



TaxNewsFlash

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Notice 2021-39: Transition relief, new Schedules K-2 and K-3 for enhanced reporting of international tax matters by pass-through entities

The IRS today released an advance version of Notice 2021-39 to provide transition relief for tax years beginning in 2021 with respect to new Schedules K-2 and K-3 required for Forms 1065, *U.S. Return of Partnership Income*, 1120-S, *U.S. Income Tax Return for an S Corporation*, and 8865, *Return of U.S. Persons With Respect to Certain Foreign Partnerships*.

[Notice 2021-39](#) [PDF 128 KB] includes:

- Background information on Schedules K-2 and K-3 and the penalties that may apply for failure to furnish complete and correct information with respect to such schedules
- Transition relief from these penalties for any incorrect or incomplete reporting on Schedules K-2 and K-3 if the filer establishes to the satisfaction of the IRS Commissioner that it made a good faith effort to comply with the new reporting requirements

Notice 2021-39 clarifies that for purposes of determining whether a filer of Schedule K-2 or Schedule K-3 makes a good faith effort, the IRS will take into account the extent to which the filer has made changes to its systems, processes, and procedures for collecting and processing information relevant to filing the Schedules K-2 and K-3 and the extent to which the filer has obtained information from partners, shareholders or the controlled foreign partnerships or applied reasonable assumptions when information is not obtained.

Notice 2021-39 provides that the IRS will also take into account the steps taken by the filer to modify the partnership or S corporation agreement or governing instrument to facilitate the sharing of information with partners and shareholders that is relevant to determining whether and how to file Schedules K-2 and K-3.

KPMG observation

Notice 2021-39 does not address the interaction between the centralized partnership audit procedures and Schedules K-2 and K-3, including any penalties that may arise under those procedures due to an adjustment to an item on Schedule K-2 or K-3. In contrast, the IRS in Notice 2021-13 (in which the IRS provided relief from certain penalties due to the inclusion of incurrence information in reporting partners' beginning capital account balances on 2020 Schedules K-1) indicated it would waive any section 6662 accuracy-related penalty with respect to an imputed underpayment attributable to an adjustment to a partner's beginning capital account balance for which the partnership qualified for relief under Notice 2021-13. Read [TaxNewsFlash](#)

Draft forms, instructions for 2021

The IRS today also released draft versions of instructions related to Schedules K-2 and K-3 for tax years beginning in 2021.

- [Form 8865, Instructions for Schedule K-2 and Schedule K-3](#) [PDF 530 KB]
- [Form 1120-S, Shareholder's Instructions for Schedule K-3, Shareholder's Share of Income, Deductions, Credits, etc.—International](#) [PDF 335 KB]
- [Form 1065, Instructions for Schedule K-2 and Schedule K-3](#) [PDF 649 KB]
- [Form 1120-S, Instructions for Schedule K-2 and Schedule K-3](#) [PDF 507 KB]
- [Form 1065, Instructions for Schedule K-3](#) [PDF 402 KB]

All of these draft instructions reflect a watermark date of June 29, 2021, and include cautionary language that they are subject to OMB approval before they are finalized and officially released.

As noted in a related IRS release—[IR-2021-140](#) (June 30, 2021)—the draft instructions provide guidance to partnerships, S corporations, and U.S. persons required to file Form 8865 with respect to controlled foreign partnerships on how to provide international tax information. This is relevant for any person required to file Forms 1065, 1120-S or 8865 but only if the entity for which the form is being filed has items of international tax relevance (generally foreign activities or foreign partners).

These changes do not affect partnerships and S corporations with no items of international tax relevance.

In Notice 2021-39, the IRS has requested comments regarding instances when the draft instructions do not provide sufficient guidance on how to complete the returns or when additional clarity is needed. Suggestions are specifically requested by the IRS in Notice 2021-39 as to how to address structures and situations that make it difficult to determine certain information (for example, tiered partnership structures or publicly traded partnerships).

In general, the instructions for tax years beginning in 2021 for certain parts of the Schedules K-2 and K-3 require the partnership and the S corporation to report information unless the partnership and S corporation know that the information is not relevant to partners, shareholders or indirect partners. The IRS is soliciting comments concerning reasonable assumptions that filers could make in determining whether and how to complete Schedules K-2 and K-3 for years after the transition period and whether these assumptions may differ between various parts of the Schedules K-2 and K-3.

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