

# NEW PARTNERSHIP INTERNATIONAL INFORMATION RETURN SCHEDULES

## Authors

Galia Antebi  
Nina Krauthamer

## Tags

958(a) Attribution  
Aggregate Treatment  
Base Erosion Payments  
B.E.A.T.  
Entity Treatment  
Foreign Partners  
Foreign Tax Credits  
G.I.L.T.I.  
Partnership  
Schedule K-2  
Schedule K-3  
Sub-Part F Income

## INTRODUCTION

The I.R.S. recently released drafts of two new partnership return schedules and accompanying instructions to replace, supplement, and clarify the way partnership income, loss, deductions, credits and other items from international transactions are reported by a partnership to the I.R.S. and to its partners.<sup>1</sup>

Partnerships that have no foreign activities or foreign partners are not expected to be affected by these new forms.

## EFFECTIVE DATES AND PURPOSE

Once finalized, partnerships (including limited liability companies (“L.L.C.’s”) taxed as partnerships) that file Form 1065, *U.S. Partnership Tax Return*, would use these two new forms for tax years beginning in 2021 (filing season 2022) to report items of international tax relevance.

The proposed forms do not intend to replace existing information reporting requirements, such as Form 5471, *Information Return of U.S. Persons with Respect to Certain Foreign Corporations* or Form 8865, *Information Return of U.S. Persons with Respect to Certain Foreign Partnerships*. The new forms simply intend to standardize the format used in submitting information of international tax relevance to the partners and aims to assist the partners in completing their required information returns. It will replace the use of statements and other narrative information currently used by reporting partnerships. It will also, not surprisingly, allow the I.R.S. to verify taxpayer compliance on international matters with more ease. Penalties may apply for incomplete filing.

**New Schedule K-2** (Form 1065), *Partners’ Distributive Share Items – International*, would replace the information currently provided on Form 1065, Schedule K, lines 16(a) through 16(r). **New Schedule K-3** (Form 1065), *Partner’s – Share of Income, Deductions, Credits, etc. – International* would replace portions of Schedule K-1, Part III, Boxes 16 and 20, and would provide information to the partner generally in the format of the following forms that might be completed by the partner:

- Form 1040, *U.S. Individual Income Tax Return*
- Form 1040-NR, *U.S. Nonresident Alien Income Tax Return*
- Form 1116, *Foreign Tax Credit (Individual, Estate, or Trust)*
- Form 1118, *Foreign Tax Credit – Corporations*

<sup>1</sup> I.R. News Release 2020-155 (7/14/20).

- Form 1120, *U.S. Corporation Income Tax Return*
- Form 1120-F, *U.S. Income Tax Return of a Foreign Corporation*
- Form 4797, *Sales of Business Property*
- Form 8949, *Sales and Other Dispositions of Capital Assets*
- Form 8991, *Tax on Base Erosion Payments of Taxpayers with Substantial Gross Receipts*
- Form 8992, *U.S. Shareholder Calculation of Global Intangible Low-Taxed Income (GILTI)*
- Form 8993, *Section 250 Deduction for Foreign Derived Intangible Income (FDII) and Global Intangible Low-Taxed Income (GILTI)*

## INTERNATIONAL TAX RELEVANCE

Schedule K-2 and Schedule K-3 each contain nine parts, generally covering the information required with respect to the most common international tax provisions in the Internal Revenue Code (“Code”). Schedule K-3 contains a tenth part applicable only to the distributive share of a partner in relation to a sale of a partnership interest. A computer-generated Schedule K-2 that deviates from the official form can only be used with prior approval from the I.R.S. and would be subject to annual review.

The Schedules’ parts are described below.

### **Part I: Partnership’s Share of Current Year International Transaction Information**

This part is used to report information for international tax items not reported elsewhere on the Schedule K-2 or K-3. It indicates whether specified attachments and statements with information not elsewhere identified on a designated part on the form are included.

For example, Part I would indicate whether information regarding Code §267A disallowed interest or royalty payment deduction is included. For each partner that is disallowed a deduction, a statement would be attached to his Schedule K-3, which would identify the amount of interest and/or royalty paid or accrued by the partnership for which the partner is disallowed a deduction, as well as the extent to which information reported elsewhere on Schedule K-3 reflects amounts of interest or royalty for which the partner is disallowed a deduction.

### **Part II: Foreign Tax Credit Limitation**

The part is used to compute the partnership’s income or loss by source and separate category of income and to report the partner’s distributive share of such income or loss. Partners will use the information to compute and claim a foreign tax credit on Forms 1116 or 1118

A partnership would complete this part if it has foreign source income, deductions, or losses, or has paid or accrued foreign taxes and has at least one, direct or indirect



(through a pass-through entity) partner that is eligible to claim a foreign tax credit.

The information provided on Schedule K-2 includes the partnership income and taxes by source and category. The information provided on Schedule K-3 includes a partner's distributive share of the partnership's income and taxes by source and category to be used by the partner together with its other foreign source income and taxes in that category to compute and claim its foreign tax credit.

### **Part III: Other Information for Preparation of Form 1116, Foreign Tax Credit (Individual, Estate, or Trust) or Form 1118, Foreign Tax Credit – Corporations**

If Part II is completed, this part will also need to be completed to provide additional information for partners to compute and claim a foreign tax credit.

Section 1 includes information that partners need to allocate and apportion their research and experimental (R&E) expenses.

Section 2 includes information that partners need to allocate and apportion their interest expenses.

Section 3 includes information on foreign taxes paid or accrued by the partnership (including on U.S. source income), and the partner's distributive share of such taxes. For each of the amounts listed a statement providing the amount in both foreign currency and U.S. dollars, as well as the exchange rate used, and the dates of payment must be attached. An indication of this attachment is made on Part I, box 4, foreign tax translation.

### **Part IV: Other Foreign Transaction Information for U.S. Partners**

Section 1 includes information necessary for partners to determine the deduction under Code §250 with respect to Foreign-Derived Intangible Income (F.D.I.I.).

Section 2 includes information on income adjustments required under Code §743(b), by source and category.

Section 3 includes information on distributions from foreign corporations to the partnership and the partner's share of such distribution. Partner's will use this information not only to calculate and claim foreign tax credit, but also to

- exclude distributions of previously taxed earnings and profits ("P.T.E.P.") from gross income,
- report foreign currency gain or loss with respect to distributions of P.T.E.P., and
- compute and claim dividend received deduction under Code §245A.

### **Part V: Information on Partners' Section 951(a)(1) and Section 951A Inclusions (Subpart F Income and G.I.L.T.I.)**

This part is used to report the partners' Subpart F income inclusion, Code §956 income inclusion, and their share of controlled foreign corporation ("C.F.C.") items needed to determine their G.I.L.T.I. inclusion (tested income, tested loss, qualified business asset investment ("Q.B.A.I."), tested loss Q.B.A.I., and tested interest income and expense) with respect to C.F.C.'s owned, directly or indirectly, by the partnership. Partners will use this information to complete Form 8992, *U.S. Shareholder*

*Calculation of Global Intangible, Low-Taxed Income (G.I.L.T.I.), and report their gross income on their applicable income tax return.*

With a goal to conform the treatment of Subpart F income earned through a domestic partnership with the treatment of G.I.L.T.I. earned through a domestic partnership as provided in Treas. Reg. §1.951A-1(e)(1), Proposed Regulations §1.958-1(d)(1) provide that except as otherwise provided, for purposes of Code §951, a domestic partnership is not treated as owning stock in a foreign corporation within the meaning of Code §958(a). However, for purposes of determining whether a U.S. person is a U.S. shareholder (owning 10% or more, directly, indirectly or constructively) and whether a foreign corporation is a C.F.C., a domestic partnership is not disregarded as an owner. As a result, if a U.S. partner is a 5% partner in a domestic partnership that owns 100% of a foreign corporation, the foreign corporation would be treated as a C.F.C.; but the U.S. partner would not be a U.S. shareholder with respect to this C.F.C. Compare that with a domestic upper-tier partnership that is 10% owned by a U.S. person, and that owns 90% of a lower-tier domestic partnership that owns 100% of a foreign corporation. Here, the U.S. person is treated as a U.S. shareholder under the applicable attribution rules as amplified under Code §958(b)(2), according to which the upper-tier partnership that is treated as owning 90% of the foreign corporation under Code §318(a)(2) will be treated as owning 100% of the foreign corporation.<sup>2</sup>

*“A partnership may not file a Form 5471, Schedule I-1, for each C.F.C. that it owns.”*

In completing the relevant part of Schedule K-2, a domestic partnership must assume that the partnership relies on Prop. Reg. §1.958-1(d), discussed above, which treats a domestic partnership as not owning stock of a foreign corporation within the meaning of Code §958(a) for purposes of Code §951 or Code §951A). Each partner is therefore treated as owning shares in the C.F.C. For Schedule K-3, the Schedule K-3 instructions acknowledge that partnerships may not rely on the Proposed Regulations. If it does, the instructions provide that a partner should include in gross income the amounts reported in Part V for any foreign corporation for which it is a U.S. shareholder (within the meaning of Code §951(b), *i.e.*, directly or indirectly under Code §958(a) or constructively under Code §958(b)) and for which he owns shares within the meaning of Code §958(a) and exclude any amounts with respect to foreign corporations with respect to which it is not a U.S. shareholder. If a partnership does not rely on the Proposed Regulation, then any amount of Subpart F income reported on Part V of Schedule K-3 would be included by the partner in gross income as a distributive share, regardless of its status as a U.S. shareholder.

A partnership may not file a Form 5471, Schedule I-1, for each C.F.C. that it owns (within the meaning of Code Section 958(a)). In such case, the partnership will still need to provide amounts with respect to the C.F.C. as if the partnership filed Form 5471, Schedule I-1, for that C.F.C.

**Part VI: Information to Complete Form 8621, Information Return by a Shareholder of a Passive Foreign Investment Company (“P.F.I.C.”) or Qualified Electing Fund (“Q.E.F.”)**

Section 1 includes general information on foreign corporations that are P.F.I.C.’s and are held directly or indirectly by the partnership. Such information includes information about elections made by the partnership at the partnership level, for example,

<sup>2</sup> See Prop. Reg. §1.958-1(d)(3) Examples 1 and 2.

a Q.E.F. election or a mark-to-market (“M.T.M.”) election. Additionally, this section includes a summary of annual information, including acquisition of P.F.I.C. shares during the year and the value of P.F.I.C. shares held at the end of the year.

Section 2 includes additional information on P.F.I.C. or Q.E.F. The section is broken down by “general information,” “Q.E.F. information,” “M.T.M. information” and “Code §1291 and other information.”

Information provided for “Q.E.F. information,” includes the partnership’s share of total ordinary earnings and net capital gain of the P.F.I.C. for its tax year in which, or with which, the tax year of the P.F.I.C. ends.

A domestic partnership would provide this information if it made a Q.E.F. election or if any domestic lower-tier partnership made an election.

A foreign partnership should provide this information if it received an annual statement from the P.F.I.C., unless it knows that no direct or indirect partner has made a Q.E.F. election with respect to the P.F.I.C.

Information provided for “Code §1291 and other information” may be relevant for an electing P.F.I.C. as well. Therefore, generally, information provided in this part is provided with respect to all P.F.I.C.’s owned directly or indirectly by the partnership.

This section includes information on distributions received during the tax year, total distributions received in the preceding three tax years, and information relating to disposition of any block of stock in the P.F.I.C. during the partnership’s tax year.

### **Part VII: Partnership’s Interest in Foreign Corporation Income (Section 960)**

Completed if the partnership is a U.S. shareholder of a C.F.C., or has an inclusion with respect to a P.F.I.C., and the partnership has at least one partner (or is notified by a pass-through entity partner that it has at least one partner) that is eligible to claim a deemed paid foreign tax credit (whether a corporation or an individual, estate or trust that made a Code §962 election).

### **Part VIII: Partners’ Information for Base Erosion and Anti-Abuse Tax (Section 59A)**

This part will assist partners in determining if they are subject to the Base Erosion and Anti-Abuse Tax (“B.E.A.T.”), and to compute their B.E.A.T. tax, if any.

### **Part IX: Foreign Partners’ Character and Source of Income and Deductions**

Partners will use information provided in this part to compute and report any U.S. tax liability. This part must be reported by every partnership that has a foreign partner, or that knows, or has 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. The part consists of four sections:

- Section 1 identifies gross income from U.S. source that is fixed, determinable, annual or periodic (“F.D.A.P.”) and is not effectively connected with the partnership’s conduct of a U.S. trade or business (“Non-E.C.I.”), other U.S. source Non-E.C.I., foreign source non-E.C.I., effectively connected income (“E.C.I.”) derived from U.S. sources and foreign source E.C.I.



- Section 2 identifies deductions, losses, and net income in computing E.C.I.
- Section 3 provides information a partner may use to apportion deductions to E.C.I. and Non-E.C.I.
- Section 4 is completed for publicly traded partnerships that is a Code §871(m) covered partnership, regardless of whether the partnership's partners are foreign or domestic.

Partners will use the information to compute and report any U.S. tax liability on Forms 1040-NR and 1120-F, or on Forms 1042 and 1042-S.

**Part X: Foreign Partner's Distributive Share of Deemed Sale Items on Transfer of Partnership Interest**

This part appears in Schedule K-3 only and no corresponding part appears in Schedule K-2.

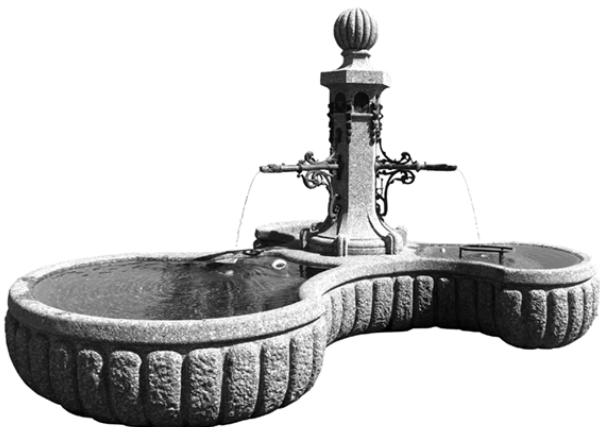
The part provides information for a foreign partner to use to determine the gain or loss it reports on its return from the transfer of an interest in a partnership. This generally applies to a partnership that directly or indirectly is engaged in the conduct of a U.S. trade or business (or from a distribution that results in recognition of gain or loss to a partner) or the gain or loss from a partnership's direct or indirect transfer of an interest in a partnership that is engaged in a U.S. trade or business. Partners will use the information to complete Form 4797, *Sales of Business Property*, and Form 8949, *Sales and Other Dispositions of Capital Assets*.

Gain or loss attributable to the transfer of a partnership interest attributable to U.S. real property interests is also identified on this part.

**FURTHER CHANGES**

The I.R.S. plans similar revisions, as applicable, to Form 1120-S, U.S. *Income Tax Return for an S Corporation*, and Form 8865, *Return of U.S. Persons with Respect to Certain Foreign Partnerships*.

Comments to the proposed and anticipated forms were accepted until September 14, 2020, and further guidance is expected to follow.



*Disclaimer: This article has been prepared for informational purposes only and is not intended to constitute advertising or solicitation and should not be relied upon, used, or taken as legal advice. Reading these materials does not create an attorney-client relationship.*