

K-2 – K-3 EXCEPTION DISCLOSURE COMPARISON

A partnership does not need to complete and file the Schedules K-2 and K-3 with the IRS if each of the following four criteria (“**domestic filing exception**”) is met regarding the partnership:

CRITERIA	DETAIL PER DRAFT INSTRUCTIONS Dated 10/26/2022	DETAIL PER DRAFT INSTRUCTIONS Dated 12/02/2022	CRI OBSERVATION
1 The partnership has no or limited foreign activity	<p>During a domestic partnership’s tax year, the domestic partnership either has no foreign activity*, or, if it does have foreign activity, such foreign activity is limited to</p> <p>a. Passive category foreign income (determined without regard to the high-taxed income exception);</p> <p>b. Upon which not more than \$300 of foreign income taxes allowable as a credit are treated as paid or accrued by the partnership; and</p> <p>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.</p>	<p>Same – no change from 10/26/2022 draft instructions</p>	<p>For truly domestic partnerships with no international activity, this will be a relatively easy threshold to meet.</p> <p>Please see Endnote for full definition of “foreign activity.”</p>
2 The partners are all U.S. citizens or resident aliens	<p>All the direct partners in the domestic partnership are:</p> <p>a. Individuals that are U.S. citizens;</p> <p>b. Individuals that are resident aliens;</p> <p>c. Domestic decedent’s estates, with solely U.S. citizen and/or resident alien individual beneficiaries;</p> <p>d. Domestic grantor trusts that have solely U.S. citizen and / or resident alien individual grantors and solely U.S. citizen and / or resident alien individual beneficiaries;</p> <p>e. Domestic non-grantor trusts (that is, trusts subject to tax under section 641) with solely U.S. citizen and/or resident alien individual beneficiaries</p>	<p>Same as 10/26/2022 draft instructions with two additional partner types considered US citizens:</p> <p>f. S corporations with a sole shareholder;</p> <p>g. Single-member LLCs, where the LLC’s sole member falls in one of the above classes, and the LLC is disregarded as an entity separate from its owner.</p>	<p>Noticeably absent from this definition of “US Citizens” are C Corporations, S Corporations with multiple shareholders, and other partnerships.</p> <p>If your partnership has <i>any</i> partners that fall in those excluded categories of partners, then the <i>entire</i> partnership is precluded from using the domestic filing exception and you must prepare the K-2 and K-3’s for every partner.</p>

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<p>3 Partnership sends timely notification to its partners of its intent not to provide Schedule K-3</p>	<p>By January 15th (for calendar year partnerships), the partnership sends notifications to its partners of their intent not to provide Schedule K-3 to the partners unless the partners request the schedule.</p>	<p>Partnership sends notifications to its partners of their intent not to provide Schedule K-3 to the partners. This notification can be anytime up until the time when the partnership furnishes the Schedule K-1 to the partner.</p> <p>The notice can be provided as an attachment to the Schedule K-1.</p>	<p>The IRS relaxed the timing of when the notifications must be sent to the partners (no longer limited to before 1/15), however there is a significant “catch” in the fourth criteria (discussed below).</p> <p>We can envision many clients opting to include the notification as part of the K-1 package itself. This effectively shifts the responsibility of including the notification from the partnership representative to the tax preparer.</p>
<p>4 The partnership does not receive a request from any partner for a Schedule K-3 before the “one month date”.</p>	<p>The “1-month date” is one month before the due date (without extension) of the partnership’s Form 1065. Therefore this criteria is met if no partners explicitly request a Schedule K-3 before 02/15.</p> <p>If a partner requests a Schedule K-3 before the 1-month date lapses, the partnership is required to prepare Schedule K-2 and Schedule K-3 as it relates to the requesting partner. Those schedules must also be remitted to the IRS.</p> <p>If a partner requests a Schedule K-3 after the 1-month date lapses, the domestic filing exception is met. The partnership does not have to submit Schedule K-2 and K-3 to the IRS. However, they must provide the requesting partner a copy of their K-3 on the later of:</p> <ul style="list-style-type: none"> a. Date the partnership files its 1065, or b. 1 month from the date the partner made the request for Schedule K-3. 	<p>The “1-month date” is one month before the date the partnership files the Form 1065 (<i>including</i> extensions). Therefore the latest to provide the partner notification in criteria #3 is 08/15 for calendar year partnerships with timely filed extensions.</p> <p>If a partner requests a Schedule K-3 before the 1-month date lapses, the partnership is required to prepare Schedule K-2 and Schedule K-3 as it relates to the requesting partner. Those schedules must also be remitted to the IRS.</p> <p>If a partner requests a Schedule K-3 after the 1-month date lapses, the domestic filing exception is met. The partnership does not have to submit Schedule K-2 and K-3 to the IRS. However, they must provide the requesting partner a copy of their K-3 on the later of:</p> <ul style="list-style-type: none"> a. Date the partnership files its 1065, or b. 1 month from the date the partner made the request for Schedule K-3. 	<p>Because the timing of the notifications can be any time until the partnership provides the Schedule K-1 to its partners, the 1-month date is also on a sliding scale.</p> <p>For example, if a partnership provides K-1 packages on March 15th with notification that it won’t be providing Schedule K-3, the partnership cannot file its Form 1065 until the 1-month date lapses on April 15th. This would require the partnership filing an extension in order to fulfil the 1-month date.</p> <p>If the K-1’s can’t go out by 08/15, the partnership cannot include notification as part of the K-1 packages and must be separately sent.</p> <p>Also note that we only have to provide the K-2 and related K-3 for those partners explicitly requesting. Partnerships are not required to prepare the Schedule K-3 for the non-requesting partners.</p> <p>Consider the 1-month date to set expectations on filing timeline. If a partnership does not want to extend, then notifications would have to go out by 02/15. After that, the partnership cannot meet the 1-month date without an extension.</p>

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