KPMG

TaxNewsFlash

United States

No. 2020-369
June 5, 2020

Notice 2020-43: Comments requested on tax capital reporting by partnerships, and interim methods provided

The IRS today released an advance version of Notice 2020-43 to seek public comment on a proposed requirement for partnerships to use only one of two alternative methods to satisfy the partnership requirement to report partner tax capital (Tax Capital Reporting Requirement) for tax years that end on or after December 31, 2020.

Read **Notice 2020-43** [PDF 43 KB]

As background, partnerships and certain other persons are required to report partner capital accounts in Box L on the Schedule K-1 (Form 1065) or in Box F on the Schedule K-1 (Form 8865), each as they currently appear on the 2019 forms—the "Tax Capital Reporting Requirement." The final versions of these 2019 forms and their instructions provide that partnerships and other persons must report partner capital accounts consistent with the reporting requirements in the 2018 forms and instructions, including the requirement to report negative tax basis capital accounts on a partner-by-partner basis. Notice 2020-43 provides two methods of reporting tax capital:

- The Modified Outside Basis Method
- The Modified Previously Taxed Capital Method

Both of these methods are described below.

A partnership must use one of these two methods for purposes of satisfying the reporting requirements, and the method selected must be used with respect to all partners. For tax years after 2020, a partnership may change its method by attaching a disclosure to each Schedule K-1 describing the change, if any, to the amount attributable to each partner's beginning and end-of-year balances, and the reason for the change.

Modified Outside Basis Method

The partner's Modified Outside Basis Method is the partner's adjusted basis in its partnership interest, determined under the principles and provisions of subchapter K (including those contained in sections 705, 722, 733, and 742), and subtracting from that basis the partner's share of partnership liabilities under section 752.

KPMG observation

To apply this method, all partners must notify the partnership, in writing, of their outside basis (and, in subsequent years, any changes not attributable to partnership items). Notification of any changes attributable to non-partnership items must be provided by the partners to the partnership within 30 days or by the tax year-end of the partnership, whichever is later. Given this timing restriction, query whether the partnership agreement would need to require the partners to timely provide such information to the partnership, and whether existing partnerships need to consider amending their agreements to so provide.

Modified Previously Taxed Capital Method

The Modified Previously Taxed Capital Method revises the "previously taxed capital" described in Reg. section 1.743-1(d)(2) to determine a partner's section 743 adjustment but only for purposes of the Tax Capital Reporting Requirement in two ways:

- First, the cash a partner would receive on a partnership liquidation and calculations of gain and loss in the hypothetical transaction would be based on the assets' fair market value, if readily available. If the fair market value is not readily available, a partnership may determine its partnership net liquidity value and gain or loss by using such assets' bases as determined under section 704(b), GAAP, or the basis set forth in the partnership agreement for purposes of determining what each partner would receive if the partnership were to liquidate, as determined by partnership management.

- Second, for purposes of this method, all liabilities are treated as nonrecourse for purposes calculating gain or loss on the hypothetical transaction.

A partnership that adopts the Modified Previously Tax Capital Method must attach (each year) a statement that indicates the method used to determine the partnership net liquidity value.

KPMG observation

The use of Modified Previously Tax Capital Method would likely increase the partnership's tax compliance burden and cost, as it will require a hypothetical sale calculation of all partnership assets at year-end, and an allocation of that gain or loss taking into account section 704(c) among the partners. If the partnership is held by a large number of partners, or if the partnership has complex section 704(c) attributes or a large number of assets subject to section 704(c), the administrative work necessary to determine the tax capital may be a significant.

Comments requested

Comments are specifically requested by August 4, 2020, concerning:

- Whether the methods used to satisfy the Tax Capital Reporting Requirement in Notice 2020-43 need to be modified or adopted

- Whether an ordering rule should apply to the basis used in determining the partnership's net liquidity value—for example, use of fair market value is required, but if not readily available, section 704(b) book basis is required, and, if the partnership does not maintain section 704(b) capital, GAAP is required, etc.

- How, if at all, the Tax Capital Reporting Requirement should be modified to apply to partnerships that are treated as publicly traded partnerships under section 7704

- Whether the "transactional approach"* or similar method, should be permitted for purposes of meeting the Tax Capital Reporting Requirement and, if recommended, what additional guidance would be necessary

- Whether and in what circumstances limitations should be imposed on partnerships to change from one method to another (for example, whether there should be a limit on how many times the method can be changed over a period of years), including compliance with such rules in the case of the merger of partnerships using different methods

*Under the transactional approach, a partners tax capital account is (1) increased by the amount of money and the tax basis of property contributed by the partner to the partnership (less liabilities assumed by the partnership or to which property is subject) as well as allocations of income or gain made by the partnership to the partner, and (2) decreased by the amount of money and the tax basis of property distributed by the partnership to the partner (less any liabilities assumed by the partner or to which the property is subject) as well as allocations of loss or deduction made by the partnership to the partner.

Direct comments, including requests for subscriptions, to Washington National Tax. For more information, contact KPMG's Federal Tax Legislative and Regulatory Services Group at + 1 202.533.4366, 1801 K Street NW, Washington, DC 20006-1301.