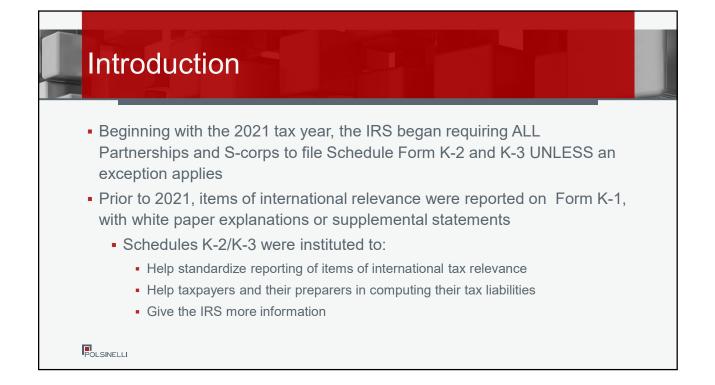


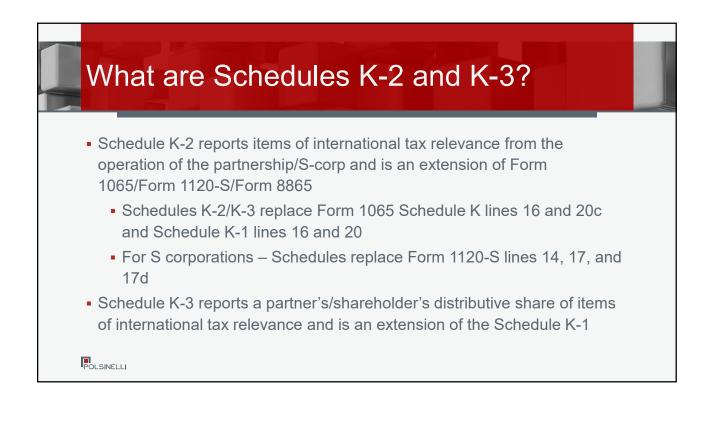
Exploring the Beyond: An introduction to Schedule K-2 and K-3

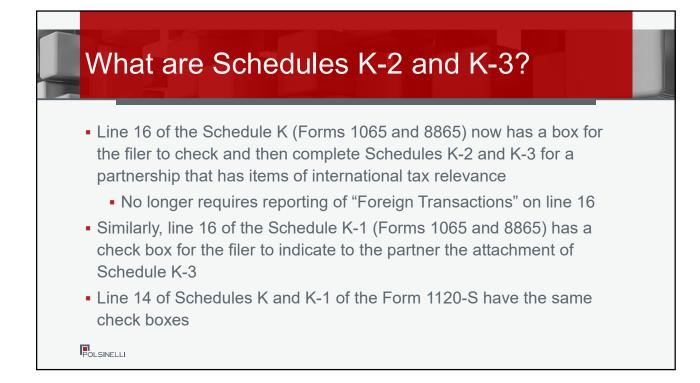
SCOTT AHRONI, ESQ., LL.M. POLSINELLI P.C. 600 Third Avenue, 42nd Floor New York New York 10016 sahroni@polsinelli.com Tel: (212) 413-2890

Overview of Seminar

- Provide an overview of the new Schedules K-2/K-3
- Detail Exceptions for Filing Schedules K-2/K-3
- Discuss Parts I, II and III of the Schedules K-2/K-3
- Discuss Penalty abatements and resolution options







Quiet Beginnings

- IRS introduced Schedules K-2 and K-3 in July, 2021
- Initial K-2 and K-3 Instructions (08/25/21): "Partnerships need not complete this schedule if partnership does not have items of international tax relevance (typically, international activities or foreign partners)"
- This was interpreted by many practitioners that so long as the entity did not have international activities or foreign partners, K-2 and K-3 was not required



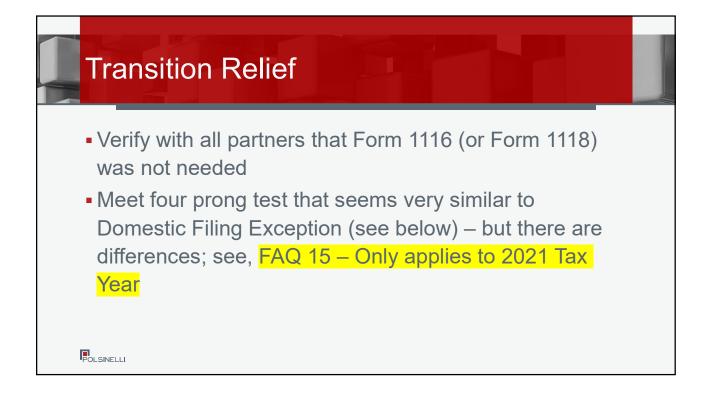


• In January 2022 final K-2/K-3 Instructions released:

"A partnership [or S-corporation] with no foreign source income, no assets generating foreign source income and no foreign taxes paid or accrued may still need to report information on Schedules K-2 and K-3"

"For example, if the partner claims a credit for foreign taxes paid by the partner, the partner may need certain information from partnership to complete Form 1116"



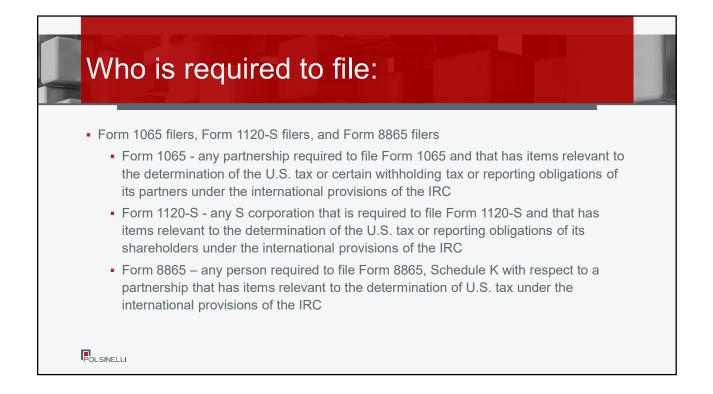


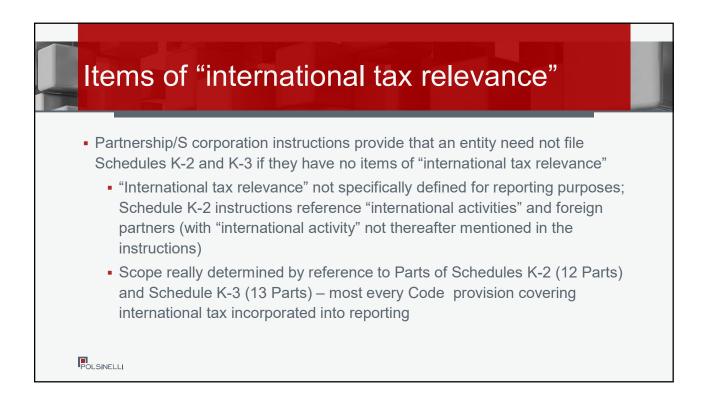


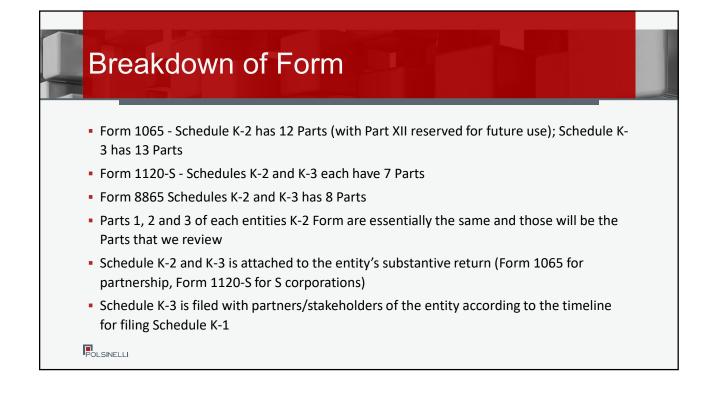


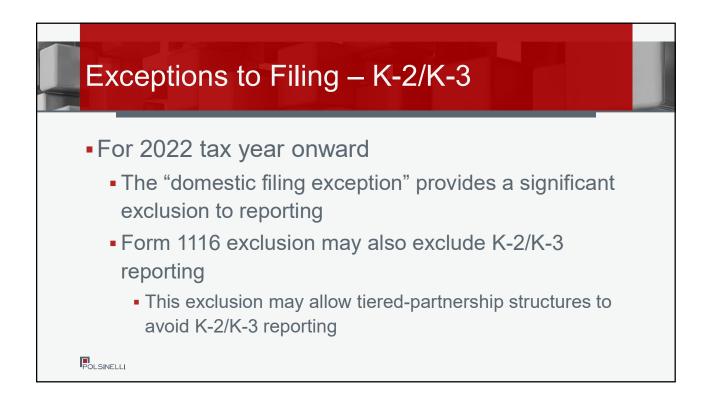
Transition Relief – FAQ # 15

- If a domestic partnership or S-corporation qualifies for the exception, no Schedules K-2 and K-3 are required to be filed
- If domestic partnership/S-corp is notified by a partner BEFORE filing of entity return that K-3 information is needed, the FAQ# 15 relief is not met and K-3 must be provided to the partner and K-2/K-3 must be filed with the IRS
- If notification by partner is AFTER filing of entity return, the entity must provide such information to the partner



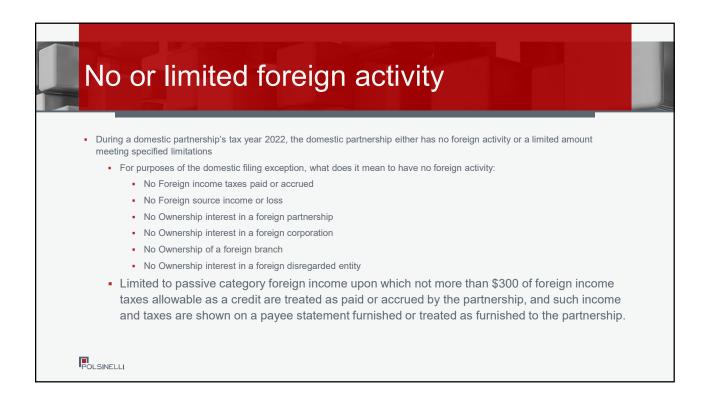


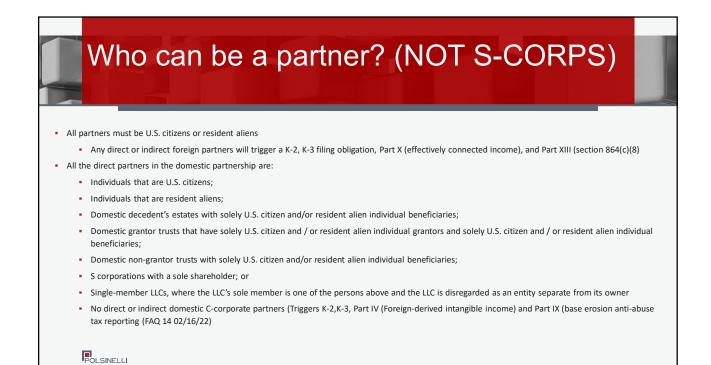


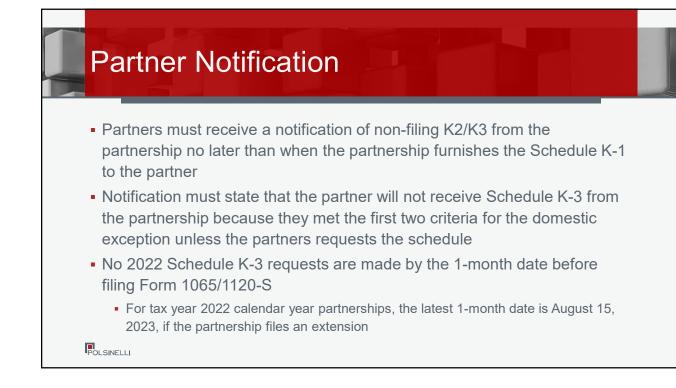


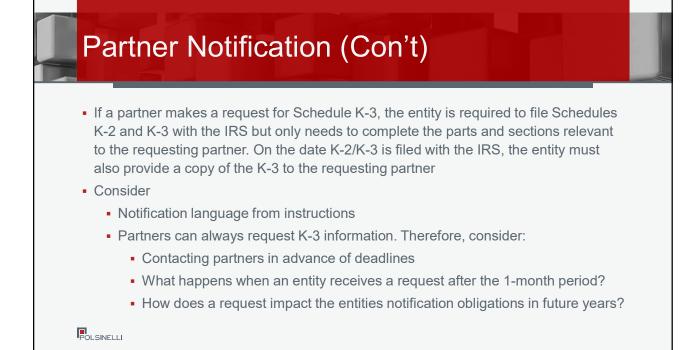
Domestic Filing Exception

- A domestic partnership/s-corp does not need to complete and file with the IRS the Schedules K-2 and K-3 or furnish to a partner the Schedule K-3 (except where requested by a partner) if each of the following four criteria are met with respect to the partnership's tax year (only three requirements for S-corps):
 - Entity has no or limited foreign activity
 - All partners/SHs must be U.S. citizens or resident aliens, including certain trusts and estate
 - Partner notification
 - No 2022 Schedule K-3 requests by the 1-month date before filing of entity return









For	m 1116 Exclusion
In add	lition to DFE, you can also be exempt from filing under Form 1116 exception. To qualify
	ll partners in partnership must meet the Form 1116 exception, i.e., all partners are not equired to file Form 1116
	The partners only receive qualified passive income
	• All foreign source income and foreign taxes are reported on a qualified payee statement such as a Form 1099
	 The amount of creditable foreign tax paid/accrued by the individual during the taxable year does not exceed \$300 (or \$600 for married filing jointly)
d	II partners/shareholders notify the entity that no K-3 is needed within the "one month ate", i.e., no later than one more before the return is filed or one month before the return ue date
	hen the partnership is exempt from filing K-2/K-3

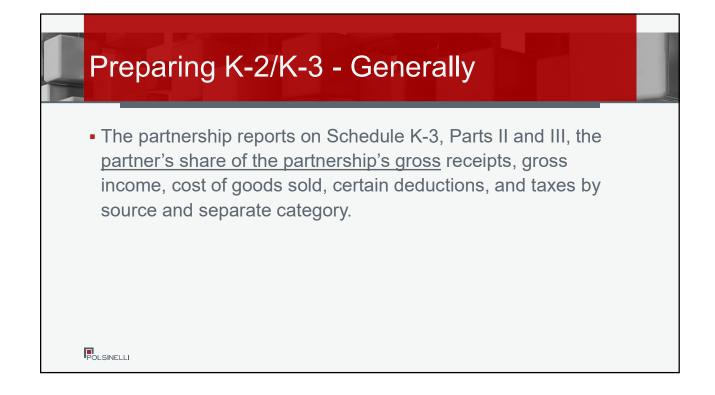
Form 1116 Exclusion

Example: Partnership has \$1,000 of foreign taxes paid or accrued on passive foreign source income. The pship itself does not qualify for DFE since it has more than \$300 in foreign taxes paid or accrued on passive income. However the partners may qualify for the Form 1116 exception. Assume the partnership has 4 partners each with 25% interests – then each partner only has \$250 in foreign taxes paid or accrued. Assume that the passive foreign source income is all of the income that the partners receive and they notify the partnership within one month of the partnership's filing of the entity return, no K-2/K-3 is required

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Preparing K-2/K-3 - Generally

- On Schedule K-2, Part 1, requires the partnership to report items that are not specifically reported elsewhere on the Schedules K-2 and K-3. If any boxes are checked on Part I, the partnership should have attached statements to the Schedule K-3 with additional information not otherwise reported on the Schedules K-2 and K-3.
- On Schedule K-2, Parts II and III, the partnership reports its <u>gross</u> income, <u>gross</u> receipts, cost of goods sold, certain deductions, and taxes by source and separate category. The partnership also reports information that the partner needs to allocate and apportion expenses and determine the source of certain items of gross income and gross receipts.



Preparing K-2/K-3 - Generally

- The partner adds its <u>share of the partnership's</u> foreign source gross income, gross receipts, cost of goods sold, certain deductions, and taxes by separate category to its other foreign source gross income, gross receipts, cost of goods sold, certain deductions, and taxes in that separate category to figure its foreign tax credit.
- The partnership also reports on the Schedule K-3 the <u>distributive share</u> of expenses and the allocation and apportionment factors so that the partner may determine expenses allocated and apportioned to foreign source income.



