

# IRS Finalizes New Pass-Through Entity Reporting Requirements for 2021 Tax Year

The IRS has announced several new pass-through entity reporting requirements to be introduced for the 2021 tax year. The new requirements serve to provide greater detail to partners and shareholders of pass-through entities to assist them in preparing their respective tax returns. Most notable of these requirements are the Schedules K-2, K-3 and Section 1061 Worksheet A.

Schedules K-2 and K-3 will report certain international items that were previously reported on Schedule K-1 lines 16 and 20 and other items required to be disclosed by the pass-through entities in K-1 attachments. It provides the partners and shareholders with additional details regarding these international items so that they can more accurately calculate their U.S. income tax liability. Many items were previously reported as footnotes to the Schedule K and K-1, however Schedules K-2 and K-3 will formalize reporting. The information provided on this schedule will help partners and shareholders determine the following items:

- Income, loss and foreign taxes paid or accrued by source and Section 904 income category to assist in calculating a foreign tax credit.
- The amount of section 250 deduction that can be claimed in relation to foreign-derived intangible income.
- The distribution amount from a foreign corporation that is attributed to previously taxed earnings and profits (“PTEP”) and the specific type of PTEP from which the amount is distributed.
- Foreign currency gain or loss on the PTEP that must be recognized under section 986(c).
- Section 951(a)(1), 951A and 956 inclusions.
- Information to be reported on Form 8621, Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund.
- The amount of base erosion payments paid and base erosion benefit incurred for purposes of the base erosion and anti-abuse tax (“BEAT”).
- The amount of U.S. tax liability to claim on Form 1040-NR with respect to ECI or FDAP income.
- The amount of U.S. withholding tax and U.S. tax liability to claim on Forms 1042 and 1042-S related to transactions under section 871(m).
- Deemed sale items with respect to a transfer of partnership interest.

The IRS also implemented additional filing requirements in relation to section 1061. Under this section, a partner that holds one or more applicable partnership interests (API) must recharacterize certain long-term capital gains attributed to capital assets held between one and three years as short-term capital gains. Therefore, when section 1061 is applicable, a capital asset must be held for greater than three years in order to receive long-term capital gain treatment. An applicable partnership interest is defined as “any interest in a partnership which, directly or indirectly, is transferred to (or is held by) the taxpayer in connection with the performance of substantial services by the taxpayer, or any other related person, in any applicable trade or business.”<sup>1</sup> Beginning

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<sup>1</sup> I.R.C. § 1061(c)(1)



with tax returns filed after December 31, 2021, pass-through entities will complete and attach Worksheet A to each API Holder's Schedule K-1. The worksheet will detail the amount of capital gain to be recharacterized.

#### Action Items to Take

For all pass-through entities, review any international items at the entity level and request disclosures from partners and shareholders regarding their interests in foreign entities. This will require annual follow ups with the shareholders/partners after they file their returns to obtain the impact on the partnership-level reporting. This will help determine which sections, if any, of the Schedule K-2/K-3 will need to be completed.

For partnerships with API holders, review any disclosures provided in prior years regarding section 1061. Make note of additional information that will need to be collected for the filing of Worksheet A.

#### Contact Us

For more information on the updated K-1 reporting requirements, please contact your Bennett Thrasher Tax advisor by calling 770.396.2200.