



2023 Study Cards



SEE

Special Enrollment Exam
Part 2 - Businesses

Business Entities

Employer Identification Number

An employer Identification Number (EIN) is required for the following entities:

1. Reporting employment taxes and excise taxes.
2. A partnership.
3. A corporation.
4. Limited Liability Company (LLC).
5. A trust or an estate.
6. An employee plan.
7. An exempt organization.

How to apply for an EIN. A taxpayer (T/P) can apply for an EIN by telephone, fax, mail or online at [IRS.gov/Businesses](https://www.irs.gov/Businesses).

Form SS-4. Use Form SS-4, Application for Employer Identification Number, to apply for an EIN.

Business Entities

Sole Proprietorship

Definition. A sole proprietorship is an unincorporated business that is owned by one individual. The business is not a separate entity apart from its owner. Its liabilities are personal liabilities and the owner undertakes the risk of the business for all assets owned, whether or not used in the business.

Reporting requirements. Business profits or losses of a sole proprietorship are reported on Schedule C of Form 1040 or 1040-SR. A sole proprietor may also be required to file other returns (such as employment or excise tax returns).

Employer identification number (EIN). A sole proprietorship does not need a separate EIN, unless required to file employment or excise tax returns.

New EIN required. A sole proprietor will need a new EIN if any of the following are true:

- ▶ Filing for bankruptcy under Chapter 7 (liquidation) or Chapter 11 (reorganization).
- ▶ Incorporating.
- ▶ A sole proprietor that takes in partners and operate as a partnership.
- ▶ Establishing a pension, profit sharing, or retirement plan.

New EIN not required. A sole proprietor will not need a new EIN if any of the following are true:

- ▶ Change the name of the business.
- ▶ Change location or add locations.
- ▶ Operating multiple businesses.

Business Entities

Partnership

Definition. A partnership is the relationship between two or more persons who join together to carry on a trade or business. Each partner contributes money, property, labor or skill, and expects to share in the profits and losses of the business. An unincorporated organization with two or more members is generally classified as a partnership for federal tax purposes if its members carry on a trade, business, financial operation, or venture and divide its profits. Partners in a partnership are personally liable for its debts. A qualified joint venture conducted by a husband and wife who file a joint return is not rated as a partnership for federal tax purposes. A qualified joint venture, for purposes of this provision, includes only businesses that are owned and operated by spouses as co-owners, and not in the name of a state law entity (including a general or limited liability company). A partnership must file an annual information return to report the income, deductions, gains, losses, etc., from its operations, but it does not pay income tax. Instead, it “passes through” any profits or losses to its partners. Each partner includes his or her share of the partnership's items on his or her tax return.

Reporting requirements. A partnership files Form 1065, U.S. Return of Partnership Income, plus other returns that apply (such as employment or excise tax returns). The partnership is required to send a copy of Schedule K-1 (Form 1065) to each partner showing each partner's share of the partnership's income, gain, loss, deductions, and credits for the tax year.

Employer identification number (EIN). A partnership is required to obtain an EIN.

Business Entities Partnership

New EIN required. A partnership will need a new EIN if any of the following are true:

- ▶ Incorporating.
- ▶ One partner takes over and operates as a sole proprietorship.
- ▶ The partnership is terminated and a new partnership is begun.

New EIN not required. A partnership will not need a new EIN if any of the following are true:

- ▶ The partnership declares bankruptcy. However, if a liquidating trust is established for a partnership that is in bankruptcy, an EIN for that trust is required.
- ▶ The partnership name changes.
- ▶ Change location or add locations.
- ▶ The partnership terminates under IRC Section 708(b)(1)(B). A partnership shall be considered terminated if within a 12-month period there is a sale or exchange of at least 50% of the total interest in partnership capital and profits to another partner. If the purchaser and remaining partners immediately contribute the properties to a new partnership, they can retain the old partnership EIN.

Business Entities

C Corporation

Definition. A corporation is defined as a legal entity or structure created under the authority of the laws of a state consisting of a person, or group of persons, who become shareholders. The entity's existence is considered separate and distinct from that of its members. Since a corporation is an entity in its own right, it is liable for its own debts and obligations. In forming a corporation, prospective shareholders transfer money, property, or both, for the corporation's capital stock. A corporation generally takes the same deductions as a sole proprietorship to figure its taxable income. A corporation can also take special deductions. The profit of a corporation is taxed to the corporation when earned, and then is taxed to the shareholders when distributed as dividends (double taxation). However, shareholders cannot deduct any loss of the corporation.

Reporting requirements. C Corporations usually file a Form 1120 series return, plus other returns that apply (such as employment or excise tax returns).

Employer identification number (EIN). A corporation is required to obtain an EIN.

Business Entities

C Corporation

New EIN required. A corporation will need a new EIN if any of the following are true:

- ▶ The corporation is a subsidiary of a corporation and currently uses the parent's corporate EIN.
- ▶ The corporation becomes a subsidiary of a corporation.
- ▶ The corporation becomes a partnership or a sole proprietorship.
- ▶ The corporation creates a new corporation after a statutory merger.
- ▶ The corporation receives a new corporate charter.

New EIN not required. A corporation will not need a new EIN if any of the following are true:

- ▶ The corporation is a division of a corporation.
- ▶ After a corporate merger, the surviving corporation uses its existing EIN.
- ▶ A corporation declares bankruptcy. However, if a liquidating trust is established for a corporation that is in bankruptcy, an EIN for that trust is required.
- ▶ Corporate name change or change in location or add locations.
- ▶ The corporation elects to be taxed as an S Corporation by filing Form 2553.
- ▶ The corporation is sold and the assets, liabilities and charters are obtained by the buyer.
- ▶ After a corporate reorganization, the corporation only changes identity, form, or place of organization.

Business Entities

S Corporation

Definition. An eligible domestic corporation can avoid double taxation (once to the corporation and again to the shareholders) by electing to be treated as an S corporation. S corporations are corporations that elect to pass corporate income, losses, deductions and credit through to their shareholders for federal tax purposes. Shareholders of S corporations report the flow-through of income and losses on their personal tax returns and are assessed tax at their individual income tax rates. This allows S corporations to avoid double taxation on the corporate income. Generally, an S corporation is exempt from federal income tax other than tax on certain capital gains and passive income.

Form 2553. In order to become an S corporation, the corporation must submit Form 2553 Election by a Small Business Corporation (PDF), and be signed by all the shareholders.

Reporting requirements. S Corporations file a Form 1120S, U.S. Income Tax Return for an S Corporation, plus other returns that apply (such as employment or excise tax returns). The S corporation is required to send a copy of Schedule K-1 (Form 1120S) to each shareholder showing each shareholder's share of the S corporation's income, gain, loss, deductions, and credits for the tax year.

Employer identification number (EIN). An S corporation is required to obtain an EIN.

Business Entities

Limited Liability Company (LLC)

Definition. A limited liability company (LLC) is an entity formed under state law by filing articles of organization as an LLC. Unlike a partnership, none of the members of an LLC are personally liable for its debts. An LLC may be classified for federal income tax purposes as a partnership, a corporation, or an entity disregarded as an entity separate from its owner by applying the rules in regulations section 301.7701-3. A domestic LLC with at least two members that does not file Form 8832, Entity Classification Election, is classified as a partnership for federal income tax purposes.

Single member LLC. A single member LLC generally has the following choices:

1. File Form 8832 to be taxed as a corporation.
2. If qualified, file Form 2553, Election by a Small Business Corporation (Under Section 1362 of the Internal Revenue Code), to be taxed as an S corporation.
3. Be taxed (by default) as a disregarded entity:
 - ▶ If the single member is an individual, the LLC will be taxed as a sole proprietorship.
 - ▶ If the single member is a business entity, the LLC will be taxed as a division of the corporation.

Multiple members LLC. A multiple members LLC generally has the following choices:

1. File Form 8832 to be taxed as a corporation.
2. If qualified, file Form 2553 to be taxed as an S-Corporation.
3. Be taxed (by default) as a partnership.

Business Entities

Estate

Definition. An estate is a legal entity created as the result of a person's death. The decedent's estate is a separate legal entity for federal tax purposes. An estate consists of real and/or personal property of the deceased person. The estate pays any debts owed by the decedent and then distributes the balance of the estate's assets to the beneficiaries of the estate. The estate exists until the final distribution of the assets is made to the heirs and other beneficiaries.

Reporting requirements. Estates file either Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return, and/or Form 1041, U.S. Income Tax Return for Estates and Trusts, plus other returns that apply (such as employment or excise tax returns).

Employer identification number (EIN). An estate is required to obtain an EIN.

Business Entities

Trust

Definition. A trust is an arrangement through which trustees take title to property for the purpose of protecting or conserving it for the beneficiaries under the ordinary rules applied in chancery or probate courts. A trust is a legal entity created under state law and taxed under federal law. A trust may be created during an individual's lifetime (inter vivos) or at the time of his or her death under a will (testamentary).

Revocable/Irrevocable Trust: An irrevocable trust is a trust, which, by its terms, cannot be modified, amended, or revoked. For tax purposes, an irrevocable trust can be treated as a simple, complex, or grantor trust, depending on the powers listed in the trust instrument. A revocable trust may be revoked and is considered a grantor trust (IRC § 676). State law and the trust instrument establish whether a trust is revocable or irrevocable. If the trust instrument is silent on revocability, then most states consider the trust revocable.

Living Trust: A living person creates an inter vivos trust during that person's lifetime. An inter vivos trust can be established as revocable or irrevocable. An inter vivos trust can be a simple, complex, or grantor trust depending on the trust instrument.

Testamentary Trust: A testamentary trust is created by a will, which begins its existence upon the death of the person making the will, when property is transferred from the decedent's estate. Testamentary trusts are generally simple or complex trusts. A testamentary trust is irrevocable by definition, as it comes into being at the death of the grantor.

Business Entities

Trust

Grantor. The grantor (also known as trustor, settlor, or creator) is the creator of the trust relationship and is generally the owner of the assets initially contributed to the trust. The grantor generally establishes, in the trust instrument, the terms and provisions of the trust relationship between the grantor, the trustee, and the beneficiary. The grantor may retain control over all or a portion of the trust, which may result in the grantor being subject to tax on the income from that portion of the trust.

Reporting requirements. Form 1041, U.S. Income Tax Return for Estates and Trusts, plus other returns that apply (such as employment tax returns).

New EIN required. A trust will need a new EIN if any of the following are true:

- ▶ A trust changes to an estate.
- ▶ A living (inter vivos) trust changes to a testamentary trust.
- ▶ The revocable trust changes to an irrevocable trust.

New EIN not required. A trust will not need a new EIN if any of the following are true:

- ▶ The trustee changes.
- ▶ The grantor or beneficiary changes his or her name or address.

Business Entities Exempt Organization

Definition. A tax exempt organization is a non-profit organization that is exempt from certain taxes because it is described under Section 501 of the Internal Revenue Code (IRC). Certain organizations are required to apply to the IRS for a determination letter that grants them formal tax exemption, while other organizations are treated as tax exempt as long as they are organized and operated under an applicable section of the Code.

IRC Section 501(c)(3) Organization: This is an organization that is organized and operated exclusively for one or more of the following purposes: charitable, religious, educational, scientific, literary, testing for public safety, fostering national or international amateur sports competition (but only if none of its activities involve providing athletic facilities or equipment), or the prevention of cruelty to animals. To qualify, the organization must be a corporation, community chest, fund, unincorporated association, or foundation. A trust is a fund or foundation and will qualify. However, an individual or a partnership will not qualify.

Reporting requirements. Exempt organizations usually file a Form 990 series return plus other returns that apply (such as employment or excise tax returns).

Employer identification number (EIN). All non-profit organizations must apply for an EIN before filing for exempt status.

Accounting period. The following are acceptable tax years:

1. Calendar year.
2. Fiscal year (12 consecutive months ending on the last day of any month except December).
3. 52-53 week tax year. The 52-53 week tax year must always end on:
 - ▶ Whatever date this same day of the week last occurs in a calendar month, or
 - ▶ Whatever date this same day of the week falls that is nearest to the last day of the calendar month.

Adopting a tax year. A T/P adopts a tax year when filing his or her first income tax return by the due date (NOT including extensions) for filing a return for that year.

Calendar year. A T/P must adopt the calendar year if:

1. T/P keeps no books or records;
2. T/P has no annual accounting period;
3. T/P's present tax year does not qualify as a fiscal year; or
4. T/P is required to use a calendar year by a provision in the Internal Revenue Code or the Income Tax Regulations.

Short tax year. A short tax year is a tax year of less than 12 months. A short period tax return may be required when a taxable entity is not in existence for an entire tax year, or changed accounting periods.

Death of individual. When a T/P dies, a tax return must be filed for the decedent by the 15th day of the 4th month after the close of the T/P's regular tax year. The decedent's final return will be a short period tax return that begins on January 1st, and ends on the date of death.

Change in accounting period. A T/P must, with certain exceptions, get approval from the IRS to change tax years. To get approval, the T/P must file Form 1128, Application to Change a Tax Year, by the due date (not including extensions) of the tax return for the short period required to effect the change.

Individuals. Generally, individuals must adopt the calendar year as their tax year. An individual can adopt a fiscal year provided that the individual maintains his or her books and records on the basis of the adopted fiscal year.

Married couple. A newly married couple can adopt the accounting period of the other spouse without first getting approval.

Partnerships, S Corporations, and Personal Service Corporations (PSCs). Generally, partnerships, S corporations (including electing S corporations), and PSCs must use a required tax year. A required tax year is a tax year that is required under the Internal Revenue Code and Income Tax Regulations. The entity does not have to use the required tax year if it receives IRS approval to use another permitted tax year or makes an election under section 444 of the Internal Revenue Code.

Types of accounting methods:

1. Cash method.
2. Accrual method.
3. Special methods of accounting for certain item of income and expenses.
4. A hybrid method which combines elements of two or more of the above accounting methods.

Combination (hybrid) method. A T/P can use any combination of cash, accrual, and special methods of accounting if the combination clearly shows income and it is used consistently. However, the following restrictions apply:

1. If an inventory is necessary to account for income, the accrual method must be used for purchases and sales. Generally, the cash method can be used for all other items of income and expenses.
2. If the cash method is used for reporting income, the cash method must also be used for reporting expenses.
3. If the accrual method is used for reporting expenses, the accrual method must also be used for reporting income.
4. Any combination that includes the cash method is treated as the cash method.

Two or more businesses. A T/P can use a different accounting method for each separate and distinct business if the method used clearly shows income.

Cash Method

The cash method of accounting is used by most individuals and many small business taxpayers. The following entities cannot use the cash method:

1. A corporation (other than an S corporation or a qualified personal service corporation) with average annual gross receipts for the preceding 3 years exceeding \$27 million.
2. A partnership with a corporation (other than an S corporation and a qualified personal service corporation) as a partner and with the partnership having average annual gross receipts for the preceding 3 years exceeding \$27 million.
3. A tax shelter, as defined in section 448(d)(3).

Small business taxpayers. A small business taxpayer is a taxpayer that has average annual gross receipts of \$27 million or less for the prior 3 tax years and is not a tax shelter.

Income. Include in gross income all items of income actually or constructively received or made available without restriction during the year. T/P cannot delay receipt of income.

Expenses. Deduct expenses in the year they were actually paid.

Expenses paid in advance. Expenses paid in advance are deductible only in the year to which it applies, unless the expense qualifies for the 12-month rule. Under the 12-month rule, a T/P is not required to capitalize amounts paid to create certain benefits for the T/P that do not extend beyond the earlier of the following:

1. 12 months after the right or benefit begins, or
2. The end of the tax year after the tax year in which payment is made.

Cash Method (cont.)

Special rules for farming businesses. Generally, a T/P engaged in the trade or business of farming is allowed to use the cash method for its farming business. However, certain corporations (other than S corporations) and partnerships that have a partner that is a corporation must use an accrual method for their farming business, unless they meet the gross receipts test discussed on the previous card).

Qualified personal service corporation (PSC). A PSC that meets the following function and ownership tests can use the cash method:

1. **Function test.** A corporation meets the function test if at least 95% of its activities are in the performance of services in the fields of health, veterinary services, law, engineering (including surveying and mapping), architecture, accounting, actuarial science, performing arts, or consulting.
2. **Ownership test.** A corporation meets the ownership test if at least 95% of its stock is owned, directly or indirectly, at all times during the year by one or more of the following:
 - a. Employees performing services for the corporation in a field qualifying under the function test.
 - b. Retired employees who had performed services in those fields.
 - c. The estate of an employee described in (a) or (b).
 - d. Any other person who acquired the stock by reason of the death of an employee referred to in (a) or (b), but only for the 2-year period beginning on the date of death.

Accrual Method

Under an accrual method of accounting, income is reported in the year earned and expenses are deducted or capitalized in the year incurred. The purpose of this method of accounting is to match income and expenses in the correct year.

Income. Report income on the earliest of the following dates:

- ▶ When payment is received.
- ▶ When the income is due.
- ▶ When the income is earned.
- ▶ When title has passed.

Advance income for services. Postpone including the advance payments in income until they are earned. Do not postpone including the payments beyond the following tax year.

Expenses. Deduct or capitalize business expenses when they become a liability, whether or not paid in the same year.

Accrual Method (cont.)

Related persons. Do not deduct business expenses and interest owed to a related cash basis person until the payments have been made and the related person includes the payments in their gross income. For the purpose of the related party rule, the following are related persons:

1. Member of a family including brother and sisters (either whole or half), spouses, ancestors, and lineal descendants.
2. Two entities (such as partnership, corporation, fiduciary) if the same individual has more than 50% interest in each entity.
3. The fiduciaries of two different trusts, and the fiduciary and beneficiary of two different trusts, if the same person is the grantor of both trusts.
4. A tax-exempt educational or charitable organization and a person (if an individual, including the members of the individual's family) who directly or indirectly controls such an organization.
5. The grantor and fiduciary, and the fiduciary and beneficiary, of any trust.
6. A PSC and any employee-owner, regardless of the amount of stock owned by the employee-owner.

Change in Accounting Method

Approval required. The following changes in accounting methods require the consent of the IRS (use Form 3115, Application for Change in Accounting Methods):

1. Change from cash method to the accrual method or vice versa.
2. Change in the method or basis used to value inventories.
3. Change in the method of figuring depreciation or amortization method (except for certain permitted changes to the straight-line method).
4. Change involving the adoption, use, or discontinuance of any other specialized method of computing taxable income.
5. Change where the IRC and Treasury Regulations requires the IRS consent before adopting the change.

Approval not required. The following changes in accounting methods do not require the consent of the IRS:

1. A correction of mathematical or posting errors.
2. A correction of errors in computing tax liability (such as an error in computing credits).
3. An adjustment of any item of income or deduction that does not involve the proper time for including it in income or deducting it.
4. Certain adjustments in the useful life of a depreciable or amortizable asset.

Items included in inventory:

1. Merchandise or stock in trade. Merchandise includes the following:
 - a) Purchased merchandise if the title has passed to T/P.
 - b) Goods under contract for sale that has not yet been segregated and applied to the contract.
 - c) Goods out on consignment.
 - d) Goods held for sale in display rooms, merchandise mart rooms, or booths located away from place of business.

Merchandise not included in inventory:

- a) Goods sold, but only if title has passed to buyer.
 - b) Goods consigned to T/P.
 - c) Goods ordered to future delivery if T/P does not have title.
2. Raw materials.
3. Work in process.
4. Finished products.
5. Supplies that physically become a part of the item intended for sale.
6. C.O.D. mail sales (C.O.D. payment not received).
7. Containers.

Cost identification. There are three methods of identifying items in inventory:

1. **Specific identification method.** This method is used to identify the cost of each inventoried item by matching the item with its cost of acquisition in addition to other allocable costs, such as labor and transportation.
2. **First-in first-out (FIFO) method.** This method assumes that the items of inventory purchased or produced first are sold first. The items in inventory at the end of the year are valued as the items most recently purchased or produced.
3. **Last-in first-out (LIFO) method.** This method assumes that the items in inventory purchased or produced last are sold first. The items included in closing inventory are considered to be those from the opening inventory plus those items acquired in the current year and not sold.

Valuing inventory. The following methods are available for valuating inventory:

1. **Cost method.** The cost of acquisition in addition to costs allocable to the merchandise.
2. **Lower of cost or market method.** This method compares the market value of each item in inventory with its cost and uses the lower value as its inventory value.
3. **Retail method.** The total retail selling price of goods on hand at the end of the year in each department or of each class of goods is reduced to approximate cost by using an average markup expressed as a percentage of the total selling price.

Under the uniform capitalization rule, direct costs and most indirect costs incurred in production and resale activities must be capitalized (added to basis). Recover these costs through depreciation, amortization, or cost of goods sold.

The following activities are subject to the uniform capitalization rules:

1. Production of real or tangible personal property for use in a trade or business or an activity engaged in for profit.
2. Production of real property or tangible personal property for sale to customers.
3. Acquired property for resale.

Producing property. A T/P is producing property if he or she constructs, builds, installs, manufactures, develops, improves, creates, raises, or grows the property. Property produced for the T/P under a contract is treated as produced to the extent that the T/P makes payments or otherwise incur costs in connection with the property.

Tangible personal property. Tangible personal property includes films, sound recordings, video tapes, books, artwork, photographs, or similar property containing words, ideas, concepts, images, or sounds. However, free-lance authors, photographers, and artists are exempt from the uniform capitalization rules if they qualify.

Exceptions. A T/P is not subject to the uniform capitalization rules if the T/P's average annual gross receipts are \$27 million or less for the 3 preceding tax years and is not a tax shelter. In addition, the following are not subject to the uniform capitalization rules.

- ▶ Property produce that is not use in a trade, business, or activity conducted for profit.
- ▶ Qualified creative expenses paid or incurred as a freelance (self-employed) writer, photographer, or artist that are otherwise deductible on the T/P's tax return.
- ▶ Property produce under a long-term contract, except for certain home construction contracts.
- ▶ Research and experimental expenses deductible under section 174 of the IRC.
- ▶ Before 2018, costs for personal property acquired for resale if the average annual gross receipts for the 3 previous tax years do not exceed \$10 million.

Partnerships Defined

Organizations classified as partnerships. An unincorporated organization with two or more members is generally classified as a partnership for federal tax purposes if its members carry on a trade, business, financial operation, or venture and divide its profits. However, a joint undertaking merely to share expenses is not a partnership. For example, co-ownership of property maintained and rented or leased is not a partnership unless the co-owners provide services to the tenants.

Organizations formed after 1996. An organizations formed after 1996 is classified as a partnership for federal tax purposes if it has two or more members and it is none of the following:

1. An organization formed under a federal or state law that refers to it as a corporation, body corporate, or body politic.
2. An organization formed under a state law that refers to it as a joint-stock company or joint-stock association.
3. An insurance company.
4. Certain banks.
5. An organization wholly owned by a state, local, or foreign government.
6. An organization specifically required to be taxed as a corporation by the Internal Revenue Code.
7. Certain foreign organizations identified in section 301.7701-2(b)(8) of the regulations.
8. A tax-exempt organization or a real estate investment trust.
9. An organization classified as a trust under section 301.7701-4 of the regulations.
10. Any other organization that elects to be classified as a corporation by filing Form 8832.

Partnerships Formation

Exclusion from partnership treatment. Certain partnerships that do not actively conduct a business can choose to be completely or partially excluded from being treated as partnerships for federal income tax purposes. All the partners must agree to make the choice, and the partners must be able to compute their own taxable income without computing the partnership's income.

Electing the exclusion. An eligible organization that wishes to be excluded from the partnership rules must make the election not later than the time for filing (including extensions) the partnership return for the first tax year for which exclusion is desired.

Partnership agreements. The agreement or any modification can be oral or written. Partners can modify the agreement for a particular tax year after the close of the year but not later than the date for filing (excluding extensions) the partnership return for that year. The modifications must be agreed to by all the partners or adopted in any other manner provided by the partnership agreement. A partner's share of income, gains, losses, deductions, or credits is usually determined by the partnership agreement. If the partnership agreement or any modification is silent on any matter, the provisions of local law are treated as part of the agreement.

Partnerships

Family Partnerships

A family partnership includes only spouses, ancestors (parent), and lineal descendants (child) or any trust for the primary benefit of those persons. Family members will be recognized as partners only if one of the following requirements is met:

- ▶ If capital is a material income-producing factor, they acquired their capital interest in a bona fide transaction (even if by gift or purchase from another family member), actually own the partnership interest, and actually control the interest.
- ▶ If capital is not a material income-producing factor, they joined together in good faith to conduct a business. They agreed that contributions of each entitle them to a share in the profits, and some capital or service has been (or is) provided by each partner.

Capital interest. A capital interest in a partnership is an interest in its assets that is distributable to the owner of the interest in either of the following situations.

- ▶ The owner withdraws from the partnership.
- ▶ The partnership liquidates.

The mere right to share in earnings and profits is not a capital interest in the partnership.

Gift of capital interest. If a family member (or any other person) receives a gift of a capital interest in a partnership in which capital is a material income-producing factor, the donee's distributive share of partnership income must be figured by reducing the partnership income by reasonable compensation for services the donor renders to the partnership. The donee's distributive share of partnership income attributable to donated capital must not be proportionately greater than the donor's distributive share attributable to the donor's capital.

Purchase. An interest purchased by one family member from another family member is considered a gift from the seller.

Partnerships

Family Partnerships

Business owned and operated by spouses. If spouses carry on a business together and share in the profits and losses, they may be partners whether or not they have a formal partnership agreement. If so, they should report income or loss from the business on Form 1065. They should not report the income on a Schedule C (Form 1040 or 1040-SR) in the name of one spouse as a sole proprietor. However, the spouses can elect not to treat the joint venture as a partnership by making a Qualified Joint Venture Election.

Qualified joint venture election. Spouses can make a qualified joint venture election if they meet all of the following:

1. The only members of the joint venture are the husband and wife.
2. The filing status of the husband and wife is married filing jointly.
3. Both spouses materially participate in the trade or business.
4. Both spouses elect not to be treated as a partnership.

Under this election, a qualified joint venture conducted by spouses who file a joint return is not treated as a partnership for federal tax purposes and therefore does not file Form 1065. Each spouse takes into account his or her respective share of these items as a sole proprietor. Each spouse would account for his or her respective share on the appropriate form, such as Schedule C (Form 1040 or 1040-SR).

Partnerships Filing Requirements

Partnership return (Form 1065). Every partnership that engages in a trade or business or has gross income must file an informational return on Form 1065. A partnership is not considered to engage in a trade or business, and is not required to file a Form 1065, for any tax year in which it neither receives income nor has any expenses treated as deductions or credits for federal tax purposes. The partnership return can be signed by any partner.

Due date. Form 1065 must be filed by the **15th day of the 3rd month** following the close of the partnership's tax year. Partnerships with more than 100 partners must e-file the return.

Short period return. If a partnership is terminated before the end of what would otherwise be its tax year, Form 1065 must be filed for the short period, which is the period from the beginning of the tax year through the date of termination. The return is due the 15th day of the 3rd month following the date of termination.

Electronic filing. Certain partnerships with more than **100 partners** are required to file Form 1065, Schedules K-1, and related forms and schedules electronically.

Extension of time to file. A partnership can request an automatic 6-month extension of time to file by filing Form 7004 by the regular due date of the partnership return.

Partnerships

Filing Requirements

Other Schedules for Form 1065

Schedule K. Schedule K is a summary schedule of all the partners' shares of the partnership's income, credits, deductions, etc. All partnerships must complete Schedule K. Rental activity income (loss) and portfolio income aren't reported on page 1 of Form 1065. These amounts aren't combined with trade or business activity income (loss). Schedule K is used to report the totals of these and other amounts.

Schedule K-1. Schedule K-1 shows each partner's separate share. Attach a copy of each Schedule K-1 to the Form 1065.

Schedules L, M-1, and M-2. Schedule L, Balance Sheets per Books, schedule M-1, Reconciliation of Income (Loss) per Books With Income (Loss) per Return and schedule M-2, Analysis of Partners' Capital Accounts, are not required to be completed if the partnership satisfy all 4 of the following conditions.

1. The partnership's total receipts for the tax year were less than \$250,000.
2. The partnership's total assets at the end of the tax year were less than \$1 million.
3. Schedules K-1 are filed with the return and furnished to the partners on or before the due date (including extensions) for the partnership return.
4. The partnership is not filing and is not required to file Schedule M-3.

Partnerships

Filing Requirements

Other Schedules for Form 1065

Schedule M-3. Schedule M-3, Net Income (Loss) Reconciliation for Corporations With Total Assets of \$10 Million or More, must be filed if **any** of the following is true:

- ▶ The amount of total assets at the end of the tax year is equal to \$10 million or more.
- ▶ The amount of adjusted total assets for the tax year is equal to \$10 million or more.
- ▶ The amount of total receipts for the tax year is equal to \$35 million or more.
- ▶ An entity that is a reportable entity partner with respect to the partnership owns or is deemed to own, directly or indirectly, an interest of 50% or more in the partnership's capital, profit, or loss, on any day during the tax year of the partnership.

Information return required of partnership. If a partner exchanges a partnership interest attributed to unrealized receivables or inventory for money or property, he or she must notify the partnership in writing within 30 days. When the partnership is notified of an exchange, the partnership must file Form 8308, Report of a Sale or Exchange of Certain Partnership Interests. Form 8308 is filed with Form 1065. If notified of an exchange after filing Form 1065, the partnership must file Form 8308 separately, within 30 days of the notification.

Partnerships

Filing Requirements

Penalties

Failure to file penalty. The failure to file penalty is \$220 times the total number of partners in the partnership during any part of the year for each month (or part of a month) the return is late or incomplete, up to 12 months.

Failure to furnish information timely. For each failure to furnish Schedule K-1 to a partner when due and each failure to include on Schedule K-1 all the information required to be shown (or the inclusion of incorrect information), a \$290 penalty may be imposed with respect to each Schedule K-1 for which a failure occurs. The maximum penalty is \$3,532,500 for all such failures during a calendar year. If the requirement to report correct information is intentionally disregarded, each \$290 penalty is increased to \$580 or, if greater, 10% of the aggregate amount of items required to be reported. There is no limit to the amount of the penalty.

Partnerships Tax Year

A partnership determines its tax year as if it were a taxpayer. In general, a partnership must use its required tax year.

Required tax year. A partnership must adapt its tax year to its partners' tax year as follows:

1. **Majority interest tax year.** If one or more partners having the same tax year own more than a 50% (majority) interest, the partnership must use the tax year of those partners.
2. **Principal partner.** If there is no majority interest tax year, the partnership is required to use the tax year of its principal partners (5% or more interest).
3. **Least aggregate deferral of income.** If there is no majority interest tax year or the principal partners do not have the same tax year, the partnership must use a tax year that results in the least aggregate deferral of income to the partners.

Exceptions. There are three exceptions to the required tax year rule:

1. **Business purpose tax year.** If a partnership establishes an acceptable business purpose for having a tax year that is different from its required tax year.
2. The partnership can make a section 444 election.
3. A partnership can use a tax year other than its required tax year if it elects a 52-53-week tax year that ends with reference to either its required tax year or a tax year elected under section 444.

Partnerships Tax Year

Least aggregate deferral of income. Compare the deferral that all the partners would get if the partnership used the tax year of one of its partners. A computation must be made for each partner whose tax year is different from the other partners as follows:

1. Determine the number of months of deferral for each partner using one partner's tax year. The months of deferral are found by counting the months from the end of the partnership's tax year forward to the end of that partner's tax year.
2. Multiply each other partner's deferral period found in step (1) by that partner's share of his or her interest in the partnership profits for the year.
3. Add the amounts figured in step (2) to get the aggregate (that is, the total amount of) deferral for that partner's tax year.
4. Repeat steps (1) through (3) for each partner's tax year that is different from the other partners' years.

Changing tax years. When a partnership changes its tax year, a short period return must be filed. The short period return covers the number of months between the end prior tax year and the beginning of the newly elected tax year.

Partnerships Tax Year

Section 444 election. Under section 444 of the IRC, certain partnerships can elect to use a tax year different from their required tax year. To be eligible to make the election, a partnership must meet all of the following conditions:

1. It is not a member of a tiered structure (such as the partnership owns or is owned by another partnership).
2. It has not previously had a section 444 election in effect.
3. It does not choose a tax year where the deferral period is longer than:
 - a) Three months, or
 - b) The deferral period of the tax year being changed, if this period is shorter.

Note: A partnership should not make a section 444 election when it wants to establish a business purpose for having a tax year different from its required year. If a section 444 election is made, a partnership must file the required returns including Form 8716, Election To Have a Tax Year Other Than a Required Tax Year and must make certain required payments by the earlier of:

1. The 15th day of the 5th month following the month that includes the 1st day of the tax year the election will be effective, or
2. The due date (without extensions) of the return resulting from the election.

Partnerships

Business Start-up & Organizational Costs

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Organizational and start-up costs. A partnership can elect to deduct up to \$5,000 of business start-up costs **and** up to \$5,000 in organizational expenses in the year the business is started. The \$5,000 deduction is reduced by the amount the total costs exceed \$50,000. If the total costs exceed \$55,000 or more, the deduction is reduced to zero. Any costs not deducted must be amortized over 180 months (15 years) beginning with the month the partnership begins business.

Start-up costs include amounts paid for the following:

- ▶ An analysis or survey of potential markets, products, labor supply, transportation facilities, etc.
- ▶ Advertisements for the opening of the business.
- ▶ Salaries and wages for employees who are being trained and their instructors.
- ▶ Travel and other necessary costs for securing prospective distributors, suppliers, or customers.
- ▶ Salaries and fees for executives and consultants, or for similar professional services.

Partnerships

Business Start-up & Organizational Costs

Organizational costs. The costs to organize a partnership are the direct costs of creating the partnership. Organizational costs include the following fees:

- ▶ Legal fees for services incident to the organization of the partnership, such as negotiation and preparation of the partnership agreement.
- ▶ Accounting fees for services incident to the organization of the partnership.
- ▶ Filing fees.

Nonqualifying costs. The following costs cannot be amortized:

- ▶ The cost of acquiring assets for the partnership or transferring assets to the partnership.
- ▶ The cost of admitting or removing partners, other than at the time the partnership is first organized.
- ▶ The cost of making a contract concerning the operation of the partnership trade or business including a contract between a partner and the partnership.
- ▶ The costs for issuing and marketing interests in the partnership such as brokerage, registration, and legal fees and printing costs. These “syndication fees” are capital expenses that cannot be depreciated or amortized.

Partnerships

Partnership Income or Loss

A partnership computes its income and files its return in the same manner as an individual. However, certain deductions are not allowed to the partnership.

Elections made by the partnership. The partnership, not the partners, makes most choices about how to compute income. These include choices for the following:

1. Accounting methods.
2. Depreciation methods and section 179 elections.
3. Accounting for specific items, such as depletion or installment sales.
4. Nonrecognition of gain on involuntary conversions of property.
5. Amortization of certain organization fees and business startup costs of the partnership.

Elections made by the partners. Elections under the following sections are made by each partner separately on the partner's tax return:

1. Section 59(e) (election to deduct ratably certain qualified expenditures such as intangible drilling costs, mining exploration expenses, or research and experimental expenditures).
2. Section 108 (income from discharge of indebtedness).
3. Section 617 (deduction or recapture of certain mining exploration expenditures paid or incurred).
4. Section 901 (foreign tax credit).

Partnerships

Partnership Income or Loss

Separately stated items. Certain items must be separately stated on the partnership return (listed on Schedule K of Form 1065) and deducted on the partner's individual return. Schedule K is a summary schedule of all partners' share of the partnership's income, credits, deductions, etc. Partner items are furnished to the partner on Schedule K-1 (Form 1065). A partnership is required to furnish copies of Schedule K-1 to each partner. The partnership is subject to a \$290 penalty for each failure to furnish a Schedule K-1 to a partner. The maximum penalty is \$3,532,500 for the calendar year. If the reporting requirement is intentionally disregarded, each \$290 penalty is increased to \$580 or, if greater, 10% of the aggregate amount of items required to be reported. There is no limit to the amount of the penalty.

These items are the following:

1. Ordinary income or loss from trade or business activities.
2. Net income or loss from rental real estate activities.
3. Net income or loss from other rental activities.
4. Guaranteed payments.
5. Interest income.
6. Ordinary dividends.
7. Qualified dividends.
8. Royalties.

Continued on next card

Partnerships

Partnership Income or Loss

Separately stated items (cont.)

9. Net short-term capital gain (loss).
10. Net long-term capital gain (loss).
11. Collectibles (28%) gain (loss).
12. Unrecaptured section 1250 gain.
13. Net section 1231 gain (loss).
14. Other income (loss).
15. Section 179 deduction.
16. Self-employment earnings.
17. Credits.
18. Foreign transactions including taxes paid or accrued to foreign countries and U.S. possessions.
19. Alternative minimum tax items.
20. Tax-exempt income and nondeductible expenses.
21. Distributions.
22. Other information on items of income, gain, loss, deduction, or credit, as provided by regulations.

Partnerships Income or Loss

Partner's Income and Loss

A partner's income or loss from a partnership is his or her distributive share of partnership items for the partnership's tax year that ends with or within the partner's tax year. A partner must report his or her distributive share of partnership items (such as income, gain, loss, deduction, or credit) on his or her tax return, whether or not it is actually distributed.

Limits on losses. A partner's distributive share of partnership loss is allowed only to the extent of the adjusted basis of the partner's partnership interest. The adjusted basis is figured at the end of the partnership's tax year in which the loss occurred, before taking the loss into account. Any loss that is more than the adjusted basis is not deductible for that year and must be carried over to a year in which the partner's adjusted basis is more than zero.

At-risk limits. The at-risk rules limit a partner's deductible loss to the amounts for which the partner is considered at risk in the activity. A partner is considered at risk for all of the following amounts:

1. The money and adjusted basis of any property contributed to the activity.
2. The partner's share of net income retained by the partnership.
3. Certain amounts borrowed by the partnership for use in the activity if the partner is personally liable for repayment or the amounts borrowed are secured by the partner's property (other than property used in the activity).

Partnerships Self-Employment Tax

Schedule SE

General partner. Include distributive share of partnership income, include guaranteed payments in figuring self-employment tax. General partners' net earnings (loss) from self-employment do not include the following.

- ▶ Dividends on any shares of stock and interest on any bonds, debentures, notes, etc., unless the dividends or interest are received in the course of a trade or business, such as a dealer in stocks or securities or interest on notes or accounts receivable.
- ▶ Rentals from real estate, except rentals of real estate held for sale to customers in the course of a trade or business as a real estate dealer or payments for rooms or space when significant services are provided.
- ▶ Royalty income, except royalty income received in the course of a trade or business.

Limited partner. Exclude distributive share of partnership income, include guaranteed payments in figuring self-employment tax.

Inactive partner. Include distributive share of partnership income and guaranteed payments in figuring self-employment tax.

Deceased partner. Include distributive share of partnership income through the end of the month in which death occurs in figuring self-employment tax.

Spouses as partners. Both spouses include business income in figuring self-employment tax and must file separate Schedules SE (Form 1040 or 1040-SR) to report self-employment tax.

Retired partner. Include distributive share of partnership income and guaranteed payments in figuring self-employment tax.

Partnerships

Partnership Distributions

Actual distribution. Distributions are usually not taxable since a partner must include in income any share of partnership income, whether it is distributed or not. However, distributions are taxable if they are treated as a liquidation or as a sale or exchange of all or part of a partner's interest.

Certain distributions treated as a sale or exchange. When a partnership distributes the following items, the distribution may be treated as a sale or exchange of property rather than a distribution:

- ▶ Unrealized receivables or substantially appreciated inventory items distributed in exchange for any part of the partner's interest in other partnership property, including money.
- ▶ Other property (including money) distributed in exchange for any part of a partner's interest in unrealized receivables or substantially appreciated inventory items.

Exception. This treatment does not apply to the following distributions:

- ▶ A distribution of property to the partner who contributed the property to the partnership.
- ▶ Payments made to a retiring partner or successor in interest of a deceased partner that are the partner's distributive share of partnership income or guaranteed payments.

Substantially appreciated inventory items. Inventory items of the partnership are considered to have appreciated substantially in value if, at the time of the distribution, their total fair market value is more than 120% of the partnership's adjusted basis for the property. However, if a principal purpose for acquiring inventory property is to avoid ordinary income treatment by reducing the appreciation to less than 120%, that property is excluded.

Partnerships

Partnership Distributions

Partner's gain or loss. A partner generally recognizes gain on a partnership distribution only to the extent any money (and marketable securities treated as money) included in the distribution exceeds the adjusted basis of the partner's interest in the partnership. Any gain recognized is generally treated as capital gain from the sale of the partnership interest on the date of the distribution. If partnership property (other than marketable securities treated as money) is distributed to a partner, he or she generally does not recognize any gain until the sale or other disposition of the property.

Marketable securities treated as money. A market security distributed to a partner is treated as money in determining whether gain is recognized on the distribution. However, this treatment does not apply if that partner contributed the security to the partnership or an investment partnership made the distribution to an eligible partner.

Partnerships

Partnership Distributions

Loss on distribution. A partner does not recognize loss on a partnership distribution unless all of the following requirements are met:

1. The adjusted basis of the partner's interest in the partnership exceeds the distribution.
2. The partner's entire interest in the partnership is liquidated.
3. The distribution is in money, unrealized receivables, or inventory items.

Distribution of Partner's Debt. If a partnership acquires a partner's debt and extinguishes the debt by distributing it to the partner, the partner will recognize capital gain or loss to the extent the fair market value of the debt differs from the basis of the debt. The partner is treated as having satisfied the debt for its fair market value. If the issue price (adjusted for any premium or discount) of the debt exceeds its fair market value when distributed, the partner may have to include the excess amount in income as canceled debt.

Partnerships

Partner's Basis for Distributed Property

Unless there is a complete liquidation of a partner's interest, the basis of property distributed to a partner by a partnership is its adjusted basis to the partnership immediately before the distribution. However, the basis of the property to the partner cannot be more than the partner's adjusted basis in the partnership reduced by any money received in the same transaction.

Complete liquidation of partner's interest. The basis of property received in complete liquidation of a partner's interest is the adjusted basis of the partner's interest in the partnership reduced by any money distributed to the partner in the same transaction.

Holding period for distributed property. A partner's holding period for property distributed to the partner includes the period the property was held by the partnership. If the property was contributed to the partnership by a partner, then the period it was held by that partner is also included.

Partnerships

Partner's Basis for Distributed Property

Basis divided among properties. If the basis of property received is the adjusted basis of the partner's interest in the partnership (reduced by money received in the same transaction), it must be divided among the properties distributed to the partner. For property distributed after August 5, 1997, allocate the basis using the following rules:

1. Allocate the basis first to unrealized receivables and inventory items included in the distribution by assigning a basis to each item equal to the partnership's adjusted basis in the item immediately before the distribution. If the total of these assigned bases exceeds the allocable basis, decrease the assigned bases by the amount of the excess.
2. Allocate any remaining basis to properties other than unrealized receivables and inventory items by assigning a basis to each property equal to the partnership's adjusted basis in the property immediately before the distribution. If the allocable basis exceeds the total of these assigned bases, increase the assigned bases by the amount of the excess. If the total of these assigned bases exceeds the allocable basis, decrease the assigned bases by the amount of the excess.

Allocating a basis increase. Allocate any basis increase required in rule (2), above, first to properties with unrealized appreciation to the extent of the unrealized appreciation. If the basis increase is less than the total unrealized appreciation, allocate it among those properties in proportion to their respective amounts of unrealized appreciation. Allocate any remaining basis increase among all the properties in proportion to their respective fair market values.

Continue on next card

Partnerships

Partner's Basis for Distributed Property

Allocating a basis decrease. Use the following rules to allocate any basis decrease required in rule (1) or rule (2), on previous card:

1. Allocate the basis decrease first to items with unrealized depreciation to the extent of the unrealized depreciation. If the basis decrease is less than the total unrealized depreciation, allocate it among those items in proportion to their respective amounts of unrealized depreciation.
2. Allocate any remaining basis decrease among all the items in proportion to their respective assigned basis amounts (as decreased in (1)).

Distributions before August 6, 1997. For property distributed before August 6, 1997, allocate the basis using the following rules:

1. Allocate the basis first to unrealized receivables and inventory items included in the distribution to the extent of the partnership's adjusted basis in those items. If the partnership's adjusted basis in those items exceeded the allocable basis, allocate the basis among the items in proportion to their adjusted bases to the partnership.
2. Allocate any remaining basis to other distributed properties in proportion to their adjusted bases to the partnership.

Partnerships

Partner's Basis for Distributed Property

Partner's basis more than partnership basis. If the basis of a partner's interest to be divided in a complete liquidation of the partner's interest is more than the partnership's adjusted basis for the unrealized receivables and inventory items distributed, and if no other property is distributed to which the partner can apply the remaining basis, the partner has a capital loss to the extent of the remaining basis of the partnership interest.

Special adjustment to basis. A partner who acquired any part of his or her partnership interest in a sale or exchange or upon the death of another partner may be able to choose a special basis adjustment for property distributed by the partnership. To choose the special adjustment, the partner must have received the distribution within 2 years after acquiring the partnership interest. Also, the partnership must not have chosen the optional adjustment to basis when the partner acquired the partnership interest.

Partnerships

Transactions Between Partner & Partnership

Guaranteed Payments

Payments to a partner for services, or for use of capital, to the extent they are figured without regard to the income of the partnership are treated the same way as payments made to a person who is not a partner. This treatment is for purposes of determining gross income and deductible business expenses.

Minimum payment. If a partner is to receive a minimum payment from the partnership, the guaranteed payment is the amount by which the minimum payment is more than the partner's distributive share of the partnership income before taking into account the guaranteed payment.

Partner's treatment of guaranteed payments. The partner includes the guaranteed payments in income in the partner's tax year in which the partnership's tax year ends.

Partnership treatment of guaranteed payments. Guaranteed payments are generally deducted by the partnership as a business expense.

Exception: Guaranteed payments made to a partner for organizing the partnership or syndicating interests in the partnership must be capitalized.

Partnerships

Transactions between Partner & Partnership

Guaranteed Payments (cont.)

Payments resulting in loss. If a partnership agreement provides for guaranteed payments to a partner and the payments result in a partnership loss in which the partner shares, the partner must:

1. Report the full amount of the guaranteed payments as ordinary income, and
2. Separately take into account the appropriate distributive share of the partnership loss.

Self-employed health insurance premiums. Premiums for health insurance paid by a partnership on behalf of a partner for services rendered as a partner are treated as guaranteed payments. The partnership can deduct the payments as a business expense, and the partner must include them in gross income. However, if the partnership accounts for insurance paid for a partner as a reduction in distributions to the partner, the partnership cannot deduct the premiums.

Partnerships

Transactions between Partner & Partnership

Sale & Exchange of Property to Related Parties

Gains. Gains are treated as ordinary income in a sale or exchange of property directly or indirectly between a partner and a partnership or between two partnerships if both of the following apply:

1. More than 50% of interest in the partnership(s) is directly or indirectly owned by the same partner(s), and
2. The property transferred is not a capital asset (such as accounts receivables, inventory, stock-in-trade, and real property used in a business).

Losses. Losses are not allowed from a sale or exchange of property (other than an interest in the partnership) between a partnership and a person who directly or indirectly owns more than 50% interest of the capital or profit in the partnership. If the purchaser later sells the property, any gain realized will be taxable only to the extent it is more than the loss that was not allowed.

Partnerships

Transactions between Partner & Partnership

Sale & Exchange of Property to Related Parties (cont.)

More than 50% ownership. To determine if there is more than a 50% ownership in partnership capital or profits, the following rules apply:

1. An interest directly or indirectly owned by a corporation, partnership, estate, or trust is considered to be owned proportionately by its shareholders, partners, or beneficiaries.
2. An individual is considered to own the interest directly or indirectly owned by a family member. Family member includes only brothers, sisters, half-brothers, half-sisters, spouses, ancestors, and lineal descendants.
3. If a person is considered to own an interest using rule (1), that person (the “constructive owner”) is treated as if actually owning that interest when rules (1) and (2) are applied. However, if a person is considered to own an interest using rule (2), that person is not treated as actually owning that interest in reapplying rule (2) to make another person the constructive owner.

Partnerships

Transactions between Partner & Partnership

Contribution of Property

Neither the partners nor the partnership recognizes a gain or loss when property is contributed to the partnership in exchange for a partnership interest. If a partner contributes property to a partnership, the partnership basis in the property is the same as a partner adjusted basis of the property increased by any gain recognized by the partner.

Exception: A gain or loss is recognized if a partner contributes property to a partnership and:

1. Before or after the contribution, other property is distributed to the contributing partner, or
2. After the contribution, the contributed property is distributed to another partner within 7 years.

Note: A gain is recognized by the partner if the property contributed to a partnership is subject to liabilities in excess of the partner's basis in the property.

Disguised sales. A contribution of money or other property to the partnership followed by a distribution of different property from the partnership to the partner is not treated as a contribution, but as a sale of property, if both of the following tests are met:

1. The distribution would not have been made but for the contribution.
2. The partner's right to the distribution does not depend on the success of partnership.

If the contribution and distribution occur within 2 years of each other, the transfers are presumed to be a sale unless the facts clearly indicate that the transfers are not a sale.

Partnerships

Transactions between Partner & Partnership

Contribution of Property (cont.)

Partnership's gain or loss on contributed property. The following rules determine the character of the partnership's gain or loss on a disposition of certain types of contributed property:

1. **Unrealized receivables.** If the property was an unrealized receivable in the hands of the contributing partner, any gain or loss on its disposition by the partnership is ordinary income or loss.
2. **Inventory items.** If the property was an inventory item in the hands of the contributing partner, any gain or loss on its disposition by the partnership within 5 years after the contribution is ordinary income or loss.
3. **Capital assets.** If the property was a capital asset in the contributing partner's hands, any loss on its disposition by the partnership within 5 years after the contribution is a capital loss. The capital loss is limited to the amount by which the partner's adjusted basis for the property exceeded the property's fair market value immediately before the contribution.

Contribution of services. If a partner acquires an interest in partnership capital as compensation for services performed, the FMV of the interest must be included in the partner's gross income.

Partnerships

Basis of Partner's Interest

Original basis. The money a partner contributed plus the adjusted basis of property he or she contributed.

Adjustments to basis. The partner's original basis of an interest is increased by:

1. The partner's additional contributions to the partnership, including an increased share of, or assumption of, partnership liabilities.
2. The partner's distributive share of both taxable and nontaxable partnership income.
3. The partner's distributive share of the excess of the deductions for depletion over the basis of the depletable property, unless the property is oil or gas wells whose basis has been allocated to partners.

decreased by:

1. The money (including a decreased share of partnership liabilities or an assumption of the partner's individual liabilities by the partnership) and adjusted basis of property distributed to the partner by the partnership.
2. The partner's distributive share of the partnership losses.
3. The partner's distributive share of nondeductible partnership expenses that are not capital expenditures. This includes the partner's share of any section 179 expenses, even if the partner cannot deduct the entire amount on his or her individual income tax return.
4. The partner's deduction for depletion for oil and gas wells.

Partnerships

Basis of Partner's Interest

Effect of Partnership Liabilities

A partner's basis includes a partnership liability. A partner's basis in a partnership interest includes the partner's share of a partnership liability only if, and to the extent that, the liability:

1. Creates or increases the partnership's basis in any of its assets,
2. Gives rise to a current deduction to the partnership, or
3. Is a nondeductible, noncapital expense of the partnership.

Recourse liability. Partners have an economic risk of loss for that liability. The partner's share of such liability equals that partner's share of economic risk of loss.

Nonrecourse liability. Partners have no economic risk of loss for that liability. A partner's share of such liability is determined by the partner's ratio for sharing profits.

Economic risk of loss. A partner has an economic risk of loss if the partner would be obligated to make a payment to the creditor or a contribution to the partnership with respect to the liability if the partnership was liquidated.

Property subject to a liability. If property contributed to a partnership by a partner or distributed by the partnership to a partner is subject to a liability, the transferee is treated as having assumed the liability to the extent it does not exceed the FMV of the property.

Partnerships

Disposition of Partner's Interest

Gain on distribution. Upon the receipt of the distribution, the partner will recognize a gain on the distribution to the extent that money distributed is more than the partner's adjusted basis. The gain is a capital gain. Any part of the gain that is for the partner's interest in inventory items and unrealized receivables is treated as ordinary income. No gain is recognized on the distribution of property until the partner sells or disposes of it.

Relief of liabilities. If a partner is relieved of any partnership liabilities, that partner must include the amount of the liability relieved as part of the amount realized for his or her interest.

Loss on distribution. The partner will recognize a loss only if the distribution is in money, unrealized receivables, and inventory items. No loss is recognized if any other property is received.

Closing of partnership year. The partnership's tax year is not closed because of the sale, exchange, or liquidation of a partner's interest, the death of a partner, or the entry of a new partner. However if a partner sells, exchanges, or liquidates his or her entire interest, the partnership's tax year is considered closed for that partner.

Partnerships

Unrealized Receivables and Inventory Items

Payments for Unrealized Receivables and Inventory Items. If a partner receives money or property in exchange for any part of a partnership interest, the amount due to his or her share of the partnership's unrealized receivables or inventory items results in ordinary income or loss.

Unrealized receivables. Unrealized receivables include any rights to payment not already included in income for the following items:

1. Goods delivered or to be delivered to the extent the payment would be treated as received for property other than a capital asset.
2. Services rendered or to be rendered.

Inventory items. Inventory items are not limited to stock-in-trade of the partnership. They also include the following property:

1. Property that would properly be included in the partnership's inventory if on hand at the end of the tax year or that is held primarily for sale to customers in the normal course of business.
2. Property that, if sold or exchanged by the partnership, would not be a capital asset or section 1231 property (real or depreciable business property held for more than one year).
3. Property held by the partnership that would be considered inventory if held by the partner selling the partnership interest or receiving the distribution.

Inventory items held for more than 5 years. If a partner sells inventory items that he or she held for more than 5 years and the items were capital assets in the partner's hands at the time of sale, it is considered a capital gain or loss. The 5-year rule does not apply to accounts receivable.

Partnerships

Disposition of Partner's Interest

Deceased partner. The death of a partner closes the partnership's tax year for that partner. The deceased partner's share of partnership's items must be included in the partner's final tax return (Form 1040 or 1040-SR).

Installment sale of partnership interest. A partner who sells a partnership interest at a gain may be able to report the sale on the installment method. However, the gain allocated to unrealized receivables or inventory items is ordinary income and must be reported in the year of the sale. The gain allocated to the other assets is capital gain and can be reported under the installment method.

Payments in liquidation of interest in partnership property. Payments made in liquidation of the interest of a retiring or deceased partner in exchange for his or her interest in partnership property are considered a distribution, not a distributive share or guaranteed payment that could give rise to a deduction for the partnership.

Payments not in liquidation of interest in partnership property. Payments made by the partnership to a retiring partner or successor in interest of a deceased partner that are not made in exchange for an interest in partnership property are treated as distributive shares of partnership income or guaranteed payments.

Partnerships

Bipartisan Budget Act of 2015 (BBA)

The BBA created a new centralized partnership audit regime effective for partnership tax years beginning after 2017. The new audit regime applies to all partnerships unless the partnership is an eligible partnership and elects out by making a valid election.

Role of partnership representative. Under the centralized partnership audit regime, partnerships are required to designate a partnership representative. The partnership representative will have the sole authority to act on behalf of the partnership under the centralized partnership audit regime. The designated partnership representative is a partner or other person with substantial presence in the U.S. If the designated partnership representative is an entity, the partnership must also appoint a designated individual to act on behalf of the entity partnership representative. The partnership must include information regarding the partnership representative and designated individual (if applicable) on Form 1065, Schedule B.

Electing out of the centralized partnership audit regime. A partnership can elect out of the centralized partnership audit regime for a tax year if the partnership has 100 or fewer eligible partners. The number of partners is calculated using the number of Schedules K-1 required to be issued by the partnership. A partner is an eligible partner if it is an individual, C corporation, foreign entity that would be treated as a C corporation if it was domestic, S corporation, or an estate of a deceased partner. A partner cannot be: (1) a partnership, (2) a trust, (3) a foreign entity that would not be treated as a C corporation were it a domestic entity, (4) A disregarded entity described in Regulations section 301.7701-2(c)(2)(i), (5) An estate of an individual other than a deceased partner, (6) Any person that holds an interest in the partnership on behalf of another person.

Corporations

Businesses Taxed as Corporations

Businesses formed after 1996. The following businesses formed after 1996 are taxed as corporations:

1. A business formed under a federal or state law that refers to the business as a corporation, body corporate, or body politic.
2. A business formed under a state law that refers to the business as a joint-stock company or joint-stock association.
3. An insurance company.
4. Certain banks.
5. A business wholly owned by a state or local government.
6. A business specifically required to be taxed as a corporation by the Internal Revenue Code. (For example, certain publicly traded partnerships).
7. Certain foreign businesses.
8. Any other business that elects to be taxed as a corporation (for example a limited liability company (LLC)) by filing Form 8832, Entity Classification Election within 75 days the election takes effect.

Businesses formed before 1997. A business formed before 1997 and taxed as a corporation under the old rules will generally continue to be taxed as a corporation.

Corporations

Businesses Taxed as Corporations

Personal service corporations. A corporation is a personal service corporation if it meets all of the following requirements:

1. Its principal activity during the “testing period” is performing personal services. Generally, the testing period for any tax year is the prior tax year. If the corporation has just been formed, the testing period begins on the first day of its tax year and ends on the earlier of:
 - a. The last day of its tax year, or
 - b. The last day of the calendar year in which its tax year begins.
2. Its employee-owners substantially perform the services in (1). This requirement is met if more than 20% of the corporation's compensation cost for its activities of performing personal services during the testing period is for personal services performed by employee-owners.
3. Its employee-owners own more than 10% of the fair market value of its outstanding stock on the last day of the testing period.

Personal services. Personal services include any activity performed in the fields of accounting, actuarial science, architecture, consulting, engineering, health (including veterinary services), law, and the performing arts.

Corporations

Businesses Taxed as Corporations

Personal service corporations (cont.)

Employee-owners. A person is an employee-owner of a personal service corporation if both of the following apply:

1. He or she is an employee of the corporation or performs personal services for, or on behalf of, the corporation (even if he or she is an independent contractor for other purposes) on any day of the testing period.
2. He or she owns any stock in the corporation at any time during the testing period.

Closely held corporations. A corporation is closely held if all of the following apply:

1. It is not a personal service corporation.
2. At any time during the last half of the tax year, more than 50% of the value of its outstanding stock is, directly or indirectly, owned by or for five or fewer individuals. "Individual" includes certain trusts and private foundations.

Corporations

Property Exchanged for Stock

Control of a corporation. If one or more persons (individuals, corporations, partnerships, trusts or estates) transfer money or property to a corporation solely in exchange for stock of that corporation, and immediately after the exchange, the transferor(s) controls the corporation, no gain or loss is recognized by the transferor(s) or the corporation (Section 351). To be in control, the transferors must, as a group, own:

1. At least 80% of the total combined voting power of all classes of stock entitled to vote, and
2. At least 80% of the total number of shares of all other classes of stock.

Exception: This rule does not apply in the following situations:

- ▶ The corporation is an investment company.
- ▶ A T/P transfers of property in a bankruptcy proceeding in exchange for stock used to pay creditors.
- ▶ The stock is received in exchange for the corporation's debt (other than a security) or for interest on the corporation's debt (including a security) that accrued while shareholder held the debt.

Services exchanged for stock. Transfer of services to a corporation in return for stock results in taxable compensation in the amount of the FMV of the stock.

Property or money received. If property is received, including money, in addition to stock in exchange for property transferred to a corporation, the gain (if any) is taxable to the extent of the money or FMV of the property received.

Corporations

Property Exchanged for Stock

Gain or loss not recognized by corporation. No gain or loss is recognized by a corporation for property received in exchange for stock.

Nonqualified preferred stock. Nonqualified preferred stock is treated as property other than stock. Generally, it is preferred stock with any of the following features:

- ▶ The holder has the right to require the issuer or a related person to redeem or buy the stock.
- ▶ The issuer or a related person is required to redeem or buy the stock.
- ▶ The issuer or a related person has the right to redeem or buy the stock and, on the issue date, it is more likely than not that the right will be exercised.
- ▶ The dividend rate on the stock varies with reference to interest rates, commodity prices, or similar indices.

Assumption of liabilities. If a property subject to liabilities is transferred to a corporation, the exchange is not treated as money or other property received by the shareholder in determining recognized (taxable) gain on the transaction. There are two exceptions to this treatment:

1. If the liabilities the corporation assumes are more than the adjusted basis in the property transferred, gain is recognized up to the difference. However, if the liabilities assumed give rise to a deduction when paid, such as a trade account payable or interest, no gain is recognized.
2. If there is no good business reason for the corporation to assume the liabilities, or if the main purpose in the exchange is to avoid federal income tax, the assumption is treated as if money is received in the amount of the liabilities.

Corporations

Property Exchanged for Stock

Basis of Stock Received

The basis of stock received in exchange for the transfer of property to a corporation is the same as the basis of property transferred:

Decreased by:

1. The FMV of any other property received.
2. The amount of money received.
3. Any loss recognized on the exchange.

Increased by:

1. Any amount treated as a dividend.
2. Any gain recognized on the exchange.

Corporations

Property Exchanged for Stock

Basis of Property Transferred

80% control transaction. If a corporation receives property by issuing stock in exchange, in an 80% control transaction, the basis of the property to the corporation is the same as the transferor had in the property increased by any gain recognized on the exchange by the transferor. The corporation's holding period for the property received includes the time held by the transferor.

Other than 80% transaction. If a corporation receives property by issuing stock for it, other than in an 80% control transaction, the basis of the property to the corporation is the FMV of the stock at the time of the exchange.

Note: If the stock has no established value, the FMV of the property may be used to set the value of the stock if all outstanding stock is issued in exchange for that property.

Corporations

Return Filing & Payment Requirements

Filing requirements (Form 1120). A corporation must file a return unless it has dissolved, even if it has stopped doing business and disposed of all its assets except for a small sum of cash retained to pay state taxes to preserve its corporate charter or it is in bankruptcy.

Required e-filing. Certain corporations with total assets of \$10 million or more that file at least 250 returns a year are required to e-file Form 1120. However, in certain instances, these corporations can request a waiver.

Filing due date:

Calendar year corporation - **April 15.**

Fiscal year corporation - **15th day of the 4th month** following the close of fiscal year.

Note: A corporation with a fiscal tax year ending June 30 must file by the 15th day of the 3rd month after the end of its tax year.

Extension of time to file (Form 7004). A corporation will receive an automatic **6-month extension** by submitting Form 7004. Any tax due must be paid with Form 7004.

Note: A corporation with a fiscal tax year ending June 30, the automatic extension is for 7 months.

Who must sign the return. The return must be signed and dated by:

- ▶ The president, vice president, treasurer, assistant treasurer, chief accounting officer; or
- ▶ Any other corporate officer (such as tax officer) authorized to sign.

Corporations

Return Filing & Payment Requirements

Tax payments. A corporation must pay its tax due in full no later than the 15th day of the 4th month after the end of its tax year.

Electronic deposit requirement. Corporations must use electronic funds transfers to make all federal tax deposits (such as deposits for employment, excise, and corporate income tax). Generally electronic funds transfers are made using the Electronic Federal Tax Payment System (EFTPS). However, if the corporation does not want to use EFTPS, it can arrange for its tax professional, financial institution, payroll service, or other trusted third party to make deposits on its behalf.

Penalties

Failure to file - 5% per month not exceeding 25% of the unpaid tax. Minimum penalty for a return over 60 days late is the smaller of the tax due or \$450.

Failure to pay - 0.5% per month not exceeding 25% of the unpaid tax.

Recordkeeping

A corporation should keep its records for as long as they may be needed for the administration of any provision of the Internal Revenue Code. Usually records that support items of income, deductions, or credits on the return must be kept for **3 years** from the date the return is due or filed, whichever is later. Records that verify the corporation's basis in property should be kept for as long as they are needed to figure the basis of the original or replacement property.

Corporations

Estimated Tax Payments & Extensions

Estimated Tax

Estimated tax requirement. Expected tax is \$500 or more.

Estimated tax payments dates. Installment payments of estimated tax are due by the 15th day of the 4th, 6th, 9th, 12th months of the corporation's tax year.

Methods used to figure each installment:

Method 1. Each required installment is 25% of the income tax the corporation will show on its return for the current year.

Method 2. Each required installment is 25% of the income tax shown on the corporation's return for the previous year.

Other methods. If a corporation's income is expected to vary during the year (such as the business is seasonal), it may be able to lower the amount of one or more required installments by using one or both of the following methods:

1. The annualized income installment method.
2. The adjusted seasonal installment method.

Corporations

Estimated Tax Payments & Extensions

Estimated Tax (cont.)

Quick refund of overpayments. A corporation that overpays its estimated tax may use Form 4466, Corporation Application for Quick Refund of Overpayment of Estimated Tax, for a quick refund of any overpayment. The form is filed after the close of the corporation's tax year and no later than the due date for filing the corporation's tax return (not including extensions).

The overpayment must be:

1. At least 10% of tax liability, and
2. At least \$500.

Corporations Accounting Methods

Accounting methods. A corporation can use the following methods of accounting:

- ▶ Cash
- ▶ Accrual
- ▶ Any other method authorized by the Internal Revenue Code.

Accrual method. A corporation, other than a qualified personal service corporation, must use the accrual method of accounting if it is not a small business taxpayer (average annual gross receipts of \$27 million or less for the 3 prior tax years and is not a tax shelter). If inventories are required, the accrual method generally must be used for sales and purchases of merchandise. However, a small business taxpayer using a cash method can adopt or change its accounting method to account for inventories in the same manner as materials and supplies that are nonincidental.

Nonaccrual experience method. Accrual method corporations are not required to maintain accruals for certain amounts from the performance of services that, on the basis of their experience, will not be collected, if:

- ▶ The services are in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting, or
- ▶ The corporation is a small business taxpayer (average annual gross receipts of \$27 million or less for the 3 prior tax years and is not a tax shelter).

Corporations Accounting Periods

Accounting periods. Corporations can use either a calendar year or a fiscal year as its tax year. A corporation must adopt a tax year by the due date (not including extensions) of its first income tax return.

Personal service corporation. A personal service corporation must use a calendar year as its tax year unless:

- ▶ It elects to use a 52-53 week tax year that ends with reference to the calendar year;
- ▶ It can establish a business purpose for a different tax year and obtains approval of the IRS, or
- ▶ It elects under section 444 of the Internal Revenue Code to have a tax year other than a calendar year. Use Form 8716, Election to Have a Tax Year Other Than a Required Tax Year, to make the election.

Corporations Start-Up Expenses

Organizational and start-up costs. A corporation can elect to deduct up to \$5,000 of business start-up costs **and** up to \$5,000 in organizational expenses in the year the business is started. The \$5,000 deduction is reduced by the amount the total costs exceed \$50,000. If the total costs exceed \$55,000 or more, the deduction is reduced to zero. Any costs not deducted must be amortized over 180 months (15 years) beginning with the month the partnership begins business.

Start-up costs include amounts paid for the following:

- ▶ An analysis or survey of potential markets, products, labor supply, transportation facilities, etc.
- ▶ Advertisements for the opening of the business.
- ▶ Salaries and wages for employees who are being trained and their instructors.
- ▶ Travel and other necessary costs for securing prospective distributors, suppliers, or customers.
- ▶ Salaries and fees for executives and consultants, or for similar professional services.

Choosing to amortize. To amortize, complete Form 4562 and attach it to the corporate return for the year in which the amortization period begins.

Corporations Organizational Expenses

Organizational expenses. A corporation can elect to deduct up to \$5,000 of organizational costs as current expenses. The \$5,000 deduction is reduced by the amount the total costs exceed \$50,000. If the total costs exceed \$55,000 or more, the deduction is reduced to zero. Any costs not deducted must be amortized over 180 months (15 years) beginning with the month the corporation begins business. These expenses must be incurred before the end of the first year the corporation is in business. A cash or accrual basis corporation can amortize organizational costs incurred in the first year, even if it does not pay them in that year. Organizational expenses include:

1. Expenses of temporary directors and organizational meetings of directors or shareholders,
2. State incorporation fees, and
3. Accounting expenses and legal fees incident to organization, such as drafting the charter, bylaws, minutes of organizational meetings, and terms of the original stock certificates.

Expenses that cannot be deducted or amortized:

1. Expenses for issuance or sale of stock or securities, such as commissions, professional fees, and printing costs, and
2. Expenses for the transfer of assets to the corporation.

Corporations

Related Party Transactions

A corporation that uses an accrual method of accounting cannot deduct business expenses and interest owed to a related person who uses the cash method of accounting until the corporation makes the payment and the corresponding amount is includible in the related person's gross income. Determine the relationship, for this rule, as of the end of the tax year for which the expense or interest would otherwise be deductible. If a deduction is denied, the rule will continue to apply even if the corporation's relationship with the person ends before the expense or interest is includible in the gross income of that person. These rules also deny the deduction of losses on the sale or exchange of property between related persons.

Related persons. For purposes of this rule, the following persons are related to a corporation:

1. Another corporation that is a member of the same controlled group as defined in section 267(f) of the Internal Revenue Code.
2. An individual who owns, directly or indirectly, more than 50% of the value of the outstanding stock of the corporation.
3. A trust fiduciary when the trust or the grantor of the trust owns, directly or indirectly, more than 50% in value of the outstanding stock of the corporation.
4. An S corporation if the same persons own more than 50% in value of the outstanding stock of each corporation.

Continued on next card

Corporations

Related Party Transactions

Related persons (cont.)

5. A partnership if the same persons own more than 50% in value of the outstanding stock of the corporation and more than 50% of the capital or profits interest in the partnership.
6. Any employee-owner if the corporation is a personal service corporation, regardless of the amount of stock owned by the employee-owner.

Ownership of stock. To determine whether an individual directly or indirectly owns any of the outstanding stock of a corporation, the following rules apply:

1. Stock owned, directly or indirectly, by or for a corporation, partnership, estate, or trust is treated as being owned proportionately by or for its shareholders, partners, or beneficiaries.
2. An individual is treated as owning the stock owned, directly or indirectly, by or for the individual's family. Family includes only brothers and sisters (including half-brothers and half-sisters), a spouse, ancestors, and lineal descendants.
3. Any individual owning (other than by applying rule (2)) any stock in a corporation is treated as owning the stock owned directly or indirectly by that individual's partner.
4. To apply rule (1), (2), or (3), stock constructively owned by a person under rule (1) is treated as actually owned by that person. But stock constructively owned by an individual under rule (2) or (3) is not treated as actually owned by the individual for applying either rule (2) or (3) to make another person the constructive owner of that stock.

Complete liquidations. The disallowance of losses from the sale or exchange of property between related persons does not apply to liquidating distributions.

Corporations

Corporate Preference Items

A corporation must make special adjustments to certain items before it takes them into account in determining its taxable income. These items are known as corporate preference items and they include the following:

- ▶ Gain on the disposition of section 1250 property.
- ▶ Percentage depletion for iron ore and coal (including lignite).
- ▶ Amortization of pollution control facilities.
- ▶ Mineral exploration and development costs.

Corporations

Dividend Received Deduction

Dividends from foreign corporations. Generally, 100% of the foreign-source portion of dividends (and items treated as dividends) from 10%-owned foreign corporations received after December 31, 2017, may be deducted.

Dividends from domestic corporations. A corporation can deduct, within certain limits, 50% of the dividends received if the corporation receiving the dividend owns less than 20% of the corporation distributing the dividend. If the corporation owns 20% or more of the distributing corporation's stock, it can, subject to certain limits, deduct 65% of the dividends received.

No deduction allowed. No deduction is allowed for dividends received from the following:

1. A real estate investment trust (REIT).
2. A corporation exempt from tax under section 501 or 521 of the Internal Revenue Code either for the tax year of the distribution or the preceding tax year.
3. A corporation whose stock has been held less than 46 days during the 91-day period beginning 45 days before the stock became ex-dividend with respect to the dividend.
4. A corporation whose preferred stock was held less than 91 days during the 181-day period beginning 90 days before the stock became ex-dividend with respect to the dividend if the dividend received on it are for a period or periods totaling more than 366 days. Ex-dividend means the holder has no rights to the dividend.
5. Any corporation, if the corporation is under an obligation (pursuant to a short sale or otherwise) to make related payments for substantially similar or related property.

Corporations

Dividend Received Deduction

Limit on deduction for dividends. The total deduction for dividends received or accrued is generally limited (in the following order) to:

1. 65% of the difference between taxable income and the 100% deduction allowed for dividends received from affiliated corporations, or by a small business investment company, for dividends received or accrued from 20%-owned corporations, then
2. 80% of the difference between taxable income and the 100% deduction allowed for dividends received from affiliated corporations, or by a small business investment company, for dividends received or accrued from less-than-20%-owned corporations (reducing taxable income by the total dividends received from 20%-owned corporations).

Figuring the limit. In figuring the limit, determine taxable income without the following items:

1. The net operating loss deduction.
2. The domestic production activities deduction.
3. The deduction for dividends received.
4. Any adjustment due to the nontaxable part of an extraordinary dividend.
5. Any capital loss carryback to the tax year.

Effect of net operating loss. If a corporation has a net operating loss (NOL) for a tax year, the limit of 65% (or 50%) of taxable income does not apply. To determine whether a corporation has an NOL, figure the dividends-received deduction without the 65% (or 50%) of taxable income limit.

Corporations

Charitable Contributions

Limit on contributions. Contributions are limited to 10% of taxable income. Taxable income for this purpose is figured without taking into account the following:

1. Deduction for charitable contributions.
2. Deductions for dividends received.
3. Any domestic activities production deduction.
4. Any capital loss carryback to the tax year.
5. The deduction allowed under sec. 249 of IRC for bond premium.
6. Any NOL carryback to the tax year.

Carryover of excess contributions. Charitable contributions over the 10% limit can be carried over to each of the following 5 years. Any excess not used up within that period is lost.

Cash contributions. A corporation must maintain a record of any contribution of cash, check, or other monetary contribution, regardless of the amount. The record can be a bank record, receipt, letter, or other written communication from the donee indicating the name of the organization, the date of the contribution, and the amount of the contribution.

Contributions of property other than cash. If a corporation (other than a closely-held or a personal service corporation) claims a deduction of more than \$500 for contributions of property other than cash, a schedule describing the property and the method used to determine its fair market value must be attached to the corporation's return. In addition the corporation should keep a record of:

- ▶ The approximate date and manner of acquisition of the donated property and
- ▶ The cost or other basis of the donated property held by the donor for less than 12 months prior to contribution.

Corporations

Charitable Contributions

Contributions of property other than cash by closely held and personal service corporations. Closely held and personal service corporations must complete and attach Form 8283, Noncash Charitable Contributions, to their returns if they claim a deduction of more than \$500 for non-cash contributions. For all other corporations, if the deduction claimed for donated property exceeds \$5,000, complete Form 8283 and attach it to the corporation's return.

Reduced deduction for contributions of certain property. For a charitable contribution of property, the corporation must reduce the contribution by the sum of:

1. The ordinary income and short-term capital gain that would have resulted if the property were sold at its fair market value (FMV), and
2. For certain contributions, the long-term capital gain that would have resulted if the property were sold at its FMV. The reduction for the long-term gain applies to:
 - a) Contributions of tangible personal property for use by an exempt organization for a purpose or function unrelated to the basis for its exemption,
 - b) Contributions of any property to or for the use of certain private foundations except for stock which for market quotations are readily available, and
 - c) Contributions of any patent, certain copyrights, trademark, trade name, trade secret, know-how, software (that is a section 197 intangible), or similar property, or applications or registrations of such property.

Corporations Capital Gains & Losses

Capital gains. The capital gains tax rate for corporations is the same as the income tax rate. All income for a corporation is taxed at the federal corporate flat tax rate of 21%.

Capital losses. Deduct capital losses only to the extent of capital gains.

A capital loss is carried to other years in the following order:

First: Carryback losses 3 years prior to the loss year (apply the loss to the earliest year first).

Then: Any remaining loss is carried forward 5 years.

Note: If an election has been made to forgo the carryback period, it cannot be changed.

Treatment of loss. Short-term loss (when carried to another year).

S corporation status. Capital loss cannot be carried back from, or to, a year in which the corporation was an S corporation.

Refunds. When carrying back a capital loss to an earlier tax year, refigure the tax for that year. If the corrected tax is less than the tax originally owed, use either Form 1139, Corporate Application for Tentative Refund, or Form 1120X, Amended U.S. Corporation Income Tax Return, to apply for a refund.

Form 1139. A corporation can get a refund faster by using Form 1139, Corporation Application for Tentative Refund. It cannot file Form 1139 before filing the return for the corporation's capital loss year, but it must file Form 1139 no later than 1 year after the year it sustains the capital loss.

Corporations Net Operating Losses

A corporation generally figures and deducts an NOL the same way an individual does. For losses incurred in tax years beginning after December 31, 2020, only farming losses and losses of an insurance company (other than a life insurance company) can be carried back. The carryback period for these losses is 2 years. For NOLs that can be carried back, the corporation can elect to waive the carryback period and instead carry the NOL forward indefinitely to future years.

Figuring an NOL. If the NOL available for a carryback or carryforward year is greater than the taxable income for that year, the corporation must modify its taxable income to figure how much of the NOL it will use up in that year and how much it can carry over to the next tax year. Its carryover is the excess of the available NOL over its modified taxable income for the carryback or carryforward year.

Modified taxable income. A corporation figures its modified taxable income the same way it figures its taxable income, with the following exceptions.

- ▶ It can deduct NOLs only from years before the NOL year whose carryover is being figured.
- ▶ It must figure its deduction for charitable contributions without considering any NOL carrybacks.
- ▶ It cannot take any domestic activities production deduction.
- ▶ The modified taxable income for any year cannot be less than zero.

Corporations At-Risk Limits

The at-risk rules limit losses from most activities to the amount at risk in the activity. The at-risk limits apply to certain closely held corporations (other than S corporations). The amount at risk generally equals:

- ▶ The money and the adjusted basis of property contributed by the taxpayer to the activity, and
- ▶ The money borrowed for the activity.

Closely held corporation. For the at-risk rules, a corporation is a closely held corporation if, at any time during the last half of the tax year, more than 50% in value of its outstanding stock is owned directly or indirectly by, or for, five or fewer individuals. To figure if more than 50% in value of the stock is owned by five or fewer individuals, apply the following rules:

1. Stock owned, directly or indirectly, by or for a corporation, partnership, estate, or trust is considered owned proportionately by its shareholders, partners, or beneficiaries.
2. An individual is considered to own the stock owned, directly or indirectly, by or for his or her family. Family includes only brothers and sisters (including half-brothers and half-sisters), a spouse, ancestors, and lineal descendants.
3. If a person holds an option to buy stock, he or she is considered to be the owner of that stock.
4. When applying rule (1) or (2), stock considered owned by a person under rule (1) or (3) is treated as actually owned by that person. Stock considered owned by an individual under rule (2) is not treated as owned by the individual for again applying rule (2) to consider another the owner of that stock.

Corporations Tax Calculations

Tax Rates. Corporations, including qualified personal service corporations, figure their tax by multiplying taxable income by a flat tax rate of 21%.

Base erosion minimum tax. If a corporation is an applicable taxpayer, a tax equal to the base erosion minimum tax amount for the tax year may be imposed. This tax is reported using Form 8991.

Applicable taxpayer. An applicable taxpayer is, with respect to any tax year, a taxpayer which meets all of the following criteria.

- ▶ The taxpayer is a corporation other than a regulated investment company, a real estate investment trust, or an S corporation.
- ▶ The taxpayer has average annual gross receipts for the 3-tax-year period ending with the preceding tax year that are at least \$500 million (the “gross receipts test”).
- ▶ The taxpayer has a base erosion percentage for the tax year of 3% or higher; 2% or higher for a taxpayer who is a member of an affiliated group which includes a bank or a registered securities dealer as defined in section 59A(b)(3)(B) (the “base erosion percentage test”).

Alternative minimum tax. The alternative minimum tax does not apply to corporations for tax years beginning after 2017 and before 2023. In addition, corporations may treat a portion of their prior year alternative minimum tax credit carryover as refundable. Corporations use Form 8827 to figure the minimum tax credit, if any, for AMT incurred in prior tax years, the refundable AMT credit amount, and to figure any minimum tax credit carryforward.

Corporations Earnings & Profits

Determining Accumulated Earnings and Profits

Figuring accumulated E & P with current year profit:

Begin with:	Accumulated E & P - 1/1/2022
Add:	Current year profit
Subtract:	Distributions for the year
Equals:	Accumulated E & P - 12/31/2022

Figuring accumulated E & P with current year operating loss:

Begin with:	Accumulated E & P - 1/1/2022
Subtract:	Prorated operating loss to date of distribution
Equals:	E & P available at date of distribution
Subtract:	Distributions for the year
Equals:	Accumulated E & P - 12/31/2022

Corporations Earnings & Profits

Adjustment to Earnings and Profits

Property Distributed to Shareholder	Earnings & Profits
Cash	Decreased by amount of cash (not below zero)
Obligation to corporation	Decreased by principal amount of obligation
OID obligation	Decreased by the issue price of obligation
Other property	Decreased by adjusted basis of property

Appreciated property. For a distribution of appreciated property (other than the corporation's obligations), increase earnings and profits by the excess of the FMV over the adjusted basis of the property. Decrease E&P, but not below zero, by the FMV of the appreciated property.

Corporations

Reconciliation of Tax with Book Income (Loss)

Schedule M-1 - Reconciliation of Income (Loss) per Books With Income per Return. Schedule M-1 provides for the necessary adjustments to reconcile net income (loss) shown on the corporation's books to taxable income shown on the corporation's tax return. The following is an example on how to reconcile book income (loss) to taxable income (loss).

Net income (loss) per books

Add items that reduce book income but not taxable income:

- + Federal income tax
- + Excess of capital losses over capital gains
- + Income subject to tax not recorded on books
- + Excess charitable contribution (not tax deductible for that year)
- + Travel and entertainment over the 50% limit
- + Life insurance premiums not deductible on tax return

Subtract items that increase book income but not taxable income:

- Tax-exempt interest
- Depreciation: tax depreciation over book depreciation

Taxable income shown on tax return

Corporations

Reconciliation of Tax versus Book Income (Loss)

Form 1120

Schedules M-1 and M-2. Corporations with total receipts **and** total assets at the end of the year less than \$250,000 are not required to file Schedule M-1, Reconciliation of Income (Loss) per Books With Income per Return and Schedule M-2, Analysis of Unappropriated Retained Earnings per Books.

Schedule M-3. A corporation with total assets (non-consolidated or consolidated for all corporations included within a tax consolidated group) of \$10 million or more on the last day of the tax year must complete Schedule M-3, Net Income (Loss) Reconciliation for Corporations With Total Assets of \$10 Million or More, instead of Schedule M-1.

Corporations Accumulated Earnings Tax

A corporation can accumulate its earnings for a possible expansion or other bona fide business reasons. However, if a corporation allows earnings to accumulate beyond the reasonable needs of the business, it may be subject to an accumulated earnings tax of **20%**. If the accumulated earnings tax applies, interest applies to the tax from the date the corporate return was originally due, without extensions.

To determine if the corporation is subject to this tax, first treat an accumulation of \$250,000 or less generally as within the reasonable needs of most businesses. Treat an accumulation of \$150,000 or less as within the reasonable needs of a business whose principal function is performing services in the fields of accounting, actuarial science, architecture, consulting, engineering, health (including veterinary services), law, and the performing arts.

Reasonable needs of the business include the following:

- ▶ Specific, definite, and feasible plans for use of the earnings accumulation in the business.
- ▶ The amount necessary to redeem the corporation's stock included in a deceased shareholder's gross estate, if the amount does not exceed the reasonably anticipated total estate and inheritance taxes and funeral and administration expenses incurred by the shareholder's estate.

Corporations

Distributions to Shareholders

Distributions to shareholders. Distributions to shareholders are treated as the following:

1. A dividend (to the extent of current and accumulated earnings and profits).
2. Return of capital (amount over earnings and profits - the shareholder must reduce his or her adjusted basis in the stock by this amount).
3. Capital gain (amount received in excess of shareholder's basis).

Amount of distribution. The amount of distribution received by a shareholder is any money plus the FMV of other property received and reduced by liabilities of the corporation assumed by the shareholder. The basis of property received by the shareholder is its FMV.

Property. Includes money, securities, and indebtedness to the corporation, except stock of the distributing corporation or rights to acquire such stock.

Amount distributed. The amount of a distribution is generally the amount of any money paid to the shareholder plus the fair market value (FMV) of any property transferred to the shareholder. However, this amount is reduced (but not below zero) by the following liabilities:

- ▶ Any liability of the corporation the shareholder assumes in connection with the distribution.
- ▶ Any liability to which the property is subject immediately before, and immediately after, the distribution.

Note: The FMV of any property distributed becomes the shareholder's basis in that property.

Corporations

Distributions to Shareholders

Distribution of stock rights. A distribution to shareholders of stock or rights to acquire stock is not included in the shareholder's gross income unless it is one of the following:

1. Any shareholder has the choice to receive cash or other property instead of stock or stock rights.
2. A disproportionate distribution. The distribution gives cash or other property to some shareholders and an increase in the percentage interest in the corporation's assets or earnings and profits to other shareholders.
3. The distribution is in convertible preferred stock and has the same result as in (2).
4. The distribution gives preferred stock to some common stock shareholders and gives common stock to other common stock shareholder.
5. The distribution is on preferred stock.

Corporations

Distributions to Shareholders

Below-market loans. If a corporation gives a shareholder a loan on which no interest is charged or on which interest is charged at a rate below the applicable federal rate, the interest not charged may be treated as a distribution to the shareholder.

Corporation cancels shareholder's debt. If a corporation cancels a shareholder's debt without repayment by the shareholder, the amount canceled is treated as a distribution to the shareholder.

Transfers of property to shareholder below FMV. For a shareholder who is not a corporation, if the FMV of the property on the date of the sale or exchange exceeds the price paid by the shareholder, the excess may be treated as a distribution to the shareholder.

Unreasonable rents. If a corporation rents property from a shareholder and the rent is unreasonably more than the shareholder would charge to a stranger for use of the same property, the excessive part of the rent may be treated as a distribution to the shareholder.

Unreasonable salaries. If a corporation pays an employee who is also a shareholder a salary that is unreasonably high considering the services actually performed by the shareholder-employee, the excessive part of the salary may be treated as a distribution to the shareholder-employee.

Corporations

Dividends & Distributions

Distribution of appreciated property. If a corporation distributes property, other than its own stock, to a shareholder and the FMV exceeds the adjusted basis of the property, the corporation will recognize gain on the excess of FMV over adjusted basis.

Distribution of depreciated property. If the FMV of depreciated property distributed to shareholders, either as a dividend or in liquidation, exceeds the adjusted basis, the corporation must report the difference as ordinary income because of the depreciation.

Distribution of property subject to liability. If a corporation distributes property subject to a liability to a shareholder and the shareholder assumes the liability, the corporation will recognize a gain in the amount that the liability assumed by the shareholder exceeds the corporation's adjusted basis in the property. For gain recognition purposes, the FMV of a property is the greater of the actual FMV of the property or the amount of liabilities the shareholder assumes in connection with the distribution of the property.

Transfer of stock to creditor. If a corporation transfers stock to a creditor to satisfy a debt, the debt is considered paid with money equal to the FMV of the stock. The corporation will recognize income from the discharge of indebtedness if the debt exceeds the FMV of the stock. A corporation can exclude all or a portion of the income created by the stock for debt transfer if it is in a bankruptcy proceeding. If it is not in a bankruptcy proceeding, it can exclude the income to the extent it is insolvent.

Corporations

Reporting Dividends & Other Distributions

Form 1099-DIV. A corporation must file Form 1099-DIV, Dividends and Distributions, with the IRS for each shareholder to whom the corporation paid gross dividends of \$10 or more during the calendar year. If a payer makes a payment that may be a dividend but the payer is unable to determine whether any part of the payment is a dividend by the time Form 1099-DIV must be filed, the entire payment must be reported as a dividend. The corporation must file Form 1096, Annual Summary and Transmittal, by February 28 (March 31 if filing electronically) of the year following the close of the calendar year in which the dividends or distributions were made. Form 1099-DIV must be furnished to shareholders by January 31 of the following year.

Form 5452. File Form 5452, Corporate Report of Nondividend Distributions, if nondividend distributions were made to shareholders. A calendar tax year corporation must file Form 5452 with its income tax return for the tax year in which the nondividend distributions were made. A fiscal tax year corporation must file Form 5452 with its income tax return due for the first fiscal year ending after the calendar year in which the nondividend distributions were made.

Withholding agent. A withholding agent is any person required to withhold the tax. A withholding agent may be an individual, a trust, estate, partnership, corporation, etc.

Withholding of income to foreign entities. A withholding agent is required to withhold tax at the rate of **30%** on payments of rents, dividends, interest, and other fixed or determinable annual or periodic income from sources within the U.S. to a nonresident alien individual, foreign partnership, or foreign corporation. If this income is connected with the conduct of a trade or business in the U.S., the person receiving the payments may claim exemption from withholding by filing a statement with the withholding agent.

Returns required. Form 1042, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons, is required to be filed by the withholding agent by March 15 of the following year. Even if no taxes were withheld during the year, a separate Form 1042-S is required for each payee (recipient) of income to whom payments were made regardless of the amount of tax withheld. This form must be transmitted with the annual Form 1042.

Backup withholding. A corporate payer must withhold **24%** (backup withholding rate) from a reportable payment made to a U.S. person that is subject to Form 1099 reporting for any of the following reasons:

1. The U.S. person has not provided its taxpayer identification number (TIN) in the manner required.
2. The IRS notifies the payer that the TIN furnished by the payee is incorrect.
3. There has been a notified payee underreporting.
4. There has been a payee certification failure.

Payments subject to backup withholding. The following payments can be subject to backup withholding:

1. Interest payment.
2. Dividends.
3. Patronage dividends, but only if at least half the payment is in money.
4. Rents, profits, or other gains.
5. Commissions, fees, or other payments to an independent contractor.

Recordkeeping. All records on employment taxes must be kept for at least 4 years and should be available for IRS review.

Corporations Stock Redemption

IRC Sec. 302(c)

Constructive ownership of stock. An individual is considered owning stock that is owned, directly or indirectly, by any of the following:

1. Spouse (if not legally separated).
2. Children.
3. Grandchildren.
4. Parents.
5. A trust (if beneficiary).
6. A partnership (in proportion to the individual's interest).
7. A corporation (in proportion to interest) if the individual owns more than 50% of stock.

Note: An individual is not considered to own stock that is owned by brothers, sisters, aunts or uncles.

Corporations Stock Redemption

Distribution in redemption of stock (complete redemption). If a corporation redeems its stock, the redemption is treated as a distribution, in part or full payment, in exchange for stock, if the distribution:

1. Is not equivalent to a dividend,
2. Is a substantially disproportionate redemption of stock,
3. Terminates the shareholder's interest, or
4. Is a redemption from noncorporate shareholder in partial liquidation.

Substantially disproportionate redemption of stock. After a stock redemption, if a shareholder's ownership percentage of all voting stock is less than 80% of his percentage of all voting stock held before the redemption, and the shareholder owns less than 50% of all voting stock of the corporation after the redemption, the redemption is considered substantially disproportionate.

Corporations Stock Redemption

IRC Sec. 302(a)(b)(e)

Complete redemption. A complete redemption of shareholder's stock is treated as a sale and the shareholder recognizes a capital gain or loss on the transaction. Because the redemption terminates the shareholder's interest, none of the payment received is considered a dividend. Therefore, earnings and profits are ignored.

Partial redemption. In a partial redemption, the shareholder's interest is not terminated. Hence, a distribution is considered a dividend to the extent of current earnings and accumulated earnings and profits.

Corporations Liquidations

IRC Sec. 302(b)

Form 966, Corporate Dissolution or Liquidation. A corporation must report the adoption of a resolution or plan for the dissolution of the corporation or for the liquidation of all or part of its stock to the IRS within 30 days by filing Form 966.

Request for prompt assessment. A corporation that is contemplating dissolution, is in the process of dissolving, or has already dissolved, may file a written request with the IRS for a prompt assessment. An assessment or a proceeding in court without assessment for the tax must then begin within **18 months** after the receipt of a written request or **3 years** after the return was filed.

Form 1099-DIV. A corporation making any distribution as part of a liquidation must file Form 1099-DIV in each calendar year of the liquidation for each shareholder to whom it makes distributions of \$600 or more by the last day of February of the next year.

Partial liquidation. A distribution that is treated as being in redemption of stock if the distribution is:

1. Not essentially equivalent to a dividend,
2. In redemption of stock held by a shareholder who is not a corporation, and
3. In partial liquidation of the distributing corporation.

Corporations Liquidations

Complete liquidation. A distribution that is one of a series of distributions in redemption of all of the stock of the corporation pursuant to a plan and is not essentially equivalent to a dividend.

Corporation's gain or loss in complete liquidation. A corporation will recognize a gain or loss upon distribution of property in complete liquidation to a noncorporate shareholder as if the corporation had sold property to shareholder at FMV. If property distributed is subject to a liability that is assumed by the shareholder, the FMV of the property distributed will be treated as having a FMV not less than the liabilities.

Corporation's gain or loss = FMV - adjusted basis

Shareholder's basis in property received in liquidation. If property is distributed in complete liquidation and there is a gain or loss recognized by the shareholder, then the basis to shareholder is the FMV.

Liabilities assumed by shareholder. If the amount liabilities assumed on the property is less than its FMV, the liabilities have no effect on the shareholder's basis in property received. If the liabilities are more than FMV, the shareholder's basis will be the amount of liabilities assumed.

S Corporations The Election

Becoming an S corporation. A corporation can become an S corporation if:

1. It meets the requirements of S corporation status.
2. All its shareholders consent to S corporation status.
3. It uses a permitted tax year, or elects to use a tax year other than a permitted tax year.
4. It files Form 2553, Election by a Small Business Corporation, to indicate it chooses S corporation status.

Requirements of an S corporation. To qualify for S corporation status, a corporation must meet all of the following tests:

1. It must be a domestic corporation.
2. It must have only one class of stock (disregarding differences in voting rights).
3. It must have no more than 100 shareholders. Treat a T/P and his or her spouse (and their estates) as one shareholder for this test.
4. It must have as shareholders only individuals, estates, and certain trusts and financial institutions. Partnerships and corporations cannot be shareholders.
5. It must have shareholders who are citizens or residents of the U.S. Nonresident aliens cannot be shareholders.

S Corporations The Election

Ineligible domestic corporations. The following are domestic corporations ineligible to elect S corporation status.

1. A bank or thrift institution that uses the reserve method of accounting for bad debts under section 585.
2. An insurance company subject to tax under subchapter L of the Code.
3. A DISC (Domestic International Sales Corporation).
4. A corporation that has elected to be treated as a possessions corporation under section 936.

One class of stock. The outstanding shares of the corporation must be identical as to the rights of the holders in the profits and in the assets of the corporation. Stock may have differences in voting rights and still be considered one class of stock.

Form 2553 - Electing S Corporation Status. The election of S corporation status is effective for a tax year if Form 2553 is filed:

1. Any time during the previous tax year, or
2. By the 15th day of the 3rd month of the tax year to which the election applies.

Note: Certain corporations with reasonable cause for not timely filing Form 2553 can request to have the form treated as timely filed by filing Form 2553 as an attachment to Form 1120S, U.S. Income Tax Return for an S Corporation.

S Corporations

Termination of Status

The corporation's status as an S corporation may be terminated in any of the following ways:

1. By revoking the election,
2. By ceasing to qualify as an S corporation, or
3. By violating the passive investment income restrictions on S corporations with pre-S corporation's earnings and profits for three consecutive tax years.

Note: Terminations are effective on the date of the terminating event.

Terminating events. The following events will cause the corporation's S status to be terminated:

1. Having more than 100 shareholders,
2. Transferring stock in the S corporation to a corporation, partnership, ineligible trust, or a nonresident alien,
3. Creating a second class of stock, or
4. Acquiring a subsidiary, other than certain nonoperating subsidiaries.

Five-year waiting period. If a corporation's S status has been terminated, it must wait 5 tax years before becoming an S corporation again. If the corporation received the permission of the IRS, the waiting period may be less than 5 years.

S Corporations Revoking Status

An S corporation election may be revoked by the corporation for any tax year. The election can be revoked only if the shareholders who collectively own more than 50% of the outstanding shares in the S corporation's stock consent to the revocation. The revocation may specify a revocation date that is on or after the date the revocation is filed.

S Termination Year

The corporation will have to file two returns to cover the S termination year. One covers the 1120S (S corporation) short year and one covers the 1120 (C corporation) short year. The S termination year will count only as one tax year for figuring carrybacks and carryovers, even though two returns are filed for the year.

After the S termination year is divided into an 1120S short year and an 1120 short year, the separately stated items of income, loss, credit, and deduction, and the amount of the nonseparately stated income or loss must be divided between the periods.

S Corporations

Filing Requirements & Extensions

Due date of return. File Form 1120S by the **15th day of the 3rd month** after the end of the tax year.

Required e-filing. Certain corporations with total assets of \$10 million or more that file at least 250 returns a year are required to e-file Form 1120. However, in certain instances, these corporations can request a waiver.

Extension of time for filing. File Form 7004 for an automatic 6-month extension.

Penalties

Failure to file - 5% per month not exceeding 25% of the unpaid tax. Minimum penalty for a return over 60 days late is the smaller of the tax due or \$450.

Failure to pay - 0.5% per month not exceeding 25% of the unpaid tax.

Failure to furnish information timely. For each failure to furnish Schedule K-1 to a shareholder when due and each failure to include on Schedule K-1 all the information required to be shown (or the inclusion of incorrect information), a \$290 penalty may be imposed with respect to each Schedule K-1 for which a failure occurs. The maximum penalty is \$3,532,500 for all such failures during a calendar year. If the requirement to report correct information is intentionally disregarded, each \$290 penalty is increased to \$580 or, if greater, 10% of the aggregate amount of items required to be reported. There is no limit to the amount of the penalty.

S Corporations Tax Year

Permitted Tax Year

A permitted tax year is a calendar year or any other fiscal year for which the corporation establishes a substantial business purpose to the satisfaction of the IRS. An S corporation may elect under section 444 to have a tax year other than the permitted tax year.

Section 444 election. To be eligible to make the election, an S corporation must meet all of the following conditions:

1. It is not a member of a tiered structure (other than those made up of one or more partnerships or S corporations, all of which have the same tax year).
2. It has not previously had a section 444 election in effect.
3. It adopts a fiscal year where the deferral period (the number of months between the end of the elected tax year and the close of the required tax year) is 3 months or less.

Making the election. Make the section 444 election by filing Form 8716, Election To Have a Tax Year Other Than a Required Tax Year, with the IRS by the earlier of:

1. Any time during the previous year, or
2. By the 15th day of the 3rd month of the tax year to which the election applies.

S Corporations

Shareholder's Basis in Stock

Adjustment to basis of shareholder's stock

Increases:

1. All income that is separately stated and passed through to the shareholder.
2. Any nonseparately stated income of the S corporation.
3. The amount of the deductions for depletion that is more than the basis of the property being depleted.

Decreases:

1. Distributions that were not included in the shareholder's income.
2. All losses and deductions of the S corporation that are separately stated and passed through to the shareholder.
3. Any nonseparately stated loss of the S corporation.
4. Any expense of the S corporation that is not deductible in figuring its income and not properly chargeable to a capital account.
5. The shareholder's deduction for depletion of oil and gas property held by the S corporation to the extent it does not exceed the proportionate share of the adjusted basis of that property allocated to the shareholder.

S Corporations

Losses and Deductions

Shareholder's losses and deductions. S corporation shareholders claim their share of corporate losses and deductions, subject to limitations, on their individual tax returns.

Limits on losses. The amount of losses and deductions a shareholder can take is limited to the adjusted basis of:

1. The shareholder's stock, plus
2. Any loans the shareholder makes to the corporation.

Carryover of loss and deductions. If a shareholder's share of loss or deductions exceeds his or her basis in the stock, the shareholder may carry the unused loss or deductions forward, and deduct the excess in later years until used up, unless limited by some other provision.

S Corporations

Income and Expenses

Figuring income and expenses. To figure income, divide the items of income, loss, expense, and credit into two categories:

1. Separately stated items, and
2. Items used to figure nonseparately stated income or loss.

Note: The separately stated items and the nonseparately stated income or loss are known as pass-through items. These items are passed through to the shareholders on a pro rata basis figured on each shareholder's percentage of stock owned and the number of days in the tax year that the shareholder owned the stock.

S Corporations Income & Losses

Separately stated items. The list of items that must be separately stated includes, but is not limited to:

1. Ordinary business income (loss).
2. Net income or loss from rental real estate activities.
3. Net income or loss from other rental activities.
4. Portfolio income or loss:
 - a) Interest income.
 - b) Dividend income.
 - c) Royalty income.
 - d) Net short-term capital gain or loss.
 - e) Net long-term capital gain or loss.
5. Collectibles (28%) gain (loss) and unrecaptured section 1250 gain.
6. Section 1231 net gain or loss.
7. Charitable contributions.
8. Section 179 expense deductions.
9. Expenses related to portfolio income or loss.
10. Credits.
11. Tax preference and adjustment items needed to figure shareholder's alternative minimum tax.

S Corporations Income & Losses

Corporate deductions. The following are expenses deducted by the S corporation (not passed through) in computing ordinary income and loss:

1. Compensation to officers.
2. Salary and wages.
3. Repairs and maintenance.
4. Bad debts.
5. Rental expense.
6. Taxes and licenses.
7. Interest expense.
8. Depreciation not claimed on Form 1125-A or elsewhere on return.
9. Depletion (Do not deduct oil and gas depletion.)
10. Advertising.
11. Employee benefit program.
12. Pension and profit sharing.
13. Start-up and organizational expenses.

S Corporations Taxes

An S corporation may be subject to the following taxes:

1. Tax on excess net passive investment income.
2. Tax on built-in gains.
3. Investment credit recapture tax.
4. LIFO recapture tax.

S Corporations Taxes

Tax on excess net passive income. If an S corporation has pre-S corporation earnings and profits and its passive investment income is more than 25% of its gross receipts, the S corporation may be subject to a tax on excess net passive income. If passive investment income is more than 25% of gross receipts for 3 consecutive tax years, and the corporation has pre-S corporation earnings and profit at the end of those tax years, the corporation's S corporation status will be terminated.

Passive investment income. Passive investment income includes gross receipts from royalties, rents, dividends, interest, annuities.

Net passive income. Net passive income is passive income reduced by deductions directly connected with the production of passive investment income.

Excess net passive income. Excess net passive income is the amount that has the same ratio to net passive income as the amount of passive investment income that exceeds 25% of gross receipts has to passive investment income.

Note: An S corporation will not be subject to the tax on excess net passive income if it has been an S corporation for each of its tax years.

S Corporations Taxes

Tax on built-in gains. If a C corporation elects to be taxed as an S corporation, it could be subject to a built-in gains tax on appreciation that arose prior to converting to an S corporation. The S corporation may owe the tax if it has net recognized built-in gains during the recognized period. The recognized period is 5 years beginning on the first day of the first taxable year for which the corporation was an S corporation or the year in which the assets were acquired.

Investment credit recapture tax. Tax may apply if the corporation claimed investment credit on a prior year's corporate tax return before becoming an S corporation. If the S corporation makes an early disposition of the property, the S corporation, and not its shareholders, will be liable for payment of the tax.

LIFO recapture tax. If a corporation made the election to be an S corporation after Dec. 17, 1987, and used the LIFO inventory pricing method for its last tax year before its S election, the corporation may be liable for LIFO recapture.

S Corporations Distributions

Treatment of Distributions

If an S corporation has accumulated earnings and profits, the distribution is a dividend to the extent of earnings and profits.

Earnings and profits. An S corporation is not considered to have earnings and profits for tax years beginning after 1982 in which it was an S corporation. However, an S corporation can have E & P from:

1. Liquidations, redemptions, and reorganizations governed by the rules of Subchapter C of the IRC.
2. Tax years in which the corporation was not an S corporation.
3. Any of the S corporation's tax years that began before 1983.
4. A corporation acquisition that results in a carryover of earnings and profits under section 381 of the IRC.

S Corporations Distributions

Shareholder's Treatment of Distributions - S Corporation with no E & P

If an S corporation has no earnings and profits, a distribution to shareholders is treated as:

1. A return of capital (reduce shareholder's basis).
2. A capital gain (amount in excess of shareholder's basis).

Distribution of appreciated property. Corporation will treat distribution as if it had sold the property to the distributee for FMV. The corporation will have to recognize a gain and pass that gain through to its shareholders.

S corporation as a shareholder. If an S corporation is a shareholder in another corporation, the S corporation is treated as an individual.

S Corporations Distributions

Shareholder's Treatment of Distribution - S Corporation with E & P

If an S corporation has earnings and profits but has not elected to distribute them first, any distribution made will come from one or more of the following sources (in order):

- First***, treat the distribution as coming out of the accumulated adjustment account (AAA), to the extent of the AAA. This distribution is a return of capital and reduces the shareholder's adjusted basis.
 - Second***, treat any cash distributed as coming out of previously taxed income (PTI) from S corporation tax years beginning before 1983, after the distributions have reduced the AAA to zero.
 - Third***, treat that portion of the distribution remaining as a dividend to the extent of earnings and profits.
 - Fourth***, any excess is treated as return of capital and reduces any remaining basis of the shareholder's stock.
 - Fifth***, any excess is taxed as a gain from the sale or exchange of property.
- Note:** An S corporation can elect, with the consent of their shareholders, to first distribute earnings and profits.

Businesses Information Returns

Which form to file and the due dates

Form	Due Date
W-2 (to employee).	January 31,
W-2 and W-3 (to the social security administration.	January 31, whether filing paper forms or electronically.
941 or 944, Social security and Medicare taxes and income tax withholding.	April 30, July 31, October 31 and January 31 of the next year.
940, Federal unemployment (FUTA) tax.	January 31. April 30, July 31, October 31, and January 31, but only if the liability for unpaid tax is more than \$500.
1099-MISC, required for payment of \$600 or more, royalty payments of 10 or more, and if taxes were withheld from payment.	January 31 to payee. Last day in February to IRS (March 31 if e-filing).
Form 8300, Report of Cash Payments Over \$10,000 Received in a Trade or Business.	15 days after receiving the \$10,000 payment.

Types of Self-Employment Income:

- ▶ Income from sole proprietorship and non employee compensation.
- ▶ Corporate director fees.
- ▶ Partnership income from partnership operating a business (unless limited partner).
- ▶ Guaranteed payment from a partnership.
- ▶ Bartering income.
- ▶ Real estate rent (if received as a real estate dealer).
- ▶ Income paid to retired insurance agents based on commissions received prior to retirement.
- ▶ Interest received in a trade or business.
- ▶ Newspaper vendor's income if vendor is 18 or over.
- ▶ Net earnings of members of the clergy (unless taken a vow of poverty).
- ▶ Gains and losses by a dealer in options or commodities from dealing or trading in section 1256 contracts or property related to those contracts.
- ▶ A professional fiduciary who administers a deceased person's estate.

Income Not Considered Self-Employment Income:

- ▶ Shareholder's share of S corporation's taxable income.
- ▶ Fees received for services performed as a notary public.

Business Expenses

Cost of Goods Sold

Cost of goods sold. If a sole proprietor makes or buys goods to sell, the proprietor can deduct the cost of goods sold from gross receipts on Schedule C. However, to determine these costs, the inventory must be valued at the beginning and end of each tax year.

Figuring Cost of goods sold. Figure cost of goods sold by filling out lines 35 through 42 of Schedule C as follows:

- 35 Inventory at beginning of year \$ _____
- 36 Purchases less cost of items withdrawn for personal use \$ _____
- 37 Cost of labor. Do not include any amounts paid to the T/P \$ _____
- 38 Materials and supplies \$ _____
- 39 Other costs \$ _____
- 40 Add lines 35 through 39 \$ _____
- 41 Inventory at end of year \$ _____
- 42 Cost of goods sold. Subtract line 41 from line 40.
Enter the result here and on page 1, line 4 \$ _____

Business Expenses Employees' Pay

Who are employees. Before an employer can know how to treat payments made to workers for services, the employer must first know the business relationship that exists between employer and the person performing the services. The person performing the services may be one of the following:

1. An independent contractor.
2. A common-law employee.
3. A statutory employee.
4. A statutory nonemployee.

Independent contractor. People such as lawyers, contractors, subcontractors, and auctioneers who follow an independent trade, business, or profession in which they offer their services to the public, are generally not employees. However, whether such people are employees or independent contractors depends on the facts in each case. The general rule is that an individual is an independent contractor if the person for whom the services are performed, has the right to control or direct only the result of the work and not the means and methods of accomplishing the result.

Common-law employee. Under common-law rules, anyone who performs services for a T/P is the T/P's employee if the T/P has the right to control what will be done and how it will be done. This is so even when the T/P gives the employee freedom of action. What matters is the right to control the details of how the services are performed.

Business Expenses Employees' Pay

Statutory employee. If workers are independent contractors under the common law rules, such workers may nevertheless be treated as employees by statute (“statutory employees”) for certain employment tax purposes if they fall within any one of the following four categories and meet the three conditions described under Social security and Medicare taxes on the next card:

1. A driver who distributes beverages (other than milk) or meat, vegetable, fruit, or bakery products; or who picks up and delivers laundry or dry cleaning, if the driver is T/P’s agent or is paid on commission.
2. A full-time life insurance sales agent whose principal business activity is selling life insurance or annuity contracts, or both, primarily for one life insurance company.
3. An individual who works at home on materials or goods that employer supplies and that must be returned to employer, if employer also furnish specifications for the work to be done.
4. A full-time traveling or city salesperson who works on behalf of an employer and turns in orders to the employer from wholesalers, retailers, contractors, or operators of hotels, restaurants, or other similar establishments. The goods sold must be merchandise for resale or supplies for use in the buyer's business operation. The work performed for employer must be the salesperson's principal business activity.

Business Expenses Employees' Pay

Social security and Medicare taxes. Social security and Medicare taxes are withheld from the wages of statutory employees if all three of the following conditions apply:

1. The service contract states or implies that substantially all the services are to be performed personally by them.
2. They do not have a substantial investment in the equipment and property used to perform the services (other than an investment in transportation facilities).
3. The services are performed on a continuing basis for the same payer.

Statutory nonemployee. There are three categories of statutory nonemployees: direct sellers, licensed real estate agents, and certain companion sitters. Direct sellers and licensed real estate agents are treated as self-employed for all federal tax purposes, including income and employment taxes, if both of the following apply:

1. Substantially all payments for their services as direct sellers or real estate agents are directly related to sales or other output, rather than to the number of hours worked.
2. Their services are performed under a written contract providing that they will not be treated as employees for federal tax purposes.

Business Expenses Employees' Pay

Family employees

Child employed by parents. Payments for services of a child under age 18 who works for his or her parent in a business are not subject to social security and Medicare taxes if the business is a sole proprietorship or a partnership in which each partner is a parent of the child. If these payments are for work other than in a business, such as domestic work in the parent's private home, they are not subject to social security, Medicare, and FUTA taxes until the child reaches age 21. The payments are generally subject to income tax withholding unless the payments are for domestic work in the parent's home, or unless the payments are for work other than in a trade or business and are less than \$50 in the quarter or the child is not regularly employed to do such work.

One spouse employed by another. The wages for the services of an individual who works for his or her spouse in a trade or business are subject to income tax withholding and social security and Medicare taxes, but not to FUTA tax. However, the payments for services of one spouse employed by another in other than a trade or business, such as domestic service in a private home, are not subject to social security, Medicare, and FUTA taxes.

Covered services of a child or spouse. The wages for the services of a child or spouse are subject to income tax withholding as well as social security, Medicare, and FUTA taxes if he or she works for:

- ▶ A corporation, even if it is controlled by the child's parent or the individual's spouse.
- ▶ A partnership, even if the child's parent is a partner, unless each partner is a parent of the child.
- ▶ A partnership, even if the individual's spouse is a partner.
- ▶ An estate, even if it is the estate of a deceased parent.

Business Expenses

Employees' Pay

Tests for deducting pay

To be deductible, employees' pay must be an ordinary and necessary expense and must be paid or incurred. In addition, the pay must meet both of the following tests:

Test 1. It must be reasonable.

Test 2. It must be for services performed.

Awards

An employer can deduct amounts paid to employees as awards, whether paid in cash or property.

Achievement awards. An achievement award is an item of tangible personal property that meets all the following requirements:

- ▶ It is given to an employee for length of service or safety achievement.
- ▶ It is awarded as part of a meaningful presentation.
- ▶ It is awarded under conditions and circumstances that do not create a significant likelihood of disguised pay.

Length-of-service award. An award will qualify as a length-of-service award only if either of the following applies:

- ▶ The employee receives the award after his or her first 5 years of employment.
- ▶ The employee did not receive another length-of-service award (other than one of very small value) during the same year or in any of the prior 4 years.

Business Expenses Employees' Pay

Awards (cont.)

Safety achievement award. An award for safety achievement will qualify as an achievement award unless one of the following applies:

1. It is given to a manager, administrator, clerical employee, or other professional employee.
2. During the tax year, more than 10% of employees, excluding those listed in (1), have already received a safety achievement award (other than one of very small value).

Deduction limit for awards. The deduction for the cost of employee achievement awards given to any one employee during the tax year is limited to the following:

- ▶ \$400 for awards that are not qualified plan awards.
- ▶ \$1,600 for all awards, whether or not qualified plan awards.

Bonuses. Bonuses are deductible if the bonus is intended as additional pay for services that were actually performed and not as a gift. This applies whether the bonus was cash or property.

Gifts of nominal value. An employer can deduct as nonwage business expense, food or merchandise of nominal value distributed to employees at holidays. The deduction for de minimis gifts of food or drink are not subject to the 50% deduction limit that generally applies to meals.

Educational expenses. If an employer pays or reimburses education expenses for an employee, the employer can deduct the payments if they are part of a qualified educational assistance program.

Business Expenses Employees' Pay

Fringe Benefits

Deduct the cost of fringe benefits. The value of some fringe benefits are also excluded from employees' pay.

Meals and lodging. Deduct the cost of furnishing meals and lodging to employees.

Deduction limit on meals. An employer can generally deduct only 50% of the cost of furnishing meals to employees. However, the employer can deduct the full cost of the following meals:

- ▶ Meals whose value is included in an employee's wages.
- ▶ Meals that qualify as a de minimis fringe benefit. This includes meals furnished to employees at the employer's place of business if more than half of these employees are provided the meals for the employer's convenience.
- ▶ Meals furnish to employees at the work site when the employer operates a restaurant or catering service.
- ▶ Meals furnish to employees as part of the expense of providing recreational or social activities, such as a company picnic.

Vacation pay. Deduct vacation pay only in the tax year in which the employee actually receives it. This rule applies regardless of whether the employer uses the cash or accrual method of accounting.

Compensation for injuries. Deduct amounts paid to employees for sickness and injury, including lump-sum payments paid or accrued.

Business Expenses Employees' Pay

Employee benefit programs. Deduct amounts spent on employee benefit programs. Employee benefit programs include the following:

- ▶ Accident and health plans.
- ▶ Adoption assistance.
- ▶ Cafeteria plans.
- ▶ Dependent care assistance.
- ▶ Educational assistance.
- ▶ Life insurance coverage.
- ▶ Welfare benefit funds.

Property as compensation. Transfer of property (including company stock) to employees for services are deductible as wages. The deductible amount is the fair market value on the date of the transfer. The difference between FMV and the adjusted basis is considered a capital gain or loss to the employer.

Construction of capital assets. Salaries and other payments incurred for constructing capital assets cannot be deducted. The costs must be included in the basis of the constructed asset and depreciated.

Business Expenses Employees' Pay

Reporting expenses and reimbursements. A reimbursement or allowance arrangement provides for payment of advances, reimbursements, and allowances for travel and non-entertainment related meals expenses incurred by employees during the ordinary course of business. How to deduct a business expense under a reimbursement or allowance arrangement depends on whether the employer has:

- ▶ An accountable plan, or
- ▶ A nonaccountable plan.

Accountable plans. An accountable plan requires employees to meet all of the following requirements. Each employee must:

1. Have paid or incurred deductible expenses while performing services as an employee,
2. Adequately account to the employer for these expenses within a reasonable period of time, and
3. Return any excess reimbursement or allowance within a reasonable period of time.

An arrangement under which an employer advances money to employees is treated as meeting (3) above only if the following requirements are also met.

- ▶ The advance is reasonably calculated not to exceed the amount of anticipated expenses.
- ▶ The employer makes the advance within a reasonable period of time of the employee paying or incurring the expense.

Business Expenses Employees' Pay

Accountable plans (cont.)

Reasonable period of time. A reasonable period of time depends on the facts and circumstances.

Generally, actions that take place within the times specified in the following list will be treated as taking place within a reasonable period of time.

1. Employer gives an advance within 30 days of the time the employee pays or incurs the expense.
2. Employees adequately account for their expenses within 60 days after the expenses were paid or incurred.
3. Employees return any excess reimbursement within 120 days after the expenses were paid or incurred.
4. Employer gives a periodic statement (at least quarterly) to his or her employees that asks them to either return or adequately account for outstanding advances and they comply within 120 days of the date of the statement.

Nonaccountable plans. A nonaccountable plan is an arrangement that doesn't meet the requirements for an accountable plan. All amounts paid, or treated as paid, under a nonaccountable plan are reported as wages on Form W-2. The payments are subject to income tax withholding, social security, Medicare, and federal unemployment taxes. Deduct the reimbursement as compensation or wages only to the extent it meets the deductibility tests for employees' pay.

Business Expenses Employees' Pay

Employment Taxes

Keep all records of employment taxes for at least 4 years. These should be available for IRS review.

The records should include the following information:

1. The employer's identification number (EIN).
2. Amounts and dates of all wage, annuity, and pension payments.
3. Amounts of tips reported to the employer by the employer's employees.
4. Records of allocated tips.
5. The fair market value of in-kind wages paid.
6. Names, addresses, social security numbers, and occupations of employees and recipients.
7. Any employee copies of Forms W-2 and W-2c that were returned to the employer as undeliverable.
8. Dates of employment for each employee.
9. Periods for which employees and recipients were paid while absent due to sickness or injury and the amount and weekly rate of payments the employer or third party payers made to them.
10. Copies of employees' and recipients' income tax withholding allowance certificates (Forms W-4, W-4P, W-4(SP), W-4S, and W-4V).

Continued on next card

Business Expenses Employees' Pay

Employment Taxes (cont.)

11. Dates and amounts of tax deposits that the employer made and acknowledgment numbers for deposits made by EFTPS.
12. Copies of returns filed and confirmation numbers.
13. Records of fringe benefits and expense reimbursements provided to employees, including substantiation.
14. Documentation to substantiate any credit claimed.

Form W-4. When hiring an employee, the employer must have the employee complete a Form W-4, Employee's Withholding Allowance Certificate. Form W-4 tells the employer, the marital status, the number of withholding allowances, and any additional amount to use when deducting federal income tax from the employee's pay. If an employee fails to give the employer a properly completed Form W-4, the employer must withhold federal income taxes from the employee's wages as if the employee was single and claiming no withholding allowances.

Business Expenses

Employees' Pay

Employment Taxes (cont.)

Depositing employment taxes. There are two deposit schedules: monthly or semiweekly. The deposit schedule that a calendar year employer must use is based on the total tax liability that the employer reported on Form 941 during the four-quarter lookback period that begins July 1 and ends June 30 of the previous year. If the employer reported payroll taxes of \$50,000 or less for the lookback period, the employer makes monthly deposits. If the employer reported payroll taxes of more than \$50,000 the lookback period, the employer makes semiweekly deposits.

Deposit penalties. For amounts not properly or timely deposited, the penalty rates are as follows:

- 2% - Deposits made 1 to 5 days late.
- 5% - Deposits made 6 to 15 days late.
- 10% - Deposits made 16 or more days late. Also applies to amounts paid within 10 days of the date of the first notice the IRS sent asking for the tax due.
- 10% - Amounts that should have been deposited, but instead were paid directly to the IRS, or paid with the tax return.
- 15% - Amounts still unpaid more than 10 days after the date of the first notice the IRS sent asking for the tax due or the day on which the taxpayer received notice and demand for immediate payment, whichever is earlier.

Business Expenses

Employees' Pay

Trust fund taxes. Trust fund taxes are income tax, social security tax, and Medicare tax withheld from the employee's wages. Certain excise taxes are also considered trust fund taxes because they are collected and held in trust for the government until submitted in a federal tax deposit.

Trust fund recovery penalty. If income, Social Security, and Medicare taxes are not withheld or are not paid to the IRS, a penalty may be assessed against any person responsible for collecting, accounting for, and paying of the taxes. A responsible person may be one of the following:

1. An officer or an employee of a corporation.
2. A member or employee of a partnership.
3. A corporate director or shareholder.
4. A member of a board of trustees of a nonprofit organization.
5. Another person with sufficient authority and control over funds to direct their disbursement including someone who signs checks for the business.

This penalty does not apply to the employer's portion of social security or FUTA. The penalty is computed based on two amounts which constitute trust fund tax:

1. The unpaid income taxes that should have been withheld, or were withheld but not paid, plus
2. The employee's portion of the Social Security/Medicare taxes that should have been withheld, or were withheld but not paid.

Recordkeeping. All records on employment taxes must be kept for at least 4 years.

Business Expenses

Rent Expense

Rent paid in advance. If rent is paid in advance, deduct only the amount that applies to the use of the rented property for the tax year. The balance can be deducted only over the period to which it applies.

Cost of acquiring a lease. Any amount paid to acquire an existing lease must be amortized over the remaining term of the lease.

Commissions, bonuses, and fees. Commissions, bonuses, fees and other amounts paid to obtain a lease on a property used for business are capital expenses and must be amortized over the term of the lease.

Leasehold improvements. The cost of improvements to a leased property must be depreciated using MACRS. The cost is depreciated over its appropriate recovery period. Do not amortize the cost over the remaining term of the lease.

Assignment of a lease. If a long-term lessee makes capital improvements to land and later assigns all lease rights to a T/P, the amount that is paid to the assignment is a capital investment to the T/P. If the rental value of the leased land increases since the lease began, part of the capital investment is for the increased rental value. This increase is a cost of getting the lease and must be amortized over the remaining term of the lease.

Business Expenses

Interest Expenses

Allocation of interest. Allocate the interest on a loan used for business, personal, investment, and passive activities. Allocate interest on a loan the same way as allocating the loan proceeds.

Secured loan. The allocation of loan proceeds and the related interest is not affected by the use of the property that secures the loan. For example, if a business property is used to secure a loan where the proceeds are used for personal use, the interest is allocated to personal use even though the loan is secured by business property.

Points. Points on a loan relating to a trade or business must be amortized over the life of the loan.

Prepaid Interest. Deductible only in the year to which it pertains.

Delinquent debt. An accrual basis T/P can still deduct interest on a loan he or she is unlikely to be able to repay.

Prepayment penalty. Deduct the penalty as interest.

Business related debt. Deduct all interest on a debt related to a trade or business.

Cash basis taxpayer. Deduct only payments of interest actually paid during tax year.

Accrual basis taxpayer. Deduct interest when it accrues during tax year.

Business Expenses

Interest Expenses

Nondeductible Interest Expenses:

1. Commitment fees or standby charges. Fees incurred to have business funds readily available over a period of time, but not for the actual use of funds.
2. Interest on individual income tax owed.
3. Interest related to tax exempt income.

Capitalization of Interest. Under the uniform capitalization rules, interest must be capitalized on debt used to finance the production of real or tangible personal property. Capitalize interest incurred during the production of the following properties:

1. Real property.
2. Tangible personal property with a class life of 20 years or more.
3. Tangible personal property with an estimated production period of more than 2 years.
4. Tangible personal property with an estimated production period of more than one year if cost of production is more than \$1 million.

Interest expense limitation. The business interest expense deduction allowed for a tax year is generally limited to the sum of:

1. Business interest income,
2. 30% of the adjustable taxable income, and
3. Floor plan financing interest.

Business Expenses Taxes

Deductible taxes. A T/P can deduct various federal, state, local, and foreign taxes directly attributed to his or her trade or business. The following are deductible taxes:

- ▶ Real estate taxes.
- ▶ State and local income taxes.
- ▶ Employment taxes.
- ▶ Personal property tax.
- ▶ State unemployment payments.
- ▶ Foreign income taxes.
- ▶ Franchise taxes.
- ▶ Fuel taxes.
- ▶ Excise taxes.
- ▶ Occupational taxes.
- ▶ One-half of self-employment tax.

Taxes for local benefits. Taxes for local benefits that tend to increase the value of the property (such as assessments for construction of streets, sidewalks, and water and sewer systems) are not deductible. These assessments must be capitalized. Assessments for maintenance and repairs (such as repairing streets, sidewalks, and water and sewer systems) are deductible as business expenses.

Sales tax. Treat any sales tax paid on a service or on the purchase or use of property as part of the cost of the service or property. If the service or property is a deductible expense the sales tax is deductible. If the property is for resale, the sales tax is part of the cost of merchandise.

Business Expenses

Insurance Expenses

Deductible Premiums:

1. Fire, theft, accident, flood or other similar insurance.
2. Merchandise and inventory insurance.
3. Credit insurance to cover losses from business bad debts. Report any proceeds from this insurance as ordinary income.
4. Group hospitalization and medical insurance for employees, including long-term care insurance.
 - a) If a partnership pays accident and health insurance premiums for its partners, it generally can deduct them as guaranteed payments to partners.
 - b) If an S corporation pays accident and health insurance premiums for its more-than-2% shareholder-employees, it generally can deduct them, but must also include them in the shareholder's wages subject to federal income tax withholding.
5. Liability insurance.
6. Malpractice insurance.

Continue on next card

Business Expenses

Insurance Expenses

Deductible Premiums (cont.)

7. Workers' compensation insurance set by state law that covers any claims for bodily injuries or job-related diseases suffered by employees in the business, regardless of fault.
 - a. If a partnership pays workers' compensation premiums for its partners, it generally can deduct them as guaranteed payments to partners.
 - b. If an S corporation pays workers' compensation premiums for its more-than-2% shareholder-employees, it generally can deduct them, but must also include them in the shareholder's wages.
8. Contributions to a state unemployment insurance fund.
9. Overhead insurance. Covers overhead expenses during long period of disability of taxpayer.
10. Car and other vehicle insurance. Deduct only the part of premiums that applies to business use.
11. Life Insurance covering officers and employees if employer is not the beneficiary under the contract and can show that the premiums represent the current pay.
12. Business interruption insurance that pays for lost profits if the business is shut down due to a fire or other cause. Report the proceeds as ordinary income.

Business Expenses

Insurance Expenses

Nondeductible Premiums:

1. Self-insurance reserve funds.
2. Premiums for a policy covering loss of earnings.
3. Life Insurance policy as security for business loan.
4. Certain life insurance and annuities.

Cash or accrual method prepayment. A T/P cannot deduct the entire premiums for an insurance policy that covers more than one tax year in the year the payment is made or incurred. Deduct only the part of the premium that applies to that year. For each later year, deduct the part that applies for that year. If a cash basis T/P pays a premium that covers part of the previous year, the T/P can deduct the part of the premium that applies to the previous years as well as the part that applies to the tax year the premium is paid.

Business Expenses

Bad Debts

Qualifications for deductible bad debt:

1. Must be a true creditor-debtor relationship.
2. Must be a legal obligation to pay debt.
3. Must realize a loss due to bad debt (i.e. actual loss of money that was reported as income).
4. Must show that the debt is worthless.
5. Must have taken reasonable steps to collect the debt.

Two types of bad debt. There are two types of bad debts: business and nonbusiness.

Non-business bad debt:

- a) All bad debts not relating to trade or business.
- b) Must be totally worthless to be deducted.
- c) Deducted as short-term capital loss on Form 8949 and Schedule D.
- d) A loan to a relative or friend that is later forgiven is a gift and not deductible.

Continued on next card

Business Expenses

Bad Debts

Two types of bad debt (cont.)

Business bad debt. A business bad debt is a loss from the worthlessness of a debt that was either:

- a) Created or acquired in a trade or business, or
- b) Closely related to a trade or business.

Types of business bad debts:

1. Mainly the result of credit sales to customers.
2. Loans to suppliers, clients, employees, or distributors.
3. Partner can deduct amount paid for an insolvent partner's share of debt.
4. A business loan is guaranteed if the taxpayer:
 - ▶ Made the guarantee in the course of a trade or business,
 - ▶ Has a legal duty to pay the debt,
 - ▶ Made the guarantee before the debt became worthless, and
 - ▶ Received reasonable consideration for making the guarantee.

Business Expenses

Bad Debts

Methods of treating business bad debt (two types):

1. **Specific charge-off:**

- a) All T/P's must use this method, except financial institutions, unless the requirements to use the nonaccrual-experience method are met.
- b) Partial bad debt: Deduction is limited to the amount charged-off the books that year.
- c) Totally worthless debts: Deduct only in the tax year it becomes worthless. Not required to make actual charge-off on the books.

2. **Nonaccrual-experience.** Under this method of accounting, an accrual basis T/P does not have to accrue income that is not expected to be collected. Applies to amounts to be received (accounts receivable) for the performance of services. This method cannot be used if interest and penalties are required to be paid for late payments.

Note: **Cash basis T/P.** Cannot take a bad debt deduction for amounts owed to T/P because it was never included in income. T/P must have a basis in the debt.

Accrual basis T/P. Deduct bad debt against income previously reported.

Recovery of a bad debt. Include in income any amount of bad debt recovered in a later year, but only up to the amount of the deduction that reduced tax in the year deducted. Report the recovery as "Other income" on the appropriate business form or schedule.

Business Expenses

Business Travel & Entertainment

Travel in the U.S.

1. **Travel entirely for business.** Deduct all travel expenses.
2. **Travel primarily for business.** Deduct only business-related travel expenses including travel expenses to and from business destination.
3. **Travel primarily for personal reasons.** Deduct only business-related expenses. Do not include travel expenses to and from destination.

Travel outside the U.S.

1. **Travel entirely for business.** Deduct all travel expenses.
2. **Travel primarily for business.** If at least 25% of the trip is spent on nonbusiness activities, deduct only business-related expenses and allocate travel expenses to and from destination between business and non-business activities.
3. **Travel primarily for vacation.** Deduct only business-related expenses. Do not include travel expenses to and from destination.

Travel expenses for others. Travel expenses paid for others (including spouse, dependent, or employee) cannot be deducted unless the individual is an employee, has a bona fide business purpose for the travel, and the travel expenses would otherwise be deductible.

Business Expenses

Business Travel & Entertainment

Meals and entertainment. In general, entertainment expenses are nondeductible. However, there are a few exceptions to the general rule including:

- ▶ Entertainment treated as compensation on and treated as wages to the T/P's employees.
- ▶ Recreational expenses for employees such as a holiday party or a summer picnic.
- ▶ Expenses related to attending business meetings or conventions of certain exempt organizations such as business leagues, chambers of commerce, professional associations, etc.
- ▶ Entertainment sold to customers. For example, if the T/P's runs a nightclub, the expenses for the entertainment furnish to the customers, such as a floor show, are not subject to the nondeductible rules.

Examples of nondeductible entertainment:

- ▶ **Entertainment events.** This includes expenses for entertaining guests at nightclubs, at social, athletic, and sporting clubs, at theaters, at sporting events.
- ▶ **Entertainment facilities.** Any expense for the use of an entertainment facility.
- ▶ **Club dues and membership fees.** Dues (including initiation fees) for membership in any club organized for business, pleasure, recreation, or other social purposes.

50% limit. Only 50% of meals and entertainment can be deducted. However, a T/P can deduct 100% of meal expenses if the meals are food and beverages provided by a restaurant, and paid or incurred after December 31, 2020, and before January 1, 2023.

Business Expenses

Business Travel & Entertainment

Taking turns paying for meals or entertainment. Expenses are not deductible when a group of business acquaintances take turns picking up each other's meals and entertainment checks without regard to whether any business purposes are served.

Business gift expenses. The following are limits on business gifts:

1. Deduct no more than \$25 per person.
2. Gift to spouse or family member of a customer is treated as a gift to that customer.
3. T/P and spouse are treated as one T/P under the \$25 per person limit rule.

Business Expenses Casualty & Theft Losses

Casualty and theft losses on business or income producing properties are treated the same as nonbusiness casualty losses except:

1. Losses do not have to be attributed to a federally declared disaster.
2. There is no deduction limit on business losses.
3. The replacement period to postpone reporting gain is 3 years.
4. A condemnation loss can be deducted.

Part business & part personal-use property. The casualty/theft loss deduction must be figured as though there were two separate casualties/thefts:

1. One affecting the personal use property, and
2. One affecting the business or income producing property.

Disaster area loss. A loss in a federally declared disaster area can be deducted on the tax return for the year preceding the year of the disaster.

Loss of inventory. A casualty/theft loss of inventory is automatically claimed through the increase in the cost of goods sold by reducing ending inventory. A T/P can choose to deduct the loss separately by eliminating the item from cost of goods sold by lowering opening inventory or purchases by the amount of the loss.

Business Expenses

Other Business Expenses

Other Deductible Business Expenses:

1. Licenses and regulatory fees.
2. Penalties and fines for nonperformance of a contract.
3. Environmental cleanup costs (the cost of cleaning up and treating groundwater contaminated with hazardous waste resulting from business operations).
4. Expenses for moving machinery from one city or plant to another.

Nondeductible Business Expenses:

1. Anticipated liabilities or reserves.
2. Lobbying and political expenses and political contributions.
3. Bribes and kickbacks (if paid to government employee or to others in violation of federal and state law).
4. Dues paid for membership in any club organized for business, pleasure, recreation, or any other social purpose.
5. Charitable contributions (must be deducted as an itemized deductions on Schedule A).
6. Kickbacks, bribes, and rebates paid in Medicare or Medicaid programs.
7. Penalties and fines paid to any government for violation of any law.
8. Demolition expenses or losses of a structure. Must be added to basis of the land.

Business Income

Qualified Business Income (QBI) Deduction

Owners of sole proprietorships, partnerships, S corporations (not C corporations) and some trusts and estates may be eligible for a qualified business income (QBI) deduction (Section 199A) for tax years beginning after December 31, 2017. The QBI deduction has two components:

1. **QBI Component.** This component of the deduction equals 20% of QBI from a domestic business operated as a sole proprietorship or through a partnership, S corporation, trust or estate. The QBI Component is subject to limitations, depending on the T/P's taxable income, that may include the type of trade or business, the amount of W-2 wages paid by the qualified trade or business and the unadjusted basis immediately after acquisition (UBIA) of qualified property held by the trade or business.
2. **REIT/PTP Component.** This component of the deduction equals 20% of qualified real estate investment trust (REIT) dividends and qualified publicly traded partnership (PTP) income. This component is not limited by W-2 wages or the UBIA of qualified property. Depending on the taxpayer's taxable income, the amount of PTP income that qualifies may be limited depending on the PTP's trade or business.

Qualified Business Income (QBI). QBI is the net amount of qualified items of income, gain, deduction and loss from any qualified trade or business, including income from partnerships, S corporations, sole proprietorships, and certain trusts. Generally this includes, but is not limited to, the deductible part of self-employment tax, self-employed health insurance, and deductions for contributions to qualified retirement plans (e.g. SEP, SIMPLE and qualified plan deductions).

Business Income

Qualified Business Income (QBI) Deduction

QBI does not include the following items:

- ▶ Items that are not properly includable in taxable income
- ▶ Investment items such as capital gains or losses or dividends
- ▶ Interest income not properly allocable to a trade or business
- ▶ Wage income (except for statutory employees where Form W-2, box 13 is checked)
- ▶ Income that is not effectively connected with the conduct of business within the U.S.
- ▶ Commodities transactions or foreign currency gains or losses
- ▶ Certain dividends and payments in lieu of dividends
- ▶ Income, loss, or deductions from notional principal contracts
- ▶ Annuities, unless received in connection with the trade or business
- ▶ Amounts received as reasonable compensation from an S corporation
- ▶ Amounts received as guaranteed payments from a partnership
- ▶ Payments received by a partner for services other than in a capacity as a partner
- ▶ Items treated as capital gains or losses
- ▶ Qualified REIT dividends (deducted under the REIT/PTP component)
- ▶ Qualified PTP income (deducted under the REIT/PTP component)

Business Income

Qualified Business Income (QBI) Deduction

Form 8995

Deduction limits. The deduction is limited to the lesser of the QBI component plus the REIT/PTP component or 20 percent of the taxable income minus net capital gain. For the QBI component, if the trade or business is a specified trade or business (SSTB), the T/P can claim the credit only if his or her taxable income is less than or equal to \$170,050 (\$340,100 if married filing jointly). For business owners with taxable income in excess of \$220,050 (\$440,100 if married filing jointly), no deduction is allowed against income earned in a SSTB.

SSTB. An SSTB is a trade or business involving health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of the trade or business is the reputation or skill of one or more of its owners or employees.

Form 8995. Individuals and eligible estates and trusts that have QBI use Form 8995 to figure the QBI deduction.

Business Expenses Depreciation

Depreciable property. Property is depreciable if it meets these requirements:

1. Must be property owned.
2. Must be used in a business or income-producing activity.
3. Must have a determinable useful life lasting longer than 1 year.

Depreciable property may be:

1. **Tangible.** Property that can be seen or touched. Two types:
 - a) Real property. Land and anything that is erected on, growing on, or attached to the land. However, land itself is never depreciable.
 - b) Personal property. Machinery or equipment that is not real estate.
2. **Intangible.** Property that cannot be seen or touched:
 - a) Copyright
 - b) Patent
 - c) Computer software

Business Expenses

Depreciation

Nondepreciable property:

1. Property placed in service and disposed of in the same year.
2. Equipment used to build capital improvements (Uniform Capitalization Rules)
3. Section 197 intangibles (must be amortized).
4. Land.
5. Demolition of buildings. Add these costs to the basis of the land.
6. Leased property.

Business Expenses Depreciation

Basis of depreciable property. To figure the depreciation deduction, first determine the basis of the property.

Cost as basis. The basis of property purchased is its cost plus amounts paid for items such as sales tax, freight charges, and installation and testing fees. The cost includes the amount paid in cash, debt obligations, other property, or services.

Property changed from personal use. If property held for personal use is later converted to use in a business or income-producing activity, the depreciable basis is the lesser of the following:

1. The fair market value (FMV) of the property on the date of the change in use.
2. The original cost or other basis adjusted as follows.
 - ▶ Increased by the cost of any permanent improvements or additions and other costs that must be added to basis.
 - ▶ Decreased by any deductions claimed for casualty and theft losses and other items that reduced the basis.

When to begin depreciation. Begin depreciating property when it is placed in service for use in a trade or business or for the production of income.

Placed in service. A property is placed in service when it is ready and available for a specific use, even if it is not actually being used.

Business Expenses Depreciation

Idle property. Continue to claim a deduction for depreciation on property used in a business or for the production of income even if it is temporarily idle (not in use).

Special depreciation allowance for certain property. For certain qualified property acquired after September 27, 2017 and before January 1, 2023, a T/P can take an additional 100% special allowance. The allowance is an additional deduction taken **after** any section 179 deduction and **before** figuring regular depreciation under MACRS. Qualified property is one of the following.

- ▶ Tangible property depreciated under MACRS with a recovery period of 20 years or less.
- ▶ Computer software defined in and depreciated under section 167(f)(1) of the IRC.
- ▶ Water utility property.
- ▶ Qualified film, television, and live theatrical productions, as defined in sections 181(d) and (e) of the IRC.
- ▶ A specified plant for which the T/P made the election to apply section 168(k)(5) for the tax year in which the plant is planted or grafted.
- ▶ It is not excepted property.

Electing out of the special depreciation allowance. A T/P can elect, for any class of property, to not deduct any special depreciation for all such property during the tax year. To make the election, attach a statement with the return.

Business Expenses Depreciation

Modified Accelerated Cost Recovery System (MACRS)

Applies to all tangible property placed in service after 1986. Two systems for depreciating property:

1. Regular MACRS also called the General Depreciation System applies to most properties.
2. Alternate MACRS (ADS).

Property classes under regular MACRS:

3-year property. Includes tractor units and race horses over 2 years old.

5-year property. Includes trucks, computers, office machinery, and automobiles.

7-year property. Includes office furniture and fixtures and any property that does not have a class life.

10-year property. Includes vessels, barges, and similar water transportation equipment, and trees or vines bearing fruit or nuts.

15-year property. Includes certain depreciable improvements made directly to land or added to it, such as shrubbery, fences, roads, and bridges.

20-year property. Includes municipal sewers and farm buildings.

Residential rental property. Depreciated over 27.5 years.

Nonresidential real property. Includes sec. 1250 property; depreciated over 39 years.

Business Expenses

Depreciation

Regular MACRS (cont.)

Conventions

- ▶ **Half-year convention.** Use this convention to figure depreciation for property other than nonresidential real and residential rental property. This convention treats all property placed in service, or disposed of, during the tax year as placed in service, or disposed of, on the midpoint of that tax year.
- ▶ **Mid-quarter convention.** Use this convention if total depreciable bases of MACRS property placed in service during the last three months of the tax year exceed 40% of the total depreciable bases of all property placed in service that year.
- ▶ **Mid-month convention.** Use this convention for all nonresidential real and residential rental property. Treat property placed in service, or disposed of, during any month as placed in service, or disposed of, on the midpoint of that month.

Depreciation Methods

MACRS provides three depreciation methods under GDS and one depreciation method under ADS.

- ▶ The 200% declining balance method over a GDS recovery period.
- ▶ The 150% declining balance method over a GDS recovery period.
- ▶ The straight line method over a GDS recovery period.
- ▶ The straight line method over an ADS recovery period.

Business Expenses Depreciation

Alternate MACRS (ADS)

Under this method, depreciation is figured using the straight line method but over alternate MACRS recovery period.

Property	Recovery Period	Convention
Residential rental property	30 years	Mid-month
Nonresidential real property	40 years	Mid-month
Autos & trucks	5 years	Half-year, or mid-quarter
Single purpose agricultural & horticultural structures	15 years	Half-year, or mid-quarter
Trees or vines bearing fruit or nuts	20 years	Half-year, or mid-quarter

Election. Make the election to use the alternate MACRS by the tax return due date (including extensions) for the year property is placed in service. Once the election is made to use the alternate MACRS method, the T/P cannot switch to any other method.

Business Expenses Depreciation

Alternative MACRS (ADS) (cont.)

ADS must be used for the following properties:

1. Nonresidential real property, residential real property, and qualified improvement property held by an electing real property trade or business (as defined in section 163(j)(7)(B) of the IRC).
2. Any property with a recovery period of 10 years or more under the GDS held by an electing farming business (as defined in section 163(j)(7)(C) of the IRC).
3. Any tax-exempt use property.
4. Any tax-exempt bond-financed property.
5. All property used predominantly in a farming business and placed in service during any tax year in which an election is made not to apply the uniform capitalization rules to certain farming costs.
6. Any property imported from a foreign country for which an Executive Order is in effect because the country maintains trade restrictions or engages in other discriminatory acts.
7. Any tangible property used predominantly outside the U.S. during the tax year.

Accelerated Cost Recovery System (ACRS)

ACRS was used for tangible depreciable property placed in service after 1980 and before 1987.

Property placed in service in those years must continue to use ACRS to figure depreciation.

All ACRS properties use the half-year convention except 19 year real property which uses the mid-month convention.

Business Expenses Depreciation

Section 179 Deduction

By electing to take a section 179 deduction, a T/P can expense certain qualifying property instead of depreciating the property. To qualify for the section 179 deduction, the property must be 1) eligible property, 2) acquired for business use, and 3) been acquired by purchase.

Eligible property. To qualify for the section 179 deduction, the property must be one of the following types of depreciable property:

1. Tangible personal property.
2. Other tangible property (except buildings and their structural components) used as:
 - a. An integral part of manufacturing, production, or extraction or of furnishing transportation, communications, electricity, gas, water, or sewage disposal services,
 - b. A research facility used in connection with any of the activities in (a) above, or
 - c. A facility used in connection with any of the activities in (a) for the bulk storage of fungible commodities.
3. Single purpose agricultural (livestock) or horticultural structures.
4. Storage facilities (except buildings and their structural components) used in connection with distributing petroleum or any primary product of petroleum.
5. Off-the-shelf computer software.
6. Qualified section 179 real property (e.g., Improvements to nonresidential real property placed in service after the date the nonresidential real property was first placed in service).

Business Expenses Depreciation

Section 179 Deduction (cont.)

Property not eligible. The following properties do not qualify for the section 179 deduction.

- ▶ Land and land improvements including buildings, paved parking areas and fences.
- ▶ Certain property leased to others (if T/P is a noncorporate lessor).
- ▶ Property used predominantly outside the U.S. except property described in section 168(g)(4) of the IRC.
- ▶ Property used by certain tax-exempt organizations, except property used in connection with the production of income subject to the tax on unrelated trade or business income.
- ▶ Property used by governmental units or foreign persons or entities, except property used under a lease with a term of less than 6 months.
- ▶ Property acquired from a related person.

Partial business use. To elect the section 179 deduction, more than 50% of the properties' use must be for trade or business. If property is used for both business and personal, allocate the cost of the property to reflect only the business use by multiplying the cost by the percentage of business use.

Trade-in of other property. If the qualifying property was purchased with cash and a trade-in, its cost for purposes of the section 179 deduction includes only the cash paid.

Business Expenses Depreciation

Section 179 Deduction (cont.)

Deduction limit. For 2022, the maximum section 179 expense deduction is \$1,080,000.

Investment limit. For each dollar that the cost for section 179 property is over \$2,700,000, reduce the \$1,080,000 limit by one dollar. If the cost of section 179 property placed in service during the tax year is \$3,780,000 or more, no section 179 deduction is allowed.

Taxable business income limit. The total amount expensed cannot exceed the taxable income from all trade and businesses for that year. Excess amount must be carried over to the next year and figured into the section 179 deduction for that year.

Depreciation limits on cars, trucks, and vans. The first-year limit on the total amount of section 179 deduction, special depreciation allowance, and depreciation deduction that can be claimed for passenger autos, including trucks and vans and placed in service in 2022 is \$19,200 (\$11,200 if electing not to claim the special depreciation allowance). The maximum section 179 expense deduction for sport utility vehicles placed in service in tax years beginning in 2022 is \$27,000.

Election. To take the section 179 deduction, complete Part I of Form 4562.

Business Expenses Depreciation

Section 179 Deduction (cont.)

Place in service rule. For purposes of the section 179 deduction, a property is placed in service in the tax year if it is first made ready and available for a specific use. For example, if the property is first made ready and available in 2021 but is not actually used until 2022, the property is considered placed in service in 2021.

Partnerships and partners. The section 179 deduction limits apply both to the partnership and to each partner. The partnership determines its section 179 deduction subject to the limits. It then allocates the deduction among its partners. Each partner adds the amount allocated from partnerships to his or her nonpartnership section 179 costs and then applies the dollar limit to this total. To determine any reduction in the dollar limit for costs over \$2,700,000, the partner does not include any of the cost of section 179 property placed in service by the partnership. After the dollar limit (reduced for any nonpartnership section 179 costs over \$2,700,000) is applied, any remaining cost of the partnership and nonpartnership section 179 property is subject to the business income limit.

S corporation and shareholders. Generally, the rules that apply to a partnership and its partners also apply to an S corporation and its shareholders.

Business Expenses Depreciation

Section 179 Deduction (cont.)

Section 179 recapture. A T/P may have to recapture the section 179 deduction if, in any year during the property's recovery period, the business use drops to 50% or less. In the year the business use drops to 50% or less, the T/P must report as ordinary income the difference between the amount taken as a section 179 deduction and the amount of depreciation that would have been allowable on the property.

Where to figure and report recapture. Use Form 4797, Part IV, to figure the recapture amount. Report the recapture amount as other income on the same form or schedule used to take the depreciation deduction. For example, report the recapture amount as other income on Schedule C (Form 1040 or 1040-SR) if the depreciation deduction was taken on Schedule C. If the depreciation deduction was taken on Form 2106, report the recapture amount on Schedule 1 (Form 1040 or 1040-SR), other income, line 8.

Business Expenses Amortization

Section 197 Intangibles

Section 197 intangibles acquired after August 10, 1993, must be amortized over 15 years. The following assets are section 197 intangibles:

1. Goodwill.
2. Going concern value.
3. Workforce in place.
4. Business books and records, operating systems, or any other information base, including lists or other information concerning current or prospective customers.
5. A patent, copyright, formula, process, design, pattern, know-how, format, or similar item.
6. A customer-based intangible.
7. A supplier-based intangible.
8. A license, permit, or other right granted by a governmental unit or agency (including issuances and renewals).
9. A covenant not to compete entered into in connection with the acquisition of an interest in a trade or business.
10. A franchise, trademark, or trade name.

Business Expenses Depletion

Depletion is the using up of natural resources by mining, quarrying, drilling, or felling. The depletion deduction allows an owner or operator to account for the reduction of a product's reserves. Depletion can be deducted for mineral property or standing timber.

Mineral property includes oil and gas wells, mines, and other natural deposits (including geothermal deposits). There are two ways of figuring depletion on mineral property:

- ▶ Cost depletion.
- ▶ Percentage depletion.

Use the method that gives the larger deduction. However, unless T/P is an independent producer or royalty owner, T/P generally cannot use percentage depletion for oil and gas wells.

Timber. Figure timber depletion only by the cost method. Percentage depletion does not apply to timber.

Businesses Limitation on Losses

Net Operating Loss (NOL)

If a T/P's business deductions are more than business income, the T/P may have an NOL. Examples of typical losses include, but are not limited to, losses from the following:

1. A trade or business.
2. Unreimbursed employee business expenses (only for employees still eligible to take employee business expenses).
3. Casualty and theft losses resulting from a federally declared disaster.
4. Moving expenses (only for member of the Armed Forces on active duty that qualify to deduct moving expenses).
5. Rental property.

Figuring an NOL. Separate business income and deductions from non-business income and deductions.

Business income (for purposes of figuring an NOL):

1. Gross receipts from trade or business.
2. Salary or wages earned.
3. Share of income from partnerships or S corporations.
4. Rental income.
5. Gain from the sale or exchange of depreciable property or real estate used in business.

Businesses Limitation on Losses

Net Operating Loss (cont.)

Business deductions. The following are deductions that are connected to a trade or business:

1. If itemizing deductions, casualty and theft losses resulting from a federally declared disaster (even if nonbusiness property).
2. Moving expenses for members of the Armed Forces on active duty.
3. State income tax on income attributable to trade or business (including wages, salary, and unemployment compensation).
4. Rental losses.
5. Loss on sale or exchange of business real estate or depreciable property.
6. Loss on the sale of accounts receivable (if an accrual basis T/P).
7. The deduction of the deductible part of self-employment tax or self-employment health insurance.
8. Business loss from a partnership or S corporation.
9. Interest and litigation expenses on state and federal income taxes related to business.
10. Unrecovered investment in a pension or annuity claimed on a decedent's final return.
11. Loss on the sale of stock in a small business corporation, up to ordinary loss.
12. Ordinary loss on the sale or exchange of section 1244 (small business) stock.
13. Educator expenses.

Businesses

Limitation on Losses

Net Operating Loss (cont.)

Figure an NOL without deducting the following items:

1. Capital losses in excess of capital gains.
2. The section 1202 exclusion of the gain from the sale or exchange of qualified small business stock.
3. Nonbusiness deductions in excess of nonbusiness income.
4. Net operating loss deduction.
5. The section 199A deduction for qualified business income.

Non business income:

- ▶ Dividends.
- ▶ Interest.
- ▶ Annuities.
- ▶ Income from endowments.

Non business deductions:

- ▶ Alimony paid.
- ▶ IRA and self-employment retirement plans deductions.
- ▶ HSA and Archer MSA deductions.
- ▶ Most itemized deductions (except casualty and theft losses, state income tax on business income, and any employee business expenses).
- ▶ The standard deduction.
- ▶ Charitable deduction if taking the standard deduction.

Businesses Limitation on Losses

Net Operating Loss (cont.)

How to figure an NOL: $\text{Business Income} - \text{Business Deductions} = \text{NOL}$

Ignore NOL carryover from previous years when computing NOL.

When to use an NOL:

- ▶ Carryback: No carrybacks
- ▶ Carryforward: Indefinitely

Exceptions to the No Carryback Rule. Farming losses qualify for a 2-year carryback period. Only the farming loss part of an NOL can be carried back 2 years.

Farming loss. A farming loss is the smaller of:

1. The amount that would be the NOL for the tax year if only income and deductions attributable to farming businesses were taken into account, or
2. The NOL for the tax year.

NOL limitation. The NOL deduction cannot exceed 80% of taxable income (determined without any NOL deduction) for losses arising in tax years beginning after 2017.

Waiving the carryback period. A T/P can choose not to carry back an NOL due to farming losses. If this choice is made, carry the NOL forward indefinitely until it is used. To make this choice, attach a statement to the original return filed by the due date (including extensions) for the NOL year. This statement must show that the T/P is choosing to waive the carryback period under section 172(b).

Businesses Limitation on Losses

Not for Profit Activities

These activities are considered hobbies and the losses are limited to the income from such activities. The losses cannot be used to offset other income. In determining whether a T/P is carrying on an activity for profit, several factors are taken into account. No one factor alone is decisive. Among the factors to consider are whether:

- ▶ The activity was carry on in a businesslike manner.
- ▶ The time and effort put into the activity.
- ▶ The T/P depends on the income for his or her livelihood.
- ▶ Losses are due to circumstances beyond the control of the T/P (or are normal in the start-up phase of that type of business).
- ▶ Changes in methods of operation are made in an attempt to improve profitability.
- ▶ The T/P (or advisors) have the knowledge needed to carry on the activity as a successful business.
- ▶ The T/P was successful in making a profit in similar activities in the past.
- ▶ The activity makes a profit in some years.
- ▶ The T/P can expect to make a future profit from the appreciation of the assets used in the activity.

Businesses

Limitation on Losses

Not for Profit Activities (cont.)

Presumption that an activity is for profit. An activity is presumed to be carried on for profit if it produced a profit in at least:

- ▶ 3 of the last 5 years, or
- ▶ 2 of the last 7 years for activities in breeding, training, showing or racing horses.

Form 5213. By filing Form 5213, a T/P can postpone any determination that the activity is not carried on for profit until 5 (or 7) years have passed since starting the activity. The benefit gained by making this election is that the IRS will not immediately question whether the activity is engaged in for profit.

Limit on deductions. Deductions taken for personal as well as for business activities are allowed in full. For individuals, all nonbusiness deductions, such as those for home mortgage interest, taxes, and casualty losses (attributed to a federally declared disaster) may also be deducted. Miscellaneous itemized deductions subject to the 2% of AGI are no longer deductible.

The limit on not-for-profit losses applies to individuals, partnerships, estates, trusts, and S corporations. It does not apply to corporations other than S corporations.

Partnerships and S corporations. If a partnership or S corporation carries on a not-for-profit activity, these limits apply at the partnership or S corporation level. They are reflected in the individual shareholder's or partner's distributive shares.

Businesses Limitation on Losses

At-Risk Limits

The at-risk rules limit losses from most activities to the loss or the amount at risk, whichever is less.

Amount at risk:

1. The money and adjusted basis of property contributed to the activity, and
2. Amounts borrowed for use in the activity are at-risk if:
 - a) T/P is personally liable for repayment, or
 - b) T/P pledges property (other than property used in the activity) as security for the loan.

Amounts borrowed. The loan cannot be nonrecourse (T/P is not personally liable and lender's only recourse is to T/P's interest in the activity) or from a relative or persons having an interest in the activity (other than a creditor).

Note: Apply the at-risk rules before the passive activity rules discussed in the next card.

Businesses Limitation on Losses

Passive Activity Limits

Two types of passive activities:

1. Trade or business activity in which T/P does not materially participate.
2. Rental activity, even if materially participated in them, unless a real estate professional.

Loss limits. Deduct losses up to income from passive activities. Cannot offset income, other than passive income, with losses from passive activities.

Exception: Deduct up to \$25,000 (\$12,500 for MFS) of losses from rental real estate, in which T/P actively participated, from non-passive income.

Note: First determine the amount at risk, before using the passive activity rules.

Material participation. A trade or business activity is not a passive activity if T/P materially participated in the activity.

Material participation tests. A T/P materially participated in a trade or business activity for a tax year if any of the following tests is met:

1. T/P participated in the activity for more than 500 hours.
2. T/P participation was substantially all the participation in the activity of all individuals for the tax year, including the participation of individuals who did not own any interest in the activity.

Continued on next card

Businesses Limitation on Losses

Passive Activity Limits (cont.)

Material participation tests (cont.)

3. T/P participated in the activity for more than 100 hours during the tax year, and participated at least as much as any other individual (including individuals who did not own any interest in the activity) for the year.
4. The activity is a significant participation activity, and T/P participated in all significant participation activities for more than 500 hours. A significant participation activity is any trade or business activity in which T/P participated for more than 100 hours during the year and in which T/P did not materially participate under any of the material participation tests, other than this test.
5. T/P materially participated in the activity for any 5 (whether or not consecutive) of the 10 immediately preceding tax years.
6. The activity is a personal service activity in which T/P materially participated for any 3 (whether or not consecutive) preceding tax years. An activity is a personal service activity if it involves the performance of personal services in the fields of health (including veterinary services), law, engineering, architecture, accounting, actuarial science, performing arts, consulting, or any other trade or business in which capital is not a material income-producing factor.
7. Based on all the facts and circumstances, T/P participated in the activity on a regular, continuous, and substantial basis during the year.

Types of General Business Credits

1. **Credit for employer-provided childcare facilities and services (Form 8882).** The credit is 25% of qualified expenses an employer pays for childcare and 10% of qualified expenses paid for childcare resources and referral services. This credit is limited to \$150,000 each year.
2. **Credit for increasing research activities (Form 6765).** The credit is 20% of the amount by which research expenses for the year are more than the average base period amount.
3. **Credit for small employer pension plan startup costs (Form 8881).** This credit applies to pension plan setup costs. The credit equals 50% of the cost to set up and administer the plan, up to \$500 per year for each of the first 3 years of the plan. A T/P can choose to start claiming the credit in the tax year before the tax year in which the plan becomes effective.
4. **Disabled access credit (Form 8826).** An eligible small business is entitled to a nonrefundable disabled access credit for expenditures incurred to make a business accessible to disabled individuals. The amount of the credit is 50% of the amount the expenditures for a year that are more than \$250 but not more than \$10,250. For purposes of the credit, an eligible small business is any business or person that:
 - a. Had gross receipts for the preceding tax year that did not exceed \$1 million or had no more than 30 full-time employees during the preceding tax year, and
 - b. Elects (by filing Form 8826) to claim the disabled access credit for the tax year.

Continued on next card

Types of General Business Credits (cont.)

5. ***Credit for small employer health insurance premiums (Form 8941).*** The maximum credit is 50% (35% for tax-exempt small employers) of premiums paid. The credit is claimed as part of the general business credit on Form 3800. An eligible small employer is an employer with fewer than 25 full-time employees and the average wages for the tax year is less than \$58,000 per employee.
6. ***Work opportunity credit (Form 5884).*** An employer can take this credit for qualified first-year wages paid to the following targeted groups:
- | | |
|---|---|
| 1. Qualified recipient of Temporary Assistance for Needy Families (TANF). | 6. A qualified summer youth employee. |
| 2. A qualified veteran. | 7. Designated community resident. |
| 3. A qualified ex-felon. | 8. An SSI recipient. |
| 4. Long-term family assistance recipient. | 9. Supplemental Nutrition Assistance Program (SNAP) benefits (food stamps) recipient. |
| 5. A vocational rehabilitation referral. | |

Limitations on business credits. The general business credit is limited to T/P's net income tax minus the larger of:

1. Tentative minimum tax, or
2. 25% of income tax liability that is more than \$25,000.

Carryback and carryforward unused credit. Carry unused credit back one year. Remaining amount is carried forward 20 years.

Form 720. The federal excise taxes reported on Form 720, Quarterly Federal Excise Tax Return, consist of several broad categories of taxes, including the following:

1. Fuel taxes.
2. Communications and air transportation taxes.
3. Retail tax on heavy trucks, trailers, and tractors.
4. Environmental taxes on crude oil and petroleum products, the sale or use of ozone-depleting chemicals and imported products containing or manufactured with these chemicals.
5. Manufacturers taxes on the sales or use of a variety of different articles.

When to file Form 720. Form 720 is required to be filed for each quarter of the calendar year on the following dates:

<u>Quarter covered</u>	<u>Due date</u>
January - March	April 30
April - June	July 31
July - September	October 31
October - December	January 31

Payment of taxes. Generally, semimonthly deposits of excise taxes are required. A semimonthly period is the first 15 days of a month (the first semimonthly period) or the 16th through the last day of a month (the second semimonthly period). However, no deposit is required for the situations listed below; the taxes are payable with Form 720:

- ▶ The net liability for taxes listed in Part I (Form 720) does not exceed \$2,500 for the quarter.
- ▶ The gas guzzler tax is being paid on a one-time filing.
- ▶ The liability is for taxes listed in Part II (Form 720), except for the floor stocks tax which generally requires a single deposit.

When to make deposit. There are two methods for determining deposits: the regular method and the alternative method.

Regular method. The deposit of tax for a semimonthly period is due by the 14th day following that period. Generally, this is the 29th day of a month for the first semimonthly period and the 14th day of the following month for the second semimonthly period.

Alternative method. Deposits of communications and air transportation taxes may be based on taxes included in amounts billed or tickets sold during a semimonthly period instead of on taxes actually collected during the period. Under the alternative method, the tax included in amounts billed or tickets sold during a semimonthly period is considered collected during the first 7 days of the second following semimonthly period. The deposit of tax is due by the 3rd banking day after the 7th day of that period.

Highway Use Tax

Form 2290

Vehicles subject to the tax. A truck or truck tractor is subject to the highway use tax if it meets all the following tests:

1. It is a highway motor vehicle.
2. It is required to be registered for highway use.
3. It is used on a public highway.
4. It has a taxable gross weight of at least 55,000 pounds.

Note: If the vehicle is expected to be used for 5,000 miles or less (7,500 miles or less for agricultural vehicles) the highway use tax liability may be suspended during that particular tax period. Form 2290 must still be filed and T/P must sign the Statement in Support of Suspension of Tax. The vehicle will be exempt from the use tax if its public highway use does not exceed 5,000 miles during the tax period.

Filing Form 2290. Form 2290, Heavy Highway Vehicle Use Tax Return, must be filed by the last day of the month after the month the vehicle is first used on the public highways. The tax period runs from July 1 of the current year through June 30 of the next year. File a single return for all vehicles first used in the same month.

Required e-filing. If reporting 25 or more trucks on a return (Form 2290), T/P must file electronically.

Paying the tax. The tax must be paid when filing Form 2290 or the T/P can elect to make payment in four equal installments.

Purchase of Property

Cost basis. The cost basis of property is the amount of cash paid and the FMV of other property or services provided in the transaction. The following must also be included in the basis:

1. Sales and excise taxes on the purchase.
2. Freight charges to obtain the property.
3. Installation and testing charges.
4. Excise taxes.
5. Legal and accounting fees (when they must be capitalized).
6. Revenue stamps.
7. Recording fees.
8. Real estate taxes (if assumed for the seller).

Business Assets Basis

Purchase of Real Property

If property purchased is real property the following fees and other expenses are part of the basis in the property:

1. Real estate taxes owed by the seller paid by the buyer.
2. Assumption of existing mortgage. Basis includes amount paid on the mortgage assumed.
3. Settlement costs. The following are some of the settlement costs included in basis:
 - ▶ Abstract fees.
 - ▶ Charges for installing utility services.
 - ▶ Surveys.
 - ▶ Transfer taxes.
 - ▶ Title insurance.
 - ▶ Recording fees.
 - ▶ Legal fees (including title search and preparing sales contract and deed).
 - ▶ Any amounts the seller owes the purchaser pays such as back taxes, closing costs, commissions, interest, etc.

Settlement costs do not include amounts placed in escrow for future payments such as taxes and insurance. The following settlement costs cannot be included in the basis of the property:

1. Casualty insurance premiums.
2. Rent for occupancy of the property before closing.
3. Charges for utilities or other services relating to occupancy of the property before closing.
4. Charges connected with getting a loan, such as points, mortgage insurance premiums, loan assumption fees, cost of a credit report, and fees for an appraisal required by lender.
5. Fees for refinancing a mortgage.

Property Received by Gift

Figuring the basis. The following three amounts must be known to figure the basis:

1. FMV of property at time of gift.
2. Adjusted basis in hand of donor.
3. Amount of gift tax paid.

FMV less than donor's adjusted basis:

1. Basis is donor's adjusted basis in figuring depreciation and gain when sold.
2. Basis is FMV when figuring loss when sold.

FMV equal to or more than the donor's adjusted basis:

1. Basis is donor's adjusted basis, and
2. Part of the gift tax paid, depending on the date of gift:
 - a) Gift received before 1977: Increase basis by the total gift tax paid.
 - b) Gift received after 1976: Increase basis by part of the gift tax paid:
$$\text{Donee's basis} = \text{Donor's adj. basis} + \text{gift tax} \times ((\text{FMV} - \text{Donor's adj. basis}) \div (\text{FMV} - \text{the annual gift tax exclusion for the year of the gift}))$$

Inherited Property

Basis in property inherited from a decedent is generally one of the following:

1. FMV at the date of the decedent's death.
2. FMV at the alternative valuation date, if the estate elects to use alternative valuation on the federal estate tax return.
3. The value under the special-use valuation method for real property used in farming or a closely held business if chosen for estate tax purposes.
4. The decedent's adjusted basis in land to the extent of the value excluded from the decedent's taxable estate as a qualified conservation easement.

Note: If a federal estate tax return does not have to be filed, basis in the property is its appraised value at the date of death for state inheritance or transmission taxes.

Appreciated property. The above rule does not apply to appreciated property received from a decedent if a T/P or T/P's spouse originally gave the property to the decedent within 1 year before the decedent's death. T/P's basis in this property is the same as the decedent's adjusted basis in the property immediately before his or her death, rather than its FMV. Appreciated property is any property whose FMV on the day it was given to the decedent is more than its adjusted basis.

Inherited Property (cont.)

Community property. In community property states (AZ, CA, ID, LA, NV, NM, TX, WA, & WI), married individuals are each usually considered to own half the community property. When either spouse dies, the total value of the community property, even the part belonging to the surviving spouse, generally becomes the basis of the entire property. For this rule to apply, at least half the value of the community property interest must be includable in the decedent's gross estate, whether or not the estate must file a return.

Qualified joint interest. Include one-half of the value of a qualified joint interest in the decedent's gross estate. It does not matter how much each spouse contributed to the purchase price. Also, it does not matter which spouse dies first. A qualified joint interest is any interest in property held by married individuals as either of the following.

- ▶ Tenants by the entirety, or
- ▶ Joint tenants with right of survivorship if the married couple are the only joint tenants.

Basis. The surviving spouse's basis in the property owned with his or her spouse as a qualified joint interest is the cost of the surviving spouse's half of the property with certain adjustments. Decrease the cost by any deductions allowed to the surviving spouse for depreciation and depletion. Increase the reduced cost by the basis in the half inherited.

Business Assets Basis

Property Received for Services

Property received for services must be included in income at its FMV. The FMV becomes the basis in the property. If the services were performed for a price agreed on beforehand, it will be accepted as the FMV of the property if there is no evidence to the contrary.

Property purchased from employer below FMV. Include in income the difference between the purchase price and the FMV.

Exception: The difference represents a qualified employee discount.

Restricted property. If property received for services is subject to certain restrictions, the basis in the property is its FMV when it becomes substantially vested unless the T/P makes a section 83(b) election. The property is substantially vested when it is transferable or not subject to a risk of forfeiture (losing the property).

Section 83(b) election. The T/P can choose under IRC section 83(b) to include the property in income in the year of transfer. If the election is taken the basis of the property will be the FMV at the date of transfer.

Involuntary Conversions

If property is received as a result of an involuntary conversion, such as a casualty, theft, or condemnation, figure the basis of the replacement property receive using the basis of the converted property.

Similar or related property. If the replacement property is similar or related in service or use to the converted property, the replacement property's basis is the old property's basis on the date of the conversion. However, make the following adjustments.

1. Decrease the basis by the following.
 - ▶ Any loss recognized on the conversion, and
 - ▶ Any money received that was not spend on similar property.
2. Increase the basis by the following.
 - ▶ Any gain recognized on the conversion, and
 - ▶ Any cost of acquiring the replacement property.

Money or property not similar or related. If a T/P received money or property not similar or related in service or use to the converted property, and the T/P buys replacement property similar or related in service or use to the converted property, the basis of the new property is its cost decreased by the gain not recognized on the conversion.

Allocating the basis. If purchasing more than one piece of replacement property, allocate the basis among the properties based on their respective costs.

Business Assets Basis

Property Changed to Business or Rental Use

Basis for depreciation. The basis for depreciation is the lesser of the following amounts.

- ▶ The FMV of the property on the date of the change, or
- ▶ The adjusted basis on the date of the change.

Basis for the sale of the property. The basis for depreciation is the lesser of the following amounts.

- ▶ The FMV of the property on the date of the change, or
- ▶ The adjusted basis on the date of the change.

Basis for the sale of the property. The basis of the property sold will depend on whether the taxpayer is figuring a gain or loss.

Gain. The basis for figuring a gain is the adjusted basis when the property is sold.

Loss. Figure the basis for a loss by starting with the smaller of the adjusted basis or the FMV of the property at the time of the change to business or rental use. Then adjust this amount for the period after the change in the property's use to arrive at a basis for loss.

Nontaxable Exchanges

A nontaxable exchange is an exchange of real property used in a business or held for investment for other real property used for business or investment real property of a like-kind.

Like-kind exchanges. To be nontaxable, a like-kind exchange must meet all of the following conditions:

1. Both the property transferred and the property received must be real property used in a trade or business or investment property.
2. The real property must not be held primarily for sale.
3. There must be an exchange of like-kind real property.
4. Real property to be received must be identified within 45 days after the date of transfer of the real property given up in the exchange.
5. The exchange must be completed on or before the earlier of:
 - a) The 180th day after the date the property being exchanged was transferred, or
 - b) The due date, including extensions, for filing that year's tax return.

Basis in property received. The basis of the property received is the same as the basis of the property given up.

Nontaxable Exchanges (cont.)

Like-kind exchanges. The following are examples of like-kind exchanges:

1. An exchange of one rental property (such as an apartment house) with another rental property (such as rented store building).
2. An exchange of city property for farm land.
3. An exchange of improved real property for unimproved real property.
4. An exchange of real estate owned for a real estate lease that runs 30 years or more.

Not like-kind property. The rules of like-kind exchanges do not apply to the following property:

1. Real property used for personal purposes such as a home.
2. Real property held primarily for sale.
3. Any personal or intangible property.

Basis of property. The basis of real property received in a nontaxable exchange is the same as the basis of the property exchanged:

1. Decreased by any money received and any loss recognized on the exchanged, and
2. Increased by any additional cost incurred and any gain recognized on the exchange.

Stock Dividends, Rights, and Splits

Basis of stock. The basis is the purchase price plus the cost of the purchase such as commissions or recording fees.

Taxable distribution. The basis in a taxable stock dividend or stock right is its FMV at the time of the distribution.

Nondividend distribution. Considered a return of capital; reduce basis by distribution amount.

Stock dividend or split. The basis per share of stock must be adjusted if additional stock is received through stock dividend or splits.

Example: Purchased 50 shares of ABC Corp stock for \$1,500 or \$30 a share in 2019.

Purchased 100 shares of ABC Corp stock for \$4,500 or \$45 a share in 2020.

ABC declares a 3-for-2 stock split in 2022.

Basis in stock in 2022:

$50 \times 3/2 = 75$ shares with a basis of $\$1,500 \div 75 = \20 a share

$100 \times 3/2 = 150$ shares with a basis of $\$4,500 \div 150 = \30 a share

Note: The total basis amount does not change.

Business Assets Basis

Property Transfers Between Spouses

No gain or loss is recognized on a transfer of property from an individual to (or in trust for the benefit of) a spouse, or if incident to a divorce, a former spouse. This nonrecognition rule does not apply in the following situations:

- ▶ The recipient spouse or former spouse is a nonresident alien.
- ▶ Property is transferred in trust. Gain must be recognized to the extent the amount of the liabilities assumed by the trust, plus any liabilities on the property, exceed the adjusted basis of the property.

Basis in property. The transferee's basis in the property will be the same as the adjusted basis of the transferor. However, for property transferred in trust, the basis is adjusted for any gain recognized by the transferor if the liabilities assumed, plus the liabilities to which the property is subject, are more than the adjusted basis of the property transferred.

Intangible Assets

Intangible assets include goodwill, patents, copyrights, trademarks, trade names, and franchises. The basis of an intangible asset is usually the cost to buy or create it.

Business Assets Basis

Adjustments to Basis

Increases to basis:

1. Cost of improvements that add to the value of the property.
2. Rehabilitation expenses.
3. The cost of extending utility service lines to the property.
4. Legal fees, such as the cost of defending and perfecting title.
5. Legal fees for obtaining a decrease in an assessment levied against property.
6. Zoning costs.
7. Assessments for local improvements.

Decreases to basis:

- | | |
|--|--|
| 1. Section 179 deduction. | 8. Rebates received from the manufacturer or seller. |
| 2. Nontaxable corporate distribution. | 9. Investment credit (part or all of credit) taken. |
| 3. Recognized losses on involuntary exchanges. | 10. Postpone gain from sale of home. |
| 4. Deduction for allowed or allowable depreciation, amortization, and depletion. | 11. Certain canceled debt excluded from income. |
| 5. Casualty and theft losses. | 12. Rebates treated as adjustments to the sales price. |
| 6. Easements. | |
| 7. Residential energy credit. | |

Business Assets Basis

Allocating the Basis

Trade or business acquired. If a trade or business is acquired, allocate the purchase price to the various assets acquired. Allocate the business assets received in proportion to (but not more than) their fair market value in the following order:

1. Cash, demand deposits, and similar accounts.
2. Certificates of deposits, U.S. Government securities, readily marketable stock or securities, and foreign currency.
3. Property that would be included in inventory or held for sale to customers.
4. Accounts receivable, mortgages, and credit card receivables that arose in the ordinary course of business.
5. All other assets except section 197 intangibles, goodwill, and going concern value.
6. Section 197 intangibles except goodwill and going concern value.
7. Goodwill and going concern value (whether or not they qualify as section 197 intangibles).

Reporting requirement. Both the buyer and seller involved in the sale of business assets must report to the IRS the allocation of the sales price among section 197 intangibles and the other business assets. Use Form 8594 to provide this information. The buyer and seller should each attach Form 8594 to their federal income tax return for the year in which the sale occurred.

Sale of Business Property

Section 1231 Property

Section 1231 property. Property used in a trade or business and held for more than one year.

Gains and losses. Net section 1231 gains are treated as long-term capital gains. Net section 1231 losses are treated as ordinary losses.

Recapture of net ordinary losses. A net section 1231 gain is treated as ordinary income up to non-recaptured net section 1231 losses taken in prior years. Any net gains in excess of recaptured net losses in prior years are treated as long-term capital gains.

Nonrecaptured section 1231 losses. Net section 1231 losses deducted for the previous five tax years that have not yet been applied against a net section 1231 gain.

Section 1231 transactions. The following transactions result in gain or loss subject to section 1231 treatment:

1. Sales or exchanges of real property or depreciable personal property.
2. Sales or exchanges of leaseholds.
3. Sales or exchanges of cattle and horses (held longer than 2 years). Does not include poultry.
4. Sales or exchanges of other livestock.
5. Sales or exchanges of unharvested crops.
6. Cutting of timber or disposal of timber, coal, or iron ore.
7. Condemnations.
8. Casualties and thefts.

Sale of Business Property

Section 1245 Property

Section 1245 property. Property that is or has been subject to an allowance for depreciation and that is one of the following:

1. Personal property (both tangible and intangible).
2. Other tangible property used as an integral part of manufacturing, production or extraction or furnishing transportation, communication, electricity, gas, water, or sewage disposal services; a research facility in any activity listed above; a facility in any of the activities listed above for bulk storage of fungible commodities.
3. Real property to the extent that its adjusted basis was reduced by amortization deductions for certified pollution control facilities, reforestation expenditures, on-the-job training and child care facilities, or for which a section 179 deduction was taken.
4. Single purpose agricultural (livestock) or horticultural structures.
5. Storage facilities (except buildings and their structural components) used in distributing petroleum or any primary product of petroleum.

Treatment of gain. The amount of gain treated as ordinary income is limited to the lesser of:

1. The recomputed basis (depreciation taken on the property), or,
2. The gain on the disposition (amount realized minus adjusted basis).

Sale of Business Property

Section 1250 Property

Section 1250 property. Includes all real property that is subject to an allowance for depreciation and that is not and never has been section 1245 property. It includes a leasehold of land or section 1250 property subject to an allowance for depreciation. A fee simple interest in land is not included because it is not depreciable.

Treatment of gain. The amount of gain treated as ordinary income is the excess depreciation deducted over depreciation figured using the straight line method.

Installment sales. If a T/P sells property under the installment method, any depreciation recaptured under section 1245 or 1250 is taxable as ordinary income in the year of the sale, even if no payments are received in that year.

Nontaxable Property Transactions

Like-Kind Exchanges

Like-kind exchanges between related parties. Special rules limit whether certain exchanges made between related parties are nontaxable. Under these rules, if either party disposes of the property within 2 years after the exchange, the exchange is disqualified from nonrecognition treatment. Exceptions to these rules are the following:

1. Dispositions due to the death of either related party.
2. Involuntary conversions.
3. Exchanges or dispositions if it is established that their main purpose is not the avoidance of federal income tax.

Partially nontaxable exchange. Any money or unlike property received in a like-kind exchange is taxable, but only to the extent of the gain realized in the transaction. To figure the amount of the taxable gain, first determine the FMV of any unlike property received and add it to the amount of any money received then subtract any exchange expenses paid along with the adjusted basis of the property transferred. In a like-kind, if a T/P paid any money in addition to giving up like property, there is no taxable gain or deductible loss.

Assumption of liabilities. If the other party to a nontaxable exchange assumes any liabilities on property they receive, treat this transfer of liabilities as cash received in the amount of the liability.

Final Return for Decedent (Form 1040 or 1040-SR)

Income to include. The decedent's income includible on the final return is generally determined in the same way as if the person was still alive except that the taxable period is usually shorter because it ends on the date of death. The method of accounting used by the decedent (cash or accrual method) before death also determines the income includible on the final return. If the decedent uses the cash method, only income actually or constructively received before death is included in the final return. If the decedent uses the accrual method, income is reported when earned.

Deductions. Generally, the rules for deductions allowed to an individual also apply to the decedent's final income tax return.

Standard deduction. If the decedent does not itemize deductions, the full amount of the standard deduction is allowed, regardless of the date of death.

Deduction for losses. A decedent's net operating loss deduction from a prior year and any capital losses (including capital loss carryovers) can be deducted only on the decedent's final income tax return.

Estates & Trusts

Estate Income Tax

Income Tax Return of an Estate (Form 1041)

An estate is a separate taxable entity from the decedent, and comes into being with the death of the individual. The estate exists until the final distribution of its assets to the heirs or other beneficiaries. The income earned by the property during this period must be reported by the estate on Form 1041. The tax generally is figured in the same manner as for individuals with certain differences in the computation of deductions and credits. The estate's income must be reported annually on either a calendar year or fiscal year basis. The personal representative chooses the estate's accounting period when he or she files the first Form 1041.

Filing requirements. Every domestic estate with gross income of \$600 or more must file Form 1041. If one or more of the beneficiaries of the domestic estate are nonresident alien individuals, Form 1041 must be filed even if gross income is less than \$600.

Due date. Form 1041 is due by the **15th day of the 4th month** after the end of the tax year selected by the estate. The estate's first tax year can be any period that ends on the last day of a month, and that does not exceed 12 months.

Extension of time to file. The extension of time to file an estate (other than a bankruptcy estate) or trust return is **5½ months**.

Estimated tax. Estates with tax years ending 2 or more years after the date of the decedent's death must pay estimated tax in the same manner as individuals.

Income in Respect of the Decedent

All income that the decedent would have received had death not occurred that was not included on the final return is income in respect of the decedent.

How to report. Income in respect of a decedent must be included in the gross income of:

1. The decedent's estate, if the estate receives it,
2. The beneficiary, if the right to income is passed directly to the beneficiary and the beneficiary receives it, or
3. Any person to whom the estate properly distributes the right to receive it.

Character of income. The character of the income received in respect of a decedent is the same as it would have been to the decedent if he or she were alive.

Wages. Wages and other employee compensation earned by the decedent but unpaid at the time of death is income in respect to the decedent.

Capital gains and losses. The basis used to figure gain and loss for property the estate receives from the decedent usually is the fair market value.

Life insurance proceeds. Proceeds from a decedent's life insurance policy are nontaxable.

Exemption & Deductions

Exemption deduction. An estate is allowed an exemption deduction of \$600 in computing its taxable income even if the first return covers a period of less than 12 months. No exemption for dependents is allowed.

Charitable contributions. If the will provides that contributions are to be paid out of the estate's gross income, the contribution is fully deductible by the estate.

Losses. An estate can claim a deduction for a loss from the sale of property even if the sale is to a personal representative or beneficiary of the estate.

Net operating loss deduction. An estate can claim an NOL deduction, computed in the same way as by an individual, except that it cannot deduct any distributions to beneficiaries or a charitable contribution deduction. NOL carryovers of an estate are passed through to the beneficiaries in the last year of the estate.

Carryover losses. Carryover losses resulting from NOLs or capital losses sustained by the decedent prior to death cannot be deducted on the estate's income tax return.

Exemption & Deductions (cont.)

Casualty and theft losses. Losses incurred for casualty and theft during the administration of the estate can be deducted only if they have not been claimed on the federal estate tax return (Form 706).

Administration expenses. Expenses of administering an estate can be deducted either from the gross estate in figuring the federal estate tax (Form 706) or from the estate's gross income in figuring the estate's income tax (Form 1041). However, these expenses cannot be claimed for both estate tax and income tax purposes. The rule preventing double deductions do not apply to deductions for taxes, interest, business expenses, and other items accrued at the date of death. These expenses can be deducted both in figuring the federal estate tax (Form 706) and from the estate's gross income in figuring the estate's income tax (Form 1041).

Depreciation and depletion. The allowable deductions for depreciation and depletion that accrue after the decedent's death must be apportioned between the estate and the beneficiaries depending upon the income of the estate that is allocable to each.

Distribution deduction. An estate is allowed a deduction for current distributions actually made to beneficiaries out of the estate's income. The deduction cannot exceed the distributable net income of the estate.

Estates & Trusts

Estate Income Tax

Distributions to Beneficiaries

When to report estate income. A beneficiary of an estate, that must distribute all its income currently, must report his or her share of the distributable net income whether or not it was actually received. Any other amount paid, credited, or required to be distributed to the beneficiary, must also be included in the beneficiary's gross income. Each item of income keeps the same character in the beneficiaries' hands as it had in the hands of the estate. The personal representative can elect to treat distributions paid or credited within 65 days after the close of the estate's tax year as having been paid or credited on the last day of that tax year. If this election is made, the beneficiaries must report that distribution on their return for that year. Each beneficiary who receives a distribution from the estate for the tax year or to whom any item is allocated must receive a Schedule K-1. Gifts or bequests that meet certain conditions are not taxable.

Estate tax deduction. Income that a decedent had a right to receive is included in the decedent's gross estate and is subject to estate tax. This income in respect of a decedent is also taxed when received by the recipient (estate or beneficiary). However, an income tax deduction is allowed to the recipient for the estate tax paid on the income. The recipient can take this deduction only as a itemized deduction on Schedule A (Form 1040 or 1040-SR).

Trusts

Trust. A trust is a legal entity created under state law and taxed under federal law. A trust may be created during a person's lifetime (inter vivos) or at the time of death under will (testamentary).

Irrevocable trust. An irrevocable trust is a trust cannot be modified, amended, or revoked. For tax purposes, an irrevocable trust can be treated as a simple, complex, or grantor trust, depending on the powers listed in the trust instrument.

Revocable trust. A revocable trust may be revoked and is considered a grantor trust (IRC § 676).

Living trust. A living person creates an inter vivos trust during that person's lifetime. An inter vivos trust can be established as revocable or irrevocable. An inter vivos trust can be a simple, complex, or grantor trust depending on the trust instrument.

Simple trust. A simple trust is a trust that:

1. Is required to distribute all of its income currently for the tax year.
2. Does not provide for any amounts to be paid, permanently set aside, or used for charitable contributions.
3. Does not make any distribution other than current income (i.e. does not make a distribution out of corpus).

Note: If the above requirements are not met, the simple trust becomes a complex trust. Therefore, a trust may be a simple trust for one year and a complex trust another year.

Trusts

Complex trust. A complex trust is any trust that is not a simple trust. A complex trust may accumulate income (i.e., when a trust does not pay out all of its income currently).

Grantor trust. A trust where the grantor retains excessive rights to the trust. It is not a separate legal entity for federal tax law purposes. All income and deductions are reported on the grantor's own tax return.

Grantor. The person who transfers the trust property to the trust. A trust can be formed during the grantor's lifetime or become effective only upon his or her death.

Abusive trusts. Trusts established to reduce or eliminate income taxes or self-employment taxes, pay for personal expenses, and in violations of the Internal Revenue Code are abusive trusts. The penalties for a fraudulent trust can range from 75% of underpayment of tax (fraud penalty) to \$250,000 and/or 5 year in prison (tax evasion penalties).

Exemption. A simple trust is allowed a exemption of \$300. All other trusts are allowed a deduction of \$100.

Corpus. The principal of the trust.

Trusts

Distributive net income (DNI). Distributive net income is figured the same as taxable income of a trust or estate with the following modifications:

1. The deduction for amounts paid, credited, or required to be distributed to beneficiaries is not allowed.
2. The exemption deduction is not allowed.
3. Capital gains allocated to corpus and not paid, credited, or required to be distributed to any beneficiary or permanently set aside, or to be used for charitable contributions are excluded.
4. Capital losses are excluded except to the extent that they are used to determine any capital gains that are paid, credited, or required to be distributed to any beneficiary during the tax year.
5. In the case of a simple trust, extraordinary dividends and taxable stock dividends that the fiduciary, in good faith, allocates to corpus is excluded.
6. Tax-exempt interest on state and local bonds is included.
7. Tax-exempt income from a foreign trust that is determined without regard to the provisions of section 894 (relating to income exempt under treaty), is included.

Deduction for distributions to beneficiary. A trust can deduct the amount of income that is required to be distributed to the beneficiaries. If the income required to be distributed is more than the trusts DNI, the distributive deduction is limited to the DNI.

Qualifying for exemption (Section 501(c)(3) organizations). An organization may qualify for exemption from federal income tax if it is organized and operated exclusively for one or more of the following purposes:

- ▶ Charitable
- ▶ Religious
- ▶ Educational
- ▶ Scientific
- ▶ Literary
- ▶ Public Safety testing
- ▶ Fostering national sports
- ▶ The prevention of cruelty to children or animals

Qualification of organization. To be tax-exempt an organization must be one of the following:

1. A corporation (including an LLC).
2. Unincorporated association.
3. A trust.

Note: Sole proprietorships, partnerships, individuals, or loosely associated groups of individuals do not qualify.

Application for recognition of exemption. Most organizations will not be treated as tax-exempt unless they apply for recognition of exemption by filing Form 1023, Application for Recognition of Exemption. They must file Form 1023 within 27 months from the end of the month they first organized.

Required inclusions. Along with the application (Form 1023), the organization must attach the following information:

1. ***Employer identification number (EIN).*** Every exempt organization must have an EIN.
2. ***Organizing documents.*** Each application for exemption must be accompanied by a conformed copy of the organization's Articles of Incorporation (and the Certificate of Incorporation, if available), Articles of Association, Trust Indenture, Constitution, or other enabling document. A **conformed copy** is a copy that agrees with the original and all amendments to it. If the organization does not have an organizing document, it will not qualify for exemption.
3. ***Bylaws.*** Bylaws alone are not organizing documents. However, if the organization has adopted bylaws, include a current copy.
4. ***Description of activities.*** The application must include a full description of the proposed activities of the organization, including each of the fundraising activities of a section 501(c)(3) organization and a narrative description of anticipated receipts and contemplated expenditures.
5. ***Financial data.*** The application must include financial statements showing receipts and expenditures and a balance sheet for the current year and the 3 preceding years.

Form 1023-EZ. Form 1023–EZ, Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code can be used by smaller organizations seeking exemption with the IRS. Generally, these are organizations which have assets of \$250,000 or less and annual gross receipts of \$50,000 or less. The Form 1023–EZ can only be filed electronically by going to www.irs.gov/form1023-EZ or www.pay.gov.

Organization not required to file Form 1023. The following organizations are not required to file Form 1023:

1. Churches and other religious organizations including religious schools.
2. Any organization (other than a private foundation) normally having annual gross receipts of not more than \$5,000.

Gross receipts test. For purposes of the gross receipts test, an organization normally does not have more than \$5,000 annually in gross receipts if:

1. During its first tax year the organization received gross receipts of \$7,500 or less,
2. During its first 2 years the organization had a total of \$12,000 or less in gross receipts, and
3. In the case of an organization that has been in existence for at least 3 years, the gross receipts received by the organization during the immediately preceding 2 years, plus the current year, are \$15,000 or less.

Note: If an organization fails to meet this test, they must file Form 1023 within 90 days.

Tax-Exempt Organization Filing Requirements

Form 990 or 990-EZ. Tax-exempt organizations, other than private foundations, must file Form 990, Return of Organization Exempt From Income Tax, or Short Form 990-EZ. An organization may file Form 990-EZ instead of Form 990, if it meets both of the following requirements:

1. Its gross receipts during the year were less than \$200,000.
2. Its total assets at the end of the year were less than \$500,000.

Form 990-N. Small tax-exempt organizations with annual gross receipts normally \$50,000 or less must submit Form 990-N, Electronic Notice (e-Postcard) for Tax-Exempt Organizations Not Required to File Form 990 or 990-EZ, with the IRS each year, if they choose not to file a Form 990 or 990-EZ. Form 990-N must be completed and filed electronically. There is no paper form. Form 990-N requires the following information:

- ▶ The organization's legal name and mailing address.
- ▶ Any name under which it operates and does business.
- ▶ Its Internet website address (if any).
- ▶ Its employer identification number (EIN).
- ▶ The name and address of a principal officer.
- ▶ Organization's annual tax period.
- ▶ Verification that the organization's annual gross receipts are normally \$50,000 or less.
- ▶ Notification if the organization has terminated.

Tax-Exempt Organization Filing Requirements

Form 990-N exceptions. This filing requirement for Form 990-N does not apply to:

- ▶ Churches, their integrated auxiliaries, and conventions or associations of churches.
- ▶ Organizations that are included in a group return.
- ▶ Private foundations required to file Form 990-PF.
- ▶ Section 509(a)(3) supporting organizations required to file Form 990 or Form 990-EZ.

Form 990-PF. All tax-exempt private foundations must file Form 990-PF.

Form 990-T, Exempt Organization Business Income Tax Return. Even though an organization is recognized as tax exempt, it still may be liable for tax on its unrelated business income. Unrelated business income is income from a trade or business, regularly carried on, that isn't substantially related to the charitable, educational, or other purpose that is the basis for the organization's exemption. If the organization has \$1,000 or more of unrelated business income, Form 990-T must be filed in addition to the required annual information return.

Electronic filing. For tax years beginning after July 1, 2019, organizations are required to file Form 990, Form 990-EZ, Form 990-PF, Form 990-T, and related forms, schedules, and attachments electronically.

Estimated tax. Tax-exempt organizations must make quarterly payments of estimated tax on unrelated business income if it expects its tax for the year to be \$500 or more. Use Form 990-W to figure the organization's estimated tax payments.

Tax-Exempt Organization Filing Requirements

Due date. Form 990, 990EZ, 990-PF, 990-N or 990-T must be filed by the 15th day of the 5th month after the end the organization's accounting period.

Extension of time to file. Use Form 8868 to request an automatic 6-month extension of time to file Forms 990, 990-EZ, or 990-PF.

Penalties for failure to file. A tax-exempt organization that fails to file a required return is subject to a penalty of \$20 a day for each day the failure continues. The same penalty will apply if the organization fails to give correct and complete information or required information on its return. The maximum penalty for any return is the lesser of \$11,000 or 5% of the organization's gross receipts for the year. Organizations with annual gross receipts exceeding \$1,129,000 are subject to a penalty of \$110 a day with a maximum penalty for any return of \$56,000.

Employment tax returns. Tax-exempt organizations, which pay wages to employees, are responsible for withholding, depositing, and reporting federal income tax, social security taxes (FICA), and federal unemployment tax (FUTA) for such wage payments, unless that employer is specifically excepted by law from those requirements.

FUTA tax exception. Payments for services performed by an employee of a religious, charitable, educational, or other organization described in section 501(c)(3) that are generally subject to FICA taxes if the payments are \$100 or more for the year, are not subject to FUTA taxes.

Retirement Plans for Small Business Qualified Plans

A qualified plan is a retirement plan that can only be established by an employer. A sole proprietor is treated as an employer and can set up a plan. A partnership is treated as an employer of each partner. Therefore, a partnership can set up a plan but a partner cannot.

Set-up deadline. To take a deduction for a contribution for a tax year, the qualified plan must be set up (adopted) by the last day of that year (December 31 for calendar year employers).

Qualified plan requirements. For a qualified plan to qualify for special tax benefits, it must meet all of the following:

1. The plan must be in writing.
2. Contributions must be for the exclusive benefit of employees or their beneficiaries.
3. Plan assets may not be used for, or diverted to, the employer.
4. The plan must allow all employees age 21 or older and at least 1 year of service (2 years if the plan is not a 401(k) plan and provides that after not more than 2 years of service the employee has a nonforfeitable right to all of his or her accrued benefit) to participate. The plan cannot exclude an employee because he or she has reached a specific age.
5. Certain minimum coverage requirements must be met depending on the plan.
6. Contributions and benefits to be provided must not discriminate in favor of highly compensated employees.

Retirement Plans for Small Business Qualified Plans

Kinds of plans. There are two basic kinds of qualified plans:

1. **Defined contribution plan.** Provides an individual account for each participant in the plan. Benefits to be provided to participants are largely based on the amount contributed to each account. A defined contribution plan can be either a profit-sharing or a money-purchase plan.
 - a) **Profit-sharing plan.** Although it is called a “profit-sharing plan,” an employer does not actually have to make a business profit for the year in order to make a contribution (except if the contribution is for the taxpayer and the taxpayer is self-employed). A profit-sharing plan can be set up to allow for discretionary employer contributions, meaning the amount contributed each year to the plan is not fixed. An employer may even make no contribution to the plan for a given year. In general, an employer can be more flexible in making contributions to a profit-sharing plan than to a money purchase pension plan
 - b) **Money-purchase plan.** Contributions are fixed and not based on the employer's profits.
2. **Defined benefit plan.** Any plan that is not a defined contribution plan. Contributions to the plan are based on a computation of what contributions are needed to provide definitely determinable benefits to plan participants.

Retirement Plans for Small Business Qualified Plans

Minimum funding requirements. If the qualified plan is a money-purchase plan or a defined benefit plan, the self-employed individual (employer) must pay enough into the plan to satisfy the minimum funding standard for each year. The minimum funding requirements do not apply to profit-sharing plans.

Quarterly installments of required contributions. If the qualified plan is a defined benefit plan subject to the minimum funding requirement, the self-employed individual (employer) must make quarterly installment payments of the required contributions.

Due dates. The due dates for the installments are 15 days after the end of each quarter. For a calendar-year plan, the installments are due April 15, July 15, October 15, and January 15 (of the following year).

Installment percentage. Each quarterly installment must be 25% of the required annual payment.

Extended period for making contributions. Additional contributions required to satisfy the minimum funding requirement for a plan year will be considered timely, if made no later than 8½ months after the end of that year.

Contributions deadline. Deductible contributions for a tax year can be made up to the due date of the tax return (including extensions) for that year.

Retirement Plans for Small Business Qualified Plans

Limits on Contributions

Defined contribution plan. For 2022, the annual contributions and other additions to the account of a participant cannot exceed the smaller of:

1. \$61,000, or
2. 100% of the participant's compensation.

Defined benefit plan. For 2022, the annual benefit for a participant may not be more than the smaller of:

1. \$245,000, or
2. 100% of the participant's average compensation for his or her highest 3 consecutive years.

Retirement Plans for Small Business Qualified Plans

Employer Deduction

Employer deduction limits. The deduction limits for qualified plans are as follows:

Defined contribution plans:

The deduction for contributions to a defined contribution plan (profit-sharing plan or money purchase pension plan) cannot be more than 25% of the compensation paid (or accrued) during the year to eligible employees participating in the plan.

Defined benefit plans:

The deduction is based on actuarial assumptions and computations.

Retirement Plans for Small Business Qualified Plans

Employer Deduction (cont.)

Deduction Limit for Self-Employed Individuals

When figuring the deduction for contributions made for the self-employed taxpayer, compensation is net earnings from self-employment which takes into account both of the following:

1. The deduction for the deductible part of self-employment tax.
2. The deduction for contributions on T/P's behalf to the plan.

Carryover of excess contributions. If an employer contributes in excess of deduction limits for a year, the employer can carry over and deduct the excess in later years, subject to the same annual limits. The excess carryover may be subject to a 10% excise tax. The 10% excise tax does not apply to any contribution to meet the minimum funding requirement in a money purchase pension plan or a defined benefit plan even if that contribution is more than the employer's earned income for his or her trade or business.

Retirement Plans for Small Business Qualified Plans

Tax Treatment of Distributions

Distributions from a qualified plan minus a prorated part of the cost basis are subject to income tax in the year they are distributed. Since most recipients have no cost basis, a distribution is generally fully taxable. An exception is a distribution that is properly rolled over.

Rollover. A T/P can defer the tax on an eligible rollover distribution by rolling it over into an IRA or another eligible retirement plan. If a T/P receives a distribution other than cash from an employer retirement plan, the T/P must roll over the same property into an IRA or sell all or part of the property and roll over the proceeds of the sale into an IRA.

Eligible rollover distribution. This is a distribution of all (such as a lump-sum distribution) or any part of an employee's balance in a qualified retirement plan that is not any of the following:

- ▶ A required distribution.
- ▶ Any of a series of substantially equal payments made at least once a year over: a) The employee's life or life expectancy; b) The joint lives or life expectancies of the employee and beneficiary; or c) A period of 10 years or longer.
- ▶ The portion of a distribution that represents the return of an employee's nondeductible contributions to the plan.
- ▶ A hardship distribution.
- ▶ Loans treated as distributions.
- ▶ Dividends on employer securities
- ▶ The cost of life insurance coverage provided under a qualified retirement plan.

Retirement Plans for Small Business Qualified Plans

Tax Treatment of Distributions (cont.)

Withholding requirements. If a T/P takes an eligible rollover distribution that is \$200 or more, the payer is required to withhold (for Federal income tax) 20% of the taxable part of the distribution. If the T/P chooses to have the plan pay the distribution directly to an IRA or another eligible retirement plan (i.e. direct rollover), no withholding is required. If the distribution is not eligible for rollover treatment, the 20% withholding requirement does not apply.

Tax on early distribution. A distribution from a retirement plan to a T/P before he or she reaches age 59½ is a premature distribution subject to a 10% tax on the part of the distribution that is included in gross income.

Exceptions: The 10% tax will not apply if distributions before age 59½ are:

1. Made to a beneficiary (or to the estate of the employee) after the death of the employee.
2. Made due to the employee having a qualifying disability.
3. Rolled over to another retirement plan or an IRA within 60 days of the distribution.
4. Made because of an IRS levy on the plan.
5. Made as a qualified reservist distribution.
6. Made as a qualified birth or adoption distribution.
7. Made as a qualified disaster distribution.

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Retirement Plans for Small Business Qualified Plans

Tax Treatment of Distributions (cont.)

Exceptions (cont.): The 10% tax will not apply if distributions before age 59½ are:

8. Part of a series of substantially equal periodic payments, beginning after separation from service, made at least annually for the life or life expectancy of the employee or the joint lives or joint life expectancies of the employee and his or her designated beneficiary. (The payments under this exception, except in the case of death or disability, must continue for at least 5 years or until the employee reaches age 59½, whichever is the longer period).
9. Made to an employee after separation from service, if the separation occurred during or after the calendar year in which the employee reached age 55.
10. Made to an alternate payee under a qualified domestic relations order (QDRO).
11. Made to an employee for medical care to the extent that the distribution does not exceed the amount allowable as a medical expense deduction (determined without regard to whether the employee itemizes deductions).
12. Timely made to reduce excess contributions under a 401(k) plan.
13. Timely made to reduce excess employee or matching employer contributions (excess aggregate contributions).
14. Timely made to reduce excess elective deferrals.

Retirement Plans for Small Business Qualified Plans

Prohibited Transactions

Certain transactions between the plan and a disqualified person are prohibited. An excise tax is charged on these transactions.

Disqualified person. The following are disqualified persons:

1. The employer of participants in the plan.
2. A 10% partner in a partnership having the plan.
3. A fiduciary of the plan.
4. Family members.
5. Corporations, partnerships, trusts, or estates in which the person owns, directly or indirectly, at least 50% or more of the:
 - ▶ Total voting stock or the value of all stock of the corporation,
 - ▶ Capital interest or profit interest of the partnership, or
 - ▶ Beneficial interest of the trust or estate.
6. Highly compensated employees (earning 10% or more of the employer's yearly wages).
7. Employee organizations, any of whose members are covered by the plan.
8. Persons providing services to the plan.

Retirement Plans for Small Business Qualified Plans

Prohibited Transactions (cont.)

The following are prohibited transactions:

1. A transfer of plan income or assets to, or use of them by or for the benefit of, a disqualified person.
2. Dealing with plan income or assets by a fiduciary in his or her own interest.
3. The receiving of consideration by a fiduciary for his or her own account from a party that is dealing with the plan in a transaction that involves plan income or assets.
4. Any of the following acts between the plan and a disqualified person:
 - ▶ Selling, exchanging, or leasing property.
 - ▶ Lending money, extending credit.
 - ▶ Furnishing goods, services, or facilities.

Tax on prohibited transaction. The initial tax on a prohibited transaction is 15% of the amount involved for each year (or part of a year) in the taxable period. If the transaction is not corrected within the taxable period, an additional tax of 100% of the amount involved is imposed.

Retirement Plans for Small Business

Qualified Plans

Reporting Requirements

An annual return/report form must be filed by the last day of the 7th month following the end of the plan year. The following forms are used depending on the type of plan:

1. Form 5500-SF, Short Form Annual Return/Report of Small Employee Benefit Plan. Form 5500-SF is a simplified annual reporting form. Use Form 5500-SF if the plan meets all the following:
 - a) The plan is a small plan (fewer than 100 participants at the beginning of the plan year).
 - b) The plan meets the conditions for being exempt from the requirements that the plan's books and records be audited by an independent qualified public accountant.
 - c) The plan has 100% of its assets invested in certain secure investments with a readily determinable fair value.
 - d) The plan holds no employer securities.
 - e) The plan is not a multiemployer plan.
2. Form 5500-EZ, Annual Return of One Participant (Owners and Their Spouses) Retirement Plan. A plan qualifies to use this form if it covers only:
 - a) An individual and his or her spouse who wholly own a business.
 - b) Partners in a partnership and their spouses.

Note: Except for the final year, a T/P of a one-participant plan does not have to file Form 5500-EZ or any other annual report, if the total assets of the plan are \$250,000 or less.

3. Form 5500, Annual Return/Report of Employees Benefit Plan. Anyone who does not meet the requirements for filing Form 5500-EZ must file Form 5500.

Retirement Plans for Small Business

Simplified Employee Pension (SEP)

A SEP is a written plan that allows an employer to make contributions toward his or her own and his or her employees' retirement without getting involved in the more complex qualified plan.

SEP-IRA. Under a SEP, contributions are made to an individual retirement arrangement called a SEP-IRA.

Set up a SEP-IRA. The SEP-IRA must be set up for each qualifying employee and qualified leased employee, but need not be set up for excludable employees.

Deadline for setting up a SEP. A SEP can be set up for a year as late as the due date (including extensions) of the tax return for that year.

Qualifying employee. An individual who:

1. Reached the age of 21 years,
2. Worked for employer in at least 3 of the immediately preceding 5 years, and
3. Received at least \$650 in compensation from employer.

Note: An employer can use less restrictive requirements but not more restrictive ones.

Contributions to combination of plans. If an employer contributes to both a defined contribution plan and a SEP-IRA, the rules for the defined contribution plan apply.

Retirement Plans for Small Business Simplified Employee Pension (SEP)

Contributions. Contributions are not required to be made every year. If contributions are made, they must be based on a written allocation formula and must not discriminate in favor of any employees. The contribution for a particular year must be made no later than the due date (plus extensions) of the tax return for that year.

Contribution limits. For 2022, Contributions made for a year to a common-law employee's SEP-IRA cannot exceed the smaller of 25% of the employee's compensation or \$61,000.

Deduction Limit for Self-Employed Individuals. When figuring the deduction for contributions made to a T/P's own SEP-IRA, compensation is net earnings from self-employment, which takes into account both the following deductions:

1. The deduction for the deductible part of self-employment tax.
2. The deduction for contributions to the taxpayer's own SEP-IRA.

Annual contribution limit. An employer cannot consider an employee's compensation over \$305,000 when figuring the contribution limit for that employee. However, \$61,000 is the maximum contribution amount for each eligible employee.

Carryover of excess contributions. Contributions in excess of deduction limit may be carried over and deducted in later years subject to the deduction limit in those years. A nondeductible (excess) contribution to a SEP may be subject to a 10% excise tax.

Retirement Plans for Small Business Pub560Pg13

Savings Incentive Match Plans for Employees (SIMPLE)

SIMPLE plans. A SIMPLE plan is a written agreement (salary reduction agreement) between an employer and an employee that allows an employee (including self-employed individuals) to choose:

- ▶ Reduce compensation by a certain percentage each pay period (SIMPLE 401(k) plan), or
- ▶ Have the employer contribute the salary reduction to a SIMPLE IRA on behalf of the employee.

Deadline for setting up a SIMPLE IRA. A SIMPLE IRA must be set up for an employee before the first date by which a contribution is required to be deposited into the employees' IRA.

Setting up a SIMPLE IRA plan. Employers can set up a SIMPLE IRA plan if they meet both of the following requirements:

1. The employer has 100 or fewer employees who earn \$5,000 or more during the preceding year.
2. The employer did not maintain another qualified plan unless the other plan is for collective bargaining employees.

Participant in a SIMPLE IRA. Any employee who receives at least \$5,000 in compensation during any 2 years preceding the current calendar year and expected to earn at least \$5,000 during the current year.

Retirement Plans for Small Business Pub560Pg15

Savings Incentive Match Plans for Employees (SIMPLE)

Salary reduction contribution limits. The salary reduction contributions (employee-chosen contribution) that an employer can make on behalf of an employee are limited to \$14,000 (\$17,000 if age 50 or older).

Matching employer contributions. Generally the employer must make matching contributions to an employee's SIMPLE IRA in an amount equal to the employee's salary reduction contribution. Their matching contributions cannot be more than 3% of the employee's compensation for the calendar year.

Matching contributions less than 3%. An employer can reduce the 3% limit on matching contribution for a calendar year, but only if:

1. The limit is not reduced below 1%,
2. The limit is not reduced for more than 2 years out of the 5-year period that ends with (and includes) the year for which the election is effective, and
3. Employees are notified of the reduced limit within a reasonable period of time before the 60-day election period during which they can enter into salary reduction agreements.

Nonelective employer contribution. If an employer chooses to make nonelective contributions, instead of matching contributions, to each eligible employee's SIMPLE IRA, contributions must be 2% of each employee's compensation for the year. Only \$305,000 of an employee's compensation can be taken into account to figure the contribution limit.

Retirement Plans for Small Business Elective Deferrals (401(k) Plans)

Contributions by employees. Eligible employees can elect to have part of their before-tax pay contributed to a 401(k) plan rather than receive the cash. This amount (and any earnings on it) remains tax free until it is distributed.

Contributions by employer. An employer's contributions to a 401(k) plan are deductible by the employer and tax free to participating employees until distribution from the plan. Deferred amounts are included in wages for social security, Medicare, and federal unemployment (FUTA) tax purposes.

Limits on elective deferrals. For 2022, the basic limit on elective deferrals is \$20,500 (\$27,000 for participants age 50 and older).

A qualified plan can include a cash or deferred arrangement only if the qualified plan is one of the following plans:

1. A profit-sharing plan, or
2. A money-purchase plan in existence on June 27, 1974, that included a salary reduction arrangement on that date.

Partnership. A partnership can have a 401(k) plan.

Retirement Plan Rules for 2022

Type of Plan	Last Date for Contribution	Maximum Contribution	Maximum Deduction	When to Set Up Plan
SEP	Due date of employer's return (including extensions).	Smaller of \$61,000 or 25% of participants compensation.	25% of all participants compensation	Any time up to due date of employer's return (incl. ext).
SIMPLE IRA and SIMPLE 401(k) Plan	<p>Salary reduction contributions: 30 days after the end of the month for which the contributions are to be made.</p> <p>Matching or nonelective contributions: Due date of employer's return (including extensions)</p>	<p>Employee: Salary reduction contribution, up to \$14,000 (\$17,000 if age 50 or over).</p> <p>Employer contribution: Either dollar-for-dollar matching contributions, up to 3% of employee's compensation, or fixed nonelective contributions of 2% of compensation.</p>	Same as maximum contribution.	<p>Any time between 1/1 and 10/1 of the calendar year.</p> <p>For a new employer coming into existence after 10/1, as soon as administratively feasible.</p>
Qualified Plan: Defined Contribution Plan	<p>Elective deferral: Due date of employer's return (including extension).</p> <p>Employer contribution: Due date of employer's return (including extensions)</p>	<p>Employee contribution: Elective deferral up to \$20,500 (\$27,000 if age 50 or older).</p> <p>Employer contribution: Smaller of \$61,000 or 100% of participant's compensation</p>	25% of all participants' compensation, plus amount of elective deferrals made.	By the end of the year.
Qualified Plan: Defined Benefit Plan	Contributions generally must be paid in quarterly installments, due 15 days after the end of each quarter.	Smaller of \$245,000 or 100% of participant's compensation for highest 3 consecutive calendar years.	Based on actuarial assumptions and computations.	By the end of the year.

Farm Accounting

Farm Income

Gross income from farming is income from cultivating the soil or raising agricultural commodities. It includes the following amounts:

- ▶ Income from operating a stock, dairy, poultry, bee, fruit, or truck farm.
- ▶ Income from a plantation, ranch, nursery, range, orchard, or oyster bed.
- ▶ Crop shares for the use of land.
- ▶ Gains from sales of draft, breeding, dairy, or sporting livestock.

Gross income from farming is the total of the following amounts from the T/P's tax return:

- ▶ Gross farm income from Schedule F (Form 1040 or 1040-SR).
- ▶ Gross farm rental income from Form 4835.
- ▶ Gross farm income from Schedule E (Form 1040 or 1040-SR), Parts II and III.
- ▶ Gains from the sale of livestock used for draft, breeding, sport, or dairy purposes reported on Form 4797.

The following are also included in farm income.

- ▶ Sales caused by weather-related conditions.
- ▶ Agricultural program payments. Include in farm income most government payments.
- ▶ Crop insurance and crop disaster payments.
- ▶ Income From Cooperatives (Patronage Dividends).

Farm Accounting

Farm Income

Farm income does not include any of the following:

- ▶ Wages received as a farm employee.
- ▶ Income receive from contract grain harvesting and hauling with workers and machines furnished.
- ▶ Gains from the sale of farm land and depreciable farm equipment.

Estimated tax for farmers. If T/P receives at least two-thirds of gross income from farming or fishing for the previous year or the present year, he or she is only required to make one estimated payment. The due date for that payment is January 15th of the next year. If T/P files return by March 1 of the next year and pays all taxes owed, no estimated payment is required.

Farm Accounting

Sales Caused by Weather-Related Conditions

Livestock

- ▶ Weather-related conditions sales. If a sale of livestock or poultry is due to weather-related conditions, a T/P can elect to report income from a sale the following year.
- ▶ Amount to be postponed. Postpone the income only on the additional number of livestock sold solely because of weather-related conditions.

Note: The livestock does not have to be raised or sold in the weather-related conditions area to qualify for the postponement. However, the sale must occur solely because of weather-related conditions.

Crops

Crop insurance and disaster payments. Include these payments in income. A cash method T/P may postpone reporting crop insurance proceeds until the year following year the damage occurred, if it can be proved that the crops would have been sold in the following year.

Farm Inventory

Items to include in inventory. Inventory should include all items held for sale, or for use as feed, seed, etc., whether raised or purchased, that are unsold at the end of the year.

Hatchery business. If in the hatchery business, and use an accrual method of accounting, include in inventory eggs in the process of incubation.

Products held for sale. All harvested and purchased farm products held for sale or for feed or seed, such as grain, hay, silage, concentrates, cotton, tobacco, etc., must be included in inventory.

Supplies. Supplies acquired for sale or that become a physical part of items held for sale must be included in inventory. Deduct the cost of supplies in the year used or consumed in operations. Do not include incidental supplies in inventory as these are deductible in the year of purchase.

Livestock. Livestock held primarily for sale must be included in inventory. Livestock held for draft, breeding, or dairy purposes can either be depreciated or included in inventory.

Growing crops. Generally, growing crops are not required to be included in inventory. However, if the crop has a preproductive period of more than 2 years, costs associated with the crop may have to be capitalized (include in inventory).

Inventory valuation methods. The following methods are those generally available for valuing inventory:

- ▶ Cost
- ▶ Lower of cost or market
- ▶ Farm-price method
- ▶ Unit-livestock-price method

Farm inventory. Certain small farms with average annual gross receipts of \$27 million or less in the 3 preceding tax years are not required to maintain an inventory.

Sale of a farm. The sale of a farm will usually involve the sale of both nonbusiness property (personal home) and business property (the land and buildings used in the farm operation and perhaps machinery and livestock). If there is a gain from the sale, the T/P may be allowed to exclude the gain on the home. If a farm is sold that includes a house that the T/P occupies, the T/P must determine the part of the selling price and the part of the cost or other basis allocable to the home. The home includes the immediate surroundings and outbuildings relating to it that are not used for business purposes.

Disposition of farm assets. When disposing of property used in a farm business, taxable gain or loss is usually treated as ordinary income or capital gain under the rules for section 1231 transactions.

Section 1231 gains and losses. Section 1231 gains and losses are the taxable gains and losses from section 1231 transactions. Their treatment as ordinary or capital gains depends on whether there is a net gain or a net loss from all section 1231 transactions in the tax year.

Section 1231 transactions. Gain or loss on the following transactions is subject to section 1231 treatment:

- ▶ **Sale or exchange of cattle and horses.** The cattle and horses must be held for draft, breeding, dairy, or sporting purposes and held for 24 months or longer.
- ▶ **Sale or exchange of other livestock.** This livestock must be held for draft, breeding, dairy, or sporting purposes and held for 12 months or longer. Other livestock includes hogs, mules, sheep, goats, donkeys, and other fur-bearing animals. Other livestock does not include poultry.
- ▶ **Sale or exchange of depreciable personal property.** This property must be used in business and held longer than 1 year. Generally, property held for the production of rents or royalties is considered to be used in a trade or business. Examples of depreciable personal property include farm machinery and trucks. It also includes amortizable section 197 intangibles.
- ▶ **Sale or exchange of real estate.** This property must be used in business and held longer than 1 year. Examples are farm or ranch (including barns and sheds).
- ▶ **Sale or exchange of unharvested crops.** The crop and land must be sold, exchanged, or involuntarily converted, at the same time and to the same person and the land must have been held longer than 1 year. The T/P cannot keep any right or option to reacquire the land directly or indirectly (other than a right customarily incident to a mortgage or other security transaction). Growing crops sold with a leasehold on the land, even if sold to the same person in a single transaction, are not included.

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Section 1231 transactions (cont.)

- ▶ **Distributive share of partnership gains and losses.** Distributive share must be from the sale or exchange of property listed earlier and held longer than 1 year (or for the required period for certain livestock).
- ▶ **Cutting or disposal of timber.** Standing timber held as investment property is a capital asset. Gain or loss from its sale is capital gain or loss reported on Form 8949 and Schedule D (Form 1040 or 1040-SR), as applicable. If held primarily for sale to customers, it is not a capital asset. Gain or loss on its sale is ordinary business income or loss.
- ▶ **Condemnation.** The condemned property must have been held longer than 1 year. It must be business property or a capital asset held in connection with a trade or business or a transaction entered into for profit, such as investment property. It cannot be property held for personal use.
- ▶ **Casualty or theft.** The casualty or theft must have affected business property, property held for the production of rents or royalties, or investment property (such as notes and bonds). Must have held the property longer than 1 year. However, if casualty or theft losses are more than casualty or theft gains, neither the gains nor the losses are taken into account in the section 1231 computation. Section 1231 does not apply to personal casualty gains and losses.

Not section 1231 transaction. If the property is not held for the required holding period explained in the previous 2 cards, the transaction is not subject to section 1231 treatment. Any gain or loss is ordinary income.

Treatment as ordinary or capital. To determine the treatment of section 1231 gains and losses, combine all of section 1231 gains and losses for the year:

- ▶ A net section 1231 loss is treated as ordinary loss.
- ▶ A net section 1231 gain is treated as ordinary income up to nonrecaptured section 1231 losses from previous years. The rest, if any, is long-term capital gain.

Nonrecaptured section 1231 losses. Nonrecaptured section 1231 losses are net section 1231 losses for the previous 5 years that have not been applied against a net section 1231 gain by treating the gain as ordinary income. These losses are applied against net section 1231 gain beginning with the earliest loss in the 5-year period.

Forms & Schedules at a Glance

Businesses

Type of Form	Purpose of Form	Filing Date
Form 706 , United States Estate (and Generation-Skipping Transfer) Tax Return	Use Form 706 to figure a decedent's estate tax imposed on the entire estate valued at more than \$12.06 million in 2022.	9 months after the date of the decedent's death unless receiving an automatic 6-month extension.
Form 990 , Return of Organization Exempt From Income Tax	Form 990 and Form 990-EZ are used by tax-exempt organizations, nonexempt charitable trusts, and section 527 political organizations to provide the IRS with the information required by section 6033.	15th day of the 5th month after the end of the organization's accounting period.

Forms & Schedules at a Glance

Businesses

Type of Form	Purpose of Form	Filing Date
Form 990-PF , Return of Private Foundation	All private foundations exempt under section 501(c)(3) must file Form 990-PF.	15th day of the 5th month after the end of the organization's accounting period.
Form 990-T , Exempt Organization Business Income Tax Return	Tax-exempt organizations with gross income of \$1,000 or more from unrelated business must file Form 990-T.	15th day of the 5th month after the end of the organization's accounting period. Employee trusts must file by the 15th day of the 4th month.
Form 1041 , U.S. Income Tax Return for Estates and Trusts	Estates and trusts must file Form 1041 if they have gross income of \$600 or more or a beneficiary who is a nonresident alien.	15th day of the 4th month after the tax year.

Forms & Schedules at a Glance

Businesses

Type of Form	Purpose of Form	Filing Date
Form 1065 , U.S. Return of Partnership Income	Form 1065 is an information return used to report income, deductions, gains, losses, etc, from operations of a partnership.	15th day of the 3rd month after the tax year.
Form 1099-DIV , Dividends and Distributions	File Form 1099-DIV for each person paid dividends and other distributions of \$10 or more, withheld taxes, or paid \$600 or more as part of a liquidation.	Furnish Copy B of this form to recipient by January 31. File Copy A with IRS by end of February.
Form 1120 , U.S. Corporation Income Tax Return	Use Form 1120 to report the income, gains, deductions, losses, credits, and to figure the tax liability of a corporation.	15th day of the 4th month after the tax year.

Forms & Schedules at a Glance

Businesses

Type of Form	Purpose of Form	Filing Date
Form 1120-H , U.S. Income Tax Return for Homeowners Associations	A homeowners association elects to take advantage of the tax benefits provided by section 528 by filing Form 1120-H.	15th day of the 4th month after the tax year.
Form 1120S , U.S. Income Tax Return for an S Corporation	Use Form 1120S to report the income, gains, losses deductions, credits, etc., of an S corporation.	15th day of the 3rd month after the tax year.
Form 1128 - Application To Adopt, Change, or Retain a Tax Year	File Form 1128 to request a change in tax year.	By the due date (not including extensions) of the return for the effective year.

Forms & Schedules at a Glance

Businesses

Type of Form	Purpose of Form	Filing Date
Form 2553 , Election by a Small Business Corporation	A Corporation uses Form 2553 to elect to be treated as an S corporation.	15th day of the 3rd month after the beginning of the tax year the election is to take effect.
Form 3115 - Application for Change in Accounting Method	File Form 3115 to request a change in accounting method or the accounting treatment of any item.	File Form 3115 with the IRS no earlier than the first day of the year changed and no later than when the return is filed for the year of change.
Form 3800 , General Business Credit	To claim any of the general business credits	Attach to tax return.
Form 4797 , Sales of Business Property	Used to report sale of business property.	Attach to tax return.
8995-A , Qualified Business Income Deduction	Used to figure your qualified business income (QBI) deduction	Attach to tax return.

Forms & Schedules at a Glance

Type of Form	Purpose of Form	Filing Date
Form 7004 , Application for Automatic Extension of Time To File Certain Business Income Tax, Information, and Other Returns	Use Form 7704 to get an automatic 6-month extension for corporations and partnerships, 5½ month extension for estates, and trusts returns.	Before the due date of the return.
Form 8594 , Asset Acquisition Statement	To report a sale or purchase of a group of assets if goodwill or going concern attaches to assets.	Attach to tax return
Form 8824 - Like-Kind Exchanges	To report each exchange of business or investment property of a like kind.	Attached to tax return
Schedule F - Profit or Loss From Farming	Report farm income and expenses.	Attach to Form 1040 or 1040-SR.
Schedule K-1	Report partner's, shareholder's, and beneficiaries' share of items on Forms 1065, 1120S, and 1041.	Attached to tax return.