

# Relief for Partnerships from Certain Penalties Related to the Reporting of Partners' Beginning Capital Account Balances

Notice 2021-13

## SECTION 1. PURPOSE

The purpose of this notice is to provide partnerships with relief from certain penalties due to the inclusion of incorrect information in reporting their partners' beginning capital account balances on the 2020 Schedules K-1 (Form 1065) and the 2020 Schedules K-1 (Form 8865) as outlined in the 2020 Instructions for Form 1065, U.S. Return of Partnership Income (2020 Form 1065 Instructions). This notice also provides relief from accuracy-related penalties for any taxable year for the portion of an imputed underpayment attributable to the inclusion of incorrect information in a partner's beginning capital account balance reported by a partnership for the 2020 taxable year.

## SECTION 2. BACKGROUND

Section 6031 of the Internal Revenue Code (Code) and §§ 1.6031(a)-1 and 1.6031(b)-1T of the Income Tax Regulations generally require a partnership:

- to make a return for each taxable year stating the items of its gross income and deductions allowable by subtitle A of the Code and any other information as prescribed by forms and instructions for the purpose of carrying out the provisions of subtitle A of the Code, and
- to furnish to its partners statements containing each partner's distributive share of the partnership's items of income, gain, loss, deduction, or credit required to be shown on the partnership return and any additional

information required to apply particular provisions of subtitle A of the Code to the partner with respect to items related to the partnership as prescribed by form or accompanying instructions.

Pursuant to section 6031 and the accompanying Income Tax Regulations, the Internal Revenue Service (IRS) has, in forms and instructions, long required the reporting of partner capital account balances.

Prior to the 2020 taxable year, partnerships could report their partners' capital accounts for the taxable year on Schedules K-1, Partner's Share of Income, Deductions, Credits, etc., using one of a variety of methods that are based on different principles (for example, tax basis, generally accepted accounting principles (GAAP), section 704(b) book, or any other method). Starting in the 2018 taxable year, however, the instructions for Form 1065 required partnerships that did not report tax basis capital accounts to their partners to report separately the beginning and ending tax basis capital account balance of any partner that would have a negative beginning or ending tax basis capital account balance.

Beginning in the 2020 taxable year, the 2020 Form 1065 Instructions require partnerships to calculate and report their partners' capital accounts using the transactional approach for the tax basis method, irrespective of whether the beginning or ending balance is negative for a partner. The instructions for Form 8865, Return of U.S. Persons with Respect to Certain Foreign Partnerships, refer to the Form 1065 Instructions for reporting partners' capital accounts. Under the transactional approach outlined in the 2020 Form 1065 Instructions, partnerships report partner contributions, each partner's share of partnership net income or loss, withdrawals and distributions,

and other increases or decreases using tax basis principles, instead of methods based on other principles such as GAAP. The 2020 Form 1065 Instructions explain that if a partnership did not report its partners' capital accounts using the tax basis method in the 2019 taxable year and did not maintain its partners' capital accounts under the tax basis method in its books and records, the partnership may determine its partners' beginning capital accounts for the 2020 taxable year using any one of the following methods: the tax basis method, modified outside basis method, modified previously taxed capital method, or section 704(b) method (each as described in the 2020 Form 1065 Instructions).

Section 6698 imposes a penalty for failing to file a return or report at the time prescribed therefor, or for filing a return or a report that fails to show the information required under section 6031. A return required under section 6031 includes Form 1065 and each Schedule K-1. A failure to file a partnership return that shows information required under section 6031 would generally subject a partnership to the section 6698 penalty. A section 6698 penalty will not be imposed if it is shown that the failure is due to reasonable cause.

Section 6721 imposes a penalty for any failure to file an information return on or before the required filing date, and for any failure to include all of the information required to be shown on the return or the inclusion of incorrect information. When regulations under section 6011 require a partnership to file a partnership return electronically, each Schedule K-1 required to be included with the return with respect to each partner is treated as a separate information return subject to the section 6721 penalty. See section 6724(e) of the Code. Failure to electronically file a correct

Schedule K-1 when required would generally subject a partnership to a section 6721 penalty.

Section 6722 imposes a penalty for any failure to furnish a payee statement on or before the date prescribed therefor to the person to whom such statement is required to be furnished, and for any failure to include all of the information required to be shown on a payee statement or the inclusion of incorrect information. Section 6724(d)(2) provides a definition for "payee statement" that applies to section 6722. Under section 6724(d)(2)(A), a Schedule K-1 furnished to each partner is considered a payee statement. A failure to furnish a correct Schedule K-1 as required under section 6031 would generally subject a partnership to the section 6722 penalty.

Section 6724 provides an exception to a penalty for any failure under sections 6721 and 6722 if it is shown that the failure is due to reasonable cause and not to willful neglect. Under § 301.6724-1 of the Procedure and Administration Regulations, a penalty is waived for reasonable cause only if the filer establishes that either there are significant mitigating factors with respect to the failure or the failure arose from events beyond the filer's control. In addition, the filer must establish that the filer acted in a responsible manner both before and after the failure occurred.

Section 6662 imposes an accuracy-related penalty on portions of an underpayment attributable to one or more types of misconduct, such as negligence or substantial understatement of income tax. Under section 6221, the applicability of any penalties, additions to tax, or additional amounts that relate to an adjustment to a partnership-related item must be determined at the partnership level for partnerships subject to the centralized partnership audit regime enacted by the Bipartisan Budget Act

of 2015, Pub. L. 114-74, 129 Stat. 584. Section 6233 makes partnerships subject to the centralized audit regime liable for the section 6662 penalties calculated on the imputed underpayment.

### SECTION 3. RELIEF FROM PENALTIES UNDER SECTIONS 6698, 6721, AND 6722

A partnership will not be subject to a penalty under sections 6698, 6721, or 6722 due to the inclusion of incorrect information in reporting its partners' beginning capital account balances on the 2020 Schedules K-1 if the partnership can show that it took ordinary and prudent business care in following the 2020 Form 1065 Instructions to report its partners' beginning capital account balances using any one of the following methods, as outlined in the instructions: the tax basis method, modified outside basis method, modified previously taxed capital method, or section 704(b) method. For purposes of this notice, "ordinary and prudent business care" means the standard of care that a reasonably prudent person would use under the circumstances in the course of its business in handling account information. In demonstrating ordinary and prudent business care, taxpayers are reminded that capital account balances are part of a partnership's books and records and must be maintained accordingly.

In addition, a partnership will not be subject to a penalty under sections 6698, 6721, or 6722 due to the inclusion of incorrect information in reporting its partners' ending capital account balances on Schedules K-1 in taxable year 2020 or its partners' beginning or ending capital account balances on Schedules K-1 in taxable years after 2020 to the extent the incorrect information is attributable solely to the incorrect information reported as the beginning capital account balance on the 2020 Schedule K-1 for which relief under this notice is available. The penalty relief provided in this notice

is in addition to the reasonable cause exception to penalties for failing to properly report the partners' beginning capital account balances, as described in section 2 of this notice.

A partnership that fails to timely file a 2020 Form 1065, Form 8865, and Schedules K-1 is not eligible for the relief provided by this notice. A partnership that fails to include a partner's beginning capital account balance on the Schedule K-1 is also not eligible for relief. This notice does not relieve a partner of its obligation to determine the adjusted basis of its interest in the partnership for purposes of determining its tax liability or that of any other person as prescribed in section 705 of the Code and § 1.705-1(a)(1) of the Income Tax Regulations.

#### SECTION 4. RELIEF FROM PENALTIES UNDER SECTION 6662

The IRS will waive any accuracy-related penalty under section 6662 for any taxable year with respect to any portion of an imputed underpayment that is attributable to an adjustment to a partner's beginning capital account balance reported by the partnership for the 2020 taxable year to the extent the adjustment arises from the inclusion of incorrect information for which the partnership qualifies for relief under section 3 of this notice. This notice does not prevent the IRS from imposing an accuracy-related penalty under section 6662 for any portion of an imputed underpayment related to capital account reporting by the partnership that is not described in the previous sentence.

#### SECTION 5. CONTACT INFORMATION

The principal author of this notice is Margaret Burow of the Office of the Associate Chief Counsel (Passthroughs and Special Industries). For further information, please contact Ms. Burow at (202) 317-5279 (not a toll-free number).