

The Bankler Report

February 17, 2022

INTRODUCTION

Effective for tax year 2021: On January 18, 2022, the IRS posted revised instructions for schedules K-2 and K-3 for filers of Forms 1065 (Partnerships and LLC's taxed as Partnerships), 1120s (for S Corporations), and 8865 (Returns for US Persons with Respect to Certain Foreign Partnerships). These new schedules apply to pass-through entities and their partners and shareholders that have "items of international tax relevance."

A. Background:

1. Original Instructions –

- a. Schedules are intended to help partners determine income tax liability when a partnership has foreign items.
- b. The "Who Must File" section stated that an entity doesn't need to file the schedules if they didn't have "items of international tax relevance."

2. Revised Instructions –

- a) In the **NEW** "Who Must File" section, the revised language states: a partnership or S Corporation **"with no foreign source income, no assets generating foreign source income, and no foreign taxes paid or accrued may still need to report information on Schedules K-2 and K-3."**
- b) **The partnership or S Corporation must obtain information from every direct or indirect equity holder that they won't be required to file forms 1116 or 1118, otherwise it needs to file the K-2/K-3 forms.**
- c) In addition, the instructions state that "indirect interest is one that the partnership owns through other pass-through entities."
- d) "Indirect partners are partners who own the partnership through a foreign corporation or through a pass-through entity" such as partnership, S Corporation, or trust.

B. Additional information that will be required:

1. **For clients for which we prepare both the entity and ALL partners/shareholders tax returns - NONE**, since we will have all of the required information. **HOWEVER**, it will still take additional time, due to most clients having foreign income as a result of various investments (mutual funds, etc.) as **there are no de minimus exceptions.**
2. **For those entities with OUTSIDE partners/shareholders** – We currently anticipate contacting the owner and/or the preparer to provide and receive written confirmation that they do not have disqualifying income/credits ASSUMING that our client/owners have no disqualifying income/credits.

This is just another example of the government using a sledgehammer instead of a fly swatter!

This report only discusses specific provisions that we consider to be of general interest to business owners and is not a complete discussion of Forms K-2 nor K-3. Please feel free to contact us with your specific questions.