



September 14, 2020

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Ms. Margaret O'Connor
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Re: Comments on Proposed International Changes to Form 1065, Schedule K-2, and Schedule K-3

Dear Messrs. Hinding and Sutton, and Ms. O'Connor:

The American Institute of CPAs (AICPA) appreciates the efforts of the Department of the Treasury ("Treasury") and the Internal Revenue Service (IRS) in developing a redesigned partnership form for international tax reporting. The comments and suggestions provided by the AICPA are intended to support the efficient administration of tax compliance and reporting, while aligning information that partnerships already provide on schedules with the relevant tax forms used by partners.

Specifically, the AICPA submits two substantive recommendations to the Schedule K-2, *Partners' Distributive Share of Items--International*, and Schedule K-3, *Partner's Share of Income, Deductions, Credits, etc. – International*, package that includes the following items:

- I. Transmittal of Schedule K-3 in Portions
- II. Minimizing Overreporting by Allowing Partnerships the Ability to Determine the Reporting Needs of its Partners
- III. Additional Recommendations
- IV. Appendix – Recommended Form and Instruction Changes

In addition to the first two primary areas listed above, Part III includes our additional recommendations that the IRS make corresponding changes to other forms that are affected by the new schedules, including Form 1116, *Foreign Tax Credit (Individuals, Estate, or Trust)*, and

Form 1118, *Foreign Tax Credit – Corporations*. The additional comments also include a request that the IRS delay implementation of the new Schedules K-2/K-3 for one year (to taxable years beginning after December 31, 2021) in order to allow entities to make preparations for the new reporting requirements and to ensure the IRS ample time to make adjustments to other forms.

Finally, the Appendix included with this letter contains specific line-by-line comments to Schedules K-2/K-3 and the associated instructions.¹

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We appreciate your consideration of these comments and welcome the opportunity to discuss these issues further. If you have any questions, please contact Amy Wang, AICPA Senior Manager – Tax Policy & Advocacy, at (202) 434-9264 or Amy.Wang@aicpa-cima.com; Alexander Scott, AICPA Senior Manager – Tax Policy & Advocacy, at 202-434-9204 or Alexander.Scott@aicpa-cima.com; David Kirk, Chair, AICPA Foreign Partnership Reporting Task Force, at (202) 327-7189 or David.Kirk@ey.com; or me at (612) 397-3071 or Chris.Hesse@CLAconnect.com.

Sincerely,



Christopher W. Hesse, CPA
Chair, AICPA Tax Executive Committee

cc: The Honorable David J. Kautter, Assistant Secretary for Tax Policy, U.S. Department of Treasury
The Honorable Charles P. Rettig, Commissioner, Internal Revenue Service
The Honorable Michael J. Desmond, Chief Counsel, Internal Revenue Service
Mr. John P. Moriarty, Associate Chief Counsel, Income Tax and Accounting, Internal Revenue Service
Ms. Cindy Kim, Program Manager – Practice Network, Large Business & International, Cross Border Activities Practice Area, Internal Revenue Service
Ms. Karen Cate, Senior Advisor, Office of Associate Chief Counsel International, Internal Revenue Service
Mr. Peter Merkel, Branch Chief, Office of Associate Chief Counsel International
Ms. Erika Nijenhuis, Senior Counsel, Office of Tax Policy, U.S. Department of Treasury
Ms. Kamela Nelan, Attorney-Advisor, Office of Tax Policy, U.S. Department of Treasury

¹ These specific comments are intended to be in addition to the substantive comments.

AMERICAN INSTITUTE OF CPAs

Comments on Proposed International Changes to Form 1065 Schedule K-2 and Schedule K-3

September 14, 2020

BACKGROUND

Partnerships currently report information to partners on Schedule K-1 (Form 1065), *Partner's Share of Income, Deductions, Credits, etc.* ("Schedule K-1"). Information supporting certain amounts reported on the Schedule K-1 are often supplemented by numerous footnote statements and schedules to provide additional detail to the partners. In light of the complexity of the international tax rules, these supplemental whitepaper statements are necessary for partnerships with international transactions. However, this process caused the size of a Schedule K-1 package to vary greatly from partnership to partnership as a result of the dramatic U.S. federal tax changes to partnerships with global operations made by the 2017 Tax Cuts and Jobs Act (TCJA). Many TCJA provisions have altered the historic approach for partnerships and their limited information needed from its partners to now necessitate a much more expansive and comprehensive format that requires sharing of information between the partnership and partners.

Based on 2017 IRS data,² it appears that less than 5% of partnerships reported international transactions, and these partnerships accounted for more than 50% of all income reported on all partnership returns. However, as a result of the different formats and nomenclature used by different Schedule K-1 preparers, the information historically reported therein may make it difficult for partners to translate these details to their own tax returns. On July 14, 2020 Treasury and the IRS proposed changes to the Form 1065, *U.S. Return of Partnership Income*, for tax year 2021 (filing season 2022).³

The updates to Form 1065 are intended to provide greater clarity for partners on how to compute their U.S. income tax liabilities with respect to international tax matters, including how to compute deductions and credits. The draft Schedules K-2 and K-3 ("Schedules") intend to standardize the way a partnership reports international tax information to partners, offering greater transparency to the IRS, and clarity to both partnerships and their partners. Most of the information reported on Schedules K-2 and K-3 is already required for the partnership to provide to its partners or make available to the partnership under the current Schedule K-1 format.

I. Transmittal of Schedule K-3 in Portions

Overview

Beginning with tax year 2021 (*i.e.*, filing season 2022), partnerships must complete new Schedules K-2 and K-3 if a partnership: 1) must file a U.S. partnership tax return (Form 1065); and 2) it has

² [IRS 2017 Partnership Return Data](#). The [2019 IRS Data Book](#) has topline filing statistics.

³ We understand that the Schedule K-2/K-3 is also intended to apply to S corporations. For purposes of this letter, we intend the comments to apply to both partnerships and S corporations, as and when, appropriate.

items of international tax relevance (in general, certain specified non-U.S. activities or non-U.S. person partners). The new schedules would replace some of the reporting currently provided on the existing Schedule K-1.

Specifically, new Schedule K-2 would replace portions of Schedule K, while new Schedule K-3 would replace portions of Schedule K-1. Certain other sections expand types of international tax information not currently reported on Schedule K-1 (e.g., Schedule K-2, Part IV, Section 3 - Distributions for Foreign Corporation to Partnership, and Schedule K-3, Part IX, Foreign Partner's Character and Source of Income and Deductions). The new draft schedules only affect partnerships with U.S. reportable international tax items.

Recommendations

1. Treasury and the IRS should provide separate schedules that allow a taxpayer to more efficiently reflect the international tax reporting that is specific to the partnership and its partners.
2. Treasury and the IRS should provide guidance allowing all partnerships to limit the reporting obligation to the specific subset of international reporting required to allow the partnership and the partners of the partnership to satisfy their specific reporting obligations.

Analysis

The proposed standardized Schedules K-2 and K-3 will help streamline tax reporting and filing administration. This new reporting process may benefit partnerships with significant international tax reporting obligations from both an inbound and outbound perspective. However, for certain other partnerships that are only required to report a subset of the reporting contemplated through Schedules K-2 and K-3 (e.g., foreign tax credit information), the present comprehensive format of the schedules create an unnecessary tax compliance burden. An approach that "breaks apart" the draft schedules into relevant subsets allowing partnerships to prepare only those sections that are relevant to it and its partners would reduce this burden. In order to do this, the IRS could categorize partnerships in the same manner that U.S.-owned foreign corporations are categorized for purposes of filing Form 5471, *Information Return of U.S. Persons With Respect To Certain Foreign Corporations* or Form 8865, *Return of U.S. Persons With Respect to Certain Foreign Partnerships*.

Stated differently, a 22-page Schedule K-3 that may only contain several lines of useful information is largely unnecessary and is intimidating to unsophisticated taxpayers. For example, there is little need to provide a partner with a 22-page schedule simply because a partnership holds a mutual fund that has \$1,000 of foreign tax withholding reported to it on a Form 1099-DIV, *Dividends and Distributions*. A better approach is to have partnerships file a complete Schedule K-2 with the Form 1065, but only provide the partner with the sections of the Schedule K-3 that are relevant. Ideally (and similar to a Form 5471), Schedule K-3 would exist as a cover page with different boxes that taxpayers can check for each type of information that is communicated to the partner (current Part I), then Parts II-XII will contain separate sub-forms that are added on an as

needed. In the simple fact pattern above, the partner would receive a cover page Schedule K-3, along with a Part II, Section 1 and Part III Section 3 – a total of 3 pages.⁴

II. Minimizing Overreporting by Allowing Partnerships the Ability to Determine the Reporting Needs of its Partners

Overview

Based on our review, the instructions to the schedules allow some flexibility in which Parts of the Schedules are prepared based on those international transaction(s) that are relevant to a respective partnership or partners (a “downward approach”). Each Part provides varying standards as to whether it is required to be populated. While the new expanded reporting is intended to provide necessary information to the ultimate users, the proposed process currently allows for the possibility of significant over-reporting of information that is not relevant in determining the U.S. federal income tax of the partners.⁵ Reporting unnecessary information increases the reporting burden on partnerships, the likelihood for misreporting by partners, and complicates administrative processing by the IRS.

Recommendations

1. *The Upward Approach* – Treasury and the IRS should provide an approach that permits a second opportunity to consider the relevance of reporting to the users of the information, requiring the partnership to complete the Parts that it knows, or has reason to know are applicable to its partners.⁶
2. *The Alternative Downward Approach* – In the alternative, if a general “know” or “reason to know” standard for reporting is not acceptable for all Parts of the form, Treasury and the IRS should consider allowing partners to provide written notice to the partnership as to which parts of the schedules they require for their own U.S. federal income tax reporting. This procedure could be considered a “downward approach” to Schedule K-3 reporting.

Analysis

1. The Upward Approach

Under an upward approach, the AICPA recommends that the IRS expand the instructions to explicitly instruct population and reporting of the respective Parts of the Schedules only if the partnership knows or has reason to know that the respective Part applies to one or more of its

⁴ However, the partner still receives three more pages than they would have received under the previous reporting structure for example, before the proposed Schedule K-3.

⁵ For example, closely-held partnerships with all individual owners have no benefit in receiving section 250 FDII deductions in Part IV, nor would partnerships with all foreign Ultimate Beneficial Owners (UBOs) find relevant use for section 951A inclusions in Part V.

⁶ This approach is favorable from not just a partnership perspective but also helpful to partners who might receive a Schedule K-3 that is fully populated with many or most Parts that may not apply, adding confusion and risking the misreporting of U.S. federal income tax information.

direct or indirect partners. This “reason to know” standard is a common standard utilized elsewhere in reporting (see below). Instructions could insert this guidance.

This “reason to know” standard exists in the current draft of the Schedules:

- i. Schedule K-2, Part IX (Foreign Partners' Character and Source of Income and Deductions), and Schedule K-3, Part IX (Foreign Partners' Character and Source of Income and Deductions), must be populated by every partnership that has a foreign partner, or that knows, or has a reason to know, a foreign person has a U.S. income tax reporting obligation with respect to all or part of a distributive share of the partnership's income.
- ii. Schedule K-2, Part I (Partnership's Current Year International Transaction Information), and Schedule K-3, Part I (Partner's Share of Current Year International Transaction Information), Box 6, section 267A⁷ disallowed deduction.

The same “reason to know” standard is also already widely used in practice:

- i. Treasury Regulation § 1.897-2(g)(1)(ii) (a foreign person disposing of an interest in a domestic corporation may rely on documentation that the interest was not a United States real property interest as long as the foreign person did not know or have reason to know that the documentation was incorrect);
- ii. Treasury Regulation § 1.1441-7(b)(1) (a withholding agent must withhold at the full rate if it knows or has reason to know that that claim of United States status or a reduced rate is unreliable or incorrect);
- iii. Treasury Regulation § 1.6664-4(b)(1) (taxpayer's reliance on erroneous information on a Form W-2, *Wage and Tax Statement*, Form 1099-MISC, *Miscellaneous Income*, or other information return indicates reasonable cause and good faith provided the taxpayer did not know, or have reason to know, that the information was incorrect); and
- iv. Revenue Procedure 2019-40 adopted a “reason to know” standard in its safe harbors based on alternative information available, for determination of a controlled foreign corporation (CFC) based on attribution of stock ownership from a foreign shareholder under section 958(b)(4).

2. *The Alternative Downward Approach*

Providing notice to another party is a frequent requirement throughout the Code with some notices more formal than others. Partnerships often rely on their partners providing them notice through withholding certificates (*i.e.*, forms in the W-8 series and W-9, *Request for*

⁷ Unless otherwise indicated, references to a “section” are to a section of the Internal Revenue Code of 1986, as amended (the “Code”), and references to a “Treas. Reg. §” are to the Treasury regulations promulgated under the Code.

Taxpayer Identification Number and Certification) that allow the partnership to determine the status (domestic or foreign) and the tax classification (corporate or non-corporate) of its partners. Partnerships rely on these withholding certificates as the required documentation for this purpose and utilize this information to establish the foreign or non-foreign status of its partners, unless its knowledge or the statements on the form or other documentation would cause a reasonably prudent person to question the claims made.

A partnership that does not initially have such knowledge, but subsequently determines that the statement contains incorrect or unreliable information, is protected from penalties until such determination is made.⁸ Allowing partners to affirmatively request and inform the partnership through written notice as to which Parts of the Schedules are required – and therefore providing an exception to completing only those relevant Parts that partners give notice – provides reasonable relief to these extensive Schedules.

III. Additional Recommendations

1. Apply Framework to other Form Series

The provided framework of the Schedules K-2 and K-3 could apply to other series as well, in particular, to Form 1116 and Form 1118. For example, Form 1116 could be broken down into constituent schedules, or a Form 1116-EZ could be created to decrease the burden on taxpayers. Our recommendations above lend themselves to reducing the “information-overload” burden for taxpayers, practitioners, and the IRS. The tax system should strive for standardized information reporting and take advantage of automated software when available, but it should also strike the appropriate balance to limit “information-overload.”

2. Delay Reporting Requirements or Enable Transition Period

The AICPA understands that most (but not all) information is currently reported on footnotes attached to the Schedule K-1. However, due to implementation difficulties, such as software development and the COVID-19 pandemic affecting the entirety of the 2020 filing season, a delay until 2022 (taxable years beginning after December 31, 2021) would provide practitioners more time to become knowledgeable about the new Schedules and properly comply. Additionally, many partnerships, particularly tiered partnerships, do not have the resources to identify every indirect partner, their tax classifications, foreign versus domestic status for U.S. federal income tax purposes, or the necessary information the partners may need. A partnership and its partners could collaborate with respect to tax reporting obligations. However, as a practical matter, partners may be reluctant to share information with the partnership unless they are legally required to do so. As a result, partnerships may need to amend their partnership agreement or other governing documents to require partners to provide the information. Renegotiating and amending the partnership agreement may require a significant amount of time.

Alternatively, a reporting transition period during which taxpayers and practitioners use reasonable efforts to complete the forms would provide certainty and comfort in initial

⁸ Treas. Reg. § 1.1446-1(c).

compliance.⁹ Many taxpayers and practitioners will not have familiarity with the format of the information reported to them, as well as the information that is relevant to a particular taxpayer. Some taxpayers may sustain disproportionate compliance burden. A delay or transition period would enable taxpayers to gain familiarity, ultimately increasing compliance and correctness while decreasing the burden on the IRS in processing this information. Additionally, it would also allow time for the IRS to co-develop the changes to down-stream forms, such as Forms 1116 and 1118, in order to ensure that the entire new international reporting system is complete and consistent.

⁹ A transition reporting period similar to FATCA implementation is suggested as a “blueprint.”

IV. Recommended Form and Instruction Changes

APPENDIX

GENERAL COMMENTS

1. Guidance is needed on the interaction with the Centralized Partnership Audit Regime and whether all amounts reported on the Schedules K-2/K-3 are partnership related items for purposes of the Bipartisan Budget Act (BBA).¹⁰
2. Providing passive foreign investment company (PFIC) information for a qualified electing fund (QEF) will require more detail. In certain situations, foreign corporations that are CFC's with respect to a partnership may not necessarily have the same relationship with respect to all partners in that partnership. This dichotomy presents challenges in information reporting.
3. Part IV, Section 3 appears to require that passthrough entities report "Distributions from Foreign Corporations" to their partners. Elaboration is needed in the instructions pertaining to reporting challenges encountered when considering aggregate partnership treatment.
4. The draft forms do not include any information related to the dual-consolidated loss (DCL) rules. The IRS could require DCL reporting on the Schedule K-3 rather than, for example, on the Form 8858, *Information Return of U.S. Persons with Respect to Foreign Disregarded Entities (FDEs) and Foreign Branches (FBs)*.¹¹

PART II, Foreign Tax Credit Limitation

1. With respect to foreign income tax reporting, the IRS should adopt a unified framework for reporting this information by corporations and individuals. Our expectation is that this framework may lead to the potential for a single form that is used by all taxpayers for claiming foreign tax credits. For taxpayers whose only foreign tax credits arise from interest and dividends and other investments, we recommend the IRS develop an "-EZ" version of this form.

PART IV, Other Foreign Transaction Information for U.S. Partners

1. Global Intangible Low-Taxed Income (GILTI)
 - i. The new GILTI High Tax Exclusion (GILTI HTE or HTE) currently requires an election at the partnership level to the extent the partnership is a controlling domestic

¹⁰ Treas. Reg. § 301.6241-1(a)(6)(ii), -(iii).

¹¹ If DCL reporting is added to Schedule K-3, the IRS should remove the newly added requirement for partnerships to complete questions 10-13 on Schedule G to Form 8858 as if they were a corporation (new #5 under "Who Must File" in the Form 8858 instructions).

shareholder of a CFC. Confirmation is needed on how information reporting on Schedule K-2 or K-3 is affected by the HTE:

- a) Do not report information related to the application of the HTE rules on the Schedule K-3. The HTE relates to the calculation of a CFC's tested income/loss. If the HTE applies, report the amount excluded from gross tested income under the exclusion on Schedule I-1 of Form 5471. There is no information to report on Schedule K-3 with respect to an THE because it is a CFC-level item.¹²
- b) Under current law a domestic partnership making the HTE election is "controlling domestic shareholder."¹³ In that case, the partnership is required to provide notice to any of its partners that are US Shareholders of the CFC.¹⁴ Schedule K-3 should include language for the partnership to satisfy this notice requirement, if any, on the Schedule K-3 itself. This suggestion also could apply to other elections made by a partnership that require notice to the U.S. Shareholder-partners.¹⁵

2. Foreign-Derived Intangible Income (FDII)

- i. The instructions require the partnership to complete the section if it has a direct or indirect corporate partner.
 - a) Revise the instructions to not require reporting for tax-exempt corporate partners that do not have Unrelated Business Taxable Income (UBTI). Under Treas. Reg. § 1.250(b)-1(g), a tax-exempt corporate partner will have a FDII deduction only to the extent it is subject to the UBTI rules with respect to the underlying income.
 - b) It is common for intermediate partnerships in tiered partnership structures to know whether the ultimate partners are corporations. A partnership should have a requirement to provide the information only if it knows (or has reason to know) that there is an ultimate corporate partner.
 - c) In certain situations, a corporate partner may not take a FDII deduction. For example, the FDII deduction is subject to a taxable income limitation under section 250(a)(2) that could prevent a corporate partner from taking the deduction.¹⁶ Create an exception from reporting if the partnership knows that

¹² The unified Subpart-F/GILTI HTE proposed regulations would add regulatory authority for the IRS to require reporting of additional information related to HTE on the Form 5471.

¹³ Treas. Reg. § 1.964-1(c)(3).

¹⁴ Treas. Reg. § 1.951A-2(c)(7)(viii)(A)(1)(ii).

¹⁵ For example, add a checkbox to the form if an election was made, providing lines for the relevant information. The checkbox could generally refer to elections, rather than just the HTE (remove the checkbox when the unified Subpart-F/GILTI election proposed rules are finalized).

¹⁶ In that case, the FDII deduction does not add to a net operating loss (NOL) carryforward under section 172(d)(9).

its corporate partner is not taking a FDII deduction, thereby having no use for the information related to FDII.

- d) On line 3(a) through (c), the gross amounts of foreign-derived deduction eligible income (FDDEI) are reported on a separate category basis. FDII does not depend on source. Presumably, the separate-category information is provided to allow a corporate partner to allocate and apportion its FDII deduction under Treas. Reg. § 1.861-8(e)(13) for foreign tax credit (FTC) purposes. Nonetheless, the allocation and apportionment rule in Treas. Reg. § 1.861-8(e)(13) is based on FDDEI (which is a net number), rather than the gross income included in FDDEI. Provide the information for FDDEI on a separate category basis, rather than the gross amount of FDDEI income. Further, for this purpose, there is no need to break out the FDDEI amounts among the different FDDEI categories (*i.e.*, general property, intellectual property, and services).¹⁷
- e) Deduction eligible income (DEI) is a factor in determining FDII deduction. In addition, a corporate partner will need to file Form 8993, *Election of Partnership Level Treatment*, to claim its FDII deduction. The Form 8993 requires the reporting of the items excluded from DEI (lines 2a through f). The K-3 does not contain this information. Instead, the instructions require the partner to identify any amounts that are excluded from gross DEI. Difficulty arises when a partner is expected to make this determination with respect to income earned by the partnership, when many of the determinations are made at the partnership level. Guidance is needed as to how a partner is expected to make this determination with respect to income earned by the partnership, if this information is not provided on schedules by the partnership. Alternatively, the IRS should expand the form to allow the partnership to provide the exclusion amounts, rather than imposing that requirement on a partner that may lack access to the information necessary to make the determination.
- f) DEI is a net amount. The corporate partner needs to know the amount of expenses allocated to gross DEI in order to calculate its DEI. These expenses are not separately stated on the Schedule K-3. Rather, the instructions to the Schedule K-2 state that the partnership must separately state the expenses reported on line 5 that relate to DEI and those that relate to amounts excluded from DEI, returning to the white-paper reporting that the revised format is intended to avoid. The IRS should expand Part IV to either allow the reporting of net DEI or include the expense amounts allocated to gross DEI, in order to allow the partner to calculate its DEI.
- g) The partnership will need to calculate DEI in order to determine qualified business asset investment (QBAI) (reported on line 7), and presumably will know the amounts excluded from DEI. The IRS should require partnerships to

¹⁷ It does not appear necessary to have multiple columns (for the separate categories) for all the lines, when only one line needs to be reported on a separate category basis.

provide the exclusion amounts, rather than imposing that requirement on the partner, who may lack access to the information necessary to make the determination.

- h) Clarification is needed to the instructions for QBAI on line 7. The Schedule K-2 instructions state that all of the partnership's tangible property are assumed "partnership specified tangible property." The instructions include direct the partnership to separately state information on the partner's Schedule K-3 in order for the partner to determine its basis in specified tangible property. However, there is only one line 7. It is not clear whether the instructions are directing the partnership to deviate from the FDII regulations in calculating QBAI. Also, it is not clear whether the item reported to the partner on the Schedule K-3 is actually the QBAI number used in calculating the partner's FDII. The Schedule K-3 instructions state that the partner should only use a portion of the amount reported on line 7 but does not provide further guidance on how the partner determines that amount. The schedule should report to the partner the QBAI amount that it needs to consider in determining its FDII deduction.

3. Distributions from Foreign Corporations to Partnership

- i. The instructions reference section 245A. Reporting is not required for the following information: foreign-source portion of the dividend; the undistributed foreign earnings of the payor foreign corporation; and the partnership's holding period in the stock of the foreign corporation with respect to which section 245A potentially could apply. It is unclear how a partner obtains the information to determine the portion of its distributive share of a dividend for which it potentially could claim a section 245A dividend received deduction (DRD).
- ii. For tiered partnerships, the Schedule K-2 instructions for Rows A-0 reference section 958(a) ownership. If finalized, Treasury and the IRS should account for the language in Prop. Reg. § 1.958-1(d) and clarify that the rule in Prop. Reg. § 1.958-1(d)(2) applies for this purpose, rather than Prop. Reg. § 1.958-1(d)(1).¹⁸
- iii. The Schedule K-2 instructions, column (f), refer to Schedule R of Form 5471. Further guidance is needed on the interaction between the Schedule K-2 and forthcoming Schedule R.
- iv. Column (j) is a check box if a foreign corporation is a qualified foreign corporation. Clarification is needed whether that determination is made with respect to each partner if the corporation is both a CFC and a PFIC. Generally, a PFIC is not a qualified foreign corporation, but an entity that is both a CFC and a PFIC is a qualified foreign corporation with respect to section 951(b) U.S. shareholders under Notice 2004-70.

¹⁸ Proposed Reg. § 1.958-1(d)(1) states a domestic partnership is not treated as owning stock of a CFC within the meaning of section 958(a) for certain purposes). Similar application would also apply for Part V.

PART V, Information on Partners' Section 951(a)(1) and Section 951A Inclusions

1. The Schedule K-2 Instructions state that the partnership should assume that each partner is a U.S. shareholder of the CFC. This presumption will result in the partnership calculating and reporting information that is not necessary if no partner is a U.S. Shareholders in the CFC (e.g., a widely-held partnership). We recommend removing this assumption.¹⁹
2. The instructions to Schedule K-2 direct multiplying the percentage stated as the partner's share of CFC items by the amount of Subpart-F or GILTI item to determine the partner's share. The instructions leave flexibility for determining the shares of items under applicable special rules if the use of a generic percentage is not appropriate. In that case, it is unclear what to report as the partners' shares of CFC items if there are differences among items.
3. Part V does not currently include the tax year end of any CFCs held by the partnership. A U.S. shareholder takes into account its pro-rata share of the tested items of a CFC in the U.S. shareholder year that includes the last day of the CFC inclusion year. The IRS should request an inclusion of the tax year end of any CFCs held by the partnership.
4. The Schedule K-2 instructions provide that distributions of partnership previously taxed earnings and profits (PTEP) are not reported in Part IV. Partnerships that relied on Notice 2019-46 for 2018 have special reporting requirements for their GILTI PTEP under Notice 2019-46, §5.02, which is needed if a partner filed inconsistent with the partnership. Clarification is needed whether the Schedule K-3 should include the reporting required under Notice 2019-46, §5.02.
5. The Schedules K-2 and K-3 and most of the instructions refer to a partner's share of a section 951(a)(1)(B) inclusion. The instructions for the specific item on the Schedule K-2 indicates required reporting, consistent with treating Prop. Reg. § 1.958-1(d) as applying and with the required reporting of shares of Subpart-F income. Clarification is needed whether the partner's amount is determined under section 956, without regard to reductions under Treas. Reg. § 1.956-1(a)(2).

PART VI, Information to Complete Form 8621

1. Uncertainty exists whether the partnership needs to complete Part VI in all cases, or only needs to complete the part if it has a partner that has an obligation to file Form 8621, *Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund*.
2. Update the QEF inclusion to contain information applicable under section 1061. Section 1061 may require recharacterization of a partner's share of long-term capital gain with

¹⁹ The instructions should be similar to Part II and III (FTC). The K-2 instructions direct completion of the FTC sections only if the partnership has at least one partner that is eligible to claim FTCs, or has a partner that is a pass-through entity that has notified the partnership of a direct or indirect partner that needs the information. This standard is a reasonable and it is not clear why a different standard would apply for Part V.

respect to an applicable partnership interest (API) as short-term capital gain unless the capital asset has been held for more than three years. The section 1061 proposed regulations allow a partnership to look-through net capital gain inclusions, provided the underlying QEF supply the necessary information. In particular, a QEF may provide to each electing shareholder additional information to enable applicable partnership interest holders to determine the amount of their inclusion under section 1061.

3. Although the purpose of the requirement to provide information regarding accumulated post-1986 earnings and profits (E&P) for a PFIC that is also a CFC is presumably to allow partners information necessary to make a deemed dividend purging election, the required information, without more, is unlikely sufficient. Under Treas. Reg. § 1.1297-3, the required income inclusion amount is limited to the E&P accumulated while the foreign corporation was a PFIC and during the shareholder's holding period, and the Schedules K-2 and K-3 do not require information helpful to apply such limitation. The instructions should not require this information unless a partner requests it in connection with making that particular purging election.
4. It appears that Part VI needs completion for each PFIC that the domestic partnership directly or indirectly owns (even if it owns it through another domestic partnership), regardless of whether any of the partners are subject to the PFIC rules. In this case, the partnership would need to complete this section even if none of its partners are subject to the PFIC rules, or do not need all of the information in this section (see examples below). Therefore, in the below examples, the instructions should not require the PFIC information if no partner is subject to the PFIC rules.
 - i. Revise the instructions along the lines of the FTC section to require partnerships to complete this section only if they have a direct partner subject to the PFIC rules or are notified by a passthrough partner that an indirect partner is subject to the PFIC rules.
 - ii. Any U.S. partner that makes a mark-to-market election for the PFIC under a provision other than section 1296 is not required to file Form 8621 under Treas. Reg. § 1.1298-1(c)(3). It does not have any PFIC income inclusions, other than potentially in the first year of the election as required under Treas. Reg. § 1.1291-1(c)(4).
 - iii. Tax-exempt partners that are not subject to UBTI with respect to the PFICs are not required to file Form 8621 under Treas. Reg. § 1.1298-1(c)(1). They are not subject to the PFIC rules under Treas. Reg. § 1.1291-1(e).
 - iv. A domestic partnership could own a foreign corporation that is both a CFC and a PFIC. If the partners are not subject to the PFIC rules under section 1297(d) because they are subject to the subpart-F rules, the partnership should not have to complete this section.
 - v. U.S. partners of U.S. partnership do not have to file Form 8621 if the PFIC is a pedigreed QEF (provided the partnership files) although they would need to know their

QEF inclusion. The Schedule K-3 appears to contemplate that a U.S. partner of a U.S. partnership might have a filing obligation for the partnership's QEF.²⁰

PART VIII, Partners' Information for Base Erosion and Anti-Abuse Tax (Section 59A)

1. Update Lines 1-5 to include additional lines or columns to show effectively connected income (ECI) gross receipts and deductions. Line 1 of both the Schedules K-2 and K-3 states "Gross receipts for section 59A." The gross receipts that a partner takes into account may differ depending whether the partner is a domestic or foreign corporation.²¹ We recommend an additional line or column to show ECI gross receipts. For example, Line 1a reflects total gross receipts and line 1b reflects ECI gross receipts. The same issues apply for Lines 2-4 relating to gross receipts for prior years and for line 5 relating to items, including deductions, included in the denominator of the base erosion percentage as described in Treas. Reg. § 1.59A-2(e)(3).
2. Lines 1-4 state: "For purposes of determining gross receipts of a partnership which has an interest in a foreign entity, include the foreign entity's gross receipts only when such gross receipts are taken into account when determining the foreign entity's income effectively connected with a U.S. trade or business (ECI)." If the foreign entity is a partnership, the partnership partner would take into account its share of the lower-tier partnership's gross receipts, regardless of source. If the foreign entity is a corporation, the partnership shareholder includes in its gross receipts only dividends, interest, other income paid by the corporation to the partnership. However, a domestic corporate partner generally takes into account gross receipts from all sources, and the quoted statement does not appear accurate as it relates to domestic corporate partners. We recommend clarification whether the statement is meant to address the domestic and foreign corporate partners or whether it is intended to address interests held in foreign pass-throughs and corporations. If the latter, the statement may require editing.
3. Clarify the requirement to provide Schedule K-3, Part VIII only to the extent a direct or indirect partner is an applicable taxpayer. It is unclear whether the sum of Schedules K-3 items should equal the Schedule K-2 items where the Schedule K-3 reporting is not required for certain partners. The instructions indicate that the partnership does not need to complete Schedule K-3, Part VIII, for a corporate partner that is an S corporation.²² A direct partner that is individual, estate, trust, regulated investment company (RIC), or real estate investment trust (REIT) is also not subject to the base-erosion anti-abuse tax. We

²⁰ This approach is consistent with an aggregate approach for QEF inclusions, similar to proposed Subpart-F treatment of domestic partnerships.

²¹ For example, a domestic corporate partner generally takes into account its share of the partnership's total gross receipts, regardless whether the gross receipts are U.S. or foreign source, and regardless whether the gross receipts relate to passive or active income. However, a foreign corporate partner takes into account only its share of partnership gross receipts that relate to ECI (or to a permanent establishment, if applicable). In addition, if a direct partner is itself a partnership that has direct or indirect domestic and foreign corporate partners, the partnership-partner would need the breakout of ECI gross receipts vs. non-ECI gross receipts to report that information to its partners.

²² Presumably, this is to clarify that a partnership does not need to report Part VIII for a partner that is neither a pass-through partner nor an applicable taxpayer.

recommend clarifying whether direct partners that are not applicable taxpayers are required to report Schedule K-3.

4. Additional clarification is needed in the instructions regarding the phrase: “It is expected that the partnership will collaborate with its partners to identify the foreign related parties of each partner.”

PART IX, *Foreign Partners’ Character and Source of Income and Deductions*

1. Proposed Reg. § 1.163(j)-8 provides that the portion of a specified foreign partner’s allocable share of excess taxable income (ETI), excess business interest expense (EBIE), and excess business interest income (EBII) should be bifurcated between the portion treated as ECI and non-ECI. Part IX should be updated to report the tax attributes (*i.e.*, ECI and non-ECI portions) associated with any EBIE allocated to the partners.
2. The instructions indicate that partnerships with partners that have elected under section 871(d) to treat rental income not as fixed, determinable, annual, periodical income (FDAP) but instead as ECI are to report on Schedule K-3 the relevant income instead as ECI under column (f) and not as FDAP under (c). As this election is made on the income tax return of the partner, such elections have likely not historically been communicated to the partnerships. This alternative reporting on the Schedule K-3 requires the partnership to collect these elections by their partners in advance of the initial election and retain such information until revoked by the partner (who, likewise, must presumably inform the partnership in advance of revoking the choice). Challenges arise in the timing of the initial elections and revocations, as well as assigning an added documentation requirement to the partnership, and it is unclear the purpose of making this reallocation on Schedule K-3 versus solely at the partner level.