Hon. Charles P. Rettig  
Commissioner  
Internal Revenue Service  
1111 Constitution Avenue, NW  
Washington, DC 20224

Re: Draft 2019 Form 1065 and Schedule K-1.

Dear Commissioner Rettig:

Enclosed please find comments on the draft 2019 Form 1065 and Schedule K-1. These comments are submitted on behalf of the Section of Taxation and have not been approved by the House of Delegates or the Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

The Section of Taxation would be pleased to discuss these comments with you or your staff.

Sincerely,

Tom Callahan  
Chair, Section of Taxation

Enclosure

cc: Hon. David Kautter, Assistant Secretary (Tax Policy), Department of the Treasury  
Jeffrey Van Hove, Senior Advisor, Office of Tax Policy, Department of the Treasury  
Krishna P. Vallabhaneni, Tax Legislative Counsel, Department of the Treasury  
Bryan Rimmke, Attorney-Advisor, Department of the Treasury  
Hon. Michael J. Desmond, Chief Counsel, Internal Revenue Service  
William M. Paul, Deputy Chief Counsel (Technical), Internal Revenue Service  
Sunita Lough, Deputy Commissioner for Services and Enforcement, Internal Revenue Service  
Douglas O’Donnell, Commissioner, LB&I, Internal Revenue Service  
Holly Porter, Associate Chief Counsel (Passthroughs & Special Industries), Internal Revenue Service  
Clifford Warren, Senior Counsel to Associate Chief Counsel (Passthroughs & Special Industries), Internal Revenue Service
These comments (“Comments”) are submitted on behalf of the American Bar Association (the “ABA”) Section of Taxation and have not been approved by the House of Delegates or Board of Governors of the ABA. Accordingly, they should not be construed as representing the position of the ABA.

Principal responsibility for preparing these Comments was exercised by Grace Kim, Chair of the Partnerships and LLCs Committee, Ossie Borosh, Chair of the Real Estate Committee, and Beverly Katz, Vice Chair of the Partnerships and LLCs Committee. They were reviewed by Jeanne Sullivan of the Committee on Government Submissions and Eric B. Sloan, Vice Chair for Government Relations for the Section.

Although members of the Section may have clients who might be affected by the federal tax principles addressed by these Comments, no member who has been engaged by a client (or who is a member of a firm or other organization that has been engaged by a client) to make a government submission with respect to, or otherwise to influence the development or outcome of one or more specific issues addressed by, these Comments has participated in the preparation of the portion (or portions) of these Comments addressing those issues. Additionally, while the Section’s diverse membership includes government officials, no such official was involved in any part of the drafting or review of these Comments.

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Date:  December 3, 2019
Executive Summary

On September 30, 2019, the Internal Revenue Service (the “Service”) issued an early release of draft 2019 Form 1065, U.S. Return of Partnership Income, and its Schedule K-1, Partner’s Share of Income, Deductions, Credits, etc. (the “Draft Forms”). The Draft Forms contain numerous changes and additional items to be reported, including reporting partner capital accounts solely on a “tax basis” and providing each partner’s share of “Net Unrecognized Section 704(c) Gain or (loss).” Subsequently, on October 29, 2019, the Service issued draft instructions for the draft 2019 Form 1065 and its various schedules, including Schedule K-1 (the “Draft Instructions”).

We applaud the Service’s efforts to provide taxpayers with early guidance on the reporting that is anticipated to be required for the 2019 tax filing season for partnerships, and we appreciate the need for information that may assist in furthering compliance. Several of the changes to the forms represent materially new reporting requirements and do not completely define the information being requested. Thus, we anticipate that, in their current form, the new reporting requirements will result in uncertainty and confusion, with taxpayers ultimately doing the best they can to provide information that might not actually be responsive to the required reporting. In some cases, taxpayers may not be in a position to provide the required information and may need to report using estimates, which we are concerned would not further or assist in the Service’s efforts in assessing compliance risk and identifying potential noncompliance. Accordingly, we make the following recommendations.

1. Development of Technical Aspects, Safe Harbors, and Simplified Method; Provision of Guidance

We respectfully request that the U.S. Department of the Treasury (“Treasury”) and the Service further develop the technical aspects of the information requested, most notably in the areas of “tax basis capital” and section 704(c) reporting. In addition to developing the technical aspects, we recommend that Treasury and the Service provide additional clarifying guidance and seek comments regarding that guidance. Finally, we recommend that Treasury and the Service provide safe harbors and/or simplified methods for computing any amounts required to be reported.

2. Delayed Implementation of the New Reporting Requirements

a. We recommend that Treasury and the Service delay the implementation of the new reporting requirements for at least one tax year.

1 Unless indicated otherwise, all “section” references are to the Internal Revenue Code of 1986, as amended (the “Code”), and all “Treas. Reg. §” are to the Treasury regulations, in each case in effect as of the date of these Comments.
b. If an overall delay in implementation is not feasible, we recommend that only new partnerships (i.e., generally partnerships that commence in 2019) be required to comply for the 2019 tax year.

Discussion

Background

On September 30, 2019, the Service issued an early release of the Draft Forms that contain numerous changes to the current forms, including the requirements to report partner capital accounts solely on a tax basis and to provide each partner’s share of “Net Unrecognized Section 704(c) Gain or (loss).” In an accompanying Information Release, the Service explained that the changes to the Draft Forms are intended to improve the quality of the information reported by partnerships to both the Service and the partners of such entities. The Service also explained that the additional information requested is intended to aid the Service in assessing compliance risk and identifying potential noncompliance while ensuring that compliant taxpayers are less likely to be examined. The Information Release stated that the Service would accept comments for 30 days. Subsequently, on October 29, 2019, the Service issued Draft Instructions.

Prior to the 2018 tax year, partnerships were permitted to provide capital account information using one of several approaches (tax basis, 704(b), GAAP, or “other”) and thus had significant flexibility. This flexibility was reduced for the 2018 tax year with respect to any partner having negative tax basis capital either at the beginning or end of the tax year. In that case, beginning and ending capital accounts were required to be reported on a tax basis. When the concept of negative tax basis capital was first introduced to the forms, members of the tax community expressed significant confusion about the meaning of the term. The term has not been defined in administrative guidance that is subject to notice and comment under the Administrative Procedure Act. Rather, the term was defined in a combination of form instructions and an online resource called “frequently asked questions” (“FAQs”). The FAQs discussed the computation of “tax basis capital” for this purpose, and that computation included increases to the tax basis of partnership property under section 734(b) or under section 743(b). Additionally, the FAQs included a safe harbor permitting partnerships to calculate a partner’s tax basis capital account by subtracting the partner’s share of liabilities from the partner’s outside

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3 Treas. Reg. § 1.6031(a)-1(a) generally provides that every domestic partnership must file a return of partnership income under section 6031 for each tax year on the form prescribed for the partnership return, and the partnership return must contain the information required by the prescribed form and the accompanying instructions.

4 See https://www.irs.gov/businesses/partnerships/form-1065-frequently-asked-questions (last updated November 19, 2019). Before releasing the FAQ, the Service had issued Notice 2019-20, 2019-14 I.R.B. 927, which allowed partnerships to report negative tax basis capital account information with their 2018 return or at a later date (but no later than 180 days after the six-month extended due date of the partnership’s Form 1065) provided certain conditions were met.
basis. If that difference is negative, the partner has a negative tax basis capital account in the 
amount of the excess of the partner’s share of partnership liabilities over the partner’s outside 
basis.

**Description of Major New Requirements and Need for Clarifying Guidance**

Below is a description of certain of the major changes in the Draft Forms and Draft 
Instructions and the general need for additional clarifying guidance. We note that there are 
changes in many areas, and these Comments do not discuss all of the changes. Rather, these 
Comments highlight certain major new requirements and discuss the compliance challenges we 
attempt to anticipate that partnerships will face. As a general matter, we anticipate that, because the new 
information is significantly different from the information currently required and is also 
extensive, the cost of compliance could be substantial, and the absence of additional clarifying 
guidance will exacerbate the difficulty and cost of such compliance.

**Tax Basis Capital Reporting**

The Draft Forms require reporting of each partner’s tax basis capital account at the 
beginning of the tax year, increases and decreases to that capital account during the year, and the 
balance at the end of the tax year. This information is to be provided by all partnerships, for 
each partner, except in the case of certain smaller partnerships.5 The Draft Instructions explain 
that the term “tax basis capital” means:

(i) The amount of cash plus the tax basis of property contributed to a partnership by a 
partner minus the amount of cash plus the tax basis of property distributed to a 
partner by the partnership net of any liabilities assumed or taken subject to in 
connection with such contribution or distribution, plus

(ii) The partner’s cumulative share of partnership taxable income and tax-exempt 
income, minus

(iii) The partner’s cumulative share of taxable loss and nondeductible, noncapital 
expenditures.6

Unlike the FAQs, the Draft Instructions provide that section 743(b) adjustments do not 
affect the transferee partner’s tax basis capital account,7 but do not address section 734(b) 
adjustments.8 Prior to the recent release of the Draft Forms and Draft Instructions, taxpayers had 
limited notice about the concept of tax basis capital and the reporting thereof had limited

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5 A partnership is excused from providing tax basis capital information if four conditions are satisfied: the 
partnership’s total receipts for the tax year were less than $250,000; the partnership’s total assets at the end of the 
tax year were less than $1 million; Schedules K-1 were filed with the return and furnished to the partners on or 
before the due date (including extensions) for the partnership return; and the partnership is not filing and is not 
required to file Schedule M-3.

6 Draft Instructions, Item L, p. 29.

7 Draft Instructions, p. 11.

8 This differs from the treatment of basis adjustments under the FAQs.
applicability. Partnerships that could determine (by assessing their balance sheets) that no partner would have a negative tax capital account could continue to report using other methods such as GAAP, section 704(b) or “other.” The requirements in the Draft Forms and Draft Instructions, on the other hand, have a much broader application. Except for certain small partnerships, the new requirement applies to all partnerships regardless of whether any partner has negative tax basis capital. Furthermore, the definition of tax basis capital (as explained in the Draft Instructions) differs from that in the FAQs, and no simplifying safe harbor or delayed reporting is provided.

Because the definition of tax basis capital still needs clarification, we recommend that the Service delay in the implementation of this reporting requirement. Delaying implementation will allow Treasury and the Service to benefit from substantive public comments and provide partnerships time to comply with the new reporting requirements in a manner that reduces administrative burdens and costs to partnerships and partners.

**Reporting Section 704(c) Net Unrecognized Gain or (Loss)**

The Draft Forms require reporting of each partner’s share of “Net Unrecognized Section 704(c) Gain or (Loss)” at the beginning and at the end of the tax year on Schedule K-1, Item N. The term “Net Unrecognized Section 704(c) Gain or (Loss)” is not defined, and taxpayers would benefit from further clarification. For example, clarification is needed regarding whether the term includes “reverse” section 704(c) gain or loss,9 and, if so, whether the layers of such items should be reported separately or netted.10 As another example, it is unclear whether the term is intended to represent the net amount of income or deductions allocated to a partner by reason of section 704(c), including allocations of remedial income/gain and deductions/losses, and whether it is intended to take into account gain recognized under section 704(c)(1)(B) and section 737. Clear definitions would mitigate taxpayers’ compliance burdens.

**At-Risk Activity Aggregation and Passive Activity Loss Grouping**

The Draft Forms require partnerships to indicate on the Form 1065, Item K, if they have aggregated activities for section 465 at-risk purposes or grouped activities for section 469 passive activity purposes.

The instructions to Schedule K-1 require information to be provided separately (on a statement attached to the Schedule K-1) for each at-risk activity if the partnership conducts more than one. The following information is required to be provided:

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9 Revaluations under the section 704(b) regulations result in “reverse” section 704(c) gain or loss. Treas. Reg. § 1.704-3(a)(6).

10 Under proposed regulations under section 751(b), taxpayers would not be permitted to use a netting approach with regard to layers of section 704(c) built-in gain or built-in loss layers. However, the Treasury and the IRS have requested comments on when it is appropriate for partnerships to use a netting approach. Prop. Treas. Reg. § 1.704-3(a)(6)(i), 79 Fed. Reg. 3042 (2014). The complexity of the rules of section 704(c) is evidenced by the breadth and depth of issues raised in Notice 2009-70, 2009-2 C.B. 255, and the comments received in response to that notice.
(i) A statement that the information is a breakdown of at-risk activity loss amounts.
(ii) The identity of the at-risk activity; the items of income, loss, or deduction for the activity; other items of income, loss, or deduction; partnership liabilities; and any other information that relates to the activity such as distributions and partner loans.
(A box is to be checked to indicate there is more than one at-risk activity for which a statement is attached.)

Aggregating activities within a “trade or business” would reduce this burden, but arguably would require additional guidance.\(^{11}\) Because section 465 applies at the partner, not the partnership, level, partnerships generally have not prepared separate accounting for each activity held or operated by the partnership, but have, rather, maintained at-risk information only where relevant. This separate accounting and reporting requirement concerning at-risk activities therefore would present challenges for partnerships in terms of their recordkeeping and accounting for their various at-risk activities. Thus, we recommend that implementation of this reporting be delayed by at least one tax year to afford partnerships an opportunity to develop methodologies and/or software to account separately for items that relate to a particular at-risk activity.

\(^{11}\) Section 465(c)(3)(B) provides that activities described in section 465(c)(3)(A) which constitute a trade or business shall be treated as one activity if: (i) the taxpayer actively participates in the management of such trade or business or (ii) such business is carried on by a partnership or an S corporation and 65% or more of the losses for the taxable year are allocable to persons who participate in the management of the trade or business. Section 465(c)(3)(C) provides that “[t]he Secretary shall prescribe regulations under which activities described in [section 465(c)(3)(A)] shall be aggregated or treated as separate activities.” To date, no regulations have been promulgated under section 465(c)(3)(C).
Summary of Recommendations

Further Development of Technical Aspects, Safe Harbor(s), Simplified Method; Provision of Guidance

We respectfully request that Treasury and the Service further develop the technical aspects of the information that is being requested, most notably in the areas of tax basis capital and section 704(c) reporting. We have noted above some of the areas that may benefit from clarification. Without further detail, taxpayers will be uncertain as to how amounts are to be computed and may not be able to provide information that is helpful to the government. In addition to developing the technical aspects, we suggest that Treasury and the Service provide an opportunity for public comment to assist in identifying other areas that may need clarification or further detail. Finally, we recommend that Treasury and the Service provide safe harbors or simplified methods for computing amounts where the facts support a simplified method.

Delayed Implementation

Additionally, we recommend that Treasury and the Service delay the implementation of all of the new reporting requirements by at least one tax year. Specifically, we recommend that the new information be required no sooner than for partnership taxable years beginning on or after January 1, 2020. A one-year delay would provide Treasury and the Service time to publish needed guidance and would enable partnerships and their advisors to obtain information from prior tax years that is needed to comply with the reporting requirements.12

Alternatively: A Transition Approach

If an overall delay in implementation is not feasible, we recommend that only new partnerships be required to comply for the 2019 tax year. For this purpose, a new partnership should include only a partnership that commences in 2019 and does not receive any property that, in the hands of the transferor, was property having pre-existing built-in gain under section 704(c), such as in the case of a merger or tiered partnership. New partnerships would not need to obtain prior year information; however, they too would benefit from added clarity and guidance to establish computational processes that are consistent with the new reporting rules.

12 For older partnerships, the information may not be readily available and reconstruction likely would be required.