



LIST OF SUBSTANTIVE CHANGES AND ADDITIONS

PPC's Tax Planning Guide—Partnerships

Thirty-seventh Edition (April 2023)

Highlights of This Edition

The following are some of the important new features of the 2023 Edition of *PPC's Tax Planning Guide—Partnerships*:

- **Targeted Income Allocations.** Partnerships have flexibility in how they allocate taxable income and loss to their partners, provided the allocations have substantial economic effect or are in accordance with the partners' interests in the partnership (PIP). Although they cannot meet the substantial economic effect safe harbor, targeted income allocations are quite common. This edition of the *Guide* includes a comprehensive example of how targeted allocations are made and how they can meet the PIP test.
- **Domestic Filing Exception for Schedules K-2 and K-3.** Starting with their 2021 tax year, partnerships must include Schedules K-2 and K-3 in their tax return if they have *items of international tax relevance*. For tax years beginning in 2022, a *domestic filing exception* and a *Form 1116 exemption exception* are available to certain partnerships. Partnerships that qualify for either of these exceptions do not have to include Schedules K-2 and K-3 in their tax return or furnish copies of Schedule K-3 to their partners. This edition of the *Guide* expands the discussion of when partnerships have items of international tax relevance, explains the new exceptions to the filing requirement for the 2022 tax year, and provide examples of when they apply.
- **Including Partnership Debt in the Partners' Outside Basis.** This is a favorable feature of partnership taxation, but it can be challenging to correctly allocate partnership liabilities to each partner for basis inclusion. This edition of the *Guide* includes guidance on allocating debt that has been guaranteed by more than one partner and on classifying debt as recourse or nonrecourse under the tax allocation rules (which may result in classifying the debt differently than its state-law classification). It also includes a new checklist to aid in the debt classification process.
- **Favorable Transition Rule for Bottom Dollar Debt Guarantees Expires in October 2023.** Generally, a *bottom dollar* guarantee is ignored when determining whether partners have an economic risk of loss for guaranteed debt, which allows them to include that debt in their outside basis. Transitional relief that allowed partners to recognize certain bottom dollar guarantees expires in 2023. This edition of the *Guide* discusses planning options for partners that will suffer a basis decrease when the transitional relief expires.
- **Inflation-adjusted amounts.** Each year, many amounts are adjusted for inflation. The text and examples, as well as the practice aids, have been updated to include the 2023 amounts.

In addition to these featured items, your *Guide* includes the following update items detailed below.

<u>Chapter</u>	<u>Substantive Changes and Additions</u>	<u>Reference</u>
CHAPTER 1 Partnership Status and Organization	1. Cautioned tax practitioners that the designation of a partnership representative on a tax return could override what is stated in the partnership agreement based on the IRS's position in an IRS Chief Counsel Advice (CCA).	Section 109

<u>Chapter</u>	<u>Substantive Changes and Additions</u>	<u>Reference</u>
	2. Added a Practice Tip for upper-tier partnerships that receive a Schedule K-1 from a lower tier partnership that reports income based on an estimate, to help the upper-tier partnership avoid having to file an administrative adjustment request when the finalized amounts are known.	Section 109
	3. Added optional language to the sample engagement letter for when practitioners use offshore or overseas resources to assist with providing tax services.	Appendix 11
	4. Updated the discussion of the centralized partnership audit regime for final regulations issued in December 2022.	Section 109
	5. Added a new client letter outlining the eligibility requirements and steps for small partnerships to elect out of the centralized audit regime.	Appendix 10
CHAPTER 4 Basis in a Partnership Interest	1. Addressed a CCA that clarifies that PPP loan forgiveness obtained through misrepresentation or failure to initially qualify is not excludible from taxable income.	Section 402
CHAPTER 5 Partnership Liabilities	1. Expanded the discussion of allocating partnership debt to the partners for inclusion in their outside basis to explain how debt that is characterized as recourse or nonrecourse debt under state law may be classified differently under the Section 752 debt allocation rules.	Section 502
	2. Added a discussion of the <i>Tribune Media</i> case, where the IRS unsuccessfully argued that a partner did not have an economic risk of loss to debt the partner had guaranteed.	Section 504
	3. Added a discussion of determining each partner's economic risk of loss with respect to partnership debt they have guaranteed when more than one partner guarantees the same debt.	Section 504
	4. Added planning suggestions for the end of transitional relief for grandfathered bottom dollar arrangements that will expire on October 5, 2023.	Section 504
	5. Expanded the example of how a like-kind exchange of property subject to debt can affect the partners' shares of partnership debt.	Example 5-21
	6. Expanded the permanent file documentation for partnership debt to add a checklist to help practitioners determine whether a specific liability is classified as recourse or nonrecourse under the tax rules for allocating partnership debt.	Appendix 5A
CHAPTER 7 Partner and Partnership Transactions	1. Added a discussion of the <i>Deitch</i> case, where the IRS unsuccessfully attempted to argue that a lender was actually a partner because the interest on the loan resembled the return an equity investor would receive. This allowed the partnership to deduct the interest payments on the debt.	Section 701

<u>Chapter</u>	<u>Substantive Changes and Additions</u>	<u>Reference</u>
	2. Explained common terms that are often used when describing preferred returns (distributions and/or income allocations) provided for partners' services or capital contributions.	Section 702
CHAPTER 9 Allocating Taxable Income and Loss	1. Added a new example showing how taxable income and loss is allocated to the partners under a targeted allocation arrangement and how such an allocation can meet the partners' interest in the partnership test.	Example 9-1
	2. Discussed the importance of ensuring that Section 1245 recapture income is correctly allocated to partners and recognizing situations where allocation errors might occur.	Section 910
CHAPTER 12 Accounting Methods and Tax Years	1. Discussed situations where it is beneficial to elect out of installment sale reporting.	Section 1205
	2. Added a variation to Example 12-51 to expand on how and when foreign partners are disregarded when determining a partnership's year-end for federal income tax purposes.	Section 1209
	3. Added a Practice Tip discussing opportunities for newly formed businesses to establish a natural business year through either the Annual Business Cycle test or Seasonal Business test.	Section 1210
CHAPTER 13 Operating the Partnership	1. Discussed a CCA that addressed when income from renting a living space is subject to self-employment tax because the taxpayer is providing significant services to the occupants in the context of short-term rentals through online marketplaces (such as AirBnB or VRBO).	Section 1300
	2. Added an Observation reminding practitioners of the qualified business income (QBI) deduction's 2025 sunset date and to consider planning to accelerate income or defer deductions to take advantage of the deduction.	Section 1301
	3. Expanded the discussion of the requirements for aggregating businesses for the QBI deduction, including Planning Tips for determining whether and when to make the aggregation election at the individual and relevant passthrough entity level.	Section 1301
	4. Added a new Example to illustrate the benefit of reducing income below the applicable threshold to avoid the exclusion of specified service trade or business income from QBI by setting up a donor advised fund.	Example 13-39
	5. Added an observation that trade or business status may not be desirable for an activity that produces continuous losses that would reduce the QBI deduction. Added a planning tip to consider restructuring profitable triple net leases that do not rise to the level of a trade or business so that they will qualify for the QBI deduction.	Section 1301

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	6. Expanded the discussion of when partnerships are required to file Schedules K-2 and K-3 because they have items of international tax relevance and explained the new domestic filing and Form 1116 exemption exceptions that relieve some partnerships from the requirement to complete and file those schedules for the 2022 tax year.	Section 1302
	7. Updated the discussion of retirement plan contributions by self-employed individuals, including partners, for SECURE Act 2.0 changes.	Section 1311
	8. Updated the discussion of the Section 461(l) limit on excess business losses to note its extended effective date under the Inflation Reduction Act of 2022.	Section 1312
	9. Added a Caution about the change to computing adjusted taxable income for tax years beginning after 2021 that could significantly decrease the amount of business interest expense deductible in those years.	Section 1313
	10. Added an example to show how the basis in partnership property is adjusted under proposed regulations when a partnership interest is disposed of and the partnership has passed through excess business interest expense to its partners.	Example 13-93
	11. Added a new example showing how the Section 163(j) business interest expense limit is applied in a tiered partnership structure.	Example 13-94
CHAPTER 16 Distributions	1. Added a Practice Tip about ensuring that the partners' distributions have been made in accordance with the partnership agreement.	Section 1602
CHAPTER 17 Retirement or Death of a Partner	1. Added a discussion of how the outside basis of an inherited partnership interest is adjusted, including the special rule for interests that are community property under state law.	Section 1705 Example 17-23
CHAPTER 18 Adjusting the Basis of Partnership Property	1. Discussed a CCA reiterating the IRS's position that when a corporation transfers an interest in a partnership to a member of the same consolidated group, the transfer can trigger a Section 743(b) basis adjustment to partnership assets with respect to the transferee, but regulations under IRC Sec. 1502 prohibit the transferee from deducting depreciation or amortization of the basis adjustment.	Section 1803
	2. Generally, a late Section 754 election can be made under the provisions of Reg. 301.9100-2 by, among other things, filing an amended return that includes the election. Noted that this causes an issue for partnerships that are subject to the centralized audit regime and want use Reg. 301.9100-2 to make a late Section 754 election.	Section 1804
CHAPTER 20 Estate Planning Issues and Opportunities	1. Updated for Proposed Regulations that would prevent the anti-clawback rules from being used on incomplete gifts.	Section 2000

Chapter

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Reference

2. Added an example to clarify that the value of a fractional interest in property is not the same as a fraction of the whole.

Example 20-18

