August 31, 2022

Ms. Karen Cate
Senior Advisor
Office of Associate Chief Counsel
1111 Constitution Avenue, NW
International, Branch 2
Washington, DC 20224

Re: Urgent Request for Immediate Guidance Regarding New International Reporting Requirements, Schedule K-2 and Schedule K-3 for Tax Year 2021

Dear Ms. Cate:

The American Institute of CPAs (AICPA) acknowledges the substantial efforts of the Department of the Treasury ("Treasury") and the Internal Revenue Service (IRS or "Service") in developing a redesigned international tax reporting passthrough form, releasing final instructions, and providing certain transition penalty relief for tax year 2021.[1] The AICPA appreciates the consideration given to our prior recommendations[2] on international changes to Schedule K-2, *Partners' Distributive Share of Items – International* and Schedule K-3, *Partner's Share of Income, Deductions, Credits, etc. – International* (collectively with Schedule K-2, the "Schedules") for Form 1065, *U.S. Return of Partnership Income*, Form 8865, *Return of U.S. Persons With Respect to Certain Foreign Partnerships*, and Form 1120-S, *U.S. Income Tax Return for an S Corporation.*[3]

As previously discussed, we have identified additional issues that practitioners are facing this filing season and urge the IRS to provide immediate guidance in these areas, which are critical to taxpayers in complying with the filing requirements. Specifically, the following items urgently require clarification for taxpayers to properly comply with the reporting requirements of Schedule K-2 and Schedule K-3 for the 2021 tax year and beyond:

I. Provide Broader Exceptions to Schedules K-2 and K-3
   1. Relevance Exception
   2. Partner Attribute Requirement

[1] *See* Notice 2021-39 (limited penalty relief), IR-2022-38 (Feb. 16, 2022), Schedule K-2 and K-3 Frequently Asked Questions (FAQs) (rev. Feb. 16, 2022).
[2] See AICPA comment letter, "Comments on Proposed International Changes to Form 1065, Schedule K-2, and Schedule K-3," submitted September 14, 2020 and "AICPA Additional Comments Regarding Schedule K-2 and Schedule K-3", submitted February 18, 2022.
[3] Post release changes to the Schedules K-2 and K-3 Instructions for passthrough entities were released on January 18, 2022. For the sake of simplicity, all references in this letter refer will refer to Form 1065 although the comments herein apply equally to Forms 8865 and 1120-S.

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3. General Presumption

II. Provide a Permanent Extension of the Exception from Filing Schedules K-2 and K-3 for Certain Domestic Partnerships and S Corporations as provided in Frequently Asked Question (FAQ) 15[4]

III. Allow for a Consolidated Form 8082 Disclosure Filing

IV. Clarify and Simplify the Foreign Tax Credit Information Reporting on Partnership Level on Schedules K-2 and K-3, Part II

V. Allow Summarized Information on Schedule K-3, Part I, Box 1, Gain on Sale of Personal Property

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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 Cory Perry, Chair, AICPA Foreign Partnership Reporting Task Force, at (202) 521-1509, or Cory.Perry@us.gt.com; Arlene Schwartz, AICPA Senior Manager – Tax Policy & Advocacy, at (202) 434-9218, or Arlene.Schwartz@aicpa-cima.com; or me, at (601) 326-7119, or JanLewis@HaddoxReid.com.

Sincerely,

Jan Lewis, CPA
Chair, AICPA Tax Executive Committee

cc: The Honorable Charles P. Rettig, Commissioner, Internal Revenue Service
Mr. William M. Paul, Principal Deputy Chief Counsel, Internal Revenue Service

[4] Schedules K-2 and K-3 Frequently Asked Questions (Forms 1065, 1120S, and 8865).

AMERICAN INSTITUTE OF CPAs

Urgent Request for Immediate Guidance Regarding New International Reporting Changes, Schedule K-2 and Schedule K-3

August 31, 2022

I. Provide Broader Exceptions to Schedules K-2 and K-3

Background

Under section 6031(a) and the regulations thereunder, partnerships are required to make a return stating the items of gross income and deductions and any other information as prescribed by the forms and instructions. Additionally, under section 6031(b), to the extent required by forms and instructions, partnerships must provide their partners with all information needed to compute their federal income tax liability. Prior to the 2021 tax year, Line 16 and certain Line 20 codes on Schedules K-1 were used to report foreign transactions. The instructions to the Schedule K-1 stated that a partnership was required to attach whitepaper detail for additional international items not presented on the face of Schedule K-1.

For tax years beginning with 2021, the IRS introduced Schedules K-2 and K-3 (the "Schedules") to allow pass-through entities to report items of international tax relevance. Specifically, a partnership with items of international tax relevance will file Form 1065 and Schedule K-1, check the international checkbox on Line 16 and attach Schedules K-2 and K-3[5] (the "Schedules"). The Schedules are designed to report certain international items previously reported on Schedule K, Schedule K-1, and on whitepaper statements. A partnership may still need to attach whitepaper statements as described in the instructions to the Schedules K-2 and K-3 (the "Instructions").

The Instructions indicate that a partnership does not need to complete the Schedules if it does not have items of "international tax relevance." However, this statement is misleading as the terminology, "items of international tax relevance," is broader than commonly construed. For example, partnerships with domestic activity only may be required to file the Schedules because a partner in the partnership may need certain information for use in their foreign tax credit (FTC) determination. The post release changes[6] ("Post Release Changes") to the Instructions acknowledge this fact by stating that the Schedules may apply even if the partnership has "no foreign source income, no assets generating foreign source income, and no foreign taxes paid or accrued."[7]

[5] There are similar schedules and instructions for Forms 1120-S and 8865. To simplify the discussion, this letter will refer to Form 1065 solely, but the comments are equally relevant for Forms 1120-S and 8865.
[6] See https://www.irs.gov/forms-pubs/changes-to-the-2021-partnership-instructions-for-schedules-k-2-and-k-3-form-1065. There are similar post release changes for Forms 1120-S and 8865.
[7] "For example, if the partner claims a credit for foreign taxes paid by the partner, the partner may need certain information from the partnership to complete Form 1116."

Schedules K-2 and K-3 have 12 and 13 parts, respectively, with each part covering a separate international reporting requirement. The Instructions include a detailed description of when a partnership is required to complete, file, and provide a specific part of the Schedules. The requirement to file some parts is solely dependent on the partners' attributes ("Partner Attribute Requirement")[8] whereas other parts also depend on the partnership's investments ("Investment Requirement").[9]

If a partnership does not have or does not receive sufficient information to determine the Partner Attribute Requirement of its direct or indirect partners, several of the parts of the Schedules require the partnership to presume the information is relevant and to complete, file, and provide the part to its partners ("General Presumption"). For example, Part IV (Information on Partners' Section 250 Deduction With Respect to Foreign Derived Intangible Income (FDII)) is required to be completed if a partnership has a direct or indirect domestic corporate partner and if a partnership does not know whether it has any direct or indirect domestic corporate partners. If a lower-tier partnership (LTP) is owned by a pass-through entity, it is common for the LTP to not know or be unable to obtain information about its indirect ownership, especially if the ownership is held through more than one tier of pass-through entities.

It is difficult for partnerships to have transparency with their partners' attributes, especially with regard to indirect partners. Many partnerships are held indirectly through multiple tiers of pass-through entities. The Instructions provide that "except as otherwise required by statute, regulations, or other IRS guidance, a partnership is not required to obtain information from its direct or indirect partners to determine if it needs to file each of these parts."[10]

When a partnership does not know or have a reason to know the tax attributes of its direct or indirect partners, the Schedules place an administrative burden on the partnership by requiring certain parts to be completed whether or not it has any ultimate relevance to its direct and indirect partners. This requirement is in direct contrast to Schedules K and K-1, which generally require a partner to notify the partnership when certain information is required to be reported based on the tax attribute of the partner. For example, while section 6031(d) requires a partnership to report information to allow any partner that is a tax-exempt organization to determine their tax, the instructions for Form 1065 indicate that the burden is on the partner to notify the partnership of this need. Therefore, presumably only upon the notification is the partnership required to report

[8] Parts II (Foreign Tax Credit Limitation), III (Other Information for Preparation of Form 1116 or 1118), IV (Information on Partners' Section 250 Deduction With Respect to Foreign Derived Intangible Income (FDII)), IX (Partners' Information for Base Erosion an Anti-Abuse Tax (Section 59A), and X (Foreign Partners' Character and Source of Income and Deductions) are required to be completed solely based on a Partner Attribute Requirement. For example, partnerships that have any foreign persons as a direct or indirect partner are required to complete Part X.

[9] Parts V (Distribution from Foreign Corporation to Partner), VI (Information on Partners' Section 951(a)(1) and Section 951A Inclusions), VII (Information to Complete Form 8621), and VIII (Partnership's Interest in Foreign Corporation Income (Section 960) may be required to be completed if a partnership holds interest in certain foreign corporations. For example, Part VI (Information on Partners' Section 951(a)(1) and Section 951A Inclusions) must be completed with respect to a CFC if the partnership owns (within the meaning of 958) stock of the CFC subject to certain exceptions.

[10] Page 1 of Instructions.

the unrelated business taxable income (UBTI) information.[11] If, instead, the General Presumption were to apply, a partnership would have a significant burden reporting the additional UBTI information when that information may not be needed for any direct or indirect partner.

1. *Relevance Exception*

Recommendation

The AICPA recommends that the IRS provide guidance adding the Relevance Exception to each part of the Schedules. If the broader principle of the Relevance Exception was applied to each of the parts, it would alleviate the partnership requirement to report data that has no relevance to any of its partners and mitigate the costs of reporting unnecessary information.

Analysis

The requirement to file certain parts of Schedules K-2 and K-3 place an undue administrative burden on partnerships when it does not know or have a reason to know the tax attributes of its direct or indirect partners. Therefore, we suggest that the IRS provide comprehensive exceptions from filing. While the IRS has previously granted additional exceptions in response to prior comments, it would be difficult and inefficient undertaking to identify all situations where an exception may be warranted. However, the IRS has previously granted broader exceptions where a partnership knows or has reason to know that its partners (direct or indirect) do not need certain required information. For example, in the Post Release Changes, the IRS allows partnerships to forgo providing Form 5471, *Information Return of U.S. Persons With Respect to Certain Foreign Corporations*, if a partnership knows or has reason to know its direct or indirect partners do not need the information on Form 5471 to prepare their tax returns. The exception applies if the partnership knows or has reason to know the information has no relevance to the partners' determination of their tax ("Relevance Exception"). While there doesn't appear to be a definition in the statute of "know" or "have reason to know," the IRS generally has applied a facts and circumstances test when analyzing the standard for other purposes, such as sections 6015 and 4965.[12] In the context of penalty relief for Schedules K-2 and K-3 for tax years that begin in 2021, Notice 2021-39 also seems to apply a fact and circumstances test[13] when making assumptions around having a reason to know.

[11] Similar guidance is given for reporting qualifying income information, within the meaning of section 7704(c)(2), for partners who are publicly traded partnership.

[12] R.F. Kling, 81 TCM 1448; Dec, 54,292(M), TC Memo 2001-78; Treas. Reg. § 53.4965-6.

[13] Per Notice 2021-39 "... the reasonableness of an assumption may differ with respect to a partner that manages or controls the partnership, or a partnership with a partner with a significant interest in the partnership, such as a partner with a 10-percent interest, as compared to partners holding small interests for which there may not be the same ease of access to information."

2. Partner Attribute Requirement

Recommendation

Additionally, we recommend that the IRS provide guidance requiring a partnership to provide the information for parts that solely have a Partner Attribute Requirement (i.e., Parts II, III, IV, IX, and X, and collectively, the "PAR Only Parts") only when notified by the partner, unless the partnership knows or has reason to know it has direct or indirect partners meeting the Partner Attribute Requirement of the specific part.

Analysis

To be consistent with the instructions for Form 1065 and to reduce the administrative burden on partnerships, we suggest that the IRS require partnerships to fill out the PAR Only Parts only in cases when there is a Partner Attribute Requirement.

3. General Presumption

Recommendation

The AICPA recommends that the IRS issue guidance removing the General Presumption from all parts of Schedule K-2 and K-3.

Analysis

The definition of who must file according to the Partner Attribute Requirement, Investment Requirement, and General Presumption is broad, and certain situations warrant exceptions from filing. For example, Part IV, may be required, even if a partnership knows its domestic corporate partner(s) is/are not claiming a section 250 deduction, merely because the partner(s) is/are a corporate entity. To alleviate unnecessary administrative burden, we suggest that the IRS remove the General Presumption from all parts of Schedule K-2 and K-3.

II. Provide a Permanent Extension of the Exception from Filing Schedules K-2 and K-3 for Certain Domestic Partnerships and S Corporations as provided in Frequently Asked Question (FAQ) 15

Background

On January 18, 2022, the IRS introduced post-release changes [14] specific to the Schedules K-2 and K-3 Instructions for all pass-through entities. As a result of feedback from stakeholders on the breadth of the potential reporting, the IRS provided additional relief for certain domestic pass-through entities within updated FAQs regarding the Schedules K-2 and K-3. FAQ 15 was added

[14] See https://www.irs.gov/forms-pubs/changes-to-the-2021-partnership-instructions-for-schedules-k-2-and-k-3-form-1065.

on February 16, 2022,[15] which provides an exception for tax year 2021 from filing Schedules K-2 and K-3 for certain domestic partnerships and S corporations.

Recommendations

The AICPA recommends that the IRS issue guidance permanently extending the exception granted in FAQ 15, from filing Schedules K-2 and K-3, for certain domestic partnerships and S corporations. We also recommend announcing the permanency of the exception prior to the 2021 tax year extended filing season deadline of September 15, 2022.

In addition, the AICPA recommends that the IRS clarify the application of FAQ 15, requirement Number 3 in relation to the exception from filing Schedules K-2 and K-3.

Analysis

The AICPA appreciates the IRS's inclusion of the exception from filing Schedules K-2 and K-3 for tax year 2021 for certain domestic partnerships and S corporations, which provides welcome relief to many pass-through entities. Permanently extending this exception and clarifying its application would provide further relief to pass-through entities, particularly small pass-through entities where the added administrative burden may outweigh any benefit obtained from the additional information reporting. If the exception is not permanently extended, these pass-through entities will require sufficient advance notice to adequately prepare for future filing season with regard to additional staff training, client education and engagement management.

The FAQ 15 exception applies if the pass-through entity meets the following requirements:

1. In tax year 2021, the direct partners in the domestic partnership are not foreign partnerships, foreign corporations, foreign individuals, foreign estates, or foreign trusts.

2. In tax year 2021, the domestic partnership or S corporation has no foreign activity, including foreign taxes paid or accrued or ownership of assets that generate, have generated, or may reasonably be expected to generate foreign source income.[16]

3. In tax year 2020, the domestic partnership or S corporation did not provide to its partners or shareholders—nor did the partners or shareholders request the information regarding (on the form or attachments thereto) both:

    a. Line 16, Form 1065, Schedules K and K-1 (Line 14 for Form 1120-S); and

[15] https://www.irs.gov/businesses/schedules-k-2-and-k-3-frequently-asked-questions-forms-1065-1120s-and-8865.
[16] Treas. Reg. § 1.861-9(g)(3).

b. Line 20c, Form 1065, Schedules K and K-1 (Controlled Foreign Corporations, Passive Foreign Investment Companies, Form 1120-F, section 250, section 864(c)(8), section 721(c) partnerships, and section 7874) (Line 17d, Form 1120-S)

4. The domestic partnership or S corporation have no knowledge that the partners or shareholders are requesting such information for tax year 2021.

Per the FAQs, pass-through entities that qualify for this exception are not required to file Schedules K-2 and K-3 with the IRS or with their investors. However, if a pass-through entity is subsequently notified by a partner or shareholder that all or part of the information contained on Schedule K-3 is needed to complete their tax return, then the pass-through entity must provide the information to the partner or shareholder.

We also suggest clarifying the exception requirement in item Number 3 in FAQ 15. Some entities may have reported information on the relevant lines even though they were not *required* to provide such information in tax year 2020. The exception under FAQ 15 should be available to such taxpayers, provided they meet the other requirements under FAQ 15. As a result, we recommend that requirement Number 3 under FAQ 15 be reworded to apply to those domestic partnerships or S corporations that were *not required* to provide to its partners or shareholders the relevant information noted in requirement Number 3.

III. Allow for a Consolidated Form 8082 Disclosure Filing

Background

FAQ 16 provides that if an upper-tier pass-through entity believes that it should have received a Schedule K-3 from a lower-tier pass through entity but it did not receive such Schedule, it should use Form 8082, *Notice of Inconsistent Treatment or Administrative Adjustment Request (AAR)* to notify the IRS. The FAQ indicates that the IRS plans to release a new cover sheet for Form 8082 containing similar guidance. A draft version of instructions for Form 8082 was released on July 29, 2022 and incorporates the guidance in FAQ 16.[17]

Recommendation

The AICPA recommends that the IRS update the instructions to Form 8082 to allow an upper-tier partnership (UTP) that did not receive Schedules K-1 or Schedules K-3 with respect to lower-tier partnerships, to disclose all such partnerships in a single Form 8082.

[17] The draft Form 8082 instructions released July 29, 2022 note "If the pass-through entity didn't give you a Schedule K-1, Schedule K-3 (and the pass-through entity was required to provide one to you according to the instructions for Schedule K-2), Schedule Q, and/or foreign trust statement by the time you are required to file your tax return, enter as the explanation, "Schedule K-1 (Schedule K-3, Schedule Q, and/or foreign trust statement) not received."

Analysis

The instructions to Form 8082 require a separate form to be completed for each pass-through entity for which there is reporting of an inconsistent or AAR item. In certain industries, such as asset management, many partnerships may receive hundreds or thousands of Schedules K-1. Although a UTP generally should receive the same amount of Schedules K-3 as Schedules K-1, numerous investments are not furnishing the anticipated Schedules K-3, or are not furnishing it timely enough for a UTP to provide them to its own partners by its contractual deadlines.[18] This compression issue is exacerbated if the UTP is itself owned by one or more indirect pass-through entities. Therefore, to alleviate the administrative burden, we suggest allowing a UTP that did not receive Schedules K-1 or K-3 with respect to lower-tier partnerships to file a single Form 8082.

IV. Clarify and Simplify the Foreign Tax Credit Information Reporting on Partnership Level on Schedules K-2 and K-3, Part II

Background

Part II of Schedules K-2 and K-3 is used to determine a partnership or S corporation's income or loss by source, separate category of income, and to report the partner or the shareholder's distributive share of such income or loss. This information is used by the partners or shareholders to determine and claim the FTC on Forms 1116 or 1118. Forms 1116 and 1118 require the taxpayer to report the foreign country or United States (U.S.) possession with respect to which the gross income is sourced. Thus, to align with Forms 1116 and 1118, the Instructions to Schedules K-2 and K-3 require the taxpayer to enter on a separate line, the two-letter code from the list[19] for the foreign country or U.S. possession within which the gross income is sourced. Further, the Instructions explicitly prohibit the use of "various" or "OC" for the country code.[20]

Recommendations

The AICPA recommends that the IRS minimize the administrative burden on taxpayers by:

- Removing the per-country reporting of gross income for Part II of Schedules K2 & K3 and replacing it with a question to either Schedule B (Form 1065) or Schedule K-2 asking whether a partnership made payments for certain disallowed credits for refundable and noncompulsory payments and for taxes paid to certain countries.

[18] The draft Form 1065 that was released on July 20, 2022, appears to acknowledge this concern. New Question 29 of Schedule B asks, "how many Schedules K-1 and Schedules K-3 were not furnished or will not be furnished timely?" Presumably, this question will enable the IRS to further study the issue, but it would be helpful for the IRS to clarify the purpose of the question in the instructions for Form 1065.

[19] https://www.irs.gov/e-file-providers/foreign-country-code-listing-for-modernized-e-file.

[20] The instruction for Form 1065, Schedules K-2 and K-3 explicitly note that "Do not enter "various" or "OC" for the country code.". The changes to the 2021 instructions for Schedules K-2 and K-3 (Form 8865) provide that "If income is U.S. source, enter "US." Do not enter "various" or "OC" for the country code."

Also, we recommend making corresponding changes to remove per-country reporting on Forms 1116 and 1118.

Alternatively, the AICPA recommends allowing a partnership to aggregate all countries with FTC allocable to each partner of less than $600 into a single code designating an aggregation of countries.

- Allowing, unless the partnership has been notified that the partner requires such information, the entry of "OC" (or another similar code) where the source of an item of gross income or gain is determined by the partner instead of specific country codes in Part II of Schedules K-2 and K-3 with an indication being provided to the partner that this information is available upon request.

  The AICPA further requests that Forms 1116 and 1118 also allow for the entry of "OC" unless the country is relevant to the taxpayer's overall FTC limitation calculation.

  Alternatively, we recommend that the IRS clarify how a code should be reported when the income is sourced at the partner level.

- Clarifying in the Instructions or FAQs, as to the proper use and application of the additional codes (i.e., section 863(b), section 951A, NOL, HTKO, G2B, B2G, QBU and section 909 Income) on the Schedules K-2/K-3.

Analysis

Even though the section 904 FTC limitation has been applied on a separate-category-of-income basis, instead of on a per-country basis, since 1976, Treasury and the IRS continue to require the reporting of per-country information. The per-country information allows the IRS to monitor compliance with the section 901 rules that disallow credits for refundable and noncompulsory payments and for taxes paid to certain countries.[21] However, there is IRS precedence for reducing the burden on taxpayers. In the context of regulated investment companies (RICs), the preamble to the final section 853 regulations published in 2007, acknowledges that in the context of RICs, there is a significant taxpayer burden to provide the information on the tax return. Therefore, taking the administrative burden into consideration, the IRS provided that the information is generally not required to be reported to the RICs' shareholders. Instead, the section 853 regulations were revised to require that only summary foreign income and foreign tax amounts be reported to its shareholders, and Form 1116 and 1118 provide an exception to the per-country reporting for mutual funds and other RICs.

While the Instructions provide that a partnership is not allowed to report gross income using "OC" or "Various," a UTP may receive Schedules K-3 from one or more LTPs that used "OC" or "Various." Section 6222 provides that a partner must treat any partnership-related item in a manner

[21] T.D. 9357, 72 FR 48553, Aug. 24, 2007.

which is consistent with the treatment of such item on the partnership return. To report consistently with a Schedule K-1 that used "OC" or "Various," the UTP may need to also report using "OC" or "Various." It is also not uncommon for a partnership or S Corporation to receive Forms 1099s brokerage statements with "OC" or "various" listed as the country code.

Additionally, while specific foreign country names are required to be reported on Form 1116, Form 1118, and Forms' 1065 and 1120-S Schedules K-2 and K-3, under current law such information is generally irrelevant to the determination of the foreign tax credit limitation except in limited situations (e.g., where the taxpayer has income re-sourced by treaty). Further, Schedule K-3 appears to require a country code even when the income is sourced to a country at the partner level. A partnership generally does not know what country the income will be sourced to when it is sourced at the partner level. Therefore, removing the per-country reporting requirement on Schedules K-2 and K-3 for gross income will allow partnerships to provide its partners with the information needed for foreign tax credit purposes, while alleviating an unnecessary administrative burden.

Some partnerships will also experience a similar burden because they may have gross income sourced to many countries, the amounts of which are relatively small or *de minimis*. If the primary purpose of the per-country information is to monitor certain disallowed foreign taxes or payments, it would be less burdensome for partnerships to self-disclose those payments or taxes. Schedule B (Form 1065), for example, has similar questions in the context of section 267A disallowed deductions and certain transfers subject to the disguised sale disclosure requirements of Treas. Reg. § 1.707-8. Finally, the e-file schema released by the IRS includes the following additional country codes: 863(b), 951A, NOL, HTKO, G2B, B2G, QBU and 909 Income.[22] These country codes are not listed in the IRS's Foreign Country Code Listing for Modernized e-File (MeF),[23] nor are they described in the various form instructions.

V. Allow Summarized Information on Form K-3, Part I, Box 1, Gain on Sale of Personal Property

Background

Schedule K-3, Part I, Box 1 (Gain on sale of personal property) requires a partnership to report detailed transaction-by-transaction information. Per Table 1 (Information on Personal Property Sold) of the Instructions, transaction-by-transaction reporting is required if a partnership has income from the sale of personal property (other than inventory, depreciable personal property, and certain intangible property excepted from the general rule of section 865(a)) and the partnership pays income tax to a foreign country with respect to income from the sale or if the income is eligible for resourcing under an applicable treaty. This reporting requirement is voluminous for certain partnerships.

[22] The efile schema also includes a code "RIC." However, we have excluded this from the discussion herein because the IRS has previously described this code in FAQ 21 and provided guidance on its use.
[23] See *Foreign Country Code Listing for Modernized e-File (MeF)* (rev. *21-Oct-2021).*

For example, partnerships in the hedge fund industry may have hundreds or thousands of these transactions. In some cases, a partnership must attach a PDF document that exceeds one thousand pages in length to comply with the reporting requirement. The requirement to provide this supplemental information adds significant administrative cost to the taxpayer and more often than not, the information is not relevant to determining the tax of the ultimate partner unless a partner determines that the income is eligible for resourcing under an applicable treaty. Further, there could be technological challenges, including restrictions on the file size or electronic submission limitations, to furnishing or filing the Schedules.[24]

Partnerships generally do not determine a partner's share of proceeds or basis by property except in very limited circumstances.[25] Therefore, it is unclear why the Form K-3 requires the partnership to report proceeds and basis, rather than gain, for each transaction.

Recommendation

The AICPA recommends that the IRS provide guidance allowing a partnership to report summarized information by country with respect to Schedule K-3, Part I, Box 1. The per-country reporting will allow a partner to determine whether any distributive share of gain reported to it by a partnership is income eligible for resourcing under an applicable treaty. Partnerships that meet the threshold should disclose that additional information is available upon request.

Further, the AICPA recommends that the IRS update the instructions to Schedule K-3, Part I, Box 1 to report a partner's distributive share of gain instead of its allocable share of proceeds and basis.

Analysis

There is precedence in allowing a taxpayer to aggregate voluminous information and provide additional details upon request.[26] One such exception is provided for Form 8949 (*Sale and Other Disposition of Capital Assets*) where certain taxpayers, including a partnership and S corporation, are allowed to provide summary totals if the taxpayer has more than five transactions to report on the specific part. The instructions to Form 8949 further states to disclose that the information is available upon request.

[24] "The instance of a federal or state submission XML file cannot exceed 3 GB compressed. The maximum size of an individual PDF file attached to the submission is 60 MB uncompressed." Publication 4164 Modernized e-File (MeF) Guide for Software Developers and Transmitters Processing Year 2022. As many partnerships have significantly increased the size of their tax return files as a result of Schedules K-2 and K-3, it remains to be seen what percentage of e-file submissions will succeed without any technological foot-faults.

[25] Because the determination of depletion may be computed differently based on the tax attribute of a partner, section 613A(c)(7)(D) and the regulations thereunder provide special rules for partnerships to allocate the basis of oil and gas property to its partners for them to determine their depletion and gain or loss on the disposition of property. Absent these rules unique to the oil and gas industry, partnerships generally do not allocate proceeds and basis to their partners. Additionally, there are no rules for partnerships to determine how to do so outside of the oil and gas context.

[26] If the answer to a particular part of the tax return is voluminous, the AICPA Statement on Standards for Tax Services No. 2, Answers to Questions on Returns, also provides that there are reasonable grounds for omitting an answer provided that a statement should be made on the return that the data will be supplied upon examination.