

# **Ethics Update**

## **Allegheny Tax Society**

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**March 24, 2025**

## **Practice Before the IRS**

### **31 U.S. Code § 330**

### **(The Horse Act of 1884)**

31 U.S. Code § 330 (1884) was enacted as part of a War Department appropriation for “horses and other property lost in the military service” (i.e., the Civil War). It authorizes:

- The regulation of the practice of representatives of persons before the Department of the Treasury, including the IRS, and determinations of practitioner “fitness” to practice. (31 U.S.C. §330(a)).
- Types of disciplinary action, to include monetary penalties. (31 U.S.C. §330(b)).
- The regulation of certain appraisers. (31 U.S.C. §330(c)).
- Setting standards for certain written advice. (31 U.S.C. §330(d)).

## **Practice Before the IRS**

### **I.R.M. Section 1.25.1**

According to the IRS, fitness to practice means:

- Good character.
- Good reputation.

# Practice Before the IRS

## I.R.M. Section 1.25.1

- Necessary qualifications to provide valuable service to the client.
- Competency to advise and assist persons in presenting their cases. Internal Revenue Manual (I.R.M.) Section 1.25.1 (July 22, 2024). See *Syed v. Commissioner*, T.C. Memo 2017-226 (November 16, 2017) (Court questions competency of tax preparer CPA due to failure to request log of hours from client to support real estate professional status).

# Practice Before the IRS

## Circular 230

"Practice" before the IRS is defined in Circular 230 §10.2(a)(4) as:

- All matters under laws or regulations administered by the IRS relating to a taxpayer's rights, privileges, or liabilities.
- Examples include preparing, filing, corresponding, communicating, written advice (including emails), advocating/representing, giving appraisals for tax positions.
- Not mere tax return preparation

## **Practice Before the IRS Circular 230**

Examples of practice:

- Representing a client in an audit.
- Representing a client before IRS collections.
- Appearing before IRS Appeals.
- Preparing documents for submission to the IRS.
- Advising clients regarding tax positions.
- Preparing a written opinion (advice to clients regarding transactions).

## **Practice Before the IRS Circular 230**

Who is regulated?

- Attorneys.
- CPAs.
- Enrolled agents.
- Enrolled actuaries.
- Appraisers who submit appraisals supporting tax positions.

## **Practice Before the IRS**

### **Office of Professional Responsibility**

The Office of Professional Responsibility (OPR):

- Administers the laws and regulations governing practice of tax professionals before the IRS.
- Interprets and applies the standards of practice for tax professionals in Circular 230 in a fair and equitable manner.



## **Practice Before the IRS Office of Professional Responsibility**

The Office of Professional Responsibility (OPR):

- Investigates allegations of misconduct by practitioners in their practice before the IRS and imposes discipline sanctions if warranted.
- Supports the IRS' strategy to enhance enforcement of the Code by ensuring tax practitioners adhere to professional standards and follow the law.

## **Specific Activities**

### **Circular 230**

Circular 230 governs practice before the IRS.

Among the activities governed by Circular 230 are tax practice, tax return preparation and rendering tax advice.

## **Specific Activities**

### **Circular 230**

IRS position is that Congress should strengthen IRS authority to regulate tax preparers beyond that of Circular 230.

On March 10, 2025, Rep. Steve Cohen (D-TN) reintroduced the Tax Return Preparer Accountability Act (H.R. 1983), seeking to give the IRS the authority to regulate tax preparers more effectively.

## **Tax Practice**

# **Proposed Circular 230 Amendments**

On December 20, 2024, the IRS proposed several amendments to Circular 230.

Proposed Section 10.27 would establish that charging contingent fees for preparing returns or refund claims constitutes disreputable conduct.

## **Tax Practice**

# **Proposed Circular 230 Amendments**

Proposed Section 10.33 would establish new best practices, including:

- Creating a data security policy and incident response plan.
- Identifying and addressing mental health impairments that could affect client representation.
- Establishing a business continuity and succession plan.

## **Tax Practice**

# **Proposed Circular 230 Amendments**

Proposed Section 10.35 would require an understanding of the benefits and risks associated with relevant technology that is used by the practitioner to provide services to clients or to store and transmit tax return and other confidential information.

## **Tax Practice**

# **Proposed Circular 230 Amendments**

Proposed Section 10.50 would expand the definition of “incompetence” and “disreputable conduct” to include willful failure to follow any federal tax law and would clarify that practitioners can be sanctioned for conduct related to their overall fitness to practice, not just actions taken while representing clients before the IRS.

Practitioners would need to be more vigilant about their personal conduct.

## **Tax Practice**

# **Proposed Circular 230 Amendments**

Proposed Section 10.21 would clarify that the responsibility to disclose errors to clients would include any error or omission that may have been made by either the client or the practitioner or a prior practitioner.

Practitioners have a duty to promptly inform client of any error or omission and advise client regarding consequences under the Code and regulations.



# **Due Diligence**

## **Circular 230 Section 10.21**

Practitioners must exercise due diligence in:

- Preparing, approving, and/or filing returns, documents, affidavits, etc. relating to IRS matters.
- Determining correctness of oral/written representations made to the client or IRS personnel.
- Avoiding willful blindness.
- Reliance on another's work product. Standard is reasonable care.

# **AICPA Statements on Standards for Tax Services**

## **SSTS No. 3.1 Tax Consulting**

A member should use professional judgment and be competent to take on a consulting engagement.

A member may communicate tax advice orally or in writing.

# **AICPA Statements on Standards for Tax Services**

## **SSTS No. 3.1 Tax Consulting**

Notwithstanding the foregoing, a member may take a position that has a reasonable basis and is adequately disclosed or is supported by substantial authority.

A member should exercise due diligence and professional judgment when advising on tax positions for a particular situation, but a member also has a right to be an advocate.

# **AICPA Statements on Standards for Tax Services**

## **SSTS No. 1.1 Advising on Tax Positions**

A member may consider a well-reasoned construction of the applicable statute and related regulations of that jurisdiction, if any.

In addition, well-reasoned articles, treatises, or guidance issued by the applicable taxing authority (regardless of whether such sources would be treated as authority under Section 6662) and the regulations thereunder may also be considered.

# **AICPA Statements on Standards for Tax Services**

## **SSTS No. 1.1 Advising on Tax Positions**

Reasonable basis is defined in Regulation Section 1.6662-3(b)(3) as a “a relatively high standard of tax reporting, that is, significantly higher than not frivolous or not patently improper.”

The reasonable basis standard is not satisfied by a return position that is merely arguable or that is merely a colorable claim.

## **AICPA Statements on Standards for Tax Services SSTS No. 1.1 Advising on Tax Positions**

A tax position is reasonably based if based on one or more of the authorities set forth in Regulation Section 1.6662-4(d)(3)(iii).

Examples include Internal Revenue Code, regulations (proposed, temporary, and final), revenue rulings and revenue procedures, tax treaties, case law, PLRs, TAMs, AODs, GCMs, IRS notices, announcements and other administrative pronouncements.

Conclusions reached in treatises, legal periodicals, legal opinions or opinions rendered by tax professionals are not authority.

# **AICPA Statements on Standards for Tax Services**

## **SSTS No. 1.1 Advising on Tax Positions**

These also give rise to substantial authority under Regulation Section 1.6662-4(d)(3)(i) if the weight of the authorities supporting the treatment is substantial in relation to the weight of authorities supporting contrary treatment.

## **Preparer Penalties**

### **Internal Revenue Code and Regulations**

Section 7701(a)(36) defines “tax return preparer ” as “any person who prepares for compensation, or who employs one or more persons to prepare for compensation,” any tax return or any claim for refund of tax.

Regulation Section 301.7701-15(b) defines the term to include “signing tax return preparers” and “nonsigning tax return preparers.”



## Preparer Penalties

### Internal Revenue Code and Regulations

A signing tax return preparer is the individual tax return preparer who has the primary responsibility for the overall substantive accuracy of the preparation of such return or claim for refund.”

A nonsigning tax return preparer is any tax return preparer who is not a signing tax return preparer but who prepares all or a substantial portion of a return or claim for refund...with respect to events that have occurred at the time the advice is rendered.”

## Preparer Penalties

### Internal Revenue Code and Regulations

Regulation Section 301.7701-15(b)(2)(i) says that advisors who provide advice to a taxpayer or another tax return preparer are nonsignors if the advice results in a position that forms a substantial portion of the return in question.

This is important for purposes of the preparer penalty rules. Section 6694 imposes preparer penalties. *United States v. Zak*, 2020-1 U.S.T.C. ¶50,106 (N.D. Ga. December 10, 2019).

# Preparer Penalties

## AICPA Statements on Standards for Tax Services

### **SSTS No. 3.1 Tax Consulting**

When communicating tax advice in writing, a member should comply with relevant taxing authorities' standards, if any, applicable to written tax advice.

A member should assume that tax advice provided to a taxpayer will affect the manner in which the matters or transactions considered would be reported or disclosed on the taxpayer's tax returns.

## **Revenue Procedure 2024-44 Form 8275**

In Revenue Procedure 2024-44, I.R.B. 2024-52 (December 23, 2024), the IRS indicated that will be more heavily scrutinizing Form 8275 disclosure.

Form 8275 can be used to avoid taxpayer and preparer penalties.

Certain penalties can be avoided if a tax position has a reasonable basis, as long as it is adequately disclosed, or the tax position is supported by substantial authority.

Many items are adequately disclosed by merely placing them on the appropriate line item. Those are listed in the revenue procedure.

# Revenue Procedure 2024-44

## Form 8275

If buried in other deductions, then the specific item must be adequately described in an attachment or statement.

If there is a potential controversy regarding an item, then the return must disclose sufficient information to reasonably apprise the Service of the potential controversy concerning the tax treatment of the items. Form 8275 serves this purpose well.

Form 8275 will be ineffective unless the taxpayer has reasonable basis for the tax position.

**Tax Return Questions**

**AICPA Statements on Standards for Tax  
Services**

**SSTS Nos. 2.2 and 2.3**

Before signing as preparer, a member should take reasonable steps to obtain from the taxpayer the information necessary to provide appropriate answers to all required questions on a tax return.

## Tax Return Questions

Form 1065 (2024) Page 3

Schedule B Other Information (continued)	Yes	No
<b>c</b> For this tax year, did the partnership make an optional basis adjustment under section 734(b)? If "Yes," enter the total aggregate net positive amount \$ _____ and the total aggregate net negative amount \$ ( _____) of such section 734(b) adjustments for all partnership property made in the tax year. The partnership must also attach a statement showing the computation and allocation of each basis adjustment. See instructions . . . . .		
<b>d</b> For this tax year, is the partnership required to adjust the basis of partnership property under section 743(b) or 734(b) because of a substantial built-in loss (as defined under section 743(d)) or substantial basis reduction (as defined under section 734(d))? If "Yes," enter the total aggregate amount of such section 743(b) adjustments and/or section 734(b) adjustments for all partners and/or partnership property made in the tax year \$ _____. The partnership must also attach a statement showing the computation and allocation of the basis adjustment. See instructions . . . . .		
<b>11</b> Check this box if, during the current or prior tax year, the partnership distributed any property received in a like-kind exchange or contributed such property to another entity (other than disregarded entities wholly owned by the partnership throughout the tax year) . . . . . <input type="checkbox"/>		
<b>12</b> At any time during the tax year, did the partnership distribute to any partner a tenancy-in-common or other undivided interest in partnership property? . . . . . <input type="checkbox"/>		
<b>13</b> If the partnership is required to file Form 8858, Information Return of U.S. Persons With Respect to Foreign Disregarded Entities (FDEs) and Foreign Branches (FBs), enter the number of Forms 8858 attached. See instructions . . . . .		
<b>14</b> Does the partnership have any foreign partners? If "Yes," enter the number of Forms 8805, Foreign Partner's Information Statement of Section 1446 Withholding Tax, filed for this partnership . . . . .		
<b>15</b> Enter the number of Forms 8865, Return of U.S. Persons With Respect to Certain Foreign Partnerships, attached to this return . . . . .		
<b>16a</b> Did you make any payments in 2024 that would require you to file Form(s) 1099? See instructions . . . . .		
<b>b</b> If "Yes," did you or will you file required Form(s) 1099? . . . . .		
<b>17</b> Enter the number of Forms 5471, Information Return of U.S. Persons With Respect to Certain Foreign Corporations, attached to this return . . . . .		
<b>18</b> Enter the number of partners that are foreign governments under section 892 . . . . .		
<b>19</b> During the partnership's tax year, did the partnership make any payments that would require it to file Forms 1042 and 1042-S under chapter 3 (sections 1441 through 1464) or chapter 4 (sections 1471 through 1474)? . . . . .		
<b>20</b> Was the partnership a specified domestic entity required to file Form 8938 for the tax year? See the Instructions for Form 8938 . . . . .		
<b>21</b> Is the partnership a section 721(c) partnership, as defined in Regulations section 1.721(c)-1(b)(14)? . . . . .		
<b>22</b> During the tax year, did the partnership pay or accrue any interest or royalty for which one or more partners are not allowed a deduction under section 267A? See instructions . . . . .		
If "Yes," enter the total amount of the disallowed deductions \$ _____		
<b>23</b> Did the partnership have an election under section 163(j) for any real property trade or business or any farming business in effect during the tax year? See instructions . . . . .		
<b>24</b> Does the partnership satisfy one or more of the following? See instructions . . . . .		
<b>a</b> The partnership owns a pass-through entity with current, or prior year carryover, excess business interest expense.		
<b>b</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 \$30 million and the partnership has business interest expense.		
<b>c</b> The partnership is a tax shelter (see instructions) and the partnership has business interest expense.		
If "Yes" to any, complete and attach Form 8990 . . . . .		
<b>25</b> Is the partnership attaching Form 8996 to certify as a Qualified Opportunity Fund? . . . . .		
If "Yes," enter the amount from Form 8996, line 15 \$ _____		
<b>26</b> 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 . . . . .		
Complete Schedule K-3 (Form 1065), Part XIII, for each foreign partner subject to section 864(c)(8) on a transfer or distribution.		
<b>27</b> 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? . . . . .		
<b>28</b> Since December 22, 2017, did a foreign corporation directly or indirectly acquire substantially all of the properties constituting a trade or business of your partnership, and was the ownership percentage (by vote or value) for purposes of section 7874 greater than 50% (for example, the partners held more than 50% of the stock of the foreign corporation)? If "Yes," list the ownership percentage by vote and by value. See instructions.		
Percentage: By vote: _____ By value: _____		
<b>29</b> Is the partnership required to file Form 7208, Excise Tax on Repurchase of Corporate Stock (see instructions):		
<b>a</b> Under the applicable foreign corporation rules? . . . . .		

Form 1065 (2024)

## Tax Return Questions

651123  
OMB No. 1545-0123

Final K-1     Amended K-1

**Schedule K-1 (Form 1065) 2024**

Department of the Treasury  
Internal Revenue Service

For calendar year 2024, or tax year beginning      /      / 2024 ending      /      /     

**Partner's Share of Income, Deductions, Credits, etc.** See separate instructions.

Part I Information About the Partnership		Part III Partner's Share of Current Year Income, Deductions, Credits, and Other Items																																																															
<p><b>A</b> Partnership's employer identification number</p> <p><b>B</b> Partnership's name, address, city, state, and ZIP code</p> <p><b>C</b> IRS center where partnership filed return:</p> <p><b>D</b> <input type="checkbox"/> Check if this is a publicly traded partnership (PTP)</p> <p><b>Part II Information About the Partner</b></p> <p><b>E</b> Partner's SSN or TIN (Do not use TIN of a disregarded entity. See instructions.)</p> <p><b>F</b> Name, address, city, state, and ZIP code for partner entered in E. See instructions.</p> <p><b>G</b> <input type="checkbox"/> General partner or LLC member-manager    <input type="checkbox"/> Limited partner or other LLC member</p> <p><b>H1</b> <input type="checkbox"/> Domestic partner    <input type="checkbox"/> Foreign partner</p> <p><b>H2</b> <input type="checkbox"/> If the partner is a disregarded entity (DE), enter the partner's: TIN <u>          </u> Name <u>          </u></p> <p><b>I1</b> What type of entity is this partner?</p> <p><b>I2</b> If this partner is a retirement plan (IRA/SEP/Keogh/etc.), check here <input type="checkbox"/></p> <p><b>J</b> Partner's share of profit, loss, and capital (see instructions):</p> <table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 20%;"></td> <td style="width: 15%; text-align: center;">Beginning</td> <td style="width: 15%;"></td> <td style="width: 15%; text-align: center;">Ending</td> <td style="width: 15%;"></td> <td style="width: 10%;"></td> </tr> <tr> <td>Profit</td> <td style="text-align: center;">%</td> <td style="border-bottom: 1px solid black;"></td> <td style="text-align: center;">%</td> <td style="border-bottom: 1px solid black;"></td> <td style="text-align: center;">%</td> </tr> <tr> <td>Loss</td> <td style="text-align: center;">%</td> <td style="border-bottom: 1px solid black;"></td> <td style="text-align: center;">%</td> <td style="border-bottom: 1px solid black;"></td> <td style="text-align: center;">%</td> </tr> <tr> <td>Capital</td> <td style="text-align: center;">%</td> <td style="border-bottom: 1px solid black;"></td> <td style="text-align: center;">%</td> <td style="border-bottom: 1px solid black;"></td> <td style="text-align: center;">%</td> </tr> </table> <p>Check if decrease is due to: <input type="checkbox"/> Sale or <input type="checkbox"/> Exchange of partnership interest. See instructions.</p> <p><b>K1</b> Partner's share of liabilities:</p> <table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 20%;"></td> <td style="width: 15%; text-align: center;">Beginning</td> <td style="width: 15%;"></td> <td style="width: 15%; text-align: center;">Ending</td> <td style="width: 15%;"></td> <td style="width: 10%;"></td> </tr> <tr> <td>Nonrecourse</td> <td style="text-align: center;">\$</td> <td style="border-bottom: 1px solid black;"></td> <td style="text-align: center;">\$</td> <td style="border-bottom: 1px solid black;"></td> <td style="text-align: center;">\$</td> </tr> <tr> <td>Qualified nonrecourse</td> <td style="text-align: center;">\$</td> <td style="border-bottom: 1px solid black;"></td> <td style="text-align: center;">\$</td> <td style="border-bottom: 1px solid black;"></td> <td style="text-align: center;">\$</td> </tr> <tr> <td>Recourse</td> <td style="text-align: center;">\$</td> <td style="border-bottom: 1px solid black;"></td> <td style="text-align: center;">\$</td> <td style="border-bottom: 1px solid black;"></td> <td style="text-align: center;">\$</td> </tr> </table> <p><b>K2</b> Check this box if item K1 includes liability amounts from lower-tier partnerships <input type="checkbox"/></p> <p><b>K3</b> Check if any of the above liability is subject to guarantee or other payment obligations by the partner. See instructions. <input type="checkbox"/></p> <p><b>L</b> Partner's Capital Account Analysis</p> <table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 50%;">Beginning capital account</td> <td style="width: 50%; text-align: right;">\$</td> </tr> <tr> <td>Capital contributed during the year</td> <td style="text-align: right;">\$</td> </tr> <tr> <td>Current year net income (loss)</td> <td style="text-align: right;">\$</td> </tr> <tr> <td>Other increases (decreases) (attach explanation)</td> <td style="text-align: right;">\$</td> </tr> <tr> <td>Withdrawals and distributions</td> <td style="text-align: right;">\$</td> </tr> <tr> <td>Ending capital account</td> <td style="text-align: right;">\$</td> </tr> </table> <p><b>M</b> Did the partner contribute property with a built-in gain (loss)? <input type="checkbox"/> Yes    <input type="checkbox"/> No    If "Yes," attach statement. See instructions.</p> <p><b>N</b> Partner's Share of Net Unrecognized Section 704(c) Gain or (Loss)</p> <table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 50%;">Beginning</td> <td style="width: 50%; text-align: right;">\$</td> </tr> <tr> <td>Ending</td> <td style="text-align: right;">\$</td> </tr> </table>		Beginning		Ending			Profit	%		%		%	Loss	%		%		%	Capital	%		%		%		Beginning		Ending			Nonrecourse	\$		\$		\$	Qualified nonrecourse	\$		\$		\$	Recourse	\$		\$		\$	Beginning capital account	\$	Capital contributed during the year	\$	Current year net income (loss)	\$	Other increases (decreases) (attach explanation)	\$	Withdrawals and distributions	\$	Ending capital account	\$	Beginning	\$	Ending	\$	<p><b>1</b> Ordinary business income (loss)</p> <p><b>2</b> Net rental real estate income (loss)</p> <p><b>3</b> Other net rental income (loss)</p> <p><b>4a</b> Guaranteed payments for services</p> <p><b>4b</b> Guaranteed payments for capital</p> <p><b>4c</b> Total guaranteed payments</p> <p><b>5</b> Interest income</p> <p><b>6a</b> Ordinary dividends</p> <p><b>6b</b> Qualified dividends</p> <p><b>6c</b> Dividend equivalents</p> <p><b>7</b> Royalties</p> <p><b>8</b> Net short-term capital gain (loss)</p> <p><b>9a</b> Net long-term capital gain (loss)</p> <p><b>9b</b> Collectible (28%) gain (loss)</p> <p><b>9c</b> Unrecaptured section 1250 gain</p> <p><b>10</b> Net section 1231 gain (loss)</p> <p><b>11</b> Other income (loss)</p> <p><b>12</b> Section 179 deduction</p> <p><b>13</b> Other deductions</p> <p><b>14</b> Self-employment earnings (loss)</p> <p><b>15</b> Credits</p> <p><b>16</b> Schedule K-3 is attached if checked <input type="checkbox"/> Alternative minimum tax (AMT) form</p> <p><b>17</b> Tax-exempt income and nondeductible expenses</p> <p><b>19</b> Distributions</p> <p><b>20</b> Other information</p> <p><b>21</b> Foreign taxes paid or accrued</p> <p><b>22</b> <input type="checkbox"/> More than one activity for at-risk purposes? <input type="checkbox"/> More than one activity for passive activity purposes? *See attached statement for additional information.</p>
	Beginning		Ending																																																														
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For IRS Use Only

For Paperwork Reduction Act Notice, see the Instructions for Form 1065.    www.irs.gov/Form1065    Cat. No. 11394R    Schedule K-1 (Form 1065) 2024



## **News Release 2024-276 IRS Focus - Partnerships**

### **COMPETENCY IS THE ISSUE!**

On October 22, 2024, the IRS issued **News Release 2024-276 (October 22, 2024)**, in which it indicated that it has launched a specialized unit focusing on large and complex pass-through entities.

This signals a step toward the goal of **increasing audit rates** and stopping large **partnerships** from using pass-throughs to avoid paying taxes.

## News Release 2024-276 IRS Focus - Partnerships

The IRS announced the *launch of the pass-through field operations unit* under its Large Business and International (LB&I) division a little over a year after it declared a "sweeping, historic effort to restore fairness in tax compliance."

# ALL THIS GOES TO COMPETENCY!

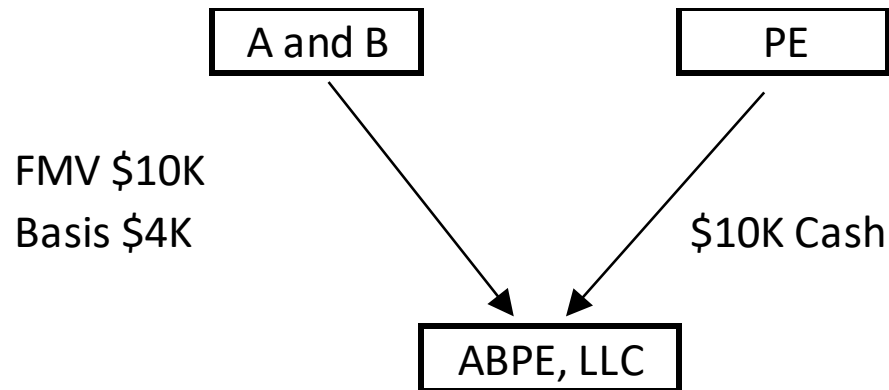
## News Release 2024-276 IRS Focus - Partnerships

The IRS continues to be concerned with improper application of Section 704(c). It is simply missed in very common fact patterns, such as the admission of a new partner.

As an example, suppose A and B are 50/50 members of AB, LLC, which is struggling. Bank denies loan. AB needs cash. PE buys in for \$10K cash. Ownership now A25%, B25%, and PE 50%.

	A/B	PE
FMV	\$10K	\$10K
Basis	4K	10K
704(c) exposure	<u>\$6K</u>	<u>\$-0-</u>

## News Release 2024-276 IRS Focus - Partnerships



If assets sold for \$10K, all gain allocated to A and B.

A's tax capital is \$2K. 704(b) capital is \$5K. 704(c) = \$3K.

B's tax capital is \$2K. 704(b) capital is \$5K. 704(c) = \$3K.

PE's tax capital is \$10K. 704(b) capital is \$10K.

## News Release 2024-276 IRS Focus - Partnerships

651123  
OMB No. 1545-0123

**Schedule K-1**  
**(Form 1065)** 2024

Department of the Treasury  
Internal Revenue Service

For calendar year 2024, or tax year beginning  /  /  2024 ending  /  /

**Partner's Share of Income, Deductions, Credits, etc.**  
See separate instructions.

**Part I Information About the Partnership**

**A** Partnership's employer identification number

**B** Partnership's name, address, city, state, and ZIP code

**C** IRS center where partnership filed return:

**D**  Check if this is a publicly traded partnership (PTP)

**Part II Information About the Partner**

**E** Partner's SSN or TIN (Do not use TIN of a disregarded entity. See instructions.)

**F** Name, address, city, state, and ZIP code for partner entered in E. See instructions.

**G**  General partner or LLC member-manager  Limited partner or other LLC member

**H1**  Domestic partner  Foreign partner

**H2**  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 (RRA/SEP/Keogh/etc.), check here

**J** Partner's share of profit, loss, and capital (see instructions):

	Beginning	Ending
Profit	%	%
Loss	%	%
Capital	%	%

Check if decrease is due to:  
 Sale or  Exchange of partnership interest. See instructions.

**K1** Partner's share of liabilities:

	Beginning	Ending
Nonrecourse	\$	\$
Qualified nonrecourse		
franchise	\$	\$
Recourse	\$	\$

**K2** Check this box if item K1 includes liability amounts from lower-tier partnerships

**K3** Check if any of the above liability is subject to guarantees or other payment obligations by the partner. See instructions

**L** Partner's Capital Account Analysis

Beginning capital account	\$
Capital contributed during the year	\$
Current year net income (loss)	\$
Other increases (decreases) (attach explanation)	\$
Withdrawals and distributions	\$(
Ending capital account	\$

**M** Did the partner contribute property with a built-in gain (loss)?  
 Yes  No. If "Yes," attach statement. See instructions.

**N** Partner's Share of Net Unrecognized Section 704(c) Gain or (Loss)

Beginning	\$
Ending	\$

**Part III Partner's Share of Current Year Income, Deductions, Credits, and Other Items**

<b>1</b> Ordinary business income (loss)	<b>14</b> Self-employment earnings (loss)
<b>2</b> Net rental real estate income (loss)	
<b>3</b> Other net rental income (loss)	<b>15</b> Credits
<b>4a</b> Guaranteed payments for services	
<b>4b</b> Guaranteed payments for capital	<b>16</b> (Schedule K-3 is attached if checked <input type="checkbox"/> )
<b>4c</b> Total guaranteed payments	<b>17</b> Alternative minimum tax (AMT) items
<b>5</b> Interest income	
<b>6a</b> Ordinary dividends	
<b>6b</b> Qualified dividends	<b>18</b> Tax-exempt income and nondeductible expenses
<b>6c</b> Dividend equivalents	
<b>7</b> Royalties	
<b>8</b> Net short-term capital gain (loss)	<b>19</b> Distributions
<b>8a</b> Net long-term capital gain (loss)	
<b>8b</b> Collectibles (28%) gain (loss)	<b>20</b> Other information
<b>9c</b> Unrecaptured section 1250 gain	
<b>10</b> Net section 1231 gain (loss)	
<b>11</b> Other income (loss)	
<b>12</b> Section 179 deduction	<b>21</b> Foreign taxes paid or accrued
<b>13</b> Other deductions	
<b>22</b> <input type="checkbox"/> More than one activity for at-risk purposes?	*See attached statement for additional information.
<b>23</b> <input type="checkbox"/> More than one activity for passive activity purposes?	

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## **News Release 2024-276** **IRS Focus - Partnerships**

Let's continue. Same facts, except:

AB property has a 10-year useful life for 704(b) and tax purposes. FMV \$10K ATB \$4K.

The equipment will be depreciated on a S/L basis.

Ordinary income from operations, excluding depreciation, is \$700.

Objective under Section 704(c) is to “protect” PE. If assets are sold, that is easy. But let's suppose assets are retained and not sold. We protect PE via depreciation and/or gain/loss on disposition of assets.

## **News Release 2024-276 IRS Focus - Partnerships**

Three ways to protect PE:

- Traditional.
- Curative.
- Remedial.

The traditional method is burdened with the so-called “ceiling rule.”

**PREPARER NEEDS TO BE COMPETENT!! WHAT  
DOES THE PARTNERSHIP/OPERATING  
AGREEMENT REQUIRE?**

## News Release 2024-276

### IRS Focus - Partnerships

	A/B Capital 704(b)	A/B Capital Tax	PE Capital 704(b)	PE Capital Tax	Equipment 704(b)	Equipment Tax	Equipment BIG
Contribution	10,000	4,000	10,000	10,000	10,000	4,000	6,000
Depreciation	(500)	-	(500)	(400)	(1,000)	(400)	(600)
Subtotal	9,500	4,000	9,500	9,600	9,000	3,600	5,400
Taxable Income	350	350	350	350	-	-	-
End of Year	9,850	4,350	9,850	9,950	9,000	3,600	5,400



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The ceiling rule limits the “protection” to the depreciation that is reflected on Form 1065 (\$400).

But we want to protect PE by getting PE a depreciation allocation equal to at least its 704(b) depreciation allocation (\$500).

The curative method solves this problem by special allocation of other ordinary income (i.e., from operations).

## News Release 2024-276

### IRS Focus - Partnerships

	A/B Capital 704(b)	A/B Capital Tax	PE Capital 704(b)	PE Capital Tax	Equipment 704(b)	Equipment Tax	Equipment BIG
Contribution	10,000	4,000	10,000	10,000	10,000	4,000	6,000
Depreciation	(500)	-	(500)	(400)	(1,000)	(400)	(600)
Subtotal	9,500	4,000	9,500	9,600	9,000	3,600	5,400
Taxable Income	350	350	350	350	-	-	-
Curative Allocation	-	100	-	(100)	-	-	-
End of Year	9,850	4,450	9,850	9,850	9,000	3,600	5,400
<b>K-1 Line 1 will show</b>		<b>450</b>		<b>(150)</b>			
<b>A's K-1</b>		<b>225</b>				<b>A's Box N</b>	<b>2,700</b>
<b>B's K-1</b>		<b>225</b>				<b>B's Box N</b>	<b>2,700</b>

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### **IRS Focus – Partnerships**

Same facts, except the property is land with a tax basis of \$10,000 and a FMV of \$50,000 when PE buys a 50% interest for \$50K.

If the LLC were to sell the land for \$50,000, the entire taxable gain would be allocated to A and B under Section 704(c), as we have seen.

## News Release 2024-276 IRS Focus – Partnerships

	Sales Price	Basis	Gain/Loss A and B	Gain/Loss PE
Tax	50,000	10,000	40,000	-
704(b)	50,000	50,000	-	-

## News Release 2024-276

### IRS Focus - Partnerships

Suppose the land were sold for \$100K.

	<u>Sales Price</u>	<u>Basis</u>	<u>Gain/Loss A and B</u>	<u>Gain/Loss PE</u>
Tax	100,000	10,000	65,000	25,000
704(b)	100,000	50,000	25,000	25,000

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**IRS Focus - Partnerships**

Suppose the land were sold for \$30K. Using the traditional method:

	<u>Sales Price</u>	<u>Basis</u>	<u>Gain/Loss A and B</u>	<u>Gain/Loss PE</u>
Tax	30,000	10,000	20,000	-
704(b)	30,000	50,000	(10,000)	(10,000)

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**IRS Focus - Partnerships**

Suppose the land were sold for \$30K. Using the curative or remedial method:

	<u>Sales Price</u>	<u>Basis</u>	<u>Gain/Loss A and B</u>	<u>Gain/Loss PE</u>
Tax	30,000	10,000	30,000	(10,000)
704(b)	30,000	50,000	(10,000)	(10,000)



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**IRS Focus - Partnerships**  
**Allocation of Recourse Liabilities**

**Recourse liabilities.** Recourse to the extent that any member or related person bears the economic risk of loss.

**READ THE LOAN DOCS!!!**

***IS THE 1065 PREPARER ALSO A  
NONSIGNING PREPARER OF THE  
PARTNER'S 1040?***





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# **News Release 2024-276**

## **IRS Focus - Partnerships**

### **Allocation of Recourse Liabilities**

**Constructive liquidation determines the risk of loss.**

- All liabilities become payable in full;
- All assets, including cash, have a value of zero;
- All of its property disposed of for liabilities;
- All items of income, gain, loss, or deduction are allocated among the members; and
- The LLC liquidates

## News Release 2024-276

### IRS Focus - Partnerships

### Allocation of Recourse Liabilities

Generally, a facts-and-circumstances inquiry including all the following statutory and contractual obligations:

- ✓ Contractual obligations outside the LLC agreement, such as **guarantees**, indemnifications, reimbursement agreements, and other obligations running directly to creditors or to other members.
- ✓ Obligations to the LLC imposed by the LLC agreement, including the obligation to make a capital contribution and to restore a deficit capital account.

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**IRS Focus - Partnerships**  
**Allocation of Recourse Liabilities**

- Private contractual agreements.
- Partnership or operating agreement.
- **Applicable state law.**
- Payment obligations imposed by state law.



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### **IRS Focus - Partnerships**

### **Allocation of Recourse Liabilities**

#### **Recourse Liability** Example.

X and Y form an equal 50/50 partnership, each contributing \$80K in cash.

The partnership purchases a building for \$400K, executing a \$240K note and using the \$160K cash for the balance.



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### **IRS Focus - Partnerships**

### **Allocation of Recourse Liabilities**

The partnership agreement allocates 80% of the losses to X, and includes all the 704(b) language with a deficit restoration obligation.

Hypo liquidation every year (assets sold for \$-0-; liabilities due).



# **News Release 2024-276**

## **IRS Focus - Partnerships**

### **Allocation of Recourse Liabilities**

	X	Y
Contribution	80,000	80,000
Loss	<u>(320,000)</u>	<u>(80,000)</u>
Capital Account	<u><u>(240,000)</u></u>	<u><u>-</u></u>