



Sunrise Series

Major tax issues impacting private equity funds

December 3, 2019

Notices

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Agenda

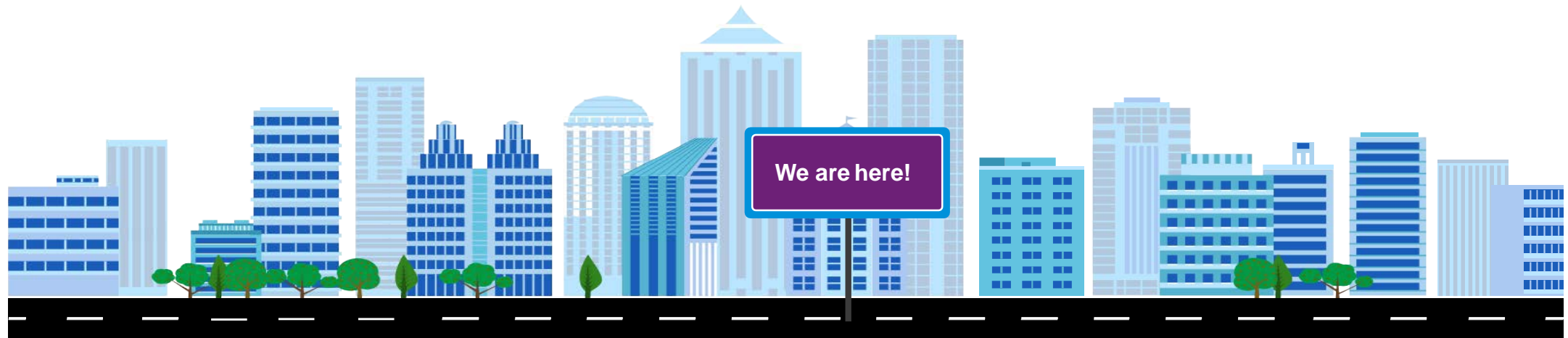
- International tax and foreign reporting – ATAD 2, CFC reporting and other significant developments
- Section 1061 – Planning opportunities and considerations
- Management company audits
- SALT update
- Updates to Form 1065 and Schedule K-1 reporting



EU ATAD 2 impact for PE

Christophe Diricks

ATAD: where are we?



1 January 2019
General application
of ATAD 1
provisions
(except exit tax)

25 April 2019
Vote of a bill for
the application of
the interest
limitation rules at
the level of tax
groups as from
2019

8 August 2019
Release of the
transposition bill
(bill 7466) for
ATAD 2: new
article 168ter
LITL

1 January 2020
Application of exit
taxation rules of ATAD 1

General application of
ATAD 2 provisions
(except reverse hybrid
rules)

1 January 2022
Application of the ATAD
2 provisions on reverse
hybrids: new article
168quater LITL

ATAD 2 : Scope in a nutshell

Mismatch outcome

- Double deduction (DD); or
- Deduction without inclusion (D/NI)

Arising

- Between associated enterprises; or
- Within a structured arrangement

Due to hybrid mismatches

- between MS and with third countries
- hybrid instruments or hybrid entities (D/NI)
- permanent establishments (D/NI)
- situations triggering double deduction (DD)
- reverse hybrids
- imported mismatches
- hybrid transfers (D/NI)
- dual residence



Primary/Secondary rules

Double deduction:

1. no deduction for the investor; or
2. no deduction for the payer

Deduction/Non-inclusion:

1. no deduction for the payer; or
2. inclusion in the payee's total net income (with exceptions)

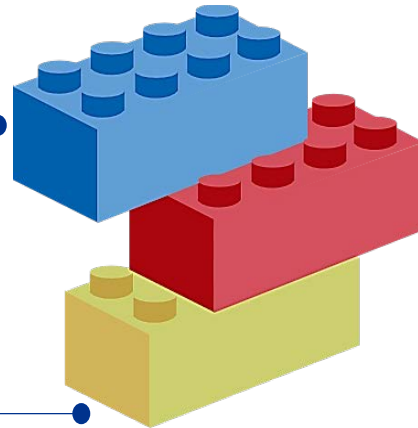
Key takeaways of the ATAD 2 transposition bill

Associated enterprise

- 'de minimis' rule: <10% in the shares/units of an investment fund, and <10% of the profit entitlement in applying acting together concept
- rebuttable presumption

Burden of proof

- lies on taxpayer upon request of Luxembourg tax authorities
- relevant, reasonable, objective and verifiable proofs



Out of scope payments

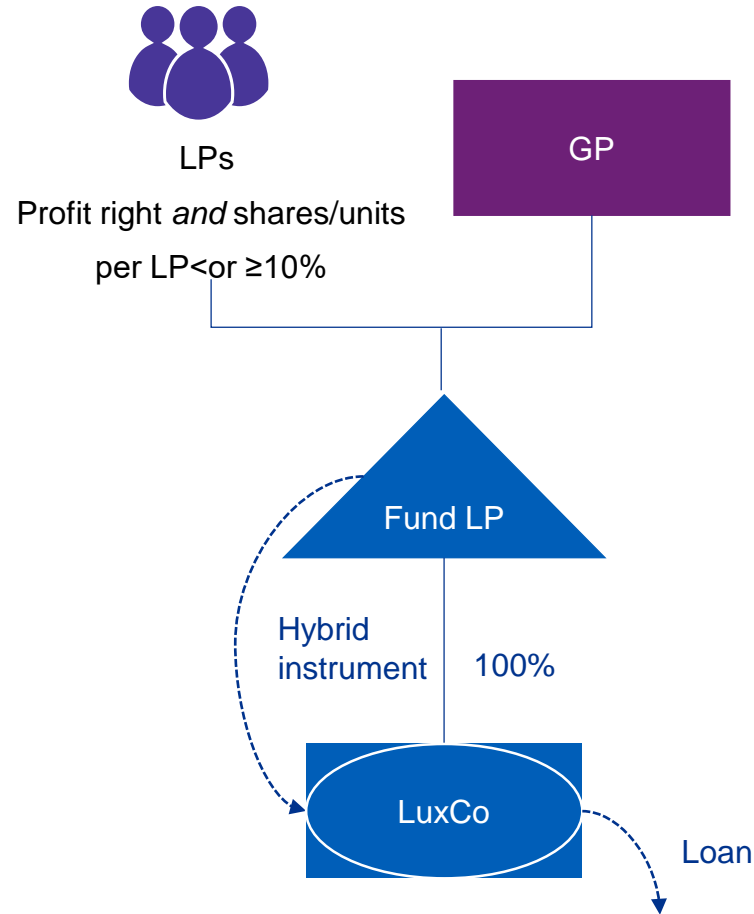
- to tax-exempt payees/investors
- transfer pricing adjustments
- to collective investment vehicles (for the application of reverse hybrid rules as from tax year 2022)

Associated enterprise and 'acting together' concept

Participation of min. 25% or 50%

Acting together in respect of the voting rights or capital ownership of an entity...

... unless the 'de minimis' rule applies



Significant influence in the management

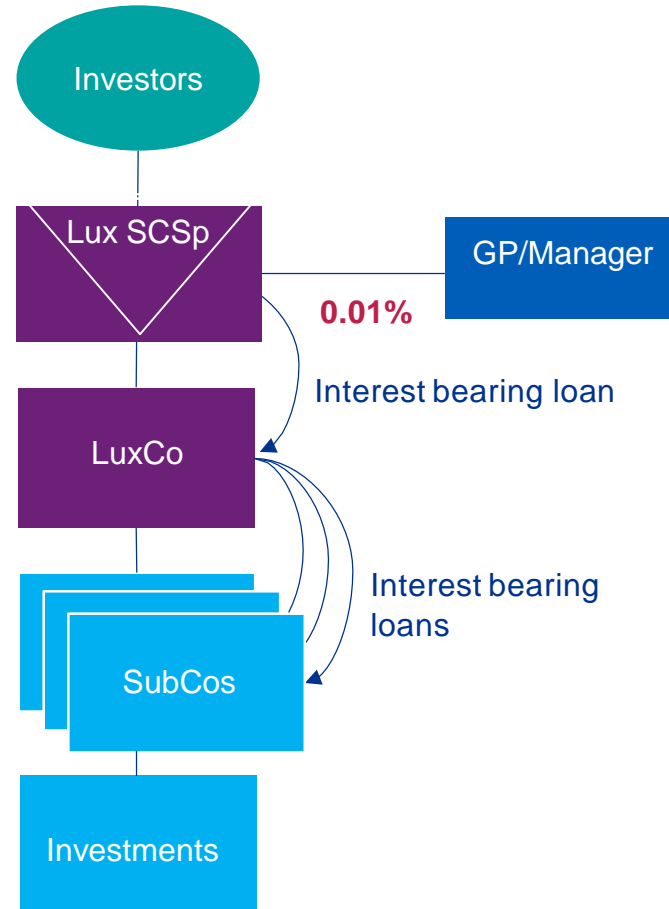
Payment to (reverse) hybrid entity and reverse hybrid rules

As from tax year 2020

Lux SCSp = reverse hybrid entity
Transparent in Luxembourg and opaque in the investors' jurisdictions

Payment giving rise to a deduction without inclusion

Deduction denied?

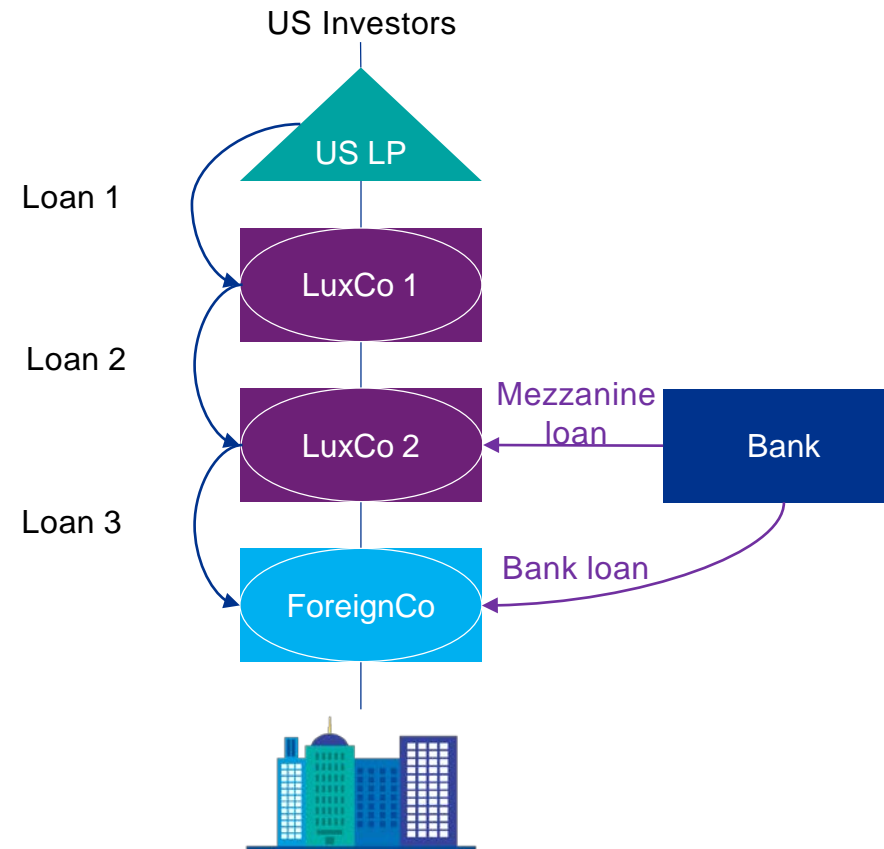


As from tax year 2022

Reverse hybrid: transparent in Luxembourg and opaque in the investors' jurisdictions

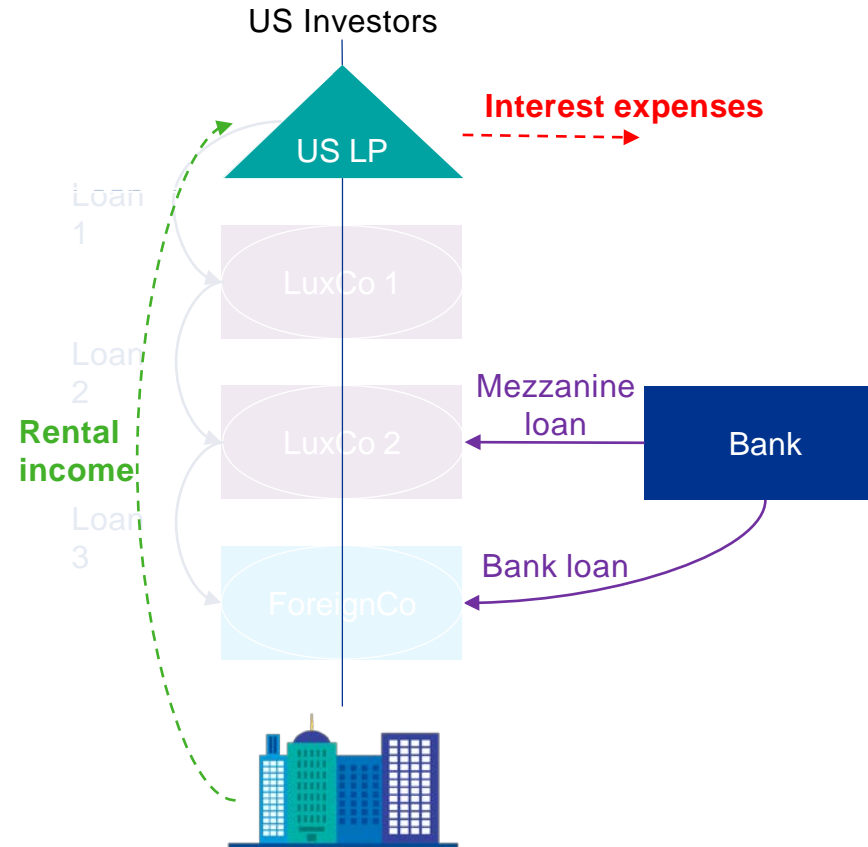
Taxation of reverse hybrids excluding CIVs?

Payment **by** hybrid entity and double deduction



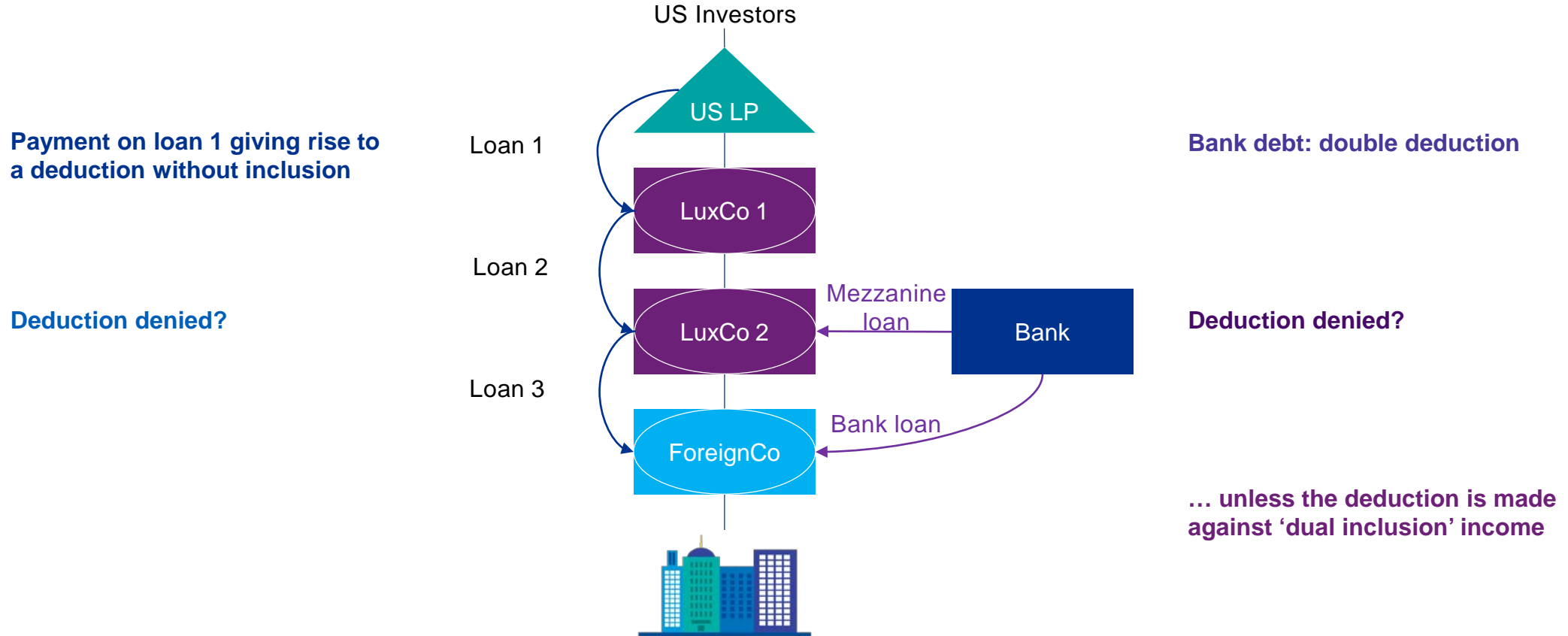
Payment **by** hybrid entity and double deduction (continued)

Check-the-box election → opaque in Luxembourg but disregarded for US tax purposes



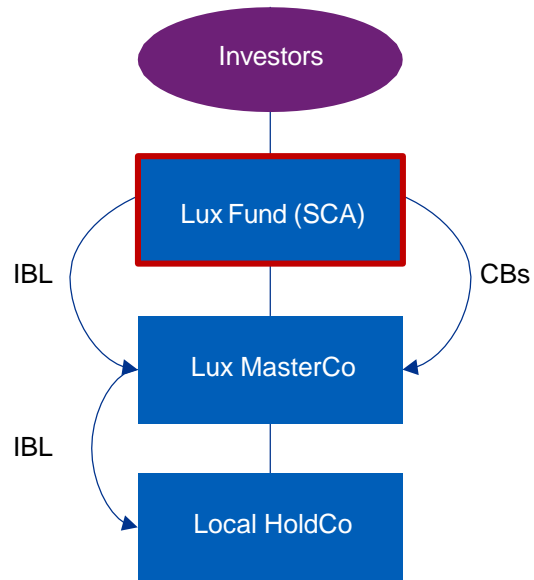
Payment **by** hybrid entity and double deduction (continued)

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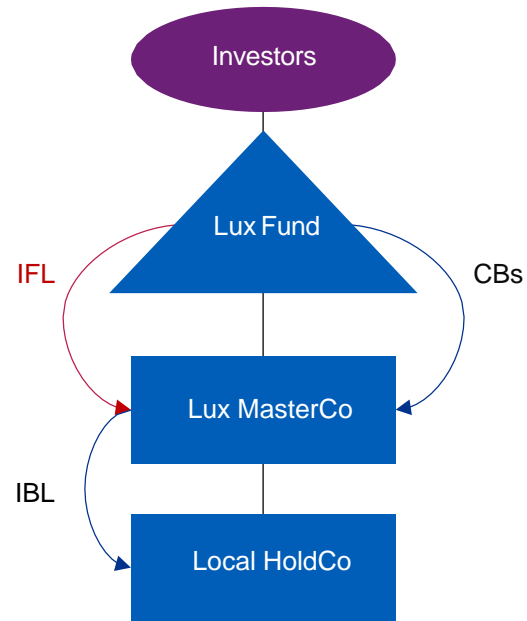


What are the available solutions?

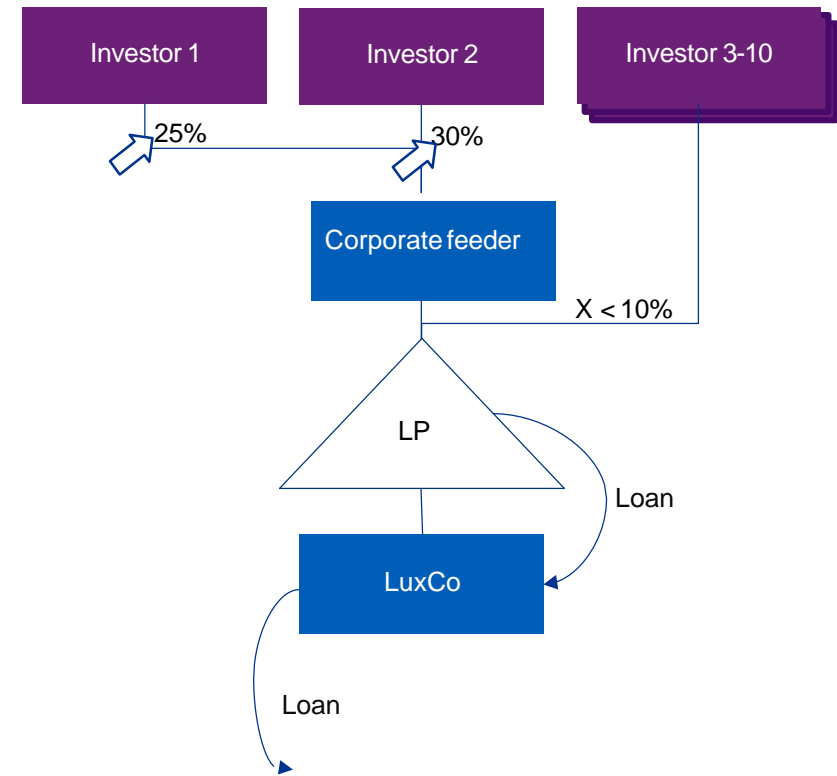
Luxembourg corporate Fund



TP Adjustment



Corporate Blocker

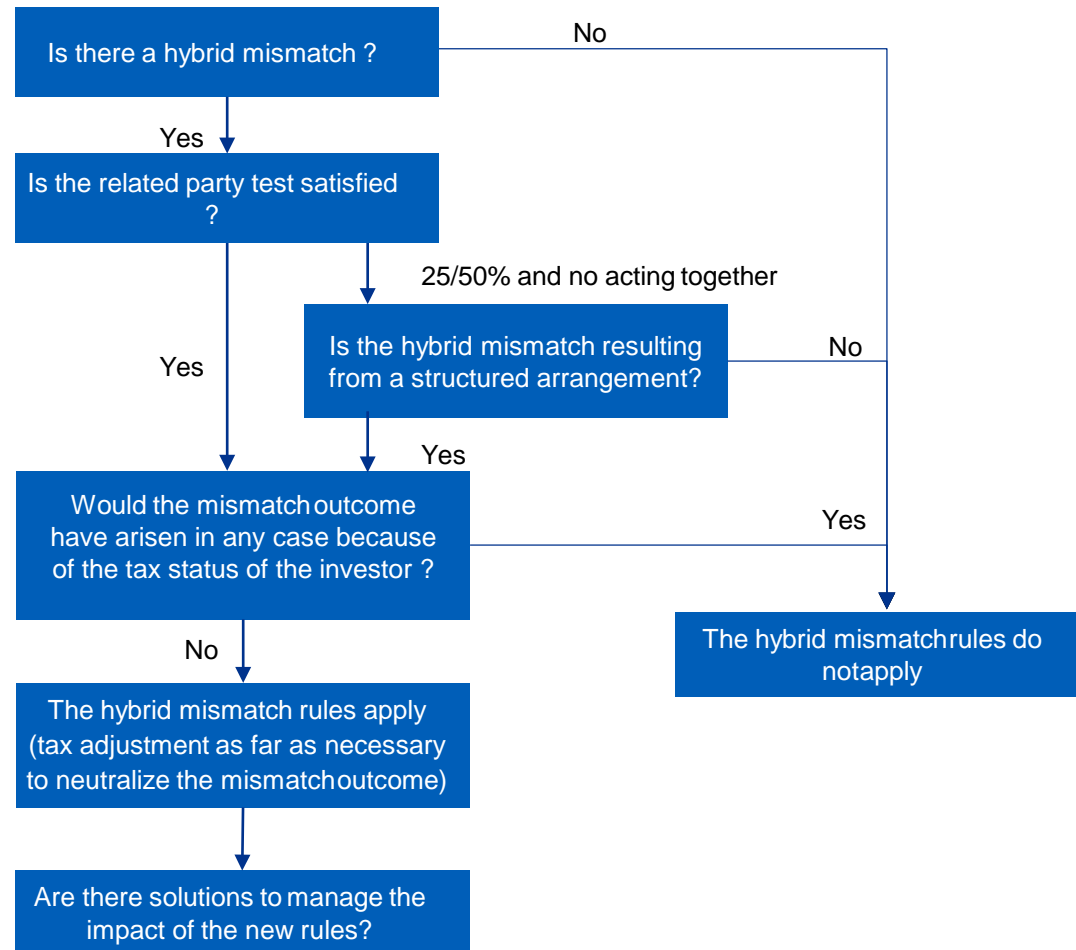


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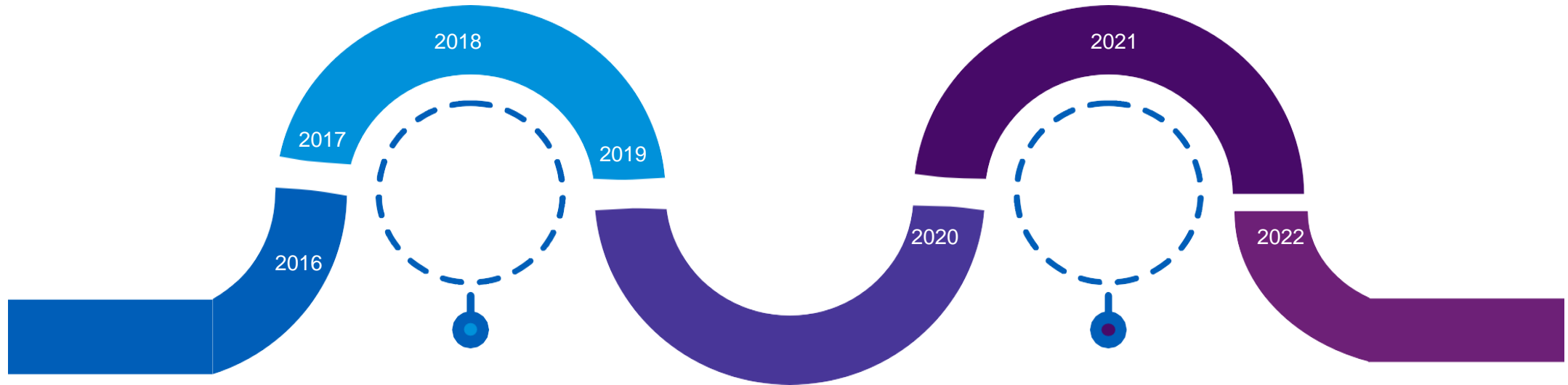


Be prepared

Impact on investments – ATAD 2 decision tree



How to prepare for ATAD 2



Existing investments need to be reviewed and structure alignments should be implemented before year-end

A hybrid mismatch analysis will become an integral part of each and every tax advice going forward

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Section 958(b)(4) Repeal Guidance

Sam Riesenber

General Overview: Proposed Regulations

Overview

- Proposed rules revise certain regulations outside of subpart F that were affected by the repeal of section 958(b)(4)
 - Broadly, the proposals modify certain rules to disregard downward attribution for certain provisions or to more closely align to application of the specific provision before repeal
- The proposed rules modify section 958(b)(4) regulations for consistency
 - No other rules in subpart F revised, including section 954(c)(6)
- Generally applicable for tax years ending on or after October 1, 2019, or transactions occurring on or after October 1, 2019, but taxpayers can apply regulations to earlier tax years affected by the repeal of section 958(b)(4) subject to a consistency requirement
 - Taxpayers can rely on the proposed regulations prior to publication of final regulations

General Overview: Proposed Regulations (cont.)

- Provisions addressed in the proposed regulations:
 - Section 267(a)(3)(B) (accrued amounts owed to CFCs)
 - Section 332 (liquidations)
 - Section 367(a) (Gain Recognition Agreements)
 - Section 672 (CFC-owned trusts)
 - Section 706 (taxable year of partnerships)
 - Section 863 (source of income)
 - Space and Ocean Income
 - International Communication Income
 - Section 904 (foreign tax credit)
 - Section 958 (constructive stock ownership)
 - Section 1297 (PFIC asset test)
 - Section 6049 (Form 1099 reporting)

Overview: Rev. Proc. 2019-40

Timeline

- Rev. Proc. 2019-40 issued on October 1, 2019
- Unless otherwise provided, guidance applies beginning with the last tax year of a foreign corporation beginning before January 1, 2018 (tied to effective date of section 958(b)(4) repeal)
 - Taxpayers can rely on the Form 5471 filing rules described in the Revenue Procedure prior to the modification of the Form 5471 instructions
 - Any subsequent guidance (example: “alternative information” and “readily available”) would be prospective only
- Guidance is permissive; taxpayers can choose to apply the rules described in the Revenue Procedure
 - No explicit requirement to attach statement or otherwise notify IRS if applying the rules in the Revenue Procedure
 - Taxpayers should maintain internal documentation that conditions in the Revenue Procedure are satisfied

Overview: Rev. Proc. 2019-40 (cont.)

- Revenue Procedure provides **limited relief**; applies for CFCs *only if* the corporation would not be a CFC without downward attribution from a foreign entity under section 318(a)(3) (“foreign-controlled CFC”)
- When relevant conditions are satisfied, relief available for:
 - Determining CFC status
 - Information used to calculate subpart F and GILTI inclusions
 - Information used to calculate section 965 inclusion and deduction
 - Penalty relief for certain failure to file Form 5471 and substantial understatement
 - Form 5471 relief for category 5 filers
- Certain relief varies based on whether USSH owns any stock in the CFC under section 958(a), and whether USSH and CFC are “related persons” under section 954(d) (more than 50%)

Rev. Proc. 2019-40: CFC Safe Harbor

Section 4 of the Revenue Procedure is a safe harbor for determining CFC status

- A foreign corporation is a CFC if it is more than 50% owned by USSHs on any day during its tax year
- IRS “will accept” U.S. person’s determination that a foreign corporation is not a CFC if certain conditions are satisfied
 - Applies **only** to **foreign-controlled CFCs**
 - U.S. person must not have any of the following:
 - **Actual knowledge** of CFC status;
 - **Statements** received of CFC status; or
 - Reliable **publicly available information** to determine CFC status
 - U.S. person must ask top-tier foreign entity whether it is a CFC, and questions about its ownership in foreign and domestic entities
 - No requirement to make any other inquiries, including of any co-owners in foreign corporation

Rev. Proc. 2019-40

Requirements based on U.S. Shareholder status in relation to foreign corporation

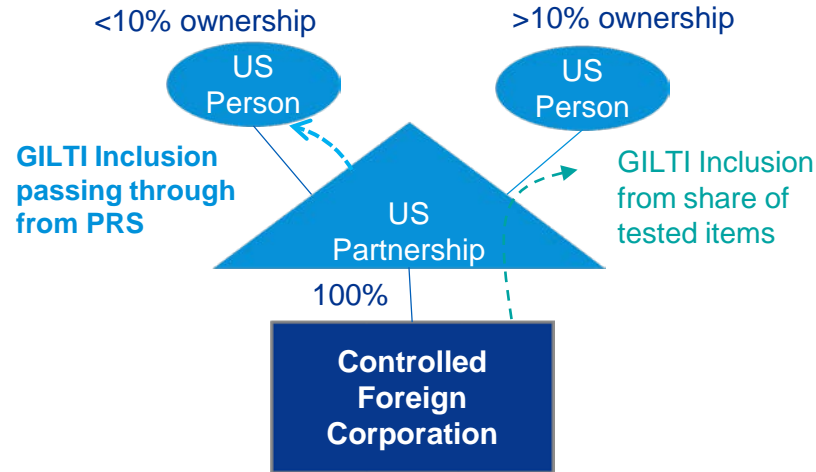
USSH	Section 958(a) Ownership	Related (more than 50%)	CFC has section 958(a) USSH	Form 5471 Category	Required Schedules
Unrelated Constructive USSH	No	No	No	N/A	N/A
	No	No	Yes	1	Page 1 identifying info, Schedules B (part II), E, E-1, J, and P
Related Constructive USSH	No	Yes	No	N/A	N/A
	No	Yes	Yes	1 and Limited 5	Page 1 identifying info, Schedules B (part II), E, E-1, G, I-1, J, and P
Unrelated Section 958(a) USSH	Yes	No	Yes	1 and Limited 5	Page 1 identifying info, Schedules B (part II), E, E-1, I, I-1, J, and P
Related Section 958(a) USSH	Yes	Yes	Yes	1 and 5	Page 1 identifying info, Schedules B (part II), E, E-1, G, H, I, I-1, J, and P



Impact of Proposed and Final CFC Regulations on Funds

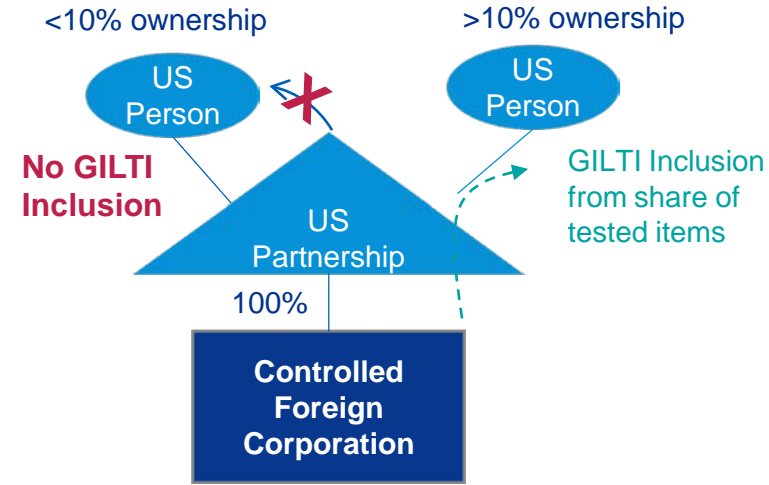
GILTI and Domestic Partnerships

Result Under 2018 Proposed Regulations



- Initial (2018) proposed rules: hybrid aggregate/entity approach to domestic partnerships that are USSHs of a CFC
 - Entity as to partners who are not themselves USSHs (i.e., own less than 10%) of partnership's CFC → include distributive share of GILTI inclusion computed by partnership
 - Aggregate as to partners who are USSHs → take into account their own pro rata shares of the CFC's elements of GILTI (e.g., tested income/loss, QBAI) and compute GILTI inclusion at the partner level

Result Under Final Regulations

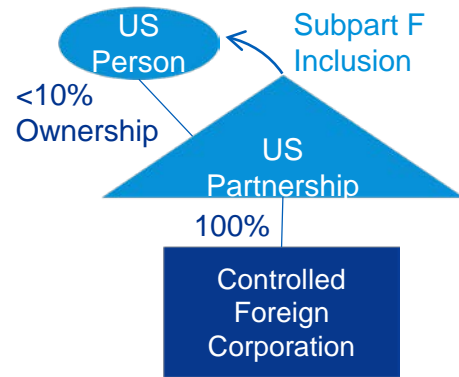


- Final rules: aggregate approach for **all** partners
 - Partners that own less than 10% of partnership's CFC → **no GILTI inclusion**
 - Domestic and foreign partnerships treated the same for GILTI
 - Domestic partnership treated as an entity only for purposes of determining U.S. Shareholder and CFC status
 - Also applies to S corporations
 - **Retroactive!** Applies to all GILTI years

Subpart F decision time...

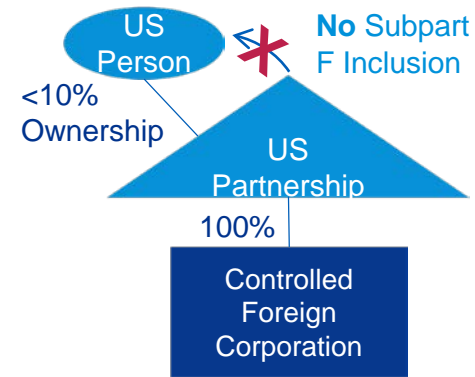
Proposed section 951 regulations permit, but do not require, aggregate treatment of a US partnership until final. So, why choose one way or the other?

Pre-Regulations Considerations



- Application of CFC/PFIC Overlap Rule
 - Still bad PFIC asset testing answer
- Allow time to adjust (perhaps do later)
- USSH LP considerations?
- Individual holding considerations (election requires related partnerships to all make the election)
- Others?

Post-Regulations Considerations



- No subpart F inclusion ...
- Any PFIC elections can be made by US partnership
- Consistency with GILTI aggregate treatment may mean less complications
- Others?

A little ambiguity in reliance aspect of SubF proposed Regulations to be aware of

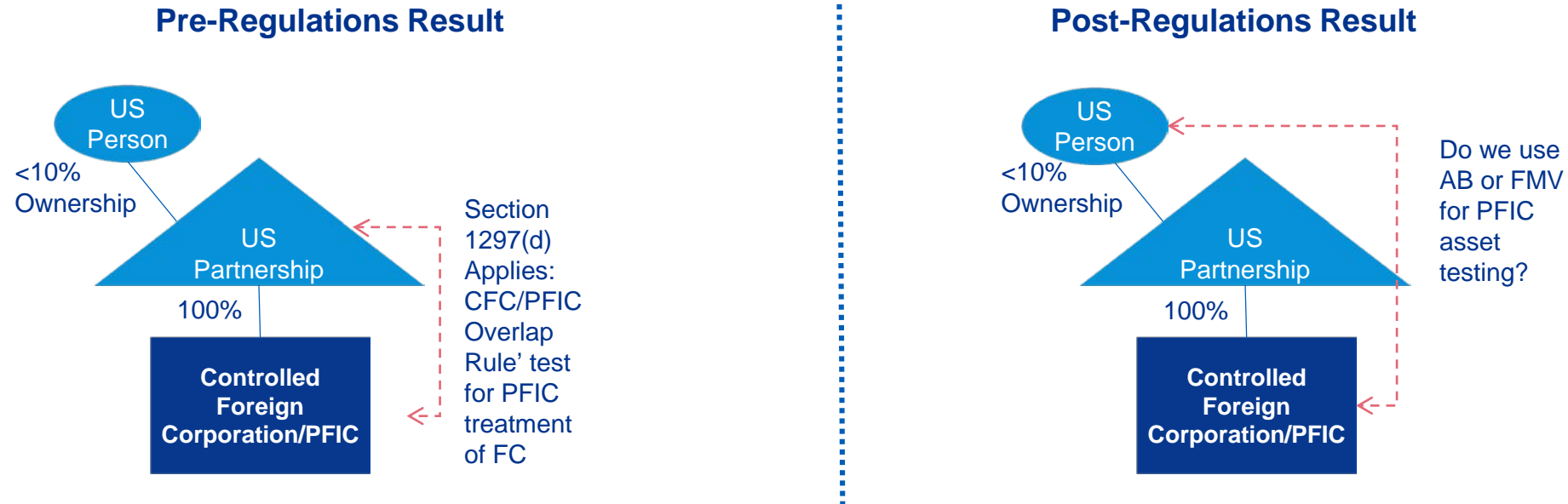
Say I want to elect in 2019 but did not in 2018 (and maybe don't want to): do I have to go back and amend 2018?

Relevant language below (proposed 1.958-1(d)(4))

... For taxable years that precede the taxable years described in the preceding sentence, a domestic partnership may apply those paragraphs to taxable years of a foreign corporation beginning after December 31, 2017, and to taxable years of the domestic partnership in which or with which such taxable years of the foreign corporation end, provided that the partnership, its partners that are United States shareholders of the foreign corporation, and other domestic partnerships that bear relationships described in section 267(b) or 707(b) to the partnership (and their United States shareholder partners) consistently apply paragraph (d) of this section with respect to all foreign corporations whose stock the domestic partnerships own within the meaning of section 958(a) (determined without regard to paragraph (d)(1) of this section).

Seems the answer is no...

PFICs: Consequence of New 958(b)(4) Guidance



- The proposed and final section 951A regulations' aggregate treatment of US partnerships means that section 1297(d) no longer applies, requiring PFIC testing, even of entities wholly-owned through a US partnership
- Guidance under 958(b)(4) repeal limited 1297(e)(2) adjusted basis testing of PFICs where the PFIC is also a CFC by virtue of 958(b)(4) repeal
- But does that guidance touch this situation?
- 338(g) elections can be critical in this fact pattern; structure for QSP...

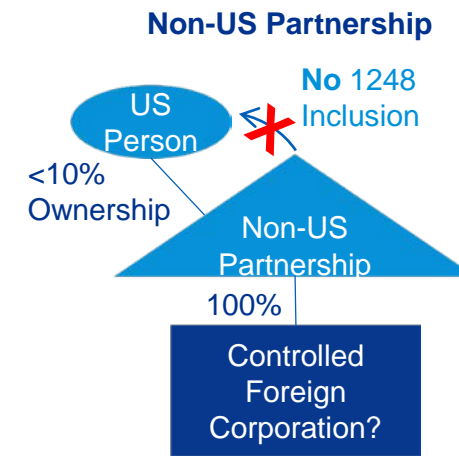
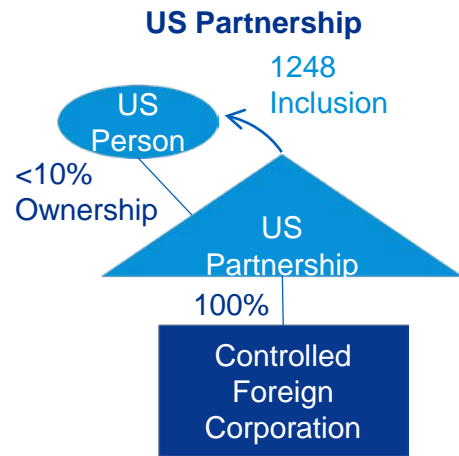
Basis Consequences Still Problematic



- The proposed and final section 951A regulations' aggregate treatment of US partnerships means that any GILTI reported on 2018 may NEVER provide for a basis adjustment to US Partnership, meaning potential double taxation (same issue for SubF to extent adopted for 2018)
- New PTEP regulations expected; clear expectation is hope that it will squarely address this issue and will provide fix

How do I hold my next target? (Is PFIC Better??)

Given that US partnerships now have aggregate treatment, should I form a US or non-US partnership for my next target/AIV/fund?



- No Subpart F (assuming election) and no GILTI to non-US shareholders.
- US partnership can make elections.
- Fewer entities (eg, hold everything together) (i.e., US partnership is the withholding agent, not withheld on for FIRPTA, look through QFPF, etc.).

- No Subpart F (assuming election) and no GILTI to non-US shareholders.
- Not necessarily a CFC...
- No 1248/751(a) related issues
- Potentially better 1297(e) result for PFIC testing.
- Maybe no 1065/K-1s prepared for non-US investors.
- Non-tax considerations.



New PFIC Proposed Regulations

PFIC Proposed Regulations

Timeline

- Published in the Federal Register on July 11, 2019
- Comments were due by September 9, 2019
- Proposed to apply to shareholder tax years that **begin** on or after publication of **final** regulations
 - Reliance on proposed rules is permitted, provided consistent application of all proposed rules
 - For non-insurance rules, can apply to all open tax years
 - For insurance rules, can apply to tax years beginning after December 31, 2017
- Also can continue to rely on Notice 88-22

- What is the current state of reliance on proposed regulations? This is **unclear**

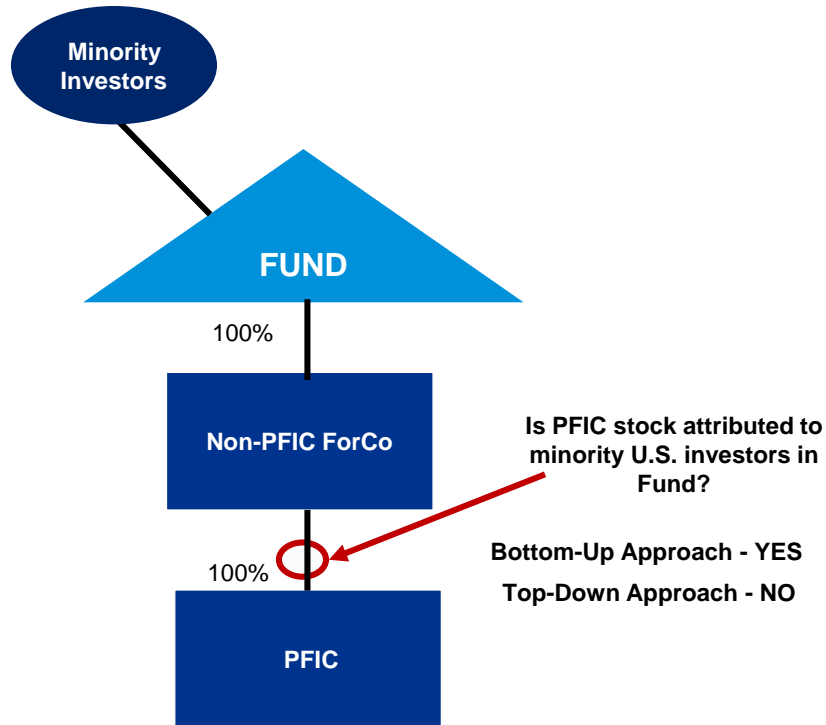
- “All open years” ← What does that mean?

General Overview of Proposed Rules

The proposed rules provide guidance on a number of issues

- Proposed rules address a number of long-standing issues, including:
 - Ownership and attribution through partnerships,
 - Income test,
 - Asset test,
 - Look-through rule for 25%-owned corporations, and look-through rule for certain domestic subsidiaries, and
 - Change-of-business exception
- Proposed rules address PFIC insurance exception, as revised by tax reform
- Not addressed in proposed rules:
 - QEF or MTM rules,
 - PFIC stock transfer non-recognition override rule (section 1291(f)),
 - Ownership attribution through options, or
 - Coordination with aggregate approach for domestic partnerships in subpart F proposed rules

PFIC Attribution Rules: Bottom-Up vs. Top-Down



General PFIC ownership attribution rules

- A US person that owns a partnership treated as owning a proportionate share of stock owned by the partnership
- US person that owns a non-PFIC corporation treated as owning proportionate share of stock owned by such corporation **only if** US person owns at least 50% of the value the non-PFIC corporation
- Uncertainty regarding application of the PFIC stock ownership attribution rules in tiered ownership structure context

PFIC proposed rules adopt top-down approach

- The proposed rules adopt exclusive application of “top-down” approach to ownership attribution through partnerships – significant and taxpayer favorable result!
 - Same result as if the partnership were disregarded and US partners directly owned partnership’s directly held stock



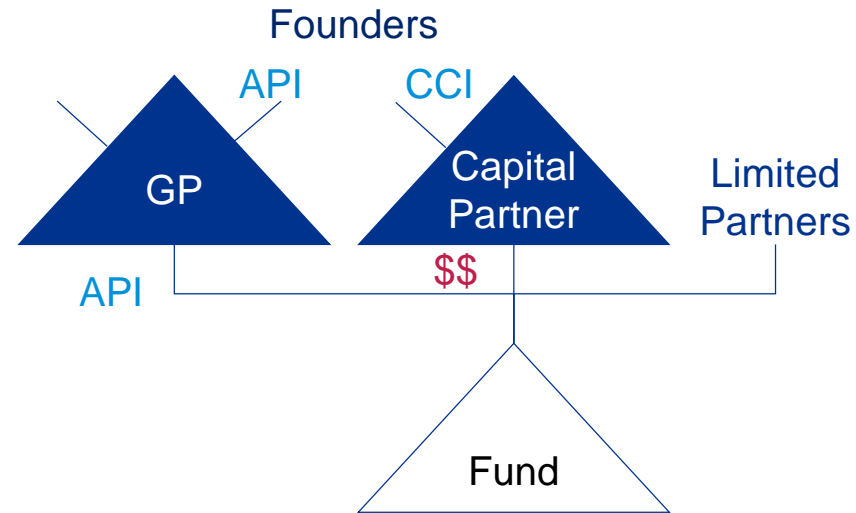
1061 Update

Sean Austin

Overview of carried interest legislation

- New section 1061 recharacterizes certain net long term capital gains with a holding period less than 3 years as short term capital gains
 - Gains “with respect to” applicable partnership interests (APIs)
 - APIs are partnership interests that are **directly or indirectly transferred to, or held by**, a **taxpayer** in connection with the performance of **substantial services** by the **taxpayer or a related person** in any “**applicable trade or business**.”
 - Aspects to focus on here:
 - Taxpayer
 - Indirectly...held by
 - Related person
 - Key Exception: Commensurate with Capital

New funds structuring

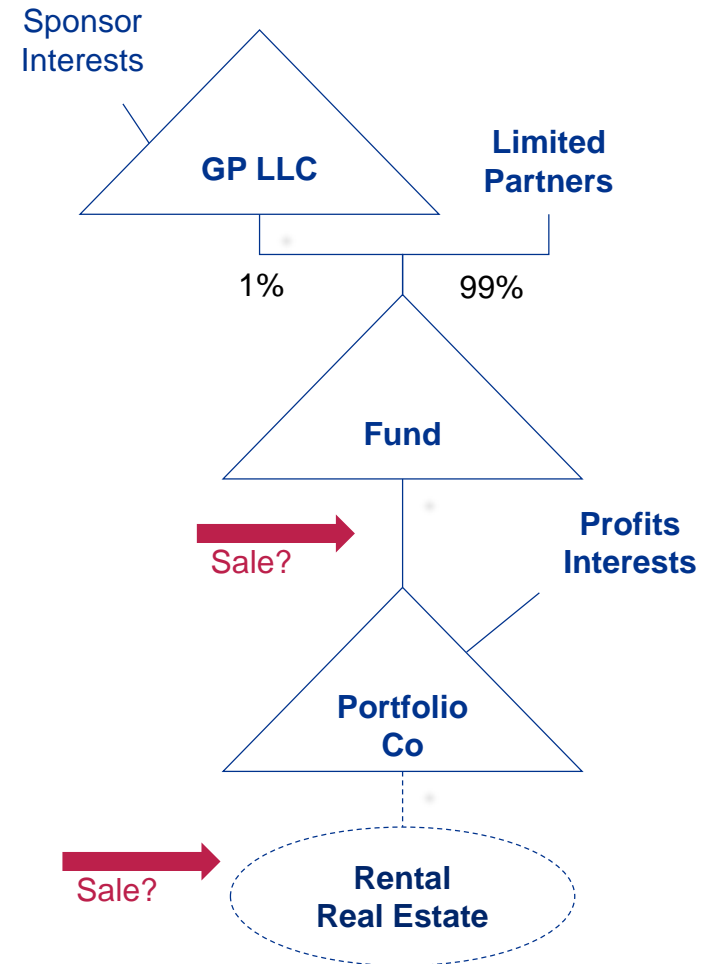


— Advantages of separating CCI from API

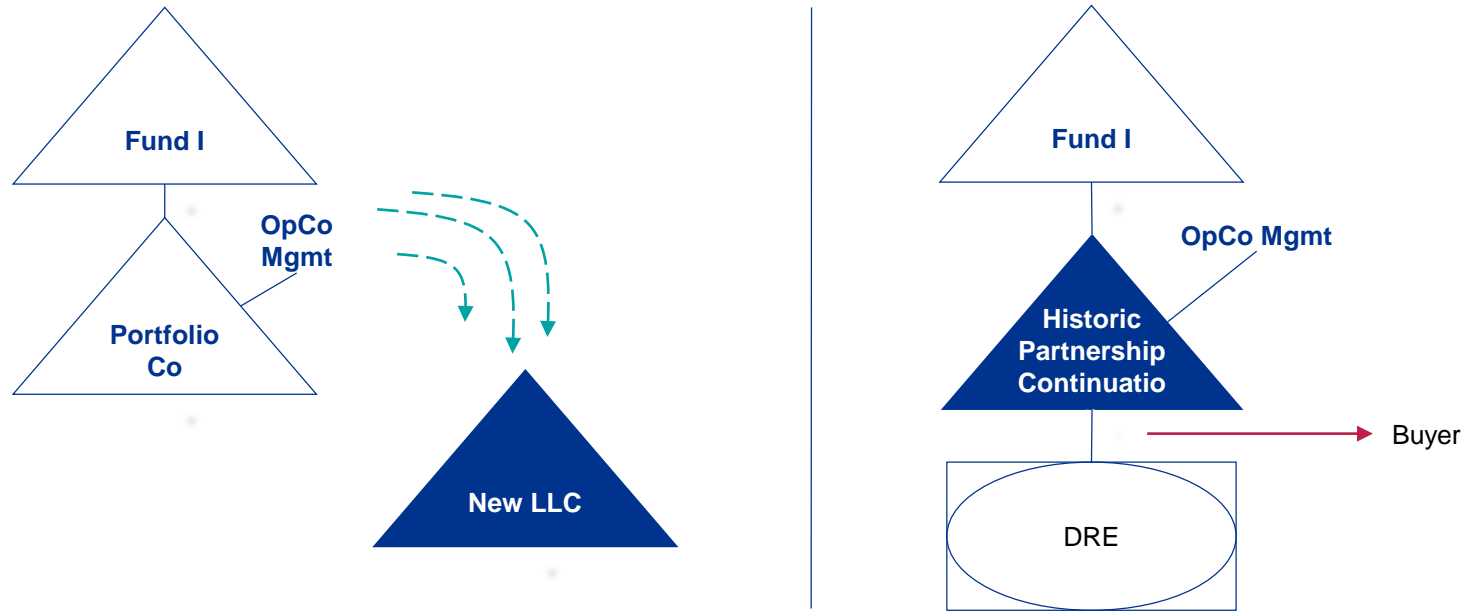
- Clearly identified distributions
- Clearly identified long term capital gains subject to recharacterization (or not) as tax allocations are made with respect to each separately-held interest and separate Schedule K-1s are issued for each
- However, no utilization of basis attributable to the CCI to take a carried interest distribution that otherwise would result in a taxable distribution of cash in excess of basis

Sell assets not interests?

- Section 1061, on its face, does not recharacterize all types of gains that may have preferential rates as short term capital gain
 - Section 1231 gain from the sale of section 1231 property
 - Section 1256 contracts
 - Qualified Dividends
 - As drafted, focus of the provision appears to be on dispositions of section 1221 property
- It is possible that technical corrections, regulations, JCT Bluebook may provide additional guidance applying section 1061 to these areas



Converting interest sale in LLC to asset sale

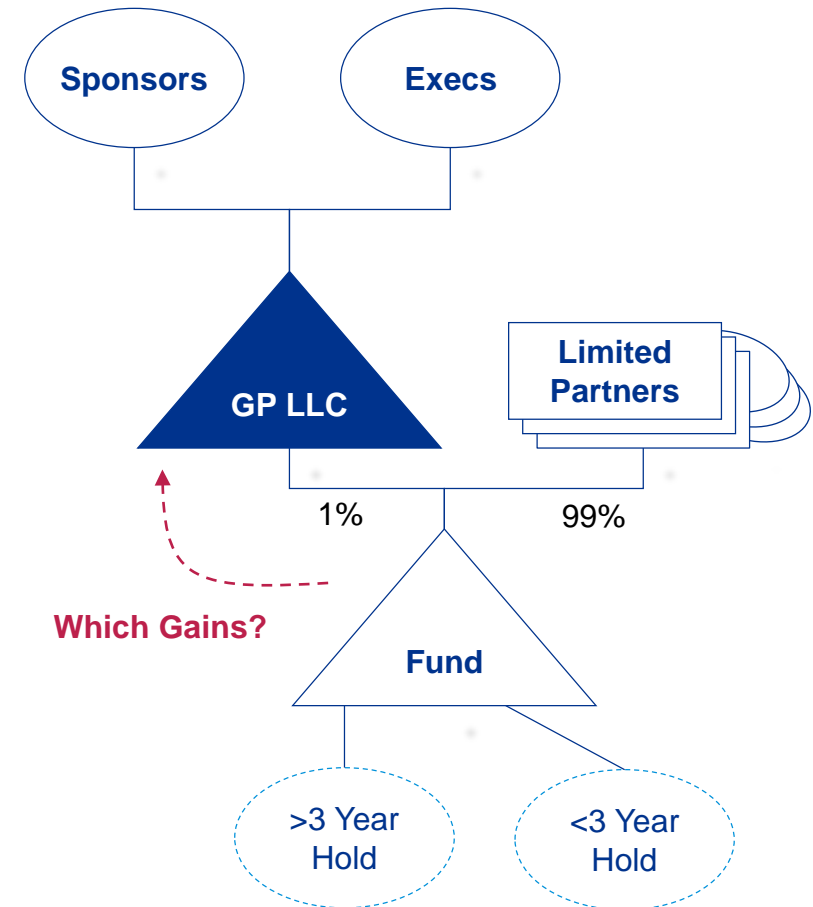


- Easy alternative? Tier up and sell
 - Fund I, Fund II, and Management contribute all their interests in Portfolio Co to New LLC.
 - New LLC becomes a continuation of Portfolio Co.
 - The historic entity, Portfolio Co, becomes a DRE of New LLC
 - New LLC sells 100% of the units of Portfolio Company to Buyer.
 - Considerations?
 - Timing of tier up? Eve of sale versus well in advance?
 - What result if New LLC immediately liquidates under state law, upon receiving sales proceeds?
 - Watch for roll equity...

Special allocations of 3+ year gains

- Overview – Fund has typical economic arrangement:
 - Cash is returned to LPs to provide them with an 8% IRR hurdle on contributed capital
 - Remaining proceeds are allocated 20% to the GP and 80% to the LPs
 - Prior to liquidation, returns are trued up and clawbacks exist for either GP or LPs to extent they received more or less than their share of distributions

Is a special allocation of 3+ Yr gains a viable alternative??



Special allocations of 3+ year gains (continued)

Hardwired allocations

- Agreement provides that only 3+ year LTCGs are allocated on the carried interest
 - Carry entitlement preliminarily determined based on all gains.
 - Less than 3 Year LTCG is allocated away from GP, but is matched with 3+ Year LTCGs *recognized* in a later period.
 - GP is taking risk as economics are reduced if subsequent 3+ Year LTCGs never materialize.

Elective allocations

- Agreement provides discretion to forgo an allocation of less than 3 Year LTCGs at time of sale
 - Carry entitlement preliminarily determined based on all gains.
 - Less than 3 Year LTCG is allocated away from GP, but is matched with 3+ Year LTCGs *realized and recognized* in a later period.
 - Revaluations, or tracking unrealized gains in portfolio assets using thresholds, required
 - GP is taking risk as economics are reduced if subsequent 3+ Year LTCGs never materialize.

Special allocations of 3+ year gains (continued)

- Capital account driven partner agreements
 - Section 704(b) “safe harbor” agreements
 - Likely provide stronger technical support for the validity of the allocations
- Regulatory “value-equals-basis” rule
 - Liquidation based on positive capital accounts quantifies the economic entitlements associated with the allocations since a partner’s capital account will not increase without the allocation of 3+ year gains.

Special allocations of 3+ year gains (continued)

— Cash driven partner agreements

- GP cash entitlements must be reduced on a dollar-for-dollar basis to the extent that insufficient 3+ year gain is available to make up for the 1-3 year gain that was allocated to other partners
 - Defer GP distributions until adequate 3+ year gain is available, or
 - Subject GP to a clawback to extent that insufficient 3+ year gain is ultimately allocated to the GP
- Because the “value-equals-basis rule” is not available for evaluating non-safe harbor allocations, it is necessary to assess the likelihood that 3+ year gain will, in fact, be available to offset the forgone allocations.
 - If there is a strong likelihood that such gain will be available it may be difficult to support such allocations.
 - Strong likelihood likely easier to fail in an elective waiver situation?

Future guidance?

- **Before incorporating such allocation provisions, partners should be mindful of language in the legislative history indicating that guidance “is to address the prevention of the abuse of the purposes of the [applicable partnership interest] provision, including through the allocation of income to tax-indifferent parties.” H.R. 1, Conf. Rep., at 268.**
 - The meaning of “tax-indifferent parties” in this context is not certain, but given the context, one can imagine that this could be intended to reference parties who are not sensitive to the character of income or possibly to whether capital assets are held for more than three years.

Holding period impacts – Follow on investments

Funds may make follow on investment calls for subsequent contributions into portfolio companies.

Partnerships

- Partners have one capital account and one basis in their partnership interest.
- Partners can have a bifurcated holding period.
 - Portion of interest issued for cash and hot assets = ST holding period starts.
 - Portion of interest issued for long term capital and section 1231 assets = HP tacks.
 - Cash contributions start a new holding period for the portion of the interest acquired with cash.

Corporations

- Shares of stock newly issued for contributed property in a section 351 transaction take a holding period based on the holding period of the contributed property (may be divided between short- and long-term).
 - Shares of stock newly issued for cash have a holding period that begins on the date of the contribution/issuance
 - A cash contribution by a shareholder without the issuance of new shares likely results in a segmented holding period for the shareholder's pre-existing shares.

Partnership follow on investments

- Consider funding follow on with debt
 - Debt-equity considerations
 - Limitations on deducting business interest expense concerns
- Use sibling partnership to invest as a preferred investor
 - Subsequent appreciation in preferred interest “capped” at coupon
 - Historic common interest with longer holding period retains growth potential
 - Must invest through separate holding partnership to avoid bifurcated holding period in “one partnership interest”
- Leveraged distribution prior to sale
 - Use netting rule if timing works
 - Cash contributions within 12 months of cash distribution are netted for purposes of determining holding period in partnership interest

Corporate follow on investments

- Consider funding follow on with preferred stock
 - Caps return on shorter-term holding period stock at coupon
 - Common shares with longer holding period bear excess upside potential
 - If sufficient E&P, is it possible to declare and pay dividend on preferred prior to exit?
 - Pricing considerations
 - Section 305
- Maximize dividend returns
 - Qualified dividends eligible for 20% rate, but not subject to recharacterization under section 1061
 - Where portfolio company is appreciated and has significant E&P a dividend return paid by leveraging up may be taxed preferentially
 - Later, unrelated, exit acquisition price is less due to leverage.
- Risk of recharacterization if planned sale and repayment of debt with funds provided by buyer.

Corporate follow on investments (continued)

- Distribute stock to carried interest partner for sale by them
 - Immediate sale if arguing section 1061 doesn't attach to property distributed; later sale to buyer otherwise
 - Planning is complex and analysis requires determination of whether asset has substantively been distributed from partnership solution, whether partnership remains substantive seller, and analysis of partnership allocations with respect to remaining sold stock is allocated to carry partner in part regardless under the partnership section 704(c) rules.



Tax controversy update

Miri Forester

IRS enforcement overview

— Current Enforcement Landscape

- New Leadership
- Growing support from Congress for an increase in IRS enforcement
- Enactment of Taxpayer First Act of 2019
- Improving partnership tax compliance is a central area of focus:
 - changes made to key partnership tax forms to improve information that is gathered on partnerships
- Elective, multi-year training program to be implemented.
 - Participants to earn the equivalent of an “light” LLM degree, with an initial focus on partnership issues.

— Centralized Partnership Audit Regime Updates

- New procedures for updating Schedule K-1 information after the due date of the partnership return
- Issuance of Draft Form 8985 (Partnership Push Out Summary), Form 8985-V (Tax Payment by a Pass-Through Partner) and Form 8986 (Partner’s Statement Required under Section 6226)

IRS enforcement trends

— SECA Tax Campaign

- Significant increase in IRS activity related to the Self-Employment Contributions Act tax.

— Form 1120-F Campaigns

- Focus on Delinquent Returns, Non-Filers and Withholding Tax Refunds
- Recent TIGTA report examines effectiveness of Form 1120-F Non-Filer Campaign

— Virtual Currency Campaign

- Campaign will address noncompliance related to the use of virtual currency through multiple treatment streams including outreach and examinations. Taxpayers with unreported virtual currency transactions are urged to correct their returns as soon as practical. The IRS is not contemplating a voluntary disclosure program specifically to address tax non-compliance involving virtual currency.
- Revenue Ruling 2019-24--first IRS guidance issued on virtual currency since IRS Notice 2014-21

— Form 1099 Information Reporting



SALT update – A mixed bag

Julia Flanagan

Nexus – A refresher

Nexus:

— Minimum connection required for a state to impose tax

Common ways nexus may be created:

- Physical presence
- Economic presence (factor thresholds)
- Agency relationships

P.L. 86-272 – Limitation on states ability to impose net income taxes

- Activity limited to the solicitation of orders for sales of tangible personal property
- Unprotected activities include:
 - Soliciting orders for services
 - Approving or rejecting orders of tangible personal property
 - Providing services (e.g. repair, installation, training, etc.)

Statute of limitations

— Three to four years in filing states, indefinite in non-filing states (unless approach under VDA)

State income and franchise taxes & gross receipts taxes

State income and franchise taxes

- Conformity to the Internal Revenue Code
- Income base (filing group, modifications)
- Income sourcing (allocation/apportionment)
 - Identify material states in terms of apportionment
 - Receipts sourcing (sales of tangible personal property, services, etc.)
- Tax credits and attributes (refundable, limitations)
- Consider state modifications (depreciation, etc.)
- Calculate the effective state tax rate – reasonable?
- Consider material franchise taxes not subject to a cap

State income and franchise taxes & gross receipts taxes (continued)

Gross receipts taxes

— Various states and localities adopt gross receipts taxes, including:

- Nevada Commerce Tax
- Ohio Commercial Activity Tax
- Oregon Corporate Activity Tax (tax years beginning on or after January 1, 2020)
- Washington Business and Occupation Tax
- California localities
- Virginia localities
- Washington localities
- Others

Sales and use taxes

Sales taxes

- Taxability determinations
 - Services vs. tangible personal property (bundled transactions)
 - Software (delivery method, pricing structure)
 - Automated determinations (product mapping)
- Exempt customer or use
 - Available exemptions (resale, government, manufacturer)
 - Resale/exemption certificates (streamline states, good faith)
- Voluntary disclosure
 - Formal agreements (binding, anonymous)
 - Benefits (lookback, penalty abatement)

Sales and use taxes (continued)

Use taxes

- Taxable purchases of supplies and equipment
 - Triggering event (initial purchase, physical movement)
- Identify promotional items and other products given away subject to use tax (removed from inventory)
 - Demonstration products or samples removed from inventory
 - Promotional items distributed at trade fairs or as advertising
 - Items distributed to customers free of charge (display racks, etc.)
 - Printed advertising materials

Update on wayfair U.S. supreme court decision

Although the U.S. Supreme Court decision in *Wayfair* involved a sales tax issue, the economic nexus provision at issue is similar to economic nexus or factor-presence nexus already applicable for income tax purposes.

States may rely on *Wayfair* to expand ability to adopt new provisions for income/franchise tax purposes or enforce existing provisions.

Massachusetts, Pennsylvania and Texas

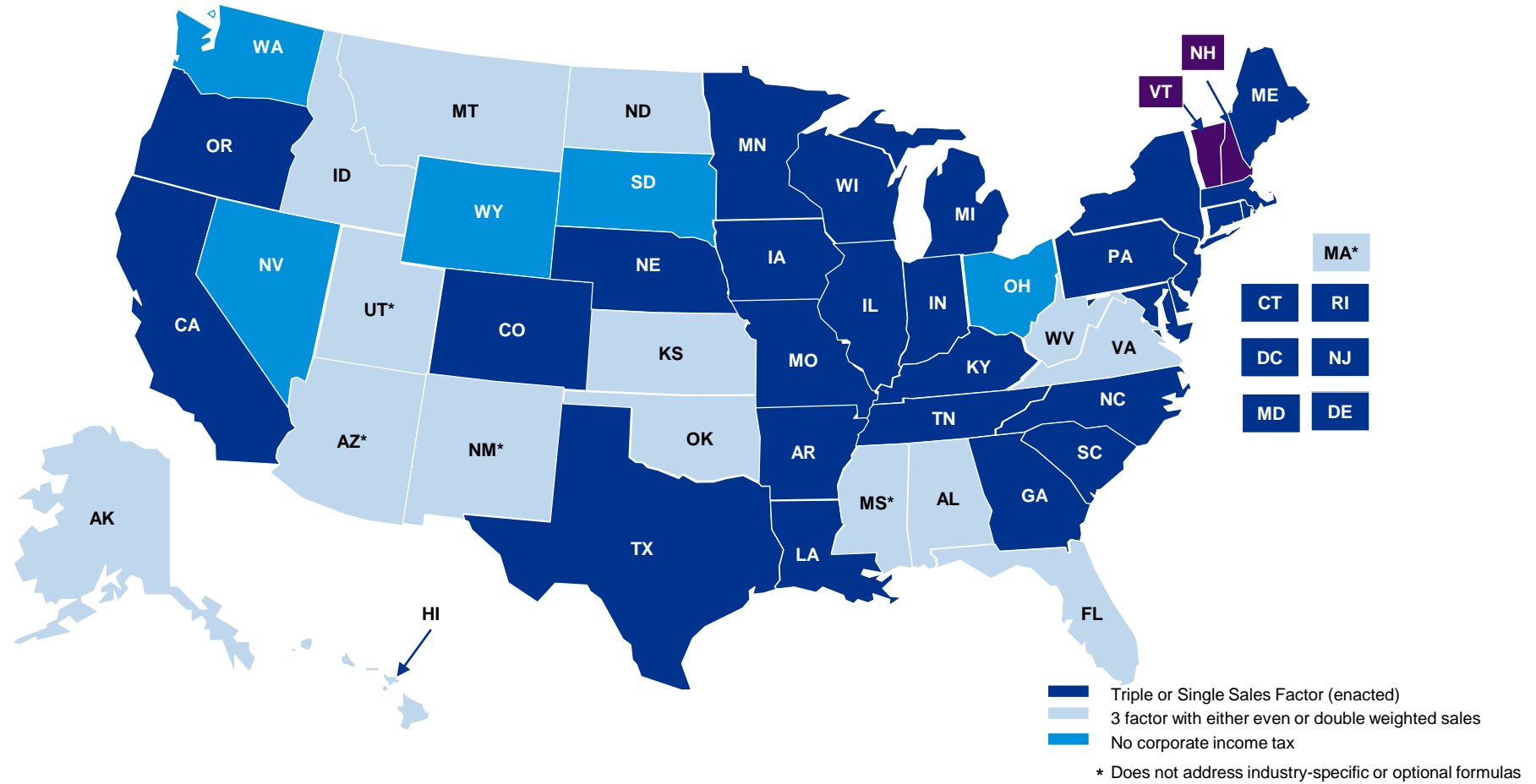
Bright-line nexus – typical provision:

- A business is deemed to have factor-presence nexus if any of the following are satisfied:
 - a. Sales are greater than \$500,000, or more than 25% of total
 - b. Property is greater than \$50,000, or more than 25% of total
 - c. Payroll is greater than \$50,000, or more than 25% of total

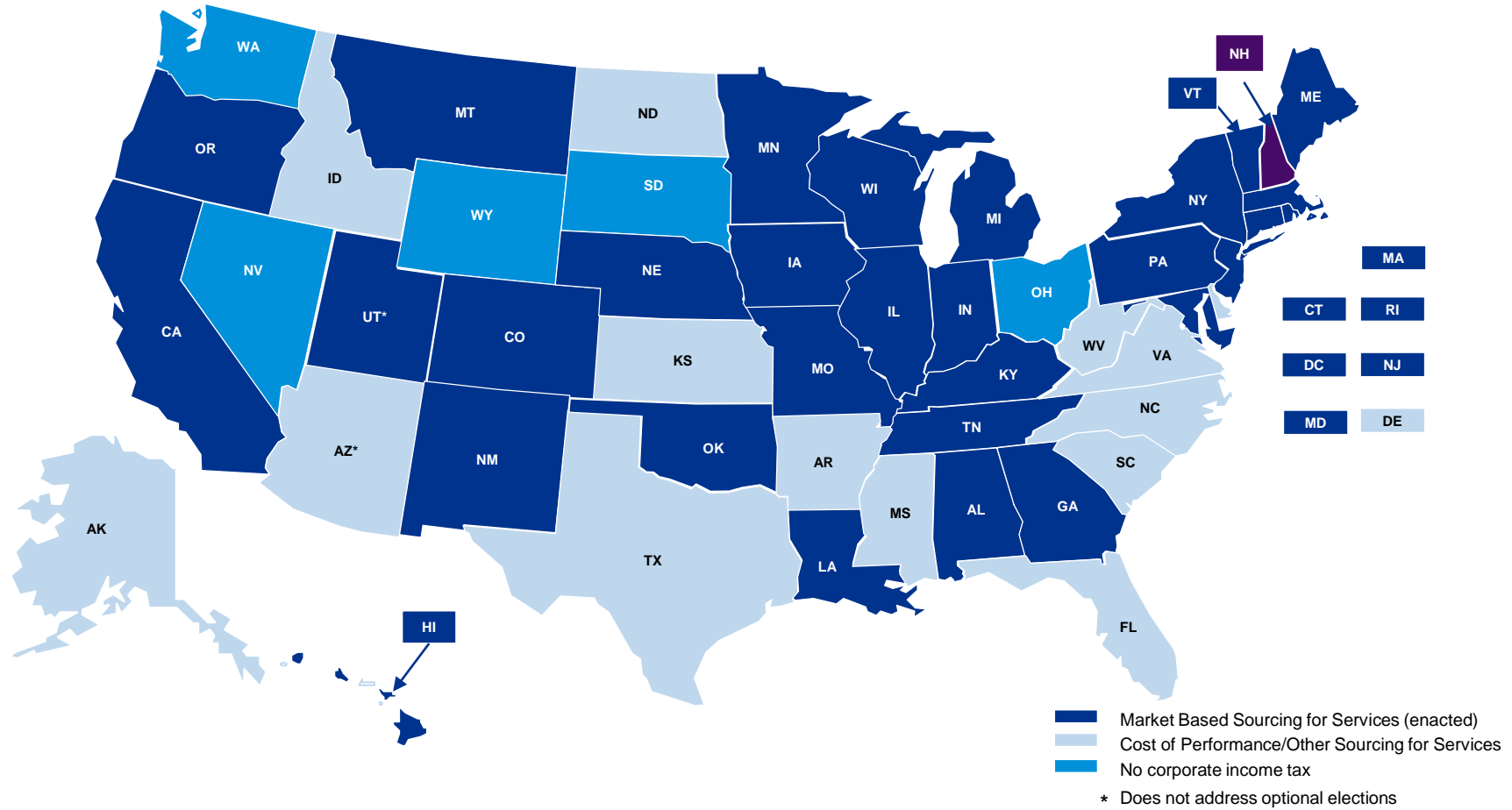


Apportionment updates and economic nexus

Apportionment formulas enacted as of September 30, 2019



Market based sourcing enacted – As of September 10th 2019





New "ish" Pass-Through Entity Taxes ("Workarounds")

Background

A number of states have proposed pass-through entity taxes as a mechanism to bypass the new federal \$10,000 cap on state and local taxes.

The goal is to shift the burden of the tax from the individual to the pass-through entity (or another business/charity) to bypass the new cap.

Connecticut is the first state to make the tax mandatory, beginning with tax years beginning on or after January 1, 2018 (discussion to follow).

Louisiana, Oklahoma and Wisconsin have enacted elective Pass through entity taxes.

Other states, such as Michigan, have adopted or proposed similar workaround programs.

Connecticut PTE tax

Overview of CT Pass-Through Entity Tax

Under the revised law, pass-through entities, including partnerships, LLCs treated as partnerships, and S corporations are required to pay an entity-level tax at the rate of 6.99% on Connecticut-sourced income.

Returns are due on or before the 15th day of the third month following the close of the entity's taxable year (i.e., March 15 for calendar-year taxpayers). Composite returns were due on April 15. The new law provides for various elective provisions, including an election to file on a combined basis with commonly owned entities (using an 80% voting test) as well as a provision to compute the tax base using an alternative basis, which is intended to mitigate the impact on corporate partners. In addition, the new law has specific provisions designed to mitigate the impact on tiered business structures.

Unlike other so-called workaround programs regarding the federal SALT deduction, the new pass-through entity tax is not elective.

Connecticut PTE tax

Revisions to Filing Requirements for Nonresidents

Starting in 2018, nonresident partners of pass-through entities are generally not required to file a Connecticut personal income tax return if (1) their only source of Connecticut income is from a pass-through entity; and (2) the pass-through business has paid the entity tax.

However, a nonresident personal income tax return must be filed if (1) the pass-through entity files a Connecticut return on a combined basis with other pass-through entities; or (2) if a partner's personal income tax would not be entirely satisfied by the credit the partner earns from the business entity.

Connecticut pass-through entities can include guaranteed payments in their 2019 base income [House Bill 7373](#) updated the language of Connecticut's new pass-through entity tax by modifying the calculation of tax due to include "any item described in section 707(c) of the Internal Revenue Code." The bill also provides that entities with a tax liability of less than \$1,000 are exempted from the estimated payment filing requirements. In addition, Connecticut has adjusted the percentage at which a pass-through owner computes a Connecticut tax credit from 93.01 percent to 87.5 percent (see [House Bill 7424](#)). Connecticut has imposed a graduated tax rate on individuals, but previously computed the tax credit at the highest marginal rate. The impact of the credit change can depend on the level of income and the marginal rate that applied to a particular partner. A nonresident partner is not required to file a Connecticut return if such partner does not owe Connecticut tax after this tax credit is applied. While the guaranteed payment change will increase payments by pass-through entities and could mean fewer nonresident partners would need to file, the tax credit rate change could mean certain nonresident partners are now required to file and make estimated payments.

Other state PTE tax enactments

- WI** on December 14th, 2018 the state enacted S.B. 883 implementing an optional PTE at a rate of 7.9%. WI does not offer a partner credit but instead excludes the income from the WI partner's tax base.
- LA** on June 22nd, 2019 the state enacted SB 223 which would create an election for S corporations and partnerships to be taxed at the entity level, and then provide shareholders, partners or members of the entities with a tax exclusion for their portion of the income that would be subject to the tax.
- OK** on April 29th 2019 the state enacted HB 2665 which created the Pass-Through Entity Tax Equity Act of 2019 to allow any entity required to file an Oklahoma partnership income tax return or Oklahoma S corporation income tax return to make an election to pay state income tax attributable to its equity owners on behalf of its equity owners, whether the owner is a natural person, a corporation or another pass-through entity. Any pass-through entity can make the optional election to pay the pass-through tax beginning tax year 2019. Beginning tax year 2020, an electing pass-through entity must make estimated tax payments.
- RI** On July 5th 2019 the state enacted HB 515A which sets a 5.99% levy on pass-through entities, which report their income on owners' personal returns. Pass-through owners would then get a state credit equal to 100% of the owner's share of tax paid by the business.
- MI** HB 4781 potentially may impose an entity-level tax on pass-through entities at a rate of 8.5 percent for 2020 tax years.

Further state/industry trends

Filing and sourcing exposure related to management fee sourcing

CA interested parties meeting

Corporate vs Partnership differences lead to complex reporting

Detection risk

Information requests from underlying investments

Annual analysis of exposure

Geographic & effective tax rate considerations

The significant reduction of the benefit of a federal tax deduction for state and local taxes paid combined with increasing state and local tax rates may spur a discussion on movement of hedge and private equity firms to states with lower tax rates.

Effective Tax Rates (ETR) for Individuals – Before and After Tax Reform			
Resident State	Before tax reform (net of federal benefit @ 39.6%)	After tax reform (no federal benefit after 1/1/18)	Change in ETR
Connecticut	4.22%	6.99%	+ 2.77%
New York State	5.33%	8.82%	+ 3.49%
New Jersey	5.42%	8.97%	+ 3.55%
New York City	7.67%	12.70%	+ 5.03%
California	8.03%	13.3%	+5.27%



Draft 2019 Form 1065 and Schedule K-1

David Kaplan

Draft 2019 Form 1065 and Schedule K-1

- On September 30, the IRS released draft Form 1065 and Schedule K-1 for 2019 returns
 - Updated draft Schedule K-1 released on October 18
 - Another updated draft Schedule K-1 released on November 8
- The drafts are in “near final” form but the IRS has solicited comments which were due within 30 days
- Expectation is to finalize the Form 1065 and Schedule K-1 in December in order to allow compliance software companies to update for the changes ahead of the filing season
- Draft instructions were released for the Form 1065 on October 29 and the draft Schedule K-1 instructions were released the following day

Key changes

- Required use of tax basis capital for the capital account reconciliation on Schedule K-1 for partnerships
- Disclosure of additional information related to section 704(c) amounts of the partnership
- Disclosures on additional information related to section 743(b) basis adjustments and current year income, gain, loss, and deduction
- Guaranteed payments will have to be bifurcated between those for capital and those for services
- Additional information on the existence of multiple activities for at-risk and passive activity purposes

Draft form 1065

Page 1

NEW Check Boxes

- Aggregated activities for section 465 at-risk purposes
- Grouped activities for section 469 passive activity purposes

Form 1065		U.S. Return of Partnership Income		OMB No. 1545-0123
Department of the Treasury Internal Revenue Service		For calendar year 2019, or tax year beginning _____, 2019, ending _____, 20____.		2019
		▶ Go to www.irs.gov/Form1065 for instructions and the latest information.		
A Principal business activity		Name of partnership		D Employer identification number
B Principal product or service	Type or Print	Number, street, and room or suite no. If a P.O. box, see instructions.		E Date business started
C Business code number		City or town, state or province, country, and ZIP or foreign postal code		F Total assets (see instructions) \$
G Check applicable boxes: (1) <input type="checkbox"/> Initial return (2) <input type="checkbox"/> Final return (3) <input type="checkbox"/> Name change (4) <input type="checkbox"/> Address change (5) <input type="checkbox"/> Amended return				
H Check accounting method: (1) <input type="checkbox"/> Cash (2) <input type="checkbox"/> Accrual (3) <input type="checkbox"/> Other (specify) ▶ _____				
I Number of Schedules K-1. Attach one for each person who was a partner at any time during the tax year ▶ _____				
J Check if Schedules C and M-3 are attached ▶ <input type="checkbox"/>				
K Check if partnership: (1) <input type="checkbox"/> Aggregated activities for section 465 at-risk purposes (2) <input type="checkbox"/> Grouped activities for section 469 passive activity purposes				

Draft form 1065 (continued)

Page 3

UPDATE Question 24 – Section 163(j) Question

- Reworded question regarding section 163(j) which will presumably remove filing requirement for partnerships with only investment items.
- Updated gross receipts test from \$25M to \$26M for inflation

24 Does the partnership satisfy one or more of the following? See instructions	
a The partnership owns a pass-through entity with current, or prior year carryover, excess business interest expense.	
b The partnership's aggregate average annual gross receipts (determined under section 448(c)) for the 3 tax years preceding the current tax year are more than \$26 million and the partnership has business interest.	
c The partnership is a tax shelter (see instructions) and the partnership has business interest expense. If "Yes" to any, complete and attach Form 8990.	

REMOVED Partnership Representative EIN/SSN lines

Designation of Partnership Representative (see instructions) Enter below the information for the partnership representative (PR) for the tax year covered by this return.	
Name of PR ▶	
U.S. address of PR ▶	U.S. phone number of PR ▶
If the PR is an entity, name of the designated individual for the PR ▶	
U.S. address of designated individual ▶	U.S. phone number of designated individual ▶

Draft form 1065 (continued)

Page 3

NEW Question 27 – 864(c)(8) Question

— Disclose number of foreign partners subject to section 864(c)(8)

27	Enter the number of foreign partners subject to section 864(c)(8) as a result of transferring all or a portion of an interest in the partnership or of receiving a distribution from the partnership ▶		
-----------	--	--	--

NEW Question 28 – disguised sale

— Check the box if disguised sale disclosure included

28	At any time during the tax year, were there any transfers between the partnership and its partners subject to the disclosure requirements of Regulations section 1.707-8?		
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Draft form 1065 (continued)

Page 4

NEW Guaranteed payment lines

— Breakout of guaranteed payments for services and for capital

Schedule K		Partners' Distributive Share Items		Total amount	
	1	Ordinary business income (loss) (page 1, line 22)		1	
	2	Net rental real estate income (loss) (attach Form 8825)		2	
	3a	Other gross rental income (loss)		3a	
	b	Expenses from other rental activities (attach statement)		3b	
	c	Other net rental income (loss). Subtract line 3b from line 3a		3c	
(Loss)	4	Guaranteed payments: a Services	4a	b Capital	4b
	c	Total. Add lines 4a and 4b		4c	
	5	Interest income		5	

REMOVED GILTI reporting lines

Foreign Transactions	16a	Name of country or U.S. possession ▶				
	b	Gross income from all sources		16b		
	c	Gross income sourced at partner level		16c		
		Foreign gross income sourced at partnership level				
	d	Reserved for future use ▶		e Foreign branch category ▶	16e	
	f	Passive category ▶		g General category ▶	h Other (attach statement) ▶	16h
		Deductions allocated and apportioned at partner level				
	i	Interest expense ▶		j Other ▶	16j	
		Deductions allocated and apportioned at partnership level to foreign source income				
	k	Reserved for future use ▶		l Foreign branch category ▶	16l	
	m	Passive category ▶		n General category ▶	o Other (attach statement) ▶	16o
	p	Total foreign taxes (check one): ▶ Paid <input type="checkbox"/> Accrued <input type="checkbox"/>			16p	
	q	Reduction in taxes available for credit (attach statement)			16q	
	r	Other foreign tax information (attach statement)				

Draft schedule K-1

Item E/Item H2

UPDATE Disregarded Entity Reporting

- Added note that TIN of DRE should not be used (not a new requirement)
- Added DRE checkbox and line to put EIN/Name of beneficial owner

Item J

NEW Check box if decrease from beginning to ending is due to sale/exchange of a partnership interest

Item K

NEW Check box if liabilities reported include amounts from an LTP

Part II Information About the Partner													
E	Partner's SSN or TIN (Do not use TIN of a disregarded entity. See inst.)												
F	Name, address, city, state, and ZIP code for partner entered in E. See instructions.												
G	<input type="checkbox"/> General partner or LLC member-manager <input type="checkbox"/> Limited partner or other LLC member												
H1	<input type="checkbox"/> Domestic partner <input type="checkbox"/> Foreign partner												
H2	<input type="checkbox"/> If the partner is a disregarded entity (DE), enter the partner's: TIN _____ Name _____												
I1	What type of entity is this partner? _____												
I2	If this partner is a retirement plan (IRA/SEP/Keogh/etc.), check here <input type="checkbox"/>												
J	Partner's share of profit, loss, and capital (see instructions):												
	<table border="1"><thead><tr><th></th><th>Beginning</th><th>Ending</th></tr></thead><tbody><tr><td>Profit</td><td>_____ %</td><td>_____ %</td></tr><tr><td>Loss</td><td>_____ %</td><td>_____ %</td></tr><tr><td>Capital</td><td>_____ %</td><td>_____ %</td></tr></tbody></table>		Beginning	Ending	Profit	_____ %	_____ %	Loss	_____ %	_____ %	Capital	_____ %	_____ %
	Beginning	Ending											
Profit	_____ %	_____ %											
Loss	_____ %	_____ %											
Capital	_____ %	_____ %											
	<input type="checkbox"/> Check if decrease is due to sale or exchange of partnership interest												
K	Partner's share of liabilities:												
	<table border="1"><thead><tr><th></th><th>Beginning</th><th>Ending</th></tr></thead><tbody><tr><td>Nonrecourse</td><td>_____ \$</td><td>_____ \$</td></tr><tr><td>Qualified nonrecourse financing</td><td>_____ \$</td><td>_____ \$</td></tr><tr><td>Recourse</td><td>_____ \$</td><td>_____ \$</td></tr></tbody></table>		Beginning	Ending	Nonrecourse	_____ \$	_____ \$	Qualified nonrecourse financing	_____ \$	_____ \$	Recourse	_____ \$	_____ \$
	Beginning	Ending											
Nonrecourse	_____ \$	_____ \$											
Qualified nonrecourse financing	_____ \$	_____ \$											
Recourse	_____ \$	_____ \$											
	<input type="checkbox"/> Check this box if Item K includes liability amounts from lower tier partnerships.												

Draft schedule K-1 (continued)

Item L

UPDATE Capital Account Reporting

— Mandatory reporting of **Tax Basis Capital**

Item N

NEW Section 704(c) Reporting

— Partner's share of net unrecognized section 704(c) gain or (loss)

L Partner's Capital Account Analysis	
	Tax Basis Capital
Beginning capital account	\$ _____
Capital contributed during the year	\$ _____
Current year net income (loss)	\$ _____
Other increase (decrease) (attach explanation)	\$ _____
Withdrawals & distributions	\$ (_____)
Ending capital account	\$ _____

M	Did the partner contribute property with a built-in gain or loss? <input type="checkbox"/> Yes <input type="checkbox"/> No If "Yes," attach statement. See instructions.
----------	--

N Partner's Share of Net Unrecognized Section 704(c) Gain or (Loss)	
Beginning	\$ _____
Ending	\$ _____

Draft schedule K-1 (continued)

Line 4

NEW Guaranteed payment lines

- Breakout of guaranteed payments for services and for capital

Line 21/Line 22

NEW Check boxes for more than one activity for at-risk purposes (section 465) and more than one activity for passive activity purposes (section 469)

- Includes * indicating additional information may be requested

Part III Partner's Share of Current Year Income, Deductions, Credits, and Other Items			
1	Ordinary business income (loss)	15	Credits
2	Net rental real estate income (loss)		
3	Other net rental income (loss)	16	Foreign transactions
4a	Guaranteed payments for services		
4b	Guaranteed payments for capital		
4c	Total guaranteed payments		
21	<input type="checkbox"/> More than one activity for at-risk purposes*		
22	<input type="checkbox"/> More than one activity for passive activity purposes*		
*See attached statement for additional information.			

Draft schedule K-1 (cont'd)

Updates to codes used for Schedule K-1

NEW Line 11F – Section 743(b) positive adjustments

NEW Line 13V – Section 743(b) negative adjustments

UPDATE Line 20Z – Section 199A information

— Removed separate line reporting:

- 20Z – Section 199A income
- 20AA – Section 199A W-2 wages
- 20AB – Section 199A unadjusted basis
- 20AC – Section 199A REIT dividends
- 20AD – Section 199A PTP income

NEW Line 20AA – Section 704(c) information

NEW Line 20AB – Section 751 gain/(loss)

NEW Line 20AC – Section 1(h)(5) gain/(loss)

NEW Line 20AD – Deemed section 1250 unrecaptured gain



What questions
do you have?



Thank you



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