NIESAR & VESTAL LLP

Law Alert

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Potential Trap for Unwary Entities Taxed as Partnerships

The Internal Revenue Service recently [February 1, 2019] released new instructions for Form 1065, U.S. Return of Partnership Income. Buried half-way through the instructions are directions on how to prepare a partner's Schedule K-1. Schedule K-1 provides information as to each partner's identity and his/her share of partnership income, deduction and other items.

Item L of Schedule K-1 provides a Partner's Capital Account Analysis. Previously, it was common practice to show a zero capital when a partner had a negative balance. The new instructions require the reporting of negative capital accounts. The penalty for failing to do so is calculated at $195 per partner per month (up to a year).

The purpose of the new instruction is to provide information to the IRS to prevent an abusive tax scheme. Most likely, if a partnership discloses such a negative capital account, then it will be at a higher risk of audit. It is impossible to predict how the amount of or number of partners with negative balances will impact the risk of an audit.

If you are in an entity taxed as a partnership and have any questions, contact Alan R. Seher, tax partner, at aseher@nvlawllp.com.