



TaxNewsFlash

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IRS provides Form 1065 FAQs, negative capital account reporting

The IRS posted a list of “frequently asked questions” (FAQs) concerning negative tax basis capital account reporting requirements on Form 1065.

Overview

Negative “tax basis capital” generally exists when a partnership allocates tax deductions or losses or makes distributions to a partner in excess of the partner’s tax basis equity in the partnership. It can also arise when a partner contributes property subject to debt in excess of the property’s adjusted tax basis to a partnership.

- The 2018 Instructions for Schedule K-1 (Form 1065) to Item L require that a partnership that does not report tax basis capital accounts to its partners must nevertheless report to a partner—on line 20 of Schedule K-1 using code AH—the amount of such partner’s tax basis capital both at the beginning of the year and at the end of the year if either amount is negative (negative tax basis capital account information).
- The Instructions for Schedule K-1 (Form 8865) incorporate this requirement by reference to the Instructions for Form 1065.

The [FAQs](#) (posted April 5, 2019) provide answers to questions regarding partnership reporting of negative “tax basis capital” and include responses and examples—plus a safe harbor approach for calculating partners’ tax basis capital accounts.

For more information, contact a tax professional with KPMG’s Washington National Tax practice:

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FAQs

The FAQs are reproduced here.

1. What is a partner's tax basis capital account?

A partner's tax basis capital account (sometimes referred to simply as "tax capital") represents its equity as calculated using tax principles, not based on GAAP, § 704(b), or other principles.

2. How do partnerships calculate a partner's tax basis capital account?

(A) In general, a partner's tax basis capital account is equal to the amount of money contributed by the partner to the partnership, increased by—

- (i) The adjusted tax basis of non-cash property contributed by the partner to the partnership, less the liabilities assumed by the partnership (or to which the property is subject) in connection with the contribution;
- (ii) The sum of the partner's distributive share for the taxable year and prior taxable years of partnership income or gain (including tax-exempt income);
- (iii) The partner's distributive share of the excess of the tax deductions for depletion (other than oil and gas depletion) over the tax basis of the property subject to depletion;
- (iv) The amount of liabilities of the partnership assumed by the partner, excluding liabilities described in (B)(ii); and
- (v) The partner's distributive share of any increase to the tax basis of partnership property under § 734(b) or with respect to partnership property under § 743(b).

(B) In general, a partner's tax basis capital account is decreased by—

- (i) Distributions of money to the partner;
- (ii) The adjusted tax basis of property distributed to the partner from the partnership, less the liabilities assumed by the partner (or to which the property is subject) in connection with the distribution;
- (iii) The sum of the partner's distributive share for the taxable year and prior taxable years of partnership losses and deductions (including expenditures which are not deductible in computing partnership taxable income and which are not capital expenditures);
- (iv) The partner's distributive share of the tax deductions for depletion of any partnership oil and gas property, not to exceed the partner's share of the adjusted tax basis of that property;
- (v) The partner's distributive share of the adjusted tax basis of charitable property contributions and foreign taxes paid or accrued;
- (vi) The amount of the partner's individual liabilities that are assumed by the partnership, excluding liabilities described in (A)(i); and
- (vii) The partner's distributive share of any decrease to the tax basis of partnership property under § 734(b) or with respect to partnership property under § 743(b).

Example 1: A contributes \$100 in cash and B contributes unencumbered, nondepreciable property with a fair market value (FMV) of \$100 and an adjusted tax basis of \$30 to newly formed Partnership AB. A's initial tax basis capital account is \$100 and B's initial tax basis capital account is \$30.

Example 2: The facts are the same as in Example 1, except B contributes nondepreciable property with a FMV of \$100, an adjusted tax basis of \$30, and subject to a liability of \$20. B's initial tax basis capital account is \$10 (\$30 adjusted tax basis of property contributed, less the \$20 liability to which the property was subject).

Example 3: The facts are the same as in Example 1, except in Year 1, the partnership earns \$100 of taxable income and \$50 of tax-exempt income. A and B are each allocated \$50 of the taxable income and \$25 of the tax-exempt income by the partnership. At the end of Year 1, A's tax basis capital account is increased by \$75, to \$175, and B's tax basis capital account is increased by \$75, to \$105.

Example 4: The facts are the same as in Example 3. Additionally, in Year 2, the partnership has \$30 of taxable loss and \$20 of expenditures which are not deductible in computing partnership taxable income and which are not capital expenditures. A and B are each allocated \$15 of the taxable loss and \$10 of the expenditures which are not deductible in computing partnership taxable income and which are not capital expenditures. At the end of Year 2, A's tax basis capital account is decreased by \$25, to \$150, and B's tax basis capital account is decreased by \$25, to \$80.

3. How can a partner's tax basis capital account be negative when the tax basis of its interest in the partnership (outside basis) is zero or positive?

A partner's tax basis capital account can be negative when its outside basis is zero or positive because outside basis is increased by the partner's share of partnership liabilities under § 752 and the partner's tax basis capital account is not. A partner's tax basis capital account can be negative if a partnership allocates tax losses or deductions or make distributions to the partner in excess of the partner's tax basis equity in the partnership, or when a partner contributes property subject to debt in excess of its adjusted tax basis to a partnership.

Example 5: On January 1, 2019, A and B each contribute \$100 in cash to a newly formed partnership. On the same day, the partnership borrows \$800 and purchases Asset X, qualified property for purposes of § 168(k), for \$1,000. Assume that the partnership properly allocates the \$800 liability equally to A and B under § 752. Immediately after the partnership acquires Asset X, both A and B have tax basis capital accounts of \$100 and outside bases of \$500 (\$100 cash contributed, plus \$400 share of partnership liabilities under § 752). In 2019, the partnership recognizes \$1,000 of tax depreciation under § 168(k) with respect to Asset X; the partnership allocates \$500 of the tax depreciation to A and \$500 of the tax depreciation to B. On December 31, 2019, A and B both have tax basis capital accounts of negative \$400 (\$100 cash contributed, less \$500 share of tax depreciation) and outside bases of zero (\$100 cash contributed, plus \$400 share of partnership liabilities under § 752, and less \$500 of share tax depreciation).

4. Do revaluations of partnership property affect a partner's tax basis capital account?

No. Revaluations of partnership property pursuant to § 704 and the regulations thereunder do not affect the tax basis of partnership property or a partner's tax basis capital account.

5. What is the tax capital account of a partner who acquired its partnership interest by transfer from another partner?

A partner that acquired its partnership interest by transfer from another partner, for example, by purchase or in a non-recognition transaction, has a tax capital account immediately after the transfer equal to the transferring partner's tax capital account immediately before the transfer with respect to the portion of the interest transferred, except no portion of any § 743(b) basis adjustment the transferring partner may have is transferred to the partner acquiring the interest as part of the transaction. If the partnership has a § 754 election in effect, the partnership increases or decreases

the tax capital account acquired by the transferee partner by an amount equal to the positive or negative adjustment to the tax basis of partnership property under § 743(b) as a result of the transfer.

6. Is there a safe harbor approach for determining whether a partnership has an obligation to report negative tax basis capital account information?

Yes. Partnerships may calculate a partner's tax basis capital account by subtracting the partner's share of partnership liabilities under § 752 from the partner's outside basis (safe harbor approach). If a partnership elects to use the safe harbor approach, the partnership must report the negative tax basis capital account information as equal to the excess, if any, of the partner's share of partnership liabilities under § 752 over the partner's outside basis.

7. Must partnerships that satisfy all four of the conditions provided in question 4 on Schedule B to the Form 1065 comply with the requirement to report negative tax basis capital account information?

No. A partnership that satisfies all four of the conditions provided in question 4 on Schedule B to the Form 1065 (and also listed below) does not have to comply with the requirement to report negative tax basis capital account information because the partnership is not required to complete item L on the Schedule K-1. The four conditions are:

- a. The partnership's total receipts for the tax year were less than \$250,000;
- b. The partnership's total assets at the end of the tax year were less than \$1 million;
- c. Schedules K-1 are filed with the return and furnished to the partners on or before the due date (including extensions) for the partnership return; and
- d. The partnership is not filing and is not required to file Schedule M-3.

8. What is the procedure for complying with the requirement to report negative tax basis capital account information for tax year 2018?

Notice 2019-20, Penalty Relief for Missing Negative Tax Basis Capital Account Information, provides additional information and penalty relief for complying with the requirement to report negative tax basis capital account information for tax year 2018 if the following conditions are met:

1. The Schedule K-1 or other applicable form or statement is timely filed, including extensions, with the IRS; is timely furnished to the appropriate partner, if applicable; and contains all other required information.
2. The person or partnership required to file the Schedule K-1 or other applicable form or statement files with the IRS, no later than one year after the original, unextended due date of the form to which the Schedule K-1 or other applicable form or statement must be attached, a schedule setting forth:
 - a. A statement that the schedule is "Filed Under Notice 2019-20";
 - b. The Schedules K-1 or other applicable forms or statements for which the schedule is filed, e.g., Schedule K-1 (Form 1065) or Schedule K-1 (Form 8865);
 - c. The partnership's name and Employer Identification Number, if any, and Reference ID Number, if any;
 - d. For each partner for which negative tax basis capital account information is required—

- i. The partner's name, address, and taxpayer identification number; and*
- ii. The amount of the partner's tax basis capital account at the beginning and end of the tax year at issue.*

With respect to the condition (2)(d)(ii), directly above, if the person or partnership required to file the Schedule K-1 or other applicable forms or statements elects to use the safe harbor approach for certain partners, the schedule must set forth for each partner for which negative tax basis capital account information is required:

- iii. The amount of the partner's outside basis, share of partnership liabilities under § 752, and tax basis capital account under the safe harbor approach at the beginning and end of the tax year at issue.*

The schedule should be sent to the following address:

1973 North Rulon White Blvd.
Ogden, UT 84404-7843
MS 4700
Attn: Ogden PTE

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