September 14, 2020

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

Re: Comments on Draft Schedules K-2 and K-3

Dear Commissioner Rettig:

Enclosed please find comments regarding the drafts of two new schedules, Schedule K-2 and Schedule K-3. 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,

Joan C. Arnold  
Chair, Section of Taxation

Enclosure

cc: Hon. David Kautter, Assistant Secretary (Tax Policy), Department of the Treasury  
Lafayette “Chip” G. Harter III, Deputy Assistant Secretary (International Tax Affairs), Department of the Treasury  
Douglas L. Poms, International Tax Counsel, Department of the Treasury  
Krishna P. Vallabhaneni, Tax Legislative Counsel, Department of the Treasury  
Erika Nijenhuis, Senior Counsel, Department of the Treasury  
Michael J. Desmond, Chief Counsel, Internal Revenue Service  
William M. Paul, Deputy Chief Counsel (Technical), Internal Revenue Service  
Douglas W. O’Donnell, Commissioner (Large Business & International), Internal Revenue Service  
Peter Blessing, Associate Chief Counsel (International), Internal Revenue Service  
Holly Porter, Associate Chief Counsel (Passthroughs & Special Industries), Internal Revenue Service  
John Hinding, Director Cross Border Activities (Large Business & International), Internal Revenue Service  
Cindy Kim, Cross Border Activities (Large Business & International), Internal Revenue Service
AMERICAN BAR ASSOCIATION
SECTION OF TAXATION

Comments on Draft Schedules K-2 and K-3

These comments (“Comments”) are submitted on behalf of the American Bar Association Section of Taxation (the “Section”) and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by Tom Greenaway. Substantive contributions were made by Ari Berk, Morgan Hann, Lori Hellkamp, Beverly Katz, and Barbara Rasch. The Comments were reviewed by Edward Tanenbaum of the Committee on Government Submissions and Kurt Lawson, 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.

Contact: Tom Greenaway
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Date: September 14, 2020
Executive Summary

On July 14, 2020, the U.S. Department of Treasury (“Treasury”) and the Internal Revenue Service (the “Service”) proposed updates to Form 1065, U.S. Return of Partnership Income, for tax year 2021 (filing season 2022) through the creation of two new schedules, Schedule K-2 and Schedule K-3 (the “Draft Schedules” or, when finalized, the “Schedules”), with accompanying instructions (the “Draft Instructions” or, when finalized, the “Instructions”). The Draft Schedules are designed to provide greater clarity for partners on how to compute their U.S. income tax liability with respect to international tax matters. We offer these comments in response to the extensive outreach effort by Treasury and the Service over the past several months. In summary, we offer several recommendations:

- First, we recommend that the Service delay implementation of the changes for certain partnerships.

- Next, we recommend that the Service revise the Draft Instructions to help partnerships navigate the challenges of gathering information from their partners, including by establishing grandfathering rules for certain partnerships and information-reporting penalty safe harbors.

- We then offer several illustrative suggestions for revisions to the Draft Instructions and forms to help partnerships report items that depend on partner-level information and relevance determinations:
  - foreign derived intangible income (“FDII”) under section 250,
  - distributions of previously taxed earnings and profits (“PTEP”),
  - subpart F inclusions and global intangible low-taxed inclusions (“GILTI”) under sections 951(a) and 951A, respectively, and
  - reporting regarding passive foreign investment company (“PFIC”) information under section 1297.

- Finally, we recommend that the Service revise the Draft Schedules K-2 and K-3 to include dual consolidated loss (“DCL”) information under section 1503(d).

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1 See IR-2020-155 (July 14, 2020).

2 Unless otherwise indicated, references to a “section” are to a section of the Internal Revenue Code of 1986, as amended (the “Code”) and all “Treas. Reg. §” references are to the Treasury regulations promulgated under the Code, all as in effect (or, in the case of proposed regulations which remain outstanding, as proposed) as of the date of these Comments.

3 Given the relatively short window of time we have enjoyed with these new proposed Schedules, we were not able to offer similarly detailed comments around foreign tax credit reporting, effectively connected income, and other complicated items captured in the Draft Schedules in this Comment.
Recommendations

I. Introduction

As noted, on July 14, 2020, Treasury and the Service proposed updates to the partnership Form 1065 for tax year 2021 (filing season 2022). The updates are designed to provide greater clarity for partners on how to compute their U.S. income tax liability with respect to international tax matters, including how to compute deductions and credits. The redesigned form and Draft Instructions also would give guidance to partnerships on how to provide international tax information to their partners. This proposed form would apply to a partnership required to file Form 1065, U.S. Return of Partnership Income, but only if the partnership has items of international tax relevance (generally foreign activities or foreign partners). This comment letter responds to the Service’s request for comments from stakeholders.4

The current version of Schedule K-1, Partner’s Share of Income, Deductions, Credits, etc., offers only one box to cover all foreign transactions. Given the complexity of international tax law and the need to report information from partnerships to partners to the Service, partnerships with a U.S. filing obligation generally attach white paper statements to Schedule K-1 to provide additional detail on international transactions to their partners. The lack of reporting standards and formats creates challenges for both the government and partners. These challenges are heightened by the new provisions of Public Law 115-97,5 which require additional information to be reported by partnerships to partners and the Service.

The updates, which Treasury and the Service hope will help address these challenges, take the form of two Draft Schedules, Schedule K-2 and Schedule K-3, which are proposed to be new for the 2021 tax year. Schedule K-2 would be used to report items of international tax relevance from the operation of a partnership. A partnership would report this information to its partners on Schedule K-3. These Schedules would replace, supplement, and clarify Schedule K-1, line 16, Foreign Transactions. The new format is proposed to assist partnerships in providing partners with the information necessary to complete their returns with respect to the international tax aspects of the Internal Revenue Code. For example, the new format would provide information necessary for corporate and individual partners to compute their foreign tax credit on Form 1118, Foreign Tax Credit—Corporations, and Form 1116, Foreign Tax Credit (Individual, Estate or Trust), respectively.

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5 An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018, Pub. L. No. 115-97, 131 Stat. 2054 (sometimes referred to as the “Tax Cuts and Jobs Act” or “TCJA”).
II. General Comments

We agree with Treasury’s and the Service’s conclusion that the current lack of consistency with respect to international partnership reporting standards and forms makes voluntary compliance more difficult for partners. In particular, the Section has long been a proponent of clear, accurate information reporting. Providing accurate information to taxpayers in a timely way is a critical step towards enhancing voluntary compliance. We agree with Treasury and the Service that starting from a solid base of information reporting makes tax administration easier for taxpayers and the Service. We also recognize and agree with Treasury and the Service that most of the information called for on Draft Schedules K-2 and K-3 is information that already should be reported by certain partnerships to their partners and potentially to the Service. We also agree that most partnerships do not have international operations or transactions, so most partnerships would not need to engage with these Schedules at all.6

A. Delay Implementation for Certain Partnerships

We also commend Treasury and the Service for recognizing that there could be potentially significant transition burdens for the affected partnerships and partners as they adapt and adopt the new reporting framework. The standardization Treasury and the Service are proposing, at least over the short-term, would lead to increased compliance costs for affected partnerships and their partners. While many partnerships and their tax return preparers should be able to adapt to this new system in time for the 2021 tax year, we fear that some partnerships might need more time to fully transition to the new reporting format or might not have easy access to the resources required for initial implementation. Accordingly, we recommend that Treasury and the Service consider a delayed implementation schedule for certain small and widely held partnerships.7

For example, compliance by small partnerships might require significant investments in tax return preparation relative to the immateriality of international information reported by those partnerships. For purposes of this recommendation, “small partnerships” could be defined as partnerships that are not required to file Schedule M-3 (Form 1065).8 In addition, “small partnerships” could include partnerships that allocate less than a certain amount of foreign source income to each partner (or, in the case of a foreign partner, less than a certain amount of U.S. source income). In these situations,

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6 A Service official noted during the notice-and-comment period that only 5% of partnerships that file Form 1065 report international transactions. The official also noted, however, that those partnerships report 50% of all income reported on partnership returns.

7 If this recommendation is adopted, we expect that the partnerships subject to delayed implementation would continue reporting relevant international information on Schedule K-1, line 16 (and related white paper statements) until they are required to adopt Schedules K-2 and K-3.

8 We recommend using the Schedule M-3 filing requirements because those rules are already familiar to partnerships, and because it would avoid creating a new assets or gross receipts test solely for purposes of implementing Schedules K-2 and K-3.
the costs of reporting *de minimis* amounts on Schedules K-2 and K-3 might outweigh the benefits of standardizing the information for partners and the Service.

If the Draft Schedules are finalized, partnerships are likely to invest more time and resources into communicating with their partners because they will need information from partners to comply and because partners will have questions about the new format of the information. In many cases, the Schedules also will increase the sheer volume of material delivered to the partners. These concerns are particularly pronounced for publicly traded partnerships and other widely held partnerships, where tax reporting burdens present a real business concern relative to other investment vehicles such as regulated investment companies. Given the significant costs and changes that affected partnerships will bear in these situations, we also recommend that the requirement to file Schedules K-2 and K-3 for the 2021 tax year should not apply to widely held partnerships whether classified as publicly traded partnerships or not.

After the 2021 tax year, if the Draft Schedules are finalized, Treasury and the Service will have more information and feedback, tax compliance software should be better suited to prepare the Schedules, and partnerships, partners and tax return preparers should have a better understanding of the format and contents of the Schedules. Accordingly, we recommend that the Service delay implementation of the Schedules for small and widely held partnerships until tax years after 2021. After that, it might be beneficial to retain a permanent *de minimis* exception to filing the Schedules because the additional compliance burden associated with any items of international relevance could discourage partnerships from making relatively modest cross-border investments. We believe that tax compliance obligations should not distort investment incentives or discourage U.S. partnerships from admitting foreign partners.

**B. Help Partnerships Navigate Challenges of Gathering Information from Partners**

1. **Offer Grandfather Protection from Certain Information Reporting & Preparer Penalties**

We acknowledge that recent developments in federal tax law have changed the relationship between partnerships and partners as a technical matter. Historically, tax information by and large flowed in one direction: from partnerships to partners. Now, to resolve technical tax issues, partnerships and partners must share more information because the characterization of an item of income or expense at the partnership level might depend on information that is only available to the partner, or vice-versa. For instance, GILTI calculations, the application of section 267A, and base erosion and anti-abuse tax (as defined in section 59A) rules are all partner-level determinations that depend on a mix of partner and partnership-level information.

We note that, while federal tax law has tightened the technical relationship between partnerships and their partners, state and foreign non-tax partnership law generally has not evolved apace. Regulation of the internal affairs of business entities
normally is a matter of state law,9 and nothing in the Code or regulations pre-empts that
general rule as applied to partnerships and their partners.10 State law generally does not
impose positive obligations on partners to share information with their partnerships. A
partnership agreement and any associated agreements (e.g., side letters) generally are the
only legal mechanisms that arrange the obligations between partnerships and partners
with respect to tax information sharing and cooperation.

Neither the Code nor the regulations give the partnership representative any
general positive authority to compel partners to provide information to the partnership.
In 2018, Treasury and the Service deliberately chose not to disturb the general state of the
law regarding interactions between partnerships and their partners outside the context of
the centralized audit regime.11 The responsibilities and authority of a partnership
representative—which override state and foreign law—attach only if a partnership is
selected for a centralized partnership audit an administrative proceeding or if the
partnership files an administrative adjustment request under the regime.12

While we agree in principle that partners and partnerships should collaborate with
respect to tax filing obligations, as a practical matter many partners are reluctant to share
information with the partnerships in which they invest. More to the point, many partners
will not share information with the partnerships in which they invest unless they are
obliged to do so under the terms of the partnership agreement or other agreement. This
practical concern is only exacerbated in an international context, where many foreign
investors are reluctant to engage with the U.S. tax compliance system owing to its
complexity, among other reasons. Indeed, many foreign investors invest in U.S.
partnerships through corporate “blockers” primarily to avoid U.S. tax reporting
obligations.

Those who manage partnerships generally are reluctant to re-negotiate partnership
agreements solely to account for changes in tax forms, since re-opening negotiations on
one term often invites partners to re-negotiate other terms in their agreements. For that
reason, it might be some time before existing—and even new—partnership agreements

9 See Cort v. Ash, 422 U.S. 66, 84 (1975) (“Corporations are creature of state law . . . except where
federal law expressly requires certain responsibilities of directors with respect to stockholders, state law
will govern the internal affairs of the corporation.”); see also Kamen v. Kemper Fin. Servs. Inc., 500 U.S.
90, 98 (1991) (“The presumption that state law should be incorporated into federal common law is
particularly strong in areas in which private parties have entered into legal relationships with the
expectation that their rights and obligations would be governed by state-law standards.”).

10 See, e.g., Remington v. United States, 210 F.3d 281, 283-84 (5th Cir. 2000) (rejecting claim that
federal trust fund recovery penalty pre-empts state partnership law).

11 T.D. 9839, 83 Fed. Reg. 38,028, 39,339 (Aug. 9, 2018) (“Except as necessary to carry out the
statute, the regulations implementing the centralized partnership audit regime attempt not to impose
requirements with respect to interactions between the partnership and the partnership representative.”).

12 Id. at 39,342; see Treas. Reg. § 301.6223-2(d).
reflect the changes in information flows between partnerships and their partners demanded by Draft Schedules K-2 and K-3.

To address these compliance challenges, we recommend that the Service offer in the Instructions a limited safe harbor from information reporting and preparer penalties for partnerships in existence prior to the release of the draft Schedule K-2 and Schedule K-3 for any reporting errors (or omissions) on Schedule K-2 and Schedule K-3 with respect to items that are within either the determination or knowledge of the partners. This grandfathering treatment could expire upon the earlier of (a) any amendment of the existing partnership agreement (whether relating to the information reporting/tax cooperation provision of the partnership agreement or otherwise) that requires the approval of the partners and (b) three years from the release of the final Schedule K-2 and Schedule K-3.

2. Provide Guidance and Safe Harbors to Partnerships that Exercise Reasonable Diligence

During the notice-and-comment period, Treasury officials explained that partnerships are obliged to report only information that is available to them. The Who Must File section of the Draft Instructions to Schedule K-2 states that, except as otherwise required by regulations or other guidance, “a partnership is not required to obtain information from its direct or indirect partners” to determine if it needs to file each of the parts of Form K-2. It also limits the obligation to provide information unless the partnership knows the information is relevant to its partners. We recommend that these two notes be re-ordered to make them flow better, and that a further note be added to that section explicitly limiting the partnership’s reporting obligation to information items within the partnership’s knowledge and control, backstopped by a reasonable diligence standard.

Many partnerships possess incomplete and uncertain information regarding their direct and indirect partners. We suggest that, without more guidance, some of these partnerships might attempt to complete all potentially relevant parts of the Schedules in these sorts of ambiguous situations. Such a result is undesirable, especially in situations where partnerships would report flawed international items to their partners and the Service based on incomplete information. Nevertheless, some preparers and partnerships may feel they have no choice despite the reassurance in the Instructions, given the risk of preparer and information reporting penalties.

In order to offer a businesslike way for partnerships to resolve these ambiguities and improve the overall quality of partnership items reported on the Schedules as part of their annual tax compliance process, we recommend that the Instructions set forth a relatively modest diligence standard (e.g., commercially reasonable efforts) to establish safe harbor penalty protection if partner-level information is requested by, but not provided to, the partnership. We note that Treas. Reg. § 301.6724-1(c)(1) and (c)(2)(6) provide reasonable cause standards for information return filers where a failure is due to
certain actions of the payee.\textsuperscript{13} Considering those standards, we suggest that the Draft Instructions be modified to include a section regarding gathering and clarifying information from partners, such as:

To the extent you are unsure whether Parts of Schedules K-2 and K-3 are relevant to your partners, or if Schedules K-2 and K-3 call for partner-level information that is not available or known to you, you may request information from your partners by means of electronic, registered or certified mail at least 60 days prior to the due date of the Schedules K-2 and K-3 and allow your partners at least 30 days to provide you with the requested information necessary to allow you to complete the schedules. To the extent your partners do not provide requested information, you shall be deemed to have satisfied your reporting obligation with respect to the requested information by documenting the partnership’s information request (e.g., a Postal Service certificate of mailing or electronic delivery verification).

We recommend that the Instructions provide another safe harbor that allows a partnership to rely on a partner’s annual assertion that all or parts of the Schedules are irrelevant to that particular partner (and its partners, if applicable), without creating a presumption that a failure by a partner to respond means that the Schedules are, in fact, relevant to that partner.

We note that there might be cases in which certain information is, in fact, relevant to a direct or indirect partner, but the partnership does not know or have reason to know whether the corresponding parts of Schedules K-2 and K-3 are relevant to any of its partners, particularly since the Draft Instructions require reporting in some cases with respect to both direct and indirect partners. Such a “tiebreaker” predicament is likely to occur, even after partnerships conduct reasonable diligence, especially in the context of tiered partnership structures. For example, intermediate partnerships in tiered partnership structures often do not know (and cannot determine) whether the ultimate partners are corporations eligible for a FDII deduction. Similarly, a partnership might not know whether the ultimate partners are U.S. shareholders of any controlled foreign corporations (as defined in section 957, “CFCs”) owned by the partnership because the partnership may not know the indirect ownership percentage that the ultimate partners have in the CFC.

We believe that setting default rules that require information reporting in these situations inevitably will impose reporting burdens on some partnerships without any corresponding benefits to either the partners or the Service. In our view, a cross-reference to the Chapter 3 presumption rules set out in Treas. Reg. § 1.1441-1(b)(2)(vii) could be noted in the Instructions as a diligence safe harbor to serve as tiebreakers in these situations, but we do not consider Chapter 3 levels of diligence appropriate across

\textsuperscript{13} See T.D. 9901, 85 Fed. Reg. 43,042, 43,048 (July 15, 2020) (“generally applicable penalty exceptions already apply to the extent information relevant to FDII is not reported on the applicable form”).

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all partnerships, given the different purposes supporting Chapter 3 withholding compared to partnership information reporting under Chapter 1.

We believe it also would be helpful to clarify in the Instructions how to deal with situations where an item may be relevant to one partner, but not to all partners. For instance, in the context of providing PFIC information for a Qualifying Electing Fund (“QEF”) under section 1293, in certain situations a partnership might invest in foreign corporations that are CFCs with respect to a partner but not with respect to all of the partners in the partnership. We recommend that the Service consider setting out some sort of materiality safe harbor in this context, such that relevance of one item as to one de minimis direct or indirect partner does not trigger a wave of irrelevant, potentially confusing, and costly information reporting to the rest of the partners. Again, we believe that partnership reporting burdens should not be designed in a way that distorts investment decisions.

III. Detailed Comments

A. FDII Reporting

1. Clarify Reporting Obligations to Tax-Exempt Corporate Partners

With respect to Part IV, section 1, Information on Section 250 Deduction With Respect to FDII, the Draft Instructions to Schedule K-2 require the partnership to complete the section if it has a direct or indirect corporate partner. We recommend that the Draft Instructions be revised to clarify that reporting is not required for tax-exempt corporate partners that do not have unrelated business taxable income (“UBTI”), as defined in section 512, with respect to its distributive share of partnership income. 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. We recommend that the Instructions provide an exclusion for corporations that notify the partnership that they are not eligible for a FDII deduction with respect to their distributive share of partnership income.

2. Revise Foreign Derived Deduction Eligible Income Reporting

We recommend that the information for foreign derived deduction eligible income (“FDDEI”) be provided on a separate category basis, rather than the gross amount of FDDEI income. On line 3(a) through (c) of Part IV, section 1, the gross amounts of FDDEI are reported on a separate category basis. We observe that FDII does not depend on the source of income. 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.

Further, for purposes of applying Treas. Reg. § 1.861-8(e)(13), we do not think that there is a need to break out the FDDEI amounts among the different FDDEI
categories (general property, intangible property, and services). In addition, for presentation purposes, it does not seem necessary to have multiple columns (for the separate categories) for all of the lines, when only one item of information needs to be reported on a separate category basis. For that reason, we recommend moving the information necessary for allocating and apportioning the FDII deduction to Part III of the Schedule K-3, which contains information for preparing the FTC forms. This would allow the FDII section of the Schedule K-3 to be only one column because the information related to calculating the FDII deduction does not need to be provided on a separate category basis.

3. **Revise Deduction Eligible Income Reporting**

We recommend revisions to the Draft Schedules relating to the calculation of deduction eligible income (“DEI”), which is a factor in determining the FDII deduction, and which a corporate partner will need to report on its Form 8993, Section 250 Deduction for Foreign-Derived Intangible Income (FDII) and Global Intangible Low-Taxed Income (GILTI), to claim its FDII deduction. In general, gross DEI is calculated by excluding certain items of income from gross income. The Form 8993 requires the separate reporting of each the items excluded from DEI (lines 2a through f), as well as the total deductions properly allocable to gross DEI (line 4). The Draft Schedules do not contain any lines for reporting any of the items excluded from gross DEI, or the expenses properly allocable to gross DEI. Instead, the Draft Instructions to Schedule K-3 require the partner to identify any amounts that are excluded from gross DEI. This makes sense for the items that are determined solely at the corporate partner level (such as GILTI inclusions). Nonetheless, the corporate partner will need information from the partnership to determine certain of the other items excluded from DEI. The Draft Instructions to Schedule K-2 seem to acknowledge this point, because they direct the partnership to state separately whether its gross income is DEI or is excluded from DEI. In the absence of any lines on Draft Schedule K-3 for reporting this information, it appears that the partnership would need to attach a white paper statement to provide this information to its partners. This instruction seems to be in tension with the stated purpose of the project to minimize white paper statements. We recommend that Draft Schedule K-3 be revised to include lines for the amounts excluded from DEI that are determined (in whole or in part) at the partnership level. The Instructions to Draft Schedule K-3 could clarify that the certain of the exclusion items are determined at the partner level. In addition, Draft Schedule K-3 could include lines for reporting the partnership level expenses that are properly allocable to DEI, which a partnership is required to report to its partners under Treas. Reg. § 1.250(b)-1(e)(2).

4. **Revise Partner’s Share of Qualified Business Asset Investment Reporting**

We believe that revisions related to the qualified business asset investment (“QBAI”) amount reported on line 7 might be in order. In general, QBAI is determined based on assets that are “partnership specified tangible property.” The Draft Instructions to Schedule K-2 state that all of the partnership’s tangible property should be assumed to be “partnership specified tangible property.” Then, the Draft Instructions state that the
partnership should separately state information on the partner’s Schedule K-3 so the partner can determine its basis in specified tangible property. There is only one line 7. We do not understand the Draft Instructions to provide the partnership authority to deviate from the FDII regulations in calculating QBAI (that is, we do not think that a partnership can assume that all of its assets are “partnership specified tangible property” even if the Draft Instructions include that directive in connection with Schedule K-2 reporting). Also, it is not clear whether the item reported to the partner on Schedule K-3 is the QBAI number that should be used in calculating the partner’s FDII. The Draft Instructions to Schedule K-3 state that the partner should use only a portion of the amount reported on line 7, but the Draft Instructions do not provide any discussion on how the partner is meant to determine that “portion.” We recommend that the Draft Instructions be revised to clarify that the amount reported to the partner on line 7 of the Schedule K-3 is the partner’s share of the partnership QBAI amount, which a partnership is required to report to its partners under Treas. Reg. § 1.250(b)-1(e)(2).

B. Section 245A Reporting – Distributions from Foreign Corporations

1. Clarify PTEP Reporting

Part IV, Section 3, of Draft Schedule K-2 reports information regarding distributions from foreign corporations. The Draft Instructions to Schedule K-2 provide that distributions of partnership PTEP are not reported in Part IV, and the partner’s Draft Instructions to Schedule K-3 tell partners to modify amounts of dividends reported on their returns to the extent the dividends are attributable to PTEP. We understand that Treasury and the Service intend to issue guidance regarding the treatment of distributions of PTEP to partnerships and their partners,¹⁴ and we have made recommendations regarding this issue.¹⁵ We expect that this section of the Schedules might require modification once additional guidance is issued. Until guidance is issued, however, it is not clear how a partner should use this information to determine the extent to which its distributive share of dividends is attributable to PTEP. It also is not clear how a partnership should determine the total amount of the partnership’s dividends to be allocated to the partners.

The Draft Instructions to Part IV, section 3, also reference section 245A. However, the Draft Schedules do not appear to report any information related to the foreign-source portion of the dividend, the undistributed foreign earnings of the payor foreign corporation, or the partnership’s holding period in the stock of the foreign corporation with respect to which section 245A potentially could apply. In addition,


certain information required to determine the deduction under section 245A at the partner
level might not have been maintained historically by a partnership because, among other
things, a partnership cannot claim a deduction under section 245A. For instance, a
partnership might not know the foreign-source portion of a dividend paid by a foreign
corporation owned by the partnership.

2. Clarify Section 958(a) Reporting Obligations

For tiered partnerships, the Draft Instructions for Schedule K-2, Rows A-O,
reference section 958(a) ownership. Certain partnerships (including foreign partnerships
and domestic partnerships that apply Prop. Treas. Reg. § 1.958-1(d)\(^{16}\)) might not be
treated as owning stock of a foreign corporation within the meaning of section 958(a).
However, the information reported by Part IV, section 3, might be relevant to partners in
any partnership that receives a distribution from a foreign corporation with respect to
which the partner may have PTEP. If this part of the Schedule is intended to report all
distributions by foreign corporations to partnerships, we recommend that the Draft
Instructions clarify which foreign corporations should be included. For example, the
information might be intended to be reported by a partnership that either (i) owns stock of
a foreign corporation within the meaning of section 958(a) or (ii) is included in a chain of
ownership described in section 958(a)(2) with respect to the foreign corporation. We
reiterate the same comment for Part V.

Column (j) is a check-box if a foreign corporation is a qualified foreign
corporation. We recommend adding some clarifying information either to the Draft
Schedule or the Draft Instructions, as each partner must make a separate determination if
the foreign 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.\(^{17}\)

C. Subpart F and GILTI Inclusions

With respect to Part V, Information on Partners’ Section 951(a)(1) and Section
951A Inclusions, the Draft Instructions to Schedule K-2 state that the partnership should
assume that each partner is a U.S. shareholder of the CFC. We believe this will result in
the partnership calculating and reporting information that will not be used if none of the
partners are U.S. Shareholders in the CFC (for example, a widely held partnership). In
line with our more general recommendation regarding relevance, we recommend that
partnerships be allowed to determine relevance based on all information available to the
partnership, including partner responses to requests for information from the partnership.

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\(^{17}\) 2004–44 I.R.B. 724.
1. **Reconsider Whether Partnerships Should Report Partner-Level Determinations**

Draft Schedule K-3, Part V, column (c), requires the partnership to report the “partner’s share of CFC items.” Generally, a partner’s pro rata share of CFC tested items (and subpart F income, if Prop. Treas. Reg. § 1.958-1(d) applies) is determined at the partner level under Treas. Reg. §§ 1.951-1 and 1.951A-1(d). A partnership might not have sufficient information to determine each partner’s share of CFC items at the partnership level. Moreover, it might not be appropriate for a partnership to determine a tax position on behalf of a partner, especially when partners generally will be bound by the partnership’s determination. To provide partners with sufficient information to determine their pro rata share of CFC items, the Schedules could instead report attributes that would allow a partner to determine its share of each CFC item. For example, the partnership could report how a distribution by the CFC with respect to the CFC item would have been allocated to the partner. We recommend that Treasury and the Service consider eliminating the partnership-level determination of the partners’ shares of CFC items and instead require reporting of attributes that would allow the partners to determine their pro rata shares at the partner level.

The Draft Instructions to Schedule K-2 indicate that the percentage stated as the partners’ shares of CFC items generally should be multiplied by the amount of Subpart F or GILTI item to determine the partner’s share. The Draft Instructions leave flexibility for the shares of items to be determined under applicable special rules if the use of a generic percentage is not appropriate. In that case, it is not clear what should be reported as the partners’ shares of CFC items if there are differences among items. If Treasury and the Service do not adopt the recommendation in the preceding paragraph, we alternatively recommend clarification regarding how amounts and percentages should be reported if the sharing percentage is not the same for each CFC item.

2. **Add Last Day of CFC’s Tax Year to Draft Schedules**

We recommend adding the last day of the CFC’s tax year to the Draft Schedules. A U.S. shareholder takes into account a subpart F or GILTI inclusion for a CFC based on the last day of the CFC’s tax year (in which it is a CFC) that ends with or within the U.S. shareholder’s tax year. The information in Part V does not include the last day of the CFC’s tax year. A partner that is a U.S. Shareholder might need this information to determine the appropriate year in which to take into account the Subpart F inclusion or CFC tested items.

3. **Clarify Whether Partner’s Share of 951(a)(1)(B) Inclusion Reflects Section 956**

The Draft Schedules and most of the Draft Instructions refer to a partner’s share of a section 951(a)(1)(B) inclusion. The Draft Instructions for the specific item on

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18 See I.R.C. § 6222(a).
Schedule K-2 indicates what is to be reported—consistent with treating Prop. Treas. Reg. § 1.958-1(d) as applying and with the requirement that shares of subpart F income be reported. We recommend that the Service clarify whether a partner’s amounts determined under section 951 are made without regard to reductions under Treas. Reg. § 1.956-1(a)(2).

D. PFIC Reporting

With respect to Part VI, Information to Complete Form 8621, the Draft Instructions to Schedule K-2 require the partnership to complete Part VI in all cases if it directly or indirectly owns a PFIC, regardless of whether it has a partner subject to the PFIC rules or required to file Form 8621. In line with our general recommendations set out above, we again recommend that partnerships be allowed to determine relevance for this part based on information available to the partnership, including partner responses to requests for information from the partnership.

Although the purpose of the requirement that accumulated post-1986 E&P be provided for a PFIC that is also a CFC is presumably to allow partners information necessary to make a deemed dividend purging election, we believe the required information, without more, is unlikely to be sufficient. Under Treas. Reg. § 1.1297-3, the amount required to be included in income is limited to the E&P accumulated while the foreign corporation was a PFIC and during the shareholder’s holding period. Draft Schedules K-2 and K-3 do not require information that would be helpful to apply such limitation. Also, it is not clear why a partnership would need to provide this information unless a partner requested it in connection with making that particular purging election. To that end, we suggest that this item explicitly be made subject to the over-arching relevance standard.

E. DCL Reporting

Finally, the Draft Schedules do not include any information related to the DCL rules. We recommend including partnership DCL reporting on Schedule K-3 rather than, for example, on Form 8858. If DCL reporting is added to Schedule K-3, then the newly added requirement for partnerships to complete questions 10-13 on Schedule G to Form 8858, Information Return of U.S. Persons With Respect to Foreign Disregarded Entities (FDEs) and Foreign Branches (FBs), as if they were a corporation (new number 5 under Who Must File in the Form 8858 Instructions) could be removed.