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KPMG report: Changes proposed in draft versions, Form 1065 and Schedule K-1 for 2019

The IRS this week released draft versions of the following forms for the tax year 2019:

- [Form 1065, U.S. Return of Partnership Income](#) [PDF 266 KB] and [Schedule K-1, Partner's Share of Income, Deductions, Credits, etc.](#) [PDF 153 KB] (this draft version of Schedule K-1 was replaced, with the new version showing a watermark date of October 18, 2019)
- [Form 1120-S, U.S. Income Tax Return for an S Corporation](#) [PDF 246 KB] and [Schedule K-1, Shareholder's Share of Income, Deductions, Credits, etc.](#) [PDF 133 KB]

According to the IRS, changes proposed in the draft versions of these forms are intended to assist the IRS in assessing compliance risk and identifying potential noncompliance. The IRS release ([IR-2019-160](#)) describes the draft forms as "near-final." Comments are due within 30 days of the release with the expectation that the forms may be finalized by December 2019.

The IRS has not yet released accompanying instructions.

Assuming the draft forms are finalized without change, significant additional time may be required to comply with the new forms for the 2019 filing season.

Summary of significant changes

Among the more significant changes proposed in the draft version of the Schedule K-1 (Form 1065) is the requirement that a partnership must report each partner's **tax** basis capital account roll-forward. For the tax year 2018, by contrast, a tax basis capital account disclosure was required **only** if a partner had a negative tax basis capital account at the beginning of the year or at the end of the year, and only the beginning and ending negative tax capital accounts were required to be disclosed.

In addition, the updated Schedule K-1 (Form 1065) requires that a partnership must report each partner's share of:

- Net unrecognized section 704(c) gain or loss, relating to contributions or revaluations of appreciated or depreciated property, determined both at the beginning and at the end of the applicable tax year
- Income or other items related to section 743(b) negative adjustments
- Guaranteed payments for services
- Guaranteed payments for capital
- Section 751 “hot” asset gain or loss
- Certain other items

Notably, although on its face the updated Schedule K-1 (Form 1065) appears limited to disclosure of a partner’s “[n]et unrecognized section 704(c) gain or loss,” the updated Schedule K-1 (Form 1065) would also require that a partnership disclose to its partners certain additional, but currently unspecified, section 704(c) information. Thus, it is possible that the IRS could require additional information to be reported.

The draft 2019 Form 1065 and Schedule K-1 (Form 1065) would further require information that could provide certain audit or statistical data points, including:

- The number of foreign partners subject U.S. federal income tax pursuant to section 864(c)(8) as a result of a transfer of all or a portion of a partnership interest or receipt of a partnership distribution
- Whether any transfers between the partnership and its partners were subject to the disguised sale disclosure requirements under Reg. section 1.707-8
- Whether the partnership aggregated or grouped activities for section 465 at-risk and section 496 passive activity purposes
- Whether the partnership has more than one activity for section 465 at-risk and section 469 passive activity purposes
- Whether a decrease in a partner’s share of partnership profit, loss, or capital is due to a sale or exchange of partnership interest
- Whether partnership liabilities include liabilities of a lower-tier partnership

Lastly, it is worth noting that, to date, the draft Form 1065 has not been revised to provide specific reporting within the capital gains boxes of long-term capital gains that have a holding period of three years or less for purposes of the “carried interest” rules of section 1061.

KPMG observation

Tax professionals expect the numerous proposed changes to the updated Form 1065 and Schedule K-1 (Form 1065) likely will add significant additional time to the tax reporting compliance process. Partnerships need to consider the possible new changes and discuss with their tax advisor what additional effort may be required to comply with the required reporting. Therefore, it will be important for partnerships to assess tax reporting and compliance readiness well in anticipation of filing deadlines.

Contact your KPMG engagement team for further information regarding the updated Form 1065 and Schedule K-1 (Form 1065).

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