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New Draft Instructions Provide Insight Into NII Tax Reporting

by **Matthew R. Madara**



Summary by **taxanalysts**


The IRS on January 3 released draft instructions for the tax year 2013 Form 1065, "U.S. Return of Partnership Income," that detail the information that partnerships must provide partners to allow them to correctly calculate net investment income tax.

Full Text Published by **taxanalysts**

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Aaron P. Nocjar of Steptoe & Johnson LLP welcomed the release of the draft instructions, although he said they provide only "a glimpse of the expected increased administrative burden placed on tax partnerships, S corporations, and trusts by the enactment of section 1411."

The IRS in November published final (T.D. 9644 ) and newly proposed (REG-130843-13 ) regulations under section 1411 on the 3.8 percent tax on some NII of individuals, estates, and trusts that have income above the statutory threshold amounts.

David Kirk, branch 2 attorney, IRS Office of Associate Chief Counsel (Passthroughs and Special Industries), one of the principal authors of the section 1411 regulations, had encouraged taxpayers to provide the IRS feedback on the draft instructions. (Prior coverage )

Significant Reporting Requirements

Steven R. Schneider of Goulston & Storrs PC did not find anything surprising in the draft instructions but noted that they "serve as a reminder of the type of detail that may need to be shown on the Form 1065."

According to the draft instructions, taxpayers will report information regarding the NII tax using Code Y in Box 20 on Schedule K-1. Examples of items that may be reported using Code Y include rental real estate income, gains and losses from dispositions of assets attributable to a section 212 for-profit activity, and gain reported on the basis in an installment sale.

Schneider said the draft instructions provide a "helpful breakout of detail that may need to be provided" to partners. "There is quite a bit of detailed reporting that the partnership may need" to provide partners, he added.

According to Schneider, the reporting requirements in the draft instructions demonstrate how complicated the section 1411 rules are and how costly they will be to administer. Tracking the data that partnerships must provide partners will increase the cost of preparing returns, he said.

Thomas J. Nichols of Meissner Tierney Fisher & Nichols SC said the partnership reporting obligations in the draft

instructions are based on the November proposed regulations, which are only effective for tax years beginning after December 31, 2013. (One exception is for charitable remainder trusts, whose ability to elect to track NII using a simplified method or the section 664 method under prop. reg. section 1.1411-3(d)(3) are effective for tax years beginning after December 31, 2012.)

"The rules for calculating the net investment tax upon disposition of passthrough entity interests are still in flux," Nichols said, adding that Treasury "dramatically changed . . . the exclusion calculation for these transactions." The IRS "may well want to wait and see how these rules will finally shape up before issuing definitive instructions and forms," he said.

More Forms and Instructions Expected

Nocjar noted that the Form 1065 draft instructions were just the beginning of the draft section 1411 instructions the IRS must release.

The IRS expects to release more forms and instructions concerning section 1411, including Form 1120S, "U.S. Income Tax Return for an S Corporation," and Form 1041, "U.S. Income Tax Return for Estates and Trusts." (Prior coverage [here](#).)

According to Nocjar, practitioners also are still waiting for the draft instructions to the section 1411 form itself, Form 8960, "Net Investment Income Tax -- Individuals, Estates, and Trusts," which were not included when the draft form [was](#) released in August 2013. "The drafting of the regulations under section 1411 was a daunting task, and I imagine the drafting of the instructions to the maze of relevant tax forms has been (and will continue to be) no easier," he said.

Tax Analysts Information

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Subject Areas: Health care tax issues
Individual income taxation
Partnership taxation

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