Chapter 2: Schedule K-1

Please note. Corrections were made to this workbook through January of 2020. No subsequent modifications were made. For clarification about acronyms used throughout this chapter, see the Acronym Glossary at the end of the Index.

For your convenience, in-text website links are also provided as short URLs. Anywhere you see **uofi.tax/xxx**, the link points to the address immediately following in brackets.

About the Author

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INTRODUCTION

Schedule K-1 (K-1) is a form provided to taxpayers to inform them of the taxable income, deductions, credits, and other information that flows through to them from their share of the activities reported on the following returns.

- Form 1065, *U.S. Return of Partnership Income*
- Form 1120S, *U.S. Income Tax Return for an S Corporation*
- Form 1041, *U.S. Income Tax Return for Estates and Trusts*

The full title of each type of K-1 is as follows.

- K-1 (Form 1065), *Partner's Share of Income, Deductions, Credits, etc.*
- K-1 (Form 1120S), *Shareholder's Share of Income, Deductions, Credits, etc.*
- K-1 (Form 1041), *Beneficiary's Share of Income, Deductions, Credits, etc.*

Although each type of K-1 is different, they share many commonalities. Page 1 of the K-1 lists the applicable amounts and page 2 lists the codes used on the K-1 and provides summarized reporting information for the recipients who file Form 1040. However, some of the items require more detailed explanations. Guidance for how to report those items is found in the instructions for the source form. Page 2 also tells the user where to look for additional information for certain items. Each partner is generally required to take into account separately the distributive share, whether or not distributed, of each class or item of partnership income, gain, loss, deduction, or credit.[1] For S Corporation shareholders, the character of any items of income, loss, deduction, or credit is determined for the S corporation and retains that character in the hands of the shareholder.[2]

> **Note.** Multiple member LLCs may elect to be taxed as a partnership, an S corporation, or a C corporation. While technically the investors are called "**members**," for tax purposes the investors are treated as partners or shareholders according to the type of tax election made at the entity level. Thus, this chapter does not refer to LLC members unless the tax rules are unique to LLC members.

In this chapter, the taxpayer issuing the K-1 is referred to as the **entity** if the rule is not specific to the type of taxpayer issuing the K-1. The recipient of the K-1 is referred to as an **individual.** Individuals owning shares of S corporation stock or an interest in a partnership are also referred to as **investors.**

Practitioner Planning Tip

Tax preparers need to review their individual clients' level of participation in any pass-through entity's activities to determine the benefits or limitations for items reported on Schedule K-1.

1. Treas. Reg. §1.702-1(a).
2. Treas. Reg. §1.1366-1(b).

QUALIFIED BUSINESS INCOME DEDUCTION[3]

For tax years beginning after 2017, individuals, estates, and trusts may be entitled to a deduction of up to 20% of their qualified business income (QBI) from a qualified trade or business, plus 20% of the aggregate amount of qualified real estate investment trust (REIT) dividends and qualified publicly traded partnership (PTP) income.[4] This deduction is called the qualified business income deduction (QBID). The QBID allowed for income attributable to a specified servicetrade or business (SSTB) is subject to additional limitations if the taxpayer's income is above certain thresholds.

Note. For more information about the QBID calculation including rules and definitions, see the 2019 *University of Illinois Federal Tax Workbook*, Volume B, Chapter 1: QBID Update.

Treas. Reg. §1.199A-1 uses the term **relevant pass-through entity** (RPE) to refer to a partnership (other than a PTP) or an S corporation that is owned, directly or indirectly, by at least one individual, estate, or trust.[5] A trust or estate is treated as an RPE to the extent it passes through QBI, W-2 wages, unadjusted basis immediately after acquisition (UBIA) of qualified property, qualified REIT dividends, or qualified PTP income.[6]

Individuals may claim the QBID for qualifying income that passes through to them from partnerships, S corporations, trusts, and estates. The K-1 from the entity is required to include the information necessary for the individual to calculate the QBID attributable to that entity. Consequently, it is the responsibility of the person who prepares the entity return to determine the following amounts related to the entity's operations.

1. QBI
2. W-2 wages from qualified trades or businesses
3. UBIA of qualified property
4. REIT dividends
5. PTP income

K-1s from S corporations and partnerships must report this information in the box for "other information" using specified codes for each reportable amount. K-1s from trusts and estates must use code I in box 14 to indicate that the information is included in a supplemental statement.

The instructions for Form 1040 include the **Qualified Business Income — Simplified Worksheet** (QBI-S Worksheet) for calculating a taxpayer's QBID. This worksheet may be used by the taxpayer if:

- Their 2018 taxable income does not exceed $157,500 ($315,000 for married filing jointly (MFJ)), and
- They are not a patron in a specified agricultural or horticultural cooperative.

Note. The taxable income threshold for 2019 is $321,400 for MFJ taxpayers, $160,725 for MFS taxpayers, and $160,700 for all other taxpayers.[7]

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3. Instructions for Schedule K-1 (Form 1065); Instructions for Schedule K-1 (Form 1120-S); and Instructions for Schedule K-1 (Form 1041).
4. IRC §199A.
5. Treas. Reg. §1.199A-1(b)(10).
6. Ibid.
7. Rev. Proc. 2018-57, 2018-49 IRB 827.

Note. Beginning in 2019, it would appear that Form 8995, *Qualified Business Income Deduction Simplified Computation,* and Form 8995-A, *Qualified Business Income Deduction,* will replace the QBI worksheet used in 2018. For more information, see the 2019 *University of Illinois Federal Tax Workbook,* Volume B, Chapter 1: QBID Update.

Taxpayers whose income exceeds the income thresholds or who are patrons in a specified cooperative can use additional worksheets and instructions contained in IRS Pub. 535, *Business Expenses*. Worksheet 12-A, *Qualified Business Income Deduction Worksheet,* is used to aggregate the information from the other worksheets in IRS Pub. 535, if necessary. The following table shows the codes that are used for each type of K-1 and where the item is included on the simplified worksheet.

Information the Recipients Need to Calculate the Deduction Under IRC §199A	Form 1065 K-1, Box 20 Code	Form 1120S K-1, Box 17 Code	QBI Simplified Worksheet
QBI	Z	V	Line 1
W-2 wages from qualified trades or businesses	AA	W	Not on worksheet
UBIA of qualified property	AB	X	Not on worksheet
REIT dividends	AC	Y	Line 6
Qualified PTP income	AD	Z	Line 6
SSTB (yes or no)	N/A	N/A	N/A

Example 1. Ursula is the 100% owner of Ursula, Inc., which is an S corporation. She is single. Her 2018 taxable income is $100,000. She is not a patron of a specified cooperative. She receives the following K-1 and completes the QBI-S Worksheet as shown after the K-1. Her QBID, as shown on the worksheet, is $20,000.

To complete the QBI-S Worksheet, the following information from box 17 of the K-1 is used. Because her income is not above the QBI threshold, the other information from box 17 (codes W and X) is not used on the worksheet.

Code V: Qualified business income	$150,000
Code Y: REIT dividends	5,000
Code Z: Qualified PTP income	0

For Example 1

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☐ Final K-1 ☐ Amended K-1 OMB No. 1545-0123

Schedule K-1 (Form 1120S) **2018**
Department of the Treasury
Internal Revenue Service

For calendar year 2018, or tax year

beginning / / 2018 ending / /

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
11-1111111

B Corporation's name, address, city, state, and ZIP code
Ursula Inc
15251 Bear Rd
Forest City, IL 61532

C IRS Center where corporation filed return

Part II Information About the Shareholder

D Shareholder's identifying number
111-11-1111

E Shareholder's name, address, city, state, and ZIP code
Ursula Bear
15251 Bear Rd
Forest City, IL 61532

F Shareholder's percentage of stock ownership for tax year . . . . 100 %

For IRS Use Only

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

1	Ordinary business income (loss)	150,000	13	Credits	
2	Net rental real estate income (loss)				
3	Other net rental income (loss)				
4	Interest income				
5a	Ordinary dividends	7,000			
5b	Qualified dividends	2,000	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	
			V		150,000
			W		75,000
			X		30,000
			Y		5,000

* See attached statement for additional information.

For Paperwork Reduction Act Notice, see the Instructions for Form 1120S. www.irs.gov/Form1120S Cat. No. 11520D **Schedule K-1 (Form 1120S) 2018**

For Example 1

2018 Qualified Business Income Deduction—Simplified Worksheet

Keep for Your Records

Before you begin: This worksheet is for taxpayers who:

- √ Have qualified business income, REIT dividends, or PTP income.
- √ Are not a patron in a specified agricultural or horticultural cooperative.
- √ Have taxable income of $157,500 or less ($315,000 or less if married filing jointly).

1.

	(a) Trade or business name	(b) Employer identification number	(c) Qualified business income or (loss)
i.	Ursula, Inc	11-1111111	150,000
ii.			
iii.			
iv.			

2.	Total qualified business income or (loss). Add the amounts in 1i through 1iv, column 1(c) . . . . **2.**	150,000	
	Note. If reporting qualified business income or (loss) from more than four trades or businesses, see the instructions for line 2 of this worksheet.		
3.	Qualified business loss carryforward from the prior year . . . . **3.**		
4.	Total qualified business income. Combine lines 2 and 3. If zero or less, enter -0- . . . . **4.**	150,000	
5.	Qualified business income component. Multiply line 4 by 20% (0.20) . . . . **5.**		30,000
6.	Qualified REIT dividends and PTP income or (loss) . . . . **6.**	5,000	
7.	Qualified REIT dividends and PTP loss carryforward from the prior year . . . . **7.**	( )	
8.	Total qualified REIT dividends and PTP income. Add lines 6 and 7. If zero or less, enter -0- . . . . **8.**	5,000	
9.	REIT and PTP component. Multiply line 8 by 20% (0.20) . . . . **9.**		1,000
10.	Qualified business income deduction before the income limitation. Add lines 5 and 9 . . . . **10.**		31,000
11.	Taxable income before qualified business income deduction . . . . **11.**	100,000	
12.	Net capital gain (see instructions) . . . . **12.**	0	
13.	Subtract line 12 from line 11. If zero or less, enter -0- . . . . **13.**	100,000	
14.	Income limitation. Multiply line 13 by 20% (0.20) . . . . **14.**		20,000
15.	Qualified business income deduction. Enter the smaller of line 10 or line 14 . . . . **15.**		20,000
16.	Total qualified business loss carryforward. Add lines 2 and 3. If more than zero, enter -0- . . . . **16.**		(0)
17.	Total qualified REIT dividends and PTP loss carryforward. Add lines 6 and 7. If more than zero, enter -0- . . . . **17.**		(0)

For Example 1

Schedule K-1 (Form 1120S) 2018 Page **2**

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

1. Ordinary business income (loss). Determine whether the income (loss) is passive or nonpassive and enter on your return as follows:

	Report on
Passive loss	See the Shareholder's Instructions
Passive income	Schedule E, line 28, column (h)
Nonpassive loss	See the Shareholder's Instructions
Nonpassive income	Schedule E, line 28, column (k)

2.	**Net rental real estate income (loss)**	See the Shareholder's Instructions
3.	**Other net rental income (loss)**	
	Net income	Schedule E, line 28, column (h)
	Net loss	See the Shareholder's Instructions
4.	**Interest income**	Form 1040, line 2b
5a.	**Ordinary dividends**	Form 1040, line 3b
5b.	**Qualified dividends**	Form 1040, line 3a
6.	**Royalties**	Schedule E, line 4
7.	**Net short-term capital gain (loss)**	Schedule D, line 5
8a.	**Net long-term capital gain (loss)**	Schedule D, line 12
8b.	**Collectibles (28%) gain (loss)**	28% Rate Gain Worksheet, line 4 (Schedule D instructions)
8c.	**Unrecaptured section 1250 gain**	See the Shareholder's Instructions
9.	**Net section 1231 gain (loss)**	See the Shareholder's Instructions
10.	**Other income (loss)**	

Code		
A	Other portfolio income (loss)	See the Shareholder's Instructions
B	Involuntary conversions	See the Shareholder's Instructions
C	Sec. 1256 contracts & straddles	Form 6781, line 1
D	Mining exploration costs recapture	See Pub. 535
E	Section 951A income	See the Shareholder's Instructions
F	Section 965(a) inclusion	See the Shareholder's Instructions
G	Subpart F income other than sections 951A and 965 inclusion	See the Shareholder's Instructions
H	Other income (loss)	See the Shareholder's Instructions

11. Section 179 deduction — See the Shareholder's Instructions

12. Other deductions

A	Cash contributions (60%)	See the Shareholder's Instructions
B	Cash contributions (30%)	See the Shareholder's Instructions
C	Noncash contributions (50%)	See the Shareholder's Instructions
D	Noncash contributions (30%)	See the Shareholder's Instructions
E	Capital gain property to a 50% organization (30%)	See the Shareholder's Instructions
F	Capital gain property (20%)	See the Shareholder's Instructions
G	Contributions (100%)	See the Shareholder's Instructions
H	Investment interest expense	Form 4952, line 1
I	Deductions—royalty income	Schedule E, line 19
J	Section 59(e)(2) expenditures	See the Shareholder's Instructions
K	Section 965(c) deduction	See the Shareholder's Instructions
L	Deductions—portfolio (other)	Schedule A, line 16
M	Preproductive period expenses	See the Shareholder's Instructions
N	Commercial revitalization deduction from rental real estate activities	See Form 8582 instructions
O	Reforestation expense deduction	See the Shareholder's Instructions
P	through **R**	Reserved for future use
S	Other deductions	See the Shareholder's Instructions

13. Credits

A	Low-income housing credit (section 42(j)(5)) from pre-2008 buildings	See the Shareholder's Instructions
B	Low-income housing credit (other) from pre-2008 buildings	See the Shareholder's Instructions
C	Low-income housing credit (section 42(j)(5)) from post-2007 buildings	See the Shareholder's Instructions
D	Low-income housing credit (other) from post-2007 buildings	See the Shareholder's Instructions
E	Qualified rehabilitation expenditures (rental real estate)	See the Shareholder's Instructions
F	Other rental real estate credits	See the Shareholder's Instructions
G	Other rental credits	See the Shareholder's Instructions
H	Undistributed capital gains credit	Schedule 5 (Form 1040), line 74, box a
I	Biofuel producer credit	See the Shareholder's Instructions
J	Work opportunity credit	See the Shareholder's Instructions
K	Disabled access credit	See the Shareholder's Instructions
L	Empowerment zone employment credit	See the Shareholder's Instructions
M	Credit for increasing research activities	See the Shareholder's Instructions
N	Credit for employer social security and Medicare taxes	See the Shareholder's Instructions

Code		*Report on*
O	Backup withholding	See the Shareholder's Instructions
P	Other credits	See the Shareholder's Instructions

14. Foreign transactions

A	Name of country or U.S. possession	Form 1116, Part I
B	Gross income from all sources	Form 1116, Part I
C	Gross income sourced at shareholder level	Form 1116, Part I
	Foreign gross income sourced at corporate level	
D	Section 951A category	Form 1116, Part I
E	Foreign branch category	Form 1116, Part I
F	Passive category	Form 1116, Part I
G	General category	Form 1116, Part I
H	Other	Form 1116, Part I
	Deductions allocated and apportioned at shareholder level	
I	Interest expense	Form 1116, Part I
J	Other	Form 1116, Part I
	Deductions allocated and apportioned at corporate level to foreign source income	
K	Section 951A category	Form 1116, Part I
L	Foreign branch category	Form 1116, Part I
M	Passive category	Form 1116, Part I
N	General category	Form 1116, Part I
O	Other	Form 1116, Part I
	Other information	
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	Section 965 information	See the Shareholder's Instructions
V	Other foreign transactions	See the Shareholder's Instructions

15. Alternative minimum tax (AMT) items

A	Post-1986 depreciation adjustment	See the Shareholder's Instructions and the Instructions for Form 6251
B	Adjusted gain or loss	See the Shareholder's Instructions and the Instructions for Form 6251
C	Depletion (other than oil & gas)	See the Shareholder's Instructions and the Instructions for Form 6251
D	Oil, gas, & geothermal—gross income	See the Shareholder's Instructions and the Instructions for Form 6251
E	Oil, gas, & geothermal—deductions	See the Shareholder's Instructions and the Instructions for Form 6251
F	Other AMT items	See the Shareholder's Instructions and the Instructions for Form 6251

16. Items affecting shareholder basis

A	Tax-exempt interest income	Form 1040, line 2a
B	Other tax-exempt income	See the Shareholder's Instructions
C	Nondeductible expenses	See the Shareholder's Instructions
D	Distributions	See the Shareholder's Instructions
E	Repayment of loans from shareholders	See the Shareholder's Instructions

17. Other information

A	Investment income	Form 4952, line 4a
B	Investment expenses	Form 4952, line 5
C	Qualified rehabilitation expenditures (other than rental real estate)	See the Shareholder's Instructions
D	Basis of energy property	See the Shareholder's Instructions
E	Recapture of low-income housing credit (section 42(j)(5))	Form 8611, line 8
F	Recapture of low-income housing credit (other)	Form 8611, line 8
G	Recapture of investment credit	See Form 4255
H	Recapture of other credits	See the Shareholder's Instructions
I	Look-back interest—completed long-term contracts	See Form 8697
J	Look-back interest—income forecast method	See Form 8866
K	Dispositions of property with section 179 deductions	See the Shareholder's Instructions
L	Recapture of section 179 deduction	See the Shareholder's Instructions
M	through **U**	See the Shareholder's Instructions
V	Section 199A income	See the Shareholder's Instructions
W	Section 199A W-2 wages	See the Shareholder's Instructions
X	Section 199A unadjusted basis	See the Shareholder's Instructions
Y	Section 199A REIT dividends	See the Shareholder's Instructions
Z	Section 199A PTP income	See the Shareholder's Instructions
AA	Excess taxable income	See the Shareholder's Instructions
AB	Excess business interest income	See the Shareholder's Instructions
AC	Other information	See the Shareholder's Instructions

Example 2. Use the same facts as **Example 1,** except Ursula's 2018 taxable income is $200,000. The business is not an SSTB. Ursula must use the worksheet found in IRS Pub. 535 to calculate her QBID. Her 2018 QBID is $31,000.

To complete Worksheet 12-A, the following information from box 17 of the K-1 is used.

Code V: Qualified business income	$150,000
Code W: W-2 wages from qualified trades or businesses	75,000
Code X: UBIA of qualified property	30,000
Code Y: REIT dividends	5,000
Code Z: Qualified PTP income	0

Worksheet 12-A. **Qualified Business Income Deduction Worksheet** *Keep for Your Records*

Part I: Trade, Business, or Aggregation Information

1. (a) Name	(b) Check if specified service	(c) Check if Aggregated	(d) Taxpayer identification number	(e) Check if Patron
A. **Ursula, Inc**	☐	☐	**11-1111111**	☐
B.	☐	☐		☐
C.	☐	☐		☐

Part II: Determine Your Qualified Business Income Component

	A	B	C
2. Qualified business income from the trade, business, or aggregation (see instructions)	**150,000**		
3. Multiply line 2 by 20% (0.20). If your taxable income is $157,500 or less ($315,000 if married filing jointly), skip lines 4 through 12 and enter line 3 on line 13	**30,000**		
4. Allocable share of W-2 wages from the trade, business, or aggregation	**75,000**		
5. Multiply line 4 by 50% (0.50)	**37,500**		
6. Multiply line 4 by 25% (0.25)	**18,750**		
7. Allocable share of the unadjusted basis of all qualified property	**30,000**		
8. Multiply line 7 by 2.5% (0.025)	**750**		
9. Add lines 6 and 8	**19,500**		
10. Enter the greater of line 5 or line 9	**37,500**		
11. W-2 wage and qualified property limitation. Enter the smaller of line 3 or line 10	**30,000**		
12. Phased-in reduction. Enter amount from Part III, line 26, if any. See instructions	**0**		
13. Qualified business income deduction before patron reduction. Enter the greater of line 11 or line 12	**30,000**		
14. Patron reduction. Enter the amount from Schedule D, line 6, if any	**0**		
15. Qualified business income component. Subtract line 14 from line 13	**30,000**		
16. Total qualified business income component. Add all amounts reported on line 15	**30,000**		

Part III: Phased-in Reduction

Caution. Complete Part III only if your taxable income is more than $157,500 but not $207,500 ($315,000 and $415,000 if married filing jointly), and line 10 is less than line 3. Otherwise, skip Part III.

		A	B	C
17. Enter amounts from line 3				
18. Enter the amount from line 10				
19. Subtract line 18 from line 17				
20. Taxable income before qualified business income deduction				
21. Threshold. Enter $157,500 ($315,000 if married filing jointly)				

For Example 2

22. Subtract line 21 from line 20			
23. Phase-in range. Enter $50,000 ($100,000 if married filing jointly)			
24. Phase-in percentage. Divide line 22 by line 23			
25. Total phase-in reduction. Multiply line 19 by line 24			
26. Qualified business income after phase-in reduction. Subtract line 25 from line 17. Enter this amount on line 12 for the corresponding trade or business			

Part IV: Determine Your Qualified Business Income Deduction				
27. Total qualified business income component from all qualified trades, businesses, or aggregations. Enter the amount from Part II, line 16	27.	**30,000**		
28. Qualified REIT dividends and qualified PTP income or (loss) (see instructions)	28.	**5,000**		
29. Qualified REIT dividends and qualified PTP loss carryforward from prior years. Enter as a negative number	29.			
30. Total qualified REIT dividends and qualified PTP income. Add lines 28 and 29. If less than zero, enter -0-	30.	**5,000**		
31. REIT and PTP component. Multiply line 30 by 20% (0.20)	31.	**1,000**		
32. Qualified business income deduction before the income limitation. Add lines 27 and 31			32.	**31,000**
33. Taxable income before qualified business income deduction	33.	**200,000**		
34. Net capital gain (see instructions)	34.	**0**		
35. Subtract line 34 from line 33. If zero or less, enter -0-	35.	**200,000**		
36. Income limitation. Multiply line 35 by 20% (0.20)			36.	**40,000**
37. Qualified business income deduction. Enter the smaller of line 32 or line 36			37.	**31,000**
38. Total qualified REIT dividend and qualified PTP loss carryforward. Add lines 28 and 29, if zero or greater enter -0-			38.	**0**
39. DPAD under section 199A(g) allocated from an agricultural or horticultural cooperative. Don't enter more than line 33 minus line 37. Enter this deduction on Form 1040, line 10. See the instructions for Form 1040, line 10			39.	**0**

DISALLOWED LOSSES AND DEDUCTIONS[8]

QBI does not include any disallowed losses or disallowed deductions because they are not included in taxable income for the year. Instead, these losses are taken into account in the tax year in which they are allowed in order to determine taxable income. **However, losses or deductions that were disallowed for tax years ending before January 1, 2018, are not taken into account for purposes of computing QBI in a later tax year.**[9]

Losses and deductions that may carry forward from years prior to January 1, 2018, include those limited under the following Code provisions.[10]

1. Basis provisions for S corporation shareholders and partnership members (IRC §§1366(d) and 704)
2. At-risk provisions for S corporation shareholders and partnership members (IRC §§1366(d) and 465)
3. Passive activities (IRC §469)
4. Partnership economic effect (IRC §704(d))

The excess business loss limitations under IRC §461(l) are first applicable to tax years beginning after December 31, 2017. Accordingly, losses from activities reported on Schedule K-1 in 2018 that carry forward under this provision affect the calculation of QBI in the year that they are allowed.

8. Instructions for Form 1040.

9. Treas. Reg. §1.199A-3(b)(1)(iv).

10. Ibid.

> **Note.** For a discussion of the IRC §461(l) excess business loss limitations, see the 2019 *University of Illinois Federal Tax Workbook,* Volume B, Chapter 2: New Developments.

GENERAL CAUTIONS AND OBSERVATIONS

When preparing a return on which the QBID is claimed, tax professionals should keep the following points in mind.

1. The QBID allowed for income attributable to an SSTB is subject to additional limitations if the taxpayer's income is above the income threshold. A K-1 will not indicate if the business is an SSTB. However, a statement should be attached to the K-1 indicating the nature of each trade or business reported. Practitioners should consult with their clients about the nature of the business reported on the K-1 if the taxpayer's income exceeds the applicable threshold.

2. If the QBI reported on the K-1 appears incorrect, practitioners should obtain the permission of the taxpayer to consult with the person who prepared the K-1 to determine if the amount is actually incorrect. If it is not correct, the preparer of the entity return should amend the entity's return. The IRS has not provided guidance on what to do if the return preparer refuses to amend the return.

3. Because disallowed losses and deductions are not included in QBI, the QBI attributable to income passed through from an entity may not equal the QBI reported on the K-1. Practitioners may wish to attach some type of disclosure and explanation if they use amounts different than those reported on the K-1 in calculating an individual's QBID. Form 8275, *Disclosure Statement,* may be used to include additional information with a return in order to avoid certain penalties.[11]

4. Solely for QBID purposes, the rental or licensing of tangible or intangible property to a related trade or business is treated as a trade or business if the rental or licensing of property and the other trade or business are commonly controlled.[12] Thus, if the individual taxpayer is renting property to the business reported on the K-1, the individual may include the net rental income in QBI.

QBI ISSUES REGARDING IRC §179 REPORTED ON K-1

QBI includes only items of income, gain, deduction, and loss from trades or businesses that are included or allowed in determining taxable income for the year.[13] Therefore, when calculating the QBID, the taxpayer's QBI from the trade or business reported on the K-1 should not include an IRC §179 deduction that the taxpayer is not able to claim.

The IRC §179 deduction is separately stated on the K-1. Even though the entity meets the requirements to claim the deduction, the taxpayer may not be able to claim the entire amount reported on the K-1. The taxpayer's allowed deduction may be limited based on the following three factors.

1. The maximum IRC §179 deduction per return is $1.02 million for 2019.[14]

2. To the extent that the taxpayer's cost of §179 property placed in service during the 2019 tax year exceeds $2.55 million,[15] the maximum deduction is reduced by the excess. (When applying this provision, the **cost** of property placed in service by the pass-through entity is not included in the total **cost.**[16]**)**

> **Note.** For information about the application of the §179 limits, see IRS Pub. 946, *How To Depreciate Property.*

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11. Instructions for Form 8275.
12. Treas. Reg. §1.199A-1(b)(14).
13. Instructions for Form 1040. See also REG-107892-18 [www.irs.gov/pub/irs-drop/reg-107892-18.pdf] Accessed on Jan. 10, 2019.
14. Rev. Proc. 2018-57, 2018-49 IRB 827.
15. Ibid.
16. IRS Pub. 946, *How To Depreciate Property*.

3. The deduction is limited to the taxpayer's taxable income for that tax year that is derived from the taxpayer's **active** conduct of **any trade or business** during that year. Accordingly, a passive investor may not deduct any §179 deduction from an activity in which they do not meaningfully participate, even though the deduction is included on the K-1.[17]

Note. The IRS instructions for preparing K-1s do not specifically address how the §179 deduction should be treated when calculating the amount reported as QBI on the K-1. If the amount of the taxpayer's allowed deduction is different from the amount reported on the K-1, practitioners should adjust the amount of QBI used in the QBID calculation.

There are two common reasons for the §179 deduction to be limited on an individual's return even though the entity-level limitations have already been applied. The first is that the individual may not meet the active participation test. The second is that the items of income and loss used to determine the QBID limitations are not always the same as those used for the §179 limitations.

Active Conduct

If taxpayers are not allowed to use the §179 deduction because they fail the active-conduct test, the disallowed §179 deductions are suspended until the asset is disposed of or the taxpayers' interests in the entity are disposed of.[18]

Example 3. Nancy has investments in a number of ventures, including a 25% interest in DG Enterprises (DG), an S corporation. Nancy did not actively participate in DG's business in 2019. For the 2019 tax year, DG reported the following amounts on Nancy's K-1.

Ordinary business income (box 1)	$40,000
§179 deduction (box 11)	10,000
QBI (box 17, code V)	40,000

The $10,000 deduction from DG is carried forward until the asset is disposed of by DG or Nancy disposes of her interest in the S corporation. Because this deduction is not included in determining her 2019 taxable income, it should also be excluded when determining her QBI. Thus, Nancy should use $40,000 as her QBI from this entity. However, if Nancy had been able to use the §179 deduction of $10,000, her QBI would be $30,000.

Caution. There appears to be inconsistency in how software packages are treating the QBI amount reported on the K-1 when a §179 expense is involved. The QBI amount is reported in box 20, code Z, for a partnership; box 17, code V, for an S corporation; or box 14, code I, for estates and trusts. Some software packages are netting the §179 amount against the QBI reported in this box, but others are not.

17. Treas. Reg. §§1.179-2(c)(1) and (c)(6).

18. Shareholder's Instructions for Schedule K-1 (Form 1120S).

Trade or Business

The definition of income from the "active conduct of any trade or business" for purposes of the §179 deduction and delimitation of income from a "qualified trade or business" for the QBID are not the same. The following chart summarizes whether certain types of income are included for purposes of calculating the limit on each deduction.

	Included in Income for Purposes of...	
	IRC §179 Deduction	QBID (IRC §199A)
Wages	Yes	No
Guaranteed payments	Yes	No
Payments to partner for services to partnership	Yes	No
Passive trade or business	No	Yes
Rental activities qualified as trade or business	Yes	Yes
Commonly controlled rental property with trade or business	No [a]	Yes [b]
Section 1231 gains/losses from noncapital assets	Yes	Maybe [c]
Capital gains and losses	No	No

[a] Absent a grouping election
[b] Treas. Reg. §1.199A-4(b)(1)(i)
[c] Treas. Reg. §1.199A-3(b)(2)(ii)(A)

Because some of these items are included in income for one purpose, but not the other, it is possible for a taxpayer to qualify for the QBID even if their business income is insufficient for the §179 deduction. It is also possible for the §179 deduction to be allowed even though a taxpayer's QBI is zero or negative for the year.

What happens when the §179 deduction exceeds business income for QBI purposes but is allowed because of other income, such as wages?

QBI includes all items of income, gain, deduction, and loss from trades or businesses that are included or allowed in determining taxable income for the year. Thus, regardless of the type of income that is used to qualify for the §179 deduction, the deduction is included in QBI. For example, if an individual has a Schedule C business loss that includes the §179 deduction that is allowed because the taxpayer's wages are included in the calculation of income for §179 purposes, the taxpayer's QBI from all businesses is also reduced by the §179 deduction.

If the taxpayer has a net loss from all of their qualified business activities for the year, the loss is carried forward for purposes of calculating the QBID for the subsequent year.[19]

Example 4. Joe is a 25% partner in TFM, LLC, which is his only source of income in 2018.

Joe received the following K-1 from the partnership for 2018. The business incurred an ordinary loss of $15,000 for the year. It paid Joe $44,000 in guaranteed payments and passed through a §179 deduction of $8,000.

For §179 purposes, Joe's business income was $29,000 ($44,000 guaranteed payments – $15,000 loss). Joe deducted the full §179 deduction of $8,000 passed through to him from the partnership.

For QBID purposes, Joe's QBI was a loss of $23,000 ($15,000 ordinary loss + $8,000 IRC §179 deduction). His 2018 QBID was $0.

Note. Guaranteed payments, like wages, are not added back to net income or considered separately as QBI even though, in all likelihood, the guaranteed payments will be subject to self-employment (SE) tax.

19. IRC §199A(c)(2).

For Example 4

651118

☐ Final K-1 ☐ Amended K-1 OMB No. 1545-0123

Schedule K-1 (Form 1065) 2018
Department of the Treasury
Internal Revenue Service

For calendar year 2018, or tax year beginning / / 2018 ending / /

Partner's Share of Income, Deductions, Credits, etc. ► See back of form and separate instructions.

Part I Information About the Partnership

A Partnership's employer identification number
44-3456789

B Partnership's name, address, city, state, and ZIP code
TFM LLC
45 Callow Ln
Allentown, PA 18104

C IRS Center where partnership filed return
Ogden

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

Part II Information About the Partner

E Partner's identifying number
333-44-5678

F Partner's name, address, city, state, and ZIP code
Joe Lonesome
13 S 5th Ave
Allentown, PA 18104

G ☒ General partner or LLC member-manager ☐ Limited partner or other LLC member

H ☐ Domestic partner ☐ Foreign partner

I1 What type of entity is this partner? **Individual**

I2 If this partner is a retirement plan (IRA/SEP/Keogh/etc.), check here ☐

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

	Beginning	Ending
Profit	25 %	25 %
Loss	25 %	25 %
Capital	25 %	25 %

K Partner's share of liabilities:

	Beginning	Ending
Nonrecourse	$	$
Qualified nonrecourse financing	$	$
Recourse	$	$

L Partner's capital account analysis:

Beginning capital account	$ 50,000
Capital contributed during the year	$
Current year increase (decrease)	$ (23,000)
Withdrawals & distributions	$( )
Ending capital account	$ 27,000

☒ Tax basis ☐ GAAP ☐ Section 704(b) book
☐ Other (explain)

M Did the partner contribute property with a built-in gain or loss?
☐ Yes ☒ No
If "Yes," attach statement (see instructions)

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

1	Ordinary business income (loss)	(15,000)
2	Net rental real estate income (loss)	
3	Other net rental income (loss)	
4	Guaranteed payments	44,000
5	Interest income	
6a	Ordinary dividends	
6b	Qualified dividends	
6c	Dividend equivalents	
7	Royalties	
8	Net short-term capital gain (loss)	
9a	Net long-term capital gain (loss)	
9b	Collectibles (28%) gain (loss)	
9c	Unrecaptured section 1250 gain	
10	Net section 1231 gain (loss)	
11	Other income (loss)	
12	Section 179 deduction	8,000
13	Other deductions	
14	Self-employment earnings (loss)	
A		29,000
C		100,000

15	Credits	
16	Foreign transactions	
17	Alternative minimum tax (AMT) items	
18	Tax-exempt income and nondeductible expenses	
19	Distributions	
20	Other information	
Z		(15,000)
AA		0
AB		200,000
AC, AD		0,0

*See attached statement for additional information.

For IRS Use Only

For Paperwork Reduction Act Notice, see Instructions for Form 1065. www.irs.gov/Form1065 Cat. No. 11394R **Schedule K-1 (Form 1065) 2018**

For Example 4

Schedule K-1 (Form 1065) 2018 Page **2**

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

1. Ordinary business income (loss). Determine whether the income (loss) is passive or nonpassive and enter on your return as follows.

	Report on
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)	
Net income	Schedule E, line 28, column (h)
Net loss	See the Partner's Instructions
4. Guaranteed payments	Schedule E, line 28, column (k)
5. Interest income	Form 1040, line 2b
6a. Ordinary dividends	Form 1040, line 3b
6b. Qualified dividends	Form 1040, 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)	
Code	
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	Schedule 1 (Form 1040), line 21 or Form 982
F Section 951A income **G** Section 965(a) inclusion **H** Subpart F income other than sections 951A and 965 inclusion **I** Other income (loss)	See the Partner's Instructions
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%)	See the Partner's Instructions
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), line 29
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	See the Partner's Instructions
T through **V**	Reserved for future use
W Other deductions	See the Partner's Instructions
X Section 965(c) deduction	See the Partner's Instructions
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	See the Partner's Instructions
H Undistributed capital gains credit	Schedule 5 (Form 1040), line 74, box a
I Biofuel producer credit	See the Partner's Instructions

Code	*Report on*
J Work opportunity credit **K** Disabled access credit **L** Empowerment zone employment credit **M** Credit for increasing research activities **N** Credit for employer social security and Medicare taxes **O** Backup withholding **P** Other credits	See the Partner's Instructions
16. Foreign transactions	
A Name of country or U.S. possession **B** Gross income from all sources **C** Gross income sourced at partner level	Form 1116, Part I
Foreign gross income sourced at partnership level	
D Section 951A category **E** Foreign branch category **F** Passive category **G** General category **H** Other	Form 1116, Part I
Deductions allocated and apportioned at partner level	
I Interest expense	Form 1116, Part I
J Other	Form 1116, Part I
Deductions allocated and apportioned at partnership level to foreign source income	
K Section 951A category **L** Foreign branch category **M** Passive category **N** General category **O** Other	Form 1116, Part I
Other information	
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 Section 951A(c)(1)(A) tested income **V** Tested foreign income tax **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 **C** Depletion (other than oil & gas) **D** Oil, gas, & geothermal—gross income **E** Oil, gas, & geothermal—deductions **F** Other AMT items	See the Partner's Instructions and the Instructions for Form 6251
18. Tax-exempt income and nondeductible expenses	
A Tax-exempt interest income	Form 1040, 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 **C** Other property	See the Partner's Instructions
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)	See the Partner's Instructions
E Basis of energy property	See the Partner's Instructions
F Recapture of low-income housing credit (section 42(j)(5))	Form 8611, line 8
G Recapture of low-income housing credit (other)	Form 8611, line 8
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 8866
L Dispositions of property with section 179 deductions **M** Recapture of section 179 deduction **N** Interest expense for corporate partners **O** through **Y** **Z** Section 199A income **AA** Section 199A W-2 wages **AB** Section 199A unadjusted basis **AC** Section 199A REIT dividends **AD** Section 199A PTP income **AE** Excess taxable income **AF** Excess business interest income **AG** Gross receipts for section 59A(e) **AH** Other information	See the Partner's Instructions

Example 5. Use the same facts as **Example 4**. For 2019, Joe receives a K-1 from the partnership showing QBI (box 20, code Z) of $19,000.

Joe's 2019 total QBI shown on the QBI-S Worksheet is $0, calculated as follows.

QBI from 2019 activities	$19,000
Qualified business loss carryforward from 2018	(23,000)
Combination of 2018 qualified business loss and 2019 QBI	($ 4,000)
Total QBI, if zero or less, enter $0	$ 0

It is possible for the §179 deduction to be limited because of insufficient qualified income but for the taxpayer to still have a QBID. In this case, the deferred §179 deduction is not included in QBI until the year that it is included in expenses on the return.

Example 6. Bruce is the sole shareholder of an S corporation that rents its office building from him personally. In 2018, he also started a new unrelated business venture that he operated as a sole proprietorship. His 2018 tax return included the following.

Net ordinary income from box 1 of the K-1	$21,000
Business loss from sole proprietorship	(25,000)
Pass-through §179 deduction from box 11 of the K-1	(15,000)
Net real estate rental income from corporate office	80,000

Bruce's 2018 business income for the §179 limitation was $0 because the sole proprietorship loss was combined with the net ordinary income from the S corporation to yield a $4,000 loss ($21,000 income – $25,000 loss). The $15,000 IRC §179 deduction carried forward to 2019.

Bruce's 2018 QBI was calculated as follows.

QBI reported in box 17, code V ($21,000 ordinary income – $15,000 §179)	$ 6,000
Plus: deferred §179 deduction	15,000
Less: business loss from sole proprietorship	(25,000)
Plus: net real estate rental income from corporate office	80,000
Total net QBI	$76,000

The deferred §179 deduction was not included in the QBI calculation because it was not included on the 2018 return. It will be taken into account in the year the deduction is allowed.

Practitioner Planning Tip

While **Example 6** concludes the QBID (but not the §179 deduction) is allowed for this self-rental activity, tax professionals are encouraged to ask probing questions to determine the facts and circumstances of the taxpayer's involvement in the rental activity. If it can be concluded that the taxpayer's involvement is regular, continuous, and has a profit motive (such as is the requirement for QBID) and the taxpayer engaged in active conduct of the rental activity (triple net leases do not typically meet this requirement), then it could be determined that the rental activity does rise to the level of active conduct of a trade or business and therefore the net rental income could be utilized to allow the §179 deduction.

Practitioner Planning Tip

In **Example 6,** Bruce may wish to contact the preparer of the entity return, indicating his inability to benefit from §179 and perhaps encourage them to use a different method, such as regular depreciation or bonus depreciation.

IRC §179 Adjustments in Future Years

If the taxpayer is not allowed to claim the §179 deduction in the tax year reported, practitioners must adjust the QBI attributable to the business in subsequent years. Adjustments need to be made in every year that the deferred §179 deduction affects the taxpayer's return, including the year of disposition of the related asset (discussed next).

Dispositions of IRC §179 Assets. Partnerships and S corporations are required to report dispositions of §179 property separately to each shareholder on a statement attached to the K-1. Partnerships indicate the disposition using code L in box 20 and S corporations use code K in box 17. The statement must include the following.[20]

- A description of the property
- The date the property was acquired and placed in service
- The date of the sale or other disposition of the property
- The individual's share of the gross sales price or amount realized
- The individual's share of the cost or other basis plus the expense of sale
- The individual's share of depreciation allowed or allowable
- The individual's share of the §179 deduction (if any) passed through for the property and the partnership's or S corporation's tax year(s) in which the amount was passed through
- If the disposition is due to a casualty or theft, a statement indicating so, and any additional information needed by the individual
- For an installment sale made during the entity's tax year, any information the individual needs to complete Form 6252, *Installment Sale Income*

The individual taxpayer must report the sale of the asset on Form 4797, *Sales of Business Property*.[21] To determine the amount of depreciation allowed or allowable, it must be determined how much of the original §179 deduction was previously claimed. If any of the original §179 deduction is still unclaimed due to the taxable income or passive activity limitations, the unused portion is deducted from the total depreciation allowed or allowable for that asset.

Note. For more information about reporting the sale on Form 4797, see the 2016 *University of Illinois Federal Tax Workbook,* Volume A, Chapter 2: S Corporation Shareholder Issues. This can be found at **uofi.tax/arc** [taxschool.illinois.edu/taxbookarchive].

As discussed previously in this chapter, losses or deductions that were disallowed for tax years beginning before January 1, 2018, are **not** taken into account for purposes of computing QBI in a later tax year.[22] Therefore, the amount of gain from the sale of the asset may be greater for QBI purposes than for income tax purposes.

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20. Instructions for Form 1065 and Instructions for Form 1120S.

21. Instructions for Form 4797.

22. Treas. Reg. §1.199A-3(b)(1)(iv).

Example 7. Minerva is a passive investor in Mercurial Muses, LLC (MM LLC). In 2015, MM LLC purchased a state-of-the-art printing press. Minerva's proportionate share of the purchase price was $10,000. The company claimed the entire purchase price as an IRC §179 deduction on its 2015 return. Because Minerva was not actively participating in the operation of the business, she could not claim the deduction on her personal return.

In 2018, the company sold the printing press. Minerva's share of the sales price was $7,500. The K-1 Minerva received for the year included the required identifying information. She calculated the amount of allowed or allowable depreciation to report on Form 4797 as follows.

Depreciation allowed or allowable (as reported on the K-1 supplementary statement)	$ 0
Plus: Minerva's share of the §179 expense deduction claimed by the entity	10,000
Less: Minerva's unused carryover of the §179 deduction for this property	(10,000)
Minerva's depreciation allowed or allowable	$ 0

As shown on the following Form 4797, Minerva realized a loss of $2,500 on the disposition of the asset subject to passive activity limitations. When calculating Minerva's QBI from MM LLC, Minerva added back the $10,000 of §179 carryover from 2015 that was used to calculate her 2018 taxable income. Therefore, her income from the disposition for QBI purposes was $7,500 ($2,500 loss + $10,000 IRC §179 carryover from 2015).

Caution. According to Treas. Reg. §1.199A-3(b)(1)(iv):

> *... losses or deductions that were disallowed, suspended, limited, or carried over from taxable years ending before January 1, 2018 (including under sections 465, 469, 704(d), and 1366(d)), are not taken into account in a later taxable year for purposes of computing QBI.*

Although pre-2018 suspended §179 deductions are not specifically mentioned, in **Example 7**, it is assumed that they are also not taken into account in computing QBI.

For Example 7

Form **4797** | Department of the Treasury Internal Revenue Service

Sales of Business Property
(Also Involuntary Conversions and Recapture Amounts Under Sections 179 and 280F(b)(2))
▶ Attach to your tax return.
▶ Go to *www.irs.gov/Form4797* for instructions and the latest information.

OMB No. 1545-0184 | 2018 | Attachment Sequence No. 27

Name(s) shown on return	Identifying number
Minerva	555-15-5151

1 Enter the gross proceeds from sales or exchanges reported to you for 2018 on Form(s) 1099-B or 1099-S (or substitute statement) that you are including on line 2, 10, or 20. See instructions	1	

Part I Sales or Exchanges of Property Used in a Trade or Business and Involuntary Conversions From Other Than Casualty or Theft—Most Property Held More Than 1 Year (see instructions)

2 (a) Description of property	(b) Date acquired (mo., day, yr.)	(c) Date sold (mo., day, yr.)	(d) Gross sales price	(e) Depreciation allowed or allowable since acquisition	(f) Cost or other basis, plus improvements and expense of sale	(g) Gain or (loss) Subtract (f) from the sum of (d) and (e)
Printing press	02/27/2015	08/25/2018	7,500	0	10,000	(2,500)

3 Gain, if any, from Form 4684, line 39	3	
4 Section 1231 gain from installment sales from Form 6252, line 26 or 37	4	
5 Section 1231 gain or (loss) from like-kind exchanges from Form 8824	5	
6 Gain, if any, from line 32, from other than casualty or theft	6	
7 Combine lines 2 through 6. Enter the gain or (loss) here and on the appropriate line as follows	7	(2,500)
Partnerships and S corporations. Report the gain or (loss) following the instructions for Form 1065, Schedule K, line 10, or Form 1120S, Schedule K, line 9. Skip lines 8, 9, 11, and 12 below. **Individuals, partners, S corporation shareholders, and all others.** If line 7 is zero or a loss, enter the amount from line 7 on line 11 below and skip lines 8 and 9. If line 7 is a gain and you didn't have any prior year section 1231 losses, or they were recaptured in an earlier year, enter the gain from line 7 as a long-term capital gain on the Schedule D filed with your return and skip lines 8, 9, 11, and 12 below.		
8 Nonrecaptured net section 1231 losses from prior years. See instructions	8	
9 Subtract line 8 from line 7. If zero or less, enter -0-. If line 9 is zero, enter the gain from line 7 on line 12 below. If line 9 is more than zero, enter the amount from line 8 on line 12 below and enter the gain from line 9 as a long-term capital gain on the Schedule D filed with your return. See instructions	9	

Part II Ordinary Gains and Losses (see instructions)

10 Ordinary gains and losses not included on lines 11 through 16 (include property held 1 year or less):

11 Loss, if any, from line 7	11	(2,500)
12 Gain, if any, from line 7 or amount from line 8, if applicable	12	
13 Gain, if any, from line 31	13	
14 Net gain or (loss) from Form 4684, lines 31 and 38a	14	
15 Ordinary gain from installment sales from Form 6252, line 25 or 36	15	
16 Ordinary gain or (loss) from like-kind exchanges from Form 8824	16	
17 Combine lines 10 through 16	17	(2,500)
18 For all except individual returns, enter the amount from line 17 on the appropriate line of your return and skip lines a and b below. For individual returns, complete lines a and b below.		
a If the loss on line 11 includes a loss from Form 4684, line 35, column (b)(ii), enter that part of the loss here. Enter the loss from income-producing property on Schedule A (Form 1040), line 16. (Do not include any loss on property used as an employee.) Identify as from "Form 4797, line 18a." See instructions	18a	
b Redetermine the gain or (loss) on line 17 excluding the loss, if any, on line 18a. Enter here and on Schedule 1 (Form 1040), line 14	18b	(2,500)

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 13086I Form **4797** (2018)

NET INVESTMENT INCOME TAX

The net investment income tax (NIIT) applies to investment income above certain thresholds. S corporation and partnership income passed through to the taxpayer is subject to this tax if the taxpayer **does not materially** participate in the operations of the company.[23]

Income from K-1s is generally included on line 4a of Form 8960, *Net Investment Income Tax — Individuals, Estates, and Trusts.* Income from dispositions of property that is reported on a K-1 is also included on line 5a.

Note. If the taxpayer materially participates in the activity of the entity, an adjustment must be made on lines 4b and 5b of the Form 8960 to subtract the income not subject to the NIIT.[24]

Example 8. Sapphire owns shares in Newton Publishing, Inc. (Newton), an S corporation. She works full time promoting Newton's publications. Her 2018 K-1 showed ordinary income of $1 million, a net IRC §1231 gain of $50,000, and a §179 deduction of $10,000. On Form 8960, the ordinary income and the §179 deduction were netted and reported on line 4a ($1 million − $10,000 = $990,000). The §1231 gain was reported on line 5a.

To show that these items of income were not subject to the NIIT, the qualifying excluded amounts were reported on lines 4b and 5b, respectively. The relevant portion of Sapphire's 2018 Form 8960 follows.

Form **8960** | **Net Investment Income Tax— Individuals, Estates, and Trusts** | OMB No. 1545-2227 | **2018**

Department of the Treasury Internal Revenue Service (99)

▶ Attach to your tax return.
▶ Go to *www.irs.gov/Form8960* for instructions and the latest information.

Attachment Sequence No. **72**

Name(s) shown on your tax return: **Sapphire** — Your social security number or EIN: **111-22-1111**

Part I **Investment Income**
☐ Section 6013(g) election (see instructions)
☐ Section 6013(h) election (see instructions)
☐ Regulations section 1.1411-10(g) election (see instructions)

1	Taxable interest (see instructions)			1	
2	Ordinary dividends (see instructions)			2	
3	Annuities (see instructions)			3	
4a	Rental real estate, royalties, partnerships, S corporations, trusts, etc. (see instructions)	4a	990,000		
b	Adjustment for net income or loss derived in the ordinary course of a non-section 1411 trade or business (see instructions)	4b	(990,000)		
c	Combine lines 4a and 4b			4c	0
5a	Net gain or loss from disposition of property (see instructions)	5a	50,000		
b	Net gain or loss from disposition of property that is not subject to net investment income tax (see instructions)	5b	(50,000)		
c	Adjustment from disposition of partnership interest or S corporation stock (see instructions)	5c			
d	Combine lines 5a through 5c			5d	0
6	Adjustments to investment income for certain CFCs and PFICs (see instructions)			6	
7	Other modifications to investment income (see instructions)			7	
8	Total investment income. Combine lines 1, 2, 3, 4c, 5d, 6, and 7			8	0

Investment Expenses Allocable to Investment Income and Modifications

Note. Taxpayers frequently engage in multiple activities through a single entity. The taxpayer may materially participate in only some of these activities. This results in an **investor** receiving both active and passive income from the same entity. A separate accounting of active and passive income is necessary for NIIT purposes.

23. IRC §1411.

24. Instructions for Form 8960.

SELECT K-1 ISSUES

CREDITS

Almost any type of business tax credit for which the entity qualifies is passed through to the K-1 recipients. Most of these tax credits are reported directly in part III of Form 3800, *General Business Credit*. Generally, the recipient does not have to complete the source credit form or attach it to Form 3800 if they are an individual taxpayer and the only source for a credit listed on Form 3800, part III, is from a partnership, S corporation, estate, trust, or cooperative. Instead of reporting the information on the source form, they can report this credit directly on Form 3800, part III, and enter the employer identification number (EIN) of the entity in column (b) of part III.[25]

Credits are reported in box 15 of the K-1 for partnerships and in box 13 of the K-1 for S corporations. Various codes are used to differentiate the types of credits reported on the K-1.

> **Example 9.** Railroad Fare, Inc. operates a restaurant and has tipped employees. The corporation is taxed as an S corporation. Each year the company completes Form 8846, *Credit for Employer Social Security and Medicare Taxes Paid on Certain Employee Tips*, to determine the amount of credit the company is qualified to receive. The credit is apportioned among the shareholders and reported in box 13 under code N of each shareholder's K-1.
>
> Barry is a 40% owner of the corporation. His 2018 net income tax was $15,416 before applying any credits. He actively participates in the business. He received a K-1 for 2018, showing that his share of the tip credit is $10,000. He completed Form 3800 as shown next to claim the credit.

25. Partner Instructions for Schedule K-1 (Form 1065).

For Example 9

Form **3800**
Department of the Treasury
Internal Revenue Service (99)

General Business Credit

► Go to *www.irs.gov/Form3800* for instructions and the latest information.
► You must attach all pages of Form 3800, pages 1, 2, and 3, to your tax return.

OMB No. 1545-0895
2018
Attachment Sequence No. **22**

Name(s) shown on return	Identifying number
Barry	455-55-9999

Part I **Current Year Credit for Credits Not Allowed Against Tentative Minimum Tax (TMT)**
(See instructions and complete Part(s) III before Parts I and II.)

1	General business credit from line 2 of all Parts III with box A checked			1	
2	Passive activity credits from line 2 of all Parts III with box B checked	2			
3	Enter the applicable passive activity credits allowed for 2018. See instructions			3	
4	Carryforward of general business credit to 2018. Enter the amount from line 2 of Part III with box C checked. See instructions for statement to attach			4	
5	Carryback of general business credit from 2019. Enter the amount from line 2 of Part III with box D checked. See instructions			5	
6	Add lines 1, 3, 4, and 5			6	

Part II **Allowable Credit**

7	Regular tax before credits: • Individuals. Enter the sum of the amounts from Form 1040, line 11a, and Schedule 2 (Form 1040), line 46, or the sum of the amounts from Form 1040NR, lines 42 and 44 • Corporations. Enter the amount from Form 1120, Schedule J, Part I, line 2; or the applicable line of your return • Estates and trusts. Enter the sum of the amounts from Form 1041, Schedule G, lines 1a and 1b; or the amount from the applicable line of your return			7	15,416
8	Alternative minimum tax: • Individuals. Enter the amount from Form 6251, line 11 • Corporations. Enter -0- • Estates and trusts. Enter the amount from Schedule I (Form 1041), line 56			8	
9	Add lines 7 and 8			9	15,416
10a	Foreign tax credit	10a			
b	Certain allowable credits (see instructions)	10b			
c	Add lines 10a and 10b			10c	
11	**Net income tax.** Subtract line 10c from line 9. If zero, skip lines 12 through 15 and enter -0- on line 16			11	15,416
12	**Net regular tax.** Subtract line 10c from line 7. If zero or less, enter -0-	12	15,416		
13	Enter 25% (0.25) of the excess, if any, of line 12 over $25,000. See instructions	13			
14	Tentative minimum tax: • Individuals. Enter the amount from Form 6251, line 9 • Corporations. Enter -0- • Estates and trusts. Enter the amount from Schedule I (Form 1041), line 54	14			
15	Enter the greater of line 13 or line 14			15	
16	Subtract line 15 from line 11. If zero or less, enter -0-			16	15,416
17	Enter the **smaller** of line 6 or line 16 **C corporations:** See the line 17 instructions if there has been an ownership change, acquisition, or reorganization.			17	

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 12392F Form **3800** (2018)

For Example 9

Form 3800 (2018) Page **2**

Part II **Allowable Credit** *(continued)*

Note: If you are not required to report any amounts on line 22 or 24 below, skip lines 18 through 25 and enter -0- on line 26.

18	Multiply line 14 by 75% (0.75). See instructions	**18**	
19	Enter the greater of line 13 or line 18	**19**	
20	Subtract line 19 from line 11. If zero or less, enter -0-	**20**	
21	Subtract line 17 from line 20. If zero or less, enter -0-	**21**	
22	Combine the amounts from line 3 of all Parts III with box A, C, or D checked	**22**	
23	Passive activity credit from line 3 of all Parts III with box B checked **23**		
24	Enter the applicable passive activity credit allowed for 2018. See instructions	**24**	
25	Add lines 22 and 24	**25**	
26	Empowerment zone and renewal community employment credit allowed. Enter the smaller of line 21 or line 25	**26**	**0**
27	Subtract line 13 from line 11. If zero or less, enter -0-	**27**	**15,416**
28	Add lines 17 and 26	**28**	
29	Subtract line 28 from line 27. If zero or less, enter -0-	**29**	**15,416**
30	Enter the general business credit from line 5 of all Parts III with box A checked	**30**	**10,000**
31	Reserved	**31**	
32	Passive activity credits from line 5 of all Parts III with box B checked **32**		
33	Enter the applicable passive activity credits allowed for 2018. See instructions	**33**	
34	Carryforward of business credit to 2018. Enter the amount from line 5 of Part III with box C checked and line 6 of Part III with box G checked. See instructions for statement to attach	**34**	
35	Carryback of business credit from 2019. Enter the amount from line 5 of Part III with box D checked. See instructions	**35**	
36	Add lines 30, 33, 34, and 35	**36**	**10,000**
37	Enter the **smaller** of line 29 or line 36	**37**	**10,000**
38	**Credit allowed for the current year.** Add lines 28 and 37. Report the amount from line 38 (if smaller than the sum of Part I, line 6, and Part II, lines 25 and 36, see instructions) as indicated below or on the applicable line of your return. • Individuals. Schedule 3 (Form 1040), line 54, or Form 1040NR, line 51 • Corporations. Form 1120, Schedule J, Part I, line 5c • Estates and trusts. Form 1041, Schedule G, line 2b	**38**	**10,000**

Form **3800** (2018)

For Example 9

Form 3800 (2018) Page **3**

Name(s) shown on return	Identifying number
Barry	455-55-9999

Part III **General Business Credits or Eligible Small Business Credits** (see instructions)

Complete a separate Part III for each box checked below. See instructions.

- **A** ☒ General Business Credit From a Non-Passive Activity
- **B** ☐ General Business Credit From a Passive Activity
- **C** ☐ General Business Credit Carryforwards
- **D** ☐ General Business Credit Carrybacks
- **E** ☐ Reserved
- **F** ☐ Reserved
- **G** ☐ Eligible Small Business Credit Carryforwards
- **H** ☐ Reserved

I If you are filing more than one Part III with box A or B checked, complete and attach first an additional Part III combining amounts from all Parts III with box A or B checked. Check here if this is the consolidated Part III . . . ▶ ☐

	(a) Description of credit **Note:** On any line where the credit is from more than one source, a separate Part III is needed for each pass-through entity.		**(b)** If claiming the credit from a pass-through entity, enter the EIN	**(c)** Enter the appropriate amount
1a	Investment (Form 3468, Part II only) (attach Form 3468)	**1a**		
b	Reserved	**1b**		
c	Increasing research activities (Form 6765)	**1c**		
d	Low-income housing (Form 8586, Part I only)	**1d**		
e	Disabled access (Form 8826) (see instructions for limitation)	**1e**		
f	Renewable electricity, refined coal, and Indian coal production (Form 8835)	**1f**		
g	Indian employment (Form 8845)	**1g**		
h	Orphan drug (Form 8820)	**1h**		
i	New markets (Form 8874)	**1i**		
j	Small employer pension plan startup costs (Form 8881) (see instructions for limitation)	**1j**		
k	Employer-provided child care facilities and services (Form 8882) (see instructions for limitation)	**1k**		
l	Biodiesel and renewable diesel fuels (attach Form 8864)	**1l**		
m	Low sulfur diesel fuel production (Form 8896)	**1m**		
n	Distilled spirits (Form 8906)	**1n**		
o	Nonconventional source fuel (carryforward only)	**1o**		
p	Energy efficient home (Form 8908)	**1p**		
q	Energy efficient appliance (carryforward only)	**1q**		
r	Alternative motor vehicle (Form 8910)	**1r**		
s	Alternative fuel vehicle refueling property (Form 8911)	**1s**		
t	Enhanced oil recovery credit (Form 8830)	**1t**		
u	Mine rescue team training (Form 8923)	**1u**		
v	Agricultural chemicals security (carryforward only)	**1v**		
w	Employer differential wage payments (Form 8932)	**1w**		
x	Carbon oxide sequestration (Form 8933)	**1x**		
y	Qualified plug-in electric drive motor vehicle (Form 8936)	**1y**		
z	Qualified plug-in electric vehicle (carryforward only)	**1z**		
aa	Employee retention (Form 5884-A)	**1aa**		
bb	General credits from an electing large partnership (Schedule K-1 (Form 1065-B))	**1bb**		
zz	Other. Oil and gas production from marginal wells (Form 8904) and certain other credits (see instructions)	**1zz**		
2	Add lines 1a through 1zz and enter here and on the applicable line of Part I	**2**		
3	Enter the amount from Form 8844 here and on the applicable line of Part II	**3**		
4a	Investment (Form 3468, Part III) (attach Form 3468)	**4a**		
b	Work opportunity (Form 5884)	**4b**		
c	Biofuel producer (Form 6478)	**4c**		
d	Low-income housing (Form 8586, Part II)	**4d**		
e	Renewable electricity, refined coal, and Indian coal production (Form 8835)	**4e**		
f	Employer social security and Medicare taxes paid on certain employee tips (Form 8846)	**4f**	45-9999999	10,000
g	Qualified railroad track maintenance (Form 8900)	**4g**		
h	Small employer health insurance premiums (Form 8941)	**4h**		
i	Increasing research activities (Form 6765)	**4i**		
j	Employer credit for paid family and medical leave (Form 8994)	**4j**		
z	Other	**4z**		
5	Add lines 4a through 4z and enter here and on the applicable line of Part II	**5**		10,000
6	Add lines 2, 3, and 5 and enter here and on the applicable line of Part II	**6**		10,000

Form **3800** (2018)

In addition to using Form 3800, if the credits are from a passive activity, the taxpayer must also complete Form 8582-CR, *Passive Activity Credit Limitations*, to determine the amount of the credit that they may claim. Any credits from passive activities that exceed the tax attributable to the taxpayer's passive activities are carried forward.[26]

Example 10. Use the same facts as **Example 9,** except Barry is a **passive** investor. Each year he must complete Form 8582-CR to determine the amount of credit he may claim. Only the tax attributable to passive income may be offset by credits from passive activities. For 2018, in addition to the $40,000 of ordinary income passed through to him by the corporation, he reported $60,000 in wages from an unrelated business. The following forms show how his credit of $8,911 is claimed.

The calculation for Form 8582-CR, line 6 (per the instructions for Form 8582-CR, page 11) follows.[27]

Gross income	$100,000	
Less: standard deduction	(12,000)	
Taxable income including net passive income	$ 88,000	
Tax owed on $88,000		$15,416
Less: net passive income	(40,000)	
Taxable income without net passive income	$ 48,000	
Less: tax owed on $48,000		(6,505)
Amount to enter on Form 8582-CR, line 6		$ 8,911

26. Instructions for Form 8582-CR.

27. Ibid.

For Example 10

Form **3800**

Department of the Treasury
Internal Revenue Service (99)

General Business Credit

▶ Go to *www.irs.gov/Form3800* for instructions and the latest information.
▶ You must attach all pages of Form 3800, pages 1, 2, and 3, to your tax return.

OMB No. 1545-0895
2018
Attachment Sequence No. 22

Name(s) shown on return: Barry
Identifying number: 455-55-9999

Part I Current Year Credit for Credits Not Allowed Against Tentative Minimum Tax (TMT)
(See instructions and complete Part(s) III before Parts I and II.)

1	General business credit from line 2 of all Parts III with box A checked			1	
2	Passive activity credits from line 2 of all Parts III with box B checked	2			
3	Enter the applicable passive activity credits allowed for 2018. See instructions			3	0
4	Carryforward of general business credit to 2018. Enter the amount from line 2 of Part III with box C checked. See instructions for statement to attach			4	
5	Carryback of general business credit from 2019. Enter the amount from line 2 of Part III with box D checked. See instructions			5	
6	Add lines 1, 3, 4, and 5			6	0

Part II Allowable Credit

7	Regular tax before credits: • Individuals. Enter the sum of the amounts from Form 1040, line 11a, and Schedule 2 (Form 1040), line 46, or the sum of the amounts from Form 1040NR, lines 42 and 44 • Corporations. Enter the amount from Form 1120, Schedule J, Part I, line 2; or the applicable line of your return • Estates and trusts. Enter the sum of the amounts from Form 1041, Schedule G, lines 1a and 1b; or the amount from the applicable line of your return			7	15,416
8	Alternative minimum tax: • Individuals. Enter the amount from Form 6251, line 11 • Corporations. Enter -0- • Estates and trusts. Enter the amount from Schedule I (Form 1041), line 56			8	0
9	Add lines 7 and 8			9	15,416
10a	Foreign tax credit	10a			
b	Certain allowable credits (see instructions)	10b			
c	Add lines 10a and 10b			10c	
11	**Net income tax.** Subtract line 10c from line 9. If zero, skip lines 12 through 15 and enter -0- on line 16			11	15,416
12	**Net regular tax.** Subtract line 10c from line 7. If zero or less, enter -0-	12	15,416		
13	Enter 25% (0.25) of the excess, if any, of line 12 over $25,000. See instructions	13	0		
14	Tentative minimum tax: • Individuals. Enter the amount from Form 6251, line 9 • Corporations. Enter -0- • Estates and trusts. Enter the amount from Schedule I (Form 1041), line 54	14	7,722		
15	Enter the greater of line 13 or line 14			15	7,722
16	Subtract line 15 from line 11. If zero or less, enter -0-			16	7,694
17	Enter the **smaller** of line 6 or line 16			17	0
	C corporations: See the line 17 instructions if there has been an ownership change, acquisition, or reorganization.				

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 12392F Form **3800** (2018)

For Example 10

Form 3800 (2018) Page **2**

Part II **Allowable Credit** *(continued)*

Note: If you are not required to report any amounts on line 22 or 24 below, skip lines 18 through 25 and enter -0- on line 26.

18	Multiply line 14 by 75% (0.75). See instructions		**18**	5,792
19	Enter the greater of line 13 or line 18		**19**	5,792
20	Subtract line 19 from line 11. If zero or less, enter -0-		**20**	9,624
21	Subtract line 17 from line 20. If zero or less, enter -0-		**21**	9,624
22	Combine the amounts from line 3 of all Parts III with box A, C, or D checked		**22**	
23	Passive activity credit from line 3 of all Parts III with box B checked	**23**		
24	Enter the applicable passive activity credit allowed for 2018. See instructions		**24**	0
25	Add lines 22 and 24		**25**	0
26	Empowerment zone and renewal community employment credit allowed. Enter the smaller of line 21 or line 25		**26**	0
27	Subtract line 13 from line 11. If zero or less, enter -0-		**27**	15,416
28	Add lines 17 and 26		**28**	0
29	Subtract line 28 from line 27. If zero or less, enter -0-		**29**	15,416
30	Enter the general business credit from line 5 of all Parts III with box A checked		**30**	
31	Reserved		**31**	
32	Passive activity credits from line 5 of all Parts III with box B checked	**32** 10,000		
33	Enter the applicable passive activity credits allowed for 2018. See instructions		**33**	8,911
34	Carryforward of business credit to 2018. Enter the amount from line 5 of Part III with box C checked and line 6 of Part III with box G checked. See instructions for statement to attach		**34**	
35	Carryback of business credit from 2019. Enter the amount from line 5 of Part III with box D checked. See instructions		**35**	
36	Add lines 30, 33, 34, and 35		**36**	8,911
37	Enter the **smaller** of line 29 or line 36		**37**	8,911
38	**Credit allowed for the current year.** Add lines 28 and 37. Report the amount from line 38 (if smaller than the sum of Part I, line 6, and Part II, lines 25 and 36, see instructions) as indicated below or on the applicable line of your return. • Individuals. Schedule 3 (Form 1040), line 54, or Form 1040NR, line 51 • Corporations. Form 1120, Schedule J, Part I, line 5c • Estates and trusts. Form 1041, Schedule G, line 2b		**38**	8,911

Form **3800** (2018)

For Example 10

Form 3800 (2018) Page **3**

Name(s) shown on return	Identifying number
Barry	455-55-9999

Part III General Business Credits or Eligible Small Business Credits (see instructions)

Complete a separate Part III for each box checked below. See instructions.

- **A** ☐ General Business Credit From a Non-Passive Activity
- **B** ☒ General Business Credit From a Passive Activity
- **C** ☐ General Business Credit Carryforwards
- **D** ☐ General Business Credit Carrybacks
- **E** ☐ Reserved
- **F** ☐ Reserved
- **G** ☐ Eligible Small Business Credit Carryforwards
- **H** ☐ Reserved

I If you are filing more than one Part III with box A or B checked, complete and attach first an additional Part III combining amounts from all Parts III with box A or B checked. Check here if this is the consolidated Part III . . . ▶ ☐

	(a) Description of credit **Note:** On any line where the credit is from more than one source, a separate Part III is needed for each pass-through entity.		**(b)** If claiming the credit from a pass-through entity, enter the EIN	**(c)** Enter the appropriate amount
1a	Investment (Form 3468, Part II only) (attach Form 3468)	**1a**		
b	Reserved	**1b**		
c	Increasing research activities (Form 6765)	**1c**		
d	Low-income housing (Form 8586, Part I only)	**1d**		
e	Disabled access (Form 8826) (see instructions for limitation)	**1e**		
f	Renewable electricity, refined coal, and Indian coal production (Form 8835)	**1f**		
g	Indian employment (Form 8845)	**1g**		
h	Orphan drug (Form 8820)	**1h**		
i	New markets (Form 8874)	**1i**		
j	Small employer pension plan startup costs (Form 8881) (see instructions for limitation)	**1j**		
k	Employer-provided child care facilities and services (Form 8882) (see instructions for limitation)	**1k**		
l	Biodiesel and renewable diesel fuels (attach Form 8864)	**1l**		
m	Low sulfur diesel fuel production (Form 8896)	**1m**		
n	Distilled spirits (Form 8906)	**1n**		
o	Nonconventional source fuel (carryforward only)	**1o**		
p	Energy efficient home (Form 8908)	**1p**		
q	Energy efficient appliance (carryforward only)	**1q**		
r	Alternative motor vehicle (Form 8910)	**1r**		
s	Alternative fuel vehicle refueling property (Form 8911)	**1s**		
t	Enhanced oil recovery credit (Form 8830)	**1t**		
u	Mine rescue team training (Form 8923)	**1u**		
v	Agricultural chemicals security (carryforward only)	**1v**		
w	Employer differential wage payments (Form 8932)	**1w**		
x	Carbon oxide sequestration (Form 8933)	**1x**		
y	Qualified plug-in electric drive motor vehicle (Form 8936)	**1y**		
z	Qualified plug-in electric vehicle (carryforward only)	**1z**		
aa	Employee retention (Form 5884-A)	**1aa**		
bb	General credits from an electing large partnership (Schedule K-1 (Form 1065-B))	**1bb**		
zz	Other. Oil and gas production from marginal wells (Form 8904) and certain other credits (see instructions)	**1zz**		
2	Add lines 1a through 1zz and enter here and on the applicable line of Part I	**2**		
3	Enter the amount from Form 8844 here and on the applicable line of Part II	**3**		
4a	Investment (Form 3468, Part III) (attach Form 3468)	**4a**		
b	Work opportunity (Form 5884)	**4b**		
c	Biofuel producer (Form 6478)	**4c**		
d	Low-income housing (Form 8586, Part II)	**4d**		
e	Renewable electricity, refined coal, and Indian coal production (Form 8835)	**4e**		
f	Employer social security and Medicare taxes paid on certain employee tips (Form 8846)	**4f**	45-9999999	10,000
g	Qualified railroad track maintenance (Form 8900)	**4g**		
h	Small employer health insurance premiums (Form 8941)	**4h**		
i	Increasing research activities (Form 6765)	**4i**		
j	Employer credit for paid family and medical leave (Form 8994)	**4j**		
z	Other	**4z**		
5	Add lines 4a through 4z and enter here and on the applicable line of Part II	**5**		10,000
6	Add lines 2, 3, and 5 and enter here and on the applicable line of Part II	**6**		10,000

Form **3800** (2018)

For Example 10

Form **8582-CR** (Rev. January 2012) Department of the Treasury Internal Revenue Service

Passive Activity Credit Limitations

▶ See separate instructions.
▶ Attach to Form 1040 or 1041.

OMB No. 1545-1034
Attachment Sequence No. 89

Name(s) shown on return: Barry
Identifying number: 455-55-9999

Part I Passive Activity Credits

Caution: *If you have credits from a publicly traded partnership, see* ***Publicly Traded Partnerships (PTPs)*** *in the instructions.*

	Credits From Rental Real Estate Activities With Active Participation (Other Than Rehabilitation Credits and Low-Income Housing Credits) (See **Lines 1a through 1c** in the instructions.)				
1a	Credits from Worksheet 1, column (a)	1a			
b	Prior year unallowed credits from Worksheet 1, column (b)	1b			
c	Add lines 1a and 1b			1c	
	Rehabilitation Credits From Rental Real Estate Activities and Low-Income Housing Credits for Property Placed in Service Before 1990 (or From Pass-Through Interests Acquired Before 1990) (See **Lines 2a through 2c** in the instructions.)				
2a	Credits from Worksheet 2, column (a)	2a			
b	Prior year unallowed credits from Worksheet 2, column (b)	2b			
c	Add lines 2a and 2b			2c	
	Low-Income Housing Credits for Property Placed in Service After 1989 (See **Lines 3a through 3c** in the instructions.)				
3a	Credits from Worksheet 3, column (a)	3a			
b	Prior year unallowed credits from Worksheet 3, column (b)	3b			
c	Add lines 3a and 3b			3c	
	All Other Passive Activity Credits (See **Lines 4a through 4c** in the instructions.)				
4a	Credits from Worksheet 4, column (a)	4a	10,000		
b	Prior year unallowed credits from Worksheet 4, column (b)	4b			
c	Add lines 4a and 4b			4c	10,000
5	Add lines 1c, 2c, 3c, and 4c			5	10,000
6	Enter the tax attributable to net passive income (see instructions)			6	8,911
7	Subtract line 6 from line 5. If line 6 is more than or equal to line 5, enter -0- and see instructions			7	1,089

Note: *If your filing status is married filing separately and you lived with your spouse at any time during the year,* ***do not*** *complete Part II, III, or IV. Instead, go to line 37.*

Part II Special Allowance for Rental Real Estate Activities With Active Participation

Note: *Complete this part only if you have an amount on line 1c. Otherwise, go to Part III.*

8	Enter the smaller of line 1c or line 7					8	
9	Enter $150,000. If married filing separately, see instructions			9			
10	Enter modified adjusted gross income, but not less than zero (see instructions). If line 10 is equal to or more than line 9, skip lines 11 through 15 and enter -0- on line 16			10			
11	Subtract line 10 from line 9			11			
12	Multiply line 11 by 50% (.50). **Do not** enter more than $25,000. If married filing separately, see instructions			12			
13a	Enter the amount, if any, from line 10 of Form 8582	13a					
b	Enter the amount, if any, from line 14 of Form 8582	13b					
c	Add lines 13a and 13b			13c			
14	Subtract line 13c from line 12			14			
15	Enter the tax attributable to the amount on line 14 (see instructions)					15	
16	Enter the **smaller** of line 8 or line 15					16	

For Paperwork Reduction Act Notice, see instructions. Cat. No. 64641R Form **8582-CR** (Rev. 01-2012)

For Example 10

Form 8582-CR (Rev. 01-2012) Page **2**

Part III **Special Allowance for Rehabilitation Credits From Rental Real Estate Activities and Low-Income Housing Credits for Property Placed in Service Before 1990 (or From Pass-Through Interests Acquired Before 1990)**

Note: *Complete this part only if you have an amount on line 2c. Otherwise, go to Part IV.*

17	Enter the amount from line 7		17	
18	Enter the amount from line 16		18	
19	Subtract line 18 from line 17. If zero, enter -0- here and on lines 30 and 36, and then go to Part V		19	
20	Enter the **smaller** of line 2c or line 19		20	
21	Enter $250,000. If married filing separately, see instructions to find out if you can skip lines 21 through 26	21		
22	Enter modified adjusted gross income, but not less than zero. (See instructions for line 10.) If line 22 is equal to or more than line 21, skip lines 23 through 29 and enter -0- on line 30	22		
23	Subtract line 22 from line 21	23		
24	Multiply line 23 by 50% (.50). Do not enter more than $25,000. If married filing separately, see instructions	24		
25a	Enter the amount, if any, from line 10 of Form 8582	25a		
b	Enter the amount, if any, from line 14 of Form 8582	25b		
c	Add lines 25a and 25b	25c		
26	Subtract line 25c from line 24	26		
27	Enter the tax attributable to the amount on line 26 (see instructions)	27		
28	Enter the amount, if any, from line 18	28		
29	Subtract line 28 from line 27		29	
30	Enter the **smaller** of line 20 or line 29		30	

Part IV **Special Allowance for Low-Income Housing Credits for Property Placed in Service After 1989**

Note: *Complete this part only if you have an amount on line 3c. Otherwise, go to Part V.*

31	If you completed Part III, enter the amount from line 19. Otherwise, subtract line 16 from line 7	31	
32	Enter the amount from line 30	32	
33	Subtract line 32 from line 31. If zero, enter -0- here and on line 36	33	
34	Enter the **smaller** of line 3c or line 33	34	
35	Tax attributable to the remaining special allowance (see instructions)	35	
36	Enter the **smaller** of line 34 or line 35	36	

Part V **Passive Activity Credit Allowed**

37	**Passive Activity Credit Allowed.** Add lines 6, 16, 30, and 36. See instructions to find out how to report the allowed credit on your tax return and how to allocate allowed and unallowed credits if you have more than one credit or credits from more than one activity. If you have any credits from a publicly traded partnership, see **Publicly Traded Partnerships (PTPs)** in the instructions.	37	8,911

Part VI **Election To Increase Basis of Credit Property**

38 If you disposed of your entire interest in a passive activity or former passive activity in a fully taxable transaction, and you elect to increase your basis in credit property used in that activity by the unallowed credit that reduced your basis in the property, check this box. See instructions ▶ ☐

39 Name of passive activity disposed of ▶

40 Description of the credit property for which the election is being made ▶

41 Amount of unallowed credit that reduced your basis in the property ▶ $

Form **8582-CR** (Rev. 01-2012)

A tax credit that passes through to a partner or shareholder does not directly affect the investor's basis.[28]

Example 11. Jennifer owns 100% of Maltese Visions, Inc. (Maltese), an S corporation that provides private detective services. In 2019, Maltese incurred $30,000 in expenses to provide its employees with health insurance. The corporation qualified for a small employer health insurance premium tax credit[29] of $10,000. On its Form 1120S, *U.S. Income Tax Return for an S Corporation,* the corporation claimed the net expense of $20,000.

The corporation's pass-through ordinary loss for 2019 was $15,000. At the beginning of the year, Jennifer's stock and loan basis were both zero. Although Jennifer cannot claim the loss on her 2019 individual return, she can claim the pass-through credit of $10,000. Her basis is not affected by claiming the credit.

FOREIGN TRANSACTIONS

Foreign transactions may qualify for special tax treatment of the foreign income and/or credits for taxes paid on the foreign income. However, these tax benefits may be limited based on the individual's tax situation. Therefore, the applicable IRS instructions (i.e., Forms 1120S, 1065, or 1041) require entities to report such information separately on the K-1s and/or in supplemental statements to the recipients. One of the most common foreign transactions reported is the payment of foreign tax. The following example illustrates how the K-1 is used in this situation.

Example 12. Rowden is the beneficiary of an estate. In 2018, the estate paid foreign taxes on dividends it received via mutual fund holdings. The estate reports the foreign taxes paid on the K-1 in box 14, ("other information") with code B and includes the additional information in a separate statement attached to the K-1. The statement contains the following information.

Foreign taxes paid	$ 900
Foreign source dividends	9,000
Source: regulated investment company/mutual funds	RIC
Total gross income	10,000
Fiduciary expenses paid	2,000
Fiduciary expenses allocated to foreign source income	1,800

Rowden uses the information provided to complete Form 1116, *Foreign Tax Credit*, which is shown following her K-1.

Note. For more information about the foreign tax credit, see the 2019 *University of Illinois Federal Tax Workbook,* Volume B, Chapter 6: Special Taxpayers.

28. IRC §§1367 and 1368.

29. See IRC §45R.

For Example 12

661117

☐ Final K-1 ☐ Amended K-1 OMB No. 1545-0092

Schedule K-1 (Form 1041) **2018**

Department of the Treasury
Internal Revenue Service

For calendar year 2018, or tax year

beginning / / 2018 ending / /

Beneficiary's Share of Income, Deductions, Credits, etc. ▶ See back of form and instructions.

Part I Information About the Estate or Trust

A Estate's or trust's employer identification number

37-1231548

B Estate's or trust's name

Hairston PW Estate

C Fiduciary's name, address, city, state, and ZIP code

In Trust Company, Executor
90911 Easy St
Granville MA 01034

D ☐ Check if Form 1041-T was filed and enter the date it was filed

E ☐ Check if this is the final Form 1041 for the estate or trust

Part II Information About the Beneficiary

F Beneficiary's identifying number

555-55-5151

G Beneficiary's name, address, city, state, and ZIP code

Rowden
5115 Sweet St

Pekin IL 61554

H ☒ Domestic beneficiary ☐ Foreign beneficiary

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

1	Interest income		11	Final year deductions	
2a	Ordinary dividends	8,000			
2b	Qualified dividends	1,000			
3	Net short-term capital gain				
4a	Net long-term capital gain				
4b	28% rate gain		12	Alternative minimum tax adjustment	
			A		0
4c	Unrecaptured section 1250 gain				
5	Other portfolio and nonbusiness income				
6	Ordinary business income				
7	Net rental real estate income		13	Credits and credit recapture	
8	Other rental income				
9	Directly apportioned deductions				
			14	Other information	
			B*	STMT	900
10	Estate tax deduction		E		8,000

*See attached statement for additional information.

Note: A statement must be attached showing the beneficiary's share of income and directly apportioned deductions from each business, rental real estate, and other rental activity.

For IRS Use Only

For Paperwork Reduction Act Notice, see the Instructions for Form 1041. *www.irs.gov/Form1041* Cat. No. 11380D **Schedule K-1 (Form 1041) 2018**

Additional information from your Schedule K-1 (Form 1041): Beneficiary's Share of Income, Deductions, Credits, etc.

Schedule K-1 (Form 1041): Beneficiary's Share of Income, Deductions, Credits, etc.
Schedule K-1: Supplemental Information **Continuation Statement**

Description	Amount
Box 14, Code B — Foreign Taxes:	
See attached Foreign Taxes Statement	900.

For Example 12

Form **1116** Department of the Treasury Internal Revenue Service (99)

Foreign Tax Credit

(Individual, Estate, or Trust)
▶ Attach to Form 1040, 1040NR, 1041, or 990-T.
▶ Go to *www.irs.gov/Form1116* for instructions and the latest information.

OMB No. 1545-0121 2018 Attachment Sequence No. 19

Name: Rowden | **Identifying number** as shown on page 1 of your tax return: 555-55-5151

Use a separate Form 1116 for each category of income listed below. See *Categories of Income* in the instructions. Check only one box on each Form 1116. Report all amounts in U.S. dollars except where specified in Part II below.

a ☐ Section 951A income
b ☐ Foreign branch income
c ☒ Passive category income
d ☐ General category income
e ☐ Section 901(j) income
f ☐ Certain income re-sourced by treaty
g ☐ Lump-sum distributions

h Resident of (name of country) ▶ USA

Note: If you paid taxes to only one foreign country or U.S. possession, use column A in Part I and line A in Part II. If you paid taxes to **more than one** foreign country or U.S. possession, use a separate column and line for each country or possession.

Part I Taxable Income or Loss From Sources Outside the United States (for category checked above)

		A	B	C		Total (Add cols. A, B, and C.)
i	**Enter the name of the foreign country or U.S. possession** ▶	RIC				
1a	Gross income from sources within country shown above and of the type checked above (see instructions): From Schedules K-1	9,000			1a	9,000
b	Check if line 1a is compensation for personal services as an employee, your total compensation from all sources is $250,000 or more, and you used an alternative basis to determine its source (see instructions) ▶ ☐					
	Deductions and losses (**Caution:** See instructions.):					
2	Expenses **definitely related** to the income on line 1a (attach statement)	1,800				
3	Pro rata share of other deductions **not definitely related:**					
a	Certain itemized deductions or standard deduction (see instructions)	12,000				
b	Other deductions (attach statement)					
c	Add lines 3a and 3b	12,000				
d	Gross foreign source income (see instructions)	9,000				
e	Gross income from all sources (see instructions)	23,000				
f	Divide line 3d by line 3e (see instructions)	0.3913				
g	Multiply line 3c by line 3f	4,696				
4	Pro rata share of interest expense (see instructions):					
a	Home mortgage interest (use the Worksheet for Home Mortgage Interest in the instructions)					
b	Other interest expense					
5	Losses from foreign sources					
6	Add lines 2, 3g, 4a, 4b, and 5	6,496			6	6,496
7	Subtract line 6 from line 1a. Enter the result here and on line 15, page 2 ▶				7	2,504

Part II Foreign Taxes Paid or Accrued (see instructions)

Credit is claimed for taxes (you must check one): (j) ☒ Paid (k) ☐ Accrued

Country	(l) Date paid or accrued	In foreign currency: Taxes withheld at source on: (m) Dividends	(n) Rents and royalties	(o) Interest	(p) Other foreign taxes paid or accrued	In U.S. dollars: Taxes withheld at source on: (q) Dividends	(r) Rents and royalties	(s) Interest	(t) Other foreign taxes paid or accrued	(u) Total foreign taxes paid or accrued (add cols. (q) through (t))
A	12/31/2018								900	900
B										
C										

8 **Add lines A through C, column (u). Enter the total here and on line 9, page 2** ▶ 8 900

For Paperwork Reduction Act Notice, see instructions. Cat. No. 11440U Form **1116** (2018)

For Example 12

Form 1116 (2018) Page 2

Part III Figuring the Credit

9	Enter the amount from line 8. These are your total foreign taxes paid or accrued for the category of income checked above Part I	9	900		
10	Carryback or carryover (attach detailed computation)	10			
	(If your income was section 951A income (box a above Part I), leave line 10 blank.)				
11	Add lines 9 and 10	11	900		
12	Reduction in foreign taxes (see instructions)	12	( )		
13	Taxes reclassified under high tax kickout (see instructions)	13			
14	Combine lines 11, 12, and 13. This is the total amount of foreign taxes available for credit			14	900
15	Enter the amount from line 7. This is your taxable income or (loss) from sources outside the United States (before adjustments) for the category of income checked above Part I (see instructions)	15	2,504		
16	Adjustments to line 15 (see instructions)	16			
17	Combine the amounts on lines 15 and 16. This is your net foreign source taxable income. (If the result is zero or less, you have no foreign tax credit for the category of income you checked above Part I. Skip lines 18 through 22. However, if you are filing more than one Form 1116, you must complete line 20.)	17	2,504		
18	**Individuals:** Enter the amount from Form 1040, line 10; or Form 1040NR, line 41. **Estates and trusts:** Enter your taxable income without the deduction for your exemption	18	11,000		
	Caution: If you figured your tax using the lower rates on qualified dividends or capital gains, see instructions.				
19	Divide line 17 by line 18. If line 17 is more than line 18, enter "1"			19	.2276
20	**Individuals:** Enter the total of Form 1040, line 11a, and Schedule 2 (Form 1040), line 46. If you are a nonresident alien, enter the total of Form 1040NR, lines 42 and 44. **Estates and trusts:** Enter the amount from Form 1041, Schedule G, line 1a; or the total of Form 990-T, lines 40, 41, and 43. Foreign estates and trusts should enter the amount from Form 1040NR, line 42			20	1,013
	Caution: If you are completing line 20 for separate category **g** (lump-sum distributions), see instructions.				
21	Multiply line 20 by line 19 (maximum amount of credit)			21	231
22	Enter the **smaller** of line 14 or line 21. If this is the only Form 1116 you are filing, skip lines 23 through 30 and enter this amount on line 31. Otherwise, complete the appropriate line in Part IV (see instructions) ▶			22	231

Part IV Summary of Credits From Separate Parts III (see instructions)

23	Credit for taxes on section 951A income	23			
24	Credit for taxes on foreign branch income	24			
25	Credit for taxes on passive category income	25			
26	Credit for taxes on general category income	26			
27	Credit for taxes on section 901(j) income	27			
28	Credit for taxes on certain income re-sourced by treaty	28			
29	Credit for taxes on lump-sum distributions	29			
30	Add lines 23 through 29			30	
31	Enter the **smaller** of line 20 or line 30			31	231
32	Reduction of credit for international boycott operations. See instructions for line 12			32	
33	Subtract line 32 from line 31. This is your **foreign tax credit.** Enter here and on Schedule 3 (Form 1040), line 48; Form 1040NR, line 46; Form 1041, Schedule G, line 2a; or Form 990-T, line 45a ▶			33	231

Form **1116** (2018)

Look-Through Rules for Partnerships and S Corporations[30]

Partners, S corporation shareholders, less-than-10% limited partners, and certain less-than-10% S corporation shareholders must follow specific rules for reporting foreign tax information.

Limited partners and S corporation shareholders who do not actively participate in the management of the S corporation and who own a less-than-10% interest (by value) in the entity generally may categorize their distributive share of foreign source income and deductions from that entity as passive income. See Treas. Reg. §1.904-5(h)(2) for more details and exceptions. This rule takes precedence over the other income category rules outlined in the instructions for Form 1116. Accordingly, even though the entity reports the income as ordinary business income, for purposes of claiming the foreign tax credit, the income is treated as passive.

ALTERNATIVE MINIMUM TAX

Entities must also report on K-1s any adjustments that the recipients must make to income and expenses for alternative minimum tax (AMT) purposes. The K-1 for each entity type has a separate box for these items as shown below. The most common entries on this form are for depreciation adjustments and exclusion items. The corresponding codes on the K-1 indicate the type of adjustment. The instructions for the K-1 and Form 6251, *Alternative Minimum Tax — Individuals*, are used to determine which line an individual taxpayer should use to report the adjustment.

Information Recipients Need to Calculate AMT	Form 1065 K-1 Box 17 Code	Form 1120S K-1 Box 15 Code
Post-1986 depreciation adjustment (line 2l of Form 6251)	A	A
Adjustment to gain or loss (line 2k of Form 6251)	B	B
Depletion adjustment (line 2d of Form 6251)	C	C
Gross income from oil, gas, and geothermal properties [a]	D	D
Deductions allocable to gross income from oil, gas, and geothermal properties [a]	E	E
Other AMT items	F	F

[a] Used to calculate the net amount entered on applicable line of Form 6251

Information Recipients Need to Calculate AMT	Form 1041 K-1 Box 12 Code
Adjustment for minimum tax purposes (line 2j of Form 6251)	A
AMT adjustment (code A) attributable to:	
Qualified dividends	B
Net short-term capital gains	C
Net long-term capital gains	D
Unrecaptured §1250 gain	E
28% rate gain	F
Adjustments attributable to depreciation (line 2l of Form 6251)	G
Adjustments attributable to depletion (line 2d of Form 6251)	H
Adjustments attributable to amortization (line 3 of Form 6251)	I
Exclusion items (portion of AMT adjustment for calculation of potential AMT credit in following year)	J

30. Instructions for Form 1116.

TAX-EXEMPT INCOME

Examples of tax-exempt income include the following.[31]

- Certain death benefits (IRC §101)
- Interest on state or local bonds (IRC §103)
- Exempt-interest dividends received from a mutual fund or other regulated investment company (IRC §§103 and 852(b)(5))
- Compensation for injuries or sickness (IRC §104)
- Income from discharge of indebtedness in a title 11 case (IRC §108)

Partnerships report tax-exempt interest in box 18 of the K-1, using code A. S corporations report tax-exempt interest in box 16 of the K-1, using code A. Individual K-1 recipients include the amount of tax-exempt interest on Form 1040, line 2a ("tax-exempt interest"). Generally, partners and S corporation shareholders[32] may increase the adjusted basis of their interests in the entities by the amount of tax-exempt income.[33]

Note. In calculating the income distribution deduction, the estate or trust is not allowed a deduction for any item of the distributable net income (DNI) that is not included in the gross income of the estate or trust.[34] Thus, tax-exempt income is not reported on the K-1s from estates and trusts.

DOMESTIC PRODUCTION ACTIVITIES DEDUCTION[35]

The Tax Cuts and Jobs Act (TCJA) repealed the domestic production activities deduction (DPAD) for tax years beginning after December 31, 2017. However, if an individual's tax year begins after December 31, 2017, and they are a recipient of the DPAD from a pass-through entity with a tax year beginning before January 1, 2018, they can take the DPAD in certain circumstances. See Form 8903, *Domestic Production Activities Deduction,* and its instructions for details.

"OTHER INFORMATION" BOXES[36]

Each type of K-1 has a box labeled only as "other information." The box number for each type of K-1 is as follows.

K-1 Type	Other Information Box
Form 1065 (partner)	20
Form 1120S (S corporation shareholder)	17
Form 1041 (beneficiary)	14

There are codes used in the "other information" box on the K-1s that provide very little useful guidance even when referencing the codes listed on page 2 of the K-1. The page 2 explanation in some cases refers only to a form number or directs the user to the instructions. **Appendix A** of this chapter offers a brief explanation of each code used in the other information boxes. For simplicity purposes, the entity tax form number is used to indicate different codes used for the same purpose on the S corporation K-1s and the partnership K-1s.

31. Instructions for Form 1041.
32. See IRC §1367(a)(1)(A).
33. Instructions for Form 1065 and Form 1120S.
34. Instructions for Form 1041.
35. Instructions for Schedule K-1 (Form 1041) for a Beneficiary Filing Form 1040.
36. Shareholder's Instructions for Schedule K-1 (Form 1120S) and Partner's Instructions for Schedule K-1 (Form 1065).

BASIS IN PARTNERSHIPS AND S CORPORATIONS

Note. For information about basis for individual taxpayers, see the 2019 *University of Illinois Federal Tax Workbook,* Volume A, Chapter 3: Calculating Basis.

Taxpayers must know their basis in the entity in order to properly report the following.

1. The individual's share of pass-through losses that can be deducted[37]
2. The income tax consequences of distributions of money and property from the entity[38]
3. Gain or loss on a sale or other disposition of the investment in the entity[39]

Accordingly, partnerships and S corporations are required to report to the K-1 recipients certain amounts that the recipient must know to properly calculate their basis in the entity. Specific codes have been designated for the following.

	Form 1065 K-1		Form 1120S K-1
Items Affecting Basis	**Box 18 Code**	**Box 19 Code**	**Box 16 Code**
Tax-exempt interest	A		A
Other tax-exempt income	B		B
Nondeductible expenses paid or incurred by the entity	C		C [a]
Distributions of cash and property			D
Repayment of loans from shareholders			E
Distributions			
Cash and marketable securities		A	
Distribution subject to IRC §737		B	
Other property		C	

[a] Generally, under IRC §1367(a)(2)(D), the basis of the shareholder's stock is decreased by the amount shown on this line.

Unfortunately, the K-1s do not always provide everything that a tax preparer needs in order to determine the taxpayer's basis in the entity. The K-1 may include a basis statement as a supplement, but the preparer of the entity return is not required to provide this information.

INITIAL BASIS

The initial basis of the taxpayer's ownership interest in a partnership or S corporation is usually the amount they paid for their share of the entity plus the adjusted basis in any property transferred to the entity in exchange for the ownership interest. However, if the investment was inherited, received as a gift, or acquired via other nontraditional means, the basis is determined in accordance with the general rules for those types of acquisitions.

The basis determined by reference to the individual's situation is also known as **outside basis**. If the ownership interest was obtained from someone other than the entity itself, the outside basis may be different than the basis the entity associates with the individual's ownership interest. Thus, even if the entity provides a basis statement with the K-1, it is necessary to verify this basis with the individual.

37. IRC §§704(d) and 1366(d)(1).
38. IRC §§731, 732, and 1368(b).
39. IRC §§736, 741, and 1001(a).

NON-DEBT ADJUSTMENTS TO BASIS[40]

Generally, basis is calculated similarly for an individual's share of partnerships and S corporations. However, debt is treated very differently depending on the entity. This portion of the chapter covers the commonalities. Debt-related adjustments are covered later for each type of entity.

Increases to Basis

The following items increase basis.

1. All capital contributions made to the entity
2. The adjusted basis of all property contributed to the entity
3. All income (including tax-exempt income) reported on the K-1
4. Excess depletion

> **Caution.** An S corporation shareholder cannot increase their stock basis by income from nontaxable debt forgiveness that is excluded from income under IRC §108.[41]

Decreases to Basis

The following transactions decrease basis.

1. Distributions of cash or other property made by the entity[42]
2. Nondeductible expenses (i.e., 50% of meals expenses)
3. Deductible losses and expenses that are individually stated on the K-1 (i.e., charitable contributions of cash and IRC §179 expenses) (Throughout the following examples and calculations, such costs are referred to as deductible losses.)
4. The amount of the individual's deduction for depletion for oil and gas property

> **Note.** The DPAD (§199) and the QBID (§199A) do not impact basis.

Distributions

Distributions are required to be shown in box 19 of partnership K-1s and box 16 of S corporation K-1s. S corporation K-1s have one code (D) for all distributions. However, partnership K-1s use one of three codes to more specifically identify what was distributed.

Type of Distribution	Box 19 Code
Cash and marketable securities	A
Distributions subject to IRC §737	B
Other property	D

40. Partner's Instructions for Schedule K-1 (1065) and Shareholder's Instructions for Schedule K-1 (Form 1120S).

41. IRC §108(d)(7)(C).

42. Dividend distributions reported on Form 1099-DIV, *Dividends and Distributions,* are not considered distributions from the entity for these purposes.

Generally, distributions are not taxable. They reduce the individual's basis in the investment. However, distributions from an S corporation or partnership **are taxable** if the distribution is in excess of the recipient's basis in the entity. In addition, a partner must recognize any gain from a distribution of IRC §737 property.

> **Note.** Property is classified as IRC §737 property if the partner receiving the property previously contributed other property with a built-in gain to the partnership within the prior seven years. For more information on IRC §737 property, see Treas. Reg. §1.737-1.

For both types of entities, if noncash property was distributed, a statement must be included with the K-1 that provides the following information.

- The property's fair market value (FMV) on the date of distribution
- The entity's basis in the property immediately before the distribution

Distributions from **S corporations are valued at FMV.**[43] If an S corporation distributes appreciated property to its shareholders, the difference between the FMV and the property's basis results in a gain that is passed through to the shareholders.

Example 13. Connor Company Inc. (an S corporation) owns a truck that was purchased for $40,000. The truck has been depreciated, and its adjusted basis for tax purposes is now $5,500. The truck has an FMV of $17,500. Connor Company distributes the truck to its sole shareholder, Ralph. Connor Company must recognize an ordinary gain of $12,000 gain ($17,500 FMV – $5,500 adjusted basis). The gain is passed through to Ralph and has to be reported on his tax return. If the corporation sold the asset and distributed the cash to Ralph, the result would be the same.

In the case of a cash distribution (not from the sale of an asset held by the corporation), if the taxpayer's basis in their S corporation shares is less than the amount of cash distributed, the shareholder must declare a gain equal to the excess of the cash distributed over the shareholder's basis in their S corporation stock.

> **Note.** A taxpayer who owns an interest in an S corporation and reports a loss, receives a distribution, disposes of stock, or receives a loan repayment from the S corporation must attach a computation detailing their S corporation basis to their return. In addition, they must check the box on Schedule E, *Supplemental Income and Loss,* line 28, column (e).[44]

28	(a) Name	(b) Enter P for partnership; S for S corporation	(c) Check if foreign partnership	(d) Employer identification number	(e) Check if basis computation is required	(f) Check if any amount is not at risk
A			☐		☐	☐
B			☐		☐	☐
C			☐		☐	☐
D			☐		☐	☐

Passive Income and Loss | Nonpassive Income and Loss

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43. Instructions for Form 1120S.

44. *Clarification on line 28, column (e), of Schedule E (Form 1040).* Feb. 6, 2019. IRS. [www.irs.gov/forms-pubs/clarification-on-line-28-column-e-of-schedule-e-form-1040] Accessed on Apr. 9, 2019.

Distributions of property from **partnerships** are valued at the **adjusted basis** to the partnership immediately before the distribution.[45] The partner's basis in the distributed property (other than in liquidation of their interest) is the **smaller** of:

1. The partnership's adjusted basis in the property immediately before the distribution, or
2. The adjusted basis of the individual's partnership interest reduced by any cash distributed in the same transaction.

If the individual receives property in **liquidation** of their partnership interest, their basis in the distributed property is equal to the adjusted basis of their partnership interest reduced by any cash distributed in the same transaction. However, any portion of the distribution that is attributable to the partner's share of the partnership's unrealized receivable or inventory items must be taxed as ordinary income. This information may not be included with the K-1. The partnership is required to provide a copy of Form 8308, *Report of a Sale or Exchange of Certain Partnership Interests,* (or a written statement with the same information) to each transferee and transferor by the later of January 31 following the end of the calendar year or 30 days after it receives notice of the exchange.[46]

Partner Capital Accounts

Item L in part II of a partnership K-1 shows the changes to the partner's capital accounts for the year. The capital account may be shown on a tax basis, a generally accepted accounting principles (GAAP) basis, an IRC §704(b) book basis, or some other basis.

> **Note.** IRC §704(b) book basis is used when capital accounts are adjusted for **book purposes only** after a contribution of money or other property to the partnership by a new or existing partner as consideration for an interest in the partnership.[47]

If the capital account analysis is presented on a tax basis, the sum of the partner's ending capital account (in item L) and the partner's ending share of liabilities (in item K) should equal the partner's basis in the partnership at the end of the tax year unless the partner did not acquire the partnership interest directly from the partnership.

DEBT BASIS IN PARTNERSHIPS AND S CORPORATION

There are two types of debt that may affect basis: loans to the entity by the investor and loans to the entity from other sources. Loans from S corporation shareholders and partners to the respective entities create basis for both types of investors. For **shareholders**, the loan basis is tracked separately from the stock basis, because repayments of reduced basis loans may be taxable as ordinary income or capital gain, depending on the situation.[48] For **partners**, the loan basis is part of the overall basis and any distributions in excess of basis are generally treated as capital gain income.[49]

Loans from **outside** sources to the entity only create basis for **partners.**[50] The partnership is responsible for reporting the partner's share of liabilities on the partner's K-1 in part II, item K.[51] The effect on basis is determined by the type of loan and whether the partner is a general or limited partner.[52]

45. Instructions for Form 1065.
46. IRS Pub. 541, *Partnerships*.
47. Treas. Reg. §1.704-1(b)(2)(iv)(f)(5).
48. Rev. Rul. 68-537, 1968-2 CB 372; Rev. Rul. 64-162, 1964-1 CB 304.
49. IRS Pub. 541, *Partnerships.*
50. IRC §465(b).
51. Instructions for Form 1065.
52. Ibid.

An S corporation **shareholder** does **not** obtain debt basis from an outside loan, even by guaranteeing the loan. However, if a shareholder makes a payment on behalf of the S corporation on a loan in which they are a guarantor, then they may increase their debt basis to the extent of that payment.[53]

Partners and Debt Basis[54]

Both outside debt and loans to the partnership create basis for the partners. Each partner's share of liabilities at the beginning and end of the year must be reported in part II, item K, on the K-1s issued to the partners.

There are three types of liabilities shown on the K-1.[55]

1. Nonrecourse
2. Qualified nonrecourse
3. Recourse

Any increases or decreases in these liabilities also increase or decrease basis. However, only recourse and qualified nonrecourse debt affect the at-risk amount. **At-risk basis** is discussed later in the chapter.

> **Note.** Amounts loaned to the partnership by the partner are included in the recourse liability amount on the partner's K-1.[56]

S Corporation Shareholders and Debt Basis

Loans that the stockholder makes to the S corporation establish the initial loan basis. Repayments of these loans reduce the loan basis. S corporations are required to report loan **repayments** to shareholders on the shareholders' K-1s in box 16 with code E. Unfortunately, S corporations are not required to report loans to the S corporation by the shareholder. Accordingly, taxpayers must provide this information to their tax preparers.

If the corporation passes through losses in excess of the shareholder's stock basis, the shareholder reduces any remaining loan basis by the amount of those losses. Once the loan basis is reduced, future income restores the basis up to the amount of the outstanding loan at the beginning of the tax year. Loan basis **must** be restored before any net increase is applied to restore the basis of a shareholder's stock in an S corporation.[57]

Documented Versus Undocumented Loans. Ideally, shareholders maintain adequate documentation for all the loans they make to an S corporation and all subsequent repayments on these loans. In practice, however, many shareholders make numerous advances to an S corporation without formally documenting any of the advances as loans. They also receive repayments of the advances without indicating which particular loans are being repaid.

Loans made in this manner are called **open-account debt.**[58] If the balance of these loans at the end of the corporation's tax year is less than $25,000, they are treated as a single loan. This special rule makes determining the tax consequences of advances and repayments much simpler. However, loan repayments on reduced-basis open-account debt create **ordinary income** for the shareholder.[59] In contrast, loan repayments on reduced-basis loans that are properly documented create **capital gain** income to the extent the repayments exceed the taxpayer's basis in the loan.[60]

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53. Treas. Reg. §1.1366-2(a)(2)(ii).
54. IRS Pub. 541, *Partnerships*.
55. Partner's Instructions for Schedule K-1 (Form 1065).
56. IRS Pub. 541, *Partnerships*.
57. IRC §1367(b)(2)(B).
58. Treas. Reg. §1.1367-2(a)(2).
59. Rev. Rul. 68-537, 1968-2 CB 372.
60. Rev. Rul. 64-162, 1964-1 CB 304.

If the balance of the open-account debt exceeds $25,000 **at the end of the year,** the debt must be separated into its components and activity must be tracked separately for each loan.[61]

Practitioner Planning Tip

Practitioners are encouraged to have in-depth conversations with their S corporation clients to determine the nature and scope of money or property shareholders contribute. Is the contribution truly a loan in which a bona fide debtor/lender relationship exists or is the contribution additional capital or open-account debt? Decisions in this area could significantly impact both corporate and shareholder results in a given tax year.

Repayments of Reduced-Basis Loans. As explained previously, loans made by a shareholder to an S corporation can be used as the basis for claiming losses and other pass-through deductions. When those loans are repaid and the basis has **not** been restored, all or part of the repayments are taxable. The taxable portion of a partial repayment is calculated based on the pro-rata value of the basis at the beginning of the tax year versus the total loan.[62]

Example 14. Paul Silver is the 100% shareholder in PDS Antiques Inc. (PDS), an S corporation. At the beginning of 2018, he had no basis in his stock and the corporation owed him $22,500 in open-account debt. The remaining basis of the debt was $7,500 at the beginning of the year.

During 2018, PDS repaid $15,000 of the loan after an upturn in business. Unfortunately, the repayment was premature and the company subsequently borrowed a significant amount of money from the bank to cover operating losses incurred later in the year. Paul did not make any additional contributions of capital nor did he make any additional loans to the company in 2018.

Paul's 2018 Schedule K-1 from PDS showed ordinary losses of $3,000. The following calculation shows the tax effect of these circumstances.

Basis at the beginning of 2018	$ 7,500	
Loan balance at the beginning of 2018	÷ 22,500	
Proportion of basis to loan balance	33.33%	
Loan repayments in 2018	× 15,000	$15,000
Nontaxable portion of loan repayments	$ 5,000	(5,000)
Taxable portion of loan repayments		$10,000

The $10,000 taxable portion was included in income on Paul's 2018 return. Because the loans were open-account debt, the $10,000 was taxed as ordinary income.

Paul's adjusted basis in the loan after the repayments was $2,500 ($7,500 beginning basis − $5,000 nontaxable payments). Of the $3,000 loss passed through from PDS, $2,500 was deducted on Paul's 2018 return and the remaining $500 was carried forward to 2019.

61. Treas. Reg. §1.1367-2(a)(2)(ii).

62. Treas. Reg. §1.1367-2(e), Example 7; See also *Smith v. Comm'r,* 424 F.2d 219 (9th Cir. 1970), *aff'g* 48 TC 872 (1967).

Restoration of Reduced-Basis Debt. The reduction in the debt basis up to the balance of the debt at the beginning of the tax year is restored first, before any net increase is applied to restore the basis of a shareholder's stock in an S corporation.[63] Increases to the debt basis are taken into account before calculating the taxable portion of any loan repayments.[64]

Example 15. Use the same facts as **Example 14,** except Paul's 2018 Schedule K-1 showed **ordinary income** of $3,000. The following calculation shows the tax effect of these circumstances.

Basis at the beginning of 2018	$ 7,500	
Plus: increases in basis from 2018 K-1	3,000	
Adjusted loan basis	$10,500	
Loan balance at the beginning of 2018	÷ 22,500	
Proportion of basis to loan balance	46.67%	
Loan repayments in 2018	× 15,000	$15,000
Nontaxable portion of loan repayments	$ 7,000	(7,000)
Taxable portion of loan repayments		$ 8,000

The $8,000 taxable portion was taxed as ordinary income on Paul's 2018 return. Paul's adjusted loan basis after the repayments was $3,500 ($10,500 adjusted basis − $7,000 nontaxable payments.) The $3,000 in ordinary income reported on the Schedule K-1 was also included in Paul's 2018 income.

Multiple Loans. A shareholder may **make more than one formal documented loan** to an S corporation. In addition, if the **balance of open-account debt** exceeds $25,000 at the end of any year, the open-account debt must be tracked as separate loans for all subsequent years. In this case, the losses reduce the debt basis in proportion to the shareholder's basis in each debt.[65]

Restoration applies first to loans repaid during the year to prevent the shareholder from recognizing gain. If multiple debts exist, remaining income amounts are then applied to each debt in proportion to the amount that each debt was reduced in prior years relative to the total amount of overall reduction for all the debts.[66]

> **Note.** For more information about debt basis and repayments of reduced basis debt (with examples), see the 2016 *University of Illinois Federal Tax Workbook,* Volume A, Chapter 2: S Corporation Shareholder Issues. This can be found at **uofi.tax/arc** [taxschool.illinois.edu/taxbookarchive].

63. IRC §1367(b)(2)(B).

64. Treas. Reg. §1.1367-2(d)(1).

65. Treas. Reg. §§1.1367-2(d)(2)(ii) and (e), Example 1.

66. Treas. Reg. §1.1367-2(c)(2).

S CORPORATION ORDERING RULES[67]

The Code establishes the order in which transactions are considered in determining the shareholder's basis in both stock and loans. The Code also allows the shareholder to elect to do this calculation in a slightly different order. The following is the default order.

Tier 1. Basis is **increased** by all capital contributions made to the corporation and all income (including tax-exempt income) reported on Schedule K-1. Basis is also increased by excess depletion under IRC §1367(a)(1)(C).[68]

Tier 2. Basis is **decreased** by property distributions (including cash) made by the corporation. (This does not include dividend distributions reported on Form 1099-DIV, *Dividends and Distributions*.)

Tier 3. Basis is **decreased** by nondeductible expenses (e.g., 50% of meals and entertainment expenses) and the oil and gas depletion deduction under IRC §1367(a)(2)(E).[69]

Tier 4. Basis is **decreased** by all deductible losses and expenses that are individually stated on Schedule K-1 (i.e., charitable contributions and IRC §179 expenses). **Throughout the following examples and calculations, this is referred to as deductible losses.**

Example 16. Erik started a nightclub that he incorporated as Midnight Sun, Inc. in 2017. He made an S election effective as of the day of incorporation. He paid $1,000 for his shares and did not personally loan any money to the company. He received the Schedule K-1 on the following page from the corporation for 2017.

Note. Only the shareholder's pro rata share of the **adjusted basis** of noncash charitable contributions reduces basis.

Erik's yearend basis in the corporation is calculated as follows.

	Stock purchase		$ 1,000
Tier 1	Plus: items of income		
	Ordinary income (box 1)	$30,000	
	Tax-exempt income (box 16, code A)	3,000	
	Total items of income	$33,000	33,000
	Remaining basis (stock purchase plus total income)		$34,000
Tier 2	Less: distributions (box 16, code D)		(15,000)
	Remaining basis		$19,000
Tier 3	Less: nondeductible losses (box 16, code C)		(500)
	Remaining basis		$18,500
Tier 4	Less: deductible losses (box 12, code A)		(800)
	Remaining basis at the end of 2017		$17,700

67. Shareholder's Instructions for Schedule K-1 (Form 1120S).

68. Treas. Reg. §1.1367-1(f)(1).

69. Treas. Reg. §1.1367-1(f)(3).

For Example 16

671117

☐ Final K-1 ☐ Amended K-1 OMB No. 1545-0123

Schedule K-1 (Form 1120S) **2017**

Department of the Treasury
Internal Revenue Service

For calendar year 2017, or tax year

beginning 04 / 01 / 2017 ending 12 / 31 / 2017

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
37-1120555

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

2913 E Anaheim St
Shreveport, LA 71109

C IRS Center where corporation filed return
Ogden, UT 84201-0013

Part II Information About the Shareholder

D Shareholder's identifying number
371-11-1111

E Shareholder's name, address, city, state, and ZIP code
Erik Northernman
2913 E Anaheim St
Shreveport, LA 71109

F Shareholder's percentage of stock ownership for tax year . . . . 100.00000 %

For IRS Use Only

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

1	Ordinary business income (loss)	30,000	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	
			A		3,000
12	Other deductions				
A		800	C		500
			D		15,000
			17	Other information	

* See attached statement for additional information.

For Paperwork Reduction Act Notice, see the Instructions for Form 1120S. www.irs.gov/Form1120S Cat. No. 11520D **Schedule K-1 (Form 1120S) 2017**

Example 17. Use the same facts as **Example 16.** For 2018, Erik received the following Schedule K-1 from Midnight Sun, Inc.

671117

☐ Final K-1 ☐ Amended K-1 OMB No. 1545-0123

Schedule K-1 (Form 1120S) **2018**

Department of the Treasury
Internal Revenue Service

For calendar year 2018, or tax year

beginning / / 2018 ending / /

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
37-1120555

B Corporation's name, address, city, state, and ZIP code
Midnight Sun, Inc
2913 E. Anaheim St.
Shreveport, LA 71109

C IRS Center where corporation filed return
Ogden, UT 84201-0013

Part II Information About the Shareholder

D Shareholder's identifying number
371-11-1111

E Shareholder's name, address, city, state, and ZIP code
Erik Northernman
2913 E. Anaheim St
Shreveport, LA 71109

F Shareholder's percentage of stock ownership for tax year . . . . 100 %

For IRS Use Only

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

1	Ordinary business income (loss)	50,000	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	
			C		5,000
12	Other deductions				
A		6,000	D		65,700
			17	Other information	
			V		44,000
			W		0
			X		0
			Y		0

* See attached statement for additional information.

For Paperwork Reduction Act Notice, see the Instructions for Form 1120S. www.irs.gov/Form1120S Cat. No. 11520D **Schedule K-1 (Form 1120S) 2018**

Erik's **2018** basis is calculated as follows.

	Carryforward basis from 2017	$17,700
Tier 1	Plus: items of income	
	Ordinary income (box 1)	50,000 [a]
	Remaining basis (carryforward basis plus total items of income)	$67,700
Tier 2	Less: distributions (box 16, code D)	(65,700)
	Remaining basis	$ 2,000 [b]
Tier 3	Less: nondeductible losses (box 16, code C)	(5,000)
	Negative subtotal = nondeductible expenses in excess of basis	($ 3,000) [c]
	Nondeductible expenses do **not** carry forward to future years	3,000
	Remaining basis	$ 0
Tier 4	Less: deductible losses (box 12, code A)	(6,000)
	Negative subtotal = deductible losses in excess of basis	($ 6,000)
	Deductible losses carried forward to future years	6,000
	Remaining basis at the end of 2018	$ 0

[a] Taxable income

[b] All distributions absorbed by basis

[c] $2,000 nondeductible expenses absorbed

Erik included the $50,000 in ordinary income on his 2018 return, but he was not allowed to claim any of the deductible losses that year. He carries these expenses forward until he has sufficient basis to deduct them **after** taking into account nondeductible expenses for the **current year.** This is required unless he makes the Treas. Reg. §1.1367-1(g) election (discussed next).

Optional Ordering Election under Treas. Reg. §1.1367-1(g)

Every shareholder has the option **to elect** to decrease basis first by deductible losses and then by nondeductible expenses (i.e., decrease basis for Tier 4 items prior to decreasing basis for Tier 3 items). This election applies to both stock basis and loan basis.

> **Note.** At first glance, making this election seems to be an easy decision. However, under the default method, the nondeductible losses do not carry forward to reduce basis in future years. Under the optional method, nondeductible losses in excess of basis **do** carry forward to reduce basis in future years.[70] Accordingly, more basis is preserved over the long run when the default method is used.

If the taxpayer's basis is limited, making this election may allow them to claim deductions earlier than they could without making the election. Once made, the election is **irrevocable** except with IRS consent. To make the election, the taxpayer must attach a statement to their timely filed original or amended return that:

1. Identifies the corporation,
2. States that the taxpayer is making the special ordering election under Treas. Reg. §1.1367-1(g), and
3. Agrees to the carryover rules under the regulation.

70. Treas. Reg. §1.1367-1(g).

Example 18. Use the same facts as **Example 17,** except Erik makes the election under Treas. Reg. §1.1367-1(g) to reduce basis by deductible losses before nondeductible expenses. This changes his calculation of basis to the following.

	Remaining basis after Tier 2 adjustments	$ 2,000 [a]
Optional Tier 3	Less: deductible losses (box 12, code A)	(6,000)
	Negative subtotal = deductible losses in excess of basis	($ 4,000) [b]
	Deductible losses carried forward to future years	4,000
	Remaining basis	$ 0
Optional Tier 4	Less: nondeductible expenses (box 16, code C)	(5,000)
	Negative subtotal = nondeductible expenses in excess of basis	($ 5,000)
	Nondeductible expenses carried forward to future years	5,000
	Remaining basis at the end of 2018	$ 0

[a] See **Example 16**

[b] $2,000 deduction on 1040

Erik included the $50,000 in ordinary income on his 2018 return. He claimed $2,000 of the deductible losses and carried forward the remaining $4,000. He carries these expenses forward until he has sufficient basis to deduct them. He **also** carries forward the $5,000 of nondeductible expenses.

Note. Not all tax software has the option to indicate that the taxpayer made the Treas. Reg. §1.1367-1(g) election. When the taxpayer has insufficient basis, it may be necessary to **manually** adjust the data input of the Schedule K-1.

A MAP OF THE S CORPORATION K-1 TO BASIS WORKSHEET

Capital infusions and loans **to the corporation** are not reported on Schedule K-1. Even if the preparer of the corporate tax return provides basis information, the preparer of the shareholder's personal return should **make inquiries** to determine that the basis information is correct.

The following chart is provided to assist practitioners who use software that does not categorize all Schedule K-1 entries into basis tiers. It shows which basis tiers apply to entries on Schedule K-1.

Tier 1. Items of Income

- Ordinary income
- Net rental income
- Interest income (taxable and tax-exempt)
- Dividends (taxable and tax-exempt)
- Capital gains
- Royalty income
- Net §1231 gains
- Nontaxable municipal interest income
- Any other income shown on the K-1
- The excess of the deductions for depletion over the basis of the property subject to depletion (except for oil and gas properties)[71]

Tier 2. Distributions

Tier 3. **Nondeductible Expenses (**Optional Tier 4 if special ordering election made)

- Disallowed meals and entertainment
- Expenses related to tax-exempt income
- Life insurance premiums
- Timing difference of transactions between accrual-basis corporations and cash-basis shareholders (This can be a positive or negative adjustment.)
- The depletion deduction for any oil and gas property held by the corporation, but only to the extent the shareholder's portion of the property's adjusted basis exceeds that deduction

Tier 4. **Deductible Losses and Other Expenses** (Optional Tier 3 if special ordering election made)

- Ordinary losses
- Net rental losses
- Capital losses
- Net §1231 losses
- §179 deduction
- Charitable contributions
- Investment expenses
- Investment interest expense
- Depletion for any oil and gas property held by the S corporation to the extent the deduction does **not** exceed the proportionate share of the adjusted basis of the property allocated to the shareholder[72]

The following Schedule K-1 shows which tiers apply to various entries for income and expenses. The tier numbers shown in parentheses apply to negative entries. A worksheet is also provided to assist the preparer in calculating basis.

> **Note.** A separate worksheet should be maintained using the alternative minimum tax (AMT) adjustments in box 15 to track the shareholder's basis for AMT purposes.

71. IRC §1367(a)(1)(C).

72. IRC §1367(a)(2)(E).

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☐ Final K-1 ☐ Amended K-1 OMB No. 1545-0123

2

Schedule K-1 (Form 1120S) 2018
Department of the Treasury
Internal Revenue Service

For calendar year 2018, or tax year

beginning / / 2018 ending / /

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) **Tier 1 or (Tier 4)**	13	Credits **Code O: Tier 2**
2	Net rental real estate income (loss) **Tier 1 or (Tier 4)**		
3	Other net rental income (loss) **Tier 1 or (Tier 4)**		
4	Interest income **Tier 1**		
5a	Ordinary dividends **Tier 1**		
5b	Qualified dividends **Not applicable**	14	Foreign transactions **Not applicable**
6	Royalties **Tier 1**		
7	Net short-term capital gain (loss) **Tier 1 or (Tier 4)**		
8a	Net long-term capital gain (loss) **Tier 1 or (Tier 4)**		
8b	Collectibles (28%) gain (loss) **Not applicable**		
8c	Unrecaptured section 1250 gain **Not applicable**		
9	Net section 1231 gain (loss) **Tier 1 or (Tier 4)**		
10	Other income (loss) **Tier 1 or (Tier 4)**	15	Alternative minimum tax (AMT) items **Code A: T1 or (T4)**
			Code B: T1 or (T4)
			Code C: Tier 4
			Code D: Tier 1
			Code E: Tier 4
11	Section 179 deduction **Tier 4**	16	Items affecting shareholder basis **Code A: Tier 1**
12	Other deductions **Codes A-O: Tier 4**		**Code B: Tier 1**
	Codes P-R: Not applic.		**Code C: Tier 3**
	Codes S: Tier 4		**Code D: Tier 2**
			Code E: Loan Basis
		17	Other information **Codes K&L: Tier 1**

AMT basis only

* See attached statement for additional information.

For Paperwork Reduction Act Notice, see the Instructions for Form 1120S. www.irs.gov/Form1120S Cat. No. 11520D Schedule K-1 (Form 1120S) 2018

S Corporation Stockholder Basis Carryforward
Optional Ordering Election Not Made

		Stock Basis		Loan Basis
Basis at beginning of year		____		____
Plus: additional contributions during year		____		____
Plus: **Tier 1** income and gains from K-1 box: [a]				
1	____			
2	____			
3	____			
4	____			
5a	____			
6	____			
7	____			
8a	____			
9	____			
10 Code A	____			
10 Code B	____			
10 Code C	____			
10 Code D	____			
10 Code E	____			
16 Code A	____			
16 Code B	____			
17 Code K	____			
17 Code L	____			
Income subtotal	____			
Income items added to basis [b]		____		____
Subtotal 1		____		____
Less: **Tier 2** payments received	16 Code D	____	16 Code E	____
Less: **Tier 2** backup withholding	13 Code O	____		____
Subtotal 2 [c]		____		____
Total: larger of subtotal 2 or $0 [d]		____		____

[a] Negative entries on the K-1 go to Tier 4.

[b] Amount up to reduced basis debt existing at beginning of year should be entered in Loan Basis column, with any remainder entered in Stock Basis column.

[c] If subtotal 2 is negative, the taxpayer must recognize income.

[d] Basis cannot be negative.

**S Corporation Stockholder Basis Carryforward
Optional Ordering Election Not Made *(Continued)***

		Stock Basis	Loan Basis	Carryforwards
Total from page 1		______	______	
Less: **Tier 3** nondeductible expenses:				
Prior year carryforward	______			
16 Code C	______			
Tier 3 subtotal	______			
Subtotal 3 [a]		______	______	______
Larger of Subtotal 3 or $0		______	______	
Less: **Tier 4** deductible expenses and losses:				
Prior year carryforward	______			
K-1 box:				
1	______			
2	______			
3	______			
7	______			
8a	______			
9	______			
10 Code A	______			
10 Code B	______			
10 Code C	______			
10 Code D	______			
10 Code E	______			
11	______			
12 Codes A through O, S	______			
17 Code R	______			
Tier 4 subtotal	______			
Subtotal 4 [b]		______	______	______
Larger of Subtotal 4 or $0		______	______	

[a] Enter tier 3 subtotal in Stock Basis column to the extent that stock basis after subtracting tier 2 expenses is positive.

[b] Enter tier 4 subtotal in Stock Basis column to the extent that stock basis after subtracting tier 3 expenses is positive. If this subtotal is negative, the Tier 4 expenses carry forward to the next year.

The IRS prepared a series of worksheets to assist taxpayers in calculating their S corporation stock basis and loan basis. They are available in the Shareholder's Instructions for Schedule K-1 (1120S). These are in a different format and more extensive than the tools presented above. Excerpts from the instructions follow.

Worksheet Instructions for Figuring a Shareholder's Stock and Debt Basis

CAUTION *Don't use this worksheet if you have made an election under Regulations section 1.1367-1(g).*

Part I. Shareholder Stock Basis

CAUTION *This worksheet addresses adjustments to stock basis as provided under section 1367. Other code sections might also cause a reduction in S corporation stock basis. For example, certain credits require the reduction of both an S corporation's assets as well as the shareholder's stock basis. See sections 50(c)(1) and (5) for details.*

Line 1. Enter your basis in the stock of the S corporation at the beginning of the corporation's tax year. Unless this is your initial year owning stock in the S corporation, this amount should be the same as your ending stock basis from the prior tax year.

Stock basis can't be less than zero.

Don't include any basis from indebtedness on this line. Stock basis and debt basis must be figured separately. Debt basis is addressed in Part II of this worksheet.

Line 2. Enter any additional contributions to the capital of the S corporation or any additional acquisitions of stock. Don't include any loans to the S corporation.

The basis of stock you purchased is usually its cost.

If you contributed property to the S corporation in exchange for stock in a section 351 transaction, your stock basis is generally figured by taking the carryover basis of assets transferred to the corporation, less the liabilities assumed by the corporation. If the assumed liabilities exceed the adjusted tax basis of the contributed assets, see section 357(c). See section 358 for more information on the basis of stock received in a section 351 transaction.

The basis of inherited property is generally the fair market value (FMV) at the date of death or the alternate valuation date.

The basis of stock acquired by gift is generally the basis of the stock in the hands of the donor. There are special rules if the FMV of the stock is less than the donor's adjusted basis. See Regulations section 1.1015-1.

The basis for stock received as compensation is the FMV on the date the compensation is included in income. See Pub. 551 for details.

Line 3. Enter on lines 3a through 3m all separately figured and non-separately figured items of income from the Schedule K-1. See below for special instructions.

Reminder. Enter only positive amounts from the Schedule K-1 on line 3. Negative amounts (decreases to stock basis) are entered on Part III.

Line 3i. Enter the amount of other income that increases basis. Special rules apply to basis adjustments resulting from section 965 inclusions and deductions. Report the amount reported on Schedule K-1, box 10, code F reduced by box 12, code K. The amount reported as section 965(c) deductions on Schedule K-1, box 12, code K is not treated as a deduction that will separately reduce basis under Part III of this worksheet. See Regulations section 1.965-3(f)(2) for more information.

Line 3j. Enter the amount by which your cumulative depletion deduction exceeds your proportionate share of basis in the property subject to depletion. See information reported in Schedule K-1, box 15, using code C.

For oil and gas depletion, don't enter an amount. See the instructions for line 8b for the decrease to basis.

Line 3k. Enter the sum of the amounts from Schedule K-1, box 16, codes A and B. Also add the amount from Schedule K-1, box 12, code K. See Regulations section 1.965-3(f)(2) for more information.

CAUTION *Basis isn't increased by excluded discharge of indebtedness income of the S corporation under sections 108(a) and 108(d)(7)(A).*

The income reported on line 3 should be reported on the appropriate areas of your return. See specific instructions for Income (Loss), later.

Line 6. Enter the distributions reported on Schedule K-1, box 16, code D. Don't include any Form 1099-DIV distributions on this line.

Note. If the amount of the distribution is more than the stock basis before distributions, report the excess amount as a capital gain on Form 8949 and Schedule D. Don't increase your stock basis for the amount of capital gain reported for the excess. See *Nondividend distributions* in the Instructions for Form 8949.

Line 8a. Enter the amount from Schedule K-1, box 16, code C.

Line 8b. Enter the amount of oil and gas depletion claimed on your personal return up to your proportionate share of basis in the property subject to depletion. Any cumulative depletion in excess of your proportionate share of basis in the property subject to depletion won't reduce your basis.

Don't enter an amount for depletion not related to oil and gas property.

Line 11. Use Part III to figure the total allowable loss and deduction items from stock basis. Enter the total from Part III, line 13, column (c). This amount can't exceed the amount on line 10.

Line 12. Use Part II to figure the debt basis restoration, if any. Enter the total from Part II, line 8.

Line 13. Enter any other decreases to stock basis not accounted for on the lines above. This includes the reduction to basis for the sale or redemption of part of your stock.

TIP *If a portion of your stock is redeemed, sold, or otherwise disposed of during the year, attach two separate worksheets. Use the first to figure your stock basis at the date of sale and the second to figure your stock and debt basis at year end.*

Worksheet for Figuring a Shareholder's Stock and Debt Basis

Part I—Shareholder Stock Basis

1. Stock basis at the beginning of the corporation's tax year			**1.**
2. Basis from any capital contributions made or additional stock acquired during the tax year			**2.**
3a. Ordinary business income (losses go on Part III)	**3a.**		
b. Net rental real estate income (losses go on Part III)	**3b.**		
c. Other net rental income (losses go on Part III)	**3c.**		
d. Interest income	**3d.**		
e. Ordinary dividends	**3e.**		
f. Royalties	**3f.**		
g. Net capital gains (losses go on Part III)	**3g.**		
h. Net section 1231 gain (losses go on Part III)	**3h.**		
i. Other income (losses go on Part III)	**3i.**		
j. Excess depletion adjustment	**3j.**		
k. Tax-exempt income	**3k.**		
l. Recapture of business credits	**3l.**		
m. Other items that increase stock basis	**3m.**		
4. Add lines 3a through 3m			**4.**
5. Stock basis before distributions. Add lines 1, 2, and 4			**5.**
6. Distributions (excluding dividend distributions)			**6.**
Note. If line 6 is larger than line 5, subtract line 5 from line 6 and report the result as a capital gain on Form 8949 and Schedule D. See instructions.			
7. Stock basis after distributions. Subtract line 6 from line 5. If the result is zero or less, enter -0-, skip lines 8 through 14, and enter -0- on line 15			**7.**
8a. Nondeductible expenses	**8a.**		
b. Depletion for oil and gas	**8b.**		
9. Add lines 8a and 8b			**9.**
10. Stock basis before loss and deduction items. Subtract line 9 from line 7. If the result is zero or less, enter -0-, skip lines 11 through 14, and enter -0- on line 15			**10.**
11. Allowable loss and deduction items. Enter the amount from Part III, line 13, column (c)			**11.**
12. Debt basis restoration (see net increase in instructions for Part II, line 8)			**12.**
13. Other items that decrease stock basis			**13.**
14. Add lines 11, 12, and 13			**14.**
15. Stock basis at the end of the corporation's tax year. Subtract line 14 from line 10. If the result is zero or less, enter -0-			**15.**

Part II. Shareholder Debt Basis

You must complete this section if you have personally loaned money to the corporation.

You must account for each formal note (notes with a written instrument) made to your S corporation by entering it separately in its own column. You can't aggregate multiple loans into a single column. If you have more than 3 loans, use additional copies of Part II.

Loans made to the S corporation that aren't evidenced by a written instrument are referred to as an open account debt and aren't separately tracked. If an open account debt has a year-end balance of more than $25,000, it will be classified as a formal note at the beginning of the next tax year and must be separately tracked.

CAUTION *Loans that a shareholder guarantees or co-signs aren't part of a shareholder's loan basis except to the extent the shareholder makes a payment on the loan guaranteed or co-signed.*

Line 1. Enter the balance of each loan to the S corporation at the beginning of the corporation's tax year in a separate column.

Line 2. Enter any new loans made during the tax year and evidenced by a formal note in a separate column. If a formal note is refinanced, any increase should be entered on line 2 under the same column as the original loan.

Advances and repayments made during the S corporation's tax year on an open account are netted at the close of the S corporation's tax year to determine the amount of any net advance or net repayment. See Regulations section 1.1367-2(d)(2). Enter any net advances on line 2 under the same column as the open account debt. If this is the first year of the open account debt, enter the net advance in its own column on line 2.

CAUTION *Any debt that exceeded $25,000 at the end of the prior year is treated as a formal note for purposes of calculating the gain on loan repayment. See Regulations section 1.1367-2(a)(2)(ii).*

Line 4. For a formal note, enter the amount of principal repayment specific to each loan.

For open account debt, if the repayments exceed the advances for the tax year, the net repayment should be entered on line 4.

Line 6. Enter the debt basis of your loan(s) to the S corporation at the beginning of the corporation's tax year.

Line 7. Enter the amount from line 2 on line 7.

Line 8. You have reduced debt basis if line 6 is less than line 1.

Per section 1367(b)(2)(B), if debt basis has been reduced, it can only be restored with a net increase. The net increase is the amount by which the items that increase stock basis per section 1367(a)(1) (for example, income, tax exempt income, and excess depletion) exceed the items that decrease stock basis per section 1367(a)(2) (for example, losses, deductions, nondeductibles, nondividend distributions, etc.). See Regulations section 1.1367-2(c)(1).

The net increase is figured as follows:

Part I, line 4
Minus Part I, line 6
Minus Part I, line 9
Minus Part I, line 13 (as applicable)
Minus Part III, line 13(a)
Minus Part III, line 13(b)

If the net increase figured exceeds the total reduction in debt basis (line 1 minus line 6), then the restoration is limited to the amount needed to restore debt basis to the face of the loan.

CAUTION *If you have multiple debts, the net increase is applied first to restore the reduction of basis in any debt repaid in the tax year to the extent necessary to offset any gain that would otherwise be realized. Any remaining net increase is applied to each debt in proportion to its reduced basis. See Regulations section 1.1367-2(c)(2).*

Line 13. Enter the smaller of the nondeductible expenses and oil and gas depletion deductions in excess of stock basis (Part I, line 9 minus line 7) or Part II, line 12.

Nondeductible expenses in excess of stock and debt basis don't carry forward (unless an election under Regulations section 1.1367-1(g) is made. As noted earlier, don't use this worksheet if that election has been made).

Line 15. Enter the amount from Part III, line 13(d) in the total column on line 15.

CAUTION *If you have more than one loan to the corporation, any allocated reduction is prorated to the loans based on the ratio that each individual loan basis bears to the aggregate bases of the loans. See Regulations section 1.1367-2(b)(3).*

Line 19. The character of the gain on repayment is dependent on whether the debt is evidenced by a formal note or is an open account.

Debt evidenced by a formal note will result in capital gain, and should be reported on Form 8949 and Schedule D.

Any open account debt will result in ordinary gain, and should be reported on Form 4797.

CAUTION *Gain recognized on loan repayment doesn't increase basis.*

Part II—Shareholder Debt Basis

		Debt 1 ☐ Formal note ☐ Open account debt	Debt 2 ☐ Formal note ☐ Open account debt	Debt 3 ☐ Formal note ☐ Open account debt	Total
Amount of Debt:					
1.	Loan balance at the beginning of the corporation's tax year				
2.	Additional loans (see instructions)				
3.	Loan balance before repayment. Combine lines 1 and 2				
4.	Principal portion of debt repayment (this line doesn't include interest)	( )	( )	( )	( )
5.	Loan balance at the end of the corporation's tax year. Combine lines 3 and 4				
Adjustments to Debt Basis:					
6.	Debt basis at the beginning of the corporation's tax year				
7.	Enter the amount, if any, from line 2				
8.	Debt basis restoration (see instructions)				
9.	Debt basis before repayment. Combine lines 6, 7, and 8				
10.	Divide line 9 by line 3				
11.	Nontaxable debt repayment. Multiply line 10 by line 4				
12.	Debt basis before nondeductible expenses and losses. Subtract line 11 from line 9				
13.	Nondeductible expenses and oil and gas depletion deductions in excess of stock basis				
14.	Debt basis before losses and deductions. Subtract line 13 from line 12. If the result is zero or less, enter -0-				
15.	Allowable losses in excess of stock basis. Enter the amount from Part III, line 13, column (d)				
16.	**Debt basis at the end of the corporation's tax year.** Subtract line 15 from line 14. If the result is zero or less, enter -0-				
Gain on Loan Repayment:					
17.	Repayment. Enter the amount from line 4				
18.	Nontaxable repayments. Enter the amount from line 11				
19.	**Reportable gain.** Subtract line 18 from line 17 . . .				

Part III. Allowable Loss and Deduction Items

The corporate losses and other deduction items are limited to the sum of your stock and debt basis. When stock and debt basis is insufficient, and there is more than one type of loss or deduction item that reduces basis, the amounts allowed as a loss or deduction are allocated on a pro rata basis. See Regulations sections 1.1366-2(a)(4) and (5).

Loss and deductions in excess of basis are suspended and carried forward indefinitely and the character of the loss and deduction items is retained.

Part III shows the pro rata allocation and tracks any loss or deduction carryforward.

Column (a). Enter the loss and deduction amounts for each item as reported on your Schedule K-1.

Column (b). Enter any loss or deduction items disallowed due to basis limitations in prior years that were carried forward.

Column (c). If Part I, line 10, is zero, skip column (c).

If stock basis, as reported on Part I, line 10, is greater than the sum of column (a) and column (b), line 13, enter the sum of each line for column (a) plus column (b) in column (c). If stock basis, as reported on Part I, line 10, is less than the sum of column (a) and column (b), line 13, enter the pro rata amount on the corresponding line in column (c). The total allocation amount reported in column (c), line 13, can't exceed the amount reported on Part I, line 10.

Column (d). If Part II, line 14, is zero, skip column (d).

If column (c), line 13, is less than Part I, line 10, skip column (d).

If debt basis, as reported on Part II, line 14, is greater than column (a) plus column (b) minus column (c), line 13, enter column (a) plus column (b) minus column (c), in column (d) for each line item. If debt basis, as reported on Part II, line 14, is less than column (a) plus column (b) minus column (c), line 13, enter the pro rata amount on the corresponding line in column (d). The total allocation amount reported in column (d), line 13, can't exceed the amount reported on Part II, line 14.

The allowable losses and deductions from columns (c) and (d) should be reported on the appropriate areas of your return (subject to any additional limitations).

Column (e). If the sum of column (a) plus (b) exceeds the sum of column (c) plus (d), enter the excess in column (e) for each line item. If you disposed of all your stock, see Regulations section 1.1366-2(a)(6).

Part III—Allowable Loss and Deduction Items

		(a) Current year losses and deductions	(b) Carryover amounts (column (e)) from the previous year	(c) Allowable loss from stock basis	(d) Allowable loss from debt basis	(e) Carryover amounts
1.	Ordinary business loss					
2.	Net rental real estate loss					
3.	Other net rental loss					
4.	Net capital loss					
5.	Net section 1231 loss					
6.	Other loss					
7.	Section 179 deductions					
8.	Charitable contributions					
9.	Investment interest expense					
10.	Section 59(e)(2) expenditures					
11.	Other deductions					
12.	Foreign taxes paid or accrued					
13.	**Total Loss.** Combine lines 1 through 12 for each column. Enter the total loss in column (c) on line 11 of Part I and enter the total loss in column (d) on line 15 of Part II					

A MAP OF THE PARTNERSHIP K-1 TO BASIS WORKSHEET

2

Adjustments to a partner's basis do not involve tiers as adjustments to the S corporation shareholder's basis do. The IRS provides a worksheet in the Partner's Instructions for Schedule K-1 (1065). The following K-1 shows how the entries are mapped to the IRS's "Worksheet for Adjusting the Basis of a Partner's Interest in the Partnership" (the Worksheet), which follows the K-1. Notes that explain many of the entries on the Schedule K-1 and the worksheet are also provided.

651118

☐ Final K-1 ☐ Amended K-1 OMB No. 1545-0123

Schedule K-1 (Form 1065) **2018**

Department of the Treasury
Internal Revenue Service

For calendar year 2018, or tax year

beginning / / 2018 ending / /

Partner's Share of Income, Deductions, Credits, etc. ► See back of form and separate instructions.

Part I Information About the Partnership

A Partnership's employer identification number

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

C IRS Center where partnership filed return

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

Part II Information About the Partner

E Partner's identifying number

F Partner's name, address, city, state, and ZIP code

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

H ☐ Domestic partner ☐ Foreign partner

I1 What type of entity is this partner?

I2 If this partner is a retirement plan (IRA/SEP/Keogh/etc.), check here ☐

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

	Beginning	Ending
Profit	%	%
Loss	%	%
Capital	%	%

K Partner's share of liabilities:

	Beginning	Ending
Nonrecourse	$	$ **Note B**
Qualified nonrecourse financing	$	$
Recourse	$	$

L Partner's capital account analysis:

Beginning capital account	$
Capital contributed during the year	$ **Note A**
Current year increase (decrease)	$

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

1	Ordinary business income (loss)	**Line 4 or (10)**
2	Net rental real estate income (loss)	**Line 4 or (10)**
3	Other net rental income (loss)	**Line 4 or (10)**
4	Guaranteed payments	**n/a**
5	Interest income	**Line 4**
6a	Ordinary dividends	**Line 4**
6b	Qualified dividends	**n/a**
6c	Dividend equivalents	**Line 4**
7	Royalties	**Line 4**
8	Net short-term capital gain (loss)	**Line 4 or (10)**
9a	Net long-term capital gain (loss)	**Line 4 or (10)**
9b	Collectibles (28%) gain (loss)	**n/a**
9c	Unrecaptured section 1250 gain	**n/a**
10	Net section 1231 gain (loss)	**Line 4 or (10)**
11	Other income (loss)	**Line 4 or (10)**
12	Section 179 deduction	**Line 10**
13	Other deductions	**Line 10**
14	Self-employment earnings (loss)	**n/a**
15	Credits	**n/a**
16	Foreign transactions	**n/a**
17	Alternative minimum tax (AMT) items	**n/a** — **Separate basis calc**
18	Tax-exempt income and nondeductible expenses	
18 A		**Line 4**
18 B		**Line 4**
18 C		**Line 9**
19	Distributions	**Note F**
20	Other information	
20 L		**Line 4**
20 AH		**Notes C & G**

*See attached statement for additional information.

Worksheet for Adjusting the Basis of a Partner's Interest in the Partnership *Keep for Your Records*

1.	Your adjusted basis at the end of the prior year. Do not enter less than zero. Enter -0- if this is your first tax year	**1.**
	Increases:	
2.	Money and your adjusted basis in property contributed to the partnership less the associated liabilities (but not less than zero)	**2.** **Note A**
3.	Your increased share of or assumption of partnership liabilities. (Subtract your share of liabilities shown in item K of your 2017 Schedule K-1 from your share of liabilities shown in item K of your 2018 Schedule K-1 and add the amount of any partnership liabilities you assumed during the tax year (but not less than zero))	**3.** **Note B**
4.	Your share of the partnership's income or gain (including tax-exempt income) reduced by any amount included in interest income with respect to the credit to holders of clean renewable energy bonds	**4.** **Note C**
5.	Any gain recognized this year on contributions of property. Do not include gain from transfer of liabilities	**5.** **Note D**
6.	Your share of the excess of the deductions for depletion (other than oil and gas depletion) over the basis of the property subject to depletion	**6.** **Note E**
	Decreases:	
7.	Withdrawals and distributions of money and the adjusted basis of property distributed to you from the partnership. Do not include the amount of property distributions included in the partner's income (taxable income)	**7.** **Note F**
	Caution: A distribution may be taxable if the amount exceeds your adjusted basis of your partnership interest immediately before the distribution.	
8.	Your decreased share of partnership liabilities and any decrease in your individual liabilities because they were assumed by the partnership. (Subtract your share of liabilities shown in item K of your 2018 Schedule K-1 from your share of liabilities shown in item K of your 2017 Schedule K-1 and add the amount of your individual liabilities that the partnership assumed during the tax year (but not less than zero))	**8.** **Note B**
9.	Your share of the partnership's nondeductible expenses that are not capital expenditures	**9.** **Note H**
10.	Your share of the partnership's losses and deductions (including capital losses). However, include your share of the partnership's section 179 expense deduction for this year even if you cannot deduct all of it because of limitations	**10.** **See K-1 Map**
11.	The amount of your deduction for depletion of any partnership oil and gas property, not to exceed your allocable share of the adjusted basis of that property	**11.** **Note E**
12.	Your share of the adjusted basis of charitable property contributions and foreign taxes paid or accrued	**12.** **Note G**
13.	Your adjusted basis in the partnership at the end of this tax year. (Add lines 1 through 6 and subtract lines 7 through 13 from the total. If zero or less, enter -0-.)	**13.**
	Caution: The deduction for your share of the partnership's losses and deductions is limited to your adjusted basis in your partnership interest. If you entered zero on line 13 and the amount figured for line 13 was less than zero, a portion of your share of the partnership losses and deductions may not be deductible. (See *Basis Limitations*, earlier, for more information.)	

The following notes explain the entries on the Schedule K-1 and the worksheet for adjusting the basis of a partner's interest in the partnership.

Note A. Money and adjusted basis in property contributed to the partnership less the associated liabilities

Item L in part II of the K-1 shows capital contributed during the year. If item L is presented on the tax basis, this amount may be used for line 2 of the worksheet. If item L is not presented on the tax basis, the practitioner will need to know the partner's tax basis in any property contributed to the partnership during the year and the associated liabilities assumed by the partnership at that time.

Note B. Increases and decreases to partnership liabilities and debt assumptions

Item K in part II of the K-1 shows the beginning and ending values of the partner's share of partnership debt for the tax year. (All three types of debt—nonrecourse, qualified nonrecourse, and recourse — are included in basis, but all three are not included in the at-risk amount as discussed later in the chapter.)

Practitioner Planning Tip

Although all three types of debt are included in basis, a limited partner or limited liability member may not receive a Schedule K-1 showing all three types of debt. In practice, debt allocations may be made on the basis of whether a partner has any liability for a particular type of debt. For example, limited partners and limited liability members generally have no liability for recourse debt and are not allocated any recourse debt. Practitioners should review the debt allocations in light of the individual partner's status to determine if there should be a basis or at-risk basis adjustment for the liabilities being reported.

The change in the partner's share of liabilities may be calculated by using the following formula.

	Ending share of liabilities
−	Beginning share of liabilities
	Net change in the share of liabilities

If the net change is a positive number, it is included in line 3 of the worksheet. If the net change is a negative number, it is included in line 8 of the worksheet.

Only liabilities that are completely assumed by the other party should be included in line 3 or line 8 of the worksheet. If the partner assumes a liability of the partnership, the partnership should remove the liability from their books so that the balance no longer is included in any partner's share of liabilities at the end of the year. If the partnership assumes a liability of the partner, the partner has been relieved of a personal debt and is only liable for their share of the liability based on the partnership agreement at the end of the year.

Practitioners should be careful not to include any assumptions of liabilities that are already accounted for in other adjustments. For example, only equity in property contributed to the partnership is added to basis (Note A); therefore, the assumption of the related liability has already been included in the basis adjustment.

Note C. Income items less interest attributable to clean renewable energy bonds

The income included on line 4 of the worksheet is comprised of all the positive amounts tied to line 4 as shown on the K-1 "Map to Basis Worksheet." In addition, any adjustment for interest income from clean renewable energy bonds is reported separately as a supplement to the K-1. Code AH in box 20 should indicate that the information is attached. See IRC §54 and IRS Notice 2007-26 for more information about this adjustment.

Note D. Gain on contributed property

Only the adjusted tax basis of property at the time of transfer is included in increases to basis. However, if a partner must recognize gain from transferring property to the partnership, the taxable gain increases the amount of basis that the partner has contributed to the partnership. This adjustment allows the partner to avoid double taxation on the gain.

Note E. Depletion

The Code has several provisions allowing various methods for calculating the deductible expense attributable to the depletion of natural resources. These methods are contained in IRC §§611 through 613A and the associated regulations. The partnership must provide to each partner the information they need to calculate depletion. Calculation of depletion and the related adjustments are outside the scope of this chapter.

Note F. Distributions

Extensive information on distributions is included elsewhere in the chapter. If the distribution of property has already been included in the partner's income (e.g., as part of guaranteed payments), it should not be included again on this line.

Note G. Charitable property and foreign taxes paid or accrued

The information necessary to make the adjustments on line 12 of the worksheet should be reported by the partnership in supplemental information included with the K-1. Code AH in box 20 of the K-1 is used to indicate that some supplemental information is available.

Note H. Nondeductible expenses

The nondeductible expenses paid or incurred by the partnership are not deductible on the individual's return. The individual must decrease the adjusted basis of their interest in the partnership by this amount.

THE THREE LOSS LIMITATIONS

Three different sets of rules may limit the amount of losses deductible by an investor in a pass-through entity. These limitations, in the order in which they are applied, are as follows. Note that the same at-risk rules and passive activity rules apply to investors in both partnerships and S corporations.

1. The basis limitations (IRC §704(d) for partners and IRC §1366(d) for S corporation shareholders)
2. The at-risk rules under IRC §465
3. The passive activity loss rules under IRC §469

Although basis is calculated differently for each type of entity, individuals may not deduct losses in excess of their basis in either type of entity. The mechanics of calculating basis for each entity type are discussed earlier in the chapter.

Note. For more information on these topics and comprehensive examples, see the 2016 *University of Illinois Federal Tax Workbook,* Volume A, Chapter 2: S Corporation Shareholder Issues and the 2017 *University of Illinois Federal Tax Workbook,* Volume B, Chapter 4: Partner Issues. These can be found at **uofi.tax/arc** [taxschool.illinois.edu/taxbookarchive].

AT-RISK RULES[73]

The at-risk rules apply to any trade or business or income-producing activity. Under the at-risk rules, a taxpayer can only claim a loss up to the amount for which they are at risk. Taxpayers are at risk for the following.

1. The amount of money plus the adjusted basis of property contributed to the entity
2. The amounts the individual borrowed for use in the entity's activity as long as the individual either:
   a. Is personally liable for repayment, or
   b. Has pledged property as security for the debt

73. IRC §465.

Example 19. Charlie has an interest in a partnership. She contributed various assets with a $40,000 FMV and a cost basis of $30,000 to the partnership, plus $80,000 cash. Of this cash contribution, $70,000 was a bank loan guaranteed by Charlie's mother. Because Charlie's debt had a guarantee, it does not provide her with basis under the at-risk rules. Charlie's initial at-risk amount is calculated as follows.

Asset Type	At-Risk
Cash	$10,000
Asset basis	30,000
Qualifying debt	0
Total basis under at-risk rules	$40,000

In applying the at-risk rules:

> *...substance will prevail over form. Regardless of the form a transaction may take, the taxpayer's amount at risk will not be increased if the transaction is inconsistent with normal commercial practices or is, in essence, a device to avoid [the at-risk rules of] section 465.*[74]

Generally, transactions that add to the basis also add to the amount of financial risk investors bear from their investment in the entity. However, if the individual does not bear any true economic risk, the transaction is disregarded under the at-risk rules. One example of this is shares purchased with borrowed funds when the shares are used as collateral for the loan.[75] Money borrowed from someone who also holds an interest in the entity's profits or equity does not qualify as an amount at risk for the investor who uses the loan to purchase the ownership interest.[76]

Certain debts do not increase the at-risk amount.[77] In most cases, nonrecourse debts or debts with a guarantee or stop-loss provision are not considered to place the investor in additional risk.[78]

However, the rules for money loaned to an entity are less stringent than those for money used to buy into the entity. For debt purposes, the amount at risk can include loans the individual made to the company even if the funds were borrowed from another investor in the same entity.[79]

At-Risk Rules for Partners' Shares of Partnership Liabilities

As discussed earlier, there are three types of liabilities shown on a K-1 issued by a partnership.

1. Nonrecourse
2. Qualified nonrecourse
3. Recourse

Only recourse and qualified nonrecourse debt affect the at-risk amount. A recourse liability is any obligation to the extent that any partner or a related person has an economic risk of loss for that liability.[80] Qualified nonrecourse financing is debt secured by real property used in an activity of holding real property and is treated as an amount at risk.

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74. Prop. Treas. Reg. §1.465-1(b).
75. IRS Pub. 925, *Passive Activity and At-Risk Rules.*
76. Treas. Regs. §§1.465-8(a) and 1.465-20(a).
77. IRC §465(b)(3).
78. IRC §465(b)(4).
79. IRS Pub. 925, *Passive Activity and At-Risk Rules.*
80. Treas. Reg. §1.752-2(a).

The partner's share of any net increase in recourse and qualified nonrecourse debt for the year increases the partner's at-risk amount. Likewise, decreases in the net liabilities decrease the at-risk amount.

Limited Partner. A limited partner generally has no obligation to contribute additional capital to the partnership and therefore does not have an economic risk of loss in partnership recourse liabilities. Thus, absent some other factor such as the guarantee of a partnership liability by the limited partner or the limited partner making the loan to the partnership, a limited partner generally does not have a share of partnership recourse liabilities.[81]

Note. For more information on the effect of partnership liabilities, including rules for limited partners and examples, see Treas. Regs. §§1.752-1 through 1.752-5.

Adjustment to the At-Risk Amount

Each investor's at-risk amount is adjusted annually. The appropriate time to calculate the at-risk amount is at the end of the entity's tax year.[82]

The at-risk amount is increased by the additional amount of money or property basis and qualified debt contributed to the business. At-risk basis is also increased by the investor's share of the entity's income. It is reduced by losses allowed and by the amount of distributions made. The at-risk amount is also reduced if previously qualifying debt subsequently becomes unqualified. This could occur if someone else guarantees the debt or if the debt becomes nonrecourse. Conversely, when debt that previously did not qualify as at-risk becomes qualified, the debt increases basis.[83]

Example 20. Use the same facts as **Example 19.** After Charlie's initial investment, she received her first K-1 from the partnership. The K-1 reported ordinary income of $15,000 and distributions of $14,000. Charlie's at-risk amount at the end of the partnership's tax year is increased by the $15,000 of income and deceased by the $14,000 of distributions. This net difference of $1,000 is added to her initial at-risk amount of $40,000 for a new total of $41,000.

Note. Form 6198, *At-Risk Limitations,* is used to calculate the amounts at risk and determine the amount of deductible losses for the current tax year.

The at-risk rules are similar to the basis rules. **Losses limited under both rules are carried forward until the taxpayer has sufficient basis to claim the deferred losses.**[84] However, the manner in which the amounts of allowed losses are determined is different when multiple categories of losses are subject to the limitations.

- **For basis purposes,** deductible items and nondeductible losses from an S corporation are considered separately under their own tiers. When basis limitations apply, each tier absorbs basis until the next is considered. (See the "S Corporation Ordering Rules" section earlier in the chapter.)
- **When at-risk limitations apply,** the excess is prorated between deductible and nondeductible items.[85]

The following examples illustrate the differences between the basis and at-risk limitations.

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81. IRS Pub. 541, *Partnerships*.

82. Prop. Treas. Reg. §1.465-1(a).

83. IRS Pub. 925, *Passive Activity and At-Risk Rules.*

84. Ibid.

85. IRS Pub. 925, *Passive Activity and At-Risk Rules.*

Example 21. In 2018, Debby purchased stock in CSZ Inc., an S corporation, for $10,000. The funds used for the purchase came from her savings, so they qualify for both basis and at-risk purposes. The 2018 K-1 Debby received showed an ordinary loss of $18,500 in box 1 and nondeductible expenses of $1,500 in box 16, code C ("nondeductible expenses"). Debby previously made a Treas. Reg. §1.1367-1(g) election to consider deductible losses prior to nondeductible expenses. She had not made any loans to the corporation.

For basis purposes, Debby's deductible loss is calculated as follows. She is allowed to deduct $9,250 of ordinary losses on her 2018 return. Although she qualifies to deduct $10,000 under the basis rules, her deduction is limited to $9,250 under the at-risk rules.

Calculation of Debby's loss as limited by basis:

	Additions to basis (stock purchase)	$10,000
Tier 1	Items of income	0
Tier 2	Distributions	0
Optional Tier 3	Less: deductible losses	(18,500)
	Negative subtotal = deductible losses in excess of basis	($ 8,500) [a]
	Deductible losses carried forward to future years	8,500
	Remaining basis before consideration of nondeductible expenses	$ 0
Optional Tier 4	Less: nondeductible expenses/losses	(1,500)
	Negative subtotal = nondeductible expenses in excess of basis	($ 1,500)
	Nondeductible expenses carried forward to future years	1,500
	Remaining basis at the end of 2018	$ 0

[a] $10,000 allowed

Calculation of Debby's loss as limited by the at-risk rules:

	Deductible		**Nondeductible**		**Total**	
Expenses/losses from K-1		$18,500		$1,500		$20,000
Total at risk	$10,000		$10,000		$10,000	
Percentage of total	× 92.5%		× 7.5%		× 100%	
At-risk expenses allowed in 2018	$ 9,250	(9,250)	$ 750	(750)	$10,000	(10,000)
K-1 expenses carried forward		$ 9,250		$ 750		$10,000

Example 22. In 2018, Juan purchased stock in WC Contractors Inc., an S corporation, for $20,000. Half of the funds used for the purchase came from his savings, and the other half came from his father, who owns the rest of the shares of the corporation. The 2018 K-1 Juan received shows an ordinary loss of $18,500 in box 1 and nondeductible expenses of $1,500 in box 16 (code C).

Juan's $20,000 investment established sufficient basis to allow the full $18,500 of ordinary loss and absorb the $1,500 in nondeductible expenses. However, only the $10,000 from Juan's savings qualified for at-risk purposes. The amount of deductible and nondeductible losses was prorated as follows.

	Deductible		**Nondeductible**		**Total**	
Expenses/losses from K-1		$18,500		$1,500		$20,000
Total at risk	$10,000		$10,000		$10,000	
Percentage of total	× 92.5%		× 7.5%		× 100%	
At-risk expenses allowed in 2018	$ 9,250	(9,250)	$ 750	(750)	$10,000	(10,000)
K-1 expenses carried forward		$ 9,250		$ 750		$10,000

Even though Juan's initial basis was $20,000, he was only allowed to deduct $9,250 of the deductible losses on his 2018 return because of the at-risk limitation. The $750 of nondeductible expenses reduced his amount at risk to $0. The remaining $9,250 of deductible losses and $750 of nondeductible expenses were carried forward to his 2019 return.

Juan filed the following Form 6198 with his 2018 return.

For Example 22

Form **6198** (Rev. November 2009) Department of the Treasury Internal Revenue Service

At-Risk Limitations

▶ Attach to your tax return.
▶ See separate instructions.

OMB No. 1545-0712
Attachment Sequence No. **31**

Name(s) shown on return: **Juan**
Identifying number: **355-55-5555**

Description of activity (see page 2 of the instructions)

Part I Current Year Profit (Loss) From the Activity, Including Prior Year Nondeductible Amounts. See page 2 of the instructions.

1	Ordinary income (loss) from the activity (see page 2 of the instructions)	1	(18,500)
2	Gain (loss) from the sale or other disposition of assets used in the activity (or of your interest in the activity) that you are reporting on:		
a	Schedule D	2a	
b	Form 4797	2b	
c	Other form or schedule	2c	
3	Other income and gains from the activity, from Schedule K-1 of Form 1065, Form 1065-B, or Form 1120S, that were not included on lines 1 through 2c	3	
4	Other deductions and losses from the activity, including investment interest expense allowed from Form 4952, that were not included on lines 1 through 2c	4	(1,500)
5	Current year profit (loss) from the activity. Combine lines 1 through 4. See page 3 of the instructions before completing the rest of this form	5	(20,000)

Part II Simplified Computation of Amount At Risk. See page 3 of the instructions before completing this part.

6	Adjusted basis (as defined in section 1011) in the activity (or in your interest in the activity) on the first day of the tax year. **Do not** enter less than zero	6	
7	Increases for the tax year (see page 3 of the instructions)	7	10,000
8	Add lines 6 and 7	8	10,000
9	Decreases for the tax year (see page 4 of the instructions)	9	
10a	Subtract line 9 from line 8 ▶ 10a 10,000		
b	If line 10a is **more** than zero, enter that amount here and go to line 20 (or complete Part III). Otherwise, enter -0- and see **Pub. 925** for information on the recapture rules	10b	10,000

Part III Detailed Computation of Amount At Risk. If you completed Part III of Form 6198 for the prior year, see page 4 of the instructions.

11	Investment in the activity (or in your interest in the activity) at the effective date. **Do not** enter less than zero	11	
12	Increases at effective date	12	
13	Add lines 11 and 12	13	
14	Decreases at effective date	14	
15	Amount at risk (check box that applies):		
a	☐ At effective date. Subtract line 14 from line 13. **Do not** enter less than zero.		
b	☐ From your prior year Form 6198, line 19b. **Do not** enter the amount from line 10b of your prior year form.	15	
16	Increases since (check box that applies):		
a	☐ Effective date **b** ☐ The end of your prior year	16	
17	Add lines 15 and 16	17	
18	Decreases since (check box that applies):		
a	☐ Effective date **b** ☐ The end of your prior year	18	
19a	Subtract line 18 from line 17 ▶ 19a		
b	If line 19a is **more** than zero, enter that amount here and go to line 20. Otherwise, enter -0- and see **Pub. 925** for information on the recapture rules	19b	

Part IV Deductible Loss

20	**Amount at risk.** Enter the **larger** of line 10b or line 19b	20	10,000
21	**Deductible loss.** Enter the **smaller** of the line 5 loss (treated as a positive number) or line 20. See page 8 of the instructions to find out how to report any deductible loss and any carryover	21	(10,000)

Note: *If the loss is from a passive activity, see the Instructions for* ***Form 8582,*** *Passive Activity Loss Limitations, or the Instructions for* ***Form 8810,*** *Corporate Passive Activity Loss and Credit Limitations, to find out if the loss is allowed under the passive activity rules. If only part of the loss is subject to the passive activity loss rules, report only that part on Form 8582 or Form 8810, whichever applies.*

For Paperwork Reduction Act Notice, see page 8 of the instructions. Cat. No. 50012Y Form **6198** (Rev. 11-2009)

At-Risk Recapture

When an individual's at-risk amount in their partnership or S corporation investment has a net decrease for the tax year, they must recapture at least a portion of the losses previously allowed. This is accomplished by increasing the year's income from the entity by the lesser of:[86]

- The negative at-risk amount (expressed as a positive income amount), or
- The total amount of losses deducted in previous tax years minus any amounts previously added to income under this recapture rule.

The recapture amount that must be recognized in the tax year is not used to offset a net loss that exists from the activity for that year. However, the recaptured amount can be deducted from the income from that activity in a subsequent year.[87]

Example 23. Frank purchased his interest in a partnership in part with a bank loan. In 2018, his mother guaranteed the loan with the bank. The loan balance was $70,000 at the end of the year. For 2018, Frank's share of the partnership loss was $5,000, which was reported as a negative amount in box 1 of the K-1. Frank's initial basis was $110,000, and he claimed the following losses in prior years.

Initial basis		$110,000
2016 loss claimed	($40,000)	
2017 loss claimed	(40,000)	
Total prior year losses	($80,000)	(80,000)
2018 beginning basis		$ 30,000

Frank's basis under the at-risk rules at the end of 2018 is as follows.

2018 beginning amount at-risk	$30,000
Reduction in at-risk amount due to debt guarantee	(70,000)
2018 ending at-risk basis	($40,000)

Frank's basis is negative at the end of the year. This triggers recapture of at least part of the $80,000 of losses he claimed in prior years. The amount to recapture is the lesser of the following amounts.

- The negative at-risk amount ($40,000, expressed as a positive number)
- The total amount of losses deducted in previous tax years ($80,000 – $0 amount previously added to income under the recapture rule)

Therefore, the amount recaptured is $40,000. Frank must report an additional $40,000 of ordinary income for 2018. The recaptured $40,000 becomes a suspended carryforward loss for Frank. The $5,000 loss for 2018 is added to the $40,000 suspended loss that carries forward to 2019 and future years. The $45,000 total can be used to offset future basis increases.

86. IRS Pub. 925, *Passive Activity and At-Risk Rules.*

87. IRC §465(e)(1)(B).

At-Risk Aggregation Rules

When a business entity engages in more than one type of business activity, special rules determine which activities must be looked at separately and when they can be aggregated. Generally, activities involving the following must be treated separately.[88]

- Film or video tape
- Leased personal property (IRC §1245 property)
- Farming
- Oil and gas property
- Geothermal property

The at-risk rules apply separately to **each** film, **each** item of leased property, and **each** farming activity.[89] However, the following **exceptions** to this general rule apply to partnerships and S corporations.

- All activity involving the leasing of personal property (§1245 property) must be aggregated into one single activity.[90]
- All at-risk activities constituting a trade or business can be aggregated into one activity if the taxpayer actively participates in the management of the business **or** at least 65% of the losses for the tax year are allocable to persons who actively participate in the management of the business.[91]

Active participation is defined differently than material participation. Indicators of **active participation** include when the investor:

- Makes operational or management decisions for the business,
- Performs services for the business, and
- Makes hiring and firing decisions for the business.

Conversely, the absence of management control, the ability to terminate only a top manager, and using independent contractors rather than employees denotes that the investor does not actively participate.[92]

Note. The aggregation rules explain why many publicly traded partnerships, especially the oil and gas ventures, issue K-1s with supplemental statements showing the amounts attributable to several activities.

88. IRC §465(c)(1).
89. IRC §465(c)(2)(A).
90. IRC §§465(c)(2)(B) and (c)(2)(B)(i).
91. IRC §465(c)(3)(B).
92. *Managing S Corporation At-Risk Loss Limitations.* Murphy, Elizabeth. Jan. 31, 2010. Journal of Accountancy. [www.journalofaccountancy.com/issues/2010/feb/20092074.html] Accessed on Apr. 5, 2019.

PASSIVE ACTIVITY LOSS RULES[93]

> **Note.** For more information about material participation, grouping, and other passive activity rules, see the 2014 *University of Illinois Federal Tax Workbook,* Volume B, Chapter 4: Passive Activities. This can be found at **uofi.tax/arc** [taxschool.illinois.edu/taxbookarchive].

The third hurdle that an investor must overcome to deduct losses passed through from an S corporation or partnership is the passive activity loss (PAL) rules. As with the general basis rules and the at-risk rules, the investor's ability to deduct a loss may be limited by the PAL rules.[94]

In general, under the passive loss rules, a loss or credit from a passive activity may only be used to the extent the taxpayer has income from a passive activity. If passive activity losses exceed a taxpayer's passive activity income, the losses are suspended until the taxpayer has sufficient income from the activity giving rise to the passive loss or from some other passive activity. The losses also cease to be suspended when the taxpayer disposes of the entire interest in the activity in a fully taxable transaction.[95]

Material Participation

As an initial rule, when the investor **does not materially participate** in the entity's business,[96] or if the entity is in the business of **real estate rental,**[97] the PAL rules apply. **Material participation** is generally defined as regular, continuous, and substantial involvement in the operations of the business activity by the individual.[98] However, the individual is considered to materially participate **if any of the following apply** during the year.[99]

1. The individual participates in the activity for more than 500 hours.
2. The individual's participation in the activity constitutes substantially all the participation in the activity by all individuals (including nonshareholders/nonpartners).
3. The individual participates in the activity for more than 100 hours, and no other individual participates in the activity more than the individual.
4. The activity is a significant participation activity, and the individual's aggregate participation in all significant participation activities exceeds 500 hours.
5. The individual materially participated in the activity for any five of the preceding 10 tax years (not necessarily consecutive).
6. The activity is a personal service activity,[100] and the individual materially participated in any three preceding tax years (not necessarily consecutive).
7. Based on the facts and circumstances, the individual participates on a regular, continuous, and substantial basis.[101]

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93. IRC §469.
94. IRC §469(a).
95. Instructions for Form 8582.
96. IRC §469(c)(1)(B).
97. IRC §469(c)(2).
98. IRC §469(h)(1).
99. Temp. Treas. Reg. §1.469-5T(a).
100. Defined in Temp. Treas. Reg. §1.469-5T(d).
101. See also *Gregg v. U.S.,* 186 F.Supp.2d 1123 (D. Or. 2001).

Rental Real Estate

The general rule classifying real estate rental as passive is accompanied by two ancillary rules relating to real estate. First, real estate activity is not classified as passive income when the investor is a **real estate professional.**[102]

Second, even when the real estate rental is considered passive, taxpayers may be allowed to deduct up to $25,000 of rental losses against other active income if they **actively** participated in the real estate activity.[103] However, this amount is reduced if the taxpayer's adjusted gross income exceeds $100,000.[104] Different rules apply to married taxpayers filing separate returns.[105] Disallowed rental losses carry forward to future years.[106]

Activities that are sufficiently related may be grouped so that a taxpayer meets the participation requirements for the grouped activities even if the participation requirements are not met for any particular activity by itself.[107]

Note. Any losses suspended under the passive loss rules should be listed on Form 8582, *Passive Activity Loss Limitations.*

Practitioner Planning Tip

When a client receives a final K-1, practitioners are advised to look for previously disallowed losses that may be permitted in the year of disposition.

Limited Partners

Limited partners do not qualify as materially participating in their partnership's activities except as allowed under the regulations.[108] The same restriction applies to the active participation tests for rental real estate activities.[109]

The regulations provide an exception for a limited partner who satisfies test 1, 5, or 6 (listed earlier) for material participation.[110] In addition, these regulations provide that if a limited partner is also a general partner, the limited partnership interest is treated as a general partnership interest.[111]

It was initially the IRS's position that because of their limited liability under state law, members of LLCs and LLPs (limited liability partnerships) were limited partners for purposes of determining material participation. However, both the Tax Court and the Court of Federal Claims have held that LLC and LLP members' interests are not IRC §469(h)(2) limited partnership interests subject to the more stringent test for material participation under the passive activity rules. This is because both LLC members and LLP partners can be treated as general partners under state laws.[112] Members of LLCs and LLPs are therefore entitled to use all seven material participation tests.

102. IRC §469(c)(7).
103. IRC §469(i).
104. IRC §469(i)(3)(A).
105. IRC §469(i)(5).
106. IRC §469(b).
107. Treas. Reg. §1.469-4.
108. IRC §469(h)(2).
109. IRC §469(i)(6)(C).
110. Temp. Treas. Reg. §1.469-5T(e)(2).
111. Temp. Treas. Reg. §1.469-5T(e)(3)(ii).
112. *Thompson v. U.S.,* 87 Fed. Cl. 728 (Fed. Cl. 2009); *Garnett v. Comm'r,* 132 TC No. 19 (2009).

SELECT PARTNER ISSUES

K-1 (FORM 1065), BOX 14[113]

A general partner is subject to SE tax on profits passed through from the partnership and on guaranteed payments received from the partnership. Box 14 shows the unadjusted amount of net income subject to SE tax and other amounts that a taxpayer needs to know if they choose to use the farm or nonfarm optional methods to calculate their SE tax.

Box 14, code A indicates the partner's portion of net earnings subject to SE tax plus the guaranteed payments received by the partner. The partner should adjust this amount by any separately stated items from the K-1 that affect their net taxable earnings subject to SE tax. Only the portion of the separately stated item claimed on the individual partner's return should be included in the adjustment.

> **Example 24.** Use the same facts as **Example 4.** Box 14, code A of Joe's K-1 shows the combined total of his share of partnership loss and the guaranteed payments he received in 2018 ($44,000 guaranteed payments – $15,000 ordinary loss = $29,000). Joe was able to deduct the full $8,000 of the IRC §179 deduction claimed by the partnership, so his **net** SE income was $21,000 for 2018.

Box 14, code B indicates the partner's portion of **gross farming and fishing income** from activities subject to SE tax and may allow the taxpayer to qualify as a farmer for estimated tax purposes. Individual partners need this amount to calculate net earnings from self-employment under the farm optional method in section B, part II of Schedule SE, *Self-Employment Tax*.

Box 14, code C indicates the partner's portion of **gross nonfarm income** from activities subject to SE tax. Individual partners need this amount to calculate net earnings from self-employment under the nonfarm optional method in section B, part II of Schedule SE.

> **Note.** The amounts reported under codes B and C are **not** included on the individual's tax return, but are necessary to determine if a taxpayer qualifies for the optional methods. The amounts may also be useful in determining if a taxpayer meets certain gross income tests for Code provisions applicable only to taxpayers who qualify as farmers. For example, farmers qualify for special provisions regarding the payment of estimated income taxes.

The optional methods of calculating SE earnings may be used by taxpayers who want credit towards their social security coverage even though they have a loss or a small amount of SE income. A worker can use the optional method if their net income from nonfarm self-employment is less than $5,717 and also less than 72.189% of their gross nonfarm income. In addition, they must have net earnings from self-employment of at least $400 in two of the last three years.[114]

The farm optional method may be used if either **gross income from farm self-employment** was $7,920 or less **or net farm profits** were less than $5,717.[115] Additional requirements for the nonfarm optional method can be found in the instructions for Schedule SE.

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113. Instructions for Form 1065.

114. *If You Are Self-Employed.* 2019. Social Security Administration. [www.ssa.gov/pubs/EN-05-10022.pdf] Accessed on Apr. 5, 2019.

115. Ibid.

UNREIMBURSED PARTNERSHIP EXPENSES

A partner may incur out-of-pocket expenses related to a partnership. The partner may only deduct these expenses from gross income when the partnership agreement requires the partner to pay such expenses.[116] Unreimbursed expenses are deducted in part II of Schedule E, *Supplemental Income and Loss*.[117]

The total deductible expenses are listed separately from other amounts from the partnership and identified using code "UPE."[118] If the unreimbursed expenses are from the active conduct of a trade or business, then these expenses also reduce SE income.[119] UPE may also reduce any QBI from the partnership.

> **Note.** It is the IRS's position that generally all deductions attributable to a trade or business should be taken into account when calculating QBI. The final IRC §199A regulations specify that the deduction for 50% of SE tax is considered a deduction attributable to a trade or business.[120] Unfortunately, the final §199A regulations decline to address whether deductions for unreimbursed partnership expenses, the interest expense to acquire partnership and S corporation interests, and state and local taxes are attributable to a trade or business.[121] Therefore, tax practitioners will need to make this determination.

Example 25. Tara is a partner in 4U Consultants, Ltd. According to the terms of the partnership agreement, each partner must pay for their own out-of-pocket mileage expenses. For 2018, Tara received a K-1 from the partnership. The following information was included.

Ordinary business income (box 1)	$ 40,000
Guaranteed payments (box 4)	80,000
Net earnings subject to SE tax (box 14, code A)	120,000
QBI (box 20, code Z)	40,000

Tara drove 100,000 documented, verifiable business miles in 2018 on behalf of the partnership. Her 2018 mileage deduction was $54,500 ($0.545[122] × 100,000). She reports mileage and information about the vehicle on page 2 of Form 4562, *Depreciation and Amortization,* and the corresponding deduction on page 2 of Schedule E. Only the net SE income of $65,500 ($120,000 – $54,500) is subject to SE tax. The IRS has not given any specific instructions on if or how to adjust the QBI reported by the partnership for UPE or for the deduction for half of SE taxes when claiming UPE. However, the IRS does specify that QBI from the partnership includes only the net ordinary income and not the guaranteed payments. Accordingly, Tara chose to allocate the UPE and deduction for SE taxes proportionately between the net ordinary income and guaranteed payments to determine her QBI.

Tara's total earnings from the partnership was $120,000. QBI from the partnership includes only the net ordinary income and not the guaranteed payments. After allocating SE taxes and UPE, Tara's QBI is $20,291.

Unadjusted QBI is ⅓ of total earnings ($40,000 ÷ $120,000)	$40,000
Less: ⅓ of the UPE of $54,500	(18,167)
Less: ⅓ of the deduction for SE taxes of $4,627	(1,542)
QBI from the partnership	$20,291

116. See, e.g., *Johnson v. Comm'r*, TC Memo 1984-598 (Nov. 19, 1984).

117. Instructions for Schedule E.

118. Ibid.

119. See IRS Pub. 587, *Business Use of Your Home.*

120. Treas. Reg. §1.199A-3(b)(1)(vi).

121. TD 9847, 2019-09 IRB 670, 681.

122. IRS Notice 2018-3, 2018-2 IRB 285.

APPENDIX — "OTHER INFORMATION" BOX CODES

Each type of K-1 has a box labeled only as "other information." The box number for each type of K-1 is as follows.

K-1 Type	Other Information Box
Form 1065 (partner)	20
Form 1120S (S corporation shareholder)	17
Form 1041 (beneficiary)	14

Following is a brief explanation of each code used in these "other information" boxes.

Information Reported on Both S Corporation and Partnership K-1s

Investment Income (Code A). This amount is used in determining net investment income when calculating the allowable deduction for interest expense attributable to investment income. It is reported on line 4a of Form 4952, *Investment Interest Expense Deduction.*

Investment Expenses (Code B). This amount is also used in determining net investment income when calculating the allowable deduction for interest expense attributable to investment income. It is reported on line 5 of Form 4952.

Qualified Rehabilitation Expenditures (Other than Rental Real Estate) (1120S code C; 1065 code D). This is the amount of qualified rehabilitation expenditures used to calculate rehabilitation investment credits on Form 3468, *Investment Credit,* for property that is not related to rental real estate activities. It may be combined with rehabilitation expenditures specifically related to rental real estate that are reported in other boxes on the K-1. The expenditures related to rental real estate activities (1120S K-1 box 13, code E and 1065 K-1 box 15, code E) are reported separately from other qualified rehabilitation expenditures because they are subject to different passive activity limitation rules. See the instructions for Form 8582-CR, *Passive Activity Credit Limitations,* for details.

Basis of Energy Property (1120S code D; 1065 code E). The entity should provide a statement for this code that provides the information necessary to calculate the energy credit on Form 3468.

Recapture of Low-Income Housing Credit (1120S codes E and F; 1065 codes F and G). There are two types of low-income housing credits that may require recapture under certain circumstances.[123] If necessary, the credits to recapture are identified on the K-1 and reported by the individual on Form 8611, *Recapture of Low-Income Housing Credit.* Taxpayers must keep a record of each type of recapture so that they can correctly calculate any additional credit recapture that may result from the disposition of all or part of their investment in the entity.

Recapture of Investment Credit (1120S code G; 1065 code H). If the individual taxpayer is required to recapture any investment credit, the entity must disclose the information needed so that the individual K-1 recipient can complete Form 4255, *Recapture of Investment Credit*. The taxpayer may also need to refer to the Form 3468 that was used to claim the original investment credit for other information needed to complete Form 4255.

[123] Instructions for Form 8611.

Recapture of Other Credits (1120S code H; 1065 code I). On a statement attached to the K-1, the entity must report any information that the individual needs to calculate the recapture of other credits. Recapture may be related to any of the following credits.

- New markets credit (see Form 8874, *New Markets Credit*, and Form 8874-B, *Notice of Recapture Event for New Markets Credit*)
- Indian employment credit (see IRC §45A(d))
- Credit for employer-provided childcare facilities and services (see Form 8882, *Credit for Employer-Provided Childcare Facilities and Services*)
- Alternative motor vehicle credit (see IRC §30B(h)(8))
- Alternative fuel vehicle refueling property credit (see IRC §30C(e)(5))
- Qualified plug-in electric drive motor vehicle credit (see IRC §30D(f)(5))

Look-Back Interest — Completed Long-Term Contracts (1120S code I; 1065 code J). Certain long-term contacts are subject to the imposition or refund of interest under the Code. Any necessary information for the individual to calculate their share of the interest should be included with the K-1. The individual should report the interest on Form 8697, *Interest Computation Under the Look-Back Method for Completed Long-Term Contracts*.

Look-Back Interest — Income Forecast Method (1120S code J; 1065 code K). This information is used to calculate interest due or refundable for certain property placed in service after September 13, 1995, and depreciated under the income forecast method. The individual taxpayer reports the interest on Form 8866, *Interest Computation Under the Look-Back Method for Property Depreciated Under the Income Forecast Method*.

Dispositions of Property with §179 Deductions (1120S code K; 1065 code L). The issuing entity must report dispositions of property for which the entity elected to pass through the §179 deduction when the property was acquired.

Recapture of §179 Deduction (1120S code L; 1065 code M). The issuing entity must report the individual taxpayer's share of any recapture of §179 expense if the business use of any property for which the §179 expense deduction was passed through dropped to 50% or less before the end of the recapture period.

IRC §453(l)(3) Information (1120S code M; 1065 code O). The entity should report any information that the investor needs to calculate the interest due under §453(l)(3) with respect to the disposition of certain timeshares and residential lots on the installment method. On Form 1040, the individual taxpayer reports the interest on Schedule 4, *Other Taxes*, line 62, with box "c" checked and "453(l)(3)" entered on the blank line. See IRC §453(l)(3) for details on how to calculate the interest.

IRC §453A(c) Information (1120S code N; 1065 code P). The entity should report any information that the investor needs to calculate the interest due under §453A(c) with respect to certain installment sales. On Form 1040, the individual taxpayer reports the interest on Schedule 4, line 62, with box "c" checked and "453A(c)" entered on the blank line. See IRC §453A(c) for details on how to calculate the interest.

IRC §1260(b) Information (1120S code O; 1065 code Q). The entity should report any information that the investor needs to calculate the interest due under IRC §1260(b), related to gains from certain constructive ownership transactions. The individual's tax liability is increased by the interest charge on any deferral of gain recognition under IRC §1260(b). On Form 1040, the individual taxpayer reports the interest on Schedule 4, line 62, with box "c" checked and "1260(b)" entered on the blank line. See IRC §1260(b) for details on how to calculate the interest.

Interest Allocable to Production Expenditures (1120S code P; 1065 code R). The entity should report any information that the investor needs that relates to interest the investor is required to capitalize under IRC §263A for production expenditures. See Treas. Regs. §§1.263A-8 through 1.263A-15 for details.

CCF Nonqualified Withdrawals (1120S code Q; 1065 code S). The entity should report the investor's share of nonqualified withdrawals from a capital construction fund (CCF). These withdrawals are taxed separately from other gross income at the highest marginal ordinary income or capital gains tax rate. The individual must include a statement with their tax return to show the computation of both the tax and interest for a nonqualified withdrawal. On Form 1040, the interest is reported on Schedule 4, line 62, with box "c" checked and "CCF" entered on the blank line. See IRC §7518 and IRS Pub. 595, *Capital Construction Fund for Commercial Fishermen,* for more information.

Depletion Information — Oil and Gas (1120S code R; 1065 code T). This category includes information about the investor's share of gross income from the property, share of production for the tax year, and other information needed to calculate the depletion deduction for oil and gas wells. The entity should also allocate to each investor a proportionate share of the adjusted basis of each of its oil or gas properties. See IRS Pub. 535, *Business Expenses*, for details on how to calculate the depletion deduction. The investor's basis must also be reduced by the amount of this deduction up to the extent of the investor's adjusted basis in the property.

IRC §108(i) Information (1120S code T; 1065 code X). If the entity made an IRC §108(i) election, it should provide all the information the investor needs to determine their share of the following.

- Deferred cancellation of debt income
- Deferred original issue discount deduction

For partners, the instructions also require the following.

- The deferred IRC §752 amount that is treated as a distribution of money in the current tax year
- The deferred IRC §752 amount remaining as of the end of the current tax year (IRC §752 relates to increases in a partner's share of the liabilities because of the assumption by such partner of partnership liabilities.)

Net Investment Income (1120S code U; 1065 code Y). The entity may use this code to report information that the investor may need to determine their net investment income tax under IRC §1411, including information regarding income from controlled foreign corporations (CFCs) and passive foreign investment companies (PFICs), the stock of which is owned by the entity. Any information not provided elsewhere on the K-1 (or an attachment to the K-1) is provided using this code. For CFCs and PFICs that the investor treats as qualified electing funds (QEFs), the information that is relevant to the investor depends on whether the investor, the entity, or a subsidiary pass-through entity made an election under Treas. Reg. §1.1411-10(g) with respect to the CFC or QEF. For example, if the entity made an election under Treas. Reg. §1.1411-10(g) for a CFC, the stock of which is owned by the entity, and the relevant income and deduction items derived from that CFC are reported elsewhere on the K-1, the investor does not need the information provided using this code to complete Form 8960. See Treas. Regs. §§1.1411-1 through 1.1411-10 for more details.

Excess Taxable Income (1120S code AA; 1065 code AE). If the entity is required to file Form 8990, *Limitation on Business Interest Expense Under Section 163(j)*, it may determine it has excess taxable income. An S corporation shareholder may be required to report this amount on Form 8990, Schedule B, line 45(c). A partner may be required to report this amount on Form 8990, Schedule A, line 43(f). See the instructions for Form 8990 for details.

Excess Business Interest Income (1120S code AB; 1065 code AF). If the entity is required to file Form 8990, it may determine it has excess business interest income. The S corporation shareholder may be required to report this amount on Form 8990, Schedule B, line 45(d). A partner may be required to report this amount on Form 8990, Schedule A, line 43(g). See the instructions for Form 8990 for details.

Other Information (1120S code AC; 1065 code AH). These codes are used to indicate that one of the following may be reported in supplemental information included with the K-1. These codes may also be used for transactions specific to partnerships or S corporations. Such transactions are described in the next sections of the chapter.

1. **Any information needed to complete a disclosure statement for reportable transactions in which the entity participates** — If the entity participates in a transaction that must be disclosed on Form 8886, *Reportable Transaction Disclosure Statement*, both the investor and the entity may be required to file Form 8886 for the transaction. The determination of whether the investor is required to disclose a transaction of the entity is based on the category(ies) under which the transaction qualifies for disclosure and is determined by the investor and the entity. Failure to file Form 8886 when required may expose a taxpayer to penalties. See the instructions for Form 8886 for details.

2. **Excess business loss limitation** — If the entity has deductions attributable to a business activity, it must provide a statement showing the aggregate gross income or gain and the aggregate deductions from the business activity that the investor needs to calculate any excess business loss limitation. See IRC §461 and the instructions for Form 461, *Limitation on Business Losses*, for details.

3. **Qualified investment in qualifying advanced coal project property** — The information provided by the entity is used to calculate the related tax credits on Form 3468.

4. **Qualified investment in qualifying gasification property** — The information provided by the entity is used to calculate the related tax credits on Form 3468.

5. **Qualified investment in qualifying advanced energy project credit property** — The investor uses the information provided by the entity to calculate the amount to report on Form 3468.

6. **Inversion gain** — The entity must provide a statement showing the amounts of each type of income or gain that is included in inversion gain. The entity includes inversion gain in income elsewhere on the K-1. Inversion gain is also reported under the other information code because taxable income and alternative minimum taxable income cannot be less than the inversion gain. In addition, the inversion gain:

   a. Is not taken into account in calculating the net operating loss (NOL) for the tax year or the NOL that can be carried over to each tax year,

   b. May limit the investor's credits, and

   c. Is treated as income from sources within the United States for the foreign tax credit.

   See IRC §7874 for more information.

7. **Any other information** — An entity may use this code to indicate that it is providing any other information that it believes the investor needs to file their return.

Other Information Reported in Box 17 for S Corporation Shareholders

The following items are specified in the instructions for K-1s issued to S corporation shareholders (but not to partners). They may be reported in box 17, using code AC.

1. **Gross farming and fishing income** — Individual shareholders report this income, as an item of information, on Schedule E, *Supplemental Income and Loss*, in part V, on line 42. This income should not be reported elsewhere on Form 1040.

2. **The amount included in gross income with respect to qualified zone academy bonds issued before October 4, 2008** — Income with respect to these qualified zone academy bonds cannot be used to increase the shareholder's stock basis. Because this amount is already included in income elsewhere on the K-1, the shareholder must reduce their stock basis by this amount. This should be included in part I, line 13, of the worksheet for figuring a shareholder's stock and debt basis found in the shareholder's instructions for the K-1 (1120S).

3. **The amount included in gross income with respect to clean renewable energy bonds —** Income with respect to clean renewable energy bonds cannot be used to increase the shareholder's stock basis. Because this amount is already included in income elsewhere on the K-1, the shareholder must reduce their stock basis by this amount. It should be included in part I, line 13, of the worksheet for figuring a shareholder's stock and debt basis found in the shareholder's instructions for the K-1 (1120S).[124]

Other Information Reported in Box 20 for Partners

The following items are specified in the instructions for K-1s issued to partners (but not to S corporation shareholders).

1. **Fuel Tax Credit Information (1065 code C).** The partnership should report the number of gallons of each fuel sold or used during the tax year for a nontaxable use qualifying for the credit for taxes paid on fuels, type of use, and the applicable credit per gallon. This information is used to complete Form 4136, *Credit for Federal Tax Paid on Fuels.*

2. **Interest Expense for Corporate Partners (1065 code N).** The partnership should report each corporate partner's share of the partnership's interest expense. This amount is reported elsewhere on Schedule K-1 and the total amount is reported here for information purposes only. A corporate partner's share of interest income, interest expense, and partnership liabilities are treated as income, expense, and liabilities of the corporation for purposes of the limitation on the deduction for interest under IRC §163(j).

3. **Unrelated Business Taxable Income (1065 code V).** This information is provided for use by a partner that is a tax-exempt organization.

4. **Precontribution Gain (Loss) (1065 code W).** If the partnership distributed any property with precontribution gain or loss to any partner other than the contributing partner and the date of the distribution was within seven years of the date the property was contributed to the partnership, the contributing partner must recognize a gain or loss under IRC §704(c)(1)(B). If the partnership made such a distribution during its tax year, in addition to indicating the distribution in box 20 with code W, it must attach a statement providing the amount of the partner's precontribution gain or loss and identifying the character of the gain or loss (for example, capital gain or loss or IRC §1231 gain or loss). The precontribution gain or loss is reported on Form 8949/Schedule D or Form 4797 in accordance with the information provided by the partnership.

5. **Partner's Share of Gross Receipts (1065 code AG).** This code is used to report each partner's share of the gross receipts under IRC §59A(e) applicable to certain corporations with average gross receipts over $500 million.

6. Other Information (1065 code AH). The partnership should also report the following.

   a. Any information a PTP needs in order to determine whether it meets the 90% qualifying income test of IRC §7704(c)(2).

   b. Noncash charitable contributions — If the partnership made a noncash charitable contribution, the partner's share of the partnership's adjusted basis in the property is limited to basis. Accordingly, the partnership must report this basis to the partners.

   c. Interest and additional tax on compensation deferred under an IRC §409A nonqualified deferred compensation plan that does not meet the requirements of IRC §409A — See §409A(a)(1)(B) to calculate the interest and additional tax on this income. The partner should report this interest and tax on Schedule 4 (Form 1040), line 62. This income is already included in the amount in the K-1 box 4 ("guaranteed payments").

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124. See IRC §54 and IRS Notice 2007-26, 2007-14 IRB 870.

d. The information needed to complete Schedule P (Form 1120-F), *List of Foreign Partner Interests in Partnerships* — The partnership reports this information on an attached statement to partners that are corporations or partners that are partnerships if the reporting partnership knows that one or more of the partners is a foreign corporation.

e. Conservation reserve program payments — Individuals who received social security retirement or disability benefits and are partners in farm partnerships that receive conservation reserve program payments do not pay SE tax on their portion of the payments. The partnership should report the investor's portion of the conservation reserve program payments in box 20 using code AH. The partner should exclude the payment from calculation of SE tax. See Schedule SE for more information.

f. Acceleration of AMT credit (corporations only) — If a corporate partner has made an election to accelerate the AMT credit in lieu of bonus depreciation, it is required to notify the partnership in writing of this election. See Rev. Proc. 2009-16 and Rev. Proc. 2009-33 for more information about the written notification that the electing corporate partner must provide to the partnership. See IRC §168(k)(4) for additional information.

g. IRC §250, effective for tax years beginning after 2017, allows a domestic corporation a deduction for the eligible percentage of foreign-derived intangible income and global intangible low-taxed income (GILTI). If applicable, the partnership should provide the necessary information to each domestic corporate partner for its calculation of this deduction.

h. The partnership will provide information for the partner to determine their effectively connected gain or loss under IRC §864(c)(8) if they are a nonresident alien or foreign corporate partner that had gain or loss from the sale, exchange, or other disposition of their partnership interest.

i. If the partnership has related foreign partners (an IRC §721(c) partnership), the partnership must disclose information necessary for an affected U.S. partner to make any required adjustments to their share of income, etc., reported on the K-1.

j. IRC §1061 information — The partnership should furnish to the partners any IRC §1061 information needed to calculate their capital gains with respect to an applicable partnership interest.

k. The partnership reports the partner's share of the adjusted basis of noncash and capital gain property contributions and the partner's share of the excess of the FMV over the adjusted basis of noncash and capital gain property contributions.

l. Patron reduction and domestic production activities deduction under IRC §199A(g)(2) — If the partnership is a patron of an agricultural or horticultural cooperative, the partner must calculate their patron reduction using Schedule D in IRS Pub. 535. The investor may also be allowed a domestic production activities deduction, if one is passed through from the cooperative to the partnership and then from the partnership to the partner. See IRS Pub. 535 for more information.

Other Information Reported in Box 14 for Beneficiaries[125]

The following information and related codes are used in box 14 of the K-1s issued with Form 1041.

1. **Gross Farming and Fishing Income (1041 code F).** Individual beneficiaries report this income, as an item of information, on Schedule E (Form 1040), line 42. This type of gross income is separately stated to help determine if the beneficiary qualifies for the special estimated tax rules for the individuals with over two-thirds of their gross income from farming and fishing. This item is not reported anywhere else on Form 1040.

2. **Net Investment Income Tax (1041 code H).** This amount is the beneficiary's adjustment for IRC §1411 net investment income or deductions. The beneficiary enters this amount on line 7 of Form 8960, as applicable. See the instructions for Form 8960.

3. **Other Information (1041 code Z).** If this code is used, the fiduciary should provide any additional information the beneficiary may need to file their return that is not shown elsewhere on the K-1. Examples include the following.

   a. The beneficiary's distributive share of the net amount of IRC §965(a) inclusion less the corresponding §965(c) deduction — IRC §965 deals with the treatment of deferred foreign income upon transition to the participation exemption system of taxation.

   b. If the beneficiary receives a statement regarding the splitting of foreign tax credits from the income to which it relates, IRC §909 may prevent the beneficiary from deducting the foreign tax credit until the related foreign income is taken into account. See Form 1116, *Foreign Tax Credit*, and IRS Pub. 514, *Foreign Tax Credit for Individuals*, for more information.

   c. The fiduciary should provide the information the beneficiary needs to calculate their IRC §951A (GILTI) inclusion. IRC §951A requires U.S. shareholders of foreign corporations to report their ratable share of GILTI in taxable income. For details, see the instructions for Form 8992, *U.S. Shareholder Calculation of Global Intangible Low-Taxed Income (GILTI).*

125. Instructions for Schedule K-1 (Form 1041) for a Beneficiary Filing Form 1040.