

Current Federal Tax Developments

Week of October 7, 2019

Edward K. Zollars, CPA
(Licensed in Arizona)

ACCOUNTING
CONTINUING EDUCATION

CURRENT FEDERAL TAX DEVELOPMENTS
WEEK OF OCTOBER 7, 2019
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Kaplan Financial Education

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SECTION: STATE TAX

PENNSYLVANIA WILL APPLY \$500,000 ECONOMIC NEXUS RULE FOR CORPORATE INCOME TAX FILINGS IN 2020

Citation: Pennsylvania Corporation Tax Bulletin 2019-04, 9/30/19

In Pennsylvania Corporation Tax Bulletin 2019-04,¹ the state of Pennsylvania announced that it will begin treating any corporation with \$500,000 of sales into the state as having nexus with the state. The state bases this revised view of nexus based on the Supreme Court's rejection of a physical presence requirement for sales tax nexus in the *Wayfair* case.²

The Department provides the following analysis for why it has concluded physical presence should also no longer be a requirement for income tax nexus:

The Court went on to conclude “that the physical presence rule of *Quill* is unsound and incorrect.”

As a result, the Commerce Clause analysis set forth in *Complete Auto Transit* remains valid, but the physical presence rule, which was previously held in *Quill* to be a necessary part of the substantial nexus prong is incorrect. While taxpayers contested for years whether the physical presence nexus standard in *Quill* was limited to sales taxes or also applied to corporate net income taxes, the decision in *Wayfair* has made certain that, at least prospectively, no physical presence standard exists for purposes of limiting the ability of a state to impose a net income tax on an out of state taxpayer so long as the constitutional requirements under the Due Process and Commerce Clauses of the United States Constitution are satisfied.³

The bulletin notes that under Article IV of the Tax Reform Code (TRC), 72 P.S. §§7401 a corporation is subject for the following actions which the bulletin conclude have taken place when a corporation exceeds the \$500,000 sales trigger:

- Doing in business in the Commonwealth of Pennsylvania or

¹ Corporation Tax Bulletin 2019-04, Pennsylvania Department of Revenue, September 30, 2019, https://www.revenue.pa.gov/GeneralTaxInformation/TaxLawPoliciesBulletinsNotices/TaxBulletins/CT/Documents/ct_bulletin_2019-04.pdf, retrieved October 2, 2019.

² *Wayfair v. South Dakota*, 138 S. Ct. 2080, (2018)

³ Corporation Tax Bulletin 2019-04, p. 2

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■ Carrying on business in the Commonwealth of Pennsylvania.⁴

The ruling provides:

For Pennsylvania Corporate Net Income Tax purposes the decision in *Wayfair* has confirmed that out of state corporations are considered to be doing business in this Commonwealth and/or carrying on activities in this Commonwealth to the extent they are taking advantage of the economic marketplace of the Commonwealth regardless of whether they are physically present in Pennsylvania.⁵

The state notes its reasoning for setting the level at which economic nexus is triggered at \$500,000:

While the Court in *Wayfair* did not express a bright line threshold of economic activity which would satisfy the nexus requirements existing under the Due Process and Commerce Clauses, it did approve the approach of South Dakota whereby an out of state taxpayer was subjected to a sales tax collection requirement where it had in excess of either 200 sales or \$100,000 worth of sales of goods or services to South Dakota customers during the course of a tax year. While all taxpayers with nexus under the Constitution of the United States should file a Corporate Tax Report with Pennsylvania, the Department will deem there to be a rebuttable presumption that corporations without physical presence in the state, but having \$500,000 or more of direct or indirect gross receipts from any combination of the following, sourced to Pennsylvania per year pursuant to the sales factor rules contained in 72 P.S. § 7401, have a filing requirement with the Commonwealth for purposes of the Corporate Net Income Tax:²

- (1) Gross receipts from the sale, rental, lease, or licensing of tangible personal property;
- (2) Gross receipts from the sale of services; and/or,
- (3) Gross receipts from the sale or licensing of intangibles, including franchise agreements.⁶

Since Congress did impose a set of conditions under which a state cannot impose a state income tax in Public Law 86-272, the state does address that issue in the bulletin. The bulletin provides:

In interpreting this standard the Department recognizes that taxpayers with or without physical presence in the Commonwealth can still potentially claim exemption from the imposition of the Corporate Net

⁴ Corporation Tax Bulletin 2019-04, p. 2

⁵ Corporation Tax Bulletin 2019-04, p. 2

⁶ Corporation Tax Bulletin 2019-04, pp. 2-3

Income Tax under the provisions of P.L. 86-272. To the extent protection under this federal law is claimed, taxpayers should continue to file a Pennsylvania Corporate Tax Report (Form RCT-101) and complete the necessary schedules to claim this exemption from tax.⁷

The bulletin concludes by noting it will apply the revised nexus standard to taxpayers for tax years beginning on or after January 1, 2020.⁸

SECTION: 164

DO TAXES ON INVESTMENT REAL ESTATE ESCAPE THE \$10,000 CAP? IT SEEMS LIKELY.

Citation: Twitter Discussion on Taxes on Investment Property, 9/26/19

There's an interesting problem with the limitation on the deduction for taxes on Schedule A that led to a recent discussion on Twitter among tax professionals.⁹

We've likely all heard the comment that a deduction for state and local taxes is limited on Schedule A to no more than \$10,000 (\$5,000 for a married individual filing a separate return), so that real estate taxes imposed on raw land a taxpayer was holding for appreciation would be trapped by the \$10,000 cap along with their other state and local taxes.

Or would it? IRC §164(b)(6), added by the Tax Cuts and Jobs Act (TCJA) starts out with the general rule that we are familiar with:

(6) Limitation on individual deductions for taxable years 2018 through 2025—In the case of an individual and a taxable year beginning after December 31, 2017, and before January 1, 2026—

...

(B) the aggregate amount of taxes taken into account under paragraphs (1), (2), and (3) of subsection (a) and paragraph (5) of this subsection for any taxable year shall not exceed \$10,000 (\$5,000 in the case of a married individual filing a separate return).

If that was all that IRC §164(d)(6) said, then the taxes on that raw land would clearly be subject to this limit. But the provision doesn't end there—rather, two sentences are

⁷ Corporation Tax Bulletin 2019-04, p. 3

⁸ Corporation Tax Bulletin 2019-04, p. 3

⁹ <https://twitter.com/fintaxplanner/status/1177241414842888193?s=20>, September 26, 2019

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found at the end of the section that limits the application of the \$10,000 cap. The section ends:

The preceding sentence shall not apply to any foreign taxes described in subsection (a)(3) or to any taxes described in paragraph (1) and (2) of subsection (a) which are paid or accrued in carrying on a trade or business or *an activity described in section 212*. For purposes of subparagraph (B), an amount paid in a taxable year beginning before January 1, 2018, with respect to a State or local income tax imposed for a taxable year beginning after December 31, 2017, shall be treated as paid on the last day of the taxable year for which such tax is so imposed.

So, what is an activity described in §212? IRC §212(1) and (2) give us that answer—it relates to property held for the production or collection of income:

In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year—

(1) for the production or collection of income;

(2) for the management, conservation, or maintenance of property held for the production of income;

But you might protest, §212 expenses, aside from those incurred as part of a rental or royalty, are barred from being deducted following TCJA. After all, IRC §67(g) clearly states that “[n]otwithstanding subsection (a), no miscellaneous itemized deduction shall be allowed for any taxable year beginning after December 31, 2017, and before January 1, 2026.”

But note that only affects miscellaneous itemized deduction—and IRC §67(b)(2) excludes from the definition of miscellaneous itemized deductions an itemized deduction for taxes under IRC §164. And, of course, these real property taxes are deductible under IRC §164(a)(2), which gives a deduction for “[s]tate and local property taxes.”

While it is true that §212 expenses are miscellaneous itemized deductions, the tax in this case is not being deducted under §212. The law simply tells us to reference §212 to see if the activity upon which the tax is being imposed (holding real property for investment) would be covered by that section. The actual deduction remains under §164, and thus should be excluded from being impacted by §67(g)’s bar on miscellaneous itemized deductions.

So, is there a way the IRS could try and attack the deduction? It is possible the IRS might argue the use of the word “activity” requires more than merely the passive holding of property. After all, §212 itself doesn’t use the word activity when referring to items. But that ignores the fact that we distinguish a trade or business from a §212 undertaking primarily by looking at the taxpayer’s level of activity.

The IRS could argue that “activity” was Congress’s attempt to insure no one believed that the \$10,000 cap applied to rental properties—but Congress could have much more

easily directly referenced rental and royalty property, as they did in IRC §62 when allowing such deductions in computing adjusted gross income.

As well, the IRS has yet to issue any guidance suggesting that the §163(d) \$10,000 limitation on deduction of real estate taxes should be applied to the holding of land held for speculation, nor has there been any reports of the IRS or Treasury officials giving such guidance at conferences.

So, at least for now, it appears that deducting such taxes on line 6 of Schedule A, not subject to the \$10,000 limit, has at least a reasonable basis, if not outright substantial authority under the law.

SECTION: 704

DRAFTS OF 2019 FORMS 1065 AND 1120S, AS WELL AS K-1S, ISSUED BY IRS

Citation: Draft Forms 1065, 1120S, Schedule K-1 (Form 1065) and Schedule K-1 (Form 1120S), 9/26/19

The IRS has released new and/or update draft Forms 1065, 1120S, and the related K-1s for 2019. The new form contains certain changes for 2019 returns.

Some of the more significant revisions are:

- Required use of tax basis capital for the capital account reconciliation on Schedule K-1 for partnerships;
- Disclosure of additional information related to §704(c) transactions on the partnership Schedule K-1;
- Guaranteed payments will have to be split on the partnership K-1 between those for capital and those for services;
- Additional information on the existence of activities for at-risk and passive activity purposes on all forms; and
- Switch to the descriptive text disclosures for §199A information that was first revealed on the July draft of the Form 1120S Schedule K-1.

Here are the pages from the Form 1065 for 2019:

Form 1065 Department of the Treasury Internal Revenue Service	U.S. Return of Partnership Income For calendar year 2019, or tax year beginning _____, 2019, ending _____, 20_____. ► Go to www.irs.gov/Form1065 for instructions and the latest information.	OMB No. 1545-0123 <div style="font-size: 2em; font-weight: bold;">2019</div>
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		
Caution: Include only trade or business income and expenses on lines 1a through 22 below. See instructions for more information.		
Income	1a Gross receipts or sales	1a _____
	b Returns and allowances	1b _____
	c Balance. Subtract line 1b from line 1a	1c _____
	2 Cost of goods sold (attach Form 1125-A)	2 _____
	3 Gross profit. Subtract line 2 from line 1c	3 _____
	4 Ordinary income (loss) from other partnerships, estates, and trusts (attach statement)	4 _____
	5 Net farm profit (loss) (attach Schedule F (Form 1040 or 1040-SR))	5 _____
	6 Net gain (loss) from Form 4797, Part II, line 17 (attach Form 4797)	6 _____
7 Other income (loss) (attach statement)	7 _____	
8 Total income (loss). Combine lines 3 through 7	8 _____	
Deductions <small>(see instructions for limitations)</small>	9 Salaries and wages (other than to partners) (less employment credits)	9 _____
	10 Guaranteed payments to partners	10 _____
	11 Repairs and maintenance	11 _____
	12 Bad debts	12 _____
	13 Rent	13 _____
	14 Taxes and licenses	14 _____
	15 Interest (see instructions)	15 _____
	16a Depreciation (if required, attach Form 4562)	16a _____
	b Less depreciation reported on Form 1125-A and elsewhere on return	16b _____
	16c _____	16c _____
	17 Depletion (Do not deduct oil and gas depletion.)	17 _____
18 Retirement plans, etc.	18 _____	
19 Employee benefit programs	19 _____	
20 Other deductions (attach statement)	20 _____	
21 Total deductions. Add the amounts shown in the far right column for lines 9 through 20	21 _____	
22 Ordinary business income (loss). Subtract line 21 from line 8	22 _____	
Tax and Payment	23 Interest due under the look-back method—completed long-term contracts (attach Form 8697)	23 _____
	24 Interest due under the look-back method—income forecast method (attach Form 8866)	24 _____
	25 BBA AAR imputed underpayment (see instructions)	25 _____
	26 Other taxes (see instructions)	26 _____
	27 Total balance due. Add lines 23 through 26	27 _____
	28 Payment (see instructions)	28 _____
	29 Amount owed. If line 28 is smaller than line 27, enter amount owed	29 _____
	30 Overpayment. If line 28 is larger than line 27, enter overpayment	30 _____
Sign Here	Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than partner or limited liability company member) is based on all information of which preparer has any knowledge.	
Paid Preparer Use Only	Signature of partner or limited liability company member _____ Date _____	
Paid Preparer Use Only	Print/Type preparer's name _____ Preparer's signature _____ Date _____	Check <input type="checkbox"/> if self-employed PTIN _____ Firm's name ► _____ Firm's EIN ► _____ Firm's address ► _____ Phone no. _____
For Paperwork Reduction Act Notice, see separate instructions.		
Cat. No. 11390Z		Form 1065 (2019)

A new piece of information is required at the top of Form 1065, asking if the partnership has aggregated activities for §465 at-risk purposes or has grouped activities for §469 passive activity purposes.

Schedule B Other Information

1 What type of entity is filing this return? Check the applicable box:		Yes	No	
a <input type="checkbox"/> Domestic general partnership	b <input type="checkbox"/> Domestic limited partnership			
c <input type="checkbox"/> Domestic limited liability company	d <input type="checkbox"/> Domestic limited liability partnership			
e <input type="checkbox"/> Foreign partnership	f <input type="checkbox"/> Other ▶			
2 At the end of the tax year:				
a Did any foreign or domestic corporation, partnership (including any entity treated as a partnership), trust, or tax-exempt organization, or any foreign government own, directly or indirectly, an interest of 50% or more in the profit, loss, or capital of the partnership? For rules of constructive ownership, see instructions. If "Yes," attach Schedule B-1, Information on Partners Owning 50% or More of the Partnership				
b Did any individual or estate own, directly or indirectly, an interest of 50% or more in the profit, loss, or capital of the partnership? For rules of constructive ownership, see instructions. If "Yes," attach Schedule B-1, Information on Partners Owning 50% or More of the Partnership				
3 At the end of the tax year, did the partnership:				
a Own directly 20% or more, or own, directly or indirectly, 50% or more of the total voting power of all classes of stock entitled to vote of any foreign or domestic corporation? For rules of constructive ownership, see instructions. If "Yes," complete (i) through (iv) below				
(i) Name of Corporation	(ii) Employer Identification Number (if any)	(iii) Country of Incorporation	(iv) Percentage Owned in Voting Stock	
DO NOT FILE				
b Own directly an interest of 20% or more, or own, directly or indirectly, an interest of 50% or more in the profit, loss, or capital in any foreign or domestic partnership (including an entity treated as a partnership) or in the beneficial interest of a trust? For rules of constructive ownership, see instructions. If "Yes," complete (i) through (v) below				
(i) Name of Entity	(ii) Employer Identification Number (if any)	(iii) Type of Entity	(iv) Country of Organization	(v) Maximum Percentage Owned in Profit, Loss, or Capital
4 Does the partnership satisfy all four of the following conditions?		Yes	No	
a The partnership's total receipts for the tax year were less than \$250,000.				
b The partnership's total assets at the end of the tax year were less than \$1 million.				
c Schedules K-1 are filed with the return and furnished to the partners on or before the due date (including extensions) for the partnership return.				
d The partnership is not filing and is not required to file Schedule M-3 If "Yes," the partnership is not required to complete Schedules L, M-1, and M-2; item F on page 1 of Form 1065; or item L on Schedule K-1.				
5 Is this partnership a publicly traded partnership, as defined in section 469(k)(2)?				
6 During the tax year, did the partnership have any debt that was canceled, was forgiven, or had the terms modified so as to reduce the principal amount of the debt?				
7 Has this partnership filed, or is it required to file, Form 8918, Material Advisor Disclosure Statement, to provide information on any reportable transaction?				
8 At any time during calendar year 2019, did the partnership have an interest in or a signature or other authority over a financial account in a foreign country (such as a bank account, securities account, or other financial account)? See instructions for exceptions and filing requirements for FinCEN Form 114, Report of Foreign Bank and Financial Accounts (FBAR). If "Yes," enter the name of the foreign country ▶				
9 At any time during the tax year, did the partnership receive a distribution from, or was it the grantor of, or transferor to, a foreign trust? If "Yes," the partnership may have to file Form 3520, Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts. See instructions				
10a Is the partnership making, or had it previously made (and not revoked), a section 754 election? See instructions for details regarding a section 754 election.				
b Did the partnership make for this tax year an optional basis adjustment under section 743(b) or 734(b)? If "Yes," attach a statement showing the computation and allocation of the basis adjustment. See instructions				

Schedule B Other Information (continued)

	Yes	No
c Is the partnership required to adjust the basis of partnership assets 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," attach a statement showing the computation and allocation of the basis adjustment. See instructions		
11 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"/>
12 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?		
13 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		
14 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		
15 Enter the number of Forms 8865, Return of U.S. Persons With Respect to Certain Foreign Partnerships, attached to this return		
16a Did you make any payments in 2019 that would require you to file Form(s) 1099? See instructions		
b If "Yes," did you or will you file required Form(s) 1099?		
17 Enter the number of Forms 5471, Information Return of U.S. Persons With Respect To Certain Foreign Corporations, attached to this return		
18 Enter the number of partners that are foreign governments under section 892		
19 During the partnership's tax year, did the partnership make any payments that would require it to file Form 1042 and 1042-S under chapter 3 (sections 1441 through 1464) or chapter 4 (sections 1471 through 1474)?		
20 Was the partnership a specified domestic entity required to file Form 8938 for the tax year? See the Instructions for Form 8938		
21 Is the partnership a section 721(c) partnership, as defined in Regulations section 1.721(c)-1T(b)(14)?		
22 During the tax year, did the partnership pay or accrue any interest or royalty for which the deduction is not allowed under section 267A? See instructions If "Yes," enter the total amount of the disallowed deductions		\$
23 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		
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.		
25 Is the partnership electing out of the centralized partnership audit regime under section 6221(b)? See instructions. If "Yes," the partnership must complete Schedule B-2 (Form 1065). Enter the total from Schedule B-2, Part III, line 3 If "No," complete Designation of Partnership Representative below.		
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	
26 Is the partnership attaching Form 8996 to certify as a Qualified Opportunity Fund? If "Yes," enter the amount from Form 8996, line 14		\$
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		
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?		

The last two questions are new for 2019.

Schedule K Partners' Distributive Share Items		Total amount
Income (Loss)	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
	4 Guaranteed payments: a Services 4a b Capital 4b	4c
	c Total. Add lines 4a and 4b	4c
	5 Interest income	5
	6 Dividends and dividend equivalents: a Ordinary dividends	6a
	b Qualified dividends 6b c Dividend equivalents 6c	6c
	7 Royalties	7
8 Net short-term capital gain (loss) (attach Schedule D (Form 1065))	8	
9a Net long-term capital gain (loss) (attach Schedule D (Form 1065))	9a	
b Collectibles (28%) gain (loss)	9b	
c Unrecaptured section 1250 gain (attach statement)	9c	
10 Net section 1231 gain (loss) (attach Form 4797)	10	
11 Other income (loss) (see instructions) Type ▶	11	
Deductions	12 Section 179 deduction (attach Form 4562)	12
	13a Contributions	13a
	b Investment interest expense	13b
	c Section 59(e)(2) expenditures: (1) Type ▶ (2) Amount ▶	13c(2)
d Other deductions (see instructions) Type ▶	13d	
Self-Employment	14a Net earnings (loss) from self-employment	14a
	b Gross farming or fishing income	14b
	c Gross nonfarm income	14c
Credits	15a Low-income housing credit (section 42(j)(5))	15a
	b Low-income housing credit (other)	15b
	c Qualified rehabilitation expenditures (rental real estate) (attach Form 3468, if applicable)	15c
	d Other rental real estate credits (see instructions) Type ▶	15d
	e Other rental credits (see instructions) Type ▶	15e
	f Other credits (see instructions) Type ▶	15f
Foreign Transactions	16a Name of country or U.S. possession ▶	16a
	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)		
Alternative Minimum Tax (AMT) Items	17a Post-1986 depreciation adjustment	17a
	b Adjusted gain or loss	17b
	c Depletion (other than oil and gas)	17c
	d Oil, gas, and geothermal properties—gross income	17d
	e Oil, gas, and geothermal properties—deductions	17e
	f Other AMT items (attach statement)	17f
Other Information	18a Tax-exempt interest income	18a
	b Other tax-exempt income	18b
	c Nondeductible expenses	18c
	19a Distributions of cash and marketable securities	19a
	b Distributions of other property	19b
	20a Investment income	20a
b Investment expenses	20b	
c Other items and amounts (attach statement)		

Analysis of Net Income (Loss)

1	Net income (loss). Combine Schedule K, lines 1 through 11. From the result, subtract the sum of Schedule K, lines 12 through 13d, and 16p						1
2	Analysis by partner type:						
	(i) Corporate	(ii) Individual (active)	(iii) Individual (passive)	(iv) Partnership	(v) Exempt Organization	(vi) Nominee/Other	
a	General partners						
b	Limited partners						

Schedule L Balance Sheets per Books

		Beginning of tax year		End of tax year	
		(a)	(b)	(c)	(d)
Assets					
1	Cash				
2a	Trade notes and accounts receivable				
b	Less allowance for bad debts				
3	Inventories				
4	U.S. government obligations				
5	Tax-exempt securities				
6	Other current assets (attach statement)				
7a	Loans to partners (or persons related to partners)				
b	Mortgage and real estate loans				
8	Other investments (attach statement)				
9a	Buildings and other depreciable assets				
b	Less accumulated depreciation				
10a	Depletable assets				
b	Less accumulated depletion				
11	Land (net of any amortization)				
12a	Intangible assets (amortizable only)				
b	Less accumulated amortization				
13	Other assets (attach statement)				
14	Total assets				
Liabilities and Capital					
15	Accounts payable				
16	Mortgages, notes, bonds payable in less than 1 year				
17	Other current liabilities (attach statement)				
18	All nonrecourse loans				
19a	Loans from partners (or persons related to partners)				
b	Mortgages, notes, bonds payable in 1 year or more				
20	Other liabilities (attach statement)				
21	Partners' capital accounts				
22	Total liabilities and capital				

Schedule M-1 Reconciliation of Income (Loss) per Books With Income (Loss) per Return

Note: The partnership may be required to file Schedule M-3. See instructions.

1	Net income (loss) per books		6	Income recorded on books this year not included on Schedule K, lines 1 through 11 (itemize):
2	Income included on Schedule K, lines 1, 2, 3c, 5, 6a, 7, 8, 9a, 10, and 11, not recorded on books this year (itemize):		a	Tax-exempt interest \$
3	Guaranteed payments (other than health insurance)		7	Deductions included on Schedule K, lines 1 through 13d, and 16p, not charged against book income this year (itemize):
4	Expenses recorded on books this year not included on Schedule K, lines 1 through 13d, and 16p (itemize):		a	Depreciation \$
a	Depreciation \$		8	Add lines 6 and 7
b	Travel and entertainment \$		9	Income (loss) (Analysis of Net Income (Loss), line 1). Subtract line 8 from line 5
5	Add lines 1 through 4			

Schedule M-2 Analysis of Partners' Capital Accounts

1	Balance at beginning of year		6	Distributions: a Cash
2	Capital contributed: a Cash		b Property	
	b Property		7	Other decreases (itemize):
3	Net income (loss) per books		8	Add lines 6 and 7
4	Other increases (itemize):		9	Balance at end of year. Subtract line 8 from line 5
5	Add lines 1 through 4			

Here is the draft K-1 for the Form 1065 for 2019. This form has more noticeable changes.

§704(c) gain/loss and adds questions asking if there is more than one activity for at-risk purposes as well as for passive activity purposes.

As well, it separately asks for information on two types of guaranteed payments, asking for information on such payments for service and for capital, along with the total guaranteed payments.

And, finally, it asks the partnership to disclose if there is more than one activity for at-risk and passive activity purposes and, if so, directs the partner to additional information the partnership will supply—though, until the instructions are released, we can't know for sure what exactly the IRS will expect the partnership to disclose to the partner.

This list identifies the codes used on Schedule K-1 for all partners and provides summarized reporting information for partners who file Form 1040 or 1040-SR. For detailed reporting and filing information, see the separate Partner's Instructions for Schedule K-1 and the instructions for your income tax return.

Code	Report on
1. Ordinary business income (loss). Determine whether the income (loss) is passive or nonpassive and enter on your return as follows.	
Passive loss	See the Partner's Instructions
Passive income	Schedule E, line 28, column (h)
Nonpassive loss	See the Partner's Instructions
Nonpassive income	Schedule E, line 28, column (k)
2. Net rental real estate income (loss)	See the Partner's Instructions
3. Other net rental income (loss)	See the Partner's Instructions
Net income	Schedule E, line 28, column (h)
Net loss	See the Partner's Instructions
4a. Guaranteed payment Services	See the Partner's Instructions
4b. Guaranteed payment Capital	See the Partner's Instructions
4c. Guaranteed payment Total	See the Partner's Instructions
5. Interest income	Form 1040 or 1040-SR, line 2b
6a. Ordinary dividends	Form 1040 or 1040-SR, line 3b
6b. Qualified dividends	Form 1040 or 1040-SR, line 3a
6c. Dividend equivalents	See the Partner's Instructions
7. Royalties	Schedule E, line 4
8. Net short-term capital gain (loss)	Schedule D, line 5
9a. Net long-term capital gain (loss)	Schedule D, line 12
9b. Collectibles (28%) gain (loss)	28% Rate Gain Worksheet, line 4 (Schedule D instructions)
9c. Unrecaptured section 1250 gain	See the Partner's Instructions
10. Net section 1231 gain (loss)	See the Partner's Instructions
11. Other income (loss)	
<i>Code</i>	
A Other portfolio income (loss)	See the Partner's Instructions
B Involuntary conversions	See the Partner's Instructions
C Sec. 1256 contracts & straddles	Form 6781, line 1
D Mining exploration costs recapture	See Pub. 535
E Cancellation of debt	
F Section 743(b) positive adjustments	
G Section 965(a) inclusion	
H Income under subpart F (other than inclusions under sections 951A and 965)	See the Partner's Instructions
I Other income (loss)	
12. Section 179 deduction	See the Partner's Instructions
13. Other deductions	
A Cash contributions (60%)	
B Cash contributions (30%)	
C Noncash contributions (50%)	
D Noncash contributions (30%)	
E Capital gain property to a 50% organization (30%)	
F Capital gain property (20%)	
G Contributions (100%)	
H Investment interest expense	Form 4952, line 1
I Deductions—royalty income	Schedule E, line 19
J Section 59(e)(2) expenditures	See the Partner's Instructions
K Excess business interest expense	See the Partner's Instructions
L Deductions—portfolio (other)	Schedule A, line 16
M Amounts paid for medical insurance	Schedule A, line 1, or Schedule 1 (Form 1040 or 1040-SR), line 16
N Educational assistance benefits	See the Partner's Instructions
O Dependent care benefits	Form 2441, line 12
P Preproductive period expenses	See the Partner's Instructions
Q Commercial revitalization deduction from rental real estate activities	See Form 8582 instructions
R Pensions and IRAs	See the Partner's Instructions
S Reforestation expense deduction through U	See the Partner's Instructions
T through U	Reserved for future use
V Section 743(b) negative adjustments	
W Other deductions	See the Partner's Instructions
X Section 965(c) deduction	
14. Self-employment earnings (loss)	
Note: If you have a section 179 deduction or any partner-level deductions, see the Partner's Instructions before completing Schedule SE.	
A Net earnings (loss) from self-employment	Schedule SE, Section A or B
B Gross farming or fishing income	See the Partner's Instructions
C Gross non-farm income	See the Partner's Instructions
15. Credits	
A Low-income housing credit (section 42(j)(5)) from pre-2008 buildings	
B Low-income housing credit (other) from pre-2008 buildings	
C Low-income housing credit (section 42(j)(5)) from post-2007 buildings	
D Low-income housing credit (other) from post-2007 buildings	
E Qualified rehabilitation expenditures (rental real estate)	
F Other rental real estate credits	
G Other rental credits	
H Undistributed capital gains credit	Schedule 3 (Form 1040 or 1040-SR), line 13, box a See the Partner's Instructions
I Biofuel producer credit	
J Work opportunity credit	
K Disabled access credit	
L Empowerment zone employment credit	
M Credit for increasing research activities	See the Partner's Instructions
N Credit for employer social security and Medicare taxes	
O Backup withholding	
P Other credits	
16. Foreign transactions	
A Name of country or U.S. possession	
B Gross income from all sources	Form 1116, Part I
C Gross income sourced at partner level	
<i>Foreign gross income sourced at partnership level</i>	
D Reserved for future use	
E Foreign branch category	
F Passive category	Form 1116, Part I
G General category	
H Other	
<i>Deductions allocated and apportioned at partner level</i>	
I Interest expense	Form 1116, Part I
J Other	Form 1116, Part I
<i>Deductions allocated and apportioned at partnership level to foreign source income</i>	
K Reserved for future use	
L Foreign branch category	
M Passive category	Form 1116, Part I
N General category	
O Other	
<i>Other information</i>	
P Total foreign taxes paid	Form 1116, Part II
Q Total foreign taxes accrued	Form 1116, Part II
R Reduction in taxes available for credit	Form 1116, line 12
S Foreign trading gross receipts	Form 8873
T Extraterritorial income exclusion	Form 8873
U through V	Reserved for future use
W Section 965 information	
X Other foreign transactions	See the Partner's Instructions
17. Alternative minimum tax (AMT) items	
A Post-1986 depreciation adjustment	
B Adjusted gain or loss	See the Partner's Instructions and the Instructions for Form 6251
C Depletion (other than oil & gas)	
D Oil, gas, & geothermal—gross income	
E Oil, gas, & geothermal—deductions	
F Other AMT items	
18. Tax-exempt income and nondeductible expenses	
A Tax-exempt interest income	Form 1040 or 1040-SR, line 2a
B Other tax-exempt income	See the Partner's Instructions
C Nondeductible expenses	See the Partner's Instructions
19. Distributions	
A Cash and marketable securities	
B Distribution subject to section 737	See the Partner's Instructions
C Other property	
20. Other information	
A Investment income	Form 4952, line 4a
B Investment expenses	Form 4952, line 5
C Fuel tax credit information	Form 4136
D Qualified rehabilitation expenditures (other than rental real estate)	
E Basis of energy property through G	See the Partner's Instructions
H Recapture of investment credit	See Form 4255
I Recapture of other credits	See the Partner's Instructions
J Look-back interest—completed long-term contracts	See Form 8697
K Look-back interest—income forecast method	See Form 8666
L Dispositions of property with section 179 deductions	
M Recapture of section 179 deduction	
N Interest expense for corporate partners through Y	
Z Section 199A information	
AA Section 704(c) information	See the Partner's Instructions
AB Section 751 gain (loss)	
AC Section 1(h)(5) gain (loss)	
AD Section 1250 unrecaptured gain	
AE Excess taxable income	
AF Excess business interest income	
AG Gross receipts for section 59A(e)	
AH Other information	

The IRS had previously issued a draft Form 1120S Schedule K-1 that had been discussed on the Current Federal Tax Developments site.¹⁰ The IRS has now updated that K-1 and released the draft of the Form 1120S as well.

¹⁰ Edward Zollars, “Draft Schedule K-1, Form 1120S Consolidates §199A Information to a Single Code for 2019,” Current Federal Tax Developments website, July 29, 2019, <https://www.currentfederaltaxdevelopments.com/blog/2019/7/29/draft-schedule-k-1-form-1120s-consolidates-199a-information-to-a-single-code-for-2019> (retrieved October 1, 2019)

Form 1120-S Department of the Treasury Internal Revenue Service	U.S. Income Tax Return for an S Corporation ▶ Do not file this form unless the corporation has filed or is attaching Form 2553 to elect to be an S corporation. ▶ Go to www.irs.gov/Form1120S for instructions and the latest information.	OMB No. 1545-0123 <div style="font-size: 2em; font-weight: bold;">2019</div>
For calendar year 2019 or tax year beginning _____, 2019, ending _____, 20		
A S election effective date	Name _____ Number, street, and room or suite no. if a P.O. box, see instructions. _____ City or town, state or province, country, and ZIP or foreign postal code _____	D Employer identification number _____
B Business activity code number (see instructions)	TYPE OR PRINT	E Date incorporated _____ F Total assets (see instructions) \$ _____
C Check if Sch. M-3 attached <input type="checkbox"/>		
G Is the corporation electing to be an S corporation beginning with this tax year? <input type="checkbox"/> Yes <input type="checkbox"/> No If "Yes," attach Form 2553 if not already filed		
H Check if: (1) <input type="checkbox"/> Final return (2) <input type="checkbox"/> Name change (3) <input type="checkbox"/> Address change (4) <input type="checkbox"/> Amended return (5) <input type="checkbox"/> S election termination or revocation		
I Enter the number of shareholders who were shareholders during any part of the tax year _____		
J Check if corporation: (1) <input type="checkbox"/> Aggregated activities for section 465 at-risk purposes (2) <input type="checkbox"/> Grouped activities for section 469 passive activity purposes		
Caution: Include only trade or business income and expenses on lines 1a through 21. See the instructions for more information.		
Income	1a Gross receipts or sales b Returns and allowances c Balance. Subtract line 1b from line 1a 2 Cost of goods sold (attach Form 1125-A) 3 Gross profit. Subtract line 2 from line 1c 4 Net gain (loss) from Form 4797, line 17 (attach Form 4797) 5 Other income (loss) (see instructions—attach statement) 6 Total income (loss). Add lines 3 through 5	1a 1b 1c 2 3 4 5 6
Deductions (see instructions for limitations)	7 Compensation of officers (see instructions—attach Form 1125-E) 8 Salaries and wages (less employment credits) 9 Repairs and maintenance 10 Bad debts 11 Rents 12 Taxes and licenses 13 Interest (see instructions) 14 Depreciation not claimed on Form 1125-A or elsewhere on return (attach Form 4562) 15 Depletion (Do not deduct oil and gas depletion.) 16 Advertising 17 Pension, profit-sharing, etc., plans 18 Employee benefit programs 19 Other deductions (attach statement) 20 Total deductions. Add lines 7 through 19 21 Ordinary business income (loss). Subtract line 20 from line 6	7 8 9 10 11 12 13 14 15 16 17 18 19 20 21
Tax and Payments	22a Excess net passive income or LIFO recapture tax (see instructions) b Tax from Schedule D (Form 1120-S) c Add lines 22a and 22b (see instructions for additional taxes) 23a 2019 estimated tax payments and 2018 overpayment credited to 2019 b Tax deposited with Form 7004 c Credit for federal tax paid on fuels (attach Form 4136) d Refundable credit from Form 8827, line 5c e Add lines 23a through 23d 24 Estimated tax penalty (see instructions). Check if Form 2220 is attached 25 Amount owed. If line 23e is smaller than the total of lines 22c and 24, enter amount owed 26 Overpayment. If line 23e is larger than the total of lines 22c and 24, enter amount overpaid 27 Enter amount from line 26: Credited to 2020 estimated tax ▶ Refunded ▶	22a 22b 22c 23a 23b 23c 23d 23e 24 25 26 27
Sign Here	Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.	
Paid Preparer Use Only	Signature of officer _____ Date _____ Title _____ Print/Type preparer's name _____ Preparer's signature _____ Date _____ Firm's name ▶ _____ Firm's address ▶ _____	
May the IRS discuss this return with the preparer shown below? See instructions. <input type="checkbox"/> Yes <input type="checkbox"/> No		
Check <input type="checkbox"/> if self-employed PTIN _____ Firm's EIN ▶ _____ Phone no. _____		
For Paperwork Reduction Act Notice, see separate instructions.		

Cat. No. 11510H

Form 1120-S (2019)

As with the draft Form 1065, a new line is added at the top of the form to indicate if the S corporation has aggregated activities for §465 at-risk purposes or grouped activities for §469 passive activity purposes.

Schedule B Other Information (see instructions)

- 1 Check accounting method: a Cash b Accrual c Other (specify) ▶ _____
- 2 See the instructions and enter the:
 a Business activity ▶ _____ b Product or service ▶ _____
- 3 At any time during the tax year, was any shareholder of the corporation a disregarded entity, a trust, an estate, or a nominee or similar person? If "Yes," attach Schedule B-1, Information on Certain Shareholders of an S Corporation
- 4 At the end of the tax year, did the corporation:
 a Own directly 20% or more, or own, directly or indirectly, 50% or more of the total stock issued and outstanding of any foreign or domestic corporation? For rules of constructive ownership, see instructions. If "Yes," complete (i) through (v) below

Yes	No

(i) Name of Corporation	(ii) Employer Identification Number (if any)	(iii) Country of Incorporation	(iv) Percentage of Stock Owned	(v) If Percentage in (iv) Is 100%, Enter the Date (if any) a Qualified Subchapter S Subsidiary Election Was Made

- b Own directly an interest of 20% or more, or own, directly or indirectly, an interest of 50% or more in the profit, loss, or capital in any foreign or domestic partnership (including an entity treated as a partnership) or in the beneficial interest of a trust? For rules of constructive ownership, see instructions. If "Yes," complete (i) through (v) below

Yes	No

(i) Name of Entity	(ii) Employer Identification Number (if any)	(iii) Type of Entity	(iv) Country of Organization	(v) Maximum Percentage Owned in Profit, Loss, or Capital

- 5a At the end of the tax year, did the corporation have any outstanding shares of restricted stock?
 If "Yes," complete lines (i) and (ii) below.
 (i) Total shares of restricted stock ▶ _____
 (ii) Total shares of non-restricted stock ▶ _____

Yes	No

- b At the end of the tax year, did the corporation have any outstanding stock options, warrants, or similar instruments?
 If "Yes," complete lines (i) and (ii) below.
 (i) Total shares of stock outstanding at the end of the tax year ▶ _____
 (ii) Total shares of stock outstanding if all instruments were executed ▶ _____

Yes	No

6 Has this corporation filed, or is it required to file, **Form 8918**, Material Advisor Disclosure Statement, to provide information on any reportable transaction?

7 Check this box if the corporation issued publicly offered debt instruments with original issue discount
 If checked, the corporation may have to file **Form 8281**, Information Return for Publicly Offered Original Issue Discount Instruments.

Yes	No

8 If the corporation (a) was a C corporation before it elected to be an S corporation or the corporation acquired an asset with a basis determined by reference to the basis of the asset (or the basis of any other property) in the hands of a C corporation and (b) has net unrealized built-in gain in excess of the net recognized built-in gain from prior years, enter the net unrealized built-in gain reduced by net recognized built-in gain from prior years. See instructions ▶ \$ _____

9 Did the corporation 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

10 Does the corporation satisfy one or more of the following? See instructions

- a The corporation owns a pass-through entity with current, or prior year carryover, excess business interest expense.
 b The corporation'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 corporation has business interest expense.
 c The corporation is a tax shelter and the corporation has business interest expense.
 If "Yes," complete and attach Form 8990.

Yes	No

- 11 Does the corporation satisfy both of the following conditions?
 a The corporation's total receipts (see instructions) for the tax year were less than \$250,000.
 b The corporation's total assets at the end of the tax year were less than \$250,000.
 If "Yes," the corporation is not required to complete Schedules L and M-1.

Yes	No

Schedule B Other Information (see instructions) (continued)		Yes	No
12	During the tax year, did the corporation have any non-shareholder debt that was canceled, was forgiven, or had the terms modified so as to reduce the principal amount of the debt? If "Yes," enter the amount of principal reduction ▶ \$		
13	During the tax year, was a qualified subchapter S subsidiary election terminated or revoked? If "Yes," see instructions		
14a	Did the corporation make any payments in 2019 that would require it to file Form(s) 1099?		
b	If "Yes," did the corporation file or will it file required Form(s) 1099?		
15	Is the corporation attaching Form 8996 to certify as a Qualified Opportunity Fund? If "Yes," enter the amount from Form 8996, line 14 ▶ \$		

Schedule K Shareholders' Pro Rata Share Items		Total amount
Income (Loss)	1 Ordinary business income (loss) (page 1, line 21)	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	
	4 Interest income 4	
	5 Dividends: a Ordinary dividends 5a	
	b Qualified dividends 5b	
	6 Royalties 6	
	7 Net short-term capital gain (loss) (attach Schedule D (Form 1120-S)) 7	
8a Net long-term capital gain (loss) (attach Schedule D (Form 1120-S)) 8a		
b Collectibles (28%) gain (loss) 8b		
c Unrecaptured section 1250 gain (attach statement) 8c		
9 Net section 1231 gain (loss) (attach Form 4797) 9		
10 Other income (loss) (see instructions) Type ▶	10	
Deductions	11 Section 179 deduction (attach Form 4562) 11	
	12a Charitable contributions 12a	
	b Investment interest expense 12b	
	c Section 59(e)(2) expenditures (1) Type ▶ (2) Amount ▶ 12c(2)	
d Other deductions (see instructions) Type ▶	12d	
Credits	13a Low-income housing credit (section 42(j)(5)) 13a	
	b Low-income housing credit (other) 13b	
	c Qualified rehabilitation expenditures (rental real estate) (attach Form 3468, if applicable) 13c	
	d Other rental real estate credits (see instructions) Type ▶ 13d	
	e Other rental credits (see instructions) Type ▶ 13e	
	f Biofuel producer credit (attach Form 6478) 13f	
	g Other credits (see instructions) Type ▶	13g
Foreign Transactions	14a Name of country or U.S. possession ▶	
	b Gross income from all sources 14b	
	c Gross income sourced at shareholder level 14c	
	Foreign gross income sourced at corporate level	
	d Reserved for future use 14d	
	e Foreign branch category 14e	
	f Passive category 14f	
	g General category 14g	
	h Other (attach statement) 14h	
	Deductions allocated and apportioned at shareholder level	
	i Interest expense 14i	
	j Other 14j	
	Deductions allocated and apportioned at corporate level to foreign source income	
	k Reserved for future use 14k	
	l Foreign branch category 14l	
	m Passive category 14m	
	n General category 14n	
o Other (attach statement) 14o		
Other information		
p Total foreign taxes (check one): <input type="checkbox"/> Paid <input type="checkbox"/> Accrued ▶ 14p		
q Reduction in taxes available for credit (attach statement) 14q		
r Other foreign tax information (attach statement)		

Schedule K Shareholders' Pro Rata Share Items (continued)		Total amount
Alternative Minimum Tax (AMT) Items	15a Post-1986 depreciation adjustment	15a
	b Adjusted gain or loss	15b
	c Depletion (other than oil and gas)	15c
	d Oil, gas, and geothermal properties—gross income	15d
	e Oil, gas, and geothermal properties—deductions	15e
	f Other AMT items (attach statement)	15f
Items Affecting Shareholder Basis	16a Tax-exempt interest income	16a
	b Other tax-exempt income	16b
	c Nondeductible expenses	16c
	d Distributions (attach statement if required) (see instructions)	16d
	e Repayment of loans from shareholders	16e
Other Information	17a Investment income	17a
	b Investment expenses	17b
	c Dividend distributions paid from accumulated earnings and profits	17c
	d Other items and amounts (attach statement)	
Reconciliation	18 Income (loss) reconciliation. Combine the amounts on lines 1 through 10 in the far right column. From the result, subtract the sum of the amounts on lines 11 through 12d and 14p	18

Schedule L Balance Sheets per Books		Beginning of tax year		End of tax year	
Assets		(a)	(b)	(c)	(d)
1	Cash				
2a	Trade notes and accounts receivable				
b	Less allowance for bad debts	()		()	
3	Inventories				
4	U.S. government obligations				
5	Tax-exempt securities (see instructions)				
6	Other current assets (attach statement)				
7	Loans to shareholders				
8	Mortgage and real estate loans				
9	Other investments (attach statement)				
10a	Buildings and other depreciable assets				
b	Less accumulated depreciation	()		()	
11a	Depletable assets				
b	Less accumulated depletion	()		()	
12	Land (net of any amortization)				
13a	Intangible assets (amortizable only)				
b	Less accumulated amortization	()		()	
14	Other assets (attach statement)				
15	Total assets				
Liabilities and Shareholders' Equity					
16	Accounts payable				
17	Mortgages, notes, bonds payable in less than 1 year				
18	Other current liabilities (attach statement)				
19	Loans from shareholders				
20	Mortgages, notes, bonds payable in 1 year or more				
21	Other liabilities (attach statement)				
22	Capital stock				
23	Additional paid-in capital				
24	Retained earnings				
25	Adjustments to shareholders' equity (attach statement)				
26	Less cost of treasury stock		()		()
27	Total liabilities and shareholders' equity				

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Schedule M-1 Reconciliation of Income (Loss) per Books With Income (Loss) per Return
Note: The corporation may be required to file Schedule M-3. See instructions.

<p>1 Net income (loss) per books</p> <p>2 Income included on Schedule K, lines 1, 2, 3c, 4, 5a, 6, 7, 8a, 9, and 10, not recorded on books this year (itemize) _____</p> <p>3 Expenses recorded on books this year not included on Schedule K, lines 1 through 12 and 14p (itemize):</p> <p style="margin-left: 20px;">a Depreciation \$ _____</p> <p style="margin-left: 20px;">b Travel and entertainment \$ _____</p> <p>4 Add lines 1 through 3</p>	<p>5 Income recorded on books this year not included on Schedule K, lines 1 through 10 (itemize):</p> <p style="margin-left: 20px;">a Tax-exempt interest \$ _____</p> <p>6 Deductions included on Schedule K, lines 1 through 12 and 14p, not charged against book income this year (itemize):</p> <p style="margin-left: 20px;">a Depreciation \$ _____</p> <p>7 Add lines 5 and 6</p> <p>8 Income (loss) (Schedule K, line 18). Subtract line 7 from line 4</p>
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Schedule M-2 Analysis of Accumulated Adjustments Account, Shareholders' Undistributed Taxable Income Previously Taxed, Accumulated Earnings and Profits, and Other Adjustments Account
(see instructions)

	(a) Accumulated adjustments account	(b) Shareholders' undistributed taxable income previously taxed	(c) Accumulated earnings and profits	(d) Other adjustments account
1 Balance at beginning of tax year				
2 Ordinary income from page 1, line 21				
3 Other additions				
4 Loss from page 1, line 21	()			
5 Other reductions	()			()
6 Combine lines 1 through 5				
7 Distributions				
8 Balance at end of tax year. Subtract line 7 from line 6				

Form **1120-S** (2019)

The second revision of the Draft Schedule Form 1120S K-1 is also released. As with the original July 25, 2019 draft, this Schedule K-1 include the one-line reference to §199A information.

671119
 OMB No. 1545-0123

Schedule K-1
(Form 1120-S)

Department of the Treasury
Internal Revenue Service

2019

For calendar year 2019, or tax year

beginning / / 2019 ending / /

Final K-1 Amended K-1

Shareholder's Share of Income, Deductions, Credits, etc.

▶ See back of form and separate instructions.

Part I Information About the Corporation

A Corporation's employer identification number

B Corporation's name, address, city, state, and ZIP code

C IRS Center where corporation filed return

Part II Information About the Shareholder

D Shareholder's identifying number

E Shareholder's name, address, city, state, and ZIP code

F Shareholder's percentage of stock ownership for tax year _____ %

For IRS Use Only

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

1	Ordinary business income (loss)	13	Credits
2	Net rental real estate income (loss)		
3	Other net rental income (loss)		
4	Interest income		
5a	Ordinary dividends		
5b	Qualified dividends	14	Foreign transactions
6	Royalties		
7	Net short-term capital gain (loss)		
8a	Net long-term capital gain (loss)		
8b	Collectibles (28%) gain (loss)		
8c	Unrecaptured section 1250 gain		
9	Net section 1231 gain (loss)		
10	Other income (loss)	15	Alternative minimum tax (AMT) items
11	Section 179 deduction	16	Items affecting shareholder basis
12	Other deductions		
		17	Other information

18 More than one activity for at-risk purposes*

19 More than one activity for passive activity purposes*

* See attached statement for additional information.

At the bottom right side of the K-1, the S corporation must disclose if it has more than one activity for at-risk purposes and more than one activity for passive activity

purposes. If so, the S corporation will presumably (once the instructions are released) be directed to provide specific information per the asterisk note on the form.

Schedule K-1 (Form 1120-S) 2019		Page 2
<p>This list identifies the codes used on Schedule K-1 for all shareholders and provides summarized reporting information for shareholders who file Form 1040 or 1040-SR. For detailed reporting and filing information, see the separate Shareholder's Instructions for Schedule K-1 and the instructions for your income tax return.</p>		
<p>1. Ordinary business income (loss). Determine whether the income (loss) is passive or nonpassive and enter on your return as follows:</p> <p>Passive loss Passive income Nonpassive loss Nonpassive income</p>	<p><i>Report on</i> See the Shareholder's Instructions Schedule E, line 28, column (h) See the Shareholder's Instructions Schedule E, line 28, column (k)</p>	<p><i>Code</i> N Credit for employer social security and Medicare taxes O Backup withholding P Other credits</p>
<p>2. Net rental real estate income (loss)</p>	<p>See the Shareholder's Instructions</p>	<p>14. Foreign transactions</p> <p>A Name of country or U.S. possession B Gross income from all sources C Gross income sourced at shareholder level</p> <p><i>Foreign gross income sourced at corporate level</i> D Reserved for future use E Foreign branch category F Passive category G General category H Other</p> <p><i>Deductions allocated and apportioned at shareholder level</i> I Interest expense J Other</p> <p><i>Deductions allocated and apportioned at corporate level to foreign source income</i> K Reserved for future use L Foreign branch category M Passive category N General category O Other</p> <p><i>Other information</i> P Total foreign taxes paid Q Total foreign taxes accrued R Reduction in taxes available for credit S Foreign trading gross receipts T Extraterritorial income exclusion U Section 965 information V Other foreign transactions</p>
<p>3. Other net rental income (loss) Net income Net loss</p>	<p>Schedule E, line 28, column (h) See the Shareholder's Instructions Form 1040 or 1040-SR, line 2b</p>	
<p>4. Interest income</p>	<p>Form 1040 or 1040-SR, line 3b</p>	
<p>5a. Ordinary dividends</p>	<p>Form 1040 or 1040-SR, line 3a</p>	
<p>5b. Qualified dividends</p>	<p>Form 1040 or 1040-SR, line 3a</p>	
<p>6. Royalties</p>	<p>Schedule E, line 4</p>	
<p>7. Net short-term capital gain (loss)</p>	<p>Schedule D, line 5</p>	
<p>8a. Net long-term capital gain (loss)</p>	<p>Schedule D, line 12</p>	
<p>8b. Collectibles (28%) gain (loss)</p>	<p>28% Rate Gain Worksheet, line 4 (Schedule D instructions)</p>	
<p>8c. Unrecaptured section 1250 gain</p>	<p>See the Shareholder's Instructions</p>	
<p>9. Net section 1231 gain (loss)</p>	<p>See the Shareholder's Instructions</p>	
<p>10. Other income (loss) <i>Code</i> A Other portfolio income (loss) B Involuntary conversions C Sec. 1256 contracts & straddles D Mining exploration costs recapture E Reserved for future use F Section 965(a) inclusion G Income under subpart F (other than inclusions under sections 951A and 965) H Other income (loss)</p>	<p>See the Shareholder's Instructions See the Shareholder's Instructions Form 6781, line 1 See Pub. 535 See the Shareholder's Instructions See the Shareholder's Instructions</p>	
<p>11. Section 179 deduction</p>	<p>See the Shareholder's Instructions</p>	
<p>12. Other deductions A Cash contributions (60%) B Cash contributions (30%) C Noncash contributions (50%) D Noncash contributions (30%) E Capital gain property to a 50% organization (30%) F Capital gain property (20%) G Contributions (100%) H Investment interest expense I Deductions—royalty income J Section 59(e)(2) expenditures K Section 965(c) deduction L Deductions—portfolio (other) M Preproductive period expenses N Commercial revitalization deduction from rental real estate activities O Reforestation expense deduction P through R S Other deductions</p>	<p>See the Shareholder's Instructions Form 4952, line 1 Schedule E, line 19 See the Shareholder's Instructions See the Shareholder's Instructions Schedule A, line 16 See the Shareholder's Instructions See Form 8582 instructions See the Shareholder's Instructions Reserved for future use See the Shareholder's Instructions</p>	
<p>13. Credits A Low-income housing credit (section 42(i)(5)) from pre-2008 buildings B Low-income housing credit (other) from pre-2008 buildings C Low-income housing credit (section 42(i)(5)) from post-2007 buildings D Low-income housing credit (other) from post-2007 buildings E Qualified rehabilitation expenditures (rental real estate) F Other rental real estate credits G Other rental credits H Undistributed capital gains credit I Biofuel producer credit J Work opportunity credit K Disabled access credit L Empowerment zone employment credit M Credit for increasing research activities</p>	<p>See the Shareholder's Instructions Schedule 3 (Form 1040 or 1040-SR), line 13, box a See the Shareholder's Instructions</p>	
<p>15. Alternative minimum tax (AMT) items A Post-1986 depreciation adjustment B Adjusted gain or loss C Depletion (other than oil & gas) D Oil, gas, & geothermal—gross income E Oil, gas, & geothermal—deductions F Other AMT items</p>	<p>See the Shareholder's Instructions and the Instructions for Form 6251</p>	
<p>16. Items affecting shareholder basis A Tax-exempt interest income B Other tax-exempt income C Nondeductible expenses D Distributions E Repayment of loans from shareholders</p>	<p>Form 1040 or 1040-SR, line 2a See the Shareholder's Instructions</p>	
<p>17. Other information A Investment income B Investment expenses C Qualified rehabilitation expenditures (other than rental real estate) D Basis of energy property E Recapture of low-income housing credit (section 42(i)(5)) F Recapture of low-income housing credit (other) G Recapture of investment credit H Recapture of other credits I Look-back interest—completed long-term contracts J Look-back interest—income forecast method K Dispositions of property with section 179 deductions L Recapture of section 179 deduction M through U V Section 199A information W through Z AA Excess taxable income AB Excess business interest income AC Other information</p>	<p>Form 4952, line 4a Form 4952, line 5 See the Shareholder's Instructions See the Shareholder's Instructions Form 8611, line 8 Form 8611, line 8 See Form 4255 See the Shareholder's Instructions See Form 8697 See Form 8866 See the Shareholder's Instructions Reserved for future use See the Shareholder's Instructions</p>	

SECTION: 4980H INDIVIDUAL COVERAGE HRA PROPOSED REGULATIONS ON DISCRIMINATION AND SHARED RESPONSIBILITY PAYMENT ISSUED BY IRS

Citation: REG-136401-18, 9/30/19

Proposed regulations (REG-136401-18¹¹) have been issued by the IRS related to the integration of the shared responsibility payment under §4980H and certain nondiscrimination rules that apply to health reimbursement arrangement need due to the creation of individual coverage HRA in TD 9867.

The IRS provides the following initial justification for these proposed regulations:

Taking into account the comments received in response to Notice 2018-88, as well as comments received in response to the proposed integration regulations and proposed PTC regulations, the Treasury Department and the IRS propose the following regulations under sections 4980H and 105 to clarify the application of those sections to individual coverage HRAs and to provide related safe harbors to ease the administrative burdens of avoiding liability under section 4980H and avoiding income inclusion under section 105(h). These proposed regulations do not include any changes to the final integration regulations or the final PTC regulations.¹²

The preamble reminds taxpayers that §4980H only relates to applicable large employers (ALE). Such employers are those who may be hit with a shared responsibility payment if the the ALE:

- Fails to offers minimum essential coverage to its employees or
- Offers such minimum essential coverage but it either fails to provide minimum value or is considered unaffordable to at least one employee.¹³

As such, employer who are not ALEs (generally those that employed fewer than 50 full time employees plus full time equivalents on average in the prior year) are not impacted by the proposed regulations under §4980H.¹⁴

¹¹ REG-136401-18, September 27, 2019, <https://s3.amazonaws.com/public-inspection.federalregister.gov/2019-20034.pdf>, retrieved September 27, 2019

¹² REG-136401-19, p. 11

¹³ IRC §4980H

¹⁴ REG-136401-19, p. 12

***Safe Harbor for Affordability Based on Individual Coverage Cost
(Proposed Reg. §54.4980H-5(f))***

One key issue with individual coverage HRAs is determining if the cost of coverage is affordable. Since such program use employer provided benefits along with an employer purchase of an individual plan the employee obtains, the question becomes how to account for the cost of the individual plan the employee obtains that is in excess of any reimbursement received by the employee under the plan.

Proposed Reg. §54.4980H-5(f) contains proposed safe harbors employers may use who offer such plans. The regulations provide that these new safe harbors, and not the safe harbors found at Reg. §54-4980H-5(e), apply to individual coverage HRAs.¹⁵

The set of safe harbors for individual coverage HRA programs are found at Proposed Reg. §54-4980H-5(f). The regulations note that these rules are not designed to dovetail perfectly with the rules for when employees will qualify for a premium tax credit (PTC) under §36B:

An applicable large employer member that offers an individual coverage HRA is not subject to an assessable payment under section 4980H(b) with respect to any full-time employee receiving the applicable premium tax credit or cost-sharing reduction for a period for which the individual coverage HRA is determined to be affordable and to provide minimum value applying the safe harbors provided in this paragraph (f). The preceding sentence applies even if the applicable large employer member's offer of an individual coverage HRA that is affordable and provides minimum value applying the safe harbors under this paragraph (f) is not affordable or does not provide minimum value for a particular employee under §1.36B-2(c)(3)(i)(B), (c)(3)(vi), and (c)(5) of this chapter, and an applicable premium tax credit or cost-sharing reduction is allowed or paid with respect to that employee.¹⁶

The regulations provide that these safe harbors only apply “with respect to the full-time employees and their dependents to whom the applicable large employer member offered the opportunity to enroll in an individual coverage HRA.”¹⁷

If an employer offers the individual HRA program to certain full-time employees and a traditional employer-sponsored program to other employees, these safe harbors may be used for those offered the individual coverage HRA and the general safe harbors under Reg. §54-4980H-5(e) for the other employees.¹⁸

¹⁵ Proposed Reg. §54-4980H-5(e)(2)

¹⁶ Proposed Reg. §54-4980H-5(f)(1)

¹⁷ Proposed Reg. §54-4980H-5(f)(2)

¹⁸ Proposed Reg. §54-4980H-5(f)(2)

The use of the safe harbors are optional for any ALE and the ALE may choose to apply the safe harbors any allowed class of employees so long as the ALE does so on a uniform and consistent basis for all employees in the affected class. Each of the individual coverage HRA safe harbors may be used in combination with other such safe harbors so long as all conditions of the various safe harbors are met.¹⁹

A individual coverage HRA that meets the requirements to be affordable under Reg. §1.36B-2(c)(5) related to the premium tax credit will be treated as providing minimum value for each month.²⁰

Look Back Month Safe Harbor (Proposed Reg. §54-4980H-5(f)(4))

The first safe harbor for individual coverage HRAs is the *look back method safe harbor* that determines the cost of the plan to the employee. For purposes of determining an employee's contribution to the HRA, an ALE may use the monthly premium for the applicable lowest cost silver plan:

- In the case of calendar year individual coverage HRAs, an ALE may use the monthly premium for the lowest cost silver plan for January of the prior calendar year²¹ and
- For individual coverage HRAs that are on a plan year other than a calendar year, an ALE may use the monthly premium for the applicable lowest cost silver plan for January of the current calendar year.²²

The regulation provides the following rules to determine an employee's safe harbor premium:

Application of look-back month safe harbor to employee's current circumstances. In determining the monthly premium for the applicable lowest cost silver plan based on the applicable look-back month, the applicable large employer member must use the employee's applicable age for the current plan year and the employee's applicable location for the current calendar month. In general, the applicable large employer member may use the monthly premium of the applicable lowest cost silver plan for the applicable look-back month for all calendar months of the plan year. However, to the extent the employee's applicable location changes during the plan year, although the applicable large employer member may continue to determine the monthly premium based on the applicable look-back month, the applicable large employer member must use the employee's new applicable location, in accordance with the rules set forth under paragraph (f)(6) of this

¹⁹ Proposed Reg. §54-4980H-5(f)(2)

²⁰ Proposed Reg. §54-4980H-5(f)(3)

²¹ Proposed Reg. §54-4980H-5(f)(4)(i)(A)

²² Proposed Reg. §54-4980H-5(f)(4)(i)(B)

section if applicable, to determine the applicable lowest cost silver plan used to determine the monthly premium.

That is, if the employee's location changes (generally, the primary place of employment), the employer will need to update the safe harbor premium to reflect the new location.

Affordability Safe Harbor (Proposed Reg. §54-4980H-5(f)(5))

The *affordability safe harbors* are the same as found in the general affordability safe harbors found in Reg. §54.5480H-5(e)(2)(ii), (iii) and (iv) with a few modifications.

For an employer wishing to use the *Form W-2 Safe Harbor*, the regulations require the following modifications to the standard rule:

An applicable large employer member satisfies the Form W-2 safe harbor of paragraph (e)(2)(ii) of this section with respect to an offer of an individual coverage HRA to an employee for a calendar year, or if applicable, part of a calendar year, if the individual coverage HRA is affordable under the Form W-2 safe harbor under paragraph (e)(2)(ii) of this section but substituting “the employee’s required HRA contribution, as determined taking into account any other safe harbors in paragraph (f) of this section, if applicable” for each of the following phrases -- “that employee’s required contribution for the calendar year for the employer’s lowest cost self-only coverage that provides minimum value”, “the required employee contribution”, “the employee’s required contribution”, and “the employee’s required contribution for the employer’s lowest cost self-only coverage that provides minimum value.”²³

Similarly, employers looking to use the *Rate of Pay Safe Harbor*, the following modifications to the standard safe harbor must be taken into account:

An applicable large employer member satisfies the rate of pay safe harbor of paragraph (e)(2)(iii) of this section with respect to an offer of an individual coverage HRA to an employee for a calendar month if the individual coverage HRA is affordable under the rate of pay safe harbor of paragraph (e)(2)(iii) of this section but substituting “the employee’s required HRA contribution, as determined taking into account any other safe harbors in paragraph (f) of this section, if applicable,” for “the employee’s required contribution for the calendar month for the applicable large employer member’s lowest cost self-only coverage that provides minimum value.”²⁴

²³ Proposed Reg. §54-4980H-5(f)(5)(i)

²⁴ Proposed Reg. §54-4980H-5(f)(5)(ii)

For employers looking to use *Federal Poverty Line Safe Harbor*, the following modifications are made to the standard safe harbor:

An applicable large employer member satisfies the Federal poverty line safe harbor of paragraph (e)(2)(iv) of this section with respect to an offer of an individual coverage HRA to an employee for a calendar month if the individual coverage HRA is affordable under the federal poverty line safe harbor of paragraph (e)(2)(iv) of this section but substituting “the employee’s required HRA contribution, as determined taking into account any other safe harbors in paragraph (f) of this section, if applicable,” for “the employee’s required contribution for the calendar month for the applicable large employer member’s lowest cost self-only coverage that provides minimum value.”²⁵

Location Safe Harbor (Proposed Reg. §54.4580H-5(f)(6))

Since the cost will be based on the lowest cost silver plan for an area, and the prices for such plans vary wildly around the country and even in neighboring jurisdictions, a safe harbor has been established to determine the location of an employee. As IRS describes in the preamble:

In Notice 2018-88, the Treasury Department and the IRS expressed concerns about the burden on employers that could result from requiring affordability to be determined based on each employee’s place of residence, noting that employees’ places of residence might change over time and employers may have difficulty keeping their records up to date.²⁶

The safe harbor provides that the employee’s primary site of employment will be considered the employee’s location to determine the employee’s required HRA contribution based on the lowest cost silver plan available at that location.²⁷

The regulation outlines a general rule for what will be considered the employee’s primary place of employment. The primary place of employment for an employee will generally be the location at which the ALE reasonably expects the employee to perform services on the first day of the plan year.²⁸

But what happens if the employee is moved to another work location? The regulation continues to provide that the primary place of employment will be changed during the year if:

- The locations at which the employee performs services changes and

²⁵ Proposed Reg. §54-4980H-5(f)(5)(iii)

²⁶ REG-136401-19, p. 12

²⁷ Proposed Reg. §54-4980H-5(f)(6)(i)

²⁸ Proposed Reg. §54-4980H-5(f)(6)(ii)

- The employer reasonable expects the change to be permanent or indefinite.²⁹

In this case, the change is treated as taking place no later than the first day of the second calendar month after the employee begins performing services at the new location.³⁰

But the complexity isn't quite done—the regulation offers the following special rule if the employer begins offering the plan after the first day of the plan year:

Nonetheless, if an applicable large employer member is first offering an individual coverage HRA to a class of employees, and the change in location occurs prior to the individual coverage HRA's initial plan year, the employee's primary site of employment is treated as changing no later than the later of the first day of the plan year or the first day of the second calendar month after the employee has begun performing services at the new location.³¹

Further complicating the issue is determining a work location for workers who work from home but may (or may not) also come into an employer's location from time to time. The regulations refer to such workers as *remote workers*. For such workers, the primary work location is determined as follows:

- If the employee regularly performs services from home or another location other than the employer's premises, but may be requested by the employer to work at or report to a particular employer location, the location at which he/she may requested to report will be the primary work location (the regulation cites the case of "a teleworker with an assigned office space or available workspace at a particular location to which he or she may be required to report" as an example of this situation).
- If there is no such assigned office space or a particular location to report, then the employee's residence is the primary site of employment.³²

If the employer chooses not to apply the location safe harbor, the employee's applicable location will be where the employee resides for the calendar month.³³

Employee's Applicable Age (Proposed Reg. §54-4980H-5(f)(7)(i))

Since the rate an employee will pay depends on the employee's age, the regulations provide the method for the employer to determine the employee's *applicable age*.

²⁹ Proposed Reg. §54-4980H-5(f)(6)(ii)

³⁰ Proposed Reg. §54-4980H-5(f)(6)(ii)

³¹ Proposed Reg. §54-4980H-5(f)(6)(ii)

³² Proposed Reg. §54-4980H-5(f)(6)(iii)

³³ Proposed Reg. §54-4980H-5(f)(7)(ii)

- The age for an employee who is or will be eligible for an individual coverage HRA on the first day of the plan year, the employee's age on that date will be his/her *applicable age*.
- If an employee first becomes eligible for an individual coverage HRA during the plan year, the employee's age on the date he/she first becomes eligible will be his/her *applicable age*.³⁴

Applicable Lowest Cost Silver Plan (Proposed Reg. §54.4980H-5(f)(7)(iii))

The lowest cost self-only coverage for the employee offered through the Exchange for the employee's applicable location for the month is treated as the applicable lowest cost silver plan under these regulations.³⁵

If the same ratings area has different lowest cost silver plans in different portions of the same ratings area, the plan available in the part of the rating area that contains the employee's applicable location is the plan that will be treated as the applicable lowest cost silver plan.³⁶

The lowest cost silver plan identified for employees of all ages is defined as follows:

(C) Lowest cost silver plan identified for use for employees of all ages. The applicable lowest cost silver plan for an employee is the lowest cost silver plan for the lowest age band in the individual market for the employee's applicable location.³⁷

Required HRA Contribution (Proposed Reg. §54-4980H-5(f)(7)(vii))

The required HRA contribution for purposes of the individual HRA rules is computed as follows:

In general, the required HRA contribution means the required HRA contribution as defined in §1.36B-2(c)(5)(ii) of this chapter. However, for purposes of the safe harbors set forth in this paragraph (f), the required HRA contribution is determined based on the applicable lowest cost silver plan as defined in paragraph (f)(7)(iii) of this section and the monthly premium for the applicable lowest cost silver plan is determined based on the employee's applicable age, as defined in

³⁴ Proposed Reg. §54-4980H-5(f)(7)(i)

³⁵ Proposed Reg. §54-4980H-5(f)(7)(iii)(A)

³⁶ Proposed Reg. §54-4980H-5(f)(7)(iii)(B)

³⁷ Proposed Reg. §54-4980H-5(f)(7)(iii)(C)

paragraph (f)(7)(i) of this section, and the employee's applicable location, as defined in paragraph (f)(7)(ii) of this section.³⁸

³⁸ Proposed Reg. §54-4980H-5(f)(7)(vii)

IRS Examples of Applying the Individual Coverage HRA Rules

The IRS provides the following two examples of applying these rules.

TEMPORARY REGULATION §54.4980H-5(F)(H) EXAMPLE 1

Location safe harbor and look-back month safe harbor applied to calendar-year individual coverage HRA)

(A) Facts. For 2020, Employer Y offers all full-time employees and their dependents an individual coverage HRA with a calendar-year plan year and makes \$6,000 available in the HRA for the 2020 calendar-year plan year to each full-time employee without regard to family size, which means the monthly HRA amount for each full-time employee is \$500. All of Employer Y's employees have a primary site of employment in City A. Employer Y chooses to use the location safe harbor and the look-back month safe harbor. Employer Y also chooses to use the rate of pay safe harbor for its full-time employees. Employee M is 40 years old on January 1, 2020, the first day of the plan year. The monthly premium for the applicable lowest cost silver plan for a 40 year old offered through the Exchange in City A for January 2019 is \$600. Employee M's required HRA contribution for each month of 2020 is \$100 (cost of the applicable lowest cost silver plan determined under the location safe harbor and the look-back month safe harbor (\$600) minus the monthly HRA amount (\$500)). The monthly amount determined under the rate of pay safe harbor for Employee M is \$2,000 for each month in 2020.

(B) Conclusion. Employer Y has made an offer of affordable, minimum value coverage to Employee M for purposes of section 4980H(b) for each month of 2020 because Employee M's required HRA contribution (\$100) is less than the amount equal to the required contribution percentage for 2020 multiplied by the monthly amount determined under the rate of pay safe harbor for Employee M (9.78 percent of \$2,000 = \$196). Employer Y will not be liable for an assessable payment under section 4980H(b) with respect to Employee M for any calendar month in 2020. (Also, Employer Y will not be liable for an assessable payment under section 4980H(a) for any calendar month in 2020 because it offered an individual coverage HRA, an eligible employer-sponsored plan that is minimum essential coverage, to all full-time employees and their dependents for each calendar month in 2020.)

TEMPORARY REGULATION §54.4980H-5(F)(H) EXAMPLE 2

Location safe harbor and look-back month safe harbor applied to non-calendar year individual coverage HRA

(A) Facts. Employer Z offers all full-time employees and their dependents an individual coverage HRA with a non-calendar year plan year of July 1, 2020 through June 30, 2021, and makes \$6,000 available in the HRA for the plan year to each full-time employee without regard to family size, which means the monthly HRA amount for each full-time employee is \$500. All of Employer Z's employees have a primary site of employment in City B. Employer Z chooses to use the location safe harbor and the look-back month safe harbor. Employer Z also chooses to use the rate of pay safe harbor for its full-time employees. Employee N is 40 years old on July 1, 2020, the first day of the plan year. The monthly premium for the applicable lowest cost silver plan for a 40 year old offered through the Exchange in City B for January 2020 is \$600. Employee N's required HRA contribution for each month of the plan year beginning July 1, 2020, is \$100 (cost of the applicable lowest cost silver plan determined under the location safe harbor and the look-back month safe harbor (\$600) minus the monthly HRA amount (\$500)). The monthly amount determined under the rate of pay safe harbor for Employee N is \$2,000 for each month of the plan year beginning July 1, 2020.

(B) Conclusion. Employer Z has made an offer of affordable, minimum value coverage to Employee N for purposes of section 4980H(b) for each month of the plan year beginning July 1, 2020, because Employee N's required HRA contribution (\$100) is less than the amount equal to the required contribution percentage for plan years beginning in 2020 multiplied by the monthly amount determined under the rate of pay safe harbor for Employee N (9.78 percent of \$2,000 = \$196). Employer Z will not be liable for an assessable payment under section 4980H(b) with respect to Employee N for any calendar month in the plan year beginning July 1, 2020. (Also, Employer Z will not be liable for an assessable payment under section 4980H(a) for any calendar month in the plan year beginning July 1, 2020, because it offered an individual coverage HRA, an eligible employer-sponsored plan that is minimum essential coverage, to all full-time employees and their dependents for each calendar month in that plan year.)

Revision to Anti-Discrimination Rules Under §105 for Individual Coverage HRAs

Employer paid medical expense plans (now referred to as HRAs) are generally subject to special anti-discrimination rules that don't apply to fully insured programs. Such rules could significantly compromise the use of individual coverage HRAs, so the IRS has added a special discrimination rule under §105(h) to apply to such plans.

The new provision, added at Proposed Reg. §1.105-11(c)(3)(i)(B)(2), provides:

(2) Exception to uniformity rule. With respect to an individual coverage HRA, as defined in §54.9802-4(b) of this chapter, if the maximum dollar amount made available varies for participants within a class of employees set forth in §54.9802-4(d) of this chapter, or varies between classes of employees offered the individual coverage HRA, the plan does not violate the requirements of this paragraph (c)(3) by virtue of that variance; provided that, within a class of employees, the maximum dollar amount made available varies only in accordance with the same terms requirement set forth in §54.9802-4(c)(3) of this chapter, and, with respect to differences in the maximum dollar amount made available for different classes of employees, each of the classes of employees is one of the classes of employees set forth in §54.9802-4(d) of this chapter. Specifically, with respect to age-based variances, in the case of an individual coverage HRA, if the maximum dollar amount made available to participants who are members of a particular class of employees increases based on the age of each participant and the increases in the maximum dollar amount comply with the age-variation rule under the same terms requirement set forth under §54.9802-4(c)(3)(iii)(B) of this chapter, the plan does not violate the requirements of this paragraph (c)(3) with respect to those increases.

However, the IRS warns that this rule does not eliminate the risk of issues. As the preamble notes:

Nonetheless, the Treasury Department and the IRS note that satisfying the terms of the safe harbors under the proposed regulations does not automatically satisfy the prohibition on nondiscriminatory operation under §1.105-11(c)(3)(ii). Thus, among other situations, if a disproportionate number of HCIs qualify for and utilize the maximum HRA amount allowed under the same terms requirement based on age in comparison to the number of non-HCIs who qualify for and use lower HRA amounts based on age, the individual coverage HRA may be found to be discriminatory, with the result that excess reimbursements of the HCIs will be included in their income.³⁹

If an individual coverage HRA fails to provide nondiscriminatory benefits under Reg. §1.105-11(c)(3)(i) solely due to variations in age, it will not be treated as providing

³⁹ REG-136401-19, p. 52

discriminatory benefits so long as the individual coverage HRA satisfies the age variation exemption under Reg. §54-9802-4(c)(3)(iii)(B). That special rule provides:

(B)Variation due to age. An HRA does not fail to be provided on the same terms to participants in a class of employees solely because the maximum dollar amount made available under the terms of the HRA to those participants to reimburse medical care expenses for any plan year increases as the age of the participant increases, so long as the requirements in paragraphs (c)(3)(iii)(B)(1) and (2) of this section are satisfied. For the purpose of this paragraph (c)(3)(iii)(B), the plan sponsor may determine the age of the participant using any reasonable method for a plan year, so long as the plan sponsor determines each participant's age for the purpose of this paragraph (c)(3)(iii)(B) using the same method for all participants in the class of employees for the plan year and the method is determined prior to the plan year.

(1) The same maximum dollar amount attributable to the increase in age is made available to all participants who are the same age.

(2) The maximum dollar amount made available to the oldest participant(s) is not more than three times the maximum dollar amount made available to the youngest participant(s).⁴⁰

Proposed Applicability Date

The preamble to the proposed regulations provides the following proposed applicability date. Note that these have been issued as *reliance proposed regulations* which allows taxpayers to rely upon these regulations for 2020 (and potentially later years):

The proposed regulations under section 4980H are proposed to apply for periods beginning after December 31, 2019, and the proposed regulations under section 105(h) are proposed to apply for plan years beginning after December 31, 2019. The Treasury Department and the IRS recognize that employers may want to offer individual coverage HRAs beginning on January 1, 2020, and, therefore, may need applicable guidance with respect to sections 4980H and/or 105(h) to design and implement programs involving individual coverage HRAs prior to the issuance of any final regulations and in advance of the plan year for which the individual coverage HRAs will be offered.

Accordingly, taxpayers may rely on the proposed regulations under section 4980H for periods during any plan year of individual coverage HRAs beginning before the date that is six months following the publication of any final regulations, and taxpayers may rely on the proposed regulations under section 105(h) for plan years of individual coverage HRAs beginning before the date that is six months following the publication of any final regulations.⁴¹

⁴⁰ Reg. §54-9802-4(c)(3)(iii)(B)

⁴¹ REG-136401-19, p. 54

