

## Small Business Quickfinder<sup>®</sup> Handbook (2023 Tax Year)

### Post-publication Updates

#### Replacement Pages for Two-Sided (Duplex) Printing

**Instructions:** This packet contains “marked up” changes to the pages in the *Small Business Quickfinder<sup>®</sup> Handbook* that were affected by developments after the Handbook was published.

This is a specially designed update packet for owners of the 3-ring binder version of the *Handbook* who have access to a printer that prints two-sided (duplex). Simply print the entire PDF file (make sure to select two-sided or duplex printing), three-hole punch the pages, and then replace the pages in your *Handbook*. It's that easy.



# Reference Materials and Worksheets



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## Where to File: Business Returns Filing Addresses—2023 Returns

**Note:** At the time of publication, the IRS had not released the 2023 filing addresses for business returns. This information will be posted to the *Handbook Updates* section of [tax.thomsonreuters.com/quickfinder](https://tax.thomsonreuters.com/quickfinder) when available.

## Principal Business Activity Codes—Forms 1065, 1120, and 1120-S

**Note:** At the time of publication, the IRS had not released the 2023 principal business activity codes for business returns. This information will be posted to the *Handbook Updates* section of [tax.thomsonreuters.com/quickfinder](https://tax.thomsonreuters.com/quickfinder) when available.

## Business Quick Facts Data Sheet<sup>1</sup>

	2024	2023	2022	2021	2020
<b>FICA/SE Taxes</b>					
<b>Maximum earnings subject to tax:</b>					
Social Security tax	\$ 168,600	\$ 160,200	\$ 147,000	\$ 142,800	\$ 137,700
Medicare tax	No Limit	No Limit	No Limit	No Limit	No Limit
<b>Maximum tax paid by:</b>					
Employee—Social Security	\$ 10,453.20	\$ 9,932.40	\$ 9,114.00	\$ 8,853.60	\$ 8,537.40
SE—Social Security	20,906.40	19,864.80	18,228.00	17,707.20	17,074.80
Employee or SE—Medicare	No Limit	No Limit	No Limit	No Limit	No Limit
<b>Business Deductions</b>					
Section 179 deduction—limit	\$ 1,220,000 <sup>3</sup>	\$ 1,160,000	\$ 1,080,000	\$ 1,050,000	\$ 1,040,000
Section 179 deduction—SUV limit (per vehicle)	30,500 <sup>3</sup>	28,900	27,000	26,200	25,900
Section 179 deduction—qualifying property phase-out threshold	3,050,000 <sup>3</sup>	2,890,000	2,700,000	2,620,000	2,590,000
Depreciation limit—autos, trucks, and vans (1st year with special depreciation)	<sup>3</sup>	20,200	19,200	18,200	18,100
Depreciation limit—autos, trucks, and vans (1st year with no special depreciation)	<sup>3</sup>	12,200	11,200	10,200	10,100
<b>Retirement Plans</b>					
<b>SIMPLE IRA plan elective deferral limits:</b>					
Under age 50 at year end	\$ 16,000 <sup>4,3</sup>	\$ 15,500	\$ 14,000	\$ 13,500	\$ 13,500
Age 50 or older at year end	19,500 <sup>4,3</sup>	19,000	17,000	16,500	16,500
<b>401(k), 403(b), 457, and SARSEP elective deferral limits:</b>					
Under age 50 at year end	\$ 23,000 <sup>3</sup>	\$ 22,500	\$ 20,500	\$ 19,500	\$ 19,500
Age 50 or older at year end	30,500 <sup>3</sup>	30,000	27,000	26,000	26,000
<b>Profit-sharing plan/SEP contribution limits</b>					
Compensation limit (for employer contributions to profit-sharing plans)	345,000 <sup>3</sup>	330,000	305,000	290,000	285,000
Defined benefit plans—annual benefit limit	275,000 <sup>3</sup>	265,000	245,000	230,000	230,000
Key employee compensation threshold	220,000 <sup>3</sup>	215,000	200,000	185,000	185,000
Highly compensated threshold	155,000 <sup>3</sup>	150,000	135,000	130,000	130,000
<b>Estate and Gift Taxes</b>					
Estate tax exclusion	\$13,610,000 <sup>2,3</sup>	\$12,920,000 <sup>2</sup>	\$12,060,000 <sup>2</sup>	\$11,700,000 <sup>2</sup>	\$11,580,000 <sup>2</sup>
Gift tax exclusion	\$13,610,000 <sup>2,3</sup>	12,920,000 <sup>2</sup>	12,060,000 <sup>2</sup>	11,700,000 <sup>2</sup>	11,580,000 <sup>2</sup>
GST tax exemption	13,610,000 <sup>3</sup>	12,920,000	12,060,000	11,700,000	11,580,000
Gift tax annual exclusion	18,000 <sup>3</sup>	17,000	16,000	15,000	15,000

<sup>1</sup> See Tab 3 an expanded *Quick Facts Data Sheet*.

<sup>2</sup> Plus the amount of any deceased spousal unused exclusion and/or any restored exclusion related to lifetime gifts to a same-sex spouse—see Tab 22.

<sup>3</sup> Amount not released by IRS at publication time; will be posted to the *Handbook Updates* section of [tax.thomsonreuters.com/quickfinder](https://tax.thomsonreuters.com/quickfinder) when available.

<sup>4</sup> Beginning in 2024, this limit is increased by 10% if the employer has no more than 25 employees. For employers with 26–100 employees, higher elective deferral limits are allowed if the employer contributes either 3% of compensation or 4% of an employee's elective deferrals.

## Types of Payments—Where to Report

**Source:** 2023 *General Instructions for Certain Information Returns (Forms 1096, 1097, 1098, 1099, 3921, 3922, 5498, and W-2G)*.

Below is an alphabetic list of some payments and the forms to file and report them on. However, it is not a complete list of all payments, and the absence of a payment from the list does not indicate that the payment is not reportable. For instructions on a specific type of payment, see the separate instructions in the form(s) listed.

Type of Payment	Report on Form	Type of Payment	Report on Form	Type of Payment	Report on Form
ABLE accounts:		Employee compensation .....	W-2	Tax-exempt OID .....	1099-OID
—Contributions .....	5498-QA	Excess deferrals, excess contributions-distributions .....	1099-R	Patronage dividends .....	1099-PATR
—Distributions .....	1099-QA	Exercise of incentive stock option under section 422(b) .....	3921	Payment card transactions .....	1099-K
Abandonment .....	1099-A	Fees—employee .....	W-2	Pensions .....	1099-R
Accelerated death benefits .....	1099-LTC	Fees—nonemployee .....	1099-NEC	Points .....	1098
Acquisition of control .....	1099-CAP	Fishing boat crew members proceeds .....	1099-MISC	Prizes—employee .....	W-2
Agriculture payments .....	1099-G	Fish purchases for cash .....	1099-MISC	Prizes—nonemployee .....	1099-NEC
Allocated tips .....	W-2	Foreclosures .....	1099-A	Profit-sharing plan .....	1099-R
Alternate TAA payments .....	1099-G	Foreign persons' income .....	1042-S	Punitive damages .....	1099-MISC
Annuities .....	1099-R	401(k) contributions .....	W-2	Qualified longevity annuity contract .....	1098-Q
Archer MSAs:		404(k) dividend .....	1099-DIV	Qualified plan distributions .....	1099-R
—Contributions .....	5498-SA	Gambling winnings .....	W-2G	Qualified tuition program payments .....	1099-Q
—Distributions .....	1099-SA	Golden parachute—employee .....	W-2	Real estate transactions .....	1099-S
Attorney, fees and gross proceeds .....	1099-MISC	Golden parachute—nonemployee .....	1099-NEC	Recharacterized IRA contributions .....	1099-R, 5498
Auto reimbursements—employee .....	W-2	Grants—taxable .....	1099-G	Refund—state and local tax .....	1099-G
Auto reimbursements—nonemployee .....	1099-NEC	Health care services .....	1099-MISC	Rents .....	1099-MISC
Awards—employee .....	W-2	Health coverage tax credit (HCTC) advance payments .....	1099-H	Reportable policy sale .....	1099-LS
Awards—nonemployee .....	1099-NEC	Health savings accounts:		Retirement .....	1099-R
Barter exchange income .....	1099-B	—Contributions .....	5498-SA	Roth conversion IRA contributions .....	5498
Bond tax credit .....	1097-BTC	—Distributions .....	1099-SA	Roth conversion IRA distributions .....	1099-R
Bonuses—employee .....	W-2	Income attributable to domestic production activities, deduction for .....	1099-PATR	Roth IRA contributions .....	5498
Bonuses—nonemployee .....	1099-NEC	Income tax refunds—state and local .....	1099-G	Roth IRA distributions .....	1099-R
Broker transactions .....	1099-B	Indian gaming profits paid to tribal members .....	1099-MISC	Royalties .....	1099-MISC, 1099-S
Cancellation of debt .....	1099-C	Interest income .....	1099-INT	Timber—pay-as-cut contract .....	1099-S
Capital gain distributions .....	1099-DIV	Tax-exempt .....	1099-INT	Sales:	
Car expense—employee .....	W-2	Interest, mortgage .....	1098	—Real estate .....	1099-S
Car expense—nonemployee .....	1099-NEC	IRA contributions .....	5498	—Securities .....	1099-B
Changes in capital structure .....	1099-CAP	IRA distributions .....	1099-R	Section 1035 exchange .....	1099-R
Charitable gift annuities .....	1099-R	Life insurance contract distributions .....	1099-R, 1099-LTC	Seller's investment in life insurance contract .....	1099-SB
Commissions—employee .....	W-2	Liquidation—distributions .....	1099-DIV	SEP contributions .....	W-2, 5498
Commissions—nonemployee .....	1099-NEC	Loans, distribution from pension plan .....	1099-R	SEP distributions .....	1099-R
Commodities transactions .....	1099-B	Long-term care benefits .....	1099-LTC	Severance pay .....	W-2
Compensation—employee .....	W-2	Medicare Advantage MSAs:		Sick pay .....	W-2
Compensation—nonemployee .....	1099-NEC	—Contributions .....	5498-SA	SIMPLE contributions .....	W-2, 5498
Contributions of motor vehicles, boats, and airplanes .....	1098-C	—Distributions .....	1099-SA	SIMPLE distributions .....	1099-R
Cost of current life insurance protection .....	1099-R	Medical services .....	1099-MISC	Student loan interest .....	1098-E
Coverdell ESA contributions .....	5498-ESA	Mileage—employee .....	W-2	Substitute payments in lieu of dividends or tax-exempt interest .....	1099-MISC
Coverdell ESA distributions .....	1099-Q	Mileage—nonemployee .....	1099-NEC	Supplemental unemployment .....	W-2
Crop insurance proceeds .....	1099-MISC	Military retirement .....	1099-R	Tax refunds—state and local .....	1099-G
Damages .....	1099-MISC	Mortgage assistance payments .....	1098-MA	Third party network transactions .....	1099-K
Death benefits .....	1099-R	Mortgage interest .....	1098	Tips .....	W-2
Debt cancellation .....	1099-C	Moving expense .....	W-2	Traditional IRA contributions .....	5498
Dependent care payments .....	W-2	Nonemployee compensation .....	1099-NEC	Traditional IRA distributions .....	1099-R
Direct rollovers .....	1099-Q, 1099-R, 5498	Nonqualified deferred compensation:		Transfer of stock acquired through an employee stock purchase plan under section 423(c) .....	3922
Direct sales of consumer products for resale .....	1099-MISC, 1099-NEC	—Beneficiary .....	1099-R	Tuition .....	1098-T
Directors' fees .....	1099-MISC	—Employee .....	W-2	Unemployment benefits .....	1099-G
Discharge of indebtedness .....	1099-C	Nonemployee .....	1099-NEC	Vacation allowance—employee .....	W-2
Dividends .....	1099-DIV	Original issue discount (OID) .....	1099-OID	Vacation allowance—nonemployee .....	1099-NEC
Donation of motor vehicle .....	1098-C			Wages .....	W-2
Education loan interest .....	1098-E				
Employee business expense reimbursement .....	W-2				

# Partnerships



## Tab B Topics

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## BASICS OF PARTNERSHIPS

Form 1065; See also IRS Pub. 541 and Partnership Example on Page B-16

**Filing requirements.** Every domestic (non-foreign) partnership that has income, deductions, and/or tax credits for the year must file a return, unless it has elected not to be treated as a partnership (see *Exclusion From Partnership Treatment* on Page B-4) [Reg. 1.6031(a)-1].

**Schedules K-2 and K-3.** Schedule K-2 (Partners' Distributive Share Items-International) and Schedule K-3 (Partner's Share of Income, Deductions, Credits, etc.-International) replaced the boxes on Schedule K-1 related to reporting items of international tax relevance. A partnership with no foreign owners, no foreign source income, no assets generating foreign source income, and no foreign taxes paid or accrued may still be required to file Schedules K-2 and K-3 if a partner claims a foreign tax credit or otherwise needs information from the partnership in order to complete Form 1116 [Foreign Tax Credit (Individual, Estate, or Trust)] or Form 1118 (Foreign Tax Credit-Corporations). All partnerships are required to complete the applicable parts of Schedules K-2 and K-3 unless the partnership is certain that none of the partners will need to file Form 1116 or Form 1118. The FAQ section of the IRS website is a good source for new developments. The frequently asked questions (FAQs) for Schedules K-2 and K-3 can be found at [www.irs.gov/businesses/schedules-k2-and-k3-frequently-asked-questions-forms-1065-1120s-and-8865](http://www.irs.gov/businesses/schedules-k2-and-k3-frequently-asked-questions-forms-1065-1120s-and-8865). **2022** Partnership Instructions for Schedules K-2 and K-3 (Form 1065); **dated December 23, 2022**; provide a *domestic filing exception* and a *Form 1116 exemption exception* for filing and furnishing Schedules K-2 and K-3 **for tax years beginning in 2022**.

**Domestic filing exception.** Partnerships that meet this exception do not have to include Schedules K-2 and K-3 in their tax return or furnish copies of Schedule K-3 to their partners unless requested by a partner after the date one month before the date the partnership files its Form 1065. If a partner requests a Schedule K-3 after the one-month date, the partnership must provide the schedule to the partner, but Schedules K-2/K-3 are not filed with the IRS. Domestic partnerships potentially qualify for the domestic filing exception if they have no foreign activity or have limited foreign activity. For this exception, foreign activity is:

- 1) Payment or accrual of foreign income taxes.
- 2) Foreign-source income or loss.
- 3) Ownership interest in a foreign partnership (generally, a partnership that is not a domestic partnership).
- 4) Ownership interest in a foreign corporation.
- 5) Ownership of a foreign branch.
- 6) Ownership interest in a disregarded foreign entity.

**Limited foreign activity.** If a partnership has foreign activity, such foreign activity is limited to:

- 1) Passive category foreign income (for example, dividend income);

- 2) Upon which no more than \$300 of foreign income taxes allowable as a foreign tax credit (FTC) are paid or accrued by the partnership; and
- 3) The foreign income and FTC are shown on a payee statement (for example, Form 1099) furnished to the partnership.

Domestic partnerships that have no (or limited) foreign activity qualify for the domestic filing exception if they meet the following three tests: 1) U.S. Citizen/Resident Alien Partners Test; 2) Notification Test; and 3) No Schedule K-3 Requests by the One-Month Date.

**Form 1116 exemption exception.** A domestic partnership is not required to complete Schedules K-2 and K-3 if all partners are eligible for the Form 1116 exemption and the partnership receives notification of the partners' eligibility for such exemption by the one-month date.

**Filing deadline.** Returns are due by the 15th day of the third month following the close of the tax year.

**Extension deadline and form number.** The extended deadline is six months (Reg. 1.6081-2). For calendar year 2023 returns, the extended due date is September 16, 2024. File Form 7004 to extend the filing deadline.

**Electronic filing requirements.** Partnerships with more than 100 partners and partnerships required to file at least 10 returns of any type during the calendar year are required to file returns electronically. Other partnerships generally have the option to file electronically. The IRS may provide waivers and exemptions where electronic filing would cause undue hardship, or where the technology required to file in electronic form conflicts with religious beliefs.

**Penalties.** The statutory penalty amount for failure to file a partnership return is indexed by a cost-of-living adjustment (COLA). The COLA adjusted penalty amount for failure to file a return in 2024 is \$235 per month or part of a month per partner up to twelve months (IRC Sec. 6698; Rev. Proc. 2022-38). The penalty is assessed against the partnership. Rev. Proc. 84-35 provides relief to certain small partnerships (generally partnerships with 10 or fewer partners at all times during the year) from the penalty under IRC Sec. 6698(a) for failure to file a partnership return. The revenue procedure references the small partnership exception in IRC Sec. 6231(a)(1)(B), which was repealed by the Bipartisan Budget Act of 2015. In a Program Manager Technical Advice (PMTA 2020-01), the IRS concluded that despite the repeal of IRC Sec. 6231(a)(1)(B), Rev. Proc. 84-35 continues to apply.

**Amended return.** Partnerships that become aware of incorrect items of income, deductions, etc. may amend the return. Small partnerships (non-BBA—see *Partnership Audit Rules* on Page B-2) and partnerships that elect out of the centralized partnership audit regime—see *Electing out of the rules* on Page B-2) filing electronically to amend Form 1065 and Schedules K-1 check box G(5) on page 1 of Form 1065 to indicate that it is an amended return and follow the Form 1065 instructions for statements and explanations that are required. An amended Schedule K-1 should be provided to each partner. Partnerships subject to the centralized partnership audit regime must use Form 8082 [Notice of Inconsistent Treatment or Administrative Adjustment Request (AAR)] to file electronically. If paper returns are used to correct a previously filed partnership return, use Form 1065X [Amended Return or Administrative Adjustment Request (AAR)].

**Schedules K-1/K-3 deadline.** Partnerships are required to furnish a Schedule K-1/K-3 to each partner by the due date, including extensions, of the partnership tax return (Form 1065). For statements required to be furnished in 2024, a \$310 penalty, imposed with respect to each Schedule K-1/K-3 for which a failure occurs, applies for failure to furnish Schedule K-1/K-3 when due or failure to include all required information or for including incorrect information. The maximum penalty is \$3,783,000 for all such failures during a calendar year for taxpayers with average annual gross receipts for the most recent three tax years of more than \$5,000,000. For

taxpayers with average annual gross receipts of \$5,000,000 or less, the maximum penalty is \$1,261,000. If the requirement to report correct information is intentionally disregarded, each \$310 penalty is increased to \$630 or, if greater, 10% of the aggregate amount of items required to be reported, and the \$1,261,000 (or \$3,783,000) maximum doesn't apply. The \$310 penalty may be reduced to \$60 or \$120 per failure, and the \$1,261,000 (or \$3,783,000) maximum penalty to \$220,500 or \$630,500 (or \$630,500 or \$1,891,500), respectively, depending on when the failure is corrected (IRC Sec. 6722; Rev. Proc. 2022-38).

**Electronic Schedule K-1.** Partnerships required to furnish a K-1 to a partner may provide it in an electronic format instead of on paper. The partner's affirmative consent to receive the K-1 in electronic format is one of the requirements of Rev. Proc. 2012-17 that must be met for the partnership to be treated as furnishing the K-1 timely.

**Income/tax rates.** Profits and losses are passed through to partners on Schedule K-1 and taxed on their individual returns.

**Limited liability companies (LLCs)** are created and regulated under state law. Those with more than one member are treated as partnerships for federal income tax purposes, unless an election is made to be taxed as a corporation. LLCs generally have the same options as partnerships for electing tax treatment under check-the-box regulations. See *Limited Liability Company (LLC)* on Page F-1 for more information.

**Partnership representative.** A partnership's primary representative in dealings with the IRS is its *partnership representative* (PR). The partnership must designate its PR by completing information on page 3 of Form 1065 for the tax year for which the designation applies. Designation of a PR is made separately for each tax year, and is only effective for the tax year for which it is made [Reg. 301.6223-1(a) and (c)].

The PR is not required to be a partner, and can be any person (including an individual or an entity) with a substantial presence in the U.S. A wholly-owned disregarded entity is eligible to serve as a PR, and the partnership can designate itself as its own PR. A person who is not an individual can be a PR only if an individual who meets the substantial presence test is appointed by the partnership as the sole individual through whom the PR will act. A PR meeting these requirements is an *entity partnership representative* and the individual through whom such an entity partnership representative acts is the *designated individual*. The designated individual must be appointed at the same time as the PR [Reg. 301.6223-1(b)].

The PR has the sole authority to bind the partnership and all partners. If a partnership does not designate a PR, the IRS may select any person as the PR, with certain limitations. Partnerships will need to ensure their agreements establish procedures for choosing, removing, and replacing the PR. In addition, the partnership agreement should carefully outline the duties of the representative. Consider addressing in the partnership agreement whether the:

- PR must provide partners with copies of IRS notices and inform them of the status of an audit or tax proceeding.
- Consent of a majority of the partners is needed before the PR can agree to extend the statute of limitations or settle with the IRS. (While such a provision will not limit the PR's authority in the eyes of the IRS, it may give partners recourse under state law if the PR fails to comply.)
- Partnership agreement should limit the PR's fiduciary risk through indemnity protection.

## Partnership Audit Rules

For tax years beginning after 2017, the TEFRA audit procedures and the electing large partnership rules are repealed and replaced by the Bipartisan Budget Act of 2015 (BBA) *centralized partnership audit regime*. Under the current regime, any adjustment to a *partnership-related item* (any item or amount with respect to the partnership that is relevant in determining the federal income tax liability of any person, and any partner's distributive share of any such item or amount) is made at the partnership level. Any additional tax, penalty, or amount related to the tax is determined and collected at the partnership level unless the partnership elects

an alternative payment process (also known as a push-out election) [IRC Secs. 6221(a), 6226, and 6241; Regs. 301.6221(a)-1, 301.6226-1, and 301.6241-6]. The IRS has launched a BBA centralized partnership audit regime website. It is intended to be a one-stop location for anything BBA-related and can be found at [www.irs.gov/businesses/partnerships/bba-centralized-partnership-audit-regime](http://www.irs.gov/businesses/partnerships/bba-centralized-partnership-audit-regime).

If adjustments to partnership items are made, the partnership will be required to pay the *imputed underpayment amount*, which is generally the net of all adjustments for the reviewed year multiplied by the highest individual or corporate tax rate in effect for that year. However, the partnership can pay a lower amount if it can show that the underpayment would be lower if it were based on certain partner-level information. This could include the partners' amended returns, the tax rates applicable to specific types of partners (individuals, corporations, or tax-exempt organizations), and the type of income subject to the adjustments (IRC Sec. 6225). The IRS has issued final regulations (TD 9969) addressing exceptions for certain partnership-related items from the centralized partnership audit regime. The regulations provide alternative rules that will apply to the examination of excepted items by the IRS. The centralized partnership audit regime does not apply to a partnership-related item if the item involves a special enforcement matter under IRC Sec. 6241(II). The final regulations allow the IRS to focus on a single partner or small group of partners with respect to a limited set of partnership-related items without unduly burdening the partnership and avoiding procedural concerns about the appropriate level at which such items must be examined. The regulations also provide that IRC Sec. 6221(b) generally doesn't apply to a partnership with a QSub as a partner [Reg. 301.6221(b)-1]. Additionally, these regulations address nonincome adjustments that must be included in the computation of imputed underpayments. The regulations affect partnerships and partners to whom special enforcement matters apply. Final regulations are effective on December 9, 2022.

**Electing out of the rules.** Partnerships with 100 or fewer partners can elect out of the audit rules for any tax year, in which case the partnership and its partners will be audited under the general rules for individual taxpayers [IRC Sec. 6221(b); Reg. 301.6221(b)-1]. Generally, a partnership is treated as having 100 or fewer partners for a tax year if it is required to furnish 100 or fewer Schedules K-1. The election is available only if each of the partners is an individual, a C or S corporation, a foreign entity that would be treated as a C corporation were it domestic, the estate of a deceased partner or another person identified in future IRS guidance. The election is made annually and may be revoked only with IRS consent. Partnerships must file Form 1065, Schedule B-2 (Election Out of the Centralized Partnership Audit Regime) with their Form 1065 to make the election.

**Caution:** Partnerships may assume they will be able to elect out of the audit procedures because they have 100 or fewer partners. However, the election is not available if any partner is a partnership, disregarded entity, trust, or foreign entity that would not be treated as a C corporation were it a domestic entity. (This could change if the IRS becomes convinced that expansion of the election out rules to tiered partnerships would not be overly burdensome.) Additionally, if any partner is an S corporation, the number of K-1s it must furnish to its shareholders must also be taken into account.

The partnership agreements of eligible partnerships should address whether an election out will be mandatory. In most situations, an election out will be preferable. However, partnerships looking to maintain flexibility in their partnership agreements should include provisions indicating how the decision to elect out will be made. Partnerships choosing to elect out may want to amend their agreements to prohibit the transfer of partnership interests to ineligible partners and to limit the number of partners to 100 or less.

**Push-out election.** Under the audit regime, a partnership must pay the imputed underpayment amount (along with penalties and interest) resulting from an IRS audit unless it makes a push-out election, which lets a partnership push an adjustment out to the

Form **1065** U.S. Return of Partnership Income OMB No. 1545-0123  
 Department of the Treasury Internal Revenue Service For calendar year 2023, or tax year beginning 5/1, 2023, ending 12/31, 2023  
 Go to [www.irs.gov/Form1065](http://www.irs.gov/Form1065) for instructions and the latest information. **2023**

**A** Principal business activity: Recreation  
**B** Principal product or service: Skydiving  
**C** Business code number: 713900

Name of partnership: Shout and Jump  
 Number, street, and room or suite no. If a P.O. box, see instructions: 444 Aviator Blvd.  
 City or town, state or province, country, and ZIP or foreign postal code: Flagstaff, AZ 86001

**D** Employer identification number: 411234567  
**E** Date business started: May 1, 2023  
**F** Total assets (see instructions): \$ 332,244

**G** Check applicable boxes: (1)  Initial return (2)  Final return (3)  Name change (4)  Address change (5)  Amended return  
**H** Check accounting method: (1)  Cash (2)  Accrual (3)  Other (specify):  
**I** Number of Schedules K-1. Attach one for each person who was a partner at any time during the tax year: 2  
**J** Check if Schedules C and M-3 are attached:   
**K** Check if partnership: (1)  Aggregated activities for section 465 at-risk purposes (2)  Grouped activities for section 469 passive activity purposes

**Caution:** Include only trade or business income and expenses on lines 1a through 23 below. See instructions for more information.

	1a	b	c	1c	
<b>Income</b>	Gross receipts or sales	Less returns and allowances	Balance		
	413,692			413,692	
	Cost of goods sold (attach Form 1125-A)			61,692	
	Gross profit. Subtract line 2 from line 1c			352,000	
	Ordinary income (loss) from other partnerships, estates, and trusts (attach statement)				
	Net farm profit (loss) (attach Schedule F (Form 1040))				
	Net gain (loss) from Form 4797, Part II, line 17 (attach Form 4797)				
	Other income (loss) (attach statement)				
	<b>Total income (loss).</b> Combine lines 3 through 7			352,000	
<b>Deductions</b> (see instructions for limitations)	Salaries and wages (other than to partners) (less employment credits)			48,182	
	Guaranteed payments to partners			70,500	
	Repairs and maintenance			1,986	
	Bad debts				
	Rent			14,200	
	Taxes and licenses			4,946	
	Interest (see instructions)			6,175	
	Depreciation (if required, attach Form 4562)	22,800			
	Less depreciation reported on Form 1125-A and elsewhere on return			22,800	
	Depletion (Do not deduct oil and gas depletion.)				
Retirement plans, etc.					
Employee benefit programs			4,800		
Energy efficient commercial buildings deduction (attach Form 7205)					
Other deductions (attach statement)			50,187		
<b>Total deductions.</b> Add the amounts shown in the far right column for lines 9 through 21				223,776	
<b>Ordinary business income (loss).</b> Subtract line 22 from line 8				128,224	
<b>Tax and Payment</b>	Interest due under the look-back method—completed long-term contracts (attach Form 8697)				
	Interest due under the look-back method—income forecast method (attach Form 8866)				
	BBA AAR imputed underpayment (see instructions)				
	Other taxes (see instructions)				
	<b>Total balance due.</b> Add lines 24 through 27				
	Elective payment election amount from Form 3800				
	Payment (see instructions)				
<b>Amount owed.</b> If the sum of line 29 and line 30 is smaller than line 28, enter amount owed					
<b>Overpayment.</b> If the sum of line 29 and line 30 is larger than line 28, enter overpayment					

**Sign Here**  
 Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than partner or limited liability company member) is based on all information of which preparer has any knowledge.  
 Signature of partner or limited liability company member: Jerry Javit Date: 3/11/24  
 May the IRS discuss this return with the preparer shown below? See instructions.  Yes  No

**Paid Preparer Use Only**  
 Print/Type preparer's name: Preparer's signature: Date: Check  if self-employed PTIN:  
 Firm's name: Firm's EIN:  
 Firm's address: Phone no.:

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 11390Z Form 1065 (2023)

## Line-By-Line Instructions

The Form 1065 and supporting schedules shown at left and on the following pages were prepared for Shout and Jump using the information from the Cash Flow and Income Statements and the Balance Sheet as of December 31, 2023.

### Form 1065, Page 1 Instructions

**Items A–C: Business activity.** For a list of partnership principal business activity codes, see Tab O.

**Item D: Employer identification number.** See *Employer Identification Numbers (EINs)* on the inside front cover of the *Small Business Quickfinder® Handbook* for information on obtaining an EIN.

**Item E: Date business started.** The date the business started to conduct business, even if the partnership was organized earlier. A



partnership does not file a return until the first tax year it conducts business.

**Item F: Total assets.** If question 4 from Schedule B is answered “yes,” item F is not required to be completed. Item F should equal line 14, column (d), Schedule L. If no ending assets, enter “0”.

**Item G: Check applicable boxes.** In this example, the initial return box is checked since it is the partnership’s first return.

**Item H: Accounting method.** Purchases and sales of inventory must generally be accounted for under the accrual method. Since taxpayers (not including tax shelters) with average annual gross receipts of \$25 million (\$29 million for 2023) or less are allowed to use the cash method even if they hold inventory, Shout and Jump uses the cash method of accounting for all purchases and sales. See Tab L of the *Small Business Quickfinder® Handbook* for limitations on when the cash method may be used by a partnership.

The cash method does not recognize accounts payable or receivable in computing income or cost of goods sold (COGS).

### Accounts Payable:

- **Cash method.** The cost of inventory is deducted when the inventory is sold or paid for, whichever occurs later. A cash basis taxpayer does not recognize accounts payable when computing COGS.
- **Hybrid method.** The cost of inventory purchased on account is recognized regardless of when payment is made.

### Accounts Receivable:

- **Cash method.** Accounts receivable are not recognized as income until the customer makes payment.
- **Hybrid method.** Sales on account are recognized as income regardless of when customer makes payment.

**Item J: Schedules C and M-3.** Check if Schedules C and M-3 are attached. See *Schedule M-3 (Form 1065)* on Page B-25 for filing requirements.

**Item K: At-risk and passive activity purposes.** Check if activities are aggregated for IRC Sec. 465 at-risk purposes or grouped for IRC Sec 469 passive activity purposes. See *At-Risk Activity* on Page B-10.

**Lines 1–8: Business activity income.** Only trade or business activity income is reported on these lines. Portfolio income is reported on Schedule K. Rental activities are entered on Form 8825 and the net income or loss is carried to Schedule K.

**Practice Tip:** No direct reporting on Form 1065 of any amounts from Forms 1099-K is required. The IRS will use the data from Forms 1099-K to help determine if gross receipts are fully reported. Preparers should review the Forms 1099-K received to be sure that in the aggregate they do not significantly exceed the gross receipts reported, but the IRS requires no reconciliation.

**Line 2: Form 1125-A (Cost of Goods Sold).** If the production, purchase or sale of merchandise is an income-producing factor, merchandise inventories must be taken into account at the beginning and end of each tax year. See *Inventories* on Page L-8 of the *Small Business Quickfinder® Handbook* for information on inventory valuation methods.

In addition to the direct inventory costs, UNICAP requires partnerships to capitalize or include in inventory certain indirect costs incurred in connection with the production of real or tangible personal property held in inventory or held for sale in the ordinary course of business, but not if average annual gross receipts are \$25 million (\$29 million for 2023) or less unless the partnership

is a tax shelter. See *Uniform Capitalization Rules* on Page L-9 of the *Small Business Quickfinder® Handbook* for information on IRC Sec. 263A.

**Line 4: Ordinary income (loss) from other partnerships, estates, and trusts.** If this partnership is a partner in another partnership or a beneficiary of an estate or trust, enter the partnership's share of ordinary income from Schedule K-1. Enter portfolio income and rental activity income (loss) on Schedule K.

**Line 5: Farm income (loss).** Use Schedule F of Form 1040 to figure net farming income and attach it to Form 1065. If the partnership received farm income from another partnership, report it on line 4.

**Line 6: Form 4797.** Enter net gain or loss from line 17 of Form 4797 (Part II). Section 1231 gain (loss) from Form 4797 is entered on line 10 of Schedule K.

**Line 7: Other income (loss).** Use line 7 for trade or business income not included on lines 1a through 6.

*Examples of income to include:*

- Interest derived in the ordinary course of the partnership's trade or business, such as interest charged on receivable balances.  
🔗 **Note:** Interest earned from a savings account is portfolio interest and should not be reported on this line. Report portfolio interest income on line 5 of Schedule K.
- Recoveries of bad debts deducted in earlier years under the specific charge-off method.
- Taxable income from insurance proceeds.
- Recapture amount for IRC Sec. 280F when the business use of listed property drops to 50% or less.
- All Section 481 income adjustments from accounting method changes.
- Proceeds from certain employer-owned life insurance contracts issued after August 17, 2006 [IRC Sec. 101(j)].

Do not include items requiring separate computations that must be reported on Schedules K and K-1. Do not report portfolio or rental activity income (loss) on this line.

**Lines 9—22: Business activity deductions.** Use these lines for trade or business activity deductions. Portfolio and rental activity deductions should be listed on a separate schedule and carried to Schedule K.

**Line 9: Wages.** Report the gross wages paid (including withheld taxes) minus any employment credits on line 9. Do not include any commissions paid to independent contractors. Payments to partners for services rendered are not wages.

Both the employee and employer portions of the social security taxes are 6.2% for wages paid in tax year 2023. Medicare taxes for both the employee and employer are 1.45% (2.9% total). For further coverage, see Tab 23.

**Line 10: Guaranteed payments to partners.** Enter payments to partners for services rendered or for the use of capital that are not determined by partnership profits. Also enter this amount on line 4a of Schedule K. In this example, the partnership paid Jerry \$36,500 and Bob \$30,800. Payments for the use of capital are reported on line 4b of Schedule K with the total amount of guaranteed payments to partners entered on line 4c. The payments are deductible by the partnership and taxable to the partners.

In addition to payments for services rendered, guaranteed payments also include group medical insurance premiums paid by the partnership for the benefit of the partners. In this example, the partnership paid \$1,600 of premiums for each partner. This amount

should also be entered on line 13e of Schedule K, and line 13 of Schedule K-1, code M since it may be a deduction for the partners on their individual tax returns.

Do not include payments that should be capitalized. For example, although payments to a partner for services rendered in organizing a partnership may be guaranteed payments, they are not deductible on line 10. These amounts should be separately reported on line 4a of Schedules K and K-1. Do not include distributive shares of partnership profits.

Guaranteed payments are generally subject to SE tax—see *Guaranteed Payments* on Page B-9.

**Line 11: Repairs** that do not add to the value of the property being repaired or appreciably prolong its life are deductible on this line.

**Line 12: Bad debts.** Debts that became worthless during the tax year are deductible on this line only if they were previously included in taxable income. Generally, a cash method taxpayer does not deduct bad debts.

**Line 13: Rent.** The partnership paid \$1,775 monthly facility rent.

**Line 14: Taxes** reported on line 14 include the employer's share of FICA, state unemployment taxes, and federal unemployment taxes. To keep the example simple, a 6% total tax rate was assumed for SUTA and FUTA and all payroll taxes were deposited before year end. The employees' share of FICA plus state and federal income tax withholding was reported as wages on line 9. Sales taxes collected and paid over to the state are not included because the amount collected was not added to gross income.

*Taxes that should not be reported on line 14 include:*

- Sales taxes on the purchase of assets or supplies, which should be added to the cost basis of the asset or supply.
- Taxes paid in connection with COGS, which should be reported on Form 1125-A.
- Taxes assessed on property improvements, which are added to the cost basis of the asset.
- Federal income, estate, inheritance, legacy, succession, and gift taxes.
- Section 901 foreign taxes, which are reported on Schedule K.
- Taxes allocated to portfolio income and rental activities, which are reported on Schedule K and Form 8825, respectively.
- Taxes capitalized or included in inventories under UNICAP.

**Line 15: Interest.** The partnership paid \$6,175 in interest on the loan to purchase the airplane. Since the partnership's gross receipts are not over \$29 million dollars, the entire amount is deductible and is not subject to the interest expense limitation.

*Interest that is not reported on line 15 includes:*

- Interest capitalized or included in inventory under UNICAP.
- Interest on debt used to purchase rental property or in a rental activity (report on line 2 or 3b of Schedule K).
- Interest on debt used to purchase investment property (report on line 13c of Schedule K and line 13 of Schedule K-1, code H).
- Interest on debt proceeds allocated to distributions made to partners during the tax year. Instead, report the interest on line 13e of Schedule K and line 13, code **WAC** of Schedule K-1.
- Interest paid by a partnership to a partner for the use of capital is entered on page 1, line 10, as a guaranteed payment.

**Line 16: Depreciation.** See the *Depreciation Schedule* on Page B-17 for computation of the \$22,800 deduction. See also Form 4562 on Page B-27. The Section 179 deduction is not reported here; it is entered on line 12 of Schedules K and K-1. The Section 179 limitations first apply at the partnership level, and then



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**Schedule B Other Information (continued)**

**b** Under the covered surrogate foreign corporation rules? If "Yes" to either (a) or (b), complete Form 7208, Excise Tax on Repurchase of Corporate Stock. See the Instructions for Form 7208. Yes No X

**30** At any time during this tax year, did the partnership (a) receive (as a reward, award, or payment for property or services); or (b) sell, exchange, or otherwise dispose of a digital asset (or financial interest in a digital asset)? See instructions. X

**31** Is the partnership electing out of the centralized partnership audit regime under section 6221(b)? See instructions. If "Yes," the partnership must complete Schedule B-2 (Form 1065). Enter the total from Schedule B-2, Part III, line 3. X  
If "No," complete Designation of Partnership Representative below.

**Designation of Partnership Representative** (see instructions)  
Enter below the information for the partnership representative (PR) for the tax year covered by this return.

Name of PR Jerry Taxit  
U.S. address of PR 007 Like-Kind Ave., Phase-Out, AZ 85555 U.S. phone number of PR (567) 890-1234  
If the PR is an entity, name of the designated individual for the PR U.S. phone number of designated individual (567) 890-1234

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**Line 31: Electing out of centralized partnership audit regime.** See *Electing out of the rules* on Page B-2.

**Schedule K, Page 5 (Form 1065)**

**Partners' shares of income, credits, deductions, etc.** All partnerships are required to complete Schedule K. Schedule K is the combined total from each partner's Schedule K-1. If the partnership has more than one trade or business activity, a statement should be attached to each partner's Schedule K-1 that identifies each activity.

**Line 1: Ordinary business income (loss).** Enter the amount from line 23, page 1, of Form 1065.

**Line 2: Rental real estate activities.** Use Form 8825 to report income and expenses from rental real estate activities. Report the net income (loss) on line 2.

**Line 3: Other rental activities.** Use line 3a to report income and 3b for expenses from rental activities not included on line 2. Attach a separate schedule listing all expenses reported on line 3b. These amounts are netted on line 3c.

**Line 4: Guaranteed payments.** Enter the amount from line 10 of Form 1065 (page 1), plus any guaranteed payments the partnership is required to capitalize. Generally, guaranteed payments are not considered passive income.

In this example, the guaranteed payments include the group medical insurance premiums paid for the partners. These payments for services are included on line 4a with total guaranteed payments shown on line 4c.

**Lines 5-9: Portfolio income (loss).** Enter only taxable portfolio income (loss). Do not reduce portfolio income by portfolio deductions. If any capital gain or loss is from disposition of nondepreciable personal property used in a trade or business, it may not be treated as portfolio income. Report such gain or loss on line 11 of Schedule K.

In this example, the \$316 of interest earned from the partnership savings account is entered on line 5.

**Line 10: Section 1231 gain or loss.** Enter amount from line 7 of Form 4797.

**Line 11: Other income (loss).** Report the following (Schedule K-1 codes are shown):

- Other portfolio income or loss not reported on lines 5-10—Code A. Identify on an attachment.
- Gain or loss from involuntary conversions due to casualty or theft (Form 4684). The gain or loss must be from property used in a trade or business or for income-producing purposes—Code B.
- Gains or losses from Section 1256 contracts—Code C.
- Mining exploration costs recapture information—Code D.
- Cancellation of debt—Code E.
- Section 743(b) positive adjustments—Code F.

*Continued on the next page*

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**Schedule K Partners' Distributive Share Items**

		Total amount
Income (Loss)	<b>1</b> Ordinary business income (loss) (page 1, line 23)	128,224
	<b>2</b> Net rental real estate income (loss) (attach Form 8825)	2
	<b>3a</b> Other gross rental income (loss)	3a
	<b>b</b> Expenses from other rental activities (attach statement)	3b
	<b>c</b> Other net rental income (loss). Subtract line 3b from line 3a	3c
	<b>4</b> Guaranteed payments: <b>a</b> Services <b>4a</b> <b>b</b> Capital <b>4b</b>	4c 70,500
	<b>c</b> Total. Add lines 4a and 4b	4c 70,500
	<b>5</b> Interest income	5 316
	<b>6</b> Dividends and dividend equivalents: <b>a</b> Ordinary dividends <b>6a</b>	6a
	<b>b</b> Qualified dividends <b>6b</b> <b>c</b> Dividend equivalents <b>6c</b>	6c
	<b>7</b> Royalties	7
<b>8</b> Net short-term capital gain (loss) (attach Schedule D (Form 1065))	8	
<b>9a</b> Net long-term capital gain (loss) (attach Schedule D (Form 1065))	9a	
<b>b</b> Collectibles (28%) gain (loss)	9b	
<b>c</b> Unrecaptured section 1250 gain (attach statement)	9c	
<b>10</b> Net section 1231 gain (loss) (attach Form 4797)	10	
<b>11</b> Other income (loss) (see instructions) Type:	11	
Deductions	<b>12</b> Section 179 deduction (attach Form 4562)	12 25,000
	<b>13a</b> Cash contributions	13a
	<b>b</b> Noncash contributions	13b
	<b>c</b> Investment interest expense	13c
	<b>d</b> Section 59(e)(2) expenditures: (1) Type: (2) Amount: <b>13d(2)</b>	13d(2)
<b>e</b> Other deductions (see instructions) Type: Partners' Health Insurance	13e 3,200	
Self-Employment	<b>14a</b> Net earnings (loss) from self-employment	14a 198,724
	<b>b</b> Gross farming or fishing income	14b
	<b>c</b> Gross nonfarm income	14c 352,000
Credits	<b>15a</b> Low-income housing credit (section 42(j)(5))	15a
	<b>b</b> Low-income housing credit (other)	15b
	<b>c</b> Qualified rehabilitation expenditures (rental real estate) (attach Form 3468, if applicable)	15c
	<b>d</b> Other rental real estate credits (see instructions) Type:	15d
	<b>e</b> Other rental credits (see instructions) Type:	15e
	<b>f</b> Other credits (see instructions) Type:	15f
Alternative Minimum Tax (AMT) Items	<b>17a</b> Post-1986 depreciation adjustment	17a
	<b>b</b> Adjusted gain or loss	17b
	<b>c</b> Depletion (other than oil and gas)	17c
	<b>d</b> Oil, gas, and geothermal properties—gross income	17d
	<b>e</b> Oil, gas, and geothermal properties—deductions	17e
	<b>f</b> Other AMT items (attach statement)	17f
	<b>18a</b> Tax-exempt interest income	18a
Other Information	<b>b</b> Other tax-exempt income	18b
	<b>c</b> Nondeductible expenses	18c 280
	<b>19a</b> Distributions of cash and marketable securities	19a 20,000
	<b>b</b> Distributions of other property	19b
	<b>20a</b> Investment income	20a 316
	<b>b</b> Investment expenses	20b
	<b>c</b> Other items and amounts (attach statement)	
<b>21</b> Total foreign taxes paid or accrued	21	

Form 1065 (2023)

**Line 27: Transfers between the partnership and partners.** Indicate on line 27 if there were any transfers between the partnership and its partners subject to the disclosure requirements of Reg. 1.707-8.

**Line 28: Acquisition by foreign corporation.** Provide the indicated information as applicable.

**Line 29: Excise tax on repurchase of corporate stock.** Indicate if the partnership is filing Form 7208 relating to the excise tax on repurchase of corporate stock. See Form 7208 instructions for details.

**Line 30: Digital assets.** Indicate if the partnership received, sold, exchanged, or disposed of a digital asset.

- Section 951(a) income inclusions—Code H.
- **Any other item of income or loss not included in lines 1–10. Use Code I.**
- Gains from the disposition of farm recapture property (see Form 4797)—Code **IP**.
- Other Section 1252 gains or losses—Code **IP**.
- Gains or losses from Section 1254 property—Code I.
- Tax benefit item recoveries (IRC Sec. 111)—Code **IJ**.
- Gambling gains and losses—Code **IK**.
- Section 751(b) gains or losses—Code **IL**.
- Specially allocated ordinary gain (loss)—Code **IR**.
- Gain from sale of Section 1202 stock that is eligible for exclusion—Code **IO**.
- Gain from Section 1045 rollover—Codes **IM and N**.
- Gains or losses on qualified preferred stock of the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation—Code **IQ**.
- Gain or loss from line 7 or 15 of Schedule D that is not portfolio income—Code **IS**.
- **Any other item of income or loss not assigned a specific code—Code ZZ.**

**Line 12: Section 179 expense deduction.** Enter amount from line 12 of Form 4562. Line 12 of Schedule K-1 should not be completed for any partner that is an estate or trust. The limitations on the Section 179 deduction apply first at the partnership level, and then at the partner level.

**Line 13a and 13b: Charitable contributions.** Enter charitable contributions made by the partnership. Report on line 13 of each Schedule K-1 with the code and amount for each contribution category. For partnership noncash contributions greater than \$5,000, give each partner a copy of Form 8283. Attach Form 8283 (Noncash Charitable Contributions) to Form 1065 if the deduction claimed for noncash contributions exceeds \$500.

**Line 13c: Investment interest expense.** Enter interest paid or accrued to purchase or carry property held for investment.

**Line 13d: Section 59(e)(2) expenditures.** See the IRS instructions for Schedule K.

**Line 13e: Other deductions.** Use line 13e for deductions not included on other lines. Also enter each partner's share on Schedule K-1, line 13, with the applicable code, or provide the information on a statement attached to the K-1, as required by the Schedules K and K-1 instructions.

In this example, the amount of the group medical insurance premiums paid by the partnership for each partner is included on line 4a as taxable guaranteed payments and listed again on line 13e as a deductible expense on the partners' tax returns. Qualifying individual partners can deduct 100% of such amounts on Form 1040 as an adjustment to income.

**Line 14a: Net earnings (loss) from self-employment.** In general, the profits from trade or business activities and certain rental activities are subject to SE tax when passed through to the general partners. A limited partner's share of income is not normally SE income unless it is considered guaranteed payments for services rendered (see the Note under *Self-employment (SE) tax* on Page B-3 for information about LLC members who have limited liability like limited partners but who were active in the service business). Portfolio income and rental real estate income are generally not subject to SE tax unless the income is received in the course of a trade or business. Guaranteed payments are generally subject to SE tax—see *Guaranteed Payments* on Page B-9. The ordinary gain from Form 4797 reported on line 6 of Form 1065 (page 1) is not subject to SE tax. See the IRS Schedule K instructions for the worksheet for figuring net earnings (loss) from self-employment.

In this example, the amount on line 14a equals the ordinary income from line 1, plus the guaranteed payments from line 4a. See the worksheet in the Form 1065 instructions for other amounts to include.

**Line 14c: Gross nonfarm income.** In this example, the amount reported on line 14c equals the gross profit amount from line 3 on page 1 of Form 1065.

**Line 15: Credits.** See *Tax Credits* on Page O-5 and IRS Schedule K instructions.

**Line 16: Foreign transactions.** Check the box to indicate that the partnership is reporting items of international tax relevance and attach Schedule K-2 (Form 1065).

**Lines 17a–17f: Alternative minimum tax items.** Amounts reported on these lines are for the computation of the AMT. See IRS Schedule K instructions for details.

**Lines 18a and 18b: Tax-exempt income.** See IRS Schedule K instructions.

**Line 18c: Nondeductible expenses.** In this example, the nondeductible portion of meals is entered.

**Lines 19a and 19b: Distributions.** The December cash distributions to Bob and Jerry are combined on line 19a.

**Line 20a: Investment income.** In this example, \$316 interest income is entered.

**Line 20b: Investment expenses.** Enter deductible expenses (other than interest) directly connected with the production of investment income. See IRS Form 4952 instructions for details.

**Line 20c: Other items and amounts.** Attach a statement to provide details of several items listed in the IRS Schedule K instructions. On Schedule K-1, enter the appropriate code in the line 20 code box, followed by an asterisk. In the amount box, enter "STMT."

**Line 21: Foreign taxes.** Enter total creditable foreign taxes paid or accrued.

### Analysis of Net Income (Loss), Form 1065 (Page 6)

Income and deduction items on Schedule K are netted against each other. Line 2 shows the portion of line 1 that is allocated to each type of partner. Individual partners are further split into active or passive categories. Guidance for classifying partners as active or passive is in the Form 1065 instructions. Apply it to each partner separately. If the partnership cannot make a reasonable determination whether a partner's participation in a trade or business activity is material or whether a partner's participation in a rental real estate activity is active, classify the partner as *passive*.

### Schedule L, Page 6 (Form 1065)

**Balance sheet.** The balance sheet should agree with the partnership's books and records. See *Balance Sheet* on Page L-15 of the *Small Business Quickfinder® Handbook* for more information. However, if question 4 on Schedule B is answered "yes," the partnership is not required to complete Schedule L.

**Line 1: Cash.** See the *Cash Flow Statement* on Page B-18.

**Line 9b: Accumulated depreciation.** See the *Depreciation Schedule* on Page B-17 for a list of depreciable assets and accumulated depreciation. Many partnerships use tax depreciation for bookkeeping purposes. See Tab 10 for other examples.

**Line 17: Other current liabilities.** In this example, the liabilities on line 17 include sales taxes collected in December of 2023 (\$1,288), but not paid over to the state until January of 2024.

**Line 18: Nonrecourse loans.** Those liabilities of the partnership for which none of the partners have any personal liability.

**Line 19b: Notes payable.** In this example, the remaining principal balance on the airplane loan as of December 31, 2023 is entered on line 19. Here, the balance due was not split between the amount due in less than one year versus the amount due in one year or more. If the tax return preparer can obtain access to this information, each partnership loan should be split between the amounts reportable on lines 16 and 19.

**Line 21: Partners' capital accounts.** This is the same as owners' equity or the net worth of a partnership. Partnership capital equals the partnership assets minus the partnership liabilities. Line 21

- Portfolio income or loss.
- Tax-exempt income.
- Excluded cancellation of debt (COD) income.

**Line 1: Gross receipts or sales.** Enter gross receipts from trade or business operations except those reported on lines 4 and 5.

Shout and Jump, Inc., made \$413,692 from sales revenue. Interest income of \$316 from the business savings account is reported on Schedules K and K-1.

**Line 2: Cost of goods sold.** See instructions for Form 1125-A on Page D-18.

**Line 4: Net gain (loss) from Form 4797.** Report on line 4 only ordinary gains or losses from the sale, exchange or involuntary conversion of assets used in a trade or business activity (from line 17, Part II of Form 4797). Sales or exchanges of assets used in rental activities and net Section 1231 gains and losses (see *Disposition of Assets* on Page N-16 of the *Small Business Quickfinder® Handbook*) must be reported separately on Schedule K. Report dispositions of Section 179 property in box 17 of Schedule K-1 using code K.

**Line 5: Other income.** Use line 5 to report trade or business income (not rental activity) that is not reported on lines 1–4. List the type and amount of income on an attached statement.

*Examples include:*

- Interest or service charges on accounts receivable balances.
- Recoveries of bad debts deducted in earlier years under the specific charge-off method.
- Taxable insurance proceeds.
- Section 280F recapture.
- Section 481 adjustments from accounting method changes.
- Certain proceeds from corporate owned life insurance contracts.
- Partnership income or loss (line 1, Part III Schedule K-1, Form 1065).

**Deductions.** Report only trade or business activity expenses on lines 7–20. Do not report rental activity expenses, deductions allocable to portfolio income, or nondeductible expenses.

**Limitations on deductions.** An S corporation may be limited in deducting trade or business activity expenses under these rules:

- Section 263A UNICAP rules require corporations to capitalize or include in inventory certain costs incurred in connection with the production of real and tangible personal property held in inventory or held for sale in the ordinary course of business.
- An accrual basis S corporation can only deduct a business expense owed to a related party in the corporation's tax year that includes the day on which the related party reports the payment as income (IRC Sec. 267).
- Business start-up and organizational costs must be capitalized unless a deemed election is made to deduct or amortize them.
- If the corporation claims any of several tax credits listed in the Form 1120-S instructions, reduce the otherwise allowable deductions for expenses used to figure the credit by the amount of the current-year credit.

**Line 7: Compensation of officers.** Enter total wages paid to officers plus fringe benefit expenditures made on behalf of officers owning more than 2% of the corporation's stock. The fringe benefits are also reported as wages in box 1 of Form W-2. Fringe benefits for officers owning 2% or less of the corporation's stock are reported on line 18, page 1 of Form 1120-S, and are not taxable to the employee. In this example, \$1,600 for each of the three non-owner employees is reported on line 18.

Do not include on line 7 wages reported elsewhere on the return, such as amounts included in COGS.

**Note:** When a corporation's total receipts (page 1, line 1a, plus lines 4 and 5; income reported on Schedule K, lines 3a, 4, 5a, and 6; income or net gain reported on Schedule K, lines 7, 8a, 9, and 10; and income or net gain reported on Form 8825, lines 2, 19, and 20a) are \$500,000 or more, it needs to complete

Form 1125-E (Compensation of Officers). Enter on Form 1120-S, line 7, the amount from Form 1125-E, line 4. (A sample form for a similar example is on Page C-24.)

**Health insurance.** In this example, the wages paid to Jerry and Bob plus the health insurance premiums paid on their behalf are entered on line 7 of Form 1120-S and in box 1 of Form W-2. The health insurance is identified in box 14 of Form W-2 so that Jerry and Bob may deduct the amount on their individual tax returns. See example of Jerry's 1040 on Page D-26. Unlike the partnership example, health insurance is not reported as a separately stated item on Schedule K-1. Also, S corporation payments for shareholders' health insurance are not FICA wages.

**Caution:** Beginning in 2014, medical reimbursement plans (MRPs) are considered group health plans under the Affordable Care Act (ACA). The ACA requires group health plans to meet certain market reform requirements regarding unlimited benefits and no-cost coverage (Notice 2013-54). Failure to meet market reform requirements results in significant penalties. The 2016 Cures Act provides for Qualified Small Employer Health Reimbursement Arrangements (QSEHRAs) (see *Health Insurance Plans* on Page K-12 of the *Small Business Quickfinder® Handbook* for details), that are not subject to penalties. Notice 2015-17 provides transitional relief for small employers (average of less than 50 employees in the prior tax year) that reimburse or pay premiums for employee health care policies. The Notice also provides guidance for S corporations that pay or reimburse more-than-2% shareholders for premiums for individual health insurance policies. The IRS will not assert the penalties with regard to more-than-2% S corporation shareholder-employees until additional guidance is issued.

**Line 8: Salaries and wages.** Enter gross wages paid to employees who are not officers of the corporation. Include fringe benefits made on behalf of employees (other than officers) owning more than 2% of the corporation's stock. Also report these fringe benefits as wages in box 1 of Form W-2.

Do not include on line 8 wages reported elsewhere on the return, such as amounts included in COGS.

Also, reduce wages on lines 7 and 8 by any applicable employment credits.

**Note:** Both the employee and employer portion of social security taxes are 6.2% for wages paid. Medicare taxes for both the employee and employer are 1.45% (2.9% total). For further coverage, see Tab 23.

**Line 9: Repairs and maintenance.** Enter cost of incidental repairs that do not add to the value of the property or appreciably prolong its life. The corporation paid \$1,986 for repairs.

**Line 10: Bad debts.** Enter only trade or business activity bad debts that became worthless during the year. **Note:** A bad debt can only be deducted if the amount was previously included in income.

**Line 11: Rents.** The corporation paid \$1,775 per month to rent its facility for a total of \$14,200.

**Line 12: Taxes.** Enter taxes paid or incurred in the trade or business activities of the corporation.

*Do not include the following on line 12:*

- Taxes reported elsewhere on the return, such as COGS.
- Taxes incurred in the production or collection of income, or for the management, conservation, or maintenance of property held to produce income. Report these taxes separately on Schedules K, line 12d, and K-1, box 12, code **SZZ** (or **Z** if the item could be reported as an itemized deduction).
- Taxes allocable to portfolio income or rental activities. Report on appropriate lines of Schedules K and K-1.
- Sales tax paid in connection with the acquisition of property is added to the cost of the property. Taxes paid on the disposition of property reduce the amount realized upon disposition.

*Continued on the next page*

Form <b>1125-A</b>		<b>Cost of Goods Sold</b>		OMB No. 1545-0123	
(Rev. November 2018) Department of the Treasury Internal Revenue Service		▶ Attach to Form 1120, 1120-C, 1120-F, 1120S, or 1065. ▶ Go to <a href="http://www.irs.gov/Form1125A">www.irs.gov/Form1125A</a> for the latest information.			
Name <b>Shout and Jump, Inc.</b>		Employer identification number <b>41-1234567</b>			
<b>1</b>	Inventory at beginning of year	<b>1</b>		<b>0</b>	
<b>2</b>	Purchases	<b>2</b>		<b>67,418</b>	
<b>3</b>	Cost of labor	<b>3</b>			
<b>4</b>	Additional section 263A costs (attach schedule)	<b>4</b>			
<b>5</b>	Other costs (attach schedule)	<b>5</b>			
<b>6</b>	<b>Total.</b> Add lines 1 through 5	<b>6</b>		<b>67,418</b>	
<b>7</b>	Inventory at end of year	<b>7</b>		<b>5,726</b>	
<b>8</b>	<b>Cost of goods sold.</b> Subtract line 7 from line 6. Enter here and on Form 1120, page 1, line 2 or the appropriate line of your tax return. See instructions	<b>8</b>		<b>61,692</b>	
<b>9a</b>	Check all methods used for valuing closing inventory:				
	(i) <input checked="" type="checkbox"/> Cost				
	(ii) <input type="checkbox"/> Lower of cost or market				
	(iii) <input type="checkbox"/> Other (Specify method used and attach explanation.) ▶				
<b>b</b>	Check if there was a writedown of subnormal goods <input type="checkbox"/>				
<b>c</b>	Check if the LIFO inventory method was adopted this tax year for any goods (if checked, attach Form 970) <input type="checkbox"/>				
<b>d</b>	If the LIFO inventory method was used for this tax year, enter amount of closing inventory computed under LIFO <b>9d</b>				
<b>e</b>	If property is produced or acquired for resale, do the rules of section 263A apply to the entity? See instructions <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No				
<b>f</b>	Was there any change in determining quantities, cost, or valuations between opening and closing inventory? If "Yes," attach explanation <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No				

- Taxes on special assessments that increase the value of the property are added to the cost of the property.
- Federal income taxes (except for the portion of built-in gains tax allocable to ordinary income).
- Taxes not imposed on the corporation.
- Taxes allocable to Section 263A capitalization.
- Section 901 foreign taxes must be reported separately using Schedules K-2 and K-3.

**Line 13: Interest.** Include interest incurred in the trade or business activities of the corporation that is not claimed elsewhere on the return. Interest related to rental activities or portfolio income must be reported separately on Schedules K and K-1.

Interest allocable to certain property produced by an S corporation for its own use or for sale must be capitalized. Interest allocable to an asset used to produce the above property must also be capitalized. See *Capitalization of Interest* on Page L-10 of the *Small Business Quickfinder® Handbook* for more information.

Generally, prepaid interest can only be deducted over the period to which the prepayment applies. See IRC Sec. 461(g) for details.

In this example, the corporation deducts the interest paid on the airplane loan. Since the S corporation's gross receipts are not over \$29 million dollars, the entire amount is deductible and is not subject to the interest expense limitation. See *Business Interest Expense Limitation* on Page B-5 for the post-TCJA rules on interest limitations.

**Line 14: Depreciation.** Enter depreciation from Form 4562 not claimed on Form 1125-A (COGS) or elsewhere on the return. The Section 179 deduction is not included on line 14. It must be reported separately on Schedules K and K-1.

**Line 15: Depletion.** Do not enter depletion for oil and gas properties on this line. The

corporation reports the necessary information to each shareholder in box 17 of Schedule K-1 using code R.

**Line 16: Advertising.** The corporation incurred \$13,183 in advertising costs, of which \$2,016 was during the start-up period of the business and is reported as start-up costs on line 20.

**Line 17: Pension, profit-sharing, etc., plans.** Enter contributions not claimed elsewhere on the return made by the corporation for its employees under a qualified pension, profit-sharing, annuity, SEP, SIMPLE, or any other deferred-compensation plan. If the corporation contributes to an IRA for employees, include the contribution in wages on line 8, or on line 3 of Form 1125-A. This amount must be reduced for certain retirement related credits (for example, employer contributions and military spouse participation credits).

**Line 18: Employee benefit programs.** Enter amounts for fringe benefits paid or incurred on behalf of employees owning 2% or less of the corporation's stock.

*These fringe benefits include:*

- Employer contributions to certain accident and health plans,
- Cost of up to \$50,000 of group term-life insurance on an employee's life and
- Meals and lodging furnished for the employer's convenience (on the business premises).

Report amounts paid on behalf of more-than-2% shareholders as taxable wages on the shareholder's Form W-2. These expenses of the S corporation are deducted on line 7 or 8 of Form 1120-S. In this example, the three non-shareholder employees had health insurance premiums paid for them in the amount of \$1,600 per employee for a total of \$4,800.

**Note:** Qualified small employers are eligible for the small employer health insurance credit (IRC Sec. 45R). The amount

of the credit is up to 50% of the lesser of employer-paid premiums or the small business benchmark premium. For further coverage see *Small Employer Health Insurance Credit* on Page K-16 of the *Small Business Quickfinder® Handbook*.

For purposes of this example it is assumed that Shout and Jump does not qualify for the small employer health insurance credit.

**Line 19: Energy efficient commercial buildings deduction.** Attach Form 7205. See *Energy-Efficient Commercial Building Deduction* on Page O-12.

**Line 20: Other deductions.** Attach a schedule similar to the one shown on Page D-26 to report other trade or business activity expenses not deducted elsewhere on the return. Do not include items that must be reported separately on Schedules K and K-1.

Use line 20 to deduct amortization. Do not deduct fines or penalties.

**Line 22: Ordinary business income (loss).** This amount is the nonseparately computed income or loss as defined in IRC Sec. 1366(a)(2) attributable to trade or business activities of the corporation. This amount is entered on line 1 of Schedule K. Line 22 is not used in figuring the tax on line 23a or 23b.

**Line 23: Tax.** See *S Corporation Taxes* on Page D-7 for information on built-in gains tax, ENPI tax and other S corporation taxes.

**Line 24d: Elective payment election.** See *Elective Payment Elections And Transfer Elections* on Page O-5.

## Cost of Goods Sold

### Form 1125-A

See *Inventories* on Page L-8 of the *Small Business Quickfinder® Handbook* for inventory valuation methods and Section 263A UNICAP rules.

**Note:** The cash accounting method generally cannot be used when inventories are necessary to account for purchases and sales. There is an exception to this rule for taxpayers with average annual receipts of \$29 million or less. See *Accounting Methods* on Page L-1 of the *Small Business Quickfinder® Handbook* for details including other exceptions.

**Line 1.** The beginning inventory should equal the ending inventory of the prior-year return. If it is different, attach a statement explaining the change.

**Line 2.** Purchases for manufacturers includes the cost of raw materials and parts used to make a finished product. Purchases for merchants includes merchandise bought for resale.

**Line 3.** Payroll costs usually are an element of COGS only in a manufacturing or mining business.

**Line 4.** An entry is required on this line only for corporations that have elected a

simplified method of accounting. See Form 1125-A instructions for more details. Also refer to *Uniform Capitalization Rules* on Page L-9 of the *Small Business Quickfinder® Handbook*.

**Line 5.** Enter any other inventory costs not included on lines 2–4. Freight-in is entered here. Freight-out is an operating/selling expense not included in inventory.

**Line 7.** A physical count of inventory must be taken at least once a year, ideally at the end of the tax year. In this example, the cost of inventory at the end of the year was \$5,726.

**Line 9e: Section 263A UNICAP rules** require corporations to capitalize or include in inventory certain costs incurred in connection with the production of real and tangible personal property held in inventory or held for sale in the ordinary course of business. The rules also apply to personal property (tangible and intangible) acquired for resale. Corporations with \$29 million or less of average annual gross receipts for the prior three years are exempt from the UNICAP rules.

## Other Information

### Schedule B, Page 2, Form 1120-S

**Item 1: Accounting method.** Although the accrual method is generally required to account for purchases and sales of inventory, Shout and Jump, Inc., meets the \$29 million gross receipts threshold and is eligible to use the cash method. Under the cash method, income is reported when constructively received, and expenses are deducted when actually paid or the items are consumed, whichever is later. For a business with inventory that is eligible to use the cash method, inventory is (1) accounted for in the same manner as nonincidental materials and supplies, (2) conforms to the method reflected in the taxpayer's Applicable Financial Statement (AFS) for each tax year, or (3) if the taxpayer doesn't have an AFS for the tax year, conforms to the method reflected in the taxpayer's books and records prepared in accordance with the taxpayer's accounting procedures (Reg. 1.471-1).



Some businesses use a hybrid method, accounting for purchases and sales of inventory using the accrual method, and cash method for all other income and expenses. The cash method and the hybrid method are similar in that the cost of purchasing inventory cannot be deducted until the inventory is sold. However, under the hybrid method, inventory purchased on account (accounts payable) is deducted when sold, regardless of when paid for.

Form 1120-S (2023) Page 2

**Schedule B Other Information** (see instructions)

1 Check accounting method: a  Cash b  Accrual  
c  Other (specify) \_\_\_\_\_

2 See the instructions and enter the:  
a Business activity **Recreation** b Product or service **Skydiving**

3 At any time during the tax year, was any shareholder of the corporation a disregarded entity, a trust, an estate, or a nominee or similar person? If "Yes," attach Schedule B-1, Information on Certain Shareholders of an S Corporation  X

4 At the end of the tax year, did the corporation:  
a Own directly 20% or more, or own, directly or indirectly, 50% or more of the total stock issued and outstanding of any foreign or domestic corporation? For rules of constructive ownership, see instructions. If "Yes," complete (i) through (v) below  X

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

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

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

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

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

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

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

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

9 Did the corporation have an election under section 163(j) for any real property trade or business or any farming business in effect during the tax year?  X

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

a The corporation owns a pass-through entity with current, or prior year carryover, excess business interest expense.

b The corporation's aggregate average annual gross receipts (determined under section 448(c)) for the 3 tax years preceding the current tax year are more than \$29 million and the corporation has business interest expense.

c The corporation is a tax shelter and the corporation has business interest expense. If "Yes," complete and attach Form 8990, Limitation on Business Interest Expense Under Section 163(j).

11 Does the corporation satisfy both of the following conditions?  X

a The corporation's total receipts (see instructions) for the tax year were less than \$250,000.

b The corporation's total assets at the end of the tax year were less than \$250,000.

If "Yes," the corporation is not required to complete Schedules L and M-1.

Form 1120-S (2023)

**Item 8.** Complete line 8 if the S corporation has net unrealized built-in gains. See *Built-In Gains (BIG) Tax* on Page D-8.

**Item 9.** This item applies if the corporation is limited with respect to its interest expense deduction for the year. See *Business Interest Expense Limitation* on Page B-5 for more information.

**Item 10.** Shout and Jump, Inc. checks the "No" box as it is eligible to deduct business interest expense without filing Form 8990 and it does not own a pass-through entity with excess business interest expense. As it has been in existence for less than three years, the corporation need only meet the \$29 million or less gross receipts test for the period of its existence by annualizing its 2023 gross receipts [IRC Sec. 448(c)(3)].



**Item 14.** Use line 14 to indicate if the S corporation was responsible for filing, and ultimately filed, any 2023 Forms 1099. Filing requirements can be found in the form's instructions.

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

### Schedules K (Pages 3–4, Form 1120-S) and K-1

Schedule K, Form 1120-S, is a summary of total corporate income, deductions, credits, etc., and is part of the corporation's tax return. Schedule K-1 shows each shareholder's separate share of the items. The corporation provides each shareholder a Schedule K-1 and includes copies with the Form 1120-S it files with the IRS.

Schedule K provides a detailed description of items. Although Schedule K-1 follows the general outline of Schedule K, many specific items on Schedule K-1 are identified by codes.

The corporation is liable for taxes on lines 23a, b, and c on page 1 of Form 1120-S. Shareholders are liable for income tax on their shares of the corporation's income reported on Schedule K-1. The total pro rata share items of all Schedules K-1 should

Form 1120-S (2023) Page 3

**Schedule B Other Information** (see instructions) (continued)

	Yes	No
12 During the tax year, did the corporation have any non-shareholder debt that was canceled, was forgiven, or had the terms modified so as to reduce the principal amount of the debt? If "Yes," enter the amount of principal reduction \$		X
13 During the tax year, was a qualified subchapter S subsidiary election terminated or revoked? If "Yes," see instructions		X
14a Did the corporation make any payments in 2023 that would require it to file Form(s) 1099?	X	
b If "Yes," did or will the corporation file required Form(s) 1099?	X	
15 Is the corporation attaching Form 8996 to certify as a Qualified Opportunity Fund? If "Yes," enter the amount from Form 8996, line 15 \$		X
16 At any time during the tax year, did the corporation: (a) receive (as a reward, award, or payment for property or services), or (b) sell, exchange, or otherwise dispose of a digital asset (or a financial interest in a digital asset)? See instructions		X

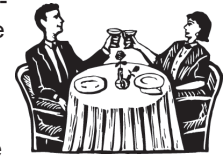
**Schedule K Shareholders' Pro Rata Share Items**

	Total amount
1 Ordinary business income (loss) (page 1, line 22)	122,236
2 Net rental real estate income (loss) (attach Form 8825)	
3a Other gross rental income (loss)	
b Expenses from other rental activities (attach statement)	
3c Other net rental income (loss). Subtract line 3b from line 3a	
4 Interest income	316
5 Dividends: a Ordinary dividends	
b Qualified dividends	
6 Royalties	
7 Net short-term capital gain (loss) (attach Schedule D (Form 1120-S))	
8a Net long-term capital gain (loss) (attach Schedule D (Form 1120-S))	
b Collectibles (28%) gain (loss)	
c Unrecaptured section 1250 gain (attach statement)	
9 Net section 1231 gain (loss) (attach Form 4797)	
10 Other income (loss) (see instructions) Type:	
11 Section 179 deduction (attach Form 4562)	25,000
12a Charitable contributions	
b Investment interest expense	
c Section 59(e)(2) expenditures Type:	
d Other deductions (see instructions) Type:	
13a Low-income housing credit (section 42(j)(5))	
b Low-income housing credit (other)	
c Qualified rehabilitation expenditures (rental real estate) (attach Form 3468, if applicable)	
d Other rental real estate credits (see instructions) Type:	
e Other rental credits (see instructions) Type:	
f Biofuel producer credit (attach Form 6478)	
g Other credits (see instructions) Type:	
14 Attach Schedule K-2 (Form 1120-S), Shareholders' Pro Rata Share Items—International, and check this box to indicate you are reporting items of international tax relevance <input type="checkbox"/>	
15a Post-1986 depreciation adjustment	
b Adjusted gain or loss	
c Depletion (other than oil and gas)	
d Oil, gas, and geothermal properties—gross income	
e Oil, gas, and geothermal properties—deductions	
f Other AMT items (attach statement)	
16a Tax-exempt interest income	
b Other tax-exempt income	
c Nondeductible expenses	280
d Distributions (attach statement if required) (see instructions)	20,000
e Repayment of loans from shareholders	
f Foreign taxes paid or accrued	

Form 1120-S (2023)

entered on line 12 b and d of Schedule K and in box 12 of Schedule K-1.

Enter only taxable interest and dividends. Interest earned from trade or business operations, such as service charges on unpaid accounts receivable items, should be reported on line 5, page 1 of Form 1120-S.



See *Dividends* in Tab 5 for qualified dividend rules. Dividends eligible for the 0%, 15%, and 20% tax rates should be entered in box 5b of Schedule K-1.

If any gain or loss from Schedule D is not portfolio income (such as a gain or loss from the disposition of nondepreciable personal property used in a trade or business), enter the amount on line 10 of Schedule K and in box 10 of the K-1, using code **HS**.

In this example, the business earned \$316 from a savings account.

**Line 9: Section 1231 gain (loss).** Enter the Section 1231 gain (loss) from Form 4797.

**Line 10: Other income (loss).** Identify and include other income or losses not reported on lines 1–9 on a separate attachment, such as:

- Wagering gains and losses.
- Recovery of tax benefit items.
- Gain or loss from IRC Sec. 1256 marked to market contracts.
- Loss from involuntary conversions due to casualty or theft.

- Gain from sale or exchange of qualified small business stock eligible for Section 1202 exclusion or Section 1045 rollover. Any net loss from involuntary conversions due to casualties or thefts should be reported on line 10 of Schedule K instead of line 9, and in box 10, code B of the K-1. See the Schedule K line 10 instructions for how to report involuntary conversion net gain.

**Line 11: Section 179 deduction.** Enter the amount from line 12 of Form 4562. The Section 179 deduction limitations apply at both the S corporation level and the individual shareholder level. For more details, see *Section 179 Deduction* on Page 10-12. Do not complete box 11 of Schedule K-1 for shareholders that are estates or trusts, since these entities are not eligible for the Section 179 deduction. An S corporation is not considered a component member of a controlled group of corporations. Thus, an S corporation can claim the maximum Section 179 deduction without having to apportion it among the other controlled group members (INFO 2013-0016).

equal the amount reported on the same line of Schedule K.

Unlike certain partnership income, S corporation income is not SE income and is not subject to SE tax.

See *Shareholder's Pro Rata Share (Schedule K-1)* on Page D-7 for how to divide each shareholder's share of income and deduction items on Schedule K-1.

**Reduction of income items reported on Schedule K:**

- Each recognized built-in gain item is reduced by its proportionate share of the built-in gains tax.
- Each item of passive investment income is reduced by its proportionate share of the ENPI tax.



See *S Corporation Taxes* on Page D-7 for more information.

**These instructions refer to line numbers on Schedule K, Form 1120-S.**

**Line 1: Ordinary business income (loss).** Enter the amount from line 22, page 1 of Form 1120-S. Do not reduce the amount

by any limitations due to a shareholder's basis, at-risk amount or passive activity limitations. These limitations are determined at the shareholder level.

If the corporation is involved in more than one trade or business activity, see the Form 1120-S instructions for passive activity reporting requirements.

**Line 2: Net rental real estate income (loss).** Use Form 8825 (Rental Real Estate Income and Expenses of a Partnership or an S Corporation) to determine the amount to enter on line 2.



**Line 3: Income and expenses of other rental activities.** Use line 3 for rental activities not reported on line 2. Enter gross income on line 3a, and attach a statement listing all expenses reported on line 3b (Schedule K only). See Form 1120-S instructions for passive activity reporting requirements.

**Lines 4–8: Portfolio income (loss).** Do not reduce the amounts for expenses allocated to portfolio income. These expenses are

4) Provisions that investments must not jeopardize the carrying out of exempt purposes.

5) Provisions to assure expenditures further exempt purposes.

Violating these provisions results in taxes and penalties against the private foundation and, in some cases, its managers, substantial contributors, and certain related persons.

**Disclosure.** A private foundation must make its annual returns, determination letter, and exemption application available for public inspection. See *Disclosure Requirements* on Page E-7 for a discussion of the penalties for failure to disclose. Unlike other tax-exempt organizations, a private foundation is required to disclose the names and addresses of its contributors.

**Caution:** Do not report personal information about the grantees or others that is not required and could be used for identity theft (for example, social security number or bank account information).

## Excise Taxes

**Private foundations are subject to excise taxes** on (1) net investment income, (2) self-dealing, (3) failure to distribute income, (4) excess business holdings, (5) investments that jeopardize exempt status, and (6) expenditures that do not further the exempt purpose.

**Note:** Item 1 is reported on Form 990-PF, and items 2–6 are reported on Form 4720 (Return of Certain Excise Taxes Under Chapter 41 and 42 of the IRC).

**Net investment income.** IRC Sec. 4940 imposes a 1.39% excise tax on the net investment income (interest, dividends, rents, royalties, securities loan payments, and income from similar sources) and capital gain net income of private foundations.

**Self-dealing.** IRC Sec. 4941 imposes on the disqualified person (not the foundation) an excise tax equal to 10% of the self-dealing amount, plus an additional 200% tax if the action is not corrected. Managers of the foundation may also be subject to a 5% tax if they knowingly allow the self-dealing to take place. The maximum amount of tax imposed on the foundation manager with respect to any one act of self-dealing shall not exceed \$20,000. For more information, see the IRS's Issue Snapshot on this topic at [www.irs.gov/charities-non-profits/private-foundations-incident-and-tenuous-exception-to-self-dealing-under-treas-reg-534941d-2f2](http://www.irs.gov/charities-non-profits/private-foundations-incident-and-tenuous-exception-to-self-dealing-under-treas-reg-534941d-2f2).

**Failure to distribute income.** Private foundations must annually distribute to charity the greater of their net investment income or 5% of net investment assets. IRC Sec. 4942 imposes a 30% tax on undistributed amounts. If corrective action is not taken in a timely manner, a second tier tax of 100% of the undistributed income may be imposed.

**Note:** This does not apply to private operating foundations.

**Excess business holdings.** Combined holdings of a private foundation and its disqualified persons are not permitted to exceed 20% of a corporation's voting stock, 20% of the profits interest in a partnership, or 20% beneficial interest in other entities. A 10% initial excise tax is imposed on the excess business holdings. A second-tier tax equal to 200% of the excess holdings is imposed if corrective action is not taken in a timely manner (IRC Sec. 4943).

Certain businesses contributing all profits to charity and wholly owned by a private foundation are not subject to the excess business holdings tax [IRC Sec. 4943(g)].

Disqualified persons generally include a substantial contributor (including family members), a manager or a more-than-20% owner of a substantial contributor (including family members) to the private foundation. See IRC Sec. 4946(a) for more details.

The excess business holdings tax applies to donor advised funds.

**Terminations.** A private foundation generally must give notice and pay an excise tax under IRC Sec. 507(c) to terminate its status. To avoid tax, it can distribute all its assets to a qualifying Section 509(a)(1) organization that has been in continuous existence for at least 60 months prior to the distribution (Rev. Rul. 2003-13).

## BECOMING AN EXEMPT ORGANIZATION

### Application Procedure

Organizations seeking exempt status from federal income tax must submit an electronic application with the IRS. An organization applying under IRC Sec. 501(c)(3) submits Form 1023 [Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code] or if they qualify, Form 1023-EZ [Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code]. (See *Form 1023-EZ* on Page E-5 for a discussion on who qualifies to file the shorter Form 1023-EZ.)

Most other organizations submit Form 1024 [Application for Recognition of Exemption Under Section 501(a)]. Certain organizations filing for tax exempt status under IRC Sec. 501(c)(4), use Form 1024-A [Application for Recognition of Exemption Under Section 501(c)(4) of the Internal Revenue Code] which must be filed electronically. See the Organization Reference Chart in IRS Pub. 557 for the proper form.

The following organizations may be considered tax-exempt under IRC Sec. 501(c)(3) even if they do not file Form 1023:

- Churches and integrated auxiliaries of churches, and conventions or associations of churches.
- Any organization that is not a private foundation and has gross receipts in each tax year of normally not more than \$5,000.

Even if not required to file to be tax-exempt, organizations may choose to file Form 1023 to receive a determination letter that recognizes their 501(c)(3) status and specifies whether contributions to them are tax deductible.

**Relief for late filed applications.** Organizations described in IRC Secs. 501(c)(3), 501(c)(9), 501(c)(17), and 501(c)(29) are generally required to apply for recognition of tax-exempt status within 27 months from the end of the month in which the organization is formed to be recognized as exempt from the date of formation. Organizations applying after the 27-month period (late applications) are generally granted tax-exempt status as of the date the application is filed.

However, an organization filing a late application may request specific relief to be recognized and treated as tax-exempt effective as of a date earlier than the application date (Reg. 301.9100-3). This relief is sometimes referred to as 9100 relief. The IRS's Exempt Organization Determinations group (EO Determinations) can grant 9100 relief if certain requirements are met. An organization must provide evidence that—

- 1) It acted reasonably and in good faith in missing the 27-month deadline, and
- 2) The granting of relief will not prejudice the interests of the government.

An organization applying for recognition under Section 501(c)(3) and requesting relief must submit Form 1023 (rather than Form 1023-EZ).

**Expedited process.** The IRS will expedite applications if there is a compelling reason to process the case ahead of others. Compelling reasons include: (1) a pending grant that is needed to secure the organization's ability to continue operating, (2) a newly created organization providing disaster relief to victims of emergencies such as floods and hurricanes, or (3) IRS errors causing undue delays in issuing a determination letter. The IRS will not expedite the review of applications of automatically revoked organizations requesting reinstatement of tax-exempt status. For more information, see [www.irs.gov](http://www.irs.gov) and search for "expedited application."

**Form 1023-EZ.** Form 1023-EZ, which is much shorter than Form 1023, is available to most domestic organizations with gross receipts of no more than \$50,000 and assets of \$250,000 or less (for the current year and next two years). The instructions (see [www.irs.gov/pub/irs-pdf/i1023ez.pdf](http://www.irs.gov/pub/irs-pdf/i1023ez.pdf)) include an eligibility worksheet that must be completed before filing the form. A \$275 user fee

applies and the form must be submitted online using [www.pay.gov](http://www.pay.gov) (Rev. Proc. 2024-5).

## Required Inclusions for Form 1023

**Employer identification number.** Every exempt organization is required to have an EIN prior to filing the application. See *Employer Identification Numbers (EINs)* on the inside front cover for how to obtain an EIN.

**Organizing documents.** There must be an organizing document to qualify for exempt status. Each Form 1023 must include a copy of the organization's corporate articles of incorporation, LLC articles of organization, articles of association, trust indenture, constitution, or other enabling document. Any amendments should be attached in chronological order.

**Bylaws.** If the organization has adopted bylaws, include a current copy and any amendments. The bylaws are not required to be signed unless they are the organizing document. To be considered the organizing document, the bylaws must be properly structured and include name, purpose, signatures, and intent to form an organization.

**Description of activities.** A full description of the past, present, and planned activities of the organization must be included in the application. Describe the who, what, where, and when of the activity. Also include how the activity (1) is funded and (2) furthers the exempt purpose. List any alternate names (that is, an "aka" or "dba") under which the organization operates. A copy from the organization's website may be attached to support the description of activities.

**Financial data.** The organization must complete a Statement of Revenues and Expenses schedule as follows (years in existence refer to completed tax years):

- 1) If in existence less than five years, complete the statement for each year in existence and provide projections of likely revenues and expenses based on a reasonable and good faith estimate of future finances for a total of: (a) three years of financial information if the organization has not completed one tax year or (b) four years of financial information if the organization has completed one tax year.
- 2) If in existence five or more years, complete the schedule for the current year and the most recent four tax years.

A balance sheet for the most recently completed tax year must also be provided.

**Fundraising activities description.** Include sufficient detail to show how the activities will be financed.

**Attachments.** Every attachment should be in English and show the name and EIN of the organization, the date, an identifiable heading and that it is an attachment to the application form. Attachments should be consolidated into on single PDF and identify the part and line number to which the information relates.

**Attachments should be in the following order:**

- Organizing document.
- Amendments to the organizing document (in chronological order).
- Bylaws or other rules of operation and any amendments (if adopted).
- Form 2848, Power of Attorney and Declaration of Representatives (if applicable).
- Form 8821, Tax information Authorization (if applicable).
- Supplemental responses (if the response does not fit in the text field in the application) and any additional information to support the request.

**Additional information that may be requested** includes copies of advertising placed, copies of publications, distributed written material used for expressing views on proposed legislation, and copies of leases, contracts, or agreements.

**Observation:** While organizations submitting Form 1023-EZ electronically are not required to provide the documents required by the Form 1023, questions about the organizational structure and provisions in the governing documents are included in the Form 1023-EZ.

## User Fee for Exempt Organization

The following user fees are required for applications filed (Rev. Proc. 2024-5, Appendix A):

- \$275 for applications submitted electronically on Form 1023-EZ.
- \$600 for applications submitted electronically on Form 1023.
- **\$3,500** for group applications.

## Group Exemption Letter

An organization controlled by a central organization (church, Boy Scouts, Girl Scouts, fraternal organization, etc.) may already be covered by a group exemption letter. If not, the central organization may update its group exemption letter and submit it at the next annual ruling date. Each branch may not have to apply separately.

**Note:** Beginning June 17, 2020, the IRS is not accepting any request for group exemption letters until proposed guidance is finalized (Notice 2020-36). Meanwhile, the earlier guidance in Rev. Proc. 80-27 continues to apply, and practitioners should watch for finalized guidance superceding the previous guidance.

**Central organization.** An organization that has one or more subordinates under its general supervision or control.

**Subordinate organization.** A chapter, local, post or unit of a central organization. A subordinate may or may not be incorporated, and it must have an organizing document. A subordinate that is organized and operated in a foreign country cannot be included in a group exemption letter. A subordinate described in IRC Sec. 501(c)(3) may not be included in a group exemption letter if it is a private foundation described in IRC Sec. 509(a).

**Keeping the group exemption letter in force.** The following conditions must be met for a group exemption to be effective:

- 1) The existence of the central organization.
- 2) The continued qualification of the central organization for Section 501(c) exempt status.
- 3) The annual submission by the central organization of the information about its subordinate organizations. The IRS no longer sends the List of Parent and Subsidiary Accounts to the central organizations.
- 4) The annual filing of any required information return (for example, Form 990).

## Effective Date of Exemption

A determination letter recognizing exemption is effective as of the date of formation of an organization if the application was timely filed. If an organization is required to alter its activities or substantially amend its charter to qualify, the ruling or determination letter recognizing exemption will be effective as of the date specified in the letter.

**Application filed after the 27-month period.** An organization that files its application for recognition of exemption after the 27-month period and receives a favorable determination letter generally has an effective date only from the postmark date on the application.

However, an organization applying after the applicable deadline can request an extension of time to apply in order to be recognized as exempt from its inception if it submits evidence that it *acted reasonably and in good faith* and granting the extension will not prejudice the interests of the government.

## Appeal Procedure

If an adverse determination letter is received, a protest may be submitted to the Appeals Office. It must be submitted to the Exempt Organization (EO) area manager of the office issuing the adverse letter within 30 days from the date of the letter and must state whether it requests Independent Office of Appeals consideration.



See IRS Pub. 557 (Tax-Exempt Status for Your Organization) for a complete list of information and instructions to file an appeal.

## Revocation or Modification of Exempt Status

A determination letter recognizing exemption may be revoked or modified by (Rev. Proc. 2024-5):

- 1) Notice to the organization,
- 2) New legislation or ratification of a tax treaty,
- 3) A United States Supreme Court decision,
- 4) Issuance of a temporary or final regulation,
- 5) Issuance of a revenue ruling, revenue procedure, or other statement published in the *Internal Revenue Bulletin*, or
- 6) Failure to file a required annual return or notice for three consecutive years. (See *Automatic Revocation* on Page E-2.)

**Note:** If an organization no longer qualifies for exempt status under the Code section under which they qualified, the IRS will revoke its status. The revoked organization will need to apply for recognition under a different Code section. **This can now be done by electronically filing Form 8940 (Rev. Proc. 2024-5, Section 7).** (See [www.irs.gov/pub/foia/ig/spder/TEGE-04-0216-0003.pdf](http://www.irs.gov/pub/foia/ig/spder/TEGE-04-0216-0003.pdf).)

## FORM 990, 990-EZ, OR 990-N

Tax-exempt organizations generally must file either (1) an annual information return on Form 990 or Form 990-EZ or (2) an annual electronic notice using Form 990-N, depending on the organization's gross receipts and total assets [IRC Sec. 6033(a)]. Exceptions to the filing requirements apply to organizations with gross receipts below a specific amount and to certain religious and governmental organizations.

**Note:** All exempt organization annual returns must be filed electronically.

Form 990 consists of a core form and 16 schedules (lettered A through R) that the organization may be required to include for the return to be considered complete. While some of the governance and policy questions are not required by tax law, a negative answer (or no answer) may not be perceived well by the IRS or potential donors.

Form 990-EZ includes eight of the Form 990 series schedules. See *Completing Form 990-EZ* on Page E-8 for more information on completing the form.

### Filing Requirements<sup>1, 2</sup>

Tax Year	Form 990-N <sup>3</sup>	Form 990-EZ <sup>4</sup>		Form 990	
		Gross Receipts normally ≤	Gross Receipts between and Total Assets <	Gross Receipts ≥	or Total Assets ≥
2010 and later	\$50,000	\$50,000 – \$200,000	\$500,000	\$200,000	\$500,000

<sup>1</sup> Sponsoring organizations of donor-advised funds and controlling organizations described in IRC Sec. 512(b)(13) must file Form 990 regardless of the amount of their gross receipts or assets.

<sup>2</sup> See Appendix B of the Form 990 instructions for guidance on calculating gross receipts.

<sup>3</sup> Organizations that qualify to file Form 990-N may choose to file either Form 990 or 990-EZ (in their entirety) instead. See *Electronic Notice (Form 990-N)* on Page E-1.

<sup>4</sup> Organizations that qualify to file Form 990-EZ may choose to file Form 990 instead.

## Disclosure Requirements

Exempt organizations must provide a copy of their exemption application and the previous three years' annual information returns (Forms 990, 990-EZ, 990-PF, and 990-T) to anyone requesting them in person or in writing. In addition, all Form 990/990-EZ schedules (except certain parts of Schedule B), attachments, and supporting documents must be disclosed. Requests in person must be fulfilled the same day, and written requests must be fulfilled in 30 days [IRC Sec. 6104(d)].

## Exceptions:

- The organization has made the documents widely available (for example, published on the internet).
- The requests are part of a harassment campaign.

It is easier to comply with the public disclosure requirements by posting electronic forms online.

**Observation:** While certain parts of Schedule B are not required to be publicly disclosed, state law may require they be disclosed to the state's attorney general.

**Note:** Form 990-T [for organizations other than Section 501(c)(3) organizations] is not required to be disclosed.

**Penalty.** \$20 for each day inspection of an annual return was not permitted, not to exceed the lesser of \$12,000 (for returns required to be filed in 2024) or 5% of gross receipts per return. Failure to disclose the exemption application draws a \$20 per day penalty that applies for as long as the failure continues [IRC Sec. 6652(c)(1)(C) and (D)].

**Private information.** For certain organizations, only parts of Schedule B (Schedule of Contributors) are open for public inspection. The IRS cannot disclose the names and addresses of contributors. However, all other information, including the amount of contributions, the description of noncash contributions and any other information, is required to be made available for public inspection unless it clearly identifies the contributor. Additionally, the IRS cannot disclose portions of the exemption application related to things such as trade secrets and patent processes.

Final regulations remove the requirement for organizations, other than Section 501(c)(3) and Section 527 organizations, to provide the contributors' names and addresses on Schedule B [Reg. 1.6033-2(a)(2)(ii)(F)]. However, these entities must collect and retain this information in their books and records. Additionally, the information must be made available to the IRS on request.

**Caution:** Section 501(c)(3) and 527 organizations are still required to report the names and addresses.

## Requesting a Copy of Return from IRS

To request a copy of a previously filed return or to inspect an exempt organization return through the IRS, use Form 4506-A (Request for Public Inspection or Copy of Exempt or Political Organization IRS Form).

## Affinity Programs

Through an affinity program, a nonprofit organization may increase its visibility and nondues revenue by lending its name, logo, or mailing list to an outside entity (both nonprofit and commercial). If not structured as a royalty, the income generated may be taxable.

### To limit this possibility, a nonprofit organization:

- 1) Must not actively participate or exert substantial control in the entity's programs;
- 2) Must charge the entity FMV;
- 3) Must specifically state that the revenue is from the licensing of the nonprofit's name, logo, or mailing list; and
- 4) Must not assume the risk of profit or loss from the program.

## Proxy Tax

Section 501(c)(4), (c)(5), and (c)(6) organizations that engage in lobbying and political activities must report the information on Schedule C (Form 990 or 990-EZ) and notify members to the extent their payments are not deductible because of such activities or compute and pay the proxy tax on Form 990-T (whether or not they have gross income from an unrelated trade or business). If the organization pays the proxy tax, the members' dues are deductible as a business expense [IRC Secs. 162(e) and 6033(e)].

## Lobbying Expenditures

In general, a charitable organization may lose its exempt status if a substantial part of its activities consist of carrying on propaganda or attempts to influence legislation. However, the meaning of the term *substantial* is unclear.

**Election.** Public charities (other than church organizations and private foundations) can make the lobbying election, which allows a limited amount to be spent for influencing legislation. Use Form 5768 [Election/Revocation of Election by an Eligible Section 501(c)(3) Organization to Make Expenditures to Influence Legislation] to make the election.

If the election is made, the organization will not lose its tax-exempt status unless it normally makes lobbying expenditures in excess of limits imposed by IRC Sec. 4911 (see IRS Pub. 557 for limits).

**Excise taxes.** If the organization exceeds the lobbying expenditure limits, and/or loses its exempt status due to excess lobbying expenditures, excise taxes may be imposed on the organization and any managers who agreed to making the excess lobbying expenditures.

## COMPLETING FORM 990-EZ

The Form 990-EZ posted on [www.irs.gov](http://www.irs.gov) includes question-mark icons throughout the form that provide help windows. The guidance provides helpful information and links to the IRS's website. It is intended to help small and mid-sized organizations avoid common mistakes when completing the return, but is not intended to replace the detailed instructions.

**Item A.** Accounting period. Use the 2023 Form 990-EZ to report on a calendar or fiscal year accounting period that began in 2023. If a fiscal year, show the month and day the fiscal year began in 2023 and the date the fiscal year ended.

**Item B.** Check "Name Change" to indicate the organization has changed its legal name since filing the previous year's return, file by paper (not electronically), and attach the legal document(s) required in the Form 990-EZ instructions to support the name change. Check "Initial Return" if this is the first time the organization is filing a Form 990-EZ and it has not previously filed a Form 990, 990-PF, 990-T, or 990-N. If "Final return/terminated" is checked, see the instructions for Line 36 and attach Schedule N (Liquidation, Termination, Dissolution, or Significant Disposition of Assets).

**Practice Tip:** Written name change requests may take more than six months to process resulting in a delay in the Business Master File or TEOS records being updated. Some organizations have experienced a loss of funding because the new name does not appear in the IRS databases. Check the organization's records in the IRS Business Master File at least once a year.

**Item F.** Enter four-digit group exemption number, if applicable.

**Caution:** If the organization is included in a group exemption letter as a subordinate organization, the organization should file Form 990-EZ only if the organization is not included in a group return filed by the central/parent organization for the tax year. The central/parent organization of a group ruling cannot file Form 990-EZ but must file Form 990.

**Item H.** The organization must either check this box (if Schedule B is not required) or attach Schedule B. Failure to do either will result in an incomplete return. Generally, organizations that do not receive contributions of \$5,000 or more from any one contributor (reportable on line 1 of Form 990-EZ) do not need to attach Schedule B. The contributor's \$5,000 amount is determined by totaling all of the contributor's direct and indirect gifts, grants, or contributions of \$1,000 or more for the year.

**Item J.** Check the applicable box. If the organization is exempt under IRC Sec. 501(c) other than 501(c)(3), check the second

box and insert in the parentheses the number from the Exempt Organizations Reference Chart in Appendix A of the Form 990-EZ instructions.

**Item K.** Check the box describing the organization's legal entity form or status under state law in its state of legal domicile.

## Part I—Revenue, Expenses, and Changes in Net Assets or Fund Balances

All organizations that file Form 990-EZ must complete Part I. Check the box in the heading of Part I if Schedule O contains any information pertaining to this part.

**Line 1.** Enter the gross amounts of contributions, gifts, grants, and bequests received from individuals, trusts, corporations, estates, affiliates, foundations, public charities, and other exempt organizations, or raised by an outside professional fundraiser.

**Example #1:** An organization hires a professional fundraiser. The gross amount of the gift solicited by the fundraiser is \$2,000 and the fundraiser's expenses are \$500. The \$2,000 gross amount should be reported on line 1; fundraising expenses of \$500 are not subtracted on this line even though the organization receives only the net amount of \$1,500.

Report the value of noncash contributions at the time of the donation. For example, report the gross value of a donated car as of the time the car was received as a donation.

Report amounts received as voluntary contributions; for example, payments, or the part of any payment, for which the payer (donor) does not receive full market value (FMV) from the recipient (donee) organization. Contributions are reported on line 1 regardless of whether they are deductible by the contributor. Contributions can arise from fundraising events when an excess payment is received; see *Excess payments* on Page E-9.

**Example #2:** Harvey purchases a vacation in a silent auction at an American Cancer Society benefit. The FMV of the vacation is \$1,000, reported on line 6b and on line 6c. Harvey is the highest bidder at \$1,700. \$700 is entered on line 1 and line 6b (within the parentheses).

Contributions can also arise when items of only nominal or insubstantial value are given or offered. Token benefits have a nominal value (for 2023, adjusted annually for inflation) if:

- 1) The FMV is less than or equal to 2% of the payment or \$125 (whichever is less) or
- 2) The payment is \$62.50 or more, the benefit bears the organization's name or symbol, and the cost (not FMV) is \$12.50 or less.

Report amounts received indirectly from the public through solicitation campaigns conducted by federated fundraising agencies such as the United Way.

Grants made to encourage the organization's exempt purpose programs or activities are reported as contributions. Include grants from government agencies in contributions if the primary purpose of the grant is to enable the donee to provide a service to, or maintain a facility for, the direct benefit of the public rather than to service the direct and immediate need of the grantor.

**Note:** Amounts of Paycheck Protection Program (PPP) loans that are forgiven are reported on line 1 as contributions from a governmental unit in the tax year that the amounts are forgiven.

Include membership dues and assessments to the extent they are contributions and not payment for benefits received.

Also include contributions received through an associated organization (for example, parent, subordinate, or brother/sister organization) or a commercial co-venture.

Contributions may generally be (but are not required by the IRS to be) reported in accordance with ASC 958. However, the value

of siloed net operating losses at [www.irs.gov/newsroom/faqs-carryback-of-nols-by-certain-exempt-organizations](http://www.irs.gov/newsroom/faqs-carryback-of-nols-by-certain-exempt-organizations).

## Qualified Business Income (QBI) Deduction for Trusts

For tax years 2018–2025, trusts may be able to deduct up to 20% of their QBI under IRC Sec. 199A. In general, trusts compute a deductible amount for each of their trades or businesses. The deductible amount is generally 20% of the business’s QBI. However, if the trust’s taxable income exceeds certain threshold amounts, the deduction is limited to an amount based on the business’s W-2 wages or a combination of W-2 wages and investment in qualified property (the wage/investment limit).

**Calculating QBI.** UBI is computed separately for each unrelated trade or business [IRC Sec. 512(a)(6)]. Consequently, QBI does not include items of income, gain, deduction, and loss from any unrelated trade or business that operated at a loss. Similarly, when computing the wage/investment limit, trusts should not include any W-2 wages or qualified property from an unrelated trade or business. Taxable income (before the QBI deduction) is the amount reported on Part I, line 7 of the Form 990-T minus the Section 512(b)(12) specific deduction reported on Part I, line 8. Unrelated trades or businesses that are not included in UBTI because they operated at a loss are not included in the QBI calculation.

**Reporting the QBI deduction.** The QBI deduction is reported on Part I, line 9 of the Form 990-T. Forms 8995 and 8995-A are used to compute the QBI deduction.

👁 **Observation:** Tax-exempt organizations created as corporations cannot claim the QBI deduction.

## Dual Use of Assets or Facilities

An asset or facility necessary to the conduct of exempt functions also may be used in a commercial endeavor. In these cases, the use of the asset or facility for exempt functions does not, by itself, make the income from the commercial endeavor gross income from a related trade or business. The test is whether the activities that produce the income in question contribute importantly to the accomplishment of exempt purposes.

**Example:** A museum has a theater auditorium designed for showing educational films in connection with its program of public education in the arts and sciences. The theater is a principal feature of the museum and operates continuously while the museum is open to the public. Any income it generates should be related to the museum’s exempt purpose and not taxable unrelated business income. However, if the organization operates the theater on a regular basis as a motion picture theater for the public when the museum is closed (and shows the same selection of first-run movies that a commercial theater would show), the income would be unrelated trade or business income.

## Depreciation

For assets used in an activity that produces unrelated business income with respect to the organization, the entity is allowed to use regular MACRS depreciation rules to claim depreciation on those assets [IRC Sec. 168(h)(1)(D)].

## Allocation of Expenses

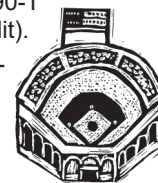
All business expenses must be allocated between UBI and exempt activities. Organizations must maintain adequate records of expenses allocated to each activity.

## Elective Payment of Clean Energy Credits

The Inflation Reduction Act of 2022 allows certain tax-exempt entities to treat certain energy-related investment and production tax credit amounts for tax years beginning after December 31, 2022, as direct payments of tax (“the direct pay option”) allowing exempt organizations to monetize these credits. Alternatively, these credits may be transferred to certain unrelated parties.

Applicable entities may take advantage of these credits listed in IRC Sec. 6417(b), which are refundable, to reduce the tax liability arising from unrelated business activities and to claim a refund regardless of whether there is taxable income [IRC Sec. 6417(d)(1)]. The credit is reported on Part IV, line 6g of Form 990-T and flows from Form 3800 (General Business Credit).

**Advance registration.** Electing the elective payment requires registering with the IRS through an IRS electronic portal in advance of filing the return on which the election is made. A valid registration number for the applicable credit property must be included on the Form 3800. **The IRS portal is now open and available at <https://www.irs.gov/credits-deductions/register-for-elective-payment-or-transfer-of-credits>.**



## COMPREHENSIVE EXAMPLE

Anytown Lions Club is operated by volunteers and conducts activities meant to promote the general welfare of all citizens. Anytown also operates a charitable gaming operation (pull-tabs) using paid workers. The following Income Statement and Balance Sheet present Anytown’s results for the current year.

The completed Forms 990-EZ (including pages 2 and 3 of Schedule G), 990-T, and Schedule A (Form 990-T) in the following pages illustrate the current year required annual information reporting and unrelated business income tax reporting for Anytown based on the financial results presented.

Income:		
Noncash contributions		
– auction items .....	\$ 4,140	Pull-tabs..... \$ 174,943
Interest.....	1,162	Fundraising events .....
		8,921
		<b>Total Income..... \$ 189,166</b>
Expenses:		
General:		Fundraising events: \$ 5,906
Supplies.....	\$ 2,702	Gambling activities (pull-tabs):
Conferences .....	1,294	Supplies.....
Dues .....	1,408	Rent.....
Federal income tax ...	6,335	Accounting fees .....
Grants.....	1,784	Salaries.....
Subtotal—General	\$ 13,523	Repairs .....
		900
		Taxes and license .....
		22,722
		Pull-tab cash prizes .....
		91,633
		Subtotal .....
		\$ 164,951
		<b>Total Expenses .....</b>
		<b>\$ 178,474</b>
		<b>Net Excess (Deficit) .....</b>
		<b>\$ 10,692</b>
Balance Sheet:		
	<b>Beginning of Year:</b>	<b>End of Year:</b>
Cash .....	\$ 3,513	\$ 3,487
Temporary Investments .....	116,093	129,938
Inventory.....	1,813	1,487
Accounts Payable.....	( 3,559)	( 6,360)
Fund Balance .....	( 117,860)	( 128,552)

Form 990-EZ (2023) Page 2

**Part II Balance Sheets** (see the instructions for Part II) Check if the organization used Schedule O to respond to any question in this Part II

22	Cash, savings, and investments	119,606	(A) Beginning of year	(B) End of year
23	Land and buildings	23	23	22 133,425
24	Other assets (describe in Schedule O)	1,813	24	1,487
25	<b>Total assets</b>	121,419	25 134,912	
26	<b>Total liabilities</b> (describe in Schedule O)	3,559	26	6,360
27	<b>Net assets or fund balances</b> (line 27 of column (B) must agree with line 21)	117,860	27	128,552

**Part III Statement of Program Service Accomplishments** (see the instructions for Part III) Check if the organization used Schedule O to respond to any question in this Part III

What is the organization's primary exempt purpose? Promoting health and safety of children and elderly adults.

Describe the organization's program service accomplishments for each of its three largest program services, as measured by expenses. In a clear and concise manner, describe the services provided, the number of persons benefited, and other relevant information for each program title.

**28 National Child Safety Council**

(Grants \$955) ( ) if this amount includes foreign grants, check here  **28a** 955

**29 Donations to nursing homes and other charitable organizations**

(Grants \$29) ( ) if this amount includes foreign grants, check here  **29a** 829

**30**

(Grants \$ ) ( ) if this amount includes foreign grants, check here  **30a**

(Grants \$ ) ( ) if this amount includes foreign grants, check here  **31a**

**32 Total program service expenses** (add lines 28a through 31a) **32** 1,784

**Part IV List of Officers, Directors, Trustees, and Key Employees** (list each one even if not compensated—see the instructions for Part IV) Check if the organization used Schedule O to respond to any question in this Part IV

(e) Name and title	(f) Average hours per week devoted to position	(g) Reportable (Forms W-2/1099-MISC/1099-NEC) (if not paid, enter -0-)	(d) Health benefits, contributions to employee benefit plans, and deferred compensation	(e) Estimated amount of other compensation
Dick Johnson, President	5	0	0	0
Tom Smith, Secretary	5	0	0	0
George Wilson, Treasurer	5	0	0	0

Form 990-EZ (2023) OMB No. 1545-0047

**2023**

Department of the Treasury Internal Revenue Service

**Short Form Return of Organization Exempt From Income Tax**

Under section 501(c), 527, or 4947(e)(1) of the Internal Revenue Code (except private foundations) Do not enter social security numbers on this form, as it may be made public. Go to [www.irs.gov/Form990EZ](http://www.irs.gov/Form990EZ) for instructions and the latest information.

A For the 2023 calendar year, or tax year beginning , 2023, and ending , 20

B Check if applicable:  Address change  Name change  Initial return  Final return/terminated  Amended return  Application pending

C Name of organization: Anytown Lions Club

Number and street (or P.O. box if mail is not delivered to street address): P.O. Box 123

City or town, state or province, country, and ZIP or foreign postal code: Anytown, TX 77777

D Employer identification number: 41 1234567

E Telephone number: 902 555-6111

F Group Exemption Number:

G Accounting Method:  Cash  Accrual Other (specify):

H  If the organization is not required to attach Schedule B (Form 990).

I Website:

J Tax-exempt status (check only one):  501(c)(3)  501(c)(4)  4947(a)(1) or  527  Other:

K Form of organization:  Corporation  Trust  Association  Other:

L Add lines 5b, 6c, and 7b to line 9 to determine gross receipts. If gross receipts are \$200,000 or more, or if total assets (Part II, column (B)) are \$500,000 or more, file Form 990 instead of Form 990-EZ. \$ 189,166

**Part I Revenue, Expenses, and Changes in Net Assets or Fund Balances** (see the instructions for Part I) Check if the organization used Schedule O to respond to any question in this Part I

	6a	6b	6c	6d	7a	7b	7c	8	9	10	11	12	13	14	15	16	17	18	19	20	21	
1	Contributions, gifts, grants, and similar amounts received																					
2	Program service revenue including government fees and contracts																					
3	Membership dues and assessments																					
4	Investment income																					
5a	Gross amount from sale of assets other than inventory		5a																			
b	Less: cost or other basis and sales expenses		5b																			
c	Gain or (loss) from sale of assets other than inventory (subtract line 5b from line 5a)		5c																			
6	Gaming and fundraising events:																					
a	Gross income from gaming (attach Schedule G if greater than \$15,000)	6a	174,943																			
b	Gross income from fundraising events (not including from fundraising events reported on line 1) (attach Schedule G if the sum of such gross income and contributions exceeds \$15,000)	6b	8,921																			
c	Less: direct expenses from gaming and fundraising events	6c	164,951																			
d	Net income or (loss) from gaming and fundraising events (add lines 6a and 6b and subtract line 6c)	6d	18,913																			
7a	Gross sales of inventory, less returns and allowances	7a																				
b	Less: cost of goods sold	7b																				
c	Gross profit or (loss) from sales of inventory (subtract line 7b from line 7a)	7c																				
8	Other revenue (describe in Schedule O)	8																				
9	<b>Total revenue</b> (Add lines 1, 2, 3, 4, 5c, 6d, 7c, and 8)	9																				
10	Grants and similar amounts paid (list in Schedule O)	10																				
11	Benefits paid to or for members	11																				
12	Salaries, other compensation, and employee benefits	12																				
13	Professional fees and other payments to independent contractors	13																				
14	Occupancy, rent, utilities, and maintenance	14																				
15	Printing, publications, postage, and shipping	15																				
16	Other expenses (describe in Schedule O)	16																				
17	<b>Total expenses</b> (Add lines 10 through 16)	17																				
18	Excess or (deficit) for the year (subtract line 17 from line 9)	18																				
19	Net assets or fund balances at beginning of year (from line 27, column (A)) (must agree with end-of-year figure reported on prior year's return)	19																				
20	Other changes in net assets or fund balances (explain in Schedule O)	20																				
21	Net assets or fund balances at end of year (Combine lines 18 through 20)	21																				

For Paperwork Reduction Act Notice, see the separate instructions.

Form 990-EZ (2023) Cat. No. 10642I

\* Schedule O is omitted due to space limitations.

reporting company is a corporation, LLC, or any other entity created by filing a document with the Secretary of State (SOS) or similar office. Because sole proprietorships (excluding single-member LLCs), trusts, and general partnerships do not require the filing of a formal document, they generally are not considered a reporting company and will not have a filing requirement.

👁 **Observation:** Although not explicitly included in the domestic reporting company definition, it appears that most limited partnerships, LLPs, and LLLPs will be subject to the new reporting rules because they fall into the category of “any other entity created by filing a document with the SOS.”

A foreign reporting company is a corporation, LLC, or similar entity that registers to do business in the U.S. by filing a document with the SOS or similar office. Just like domestic companies, the key to whether a foreign company must report beneficial ownership is whether a document is filed to register the entity. If registration of the foreign entity is not required under state law, the entity is not a reporting company and is not required to report beneficial ownership information to FinCEN.

Companies that meet one of 23 statutory exemptions are excluded from the definition of a reporting company and are not subject to the new reporting rules. Most of these exemptions are for entities such as financial institutions, insurance companies, securities brokers, and other types of entities that are already required to report ownership information to a governmental authority.

**Initial report.** For existing reporting companies created or registered before 2024, the initial report is due January 1, 2025. For reporting companies created or registered after 2023, the initial report is due 30 days after the entity’s creation or registration. For newly created or registered entities, the initial report should be filed as part of the entity formation engagement.

🔗 **Note:** FinCEN has **issued** an extension to the filing deadline for entities created or registered in 2024 to 90 days from the date of formation or registration. **Practitioners should stay alert to see if this proposed rule becomes final.**

**Updated report.** An updated report must be filed when there is a change to previously reported information about the reporting company or its beneficial owners. The updated report is due within 30 days of the change. If a reporting company files an information report and later qualifies for one of the 23 filing exemptions, an updated report should be filed to report the change in exemption status.

**Corrected report.** Corrected reports are required when any information previously reported is discovered to be inaccurate. The corrected report is due within 30 days after the reporting company becomes aware or has reason to know of the error.

## Information Required

Beneficial Ownership Information (BOI) must be reported for the reporting company’s beneficial owners and certain company applicants. BOI includes an individual’s full legal name, date of birth, street address, and a unique ID number. The unique ID number can be from a nonexpired U.S. passport, state driver’s license, or other photo-identification card issued by a state or local government.

If the individual does not have any of those documents, then a nonexpired foreign passport can be used. An image of the document showing the unique ID number must also be included with the report. Similar information about the reporting company must also be reported, including the company’s legal name, DBA, street address, jurisdiction where it was formed or registered, and tax ID. Individuals and reporting companies can request a FinCEN identifier (FinCEN ID) to use in place of supplying detailed information on the report.

A FinCEN ID is a unique number assigned by FinCEN by submitting the same information as is required of a beneficial owner or reporting company. A FinCEN ID may be useful to individuals that would prefer to send their personal information directly to FinCEN rather than through the reporting company. Or it may be useful to individuals that are required to supply information as a beneficial owner or company applicant of several reporting companies. Individuals and companies with a FinCEN ID must update their

information within 30 days of any changes and must correct inaccurate information within 30 days of identifying inaccuracies.

## Beneficial Owners

Two groups of individuals are considered *beneficial owners* of a reporting company: (1) any individual who directly or indirectly exercises substantial control over the reporting company; or (2) any individual who directly or indirectly owns or controls at least 25% of the reporting company’s ownership interests.

**Substantial control.** Individuals have *substantial control* if they have substantial influence over important decisions made by the reporting company. These individuals do not need to have actual ownership in the company to be a beneficial owner for reporting purposes. Important decisions associated with substantial control include decisions related to the following:

- The business’s nature, scope, and attributes, including the sale, lease, mortgage, or other transfer of principal assets.
- Reorganizing, dissolving, or merging the reporting company.
- Major expenditures or investments, issuing equity, incurring debt, or approving the operating budget.
- Selecting or terminating business lines or ventures, or geographic focus.
- Compensation and incentive programs for senior officers.
- Entering into, terminating, or fulfilling significant contracts.
- Amending substantial governance documents.

The reporting company’s senior officers are automatically deemed to have substantial control, as are individuals with the authority to appoint or remove any senior officer or a majority of the board of directors. Senior officers include the president, chief financial officer, general counsel, chief executive officer, chief operating officer, and any other officer who performs a similar function, regardless of their official title.

**Ownership interest.** The regulations define an ownership interest broadly. It includes any equity, stock, or similar interest; any capital or profits interest; any convertible interest (including convertible debt interest); a future interest, warrant, or right; any put, call, straddle, or other option to buy or sell any of the items previously mentioned; and any other instrument, contract, understanding, or mechanism used to establish ownership.

An individual may have ownership in a reporting entity through ownership in one or more intermediary entities that separately or collectively own an interest in a reporting company. When a trust holds an ownership interest in a reporting company, the following individuals can be treated as owners: a trustee with the authority to dispose of trust assets, a beneficiary who is the sole beneficiary or has the right to demand distributions of substantially all assets from the trust, or a grantor with the right to withdraw assets or revoke the trust. According to the preamble to the final regulations, it’s possible that an ownership interest held by a trust will be considered held simultaneously by multiple parties if more than one individual meets the criteria for substantial control. The preamble also explains that FinCEN considered addressing constructive ownership or attribution in defining an ownership interest but determined that doing so would be overinclusive and could create significant burdens for reporting companies. It appears that only actual indirect ownership, but not attribution from a related party, will be counted.

**Exceptions.** There are five exceptions to the definition of a beneficial owner:

- 1) A minor child when the reporting company includes the information of the child’s parent or guardian.
- 2) A nominee, intermediary, custodian, or agent of another individual.
- 3) A reporting company’s employee who is not a senior officer and is acting solely in their capacity as an employee.
- 4) An individual having only a future interest in the reporting company through a future inheritance.
- 5) A creditor of the reporting company.

## Company Applicants

The company applicant is the individual who directly files the document that creates or registers the reporting company. If more than one individual participates in filing the document, the person primarily responsible for overseeing the filing is also considered a company applicant. So, up to two individuals can be the company applicant. Company applicants must provide the same information that is required of beneficial owners, but only if the reporting company is formed or registered after 2023. FinCEN recognizes that tracking down the personal information for company applicants of reporting companies that have been in existence for a number of years may be very difficult, if not impossible in some cases. Therefore, reporting companies formed or registered before 2024 do not have to supply BOI for their company applicants.

**Caution:** A tax professional that assists clients with entity formation engagements after 2023, may need to provide their BOI to FinCEN as a company applicant.

## Penalties

Reporting companies are responsible for filing BOI reports, but beneficial owners (including senior officers) and company applicants are also subject to civil and criminal penalties for failing to provide information or providing false information to the reporting company. The fine for willfully failing to complete an initial or updated report or for willfully providing false or fraudulent information to a reporting company is \$500 per day, up to \$10,000, and imprisonment for up to two years. The fine for knowingly disclosing or using BOI without authorization is \$500 per day, up to \$250,000, and imprisonment for up to five years. A safe harbor to avoid penalties is available if a corrected report is filed no later than 90 days after the report with inaccurate information is submitted.

**Caution:** It is unclear to what extent tax professionals should be involved in advising clients and providing BOI reporting services. Until specific guidance has been issued, there is some risk that advising clients on BOI reporting is the unauthorized practice of law, which is expressly prohibited in some states. Tax professionals should consult with their state regulators, insurance carriers, and/or legal counsel before the filing period opens on January 1, 2024.

## LLCs—OTHER CONSIDERATIONS

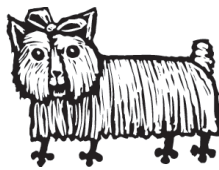
### Loss Limitations

Members in an LLC may be limited in deducting LLC losses under the following rules:

- 1) Basis rules.
- 2) At-risk rules.
- 3) Passive loss rules.

Neither an LLC taxed as a C corporation nor its members are subject to the loss limitation rules (except certain closely held entities).

The members of an LLC taxed as an S corporation are subject to the loss limitation rules in the same manner as any other S corporation shareholder. An LLC taxed as a disregarded entity is subject to the loss limitation rules to the same extent the owner is subject to those rules, since the income or loss of the LLC is deemed to be that of the owner. The following discussion addresses how the loss limitation rules affect a member's ability to deduct losses passed through from an LLC taxed as a partnership. See *Special rules for qualified conservation contributions* on Page N-18 for rules related to the deduction for qualified conservation easement contributions.



## Excess Business Loss Limitation

For tax years beginning after 2020 and before 2029, excess business losses of a taxpayer other than a C corporation are not allowed for the tax year. Such losses are carried forward and treated as part of the taxpayer's net operating loss (NOL) for determining any NOL carryforward in subsequent tax years. An *excess business loss* is the amount of the taxpayer's net business loss over a threshold (\$578,000 for MFJ and \$289,000 for all other filers for 2023). In the case of an LLC classified as a partnership, the provision applies at the member level. Each member's share of the LLC's items of business income, gain, deduction, or loss is taken into account in applying the member's limit on excess business losses for the year.

**Note:** The excess business loss rule limits an individual's ability to offset nonbusiness income (such as investment income) with an overall loss from business, even if the taxpayer is materially participating in the business.

## Basis Rules

A member's allocable share of loss from an LLC taxed as a partnership is deductible only to the extent of the member's outside basis in his LLC interest at the end of the LLC year. In determining a member's outside basis at year end, adjustments for increases and decreases are made in a specific order according to Reg. 1.704-1(d)(2).



**Outside basis.** When an interest in an LLC taxed as a partnership is acquired in exchange for a direct contribution to the LLC and no liabilities are contributed or assumed, the member's initial outside basis (under IRC Secs. 705 and 722) equals:

- 1) The amount of money contributed, plus
- 2) The adjusted basis of property contributed, plus
- 3) The amount of taxable income recognized from a contribution of services, plus
- 4) The amount of gain recognized because of the investment company rule of IRC Sec. 721(b).

See *Basis* on Page B-10 and *Partner's Adjusted Basis Worksheet* on Page A-7.

**Basis from liabilities.** In a partnership, the partner's basis is increased by partnership liabilities. A member's basis in a multi-member LLC is determined in the same manner as in a general partnership.

## At-Risk Rules

The at-risk rules are designed to limit a member from deducting losses when there has been no actual out-of-pocket loss. Members of an LLC taxed as a partnership are denied at-risk basis for their share of LLC nonrecourse debts. Since much LLC debt is generally nonrecourse (unless the debt is qualified nonrecourse financing incurred in connection with real estate transactions), many LLC members are only able to deduct out-of-pocket LLC losses under the at-risk provisions.

Amounts at risk are generally determined on an activity-by-activity basis. However, some activities can be aggregated to give the taxpayer a larger "pool" of at-risk basis against which losses can be deducted.

**Member guarantees of LLC debt.** The IRS issued a Legal Advice (A.M. 2014-003) providing guidance on how member guarantees of LLC debt affect the at-risk basis of its members. This guidance applies to LLCs classified as partnerships and to SMLLCs treated as disregarded entities for federal tax purposes. The following table summarizes the guidance provided in A.M. 2014-003.

	Accounting for Bookkeeping	Accounting for Income Tax
Intangible Drilling Costs	<p><b>GAAP</b> In general, costs of drilling exploratory wells that do not find proved reserves are expensed as incurred. Costs to explore and develop a producing well are capitalized and deducted through depreciation, depletion and amortization.</p> <p><b>E&amp;P</b> Must be amortized over 60 months for productive wells. Currently expensed for nonproductive wells [IRC Sec. 312(n)(2)(A)].</p>	<p><b>TAX</b> Intangible drilling costs (IDC) include wages, fuel, repairs, hauling, and supplies paid for in connection with the drilling or preparing of a well for the production of oil, gas, geothermal steam, or geothermal hot water. The costs are intangible because they are not directly for the purchase of tangible depreciable assets. Costs may be deducted currently as an operating expense, or capitalized and recovered through depletion or amortization (Regs. 1.612-4 and 1.612-5).</p> <p><b>AMT</b> The amount of costs deducted for regular tax that exceeds 65% of the net income from all properties is added back into income for AMT [IRC Sec. 57(a)(2)]. The add-back is not required if the IDC is amortized over 60 months for regular tax purposes [IRC Sec. 59(e)]. Independent producers are normally exempt from the AMT preference for excess IDC.</p>
Interest Expenses	<p><b>GAAP</b> Interest costs are generally expensed as incurred. Interest is capitalized (added to basis) only during the period of time that is required to get the asset ready for its intended use. Intended use means <i>sale or use within the business</i>. Interest is not capitalized for inventories that are routinely produced in large quantities on a repetitive basis.</p> <p>The amount of interest to be capitalized during any given accounting period equals the <i>capitalization rate</i> times the <i>average accumulated expenditures</i> made on the asset.</p> <p><b>Example:</b> On January 1, a corporation borrows \$400,000 at a rate of 8% to renovate an office building to be used in the corporation's business. On February 1, the corporation pays a building contractor \$50,000 to start the renovation project, which the contractor begins on February 1. On March 1, the corporation pays the contractor another \$50,000.</p> <p>On April 1, the renovation project is completed, and the corporation pays the contractor the balance due of \$300,000. Total interest accrued on the \$400,000 loan between January 1 and April 1 equals \$8,000 (8% annual interest on \$400,000 over a three-month period). Amount of interest to be capitalized is computed as follows: \$50,000 payment made on February 1 multiplied by two-twelfths of the capitalization period equals \$8,333. \$50,000 payment made on March 1 multiplied by one-twelfth of the capitalization period equals \$4,167. \$8,333 plus \$4,167 equals \$12,500 average expenditures during capitalization period. \$12,500 multiplied by 8% capitalization rate equals \$1,000 of interest that is added to the basis of the building.</p> <p>The other \$7,000 of interest accrued from January 1 through April 1 is deducted as a current operating expense.</p> <p><b>E&amp;P</b> Nondeductible interest expenses for income tax purposes are deductible for E&amp;P purposes.</p>	<p><b>TAX</b> Allocation rules require interest to be categorized as:</p> <ul style="list-style-type: none"> <li>• Mortgage interest—generally deductible.</li> <li>• Business interest—generally deductible.</li> <li>• Investment interest—deductible limited to net investment income for noncorporate taxpayers.</li> <li>• Passive activity interest—passive activity limitations apply.</li> <li>• Interest on tax-exempt investments—not deductible.</li> <li>• Capitalized interest—subject to capitalization rules (see <i>Capitalization of Interest</i> on Page L-10).</li> <li>• Federal estate tax interest—generally deductible.</li> <li>• Interest on qualified education loans—deductible subject to limitations.</li> <li>• Personal interest—not deductible.</li> </ul> <p>Every business is subject to a net interest expense disallowance. [IRC Sec. 163(j)]. See <i>Interest</i> on Page O-2 and <i>Business Interest Expense Limitation</i> on Page B-5.</p> <p>Interest paid on debt properly allocable to a trade or business is deductible based on overall interest limitation rules. Temp. Reg. 1.163-9T(b)(2)(i)(A) states that interest paid on underpayments of individual federal, state or local income taxes is nondeductible personal interest regardless of the source of the income generating the tax liability. See <i>Pugh</i> (TC Summary Opinion 2019-2) for a Tax Court decision where an individual satisfied that the properties were “allocable” to the taxpayer’s business and was therefore allowed a business interest deduction.</p> <p>Special rules apply to partnerships and S corporations on debt-financed distributions. If the partnership or S corporation borrows funds, the allocation rules apply. If those funds are allocated to distributions made to partners or shareholders, the distributed loan proceeds and related interest expense must be reported to the partners and shareholders separately. This is because the loan proceeds and the interest expense must be allocated depending on how the partner or shareholder uses the proceeds.</p> <p>Under an optional method, the partnership or S corporation may choose to allocate the distributed loan proceeds to other expenditures it makes during the tax year of the distribution. This allocation is limited to the amount of the other expenditures less any loan proceeds already allocated to them. For any distributed loan proceeds that are more than the amount allocated to the other expenditures, the rules in the previous paragraph apply.</p> <p>If the partnership or S corporation does not use the optional method, it reports the interest expense on the loan proceeds on the “Other deduction,” lines 13 (Code <b>W</b> AC) and 12 (Code <b>S</b> AC) of the Form 1065 Schedule K-1 and Form 1120-S Schedule K-1, respectively. The expense is identified on an attached schedule as “Interest expense allocated to debt-financed distributions.”</p> <p>If the partnership or S corporation uses the optional method, it reports the interest expense on the loan proceeds allocated to other expenditures on the appropriate line or lines of Schedule K-1.</p> <p>See IRS Notice 89-35 for more information on the pass-through entity interest expense reporting rules.</p>
Inventory Valuation Methods	<p><b>GAAP</b> Inventory may be valued by (1) specific identification, (2) first-in first-out (FIFO), (3) last-in first-out (LIFO), or (4) average cost methods. If the net realizable value of the inventory is less than cost, the inventory should be reduced to the net realizable value.</p> <p>See <i>Cost of Goods Sold (COGS)</i> on Page O-18, for more information.</p> <p><b>E&amp;P</b> The LIFO method is not allowed for E&amp;P purposes [IRC Sec. 312(n)(4)].</p>	<p><b>TAX</b> The specific identification, FIFO or LIFO methods can be used [Reg. 1.471-2(d)]. Valuation at either cost or the lower of cost or market may be appropriate [Reg. 1.471-2(c)].</p> <p>Form 970 (Application To Use LIFO Inventory Method) must be filed in order to use the LIFO method for regular tax purposes (Reg. 1.472-3).</p>

Table continued on the next page

	Accounting for Bookkeeping	Accounting for Income Tax
Lease and Rental Expenses	<p><b>GAAP</b> A lease should be classified as a <i>finance lease</i> by the lessee if the lease meets <i>any</i> of the following criteria at the commencement date:</p> <ul style="list-style-type: none"> <li>• The lease transfers ownership of the leased asset to the lessee on or before the end of the lease term.</li> <li>• The lease gives the lessee an option to purchase the asset and the lessee is reasonably certain to exercise that option.</li> <li>• The lease term represents the major part of the remaining economic life of the leased asset. (However, if the leased asset is at or near the end of its economic life as of the beginning of the lease, this criterion is not applicable.)</li> <li>• The present value of the sum of the lease payments and any residual value guaranteed by the lessee equals or exceeds the fair value of the leased asset.</li> <li>• The leased asset is so specialized for a particular purpose that it is not expected to have an alternative use to the lessor when the lease is over.</li> </ul> <p>If none of these criteria are met, a lease should be classified as an operating lease. For operating leases, a lessee is required to recognize a <i>right-of-use asset</i> and a <i>lease liability</i>, unless the lease has a term of 12 months or less as of the commencement date and does not have a purchase option that the lessee is reasonably certain to exercise. The right-of-use asset represents the lessee's right to use the leased asset over the term of the lease. The lease liability refers to the lessee's obligation to make lease payments as defined in the lease. The recognition of the right-of-use asset and lease liability is applicable to both operating and finance leases.</p>	<p><b>TAX</b> Lease and rental expenses are deductible if paid for the use of property not owned by the business. Payments resulting in acquisition of equity are capital expenses and are not deductible as rent.</p> <p>Payment of advance rent is deductible only to the extent the rent applies to the current year.</p> <p>If the lessee pays property tax or other expenses for the lessor's property, the amounts are considered rent paid. Also see <i>Leasehold Improvements</i> on Page O-22.</p> <p><b>Lease with option to buy.</b> Whether a lease payment is deductible as rent or capitalized as an acquisition expense depends on facts and circumstances. The answer depends on whether the burdens and benefits of ownership have passed to the purported purchaser (<i>Gaudio</i>, TC Memo 1998-408). For example, if a lessee agrees to make lease payments that are higher than fair rental value in exchange for a lower option price, the transaction is treated as the purchase of an asset, not as a lease arrangement.</p> <p><i>Factors considered by the courts:</i></p> <ul style="list-style-type: none"> <li>• Intent of the parties.</li> <li>• Whether legal title is transferred or equity created.</li> <li>• Whether rights of possession are vested in the purchaser.</li> <li>• Which party bears the risk of loss or damage to the property.</li> <li>• Which party receives profits from the operation and sale of the property.</li> <li>• Option price in relation to the value of the property.</li> <li>• Which party pays property tax.</li> </ul> <p><b>Cost of acquiring a lease.</b> Commissions, bonuses or fees paid to acquire a lease are amortized over the life of the lease. If an existing lease is acquired from another lessee, any additional costs incurred in securing the lease are also amortized over the life of the lease.</p> <p><b>Option to renew.</b> The term of a lease for amortization purposes includes all renewal options if less than 75% of the cost of getting the lease is for the term remaining on the purchase date [IRC Sec. 178(a)]. Allocation of the cost between the original term and the option term is made based on facts and circumstances, using a present value computation [Reg. 1.178-1(b)(5)].</p> <p><b>Termination payments.</b> Treatment of lease termination payments depends on whether the termination is connected to acquisition of new property. If a termination payment takes the form of damages to release a lessee from an unprofitable contract, the amount is a deductible business expense. If the lease is terminated in order for the taxpayer to acquire new property, such as when a company moves its headquarters, the termination payment is considered an acquisition cost for the new property and must be capitalized (Ltr. Rul. 9607016).</p> <p>Also see <i>Uniform Capitalization Rules</i> on Page L-9 for rent payments that must be capitalized.</p>
Leasehold Improvements	<p><b>GAAP</b> A leasehold improvement should be amortized or depreciated over the shorter of the life of the improvement or the length of the lease.</p> <p>The depreciation method and life should be the same as similar assets that are owned by the business.</p>	<p><b>TAX</b> The tenant must use MACRS depreciation for the class of property being leased [IRC Sec. 168(i)(8)]. Unrecovered basis is allowed as a loss when the lease is terminated.</p> <p><b>Note:</b> If the tenant reimburses the landlord for improvements, the cost is considered advance rent, which is deductible over the remaining lease term. If the remaining lease term is shorter than the MACRS recovery period, it may be advantageous for the tenant to reimburse the landlord for the cost of the improvements, rather than making the improvements directly [Reg. 1.61-8(c)].</p> <p>If the tenant makes improvements in lieu of rent, the cost is considered rent if the intent is plainly disclosed in the rental agreement [<i>McGrath</i>, TC Memo 2002-231, <i>aff'd</i> 92 AFTR 2d 2003-6159 (5th Cir. 2003)].</p> <p>Qualified improvement property qualifies for a 15-year recovery period and may be eligible for 100% bonus depreciation (see Tab 7 in the <i>Depreciation Quickfinder® Handbook</i>). It qualifies for Section 179 expensing as qualified real property [IRC Sec. 179(e)].</p>



# What's New



## Tab Q Topics

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Student Loan Relief .....	Page Q-1
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Inflation Reduction Act of 2022 (P. L. 117-169) Selected Tax Provisions .....	Page Q-6
SECURE 2.0 Act of 2022 Summary of Major Provisions.....	Page Q-12

## INFLATION-ADJUSTED AMOUNTS

For a summary of inflation-adjusted amounts for 2023 (plus 2024 and 2022 and prior years), see the *Business Quick Facts Data Sheet* on Page A-1.

## TAX LEGISLATION

### Inflation Reduction Act of 2022

On August 16, 2022, President Biden signed into law the Inflation Reduction Act of 2022 (H.R. 5376, P.L. 117-169). The Act includes a 15% corporate alternative minimum tax, a 1% excise tax on stock buybacks, and numerous environmental and green energy tax credits. The Act adds IRC Sec. 5000D, which imposes a new excise tax on sales by drug manufacturers, producers, and importers of “designated drugs” during the time that the manufacturer, etc., fails to enter into drug pricing agreements under the Social Security Act. The Act extends the current Premium Tax Credit (PTC) rules through 2025. The Act also increases the qualified small business payroll tax credit for research activities after 2022 [IRC Sec. 41(h)(4)(B) and (h)(5)(B) and IRC Sec. 3111(f)].

See the table *Inflation Reduction Act of 2022 (P. L. 117-169) Selected Tax Provisions* on Page Q-6 for a summary of selected tax provisions included in the Act.

### Consolidated Appropriations Act, 2023

Congress passed the Consolidated Appropriations Act of 2023 (H.R. 2617) and it was signed by President Biden on December 29, 2022. The bill contains the Setting Every Community Up for Retirement 2.0 Act of 2022 (SECURE 2.0), which includes dozens of retirement-related provisions intended to build on reforms passed in late 2019. Among the key retirement provisions in the Act are: (1) expanding automatic enrollment in retirement plans; (2) increasing the age for the required beginning date for mandatory distributions; (3) a higher catch-up limit to apply at age 60, 61, 62, and 63; and (4) elimination of the additional tax on corrective distributions of excess contributions. The Act also includes a number of smaller non-retirement tax provisions including changes to Achieving a Better Life Experience (ABLE) accounts under IRC Sec. 529A and modifications to the rules governing charitable conservation easements under IRC Sec. 170. The bill doesn't include the traditional set of tax extenders.

See the table *SECURE 2.0 Act of 2022 Summary of Major Provisions on Page Q-12* for a summary of selected tax provisions included in the Act.

## STUDENT LOAN RELIEF

In August 2022, President Biden announced a plan to forgive certain federal student loan debt, fulfilling a campaign promise. The relief was to be provided in response to the financial burdens imposed on low and middle-income borrowers related to the COVID-19 pandemic. By September 2022, several lawsuits were filed challenging the debt forgiveness plan. In October 2022, the student loan forgiveness application portal opened, despite rising legal challenges and the Eighth Circuit Court of Appeals' emergency order to temporarily block the plan. In November 2022, the plan was blocked by multiple judges and the Department of Education stopped accepting applications. President Biden asked the U.S. Supreme Court to remove the block and the Court agreed to hear arguments for cases brought against the plan. On June 30, 2023, the Supreme Court struck down President Biden's student loan forgiveness plan, ruling that relief under Biden's current plan is illegal and cannot move forward. However, there may be other paths for the implementation of Biden's plan.

### Education Act

As a result of Sputnik, in 1958 Congress authorized the first federal student loans under the National Defense Education Act of 1958 (Education Act). With the Soviet Union successfully launching the first earth-orbiting satellite, Americans worried that their educational system wasn't producing enough scientists and engineers. Funding began in 1958 and was increased over the next several years. The funding spurred college attendance in the U.S. In 1960, there were 3.6 million college students in the U.S. By 1970, that amount had more than doubled. The original federal student loan of \$1,000 per student, per year has billowed into \$1.6 trillion of outstanding federal student loans extended to 43 million borrowers.

The terms of federal loans are set by law and contain several favorable features including (1) deferral of any repayment until after graduation; (2) loan qualification regardless of credit history; (3) relatively low fixed interest rates; (4) income-sensitive repayment plans; and (5) for certain borrowers, government payment of interest while the borrower is in school. The Education Act allows the Secretary of Education to cancel or reduce loans, but only in limited circumstances and to a particular extent.

### HEROES Act

The September 11<sup>th</sup> terrorist attacks spurred Congress to enact the Higher Education Relief Opportunities for Students Act of 2001 due to concern that borrowers affected by the crisis, particularly those who served in the military, would need additional assistance. The law gave the Secretary of Education specific waiver authority to respond to conditions in the national emergency caused by the attacks on 9/11, for a limited time period. Not wanting this provision to expire, Congress issued the Higher Education Relief Opportunities for Students Act of 2003 (HEROES Act) in September of 2003. This Act extended the terms of the 2001 statute to include any war or national emergency, not just the attacks on 9/11. The HEROES Act provides that the Secretary of Education can waive or modify any statutory or regulatory provision applicable to the student financial assistance programs under the Education Act in connection with a war, other military operation, or national emergency. Under the HEROES Act, a national emergency is a national emergency declared by the President of the United States.

## COVID-19

On March 13, 2020, former President Trump declared the COVID-19 pandemic a national emergency. One week later, the Secretary of Education suspended loan repayments and interest accrual for all federally-held student loans. In August 2022, President Biden announced that the COVID-19 pandemic was over, but not before he announced his plan to reduce or eliminate federal student debts directly. The terms of President Biden's plan would have cancelled up to \$20,000 in student debt for federal borrowers who were Pell Grant recipients and up to \$10,000 in student debt for other federal borrowers making under \$125,000 per year. In its June 30, 2023 rulings, the Supreme Court ruled that the HEROES Act is not the appropriate law to carry out this relief.

### ***Biden vs. Nebraska***

In this case, six states sued, arguing that the HEROES Act doesn't authorize President Biden's loan cancellation plan. The Court said that the HEROES Act allows the Secretary of Education to "waive or modify" existing statutory or regulatory provisions applicable to financial assistance programs under the Education Act but doesn't allow him to rewrite that statute to the extent of canceling \$430 billion of student loan principal. It continued by saying that the Secretary of Education's power doesn't permit "basic and fundamental changes in the scheme" designed by Congress. While Congress specified in the Education Act a few situations that qualify a borrower for loan forgiveness, the Secretary extended the forgiveness to nearly every borrower in the country. The Court determined that this was highly unlikely to be authorized by Congress through such a subtle modification.

### **President's Response**

On the day of Supreme Court ruling, the White House issued a fact sheet announcing new actions to provide debt relief and support for student loan borrowers. The Secretary of Education initiated a rulemaking process aimed at opening an alternative path to debt relief using authority under the Higher Education Act. The Department of Education has also finalized an affordable repayment plan. The Department is instituting a 12-month "on-ramp" to repayment beginning October 1, 2023 through September 30, 2024. During this time, financially vulnerable borrowers who miss monthly payments are not considered delinquent, reported to credit bureaus, placed in default, or referred to debt collection agencies. The Fact Sheet with more information can be found at [www.whitehouse.gov/briefing-room/statements-releases/2023/06/30/fact-sheet-president-biden-announces-new-actions-to-provide-debt-relief-and-support-for-student-loan-borrowers/](https://www.whitehouse.gov/briefing-room/statements-releases/2023/06/30/fact-sheet-president-biden-announces-new-actions-to-provide-debt-relief-and-support-for-student-loan-borrowers/).

## BENEFICIAL OWNERSHIP REPORTING

The Corporate Transparency Act of 2020 (CTA), enacted January 1, 2021, created new reporting requirements relating to the beneficial owners of certain companies doing business in the U.S. The Financial Crimes Enforcement Network (FinCEN) issued final regulations on September 29, 2022 that will become effective on January 1, 2024. The new rules are intended to protect the U.S. financial systems from criminal use by providing information to national security, intelligence, and law enforcement agencies to help prevent the use of so-called shell companies to launder money or hide assets.

According to the preamble to the regulations, shell companies are typically non-publicly traded corporations, LLCs, or other types of entities with no physical presence and little to no economic value. They can be used to carry out financial transactions while concealing their owners' involvement. Some shell companies are used to engage in criminal activity, such as money laundering, human

and drug trafficking, tax or financial fraud, terrorism financing, or other illegal activity.

Currently, the data available to law enforcement about who owns and operates businesses is generally limited to what is collected when the entity is created. Most states do not require detailed information about ownership or control when a company is formed. The new reporting requirements aim to increase transparency and create a centralized database with beneficial ownership information, hindering the ability for criminals to use shell companies for illegal activity.

### **Filing Requirements**

Both domestic and foreign reporting companies are subject to the new beneficial ownership reporting requirements. A domestic reporting company is a corporation, LLC, or any other entity created by filing a document with the secretary of state (SOS) or similar office. Because sole proprietorships, trusts, and general partnerships do not require the filing of a formal document, they generally are not considered a reporting company and will not have a filing requirement.

👁 **Observation:** Although not explicitly included in the domestic reporting company definition, it appears that most limited partnerships, LLPs, and LLLPs will be subject to the new reporting rules because they fall into the category of "any other entity created by filing a document with the SOS."

A foreign reporting company is a corporation, LLC, or similar entity that registers to do business in the U.S. by filing a document with the SOS or similar office. Just like domestic companies, the key to whether a foreign company must report beneficial ownership is whether a document is filed to register the entity. If registration of the foreign entity is not required under state law, the entity is not a reporting company and is not required to report beneficial ownership information to FinCEN.

Companies that meet one of 23 statutory exemptions are excluded from the definition of a reporting company and are not subject to the new reporting rules. Most of these exemptions are for entities such as financial institutions, insurance companies, securities brokers, and other types of entities that are already required to report ownership information to a governmental authority. A list of exemptions can be found at *Reporting Company Exemptions* on Page Q-4.

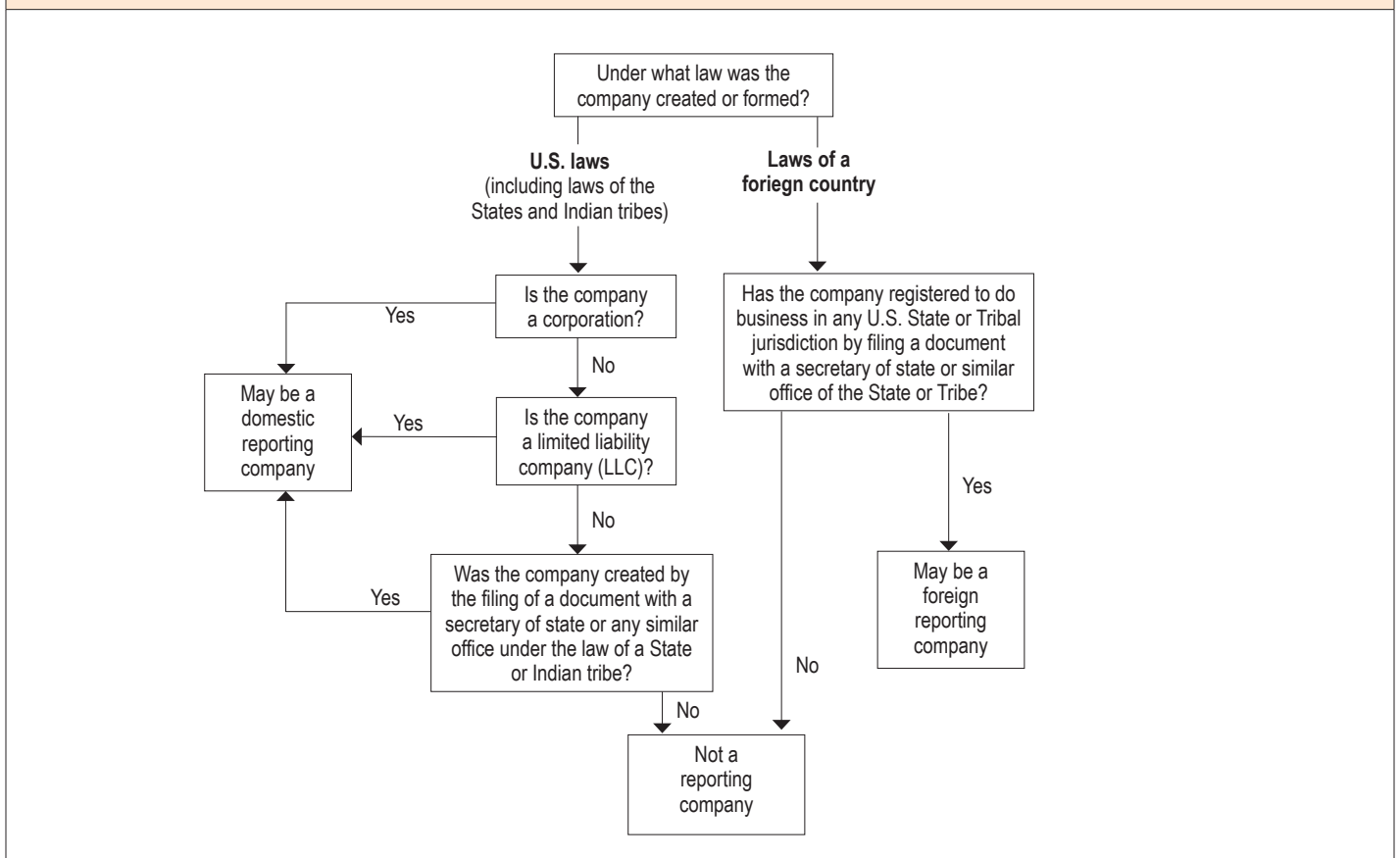
There is one significant exemption that is an outlier from this general rule—a large operating company. A large operating company is any entity with (a) more than 20 full-time U.S. employees, (b) an operating presence at a physical office in the U.S., and (c) more than \$5,000,000 of U.S. sourced gross receipts (net of returns and allowances) reported on its prior year federal income tax or information return. Presumably, meeting these criteria makes a company less likely to be a shell company, so large operating companies are exempt from the reporting requirements.

### **Important Filing Dates**

**Initial Report.** For existing reporting companies created or registered before 2024, the initial report is due January 1, 2025. So, tax professionals still have plenty of time to identify which clients must file and collect the information needed. For reporting companies created or registered after 2023, the initial report is due 30 days after the entity's creation or registration. This short turnaround means that for newly created or registered entities, the initial report should probably be filed as part of the entity formation engagement. So, professionals should request the necessary information at the time of entity formation or registration.

📌 **Note:** FinCEN has **extended for 2024 only** the initial filing deadline for beneficial ownership reports from 30 to 90 days for

## Beneficial Ownership Reporting Requirements



entities created or registered in 2024. This **would give gives** those entities additional time to understand the new reporting obligation and collect the necessary information to complete the filing.

**Updated Report.** An updated report must be filed when there is a change to previously reported information about the reporting company or its beneficial owners. The updated report is due within 30 days of the change. It is imperative that clients are aware of this requirement, so they timely inform their advisors of any changes that need to be reported. If a reporting company files an information report and later qualifies for one of the 23 filing exemptions, an updated report should be filed to report the change in exemption status.

**Corrected Report.** Corrected reports are required when any information previously reported is discovered to be inaccurate. The corrected report is due within 30 days after the reporting company becomes aware or has reason to know of the error.



FinCEN is in the process of creating a secure electronic filing system that will be accessed via their website and will begin accepting reports on January 1, 2024.

### Reported Information

Beneficial ownership information (BOI) must be reported for the reporting company's beneficial owners and certain company applicants. BOI includes an individual's full legal name, date of birth, street address, and a unique ID number. The unique ID number can be from a non-expired U.S. passport, state driver's license, or other photo-identification card issued by a state or local government. If the individual does not have any of those documents, then a non-expired foreign passport can be used. An image of the document showing the unique ID number must also be included with the report.

Similar information about the reporting company must also be reported, including the company's legal name, DBA, street address, jurisdiction where it was formed or registered, and tax ID.

Individuals and reporting companies can request a FinCEN identifier (FinCEN ID) to use in place of supplying detailed information on the report. A FinCEN ID is a unique number assigned by FinCEN by submitting the same information as is required of a beneficial owner or reporting company. A FinCEN ID may be useful to individuals who would prefer to send their personal information directly to FinCEN rather than through the reporting company. Or it may be useful to individuals who are required to supply information as a beneficial owner or company applicant of several reporting companies. Individuals and companies with a FinCEN ID must update their information within 30 days of any changes and must correct inaccurate information within 30 days of identifying inaccuracies.

### Beneficial Owners

Two groups of individuals are considered beneficial owners of a reporting company: (1) any individual who directly or indirectly exercises substantial control over the reporting company; or (2) any individual who directly or indirectly owns or controls at least 25% of the reporting company's ownership interests.

**Substantial Control.** Individuals have substantial control if they have substantial influence over important decisions made by the reporting company. These individuals do not need to have actual ownership in the company to be a beneficial owner for reporting purposes. Important decisions associated with substantial control include decisions related to—

- The business's nature, scope, and attributes, including the sale, lease, mortgage, or other transfer of principal assets.
- Reorganizing, dissolving, or merging the reporting company.

*Continued on the next page*

- Major expenditures or investments, issuing equity, incurring debt, or approving the operating budget.
- Selecting or terminating business lines or ventures, or geographic focus.
- Compensation and incentive programs for senior officers.
- Entering into, terminating, or fulfilling significant contracts.
- Amending substantial governance documents.

The reporting company's senior officers are automatically deemed to have substantial control, as are individuals with the authority to appoint or remove any senior officer or a majority of the board of directors. Senior officers include the president, chief financial officer, general counsel, chief executive officer, chief operating officer, and any other officer who performs a similar function, regardless of their official title.

**Ownership Interest.** The regulations define an ownership interest broadly. It includes any equity, stock, or similar interest; any capital or profits interest; any convertible interest (including convertible debt interest); a future interest, warrant, or right; any put, call, straddle, or other option to buy or sell any of the items previously mentioned; and any other instrument, contract, understanding, or mechanism used to establish ownership.

An individual may have ownership in a reporting entity through ownership in one or more intermediary entities that separately or collectively own an interest in a reporting company.

When a trust holds an ownership interest in a reporting company, the following individuals can be treated as owners: a trustee with the authority to dispose of trust assets, a beneficiary who is the sole beneficiary or has the right to demand distributions of substantially all assets from the trust, or a grantor with the right to withdraw assets or revoke the trust. According to the preamble to the final regulations, it's possible that an ownership interest held by a trust will be considered held simultaneously by multiple parties if more than one individual meets the criteria for substantial control.

The preamble also explains that FinCEN considered addressing constructive ownership or attribution in defining an ownership interest but determined that doing so would be overinclusive and could create significant burdens for reporting companies. So, it appears that only actual indirect ownership, but not attribution from a related party, will be counted.

**Exceptions.** There are five exceptions to the definition of a beneficial owner:

- 1) A minor child when the reporting company includes the information of the child's parent or guardian.
- 2) A nominee, intermediary, custodial, or agent of another individual.
- 3) A reporting company's employee who is not a senior officer and is acting solely in their capacity as an employee.
- 4) An individual having only a future interest in the reporting company through a future inheritance.
- 5) A creditor of the reporting company.

## Company Applicants

The company applicant is the individual who directly files the document that creates or registers the reporting company. If more than one individual participates in filing the document, the person primarily responsible for overseeing the filing is also considered a company applicant. So, up to two individuals can be the company applicant.

Company applicants must provide the same information that is required of beneficial owners, but only if the reporting company is formed or registered after 2023. FinCEN recognizes that tracking down the personal information for company applicants of reporting

companies that have been in existence for a number of years may be very difficult, if not impossible in some cases. So, reporting companies formed or registered before 2024 do not have to supply BOI for their company applicants.

## Penalties for Reporting Violations

Penalties for noncompliance are steep. Reporting companies are responsible for filing BOI reports, but beneficial owners (including senior officers) and company applicants are also subject to civil and criminal penalties for failing to provide information or providing false information to the reporting company.

The fine for willfully failing to complete an initial or updated report or for willfully providing false or fraudulent information to a reporting company is \$500 per day, up to \$10,000 and imprisonment for up to two years. The fine for knowingly disclosing or using BOI without authorization is \$500 per day, up to \$250,000 and imprisonment for up to five years.

A safe harbor to avoid penalties is available if a corrected report is filed no later than 90 days after the report with inaccurate information is submitted.

## Confidentiality of the Information Collected

The law limits the disclosure of BOI to federal agencies engaged in national security, intelligence, or law enforcement. The information can also be disclosed to state law enforcement agencies if authorized by a court as part of a civil or criminal investigation and to certain foreign authorities if requested by a federal agency under an international treaty. Financial institutions subject to customer due diligence requirements may also request BOI from FinCEN with consent from the reporting company. FinCEN plans to issue additional regulations to clarify who may access BOI and for what purpose, as well as what safeguards will be used to ensure the information is safe and protected.

## Reporting Company Exemptions

The following types of companies are not included in the definition of reporting company with respect to the beneficial ownership information reporting requirements:

- 1) *Securities reporting issuer.* An issuer of securities that is either registered under Section 12 or required to file supplementary and periodic information under Section 15(d) of the Securities Exchange Act of 1934.
- 2) *Governmental authority.* A federal, tribal, or state entity that exercises governmental authority on behalf of the U.S. or any Indian tribe, state, or political subdivision.
- 3) *Bank.* Any bank as defined in Section 3 of the Federal Deposit Insurance Act, Section 2(a) of the Investment Company Act of 1940, or Section 202(a) of the Investment Advisers Act of 1940.
- 4) *Credit union.* Any federal or state credit union as defined in Section 1010 of the Federal Credit Union Act.
- 5) *Depository institution holding company.* Any bank holding company as defined in Section 2 of the Bank Holding Company Act of 1956 or any savings and loan holding company as defined in Section 10(a) of the Home Owner's Loan Act.
- 6) *Money services business.* Any money business service registered with the Financial Crimes Enforcement Network (FinCEN) under 31 USC 5330 or 31 CFR 1002.380.
- 7) *Broker or dealer in securities.* Any broker or dealer as defined in Section 3 of the Securities and Exchange Act of 1934 that is registered under Section 15 of that Act.
- 8) *Securities exchange or clearing agency.* Any exchange or clearing agency as defined in Section 3 of the Securities and Exchange Act of 1934 that is registered under Sections 6 or 17A of that Act.