

Overview of Partnership Accounting and  
New Tax Return Reporting

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Summary

- ❖ New Reporting Requirements
- ❖ Basics of Partnership Accounting

IRS Publications

- ❖ New Form 1065
- ❖ New Schedule K-1
- ❖ Tax Quotes from the IRS\*
  - ▶ "Taxes are what we pay for civilized society." — Oliver Wendell Holmes, Jr., U.S. Supreme Court Justice
  - ▶ "I am proud to be paying taxes in the United States. The only thing is - I could be just as proud for half the money." — Arthur Godfrey, entertainer
  - ▶ "Taxation with representation ain't so hot either." — Gerald Barzan, humorist
  - ▶ "The hardest thing in the world to understand is the income tax." — Albert Einstein, physicist

\*These quotes reflect the opinions of their authors; their inclusion here is not an official IRS (or CMAA) endorsement of the sentiments expressed. <https://www.irs.gov/irsroom/tax-quotes>

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Form 1065 U.S. Return of Partnership Income

❖ Schedule B

- ❖ Question 27. Foreign partners recognizing gain or loss under Section<sup>1</sup> 864(c)(8) transferring or receiving a distribution related to a partner interest.
- ❖ Questions 28. Transfers between partnership and its partners subject to disclosure under Treas. Reg. 1.707-8 (disguised sales).

1. All "Section" or "Code" references are to the Internal Revenue Code of 1986, as amended.

Schedule K-1 (Form 1065)

❖ Part II

- ❖ Question E Report SSN or TIN of beneficial owner of a disregarded entity ("DE").
- ❖ Question F Report name and address of beneficial owner of DE.
- ❖ Question H-2 Report DE's TIN and name.

Schedule K-1 (Form 1065)  
Basics of Partnership Accounting

- ❖ Outside (Tax) Basis - Each partner's basis in their partnership interest
  - ▶ Cannot be less than zero
  - ▶ Calculated as:
    - + cash and tax basis of property and cash contributed to the partnership;
    - + partner's share of allocated partnership income;
    - partner's share of allocated partnership loss;
    - cash and tax basis of property distributed;
    - + partner's share of partnership liabilities; and
    - partnership's share of partner liabilities.

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### Schedule K-1 (Form 1065) Basics of Partnership Accounting

- ◆ Inside Basis - Partnership's adjusted basis in its own partnership assets
- ◆ Capital Accounts - Partner's equity investment in the partnership, determined by reference to the partnership assets and financial accounting
  - ▶ Calculated as:
    - + cash and net value of property contributed to the partnership;
    - + partner's share of allocated partnership income;
    - partner's share of allocated partnership loss; and
    - cash and net value of property distributed.

### Schedule K-1 (Form 1065) Reporting Negative Capital Accounts

- ◆ In 2018, the IRS began *requiring* partnerships to report negative tax basis capital account balances (Form 1065, Schedule K-1, Item L, line 20 code AH)

|   |          |   |
|---|----------|---|
| <b>L Partner's capital account analysis:</b>  |          | If a partnership reports other than tax basis capital accounts to its partners on Schedule K-1 in Item L (that is, GAAP, 704(b) book, or other), and tax basis capital, if reported on any partner's Schedule K-1 at the beginning or end of the tax year would be negative, the partnership must report on line 20 of Schedule K-1, using code AH, such partner's beginning and ending shares of tax basis capital. This is in addition to the required reporting in Item L of Schedule K-1. |
| Beginning capital account . . . . .           | \$ _____ |   |
| Capital contributed during the year . . . . . | \$ _____ |   |
| Current year increase (decrease) . . . . .    | \$ _____ |   |
| Withdrawals & distributions . . . . .         | \$ _____ |   |
| Ending capital account . . . . .              | \$ _____ |   |

Tax basis     GAAP     Section 704(b) book  
 Other (explain) \_\_\_\_\_

### Schedule K-1 (Form 1065) New 2019 Draft Schedule K-1 Part II Question L

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

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### Schedule K-1 (Form 1065) Exceptions to Reporting Negative Capital Accounts

- ◆ Satisfy all four conditions in Question 4 on Schedule B to Form 1065
  - ▶ Total receipts less than \$250,000
  - ▶ Total assets at year end less than \$1 million
  - ▶ Schedules K-1 filed with return and given to partners timely
  - ▶ Not required to file Schedule M-3
- ◆ 2018 Temporary Relief
  - ▶ Schedules K-1 filed with return and given to partners timely
  - ▶ Within one year of original due date, attach schedule:
    - "Filed Under Notice 2019-20"
    - Identify K-1's, partnership, and partners
    - Amount of partners' tax basis capital account amounts at beginning and end of year

### Schedule K-1 (Form 1065) Penalties for Not Reporting Negative Capital Accounts

- ◆ IRC Section 6722 - failure to furnish correct payee statements
- ◆ IRC Section 6698 - failure to file partnership return
- ◆ IRC Section 6038 (b) and (c) - failure to furnish information with respect to certain partnerships
- ◆ "any other section of the Code for filing or furnishing Schedules K-1 or other forms or statements"

### Special Provisions

- ◆ IRC Section 704(c) Built-In Gain or Loss
- ◆ Admission of New Partner to the Partnership
- ◆ Exit of Partners (Death, Retirement, Sale or Other Transfer)
- ◆ Allocations of Partnership Debt
- ◆ Other Considerations

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### Schedule K-1 (Form 1065) Admission of New Partner to the Partnership

- ❖ Reporting
- ❖ 704(c) built-in gain or loss
- ❖ Keep appreciation with partners who earned the appreciation
- ❖ Look to partnership agreement
  - ▶ Does it require 704(b) revaluation of assets?
  - ▶ Does it determine appraisal methods?
- ❖ May also be mandatory adjustments under 704(c) due to "substantial built in loss"

### Schedule K-1 (Form 1065) Section 704(c) Built-In Gain or Loss

- ❖ Fair market value of property contributed to partnership does not equal the contributing partner's adjusted tax basis
- ❖ Subsequent gain or loss on that property is allocated to the contributing partner
- ❖ Allocation of depreciation, depletion, gain or loss takes into consideration built-in gain or loss
- ❖ No shifting of gain or loss from partners through the partnership

### Schedule K-1 (Form 1065) 2018 Reporting of Built-In Gain or Loss

**Item M. Did the Partner Contribute Property With a Built-In Gain or Loss?**

Check the appropriate box to indicate whether the partner contributed property with a built-in gain or loss during the tax year. If the "Yes" box is checked, attach a statement that contains the following information:

- A description of each property the partner contributed.
- The date the property was contributed.
- The amount of the property's built-in gain or loss.

**M** Did the partner contribute property with a built-in gain or loss?  
 Yes  No  
If "Yes," attach statement (see instructions)

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Schedule K-1 (Form 1065)  
2019 Draft K-1 Reporting Built-In  
Gain or Loss (also Part III Line AA)

Part II Question N

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

Built-In Gain or Loss in the Partnership  
Agreement

- ◊ How to handle 704(c) is often addressed in the partnership agreement
  - ▶ May give wide discretion to general partner or manager
  - ▶ May fix which method to use:
    - Traditional
    - Traditional with curative
    - Remedial

704(c) Traditional Method

| A and B Form a 50/50 Partnership               |                   |           |          |
|--|-------------------|-----------|----------|
|  | 704(b) Book Value | Tax Basis |          |
| A contributes depreciable property 10 yr. life | \$10,000          | \$4,000   |          |
| B contributes cash                             | \$10,000          |           | \$10,000 |

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### 704(c) Traditional Method

- Allocation of depreciation over 10 years (tax depreciation is \$400 per year \$4,000 tax basis ÷ 10)

| Revenue equals operating expenses | 704(b) Book Depreciation | Tax Depreciation |
|-----------------------------------|--------------------------|------------------|
| A                                 | 500                      |                  |
| B                                 | 500                      | 400              |

### 704(c) Traditional Method

- End of year book value of depreciable property is \$9,000 (\$10,000 less the \$1,000 book depreciation deduction) and the adjusted tax basis is \$3,600 (\$4,000 less the \$400 tax depreciation deduction). A's built in gain with respect to the property decreases to \$5,400 (\$9,000 book value less \$3,600 adjusted tax basis). Also, at the end of AB's first year, A has a \$9,500 book capital and a \$4,000 tax basis in A's partnership interest. B, the non-contributing partner, has a \$9,500 book capital account and a \$9,600 adjusted tax basis in B's partnership interest due to being allocated all of the tax depreciation from A's contributed asset.

### 704(c) Traditional Method Sale of the Property

- If AB sells the property at the beginning of AB's second year for \$9,000, AB realizes tax gain of \$5,400 (\$9,000, the amount realized, less the adjusted tax basis of \$3,600). The entire \$5,400 gain must be allocated to A because the property A contributed has that much built-in gain remaining. If AB sells the property at the beginning of AB's second year for \$10,000, AB realizes tax gain of \$6,400 (\$10,000, the amount realized, less the adjusted tax basis of \$3,600). Only \$5,400 of gain must be allocated to A to account for A's built-in gain. The remaining \$1,000 of gain is allocated equally between A and B in accordance with the partnership agreement. If AB sells the property for less than the \$9,000 book value, AB realizes tax gain of less than \$5,400, and the entire gain must be allocated to A.

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### 704(c) Traditional Method Termination and Liquidation of Partnership

▶ If AB sells the property at the beginning of AB's second year for \$9,000, and AB engages in no other transactions that year, A will recognize a gain of \$5,400, and B will recognize no income or loss. A's adjusted tax basis for A's interest in AB will then be \$9,400 (\$4,000, A's original tax basis, increased by the gain of \$5,400). B's adjusted tax basis for B's interest in AB will be \$9,600 (\$10,000, B's original tax basis, less the \$400 depreciation deduction in the first partnership year). If the partnership then terminates and distributes its assets (\$19,000 in cash) to A and B in proportion to their capital account balance, A will recognize a capital gain of \$100 (\$9,500, the amount distributed to A, less \$9,400, the adjusted tax basis of A's interest). B will recognize a capital loss of \$100 (the excess of B's adjusted tax basis, \$9,600, over the amount received, \$9,500).

### Schedule K-1 (Form 1065) Exit and Entry of Partners

- ◊ Sale of partner interest
  - ▶ Must report recapture from IRC Section 751 "hot assets"
  - ▶ Withholding obligation under IRC Section 1446(f) unless non-foreign affidavit obtained
- ◊ Potential mandatory adjustments
  - ▶ Section 743 with respect to the transfer of partnership interest with a "substantial built in loss"
  - ▶ Section 734 with respect to "a substantial basis reduction"
  - ▶ Election made under Section 754 to allow an adjustment of the outside basis of a partner interest to be pushed through to the underlying partnership property
- ◊ Allocations of Partnership Debt

### Schedule K-1 (Form 1065)

Question J Partner's share of profit, loss and capital percentages BOY and EOY now includes a box to identify a change due to a sale or exchange of a partnership interest.

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### Schedule K-1 (Form 1065)

Part III Line 20AB Section 751 "hot asset" gain must be reported on partners K-1.

- ❖ Section 751 gain may be triggered on the sale or exchange or distribution treated as a sale or exchange attributable to "unrealized receivables" or "inventory items that have appreciated substantially in value."

### Section 751 Hot Assets

- ▶ Unrealized Receivables Section 751(c)-generally:
  - ▶ Goods delivered or to be delivered, to the extent the proceeds therefrom would be treated as amounts received from the sale or exchange of property other than a capital asset;
  - ▶ Services rendered or to be rendered;
  - ▶ Recapture income pursuant to Code Sections 1245, 1250 and 1254; and
  - ▶ Trademarks, tradenames, stock in DISCs and CFC's, and market discounts in bonds.

### Section 751 Hot Assets

- ▶ Inventory Items-Generally Section 751(d):
  - ❖ Property of the partnership of the kind described in Code Section 1221(a)(1);
  - ❖ Any other property of the partnership which, on sale or exchange by the partnership, would be considered property other than a capital asset and other than property described in Code Section 1231; and
  - ❖ Any other property held by the partnership which, if held by the selling or distributee partner, would be considered property of the type described above.

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### Section 751 Hot Assets

- ▶ Inventory (cont)
  - ◊ In general, "distribution" of inventory is distinguishable from inventory items in a "sale or exchange" of a partner interest.
  - ◊ A distribution of inventory requires that the inventory "has appreciated substantially in value" in order for it to be a Hot Asset. In general, substantial appreciation means that the fair market value of the inventory exceeds 120% of the partnership's adjusted tax basis in the inventory.
  - ◊ A sale or exchange does not require substantial appreciation in the value of the inventory for the inventory to be a Hot Asset.

### Section 751 Hot Assets

▶ Balance Sheet of ABC Partnership:

| Assets       | Adjusted Basis  | Fair Market Value |
|--------------|-----------------|-------------------|
| Cash         | \$30,000        | \$ 30,000         |
| Inventory    | 30,000          | 39,000            |
| Land         | 39,000          | 45,000            |
| <b>Total</b> | <b>\$99,000</b> | <b>\$114,000</b>  |

### Section 751 Hot Assets-Inventory

|                               | Total    | Capital Assets | 751 Assets |
|-------------------------------|----------|----------------|------------|
| 1/3 Partner Interest sold for | \$38,000 | \$25,000       | \$13,000   |
| Selling Partner's tax basis   | 33,000   | 23,000         | 10,000     |
| Total Gain                    | \$5,000  |                |            |
| Capital Gain                  |          | \$2,000        |            |
| 751 Ordinary Gain             |          |                | \$3,000    |

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Section 751-Hot Assets-Recapture

| Balance Sheet DER Partnership   |                  |                   |
|---|------------------|-------------------|
| Assets  | Adjusted Basis   | Fair Market Value |
| Cash  | \$30,000         | \$30,000          |
| Depreciable Property (Original cost \$39,000<br>[\$9,000 accumulated depreciation]) | 30,000           | 39,000            |
| Land  | 54,000           | 45,000            |
| <b>Total</b>  | <b>\$114,000</b> | <b>\$114,000</b>  |

Section 751 Hot Assets-

|                               | Total      | Capital Assets | 751 Assets |
|-------------------------------|------------|----------------|------------|
| 1/3 Partner Interest sold for | \$38,000   | \$25,000       | \$13,000   |
| Selling Partner's tax basis   | 38,000     | 22,000         | 10,000     |
| <b>Total Gain</b>             | <b>\$0</b> |                |            |
| Capital Loss                  |            | (\$3,000)      |            |
| 751 Ordinary Gain             |            |                | \$3,000    |

Section 751 Hot Asset

► Partnership must file Form 8308 Report of a Sale or Exchange of Certain Partnership Interests

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### Section 1446(f) Withholding on Dispositions of Partnership Interests

- ▶ Transferee must deduct and withhold 10% of the amount realized on a disposition.
- ▶ Exception if transferor provides a non-foreign affidavit.
- ▶ Partnership must deduct and withhold distributions to transferee (if transferee fails to withhold) and file Form 8804 Annual Return for Partnership Withholding Tax (Section 1446).

### Schedule K-1 (Form 1065)

- ▶ Part III Line 11F Report Section 743(b) positive adjustments.
- ▶ Line 13V Report Section 743(b) negative adjustments.

### Section 754 Mechanics of the Election

- ▶ Section 734(a) / 743(a) - the basis of partnership property does not change upon a transfer of a partnership interest or distribution of partnership property.
- ▶ Section 734(b) / 743(b) - if a Section 754 Election is in effect, the basis of partnership property can be adjusted upon a transfer of a partnership interest or distribution of partnership property.
- ▶ The basis adjustment only applies with respect to the transferee partner, not to the other partners:
  - ▶ Treas. Reg. § 1.743-1(j)(1) - In calculating income, deduction, gain and loss, the transferee will have a special basis for the partnership properties with basis adjustments.

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### Section 754 Mechanics of the Election - Basis Increase

- ▶ Section 734(b)(1) - increase the adjusted basis of partnership property by the amount of gain recognized to the distributee partner with respect to the distribution of partnership property under Section 732(a)(1).
- ▶ Special rules for a Section 732(a)(2) distribution and a Section 732(b) liquidating distribution:
  - ▶ Adjusted basis of property after distribution cannot exceed distributee partner's outside basis;
  - ▶ Increase the adjusted basis of partnership property by the "lost" basis
    - ▶ The distributee partner's proportionate share of the adjusted basis in partnership assets; and
    - ▶ The distributee partner's outside basis in the partner interest.

### Section 754 Mechanics of the Election - Basis Increase

- ▶ Section 743(b)(1) - increase the adjusted basis of partnership property by the difference between:
  - ▶ The transferor partner's outside basis in the partner interest, and
  - ▶ The transferor partner's proportionate share of the adjusted basis in partnership assets.

### Section 754 Mechanics of the Election - Basis Decrease

- ▶ Section 734(b)(2) - decrease the adjusted basis of partnership property by the amount of loss recognized to the distributee partner with respect to the distribution of partnership property under Section 732(a)(2);
- ▶ Special rules for a Section 732(b) liquidating distribution.
- ▶ Section 743(b)(2) - decrease the adjusted basis of partnership property by the difference between:
  - ▶ The transferor partner's proportionate share of the adjusted basis in partnership assets, and
  - ▶ The transferor partner's basis in the partner interest.

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**Section 754**  
**Section 734(a) Fact Pattern**

- ▶ Partner receives a distribution of cash from the partnership.
- ▶ The cash distribution is in excess of the partner's outside basis in its partnership interest.
- ▶ Partner recognizes gain on the distribution in the amount of such excess.
- ▶ Partnership steps up the basis of undistributed partnership assets by the amount of gain recognized by the partner;
  - ▶ If the distribution is in liquidation of the partner's interest in the partnership, the gain must be allocated to capital assets.

**Section 754**  
**Section 734(b)(1)(A) - No Step Up**

- ▶ Partner receives a distribution of cash from the partnership.
- ▶ The cash distribution equals the partner's outside basis in its partnership interest.
- ▶ Partner does not recognize gain on the distribution.
- ▶ Partnership does not adjust the basis of undistributed partnership assets.

**Section 754**  
**Section 734(b)(1)(A) - Step Up**

- ▶ Partner receives a distribution of cash from the partnership.
- ▶ The cash distribution is in excess of the partner's outside basis in its partnership interest.
- ▶ Partner recognizes gain on the distribution in the amount of such excess.
- ▶ Partnership steps us the basis of undistributed partnership assets by the amount of gain recognized by the partner.

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**Section 754**  
**Section 734(b)(1)(B) - Step Up**

- ▶ Partner receives a distribution of property from the partnership.
- ▶ Partner's basis in the distributed property equals the partner's outside basis in its partnership interest.
- ▶ Partner's share of the partnership's basis in the property is in excess of the partner's outside basis in its partnership interest:
  - ▶ Therefore Section 732(a)(2) applies.
- ▶ Partnership steps up the basis of undistributed partnership assets by such excess.

**Section 754**  
**Section 734(b)(2)(B) - Step Down**

- ▶ Partner receives a distribution of property from the partnership in liquidation of its partnership interest.
- ▶ Partner's basis in the distributed property equals the partner's outside basis in its partnership interest.
- ▶ Partner's outside basis in its partnership interest exceeds the partner's share of the partnership's basis in the distributed property.
- ▶ Partnership steps down the basis of undistributed partnership assets by such excess.

**Section 754**  
**Mechanics of the Election**

- ▶ The transferee partner's share of partnership property is:
  - ▶ The transferee partner's share of the partnership's previously taxed capital; plus
  - ▶ The transferee partner's share of partnership liabilities; and
  - ▶ Treas. Reg. § 1.743-1(d)(1).
- ▶ The transferee partner's share of previously taxed capital is based on a "hypothetical transaction":
  - ▶ Sale of all partnership property immediately after the transfer of the partnership interest to transferee in a taxable transaction for cash equal to fair market value; and
  - ▶ See Treas. Reg. § 1.743-1(d)(2).

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### Section 754 Mechanics of the Election

- ▶ The transferee partner's share of previously taxed capital equals the sum of:
  - ▶ The cash the transferee partner would receive upon a liquidation of the partnership following the hypothetical transaction; plus
  - ▶ The tax loss allocated to the transferee partner from the hypothetical transaction; less
  - ▶ The tax gain (including Section 704(c) gain) that would be allocated to the transferee partner from the hypothetical transaction.
- ▶ Treas. Reg. § 1.743-1(d)(1).

### Section 754 Example

- ▶ A is a member of ABC LLC in which the members have equal interests in capital and profits.
- ▶ ABC LLC has made a Section 754 Election.
- ▶ A sells its member interest in ABC LLC to D for \$100,000 plus the assumption of A's share of ABC LLC's liabilities.
- ▶ The current assets, liabilities and capital of ABC are as shown on its balance sheet:

### Section 754--Example

| Assets                                 | Tax Basis         | FMV               |
|--|-------------------|-------------------|
| Cash                                   | \$ 15,000         | \$ 15,000         |
| Accounts Receivable                    | \$ 45,000         | \$ 40,000         |
| Inventory                              | \$ 50,000         | \$ 75,000         |
| Equipment                              | \$ 110,000        | \$ 100,000        |
| Land & Building                        | \$ 30,000         | \$ 100,000        |
| Goodwill                               | \$ -              | \$ 70,000         |
| <b>Total Assets</b>                    | <b>\$ 250,000</b> | <b>\$ 400,000</b> |
| Liabilities & Capital                  |                   |                   |
| Accounts Payable                       | \$ 15,000         | \$ 15,000         |
| Long-Term Debt                         | \$ 85,000         | \$ 85,000         |
| <b>Member Capital</b>                  |                   |                   |
| A                                      | \$ 50,000         | \$ 100,000        |
| B                                      | \$ 50,000         | \$ 100,000        |
| C                                      | \$ 50,000         | \$ 100,000        |
| <b>Total Liabilities &amp; Capital</b> | <b>\$ 250,000</b> | <b>\$ 400,000</b> |

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### Section 754 Example

- ▶ D's outside basis in the member interest in ABC LLC is \$133,333;
  - ▶ Cash Paid to A - \$100,000; and
  - ▶ D's share of partnership liabilities - \$33,333.
- ▶ D's share of the inside basis of ABC LLC's assets is \$83,333;
  - ▶ D's interest in the partnership's previously taxed capital - \$50,000;
    - ▶ Cash D would receive on a liquidation of ABC LLC following a hypothetical transaction - \$100,000; plus
    - ▶ The tax loss allocated D from the hypothetical transaction - \$0; less
    - ▶ The tax gain that would be allocated to D from the hypothetical transaction - \$50,000.
  - ▶ D's share of partnership liabilities - \$33,333.

### Section 754 Example

- ▶ Because a Section 754 Election was previously made by ABC LLC, the basis adjustment under Section 743(b) is the difference between:
  - ▶ D's outside basis in the member interest in ABC LLC - \$133,333; and
  - ▶ D's share of the inside basis of ABC LLC's assets - \$83,333.
- ▶ The amount of the basis adjustment would be \$50,000.

### Schedule K-1(Form 1065) Section 752

- ▶ Part II
- ▶ Question K Partner's share of liabilities BOY and EOY, including Nonrecourse, Qualified Recourse and Recourse.
- ▶ Question K now requires disclosure of liabilities from lower tier partnerships.

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### Schedule K-1 (Form 1065) Allocations of Partnership Debt

- ◆ Impacts outside basis (which cannot be negative).
- ◆ IRC Section 752 (and Treas. Reg. Section 1.752-1 updated October 2019):
  - ▶ **Recourse liability:**
    - Partner or related person bears the economic risk of loss; and
    - Allocate to outside basis of the partner(s) bearing the economic risk of loss.
  - ▶ **Nonrecourse liability**
    - Partner or related person does not bear the economic risk of loss; and
    - Allocation to outside basis in accordance with sharing ratios.

### Schedule K-1 (Form 1065) Guaranties and Deficit Restoration Obligations

- ◆ Except for when encumbered property is directly contributed or distributed, Treas. Reg. Section 1.752-1(d) describes the only situation in which a partner is considered to have assumed a partnership liability.
- ◆ A partner is considered to assume a partnership liability only if:
  - ▶ (1) the assuming person is personally obligated to pay the liability;
  - ▶ (2) the person to whom the liability is owed knows of the assumption and can directly enforce the partner's or related person's obligation for the liability; and
  - ▶ (3) no other partner or person that is a related person to another partner would bear the economic risk of loss for the liability under §1.752-2 immediately after the assumption.

### Schedule K-1 (Form 1065)

- ▶ **Part III**
  - ▶ Line 4a Guaranteed payments for services;
  - ▶ Line 4b Guaranteed payment for capital; and
  - ▶ Line 4c Total guaranteed payments.

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Schedule K-1 (Form 1065)

▶ Part III 2019 New

- ▶ Part III Question 21 More than one activity for at-risk purposes.
- ▶ If more than one activity, then the partnership must generally report items of income, loss and deduction separately for each activity.
- ▶ Certain exceptions for active participation.

Schedule K-1 (Form 1065)

- ▶ Part III 2019 New Question 22 more than one activity for passive activity purposes.
- ▶ Attachment to Schedule K-1 must provide information separately for each activity.

Schedule K-1 (Form 1065)

- ▶ Part III 2019 Line 20 Code Z will be used to report Section 199A information (previously in 2018 Line 20 Code Z through AD were used to report Section 199A information).

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### Schedule K-1 (Form 1065)

- ▶ Part III Line 20 Code Z
  - ▶ The qualified business income (QBI) deduction, also known as the Section 199A deduction, is determined at the partner level where the partner is an individual, trust, or estate. Use code Z with an asterisk (Z\*) on each partner's Schedule K-1 and enter "STMT" in the entry space to indicate that the information provided on an attached statement that separately identifies the partner's distributive share of:
    - ▶ 1. Qualified items of income, gain, deduction, and loss;
    - ▶ 2. W-2 wages;
    - ▶ 3. Unadjusted basis immediately after acquisition (UBIA) of qualified property;
    - ▶ 4. Qualified publicly traded partnership (PTP) items; and
    - ▶ 5. Section 199A dividends also known as qualified real estate investment trust (REIT) dividends.

### Schedule K-1 (Form 1065)

- ▶ QBI Pass-Through Entity Reporting, or a substantially similar statement, to report information for each partner's distributive share from each trade or business;
- ▶ QBI Pass-Through Entity Aggregation Election(s), or a substantially similar statement, to report aggregated trades or businesses; and
- ▶ QBI Pass-Through Entity Reporting-Patrons of Specified Agricultural and Horticultural Cooperatives, or a substantially similar statement.

### Schedule K-1 (Form 1065)

- ▶ Part III Line 20 Code AC to report partner's share of Section 1(h)(5) gain or loss (collectibles).
- ▶ Part III Line 20 Code AD to report partner's share of deemed Section 1250 unrecaptured gain.

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### Schedule K-1 (Form 1065)

- ▶ Form 8990 Limitation on Business Interest Expense Under Section 163(j)-If the partnership is required to file Form 8990, then it must report the partner's distributive share of excess business expense.
- ▶ Part III new in 2018 Box 13 Code K to report partner's excess business interest expense under Section 163(j).

### Partnership Audits

- ◊ New rules (for partnership tax years beginning after 2017).
- ◊ Partnership tax assessments are generally made for the year in which the audit is resolved.
- ◊ The IRS can now collect imputed tax underpayment, penalties and interest from the partnership directly.
- ◊ Partnership representative:
  - ▶ Sole authority to act on behalf of partnership;
  - ▶ Does not have to be a partner; and
  - ▶ Must have US presence, and be an individual or designate individual on behalf of entity.
- ◊ Statute of limitations based on partnership return (generally three years).

### Electing Out of New Rules

- ◊ 6221 Small Partnership Election - revert to Pre-TEFRA rules that require IRS to work with partnership and each partner individually:
  - ▶ Available on an annual basis if timely file and elect out;
  - ▶ Each partner is eligible (no trust or LLC, no entity taxed as a partnership);
  - ▶ 100 or less partners; and
  - ▶ Each partner is notified.
- ◊ 6226 Alternative Election - partnership furnishes to IRS and each partner statement of partner's share of adjustment
  - ▶ Irrevocable;
  - ▶ Relieves the partnership from liability (except to extent cannot get payment from partners);
  - ▶ Precludes the IRS from collecting the tax imposed from other partners;
  - ▶ Subjects each person (who was a partner during the audit year) to tax liability (but not benefits) for the year during which the partnership issues the statement; and
  - ▶ But interest is higher and partners are subject to penalties.

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**Overview of Partnership Accounting and  
New Tax Return Reporting**

Houston CPA Society 2020 Tax Expo January 7, 2020

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