpayer has "at-risk" in the activity generating the loss**

- Policy: to prevent abusive tax shelters by limiting a taxpayer's deductible losses to the amount that the taxpayer has economically "at-risk" (i.e., the amount the taxpayer could actually lose in a "worst case" scenario (6th Cir.) or the amount there is a "realistic possibility" the taxpayer could lose (Tax Court, certain other circuits))
- A partner or shareholder may have sufficient outside basis to deduct the loss, but still can not take the deduction if it exceeds the partner's or shareholder's "at-risk" amount

**At-risk rules are applied on a partner-by-partner and an activity-by-activity basis**

- Rules apply to partnership and S corporation items at the owner level
  - Individuals, trusts and estates, and certain closely-held corporations
- Aggregation rules may apply to combine activities
  - Very limited aggregation possible; not the same as passive activity aggregation.



# At Risk Limitation: Reporting (for Form 6198)

## Form 1065 Instructions:

- Where items of income, loss, or deduction on Schedule K-1 are from more than one activity covered by the at-risk rules, the partnership must report information separately for each activity as is required by Item K instructions
  - Partner's share of nonrecourse liabilities, partnership-level qualified nonrecourse financing, and other recourse liabilities for each activity
- Additional information needed to enable the partner to compute the profit or loss from each at-risk activity and the amount at risk may be required to be separately reported pursuant to the Instructions for Form 6198 and Pub. 925.
  - Partnerships and S Corporations must give their partners and shareholders a separate statement of income, expenses, and deductions for each at-risk or not-at-risk activity.

# Passive Activity Losses

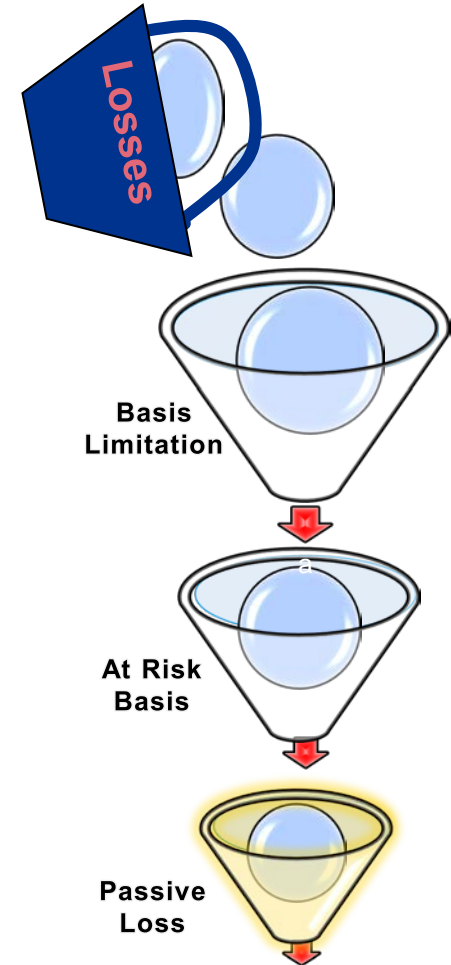
**Passive activity loss rules generally disallow a “passive activity loss” for the year**

- Policy: to prevent taxpayers from using losses from passive activities to offset salary and investment income

**A “passive activity loss” is the amount by which the aggregate losses from all passive activities exceed aggregate income from all passive activities**

**The limitation is applied by each partner, not at the partnership level**

- Individuals, trusts and estates, closely held C corporations, and personal service corporations





# Passive Activity Losses: Activities

**Generally, an activity is one or business undertaking determined based on all facts and circumstances**

- Several business undertakings that together form an appropriate “economic unit” may constitute as an activity, or
- A segregated business undertaking may itself constitute an activity

**Section 469 divides activities into three categories:**

- Non-passive: Income from activities in which the taxpayer materially participates, including activities in which wages or salaries are earned.
- Passive: Income from activities in which the taxpayer does not materially participate, and income that is per se passive
- Portfolio: Investment income such as annuities, royalties, interest, dividend, capital gains/losses, guaranteed payments for interest on capital.
  - Includes interest on working capital (bank deposits)

**Defining an activity is important because the level of participation is defined for each “activity”**

# Passive Activity Losses: Grouping

**One or more trade or business or rental “undertaking” may be treated as a single activity if the activities make up an appropriate economic unit for measurement of gain or loss under the passive activity rules**

- Facts and circumstances test
- Factors that provide the most weight: similarities and differences in types of trades or businesses, extent of common control, extent of common ownership, geographical location, and reliance between and among activities

**Partnerships, S corporations, and closely held C corporations must perform the first grouping of an entity's activities**

- Activities conducted directly or indirectly through other pass-through entities
- A partner cannot un-group the activities

**Taxpayers cannot group:**

- Rental activities with other trade or business activities – with some exceptions
- Real property rentals with personal property rentals – with some exceptions
- Activities of limited partners and limited entrepreneurs
  - Applies to motion pictures, farming, leasing, oil and gas, geothermal deposits

# Passive Activity: Reporting

## Form 1065 Instructions:

- Activity reporting requirements are unchanged from prior year
- Note that the Form 1120-S Instructions provided some additional reporting for grouped activities
  - Identify each grouping
  - Description of the groupings must be sufficient for the shareholders to determine if other activities qualify to be added to any groupings of the S corporation



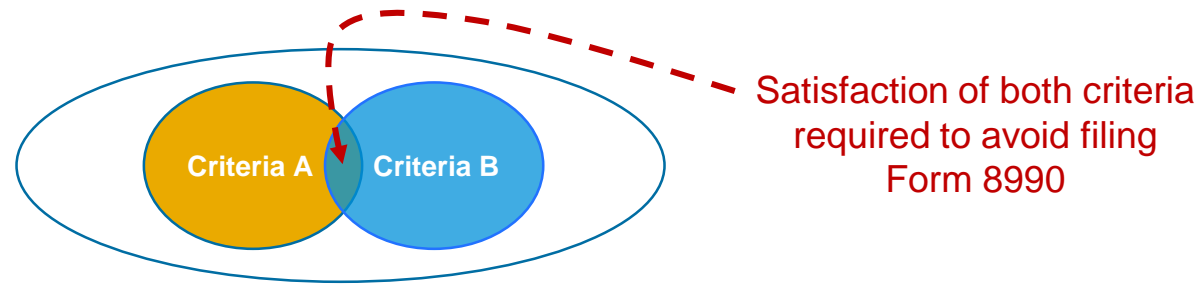
# Tax Reform: Year Two Considerations



# Section 163(j)

**Tax Reform: Year Two Considerations**

# Form 8990 Filing Requirements (Old)

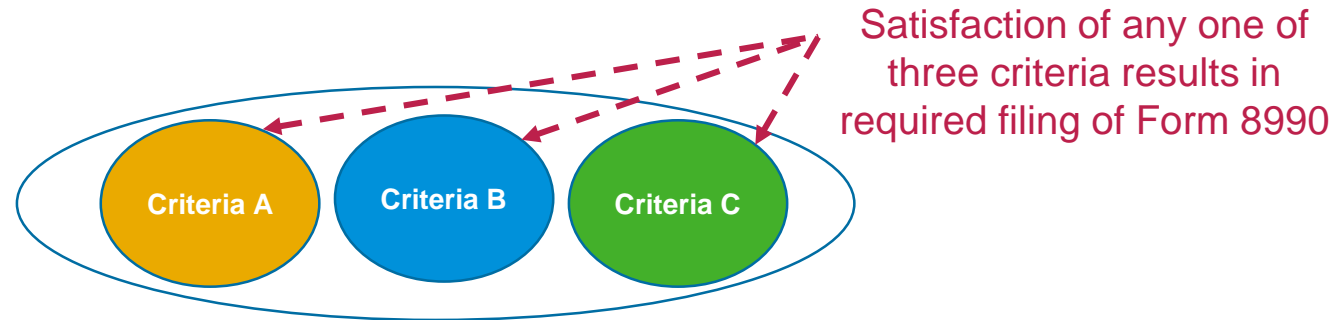


## 2018 Form 1065, Question 24

1. The partnership satisfies one of the following conditions (Criteria A) :
  - The partnership's aggregate average annual gross receipts (determined under section 448(c)) for the 3 tax years preceding the current tax year do not exceed \$25 million, and the partnership is not a tax shelter; or
  - The partnership only has business interest expense from (1) an electing real property trade or business, (2) an electing farming business, or (3) certain utility businesses under section 163(j)(7)
2. The partnership does not own a pass-through entity with current year, or prior year, carryover excess business interest expense (Criteria B).

**If “No” to either the partnership must file Form 8990.**

# Form 8990 Filing Requirements (New)



## 2019 Form 1065, Question 24

— Does the partnership satisfy one or more of the following?

1. The partnership owns a pass-through entity with current, or prior year carryover, excess business interest expense (Criteria A).
2. The partnership's aggregate average annual gross receipts (determined under section 448(c)) for the 3 tax years preceding the current tax year are more than \$26 million and the partnership has business interest (Criteria B).
3. The partnership is a tax shelter and the partnership has business interest expense (Criteria C).

**If “Yes” to any, the partnership must attach Form 8990.**

# Lower-tier limitation: Impact on basis in partnership interest

## A partner must identify and prospectively track excess business interest expense (EBIE) on an investment-by-investment basis

- A partner reduces its basis in the lower-tier partnership for its allocable share of EBIE that has been reported to it on Schedule K-1, Line 13K.
- In the subsequent year, if that particular lower-tier partnership reports out excess taxable income (ETI) or excess business interest income (EBII) to the partner, it determines how much of the EBIE carryforward is treated as “paid or accrued” in that subsequent year.
  - Treated as paid or accrued is not the same as deductible.
  - Partner must then determine its overall adjusted taxable income (ATI) (using all ETI allocated to it from all sources) and BII and determine what portion is deductible.
- If the partner disposes of all or substantially all of the interest in the lower-tier partnership, it must increase such basis for any EBIE **that has not been treated as paid or accrued** by the partner.
  - Basis increase rule applies to transfers in nonrecognition exchanges
  - Basis increase happens immediately before the transfer

### Compliance Action Items



- ❑ Complete section 163(j) limitation calculation at each partnership and report excess section 163(j) items
- ❑ Enhanced basis tracking needed for EBIE amounts from each LTP interest.



# Lower-tier limitation: Impact on partner reporting

## Example of partner reporting and tracking on Form 8990, Schedule A

### Year 1:

Form 8990 (12-2018) Page **3**

**SCHEDULE A Summary of Partner's Section 163(j) Excess Items**

*Any taxpayer that owns an interest in a partnership subject to section 163(j) should complete Schedule A before completing Part I.*

(a) Name of partnership	(b) EIN	Excess Business Interest Expense			(f) Current year excess taxable income	(g) Current year excess business interest income	(h) Excess business interest expense treated as paid or accrued (lessor of (e) or (f))	(i) Current year excess business interest expense carryforward ((e) minus (h))
		(c) Current year	(d) Prior year carryforward	(e) Total ((c) plus (d))				
43 Blaster, LLC	12-3456789	50	-	50	-	-	-	50

### Year 2:

Form 8990 (12-2018) Page **3**

**SCHEDULE A Summary of Partner's Section 163(j) Excess Items**

*Any taxpayer that owns an interest in a partnership subject to section 163(j) should complete Schedule A before completing Part I.*

(a) Name of partnership	(b) EIN	Excess Business Interest Expense			(f) Current year excess taxable income	(g) Current year excess business interest income	(h) Excess business interest expense treated as paid or accrued (lessor of (e) or (f))	(i) Current year excess business interest expense carryforward ((e) minus (h))
		(c) Current year	(d) Prior year carryforward	(e) Total ((c) plus (d))				
43 Blaster, LLC	12-3456789	-	50	50	100	-	50	-

Taxpayer name(s) shown on tax return: Lightsaber, LLC  
Identification number: 22-22222222

**Part I Computation of Allowable Business Interest Expense**

*Part I is completed by all taxpayers subject to section 163(j). Schedule A and Schedule B need to be completed before Part I when the taxpayer is a partner or shareholder of a pass-through entity subject to 163(j).*

**Section I—Business Interest Expense**

1	Current year business interest expense (not including floor plan financing interest expense), before the section 163(j) limitation . . . . .	1		
2	Disallowed business interest expense carryforwards from prior years. (Does not apply to a partnership) . . . . .	2		
3	Partner's excess business interest expense treated as paid or accrued in current year (Schedule A, line 44, column (h)) . . . . .	3	50	
4	Floor plan financing interest expense. See instructions . . . . .	4		
5	<b>Total business interest expense.</b> Add lines 1 through 4 . . . . .	5		50



# Section 199A

**Tax Reform: Year Two Considerations**

# Section 199A: Reporting

## Section 199A reporting:

- Separate line reporting has been removed for the various section 199A items (e.g. QBI, Wages, UBIA, etc.) on the Schedule K-1
- Line 20Z now requests “Section 199A information”

## Form 1065 Instructions

- On each partner’s Schedule K-1 use code Z\* and enter “STMT” to indicate that information is provided on an attached statement
- Statement must include partner’s distributive share of:
  - Qualified items of income, gain, deduction, and loss
  - W-2 Wages
  - Unadjusted basis immediately after acquisition (UBIA) of qualified property
  - Qualified PTP Items
  - REIT Dividends
- Partnerships should use statements provided, or a substantially similar statement

# Section 199A: Reporting – Statement A

## Statement A: QBI Pass-through Entity Reporting

Statement A—QBI Pass-Through Entity Reporting				
Partnership's name:		Partnership's EIN:		
Partner's name:		Partner's identifying number:		
		Trade or Business 1	Trade or Business 2	Trade or Business 3
		EIN:	EIN:	EIN:
		<input type="checkbox"/> PTP	<input type="checkbox"/> PTP	<input type="checkbox"/> PTP
		<input type="checkbox"/> Aggregated	<input type="checkbox"/> Aggregated	<input type="checkbox"/> Aggregated
		<input type="checkbox"/> SSTB	<input type="checkbox"/> SSTB	<input type="checkbox"/> SSTB
Partner's share of:				
QBI or qualified PTP items subject to partner-specific determinations:				
	Ordinary business income (loss) . . . . .			
	Rental income (loss) . . . . .			
	Royalty income (loss) . . . . .			
	Section 1231 gain (loss) . . . . .			
	Other income (loss) . . . . .			
	Section 179 deduction . . . . .			
	Charitable contributions . . . . .			
	Other deductions . . . . .			
W-2 wages . . . . .				
UBIA of qualified property . . . . .				
Section 199A dividends. . . . .				

# Section 199A: Reporting – Statement B

## Statement B: QBI Pass-through Entity Aggregation Election(s)

Statement B—QBI Pass-Through Entity Aggregation Election(s)	
Partnership's name:	Partnership's EIN:
<b>Trade or business aggregation 1*</b>	
Provide a description of the aggregated trades or businesses and an explanation of the factors met that allow the aggregation in accordance with Regulations section 1.199A-4. In addition, if the partnership holds a direct or indirect interest in a relevant pass-through entity (RPE) that aggregates multiple trades or businesses, attach a copy of the RPE's aggregations.	
<hr/>	
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Has this trade or business aggregation changed from the prior year? This includes changes in the aggregation due to a trade or business being formed, acquired, or disposed of, or having ceased operations. If yes, explain.	
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* If the partnership has more than one aggregated group, attach additional Statements B. Name the additional aggregations 2, 3, 4, etc.	

# Section 199A: Adjustments to QBI

**Items from a pass-through entity where the impact on QBI may ultimately be determined at the partner level, for example:**

- Section 1231 gains / (losses)
- Charitable contributions
- Section 179 expense
- Interest from debt-financed distribution (further guidance expected with section 163(j) regulations)

**Other potential adjustments at the partner level:**

- Prior year excess business interest expense deductible in the current year
- Oil and gas depletion
- Intangible drilling costs

# Prior Year Suspended Losses

## **Remember to take into account prior year section 199A loss carryforwards**

- Additionally, previously disallowed losses or deductions (including under sections 465, 469, 704(d), and 1366(d)) allowed in the taxable year are taken into account for purposes of computing QBI. These losses shall be used, for purposes of section 199A, in order from the oldest to the most recent on a first-in, first-out (FIFO) basis.
  - However, losses or deductions that were disallowed, suspended, limited, or carried over from taxable years ending before January 1, 2018 (including under sections 465, 469, 704(d), and 1366(d)), are not taken into account in a later taxable year for purposes of computing QBI.



# Current Developments & Items on the Horizon



# Upcoming Guidance

**Final Qualified Opportunity Zone regulations were issued on December 19, 2019**

## **Timing for additional upcoming guidance?**

- Section 163(j) Business Interest Limitations
  - Final regulations were sent to OIRA for review on December 17, 2019
- Section 1061 Carried Interest Provisions



# Questions?





Thank you



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