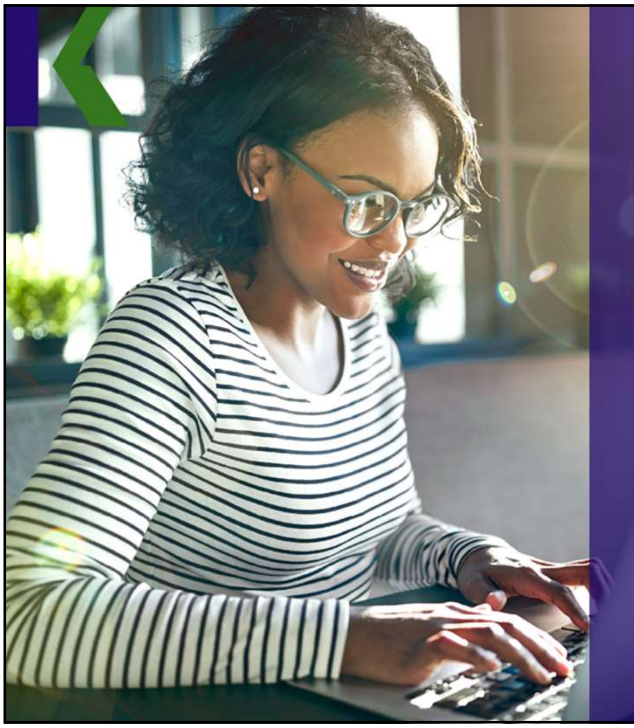

Schedules K-2 and K-3: Why Even Partnerships and S Corporations with No Foreign Activities or Members May Need to Prepare These Forms

May 10, 2024

KAPLAN

1

http://www.currentfederaltaxdevelopments.com/k2k3

Today's Course and Focus

- As the title says, we are looking today at entities without foreign operations (other than, perhaps, minor amounts of foreign tax credits) or foreign equity holders
- You will learn *why* that partnership with only a rental building in Grand Island, NE and US individual partners likely will be filing these forms—including why the partners need (and may have needed for years) the information on the forms
- The other parts of the Schedules K-2 and K-3 tend to involve more detailed international tax issues that require a background in the international tax matter in question--and those are beyond the scope of today's short session

2

Schedules K-2 and K-3 – Season Three (2023)

- IRS made virtually no changes from the 2022 version
- Seems unlikely we'll see major changes in 2024, though won't know until we at least see the draft Forms K-2/K-3 for 2024 returns (not yet released as of May 10, 2024)

Schedules K-2 and K-3 (Forms 1065 and 1120-S)

- Were originally proposed in 2020
- Finalized summer of 2021 and required to be attached to 2021 returns if applicable
- Technically, all of the information requested should have been included in plain paper form with prior year K-1s (but in reality, little of the detailed Form 1116 information was by most partnerships)

Tax Vendor Software Support

- For the first filing season back in 2021 vendors provided little support for most (or all) of the filing season
  - Re-entered much of the data even if all information was US source only
  - Was a huge benefit to being able to avoid preparing the forms, so February 15, 2022, guidance was a huge help

Tax Vendor Software Support

- In 2022 two things happened
  - IRS complicated the exception, making it less useful (especially for partnerships) – something that remains unchanged
  - Software vendors began automating support for the forms for US activity only entities
- For example, let's look at Ultratax's 2022 support

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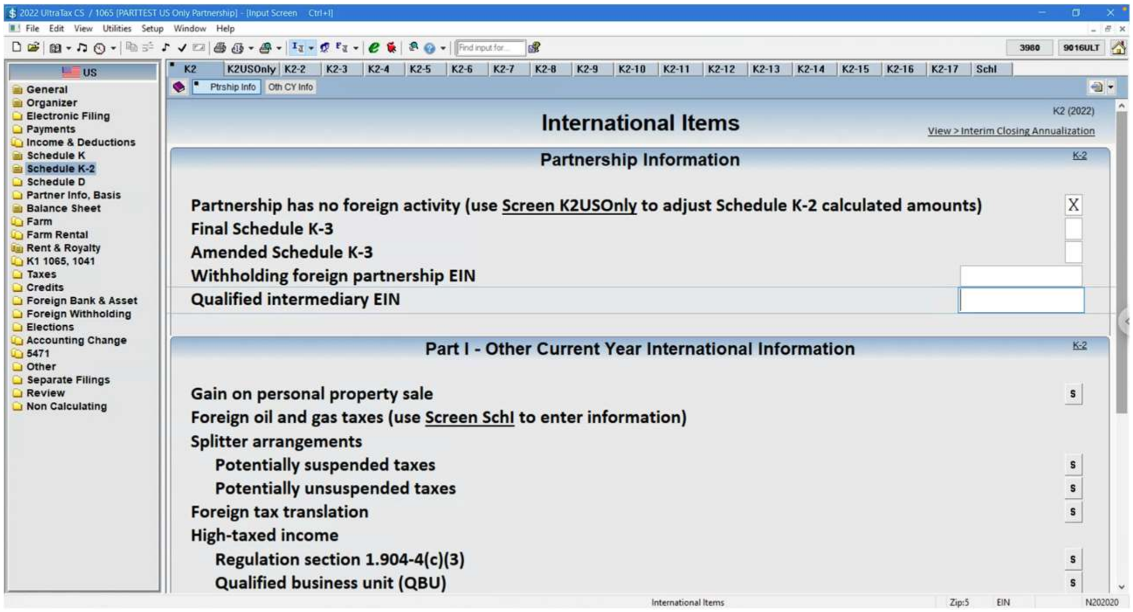

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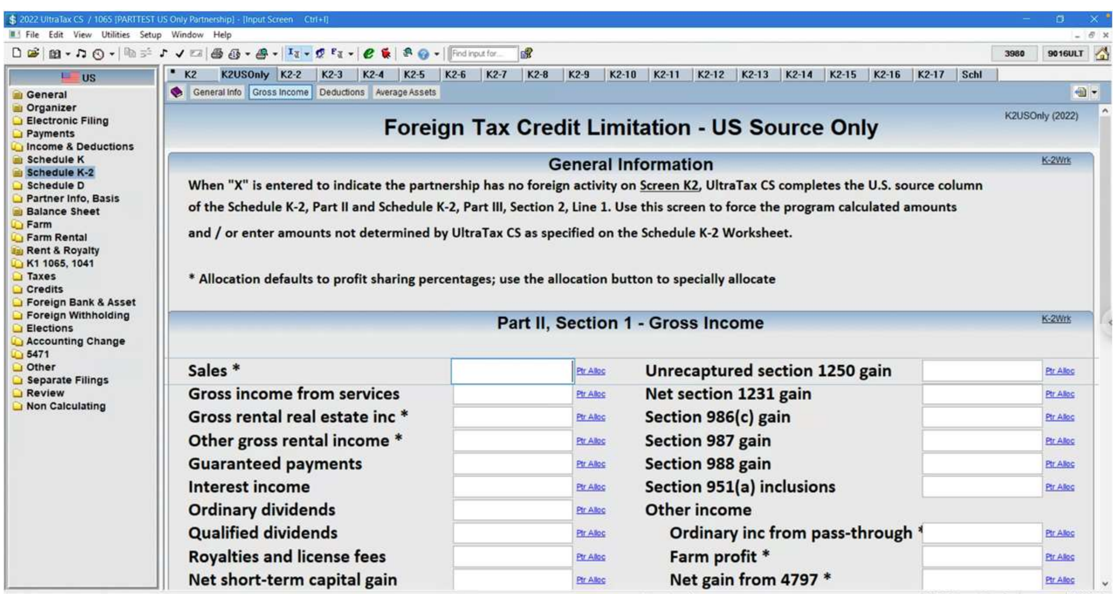

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Is There Any Time Savings in Meeting an Exception?

- Before working to meet one of the exceptions, ask yourself:
  - How much time would it take to prepare the K-2 and equity holders' K-3s?
  - How much time may be taken up with dealing with the rules for avoiding preparing the forms, including potential need to issue K-3s later upon request
- Vendors creating "standard" K-2/K-3 assuming all activity is US source
- Depending on how well your software vendor does this, preparing the forms may be simply checking one box – and much less work than the compliance with the domestic filing exception

Today's Course Concentrates on the 2023 Filings

- We are still in the 2023 calendar year filing season for the forms
- The one draft form we have shows no major changes in the areas we are covering
- But still not known what, if any, changes will be made to the exceptions for 2024 filings – that will need to wait for the draft and final instructions

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Forms K-2 and K-3 for 2023

The forms that changed only minimally from the 2022 versions

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K-2/K-3

- Which path do we take is now the key decision?
  - Domestic filing exception (if we qualify, subject to potential need to provide information after filing) or
  - Preparing the Schedules for all partners/shareholders (many pages are added to what is provided to the partners/shareholders, which may be more of a problem if provided in paper form rather than PDF)
- In many cases, the second option will incur the least time to prepare due to tax software support

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K-2/K-3

- We have a domestic filing exception
  - Does not require asking partners if they need the K-2/K-3 but
    - Will need to provide that information if asked and may need to file K-3 if informed of the need before a deadline found in the instructions
    - If informed of a need for this information in the prior year, you must provide that data in the following year
  - Notification only really required when the K-1 is provided to the partner

Domestic Filing Exception – General Description

Domestic filing exception (exception to filing Schedules K-2 and K-3). A domestic partnership (as defined under section 7701(a)(2) and (4)) does not need to **(a)** complete and file with the IRS the Schedules K-2 and K-3, or **(b)** furnish to a partner the Schedule K-3 (except where requested by a partner after the 1-month date (defined in criteria number 4, below)) if each of the following four criteria are met with respect to the partnership's tax year 2022.

Four Criteria to Use the Domestic Filing Exception

- Foreign activities (no or minimal activities)
- (Partnership only requirement) – Only ”acceptable” partners
- Notice to equity holders no Schedule K-3 will be given unless requested
- Cannot receive notice from equity holder of need for Schedule K-3 more than one month before tax return is filed
- The next few slides look at the exceptions we have

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No or Limited Foreign Activity

During a domestic partnership’s tax year 2023, the domestic partnership either has no foreign activity (as defined below) or, if it does have foreign activity, such foreign activity is limited to

(a) passive category foreign income (determined without regard to the high-taxed income exception under section 904(d)(2)(B)(iii));

(b) upon which not more than $300 of foreign income taxes allowable as a credit under section 901 are treated as paid or accrued by the partnership; and

(c) such income and taxes are shown on a payee statement (as defined in section 6724(d)(2)) that is furnished or treated as furnished to the partnership.

No or Limited Foreign Activity

Foreign activity. For purposes of the domestic filing exception, foreign activity means any of the following.

(a) foreign income taxes paid or accrued (as defined in section 901 and the regulations thereunder);

(b) foreign source income or loss (as determined in sections 861 through 865, and section 904(h), and the regulations thereunder);

(c) ownership interest in a foreign partnership (as defined in sections 7701(a)(2) and (5));

(d) ownership interest in a foreign corporation (as defined in sections 7701(a)(3) and (5));

No or Limited Foreign Activity

Foreign activity. For purposes of the domestic filing exception, foreign activity means any of the following.

(e) ownership of a foreign branch (as defined in Regulations section 1.904-4(f)(3)(vii)); and

(f) ownership interest in a foreign entity that is treated as disregarded as an entity separate from its owner (as defined in Regulations section 301.7701-3).

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US Citizen/Resident Alien Partners (Partnership Only)

During tax year 2023, all the direct partners in the domestic partnership are:

(a) individuals who are U.S. citizens;

(b) individuals that are resident aliens (as defined in section 7701(b)(1)(A) and the regulations thereunder);

(c) domestic decedent's estates (that is, decedent's estates that are not foreign estates as defined in section 7701(a)(31)(A)), with solely U.S. citizen and/or resident alien individual beneficiaries;

(d) domestic grantor trusts (that is, trusts described under sections 671 through 678) that are not foreign trusts as defined in section 7701(a)(31)(B)) and that have solely U.S. citizen and / or resident alien individual grantors and solely U.S. citizen and / or resident alien individual beneficiaries;

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US Citizen/Resident Alien Partners (Partnership Only)

During tax year 2023, all the direct partners in the domestic partnership are:

(e) domestic non-grantor trusts (that is, trusts subject to tax under section 641 that are not foreign trusts as defined in section 7701(a)(31)(B)) with solely U.S. citizen and/or resident alien individual beneficiaries;

(f) S corporations with a sole shareholder; or

(g) single-member LLCs, where the LLC's sole member is one of the persons in subparagraphs (a) through (f) and the LLC is disregarded as an entity separate from its owner (as defined in Regulations section 301.7701-3).

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Partner Notification

With respect to a partnership that satisfies criteria 1 and 2, partners receive a notification from the partnership at the latest when the partnership furnishes the Schedule K-1 to the partner. The notice can be provided as an attachment to the Schedule K-1. The notification must state that partners will not receive Schedule K-3 from the partnership unless the partners request the schedule.

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No 2022 Schedule K-3 Requests by 1-Month Date

The partnership does not receive a request from any partner for Schedule K-3 information on or before the 1-month date. The "1-month date" is 1 month before the date the partnership files the Form 1065. For tax year 2023 calendar year partnerships, the latest 1-month date is August 15, 2024, if the partnership files an extension.

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No 2022 Schedule K-3 Requests by 1-Month Date

The partnership does not receive a request from any partner for Schedule K-3 information on or before the 1-month date. The "1-month date" is 1 month before the date the partnership files the Form 1065. For tax year 2023 calendar year partnerships, the latest 1-month date is August 15, 2024, if the partnership files an extension.

Don't Add Conditions That Don't Exist in the Final Instructions

- IRS explicitly does not require that a notice be given to the partners in time to provide a 1-month notice – it can be given well after the 1-month date (up to one month in fact)
- The instructions do not require treating any notice received before August 15, 2024 as being made before the 1-month date – that is true only if the entity files its tax returns on September 15, 2024 (no earlier)
- The IRS has backed off in this area without clearly admitting they had done so (the AICPA had requested that US-only partnerships only be required to provide K-3s to partners that request them)

Requests After the 1-Month Date

If a partnership receives a request from a partner for the Schedule K-3 information after the 1-month date and has not received a request from any other partner for Schedule K-3 information on or before the 1-month date, the domestic filing exception is met and the partnership is not required to file the tax year 2022 Schedules K-2 and K-3 with the IRS or furnish the tax year 2023 Schedule K-3 to the non-requesting partners. However, the partnership is required to provide the tax year 2023 Schedule K-3, completed with the requested information, to the requesting partner on the later of the date on which the partnership files the Form 1065 or 1 month from the date on which the partnership receives the request from the partner. See Example 4. The partnership must complete and file tax year 2024 Schedules K-2 and K-3 with respect to the requesting partner by the tax year 2024 Form 1065 filing deadline

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Partnership Gets a Request from Some Partners Before the 1-Month Date

If the partnership received a request from a partner for Schedule K-3 information on or before the 1-month date and therefore the partnership does not satisfy criterion 4, the partnership is required to file the Schedules K-2 and K-3 with the IRS and furnish the Schedule K-3 to the requesting partner. The Schedules K-2 and K-3 are required to be completed only with respect to the parts and sections relevant to the requesting partner. For example, if a partner requests the information reported on Part III, Section 2 (Interest Expense Apportionment Factors), the partnership is required to complete and file Schedule K-2, Part III, Section 2 with respect to the partnership's total assets and Schedule K-3, Part III, Section 2 with respect to the requesting partner's distributive share of the assets. On the date that the partnership files Schedules K-2 and K-3 with the IRS, the partnership must provide a copy of the filed Schedule K-3 to the requesting partner. The partnership does not need to complete, attach, file, or furnish any other parts or sections of the Schedules K-2 and K-3 to the IRS, the requesting partner, or any other partner. The partnership should keep records of the information requested by the partner. See Example 3

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Partnership Gets a Request from Some Partners Before the 1-Month Date

If a partnership receives requests from partners for Schedule K-3 information both on or before the 1-month date and after the 1-month date, the partnership is required to file Schedules K-2 and K-3 as described in the prior paragraph only with respect to the partner requests received on or before the 1-month date. With respect to requests received after the 1-month date, the partnership is required to provide the Schedule K-3, completed with that partner's requested information, on the later of the date on which partnership files the Form 1065 or 1 month from the date on which the partnership receives the request from the partner. See Examples 3 and 4.

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S Corporations

- Aside from not having to consider the issue about whether the entity has disqualified entity holders, the same rules apply to Form 1120S Schedules K-2 and K-3

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SCHEDULE K-2 (Form 1065)
Department of the Treasury
Internal Revenue Service

Partners' Distributive Share Items—International

Attach to Form 1065.
Go to *www.irs.gov/Form1065* for instructions and the latest information.

OMB No. 1545-0123
2023

Name of partnership | Employer identification number (EIN)

A Is the partnership a withholding foreign partnership? ☐ Yes ☐ No If "Yes," enter your WP-EIN: ______

B Is the partnership (including the home office or any branch) a qualified derivatives dealer? ☐ Yes ☐ No If "Yes," enter your QI-EIN: ______

C Check to indicate the parts of Schedule K-2 that apply.

			Yes	No
1	Does Part I apply? If "Yes," complete and attach Part I	1		
2	Does Part II apply? If "Yes," complete and attach Part II	2		
3	Does Part III apply? If "Yes," complete and attach Part III	3		
4	Does Part IV apply? If "Yes," complete and attach Part IV	4		
5	Does Part V apply? If "Yes," complete and attach Part V	5		
6	Does Part VI apply? If "Yes," complete and attach Part VI	6		
7	Does Part VII apply? If "Yes," complete and attach Part VII	7		
8	Does Part VIII apply? If "Yes," complete and attach Part VIII	8		
9	Does Part IX apply? If "Yes," complete and attach Part IX	9		
10	Does Part X apply? If "Yes," complete and attach Part X	10		
11	Does Part XI apply? If "Yes," complete and attach Part XI	11		
12	Reserved for future use	12		

Part I Partnership's Other Current Year International Information

Check box(es) for additional specified attachments. See instructions.

☐ 1. Gain on personal property sale
☐ 2. Foreign oil and gas taxes
☐ 3. Splitter arrangements
☐ 4. Foreign tax translation
☐ 5. High-taxed income
☐ 6. Section 267A disallowed deduction
☐ 7. Reserved for future use
☐ 8. Form 5471 information
☐ 9. Other forms
☐ 10. Partner loan transactions
☐ 11. Dual consolidated loss
☐ 12. Reserved for future use
☐ 13. Other international items (attach description and statement)

Part II Foreign Tax Credit Limitation

Section 1—Gross Income

Description	(a) U.S. source	Foreign Source				(f) Sourced by partner	(g) Total
		(b) Foreign branch category income	(c) Passive category income	(d) General category income	(e) Other (category code ____)		
1 Sales							
A							
B							
C							
2 Gross income from performance of services							
A							
B							
C							
3 Gross rental real estate income							
A							
B							
C							
4 Other gross rental income							
A							
B							
C							

For Paperwork Reduction Act Notice, see the Instructions for Form 1065. Cat. No. 73927C Schedule K-2 (Form 1065) 2023

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Name of partnership | EIN

Part II Foreign Tax Credit Limation *(continued)*

Section 1—Gross Income *(continued)*

Description	(a) U.S. source	Foreign Source				(f) Sourced by partner	(g) Total
		(b) Foreign branch category income	(c) Passive category income	(d) General category income	(e) Other (category code ____)		
5 Guaranteed payments							
6 Interest income							
A							
B							
C							
7 Ordinary dividends (exclude amount on line 8)							
A							
B							
C							
8 Qualified dividends							
A							
B							
C							
9 Reserved for future use							
10 Royalties and license fees							
A							
B							
C							
11 Net short-term capital gain							
A							
B							
C							
12 Net long-term capital gain							
A							
B							
C							
13 Collectibles (28%) gain							
A							
B							
C							
14 Unrecaptured section 1250 gain							
A							
B							
C							

Schedule K-2 (Form 1065) 2023

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Schedule K-2 (Form 1065) 2023 Page **3**

Name of partnership | EIN

Part II **Foreign Tax Credit Limitation** *(continued)*

Section 1—Gross Income *(continued)*

Description	**(a)** U.S. source	Foreign Source **(b)** Foreign branch category income	**(c)** Passive category income	**(d)** General category income	**(e)** Other (category code ____)	**(f)** Sourced by partner	**(g)** Total
15 Net section 1231 gain							
A							
B							
C							
16 Section 986(c) gain							
17 Section 987 gain							
18 Section 988 gain							
19 Section 951(a) inclusions							
A							
B							
C							
20 Other income (see instructions)							
A							
B							
C							
21 Reserved for future use							
A							
B							
C							
22 Reserved for future use							
A							
B							
C							
23 Reserved for future use							
A							
B							
C							
24 **Total gross income** (combine lines 1 through 23)							
A							
B							
C							

Schedule K-2 (Form 1065) 2023

http://www.currentfederaltaxdevelopments.com/k2k3

Schedule K-2 (Form 1065) 2023 Page **4**

Name of partnership | EIN

Part II **Foreign Tax Credit Limitation** *(continued)*

Section 2—Deductions

Description	**(a)** U.S. source	Foreign Source **(b)** Foreign branch category income	**(c)** Passive category income	**(d)** General category income	**(e)** Other (category code ____)	**(f)** Sourced by partner	**(g)** Total
25 Expenses allocable to sales income							
26 Expenses allocable to gross income from performance of services							
27 Net short-term capital loss							
28 Net long-term capital loss							
29 Collectibles loss							
30 Net section 1231 loss							
31 Other losses							
32 Research & experimental (R&E) expenses							
A SIC code:							
B SIC code:							
C SIC code:							
33 Allocable rental expenses—depreciation, depletion, and amortization							
34 Allocable rental expenses—other than depreciation, depletion, and amortization							
35 Allocable royalty and licensing expenses—depreciation, depletion, and amortization							
36 Allocable royalty and licensing expenses—other than depreciation, depletion, and amortization							
37 Depreciation not included on line 33 or line 35							
38 Charitable contributions							
39 Interest expense specifically allocable under Regulations section 1.861-10(e)							
40 Other interest expense specifically allocable under Regulations section 1.861-10T							
41 Other interest expense—business							
42 Other interest expense—investment							
43 Other interest expense—passive activity							
44 Section 59(e)(2) expenditures, excluding R&E expenses on line 32							
45 Foreign taxes not creditable but deductible							

Schedule K-2 (Form 1065) 2023

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Schedule K-2 (Form 1065) 2023 Page **5**

Name of partnership | EIN

Part II **Foreign Tax Credit Limitation** *(continued)*

Section 2—Deductions *(continued)*

Description	**(a)** U.S. source	Foreign Source				**(f)** Sourced by partner	**(g)** Total
		(b) Foreign branch category income	**(c)** Passive category income	**(d)** General category income	**(e)** Other (category code ______)		
46 Section 986(c) loss							
47 Section 987 loss							
48 Section 988 loss							
49 Other allocable deductions (see instructions)							
50 Other apportioned share of deductions (see instructions)							
51 Reserved for future use							
52 Reserved for future use							
53 Reserved for future use							
54 **Total deductions** (combine lines 25 through 53)							
55 **Net income (loss)** (subtract line 54 from line 24)							

Part III **Other Information for Preparation of Form 1116 or 1118**

Section 1—R&E Expenses Apportionment Factors

Description	**(a)** U.S. source	Foreign Source				**(f)** Sourced by partner	**(g)** Total
		(b) Foreign branch category income	**(c)** Passive category income	**(d)** General category income	**(e)** Other (category code ______) (country code ______)		
1 Gross receipts by SIC code							
A SIC code:							
B SIC code:							
C SIC code:							
D SIC code:							
E SIC code:							
F SIC code:							

2 Exclusive apportionment with respect to total R&E expenses entered on Part II, line 32. Enter the following.

A R&E expense with respect to activity performed in the United States		
(i) SIC code: __________	2A(i)	
(ii) SIC code: __________	2A(ii)	
(iii) SIC code: __________	2A(iii)	
B R&E expense with respect to activity performed outside the United States		
(i) SIC code: __________	2B(i)	
(ii) SIC code: __________	2B(ii)	
(iii) SIC code:	2B(iii)	

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Part III **Other Information for Preparation of Form 1116 or 1118** *(continued)*

Section 2—Interest Expense Apportionment Factors

Description	**(a)** U.S. source	Foreign Source				**(f)** Sourced by partner	**(g)** Total
		(b) Foreign branch category income	**(c)** Passive category income	**(d)** General category income	**(e)** Other (category code ______) (country code ______)		
1 Total average value of assets							
2 Sections 734(b) and 743(b) adjustment to assets—average value							
3 Assets attracting directly allocable interest expense under Regulations section 1.861-10(e)							
4 Other assets attracting directly allocable interest expense under Regulations section 1.861-10T							
5 Assets excluded from apportionment formula							
6a Total assets used for apportionment (subtract the sum of lines 3, 4, and 5 from the sum of lines 1 and 2)							
b Assets attracting business interest expense							
c Assets attracting investment interest expense							
d Assets attracting passive activity interest expense							
7 Basis in stock of 10%-owned noncontrolled foreign corporations (see attachment)							
8 Basis in stock of CFCs (see attachment)							

Section 3—Foreign-Derived Intangible Income (FDII) Deduction Apportionment Factors

Description	**(a)** U.S. source	Foreign Source			**(e)** Sourced by partner	**(f)** Total
		(b) Passive category income	**(c)** General category income	**(d)** Other (category code ______) (country code ______)		
1 Foreign-derived gross receipts						
2 Cost of goods sold (COGS)						
3 Partnership deductions allocable to foreign-derived gross receipts						
4 Other partnership deductions apportioned to foreign-derived gross receipts						

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Part III Other Information for Preparation of Form 1116 or 1118 *(continued)*

Section 4—Foreign Taxes

Description	(a) Type of tax	(b) Section 951A category income U.S.	(b) Foreign	(c) Foreign branch category income U.S.	(c) Foreign	(c) Partner
1 Direct (section 901 or 903) foreign taxes: ☐ Paid ☐ Accrued						
A						
B						
C						
D						
E						
F						
2 Reduction of taxes (total)						
A Taxes on foreign mineral income						
B Reserved for future use						
C International boycott provisions						
D Failure-to-file penalties						
E Taxes with respect to splitter arrangements						
F Taxes on foreign corporate distributions						
G Other						
3 Foreign tax redeterminations						
A Related tax year: Date tax paid: Contested tax ☐						
B Related tax year: Date tax paid: Contested tax ☐						
C Related tax year: Date tax paid: Contested tax ☐						
4 Reserved for future use						
5 Reserved for future use						
6 Reserved for future use						

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Part III Other Information for Preparation of Form 1116 or 1118 *(continued)*

Section 4—Foreign Taxes *(continued)*

	(d) Passive category income U.S.	(d) Foreign	(d) Partner	(e) General category income U.S.	(e) Foreign	(e) Partner	(f) Other (category code ______)	(g) Total
1								
A								
B								
C								
D								
E								
F								
2								
A								
B								
C								
D								
E								
F								
G								
3								
A								
B								
C								
4								
5								
6								

Section 5—Other Tax Information

Description	(a) U.S. source	Foreign Source: (b) Section 951A category income	(c) Foreign branch category income	(d) Passive category income	(e) General category income	(f) Other (category code _____) (country code _____)	(g) Sourced by partner	(h) Total
1 Section 743(b) positive income adjustment								
2 Section 743(b) negative income adjustment								
3 Reserved for future use								
4 Reserved for future use								

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Part IV **Information on Partners' Section 250 Deduction With Respect to Foreign-Derived Intangible Income (FDII)**

Section 1—Information To Determine Deduction Eligible Income (DEI) and Qualified Business Asset Investment (QBAI) on Form 8993

1	Net income (loss)	1	
2a	DEI gross receipts	2a	
b	DEI COGS	2b	
c	DEI properly allocated and apportioned deductions	2c	
3	Section 951(a) inclusions	3	
4	Controlled foreign corporation (CFC) dividends	4	
5	Financial services income	5	
6	Domestic oil and gas extraction income	6	
7	Foreign branch income	7	
8	Partnership QBAI	8	

Section 2—Information To Determine Foreign-Derived Deduction Eligible Income (FDDEI) on Form 8993 (see instructions)

	Description	(a) Foreign-derived income from all sales of general property	(b) Foreign-derived income from all sales of intangible property	(c) Foreign-derived income from all services	(d) Total (add columns (a) through (c))
9	Gross receipts				
10	COGS				
11	Allocable deductions				
12	Other apportioned deductions			12	

Section 3—Other Information for Preparation of Form 8993

	Description	(a) DEI	(b) FDDEI	(c) Total
13	Interest deductions			
A	Interest expense specifically allocable under Regulations section 1.861-10(e)			
B	Other interest expense specifically allocable under Regulations section 1.861-10T			
C	Other interest expense			
14	Interest expense apportionment factors			
A	Total average value of assets			
B	Sections 734(b) and 743(b) adjustment to assets—average value			
C	Assets attracting directly allocable interest expense under Regulations section 1.861-10(e)			
D	Other assets attracting directly allocable interest expense under Regulations section 1.861-10T			
E	Assets excluded from apportionment formula			
F	Total assets used for apportionment (the sum of lines 14C, 14D, and 14E subtracted from the sum of lines 14A and 14B)			
	R&E expenses apportionment factors			
15	Gross receipts by SIC code			
A	SIC code:			
B	SIC code:			
C	SIC code:			
16	R&E expenses by SIC code			
A	SIC code:		16A	
B	SIC code:		16B	
C	SIC code:		16C	

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Part V **Distributions From Foreign Corporations to Partnership**

	(a) Name of distributing foreign corporation	(b) EIN or reference ID number	(c) Date of distribution	(d) Functional currency of distributing foreign corporation	(e) Amount of distribution in functional currency
A					
B					
C					
D					
E					
F					
G					
H					
I					
J					
K					
L					
M					
N					
O					

	(f) Amount of E&P distribution in functional currency	(g) Spot rate (functional currency to U.S. dollars)	(h) Amount of distribution in U.S. dollars	(i) Amount of E&P distribution in U.S. dollars	(j) Qualified foreign corporation	(k) Reserved for future use
A					☐	
B					☐	
C					☐	
D					☐	
E					☐	
F					☐	
G					☐	
H					☐	
I					☐	
J					☐	
K					☐	
L					☐	
M					☐	
N					☐	
O					☐	

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Part VI **Information on Partners' Section 951(a)(1) and Section 951A Inclusions**

a Separate category (enter code—see instructions) . . . .

b If U.S. source, complete as a separate Part VI by separate category and check box . . . . ☐

	(a) Name of CFC	**(b)** EIN or reference ID number	**(c)** Ending of CFC tax year	**(d)** Partners' share of CFC items through their ownership in the partnership ("aggregate share")	**(e)** Aggregate share of subpart F income	**(f)** Aggregate section 951(a)(1)(B) inclusion	**(g)** Tested income
A							
B							
C							
D							
E							
F							
G							
H							
I							
J							
K							
1	**Partnership total** (sum for all CFCs)						

	(h) Tested loss	**(i)** Aggregate share of tested income	**(j)** Aggregate share of tested loss	**(k)** Aggregate share of QBAI	**(l)** Aggregate share of the tested loss QBAI amount	**(m)** Aggregate share of tested interest income	**(n)** Aggregate share of tested interest expense
A							
B							
C							
D							
E							
F							
G							
H							
I							
J							
K							
1							

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Part VII **Information Regarding Passive Foreign Investment Companies (PFICs)**

Section 1—General Information

	General Information				
	(a) Name of PFIC	**(b)** EIN or reference ID number	**(c)** Address of PFIC	**(d)** Beginning of PFIC tax year	**(e)** Ending of PFIC tax year
A					
B					
C					
D					
E					
F					
G					
H					
I					
J					
K					
L					

	Summary of Annual Information				Information Regarding Elections				
	(f) Description of each class of PFIC shares	**(g)** Dates PFIC shares acquired during tax year (if applicable)	**(h)** Total number of PFIC shares held at end of tax year	**(i)** Total value of PFIC shares held at end of tax year	**(j)** Election by partnership (enter code—see instructions)	**(k)** Check if foreign corporation has documented its eligibility to be treated as a qualifying insurance corporation under section 1297(f)(2).	**(l)** Check if PFIC has indicated its shares are "marketable stock" within the meaning of section 1296(e).	**(m)** Check if PFIC is also a CFC within the meaning of section 957.	**(n)** Check if PFIC meets the income test or asset test of section 1297(a) for the tax year.
A						☐	☐	☐	☐
B						☐	☐	☐	☐
C						☐	☐	☐	☐
D						☐	☐	☐	☐
E						☐	☐	☐	☐
F						☐	☐	☐	☐
G						☐	☐	☐	☐
H						☐	☐	☐	☐
I						☐	☐	☐	☐
J						☐	☐	☐	☐
K						☐	☐	☐	☐
L						☐	☐	☐	☐

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Part VII Information Regarding Passive Foreign Investment Companies (PFICs) *(continued)*

Section 2—Additional Information on PFIC or Qualified Electing Fund (QEF)

	General Information		QEF Information		Section 1296 Mark-to-Market Information		Section 1291 and Other Information		
	(a) Name of PFIC	**(b)** EIN or reference ID number	**(c)** Ordinary earnings	**(d)** Net capital gain	**(e)** Fair market value (FMV) of PFIC shares at beginning of tax year	**(f)** FMV of PFIC shares at end of tax year	**(g)** Dates PFIC shares were acquired	**(h)** Amount of cash and FMV of property distributed by PFIC during the current tax year (if applicable)	**(i)** Dates of distribution
A									
B									
C									
D									
E									
F									
G									
H									
I									
J									
K									
L									

	Section 1291 and Other Information					
	(j) Total creditable foreign taxes attributable to distribution by PFIC	**(k)** Total distributions from PFIC in preceding 3 tax years	**(l)** Dates PFIC shares disposed of during tax year (if applicable)	**(m)** Amount realized on disposition of PFIC shares	**(n)** Tax basis of PFIC shares on dates of disposition	**(o)** Gain (loss) on disposition of PFIC shares
A						
B						
C						
D						
E						
F						
G						
H						
I						
J						
K						
L						

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Part VIII Partnership's Interest in Foreign Corporation Income (Section 960)

A Enter EIN or reference ID number of CFC: ______ B Separate category (enter code—see instructions): ______

C If PAS was entered on line B, enter the applicable grouping under Regulations section 1.904-4(c). See instructions . . . . ______

D Check the box and attach a statement if there is more than one source country for a line. See instructions ☐ E If U.S. source, check the box and complete a separate Part VIII ☐

F If foreign oil related income or foreign oil and gas extraction income, check the box and attach a separate Part VIII ☐ G Enter functional currency of foreign corporation:

Enter amounts in functional currency of the foreign corporation (unless otherwise noted).	**(i)** Country code	**(ii)** Partnership's share of foreign corporation's net income (functional currency)	**(iii)** Foreign corporation's total net income (functional currency) (see instructions)	**(iv)** Foreign corporation's current year foreign taxes for which credit allowed (U.S. dollars) (see instructions)
1 Subpart F income groups				
a Dividends, interest, rents, royalties, and annuities (total) . .				
(1) Unit:				
(2) Unit:				
b Net gain from certain property transactions (total)				
(1) Unit:				
(2) Unit:				
c Net gain from commodities transactions (total)				
(1) Unit:				
(2) Unit:				
d Net foreign currency gain (total)				
(1) Unit:				
(2) Unit:				
e Income equivalent to interest (total)				
(1) Unit:				
(2) Unit:				
f Other foreign personal holding company income (total) . .				
(1) Unit:				
(2) Unit:				
g Foreign base company sales income (total)				
(1) Unit:				
(2) Unit:				
h Foreign base company services income (total)				
(1) Unit:				
(2) Unit:				
i Full inclusion foreign base company income (total) . . .				
(1) Unit:				
(2) Unit:				
j Insurance income (total)				
(1) Unit:				
(2) Unit:				
k International boycott income (total)				
l Bribes, kickbacks, and other payments (total)				
m Section 901(j) (total)				

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Part VIII **Partnership's Interest in Foreign Corporation Income (Section 960)** *(continued)*

Enter amounts in functional currency of the foreign corporation (unless otherwise noted).	**(i)** Country code	**(ii)** Partnership's share of foreign corporation's net income (functional currency)	**(iii)** Foreign corporation's total net income (functional currency) (see instructions)	**(iv)** Foreign corporation's current year foreign taxes for which credit allowed (U.S. dollars) (see instructions)
2 Recaptured subpart F income				
3 Tested income group (total)				
(1) Unit:				
(2) Unit:				
4 Residual income group (total)				
(1) Unit:				
(2) Unit:				
5 **Total**				

Part IX **Partners' Information for Base Erosion and Anti-Abuse Tax (Section 59A)**

Section 1—Applicable Taxpayer (see instructions for more information and definition of terms)

	Description	**(a)** Total	**(b)** Total ECI gross receipts	**(c)** Total non-ECI gross receipts
1	Gross receipts for section 59A(e)			
2	Gross receipts for the first preceding year			
3	Gross receipts for the second preceding year			
4	Gross receipts for the third preceding year			
5	Amounts included in the denominator of the base erosion percentage as described in Regulations section 1.59A-2(e)(3)			

Section 2—Base Erosion Payments and Base Erosion Tax Benefits (see instructions)

	Description	**(a)** Total	**(b)** Total base erosion payments	**(c)** Total base erosion tax benefits
6	Reserved for future use			
7	Reserved for future use			
8	Purchase or creations of property rights for intangibles (patents, trademarks, etc.)			
9	Rents, royalties, and license fees			
10a	Compensation/consideration paid for services **not** excepted by section 59A(d)(5)			
b	Compensation/consideration paid for services excepted by section 59A(d)(5)			
11	Interest expense			
12	Payments for the purchase of tangible personal property			
13	Premiums and/or other considerations paid or accrued for insurance and reinsurance as covered by sections 59A(d)(3) and 59A(c)(2)(A)(iii)			
14a	Nonqualified derivative payments			
b	Qualified derivative payments excepted by section 59A(h)			
15	Payments reducing gross receipts made to surrogate foreign corporation			
16	Other payments—specify:			
17	Base erosion tax benefits related to payments reported on lines 6 through 16, on which tax is imposed by section 871 or 881, with respect to which tax has been withheld under section 1441 or 1442 at the 30% (0.30) statutory withholding tax rate			

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Part IX **Partners' Information for Base Erosion and Anti-Abuse Tax (Section 59A)** *(continued)*

Section 2—Base Erosion Payments and Base Erosion Tax Benefits (see instructions) *(continued)*

	Description	**(a)** Total	**(b)** Total base erosion payments	**(c)** Total base erosion tax benefits
18	Portion of base erosion tax benefits reported on lines 6 through 16, on which tax is imposed by section 871 or 881, with respect to which tax has been withheld under section 1441 or 1442 at reduced withholding rate pursuant to income tax treaty. Multiply ratio of percentage withheld divided by 30% (0.30) times tax benefit. See instructions			
19	**Total base erosion tax benefits** (subtract the sum of lines 17 and 18 from the sum of lines 8 through 16)			
20	Reserved for future use			
21	Reserved for future use			
22	Reserved for future use			

Part X **Foreign Partners' Character and Source of Income and Deductions**

Section 1—Gross Income

Description	**(a)** Total	**(b)** Partner determination	Partnership Determination				
			ECI		Non-ECI		
			(c) U.S. source	**(d)** Foreign source	**(e)** U.S. source (FDAP)	**(f)** U.S. source (other)	**(g)** Foreign source
1 Ordinary business income (gross)							
2 Gross rental real estate income							
3 Other gross rental income							
4 Guaranteed payments for services							
5 Guaranteed payments for use of capital							
6 Interest income							
7 Dividends							
8 Dividend equivalents							
9 Royalties and license fees							
10 Net short-term capital gain							
11 Net long-term capital gain							
12 Collectibles (28%) gain							
13 Unrecaptured section 1250 gain							
14 Net section 1231 gain							
15 Reserved for future use							
16 Reserved for future use							
17 Reserved for future use							
18 Reserved for future use							
19 Reserved for future use							
20 Other income (loss) not included on lines 1 through 19							
21 **Gross income** (sum of lines 1 through 20)							

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Part X — Foreign Partners' Character and Source of Income and Deductions *(continued)*

Section 2—Deductions, Losses, and Net Income

Description	(a) Total	(b) Partner determination	Partnership Determination				
			ECI		Non-ECI		
			(c) U.S. source	(d) Foreign source	(e) U.S. source (FDAP)	(f) U.S. source (other)	(g) Foreign source
1 Expenses related to ordinary business income (gross)							
2 R&E expenses							
3 Expenses from rental real estate							
4 Expenses from other rental activities							
5 Royalty and licensing expenses							
6 Section 179 deduction							
7 Interest expense on U.S.-booked liabilities							
8 Interest expense directly allocable under Regulations sections 1.882-5(a)(1)(ii)(B) and 1.861-10T							
9 Other interest expense							
10 Section 59(e)(2) expenditures							
11 Net short-term capital loss							
12 Net long-term capital loss							
13 Collectibles loss							
14 Net section 1231 loss							
15 Other losses							
(1)							
(2)							
16 Charitable contributions							
17 Other:							
18 Other:							
19 Reserved for future use							
20 Reserved for future use							
21 Reserved for future use							
22 Reserved for future use							
23 Reserved for future use							
24 **Total** (sum of lines 1 through 23)							
25 **Net income (loss)** (line 21 (Section 1) minus line 24 (Section 2))							

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Part X — Foreign Partners' Character and Source of Income and Deductions *(continued)*

Section 3—Allocation and Apportionment Methods for Deductions

1 Gross income
- a Gross ECI
- b Worldwide gross income

2 Assets
- a Average U.S. assets (inside basis)
- b Worldwide assets

3 Liabilities
- a U.S.-booked liabilities of partnership
- b Directly allocated partnership indebtedness

4 Personnel
- a Personnel of U.S. trade or business
- b Worldwide personnel

5 Gross receipts from sales or services by SIC code

	(i) SIC code	(ii) ECI	(iii) Worldwide
a			
b			

6 Reserved for future use

	(i)	(ii)	(iii)
a			
b			

7 Other allocation and apportionment key

	(i) Key/Factor	(ii) Allocation
a		
b		

8 Other allocation and apportionment key

	(i) Key/Factor	(ii) Allocation
a		
b		

Section 4—Reserved for Future Use

Reserved	(a) Reserved	(b) Reserved	(c) Reserved
1 Reserved for future use			
2 Reserved for future use			
3 Reserved for future use			
4 Reserved for future use			
5 Reserved for future use			
6 Reserved for future use			
7 Reserved for future use			
8 Reserved for future use			
9 Reserved for future use			
10 Reserved for future use			

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Part XI **Section 871(m) Covered Partnerships**

1 Check the box if you are a publicly traded partnership as defined in section 7704(b) and you (a) are a covered partnership as defined in Regulations section 1.871-15(m)(1), or (b) directly or indirectly hold an interest in a lower-tier partnership that is a covered partnership . . . . ☐

2 Specify the number of units of the partnership issued and outstanding: ____________

3 For each allocation period, provide the following information for the number of units specified on line 2.

(i) Beginning of allocation period	**(ii)** End of allocation period	**(iii)** Dividends (enter four decimal places)	**(iv)** Dividend equivalents (enter four decimal places)	**(v)** Total (enter four decimal places)
		.	.	.
		.	.	.
		.	.	.
		.	.	.

Part XII **Reserved for Future Use**

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Is This More Work Than Just Preparing the Forms?

- Consider whether more time will be spent attempting to avoid filing than just preparing the forms
  - Tax software support is a key consideration here, as some packages have the option to tell the software all operations are U.S. only
  - Also have the risk that partners dribble in requests for K-3s at inopportune times during the year
  - There is also the question of how many partners will call to inquire about why they might need Schedule K-3

Why Do US Only Partnerships Have to File This?

It all boils down to Part I of Form 1116 and how that form is to be prepared if it is required.

KAPLAN

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Schedules K-2 and K-3 (Forms 1065 and 1120-S)

- Was originally proposed in 2020
- Finalized summer of 2021 and required to be attached to 2021 returns if applicable
- Technically, all of the information requested should have been included in plain paper form with prior year K-1s (but in reality, little of the detailed Form 1116 information was by most partnerships)
- It looks as if tax software may provide better support for domestic partnerships this year, so may be less of an issue to prepare the forms

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Why Does a US Only Partnership/S Corporation Need to Prepare These Forms?

- Relates to what is needed to complete Part I of Form 1116, specifically:

	Deductions and losses (**Caution:** See instructions.):				
2	Expenses **definitely related** to the income on line 1a (attach statement)				
3	Pro rata share of other deductions **not definitely related:**				
a	Certain itemized deductions or standard deduction (see instructions)				
b	Other deductions (attach statement)				
c	Add lines 3a and 3b				
d	Gross foreign source income (see instructions)				
e	Gross income from all sources (see instructions)				
f	Divide line 3d by line 3e (see instructions)				
g	Multiply line 3c by line 3f				
4	Pro rata share of interest expense (see instructions):				
a	Home mortgage interest (use the Worksheet for Home Mortgage Interest in the instructions)				
b	Other interest expense				
5	Losses from foreign sources				
6	Add lines 2, 3g, 4a, 4b, and 5				6
7	Subtract line 6 from line 1a. Enter the result here and on line 15, page 2				7

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Understanding Who Needs to File Form 1116

The exception is based on the exception to the filing of Form 1116

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Form 1116 Exception to Filing

- The "items of international tax relevance" rule means that if a partner might need information, then it has to be provided.
- However, the converse is also true: if we know no partner will need this information then the data is not required to be provided
- The foreign tax credit information potentially necessary to fill in Schedules K-2 and K-3 consumes many pages

What an Individual Needs to Know to Prepare Form 1116

- Parts II and III of Schedule K-2 and K-3 primarily give information needed by a partner to prepare Form 1116
  - Form 1116 requires gross income numbers and by country
  - Form 1116 also looks at detail of deductions and, again, by country
  - Form 1116 requires reallocation of interest expense (much on basis like the avoided cost interest rules under IRC §263A)
- This is used primarily to compute the amount of US tax that is tax due on taxable income that is foreign source

Form 1116 Page 1, Part I

Form **1116** | **Foreign Tax Credit** (Individual, Estate, or Trust) | OMB No. 1545-0121 | **2023**

Department of the Treasury
Internal Revenue Service

Attach to Form 1040, 1040-SR, 1040-NR, 1041, or 990-T.
Go to *www.irs.gov/Form1116* for instructions and the latest information.

Attachment Sequence No. **19**

Name | **Identifying number** as shown on page 1 of your tax return

Use a separate Form 1116 for each category of income listed below. See *Categories of Income* in the instructions. Check only one box on each Form 1116. Report all amounts in U.S. dollars except where specified in Part II below.

a ☐ Section 951A category income
b ☐ Foreign branch category income
c ☐ Passive category income
d ☐ General category income
e ☐ Section 901(j) income
f ☐ Certain income re-sourced by treaty
g ☐ Lump-sum distributions

h Resident of (name of country)

Note: If you paid taxes to only one foreign country or U.S. possession, use column A in Part I and line A in Part II. If you paid taxes to **more than one** foreign country or U.S. possession, use a separate column and line for each country or possession.

Part I **Taxable Income or Loss From Sources Outside the United States** (for category checked above)

		Foreign Country or U.S. Possession			Total
		A	B	C	(Add cols. A, B, and C.)
i	**Enter the name of the foreign country or U.S. possession**				
1a	Gross income from sources within country shown above and of the type checked above (see instructions):				1a
b	Check if line 1a is compensation for personal services as an employee, your total compensation from all sources is $250,000 or more, and you used an alternative basis to determine its source. See instructions ☐				

http://www.currentfederaltaxdevelopments.com/k2k3

Form 1116 Page 1, Part I

Deductions and losses (**Caution:** See instructions.):

2	Expenses **definitely related** to the income on line 1a (attach statement)				
3	Pro rata share of other deductions **not definitely related:**				
a	Certain itemized deductions or standard deduction (see instructions)				
b	Other deductions (attach statement)				
c	Add lines 3a and 3b				
d	Gross foreign source income (see instructions)				
e	Gross income from all sources (see instructions)				
f	Divide line 3d by line 3e (see instructions)				
g	Multiply line 3c by line 3f				
4	Pro rata share of interest expense (see instructions):				
a	Home mortgage interest (use the Worksheet for Home Mortgage Interest in the instructions)				
b	Other interest expense				
5	Losses from foreign sources				
6	Add lines 2, 3g, 4a, 4b, and 5				6
7	Subtract line 6 from line 1a. Enter the result here and on line 15, page 2				7

http://www.currentfederaltaxdevelopments.com/k2k3

Form 1116 Page 1, Part II

Part II Foreign Taxes Paid or Accrued (see instructions)

Country	Credit is claimed for taxes (you must check one) (j) ☐ Paid (k) ☐ Accrued	Foreign taxes paid or accrued								
		In foreign currency				In U.S. dollars				
		Taxes withheld at source on:			(p) Other foreign taxes paid or accrued	Taxes withheld at source on:			(t) Other foreign taxes paid or accrued	(u) Total foreign taxes paid or accrued (add cols. (q) through (t))
	(l) Date paid or accrued	(m) Dividends	(n) Rents and royalties	(o) Interest		(q) Dividends	(r) Rents and royalties	(s) Interest		
A										
B										
C										

8 Add lines A through C, column (u). Enter the total here and on line 9, page 2 8

For Paperwork Reduction Act Notice, see instructions. Cat. No. 11440U Form **1116** (2023)

http://www.currentfederaltaxdevelopments.com/k2k3

Form 1116 Page 1, Part III

Form 1116 (2023) Page **2**

Part III Figuring the Credit

9	Enter the amount from line 8. These are your total foreign taxes paid or accrued for the category of income checked above Part I . .	9	
10	Enter the sum of any carryover of foreign taxes (from Schedule B, line 3, column (xiv)) plus any carrybacks to the current tax year. If you enter an amount on line 10 and you don't need to attach Schedule B, check here (see instructions) . . . . ☐	10	
	(If your income was section 951A category income (box a above Part I), leave line 10 blank.)		
11	Add lines 9 and 10	11	
12	Reduction in foreign taxes (see instructions)	12	( )
13	Taxes reclassified under high tax kickout (see instructions) . .	13	
14	Combine lines 11, 12, and 13. This is the total amount of foreign taxes available for credit . . .	14	

Form 1116 Page 1, Part III

15	Enter the amount from line 7. This is your taxable income or (loss) from sources outside the United States (before adjustments) for the category of income checked above Part I. See instructions	15	
16	Adjustments to line 15 (see instructions)	16	
17	Combine the amounts on lines 15 and 16. This is your net foreign source taxable income. (If the result is zero or less, you have no foreign tax credit for the category of income you checked above Part I. Skip lines 18 through 24. However, if you are filing more than one Form 1116, you must complete line 20.)	17	
18	**Individuals:** Enter the amount from line 15 of your Form 1040, 1040-SR, or 1040-NR. **Estates and trusts:** Enter your taxable income without the deduction for your exemption	18	
	Caution: If you figured your tax using the lower rates on qualified dividends or capital gains, see instructions.		
19	Divide line 17 by line 18. If line 17 is more than line 18, enter "1"	19	
20	**Individuals:** Enter the total of Form 1040, 1040-SR, or 1040-NR, line 16, and Schedule 2 (Form 1040), line 2. **Estates and trusts:** Enter the amount from Form 1041, Schedule G, line 1a; or the total of Form 990-T, Part II, lines 2, 3, 4, and 6. Foreign estates and trusts should enter the amount from Form 1040-NR, line 16. See instructions	20	
	Caution: If you are completing line 20 for separate category **g** (lump-sum distributions), or, if you file Form 8978, Partner's Additional Reporting Year Tax, see instructions.		
21	Multiply line 20 by line 19 (maximum amount of credit)	21	
22	Increase in limitation (section 960(c)) (see instructions)	22	
23	Add lines 21 and 22	23	
24	Enter the **smaller** of line 14 or line 23. If this is the only Form 1116 you are filing, skip lines 25 through 32 and enter this amount on line 33. Otherwise, complete the appropriate line in Part IV. See instructions	24	

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http://www.currentfederaltaxdevelopments.com/k2k3

Form 1116 Page 1, Part IV

Part IV **Summary of Credits From Separate Parts III** (see instructions)

25	Credit for taxes on section 951A category income	25	
26	Credit for taxes on foreign branch category income	26	
27	Credit for taxes on passive category income	27	
28	Credit for taxes on general category income	28	
29	Credit for taxes on section 901(j) income	29	
30	Credit for taxes on certain income re-sourced by treaty	30	
31	Credit for taxes on lump-sum distributions	31	
32	Add lines 25 through 31	32	
33	Enter the **smaller** of line 20 or line 32	33	
34	Reduction of credit for international boycott operations. See instructions for line 12	34	
35	Subtract line 34 from line 33. This is your **foreign tax credit**. Enter here and on Schedule 3 (Form 1040), line 1; Form 1041, Schedule G, line 2a; or Form 990-T, Part III, line 1a	35	

Form **1116** (2023)

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Option to Bypass Calculation of FTC Limits

- Individuals (but not estates or trusts) can bypass the preparation of Form 1116 and just report the tax amount on Schedule 3, Form 1040 if all of the below are true:
  - All foreign income is passive category income (not §469 passive, but FTC passive)
  - All reported on Forms 1099INT, 1099DIV, K-1 (Form 1041) or K3 (Forms 1065 or 1120S)
  - Amount is $300 or less ($600 if married filing joint)

Option to Bypass Calculation of FTC Limits

- Issues
  - Can't carry over or from the year in which the election is made
  - Still required to take into account rules regarding whether specific taxes are eligible for the foreign tax credit
  - Must take the various reductions in tax found at line 12 of Form 1116 into account
- This option serves to shape the domestic filing exception

Schedule 3 – Direct Entry of Foreign Taxes

SCHEDULE 3
(Form 1040)

Department of the Treasury
Internal Revenue Service

Additional Credits and Payments

Attach to Form 1040, 1040-SR, or 1040-NR.
Go to *www.irs.gov/Form1040* for instructions and the latest information.

OMB No. 1545-0074
2023
Attachment Sequence No. **03**

Name(s) shown on Form 1040, 1040-SR, or 1040-NR | **Your social security number**

Part I Nonrefundable Credits

1	Foreign tax credit. Attach Form 1116 if required	1	
2	Credit for child and dependent care expenses from Form 2441, line 11. Attach Form 2441	2	
3	Education credits from Form 8863, line 19	3	
4	Retirement savings contributions credit. Attach Form 8880	4	
5a	Residential clean energy credit from Form 5695, line 15	5a	
b	Energy efficient home improvement credit from Form 5695, line 32	5b	

Reminders

- **Post event evaluation:** Please complete the course evaluation that will be viewable once the session ends. We welcome your feedback!

KAPLAN

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