Anchin Alert

Anchin, Block & Anchin LLP
Accountants and Advisors

November 14, 2019

Recently Released Draft Partnership Tax Return Instructions and Schedule K-1 Raise Questions For Taxpayers

The newly released draft 2019 partnership tax return instructions and Schedule K-1 reflect changes resulting from the Tax Cuts and Jobs Act (TCJA), as well as from other IRS initiatives. This article will highlight some of those changes, with a focus on new IRS reporting requirements related to their effort to track partners' tax basis capital.

Tax Basis Capital Reporting

In prior years, partnerships had the option to report partners' capital on Schedule K-1 on either the tax basis, GAAP basis, 704(b) book basis or other basis. The draft 2019 Schedule K-1 eliminates the options and requires the partnership to report each partner's capital account on the tax basis. The IRS hinted at these potential changes earlier in the year (relevant to the 2018 tax year) with the requirement that partnerships disclose negative tax basis capital balances either at the beginning or end of the tax year. The 2019 proposed change would now require the disclosure of tax basis capital for all partners, and not just to those with negative balances.

The new tax basis capital reporting requirement is no small undertaking and will require a review of all prior year tax returns and Schedules K-1's starting from the partnership's inception, and will also require the partnership to accurately reflect transfers, assignments and sales of partnership interests in that time period. Private investment funds such as hedge funds, private equity funds and funds of funds will undoubtedly be adversely affected since they have generally maintained partners' capital accounts on a GAAP basis and were not previously required to keep track of each partner's tax basis.

The IRS Form 1065 FAQ page provides background on tax basis capital and guidance on how it is calculated. Instructions for Schedule K-1 and how the tax basis capital is to be reported are not available at this time. We will keep you posted as more information and guidance becomes available.

Additional Proposed Changes:

- Disregarded entities – New checkbox added to indicate if the partner is a "Disregarded Entity." Disregarded entities must provide the tax identification number and the name of the beneficial owner.
- Partner's share of profit, loss, and capital - New checkbox added to indicate if the decrease in percentages reported is due to sale or exchange of partnership interest.
- Partner's share of liabilities - New checkbox added to indicate if liabilities include liabilities from lower-tier partnerships.
- Partner's Share of Net Unrecognized Section 704(c) Gain or (Loss) - This new section of Schedule K-1 will require reporting of the beginning and ending built in gain (loss) for each partner. This would apply to partners who previously contributed appreciated property to the partnership in a nontaxable transaction. In prior years, this was only required to be reported in the year of the contribution.
- Guaranteed payments will be required to be shown separately if for services or for the use of capital.

While the 2019 partnership instructions and Schedule K-1 are in draft form, the IRS has let it be known that they do not expect the final versions (anticipated for release in December 2019) to deviate materially from the draft versions. Given the multitude of changes and reporting requirements, additional time and effort will be required to comply and prepare for the coming 2019 tax filing season.

Please contact your Anchin Relationship Partner or any member of Anchin's Financial Services Practice at your earliest convenience. We stand ready to help you plan effectively and to navigate through these new rules and reporting requirements. In the meantime, we will update you as soon as possible as more information or additional guidance is issued.

ANCHIN®
Your Expert Partner
Accountants and Advisors

Anchin, Block & Anchin LLP
Accountants and Advisors
1375 Broadway, New York, NY 10018
212.840.3456 • www.anchin.com