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Reviewing S-Corp Returns

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**BY ROBERT RICKETTS, PH.D., CPA; AND
LARRY TUNNELL, PH.D., CPA**

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- For self-study programs, a certificate supplied by the CPE program sponsor after satisfactory completion of an examination

When you participate in group study and other live presentations, you will receive a completion certificate from the program sponsor. CPE program sponsors are required to keep documentation on programs for five years, including records of participation.

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- The exam for self-study in print format is located in the "Examination" section at the end of the course manual.

- You can find the course code number for both the self-study exam and the self-study evaluation in the examination's introductory material. You will complete the self-study exam and evaluation online at <https://cpegrading.aicpa.org>. You must provide the unique serial number printed on the inside front cover of this publication and you must achieve a minimum passing grade of at least 70% to qualify for CPE credit.
 - Upon achieving a passing grade, you will receive a certificate displaying the number of CPE credits earned based on a 50-minute learning segment, in compliance with CPE standards. The grading system provides a completion certificate online, which you may print or save as a PDF. The grading system maintains a transcript of your completed courses.
 - If you do not achieve a passing grade, the online grading system notifies you of this and also provides instructions for retaking the exam. You have three attempts to pass the exam. If you do not pass the exam in three attempts, please contact the Global Engagement Center at 1.888.777.7077 to obtain additional attempts.

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The information accumulated from participant evaluation forms is important in our continual efforts to provide high quality continuing education for the profession. When you participate in group study and other live presentations, please return your evaluation forms prior to departing your program sessions. When you participate in self-study, please complete the course evaluation online. Your comments are very important to us.

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Chapter 1

Case One: High Country Delicacies

Learning objectives

- Determine how transfers to corporations in exchange for stock can be nontaxable under IRC Section 351.
- Calculate the balance in an accumulated adjustments account and enter that calculation on Form 1120S, Schedule M-2.
- Determine how distributions to an S corporation shareholder are taxed.
- Identify which items go on page 1 of Form 1120S and which go on Schedule K.
- Determine which fringe benefits are taxable to a 2% S corporation shareholder.

High Country Delicacies is a Colorado S corporation with the following three shareholders:

| Name | SS number |
|-------------------|-------------|
| Linda George | 455-81-5151 |
| 4825 Stout Street | |
| Denver, CO 80205 | |
| Eileen Brown | 454-66-3333 |
| 1750 E. Yale | |
| Aurora, CO 80013 | |
| Leon Marks | 459-34-5939 |
| 1519 Glencoe | |
| Denver, CO 80220 | |

High Country Delicacies (HCD) was formed on January 1, 2021. Its federal identification number is 75-3185725, and its address is 1701 E. Yale, Aurora, CO 80013. The shareholders contributed cash and property as follows to form the S corporation:

| | | |
|---------------|--|-----------|
| Linda | Parkway Place Building | |
| | Original cost – Building | \$984,555 |
| | Accumulated depreciation | 0 |
| | Original cost – Land | 115,445 |
| | At date of contribution – Building fair market value | 984,555 |
| | Land fair market value | 115,445 |
| | Outstanding mortgage balance | 875,000 |
| | Remaining depreciable life | 15 years |
| Eileen | \$225,000 cash | |
| Leon | \$225,000 cash | |

HCD will use the Parkway Place Building (recently purchased by Linda) to open a restaurant. Eileen and Leon will oversee the operations of the restaurant, and Linda will oversee the financial end of the business (including signing the tax return), as well as maintenance and management of the building.

Linda, Eileen, and Leon are CFO, CEO, and president, respectively, of HCD. Eileen and Leon will be paid salaries of \$45,000 each per year for their efforts in managing the restaurant, and Linda will receive a salary of \$42,000 per year. Each of the shareholders owns 2,250 shares in the corporation.

HCD trial balance

HCD has the following trial balance at December 31.

| | Trial balance | |
|-------------------------------------|---------------|---------|
| Cash | 102,879 | |
| Accounts receivable | 20,000 | |
| Allowance for bad debts | | 2,500 |
| Equipment | 121,000 | |
| Accumulated depreciation, equipment | | 17,291 |
| Land | 115,445 | |
| Building | 984,555 | |
| Accumulated depreciation, building | | 24,230 |
| Accounts payable | | 26,000 |
| Mortgage payable | | 875,000 |
| Capital, Linda | | 225,000 |
| Capital, Eileen | | 225,000 |
| Capital, Leon | | 225,000 |
| Sales | | 366,500 |
| Purchases | 147,961 | |

| | Trial balance | |
|---------------------------------|---------------|-----------|
| Bad debt expense | 2,500 | |
| Insurance | 12,000 | |
| Employee wages | 135,600 | |
| Officer salaries | 132,000 | |
| Employee medical expenses | 24,000 | |
| Payroll taxes | 12,800 | |
| Charitable contributions | 1,760 | |
| Interest expense | 61,000 | |
| Property tax, building | 7,200 | |
| Property tax, F&F, Inv. | 4,300 | |
| Depreciation expense, building | 24,230 | |
| Depreciation expense, equipment | 17,291 | |
| Shareholder draws: | | |
| Linda | 20,000 | |
| Eileen | 20,000 | |
| Leon | 20,000 | |
| | 1,986,521 | 1,986,521 |

HCD has the following balance sheet and income statement balances at December 31.

| | Balance sheet | | Income statement | |
|-------------------------------------|---------------|-----------|------------------|---------|
| Cash | 102,879 | | | |
| Accounts receivable | 20,000 | | | |
| Allowance for bad debts | | 2,500 | | |
| Equipment | 121,000 | | | |
| Accumulated depreciation, equipment | | 17,291 | | |
| Land | 115,445 | | | |
| Building | 984,555 | | | |
| Accumulated depreciation, building | | 24,230 | | |
| Accounts payable | | 26,000 | | |
| Mortgage payable | | 875,000 | | |
| Capital, Linda | | 225,000 | | |
| Capital, Eileen | | 225,000 | | |
| Capital, Leon | | 225,000 | | |
| Accumulated adjustment account | | -264,599 | | |
| Sales | | | | 366,500 |
| Beginning inventory | | | | |
| Ending inventory | 11,543 | | | 11,543 |
| Purchases | | | 147,961 | |
| Bad debt expense | | | 2,500 | |
| Insurance | | | 12,000 | |
| Employee wages | | | 135,600 | |
| Officer salaries | | | 132,000 | |
| Employee medical expenses | | | 24,000 | |
| Payroll taxes | | | 12,800 | |
| Charitable contributions | | | 1,760 | |
| Interest expense | | | 61,000 | |
| Property tax, building | | | 7,200 | |
| Property tax, F&F, Inv. | | | 4,300 | |
| Depreciation expense, building | | | 24,230 | |
| Depreciation expense, equipment | | | 17,291 | |
| | 1,355,422 | 1,355,422 | 582,642 | 378,043 |

Notes to accompany trial balance

HCD uses the accrual method of accounting for tax purposes.

Assume that tax and book depreciation are the same. That is, the preceding depreciation numbers are the same as those that would be reported on Form 4562. Also, there is no alternative minimum tax (AMT) adjustment for depreciation on the building. The S corporation has chosen not to make the IRC Section 179 election or take bonus depreciation with respect to the equipment acquired during the taxable year. The building and the equipment were all placed in service on January 1. Assume that all of HCD's income is qualified business income under Section 199A; all the W-2 wages are associated with this qualified business income; and all of the S corporation's assets are used in the production of the qualified business income.

The S corporation's bad debt expense under the specific charge-off method would be \$0 for the current year.

HCD: 2021 tax return and accompanying forms and schedules

The S corporation's 2021 Form 1120S, *U.S. Income Tax Return for an S Corporation*, along with 2021 Schedules K-1 (Form 1120S), *Shareholder's Share of Income, Deductions, Credits, etc.*, for each shareholder are reproduced on the following pages. The tax return and accompanying Schedules K-1 are followed by an explanation of the rationale and calculation of each figure reported on the return.

In reviewing the return, you should pay careful attention to the following items, which are discussed in more depth throughout the rest of this chapter:

- Because the corporation was just formed, is there a short period tax return? How will this affect depreciation?
- Are there special depreciation rules for restaurant property?
- How are employee benefits taxed if the employee is an S corporation shareholder?
- How is the accumulated adjustments account balance calculated, and where is it disclosed on the Form 1120S?

U.S. Income Tax Return for an S Corporation

Department of the Treasury
Internal Revenue Service

▶ **Do not file this form unless the corporation has filed or is attaching Form 2553 to elect to be an S corporation.**
▶ **Go to www.irs.gov/Form1120S for instructions and the latest information.**

2021

For calendar year 2021 or tax year beginning 1/1/2021, ending _____

| | | | |
|--|------------------------------|---|---|
| A S election effective date <u>1/1/2021</u> | TYPE OR PRINT | Name <u>High Country Delicacies</u> | D Employer identification number <u>75-3185725</u> |
| B Business activity code number (see instructions) <u>722511</u> | | Number, street, and room or suite no. If a P.O. box, see instructions. <u>1701 E. Yale</u> | E Date incorporated <u>1/1/2021</u> |
| C Check if Sch. M-3 attached <input type="checkbox"/> | | City or town State ZIP code <u>Aurora CO 80013</u> | F Total assets (see instructions) \$ <u>1,311,401</u> |
| | | Foreign country name Foreign province/state/county Foreign postal code | |

G Is the corporation electing to be an S corporation beginning with this tax year? See instructions. Yes No

H Check if: (1) Final return (2) Name change (3) Address change (4) Amended return (5) S election termination

I Enter the number of shareholders who were shareholders during any part of the tax year 3

J Check if corporation: (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 21. See the instructions for more information.

| | | | | |
|---|---|------------|-------------------------|---------------------------|
| Income | 1a Gross receipts or sales | 1a | <u>366,500</u> | |
| | b Returns and allowances | 1b | | |
| | c Balance. Subtract line 1b from line 1a | | | 1c <u>366,500</u> |
| | 2 Cost of goods sold (attach Form 1125-A) | | | 2 <u>136,418</u> |
| | 3 Gross profit. Subtract line 2 from line 1c | | | 3 <u>230,082</u> |
| | 4 Net gain (loss) from Form 4797, line 17 (attach Form 4797) | | | 4 |
| 5 Other income (loss) (see instructions—attach statement) | | | 5 | |
| 6 Total income (loss). Add lines 3 through 5 | | | 6 <u>230,082</u> | |
| Deductions (see instructions for limitations) | 7 Compensation of officers (see instructions — attach Form 1125-E) | | | 7 <u>132,000</u> |
| | 8 Salaries and wages (less employment credits) | | | 8 <u>135,600</u> |
| | 9 Repairs and maintenance | | | 9 |
| | 10 Bad debts | | | 10 |
| | 11 Rents | | | 11 |
| | 12 Taxes and licenses | | | 12 <u>24,300</u> |
| | 13 Interest (see instructions) | | | 13 <u>61,000</u> |
| | 14 Depreciation not claimed on Form 1125-A or elsewhere on return (attach Form 4562) | | | 14 <u>41,521</u> |
| | 15 Depletion (Do not deduct oil and gas depletion.) | | | 15 |
| | 16 Advertising | | | 16 |
| | 17 Pension, profit-sharing, etc., plans | | | 17 |
| | 18 Employee benefit programs | | | 18 <u>24,000</u> |
| | 19 Other deductions (attach statement) | | | 19 <u>12,000</u> |
| | 20 Total deductions. Add lines 7 through 19 | | | 20 <u>430,421</u> |
| | 21 Ordinary business income (loss). Subtract line 20 from line 6 | | | 21 <u>-200,339</u> |
| Tax and Payments | 22a Excess net passive income or LIFO recapture tax (see instructions) | 22a | | |
| | b Tax from Schedule D (Form 1120-S) | 22b | | |
| | c Add lines 22a and 22b (see instructions for additional taxes) | | | 22c <u>0</u> |
| | 23a 2021 estimated tax payments and 2020 overpayment credited to 2021 | 23a | | |
| | b Tax deposited with Form 7004 | 23b | | |
| | c Credit for federal tax paid on fuels (attach Form 4136) | 23c | | |
| | d Add lines 23a through 23c | | | 23d <u>0</u> |
| | 24 Estimated tax penalty (see instructions). Check if Form 2220 is attached <input type="checkbox"/> | | | 24 |
| 25 Amount owed. If line 23d is smaller than the total of lines 22c and 24, enter amount owed | | | 25 <u>0</u> | |
| 26 Overpayment. If line 23d is larger than the total of lines 22c and 24, enter amount overpaid | | | 26 <u>0</u> | |
| 27 Enter amount from line 26: Credited to 2022 estimated tax ▶ Refunded ▶ | | | 27 <u>0</u> | |

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Sign Here ▶ Signature of officer _____ Date _____ Title **Chief Financial Officer**

Print/Type preparer's name _____ Preparer's signature _____ Date _____ Check if self-employed PTIN _____

Paid Preparer Use Only

Firm's name ▶ _____ Firm's EIN ▶ _____
 Firm's address ▶ _____ Phone no. _____
 City _____ State _____ ZIP code _____

May the IRS discuss this return with the preparer shown below? See instructions. Yes No

For Paperwork Reduction Act Notice, see separate instructions.

Schedule B Other Information (see instructions)

1 Check accounting method: **a** Cash **b** Accrual Yes No
c Other (specify) ▶ _____

2 See the instructions and enter the:
a Business activity ▶ _____ **b** Product or service ▶ _____

3 At any time during the tax year, was any shareholder of the corporation a disregarded entity, a trust, an estate, or a nominee or similar person? If "Yes," attach Schedule B-1, Information on Certain Shareholders of an S Corporation 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 the 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? See instructions 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 \$26 million and the corporation has business interest expense.
c The corporation is a tax shelter and the corporation has business interest expense.
If "Yes," complete and attach Form 8990.

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.

| 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 2021 that would require it to file Form(s) 1099? | X | |
| b | If "Yes," did the corporation file or will it 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 |

| Schedule K Shareholders' Pro Rata Share Items | | Total amount | |
|--|---|--------------|----------|
| Income (Loss) | 1 Ordinary business income (loss) (page 1, line 21) | 1 | -200,339 |
| | 2 Net rental real estate income (loss) (attach Form 8825) | 2 | |
| | 3a Other gross rental income (loss) 3a | | |
| | b Expenses from other rental activities (attach statement) 3b | | |
| | c Other net rental income (loss). Subtract line 3b from line 3a 3c | | 0 |
| | 4 Interest income 4 | | |
| | 5 Dividends: a Ordinary dividends 5a | | |
| | b Qualified dividends 5b | | |
| | 6 Royalties 6 | | |
| | 7 Net short-term capital gain (loss) (attach Schedule D (Form 1120-S)) 7 | | |
| Deductions | 8a Net long-term capital gain (loss) (attach Schedule D (Form 1120-S)) 8a | | |
| | b Collectibles (28%) gain (loss) 8b | | |
| | c Unrecaptured section 1250 gain (attach statement) 8c | | |
| | 9 Net section 1231 gain (loss) (attach Form 4797) 9 | | |
| | 10 Other income (loss) (see instructions) Type ▶ 10 | | |
| | 11 Section 179 deduction (attach Form 4562) 11 | | |
| | 12a Charitable contributions 12a | | 1,760 |
| | b Investment interest expense 12b | | |
| | c Section 59(e)(2) expenditures Type ▶ 12c | | |
| | d Other deductions (see instructions) Type ▶ 12d | | |
| Credits | 13a Low-income housing credit (section 42(j)(5)) 13a | | |
| | b Low-income housing credit (other) 13b | | |
| | c Qualified rehabilitation expenditures (rental real estate) (attach Form 3468, if applicable) 13c | | |
| | d Other rental real estate credits (see instructions) Type ▶ 13d | | |
| | e Other rental credits (see instructions) Type ▶ 13e | | |
| | f Biofuel producer credit (attach Form 6478) 13f | | |
| | g Other credits (see instructions) Type ▶ 13g | | |
| International Transactions | 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"/> | | |
| Alternative Minimum Tax (AMT) Items | 15a Post-1986 depreciation adjustment 15a | | 4,332 |
| | b Adjusted gain or loss 15b | | |
| | c Depletion (other than oil and gas) 15c | | |
| | d Oil, gas, and geothermal properties—gross income 15d | | |
| | e Oil, gas, and geothermal properties—deductions 15e | | |
| | f Other AMT items (attach statement) 15f | | |
| Items Affecting Shareholder Basis | 16a Tax-exempt interest income 16a | | |
| | b Other tax-exempt income 16b | | |
| | c Nondeductible expenses 16c | | |
| | d Distributions (attach statement if required) (see instructions) 16d | | 60,000 |
| | e Repayment of loans from shareholders 16e | | |
| | f Foreign taxes paid or accrued 16f | | |

| Schedule K | | Shareholders' Pro Rata Share Items (continued) | Total amount |
|--------------------------|------------|--|---------------------|
| Other Information | 17a | Investment income | 17a |
| | b | Investment expenses | 17b |
| | c | Dividend distributions paid from accumulated earnings and profits | 17c |
| | d | Other items and amounts (attach statement) | |
| Reconciliation | 18 | Income (loss) reconciliation. Combine the amounts on lines 1 through 10 in the far right column. From the result, subtract the sum of the amounts on lines 11 through 12d and 16f . . . | 18 -202,099 |

| Schedule L | | Balance Sheets per Books | | Beginning of tax year | | End of tax year | |
|---|--|---------------------------------|-----|-----------------------|-----|-----------------|------------|
| | | (a) | (b) | (c) | (d) | | |
| Assets | | | | | | | |
| 1 | Cash | | | | | | 102,879 |
| 2a | Trade notes and accounts receivable | | | 20,000 | | | |
| b | Less allowance for bad debts | | 0 | 2,500 | | | 17,500 |
| 3 | Inventories | | | | | | 11,543 |
| 4 | U.S. government obligations | | | | | | |
| 5 | Tax-exempt securities (see instructions) | | | | | | |
| 6 | Other current assets (attach statement) | | | | | | |
| 7 | Loans to shareholders | | | | | | |
| 8 | Mortgage and real estate loans | | | | | | |
| 9 | Other investments (attach statement) | | | | | | |
| 10a | Buildings and other depreciable assets | | | 1,105,555 | | | |
| b | Less accumulated depreciation | | 0 | 41,521 | | | 1,064,034 |
| 11a | Depletable assets | | | | | | |
| b | Less accumulated depletion | | 0 | | | | 0 |
| 12 | Land (net of any amortization) | | | | | | 115,445 |
| 13a | Intangible assets (amortizable only) | | | | | | |
| b | Less accumulated amortization | | 0 | | | | 0 |
| 14 | Other assets (attach statement) | | | | | | |
| 15 | Total assets | | 0 | | | | 1,311,401 |
| Liabilities and Shareholders' Equity | | | | | | | |
| 16 | Accounts payable | | | | | | 26,000 |
| 17 | Mortgages, notes, bonds payable in less than 1 year | | | | | | 875,000 |
| 18 | Other current liabilities (attach statement) | | | | | | |
| 19 | Loans from shareholders | | | | | | |
| 20 | Mortgages, notes, bonds payable in 1 year or more | | | | | | |
| 21 | Other liabilities (attach statement) | | | | | | |
| 22 | Capital stock | | | | | | |
| 23 | Additional paid-in capital | | | | | | 675,000 |
| 24 | Retained earnings | | | | | | (264,599) |
| 25 | Adjustments to shareholders' equity (attach statement) | | | | | | |
| 26 | Less cost of treasury stock | | | | | | |
| 27 | Total liabilities and shareholders' equity | | 0 | | | | 1,311,401 |

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

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

| | | | |
|--|---|---|--|
| <p>1 Net income (loss) per books -204,599</p> <p>2 Income included on Schedule K, lines 1, 2, 3c, 4, 5a, 6, 7, 8a, 9, and 10, not recorded on books this year (itemize) -----</p> <p>3 Expenses recorded on books this year not included on Schedule K, lines 1 through 12 and 16f (itemize):</p> <p>a Depreciation \$ -----</p> <p>b Travel and entertainment \$ ----- See Attached Statement 2,500</p> <p>4 Add lines 1 through 3 -202,099</p> | <p>5</p> <p>a</p> <p>6</p> <p>a</p> <p>7</p> <p>8</p> | <p>Income recorded on books this year not included on Schedule K, lines 1 through 10 (itemize):</p> <p>Tax-exempt interest \$ -----</p> <p>-----</p> <p>Deductions included on Schedule K, lines 1 through 12 and 16f, not charged against book income this year (itemize):</p> <p>Depreciation \$ -----</p> <p>-----</p> <p>Add lines 5 and 6 0</p> <p>Income (loss) (Schedule K, line 18). Subtract line 7 from line 4 -202,099</p> | <p>0</p> <p>0</p> <p>0</p> <p>0</p> <p>0</p> <p>-202,099</p> |
|--|---|---|--|

Schedule M-2 Analysis of Accumulated Adjustments Account, Shareholders' Undistributed Taxable Income Previously Taxed, Accumulated Earnings and Profits, and Other Adjustments Account
(see instructions)

| | (a) Accumulated adjustments account | (b) Shareholders' undistributed taxable income previously taxed | (c) Accumulated earnings and profits | (d) Other adjustments account |
|---|-------------------------------------|---|--------------------------------------|-------------------------------|
| 1 Balance at beginning of tax year | | | | |
| 2 Ordinary income from page 1, line 21 | | | | |
| 3 Other additions | | | | |
| 4 Loss from page 1, line 21 -200,339 | | | | |
| 5 Other reductions 4,260 | | | | |
| 6 Combine lines 1 through 5 -204,599 | | 0 | 0 | 0 |
| 7 Distributions 60,000 | | | | |
| 8 Balance at end of tax year. Subtract line 7 from line 6 -264,599 | | 0 | 0 | 0 |

671121

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

Schedule K-1 (Form 1120-S)

2021

Department of the Treasury Internal Revenue Service

For calendar year 2021, or tax year

beginning 01/01/2021 ending

Shareholder's Share of Income, Deductions, Credits, etc. See separate instructions.

Part I Information About the Corporation

Form section for Part I: Information About the Corporation. Includes fields for Employer ID number (75-3185725), Corporation name (High Country Delicacies), IRS Center (e-file), and Share count (6,750).

Part II Information About the Shareholder

Form section for Part II: Information About the Shareholder. Includes fields for Shareholder ID (455-81-5151), Shareholder name (Linda George), Current year allocation percentage (33.333333%), and Share count (2,250).

Form section for Part III: Shareholder's Share of Current Year Income, Deductions, Credits, and Other Items. Includes a table with 18 rows for various income and deduction items.

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

Table with 18 rows and 3 columns. Row 1: Ordinary business income (loss) -66,779. Row 2: Net rental real estate income (loss). Row 3: Other net rental income (loss). Row 4: Interest income. Row 5: Ordinary dividends. Row 6: Qualified dividends. Row 7: Royalties. Row 8: Net short-term capital gain (loss). Row 9: Net long-term capital gain (loss). Row 10: Collectibles (28%) gain (loss). Row 11: Unrecaptured section 1250 gain. Row 12: Net section 1231 gain (loss). Row 13: Other income (loss). Row 14: Section 179 deduction. Row 15: Other deductions. Row 16: Credits. Row 17: Alternative minimum tax (AMT) items. Row 18: Other information. Includes checkboxes for at-risk and passive activity purposes.

K-1 Statement (Sch K-1, Form 1120S)

Line 12 - Deductions

C Code C - Noncash contributions (50%) C 586

Line 15 - AMT Items

A Code A - Post-1986 depreciation adjustment A 1,444

Line 16 - Items affecting shareholder basis

D Code D - Distributions D 20,000

Line 17 - Other Information

Section 199A Information (Code V)

| | Non-SSTB | SSTB |
|---|----------|------|
| Income Items | | |
| Ordinary Income | -66,779 | 0 |
| Deduction Items | | |
| Noncash Contributions (50%) | 586 | 0 |
| Additional Information | | |
| Section 199A W-2 wages | 45,200 | 0 |
| Section 199A unadjusted basis | 368,519 | 0 |

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

2021

Department of the Treasury
Internal Revenue Service

For calendar year 2021, or tax year

beginning 01/01/2021 ending

Shareholder's Share of Income, Deductions, Credits, etc. ▶ See separate instructions.

Part I Information About the Corporation

A Corporation's employer identification number
75-3185725

B Corporation's name, address, city, state, and ZIP code
High Country Delicacies
1701 E. Yale
Aurora, CO 80013

C IRS Center where corporation filed return
e-file

D Corporation's total number of shares
Beginning of tax year 6,750
End of tax year 6,750

Part II Information About the Shareholder

E Shareholder's identifying number Shareholder: 2
454-66-3333

F Shareholder's name, address, city, state, and ZIP code
Eileen Brown
1750 E. Yale
Aurora, CO 80013

G Current year allocation percentage 33.333333 %

H Shareholder's number of shares
Beginning of tax year 2,250
End of tax year 2,250

I Loans from shareholder
Beginning of tax year \$
End of tax year \$

For IRS Use Only

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

| | | | |
|--|--|-----------|--|
| 1 | Ordinary business income (loss) | 13 | Credits |
| | -66,780 | | |
| 2 | Net rental real estate income (loss) | | |
| 3 | Other net rental income (loss) | | |
| 4 | Interest income | | |
| 5a | Ordinary dividends | | |
| 5b | Qualified dividends | 14 | Schedule K-3 is attached if checked <input type="checkbox"/> |
| 6 | Royalties | 15 | Alternative minimum tax (AMT) items |
| 7 | Net short-term capital gain (loss) | A | 1,444 |
| 8a | Net long-term capital gain (loss) | | |
| 8b | Collectibles (28%) gain (loss) | | |
| 8c | Unrecaptured section 1250 gain | | |
| 9 | Net section 1231 gain (loss) | 16 | Items affecting shareholder basis |
| | | D | 20,000 |
| 10 | Other income (loss) | | |
| | | 17 | Other information |
| | | V* | See Attached Stmt |
| 11 | Section 179 deduction | | |
| 12 | Other deductions | | |
| C | | | 587 |
| 18 | <input type="checkbox"/> More than one activity for at-risk purposes* | | |
| 19 | <input type="checkbox"/> More than one activity for passive activity purposes* | | |
| * See attached statement for additional information. | | | |

K-1 Statement (Sch K-1, Form 1120S)

Line 12 - Deductions

C Code C - Noncash contributions (50%) C 587

Line 15 - AMT Items

A Code A - Post-1986 depreciation adjustment A 1,444

Line 16 - Items affecting shareholder basis

D Code D - Distributions D 20,000

Line 17 - Other Information

Section 199A Information (Code V)

| Income Items | Non-SSTB | SSTB |
|---|----------|------|
| Ordinary Income | -66,780 | 0 |
| Deduction Items | | |
| Noncash Contributions (50%) | 587 | 0 |
| Additional Information | | |
| Section 199A W-2 wages | 45,200 | 0 |
| Section 199A unadjusted basis | 368,518 | 0 |

671121

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

Schedule K-1 (Form 1120-S)

2021

Department of the Treasury Internal Revenue Service

For calendar year 2021, or tax year

beginning 01/01/2021 ending

Shareholder's Share of Income, Deductions, Credits, etc. See separate instructions.

Part I Information About the Corporation

A Corporation's employer identification number 75-3185725
B Corporation's name, address, city, state, and ZIP code High Country Delicacies 1701 E. Yale Aurora, CO 80013
C IRS Center where corporation filed return e-file
D Corporation's total number of shares Beginning of tax year 6,750 End of tax year 6,750

Part II Information About the Shareholder

E Shareholder's identifying number 459-34-5939 Shareholder: 3
F Shareholder's name, address, city, state, and ZIP code Leon Marks 1519 Glencoe Denver, CO 80220
G Current year allocation percentage 33.333333 %
H Shareholder's number of shares Beginning of tax year 2,250 End of tax year 2,250
I Loans from shareholder Beginning of tax year \$ End of tax year \$

For IRS Use Only

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

Table with 3 columns: Line number, Description, and Amount. Includes rows for Ordinary business income (loss), Net rental real estate income (loss), Credits, Dividends, Royalties, Capital gains, and Other income (loss).

K-1 Statement (Sch K-1, Form 1120S)

Line 12 - Deductions

C Code C - Noncash contributions (50%) C 587

Line 15 - AMT Items

A Code A - Post-1986 depreciation adjustment A 1,444

Line 16 - Items affecting shareholder basis

D Code D - Distributions D 20,000

Line 17 - Other Information

Section 199A Information (Code V)

| Income Items | Non-SSTB | SSTB |
|---|----------|------|
| Ordinary Income | -66,780 | 0 |
| Deduction Items | | |
| Noncash Contributions (50%) | 587 | 0 |
| Additional Information | | |
| Section 199A W-2 wages | 45,200 | 0 |
| Section 199A unadjusted basis | 368,518 | 0 |

Form **8453-S**

**U.S. S Corporation Income Tax Declaration
for an IRS e-file Return**

OMB No. 1545-0123

▶ **File electronically with the corporation's tax return. (Don't file paper copies.)**
▶ **Go to www.irs.gov/Form8453S for the latest information.**

2021

Department of the Treasury
Internal Revenue Service

For calendar year 2021, or tax year beginning 1/1, 2021, and ending , 20

Name of corporation: **High Country Delicacies** Employer identification number: **75-3185725**

Part I Tax Return Information (whole dollars only)

| | | | |
|----------|--|----------|----------|
| 1 | Gross receipts or sales less returns and allowances (Form 1120-S, line 1c) | 1 | 366,500 |
| 2 | Gross profit (Form 1120-S, line 3) | 2 | 230,082 |
| 3 | Ordinary business income (loss) (Form 1120-S, line 21) | 3 | -200,339 |
| 4 | Net rental real estate income (loss) (Form 1120-S, Schedule K, line 2) | 4 | 0 |
| 5 | Income (loss) reconciliation (Form 1120-S, Schedule K, line 18) | 5 | -202,099 |

Part II Declaration of Officer (see instructions) Be sure to keep a copy of the corporation's tax return.

- 6a** I consent that the corporation's refund be directly deposited as designated on the **Form 8050**, Direct Deposit of Corporate Tax Refund, that will be electronically transmitted with the corporation's 2021 federal income tax return.
- b** I do not want direct deposit of the corporation's refund or the corporation is not receiving a refund.
- c** I authorize the U.S. Treasury and its designated Financial Agent to initiate an electronic funds withdrawal (direct debit) entry to the financial institution account indicated in the tax preparation software for payment of the corporation's federal taxes owed on this return, and the financial institution to debit the entry to this account. To revoke a payment, I must contact the U.S. Treasury Financial Agent at **888-353-4537** no later than 2 business days prior to the payment (settlement) date. I also authorize the financial institutions involved in the processing of the electronic payment of taxes to receive confidential information necessary to answer inquiries and resolve issues related to the payment.

If the corporation is filing a balance due return, I understand that if the IRS doesn't receive full and timely payment of its tax liability, the corporation will remain liable for the tax liability and all applicable interest and penalties.

Under penalties of perjury, I declare that I'm an officer of the above corporation and that the information I've given my electronic return originator (ERO), transmitter, and/or intermediate service provider (ISP) and the amounts in Part I above agree with the amounts on the corresponding lines of the corporation's 2021 federal income tax return. To the best of my knowledge and belief, the corporation's return is true, correct, and complete. I consent to my ERO, transmitter, and/or ISP sending the corporation's return, this declaration, and accompanying schedules and statements to the IRS. I also consent to the IRS sending my ERO, transmitter, and/or ISP an acknowledgement of receipt of transmission and an indication of whether or not the corporation's return is accepted and, if rejected, the reason(s) for the rejection. If the processing of the corporation's return or refund is delayed, I authorize the IRS to disclose to my ERO, transmitter, and/or ISP the reason(s) for the delay, or when the refund was sent.

Sign Here | _____ | _____ | **Chief Financial Officer**
Signature of officer | Date | Title

Part III Declaration of Electronic Return Originator (ERO) and Paid Preparer (see instructions)

I declare that I've reviewed the above corporation's return and that the entries on Form 8453-S are complete and correct to the best of my knowledge. If I'm only a collector, I'm not responsible for reviewing the return and only declare that this form accurately reflects the data on the return. The corporate officer will have signed this form before I submit the return. I'll give the officer a copy of all forms and information to be filed with the IRS, and I've followed all other requirements in **Pub. 3112**, IRS e-file Application and Participation, and **Pub. 4163**, Modernized e-File (MeF) Information for Authorized IRS e-file Providers for Business Returns. If I'm also the Paid Preparer, under penalties of perjury I declare that I've examined the above corporation's return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. This Paid Preparer declaration is based on all information of which I've any knowledge.

| | | | | | |
|-----------------------|--|------|--|---|-------------------|
| ERO's Use Only | ERO's signature | Date | Check if also paid preparer <input type="checkbox"/> | Check if self-employed <input type="checkbox"/> | ERO's SSN or PTIN |
| | Firm's name (or yours if self-employed), address, and ZIP code | | | | EIN Phone no. |

Under penalties of perjury, I declare that I've examined the above corporation's return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. This declaration is based on all information of which I've any knowledge.

| | | | | | |
|-------------------------------|----------------------------|----------------------|------|---|------------|
| Paid Preparer Use Only | Print/Type preparer's name | Preparer's signature | Date | Check if self-employed <input type="checkbox"/> | PTIN |
| | Firm's name | | | | Firm's EIN |
| | Firm's address | | | | Phone no. |

For Privacy Act and Paperwork Reduction Act Notice, see instructions.

Form **8453-S** (2021)

HTA

Form **1125-A**

(Rev. November 2018)

Department of the Treasury
Internal Revenue Service

Cost of Goods Sold

▶ **Attach to Form 1120, 1120-C, 1120-F, 1120S, or 1065.**
▶ **Go to www.irs.gov/Form1125A for the latest information.**

OMB No. 1545-0123

Name **High Country Delicacies** Employer identification number **75-3185725**

| | | | |
|----------|--|----------|---------|
| 1 | Inventory at beginning of year | 1 | |
| 2 | Purchases | 2 | 147,961 |
| 3 | Cost of labor | 3 | |
| 4 | Additional section 263A costs (attach schedule) | 4 | |
| 5 | Other costs (attach schedule) | 5 | |
| 6 | Total. Add lines 1 through 5 | 6 | 147,961 |
| 7 | Inventory at end of year | 7 | 11,543 |
| 8 | Cost of goods sold. 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 | 8 | 136,418 |

- 9a** Check all methods used for valuing closing inventory:
- (i) Cost
 - (ii) Lower of cost or market
 - (iii) Other (Specify method used and attach explanation.) ▶ _____
- b** Check if there was a writedown of subnormal goods ▶
- c** Check if the LIFO inventory method was adopted this tax year for any goods (if checked, attach Form 970) ▶
- d** If the LIFO inventory method was used for this tax year, enter amount of closing inventory computed under LIFO **9d** | _____ |
- e** If property is produced or acquired for resale, do the rules of section 263A apply to the entity? See instructions Yes No
- f** Was there any change in determining quantities, cost, or valuations between opening and closing inventory? If "Yes," attach explanation Yes No

Depreciation and Amortization (Including Information on Listed Property)

Department of the Treasury
Internal Revenue Service (99)

▶ Attach to your tax return.

▶ Go to www.irs.gov/Form4562 for instructions and the latest information.

Attachment
Sequence No. **179**

| | | |
|--|--|----------------------------------|
| Name(s) shown on return High Country Delicacies | Business or activity to which this form relates 1120S | Identifying number 75-3185725 |
|--|--|----------------------------------|

Part I Election To Expense Certain Property Under Section 179

Note: If you have any listed property, complete Part V before you complete Part I.

| | | |
|---|------------------------------|------------------|
| 1 Maximum amount (see instructions) | 1 | 1,050,000 |
| 2 Total cost of section 179 property placed in service (see instructions) | 2 | 121,000 |
| 3 Threshold cost of section 179 property before reduction in limitation (see instructions) | 3 | 2,620,000 |
| 4 Reduction in limitation. Subtract line 3 from line 2. If zero or less, enter -0- | 4 | 0 |
| 5 Dollar limitation for tax year. Subtract line 4 from line 1. If zero or less, enter -0-. If married filing separately, see instructions | 5 | 1,050,000 |
| 6 | | |
| (a) Description of property | (b) Cost (business use only) | (c) Elected cost |
| | | |
| 7 Listed property. Enter the amount from line 29 | 7 | |
| 8 Total elected cost of section 179 property. Add amounts in column (c), lines 6 and 7 | 8 | 0 |
| 9 Tentative deduction. Enter the smaller of line 5 or line 8 | 9 | 0 |
| 10 Carryover of disallowed deduction from line 13 of your 2020 Form 4562 | 10 | |
| 11 Business income limitation. Enter the smaller of business income (not less than zero) or line 5. See instructions | 11 | |
| 12 Section 179 expense deduction. Add lines 9 and 10, but don't enter more than line 11 | 12 | 0 |
| 13 Carryover of disallowed deduction to 2022. Add lines 9 and 10, less line 12 | ▶ 13 | 0 |

Note: Don't use Part II or Part III below for listed property. Instead, use Part V.

Part II Special Depreciation Allowance and Other Depreciation (Don't include listed property. See instructions.)

| | | |
|---|----|--|
| 14 Special depreciation allowance for qualified property (other than listed property) placed in service during the tax year. See instructions | 14 | |
| 15 Property subject to section 168(f)(1) election | 15 | |
| 16 Other depreciation (including ACRS) | 16 | |

Part III MACRS Depreciation (Don't include listed property. See instructions.)

Section A

| | | |
|---|----|--|
| 17 MACRS deductions for assets placed in service in tax years beginning before 2021 | 17 | |
| 18 If you are electing to group any assets placed in service during the tax year into one or more general asset accounts, check here <input type="checkbox"/> | | |

Section B - Assets Placed in Service During 2021 Tax Year Using the General Depreciation System

| (a) Classification of property | (b) Month and year placed in service | (c) Basis for depreciation (business/investment use only—see instructions) | (d) Recovery period | (e) Convention | (f) Method | (g) Depreciation deduction |
|--------------------------------|--------------------------------------|--|---------------------|----------------|------------|----------------------------|
| 19 a 3-year property | | | | | | |
| b 5-year property | | | | | | |
| c 7-year property | | 121,000 | 7 | HY | 200DB | 17,291 |
| d 10-year property | | | | | | |
| e 15-year property | | | | | | |
| f 20-year property | | | | | | |
| g 25-year property | | | 25 yrs. | | S/L | |
| h Residential rental property | | | 27.5 yrs. | MM | S/L | |
| | | | 27.5 yrs. | MM | S/L | |
| i Nonresidential real property | 1/1/2021 | 984,555 | 39 yrs. | MM | S/L | 24,230 |

Section C - Assets Placed in Service During 2021 Tax Year Using the Alternative Depreciation System

| 20 a Class life | (b) Month and year placed in service | (c) Basis for depreciation (business/investment use only—see instructions) | (d) Recovery period | (e) Convention | (f) Method | (g) Depreciation deduction |
|-----------------|--------------------------------------|--|---------------------|----------------|------------|----------------------------|
| b 12-year | | | 12 yrs. | | S/L | |
| c 30-year | | | 30 yrs. | MM | S/L | |
| d 40-year | | | 40 yrs. | MM | S/L | |

Part IV Summary (See instructions.)

| | | |
|--|----|--------|
| 21 Listed property. Enter amount from line 28 | 21 | |
| 22 Total. Add amounts from line 12, lines 14 through 17, lines 19 and 20 in column (g), and line 21. Enter here and on the appropriate lines of your return. Partnerships and S corporations—see instructions | 22 | 41,521 |
| 23 For assets shown above and placed in service during the current year, enter the portion of the basis attributable to section 263A costs | 23 | |

For Paperwork Reduction Act Notice, see separate instructions.

Form **2553**

(Rev. December 2017)

Department of the Treasury
Internal Revenue Service

Election by a Small Business Corporation

(Under section 1362 of the Internal Revenue Code)

(Including a late election filed pursuant to Rev. Proc. 2013-30)

▶ You can fax this form to the IRS. See separate instructions.

▶ Go to www.irs.gov/Form2553 for instructions and the latest information.

OMB No. 1545-0123

Note: This election to be an S corporation can be accepted only if all the tests are met under *Who May Elect* in the instructions, all shareholders have signed the consent statement, an officer has signed below, and the exact name and address of the corporation (entity) and other required form information have been provided.

| Part I Election Information | | |
|-----------------------------|--|--|
| Type or Print | Name (see instructions) High Country Delicacies | A Employer identification number 75-3185725 |
| | Number, street, and room or suite no. If a P.O. box, see instructions. 1701 E.Yale | B Date incorporated 1/1/2021 |
| | City or town, state or province, country, and ZIP or foreign postal code Aurora, CO 80013 | C State of incorporation |

D Check the applicable box(es) if the corporation (entity), after applying for the EIN shown in A above, changed its name or address

E Election is to be effective for tax year beginning (month, day, year) (see instructions) ▶ 1/1/2021

Caution: A corporation (entity) making the election for its first tax year in existence will usually enter the beginning date of a short tax year that begins on a date other than January 1.

F Selected tax year:
(1) Calendar year
(2) Fiscal year ending (month and day) ▶ _____
(3) 52-53-week year ending with reference to the month of December
(4) 52-53-week year ending with reference to the month of ▶ _____
If box (2) or (4) is checked, complete Part II.

G If more than 100 shareholders are listed for item J (see page 2), check this box if treating members of a family as one shareholder results in no more than 100 shareholders (see test 2 under *Who May Elect* in the instructions) ▶

| | |
|---|---|
| H Name and title of officer or legal representative whom the IRS may call for more information Linda George, Chief Financial Officer | Telephone number of officer or legal representative |
|---|---|

I If this S corporation election is being filed late, I declare I had reasonable cause for not filing Form 2553 timely. If this late election is being made by an entity eligible to elect to be treated as a corporation, I declare I also had reasonable cause for not filing an entity classification election timely and the representations listed in Part IV are true. See below for my explanation of the reasons the election or elections were not made on time and a description of my diligent actions to correct the mistake upon its discovery. See instructions.

Sign Here

Under penalties of perjury, I declare that I have examined this election, including accompanying documents, and, to the best of my knowledge and belief, the election contains all the relevant facts relating to the election, and such facts are true, correct, and complete.

▶ _____ Title _____ Date _____
Signature of officer

| | |
|---------------------------------|--|
| Name High Country Delicacies | Employer identification number 75-3185725 |
|---------------------------------|--|

Part I Election Information (continued) **Note:** If you need more rows, use additional copies of page 2.

| J Name and address of each shareholder or former shareholder required to consent to the election. (see instructions) | K Shareholder's Consent Statement Under penalties of perjury, I declare that I consent to the election of the above-named corporation (entity) to be an S corporation under section 1362(a) and that I have examined this consent statement, including accompanying documents, and, to the best of my knowledge and belief, the election contains all the relevant facts relating to the election, and such facts are true, correct, and complete. I understand my consent is binding and may not be withdrawn after the corporation (entity) has made a valid election. If seeking relief for a late filed election, I also declare under penalties of perjury that I have reported my income on all affected returns consistent with the S corporation election for the year for which the election should have been filed (see beginning date entered on line E) and for all subsequent years. | | L Stock owned or percentage of ownership (see instructions) | | M Social security number or employer identification number (see instructions) | N Shareholder's tax year ends (month and day) |
|--|---|------|---|------------------|---|---|
| | Signature | Date | Number of shares or percentage of ownership | Date(s) acquired | | |
| Linda George 4825 Stout Street Denver , CO 80205 | | | 2,250 sh. | | 455-81-5151 | 12/31 |
| Eileen Brown 1750 E. Yale Aurora, CO 80013 | | | 2,250 sh. | | 454-66-3333 | 12/31 |
| Leon Marks 1519 Glencoe Denver, CO 80220 | | | 2,250 sh. | | 459-34-5939 | 12/31 |
| | | | | | | |
| | | | | | | |
| | | | | | | |
| | | | | | | |
| | | | | | | |

| | |
|---------------------------------|--|
| Name High Country Delicacies | Employer identification number 75-3185725 |
|---------------------------------|--|

Part II Selection of Fiscal Tax Year (see instructions)

Note: All corporations using this part must complete item O and item P, Q, or R.

O Check the applicable box to indicate whether the corporation is:

1. A new corporation **adopting** the tax year entered in item F, Part I.
2. An existing corporation **retaining** the tax year entered in item F, Part I.
3. An existing corporation **changing** to the tax year entered in item F, Part I.

P Complete item P if the corporation is using the automatic approval provisions of Rev. Proc. 2006-46, 2006-45 I.R.B. 859, to request (1) a natural business year (as defined in section 5.07 of Rev. Proc. 2006-46) or (2) a year that satisfies the ownership tax year test (as defined in section 5.08 of Rev. Proc. 2006-46). Check the applicable box below to indicate the representation statement the corporation is making.

1. **Natural Business Year** ▶ I represent that the corporation is adopting, retaining, or changing to a tax year that qualifies as its natural business year (as defined in section 5.07 of Rev. Proc. 2006-46) and has attached a statement showing separately for each month the gross receipts for the most recent 47 months. See instructions. I also represent that the corporation is not precluded by section 4.02 of Rev. Proc. 2006-46 from obtaining automatic approval of such adoption, retention, or change in tax year.

2. **Ownership Tax Year** ▶ I represent that shareholders (as described in section 5.08 of Rev. Proc. 2006-46) holding more than half of the shares of the stock (as of the first day of the tax year to which the request relates) of the corporation have the same tax year or are concurrently changing to the tax year that the corporation adopts, retains, or changes to per item F, Part I, and that such tax year satisfies the requirement of section 4.01(3) of Rev. Proc. 2006-46. I also represent that the corporation is not precluded by section 4.02 of Rev. Proc. 2006-46 from obtaining automatic approval of such adoption, retention, or change in tax year.

Note: If you do not use item P and the corporation wants a fiscal tax year, complete either item Q or R below. Item Q is used to request a fiscal tax year based on a business purpose and to make a back-up section 444 election. Item R is used to make a regular section 444 election.

Q **Business Purpose**—To request a fiscal tax year based on a business purpose, check box Q1. See instructions for details including payment of a user fee. You may also check box Q2 and/or box Q3.

1. Check here ▶ if the fiscal year entered in item F, Part I, is requested under the prior approval provisions of Rev. Proc. 2002-39, 2002-22 I.R.B. 1046. Attach to Form 2553 a statement describing the relevant facts and circumstances and, if applicable, the gross receipts from sales and services necessary to establish a business purpose. See the instructions for details regarding the gross receipts from sales and services. If the IRS proposes to disapprove the requested fiscal year, do you want a conference with the IRS National Office?

Yes No

2. Check here ▶ to show that the corporation intends to make a back-up section 444 election in the event the corporation's business purpose request is not approved by the IRS. See instructions for more information.

3. Check here ▶ to show that the corporation agrees to adopt or change to a tax year ending December 31 if necessary for the IRS to accept this election for S corporation status in the event (1) the corporation's business purpose request is not approved and the corporation makes a back-up section 444 election, but is ultimately not qualified to make a section 444 election, or (2) the corporation's business purpose request is not approved and the corporation did not make a back-up section 444 election.

R **Section 444 Election**—To make a section 444 election, check box R1. You may also check box R2.

1. Check here ▶ to show that the corporation will make, if qualified, a section 444 election to have the fiscal tax year shown in item F, Part I. To make the election, you must complete **Form 8716**, Election To Have a Tax Year Other Than a Required Tax Year, and either attach it to Form 2553 or file it separately.

2. Check here ▶ to show that the corporation agrees to adopt or change to a tax year ending December 31 if necessary for the IRS to accept this election for S corporation status in the event the corporation is ultimately not qualified to make a section 444 election.

| | |
|---------------------------------|--|
| Name High Country Delicacies | Employer identification number 75-3185725 |
|---------------------------------|--|

Part III Qualified Subchapter S Trust (QSST) Election Under Section 1361(d)(2)* Note: If you are making more than one QSST election, use additional copies of page 4.

| | |
|---------------------------------------|--------------------------------|
| Income beneficiary's name and address | Social security number |
| Trust's name and address | Employer identification number |

Date on which stock of the corporation was transferred to the trust (month, day, year) ▶

In order for the trust named above to be a QSST and thus a qualifying shareholder of the S corporation for which this Form 2553 is filed, I hereby make the election under section 1361(d)(2). Under penalties of perjury, I certify that the trust meets the definitional requirements of section 1361(d)(3) and that all other information provided in Part III is true, correct, and complete.

Signature of income beneficiary or signature and title of legal representative or other qualified person making the election _____ Date _____

* Use Part III to make the QSST election only if stock of the corporation has been transferred to the trust on or before the date on which the corporation makes its election to be an S corporation. The QSST election must be made and filed separately if stock of the corporation is transferred to the trust **after** the date on which the corporation makes the S election.

Part IV Late Corporate Classification Election Representations (see instructions)

If a late entity classification election was intended to be effective on the same date that the S corporation election was intended to be effective, relief for a late S corporation election must also include the following representations.

- 1 The requesting entity is an eligible entity as defined in Regulations section 301.7701-3(a);
- 2 The requesting entity intended to be classified as a corporation as of the effective date of the S corporation status;
- 3 The requesting entity fails to qualify as a corporation solely because Form 8832, Entity Classification Election, was not timely filed under Regulations section 301.7701-3(c)(1)(i), or Form 8832 was not deemed to have been filed under Regulations section 301.7701-3(c)(1)(v)(C);
- 4 The requesting entity fails to qualify as an S corporation on the effective date of the S corporation status solely because the S corporation election was not timely filed pursuant to section 1362(b); **and**
- 5a The requesting entity timely filed all required federal tax returns and information returns consistent with its requested classification as an S corporation for all of the years the entity intended to be an S corporation and no inconsistent tax or information returns have been filed by or with respect to the entity during any of the tax years, **or**
- b The requesting entity has not filed a federal tax or information return for the first year in which the election was intended to be effective because the due date has not passed for that year's federal tax or information return.

Line 19 (1120S) - Other Deductions

| | | | |
|---|------------------------|---|--------|
| 1 | Insurance | 1 | 12,000 |
| 2 | Total other deductions | 2 | 12,000 |

Line 12a, Sch K (1120S) - Contributions

| | | | |
|---|-----------------------------------|-----|-------|
| A | Code A - Cash contributions (60%) | A | 1,760 |
| | Total contributions | 12a | 1,760 |

Line 16d, Schedule K (1120S) - Distributions

| | | |
|---|---------------------|--------|
| 1 | Cash | 60,000 |
| | Total distributions | 60,000 |

Line 3, Sch M-1 (1120S) - Expenses Recorded on Books not Included on Sch K

| | | | |
|---|--------------------------------------|---|-------|
| 1 | Bad Debt Expense | 1 | 2,500 |
| 2 | Total expenses on books not on Sch K | 2 | 2,500 |

Summary of Unadjusted Basis of Qualified Property (4562)

12/31/2021

Summary of Qualified Property by Activity

| Activity | | Unadjusted Cost or Basis |
|----------|-----------------|-----------------------------|
| 1 | 1120S | 1,105,555 |

Detail of Qualified Property

| | Activity | Asset Description | Date In Service | Recovery Period | Years in Service | Total Cost or Basis | Business/Time Use Percent | Unadjusted Cost or Basis |
|----------|----------|-------------------|-----------------|-----------------|------------------|---------------------|---------------------------|--------------------------|
| 2 | 1120S | Building | 1/1/2021 | 39 | 1 | 984,555 | 100.00% | 984,555 |
| 3 | 1120S | Equipment | 1/1/2021 | 7.0 | 1 | 121,000 | 100.00% | 121,000 |

Tax-free exchanges under Section 351

Section 351(a) provides, in general, for the nonrecognition of gain or loss upon the transfer by one or more persons of property to a corporation solely in exchange for stock of such corporation if, immediately after the exchange, the person or persons are in control of the corporation to which the property was transferred. The phrase *one or more persons* includes individuals, trusts, estates, partnerships, associations, companies, or corporations. To be in control of the transferee corporation, the person or persons must own, immediately after the transfer, stock possessing (1) at least 80% of the total combined voting power of all classes of stock entitled to vote and (2) at least 80% of the total number of shares of all other classes of stock of such corporation.

The phrase *immediately after the exchange* does not necessarily require simultaneous exchanges by two or more persons but includes a situation where the rights of the parties have been previously defined, and non-simultaneous exchanges of property for stock are part of a prior agreement. For purposes of Section 351, stock rights and stock warrants are not included in the term *stock*.

In addition, for purposes of Section 351,

1. stock will not be treated as issued for property if it is issued for services rendered or to be rendered to or for the benefit of the issuing corporation; and
2. stock will not be treated as issued for property if it is issued for property which is of relatively small value in comparison to the value of the stock already owned (or to be received for services) by the person who transferred such property, and the primary purpose of the transfer is to qualify under this section the exchanges of property by other persons transferring property (Regs. Sec. 1.351-1).

If an exchange would meet the requirements of Section 351 if it were not for the fact that, in addition to stock, property or money (also referred to as *boot*) is also received in the exchange, then gain, if any, to the recipient will be recognized but only up to the lesser of (1) the shareholder's gain realized in the exchange and (2) the sum of money and the fair market value of the other property received (boot). No loss to the recipient will be recognized (Regs. Sec. 1.351-2).

In general, liabilities of the shareholder that are assumed by the corporation are not considered as boot and will not cause the recognition of gain (IRC Section 357(a)). There are, however, two exceptions:

1. The benefits of Section 357(a) don't extend to any exchange where the principal purpose of the assumption of liabilities by the corporation was to avoid federal income tax on the exchange, or where there was no bona fide business purpose for the assumption.
2. If the sum of the amount of the liabilities transferred by the shareholder to the corporation exceeds the total of the adjusted basis of the property transferred in the exchange, then the excess will be recognized as gain from a sale or exchange of the property by the contributing shareholder.

IRC Section 362 provides, as a general rule, that if property was transferred to a corporation in a Section 351 exchange, then the basis to the corporation will be the same as it would be in the hands of the transferor, increased by the amount of gain recognized to the transferor on the transfer.

Key review point

The balance sheet included on Schedule L is the balance sheet per books — which means that the balances in the property accounts are not necessarily equal to the original cost of the property — the accumulated depreciation per books is not necessarily the same as for tax purposes, and the retained earnings are not necessarily the same as the accumulated adjustments account.

Knowledge check

1. John gets cash of \$20,000 and 90% of the shares in Corporation ABC, an S corporation, in exchange for contributing land with a basis of \$100,000 and a fair market value of \$150,000 to ABC. Which is correct?
 - a. John would have to recognize \$50,000 of gain.
 - b. John would have to recognize \$30,000 of gain.
 - c. John would have to recognize \$20,000 of gain.
 - d. The exchange qualifies under Section 351, so John would not have to recognize any gain.
2. Maria receives 10% of the shares in Corporation XYZ, an S corporation, in exchange for providing \$30,000 worth of services for the corporation. As part of the transaction, Grace contributed appreciated property in exchange for 75% of the XYZ shares. Maria and Grace held no shares of XYZ before the transaction. Which is correct?
 - a. Grace's exchange would be nontaxable, but Maria's wouldn't.
 - b. Maria's exchange would be nontaxable, but Grace's wouldn't.
 - c. Neither Grace's exchange nor Maria's exchange would be taxable.
 - d. Both Grace's exchange and Maria's exchange would be taxable.

Accumulated adjustments account

The taxability of distributions from an S corporation are to some extent determined by the balance in the S corporation's accumulated adjustments account (AAA). The AAA is an account of the S corporation and is not apportioned among shareholders. The AAA is increased by the gross income of the S corporation, less deductible expenses and distributions allocable to the AAA. Any increases or decreases are added to the prior balance, making it a cumulative total of those items.

AAA is not increased by tax exempt income or decreased by nondeductible expenses such as those related to tax exempt income. Instead, tax exempt income and nondeductible expenses increase and decrease, respectively, the other adjustments account (OAA). Losses, but not distributions, can create a negative balance in the AAA.

The AAA is decreased (but not less than \$0) by any distributions that come out of AAA. Any distributions from AAA are tax-free to the shareholder and reduce the shareholder's basis. Distributions from OAA also are tax-free and reduce the shareholder's basis.

The analysis of the AAA and OAA is included in Schedule M-2 on page 5 of Form 1120S, and this information is necessary for shareholders to be able to determine how distributions from the S corporation are to be treated if the S corporation has regular C corporation earnings and profits.

Knowledge check

3. The XYZ Corporation, an S corporation, had beginning balances in AAA and OAA of \$30,000 and \$5,000, respectively. For the year, XYZ had \$40,000 of ordinary income, \$20,000 of dividend income, and \$2,000 of interest from municipal bonds. XYZ made a distribution of \$10,000 to its shareholders. The ending AAA and OAA balances are, respectively,
- \$60,000 and \$27,000.
 - \$80,000 and \$7,000.
 - \$70,000 and \$17,000.
 - \$90,000 and \$0.
-

Distributions

If the S corporation has no earnings and profits from a prior C corporation year, any distribution will be treated as tax-free to the extent of the shareholder's basis, and treated as gain from a sale or exchange to the extent of any excess of the distribution over the shareholder's basis.

In the case of a distribution by an S corporation that has accumulated earnings and profits, distributions are treated as, in order,

- from AAA, as tax-free return of basis, then as gain from a sale or exchange,
- dividend income to the extent of accumulated earnings and profits,
- tax-free return of basis to the extent of OAA, and
- gain from a sale or exchange to the extent the distribution exceeds basis.

If the distributions exceed the amount in the accumulated adjustments account at the close of the taxable year, the balance of the AAA will be allocated among the distributions in proportion to their respective sizes.

Distributions are entered on line 16d of Schedule K, and in box 16 of the shareholder's Schedule K-1. On the shareholder's Schedule K-1, distributions should be coded "D."

Knowledge check

4. The ABC Corporation, an S corporation with \$40,000 of AAA and \$5,000 of accumulated earnings and profits, made a \$41,000 distribution to its sole shareholder. The shareholder had a basis of \$30,000 in her ABC stock. How is the distribution taxed to the sole shareholder?
- \$41,000 tax-free.
 - \$40,000 tax-free; \$1,000 dividend income.
 - \$30,000 tax-free; \$10,000 capital gain; \$1,000 dividend income.
 - \$30,000 tax-free; \$6,000 capital gain; \$5,000 dividend income.

Allocation of S corporation income to shareholders

An S corporation must report — and a shareholder is required to take into account on the shareholder's return — the shareholder's pro rata share of the S corporation's items of income, loss, deduction, or credit. This applies whether or not any of the income is actually distributed to the shareholders. The shareholder takes these items into account in determining the shareholder's taxable income and tax liability for the shareholder's taxable year with or within which the taxable year of the corporation ends. If the shareholder dies — or if the shareholder is an estate or trust, and the estate or trust terminates — before the end of the taxable year of the corporation, the shareholder's pro rata share of these items is taken into account on the shareholder's final return.

Each shareholder must take into account separately the shareholder's pro rata share of any item of income, loss, deduction, or credit of the S corporation which, if separately taken into account by any shareholder, could affect the shareholder's tax liability for that taxable year differently than if the shareholder did not take the item into account separately. The separately stated items of the S corporation include, but are not limited to, the following items:

- The corporation's combined net amount of gains and losses from sales or exchanges of capital assets
- The corporation's combined net IRC Section 1231 gains and losses
- Charitable contributions, grouped by the applicable percentage limitations (**Note:** For 2018 and later years, the Tax Cuts and Jobs Act (TCJA) enacted a 60% of AGI limit for cash contributions to public charities (Code A on Schedule K-1). For 2020 and 2021, this limit was raised to 100% (Code G). The percentage limitation of the contribution must be indicated by reporting the appropriate code in box 12 of the shareholder's K-1.)
- Foreign income taxes
- Each of the corporation's separate items of gains and losses from wagering transactions; soil and water conservation expenditures; deduction under an election to expense certain depreciable business expenses (Section 179); and expenses such as medical, dental, and the like
- The corporation's items of portfolio income or loss, and expenses related thereto
- The corporation's tax exempt income
- Any item identified in guidance (including forms and instructions) issued by the commissioner as an item required to be separately stated

Each shareholder must also take into account separately the shareholder's pro rata share of the nonseparately computed income or loss of the S corporation. For this purpose, *nonseparately computed income or loss* means the corporation's gross income less deductions, determined by excluding any item that must be separately stated.

The calculation of each shareholder's pro rata share of any S corporation item for any taxable year starts with the calculation of the amount of that item on a per-share, per-day basis — in other words, the total item for the year, divided by the number of shares outstanding, divided by the number of days in the year. That per-share, per-day amount is then multiplied by the number of days the shareholder owned the stock and the number of shares they owned in order to determine the total amount of the income items that will be allocated to each shareholder. Purchasing shareholders do not count the day of acquisition in the number of days they own the stock for purposes of income allocation. A shareholder who disposes of stock in an S corporation is treated as the shareholder for the day of the disposition.

All nonseparately stated income and expense items should be entered on page 1 of Form 1120S, and the net amount is then carried to line 1 of Schedule K. Total amounts of separately stated income items of the S corporation are included on the various lines of Schedule K, Form 1120S. Each shareholder's share of these separately stated items is then entered in the appropriate boxes of the shareholder's Schedule K-1.

Knowledge check

5. Teresa owns 4,000 of the 10,000 outstanding shares of Stratus Corporation, a calendar-year S corporation. Stratus has income of \$20,000 per month for the first six months of the calendar year, and \$25,000 per month for the last six months. Teresa sells her 4,000 shares on December 1. How much income will Teresa recognize from Stratus for the year? Assume there are 365 days in the year.
- \$108,000.
 - \$99,123.
 - \$98,217.
 - \$8,877.

Fringe benefits

IRC Section 1372 provides that, with respect to employee fringe benefits, an S corporation shall be treated as a partnership, and any person who is a 2% shareholder of the S corporation shall be treated like a partner of a partnership. Section 1372(b) defines a 2% shareholder as any person who owns on any day during the taxable year of the S corporation more than 2% of the outstanding stock of the corporation or stock possessing more than 2% of the total combined voting power of all stock in the corporation.

Under Section 1372, a 2% shareholder who is also an employee of an S corporation is treated like a partner of a partnership. Employee fringe benefits paid or furnished by an S corporation to or for the

benefit of its 2% shareholder-employees in consideration for services rendered, therefore, are treated for income tax purposes like partnership guaranteed payments under IRC Section 707(c). An S corporation is generally entitled to deduct the cost of these employee fringe benefits under IRC Section 162(a), assuming the requirements of that section are satisfied. Like a partner, a 2% shareholder is required to include the value of such benefits in gross income and is not entitled to exclude such benefits from gross income.

The following fringe benefits are treated the same as guaranteed payments if paid to 2% shareholders:

- Accident and health benefits – This exclusion applies to contributions you make to an accident or health plan for an employee, their spouses, their dependents, and their children (younger than age 27 at the end of the tax year) in the event of personal injury or sickness.
- Achievement awards – This exclusion applies to the value of any tangible personal property (but not cash or intangible property) you give to an employee as an award for either length of service or safety achievement.
- Adoption assistance.
- Cost of up to \$50,000 of group-term life insurance coverage.
- Health savings accounts (HSAs) – An HSA is an account owned by a qualified individual who is generally your employee or former employee. Contributions to the account are used to pay current or future medical expenses of the account owner, the account owner’s spouse, and any qualified dependent.
- Lodging on your business premises – You can exclude the value of lodging you provide to an employee from the employee’s wages if it is provided on your business premises, it is for your convenience, and the employee must accept it as a condition of employment.
- Meals – You can exclude the value of meals you furnish to an employee from the employee’s wages if they are furnished on your business premises, and they are furnished for your convenience.
- Moving expense reimbursements – This exclusion applies to any amount you directly or indirectly give to an employee (including services furnished in kind) as payment for, or reimbursement of, moving expenses related to starting work at a new principal place of work.
- Transportation (commuting) benefits – This exclusion applies to benefits you provide to your employees for their personal transportation, such as commuting to and from work. These rules apply to de minimis transportation benefits and qualified transportation benefits.

Key review point

Include the preceding fringe benefit expenditures made on behalf of officers and employees owning more than 2% of the corporation’s stock, on line 7 (compensation of officers) and line 8 (salaries and wages) of Form 1120S. Also, report these fringe benefits as wages in box 1 of Form W-2. Is that the way these expenditures are reported on the HCD tax return?

Be sure to report amounts paid for health insurance coverage for a more-than-2% shareholder (including that shareholder’s spouse, dependents, and any children younger than age 27 who aren’t dependents) as an information item in box 14 of that shareholder’s Form W-2. A more-than-2% shareholder may be allowed to deduct such amounts on Form 1040, line 29.

Don't include amounts paid or incurred for fringe benefits of officers and employees owning 2% or less of the corporation's stock as compensation, salaries, or wages. These amounts are reported on line 18. See the instructions for that line for information on the types of expenditures that are treated as fringe benefits and for the stock ownership rules.

The following fringe benefits are excludable by the shareholder or employee if the awarding of the benefit does not discriminate in favor of the owners:

- Athletic facilities — You can exclude the value of an employee's use of an on-premises gym or other athletic facility you operate from an employee's wages if substantially all use of the facility during the calendar year is by your employees, their spouses, and their dependent children.
- De minimis (minimal) benefits — A de minimis benefit is any property or service you provide to an employee that has so little value (taking into account how frequently you provide similar benefits to your employees) that accounting for it would be unreasonable or administratively impracticable.
- Dependent care assistance — This exclusion applies to household and dependent care services you directly or indirectly pay for or provide to an employee under a written dependent care assistance program that covers only your employees.
- Educational assistance — This exclusion applies to educational assistance you provide to employees under an educational assistance program. The exclusion also applies to graduate level courses.
- Employee discounts — This exclusion applies to a price reduction you give your employee on property or to services you offer to customers in the ordinary course of the line of business in which the employee performs substantial services.
- No-additional-cost services — This exclusion applies to a service you provide to an employee if it doesn't cause you to incur any substantial additional costs. The service must be offered to customers in the ordinary course of the line of business in which the employee performs substantial services.
- Retirement planning services — You may exclude from an employee's wages the value of any retirement planning advice or information you provide to your employee or your employee's spouse if you maintain a qualified retirement plan.
- Working condition benefits — This exclusion applies to property and services you provide to employees so that the employees can perform their jobs. It applies to the extent the employees could deduct the cost of the property or services as a business expense or depreciation expense if they had paid for it.

Eligibility to make the S corporation election

A corporation or other entity eligible to elect to be treated as a corporation may elect to be an S corporation only if it meets all the following tests:

- It is
 - a domestic corporation, or
 - a domestic entity eligible to elect to be treated as a corporation, that timely files Form 2553,
- It has no more than 100 shareholders.
 - You can treat an individual and spouse (and their estates) as one shareholder for this test.
 - You can also treat all members of a family and their estates as one shareholder for this test.
 - All others are treated as separate shareholders.

- Its only shareholders are individuals, estates, exempt organizations described in IRC sections 401(a) or 501(c)(3), or certain trusts described in IRC Section 1361(c)(2)(A).
- It has no nonresident alien shareholders.
- It has only one class of stock (disregarding differences in voting rights). Generally, a corporation is treated as having only one class of stock if all outstanding shares of the corporation's stock confer identical rights to distribution and liquidation proceeds.
- It is not one of the following ineligible corporations:
 - A bank or thrift institution that uses the reserve method of accounting for bad debts under Section 585
 - An insurance company subject to tax under IRC subchapter L
 - A corporation that has elected to be treated as a possessions corporation under IRC Section 936
 - A domestic international sales corporation (DISC) or former DISC
- It has or will adopt or change to one of the following tax years:
 - A tax year ending December 31
 - A natural business year
 - An ownership tax year
 - A tax year elected under IRC Section 444
 - A 52- or 53-week tax year ending with reference to a year listed previously
 - Any other tax year (including a 52- or 53-week tax year) for which the corporation establishes a business purpose
- Each shareholder consents to the election

In order to make the election, complete and file Form 2553 no more than two months and 15 days after the beginning of the tax year the election is to take effect, or at any time during the tax year preceding the tax year it is to take effect. For this purpose, the two-month period begins on the day of the month the tax year begins and ends with the close of the day before the numerically corresponding day of the second calendar month following that month. Each shareholder consents by signing and dating either in column K on page 2 of Form 2553 or on a separate consent statement.

When to file

Generally, an S corporation must file Form 1120S by the 15th day of the third month after the end of its tax year. For calendar-year corporations, the due date of the 2021 return is March 15, 2022. A corporation that has dissolved must generally file by the 15th day of the third month after the date it dissolved. If the due date falls on a Saturday, Sunday, or legal holiday, the corporation can file on the next day that is not a Saturday, Sunday, or legal holiday. If the S corporation election was terminated during the tax year, and the corporation reverts to a C corporation, file Form 1120S for the S corporation's short year by the due date (including extensions) of the C corporation's short year return.

Modified accelerated cost recovery system depreciation

Under modified accelerated cost recovery system (MACRS), you can use either the general depreciation system (GDS) or the alternative depreciation system (ADS) to depreciate property. The system you choose determines what depreciation method and recovery period you use. You generally must use GDS unless you are specifically required by law to use ADS or you elect to use ADS. The depreciation rates you use for a particular asset depend in part on the property classification that the asset falls into. The following is a list of some of the property classifications under GDS and examples of the types of property included in each class.

Three-year property

- Tractor units for over-the-road use
- Any racehorse older than two years old when placed in service
- Any other horse (other than a racehorse) older than 12 years old when placed in service

Five-year property

- Automobiles, taxis, buses, and trucks
- Computers and peripheral equipment
- Office machinery (such as typewriters, calculators, and copiers)
- Appliances, carpets, furniture, and the like, used in a residential rental real estate activity
- Certain geothermal, solar, and wind energy property

Seven-year property

- Office furniture and fixtures (such as desks, files, and safes)
- Any property that does not have a class life and has not been designated by law as being in any other class

10-year property

- Vessels, barges, tugs, and similar water transportation equipment

15-year property

- Certain improvements made directly to land or added to it (such as shrubbery, fences, roads, sidewalks, and bridges)
- Any qualified improvement property (TCJA failed to include this as 15-year property and the CPA community has been asking for a technical correction since enactment of that law).

20-year property

- Farm buildings

27.5 S/L – Residential rental property

39 S/L – Nonresidential real property

The allowable methods of depreciation for the different classes of property are

| Method | Type of property |
|-------------------|---|
| GDS using 200% DB | <ul style="list-style-type: none"> • Nonfarm 3-, 5-, 7-, and 10-year property |
| GDS using 150% DB | <ul style="list-style-type: none"> • All 15- and 20-year property • Nonfarm 3-, 5-, 7-, and 10-year property |
| GDS using S/L | <ul style="list-style-type: none"> • Nonresidential real property • Qualified improvement property • Residential rental property • All 3-, 5-, 7-, 10-, 15-, and 20-year property |

Convention. *The midmonth convention.* Use this convention for nonresidential real property, residential rental property, and any railroad grading or tunnel bore. Under this convention, you treat all property placed in service or disposed of during a month as placed in service or disposed of at the midpoint of the month. This means that a one-half month of depreciation is allowed for the month the property is placed in service or disposed of.

The half-year convention. Under this convention, you treat all property placed in service or disposed of during a tax year as placed in service or disposed of at the midpoint of the year. This means that a half year of depreciation is allowed for the year the property is placed in service or disposed of. Most property that is not real estate will use the half-year convention.

Depreciation is calculated on Form 4562 but could be included on the 1120S on page 1, line 14, on Form 1125-A, or on Form 8825, line 14 (and then eventually on Schedule K).

The Coronavirus Aid, Relief, and Economic Security (CARES) Act corrected the classification of qualified improvement property to 15-year property and assigned an ADS class life of 20 years. This classification allows qualified improvement property to be eligible for bonus depreciation. The CARES Act defines qualified improvement property as “any improvement made by the taxpayer to an interior portion of a building which is nonresidential real property if such improvement is placed in service after the date such building was first placed in service.” These changes are retroactive to December 22, 2017, the effective date of the TCJA.

Key review point

Due to enactment of CARES Act of 2020, property that can be classified as QIP is eligible for bonus depreciation. Has the depreciation on the building been correctly computed for HCD?

Key review point

Because this is the first year of an S corporation tax return, there could have been a short-year return if HCD had not begun business on January 1. If there was a short period return, the depreciation would have to be calculated differently. See Rev. Proc. 89-15, 1989-1 CB 816, for the details of that calculation.

AMT depreciation adjustment

For regular MACRS, five-year or seven-year property is depreciable using the 200% declining balance method of depreciation, but for AMT purposes one can use only the 150% declining balance method. The difference is an AMT adjustment, which will go on line 15a of Schedule K, and in box 15 (code A) of each shareholder's Schedule K-1. The first-year percentage for seven-year property, from the IRS tables, is 14.29% for 200% DB, and 10.71% for 150% DB.

CARES Act and TCJA review

A detailed discussion of the CARES Act and TCJA is not included in these materials; however, your S corporation tax return review skills will certainly be improved by reviewing some of the more relevant changes made by this legislation. Two important tax provisions included in these pieces of legislation are discussed below.

Bonus depreciation

The allowance for bonus depreciation is 100% for property placed in service after September 27, 2017, and before January 1, 2023, as well as for specified plants planted or grafted after September 27, 2017, and before January 1, 2023. The property must be (a) eligible for MACRS with a depreciation period of 20 years or less, (b) water utility property, or (c) computer software (off-the-shelf).

There is no longer a requirement that the original use of qualified property must commence with the taxpayer. Therefore, the additional first-year depreciation deduction is allowed for both new and used property. The property must have been purchased in an arm's-length transaction. Also, this provision does not apply to property received as a gift or from a decedent. In the case of trade-ins, like-kind exchanges, or involuntary conversions, it applies only to any money paid in addition to the traded-in property. It does not apply to property acquired in a nontaxable exchange or to property acquired from a member of the taxpayer's family per Section 267 or from an entity in which the taxpayer has a controlling interest.

The definition of qualified property eligible for additional first-year depreciation allowance has been expanded to include qualified film, television, and live theatrical productions placed in service after September 27, 2017, and before January 1, 2027, and that would otherwise qualify as a deduction under

Section 181, *Treatment of certain qualified film and television and live theatrical productions*. A production is considered placed in service at the time of initial release, broadcast, or live staged performance.

Qualified business income deduction

For tax years after 2017, a “pass-through income deduction” of 20% is allowed under Section 199A. Under this provision, individuals will be allowed to deduct 20% of qualified business income that is passed through from a partnership or S corporation, as well as 20% of income from a sole proprietorship, certain qualifying real estate rental activities, qualified real estate investment trust dividends, qualified cooperative dividends, and qualified publicly traded partnership income. C corporations will not be eligible for the Section 199A 20% deduction (C corporation maximum tax rates have been reduced instead). The deduction reduces taxable income, rather than adjusted gross income, but is available to taxpayers who take the standard deduction.

Items are treated as qualified items of income, gain, deduction, and loss only to the extent they are effectively connected with the conduct of a trade or business within the United States. The determination of qualified items of income, gain, deduction, and loss takes items into account only to the extent they are included or allowed in the determination of taxable income for the year. If the net amount of qualified business income from all qualified trades or businesses during the taxable year is a loss, it is carried forward as a loss from a qualified trade or business to the next taxable year. For example, assume a taxpayer has qualified business income of \$20,000 from qualified business A and a qualified business loss of \$50,000 from qualified business B in Year 1. The taxpayer is not permitted a deduction for Year 1 and has a carryover qualified business loss of \$30,000 to Year 2.

Qualified business income does not include any amount paid by an S corporation that is treated as reasonable compensation of the taxpayer. Similarly, qualified business income does not include any partners guaranteed payment for services rendered with respect to the trade or business, and does not include any amount paid or incurred by a partnership to partners who are acting other than in their capacity as partners for services.

“Specified service” trades or businesses (and the trade or business of being an employee) are excluded from the definition of a qualified trade or business. A specified service trade or business is any trade or business involving the performance of services in the fields of health; law; engineering; architecture; accounting; actuarial science; performing arts; consulting; athletics; financial services; brokerage services, including investing and investment management, trading, or dealing in securities, partnership interests, or commodities; and any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees.

The exclusion from the definition of a qualified business for specified service trades or businesses does not apply for taxpayers with taxable incomes less than a threshold amount, so taxpayers with taxable incomes below the threshold amount will be eligible for the deduction, even if the trade or business is a specified service trade or business. The threshold amounts for 2021 are \$164,900 for single and head of household; \$164,925 for married filing separately; and \$329,800 for married filing jointly. These amounts

are indexed for inflation. For 2022, they are \$170,050 for single, head of household, and married filing separately; and \$340,100 for married filing jointly. The exclusion from the definition is fully phased in for a taxpayer with taxable income in excess of the threshold amount plus \$50,000 (\$100,000 in the case of a joint return).

Qualified business income deduction – Limitation

There is a limitation of the qualified business income deduction when a taxpayer's taxable income begins to exceed the lower level of the aforementioned phase-out range. This limitation is based on the W-2 wages paid in the production of trade or business income or the unadjusted basis of qualified property used in the production of qualified business income. For each qualified trade or business, the taxpayer is allowed a deductible amount equal to the lesser of

- 20% of the qualified business income with respect to such trade or business, or
- the greater of
 - 50% of the W-2 wages paid with respect to the qualified trade or business, or
 - the sum of 25% of the W-2 wages with respect to the qualified trade or business plus 2.5% of the unadjusted basis, immediately after acquisition, of all qualified property (the wage limit).

The wage limit begins to be phased in when taxable income exceeds a threshold amount, so if the taxpayer's taxable income is below the threshold amount, the deductible amount for each qualified trade or business is equal to 20% of the qualified business income with respect to each respective trade or business. The threshold amount and phase-in for the wage limit is identical to that of the exclusion from the definition of a qualified business for specified service trades or businesses, as explained previously. The salaries of officers is included in the total "W-2 wages" for purposes of the W-2 wage limit.

S corporations will have to provide their shareholders with supplemental information (wage and property basis information) to facilitate the calculation of the qualified business income deduction. This information will be included as supplemental information on Form 1120S on Schedule K line 17d, and on the shareholder's K-1, box 17. Code V is to be used to identify this information, and some of the information to be disclosed is as follows:

- Qualified business income
- W-2 wages
- Unadjusted basis of qualified property (all tangible property subject to depreciation under section 167 that is held and used by the trade or business during the tax year, for which the depreciable period has not ended)

Key review point

HCD has qualified business income, eligible for the 20% deduction. Have all of the related items been disclosed correctly on Schedule K (in the attachment) and on the Schedule K-1s?

Real estate safe harbor

The Treasury Department and the IRS are aware that whether an interest in rental real estate rises to the level of a trade or business for purposes of Section 199A is the subject of uncertainty for some taxpayers. To help mitigate this uncertainty the Treasury Department released Rev. Proc. 2019-38, 2019-42 IRB 942. Rev. Proc. 2019-38 provided a safe harbor for treating a rental real estate enterprise as a Section 199A trade or business if certain conditions are met. The determination to use this safe harbor must be made annually.

Each rental real estate enterprise will be treated as a single Section 199A trade or business if the following requirements are satisfied during the taxable year with respect to the rental real estate enterprise:

- Separate books and records are maintained to reflect income and expenses for each rental real estate enterprise
- For rental real estate enterprises that have been in existence less than four years, 250 or more hours of rental services are performed (as described in this revenue procedure) per year with respect to the rental real estate enterprise; for rental real estate enterprises that have been in existence for at least four years, in any three of the five consecutive taxable years that end with the taxable year, 250 or more hours of rental services are performed (as described in this revenue procedure) per year with respect to the rental real estate enterprise
- The taxpayer maintains contemporaneous records, including time reports, logs, or similar documents, regarding the following: (a) hours of all services performed; (b) description of all services performed; (c) dates on which such services were performed; and (d) who performed the services.
- The taxpayer or relevant pass-through entity (RPE) attaches a statement to a timely filed original return for each taxable year in which the taxpayer or RPE relies on the safe harbor. An individual or RPE with more than one rental real estate enterprise relying on this safe harbor may submit a single statement but the statement must list the required information separately for each rental real estate enterprise. The statement must include the following information:
 - A description (including the address and rental category) of all rental real estate properties that are included in each rental real estate enterprise;
 - A description (including the address and rental category) of rental real estate properties acquired and disposed of during the taxable year; and
 - (3) A representation that the requirements of this revenue procedure have been satisfied. Rental services for purpose of Rev. Proc. 2019-38 include, but are not limited to
 - advertising to rent or lease the real estate;
 - negotiating and executing leases;
 - verifying information contained in prospective tenant applications;
 - collection of rent;
 - daily operation, maintenance, and repair of the property, including the purchase of materials and supplies;
 - management of the real estate; and
 - supervision of employees and independent contractors.

Rental services may be performed by owners, including owners of an RPE, or by employees, agents, and/or independent contractors of the owners. The term rental services does not include financial or investment management activities, such as arranging financing; procuring property; studying and

reviewing financial statements or reports on operations; improving property under Regs. Sec. 1.263(a)-3(d); or hours spent traveling to and from the real estate.

Certain rental real estate arrangements excluded under this revenue procedure. The following types of property may not be included in a rental real estate enterprise and are therefore not eligible for the safe harbor:

- Real estate used by the taxpayer (including an owner or beneficiary of an RPE) as a residence under Regs. Sec. 280A(d).
- Real estate rented or leased under a triple net lease. For purposes of this revenue procedure, a triple net lease includes a lease agreement that requires the tenant or lessee to pay taxes, fees, and insurance, and to pay for maintenance activities for a property in addition to rent and utilities.
- Real estate rented to a trade or business conducted by a taxpayer or an RPE which is commonly controlled under Regs. Sec. 1.199A-4(b)(1)(i).
- The entire rental real estate interest if any portion of the interest is treated as an SSTB under Regs. Sec. 1.199A-5(c)(2) (which provides special rules where property or services are provided to an SSTB).



Chapter 2

Case Two: Superior Investments

Learning objectives

- Determine how capital gains and losses are disclosed on the Form 1120S.
- Identify which dividends are qualified and which are not.
- Determine how installment sales are disclosed by S corporations.
- Calculate the excess net passive income tax for an S corporation.

Superior Investments is a Minnesota S corporation with the following three shareholders:

| Name | SS number |
|---|-------------|
| Edmund Fitzgerald 4825 Jefferson Street Duluth, MN 55807 | 455-81-5151 |
| John Cowle 1750 Pillsbury Ave. S. Minneapolis, MN 55404 | 454-66-3333 |
| Harriet B. Hesper 1519 Dousman Street Green Bay, WI 54303 | 459-34-5939 |

Superior Investments (SI) was formed on July 1, 2013, to coordinate the investments of its three shareholders. Its S corporation election was effective on that date. Based on the infrequency of the exchanges it makes, it maintains that its operations do not constitute a trade or business. Its federal identification number is 75-3185725, and its address is 4823 Jefferson Street, Duluth, MN 55807.

SI makes investments for the three shareholders. Edmund Fitzgerald is the CEO and president of SI and oversees most of the investments. For his efforts, Edmund is paid a salary of \$200,000 per year. Each of the shareholders owns 40,000 shares in the corporation.

During the year, SI had the following transactions (assume all amounts are net of commissions):

| Transactions | Date purchased | Cost | Date sold | Sale price | Gain/Loss |
|--|----------------|-------------|------------|-------------|-----------|
| Sold 1,000 shares of Exxon | 7/20/2019 | \$102,730 | 6/26/2021 | \$93,840 | -\$8,890 |
| Bought 750 shares of Exxon | 6/12/2021 | \$68,040 | | | |
| Sold 1,000 acres of land, \$500,000 mortgage, \$800,000 this year, \$700,000 next year | 5/3/2016 | \$1,300,000 | 10/21/2021 | \$2,000,000 | \$700,000 |
| Sold painting by Picasso, held for investment | 3/4/2020 | \$545,000 | 2/15/2021 | \$643,000 | \$98,000 |

In addition, SI received the following dividends:

- Received \$30,000 of dividends from Intel Corp. (30,000 shares purchased on May 13, 2020)
- Received \$17,000 of dividends from Panadera Corp., a Brazilian corporation whose stock is not traded in the United States (10,000 shares purchased on February 17, 2020)
- Received \$11,000 of dividends from Grupo Aeromexico, a Mexican corporation (20,000 shares purchased on June 3, 2018)

In addition to the preceding transactions, SI bought \$1,000,000 of various issues of stock.

SI financial statements

SI has the following financial statements at December 31.

| | Ending balance sheet | | Income statement | |
|-------------------------------------|----------------------|-----------|------------------|---------|
| Cash | 268,065 | | | |
| Furniture and equipment | 240,000 | | | |
| Accumulated depreciation, equipment | | 100,000 | | |
| Land | 3,615,445 | | | |
| Stocks | 2,300,000 | | | |
| Bonds | 645,000 | | | |
| Other investment | 0 | | | |
| Installment note receivable | 700,000 | | | |
| | | | | |
| Accounts payable | | 26,000 | | |
| Mortgage payable | | 2,230,000 | | |
| Capital, Edmund | | 1,325,000 | | |
| Capital, John | | 1,325,000 | | |
| Capital, Harriet | | 1,325,000 | | |
| Accumulated adjustments account | | 1,437,510 | | |
| Dividend income | | | | 58,000 |
| Interest income | | | | 47,000 |
| Loss on the sale of stock | | | | -8,890 |
| Gain on the sale of land | | | | 700,000 |
| Gain on sale of painting | | | | 98,000 |
| Insurance | | | 12,000 | |
| Employee wages | | | 135,600 | |
| Officer salaries | | | 200,000 | |
| Employee medical expenses | | | 34,000 | |
| Payroll taxes | | | 27,800 | |
| Interest expense | | | 120,000 | |
| Property tax – land | | | 30,000 | |

| | Ending balance sheet | | Income statement | |
|----------------------------|----------------------|-----------|------------------|---------|
| Rent expense, building | | | 7,200 | |
| Depreciation expense, F&F | | | 30,000 | |
| Shareholder distributions: | | | | |
| Edmund | | | | |
| John | | | | |
| Harriet | | | | |
| | | | | |
| Totals | 7,768,510 | 7,768,510 | 596,600 | 894,110 |

The interest expense was on debt used to purchase land held for investment.

| | Beginning balance sheet |
|-------------------------------------|-------------------------|
| Cash | 294,865 |
| Furniture and equipment | 240,000 |
| Accumulated depreciation, equipment | -70,000 |
| Land | 4,915,445 |
| Stocks | 1,334,690 |
| Bonds | 645,000 |
| Other investment | 545,000 |
| Installment note receivable | 0 |
| Accounts payable | 0 |
| Mortgage payable | 2,730,000 |
| Capital, Edmund | 1,325,000 |
| Capital, John | 1,325,000 |
| Capital, Harriet | 1,325,000 |
| Accumulated adjustments account | 1,200,000 |

Notes to accompany financial statements

SI uses the accrual method of accounting for tax purposes.

Assume that tax and book depreciation are the same. That is, the preceding depreciation numbers are the same as those that would be reported on Form 4562. Also, there is no alternative minimum tax adjustment for depreciation on the building. The S corporation has chosen not to make the IRC Section 179 election or take bonus depreciation with respect to the equipment acquired during the taxable year.

Superior Investments – 2021 tax return and accompanying forms and schedules

The S corporation's 2021 Form 1120S, *U.S. Income Tax Return for an S Corporation*, along with 2021 Schedules K-1 (Form 1120S), *Partner's Share of Income, Deductions, Credits, etc.*, for each shareholder are reproduced on the following pages. The tax return and accompanying Schedules K-1 are followed by an explanation of the rationale and calculation of each figure reported on the return.

In reviewing the return, you should pay careful attention to the following items, which are discussed in more depth throughout the rest of this chapter:

- Because there are so many investments in the corporation, will there be a tax on excess net passive income?
- Are any installment sales treated correctly?
- Are dividends correctly classified as qualified or not qualified?
- Are deductible investment interest expense and investment expenses properly determined?

Form **1120-S**

U.S. Income Tax Return for an S Corporation

OMB No. 1545-0123

Department of the Treasury
Internal Revenue Service

Do not file this form unless the corporation has filed or is attaching Form 2553 to elect to be an S corporation.
Go to www.irs.gov/Form1120S for instructions and the latest information.

2021

For calendar year 2021 or tax year beginning _____, ending _____

| | | | |
|---|------------------------------|--|--|
| A S election effective date 6/1/2014 | TYPE OR PRINT | Name Superior Investments | D Employer identification number 75-3185725 |
| B Business activity code number (see instructions) 531390 | | Number, street, and room or suite no. If a P.O. box, see instructions. 4823 Jefferson St. | E Date incorporated 6/1/2014 |
| C Check if Sch. M-3 attached <input type="checkbox"/> | | City or town State ZIP code Duluth MN 55807 | F Total assets (see instructions) \$ 7,668,510 |
| | | Foreign country name Foreign province/state/county Foreign postal code | |

G Is the corporation electing to be an S corporation beginning with this tax year? See instructions. Yes No

H Check if: (1) Final return (2) Name change (3) Address change (4) Amended return (5) S election termination

I Enter the number of shareholders who were shareholders during any part of the tax year _____ ▶ _____ 3

J Check if corporation: (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 21. See the instructions for more information.

| | | | |
|---|---|------------|--------------|
| Income | 1a Gross receipts or sales | 1a | |
| | b Returns and allowances | 1b | |
| | c Balance. Subtract line 1b from line 1a | | 1c 0 |
| | 2 Cost of goods sold (attach Form 1125-A) | | 2 |
| | 3 Gross profit. Subtract line 2 from line 1c | | 3 0 |
| | 4 Net gain (loss) from Form 4797, line 17 (attach Form 4797) | | 4 |
| 5 Other income (loss) (see instructions—attach statement) | | 5 | |
| 6 Total income (loss). Add lines 3 through 5 | | 6 0 | |
| Deductions (see instructions for limitations) | 7 Compensation of officers (see instructions — attach Form 1125-E) | 7 | |
| | 8 Salaries and wages (less employment credits) | 8 | |
| | 9 Repairs and maintenance | 9 | |
| | 10 Bad debts | 10 | |
| | 11 Rents | 11 | |
| | 12 Taxes and licenses | 12 | |
| | 13 Interest (see instructions) | 13 | |
| | 14 Depreciation not claimed on Form 1125-A or elsewhere on return (attach Form 4562) | 14 | |
| | 15 Depletion (Do not deduct oil and gas depletion.) | 15 | |
| | 16 Advertising | 16 | |
| | 17 Pension, profit-sharing, etc., plans | 17 | |
| | 18 Employee benefit programs | 18 | |
| | 19 Other deductions (attach statement) | 19 | |
| | 20 Total deductions. Add lines 7 through 19 | 20 | 0 |
| | 21 Ordinary business income (loss). Subtract line 20 from line 6 | 21 | 0 |
| Tax and Payments | 22a Excess net passive income or LIFO recapture tax (see instructions) | 22a | |
| | b Tax from Schedule D (Form 1120-S) | 22b | |
| | c Add lines 22a and 22b (see instructions for additional taxes) | | 22c 0 |
| | 23a 2021 estimated tax payments and 2020 overpayment credited to 2021 | 23a | |
| | b Tax deposited with Form 7004 | 23b | |
| | c Credit for federal tax paid on fuels (attach Form 4136) | 23c | |
| | d Add lines 23a through 23c | | 23d 0 |
| | 24 Estimated tax penalty (see instructions). Check if Form 2220 is attached <input type="checkbox"/> | 24 | |
| 25 Amount owed. If line 23d is smaller than the total of lines 22c and 24, enter amount owed | 25 | 0 | |
| 26 Overpayment. If line 23d is larger than the total of lines 22c and 24, enter amount overpaid | 26 | 0 | |
| 27 Enter amount from line 26: Credited to 2022 estimated tax ▶ Refunded ▶ 27 0 | | | |

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

| | | | |
|-------------------------------|---|---|---|
| Sign Here | Signature of officer _____ Date _____ | Chief Executive Officer _____ Title _____ | May the IRS discuss this return with the preparer shown below? See instructions. <input type="checkbox"/> Yes <input type="checkbox"/> No |
| | Print/Type preparer's name _____ Preparer's signature _____ | Date _____ Check <input type="checkbox"/> if self-employed PTIN _____ | |
| Paid Preparer Use Only | Firm's name _____ | Firm's EIN _____ | |
| | Firm's address _____ | Phone no. _____ | |
| | City _____ State _____ | ZIP code _____ | |

For Paperwork Reduction Act Notice, see separate instructions.

Form **1120-S** (2021)

HTA

Schedule B Other Information (see instructions)

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

Table with 5 columns: (i) Name of Corporation, (ii) Employer Identification Number (if any), (iii) Country of Incorporation, (iv) Percentage of Stock Owned, (v) If Percentage in (iv) is 100%, Enter the Date (if 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

Table with 5 columns: (i) Name of Entity, (ii) Employer Identification Number (if any), (iii) Type of Entity, (iv) Country of Organization, (v) Maximum Percentage Owned in Profit, Loss, or Capital

5a At the end of the tax year, did the corporation have any outstanding shares of restricted stock? If "Yes," complete lines (i) and (ii) below. (i) Total shares of restricted stock (ii) Total shares of non-restricted stock
b At the end of the tax year, did the corporation have any outstanding stock options, warrants, or similar instruments? If "Yes," complete lines (i) and (ii) below. (i) Total shares of stock outstanding at the end of the tax year (ii) Total shares of stock outstanding if all instruments were executed
6 Has this corporation filed, or is it required to file, Form 8918, Material Advisor Disclosure Statement, to provide information on any reportable transaction?
7 Check this box if the corporation issued publicly offered debt instruments with original issue discount. If checked, the corporation may have to file Form 8281, Information Return for Publicly Offered Original Issue Discount Instruments.
8 If the corporation (a) was a C corporation before it elected to be an S corporation or the corporation acquired an asset with a basis determined by reference to the basis of the asset (or the basis of any other property) in the hands of a C corporation, and (b) has net unrealized built-in gain in excess of the net recognized built-in gain from prior years, enter the net unrealized built-in gain reduced by net recognized built-in gain from prior years. See instructions.
9 Did the corporation have an election under section 163(j) for any real property trade or business or any farming business in effect during the tax year? See instructions
10 Does the corporation satisfy one or more of the following? See instructions. a The corporation owns a pass-through entity with current, or prior year carryover, excess business interest expense. b The corporation's aggregate average annual gross receipts (determined under section 448(c)) for the 3 tax years preceding the current tax year are more than \$26 million and the corporation has business interest expense. c The corporation is a tax shelter and the corporation has business interest expense. If "Yes," complete and attach Form 8990.
11 Does the corporation satisfy both of the following conditions? a The corporation's total receipts (see instructions) for the tax year were less than \$250,000. b The corporation's total assets at the end of the tax year were less than \$250,000. If "Yes," the corporation is not required to complete Schedules L and M-1.

| 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 2021 that would require it to file Form(s) 1099? | X | |
| b | If "Yes," did the corporation file or will it 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 |

| Schedule K Shareholders' Pro Rata Share Items | | Total amount | |
|---|---|--------------|---------|
| Income (Loss) | 1 Ordinary business income (loss) (page 1, line 21) | 1 | |
| | 2 Net rental real estate income (loss) (attach Form 8825) | 2 | |
| | 3a Other gross rental income (loss) 3a | | |
| | b Expenses from other rental activities (attach statement) 3b | | |
| | c Other net rental income (loss). Subtract line 3b from line 3a 3c | | 0 |
| | 4 Interest income | 4 | 47,000 |
| | 5 Dividends: a Ordinary dividends 5a | | 58,000 |
| | b Qualified dividends 5b | 30,000 | |
| | 6 Royalties | 6 | |
| | 7 Net short-term capital gain (loss) (attach Schedule D (Form 1120-S)) | 7 | |
| 8a Net long-term capital gain (loss) (attach Schedule D (Form 1120-S)) | 8a | 702,445 | |
| b Collectibles (28%) gain (loss) 8b | | | |
| c Unrecaptured section 1250 gain (attach statement) 8c | | | |
| 9 Net section 1231 gain (loss) (attach Form 4797) | 9 | | |
| 10 Other income (loss) (see instructions) Type ▶ | 10 | | |
| Deductions | 11 Section 179 deduction (attach Form 4562) | 11 | |
| | 12a Charitable contributions | 12a | |
| | b Investment interest expense 12b | | 120,000 |
| | c Section 59(e)(2) expenditures Type ▶ | 12c | |
| d Other deductions (see instructions) Type ▶ See Attached Statement | 12d | 476,600 | |
| Credits | 13a Low-income housing credit (section 42(j)(5)) | 13a | |
| | b Low-income housing credit (other) | 13b | |
| | c Qualified rehabilitation expenditures (rental real estate) (attach Form 3468, if applicable) | 13c | |
| | d Other rental real estate credits (see instructions) Type ▶ | 13d | |
| | e Other rental credits (see instructions) Type ▶ | 13e | |
| | f Biofuel producer credit (attach Form 6478) | 13f | |
| | g Other credits (see instructions) Type ▶ | 13g | |
| International Transactions | 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"/> | | |
| Alternative Minimum Tax (AMT) Items | 15a Post-1986 depreciation adjustment | 15a | |
| | b Adjusted gain or loss | 15b | |
| | c Depletion (other than oil and gas) | 15c | |
| | d Oil, gas, and geothermal properties—gross income | 15d | |
| | e Oil, gas, and geothermal properties—deductions | 15e | |
| | f Other AMT items (attach statement) | 15f | |
| Items Affecting Shareholder Basis | 16a Tax-exempt interest income | 16a | |
| | b Other tax-exempt income | 16b | |
| | c Nondeductible expenses | 16c | |
| | d Distributions (attach statement if required) (see instructions) | 16d | 60,000 |
| | e Repayment of loans from shareholders | 16e | |
| | f Foreign taxes paid or accrued | 16f | |

| Schedule K | | Shareholders' Pro Rata Share Items (continued) | Total amount |
|--------------------------|------------|--|---------------------|
| Other Information | 17a | Investment income | 105,000 |
| | b | Investment expenses | 476,600 |
| | c | Dividend distributions paid from accumulated earnings and profits | |
| | d | Other items and amounts (attach statement) | |
| Reconciliation | 18 | Income (loss) reconciliation. Combine the amounts on lines 1 through 10 in the far right column. From the result, subtract the sum of the amounts on lines 11 through 12d and 16f | 210,845 |

| Schedule L | | Balance Sheets per Books | | Beginning of tax year | | End of tax year | |
|---|--|---------------------------------|-----------|-----------------------|-----------|-----------------|--|
| Assets | | (a) | (b) | (c) | (d) | | |
| 1 | Cash | | 294,865 | | 268,065 | | |
| 2a | Trade notes and accounts receivable | | | | | | |
| b | Less allowance for bad debts | | 0 | | 0 | | |
| 3 | Inventories | | | | | | |
| 4 | U.S. government obligations | | | | | | |
| 5 | Tax-exempt securities (see instructions) | | | | | | |
| 6 | Other current assets (attach statement) | | 2,524,690 | | 3,645,000 | | |
| 7 | Loans to shareholders | | | | | | |
| 8 | Mortgage and real estate loans | | | | | | |
| 9 | Other investments (attach statement) | | | | | | |
| 10a | Buildings and other depreciable assets | 240,000 | | 240,000 | | | |
| b | Less accumulated depreciation | 70,000 | 170,000 | 100,000 | 140,000 | | |
| 11a | Depletable assets | | | | | | |
| b | Less accumulated depletion | | 0 | | 0 | | |
| 12 | Land (net of any amortization) | | 4,915,445 | | 3,615,445 | | |
| 13a | Intangible assets (amortizable only) | | | | | | |
| b | Less accumulated amortization | | 0 | | 0 | | |
| 14 | Other assets (attach statement) | | | | | | |
| 15 | Total assets | | 7,905,000 | | 7,668,510 | | |
| Liabilities and Shareholders' Equity | | | | | | | |
| 16 | Accounts payable | | | | 26,000 | | |
| 17 | Mortgages, notes, bonds payable in less than 1 year | | 2,730,000 | | 2,230,000 | | |
| 18 | Other current liabilities (attach statement) | | | | | | |
| 19 | Loans from shareholders | | | | | | |
| 20 | Mortgages, notes, bonds payable in 1 year or more | | | | | | |
| 21 | Other liabilities (attach statement) | | | | | | |
| 22 | Capital stock | | 3,975,000 | | 3,975,000 | | |
| 23 | Additional paid-in capital | | | | | | |
| 24 | Retained earnings | | 1,200,000 | | 1,437,510 | | |
| 25 | Adjustments to shareholders' equity (attach statement) | | | | | | |
| 26 | Less cost of treasury stock | | | | | | |
| 27 | Total liabilities and shareholders' equity | | 7,905,000 | | 7,668,510 | | |

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

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

| | | |
|--|--|---|
| <p>1 Net income (loss) per books 297,510</p> <p>2 Income included on Schedule K, lines 1, 2, 3c, 4, 5a, 6, 7, 8a, 9, and 10, not recorded on books this year (itemize) -----</p> <p>3 Expenses recorded on books this year not included on Schedule K, lines 1 through 12 and 16f (itemize):</p> <p>a Depreciation \$ -----</p> <p>b Travel and entertainment \$ ----- See Attached Statement 6,668</p> <p>4 Add lines 1 through 3 304,178</p> | <p>5 Income recorded on books this year not included on Schedule K, lines 1 through 10 (itemize):</p> <p>a Tax-exempt interest \$ ----- See Statement 93,333</p> <p>6 Deductions included on Schedule K, lines 1 through 12 and 16f, not charged against book income this year (itemize):</p> <p>a Depreciation \$ -----</p> <p>7 Add lines 5 and 6 93,333</p> <p>8 Income (loss) (Schedule K, line 18). Subtract line 7 from line 4 210,845</p> | <p>93,333</p> <p>0</p> <p>93,333</p> <p>210,845</p> |
|--|--|---|

Schedule M-2 Analysis of Accumulated Adjustments Account, Shareholders' Undistributed Taxable Income Previously Taxed, Accumulated Earnings and Profits, and Other Adjustments Account
(see instructions)

| | (a) Accumulated adjustments account | (b) Shareholders' undistributed taxable income previously taxed | (c) Accumulated earnings and profits | (d) Other adjustments account |
|--|-------------------------------------|---|--------------------------------------|-------------------------------|
| 1 Balance at beginning of tax year | 1,200,000 | | | |
| 2 Ordinary income from page 1, line 21 | | | | |
| 3 Other additions | 900,778 | | | |
| 4 Loss from page 1, line 21 | | | | |
| 5 Other reductions | 603,268 | | | |
| 6 Combine lines 1 through 5 | 1,497,510 | 0 | 0 | 0 |
| 7 Distributions | 60,000 | | | |
| 8 Balance at end of tax year. Subtract line 7 from line 6 | 1,437,510 | 0 | 0 | 0 |

671121

Final K-1 Amended K-1

OMB No. 1545-0123

Schedule K-1 (Form 1120-S)

2021

Department of the Treasury Internal Revenue Service

For calendar year 2021, or tax year

beginning [] ending []

Shareholder's Share of Income, Deductions, Credits, etc. See separate instructions.

Part I Information About the Corporation
Part II Information About the Shareholder
Part III Shareholder's Share of Current Year Income, Deductions, Credits, and Other Items

K-1 Statement (Sch K-1, Form 1120S)

Line 12 - Deductions

| | | | |
|---|---|---|----------------|
| H | Code H - Investment interest expense | H | <u>40,000</u> |
| L | Code L - Deductions-portfolio (other) | | |
| | Property taxes | | <u>10,000</u> |
| | Other investment expenses | | <u>148,866</u> |
| | Code L - Total deductions-portfolio (other) | L | <u>158,866</u> |

Line 16 - Items affecting shareholder basis

| | | | |
|---|----------------------------------|---|---------------|
| D | Code D - Distributions | D | <u>20,000</u> |
|---|----------------------------------|---|---------------|

Line 17 - Other Information

| | | | |
|---|--|---|----------------|
| A | Code A - Investment income | A | <u>35,000</u> |
| B | Code B - Investment expenses | B | <u>158,866</u> |

Line 17, Code N, Section 453A(c) Information (Sch K1 (1120S))

75-3185725
Superior Investments

Edmund Fitzgerald

455-81-5151

| | | | |
|-------------|--|--|----------------------------|
| 1 | Description of property: | <u>4 - 1000 acres of investment land</u> | |
| 2 | Date acquired: | <u>5/3/2016</u> | |
| 3 | Date property sold: | <u>10/21/2021</u> | |
| 4 | Selling price, including mortgages and other debts, less mortgages, debts and other liabilities the buyer assumed or took the property subject to: | | |
| | a | Selling price including mortgages and other debts | 4a <u>2,000,000</u> |
| | b | Mortgages, debts, and other liabilities the buyer assumed or took the property | 4b <u>500,000</u> |
| | c | Subtract line 4b from line 4a | 4c <u>1,500,000</u> |
| 5 | Gross profit | | 5 <u>700,000</u> |
| 6 | Gross profit percentage | | 6 <u>0.466667</u> |
| 7 | Contract price less (4) above, plus payments received during the year (not including interest) whether stated or unstated | | 7 <u>1,300,000</u> |
| 8 | Payments received in prior years, not including interest whether stated or unstated | | 8 <u>0</u> |
| 9 | Installment sale income | | 9 <u>606,667</u> |
| 10 | Character of the income - capital or ordinary: | | 10 <u>Capital</u> |
| 11 a | Schedule K deferred obligation (Line 4c less Lines 7 and 8) | | 11a <u>200,000</u> |
| b | Shareholders's share of the deferred obligation (Line 11a multiplied by shareholder's profit percentage) | | 11b <u>66,666</u> |

This data is provided to support the calculation of Section 453A(c) interest charge for installment sale obligations. See IRC Section 453A and report any required interest on Form 1040, Sch 2, Line 15. Note that this summary does not include installment sales reported on the Section 179 Disposition sheet.

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

Department of the Treasury
Internal Revenue Service

2021

For calendar year 2021, or tax year

beginning [] ending []

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

▶ See separate instructions.

Final K-1

Amended K-1

OMB No. 1545-0123

| Part I Information About the Corporation | | Part III Shareholder's Share of Current Year Income, Deductions, Credits, and Other Items | |
|--|--|--|--|
| A Corporation's employer identification number 75-3185725 | | 1 Ordinary business income (loss) | 13 Credits |
| B Corporation's name, address, city, state, and ZIP code Superior Investments c/o Edmund Fitzgerald 4823 Jefferson St. Duluth, MN 55807 | | 2 Net rental real estate income (loss) | |
| C IRS Center where corporation filed return e-file | | 3 Other net rental income (loss) | |
| D Corporation's total number of shares Beginning of tax year 120,000 End of tax year 120,000 | | 4 Interest income 15,667 | |
| Part II Information About the Shareholder | | 5a Ordinary dividends 19,333 | 14 Schedule K-3 is attached if checked <input type="checkbox"/> |
| E Shareholder's identifying number 454-66-3333 Shareholder: 2 | | 5b Qualified dividends 10,000 | 15 Alternative minimum tax (AMT) items |
| F Shareholder's name, address, city, state, and ZIP code John Cowle 1750 Pillsbury Ave. S. Minneapolis, MN 55404 | | 6 Royalties | |
| G Current year allocation percentage 33.333333 % | | 7 Net short-term capital gain (loss) | |
| H Shareholder's number of shares Beginning of tax year 40,000 End of tax year 40,000 | | 8a Net long-term capital gain (loss) 234,148 | |
| I Loans from shareholder Beginning of tax year \$ End of tax year \$ | | 8b Collectibles (28%) gain (loss) | |
| For IRS Use Only | | 8c Unrecaptured section 1250 gain | |
| | | 9 Net section 1231 gain (loss) | 16 Items affecting shareholder basis D 20,000 |
| | | 10 Other income (loss) | |
| | | | 17 Other information A 35,000 |
| | | 11 Section 179 deduction | B 158,867 |
| | | 12 Other deductions H 40,000 | |
| | | L* 158,867 | |
| | | | |
| | | | |
| | | | |
| | | 18 <input type="checkbox"/> More than one activity for at-risk purposes* | |
| | | 19 <input type="checkbox"/> More than one activity for passive activity purposes* | |
| * See attached statement for additional information. | | | |

K-1 Statement (Sch K-1, Form 1120S)

Line 12 - Deductions

| | | | |
|---|---|---|----------------|
| H | Code H - Investment interest expense | H | <u>40,000</u> |
| L | Code L - Deductions-portfolio (other) | | |
| | Property taxes | | <u>10,000</u> |
| | Other investment expenses | | <u>148,867</u> |
| | Code L - Total deductions-portfolio (other) | L | <u>158,867</u> |

Line 16 - Items affecting shareholder basis

| | | | |
|---|----------------------------------|---|---------------|
| D | Code D - Distributions | D | <u>20,000</u> |
|---|----------------------------------|---|---------------|

Line 17 - Other Information

| | | | |
|---|--|---|----------------|
| A | Code A - Investment income | A | <u>35,000</u> |
| B | Code B - Investment expenses | B | <u>158,867</u> |

Line 17, Code N, Section 453A(c) Information (Sch K1 (1120S))

75-3185725
Superior Investments

John Cowle

454-66-3333

| | | | |
|-------------|--|--|----------------------------|
| 1 | Description of property: | <u>4 - 1000 acres of investment land</u> | |
| 2 | Date acquired: | <u>5/3/2016</u> | |
| 3 | Date property sold: | <u>10/21/2021</u> | |
| 4 | Selling price, including mortgages and other debts, less mortgages, debts and other liabilities the buyer assumed or took the property subject to: | | |
| | a | Selling price including mortgages and other debts | 4a <u>2,000,000</u> |
| | b | Mortgages, debts, and other liabilities the buyer assumed or took the property | 4b <u>500,000</u> |
| | c | Subtract line 4b from line 4a | 4c <u>1,500,000</u> |
| 5 | Gross profit | | 5 <u>700,000</u> |
| 6 | Gross profit percentage | | 6 <u>0.466667</u> |
| 7 | Contract price less (4) above, plus payments received during the year (not including interest) whether stated or unstated | | |
| | | | 7 <u>1,300,000</u> |
| 8 | Payments received in prior years, not including interest whether stated or unstated | | |
| | | | 8 <u>0</u> |
| 9 | Installment sale income | | |
| | | | 9 <u>606,667</u> |
| 10 | Character of the income - capital or ordinary: | | |
| | | | 10 <u>Capital</u> |
| 11 a | Schedule K deferred obligation (Line 4c less Lines 7 and 8) | | |
| | | | 11a <u>200,000</u> |
| b | Shareholders's share of the deferred obligation (Line 11a multiplied by shareholder's profit percentage) | | |
| | | | 11b <u>66,667</u> |

This data is provided to support the calculation of Section 453A(c) interest charge for installment sale obligations. See IRC Section 453A and report any required interest on Form 1040, Sch 2, Line 15. Note that this summary does not include installment sales reported on the Section 179 Disposition sheet.

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

Department of the Treasury
Internal Revenue Service

2021

For calendar year 2021, or tax year

beginning ending

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

▶ See separate instructions.

| Part I Information About the Corporation | | Part III Shareholder's Share of Current Year Income, Deductions, Credits, and Other Items | |
|--|--|--|--|
| A Corporation's employer identification number 75-3185725 | | 1 Ordinary business income (loss) 15,667 | 13 Credits |
| B Corporation's name, address, city, state, and ZIP code Superior Investments c/o Edmund Fitzgerald 4823 Jefferson St. Duluth, MN 55807 | | 2 Net rental real estate income (loss) | |
| C IRS Center where corporation filed return e-file | | 3 Other net rental income (loss) | |
| D Corporation's total number of shares Beginning of tax year 120,000 End of tax year 120,000 | | 4 Interest income | |
| Part II Information About the Shareholder | | 5a Ordinary dividends 19,333 | |
| E Shareholder's identifying number Shareholder: 3 459-34-5939 | | 5b Qualified dividends 10,000 | 14 Schedule K-3 is attached if checked <input type="checkbox"/> |
| F Shareholder's name, address, city, state, and ZIP code Harriet B. Hesper 1519 Dousman Street Green Bay, WI 54303 | | 6 Royalties | 15 Alternative minimum tax (AMT) items |
| G Current year allocation percentage 33.333333 % | | 7 Net short-term capital gain (loss) | |
| H Shareholder's number of shares Beginning of tax year 40,000 End of tax year 40,000 | | 8a Net long-term capital gain (loss) 234,148 | |
| I Loans from shareholder Beginning of tax year \$ _____ End of tax year \$ _____ | | 8b Collectibles (28%) gain (loss) | |
| For IRS Use Only | | 8c Unrecaptured section 1250 gain | |
| | | 9 Net section 1231 gain (loss) | 16 Items affecting shareholder basis D 20,000 |
| | | 10 Other income (loss) | |
| | | | |
| | | | |
| | | | 17 Other information A 35,000 |
| | | 11 Section 179 deduction | B 158,867 |
| | | 12 Other deductions H 40,000 | |
| | | L* 158,867 | |
| | | | |
| | | | |
| | | | |
| | 18 <input type="checkbox"/> More than one activity for at-risk purposes* | | |
| | 19 <input type="checkbox"/> More than one activity for passive activity purposes* | | |
| | * See attached statement for additional information. | | |

671121

Final K-1 Amended K-1

OMB No. 1545-0123

K-1 Statement (Sch K-1, Form 1120S)

Line 12 - Deductions

| | | | |
|---|---|---|----------------|
| H | Code H - Investment interest expense | H | <u>40,000</u> |
| L | Code L - Deductions-portfolio (other) | | |
| | Property taxes | | <u>10,000</u> |
| | Other investment expenses | | <u>148,867</u> |
| | Code L - Total deductions-portfolio (other) | L | <u>158,867</u> |

Line 16 - Items affecting shareholder basis

| | | | |
|---|----------------------------------|---|---------------|
| D | Code D - Distributions | D | <u>20,000</u> |
|---|----------------------------------|---|---------------|

Line 17 - Other Information

| | | | |
|---|--|---|----------------|
| A | Code A - Investment income | A | <u>35,000</u> |
| B | Code B - Investment expenses | B | <u>158,867</u> |

Line 17, Code N, Section 453A(c) Information (Sch K1 (1120S))

75-3185725
Superior Investments

Harriet B. Hesper

459-34-5939

| | | | |
|-------------|--|--|----------------------------|
| 1 | Description of property: | <u>4 - 1000 acres of investment land</u> | |
| 2 | Date acquired: | <u>5/3/2016</u> | |
| 3 | Date property sold: | <u>10/21/2021</u> | |
| 4 | Selling price, including mortgages and other debts, less mortgages, debts and other liabilities the buyer assumed or took the property subject to: | | |
| | a | Selling price including mortgages and other debts | 4a <u>2,000,000</u> |
| | b | Mortgages, debts, and other liabilities the buyer assumed or took the property | 4b <u>500,000</u> |
| | c | Subtract line 4b from line 4a | 4c <u>1,500,000</u> |
| 5 | Gross profit | | 5 <u>700,000</u> |
| 6 | Gross profit percentage | | 6 <u>0.466667</u> |
| 7 | Contract price less (4) above, plus payments received during the year (not including interest) whether stated or unstated | | |
| | | | 7 <u>1,300,000</u> |
| 8 | Payments received in prior years, not including interest whether stated or unstated | | |
| | | | 8 <u>0</u> |
| 9 | Installment sale income | | |
| | | | 9 <u>606,667</u> |
| 10 | Character of the income - capital or ordinary: | | |
| | | | 10 <u>Capital</u> |
| 11 a | Schedule K deferred obligation (Line 4c less Lines 7 and 8) | | |
| | | | 11a <u>200,000</u> |
| b | Shareholders's share of the deferred obligation (Line 11a multiplied by shareholder's profit percentage) | | |
| | | | 11b <u>66,667</u> |

This data is provided to support the calculation of Section 453A(c) interest charge for installment sale obligations. See IRC Section 453A and report any required interest on Form 1040, Sch 2, Line 15. Note that this summary does not include installment sales reported on the Section 179 Disposition sheet.

Form **8453-S**

**U.S. S Corporation Income Tax Declaration
for an IRS e-file Return**

OMB No. 1545-0123

▶ **File electronically with the corporation's tax return. (Don't file paper copies.)**
▶ **Go to www.irs.gov/Form8453S for the latest information.**

2021

Department of the Treasury
Internal Revenue Service

For calendar year 2021, or tax year beginning , 2021, and ending , 20

Name of corporation
Superior Investments

Employer identification number
75-3185725

Part I Tax Return Information (whole dollars only)

| | | | |
|---|--|---|---------|
| 1 | Gross receipts or sales less returns and allowances (Form 1120-S, line 1c) | 1 | 0 |
| 2 | Gross profit (Form 1120-S, line 3) | 2 | 0 |
| 3 | Ordinary business income (loss) (Form 1120-S, line 21) | 3 | 0 |
| 4 | Net rental real estate income (loss) (Form 1120-S, Schedule K, line 2) | 4 | 0 |
| 5 | Income (loss) reconciliation (Form 1120-S, Schedule K, line 18) | 5 | 210,845 |

Part II Declaration of Officer (see instructions) Be sure to keep a copy of the corporation's tax return.

- 6a I consent that the corporation's refund be directly deposited as designated on the **Form 8050**, Direct Deposit of Corporate Tax Refund, that will be electronically transmitted with the corporation's 2021 federal income tax return.
- b I do not want direct deposit of the corporation's refund or the corporation is not receiving a refund.
- c I authorize the U.S. Treasury and its designated Financial Agent to initiate an electronic funds withdrawal (direct debit) entry to the financial institution account indicated in the tax preparation software for payment of the corporation's federal taxes owed on this return, and the financial institution to debit the entry to this account. To revoke a payment, I must contact the U.S. Treasury Financial Agent at **888-353-4537** no later than 2 business days prior to the payment (settlement) date. I also authorize the financial institutions involved in the processing of the electronic payment of taxes to receive confidential information necessary to answer inquiries and resolve issues related to the payment.

If the corporation is filing a balance due return, I understand that if the IRS doesn't receive full and timely payment of its tax liability, the corporation will remain liable for the tax liability and all applicable interest and penalties.

Under penalties of perjury, I declare that I'm an officer of the above corporation and that the information I've given my electronic return originator (ERO), transmitter, and/or intermediate service provider (ISP) and the amounts in Part I above agree with the amounts on the corresponding lines of the corporation's 2021 federal income tax return. To the best of my knowledge and belief, the corporation's return is true, correct, and complete. I consent to my ERO, transmitter, and/or ISP sending the corporation's return, this declaration, and accompanying schedules and statements to the IRS. I also consent to the IRS sending my ERO, transmitter, and/or ISP an acknowledgement of receipt of transmission and an indication of whether or not the corporation's return is accepted and, if rejected, the reason(s) for the rejection. If the processing of the corporation's return or refund is delayed, I authorize the IRS to disclose to my ERO, transmitter, and/or ISP the reason(s) for the delay, or when the refund was sent.

Sign Here ▶ _____ Date _____ **Chief Executive Officer** Title _____

Part III Declaration of Electronic Return Originator (ERO) and Paid Preparer (see instructions)

I declare that I've reviewed the above corporation's return and that the entries on Form 8453-S are complete and correct to the best of my knowledge. If I'm only a collector, I'm not responsible for reviewing the return and only declare that this form accurately reflects the data on the return. The corporate officer will have signed this form before I submit the return. I'll give the officer a copy of all forms and information to be filed with the IRS, and I've followed all other requirements in **Pub. 3112**, IRS e-file Application and Participation, and **Pub. 4163**, Modernized e-File (MeF) Information for Authorized IRS e-file Providers for Business Returns. If I'm also the Paid Preparer, under penalties of perjury I declare that I've examined the above corporation's return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. This Paid Preparer declaration is based on all information of which I've any knowledge.

| | | | | | |
|-----------------------|--|------|--|---|-------------------|
| ERO's Use Only | ERO's signature | Date | Check if also paid preparer <input type="checkbox"/> | Check if self-employed <input type="checkbox"/> | ERO's SSN or PTIN |
| | Firm's name (or yours if self-employed), address, and ZIP code | | | | EIN Phone no. |

Under penalties of perjury, I declare that I've examined the above corporation's return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. This declaration is based on all information of which I've any knowledge.

| | | | | | |
|-------------------------------|----------------------------|----------------------|------|---|------------|
| Paid Preparer Use Only | Print/Type preparer's name | Preparer's signature | Date | Check if self-employed <input type="checkbox"/> | PTIN |
| | Firm's name | | | | Firm's EIN |
| | Firm's address | | | | Phone no. |

For Privacy Act and Paperwork Reduction Act Notice, see instructions.

Form **8453-S** (2021)

HTA

Name(s) shown on return. Name and SSN or taxpayer identification no. not required if shown on other side

Social security number or taxpayer identification number

Superior Investments

75-3185725

Before you check Box D, E, or F below, see whether you received any Form(s) 1099-B or substitute statement(s) from your broker. A substitute statement will have the same information as Form 1099-B. Either will show whether your basis (usually your cost) was reported to the IRS by your broker and may even tell you which box to check.

Part II Long-Term. Transactions involving capital assets you held more than 1 year are generally long-term (see instructions). For short-term transactions, see page 1.

Note: You may aggregate all long-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS and for which no adjustments or codes are required. Enter the totals directly on Schedule D, line 8a; you aren't required to report these transactions on Form 8949 (see instructions).

You must check Box D, E, or F below. Check only one box. If more than one box applies for your long-term transactions, complete a separate Form 8949, page 2, for each applicable box. If you have more long-term transactions than will fit on this page for one or more of the boxes, complete as many forms with the same box checked as you need.

- (D)** Long-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS (see **Note** above)
- (E)** Long-term transactions reported on Form(s) 1099-B showing basis **wasn't** reported to the IRS
- (F)** Long-term transactions not reported to you on Form 1099-B

| 1 | (a) Description of property (Example: 100 sh. XYZ Co.) | (b) Date acquired (Mo., day, yr.) | (c) Date sold or disposed of (Mo., day, yr.) | (d) Proceeds (sales price) (see instructions) | (e) Cost or other basis. See the Note below and see Column (e) in the separate instructions | Adjustment, if any, to gain or loss. If you enter an amount in column (g), enter a code in column (f). See the separate instructions. | | (h) Gain or (loss). Subtract column (e) from column (d) and combine the result with column (g) |
|------------------|--|---|---|--|--|---|--------------------------------|--|
| | | | | | | (f) Code(s) from instructions | (g) Amount of adjustment | |
| | 1000 shares of Exxon Corporation common stock | 7/20/2019 | 6/26/2021 | 93,840 | 102,730 | W | 6,668 | -2,222 |
| | | | | | | | | |
| | | | | | | | | |
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| | | | | | | | | |
| 2 Totals. | Add the amounts in columns (d), (e), (g), and (h) (subtract negative amounts). Enter each total here and include on your Schedule D, line 8b (if Box D above is checked), line 9 (if Box E above is checked), or line 10 (if Box F above is checked) ▶ | | | 93,840 | 102,730 | | 6,668 | -2,222 |

Note: If you checked Box D above but the basis reported to the IRS was incorrect, enter in column (e) the basis as reported to the IRS, and enter an adjustment in column (g) to correct the basis. See **Column (g)** in the separate instructions for how to figure the amount of the adjustment.

Name(s) shown on return. Name and SSN or taxpayer identification no. not required if shown on other side

Social security number or taxpayer identification number

Superior Investments

75-3185725

Before you check Box D, E, or F below, see whether you received any Form(s) 1099-B or substitute statement(s) from your broker. A substitute statement will have the same information as Form 1099-B. Either will show whether your basis (usually your cost) was reported to the IRS by your broker and may even tell you which box to check.

Part II Long-Term. Transactions involving capital assets you held more than 1 year are generally long-term (see instructions). For short-term transactions, see page 1.

Note: You may aggregate all long-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS and for which no adjustments or codes are required. Enter the totals directly on Schedule D, line 8a; you aren't required to report these transactions on Form 8949 (see instructions).

You must check Box D, E, or F below. Check only one box. If more than one box applies for your long-term transactions, complete a separate Form 8949, page 2, for each applicable box. If you have more long-term transactions than will fit on this page for one or more of the boxes, complete as many forms with the same box checked as you need.

- (D) Long-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS (see **Note** above)
- (E) Long-term transactions reported on Form(s) 1099-B showing basis **wasn't** reported to the IRS
- (F) Long-term transactions not reported to you on Form 1099-B

| 1 | (a) Description of property (Example: 100 sh. XYZ Co.) | (b) Date acquired (Mo., day, yr.) | (c) Date sold or disposed of (Mo., day, yr.) | (d) Proceeds (sales price) (see instructions) | (e) Cost or other basis. See the Note below and see Column (e) in the separate instructions | Adjustment, if any, to gain or loss. If you enter an amount in column (g), enter a code in column (f). See the separate instructions. | | (h) Gain or (loss). Subtract column (e) from column (d) and combine the result with column (g) |
|------------------|--|---|---|--|--|---|--------------------------------|--|
| | | | | | | (f) Code(s) from instructions | (g) Amount of adjustment | |
| | Picasso painting | 3/4/2020 | 2/15/2021 | 643,000 | 545,000 | | | 98,000 |
| | | | | | | | | |
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| 2 Totals. | Add the amounts in columns (d), (e), (g), and (h) (subtract negative amounts). Enter each total here and include on your Schedule D, line 8b (if Box D above is checked), line 9 (if Box E above is checked), or line 10 (if Box F above is checked) ▶ | | | 643,000 | 545,000 | | 0 | 98,000 |

Note: If you checked Box D above but the basis reported to the IRS was incorrect, enter in column (e) the basis as reported to the IRS, and enter an adjustment in column (g) to correct the basis. See **Column (g)** in the separate instructions for how to figure the amount of the adjustment.

Form **6252**

Installment Sale Income

OMB No. 1545-0228

2021

Department of the Treasury
Internal Revenue Service

▶ **Attach to your tax return.**
▶ Use a separate form for each sale or other disposition of property on the installment method.
▶ Go to www.irs.gov/Form6252 for the latest information.

Attachment
Sequence No. **67**

Name(s) shown on return

Identifying number
75-3185725

Superior Investments

1 Description of property ▶ 4 - 1000 acres of investment land

2a Date acquired (mm/dd/yyyy) ▶ 05/03/2016 **b** Date sold (mm/dd/yyyy) ▶ 10/21/2021

3 Was the property sold to a related party (see instructions) after May 14, 1980? If "No," skip line 4. Yes No

4 Was the property you sold to a related party a marketable security? If "Yes," complete Part III. If "No," complete Part III for the year of sale and the 2 years after the year of sale. Yes No

Part I Gross Profit and Contract Price. Complete this part for all years of the installment agreement.

| | | | |
|-----------|--|-----------|-----------|
| 5 | Selling price including mortgages and other debts. Don't include interest, whether stated or unstated | 5 | 2,000,000 |
| 6 | Mortgages, debts, and other liabilities the buyer assumed or took the property subject to (see instructions) | 6 | 500,000 |
| 7 | Subtract line 6 from line 5 | 7 | 1,500,000 |
| 8 | Cost or other basis of property sold | 8 | 1,300,000 |
| 9 | Depreciation allowed or allowable | 9 | |
| 10 | Adjusted basis. Subtract line 9 from line 8 | 10 | 1,300,000 |
| 11 | Commissions and other expenses of sale | 11 | |
| 12 | Income recapture from Form 4797, Part III (see instructions) | 12 | |
| 13 | Add lines 10, 11, and 12 | 13 | 1,300,000 |
| 14 | Subtract line 13 from line 5. If zero or less, don't complete the rest of this form. See instructions | 14 | 700,000 |
| 15 | If the property described on line 1 above was your main home, enter the amount of your excluded gain. See instructions. Otherwise, enter -0- | 15 | 0 |
| 16 | Gross profit. Subtract line 15 from line 14 | 16 | 700,000 |
| 17 | Subtract line 13 from line 6. If zero or less, enter -0- | 17 | 0 |
| 18 | Contract price. Add line 7 and line 17 | 18 | 1,500,000 |

Part II Installment Sale Income. Complete this part for all years of the installment agreement.

| | | | |
|-----------|---|-----------|-----------|
| 19 | Gross profit percentage (expressed as a decimal amount). Divide line 16 by line 18. (For years after the year of sale, see instructions.) | 19 | 0.466667 |
| 20 | If this is the year of sale, enter the amount from line 17. Otherwise, enter -0- | 20 | 0 |
| 21 | Payments received during year (see instructions). Don't include interest, whether stated or unstated | 21 | 1,300,000 |
| 22 | Add lines 20 and 21 | 22 | 1,300,000 |
| 23 | Payments received in prior years (see instructions). Don't include interest, whether stated or unstated | 23 | |
| 24 | Installment sale income. Multiply line 22 by line 19 | 24 | 606,667 |
| 25 | Enter the part of line 24 that is ordinary income under the recapture rules. See instructions | 25 | |
| 26 | Subtract line 25 from line 24. Enter here and on Schedule D or Form 4797. See instructions | 26 | 606,667 |

Part III Related Party Installment Sale Income. Don't complete if you received the final payment this tax year.

27 Name, address, and taxpayer identifying number of related party ▶ _____

28 Did the related party resell or dispose of the property ("second disposition") during this tax year? Yes No

29 If the answer to question 28 is "Yes," complete lines 30 through 37 below unless one of the following conditions is met. Check the box that applies.

a The second disposition was more than 2 years after the first disposition (other than dispositions of marketable securities). If this box is checked, enter the date of disposition (mm/dd/yyyy) ▶ _____

b The first disposition was a sale or exchange of stock to the issuing corporation.

c The second disposition was an involuntary conversion and the threat of conversion occurred after the first disposition.

d The second disposition occurred after the death of the original seller or buyer.

e It can be established to the satisfaction of the IRS that tax avoidance wasn't a principal purpose for either of the dispositions. If this box is checked, attach an explanation. See instructions.

| | | | |
|-----------|---|-----------|---|
| 30 | Selling price of property sold by related party (see instructions) | 30 | |
| 31 | Enter contract price from line 18 for year of first sale | 31 | |
| 32 | Enter the smaller of line 30 or line 31 | 32 | |
| 33 | Total payments received by the end of your 2021 tax year (see instructions) | 33 | |
| 34 | Subtract line 33 from line 32. If zero or less, enter -0- | 34 | 0 |
| 35 | Multiply line 34 by the gross profit percentage on line 19 for year of first sale | 35 | 0 |
| 36 | Enter the part of line 35 that is ordinary income under the recapture rules. See instructions | 36 | |
| 37 | Subtract line 36 from line 35. Enter here and on Schedule D or Form 4797. See instructions | 37 | 0 |

For Paperwork Reduction Act Notice, see page 4.

Form **6252** (2021)

HTA

**SCHEDULE D
(Form 1120-S)**

Department of the Treasury
Internal Revenue Service

Capital Gains and Losses and Built-in Gains

▶ Attach to Form 1120-S.

- ▶ Use Form 8949 to list your transactions for lines 1b, 2, 3, 8b, 9, and 10.
- ▶ Go to www.irs.gov/Form1120S for instructions and the latest information.

OMB No. 1545-0123

2021

Name: Superior Investments Employer identification number: 75-3185725

Did the corporation dispose of any investment(s) in a qualified opportunity fund during the tax year? Yes No

If "Yes," attach Form 8949 and see its instructions for additional requirements for reporting your gain or loss.

Part I Short-Term Capital Gains and Losses—Generally Assets Held One Year or Less (see instructions)

| See instructions for how to figure the amounts to enter on the lines below. This form may be easier to complete if you round off the cents to whole dollars. | (d) Proceeds (sales price) | (e) Cost (or other basis) | (g) Adjustments to gain or loss from Form(s) 8949, Part I, line 2, column (g) | (h) Gain or (loss) Subtract column (e) from column (d) and combine the result with column (g) |
|--|----------------------------------|---------------------------------|---|---|
| 1a Totals for all short-term transactions reported on Form 1099-B for which basis was reported to the IRS and for which you have no adjustments (see instructions). However, if you choose to report all these transactions on Form 8949, leave this line blank and go to line 1b | | | | 0 |
| 1b Totals for all transactions reported on Form(s) 8949 with Box A checked | | | | 0 |
| 2 Totals for all transactions reported on Form(s) 8949 with Box B checked | | | | 0 |
| 3 Totals for all transactions reported on Form(s) 8949 with Box C checked | | | | 0 |
| 4 Short-term capital gain from installment sales from Form 6252, line 26 or 37 | | | | 4 |
| 5 Short-term capital gain or (loss) from like-kind exchanges from Form 8824 | | | | 5 |
| 6 Tax on short-term capital gain included on line 23 below | | | | 6 () |
| 7 Net short-term capital gain or (loss). Combine lines 1a through 6 in column (h). Enter here and on Form 1120-S, Schedule K, line 7 or 10 | | | | 7 0 |

Part II Long-Term Capital Gains and Losses—Generally Assets Held More Than One Year (see instructions)

| See instructions for how to figure the amounts to enter on the lines below. This form may be easier to complete if you round off the cents to whole dollars. | (d) Proceeds (sales price) | (e) Cost (or other basis) | (g) Adjustments to gain or loss from Form(s) 8949, Part II, line 2, column (g) | (h) Gain or (loss) Subtract column (e) from column (d) and combine the result with column (g) |
|---|----------------------------------|---------------------------------|--|---|
| 8a Totals for all long-term transactions reported on Form 1099-B for which basis was reported to the IRS and for which you have no adjustments (see instructions). However, if you choose to report all these transactions on Form 8949, leave this line blank and go to line 8b | | | | 0 |
| 8b Totals for all transactions reported on Form(s) 8949 with Box D checked | 93,840 | 102,730 | 6,668 | -2,222 |
| 9 Totals for all transactions reported on Form(s) 8949 with Box E checked | | | | 0 |
| 10 Totals for all transactions reported on Form(s) 8949 with Box F checked | 643,000 | 545,000 | | 98,000 |
| 11 Long-term capital gain from installment sales from Form 6252, line 26 or 37 | | | | 11 606,667 |
| 12 Long-term capital gain or (loss) from like-kind exchanges from Form 8824 | | | | 12 |
| 13 Capital gain distributions (see instructions) | | | | 13 |
| 14 Tax on long-term capital gain included on line 23 below | | | | 14 () |
| 15 Net long-term capital gain or (loss). Combine lines 8a through 14 in column (h). Enter here and on Form 1120-S, Schedule K, line 8a or 10 | | | | 15 702,445 |

For Paperwork Reduction Act Notice, see the Instructions for Form 1120-S.

Schedule D (Form 1120-S) 2021

HTA

Part III Built-in Gains Tax (See instructions **before** completing this part.)

| | | | |
|-----------|---|-----------|---|
| 16 | Excess of recognized built-in gains over recognized built-in losses (attach computation statement) | 16 | |
| 17 | Taxable income (attach computation statement) | 17 | |
| 18 | Net recognized built-in gain. Enter the smallest of line 16, line 17, or line 8 of Schedule B | 18 | |
| 19 | Section 1374(b)(2) deduction | 19 | |
| 20 | Subtract line 19 from line 18. If zero or less, enter -0- here and on line 23 | 20 | 0 |
| 21 | Enter 21% (0.21) of line 20 | 21 | 0 |
| 22 | Section 1374(b)(3) business credit and minimum tax credit carryforwards from C corporation years | 22 | |
| 23 | Tax. Subtract line 22 from line 21 (if zero or less, enter -0-). Enter here and on Form 1120-S, page 1, line 22b | 23 | 0 |

Schedule D (Form 1120-S) 2021

Line 12d, Sch K (1120S) - Other Deductions

| | | |
|---|-----|---------|
| L Code L - Deductions-portfolio (other) | | |
| Property taxes | | 30,000 |
| Other investment expenses | | 446,600 |
| Total Code L - Deductions-portfolio (other) | L | 476,600 |
| Total other deductions | 12d | 476,600 |

Line 16d, Schedule K (1120S) - Distributions

| | |
|---------------------|--------|
| 1 Cash | 60,000 |
| Total distributions | 60,000 |

Line 17d, Sch K (1120S) - Other Items and Amounts

| | | |
|--|---|---------|
| N Code N - Section 453A(c) information | N | 200,000 |
|--|---|---------|

Line 6, Sch L (1120S) - Other Current Assets

| | | Beginning | End |
|-------------------------------|---|-----------|-----------|
| 1 Stock holdings | 1 | 1,334,690 | 2,300,000 |
| 2 Bond holdings | 2 | 645,000 | 645,000 |
| 3 Installment note receivable | 3 | 545,000 | 700,000 |
| 4 Total other current assets | 4 | 2,524,690 | 3,645,000 |

Line 3, Sch M-1 (1120S) - Expenses Recorded on Books not Included on Sch K

| | | |
|--|---|-------|
| 1 Wash sale deduction | 1 | 6,668 |
| 2 Total expenses on books not on Sch K | 2 | 6,668 |

Line 5, Sch M-1 (1120S) - Income Recorded on Books not Included on Sch K

| | | |
|---|---|--------|
| 1 Installment sale income (700,000-606,667) | 1 | 93,333 |
| 2 Total Income on books not on Sch K | 2 | 93,333 |

Capital gains and losses

Most property owned and used for personal purposes or investment are capital assets; for example, a personal house, furniture, car, stocks, and bonds are capital assets. A capital asset is any property except the following (among other items):

- Inventory
- Accounts or notes receivable for services rendered
 - in the ordinary course of a trade or business, or
 - for services rendered as an employee.
- Depreciable property used in a trade or business
- Real estate used in a trade or business
- Supplies regularly used in a trade or business

Corporations (including S corporations) and partnerships use Form 8949 to report the sale or exchange of a capital asset not reported on another form or schedule. Use Schedule D to figure the overall gain or loss from transactions reported on Form 8949 and to report a capital loss carryover from the previous tax year to the current tax year.

The tax treatment of a capital gain or loss depends on how long the asset is owned before it is sold or exchanged. If the holding period of a capital asset is one year or less, the gain or loss from its disposition is short term. If that is the case, it should be reported in Part I of Form 8949, on Schedule D, or both, as applicable. If the holding period of a capital asset is longer than one year, the gain or loss from its disposition is long term. If that is the case, then report it in Part II of Form 8949, on Schedule D, or both, as applicable. If a Form 1099B (or substitute statement) is received for a stock sale, box 2 may help determine whether the gain or loss is short term or long term.

The tax rates that apply to a net capital gain are generally lower than the tax rates that apply to other income. These lower rates are called the *maximum capital gains rates*. The term *net capital gain* means the amount by which net long-term capital gain for the year exceeds net short-term capital losses. The maximum tax rates for capital gains for individuals are 0%, 15%, 20%, 25%, and 28%, depending on the type of capital asset involved.

Individuals should use the Qualified Dividends and Capital Gain Worksheet in the Instructions for Form 1040 or the Schedule D Tax Worksheet in the Instructions for Schedule D (Form 1040) (whichever applies) to figure their tax if they have qualified dividends or net capital gain.

Capital gains and losses – Tax Cuts and Jobs Act

The Tax Cuts and Jobs Act of 2017 (TCJA) retained the previously adjusted tax brackets for 2018 for net long-term capital gains, but it substantially changed the tax rates for 2018.

The following chart summarizes the capital gains tax rates in effect for 2021 based on taxable income:

| Tax rate | Married filing jointly and surviving spouse | Head of household | Single | Married filing separately |
|----------|---|--------------------------------------|--------------------------------------|--------------------------------------|
| 0% | Up to \$80,800 | Up to \$54,100 | Up to \$40,400 | Up to \$40,400 |
| 15% | Over \$80,800 but not over \$501,600 | Over \$54,100 but not over \$473,750 | Over \$40,400 but not over \$445,850 | Over \$40,400 but not over \$250,800 |
| 20% | Over \$501,600 | Over \$473,750 | Over \$445,850 | Over \$250,800 |

Key review point

Sometimes adjustments need to be made to capital gains and losses as computed on Form 8949. Codes are provided for the different types of adjustments, and the codes should be entered in Form 8949 column (f). The adjustment amount itself should be entered in column (g). The following are some common codes, along with the type of adjustment to which they correspond:

- B – Form 1099-B (or substitute statement) with an incorrect basis in box 1e
- H – To show the exclusion from sale or exchange of a principal residence
- Q – Exclusion of part of the gain on the sale of qualified small business stock
- W – Nondeductible loss from a wash sale
- S – Loss from IRC Section 1244 stock in excess of the ordinary loss allowed
- C – Disposition of collectibles

Knowledge check

1. In 2021, Lisa, single, has a long-term capital gain of \$10,000, and a short-term capital loss of (\$6,000). Ignoring for the moment the 3.8% tax on net investment income, how much would her tax on her capital gains be if her regular taxable income is \$200,000?
 - a. \$0.
 - b. \$600.
 - c. \$1,000.
 - d. \$1,500.
2. Aside from Schedules K and K-1, capital gains and losses for an S corporation are reported on
 - a. Schedule B-1 and Form 4797.
 - b. Schedule D and Form 8949.
 - c. Forms 4562 and 8825.
 - d. Page 1 of Form 1120S.

Dividends

Dividends are the most common type of distribution from a corporation. They are usually paid out of earnings and profits and are generally taxed the same as ordinary income unless they are “qualified dividends” (see subsequent discussion). In general, any taxable dividend paid out of earnings and profits, including qualified dividends, will be shown in box 1a of Form 1099-DIV and box 5a of Schedule K-1.

Qualified dividends, on the other hand, are subject to the same 0%, 15%, or 20% maximum tax rate that applies to net capital gains. They should be shown in box 1b of Form 1099-DIV and box 5b of Schedule K-1.

To be considered a qualified dividend, all of the following requirements must be met:

- The dividends must have been paid by a U.S. corporation or a qualified foreign corporation.
- The dividends are not any of the following types of unqualified distributions (among others not listed):
 - Capital gain distributions
 - Dividends paid on deposits with mutual savings banks, cooperative banks, credit unions, U.S. building and loan associations, U.S. savings and loan associations, federal savings and loan associations, and similar financial institutions (Report these amounts as interest income.)
 - Dividends from a corporation that is a tax exempt organization or farmer’s cooperative during the corporation’s tax year in which the dividends were paid or during the corporation’s previous tax year
- The required holding period of the stock is met.

To be a qualified dividend, the stock on which the dividend is paid must be held for more than 60 days during the 121-day period that begins 60 days before the ex-dividend date. The ex-dividend date is the first date following the declaration of a dividend on which the buyer of a stock is not entitled to receive the next dividend payment. When counting the number of days, the stock was held, include the day of disposition but not the day of acquisition. In the case of preferred stock, the stock must have been held more than 90 days during the 181-day period that begins 90 days before the ex-dividend date if the dividends are due to periods totaling more than 366 days. If the preferred dividends are due to periods totaling less than 367 days, the 60-out-of-121-day holding period applies. A foreign corporation is a qualified foreign corporation if it meets any of the following conditions:

- The corporation is incorporated in a U.S. possession.
- The corporation is eligible for the benefits of a comprehensive income tax treaty with the United States that the Department of the Treasury determines is satisfactory for this purpose and that includes an exchange of information program.
- The corporation does not meet either of the preceding conditions, but the stock for which the dividend is paid is readily tradable on an established securities market in the United States.

As mentioned previously, the TCJA kept the prior breakpoints for the tax rates for net capital gains and also for qualified dividends. The breakpoints will be adjusted for inflation after 2018. See the chart in the previous section, “Capital gains and losses – Tax Cuts and Jobs Act,” regarding capital gains for the capital gain tax rate and taxable income break points.

Key review point

Dividends from corporations in the following countries might still be qualified even though they are not domestic corporations. Income tax treaties that the United States has with these countries satisfy the second of the preceding requirements.

| | | |
|----------------|-------------|---------------------|
| Australia | India | Philippines |
| Austria | Indonesia | Poland |
| Bangladesh | Ireland | Portugal |
| Barbados | Israel | Romania |
| Belgium | Italy | Russian Federation |
| Bulgaria | Jamaica | Slovak Republic |
| Canada | Japan | Slovenia |
| China | Kazakhstan | South Africa |
| Cyprus | South Korea | Spain |
| Czech Republic | Latvia | Sri Lanka |
| Denmark | Lithuania | Sweden |
| Egypt | Luxembourg | Switzerland |
| Estonia | Malta | Thailand |
| Finland | Mexico | Trinidad and Tobago |
| France | Morocco | Tunisia |
| Germany | Netherlands | Turkey |
| Greece | New Zealand | Ukraine |
| Hungary | Norway | United Kingdom |
| Iceland | Pakistan | Venezuela |

Review check: Were all the dividends correctly classified as ordinary and qualified?

Knowledge check

3. You are reviewing the 2021 tax return of a taxpayer who has \$10,000 of qualified dividend income and has taxable income of \$700,000 and is therefore in the 37% tax bracket. Ignoring for the moment the 3.8% tax on net investment income, what is the maximum tax on the dividend income?
- \$0.
 - \$1,000.
 - \$2,000.
 - \$3,700.

Collectibles

Gain or loss from the sale of collectibles is subject to a maximum tax rate of 28%. Collectibles gain or loss is the gain or loss from the sale or trade of a work of art, rug, antique, metal (such as bullion of gold, silver, and platinum), gem, stamp, coin, or alcoholic beverage, but in order to qualify, the previous items must have been held more than one year. Collectibles gain includes gain from the sale of an interest in a partnership, S corporation, or trust due to unrealized appreciation of collectibles held by the partnership, S corporation, or trust.

Knowledge check

4. Terry is a 10% shareholder of the Holder Corporation, an S corporation. In 2021, Holder sold some paintings it had held for several years for a gain of \$50,000. Terry is in the 39.6% tax bracket. Assuming this is Terry's only capital gain or loss, what will her tax on the collectibles gain be?
- \$19,800.
 - \$14,000.
 - \$1,980.
 - \$1,400.

Investment expenses

Before 2018, investment expenses (other than investment interest expenses) were generally treated by individuals as miscellaneous itemized deductions and were deductible only to the extent that they (along with the other miscellaneous itemized deductions) exceed 2% of AGI. IRC Section 67(c)(1) provides that if these deductions would not be allowed if incurred directly by an individual taxpayer, they will not be allowed as an indirect deduction through a pass-through entity (such as an S corporation). Although these expenses (in excess of 2% of AGI) were deductible in 2017, the TCJA makes them entirely nondeductible in 2018 and later years.

Note that Superior Investments has \$476,600 of these expenses on line 12d of Schedule K. The shareholders will have to determine if, in the long run, it might be possible or advisable to change their

investing and other practices such that they can treat the entire operations of the S corporation as a trade or business, making these expenses deductible as trade or business expenses. This might be preferable even though it would convert their long-term capital gains and qualified dividends to ordinary income. This nondeductibility could also make converting to a regular C corporation more attractive because the expenses would be deductible by a C corporation.

Investment interest expense

Interest paid on money borrowed to buy property held for investment is *investment interest* and is deductible. (It should be noted, however, that interest incurred to produce tax exempt income can't be deducted.) The deduction for investment interest expense is generally limited to net investment income. Net investment income is computed by subtracting investment expenses (other than interest expense) from investment income. Investment income generally includes gross income from property held for investment. Property held for investment includes property that produces interest, dividends, annuities, or royalties not derived in the ordinary course of a trade or business. It also includes property that produces gain or loss (not derived in the ordinary course of a trade or business) from the sale or trade of property producing these types of income or held for investment (other than an interest in a passive activity). Investment property also includes an interest in a trade or business activity in which the taxpayer did not materially participate (other than a passive activity).

Investment income does not include qualified dividends or net capital gain unless the taxpayer chooses to include them. Taxpayers can elect to include all or part of qualified dividends in investment income by completing Form 4952, line 4g, according to its instructions; however, if the election is made to include any qualified dividends in investment income, the amount of qualified dividends that are eligible for the lower capital gains tax rates must be reduced by the same amount.

Similar rules apply for net capital gains. Investment income generally does not include net capital gain from disposing of investment property (including capital gain distributions from mutual funds); however, an election to include all or part of net capital gain in investment income can be made by completing Form 4952, line 4g, according to its instructions. If this election is made, the amount of net capital gain that is eligible for the lower capital gains tax rates must be reduced by the same amount.

The amount of investment interest that is not deducted because of the net investment income limit can be carried over to the next tax year. The interest carried over is treated as investment interest paid or accrued in that next year.

To determine investment interest expense of a partner, S corporation shareholder, or beneficiary, combine the taxpayer's share of investment interest from a partnership, S corporation, estate, or trust with the taxpayer's other investment interest. The taxpayer's share of net investment income from a partnership, S corporation, estate, or trust should also be combined with the taxpayer's other net investment income for purposes of calculating the investment interest expense limitation.

Interest expense associated with a trade or business that is a passive activity to the taxpayer is not considered to be investment interest expense; however, interest expense associated with portfolio activity is considered to be investment interest expense, even if it is incurred by a partnership or S corporation in which the taxpayer does not materially participate.

Knowledge check

5. You are reviewing an individual return in which the individual had investment interest expense of \$10,000 and qualified dividend income of \$15,000. Of these amounts, \$1,000 and \$2,000, respectively, flowed through from an S corporation in which the individual was a shareholder. The individual makes no elections with respect to these transactions. How much investment interest expense would the individual be allowed to deduct?
- a. \$0.
 - b. \$1,000.
 - c. \$2,000.
 - d. \$10,000.

Excess net passive income tax

If an S corporation has accumulated earnings and profits at the close of its tax year, has passive investment income for the tax year that is in excess of 25% of gross receipts, and has excess net passive income, the corporation must pay a tax on the excess net passive income. The term *excess net passive income* can be expressed by the following formula:

$$\text{ENPI} = \text{NPI} \times \frac{\text{PII} - (.25 \times \text{GR})}{\text{PII}}$$

Where

ENPI = excess net passive income

NPI = net passive income

PII = passive investment income

GR = total gross receipts

The amount of the excess net passive income for any taxable year can't exceed the S corporation's taxable income for the taxable year. The actual tax rate is 21%, which is multiplied by the lesser of ENPI or corporate taxable income (computed as if the corporation were a regular C corporation) to arrive at the excess net passive income tax.

The term *net passive income* means passive investment income, reduced by the deductions that are directly connected with the production of the passive investment income. A deduction is directly connected with the production of passive investment income if it has a *proximate and primary*

relationship to the income. Expenses, depreciation, and similar items attributable solely to passive investment income qualify for deduction.

Passive investment income is made up of the gross receipts derived from royalties, rents, dividends, interest, and annuities. The term *passive investment income* does not include interest on any obligation acquired in the ordinary course of the corporation's trade or business from its sale of inventory.

For purposes of calculating gross receipts, in the case of dispositions of capital assets (other than stock and securities), gross receipts from the sales will be considered only to the extent of the net capital gains from these sales. In the case of sales or exchanges of stock or securities, gross receipts from the sales shall be taken into account only to the extent of the gains from these types of sales. The gross receipts on an installment sale of property other than capital assets or stock or securities are the installment payment received.

Review check: Was there accumulated earnings and profits for Superior? How do you know? Was there an excess net passive income tax? Why or why not?

Passive activity loss limitation

In general, IRC Section 469 limits the amount of losses, deductions, and credits that shareholders can claim from passive activities. The passive activity rules provide that losses and credits from passive activities can generally be applied only against income and tax (respectively) from passive activities. Therefore, passive losses can't be applied against income from *active* activities (salaries, wages, professional fees, or a business in which the shareholder materially participates) or against portfolio income.

The passive activity limitations don't apply to the S corporation. Instead, they apply to each shareholder's share of any income or loss and credit attributable to a passive activity. Because the treatment of each shareholder's share of corporate income or loss and credit depends on the nature of the activity that generated it, the corporation must report income or loss and credits separately for each activity.

If the S corporation has more than one activity, it must report information for each activity on an attachment to Schedules K and K-1. Generally, passive activities include

- activities that involve the conduct of a trade or business if the shareholder doesn't materially participate in the activity, and
- all rental activities, regardless of the shareholder's participation.

The level of each shareholder's participation in an activity must be determined by the shareholder.

Generally, portfolio income includes all gross income — other than income derived in the ordinary course of a trade or business — that is attributable to interest; dividends; royalties; income from a real estate investment trust, a regulated investment company, a real estate mortgage investment conduit, a common trust fund, a controlled foreign corporation, a qualified electing fund, or a cooperative; income from the disposition of property that produces income of a type defined as portfolio income; and income

from the disposition of property held for investment. Solely for purposes of the preceding paragraph, gross income derived in the ordinary course of a trade or business includes (and portfolio income, therefore, doesn't include) the following types of income:

- Interest income on loans and investments made in the ordinary course of a trade or business of lending money
- Interest on accounts receivable arising from the performance of services or the sale of property in the ordinary course of a trade or business of performing such services or selling such property, but only if credit is customarily offered to customers of the business
- Income from investments made in the ordinary course of a trade or business of furnishing insurance or annuity contracts or reinsuring risks underwritten by insurance companies
- Income or gain derived in the ordinary course of an activity of trading or dealing in any property if such activity constitutes a trade or business (unless the dealer held the property for investment at any time before such income or gain is recognized)

Report passive income and related deductions on the appropriate lines of Schedule K rather than on page 1 of Form 1120S.

Key review point

If the S corporation's activities do not rise to the level of a trade or business, then some of the expenses associated with the activity, such as office expenses and adviser expenses, would be treated as investment expenses, and would not be deductible.

Wash sales

A taxpayer can't deduct losses from sales or trades of stock or securities in a *wash sale* unless the loss was incurred in the ordinary course of his or her business as a dealer in stock or securities. A wash sale occurs when the taxpayer sells or trades stock or securities at a loss and within 30 days before or after the sale the taxpayer

- buys substantially identical stock or securities,
- acquires substantially identical stock or securities in a fully taxable trade, or
- acquires a contract or option to buy substantially identical stock or securities.

If a taxpayer sells stock and his or her spouse or a corporation, he or she controls buys substantially identical stock, the result is a wash sale (*control* is not specifically defined in this case). If a loss was disallowed because of the wash sale rules, the disallowed loss should generally be added to the cost of the new stock or securities. The sum is the basis in the new stock or securities. This adjustment postpones the loss deduction until the disposition of the new stock or securities. The holding period for the new stock or securities includes the holding period of the stock or securities sold.



Example 2-1

Amy buys 100 shares of X stock for \$1,000. She sells these shares for \$750 and, within 30 days of the sale, buys 100 shares of the same stock for \$800. Because she bought substantially identical stock, she cannot deduct the loss of \$250 on the sale. She will, however, add the disallowed loss of \$250 to the cost of the new stock, \$800, to obtain her basis in the new stock, which is \$1,050.

The wash sale rules apply to losses from sales or trades of contracts and options to acquire or sell stock or securities. They do not apply to losses from sales or trades of commodity futures contracts and foreign currencies. Losses from the sale, exchange, or termination of a securities futures contract to sell generally are treated in the same manner as losses from the closing of a short sale. The wash sale rules apply if a taxpayer sells common stock at a loss and, at the same time, buys warrants for common stock of the same corporation. But if the taxpayer sells warrants at a loss and, at the same time, buys common stock in the same corporation, the wash sale rules apply only if the warrants and stock are considered substantially identical.

In determining whether stock or securities are substantially identical, all the facts and circumstances in each case must be considered. Ordinarily, stocks or securities of one corporation are not considered substantially identical to stocks or securities of another corporation; however, they may be substantially identical in some cases. For example, in a reorganization, the stocks and securities of the predecessor and successor corporations may be substantially identical. Similarly, bonds or preferred stock of a corporation are not ordinarily considered substantially identical to the common stock of the same corporation.

If the number of shares of substantially identical stock or securities bought within 30 days before or after the sale is either more or less than the number of shares sold, the particular shares to which the wash sale rules apply must be determined. This is done by matching the shares bought with an equal number of the shares sold. Match the shares bought in the same order that they were bought, beginning with the first shares bought. The shares or securities so matched are subject to the wash sale rules.



Example 2-2

Dan bought 100 shares of M stock on September 25, 2020. On February 5, 2021, he sold those shares at a \$1,000 loss. On February 10, 2021, and February 11, 2021, he bought 25 shares of substantially identical stock. He can't deduct the entire \$1,000 loss. He must add one-fourth of the disallowed loss (\$250) to the basis of the 25 shares bought on February 10. Another one-fourth (\$250) of the loss is added to the basis of the shares bought on February 11. The other (\$500) of loss is deductible.

A wash sale transaction should be reported in Part I or Part II of Form 8949, with the appropriate box checked. Complete all columns. Enter "W" in column (f). Enter as a positive number in column (g) the amount of the loss not allowed.

Installment sales

An installment sale is a sale of property where at least one payment is received after the tax year of the sale. The rules for installment sales do not apply if the installment method is elected out of, or the transaction is one for which the installment method may not apply. The installment sales method can't be used for the following:

- Sale of inventory — The regular sale of inventory of personal property does not qualify as an installment sale.
- Dealer sales — Sales of personal property by a person who regularly sells or otherwise disposes of the same type of personal property on the installment plan are not installment sales. This rule also applies to real property held for sale to customers in the ordinary course of a trade or business.
- Stock or securities — The installment method can't be used to report gain from the sale of stock or securities traded on an established securities market. The entire gain must be reported on the sale in the year in which the trade date falls.
- Installment obligation — The buyer's obligation to make future payments can be in the form of a deed of trust, note, land contract, mortgage, or other evidence of the buyer's debt.

If a sale results in a loss, the installment method can't be used. If the loss is on an installment sale of business or investment property, the loss can be deducted only in the tax year of sale. If an installment sale calls for payments in a later year, and the sales contract provides for little or no interest, unstated interest might have to be recognized, even if there is a loss.

Each payment on an installment sale usually consists of the following three parts:

- Interest income
- Return of the adjusted basis in the property
- Gain on the sale

For each payment that is received, both the interest and the gain on the sale must be included in income. The return of the basis in the property is nontaxable.

Gross profit is the total gain reported on the installment method. To figure the gross profit, subtract the adjusted basis for installment sale purposes from the selling price. If the property sold was a principal residence, subtract from the gross profit any gain excluded. The selling price is the total cost of the property to the buyer and includes any of the following:

- Any money to be received by the seller
- The FMV of any property to be received by the seller
- Any existing mortgage or other debt the buyer pays, assumes, or takes
- Any selling expenses the buyer pays

The adjusted basis for installment sale purposes is the total of the following three items:

- Adjusted basis (generally its cost, less depreciation and casualty losses)
- Selling expenses
- Depreciation recapture

A certain percentage of each payment (after subtracting interest) received by the seller is reported as installment sale income. This percentage is called the *gross profit percentage* and is figured by dividing the gross profit from the sale by the contract price. The gross profit percentage generally remains the same for each payment the seller receives.

The contract price equals

- the selling price, minus
- the mortgages, debts, and other liabilities assumed or taken by the buyer, plus
- the amount by which the mortgages, debts, and other liabilities assumed or taken by the buyer exceed the adjusted basis of the seller for installment sale purposes.



Example 2-3

The Dillon Corporation, an S corporation, sells property (cost = \$32,000) for a sales price of \$80,000. Selling expenses are \$4,000. Part of the sales price is the assumption by the buyer of a liability of \$15,000. The contract price is therefore \$65,000, and the gross profit is \$44,000 ($\$80,000 - \$32,000 - \$4,000$). The gross profit percentage is 67.692% ($\$44,000 \div \$65,000$). After subtracting interest, Dillon reports 67.7% of each payment, including the down payment, as installment sale income from the sale for the tax year the corporation receives the payment. The remainder (balance) of each payment is the tax-free return of its adjusted basis. If Dillon receives \$25,000 the first year and \$40,000 the next, its installment sale income in the first year will be \$16,923 ($\$25,000 \times 67.692\%$), and in the second year will be \$27,077 ($\$40,000 \times 67.692\%$).

Review check: Was the installment sale gain recognized computed correctly?



Chapter 3

Case Three: AG Air, Inc.

Learning objectives

- Determine the tax consequences when a C corporation elects S status.
- Identify and properly report cost recovery deductions on Form 1120S, *U.S. Income Tax Return for an S Corporation*, and the associated Schedule K-1s issued to shareholders.
- Determine the tax consequences when a newly converted S corporation sells appreciated property it acquired while operating as a C corporation.
- Recognize when a distribution from a newly converted S corporation may be taxable to shareholders as dividend income.
- Identify elements of an S corporation's operations that will pass through to shareholders for use in determining their eligibility for the qualified business income (QBI) deduction.

Facts

Ag Air, Inc. was formed on July 1, 2014, by the following three investors:

| Name | ID number |
|---------------------|-------------|
| Erin Moore | 456-22-1120 |
| RR 2, Box 21 | |
| Abernathy, TX 79311 | |
| Chris Johnson | 522-44-3312 |
| RR 3, Box 122 | |
| Lubbock, TX 79404 | |
| Pat Dune | 433-64-6114 |
| RR 6, Box 21 | |
| Lubbock, TX 79414 | |

Ag Air's federal identification number is 75-4343556, and its address is RR 2, Lubbock, TX 79406. The company manufactures airplanes for use in agricultural operations, primarily crop dusting. Ag Air, Inc. operated as a regular corporation from 2014–2020, but elected to be treated as an S corporation as of January 1, 2021. The company's trial balance as of December 31, 2021, was as follows:

| | Beginning of the year | | End of the year | |
|-------------------------------------|-----------------------|-----------|-----------------|-----------|
| Cash | 97,808 | | \$106,600 | |
| Accounts receivable (no allowance) | | | 146,591 | |
| Inventories | 1,225,000 | | 1,470,000 | |
| Equipment | 2,039,800 | | 2,954,800 | |
| Accumulated depreciation, equipment | | 2,026,548 | | 2,317,628 |
| Buildings | 2,338,725 | | 2,338,725 | |
| Accumulated depreciation, building | | 389,785 | | 449,752 |
| Land | 600,000 | | 600,000 | |

| | Beginning of the year | | End of the year | |
|--|-----------------------|-----------|-----------------|------------|
| | | | | |
| Accounts payable | | | | 319,500 |
| Other current liabilities | | | | 205,880 |
| Notes payable, shareholders | | | | 250,000 |
| Mortgage payable, building | | 2,050,000 | | 2,050,000 |
| Capital stock | | 100,000 | | 100,000 |
| Additional paid-in capital | | 400,000 | | 900,000 |
| Retained earnings | | 1,335,000 | | 975,000 |
| Sales | | | | 7,290,348 |
| Gain on disposal of equipment | | | | 18,500 |
| Cost of goods sold | | | 4,487,500 | |
| Salaries | | | 840,000 | |
| Pension benefits | | | 85,000 | |
| Selling, general, and administrative expense | | | 339,656 | |
| Depreciation expense | | | 1,229,836 | |
| Interest expense | | | 106,250 | |
| Accounting fees | | | 60,000 | |
| Insurance | | | 48,000 | |
| Legal and professional fees | | | 20,650 | |
| Travel | | | 32,000 | |
| Utilities | | | 11,000 | |
| | ----- | ----- | ----- | ----- |
| Totals | 6,301,333 | 6,301,333 | 14,876,608 | 14,876,608 |

Note that the corporation depreciates its assets for book using tax depreciation methods. As of the effective date of the S corporation election, Ag Air owned inventory with an aggregate tax basis of \$1,225,000 and a fair market value of \$2,050,000 and other assets (land, buildings, machinery, and

equipment) with an aggregate tax basis of \$1,962,192 and an aggregate FMV of \$2,565,000. Its earnings and profits (E&P) were equal to its retained earnings of \$1,335,000.

The three shareholders are all officers in the corporation. Each takes a salary of \$10,000 per month. In addition, Ag Air makes a quarterly distribution in the amount of \$90,000, which is divided among the shareholders in proportion to their stock ownership (40:30:30).

All of Ag Air's manufacturing activities take place in Lubbock, Texas, and its net operating income is eligible for the QBI deduction under IRC Section 199A. A review of the working papers indicates that during 2021, the company acquired \$915,000 of new technology-enhanced equipment. It used a loan from Erin Moore, its president and majority shareholder, to help with this acquisition. It sold the equipment displaced by this new purchase to a used equipment dealer for \$18,500. The displaced equipment had been fully expensed under IRC Section 179.

The unfiled 2021 tax return for Ag Air is reprinted on the following pages for your review. In reviewing the return, you should pay careful attention to the following items, which are discussed in more depth throughout the rest of this chapter:

- How did the S election, effective January 1, 2021, affect the balance sheets on the tax return (Schedule L)?
 - Which items on the beginning balance sheet are most likely to trigger the built-in gains tax in 2021?
 - Is that tax properly reported on this return?
 - If so, where?
 - How did the built-in gains tax affect this year's return?
 - How will the realization of built-in gains tax this year affect future years' returns?
- We know that the company replaced equipment this year. Did we claim the maximum allowable cost recovery deductions with respect to the acquisition?
- Associated with the acquisition, the company sold used equipment with a zero basis. Is the resulting gain properly reported on the Form 1120S?
- Reporting income and loss of an S corporation is complex because certain items are reported on page 1 of the Form 1120S, and others are reported on Schedule K and the shareholders' K-1s. Have we properly reported all of the S corporation's items of income, deduction, gain, and loss?
- The company made quarterly distributions to its shareholders. It had E&P from C corporation years before making the S election.
 - Will any portion of these distributions be deemed to come from prior years' E&P?
 - How will you know?
 - How should this be reported to shareholders?
- How will the distributions affect the shareholders' tax bases
 - in their Ag Air stock, and
 - in their debt?
- Ag Air, Inc. is a domestic manufacturer of agricultural use airplanes. As an S corporation, can it claim a QBI deduction?

U.S. Income Tax Return for an S Corporation

Department of the Treasury
Internal Revenue Service

▶ **Do not file this form unless the corporation has filed or is attaching Form 2553 to elect to be an S corporation.**
▶ **Go to www.irs.gov/Form1120S for instructions and the latest information.**

2021

For calendar year 2021 or tax year beginning _____, 2021, ending _____, 20

| | | | |
|---|----------------------|---|--|
| A S election effective date 01/01/2021 | TYPE OR PRINT | Name Ag Air, Inc | D Employer identification number 75-4343556 |
| B Business activity code number (see instructions) 333100 | | Number, street, and room or suite no. If a P.O. box, see instructions. RR 2 | E Date incorporated 01/01/2014 |
| C Check if Sch. M-3 attached <input type="checkbox"/> | | City or town, state or province, country, and ZIP or foreign postal code Lubbock, TX 79406 | F Total assets (see instructions) \$ 4,849,336 |

G Is the corporation electing to be an S corporation beginning with this tax year? See instructions. Yes No

H Check if: (1) Final return (2) Name change (3) Address change (4) Amended return (5) S election termination

I Enter the number of shareholders who were shareholders during any part of the tax year ▶ _____

J Check if corporation: (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 21. See the instructions for more information.

| | | | | |
|---|---|------------|-----------|-----------|
| Income | 1a Gross receipts or sales | 1a | 7,290,348 | |
| | b Returns and allowances | 1b | | |
| | c Balance. Subtract line 1b from line 1a | 1c | | 7,290,348 |
| | 2 Cost of goods sold (attach Form 1125-A) | 2 | | 4,487,500 |
| | 3 Gross profit. Subtract line 2 from line 1c | 3 | | 2,802,848 |
| | 4 Net gain (loss) from Form 4797, line 17 (attach Form 4797) | 4 | | |
| 5 Other income (loss) (see instructions—attach statement) | 5 | | | |
| 6 Total income (loss). Add lines 3 through 5 ▶ | 6 | | 2,802,848 | |
| Deductions (see instructions for limitations) | 7 Compensation of officers (see instructions—attach Form 1125-E) | 7 | | 360,000 |
| | 8 Salaries and wages (less employment credits) | 8 | | 480,000 |
| | 9 Repairs and maintenance | 9 | | |
| | 10 Bad debts | 10 | | |
| | 11 Rents | 11 | | 104,040 |
| | 12 Taxes and licenses | 12 | | 172,012 |
| | 13 Interest (see instructions) | 13 | | 106,250 |
| | 14 Depreciation not claimed on Form 1125-A or elsewhere on return (attach Form 4562) | 14 | | 314,836 |
| | 15 Depletion (Do not deduct oil and gas depletion.) | 15 | | |
| | 16 Advertising | 16 | | 70,000 |
| | 17 Pension, profit-sharing, etc., plans | 17 | | 85,000 |
| 18 Employee benefit programs | 18 | | | |
| 19 Other deductions (attach statement) | 19 | | 171,650 | |
| 20 Total deductions. Add lines 7 through 19 ▶ | 20 | | 1,863,788 | |
| 21 Ordinary business income (loss). Subtract line 20 from line 6 ▶ | 21 | | 939,060 | |
| Tax and Payments | 22a Excess net passive income or LIFO recapture tax (see instructions) | 22a | | |
| | b Tax from Schedule D (Form 1120-S) | 22b | 6,396 | |
| | c Add lines 22a and 22b (see instructions for additional taxes) | 22c | | 6,396 |
| | 23a 2021 estimated tax payments and 2020 overpayment credited to 2021 | 23a | | |
| | b Tax deposited with Form 7004 | 23b | | |
| | c Credit for federal tax paid on fuels (attach Form 4136) | 23c | | |
| | d Add lines 23a through 23c | 23d | | |
| 24 Estimated tax penalty (see instructions). Check if Form 2220 is attached ▶ <input type="checkbox"/> | 24 | | | |
| 25 Amount owed. If line 23d is smaller than the total of lines 22c and 24, enter amount owed | 25 | | 6,396 | |
| 26 Overpayment. If line 23d is larger than the total of lines 22c and 24, enter amount overpaid | 26 | | | |
| 27 Enter amount from line 26: Credited to 2022 estimated tax ▶ Refunded ▶ | 27 | | | |

Sign Here Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

| | | | | | | |
|-------------------------------|----------------------------|----------------------|-------|---|-------|---|
| Signature of officer | _____ | Date | _____ | President | Title | May the IRS discuss this return with the preparer shown below? See instructions. <input type="checkbox"/> Yes <input type="checkbox"/> No |
| | _____ | | _____ | | | |
| Paid Preparer Use Only | Print/Type preparer's name | Preparer's signature | Date | Check <input type="checkbox"/> if self-employed | PTIN | |
| | Firm's name ▶ | | | Firm's EIN ▶ | | |
| | Firm's address ▶ | | | Phone no. | | |

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

| Yes | No |
|-----|----|
| | |
| | |
| | ✓ |
| | |
| | ✓ |

| (i) Name of Corporation | (ii) Employer Identification Number (if any) | (iii) Country of Incorporation | (iv) Percentage of Stock Owned | (v) If Percentage in (iv) Is 100%, Enter the Date (if 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

| Yes | No |
|-----|----|
| | |
| | ✓ |

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

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

(i) Total shares of restricted stock ▶ _____

(ii) Total shares of non-restricted stock ▶ _____

| Yes | No |
|-----|----|
| | ✓ |

- b** At the end of the tax year, did the corporation have any outstanding stock options, warrants, or similar instruments?
 If "Yes," complete lines (i) and (ii) below.

(i) Total shares of stock outstanding at the end of the tax year ▶ _____

(ii) Total shares of stock outstanding if all instruments were executed ▶ _____

| Yes | No |
|-----|----|
| | ✓ |

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

| Yes | No |
|-----|----|
| | ✓ |

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

| Yes | No |
|-----|----|
| | |

- 8** If the corporation **(a)** was a C corporation before it elected to be an S corporation **or** the corporation acquired an asset with a basis determined by reference to the basis of the asset (or the basis of any other property) in the hands of a C corporation, **and (b)** has net unrealized built-in gain in excess of the net recognized built-in gain from prior years, enter the net unrealized built-in gain reduced by net recognized built-in gain from prior years. See instructions ▶ \$ 1,427,808

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

| Yes | No |
|-----|----|
| | ✓ |

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

- a** The corporation owns a pass-through entity with current, or prior year carryover, excess business interest expense.
- b** The corporation's aggregate average annual gross receipts (determined under section 448(c)) for the 3 tax years preceding the current tax year are more than \$26 million and the corporation has business interest expense.
- c** The corporation is a tax shelter and the corporation has business interest expense.
 If "Yes," complete and attach Form 8990.

| Yes | No |
|-----|----|
| | ✓ |

- 11** Does the corporation satisfy **both** of the following conditions?

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

| Yes | No |
|-----|----|
| | ✓ |

| Schedule B Other Information (see instructions) (continued) | | Yes | No |
|--|---|-----|----|
| 12 | During the tax year, did the corporation have any non-shareholder debt that was canceled, was forgiven, or had the terms modified so as to reduce the principal amount of the debt? | | ✓ |
| | If "Yes," enter the amount of principal reduction ▶ \$ | | |
| 13 | During the tax year, was a qualified subchapter S subsidiary election terminated or revoked? If "Yes," see instructions | | ✓ |
| 14a | Did the corporation make any payments in 2021 that would require it to file Form(s) 1099? | | ✓ |
| b | If "Yes," did the corporation file or will it file required Form(s) 1099? | | ✓ |
| 15 | Is the corporation attaching Form 8996 to certify as a Qualified Opportunity Fund? | | ✓ |
| | If "Yes," enter the amount from Form 8996, line 15 ▶ \$ | | |

| Schedule K Shareholders' Pro Rata Share Items | | Total amount | |
|---|---|--------------|---------|
| Income (Loss) | 1 Ordinary business income (loss) (page 1, line 21) | 1 | 939,060 |
| | 2 Net rental real estate income (loss) (attach Form 8825) | 2 | |
| | 3a Other gross rental income (loss) 3a | | |
| | b Expenses from other rental activities (attach statement) 3b | | |
| | c Other net rental income (loss). Subtract line 3b from line 3a 3c | | |
| | 4 Interest income 4 | | |
| | 5 Dividends: a Ordinary dividends 5a | | |
| | b Qualified dividends 5b | | |
| | 6 Royalties 6 | | |
| | 7 Net short-term capital gain (loss) (attach Schedule D (Form 1120-S)) 7 | | 0 |
| 8a Net long-term capital gain (loss) (attach Schedule D (Form 1120-S)) 8a | | 0 | |
| b Collectibles (28%) gain (loss) 8b | | | |
| c Unrecaptured section 1250 gain (attach statement) 8c | | | |
| 9 Net section 1231 gain (loss) (attach Form 4797) 9 | | | |
| 10 Other income (loss) (see instructions) Type ▶ 10 | | | |
| Deductions | 11 Section 179 deduction (attach Form 4562) 11 | | 915,000 |
| | 12a Charitable contributions 12a | | |
| | b Investment interest expense 12b | | |
| | c Section 59(e)(2) expenditures Type ▶ 12c | | |
| d Other deductions (see instructions) Type ▶ 12d | | | |
| Credits | 13a Low-income housing credit (section 42(j)(5)) 13a | | |
| | b Low-income housing credit (other) 13b | | |
| | c Qualified rehabilitation expenditures (rental real estate) (attach Form 3468, if applicable) 13c | | |
| | d Other rental real estate credits (see instructions) Type ▶ 13d | | |
| | e Other rental credits (see instructions) Type ▶ 13e | | |
| | f Biofuel producer credit (attach Form 6478) 13f | | |
| | g Other credits (see instructions) Type ▶ 13g | | |
| International Transactions | 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"/> | | |
| Alternative Minimum Tax (AMT) Items | 15a Post-1986 depreciation adjustment 15a | | 5,015 |
| | b Adjusted gain or loss 15b | | |
| | c Depletion (other than oil and gas) 15c | | |
| | d Oil, gas, and geothermal properties—gross income 15d | | |
| | e Oil, gas, and geothermal properties—deductions 15e | | |
| | f Other AMT items (attach statement) 15f | | |
| Items Affecting Shareholder Basis | 16a Tax-exempt interest income 16a | | |
| | b Other tax-exempt income 16b | | |
| | c Nondeductible expenses 16c | | |
| | d Distributions (attach statement if required) (see instructions) 16d | | 360,000 |
| | e Repayment of loans from shareholders 16e | | |
| | f Foreign taxes paid or accrued 16f | | |

| Schedule K Shareholders' Pro Rata Share Items (continued) | | Total amount |
|--|--|---------------------|
| Other Information | 17a Investment income | 17a |
| | b Investment expenses | 17b |
| | c Dividend distributions paid from accumulated earnings and profits | 17c 0 |
| | d Other items and amounts (attach statement) | |
| Reconciliation | 18 Income (loss) reconciliation. Combine the amounts on lines 1 through 10 in the far right column. From the result, subtract the sum of the amounts on lines 11 through 12d and 16f | 18 24,000 |

| Schedule L Balance Sheets per Books | | Beginning of tax year | | End of tax year | |
|---|--|-----------------------|-----------|-----------------|-----------|
| | | (a) | (b) | (c) | (d) |
| Assets | | | | | |
| 1 | Cash | | 97,808 | | 106,600 |
| 2a | Trade notes and accounts receivable | | | 146,591 | |
| b | Less allowance for bad debts | () | | (0) | 146,591 |
| 3 | Inventories | | 1,225,000 | | 1,470,000 |
| 4 | U.S. government obligations | | | | |
| 5 | Tax-exempt securities (see instructions) | | | | |
| 6 | Other current assets (attach statement) | | | | |
| 7 | Loans to shareholders | | | | |
| 8 | Mortgage and real estate loans | | | | |
| 9 | Other investments (attach statement) | | | | |
| 10a | Buildings and other depreciable assets | 4,378,525 | | 5,293,525 | |
| b | Less accumulated depreciation | (2,416,333) | 1,962,192 | (2,767,380) | 2,526,145 |
| 11a | Depletable assets | | | | |
| b | Less accumulated depletion | () | | () | |
| 12 | Land (net of any amortization) | | 600,000 | | 600,000 |
| 13a | Intangible assets (amortizable only) | | | | |
| b | Less accumulated amortization | () | | () | |
| 14 | Other assets (attach statement) | | | | |
| 15 | Total assets | | 3,885,000 | | 4,849,336 |
| Liabilities and Shareholders' Equity | | | | | |
| 16 | Accounts payable | | | | 319,500 |
| 17 | Mortgages, notes, bonds payable in less than 1 year | | | | |
| 18 | Other current liabilities (attach statement) | | | | 6,396 |
| 19 | Loans from shareholders | | | | 250,000 |
| 20 | Mortgages, notes, bonds payable in 1 year or more | | 2,050,000 | | 2,050,000 |
| 21 | Other liabilities (attach statement) | | | | 205,880 |
| 22 | Capital stock | | 100,000 | | 100,000 |
| 23 | Additional paid-in capital | | 400,000 | | 900,000 |
| 24 | Retained earnings | | 1,335,000 | | 1,017,560 |
| 25 | Adjustments to shareholders' equity (attach statement) | | | | |
| 26 | Less cost of treasury stock | () | | () | |
| 27 | Total liabilities and shareholders' equity | | 3,885,000 | | 4,849,336 |

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

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

| | | | | | |
|----------|--|--------|----------|---|--------|
| 1 | Net income (loss) per books | 42,560 | 5 | Income recorded on books this year not included on Schedule K, lines 1 through 10 (itemize): | |
| 2 | Income included on Schedule K, lines 1, 2, 3c, 4, 5a, 6, 7, 8a, 9, and 10, not recorded on books this year (itemize) _____ | | a | Tax-exempt interest \$ _____ | |
| 3 | Expenses recorded on books this year not included on Schedule K, lines 1 through 12 and 16f (itemize): | | | <u>Gain/(loss) on sale of Sec. 179 property</u> | 18,500 |
| a | Depreciation \$ _____ | | 6 | Deductions included on Schedule K, lines 1 through 12 and 16f, not charged against book income this year (itemize): | |
| b | Travel and entertainment \$ _____ | | a | Depreciation \$ _____ | |
| 4 | Add lines 1 through 3 | 42,560 | 7 | Add lines 5 and 6 | 18,500 |
| | | | 8 | Income (loss) (Schedule K, line 18). Subtract line 7 from line 4 | 24,060 |

Schedule M-2 Analysis of Accumulated Adjustments Account, Shareholders' Undistributed Taxable Income Previously Taxed, Accumulated Earnings and Profits, and Other Adjustments Account
(see instructions)

| | (a) Accumulated adjustments account | (b) Shareholders' undistributed taxable income previously taxed | (c) Accumulated earnings and profits | (d) Other adjustments account |
|--|-------------------------------------|---|--------------------------------------|-------------------------------|
| 1 Balance at beginning of tax year | 1,335,000 | | | |
| 2 Ordinary income from page 1, line 21 | 939,060 | | | |
| 3 Other additions | 18,500 | | | |
| 4 Loss from page 1, line 21 | () | | | |
| 5 Other reductions | (915,000) | | | () |
| 6 Combine lines 1 through 5 | 1,337,560 | | | |
| 7 Distributions | 360,000 | | | |
| 8 Balance at end of tax year. Subtract line 7 from line 6 | 1,017,560 | | | |

Cost of Goods Sold

(Rev. November 2018)
Department of the Treasury
Internal Revenue Service

▶ **Attach to Form 1120, 1120-C, 1120-F, 1120S, or 1065.**
▶ **Go to www.irs.gov/Form1125A for the latest information.**

OMB No. 1545-0123

| | | |
|----------------------------|--|---|
| Name Ag Air, Inc | | Employer identification number 75-4343556 |
| 1 | Inventory at beginning of year | 1 0 |
| 2 | Purchases | 2 4,957,500 |
| 3 | Cost of labor | 3 1,000,000 |
| 4 | Additional section 263A costs (attach schedule) | 4 |
| 5 | Other costs (attach schedule) | 5 |
| 6 | Total. Add lines 1 through 5 | 6 5,957,500 |
| 7 | Inventory at end of year | 7 1,470,000 |
| 8 | Cost of goods sold. 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 | 8 4,487,500 |
| 9a | 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 | Check if there was a writedown of subnormal goods | <input type="checkbox"/> |
| c | Check if the LIFO inventory method was adopted this tax year for any goods (if checked, attach Form 970) | <input type="checkbox"/> |
| d | If the LIFO inventory method was used for this tax year, enter amount of closing inventory computed under LIFO | 9d |
| e | 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 |
| f | 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 |

Section references are to the Internal Revenue Code unless otherwise noted.

What's New

Small business taxpayers. For tax years beginning after December 31, 2017, the following apply.

- A small business taxpayer (defined below), may use a method of accounting for inventories that either: (1) treats inventories as nonincidental materials and supplies, or (2) conforms to the taxpayer's financial accounting treatment of inventories.
- A small business taxpayer is not required to capitalize costs under section 263A.

General Instructions

Purpose of Form

Use Form 1125-A to calculate and deduct cost of goods sold for certain entities.

Who Must File

Filers of Form 1120, 1120-C, 1120-F, 1120S, or 1065, must complete and attach Form 1125-A if the applicable entity reports a deduction for cost of goods sold.

Inventories

Generally, inventories are required at the beginning and end of each tax year if the production, purchase, or sale of

merchandise is an income-producing factor. See Regulations section 1.471-1. If inventories are required, you generally must use an accrual method of accounting for sales and purchases of inventory items.

Exception for certain taxpayers. A small business taxpayer (defined below), can adopt or change its accounting method to account for inventories in the same manner as material and supplies that are non-incidental, or conform to its treatment of inventories in an applicable financial statement (as defined in section 451(b)(3)), or if it does not have an applicable financial statement, the method of accounting used in its books and records prepared in accordance with its accounting procedures. See section 471(c)(3).

A small business taxpayer claiming exemption from the requirement to keep inventories is changing its method of accounting for purposes of section 481. For additional guidance on this method of accounting, see Pub. 538, Accounting Periods and Methods. For guidance on changing to this method of accounting, see Form 3115 and the Instructions for Form 3115.

Small business taxpayer. A small business taxpayer is a taxpayer that (a) has average annual gross receipts of \$25 million or less (indexed for inflation) for the 3 prior tax years, and (b) is not a tax shelter (as defined in section 448(d)(3)). See Pub. 538.

Uniform capitalization rules. The uniform capitalization rules of section 263A generally require you to capitalize, or include in inventory, certain costs incurred in connection with the following.

- The production of real property and tangible personal property held in inventory or held for sale in the ordinary course of business.
- Real property or personal property (tangible and intangible) acquired for resale.
- The production of real property and tangible personal property for use in its trade or business or in an activity engaged in for profit.

A small business taxpayer (defined above) is not required to capitalize costs under section 263A. See section 263A(i).

See the discussion on section 263A uniform capitalization rules in the instructions for your tax return before completing Form 1125-A. Also see Regulations sections 1.263A-1 through 1.263A-3. See Regulations section 1.263A-4 for rules for property produced in a farming business.

671121

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

Department of the Treasury
Internal Revenue Service

2021

For calendar year 2021, or tax year

beginning / / 2021 ending / /

Final K-1

Amended K-1

OMB No. 1545-0123

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

▶ See separate instructions.

| Part I Information About the Corporation | | Part III Shareholder's Share of Current Year Income, Deductions, Credits, and Other Items | |
|---|--|--|--|
| A Corporation's employer identification number 75-4343556 | | 1 Ordinary business income (loss) 375,624 | 13 Credits |
| B Corporation's name, address, city, state, and ZIP code Ag Air, Inc RR 2 Lubbock, TX 79406 | | 2 Net rental real estate income (loss) | |
| C IRS Center where corporation filed return Ogden, UT 84201-0013 | | 3 Other net rental income (loss) | |
| D Corporation's total number of shares Beginning of tax year 10,000 End of tax year 10,000 | | 4 Interest income | |
| | | 5a Ordinary dividends | |
| | | 5b Qualified dividends | 14 Schedule K-3 is attached if checked <input type="checkbox"/> |
| | | 6 Royalties | 15 Alternative minimum tax (AMT) items 2,005 |
| | | 7 Net short-term capital gain (loss) | |
| | | 8a Net long-term capital gain (loss) | |
| | | 8b Collectibles (28%) gain (loss) | |
| | | 8c Unrecaptured section 1250 gain | |
| | | 9 Net section 1231 gain (loss) | 16 Items affecting shareholder basis 144,000 |
| | | 10 Other income (loss) | |
| | | | 17 Other information K* See Statement |
| E Shareholder's identifying number 456-22-1120 | | 11 Section 179 deduction 366,000 | V* See Statement |
| F Shareholder's name, address, city, state, and ZIP code Erin Moore R 2, Box 21 Lubbock, TX 79311 | | 12 Other deductions | |
| G Current year allocation percentage 40.00 % | | | |
| H Shareholder's number of shares Beginning of tax year 4,000 End of tax year 4,000 | | | |
| I Loans from shareholder Beginning of tax year \$ 0 End of tax year \$ 0 | | | |
| For IRS Use Only | | 18 <input type="checkbox"/> More than one activity for at-risk purposes* | |
| | | 19 <input type="checkbox"/> More than one activity for passive activity purposes* | |
| | | * See attached statement for additional information. | |

Additional information from your Schedule K-1:Shareholder's Share of Income, Deductions, Credits, etc. (Erin Moore)

Schedule K-1:Shareholder's Share of Income, Deductions, Credits, etc. (Erin Moore)

Supplemental Information

Continuation Statement

| Description | Amount |
|---|--------|
| BOX 17, CODE K: | |
| SEE ATTACHED SECTION 179 DISPOSITION REPORT | |

| | |
|---|--------------------------------------|
| Name as Shown on Return Ag Air, Inc | Identifying No. 75-4343556 |
|---|--------------------------------------|

Shareholder's Disposition Report for all Assets with Section 179 Expense Taken

| Shareholder's Name Erin Moore | | | | Identifying No. 456-22-1120 | | |
|---|--|--------------------------------|--|--|--|--|
| (a) Description | (b) Date acquired | (d) Gross sales price | (f) Cost or basis, plus improve- ments and expense of sale | (g) Depreciation allowed or allowable | (h) Amount of section 179 expense deduction taken | (i) Tax Year section 179 expense deduction taken |
| | Check this Box if from a Casualty or theft | (c) Date sold | | (e) Qualified Real Prop. With s 179 | | |
| Equipment | 06/15/18 | 7,400. | 200,000. | 0. | 200,000. | 2018 |
| | 06/15/21 | | | 0. | | |
| | | | | | | |
| | | | | | | |
| | | | | | | |
| | | | | | | |
| | | | | | | |

SPSW9701.SCR 01/06/20

Statement A-QBI Pass-through Entity Reporting

| | | | |
|---|--|--|-------------------------------------|
| Corporation's name: Ag Air, Inc | | Corporation's EIN: 75-4343556 | |
| Shareholder's name: Erin Moore | | Shareholder's identifying no: 456-22-1120 | |
| Shareholder's share of: | | 1120S, Line 21 | |
| | | <input type="checkbox"/> PTP | <input type="checkbox"/> PTP |
| | | <input type="checkbox"/> Aggregated | <input type="checkbox"/> Aggregated |
| | | <input type="checkbox"/> SSTB | <input type="checkbox"/> SSTB |
| QBI or qualified PTP items subject to shareholder-specific determinations: | | | |
| Ordinary business income (loss) | | 375,624. | |
| Rental income (loss) | | | |
| Royalty income (loss) | | | |
| Section 1231 gain (loss) | | 0. | |
| Other income (loss) | | | |
| Section 179 deduction | | 366,000. | |
| Charitable contributions | | | |
| Other deductions | | | |
| W-2 wages | | 736,000. | |
| UBIA of qualified property | | 2,117,409. | |
| Section 199A dividends | | | |

Statement A-QBI Pass-through Entity Reporting

| | | | |
|---|--|--------------------------------------|-------------------------------------|
| Corporation's name: | | Corporation's EIN: | |
| Shareholder's name: | | Shareholder's identifying no: | |
| Shareholder's share of: | | <input type="checkbox"/> PTP | <input type="checkbox"/> PTP |
| | | <input type="checkbox"/> Aggregated | <input type="checkbox"/> Aggregated |
| | | <input type="checkbox"/> SSTB | <input type="checkbox"/> SSTB |
| QBI or qualified PTP items subject to shareholder-specific determinations: | | | |
| Ordinary business income (loss) | | | |
| Rental income (loss) | | | |
| Royalty income (loss) | | | |
| Section 1231 gain (loss) | | | |
| Other income (loss) | | | |
| Section 179 deduction | | | |
| Charitable contributions | | | |
| Other deductions | | | |
| W-2 wages | | | |
| UBIA of qualified property | | | |
| Section 199A dividends | | | |

671121

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

Department of the Treasury
Internal Revenue Service

2021

For calendar year 2021, or tax year

beginning / / 2021 ending / /

Final K-1

Amended K-1

OMB No. 1545-0123

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

▶ See separate instructions.

| Part I Information About the Corporation | | Part III Shareholder's Share of Current Year Income, Deductions, Credits, and Other Items | |
|---|--|--|--|
| A Corporation's employer identification number 75-4343556 | | 1 Ordinary business income (loss) 281,718 | 13 Credits |
| B Corporation's name, address, city, state, and ZIP code Ag Air, Inc RR 2 Lubbock, TX 79406 | | 2 Net rental real estate income (loss) | |
| C IRS Center where corporation filed return Ogden, UT 84201-0013 | | 3 Other net rental income (loss) | |
| D Corporation's total number of shares Beginning of tax year 10,000 End of tax year 10,000 | | 4 Interest income | |
| | | 5a Ordinary dividends | |
| | | 5b Qualified dividends | 14 Schedule K-3 is attached if checked <input type="checkbox"/> |
| | | 6 Royalties | 15 Alternative minimum tax (AMT) items 1,505 |
| | | 7 Net short-term capital gain (loss) | |
| | | 8a Net long-term capital gain (loss) | |
| | | 8b Collectibles (28%) gain (loss) | |
| | | 8c Unrecaptured section 1250 gain | |
| | | 9 Net section 1231 gain (loss) | 16 Items affecting shareholder basis 108,000 |
| | | 10 Other income (loss) | |
| | | | 17 Other information K* See Statement |
| E Shareholder's identifying number 522-44-3312 | | 11 Section 179 deduction 274,500 | V* See Statement |
| F Shareholder's name, address, city, state, and ZIP code Chris Johnson R 3, Box 122 Lubbock, TX 79404 | | 12 Other deductions | |
| G Current year allocation percentage 30.00 % | | | |
| H Shareholder's number of shares Beginning of tax year 3,000 End of tax year 3,000 | | | |
| I Loans from shareholder Beginning of tax year \$ 0 End of tax year \$ 0 | | | |
| For IRS Use Only | | 18 <input type="checkbox"/> More than one activity for at-risk purposes* | |
| | | 19 <input type="checkbox"/> More than one activity for passive activity purposes* | |
| | | * See attached statement for additional information. | |

Additional information from your Schedule K-1:Shareholder's Share of Income, Deductions, Credits, etc. (Chris Johnson)

Schedule K-1:Shareholder's Share of Income, Deductions, Credits, etc. (Chris Johnson)

Supplemental Information

Continuation Statement

| Description | Amount |
|---|--------|
| BOX 17, CODE K: | |
| SEE ATTACHED SECTION 179 DISPOSITION REPORT | |

| | |
|---|--------------------------------------|
| Name as Shown on Return Ag Air, Inc | Identifying No. 75-4343556 |
|---|--------------------------------------|

Shareholder's Disposition Report for all Assets with Section 179 Expense Taken

| Shareholder's Name Chris Johnson | | | | Identifying No. 522-44-3312 | | |
|--|--|--------------------------------|--|--|--|--|
| (a) Description | (b) Date acquired | (d) Gross sales price | (f) Cost or basis, plus improve- ments and expense of sale | (g) Depreciation allowed or allowable | (h) Amount of section 179 expense deduction taken | (i) Tax Year section 179 expense deduction taken |
| | Check this Box if from a Casualty or theft | (c) Date sold | | (e) Qualified Real Prop. With s 179 | | |
| Equipment | 06/15/18 | 5,550. | 150,000. | 0. | 150,000. | 2018 |
| | 06/15/21 | | | 0. | | |
| | | | | | | |
| | | | | | | |
| | | | | | | |
| | | | | | | |
| | | | | | | |

SPSW9701.SCR 01/06/20

Statement A-QBI Pass-through Entity Reporting

| | | | |
|---|---|--|--|
| Corporation's name: Ag Air, Inc | | Corporation's EIN: 75-4343556 | |
| Shareholder's name: Chris Johnson | | Shareholder's identifying no: 522-44-3312 | |
| | | 1120S, Line 21 | |
| Shareholder's share of: | | <input type="checkbox"/> PTP <input type="checkbox"/> Aggregated <input type="checkbox"/> SSTB | <input type="checkbox"/> PTP <input type="checkbox"/> Aggregated <input type="checkbox"/> SSTB |
| QBI or qualified PTP items subject to shareholder-specific determinations: | | | |
| | Ordinary business income (loss) | 281,718. | |
| | Rental income (loss) | | |
| | Royalty income (loss) | | |
| | Section 1231 gain (loss) | 0. | |
| | Other income (loss) | | |
| | Section 179 deduction | 274,500. | |
| | Charitable contributions | | |
| | Other deductions | | |
| | W-2 wages | 552,000. | |
| | UBIA of qualified property | 1,588,058. | |
| | Section 199A dividends | | |

Statement A-QBI Pass-through Entity Reporting

| | | | |
|---|---|--|--|
| Corporation's name: | | Corporation's EIN: | |
| Shareholder's name: | | Shareholder's identifying no: | |
| | | | |
| Shareholder's share of: | | <input type="checkbox"/> PTP <input type="checkbox"/> Aggregated <input type="checkbox"/> SSTB | <input type="checkbox"/> PTP <input type="checkbox"/> Aggregated <input type="checkbox"/> SSTB |
| QBI or qualified PTP items subject to shareholder-specific determinations: | | | |
| | Ordinary business income (loss) | | |
| | Rental income (loss) | | |
| | Royalty income (loss) | | |
| | Section 1231 gain (loss) | | |
| | Other income (loss) | | |
| | Section 179 deduction | | |
| | Charitable contributions | | |
| | Other deductions | | |
| | W-2 wages | | |
| | UBIA of qualified property | | |
| | Section 199A dividends | | |

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

Department of the Treasury
Internal Revenue Service

2021

For calendar year 2021, or tax year

beginning / / 2021 ending / /

Final K-1 Amended K-1

OMB No. 1545-0123

Shareholder's Share of Income, Deductions, Credits, etc.
▶ See separate instructions.

| Part I Information About the Corporation | | Part III Shareholder's Share of Current Year Income, Deductions, Credits, and Other Items | |
|---|--|--|--|
| A Corporation's employer identification number 75-4343556 | | 1 Ordinary business income (loss) 281,718 | 13 Credits |
| B Corporation's name, address, city, state, and ZIP code Ag Air, Inc RR 2 Lubbock, TX 79406 | | 2 Net rental real estate income (loss) | |
| C IRS Center where corporation filed return Ogden, UT 84201-0013 | | 3 Other net rental income (loss) | |
| D Corporation's total number of shares Beginning of tax year 10,000 End of tax year 10,000 | | 4 Interest income | |
| Part II Information About the Shareholder | | | |
| E Shareholder's identifying number 433-64-6114 | | 5a Ordinary dividends | |
| F Shareholder's name, address, city, state, and ZIP code Pat Dune R 6, Box 21 Lubbock, TX 79414 | | 5b Qualified dividends | 14 Schedule K-3 is attached if checked <input type="checkbox"/> |
| G Current year allocation percentage 30.00 % | | 6 Royalties | 15 Alternative minimum tax (AMT) items 1,505 |
| H Shareholder's number of shares Beginning of tax year 3,000 End of tax year 3,000 | | 7 Net short-term capital gain (loss) | |
| I Loans from shareholder Beginning of tax year \$ 0 End of tax year \$ 0 | | 8a Net long-term capital gain (loss) | |
| For IRS Use Only | | 8b Collectibles (28%) gain (loss) | |
| | | 8c Unrecaptured section 1250 gain | |
| | | 9 Net section 1231 gain (loss) | 16 Items affecting shareholder basis 108,000 |
| | | 10 Other income (loss) | |
| | | | 17 Other information K* See Statement |
| | | 11 Section 179 deduction 274,500 | V* See Statement |
| | | 12 Other deductions | |
| | | | |
| | | | |
| | | | |
| | | | 18 <input type="checkbox"/> More than one activity for at-risk purposes* |
| | | | 19 <input type="checkbox"/> More than one activity for passive activity purposes* |
| | | * See attached statement for additional information. | |

Additional information from your Schedule K-1:Shareholder's Share of Income, Deductions, Credits, etc. (Pat Dune)

Schedule K-1:Shareholder's Share of Income, Deductions, Credits, etc. (Pat Dune)

Supplemental Information

Continuation Statement

| Description | Amount |
|---|--------|
| BOX 17, CODE K: | |
| SEE ATTACHED SECTION 179 DISPOSITION REPORT | |

| | |
|--|-------------------------------|
| Name as Shown on Return Ag Air, Inc | Identifying No. 75-4343556 |
|--|-------------------------------|

Shareholder's Disposition Report for all Assets with Section 179 Expense Taken

| Shareholder's Name Pat Dune | | | | Identifying No. 433-64-6114 | | |
|---------------------------------------|--|--------------------------------|--|--|--|--|
| (a) Description | (b) Date acquired | (d) Gross sales price | (f) Cost or basis, plus improve- ments and expense of sale | (g) Depreciation allowed or allowable | (h) Amount of section 179 expense deduction taken | (i) Tax Year section 179 expense deduction taken |
| | Check this Box if from a Casualty or theft | (c) Date sold | | (e) Qualified Real Prop. With s 179 | | |
| Equipment | 06/15/18 | 5,550. | 150,000. | 0. | 150,000. | 2018 |
| | 06/15/21 | | | 0. | | |
| | | | | | | |
| | | | | | | |
| | | | | | | |
| | | | | | | |
| | | | | | | |

SPSW9701.SCR 01/06/20

Statement A-QBI Pass-through Entity Reporting

| | | | |
|--|---|--|--|
| Corporation's name: Ag Air, Inc | | Corporation's EIN: 75-4343556 | |
| Shareholder's name: Pat Dune | | Shareholder's identifying no: 433-64-6114 | |
| Shareholder's share of: | | 1120S, Line 21 | |
| | | <input type="checkbox"/> PTP <input type="checkbox"/> Aggregated <input type="checkbox"/> SSTB | <input type="checkbox"/> PTP <input type="checkbox"/> Aggregated <input type="checkbox"/> SSTB |
| QBI or qualified PTP items subject to shareholder-specific determinations: | | | |
| | Ordinary business income (loss) | 281,718. | |
| | Rental income (loss) | | |
| | Royalty income (loss) | | |
| | Section 1231 gain (loss) | 0. | |
| | Other income (loss) | | |
| | Section 179 deduction | 274,500. | |
| | Charitable contributions | | |
| | Other deductions | | |
| | W-2 wages | 552,000. | |
| | UBIA of qualified property | 1,588,058. | |
| | Section 199A dividends | | |

Statement A-QBI Pass-through Entity Reporting

| | | | |
|--|---|--|--|
| Corporation's name: | | Corporation's EIN: | |
| Shareholder's name: | | Shareholder's identifying no: | |
| Shareholder's share of: | | <input type="checkbox"/> PTP <input type="checkbox"/> Aggregated <input type="checkbox"/> SSTB | <input type="checkbox"/> PTP <input type="checkbox"/> Aggregated <input type="checkbox"/> SSTB |
| | | <input type="checkbox"/> PTP <input type="checkbox"/> Aggregated <input type="checkbox"/> SSTB | <input type="checkbox"/> PTP <input type="checkbox"/> Aggregated <input type="checkbox"/> SSTB |
| QBI or qualified PTP items subject to shareholder-specific determinations: | | | |
| | Ordinary business income (loss) | | |
| | Rental income (loss) | | |
| | Royalty income (loss) | | |
| | Section 1231 gain (loss) | | |
| | Other income (loss) | | |
| | Section 179 deduction | | |
| | Charitable contributions | | |
| | Other deductions | | |
| | W-2 wages | | |
| | UBIA of qualified property | | |
| | Section 199A dividends | | |

**SCHEDULE D
(Form 1120-S)**

Department of the Treasury
Internal Revenue Service

Capital Gains and Losses and Built-in Gains

▶ Attach to Form 1120-S.

▶ Use Form 8949 to list your transactions for lines 1b, 2, 3, 8b, 9, and 10.
▶ Go to www.irs.gov/Form1120S for instructions and the latest information.

OMB No. 1545-0123

2021

Name

Ag Air, Inc

Employer identification number

75-4343556

Did the corporation dispose of any investment(s) in a qualified opportunity fund during the tax year? ▶ Yes No
If "Yes," attach Form 8949 and see its instructions for additional requirements for reporting your gain or loss.

Part I Short-Term Capital Gains and Losses—Generally Assets Held One Year or Less (see instructions)

| See instructions for how to figure the amounts to enter on the lines below. This form may be easier to complete if you round off the cents to whole dollars. | (d) Proceeds (sales price) | (e) Cost (or other basis) | (g) Adjustments to gain or loss from Form(s) 8949, Part I, line 2, column (g) | (h) Gain or (loss) Subtract column (e) from column (d) and combine the result with column (g) |
|--|----------------------------------|---------------------------------|---|---|
| 1a Totals for all short-term transactions reported on Form 1099-B for which basis was reported to the IRS and for which you have no adjustments (see instructions). However, if you choose to report all these transactions on Form 8949, leave this line blank and go to line 1b | | | | |
| 1b Totals for all transactions reported on Form(s) 8949 with Box A checked | | | | |
| 2 Totals for all transactions reported on Form(s) 8949 with Box B checked | | | | |
| 3 Totals for all transactions reported on Form(s) 8949 with Box C checked | | | | |
| 4 Short-term capital gain from installment sales from Form 6252, line 26 or 37 | | | | 4 |
| 5 Short-term capital gain or (loss) from like-kind exchanges from Form 8824 | | | | 5 |
| 6 Tax on short-term capital gain included on line 23 below | | | | 6 (0) |
| 7 Net short-term capital gain or (loss). Combine lines 1a through 6 in column (h). Enter here and on Form 1120-S, Schedule K, line 7 or 10 | | | | 7 0 |

Part II Long-Term Capital Gains and Losses—Generally Assets Held More Than One Year (see instructions)

| See instructions for how to figure the amounts to enter on the lines below. This form may be easier to complete if you round off the cents to whole dollars. | (d) Proceeds (sales price) | (e) Cost (or other basis) | (g) Adjustments to gain or loss from Form(s) 8949, Part II, line 2, column (g) | (h) Gain or (loss) Subtract column (e) from column (d) and combine the result with column (g) |
|---|----------------------------------|---------------------------------|--|---|
| 8a Totals for all long-term transactions reported on Form 1099-B for which basis was reported to the IRS and for which you have no adjustments (see instructions). However, if you choose to report all these transactions on Form 8949, leave this line blank and go to line 8b | | | | |
| 8b Totals for all transactions reported on Form(s) 8949 with Box D checked | | | | |
| 9 Totals for all transactions reported on Form(s) 8949 with Box E checked | | | | |
| 10 Totals for all transactions reported on Form(s) 8949 with Box F checked | | | | |
| 11 Long-term capital gain from installment sales from Form 6252, line 26 or 37 | | | | 11 |
| 12 Long-term capital gain or (loss) from like-kind exchanges from Form 8824 | | | | 12 |
| 13 Capital gain distributions (see instructions) | | | | 13 |
| 14 Tax on long-term capital gain included on line 23 below | | | | 14 () |
| 15 Net long-term capital gain or (loss). Combine lines 8a through 14 in column (h). Enter here and on Form 1120-S, Schedule K, line 8a or 10 | | | | 15 |

For Paperwork Reduction Act Notice, see the Instructions for Form 1120-S.

Cat. No. 11516V

Schedule D (Form 1120-S) 2021

Part III Built-in Gains Tax (See instructions **before** completing this part.)

| | | | |
|-----------|---|-----------|---------|
| 16 | Excess of recognized built-in gains over recognized built-in losses (attach computation statement) | 16 | 843,500 |
| 17 | Taxable income (attach computation statement) | 17 | 30,456 |
| 18 | Net recognized built-in gain. Enter the smallest of line 16, line 17, or line 8 of Schedule B | 18 | 30,456 |
| 19 | Section 1374(b)(2) deduction | 19 | |
| 20 | Subtract line 19 from line 18. If zero or less, enter -0- here and on line 23 | 20 | 30,456 |
| 21 | Enter 21% (0.21) of line 20 | 21 | 6,396 |
| 22 | Section 1374(b)(3) business credit and minimum tax credit carryforwards from C corporation years | 22 | |
| 23 | Tax. Subtract line 22 from line 21 (if zero or less, enter -0-). Enter here and on Form 1120-S, page 1, line 22b | 23 | 6,396 |

Schedule D (Form 1120-S) 2021

Depreciation and Amortization
 (Including Information on Listed Property)

► Attach to your tax return.
 ► Go to www.irs.gov/Form4562 for instructions and the latest information.

| | | |
|---|--|---|
| Name(s) shown on return Ag Air, Inc | Business or activity to which this form relates Form 1120S Manufacturing | Identifying number 75-4343556 |
|---|--|---|

Part I Election To Expense Certain Property Under Section 179
Note: If you have any listed property, complete Part V before you complete Part I.

| | | |
|---|-----------|-----------|
| 1 Maximum amount (see instructions) | 1 | 1,050,000 |
| 2 Total cost of section 179 property placed in service (see instructions) | 2 | 915,000 |
| 3 Threshold cost of section 179 property before reduction in limitation (see instructions) | 3 | 2,550,000 |
| 4 Reduction in limitation. Subtract line 3 from line 2. If zero or less, enter -0- | 4 | |
| 5 Dollar limitation for tax year. Subtract line 4 from line 1. If zero or less, enter -0-. If married filing separately, see instructions | 5 | 1,050,000 |
| 6 (a) Description of property (b) Cost (business use only) (c) Elected cost | | |
| MFG Equipment | 915,000 | 915,000 |
| 7 Listed property. Enter the amount from line 29 7 | | |
| 8 Total elected cost of section 179 property. Add amounts in column (c), lines 6 and 7 | 8 | 915,000 |
| 9 Tentative deduction. Enter the smaller of line 5 or line 8 | 9 | 915,000 |
| 10 Carryover of disallowed deduction from line 13 of your 2020 Form 4562 | 10 | |
| 11 Business income limitation. Enter the smaller of business income (not less than zero) or line 5. See instructions | 11 | 1,050,000 |
| 12 Section 179 expense deduction. Add lines 9 and 10, but don't enter more than line 11 | 12 | 915,000 |
| 13 Carryover of disallowed deduction to 2022. Add lines 9 and 10, less line 12 ► 13 | | |

Note: Don't use Part II or Part III below for listed property. Instead, use Part V.

Part II Special Depreciation Allowance and Other Depreciation (Don't include listed property. See instructions.)

| | | |
|---|-----------|---|
| 14 Special depreciation allowance for qualified property (other than listed property) placed in service during the tax year. See instructions | 14 | 0 |
| 15 Property subject to section 168(f)(1) election | 15 | |
| 16 Other depreciation (including ACRS) | 16 | |

Part III MACRS Depreciation (Don't include listed property. See instructions.)

| | | |
|---|-----------|---------|
| Section A | | |
| 17 MACRS deductions for assets placed in service in tax years beginning before 2021 | 17 | 314,836 |
| 18 If you are electing to group any assets placed in service during the tax year into one or more general asset accounts, check here <input type="checkbox"/> | | |

Section B—Assets Placed in Service During 2021 Tax Year Using the General Depreciation System

| (a) Classification of property | (b) Month and year placed in service | (c) Basis for depreciation (business/investment use only—see instructions) | (d) Recovery period | (e) Convention | (f) Method | (g) Depreciation deduction |
|---------------------------------------|--------------------------------------|--|---------------------|----------------|------------|----------------------------|
| 19a 3-year property | | | | | | |
| b 5-year property | | | | | | |
| c 7-year property | | | | | | |
| d 10-year property | | | | | | |
| e 15-year property | | | | | | |
| f 20-year property | | | | | | |
| g 25-year property | | | 25 yrs. | | S/L | |
| h Residential rental property | | | 27.5 yrs. | MM | S/L | |
| | | | 27.5 yrs. | MM | S/L | |
| i Nonresidential real property | | | 39 yrs. | MM | S/L | |
| | | | | MM | S/L | |

Section C—Assets Placed in Service During 2021 Tax Year Using the Alternative Depreciation System

| | | | | | |
|-----------------------|--|--|---------|----|-----|
| 20a Class life | | | | | S/L |
| b 12-year | | | 12 yrs. | | S/L |
| c 30-year | | | 30 yrs. | MM | S/L |
| d 40-year | | | 40 yrs. | MM | S/L |

Part IV Summary (See instructions.)

| | | |
|--|-----------|---------|
| 21 Listed property. Enter amount from line 28 | 21 | |
| 22 Total. Add amounts from line 12, lines 14 through 17, lines 19 and 20 in column (g), and line 21. Enter here and on the appropriate lines of your return. Partnerships and S corporations—see instructions | 22 | 314,836 |
| 23 For assets shown above and placed in service during the current year, enter the portion of the basis attributable to section 263A costs | 23 | |

Part V Listed Property (Include automobiles, certain other vehicles, certain aircraft, and property used for entertainment, recreation, or amusement.)

Note: For any vehicle for which you are using the standard mileage rate or deducting lease expense, complete **only** 24a, 24b, columns (a) through (c) of Section A, all of Section B, and Section C if applicable.

Section A—Depreciation and Other Information (Caution: See the instructions for limits for passenger automobiles.)

| 24a Do you have evidence to support the business/investment use claimed? <input type="checkbox"/> Yes <input type="checkbox"/> No | | | | 24b If "Yes," is the evidence written? <input type="checkbox"/> Yes <input type="checkbox"/> No | | | | |
|---|-------------------------------|---|----------------------------|--|------------------------|--------------------------|-------------------------------|---------------------------------|
| (a) Type of property (list vehicles first) | (b) Date placed in service | (c) Business/investment use percentage | (d) Cost or other basis | (e) Basis for depreciation (business/investment use only) | (f) Recovery period | (g) Method/Convention | (h) Depreciation deduction | (i) Elected section 179 cost |
| 25 Special depreciation allowance for qualified listed property placed in service during the tax year and used more than 50% in a qualified business use. See instructions | | | | | | | 25 | |
| 26 Property used more than 50% in a qualified business use: | | | | | | | | |
| | | % | | | | | | |
| | | % | | | | | | |
| | | % | | | | | | |
| 27 Property used 50% or less in a qualified business use: | | | | | | | | |
| | | % | | | | S/L - | | |
| | | % | | | | S/L - | | |
| | | % | | | | S/L - | | |
| 28 Add amounts in column (h), lines 25 through 27. Enter here and on line 21, page 1 | | | | | | | 28 | |
| 29 Add amounts in column (i), line 26. Enter here and on line 7, page 1 | | | | | | | | 29 |

Section B—Information on Use of Vehicles

Complete this section for vehicles used by a sole proprietor, partner, or other "more than 5% owner," or related person. If you provided vehicles to your employees, first answer the questions in Section C to see if you meet an exception to completing this section for those vehicles.

| | (a) Vehicle 1 | | (b) Vehicle 2 | | (c) Vehicle 3 | | (d) Vehicle 4 | | (e) Vehicle 5 | | (f) Vehicle 6 | |
|--|------------------|-----------|------------------|-----------|------------------|-----------|------------------|-----------|------------------|-----------|------------------|-----------|
| 30 Total business/investment miles driven during the year (don't include commuting miles) | | | | | | | | | | | | |
| 31 Total commuting miles driven during the year | | | | | | | | | | | | |
| 32 Total other personal (noncommuting) miles driven | | | | | | | | | | | | |
| 33 Total miles driven during the year. Add lines 30 through 32 | | | | | | | | | | | | |
| 34 Was the vehicle available for personal use during off-duty hours? | Yes | No | Yes | No | Yes | No | Yes | No | Yes | No | Yes | No |
| | | | | | | | | | | | | |
| 35 Was the vehicle used primarily by a more than 5% owner or related person? | | | | | | | | | | | | |
| 36 Is another vehicle available for personal use? | | | | | | | | | | | | |

Section C—Questions for Employers Who Provide Vehicles for Use by Their Employees

Answer these questions to determine if you meet an exception to completing Section B for vehicles used by employees who aren't more than 5% owners or related persons. See instructions.

| | | |
|--|------------|-----------|
| 37 Do you maintain a written policy statement that prohibits all personal use of vehicles, including commuting, by your employees? | Yes | No |
| 38 Do you maintain a written policy statement that prohibits personal use of vehicles, except commuting, by your employees? See the instructions for vehicles used by corporate officers, directors, or 1% or more owners | | |
| 39 Do you treat all use of vehicles by employees as personal use? | | |
| 40 Do you provide more than five vehicles to your employees, obtain information from your employees about the use of the vehicles, and retain the information received? | | |
| 41 Do you meet the requirements concerning qualified automobile demonstration use? See instructions. | | |
| Note: If your answer to 37, 38, 39, 40, or 41 is "Yes," don't complete Section B for the covered vehicles. | | |

Part VI Amortization

| (a) Description of costs | (b) Date amortization begins | (c) Amortizable amount | (d) Code section | (e) Amortization period or percentage | (f) Amortization for this year |
|--|---------------------------------|---------------------------|---------------------|--|-----------------------------------|
| 42 Amortization of costs that begins during your 2021 tax year (see instructions): | | | | | |
| | | | | | |
| 43 Amortization of costs that began before your 2021 tax year | | | | | 43 |
| 44 Total. Add amounts in column (f). See the instructions for where to report | | | | | 44 |

| | | | |
|---|-------------------------------------|--------------------------------------|-------------------------------------|
| Corporation's Name: Ag Air, Inc | | Corporation's EIN: 75-4343556 | |
| | | | |
| 1120S, Line 21 | | | |
| <input type="checkbox"/> PTP | <input type="checkbox"/> PTP | <input type="checkbox"/> PTP | <input type="checkbox"/> PTP |
| <input type="checkbox"/> Aggregated | <input type="checkbox"/> Aggregated | <input type="checkbox"/> Aggregated | <input type="checkbox"/> Aggregated |
| <input type="checkbox"/> SSTB | <input type="checkbox"/> SSTB | <input type="checkbox"/> SSTB | <input type="checkbox"/> SSTB |
| Shareholder's share of: QBI or qualified PTP items subject to shareholder-specific determinations: | | | |
| Ordinary business inc (loss) | <u>939,060.</u> | _____ | _____ |
| Rental income (loss) | _____ | _____ | _____ |
| Royalty income (loss) | _____ | _____ | _____ |
| Section 1231 gain (loss) | <u>0.</u> | _____ | _____ |
| Other income (loss) | _____ | _____ | _____ |
| Section 179 deduction | <u>915,000.</u> | _____ | _____ |
| Charitable contributions | _____ | _____ | _____ |
| Other deductions | _____ | _____ | _____ |
| W-2 wages | <u>1,840,000.</u> | _____ | _____ |
| UBIA of qualified property | <u>5,293,525.</u> | _____ | _____ |
| Section 199A dividends | | | |

| | | | |
|---|-------------------------------------|-------------------------------------|-------------------------------------|
| Corporation's Name: _____ | | Corporation's EIN: _____ | |
| | | | |
| 1120S, Line 21 | | | |
| <input type="checkbox"/> PTP | <input type="checkbox"/> PTP | <input type="checkbox"/> PTP | <input type="checkbox"/> PTP |
| <input type="checkbox"/> Aggregated | <input type="checkbox"/> Aggregated | <input type="checkbox"/> Aggregated | <input type="checkbox"/> Aggregated |
| <input type="checkbox"/> SSTB | <input type="checkbox"/> SSTB | <input type="checkbox"/> SSTB | <input type="checkbox"/> SSTB |
| Shareholder's share of: QBI or qualified PTP items subject to shareholder-specific determinations: | | | |
| Ordinary business inc (loss) | _____ | _____ | _____ |
| Rental income (loss) | _____ | _____ | _____ |
| Royalty income (loss) | _____ | _____ | _____ |
| Section 1231 gain (loss) | _____ | _____ | _____ |
| Other income (loss) | _____ | _____ | _____ |
| Section 179 deduction | _____ | _____ | _____ |
| Charitable contributions | _____ | _____ | _____ |
| Other deductions | _____ | _____ | _____ |
| W-2 wages | _____ | _____ | _____ |
| UBIA of qualified property | _____ | _____ | _____ |
| Section 199A dividends | | | |

**Form 1120S
Schedule L**

**Other Liabilities
and Adjustments to Shareholders' Equity**

2021

| | |
|----------------------------|---|
| Name Ag Air, Inc | Employer ID Number 75-4343556 |
|----------------------------|---|

| | Beginning of tax year | End of tax year |
|--|-----------------------|-----------------|
| Other Current Liabilities: | | |
| <u>Federal taxes payable</u> | | 6,396. |
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| Total to Form 1120S, Schedule L, line 18▶ | | 6,396. |
| Other Liabilities: | | |
| <u>Note payable on equipment</u> | | 205,880. |
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| Total to Form 1120S, Schedule L, line 21▶ | | 205,880. |
| Adjustments to Shareholders' Equity: | | |
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| Total to Form 1120S, Schedule L, line 25▶ | | |

| | |
|---|--------------------------------------|
| Name as Shown on Return Ag Air, Inc | Identifying No. 75-4343556 |
|---|--------------------------------------|

Dispositions Report for all Assets with Section 179 Expense Taken

▶ Keep for your records

| Total Assets with Section 179 Expense Taken | | | | | | |
|--|-------------------------|--|--|--|--|--|
| (a) Description | (b) Date acquired | (d) Gross sales price | (f) Cost or basis, plus improve- ments and expense of sale | (g) Depreciation allowed or allowable | (h) Amount of section 179 expense deduction taken | (i) Tax Year section 179 expense deduction taken |
| Check this Box if from a Casualty or theft | (c) Date sold | (e) Qualified Real Prop. With s 179 | | AMT Depreciation | | |
| Equipment | 06/15/19 | 18,500. | 500,000. | 0. | 500,000. | 2018 |
| | 06/15/21 | | | 0. | | |
| | | | | | | |
| | | | | | | |
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SPSW9401.SCR 08/27/19

Computation of Taxable Income
for Built-In Gains Tax

2021

| | |
|----------------------------|---|
| Name Ag Air, Inc | Employer Identification Number 75-4343556 |
|----------------------------|---|

Income

| | | |
|---|------------|-------------------|
| 1 a Gross receipts or sales | 1 a | 7,290,348. |
| b Less returns and allowances | b | |
| c Balance | c | 7,290,348. |
| 2 Cost of goods sold (from Schedule A) | 2 | 4,487,500. |
| 3 Gross profit. Subtract line 2 from line 1c | 3 | 2,802,848. |
| 4 Dividends (Form 1120, Schedule C, line 19) | 4 | |
| 5 Interest | 5 | |
| 6 Gross rents | 6 | |
| 7 Gross royalties | 7 | |
| 8 Capital gain net income (Form 1120, Schedule D) | 8 | |
| 9 a Net gain (loss) from Form 4797, Part II, line 17 | 9 a | |
| b Gain (Loss) on disposition of Section 179 assets | b | 0. |
| 10 Other income/loss | 10 | |
| 11 Total income — Add lines 3 through 10 | 11 | 2,802,848. |

Deductions

| | | |
|---|-------------|-------------------|
| 12 Compensation of officers | 12 | 360,000. |
| 13 a Salaries and wages | 13 a | 480,000. |
| b Less employment credits | b | |
| c Balance | 13 c | 480,000. |
| 14 Repairs | 14 | |
| 15 Bad debts | 15 | |
| 16 Rents | 16 | 104,040. |
| 17 Taxes | 17 | 165,616. |
| 18 Interest | 18 | 106,250. |
| 19 Charitable contributions (see instructions for 10% limitation) | 19 | |
| 20 Depreciation (from Form 4562) | 20 | 1,229,836. |
| 21 a Less depreciation claimed elsewhere | 21 a | |
| b Balance | 21 b | 1,229,836. |
| 22 Depletion | 22 | |
| 23 Advertising | 23 | 70,000. |
| 24 Pension, profit sharing, etc, plans | 24 | 85,000. |
| 25 Employee benefit programs | 25 | |
| 26 Other deductions | 26 | 171,650. |
| 27 Total deductions — Add lines 12 through 26 | 27 | 2,772,392. |
| 28 Taxable income — Subtract line 27 from line 11. Enter here and on Schedule D, line 17 | 28 | 30,456. |
| 29 | 29 | |

199A Worksheet by Activity

2021

► Keep for your records

| | | | |
|---|--|--|------------|
| Corporation's name Ag Air, Inc | | Corporation's EIN 75-4343556 | |
| Aggregation Code: _____ | Trade or Business: 1120S, Line 21 EIN: 75-4343556 | | |
| Check if activity is NOT a qualified trade/business <input type="checkbox"/> | | | |
| Specified Service Trade or Business?..... <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | | | |
| Shareholder's share of: QBI or qualified PTP items subject to shareholder-specific determinations: | | | |
| 1 a Ordinary business income (loss)..... | 1 a | 939,060. | |
| b Adjustments..... | b | | |
| c Adjusted ordinary business income (loss) | 1 c | | 939,060. |
| 2 a Rental income (loss)..... | 2 a | | |
| b Adjustments..... | b | | |
| c Adjusted rental income (loss) | 2 c | | |
| 3 a Royalty income (loss)..... | 3 a | | |
| b Adjustments..... | b | | |
| c Adjusted royalty income (loss) | 3 c | | |
| 4 a Section 1231 gain (loss)..... | 4 a | -481,500. | |
| b Adjustments..... | b | 481,500. | |
| c Adjusted section 1231 gain (loss)..... | 4 c | | 0. |
| 5 Other income (loss)..... | 5 | | |
| 6 a Section 179 deduction..... | 6 a | 915,000. | |
| b Adjustments..... | b | | |
| c Adjusted section 179 deduction | 6 c | | 915,000. |
| 7 Charitable contributions..... | 7 | | |
| 8 Other deductions..... | 8 | | |
| 9 a W-2 wages..... | 9 a | 1,840,000. | |
| b Adjustments..... | b | | |
| c Adjusted W-2 Wages | 9 c | | 1,840,000. |
| 10 a UBIA of qualified property..... | 10 a | 5,293,525. | |
| Adjustments..... | b | | |
| c Adjusted UBIA of qualified property | 10 c | | 5,293,525. |

spsv6906.SCR 01/30/20

Additional information from your 2021 US Form 1120S: Income Tax Return for S Corp**Form 1120S: S-Corporation Tax Return****Other Deductions****Continuation Statement**

| Description | Amount |
|------------------------|-----------------|
| ACCOUNTING | 60,000. |
| INSURANCE | 48,000. |
| LEGAL AND PROFESSIONAL | 20,650. |
| TRAVEL | 32,000. |
| UTILITIES | 11,000. |
| Total | 171,650. |

Filing the S election

General

If the corporation meets all the requirements to elect S status, and all shareholders agree to the change, conversion to S status is accomplished by filing Form 2553, *Election by a Small Business Corporation*. The election must be filed on or before the 15th day of the third month of the first taxable year in which the corporation wants to be classified as an S corporation. For calendar year corporations, it must be filed on or before March 15 of the first year for which S status will be effective. If the form is filed late, the corporation can still change its status, but the effective date of the change will take place two months and 15 days before the form is filed. If that date is after January 1, the corporation will have to file two short-period returns for the year of the conversion (a Form 1120, *U.S. Corporation Income Tax Return*, and a Form 1120S).

Tax consequences of S election on C corporation

Unlike changing from a regular corporation to a partnership or LLC, conversion to an S corporation is not immediately taxable to either the corporation or the shareholders. The corporation is not deemed to have liquidated and transferred its assets and liabilities to a new entity – rather, the corporation itself remains intact, but merely changes its tax status. It does not change its taxpayer identification number, basis in assets, and the like. Its balance sheets (book and tax) transfer over to the newly converted S corporation, as do its E&P. With regard to its tax attributes, because the corporation does not go out of existence, neither do its net operating loss, capital loss, contribution, or other carryforwards (if any). Of course, because no taxes are generally calculated at the S corporation level, the tax attributes carrying forward from prior years as a C corporation may not provide any tax benefits.

Key review point

In the Ag Air return, notice that the S election effective date (page 1, box A) is January 1, 2021, whereas the date of incorporation (page 1, box E) is July 1, 2014, the date on which the original corporation was formed. The employer identification number will be the same as on last year's Form 1120. Also note that line G requires that Form 2553 must be attached to the tax return. Ag Air's Form 2553 is reproduced following its Form 1120S. ***The copy filed with the return should contain the shareholders' signatures.***

Because the S corporation is a continuation of the original C corporation, the S corporation continues depreciating the assets owned by the original corporation using the same methods and the same depreciable lives as before the S election. In effect, the S corporation steps into the shoes of the original corporation with respect to depreciation. Likewise, the S corporation carries over accumulated depreciation with respect to each asset transferred over from the original corporation. Sale or other disposition of these assets triggers depreciation and IRC Section 179 recapture just as if the original

corporation had sold them itself. The only difference is how these items are reported on Form 1120S and Schedule K.

Key review point

Beginning and ending balance sheets are presented in Schedule L, located on page 4 of Form 1120S. Although 2021 is Ag Air's first year as an S corporation, its beginning balance sheet should equal the "End of tax year" balance sheet from Form 1120 filed by the corporation for tax year 2020. These figures are reported in the beginning trial balance provided in the summary of facts. Note that the balance in ending retained earnings should be increased by Ag Air's net income.

Built-in gains tax

The built-in gains tax is imposed when gains that were inherent in the corporation's property at the date of the conversion are later realized for tax purposes. Specifically, it is imposed on the sale, within five years of the effective date of the change in status, of appreciated property owned at the date of conversion (IRC Section 1374). The tax imposed on the corporation does not relieve the shareholders from recognizing the gain on their individual tax returns as well; however, the tax is deductible on the S corporation return, so that shareholders are taxable on the S corporation's gain, net of the tax paid at the corporate level.



Example 3-1

Simpkins, Inc. is a qualified S corporation wholly owned by Sarah Simpson. Simpkins was operated for many years as a regular corporation before making the S election effective this year. During the year, Simpkins sold property recognizing a \$100,000 IRC Section 1231 gain. All of this gain was built-in gain subject to the 21% maximum corporate tax rate under Section 1374. Simpkins paid \$21,000 of built-in gains tax, which is deductible on the S corporation return. The gain is also reported on the S corporation's tax return. Both the gain and the deduction for the built-in gains tax flow through to Sarah on Schedule K-1, with the net result that Sarah will report net income/gain from Simpkins of \$79,000 on her individual income tax return.

When a regular corporation elects to be treated as an S corporation, it is very important that the corporation document both the tax basis and fair market value of all assets on its balance sheet at the date of conversion. This documentation should be maintained in the working papers so that the corporation can report and pay the proper amount of built-in gains tax over the five years following the conversion to S status. This period is referred to as the recognition period. Practitioners should note that the recognition period consists of a full five-calendar-year period (rather than tax year) from the date of conversion. For example, assume a corporation files an S election that takes effect on May 1 of year 1. In that year, the S corporation must file a short-period return for the period May 1 through December 31; the

short year does not count as a full year for purposes of determining the recognition period. The S corporation will be required to pay built-in gains tax on the recognition of built-in gain at any time up to April 30, year 6.

If a corporation has both built-in gains and built-in losses at the date of the conversion to S status, it must net these two together to calculate its net built-in gain. This amount represents the maximum amount of built-in gain that may be recognized for tax purposes over the ensuing five-year period. As a portion of this gain is recognized, the remaining built-in gain (RBIG) must be calculated. This figure becomes the new maximum amount of built-in gain that may be recognized in the subsequent year. Once the five-year recognition period has expired, the RBIG goes to zero, so that built-in gains recognized in subsequent years are not taxable. Schedule B of Form 1120-S has a question asking for the amount of the built-in gains at the time of conversion from a C corporation to an S corporation.

In any given year, realized built-in gains are offset by realized built-in losses so that only the net realized built-in gain will be taxed. The amount of net recognized built-in gain subject to taxation in a given year is further limited to the S corporation's taxable income for that year. To the extent that the realized built-in gain exceeds the S corporation's taxable income, the excess is carried forward and treated as having been realized in the next taxable year.

Knowledge check

1. Quinlan, Inc. is a qualified S corporation. This year, the third year since Quinlan's conversion to S corporation status, it realized built-in gains of \$65,000 and built-in losses of (\$20,000). As of the beginning of the year, it had unrealized net built-in gains of \$150,000 and a built-in gain carry forward of \$30,000. Taxable income was \$250,000. What is Quinlan, Inc.'s taxable built-in gain this year?
 - a. \$75,000.
 - b. \$45,000.
 - c. \$95,000.
 - d. \$150,000.

Key review point

When Ag Air made the election to be treated as an S corporation, it should have obtained a valuation of its assets for purposes of the Section 1374 tax on net built-in gains. As noted in the facts, Ag Air had the following three categories of built-in gain on its balance sheet at the date of the S conversion:

- Appreciated inventory
- Appreciated buildings and other depreciable assets
- Appreciated land

Whether or not attached to the return, practitioners should maintain a table reconciling the beginning built-in gains at the date of conversion, the amounts realized and recognized since that date, and the remaining balance as of the end of each tax year.

In reviewing the Ag Air tax return, we would expect the built-in gain inherent in the company's inventory at the date of conversion to be realized in the first S corporation year (2021 in this case). As indicated in part III of Schedule D, the company did indeed realize \$843,500 of built-in gains in 2021. Of the total, \$825,000 is attributable to the sale of its beginning inventory (see the facts of this case for the calculation of this amount). It also recognized \$18,500 in built-in gain associated with depreciable property, for a total realized gain of \$843,500.

Taxable income limitation

The recognized built-in gain is equal to the lesser of the following:

- The excess of built-in gain realized during the year over realized built-in losses
- The RBIG
- The S corporation's taxable income

For this purpose, the corporation's taxable income is computed as if it were a regular corporation. The rationale is that if the corporation had not made the S election, the tax that it would have paid would not exceed the tax computed on its net taxable income, regardless of the amount of the realized gain from sale of the appreciated assets. Therefore, taxable income for purposes of the limitation is computed as if the S corporation were a regular corporation. The instructions to Form 1120S indicate that this amount is computed by completing lines 1 through 28 of Form 1120 (not 1120S). This calculation is reported on a statement attached to the tax return.

Key review point

For Ag Air, the computation of its taxable income for purposes of the built-in gains limitation is summarized in a second statement attached to Schedule D of the return. This statement, the third-to-last attachment to Ag Air's tax return, is labeled "Form 1120S Schedule D Line 17 – Computation of Taxable Income for Built-In Gains Tax." Note that the S corporation's taxable income of \$30,456 for this purpose is not equal to the \$24,060 reported on Line 18 of Schedule K (income or loss reconciliation). The reason the two figures differ is that the built-in gains tax paid by Ag Air is deductible in computing Ag Air's ordinary business income on line 21 of page 1 of Form 1120S. This tax, which is an income tax, is not deductible in computing taxable income for a regular corporation. On Ag Air's tax return, the built-in-gains tax is reported as a deduction on page 1 of Form 1120S to reduce the amount of income to be recognized by shareholders as discussed previously. Note that this tax has not yet been paid as indicated on the S corporation's ending Balance Sheet (Schedule L), Other Current Liabilities \$6,396.

In this case, Ag Air's taxable income limitation on the net realized built-in gain is \$30,456, and its built-in gains tax is equal to \$6,396 ($\$30,456 \times 0.21$). This tax is computed in Part III of Schedule D (Form 1120S), and reported on line 22b on page one of Form 1120S. Note that taxable income for purposes of this limitation is also reported in Schedule D, Part III (line 17), and is equal to the amount reported on Schedule K, line 18 (\$24,060), increased by the built-in gains tax deducted on page 1, line 12 (\$6,396).

Note that in this statement, we have not included a deduction for the QBI deduction. As will be discussed later in the chapter, the Section 199A deduction is generally claimed at the shareholder, rather than the S corporation, level. Accordingly, the S corporation does not have a QBI deduction, and does not reduce its taxable income under Section 199A when computing the limitation on the built-in-gains tax.

Cost recovery deductions for newly acquired property

As noted in the facts of the case, Ag Air acquired \$915,000 of equipment during 2021 and wants to claim the maximum amount of cost recovery deductions available. For property acquired after September 28, 2019, the company can expense the first \$1,050,000 (2021 figure) of cost under Section 179, deduct half of the remainder as bonus depreciation, and depreciate the rest under modified accelerated cost recovery system (MACRS). Because Ag Air acquired less than \$1,050,000 in equipment in 2021, it can deduct all of its newly acquired equipment this year under Section 179.

Ag Air's Section 179 deduction, along with its depreciation on property acquired prior to 2021, are both reported on Form 4562, *Depreciation and Amortization*.

Key review point

Although the Section 179 deduction is reported on Form 4562, it is not deducted on page 1 of Form 1120S. Instead, it is reported separately to the shareholders on Schedules K and K-1. Therefore, Ag Air will not report a depreciation deduction for the newly acquired equipment in computing ordinary business income (Form 1120S, page 1, line 21). It will deduct depreciation only on the equipment the company had prior to 2021 that carried over from the regular corporation. This amount ties to the total on Form 4562, line 22, which is reported on Form 1120S, page 1, line 14 (depreciation not claimed on Form 1125-A or elsewhere on return — emphasis added). The company's \$915,000 Section 179 deduction from Form 4562, line 12 is reported on Schedule K, line 11. Each shareholder's share of this amount is reported on the same line of their Schedule K-1.

The Section 179 deduction must be reported separately to the shareholders because the maximum amount that any taxpayer can deduct in a single tax year under Section 179 is equal to the lesser of \$1,050,000 or the taxpayer's net trade or business income. If shareholders have interests in other pass-through entities or acquired eligible property on their own during the tax year, the total amount expensed under Section 179 may exceed this maximum. Alternatively, the shareholders' net trade or business income may be less than the total amounts allocated from one or more pass-through entities. In such cases, shareholders may not be able to deduct the entire amount allocated and reported on their Schedule K-1. If the Section 179 deduction was reported on page 1 of Form 1120S as a deduction in calculating ordinary business income, it would not be possible for the shareholders to accurately compute their statutory limitations under Section 179.

Income limitation on Section 179 deduction

Under Section 179(b)(3), the amount allowed as a deduction under subsection (a) for any taxable year (determined after the application of paragraphs (1) and (2)) shall not exceed the aggregate amount of taxable income of the taxpayer for such taxable year that is derived from the active conduct by the

taxpayer of any trade or business during such taxable year. This income limitation applies at both the S corporation and shareholder levels.

For purposes of calculating the shareholders' net trade or business income, their share of such income from pass-through entities is included only if the shareholder was an active participant in at least one of the entity's trade or business activities (Regs. Secs. 1.179-2(c)(2)(v) and 2(c)(3)(iii)).

Under Section 179(b)(3)(B), the excess, if any, of shareholders' pass-through deductions under Section 179 over their net active trade or business income can be carried forward indefinitely. Such carryforwards are added to the amounts, if any, expensed under Section 179 in a subsequent tax year subject to the maximum limitation imposed under Section 179 and the net trade or business income limitation for the subsequent year.



Example 3-2

Q is the sole shareholder of Lynn Inc., a qualified S corporation. For 2021, her pass-through deduction under Section 179 from Lynn Inc. was \$300,000. Her net trade or business income for that year was \$210,000. Therefore, she may deduct only \$210,000 on her current year tax return. The remaining \$90,000 disallowed under the net trade or business income limitation can be carried forward to 2022. When added to that year's Section 179 amounts, her total deduction will be limited to the lesser of \$1,080,000 (the 2022 inflation-indexed annual limitation) or her net trade or business income (before deducting the Section 179 amount) for 2022.

Knowledge check

2. Janice is president and 50% shareholder in Bantam, Inc., a qualified S corporation. This year, Bantam had net trade or business income of \$150,000 and passed through a Section 179 deduction of \$50,000. Janice has a Section 179 carryforward in the amount of \$100,000 from her personal return last year. As president of Bantam, Janice was paid a salary of \$55,000. Assuming she has no other income or deductions, what is the maximum deduction she can take on her current year return under Section 179?
- a. \$500,000.
 - b. \$150,000.
 - c. \$75,000.
 - d. \$130,000.

Sale of IRC Section 179 property

Ag Air's tax return includes Form 4797, *Sales of Business Property*, which indicates that it sold equipment for \$18,500 that had a tax basis to Ag Air of zero. Form 4797 also indicates that the property had previously been expensed by the company under Section 179. The company then carried this gain to line 13 on Form 1065, *U.S. Return of Partnership Income*.

Ordinarily, Section 179 recapture is not reported on Form 1065. Because the Section 179 deduction is claimed at the shareholder level, the associated gain or loss on such assets must also be computed at the shareholder level. The reason for this treatment is that the shareholder may not have been allowed a deduction under Section 179 for the asset when the S corporation acquired it. The total Section 179 deduction is limited to the maximum amount for the applicable year applied at the taxpayer level. Therefore, if a shareholder had Section 179 expense on the shareholder's own return either as a result of the direct purchase of eligible property, or as the result of allocations from other pass-through entities, the shareholder may not have been able to deduct the Section 179 deduction with respect to this property.

The current case is an unusual circumstance in that Ag Air was a regular corporation when the Section 179 deduction was taken on this asset so that the deduction was not limited. It would probably be best, however, not to report gain from the sale of Section 179 assets on Forms 4797, 6252, 4684, or 8824 attached to the S corporation return. Instead, the necessary information for the shareholders to properly report Section 179 recapture and gain or loss on the sale of Section 179 assets should be provided to shareholders as supplemental information on their Schedule K-1s. Shareholders can properly report this information on their Forms 4797, 6252, 4684, or 8824 on their own tax returns.

Key review point

The following information should be reported to shareholders on Schedule K-1 with respect to the sale of Section 179 assets:

- Description of the property
- Selling price
- Cost or other basis of the property
- Depreciation allowed or allowable not including Section 179 expense deduction with respect to the property
- The amount of the Section 179 deduction claimed at the corporate level with respect to the property

Individual shareholders are responsible for determining whether they could claim the full Section 179 deduction passed through from the S corporation in a prior year. In the case of Ag Air, the full amount of gain recognized on sale of the Section 179 property should be reported by the shareholders because the company was not an S corporation in the year the deduction was claimed.

Distributions to shareholders

Recall from the facts that Ag Air distributed \$90,000 per quarter (\$360,000) to its shareholders. Although S corporation distributions are generally not taxable unless they exceed the shareholders' tax basis in their stock, the tax consequences are more complex when the corporation has accumulated E&P from prior years as a regular corporation. Under Section 1368, distributions from an S corporation with E&P will have the following tax consequences:

- To the extent of the S corporation's accumulated adjustment account (AAA), the distribution is a tax-free return of capital, reducing the shareholder's tax basis in S corporation stock.

- To the extent of accumulated E&P, the distribution is classified as a taxable dividend.
- The remainder of the distribution (if any) is treated as a return of capital, tax-free to the extent of remaining stock basis. Any excess over stock basis is taxable to the shareholder as capital gain.

The S corporation retains its E&P from prior years as a regular corporation. Therefore, the S election does not allow the shareholders to avoid recognition of dividend income when those accumulated C corporation earnings are eventually distributed; however, the shareholders do not have to recognize dividend income until the S corporation has fully distributed its accumulated taxable income earned as an S corporation (the AAA account). Only after both accounts have been liquidated (AAA and E&P) will distributions be treated as a return of capital. The return of capital portion of an S corporation distribution will be taxable as a capital gain to the extent it exceeds the shareholder's stock basis.



Example 3-3

Bell, Inc., wholly owned by Jo Carter and Tricia Edwards, was established in 2015. In 2019, it made the election to be taxed under subchapter S. As of the effective date of the election, Bell had accumulated E&P of \$50,000. In its first two years of S corporation operations, it reported accumulated taxable income of \$60,000. It made no distributions in 2019, but in 2020, it distributed \$150,000 to its shareholders. Assume that Jo and Trish are equal shareholders and that each received \$75,000. The distribution would be classified as follows for tax purposes:

- The first \$60,000 (\$30,000 per shareholder) will be deemed to come from AAA and will be nontaxable to the shareholders.
- The next \$50,000 (\$25,000 per shareholder) will constitute taxable dividend income to the shareholders.
- The last \$40,000 (\$20,000 per shareholder) will be classified as a return of capital.

Knowledge check

3. Assume the same facts as in example 3-3. Further assume that the shareholders' shares of Bell's S corporation income were \$30,000 each. Under subchapter S, they would each report \$30,000 income and increase their tax bases in their Bell stock by the same amount. Assume that after accounting for the flow-through income, Jo's stock basis was \$45,000, and Tricia's was \$80,000. If each shareholder received a \$75,000 distribution, how much capital gain income will each shareholder recognize?
 - a. \$0 Capital gain to Jo; \$0 to Tricia.
 - b. \$25,000 capital gain to each shareholder.
 - c. \$5,000 capital gain to Jo; \$0 to Tricia.
 - d. \$15,000 capital gain to Jo; \$20,000 to Tricia.

The S corporation can elect under IRC Section 1368 to distribute accumulated E&P first (before AAA). Once E&P is reduced to \$0, all future distributions will be treated as a return of capital, taxable only to the extent they exceed the tax basis of the shareholder's stock. All affected shareholders must consent to this change in the normal distribution rules, or it will not be allowed. To make the election, the

S corporation must attach a statement to its timely filed, or amended, Form 1120S for the year for which the election is being made. The statement must state that all shareholders consent to the election, and it must include the amount of dividend income to be recognized by each shareholder.

Key review point

Ag Air had accumulated E&P of \$1,335,000 from its years of operation as a regular corporation. Its book income this year, from Schedule M-1, line 1, was \$42,560. This is the balance in the company's AAA (before accounting for the distribution) and should be reported on Schedule M-2, column a, line 6. The first \$42,560 distributed to the shareholders comes from AAA, leaving an ending balance of zero, which should be the balance reported Schedule M-2, column a, line 8.

Total distributions were \$360,000. Only the first \$42,560 comes from the AAA account; the remainder comes from Ag Air's accumulated E&P account (Schedule M-2, column c). In this case, the information reported on Schedule M-2 is miscategorized and will lead the S corporation to understate the amount of the distribution received by each shareholder that should be reported by them as dividend income on their individual tax returns. In this case, the shareholders must recognize dividend income of \$317,440. **This amount should be, but has not been, reported to the shareholders on their Schedule K-1s.**

This is a major review point. Ag Air should report dividend income to the shareholders of \$126,976 to Erin, equal to the difference between the \$144,000 in distributions she received and her 40% share of the S corporation's AAA account (\$17,024). Chris and Pat should each report dividend income of \$95,232, equal to the difference between the distributions they received (\$108,000 each) and their 30% shares of AAA (\$12,768 each). **These amounts should be reported on the K-1s as other information (line 17), with an attached statement indicating that these amounts constitute qualified dividends.** Equally important, the amounts reported on line 16 (items affecting shareholder basis) should be reduced by the amount deemed to have been distributed from E&P. The shareholders do not reduce stock basis by amounts taxable to them as dividends. The amounts reported on Schedule K-1, line 16 should be reduced to \$17,024 (Erin) and \$12,768 (Chris and Pat).

Finally, note that Schedule M-2 contains a reconciliation of Ag Air's E&P account (column c). This reconciliation is very important and should probably be backed up with a working paper or schedule in the working papers. For Ag Air, the beginning balance in E&P was \$1,335,000. This amount should have been reported on line 1, column c, rather than column a. Of this amount, \$317,440 was distributed as dividends to the three shareholders, leaving an ending balance of \$1,017,650. **It is important to update this account to reflect distributions to the shareholders from year to year.**

In many circumstances, the tax consequences to the shareholders may be lower if the S corporation reclassifies its distributions as salary or bonus payments (taxable to the shareholders as salary income). Although the additional salary would be taxable as ordinary income, the increased compensation income is offset by the S corporation's deduction for that compensation against its ordinary business income. The net effect is essentially \$0, although the tax savings depend on how the additional payroll tax compares to the reduced dividend tax. This strategy will be most effective if the shareholders' earned

income is at or greater than the Social Security earnings ceiling. In such cases, the additional payroll tax is limited to the Medicare tax, which will be much lower than the dividend tax, resulting in potentially significant net tax savings.



Example 3-4

Barnwell, Inc. is an S corporation with two equal shareholders, Arturo and Dunbar. The company’s ordinary business income for 2021, after deducting shareholder salaries of \$115,000 each, was \$85,000 (allocated equally between the two shareholders). In addition, it distributed \$180,000 to the two shareholders (\$90,000 each). The company had E&P from prior years of \$100,000. Its first year as an S corporation was 2021; therefore, the balance in its AAA account prior to the distributions was equal to its \$85,000 ordinary business income. If it classifies the \$180,000 in distributions as bonus payments instead, the consequences to the shareholders will be as follows:

| | Tax consequences to shareholders | |
|--------------------------|----------------------------------|----------------|
| | w/distributions | w/bonus |
| Ordinary business income | \$85,000 | (95,000) |
| Dividend income | 95,000 | 0 |
| Salary income | 115,000 | 115,000 |
| Bonus income | 0 | 180,000 |
| Total income | 295,000 | 200,000 |

The income tax savings on the missing dividend income will be partially offset by the additional 2.9% Medicare tax that will be owed on the increased salary (bonus) income, but the net savings should still be substantial.

QBI deduction

The Section 199A deduction with respect to the QBI of an S corporation is generally determined at the shareholder, rather than the S corporation, level. The shareholders each compute their QBI by aggregating their pro rata share of S corporation revenues and expenses related to QBI activities with those items incurred outside the S corporation (whether directly or indirectly). They must also have information regarding the W-2 wages paid by the S corporation and the unadjusted basis of assets used in the production of QBI to calculate any potential limitation applicable to their QBI deduction.

Key review point

Because Ag Air is in the business of manufacturing aircraft for the agricultural industry, and all of its activities occur in the United States, all of its business income constitutes QBI. The only additional information shareholders need is their share of the corporation's W-2 wages and the unadjusted basis of assets used in the production of QBI. Ag Air should provide this information on line 17 of the Schedule K-1s. **This item is not reported on the Schedules K-1 included with Ag Air's 2021 tax return, and must be added before the K-1s are sent to shareholders.** Note that the QBI deduction should not reduce the shareholders' tax basis in their S corporation stock or debt.

Shareholders' tax bases in stock and loans to S corporation

Shareholders must compute their tax bases in their S corporation stock and debt annually in order to properly apply limitations on the deductibility of pass-through losses (may not exceed basis in stock and debt) and to determine the extent to which distributions from the S corporation may generate taxable gain. IRC Section 1367 describes the calculation of the shareholders' tax basis in their S corporation stock. The shareholders' initial basis in their S corporation stock is equal to the amount paid for such stock if acquired in a taxable acquisition or the tax basis of property contributed to the corporation in exchange for the stock (increased by the gain, if any, recognized on the exchange and decreased by the value of property other than stock received in the exchange). The statute provides that basis is increased by

- the shareholder's share of items of S corporation income, including nontaxable income;
- the shareholder's share of S corporation non-separately computed income (that is, ordinary business income); and
- the excess of the deductions for depletion over the basis of the property subject to depletion.

Stock basis is decreased for any period (but not less than \$0) by the sum of the following items determined with respect to the shareholder for such period:

- Distributions by the corporation that are not includible in the income of the shareholder;
- The shareholder's share of non-separately computed S corporation loss;
- The shareholder's share of the tax basis of property contributed to eligible charitable organizations;
- The shareholder's share of any expense of the corporation not deductible in computing its taxable income and not properly chargeable to capital account; and
- The amount of the shareholder's deduction for depletion for any oil and gas property held by the S corporation to the extent such deduction does not exceed the proportionate share of the adjusted basis of such property allocated to such shareholder

The sequence in which these adjustments are made can often have a significant impact on whether a distribution triggers income to a shareholder, and if so, how much. The regulations under Section 1367 (Regs. Sec. 1.1367-1(f)) provide that adjustments to the basis of a shareholder's stock follow the preceding sequence. Basis increases are applied first before accounting for distributions (other than those classified as dividends). Finally, basis is reduced (but not less than \$0) for losses or nondeductible expenses.

Note that shareholder basis in stock does not include any portion of S corporation debt. This is true regardless of the presence of shareholder guarantees of some or all the corporation's liabilities; however, a shareholder will have a tax basis in loans made by the shareholder to the S corporation, and this basis can be used to absorb pass-through losses, but not distributions, from the S corporation.

Knowledge check

4. Kyle has a tax basis in his S corporation stock of \$120,000. He also has a \$100,000 tax basis in a note receivable (N/R) from the S corporation. This year, the S corporation reported a net ordinary business loss of \$73,000 and distributed \$125,000 to Kyle. How much gain will Kyle recognize on receipt of the distribution and what will be his tax basis in the N/R at the beginning of next year?
- \$0 gain; \$0 basis in N/R.
 - \$5,000 gain; \$27,000 basis in N/R.
 - \$78,000 gain; \$100,000 basis in N/R.
 - \$5,000 gain, \$100,000 basis in N/R.

Consistent with the preceding discussion, stock basis cannot be reduced below \$0; losses in excess of remaining stock basis after reductions for distributions and nondeductible expenses can be deducted against the shareholder's basis in indebtedness of the S corporation to the shareholder. If the losses exceed the shareholder's basis in both stock and debt, the excess is not deductible but may be carried forward indefinitely until the shareholder restores basis in stock or debt.

Adjustments to stock basis are determined as of the close of the corporation's taxable year and are generally applied at that time; however, if a shareholder disposes of stock during the corporation's taxable year, the regulations under Section 1367 (1.1367-1(d)) provide that adjustments with respect to that stock are applied immediately prior to the disposition (although still determined as of the end of the corporation's tax year). Adjustments to the basis of a shareholder's stock in an S corporation are allocated to individual shares on a per share, per day basis in accordance with IRC Section 1377(a).

Key review point

Ag Air distributed \$360,000 to its shareholders during 2021. Of this amount, \$42,560 is deemed to come from the AAA. This is the balance in the AAA account per Schedule M-2, line 6. The remaining \$317,440 is deemed to come from accumulated E&P and is therefore taxable to the shareholders as dividend income. Stock basis is reduced only by the \$42,560 distributed from AAA. Because this is the amount of taxable income passed through to the shareholders on their Schedule K-1s, their tax bases in their stock should be the same at the beginning of 2022 as they were at the beginning of 2021 (equal to their tax bases in their regular corporation stock before the S election).

Recall that the Section 199A deduction, computed by each shareholder based on information reported to them by Ag Air (and increased or decreased by other QBI or loss from other entities in which the shareholder has an interest), does *not* reduce their tax bases in their stock. Likewise, because Ag Air was

profitable, Erin's tax basis in the note receivable from the S corporation (used to help purchase new equipment) will be unchanged at \$250,000.

There is no requirement that this information be reported to the shareholders. Only items that might affect stock basis are reported to shareholders (on Schedule K-1, line 16 — Items affecting shareholder basis). The S corporation will often not know what the shareholders' actual tax bases in their stock may be. For example, if a shareholder buys shares from another shareholder, the S corporation may not be privy to the purchase price paid. Therefore, there is no requirement that the S corporation report specific information computing the shareholders' tax bases in stock and debt.



Chapter 4

Case Four: Primrose Real Estate Investments, Inc.

Learning objectives

- Apply the passive loss limitations to pass-through losses reported to shareholders.
- Calculate and properly report the tax consequences associated with the distribution of appreciated property by an S corporation to a shareholder in redemption of stock.
- Accurately determine how to allocate S corporation pass-through items when the shareholders' interests in the corporation change during the tax year.
- Identify and properly report the tax consequences associated with like-kind exchanges between the S corporation and unrelated parties.

Facts

Primrose Real Estate Investments, Inc. was formed on July 1, 2007, by the following three investors:

| Name | Number of Shares | ID Number |
|-----------------------|------------------|-------------|
| Jesse Finnegan | 400 | 453-22-1234 |
| 1207 Nature's Way | | |
| Arlington, TX 76017 | | |
| Dane Cortez | 400 | 444-55-3333 |
| 1506 CR 1924 | | |
| Weatherford, TX 76087 | | |
| Rikki Dean | 200 | 333-34-4554 |
| 1513 Prairie Oaks | | |
| Arlington, TX 76020 | | |

Primrose's federal identification number is 75-1475310, and its address is 100 Ave. H, Arlington, TX 76016. The company invests in and manages real estate and has properly been treated as an S corporation for tax purposes since its inception. The company's trial balance as of December 31, 2021, was as follows:

| | Beginning of the year | | End of the year | |
|------------------------------------|-----------------------|-----------|-----------------|-----------|
| Cash | \$275,000 | | \$94,875 | |
| Buildings | 3,272,500 | | 2,702,500 | |
| Accumulated depreciation, building | | 1,397,042 | | 1,103,452 |
| Land | 327,500 | | 247,500 | |
| Other assets | 50,000 | | 25,000 | |

| | Beginning of the year | | End of the year | |
|----------------------------------|-----------------------|-----------|-----------------|-----------|
| | | | | |
| Short-term note | | | | 285,000 |
| Long-term notes payable | | 2,050,000 | | 1,500,000 |
| Capital stock | | 100,000 | | 100,000 |
| Additional paid-in capital | | 400,000 | | 400,000 |
| Retained earnings | 22,042 | | | |
| Treasury stock | | | 750,000 | |
| Rents | | | | 525,000 |
| Gain on disposal of Lynx Meadows | | | | 513,000 |
| Taxes | | | 65,000 | |
| Advertising | | | 12,000 | |
| Insurance | | | 8,550 | |
| Interest expense | | | 110,000 | |
| Repairs & maintenance—materials | | | 50,000 | |
| Repairs & maintenance—salary | | | 40,000 | |
| Utilities | | | 60,000 | |
| Management, including salaries | | | 141,450 | |
| Depreciation expense | | | 97,535 | |
| | ----- | ----- | ----- | ----- |
| Totals | 3,947,042 | 3,947,042 | 4,404,410 | 4,426,452 |

Note that the corporation depreciates its assets for book using tax depreciation methods.

Primrose Real Estate Investments was formed in 2007 by three investors — Jesse Finnegan, Dane Cortez, and Rikki Dean — to purchase an apartment complex, which they named Starlight Way. The total cost of the property was \$2,250,000, of which \$187,500 was allocated to the land upon which the apartments were built. They financed the acquisition with cash and a large note payable. As of January 1, 2021, the remaining balance of the note was \$1,300,000. Because they were all cash investors, they did not see a need to make special allocations of income, gain, loss, or deduction. They did, however, want limited liability, so they decided to hold the property through a newly formed S corporation.

Jesse and Dane are president and vice-president, respectively, of the S corporation. Jesse spends about 75% of her time managing the company and is paid a salary of \$90,000. Dane spends less than 30% of his time on Primrose business and receives a salary of \$30,000. Because Rikki decided last year to leave the company, she received no salary in 2021.

In 2013, Primrose purchased a second property named Lynx Meadows. The company paid \$1,350,000 for the property, of which \$140,000 was allocated to the land on which it sits. It financed the acquisition with a combination of cash and debt; by 2021, the outstanding balance of the note payable was \$750,000.

In 2021, Jesse and Dane began negotiations to exchange the Starlight Way apartment complex for a restaurant property named Rorschach Corner. Rikki did not want to change the company's investment focus, so the other investors agreed to allow her to leave the company. To that end, the company transferred title to Lynx Meadows to Rikki in complete redemption of her 20% interest in the S corporation. At the date of the transfer to Rikki, the shareholders agreed that the fair market value of the apartment complex was \$1,500,000.

The redemption transaction closed on April 2, 2021, and just over one month later, Primrose closed the transaction with the owner of the restaurant, transferring the Starlight Way apartment complex, plus \$500,000 cash, to the other party in exchange for the Rorschach Corner restaurant property. Both properties in the exchange were encumbered by sizable debts. Primrose was relieved of liability for the \$1,300,000 remaining note payable on Starlight Way, but assumed a \$1,500,000 liability on the restaurant property. The net result was an increase in the company's debt of \$200,000.

Therefore, effective May 4, 2021, Jesse and Dane were each 50% owners of Primrose Real Estate Investments, Inc. which owned only one property, the restaurant at Rorschach Corner. The property was under lease when Primrose acquired it and it remained continually leased throughout the remainder of the tax year (year-end December 31, 2021).

The unfiled 2021 tax return for Primrose Real Estate Investments, Inc. is reprinted on the following pages for your review. In reviewing the return, you should pay careful attention to the following items, which are discussed in more depth throughout the rest of this chapter.

- Are the net profits or losses from operation of the S corporation's real estate rental operations properly reported on the Form 1120S, *U.S. Income Tax Return for an S Corporation*?
 - The company disposed of two properties and acquired a third during 2021. Is depreciation properly computed and reported for each property?

- With interest expense and depreciation, Primrose recognized a net rental real estate loss on Form 8825, *Rental Real Estate Income and Expenses of a Partnership or an S Corporation*. Will the passive loss rules apply to the shareholders?
- Is the distribution of the Lynx Meadows property to Rikki properly reported in the tax return?
 - Is this a distribution or a taxable exchange? If the latter, did the company properly compute the gain or loss associated with the exchange?
 - How should the exchange affect Primrose’s balance sheets (Schedule L)? Is the accounting properly reflected in the company’s ending balance sheet?
- Rikki was a shareholder in the corporation only through April 2, 2021. How should the company’s income or loss be allocated among the shareholders?
- Did the company properly report the like-kind exchange on its 2021 tax return?
 - Should the company have reported any gain on the exchange? If so, was this gain properly reported on the tax return?
 - What is the tax basis of the restaurant property acquired in the exchange?
 - Assuming the newly acquired property is “qualified restaurant property,” can Primrose expense any of it under IRC Section 179? Did it do so properly?

U.S. Income Tax Return for an S Corporation

Department of the Treasury
Internal Revenue Service

▶ Do not file this form unless the corporation has filed or is attaching Form 2553 to elect to be an S corporation.
▶ Go to www.irs.gov/Form1120S for instructions and the latest information.

2021

For calendar year 2021 or tax year beginning _____, 2021, ending _____, 20

| | | | |
|--|----------------------|---|--|
| A S election effective date 01/01/2007 | TYPE OR PRINT | Name Primrose Real Estate Investments, Inc. | D Employer identification number 75-1475310 |
| B Business activity code number (see instructions) | | Number, street, and room or suite no. If a P.O. box, see instructions. 100 Ave H | E Date incorporated 01/01/2007 |
| C Check if Sch. M-3 attached <input type="checkbox"/> | | City or town, state or province, country, and ZIP or foreign postal code Arlington, TX 76016 | F Total assets (see instructions) \$ 1,966,423 |

G Is the corporation electing to be an S corporation beginning with this tax year? See instructions. Yes No

H Check if: (1) Final return (2) Name change (3) Address change (4) Amended return (5) S election termination

I Enter the number of shareholders who were shareholders during any part of the tax year ▶ _____

J Check if corporation: (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 21. See the instructions for more information.

| | | | | |
|--|---|------------|------------|---|
| Income | 1a Gross receipts or sales | 1a | | |
| | b Returns and allowances | 1b | | |
| | c Balance. Subtract line 1b from line 1a | | 1c | 0 |
| | 2 Cost of goods sold (attach Form 1125-A) | | 2 | |
| | 3 Gross profit. Subtract line 2 from line 1c | | 3 | |
| | 4 Net gain (loss) from Form 4797, line 17 (attach Form 4797) | | 4 | 0 |
| 5 Other income (loss) (see instructions—attach statement) | | 5 | | |
| 6 Total income (loss). Add lines 3 through 5 ▶ | | 6 | 0 | |
| Deductions (see instructions for limitations) | 7 Compensation of officers (see instructions—attach Form 1125-E) | | 7 | 0 |
| | 8 Salaries and wages (less employment credits) | | 8 | 0 |
| | 9 Repairs and maintenance | | 9 | |
| | 10 Bad debts | | 10 | |
| | 11 Rents | | 11 | |
| | 12 Taxes and licenses | | 12 | |
| | 13 Interest (see instructions) | | 13 | |
| | 14 Depreciation not claimed on Form 1125-A or elsewhere on return (attach Form 4562) | | 14 | |
| | 15 Depletion (Do not deduct oil and gas depletion.) | | 15 | |
| | 16 Advertising | | 16 | |
| | 17 Pension, profit-sharing, etc., plans | | 17 | |
| | 18 Employee benefit programs | | 18 | |
| | 19 Other deductions (attach statement) | | 19 | |
| | 20 Total deductions. Add lines 7 through 19 ▶ | | 20 | 0 |
| | 21 Ordinary business income (loss). Subtract line 20 from line 6 ▶ | | 21 | 0 |
| Tax and Payments | 22a Excess net passive income or LIFO recapture tax (see instructions) | 22a | | |
| | b Tax from Schedule D (Form 1120-S) | 22b | | |
| | c Add lines 22a and 22b (see instructions for additional taxes) | | 22c | |
| | 23a 2021 estimated tax payments and 2020 overpayment credited to 2021 | 23a | | |
| | b Tax deposited with Form 7004 | 23b | | |
| | c Credit for federal tax paid on fuels (attach Form 4136) | 23c | | |
| | d Add lines 23a through 23c | | 23d | |
| | 24 Estimated tax penalty (see instructions). Check if Form 2220 is attached ▶ <input type="checkbox"/> | | 24 | |
| | 25 Amount owed. If line 23d is smaller than the total of lines 22c and 24, enter amount owed | | 25 | |
| | 26 Overpayment. If line 23d is larger than the total of lines 22c and 24, enter amount overpaid | | 26 | |
| 27 Enter amount from line 26: Credited to 2022 estimated tax ▶ Refunded ▶ | | 27 | | |

Sign Here Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

| | | | | | | |
|-------------------------------|-----------------------------------|-------------|-------|---------------------|-------|--|
| Signature of officer | _____ | Date | _____ | Title | _____ | May the IRS discuss this return with the preparer shown below? See instructions. <input type="checkbox"/> Yes <input type="checkbox"/> No |
| | Print/Type preparer's name | | _____ | | | |
| Paid Preparer Use Only | Firm's name ▶ | _____ | | Firm's EIN ▶ | _____ | |
| | Firm's address ▶ | _____ | | Phone no. | _____ | |

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 ▶ Rental Real Estate **b** Product or service ▶ Residential & Commercial Realty
- 3** At any time during the tax year, was any shareholder of the corporation a disregarded entity, a trust, an estate, or a nominee or similar person? If "Yes," attach Schedule B-1, Information on Certain Shareholders of an S Corporation
- 4** At the end of the tax year, did the corporation:
- a** Own directly 20% or more, or own, directly or indirectly, 50% or more of the total stock issued and outstanding of any foreign or domestic corporation? For rules of constructive ownership, see instructions. If "Yes," complete (i) through (v) below

| Yes | No |
|-----|----|
| | |
| | |
| | ✓ |
| | |
| | ✓ |

| (i) Name of Corporation | (ii) Employer Identification Number (if any) | (iii) Country of Incorporation | (iv) Percentage of Stock Owned | (v) If Percentage in (iv) Is 100%, Enter the Date (if 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

| Yes | No |
|-----|----|
| | |
| | ✓ |

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

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

(i) Total shares of restricted stock ▶ _____
 (ii) Total shares of non-restricted stock ▶ _____

| Yes | No |
|-----|----|
| | ✓ |

- b** At the end of the tax year, did the corporation have any outstanding stock options, warrants, or similar instruments?
 If "Yes," complete lines (i) and (ii) below.

(i) Total shares of stock outstanding at the end of the tax year ▶ _____
 (ii) Total shares of stock outstanding if all instruments were executed ▶ _____

| Yes | No |
|-----|----|
| | ✓ |

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

| Yes | No |
|-----|----|
| | ✓ |

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

| Yes | No |
|-----|----|
| | |

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

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

| Yes | No |
|-----|----|
| | ✓ |

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

- a** The corporation owns a pass-through entity with current, or prior year carryover, excess business interest expense.
b The corporation's aggregate average annual gross receipts (determined under section 448(c)) for the 3 tax years preceding the current tax year are more than \$26 million and the corporation has business interest expense.
c The corporation is a tax shelter and the corporation has business interest expense.
 If "Yes," complete and attach Form 8990.

| Yes | No |
|-----|----|
| | ✓ |

- 11** Does the corporation satisfy **both** of the following conditions?

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

| Yes | No |
|-----|----|
| | ✓ |

| Schedule B Other Information (see instructions) <i>(continued)</i> | | Yes | No |
|---|---|-----|----|
| 12 | During the tax year, did the corporation have any non-shareholder debt that was canceled, was forgiven, or had the terms modified so as to reduce the principal amount of the debt? | | ✓ |
| | If "Yes," enter the amount of principal reduction ▶ \$ | | |
| 13 | During the tax year, was a qualified subchapter S subsidiary election terminated or revoked? If "Yes," see instructions | | ✓ |
| 14a | Did the corporation make any payments in 2021 that would require it to file Form(s) 1099? | | ✓ |
| b | If "Yes," did the corporation file or will it file required Form(s) 1099? | | |
| 15 | Is the corporation attaching Form 8996 to certify as a Qualified Opportunity Fund? | | ✓ |
| | If "Yes," enter the amount from Form 8996, line 15 ▶ \$ | | |

| Schedule K Shareholders' Pro Rata Share Items | | Total amount | |
|---|---|----------------|----------------|
| Income (Loss) | 1 Ordinary business income (loss) (page 1, line 21) | 1 | 0 |
| | 2 Net rental real estate income (loss) (attach Form 8825) | 2 | -59,535 |
| | 3a Other gross rental income (loss) 3a | | |
| | b Expenses from other rental activities (attach statement) 3b | | |
| | c Other net rental income (loss). Subtract line 3b from line 3a 3c | | |
| | 4 Interest income 4 | | |
| | 5 Dividends: a Ordinary dividends 5a | | |
| | b Qualified dividends 5b | | |
| | 6 Royalties 6 | | |
| | 7 Net short-term capital gain (loss) (attach Schedule D (Form 1120-S)) 7 | | |
| 8a Net long-term capital gain (loss) (attach Schedule D (Form 1120-S)) 8a | | | |
| b Collectibles (28%) gain (loss) 8b | | | |
| c Unrecaptured section 1250 gain (attach statement) 8c | 363,000 | | |
| 9 Net section 1231 gain (loss) (attach Form 4797) 9 | | 513,000 | |
| 10 Other income (loss) (see instructions) Type ▶ 10 | | | |
| Deductions | 11 Section 179 deduction (attach Form 4562) 11 | | |
| | 12a Charitable contributions 12a | | |
| | b Investment interest expense 12b | | |
| | c Section 59(e)(2) expenditures Type ▶ 12c | | |
| d Other deductions (see instructions) Type ▶ 12d | | | |
| Credits | 13a Low-income housing credit (section 42(j)(5)) 13a | | |
| | b Low-income housing credit (other) 13b | | |
| | c Qualified rehabilitation expenditures (rental real estate) (attach Form 3468, if applicable) 13c | | |
| | d Other rental real estate credits (see instructions) Type ▶ 13d | | |
| | e Other rental credits (see instructions) Type ▶ 13e | | |
| | f Biofuel producer credit (attach Form 6478) 13f | | |
| | g Other credits (see instructions) Type ▶ 13g | | |
| International Transactions | 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"/> | | |
| Alternative Minimum Tax (AMT) Items | 15a Post-1986 depreciation adjustment 15a | | |
| | b Adjusted gain or loss 15b | | |
| | c Depletion (other than oil and gas) 15c | | |
| | d Oil, gas, and geothermal properties—gross income 15d | | |
| | e Oil, gas, and geothermal properties—deductions 15e | | |
| | f Other AMT items (attach statement) 15f | | |
| Items Affecting Shareholder Basis | 16a Tax-exempt interest income 16a | | |
| | b Other tax-exempt income 16b | | |
| | c Nondeductible expenses 16c | | |
| | d Distributions (attach statement if required) (see instructions) 16d | | |
| | e Repayment of loans from shareholders 16e | | |
| | f Foreign taxes paid or accrued 16f | | |

| Schedule K Shareholders' Pro Rata Share Items (continued) | | Total amount | |
|--|--|---------------------|----------------|
| Other Information | 17a Investment income | 17a | 0 |
| | b Investment expenses | 17b | 0 |
| | c Dividend distributions paid from accumulated earnings and profits | 17c | |
| | d Other items and amounts (attach statement) | | |
| Reconciliation | 18 Income (loss) reconciliation. Combine the amounts on lines 1 through 10 in the far right column. From the result, subtract the sum of the amounts on lines 11 through 12d and 16f . | 18 | 453,465 |

| Schedule L Balance Sheets per Books | | Beginning of tax year | | End of tax year | |
|---|--|-----------------------|------------------|----------------------|--------------------|
| | | (a) | (b) | (c) | (d) |
| Assets | | | | | |
| 1 | Cash | | 275,000 | | 94,875 |
| 2a | Trade notes and accounts receivable | | | | |
| b | Less allowance for bad debts | () | | () | |
| 3 | Inventories | | | | |
| 4 | U.S. government obligations | | | | |
| 5 | Tax-exempt securities (see instructions) | | | | |
| 6 | Other current assets (attach statement) | | | | |
| 7 | Loans to shareholders | | | | |
| 8 | Mortgage and real estate loans | | | | |
| 9 | Other investments (attach statement) | | 50,000 | | 25,000 |
| 10a | Buildings and other depreciable assets | 3,272,500 | | 2,702,500 | |
| b | Less accumulated depreciation | (1,397,042) | 1,875,458 | (1,103,452) | 1,599,048 |
| 11a | Depletable assets | | | | |
| b | Less accumulated depletion | () | | () | |
| 12 | Land (net of any amortization) | | 327,500 | | 247,500 |
| 13a | Intangible assets (amortizable only) | | | | |
| b | Less accumulated amortization | () | | () | |
| 14 | Other assets (attach statement) | | | | |
| 15 | Total assets | | 2,527,958 | | 1,966,423 |
| Liabilities and Shareholders' Equity | | | | | |
| 16 | Accounts payable | | | | |
| 17 | Mortgages, notes, bonds payable in less than 1 year | | 2,050,000 | | 1,500,000 |
| 18 | Other current liabilities (attach statement) | | | | 285,000 |
| 19 | Loans from shareholders | | | | |
| 20 | Mortgages, notes, bonds payable in 1 year or more | | | | |
| 21 | Other liabilities (attach statement) | | | | |
| 22 | Capital stock | | 100,000 | | 100,000 |
| 23 | Additional paid-in capital | | 400,000 | | 400,000 |
| 24 | Retained earnings | | -22,042 | | 431,423 |
| 25 | Adjustments to shareholders' equity (attach statement) | | | | |
| 26 | Less cost of treasury stock | | () | | (750,000) |
| 27 | Total liabilities and shareholders' equity | | 2,527,958 | | 1,966,423 |

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

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

| | | | |
|---|----------------|--|----------------|
| 1 Net income (loss) per books | 453,465 | 5 Income recorded on books this year not included on Schedule K, lines 1 through 10 (itemize): | |
| 2 Income included on Schedule K, lines 1, 2, 3c, 4, 5a, 6, 7, 8a, 9, and 10, not recorded on books this year (itemize) _____ | | a Tax-exempt interest \$ _____ | |
| 3 Expenses recorded on books this year not included on Schedule K, lines 1 through 12 and 16f (itemize): | | 6 Deductions included on Schedule K, lines 1 through 12 and 16f, not charged against book income this year (itemize): | |
| a Depreciation \$ _____ | | a Depreciation \$ _____ | |
| b Travel and entertainment \$ _____ | | 7 Add lines 5 and 6 | |
| 4 Add lines 1 through 3 | 453,465 | 8 Income (loss) (Schedule K, line 18). Subtract line 7 from line 4 | 453,465 |

Schedule M-2 Analysis of Accumulated Adjustments Account, Shareholders' Undistributed Taxable Income Previously Taxed, Accumulated Earnings and Profits, and Other Adjustments Account
(see instructions)

| | (a) Accumulated adjustments account | (b) Shareholders' undistributed taxable income previously taxed | (c) Accumulated earnings and profits | (d) Other adjustments account |
|--|-------------------------------------|---|--------------------------------------|-------------------------------|
| 1 Balance at beginning of tax year | 0 | 0 | | 0 |
| 2 Ordinary income from page 1, line 21 | 0 | | | |
| 3 Other additions | 513,000 | | | |
| 4 Loss from page 1, line 21 | () | | | |
| 5 Other reductions | (59,535) | | | () |
| 6 Combine lines 1 through 5 | 453,465 | 0 | | 0 |
| 7 Distributions | | | | |
| 8 Balance at end of tax year. Subtract line 7 from line 6 | 453,465 | 0 | | 0 |

Additional information from your Schedule K-1:Shareholder's Share of Income, Deductions, Credits, etc. (Dane Cortez)

Schedule K-1:Shareholder's Share of Income, Deductions, Credits, etc. (Dane Cortez)
Form 8825 Rental Inc/Loss Details for Reporting Purposes **Continuation Statement**

| Description | Amount |
|-----------------------------------|----------|
| LYNX MEADOWS APARTMENT COMPLEX | |
| PROPERTY DISPOSED OF THIS YEAR | |
| PROPERTY TYPE: 2 MULTI-FAMILY RES | -6,996. |
| STARLIGHT WAY APARTMENT COMPLEX | |
| PROPERTY DISPOSED OF THIS YEAR | |
| PROPERTY TYPE: 2 MULTI-FAMILY RES | -12,546. |
| RORSCHACH CORNER | |
| PROPERTY TYPE: 4 COMMERCIAL | -8,725. |

Statement A-QBI Pass-through Entity Reporting

2

| | | | |
|---|---|---|--|
| Corporation's name: Primrose Real Estate Investments, Inc. | | Corporation's EIN: 75-1475310 | |
| Shareholder's name: Dane Cortez | | Shareholder's identifying no: 444-55-3333 | |
| | | 1120S, Line 21 | Lynx Meadows Apartment Complex |
| Shareholder's share of: | | <input type="checkbox"/> PTP <input type="checkbox"/> Aggregated <input checked="" type="checkbox"/> SSTB | <input type="checkbox"/> PTP <input type="checkbox"/> Aggregated <input type="checkbox"/> SSTB |
| QBI or qualified PTP items subject to shareholder-specific determinations: | | | |
| | Ordinary business income (loss) | 0. | |
| | Rental income (loss) | | -6,995. |
| | Royalty income (loss) | | |
| | Section 1231 gain (loss) | | 243,569. |
| | Other income (loss) | | |
| | Section 179 deduction | | |
| | Charitable contributions | | |
| | Other deductions | | |
| | W-2 wages | 0. | 7,122. |
| | UBIA of qualified property | | 0. |
| | Section 199A dividends | | |

Statement A-QBI Pass-through Entity Reporting

3

| | | | |
|---|---|--|--|
| Corporation's name: Primrose Real Estate Investments, Inc. | | Corporation's EIN: 75-1475310 | |
| Shareholder's name: Dane Cortez | | Shareholder's identifying no: 444-55-3333 | |
| | | Rorschach Corner | |
| Shareholder's share of: | | <input type="checkbox"/> PTP <input type="checkbox"/> Aggregated <input type="checkbox"/> SSTB | <input type="checkbox"/> PTP <input type="checkbox"/> Aggregated <input type="checkbox"/> SSTB |
| QBI or qualified PTP items subject to shareholder-specific determinations: | | | |
| | Ordinary business income (loss) | | |
| | Rental income (loss) | -8,726. | |
| | Royalty income (loss) | | |
| | Section 1231 gain (loss) | | |
| | Other income (loss) | | |
| | Section 179 deduction | | |
| | Charitable contributions | | |
| | Other deductions | | |
| | W-2 wages | 40,357. | |
| | UBIA of qualified property | 820,264. | |
| | Section 199A dividends | | |

671121

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

Department of the Treasury
Internal Revenue Service

2021

For calendar year 2021, or tax year

beginning / / 2021 ending / /

Final K-1

Amended K-1

OMB No. 1545-0123

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

▶ See separate instructions.

| Part I Information About the Corporation | | Part III Shareholder's Share of Current Year Income, Deductions, Credits, and Other Items | |
|---|--|--|--|
| A Corporation's employer identification number 75-1475310 | | 1 Ordinary business income (loss) 0 | 13 Credits |
| B Corporation's name, address, city, state, and ZIP code Primrose Real Estate Investments, Inc. 100 Ave H Arlington, TX 76016 | | 2 Net rental real estate income (loss) -3,001 | |
| C IRS Center where corporation filed return Ogden, UT 84201-0013 | | 3 Other net rental income (loss) | |
| D Corporation's total number of shares Beginning of tax year 1,000 End of tax year 800 | | 4 Interest income | |
| | | 5a Ordinary dividends | |
| | | 5b Qualified dividends | 14 Schedule K-3 is attached if checked ▶ <input type="checkbox"/> |
| | | 6 Royalties | 15 Alternative minimum tax (AMT) items |
| | | 7 Net short-term capital gain (loss) | |
| | | 8a Net long-term capital gain (loss) | |
| | | 8b Collectibles (28%) gain (loss) | |
| | | 8c Unrecaptured section 1250 gain 18,299 | |
| | | 9 Net section 1231 gain (loss) 25,861 | 16 Items affecting shareholder basis |
| E Shareholder's identifying number 333-34-4554 | | 10 Other income (loss) | |
| F Shareholder's name, address, city, state, and ZIP code Rikki Dean 1513 Prairie Oaks Arlington, TX 76020 | | | |
| G Current year allocation percentage 5.04110 % | | | 17 Other information V* See Attached Stmt |
| H Shareholder's number of shares Beginning of tax year 200 End of tax year 0 | | 11 Section 179 deduction | |
| I Loans from shareholder Beginning of tax year \$ 0 End of tax year \$ 0 | | 12 Other deductions | |
| For IRS Use Only | | | |
| | | | |
| | | | |
| | | | |
| | | 18 <input type="checkbox"/> More than one activity for at-risk purposes* | |
| | | 19 <input type="checkbox"/> More than one activity for passive activity purposes* | |
| | | * See attached statement for additional information. | |

Additional information from your Schedule K-1:Shareholder's Share of Income, Deductions, Credits, etc. (Rikki Dean)

Schedule K-1:Shareholder's Share of Income, Deductions, Credits, etc. (Rikki Dean)

Form 8825 Rental Inc/Loss Details for Reporting Purposes

Continuation Statement

| Description | Amount |
|-----------------------------------|---------|
| LYNX MEADOWS APARTMENT COMPLEX | |
| PROPERTY DISPOSED OF THIS YEAR | |
| PROPERTY TYPE: 2 MULTI-FAMILY RES | -743. |
| STARLIGHT WAY APARTMENT COMPLEX | |
| PROPERTY DISPOSED OF THIS YEAR | |
| PROPERTY TYPE: 2 MULTI-FAMILY RES | -1,332. |
| RORSCHACH CORNER | |
| PROPERTY TYPE: 4 COMMERCIAL | -926. |

Statement A-QBI Pass-through Entity Reporting

2

| | | | |
|---|---|---|--|
| Corporation's name: Primrose Real Estate Investments, Inc. | | Corporation's EIN: 75-1475310 | |
| Shareholder's name: Rikki Dean | | Shareholder's identifying no: 333-34-4554 | |
| Shareholder's share of: | | 1120S, Line 21 | Lynx Meadows Apartment Complex |
| | | <input type="checkbox"/> PTP <input type="checkbox"/> Aggregated <input checked="" type="checkbox"/> SSTB | <input type="checkbox"/> PTP <input type="checkbox"/> Aggregated <input type="checkbox"/> SSTB |
| | | Starlight Way Apartment Complex | |
| | | <input type="checkbox"/> PTP <input type="checkbox"/> Aggregated <input type="checkbox"/> SSTB | <input type="checkbox"/> PTP <input type="checkbox"/> Aggregated <input type="checkbox"/> SSTB |
| QBI or qualified PTP items subject to shareholder-specific determinations: | | | |
| | Ordinary business income (loss) | 0. | |
| | Rental income (loss) | | -743. |
| | Royalty income (loss) | | -1,332. |
| | Section 1231 gain (loss) | | |
| | Other income (loss) | | 25,861. |
| | Section 179 deduction | | |
| | Charitable contributions | | |
| | Other deductions | | |
| | W-2 wages | 0. | 756. |
| | UBIA of qualified property | | 0. |
| | Section 199A dividends | | 3,025. |

Statement A-QBI Pass-through Entity Reporting

3

| | | | |
|---|---|--|--|
| Corporation's name: Primrose Real Estate Investments, Inc. | | Corporation's EIN: 75-1475310 | |
| Shareholder's name: Rikki Dean | | Shareholder's identifying no: 333-34-4554 | |
| Shareholder's share of: | | Rorschach Corner | |
| | | <input type="checkbox"/> PTP <input type="checkbox"/> Aggregated <input type="checkbox"/> SSTB | <input type="checkbox"/> PTP <input type="checkbox"/> Aggregated <input type="checkbox"/> SSTB |
| | | | |
| | | <input type="checkbox"/> PTP <input type="checkbox"/> Aggregated <input type="checkbox"/> SSTB | <input type="checkbox"/> PTP <input type="checkbox"/> Aggregated <input type="checkbox"/> SSTB |
| QBI or qualified PTP items subject to shareholder-specific determinations: | | | |
| | Ordinary business income (loss) | | |
| | Rental income (loss) | -926. | |
| | Royalty income (loss) | | |
| | Section 1231 gain (loss) | | |
| | Other income (loss) | | |
| | Section 179 deduction | | |
| | Charitable contributions | | |
| | Other deductions | | |
| | W-2 wages | 4,285. | |
| | UBIA of qualified property | 0. | |
| | Section 199A dividends | | |

Additional information from your Schedule K-1:Shareholder's Share of Income, Deductions, Credits, etc. (Jesse Finnegan)

Schedule K-1:Shareholder's Share of Income, Deductions, Credits, etc. (Jesse Finnegan)
Form 8825 Rental Inc/Loss Details for Reporting Purposes Continuation Statement

| Description | Amount |
|-----------------------------------|----------|
| LYNX MEADOWS APARTMENT COMPLEX | |
| PROPERTY DISPOSED OF THIS YEAR | |
| PROPERTY TYPE: 2 MULTI-FAMILY RES | -6,996. |
| STARLIGHT WAY APARTMENT COMPLEX | |
| PROPERTY DISPOSED OF THIS YEAR | |
| PROPERTY TYPE: 2 MULTI-FAMILY RES | -12,546. |
| RORSCHACH CORNER | |
| PROPERTY TYPE: 4 COMMERCIAL | -8,725. |

Statement A-QBI Pass-through Entity Reporting

2

| | | | | |
|--|---------------------------------|---|--|--|
| Corporation's name: Primrose Real Estate Investments, Inc. | | Corporation's EIN: 75-1475310 | | |
| Shareholder's name: Jesse Finnegan | | Shareholder's identifying no: 453-22-1234 | | |
| Shareholder's share of: | | 1120S, Line 21 | Lynx Meadows Apartment Complex | Starlight Way Apartment Complex |
| | | <input type="checkbox"/> PTP <input type="checkbox"/> Aggregated <input checked="" type="checkbox"/> SSTB | <input type="checkbox"/> PTP <input type="checkbox"/> Aggregated <input type="checkbox"/> SSTB | <input type="checkbox"/> PTP <input type="checkbox"/> Aggregated <input type="checkbox"/> SSTB |
| QBI or qualified PTP items subject to shareholder-specific determinations: | | | | |
| | Ordinary business income (loss) | 0. | | |
| | Rental income (loss) | | -6,995. | -12,546. |
| | Royalty income (loss) | | | |
| | Section 1231 gain (loss) | | 243,570. | |
| | Other income (loss) | | | |
| | Section 179 deduction | | | |
| | Charitable contributions | | | |
| | Other deductions | | | |
| | W-2 wages | 0. | 7,122. | 28,488. |
| | UBIA of qualified property | | 0. | 0. |
| | Section 199A dividends | | | |

Statement A-QBI Pass-through Entity Reporting

3

| | | | | |
|--|---------------------------------|--|--|--|
| Corporation's name: Primrose Real Estate Investments, Inc. | | Corporation's EIN: 75-1475310 | | |
| Shareholder's name: Jesse Finnegan | | Shareholder's identifying no: 453-22-1234 | | |
| Shareholder's share of: | | Rorschach Corner | | |
| | | <input type="checkbox"/> PTP <input type="checkbox"/> Aggregated <input type="checkbox"/> SSTB | <input type="checkbox"/> PTP <input type="checkbox"/> Aggregated <input type="checkbox"/> SSTB | <input type="checkbox"/> PTP <input type="checkbox"/> Aggregated <input type="checkbox"/> SSTB |
| QBI or qualified PTP items subject to shareholder-specific determinations: | | | | |
| | Ordinary business income (loss) | | | |
| | Rental income (loss) | -8,725. | | |
| | Royalty income (loss) | | | |
| | Section 1231 gain (loss) | | | |
| | Other income (loss) | | | |
| | Section 179 deduction | | | |
| | Charitable contributions | | | |
| | Other deductions | | | |
| | W-2 wages | 40,358. | | |
| | UBIA of qualified property | 820,265. | | |
| | Section 199A dividends | | | |

Like-Kind Exchanges
 (and section 1043 conflict-of-interest sales)
 ▶ Attach to your tax return.

▶ Go to www.irs.gov/Form8824 for instructions and the latest information.

| | |
|--|---|
| Name(s) shown on tax return Primrose Real Estate Investments, Inc. | Identifying number 75-1475310 |
|--|---|

Part I Information on the Like-Kind Exchange

Note: Generally, only real property should be described on lines 1 and 2. However, you may describe personal property transferred prior to January 1, 2018, as part of an exchange subject to the like-kind exchange transition rule described in the instructions, and/or real property on lines 1 and 2, if you are filing this form to report the disposition of property exchanged in a previously reported related party like-kind exchange. If the property described on line 1 or line 2 is real or personal property located outside the United States, indicate the country.

- 1 Description of like-kind property given up:
Apartment complex
Starlight Way Apartment Complex, 2211 Southwest Drive, Arlington, TX

- 2 Description of like-kind property received:
Restaurant
Rorschach Comer, 4814 Parker, Arlington, TX

| | | |
|---|----------|---------------|
| 3 Date like-kind property given up was originally acquired (month, day, year) | 3 | M01/16/2007 Y |
| 4 Date you actually transferred your property to the other party (month, day, year) | 4 | M05/04/2021 Y |
| 5 Date like-kind property you received was identified by written notice to another party (month, day, year). See instructions for 45-day written identification requirement | 5 | M05/04/2021 Y |
| 6 Date you actually received the like-kind property from other party (month, day, year). See instructions | 6 | M05/04/2021 Y |

- 7 Was the exchange of the property given up or received made with a related party, either directly or indirectly (such as through an intermediary)? See instructions. If "Yes," complete Part II. If "No," go to Part III . . . Yes No

Note: Do not file this form if a related party sold property into the exchange, directly or indirectly (such as through an intermediary); that property became your replacement property; and none of the exceptions on line 11 applies to the exchange. Instead, report the disposition of the property as if the exchange had been a sale. If one of the exceptions on line 11 applies to the exchange, complete Part II.

Part II Related Party Exchange Information

| | | |
|--|---------------------|------------------------------------|
| 8 Name of related party | Relationship to you | Related party's identifying number |
| Address (no., street, and apt., room, or suite no.; city or town; state; and ZIP code) | | |

- 9 During this tax year (and before the date that is 2 years after the last transfer of property that was part of the exchange), did the related party sell or dispose of any part of the like-kind property received from you (or an intermediary) in the exchange? Yes No

- 10 During this tax year (and before the date that is 2 years after the last transfer of property that was part of the exchange), did you sell or dispose of any part of the like-kind property you received? Yes No

If both lines 9 and 10 are "No" and this is the year of the exchange, go to Part III. If both lines 9 and 10 are "No" and this is not the year of the exchange, stop here. If either line 9 or line 10 is "Yes," complete Part III and report on this year's tax return the deferred gain or (loss) from line 24 unless one of the exceptions on line 11 applies.

- 11 If one of the exceptions below applies to the disposition, check the applicable box.
 - a The disposition was after the death of either of the related parties.
 - b The disposition was an involuntary conversion, and the threat of conversion occurred after the exchange.
 - c You can establish to the satisfaction of the IRS that neither the exchange nor the disposition had tax avoidance as one of its principal purposes. If this box is checked, attach an explanation. See instructions.

Name(s) shown on tax return. Do not enter name and social security number if shown on other side.

Your social security number

Primrose Real Estate Investments, Inc.

75-1475310

Part III Realized Gain or (Loss), Recognized Gain, and Basis of Like-Kind Property Received

Caution: If you transferred and received (a) more than one group of like-kind properties, or (b) cash or other (not like-kind) property, see **Reporting of multi-asset exchanges** in the instructions.

Note: Complete lines 12 through 14 **only** if you gave up property that was not like-kind. Otherwise, go to line 15.

| | | | | |
|---|--|-----------|-----------|---|
| 12 | Fair market value (FMV) of other property given up. See instructions | 12 | 600,000 | |
| 13 | Adjusted basis of other property given up | 13 | 500,000 | |
| 14 | Gain or (loss) recognized on other property given up. Subtract line 13 from line 12. Report the gain or (loss) in the same manner as if the exchange had been a sale | 14 | | 0 |
| Caution: If the property given up was used previously or partly as a home, see Property used as home in the instructions. | | | | |
| 15 | Cash received, FMV of other property received, plus net liabilities assumed by other party, reduced (but not below zero) by any exchange expenses you incurred. See instructions | 15 | | 0 |
| 16 | FMV of like-kind property you received | 16 | 2,200,000 | |
| 17 | Add lines 15 and 16 | 17 | 2,200,000 | |
| 18 | Adjusted basis of like-kind property you gave up, net amounts paid to other party, plus any exchange expenses not used on line 15. See instructions | 18 | 1,888,029 | |
| 19 | Realized gain or (loss). Subtract line 18 from line 17 | 19 | 311,971 | |
| 20 | Enter the smaller of line 15 or line 19, but not less than zero | 20 | | 0 |
| 21 | Ordinary income under recapture rules. Enter here and on Form 4797, line 16. See instructions | 21 | | |
| 22 | Subtract line 21 from line 20. If zero or less, enter -0-. If more than zero, enter here and on Schedule D or Form 4797, unless the installment method applies. See instructions | 22 | | 0 |
| 23 | Recognized gain. Add lines 21 and 22 | 23 | | 0 |
| 24 | Deferred gain or (loss). Subtract line 23 from line 19. If a related party exchange, see instructions | 24 | 311,971 | |
| 25 | Basis of like-kind property received. Subtract line 15 from the sum of lines 18 and 23. See instructions | 25 | 1,888,029 | |

Part IV Deferral of Gain From Section 1043 Conflict-of-Interest Sales

Note: This part is to be used **only** by officers or employees of the executive branch of the federal government or judicial officers of the federal government (including certain spouses, minor or dependent children, and trustees as described in section 1043) for reporting nonrecognition of gain under section 1043 on the sale of property to comply with the conflict-of-interest requirements. This part can be used **only** if the cost of the replacement property is more than the basis of the divested property.

| | | | | |
|-----------|--|-----------|--|------------|
| 26 | Enter the number from the upper right corner of your certificate of divestiture. (Do not attach a copy of your certificate. Keep the certificate with your records.) | | | - |
| 27 | Description of divested property ▶ | | | |
| 28 | Description of replacement property ▶ | | | |
| 29 | Date divested property was sold (month, day, year) | 29 | | MM/DD/YYYY |
| 30 | Sales price of divested property. See instructions | 30 | | |
| 31 | Basis of divested property | 31 | | |
| 32 | Realized gain. Subtract line 31 from line 30 | 32 | | |
| 33 | Cost of replacement property purchased within 60 days after date of sale | 33 | | |
| 34 | Subtract line 33 from line 30. If zero or less, enter -0- | 34 | | |
| 35 | Ordinary income under recapture rules. Enter here and on Form 4797, line 10. See instructions | 35 | | |
| 36 | Subtract line 35 from line 34. If zero or less, enter -0-. If more than zero, enter here and on Schedule D or Form 4797. See instructions | 36 | | |
| 37 | Deferred gain. Subtract the sum of lines 35 and 36 from line 32 | 37 | | |
| 38 | Basis of replacement property. Subtract line 37 from line 33 | 38 | | |

Rental Real Estate Income and Expenses of a Partnership or an S Corporation

OMB No. 1545-0123

▶ Attach to Form 1065 or Form 1120S.
 ▶ Go to www.irs.gov/Form8825 for the latest information.

Name: **Primrose Real Estate Investments, Inc.** Employer identification number: **75-1475310**

| 1 | Show the type and address of each property. For each rental real estate property listed, report the number of days rented at fair rental value and days with personal use. See instructions. See page 2 to list additional properties. | | | |
|----------|--|--|------------------|-------------------|
| | Physical address of each property—street, city, state, ZIP code | Type—Enter code 1–8; see page 2 for list | Fair Rental Days | Personal Use Days |
| A | 1313 Mockingbird Arlington, TX 76015 | 2 | 90 | 0 |
| B | 2211 Southwest Drive Arlington, TX 76039 | 2 | 124 | 0 |
| C | 4814 Parker Arlington, TX 76025 | 4 | 241 | 0 |
| D | | | | |

| Rental Real Estate Income | | Properties | | | | | |
|--|--|------------------------------------|---------|---------|---------|-------------|--|
| | | A | B | C | D | | |
| 2 | Gross rents | 2 | 60,000 | 140,000 | 325,000 | | |
| Rental Real Estate Expenses | | | | | | | |
| 3 | Advertising | 3 | 2,400 | 4,800 | 4,800 | | |
| 4 | Auto and travel | 4 | | | | | |
| 5 | Cleaning and maintenance | 5 | | | | | |
| 6 | Commissions | 6 | | | | | |
| 7 | Insurance | 7 | 450 | 900 | 7,200 | | |
| 8 | Legal and other professional fees | 8 | | | | | |
| 9 | Interest (see instructions) | 9 | 9,000 | 26,000 | 75,000 | | |
| 10 | Repairs | 10 | 15,000 | 5,000 | 30,000 | | |
| 11 | Taxes | 11 | 12,000 | 20,000 | 33,000 | | |
| 12 | Utilities | 12 | 3,000 | 12,000 | 45,000 | | |
| 13 | Wages and salaries | 13 | 15,000 | 60,000 | 85,000 | | |
| 14 | Depreciation (see instructions) | 14 | 12,833 | 28,125 | 56,577 | | |
| 15 | Other (list) ▶ | 15 | 5,050 | 9,600 | 6,800 | | |
| 16 | Total expenses for each property. Add lines 3 through 15 | 16 | 74,733 | 166,425 | 343,377 | | |
| 17 | Income or (loss) from each property. Subtract line 16 from line 2 | 17 | -14,733 | -26,425 | -18,377 | | |
| 18a | Total gross rents. Add gross rents from line 2, columns A through H | 18a | | | | 525,000 | |
| 18b | Total expenses. Add total expenses from line 16, columns A through H | 18b | | | | (584,535) | |
| 19 | Net gain (loss) from Form 4797, Part II, line 17, from the disposition of property from rental real estate activities | 19 | | | | | |
| 20a | Net income (loss) from rental real estate activities from partnerships, estates, and trusts in which this partnership or S corporation is a partner or beneficiary (from Schedule K-1) | 20a | | | | | |
| b Identify below the partnerships, estates, or trusts from which net income (loss) is shown on line 20a. Attach a schedule if more space is needed. | | | | | | | |
| (1) Name | | (2) Employer identification number | | | | | |
| | | | | | | | |
| | | | | | | | |
| 21 | Net rental real estate income (loss). Combine lines 18a through 20a. Enter the result here and on: • Form 1065 or 1120S: Schedule K, line 2 | 21 | | | | 59,535 | |

| | | | | |
|----------|--|---|------------------|-------------------|
| 1 | Show the type and address of each property. For each rental real estate property listed, report the number of days rented at fair rental value and days with personal use. See instructions. | | | |
| | Physical address of each property—street, city, state, ZIP code | Type—Enter code 1–8; see below for list | Fair Rental Days | Personal Use Days |
| E | | | | |
| F | | | | |
| G | | | | |
| H | | | | |

| | | Properties | | | |
|---|-----------|------------|---|---|---|
| | | E | F | G | H |
| Rental Real Estate Income | | | | | |
| 2 Gross rents | 2 | | | | |
| Rental Real Estate Expenses | | | | | |
| 3 Advertising | 3 | | | | |
| 4 Auto and travel | 4 | | | | |
| 5 Cleaning and maintenance | 5 | | | | |
| 6 Commissions | 6 | | | | |
| 7 Insurance | 7 | | | | |
| 8 Legal and other professional fees | 8 | | | | |
| 9 Interest (see instructions) | 9 | | | | |
| 10 Repairs | 10 | | | | |
| 11 Taxes | 11 | | | | |
| 12 Utilities | 12 | | | | |
| 13 Wages and salaries | 13 | | | | |
| 14 Depreciation (see instructions) | 14 | | | | |
| 15 Other (list) ▶ | 15 | | | | |
| | | | | | |
| | | | | | |
| 16 Total expenses for each property. Add lines 3 through 15 | 16 | | | | |
| 17 Income or (loss) from each property. Subtract line 16 from line 2 | 17 | | | | |

Allowable Codes for Type of Property

- 1—Single Family Residence
- 2—Multi-Family Residence
- 3—Vacation or Short-Term Rental
- 4—Commercial
- 5—Land
- 6—Royalties
- 7—Self-Rental
- 8—Other (include description with the code on Form 8825 or on a separate statement)

General Instructions

Section references are to the Internal Revenue Code.

Future Developments

For the latest information about developments related to Form 8825 and its instructions, such as legislation enacted after they were published, go to www.irs.gov/Form8825.

Which Version To Use

Use this November 2018 revision of Form 8825 for tax years beginning in 2018 or later, until a later revision is issued. Use prior revisions of this form for earlier tax years. All revisions are available at www.irs.gov/Form8825.

What's New

- The Tax Reform Act of 2017 amended section 163(j) to reflect a limitation on business interest expense. For tax years beginning after December 31, 2017, business interest expense may be limited for certain taxpayers. See the instructions for line 9.
- The Bipartisan Budget Act of 2015 repealed the electing large partnership rules for tax years beginning after 2017. As a result, the references to Form 1065-B, U.S. Return of Income for Electing Large Partnerships, were removed.

Purpose of Form

Partnerships and S corporations use Form 8825 to report income and deductible expenses from rental real estate activities, including net income (loss) from rental real estate activities that flow through from partnerships, estates, or trusts.

Before completing this form, be sure to read the following.

- *Passive Activity Limitations* in the instructions for Form 1065 or Form 1120S, especially for the definition of "rental activity."
- *Extraterritorial Income Exclusion* in the instructions for Form 1065 or 1120S.

Specific Instructions

Form 8825 provides space for up to eight properties. If there are more than eight properties, attach additional Forms 8825.

The number of columns to be used for reporting income and expenses on this form may differ from the number of rental real estate activities the partnership or S corporation has for purposes of the passive activity limitations. For example, a partnership

owns two apartment buildings, each located in a different city. For purposes of the passive activity limitations, the partnership grouped both buildings into a single activity. Although the partnership has only one rental real estate activity for purposes of the passive activity limitations, it must report the income and deductions for each building in separate columns.

However, if the partnership or S corporation has more than one rental real estate activity for purposes of the passive activity limitations, attach a statement to Schedule K that reports the net income (loss) for each separate activity. Also, attach a statement to each Schedule K-1 that reports each partner's or shareholder's share of the net income (loss) by separate activity. See *Passive Activity Reporting Requirements* in the instructions for Form 1065 or Form 1120S for additional information that must be provided for each activity.

Complete lines 1 through 17 for each property. But complete lines 18a through 21 on only one Form 8825. The figures on lines 18a and 18b should be the combined totals for all forms.

Do not report on Form 8825 any of the following.

- Income or deductions from a trade or business activity or a rental activity other than rental real estate. These items are reported elsewhere.
- Portfolio income or deductions.
- Section 179 expense deduction.
- Other items that must be reported separately to the partners or shareholders.
- Commercial revitalization deductions.

Line 1. For each property, give the street address, city or town, and zip code. If the property is located outside the United States, give the postal code and country. Specify the type of property by entering one of the following codes in the "Type" column.

Codes

- 1—Single Family Residence
- 2—Multi-Family Residence
- 3—Vacation or Short-Term Rental
- 4—Commercial
- 5—Land
- 6—Royalties
- 7—Self-Rental
- 8—Other (include description with the code on Form 8825 or on a separate statement)

For each property, enter the number of days rented at fair rental value and days with personal use. For details, see section 280A.

Line 9. Your interest expense may be limited. See the instructions for Form 8990, Business Interest Expense Limitation Under Section 163(j), for more information.

Line 14. The partnership or S corporation may claim a depreciation deduction each year for rental property (except for land, which is not depreciable). If the partnership or S corporation placed property in service during the current tax year or claimed depreciation on any vehicle or other listed property, complete and attach Form 4562, Depreciation and Amortization. See Form 4562 and its instructions to figure the depreciation deduction.

Paperwork Reduction Act Notice. We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by section 6103.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated burden for business taxpayers filing this form is approved under OMB control number 1545-0123 and is included in the estimates shown in the instructions for their business income tax return.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. See the instructions for the tax return with which this form is filed.

Form **4797**

Sales of Business Property
(Also Involuntary Conversions and Recapture Amounts Under Sections 179 and 280F(b)(2))

OMB No. 1545-0184

2021

Department of the Treasury
Internal Revenue Service

▶ Attach to your tax return.

Attachment
Sequence No. **27**

▶ Go to www.irs.gov/Form4797 for instructions and the latest information.

Name(s) shown on return

Identifying number

Primrose Real Estate Investments, Inc.

75-1476310

- 1a** Enter the gross proceeds from sales or exchanges reported to you for 2021 on Form(s) 1099-B or 1099-S (or substitute statement) that you are including on line 2, 10, or 20. See instructions
- 1b** Enter the total amount of gain that you are including on lines 2, 10, and 24 due to the partial dispositions of MACRS assets
- 1c** Enter the total amount of loss that you are including on lines 2 and 10 due to the partial dispositions of MACRS assets

1a
1b
1c

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

| 2 | (a) Description of property | (b) Date acquired (mo., day, yr.) | (c) Date sold (mo., day, yr.) | (d) Gross sales price | (e) Depreciation allowed or allowable since acquisition | (f) Cost or other basis, plus improvements and expense of sale | (g) Gain or (loss) Subtract (f) from the sum of (d) and (e) |
|---|-----------------------------|-----------------------------------|-------------------------------|-----------------------|---|--|---|
| | Apartment Complex-land | 01/15/2013 | 4/02/2021 | 200,000 | | 140,000 | 60,000 |
| | | | | | | | |
| | | | | | | | |

- 3** Gain, if any, from Form 4684, line 39
- 4** Section 1231 gain from installment sales from Form 6252, line 26 or 37
- 5** Section 1231 gain or (loss) from like-kind exchanges from Form 8824
- 6** Gain, if any, from line 32, from other than casualty or theft
- 7** Combine lines 2 through 6. Enter the gain or (loss) here and on the appropriate line as follows

3
4
5
6 453,000
7 513,000

Partnerships and S corporations. Report the gain or (loss) following the instructions for Form 1065, Schedule K, line 10, or Form 1120-S, Schedule K, line 9. Skip lines 8, 9, 11, and 12 below.

Individuals, partners, S corporation shareholders, and all others. If line 7 is zero or a loss, enter the amount from line 7 on line 11 below and skip lines 8 and 9. If line 7 is a gain and you didn't have any prior year section 1231 losses, or they were recaptured in an earlier year, enter the gain from line 7 as a long-term capital gain on the Schedule D filed with your return and skip lines 8, 9, 11, and 12 below.

- 8** Nonrecaptured net section 1231 losses from prior years. See instructions
- 9** Subtract line 8 from line 7. If zero or less, enter -0-. If line 9 is zero, enter the gain from line 7 on line 12 below. If line 9 is more than zero, enter the amount from line 8 on line 12 below and enter the gain from line 9 as a long-term capital gain on the Schedule D filed with your return. See instructions.

8
9

Part II Ordinary Gains and Losses (see instructions)

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

| 11 | 12 | 13 | 14 | 15 | 16 | 17 |
|----|----|----|----|----|----|----|
| | | | | | | |
| | | | | | | |

- 11** Loss, if any, from line 7
- 12** Gain, if any, from line 7 or amount from line 8, if applicable
- 13** Gain, if any, from line 31
- 14** Net gain or (loss) from Form 4684, lines 31 and 38a
- 15** Ordinary gain from installment sales from Form 6252, line 25 or 36
- 16** Ordinary gain or (loss) from like-kind exchanges from Form 8824
- 17** Combine lines 10 through 16.

11 (
12
13 0
14
15
16
17 0

18 For all except individual returns, enter the amount from line 17 on the appropriate line of your return and skip lines a and b below. For individual returns, complete lines a and b below.

- a** If the loss on line 11 includes a loss from Form 4684, line 35, column (b)(ii), enter that part of the loss here. Enter the loss from income-producing property on Schedule A (Form 1040), line 16. (Do not include any loss on property used as an employee.) Identify as from "Form 4797, line 18a." See instructions
- b** Redetermine the gain or (loss) on line 17 excluding the loss, if any, on line 18a. Enter here and on Schedule 1 (Form 1040), Part I, line 4

18a
18b

For Paperwork Reduction Act Notice, see separate instructions.

Cat. No. 130861

Form **4797** (2021)

Part III Gain From Disposition of Property Under Sections 1245, 1250, 1252, 1254, and 1255
(see instructions)

| 19 (a) Description of section 1245, 1250, 1252, 1254, or 1255 property: | (b) Date acquired (mo., day, yr.) | (c) Date sold (mo., day, yr.) |
|---|--------------------------------------|----------------------------------|
| A Apartment complex | 01/16/2013 | 04/02/2021 |
| B | | |
| C | | |
| D | | |

| These columns relate to the properties on lines 19A through 19D. ▶ | | Property A | Property B | Property C | Property D |
|---|------------|------------|------------|------------|------------|
| 20 Gross sales price (Note: See line 1a before completing.) | 20 | 1,300,000 | | | |
| 21 Cost or other basis plus expense of sale | 21 | 1,210,000 | | | |
| 22 Depreciation (or depletion) allowed or allowable | 22 | 363,000 | | | |
| 23 Adjusted basis. Subtract line 22 from line 21. | 23 | 847,000 | | | |
| 24 Total gain. Subtract line 23 from line 20 | 24 | 453,000 | | | |
| 25 If section 1245 property: | | | | | |
| a Depreciation allowed or allowable from line 22 | 25a | | | | |
| b Enter the smaller of line 24 or 25a. | 25b | | | | |
| 26 If section 1250 property: If straight line depreciation was used, enter -0- on line 26g, except for a corporation subject to section 291. | | | | | |
| a Additional depreciation after 1975. See instructions | 26a | 0 | | | |
| b Applicable percentage multiplied by the smaller of line 24 or line 26a. See instructions. | 26b | | | | |
| c Subtract line 26a from line 24. If residential rental property or line 24 isn't more than line 26a, skip lines 26d and 26e | 26c | 453,000 | | | |
| d Additional depreciation after 1969 and before 1976. | 26d | | | | |
| e Enter the smaller of line 26c or 26d | 26e | 0 | | | |
| f Section 291 amount (corporations only) | 26f | | | | |
| g Add lines 26b, 26e, and 26f | 26g | 0 | | | |
| 27 If section 1252 property: Skip this section if you didn't dispose of farmland or if this form is being completed for a partnership. | | | | | |
| a Soil, water, and land clearing expenses | 27a | | | | |
| b Line 27a multiplied by applicable percentage. See instructions | 27b | | | | |
| c Enter the smaller of line 24 or 27b | 27c | | | | |
| 28 If section 1254 property: | | | | | |
| a Intangible drilling and development costs, expenditures for development of mines and other natural deposits, mining exploration costs, and depletion. See instructions | 28a | | | | |
| b Enter the smaller of line 24 or 28a. | 28b | | | | |
| 29 If section 1255 property: | | | | | |
| a Applicable percentage of payments excluded from income under section 126. See instructions | 29a | | | | |
| b Enter the smaller of line 24 or 29a. See instructions | 29b | | | | |

Summary of Part III Gains. Complete property columns A through D through line 29b before going to line 30.

| | | |
|---|-----------|---------|
| 30 Total gains for all properties. Add property columns A through D, line 24 | 30 | 453,000 |
| 31 Add property columns A through D, lines 25b, 26g, 27c, 28b, and 29b. Enter here and on line 13 | 31 | 0 |
| 32 Subtract line 31 from line 30. Enter the portion from casualty or theft on Form 4684, line 33. Enter the portion from other than casualty or theft on Form 4797, line 6 | 32 | 453,000 |

Part IV Recapture Amounts Under Sections 179 and 280F(b)(2) When Business Use Drops to 50% or Less
(see instructions)

| | (a) Section 179 | (b) Section 280F(b)(2) |
|---|-----------------|------------------------|
| 33 Section 179 expense deduction or depreciation allowable in prior years. | 33 | |
| 34 Recomputed depreciation. See instructions | 34 | |
| 35 Recapture amount. Subtract line 34 from line 33. See the instructions for where to report | 35 | |

Depreciation and Amortization
 (Including Information on Listed Property)

► Attach to your tax return.
 ► Go to www.irs.gov/Form4562 for instructions and the latest information.

| | | |
|--|--|---|
| Name(s) shown on return Primrose Real Estate Investments, Inc. | Business or activity to which this form relates Form 8825 Rorschach Corner | Identifying number 75-1475310 |
|--|--|---|

Part I Election To Expense Certain Property Under Section 179
Note: If you have any listed property, complete Part V before you complete Part I.

| | | |
|---|-----------|-----------|
| 1 Maximum amount (see instructions) | 1 | 1,050,000 |
| 2 Total cost of section 179 property placed in service (see instructions) | 2 | |
| 3 Threshold cost of section 179 property before reduction in limitation (see instructions) | 3 | 2,760,000 |
| 4 Reduction in limitation. Subtract line 3 from line 2. If zero or less, enter -0- | 4 | |
| 5 Dollar limitation for tax year. Subtract line 4 from line 1. If zero or less, enter -0-. If married filing separately, see instructions | 5 | |
| 6 (a) Description of property (b) Cost (business use only) (c) Elected cost | | |
| | | |
| 7 Listed property. Enter the amount from line 29 7 | | |
| 8 Total elected cost of section 179 property. Add amounts in column (c), lines 6 and 7 | 8 | |
| 9 Tentative deduction. Enter the smaller of line 5 or line 8 | 9 | |
| 10 Carryover of disallowed deduction from line 13 of your 2020 Form 4562 | 10 | |
| 11 Business income limitation. Enter the smaller of business income (not less than zero) or line 5. See instructions | 11 | |
| 12 Section 179 expense deduction. Add lines 9 and 10, but don't enter more than line 11 | 12 | |
| 13 Carryover of disallowed deduction to 2022. Add lines 9 and 10, less line 12 ► 13 | | |

Note: Don't use Part II or Part III below for listed property. Instead, use Part V.

Part II Special Depreciation Allowance and Other Depreciation (Don't include listed property. See instructions.)

| | | |
|---|-----------|--------|
| 14 Special depreciation allowance for qualified property (other than listed property) placed in service during the tax year. See instructions | 14 | |
| 15 Property subject to section 168(f)(1) election | 15 | 46,321 |
| 16 Other depreciation (including ACRS) | 16 | |

Part III MACRS Depreciation (Don't include listed property. See instructions.)

Section A

| | | |
|---|-----------|--|
| 17 MACRS deductions for assets placed in service in tax years beginning before 2021 | 17 | |
| 18 If you are electing to group any assets placed in service during the tax year into one or more general asset accounts, check here <input type="checkbox"/> | | |

Section B—Assets Placed in Service During 2021 Tax Year Using the General Depreciation System

| (a) Classification of property | (b) Month and year placed in service | (c) Basis for depreciation (business/investment use only—see instructions) | (d) Recovery period | (e) Convention | (f) Method | (g) Depreciation deduction |
|---------------------------------------|--------------------------------------|--|---------------------|----------------|------------|----------------------------|
| 19a 3-year property | | | | | | |
| b 5-year property | | | | | | |
| c 7-year property | | | | | | |
| d 10-year property | | | | | | |
| e 15-year property | | | | | | |
| f 20-year property | | | | | | |
| g 25-year property | | | 25 yrs. | | S/L | |
| h Residential rental property | | | 27.5 yrs. | MM | S/L | |
| | | | 27.5 yrs. | MM | S/L | |
| i Nonresidential real property | | | 39 yrs. | MM | S/L | 10,256 |
| | | | | MM | S/L | |

Section C—Assets Placed in Service During 2021 Tax Year Using the Alternative Depreciation System

| | | | | | | |
|-----------------------|--|--|---------|----|-----|--|
| 20a Class life | | | | | S/L | |
| b 12-year | | | 12 yrs. | | S/L | |
| c 30-year | | | 30 yrs. | MM | S/L | |
| d 40-year | | | 40 yrs. | MM | S/L | |

Part IV Summary (See instructions.)

| | | |
|--|-----------|--------|
| 21 Listed property. Enter amount from line 28 | 21 | |
| 22 Total. Add amounts from line 12, lines 14 through 17, lines 19 and 20 in column (g), and line 21. Enter here and on the appropriate lines of your return. Partnerships and S corporations—see instructions | 22 | 56,677 |
| 23 For assets shown above and placed in service during the current year, enter the portion of the basis attributable to section 263A costs | 23 | |

Part V Listed Property (Include automobiles, certain other vehicles, certain aircraft, and property used for entertainment, recreation, or amusement.)

Note: For any vehicle for which you are using the standard mileage rate or deducting lease expense, complete **only** 24a, 24b, columns (a) through (c) of Section A, all of Section B, and Section C if applicable.

Section A—Depreciation and Other Information (Caution: See the instructions for limits for passenger automobiles.)

24a Do you have evidence to support the business/investment use claimed? Yes No **24b** If "Yes," is the evidence written? Yes No

| (a) Type of property (list vehicles first) | (b) Date placed in service | (c) Business/investment use percentage | (d) Cost or other basis | (e) Basis for depreciation (business/investment use only) | (f) Recovery period | (g) Method/Convention | (h) Depreciation deduction | (i) Elected section 179 cost |
|---|-------------------------------|---|----------------------------|--|------------------------|--------------------------|-------------------------------|---------------------------------|
| 25 Special depreciation allowance for qualified listed property placed in service during the tax year and used more than 50% in a qualified business use. See instructions . | | | | | | | 25 | |
| 26 Property used more than 50% in a qualified business use: | | | | | | | | |
| | | % | | | | | | |
| | | % | | | | | | |
| | | % | | | | | | |
| 27 Property used 50% or less in a qualified business use: | | | | | | | | |
| | | % | | | | S/L - | | |
| | | % | | | | S/L - | | |
| | | % | | | | S/L - | | |
| 28 Add amounts in column (h), lines 25 through 27. Enter here and on line 21, page 1 . | | | | | | | 28 | |
| 29 Add amounts in column (i), line 26. Enter here and on line 7, page 1 | | | | | | | 29 | |

Section B—Information on Use of Vehicles

Complete this section for vehicles used by a sole proprietor, partner, or other "more than 5% owner," or related person. If you provided vehicles to your employees, first answer the questions in Section C to see if you meet an exception to completing this section for those vehicles.

| | (a) Vehicle 1 | | (b) Vehicle 2 | | (c) Vehicle 3 | | (d) Vehicle 4 | | (e) Vehicle 5 | | (f) Vehicle 6 | |
|--|------------------|----|------------------|----|------------------|----|------------------|----|------------------|----|------------------|----|
| | Yes | No | Yes | No | Yes | No | Yes | No | Yes | No | Yes | No |
| 30 Total business/investment miles driven during the year (don't include commuting miles) | | | | | | | | | | | | |
| 31 Total commuting miles driven during the year | | | | | | | | | | | | |
| 32 Total other personal (noncommuting) miles driven | | | | | | | | | | | | |
| 33 Total miles driven during the year. Add lines 30 through 32 | | | | | | | | | | | | |
| 34 Was the vehicle available for personal use during off-duty hours? | | | | | | | | | | | | |
| 35 Was the vehicle used primarily by a more than 5% owner or related person? | | | | | | | | | | | | |
| 36 Is another vehicle available for personal use? | | | | | | | | | | | | |

Section C—Questions for Employers Who Provide Vehicles for Use by Their Employees

Answer these questions to determine if you meet an exception to completing Section B for vehicles used by employees who **aren't** more than 5% owners or related persons. See instructions.

| | Yes | No |
|--|-----|----|
| 37 Do you maintain a written policy statement that prohibits all personal use of vehicles, including commuting, by your employees? | | |
| 38 Do you maintain a written policy statement that prohibits personal use of vehicles, except commuting, by your employees? See the instructions for vehicles used by corporate officers, directors, or 1% or more owners | | |
| 39 Do you treat all use of vehicles by employees as personal use? | | |
| 40 Do you provide more than five vehicles to your employees, obtain information from your employees about the use of the vehicles, and retain the information received? | | |
| 41 Do you meet the requirements concerning qualified automobile demonstration use? See instructions. | | |

Note: If your answer to 37, 38, 39, 40, or 41 is "Yes," don't complete Section B for the covered vehicles.

Part VI Amortization

| (a) Description of costs | (b) Date amortization begins | (c) Amortizable amount | (d) Code section | (e) Amortization period or percentage | (f) Amortization for this year |
|--|---------------------------------|---------------------------|---------------------|--|-----------------------------------|
| 42 Amortization of costs that begins during your 2021 tax year (see instructions): | | | | | |
| | | | | | |
| 43 Amortization of costs that began before your 2021 tax year | | | | | 43 |
| 44 Total. Add amounts in column (f). See the instructions for where to report | | | | | 44 |

| | | | |
|--|-------------------------------------|-------------------------------------|--|
| Corporation's Name: <u>Primrose Real Estate Investments, Inc.</u> Corporation's EIN: <u>75-1475310</u> | | | |
| | | | |
| | 1120S, Line 21 | Lynx Meadows Apartment Complex | Starlight Way Apartment Complex |
| | <input type="checkbox"/> PTP | <input type="checkbox"/> PTP | <input type="checkbox"/> PTP |
| | <input type="checkbox"/> Aggregated | <input type="checkbox"/> Aggregated | <input type="checkbox"/> Aggregated |
| | <input type="checkbox"/> SSTB | <input type="checkbox"/> SSTB | <input checked="" type="checkbox"/> SSTB |
| Shareholder's share of: QBI or qualified PTP items subject to shareholder-specific determinations: | | | |
| Ordinary business inc (loss) | 0. | | |
| Rental income (loss) | | -14,733. | -26,425. |
| Royalty income (loss) | | | |
| Section 1231 gain (loss) | | 513,000. | |
| Other income (loss) | | | |
| Section 179 deduction | | | |
| Charitable contributions | | | |
| Other deductions | | | |
| W-2 wages | 0. | 15,000. | 60,000. |
| UBIA of qualified property | | 0. | 0. |
| Section 199A dividends | | | |

| | | | |
|--|-------------------------------------|-------------------------------------|-------------------------------------|
| Corporation's Name: <u>Primrose Real Estate Investments, Inc.</u> Corporation's EIN: <u>75-1475310</u> | | | |
| | | | |
| | Rorschach Corner | | |
| | <input type="checkbox"/> PTP | <input type="checkbox"/> PTP | <input type="checkbox"/> PTP |
| | <input type="checkbox"/> Aggregated | <input type="checkbox"/> Aggregated | <input type="checkbox"/> Aggregated |
| | <input type="checkbox"/> SSTB | <input type="checkbox"/> SSTB | <input type="checkbox"/> SSTB |
| Shareholder's share of: QBI or qualified PTP items subject to shareholder-specific determinations: | | | |
| Ordinary business inc (loss) | | | |
| Rental income (loss) | -18,377. | | |
| Royalty income (loss) | | | |
| Section 1231 gain (loss) | | | |
| Other income (loss) | | | |
| Section 179 deduction | | | |
| Charitable contributions | | | |
| Other deductions | | | |
| W-2 wages | 85,000. | | |
| UBIA of qualified property | 1,640,529. | | |
| Section 199A dividends | | | |

**Form 1120S
Schedule L**

Other Assets

2020

| | | |
|--|-----------------------|---|
| Name Primrose Real Estate Investments, Inc. | | Employer ID Number 75-1475310 |
| Other Current Assets: | Beginning of tax year | End of tax year |
| | | |
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| | | |
| | | |
| | | |
| Total to Form 1120S, Schedule L, line 6▶ | | |
| Other Investments: | Beginning of tax year | End of tax year |
| Other investments | 50,000. | 25,000. |
| | | |
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| | | |
| | | |
| Total to Form 1120S, Schedule L, line 9▶ | 50,000. | 25,000. |
| Other Assets: | Beginning of tax year | End of tax year |
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| | | |
| Total to Form 1120S, Schedule L, line 14▶ | | |

**Form 1120S
Schedule L**

**Other Liabilities
and Adjustments to Shareholders' Equity**

2020

| | |
|---|---|
| Name Primrose Real Estate Investments, Inc. | Employer ID Number 75-1475310 |
|---|---|

| Other Current Liabilities: | Beginning of tax year | End of tax year |
|---|-----------------------|-----------------|
| Short-term loans | | 285,000. |
| | | |
| | | |
| | | |
| | | |
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| | | |
| | | |
| | | |
| Total to Form 1120S, Schedule L, line 18 | | 285,000. |

| Other Liabilities: | Beginning of tax year | End of tax year |
|---|-----------------------|-----------------|
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| Total to Form 1120S, Schedule L, line 21 | | |

| Adjustments to Shareholders' Equity: | Beginning of tax year | End of tax year |
|---|-----------------------|-----------------|
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| | | |
| Total to Form 1120S, Schedule L, line 25 | | |

Section 1.263(a)-1(f)

▶ Attach to your income tax return

| | |
|--|--|
| Name(s) Shown on Return Primrose Real Estate Investments, Inc. | Identification Number 75-1475310 |
|--|--|

Tax Year: 2020

**Section 1.263(a)-1(f)
De Minimis Safe Harbor Election**

The taxpayer elects to make the de minimis safe harbor election under the Regulation 1.263(a)-1(f)

Name: Primrose Real Estate Investments, Inc.
Address: 100 Ave. H, Arlington TX 76016
Identification Number: 75-1475310

199A Worksheet by Activity

2020

► Keep for your records

| | | | |
|---|--|--|---------------|
| Corporation's name Primrose Real Estate Investments, Inc. | | Corporation's EIN 75-1475310 | |
| Aggregation Code: _____ | Trade or Business: 1120S, Line 21 EIN: 75-1475310 | | |
| Check if activity is NOT a qualified trade/business <input type="checkbox"/> | | | |
| Specified Service Trade or Business?..... <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | | | |
| Shareholder's share of: QBI or qualified PTP items subject to shareholder-specific determinations: | | | |
| 1 a Ordinary business income (loss)..... | 1 a _____ | 1 a 0. | |
| b Adjustments..... | b _____ | | |
| c Adjusted ordinary business income (loss) | 1 c _____ | | 1 c 0. |
| 2 a Rental income (loss)..... | 2 a _____ | | |
| b Adjustments..... | b _____ | | |
| c Adjusted rental income (loss) | 2 c _____ | | |
| 3 a Royalty income (loss)..... | 3 a _____ | | |
| b Adjustments..... | b _____ | | |
| c Adjusted royalty income (loss) | 3 c _____ | | |
| 4 a Section 1231 gain (loss)..... | 4 a _____ | | |
| b Adjustments..... | b _____ | | |
| c Adjusted section 1231 gain (loss)..... | 4 c _____ | | |
| 5 Other income (loss)..... | 5 _____ | | |
| 6 a Section 179 deduction..... | 6 a _____ | | |
| b Adjustments..... | b _____ | | |
| c Adjusted section 179 deduction | 6 c _____ | | |
| 7 Charitable contributions..... | 7 _____ | | |
| 8 Other deductions..... | 8 _____ | | |
| 9 a W-2 wages..... | 9 a _____ | 9 a 0. | |
| b Adjustments..... | b _____ | | |
| c Adjusted W-2 Wages | 9 c _____ | | 9 c 0. |
| 10 a UBIA of qualified property..... | 10 a _____ | | |
| b Adjustments..... | b _____ | | |
| c Adjusted UBIA of qualified property | 10 c _____ | | |

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199A Worksheet by Activity

2020

► Keep for your records

| | | | |
|---|--|--|----------|
| Corporation's name Primrose Real Estate Investments, Inc. | | Corporation's EIN 75-1475310 | |
| Aggregation Code: _____ | Trade or Business: Lynx Meadows Apartment Complex EIN: 75-1475310 | | |
| Check if activity is NOT a qualified trade/business <input type="checkbox"/> | | | |
| Specified Service Trade or Business?..... <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | | | |
| Shareholder's share of: QBI or qualified PTP items subject to shareholder-specific determinations: | | | |
| 1 a | Ordinary business income (loss)..... | 1 a | |
| b | Adjustments..... | b | |
| c | Adjusted ordinary business income (loss) | 1 c | |
| 2 a | Rental income (loss)..... | 2 a | -14,733. |
| b | Adjustments..... | b | |
| c | Adjusted rental income (loss) | 2 c | -14,733. |
| 3 a | Royalty income (loss)..... | 3 a | |
| b | Adjustments..... | b | |
| c | Adjusted royalty income (loss) | 3 c | |
| 4 a | Section 1231 gain (loss)..... | 4 a | 513,000. |
| b | Adjustments..... | b | |
| c | Adjusted section 1231 gain (loss)..... | 4 c | 513,000. |
| 5 | Other income (loss)..... | 5 | |
| 6 a | Section 179 deduction..... | 6 a | |
| b | Adjustments..... | b | |
| c | Adjusted section 179 deduction | 6 c | |
| 7 | Charitable contributions..... | 7 | |
| 8 | Other deductions..... | 8 | |
| 9 a | W-2 wages..... | 9 a | 15,000. |
| b | Adjustments..... | b | |
| c | Adjusted W-2 Wages | 9 c | 15,000. |
| 10 a | UBIA of qualified property..... | 10 a | 0. |
| b | Adjustments..... | b | |
| c | Adjusted UBIA of qualified property | 10 c | 0. |

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199A Worksheet by Activity

2020

► Keep for your records

| | | | |
|---|---|--|-------------|
| Corporation's name Primrose Real Estate Investments, Inc. | | Corporation's EIN 75-1475310 | |
| Aggregation Code: _____ | Trade or Business: Starlight Way Apartment Complex EIN: 75-1475310 | | |
| Check if activity is NOT a qualified trade/business <input type="checkbox"/> | | | |
| Specified Service Trade or Business?..... <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No | | | |
| Shareholder's share of: QBI or qualified PTP items subject to shareholder-specific determinations: | | | |
| 1 a Ordinary business income (loss)..... | 1 a | | |
| b Adjustments..... | b | | |
| c Adjusted ordinary business income (loss) | | | 1 c |
| 2 a Rental income (loss)..... | 2 a | -26,425. | |
| b Adjustments..... | b | | |
| c Adjusted rental income (loss) | | | 2 c |
| 3 a Royalty income (loss)..... | 3 a | | -26,425. |
| b Adjustments..... | b | | |
| c Adjusted royalty income (loss) | | | 3 c |
| 4 a Section 1231 gain (loss)..... | 4 a | | |
| b Adjustments..... | b | | |
| c Adjusted section 1231 gain (loss)..... | | | 4 c |
| 5 Other income (loss)..... | | | 5 |
| 6 a Section 179 deduction..... | 6 a | | |
| b Adjustments..... | b | | |
| c Adjusted section 179 deduction | | | 6 c |
| 7 Charitable contributions..... | | | 7 |
| 8 Other deductions..... | | | 8 |
| 9 a W-2 wages..... | 9 a | 60,000. | |
| b Adjustments..... | b | | |
| c Adjusted W-2 Wages | | | 9 c |
| 10 a UBIA of qualified property..... | 10 a | 0. | |
| b Adjustments..... | b | | |
| c Adjusted UBIA of qualified property | | | 10 c |

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199A Worksheet by Activity

2020

► Keep for your records

| | | | |
|---|--|--|------------|
| Corporation's name Primrose Real Estate Investments, Inc. | | Corporation's EIN 75-1475310 | |
| Aggregation Code: _____ | Trade or Business: Rorschach Corner EIN: 75-1475310 | | |
| Check if activity is NOT a qualified trade/business <input type="checkbox"/> | | | |
| Specified Service Trade or Business?..... <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | | | |
| Shareholder's share of: QBI or qualified PTP items subject to shareholder-specific determinations: | | | |
| 1 a Ordinary business income (loss)..... | 1 a | | |
| b Adjustments..... | b | | |
| c Adjusted ordinary business income (loss) | | | 1 c |
| 2 a Rental income (loss)..... | 2 a | -18,377. | |
| b Adjustments..... | b | | |
| c Adjusted rental income (loss) | | | 2 c |
| 3 a Royalty income (loss)..... | 3 a | | |
| b Adjustments..... | b | | |
| c Adjusted royalty income (loss) | | | 3 c |
| 4 a Section 1231 gain (loss)..... | 4 a | | |
| b Adjustments..... | b | | |
| c Adjusted section 1231 gain (loss)..... | | | 4 c |
| 5 Other income (loss)..... | | | 5 |
| 6 a Section 179 deduction..... | 6 a | | |
| b Adjustments..... | b | | |
| c Adjusted section 179 deduction | | | 6 c |
| 7 Charitable contributions..... | | | 7 |
| 8 Other deductions..... | | | 8 |
| 9 a W-2 wages..... | 9 a | 85,000. | |
| b Adjustments..... | b | | |
| c Adjusted W-2 Wages | | | 9 c |
| 10 a UBIA of qualified property..... | 10 a | 1,640,529. | |
| b Adjustments..... | b | | |
| c Adjusted UBIA of qualified property | | | 10 c |
| | | | -18,377. |
| | | | 85,000. |
| | | | 1,640,529. |

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Reporting net rental income or loss on Form 1120S

General

The front page of Form 1120S is used to report ordinary business income, as indicated on line 21. Income or loss items that may be subject to special treatment on the shareholders' individual returns are reported separately on Schedule K. Therefore, Schedule K, rather than page 1 of the tax return, is where the S corporation reports its overall net income.

In the case of net income or loss from rental real estate activities, the S corporation reports its income and expenses on Form 8825 with the net result reported on line 2 of Schedule K. Note that income and expenses are reported separately for each property held for rent before being aggregated on line 18a. As many as eight properties may be reported on a single Form 8825; if the S corporation has more properties, additional 8825 forms should be attached until the net income from all rental real estate properties is reported. The net income from all the forms is then aggregated on line 2 of Schedule K.

Note that Form 8825 is used to report only income and expenses associated with the S corporation's rental real estate activities. Income or expense items not associated with such activities should not be reported on this form. There are certain items of income and expense that are (or may be) associated with the S corporation's rental real activities but must be reported separately. For example, the Section 179 deduction, charitable contributions, and other items which are subject to statutory limitations on the shareholders' individual tax returns must be reported separately on Schedule K. Likewise, nondeductible expenditures (fines and penalties for example) should be reported separately on Schedule K (line 16c) rather than on Form 8825.

Regarding gain or loss from the sale of business property sold or disposed of by the S corporation, only ordinary gains and losses from the sale of such property (or properties) are reported on Form 8825. Line 19 reports net gain or loss from Form 4797, Part II, line 17. Part II of Form 4797, *Sales of Business Property*, reports ordinary gains and losses from sale of business property. Capital or IRC Section 1231 gains or losses and gains or losses from the sale of depreciable property are reported in Parts I and III respectively. The net gain or loss from sale or disposition of these properties may be subject to special rules (for example, aggregation with other capital gains and losses) on the shareholders' individual returns; therefore, the net gain or loss must be reported separately on Schedule K (lines 7–9).

Key review point

Note that line 4 on Form 1125-E, *Compensation of Officers*, indicates that total officer compensation should be entered on Form 1120, page 1, line 12 or the appropriate line of your return (emphasis added). If line 7 of page 1 is not the appropriate line, presumably line 13 of Form 8825 would be. This raises the

question of how to allocate officer compensation across properties, which is probably not a material issue for Primrose but might be if it treats each property as a separate activity for purposes of the passive loss rules (discussed later in this chapter).

In this tax return, it appears that Primrose has reported officer salaries on the appropriate line of Form 8825. (Note that the trial balance contains an account called “Management, including salaries.” It also contains an account called “Repairs and maintenance—salaries.” Presumably, these are salaries for apartment or building managers at each property.

The amount in this account, when added to the officer compensation equals the amount reported on line 13 of Form 8825. The remainder of the Management, including salaries account is equal to the sum of the amounts reported on line 15 of Form 8825. Therefore, it appears that both shareholder officer salaries and other salaries are reported on line 15 and allocated among the various properties.

Allocating such compensation across the different properties could be accomplished either through requiring the officers to report their time spent on each property, or by using a common allocation base, such as gross rents. Wherever the company chooses to report officer compensation, it is eventually deducted from overall taxable income on Schedule K. Therefore, the reporting position taken by the company will not affect the net amounts reported to shareholders on Schedules K-1. However, it would be wise to include a schedule in the working papers indicating how these salaries are allocated across properties.

Knowledge check

1. Assume you are reviewing a return for Nantucket, Inc., a qualified S corporation. Nantucket has the following items of income, gain, loss, and deduction associated with its rental real estate activities:

| | |
|---|------------|
| • Gross rents | \$850,000 |
| • Ordinary rental real estate expenses | (785,000) |
| • Depreciation expense | (226,000) |
| • Charitable contributions | (44,000) |
| • Net Section 1231 gain from sale of depreciable property | 385,000 |
| • Net ordinary gain from sale of business property | 37,000 |

What is the net rental real estate income that Nantucket should report on Form 8825, and Schedule K, line 2?

- a. \$217,000.
- b. \$261,000.
- c. (\$124,000).
- d. \$102,000.

Cost recovery deductions – Disposal of property

The two properties that Primrose owned at the beginning of 2021 are multifamily residential properties. They are depreciated using the straight-line method over 27.5 years. Depreciation of residential real estate is based on the mid-month convention, under which the property is deemed to have been acquired in the middle of the actual month of acquisition, rather than on the actual day acquired. This is a simplifying assumption intended to make the computation of depreciation easier, and it applies in both the year of acquisition and the year of disposition. Therefore, Primrose should claim a depreciation deduction through the date of disposal for both of the properties it disposed of this year.

Key review point

In the Primrose tax return, net rental income and loss for each property owned is reported on Form 8825. Depreciation expense is reported on line 14 for each property. Note, however, that the company filed only Form 4562, *Depreciation and Amortization*, for the newly acquired property, Rorschach Corner. There is no support for the depreciation calculations for either of the properties the company disposed of during 2021 (Lynx Meadows apartments and Starlight Way apartments). Depreciation for these properties should also be reported on Form 4562. Separate forms could be attached for each property, or the totals could be reported on the current Form 4562, line 19h (in which case, the second box at the top of the form should be changed to read “Form 8825”).

For the property distributed to Rikki in liquidation of her stock in the S corporation, depreciation should be deducted for the period January 1, 2021, through April 1, 2021, the day before the distribution to Rikki. Applying the mid-month convention, Primrose should deduct 3½ months of depreciation on this property. The depreciable basis of the property (see Schedule L) is \$1,210,000 (the original purchase price for the property less the amount allocated to land), so depreciation should be deducted in the amount of \$12,833, computed as follows:

| | |
|--|--------------|
| Depreciable basis (cost less Section 179 deduction and bonus depreciation) | \$1,210,000 |
| Depreciable life | ÷ 27.5 years |
| Full-year depreciation expense | \$ 44,000 |
| Months used during year (applying mid-month convention) | 3½ months |
| Allowable depreciation deduction, 2020 | \$ 12,833 |

This is the amount claimed on Form 8825 for this property.

Knowledge check

2. Based on the preceding illustration, what is Primrose's allowable depreciation deduction with respect to the Starlight Way apartment complex, which was disposed of on May 4, 2021? The depreciable basis of the apartment complex, not including land, was \$2,062,500.
- \$34,375.
 - \$28,125.
 - \$75,000.
 - \$37,500.

Passive loss limitations

The passive loss limitations of IRC Section 469 allow a taxpayer to deduct passive losses only to the extent of passive income reported in the same tax year. The excess of passive losses over passive gains may be carried forward indefinitely and will be deductible in full when the taxpayer fully disposes of the passive activity to which the losses were applicable. For this purpose, net income or loss from rental real estate activities is statutorily treated as net income or loss from a passive activity. This raises two interesting points in the Primrose Real Estate Investments return. Because the passive loss limitations are applied at the shareholder level and not the S corporation level, these points do not relate directly to the review of Primrose's Form 1120S. The S corporation might, however, consider adding a statement to the shareholders' Schedule K-1s informing them of the disposition of each of its properties.

The first issue is what is included in passive income with respect to the rental real estate activities. Clearly, the amounts reported on Form 8825, as well as on Schedule K, line 2 (and reported to the shareholders on Schedule K-1, line 2) constitute net income or loss from rental real estate activities; however, the gain reported on Form 4797, related to the disposition of the Lynx Meadows apartment complex, is also counted as income from a passive activity. Although this gain is reported on a separate line of the K-1s, the shareholders need to know that it constitutes passive income.

The second issue is raised by the disposition of two of Primrose's real estate properties this year. Because those two were the only properties Primrose had as of the beginning of the year, it is important to determine whether the properties were grouped for purposes of the passive activity rules. The general rule, established in Regs. Sec. 1.469-9, is that each interest in rental real estate of a qualifying taxpayer will be treated as a separate rental real estate activity, unless the taxpayer makes an election to treat all interests in rental real estate as a single rental real estate activity. The instructions to Form 8825 indicate that this election is made at the entity level.

Therefore, unless either Primrose has actively elected to treat both its properties as a single rental real estate group, or one of the shareholders has specifically elected to treat his or her interest in Primrose as a single rental real estate activity, each property owned by the S corporation should qualify as a separate rental real estate activity. Under Revenue Procedure 2010-13 (January 25, 2010), the IRS announced that taxpayers must attach a statement to their original tax returns in the first year for which multiple activities are grouped as a single activity under the passive loss rules. An attachment must also be attached in any subsequent year in which changes are made to the taxpayer's grouping(s). Assuming no

such notifications have been filed by either Primrose or the shareholders, each property owned by Primrose would be treated as a separate activity.

Key review point

Whether each property is treated as a separate activity or both have instead been grouped by the shareholders is a particularly important issue for Rikki Dean. Although Rikki disposed of her stock in Primrose, she maintained an interest in the Lynx Meadows apartment complex. Therefore, she has completely terminated her interest only in the Starlight Way apartments. If both apartments had been previously grouped into a single activity, she would not be able to treat her departure from the S corporation as a complete termination of her interest in the grouped passive activity. The instructions to Form 8825 direct the S corporation to attach a statement to the Schedules K-1 reporting each shareholder's share of the net income (loss) by separate activity. The statement attached to the shareholders' Schedule K-1s should provide the following information:

1. Each shareholder's share of the net income or loss, including Section 1231 gain, attributable to each separate property owned by Primrose
2. A statement that the company disposed of its prior interests in rental real estate activities during 2021 and that the shareholders should be allowed to deduct in full any passive loss carryforwards attributable to their investments in Primrose Real Estate Investments, Inc.

A review of the statements attached to the shareholders' Schedules K-1 shows that these requirements are met. The shareholders' shares of net rental income or loss (Schedule K-1, line 2) is disaggregated by property, and the shareholders are informed that Lynx Meadows and Starlight Way were disposed of this year.

The information provided regarding Starlight Way, however, is not sufficient. The like-kind exchange of a passive activity does not constitute a complete disposition of the taxpayer's interest in that activity. Rather, that activity has merely changed form. Therefore, any passive loss carryforwards that Jesse and Dane have with respect to Starlight Way will be carried over to the replacement property. It is therefore incorrect to state that the Starlight Way apartments were disposed of this year.

In sum, Rikki Dean will be able to deduct in full any passive loss carryforwards she had with respect to the Starlight Way apartments because she has fully disposed of her interest in the S corporation and, therefore, her interest in Starlight Way. She will not be able to deduct passive loss carryforwards related to Lynx Meadows (unless she has sufficient income from other passive sources) because she now owns that property. The other two shareholders, in contrast, will be able to deduct any passive loss carryforwards related to Lynx Meadows because that property was transferred to Rikki. They will not be able to deduct passive loss carryforwards related to Starlight Way (unless they have sufficient passive income from other sources) because those carryforwards have now been attached to the replacement property (Rorschach Corner).

Knowledge check

3. Kay Borden is a shareholder in a rental real estate S corporation that owns three properties. Kay's Schedule K-1 from the S corporation reported the following information:

- | | |
|--|-----------|
| • Net income or loss from rental real estate activity | (145,000) |
| • Net Section 1231 gain from sale of one of the company's three properties | 230,000 |
| • Section 179 deduction | (75,000) |

At the beginning of the tax year, Kay had a passive loss carryforward associated with the S corporation of \$100,000. Information reported as an attachment to her Schedule K-1 indicated that 40% of this carryforward was attributable to the property sold by the S corporation this year. Assuming she has no other interests in passive activities and that she has not previously elected to treat her investment in the S corporation as a single activity, what is the net amount of income or loss that Kay should report on her current year income tax return?

- \$0.
- (\$80,000).
- \$10,000.
- (\$30,000).

Distribution of appreciated property in complete termination of a shareholder's interest in the S corporation

General

Under IRC Section 311(b), the distribution by a corporation of appreciated property triggers recognition of gain by the corporation as if it had sold the property. In effect, the transaction is treated as if the corporation sold the property to the shareholder for fair market value and then distributed the proceeds to the shareholder. If the property is encumbered by debt, the debt is subtracted from the deemed proceeds of sale in determining the amount of the distribution to the shareholder. The distribution is then classified by the corporation in accordance with the nature of the transaction — tax-free return of capital, dividend income, or stock redemption.

Knowledge check

4. Orlando Properties distributed a tract of land to its sole shareholder, Beryl Johnson. The tax basis of the land was \$100,000, and it was encumbered by a \$75,000 mortgage. The fair market value of the land was \$250,000. How much gain will Orlando recognize on the distribution and what will be the amount of the distribution to Beryl?
- \$150,000 gain to the S corporation; \$250,000 distribution to shareholder.
 - \$150,000 gain to the S corporation; \$175,000 distribution to shareholder.
 - \$75,000 gain to the S corporation; \$250,000 distribution to shareholder.
 - \$75,000 gain to the S corporation; \$175,000 distribution to shareholder.
-

Stock redemptions

In the return that we are reviewing, Primrose distributed the Lynx Meadows apartment complex to Rikki Dean in liquidation of her interest in the S corporation. When a regular or S corporation transfers cash or property to a shareholder in exchange for stock in the corporation, the transaction is classified as a stock redemption. Under IRC Section 302, a *qualified* redemption will be treated by the shareholder as a taxable sale of the shareholder's stock in the corporation. Nonqualified redemptions are treated as distributions.

Key review point

A complete liquidation of a shareholder's interest is a qualified stock redemption under Section 302(b)(3). Therefore, in reviewing Primrose's 2021 income tax return, the transfer of Lynx Meadows apartment complex to Rikki Dean should be reported as a sale of the property on Form 4797.

Primrose did file Form 4797, but a review of the form does not show how the reported gain was calculated. According to the facts of the case, the property's agreed-upon value at the date of the transfer to Rikki was \$1,500,000. It was encumbered by a note payable of \$750,000. Accordingly, the transaction should be accounted for by Primrose as follows:

| | | |
|--------------------------------|-----------|-------------|
| Treasury stock | \$750,000 | |
| Note payable | 750,000 | |
| Accumulated depreciation | 363,000 | |
| Lynx Meadows apartment complex | | \$1,210,000 |
| Land | | 140,000 |
| Gain | | 513,000 |

Note that the debit to Treasury stock is based on the agreed-upon value of the property. The amount paid for the stock is equal to the \$1,500,000 value of the apartment complex, less the \$750,000 note payable assumed by Rikki Dean in connection with the transfer. Subtracting the note payable from the value of the transferred property leaves an estimated \$750,000 value for the stock.

To check the amount recorded as accumulated depreciation in the preceding entry, we can calculate depreciation since the property was acquired in January 2013 for \$1,350,000, of which \$140,000 was allocable to the land on which the apartment complex was built. Depreciating \$1,210,000 (\$1,350,000 – \$140,000) over 27.5 years yields a depreciation deduction of \$44,000 per year, or \$3,666.67 per month). In 2013, depreciation is calculated over 11.5 months (only one-half month allowed for January) and in 2021 it is calculated over 3.5 months (only one-half month allowed for April). Thus, at the date of disposition, the property had been depreciated for 99 months. Multiplying this figure by the \$3,666.67 monthly depreciation expense yields the accumulated depreciation figure of \$363,000. These figures tie to amounts reported in the tax return. The Treasury stock is reported on the ending balance sheet in Schedule L (line 26). The \$513,000 gain is reported on Form 4797 – \$60,000 is reported in connection with the land, and the remainder is reported in Part III, as gain from the sale of IRC Section 1250 property. Of the remainder (\$453,000), \$363,000 is characterized as unrecaptured Section 1250 gain. Although this is properly reported on the return, the shareholders must be careful not to double count it; the unrecaptured Section 1250 gain is reported on line 8c of the Schedules K-1, while the net Section 1231 gain (emphasis added) is reported on line 9. It is not obvious in this reporting structure that line 8c is already included in line 9. The attachment labeled "Statement A—QBI Pass-through Entity Reporting" does not have a separate line for unrecaptured Section 1250 gain, which is the only indication to the shareholders that the depreciation recapture is part of the Section 1231 gain.

This transaction would also be taxable to Rikki on her individual return. Her net proceeds from the sale of her stock in Primrose were \$750,000, the amount paid by Primrose for Treasury stock. She should report a taxable gain or loss equal to the difference between this amount and her tax basis in her stock. Note that her stock basis will be adjusted for her share of S corporation income or loss reported to her on Schedule K-1, including her share of the S corporation's \$513,000 gain on the deemed sale of the Lynx Meadows apartment complex.

Key review point

Because the transfer of title in the Lynx Meadows apartment complex is properly classified as a stock redemption, it is not a distribution. Schedule K does not report any distributions to shareholders; therefore, it appears that this transaction may be properly accounted for.

Allocation of gain among the shareholders

The shareholders' shares of the gain recognized by Primrose on the transfer of the Lynx Meadows apartment complex are based on their percentage of shares owned. If this percentage changes during the year, the shareholders' percentage interest in each item of income is computed on a per-share, per-day basis (IRC Section 1377(a)(1)). This requires that S corporation pass-through items are allocated to each day of the tax year and are, in turn, allocated equally among the shares of stock outstanding on each such day. For this purpose, the IRC assumes that each pass-through item is allocable equally to each day of the tax year. This assumption may be invalid when significant items are attributable to specific events such as the acquisition or sale of property. To accommodate such issues, under certain circumstances, the S corporation can opt to close its tax year as of the date of a stock ownership change and determine the amount of each pass-through item as of that date (with the remainder deemed to occur after that date).

Under Section 1377(a)(2), if any shareholders terminate their entire interest in the corporation during the taxable year, the S corporation may allocate pass-through items "as if the taxable year consisted of two taxable years the first of which ends on the date of the termination." For the corporation to use this approach for allocations, all *affected shareholders* must agree. An *affected shareholder* is any shareholder whose allocations would be affected by the election (that is, the terminated shareholders and the shareholder(s) to whom they transferred stock).

Where the change in ownership does not result from the termination of a shareholder's entire interest in the S corporation, the regulations under IRC Section 1368 nonetheless allow the S corporation to close its books as of the date of the ownership change if one of the following conditions is true (Regs. Sec. 1.1368-1(g)(2)):

- A shareholder disposes of 20% or more of the outstanding stock of the corporation in one or more transactions during any 30-day period during the tax year.

- The corporation redeems 20% or more of its outstanding stock in a qualified redemption under Section 302 within any 30-day period during the tax year.
- The corporation issues new shares of stock equal to or greater than 25% of the previously outstanding stock within any 30-day period during the tax year.



Example 4-1

J and D were 50% owners of JD, Inc., a qualified S corporation from January 1 until July 1, when D sold half her shares to R. From July 1 through December 31, J owned 50% of the company's stock and D and R each owned 25%. For the year, the company had ordinary business income of \$600,000 and claimed a Section 179 deduction of \$500,000. Assume that had the company closed its books as of June 30 (the day before R acquired shares from D), it would have reported \$350,000 in ordinary business income with no deduction under Section 179. For the period July 1 through December 31, it earned \$250,000 in ordinary business income (\$600,000 total for the year) and claimed a \$500,000 Section 179 deduction.

The company can allocate the ordinary business income and the Section 179 deduction in either of the following two ways:

| | Ordinary business income | | Section 179 deduction | |
|--|--------------------------|-------------|-----------------------|-------------|
| | Pro rata | Close books | Pro rata | Close books |
| J (50% all year) | | \$300,000 | \$250,000 | \$250,000 |
| D (50% until 7/1; 25% thereafter; 37.5% average) | 225,000 | \$237,500 | \$187,500 | \$125,000 |
| R (0% until 7/1; 25% thereafter; 12.5% average) | \$75,000 | \$62,500 | 62,500 | \$125,000 |

In this case, closing the books as of June 30 decreased R's share of ordinary business income (increasing D's share) and increased her share of the Section 179 deduction (decreasing D's share). Because D's interest in the S corporation was not terminated, the S corporation can choose to close its books as of June 30 (for purposes of allocating pass-through items) only if all three shareholders consent to the election, rather than just D and R (the affected shareholders). As illustrated by this example, the choice by the S corporation of the alternative method will usually affect the tax and economic consequences of at least some of the shareholders.

In order to elect to close the tax year under this provision, all shareholders who held stock during the tax year (rather than just those affected by the election) must consent to the election. The election under Regs. Sec. 1.1368-1(g)(2)(i) is made by attaching a statement to a timely filed (including extensions) original or amended Form 1120S. The statement must indicate that the S corporation is electing for the

taxable year under Regs. Sec. 1.1368-1(g)(2)(i) to treat the taxable year as if it consisted of separate taxable years. The statement must also set forth facts relating to the qualifying disposition (for example, sale, gift, stock issuance, or redemption), and state that each shareholder who held stock in the corporation during the taxable year consents to this election. See Regs. Sec. 1.1377-1(b)(5) for a similar statement that must be filed when the closed book method is elected in connection with the complete termination of a shareholder's interest in the S corporation.

Knowledge check

5. Kevin purchased 50% of the stock in Winters, Inc., a qualified S corporation, on July 15. The corporation purchased \$400,000 of Section 179 property on May 1. Winters, Inc. opted to expense the entire acquisition under Section 179. Which statement is correct?
- Kevin will be allocated a larger share of Winters' Section 179 deduction if the corporation elects to close its books as of the date he acquired the stock and treat the tax year as two years.
 - Kevin will be allocated no share of Winters' Section 179 deduction if the corporation elects to close its books as of the date he acquired the stock and treat the tax year as two years.
 - Kevin cannot prevent the corporation from making this election.
 - Kevin is not an affected shareholder with respect to this election.
-

Key review point

The shareholders' percentage of stock ownership for the year is reported on their individual K-1s in Part II, Box F. This percentage is a blended figure taking into account their different interests before and after Rikki's departure from the S corporation. Note that the gain recognized on the distribution of Lynx Meadows to Rikki would be partially allocated to her whether or not the shareholders elected to treat the taxable year as two separate years. This is because the property is deemed to have been sold to Rikki for its fair market value, with the proceeds of the deemed sale being distributed back to Rikki in redemption of her shares. However, had the S corporation elected to treat the tax year as two separate years, Rikki's share of this gain would be equal to her 20% interest in the company prior to the redemption, rather than her blended 5.0411% interest reported on her Schedule K-1. Likewise, this election would prevent Rikki from being allocated any portion of the taxable loss attributable to the Rorschach property. Note that Rikki's blended interest of 5.0411% is equal to her 20% interest in the S corporation times the numbers of days she owned her shares divided by 365. She owned shares until April 2, 2021, so her blended interest is equal to just over 3/12ths times 20%.

A review of Rikki's Schedule K-1 indicates that the S corporation chose not to treat 2021 as two separate tax years for purposes of allocating the gain. Doing so would shift tax liability on the gain away from Jesse and Dane and toward Rikki. As an affected shareholder, Rikki would have to agree to the election to treat the tax year as two separate years. That is likely why Primrose did not make the election. However, just to be sure, we should confirm that no such election was agreed to by the shareholders, as the presence of such an election would substantially affect the allocations among the three shareholders.

Acquisition of property by an S corporation via like-kind exchange

General

IRC Section 1031 provides that no gain or loss is recognized on the exchange of property held for productive use in a trade or business or for investment if such property is exchanged solely for property of like-kind that is to be held either for productive use in a trade or business or for investment. The only circumstance in which gain is recognized in a like-kind exchange is when the taxpayer receives *boot* in the exchange, in addition to like-kind property. Boot is largely construed as any property that is not of like-kind to the property transferred by the taxpayer. Therefore, to the extent that the taxpayer receives cash in addition to the like-kind property, it will be required to recognize gain. In this context, relief of debt is treated as cash unless the taxpayer also assumes debt in connection with the like-kind property received. In such cases, only the net amount of debt relief (that is, the excess of the amount of debt relinquished by the taxpayer over the debt assumed by the taxpayer) is treated as boot.

The most important question, then, is what constitutes *like-kind* property? Under Section 1031, like-kind property is property of the same nature, character, or class. Quality or grade is not relevant. In the case of real estate, the types of property that qualify as being of like-kind are very broadly defined. Most real estate is like-kind to other real estate. For example, improved real property is like-kind to vacant land. The issue is the taxpayer's purpose for holding the real estate; as long as the taxpayer holds both the relinquished realty and the replacement realty for either business-use or investment purposes, Section 1031 will be applicable to the exchange.

In a like-kind exchange, the taxpayer defers recognition of gain on the transfer of property by building it into the tax basis of the like-kind property received. Building the gain into the basis of the acquired property is accomplished by taking a "carryover" basis in such property equal to the taxpayer's tax basis in the property transferred. Note that carryover basis must be increased by the fair market value of any other property, including cash, transferred to the other party in exchange for the like-kind property. It is also increased by any excess debt assumed by the taxpayer in connection with the exchange. If the S corporation transfers more debt than it assumes in the exchange, the deficit is absorbed by recognizing gain, and the tax basis of the like-kind property received is not affected.

Application of Section 1031 to the Primrose exchange

In reviewing the facts of Primrose's exchange of the Starlight Way apartment complex for the Rorschach Corner restaurant property, two issues must be noted. First, Primrose was released from the \$1,300,000 note payable encumbering Starlight Way and assumed responsibility for the \$1,500,000 debt encumbering Rorschach Corner. Therefore, the company assumed an additional \$200,000 indebtedness

in the transaction which will increase its tax basis in Rorschach Corner. The assumption of additional debt does not constitute boot to Primrose.

Second, Primrose transferred \$500,000 cash to the other party as part of the exchange. This will also increase Primrose’s tax basis in Rorschach Corner. For tax purposes, the exchange should be accounted for as follows:

| | | |
|---|-----------|-----------|
| Rorschach Corner and land | 1,888,029 | |
| Note payable, Starlight Way | 1,300,000 | |
| Accumulated depreciation, Starlight Way | 1,061,971 | |
| Starlight Way apartment complex | | 2,062,500 |
| Land | | 187,500 |
| Note payable, Rorschach Corner | | 1,500,000 |
| Cash | | 500,000 |

The tax basis of the acquired property is essentially a plug figure, computed by subtracting the debit entries to the note payable and accumulated depreciation from the credit entries to the apartment complex, the underlying land, the note payable assumed, and the cash paid. In this case, Primrose’s tax basis in Rorschach Corner is \$1,888,029. Note that this is equal to the company’s \$1,188,029 tax basis in Starlight Way (includes both the land and the apartment complex), increased by the \$500,000 cash payment and the \$200,000 additional indebtedness assumed by Primrose.

Key review point

We know from the preceding accounting entry what the tax basis should be in the Rorschach Corner property; however, the issue of allocation of that basis between the land and the structure is not addressed. This is an important question because no cost recovery deductions will be available to Primrose for that portion of the purchase price allocated to land. It is possible for the parties to the exchange to agree to the allocation of the acquisition “price” between the structure and the underlying land. This would be unusual, however, in a like-kind exchange, and it may carry no weight because the parties have no adversarial interest in this allocation. Several alternatives are available. If the S corporation routinely applies a “rule of thumb” allocation of a certain percentage of the acquisition of realty to land (for example, 10%), it could continue to follow this approach. It would, however, be wise to use a consistent estimate in such cases.

Perhaps a more appropriate approach would be to apply the appreciation in the value of the transferred property proportionately to both the building and the land upon which it sits. In this case, Primrose paid \$2,250,000 for the property and allocated 8.33% of this price to the land. The total step-up in basis resulting from this exchange is \$700,000 (\$500,000 cash plus \$200,000 increase in debt). Allocating 8.33% of this step-up to the land would result in an increase of \$58,310 in the basis of the land and

\$641,690 to the building. A review of Form 4562 indicates that Primrose allocated \$1,650,000 of the total adjusted basis of the replacement property to the building. This figure represents the original basis of the building plus 92.78% of the step-up in basis. This is probably not a material issue, but it may be worth some additional discussion with the client.

Depreciation and cost recovery deductions

General

Regs. Sec. 1.168(i)-6 governs the depreciation of modified accelerated cost recovery system (MACRS) property received in a like-kind exchange. Under the regulations, the tax basis of the replacement property (the like-kind property received in the exchange) included the following two parts:

1. The portion of the basis carried over from the relinquished property
2. The step-up in basis attributable to the transfer of cash or other non-like-kind property transferred by the taxpayer in exchange for the replacement property (Recall that the assumption by the taxpayer of additional debt in connection with the exchange is equivalent to the payment of cash as part of the exchange).

The *stepped-up* basis of the replacement property is treated as new property acquired on the date of the exchange. Depreciation of the *carryover* portion of the tax basis is more complex. The regulations begin with the general rule that the carryover basis of replacement MACRS property is depreciated over the remaining recovery period of, and using the depreciation method and convention of, the relinquished MACRS property.

This general rule applies if the replacement MACRS property has the same or a shorter recovery period or the same or a more accelerated depreciation method than the relinquished MACRS property. Where the replacement property (the like-kind property received) has a shorter depreciable life than the relinquished property, however, the regulations allow the taxpayer to elect to treat the replacement property as newly acquired property placed in service at the date of the like-kind exchange.

In contrast, where the recovery period of the replacement MACRS property is longer than that of the relinquished MACRS property, the carryover portion of the taxpayer's basis in the relinquished MACRS property is depreciated beginning in the year of replacement over the remainder of the recovery period that would have applied to the replacement MACRS property if the replacement MACRS property had originally been placed in service when the relinquished MACRS property was placed in service by the acquiring taxpayer.

Because Primrose paid cash, and assumed more debt, in the like-kind exchange, it took a stepped-up basis in the replacement property as previously discussed. Its depreciation deduction will therefore be more complicated than most property acquisitions. Careful attention must be paid to this issue when reviewing its 2021 tax return.

Key review point

A review of Form 4562 filed with Primrose’s 2021 Form 1120S indicates that the company did indeed divide the basis of Rorschach Corner into two components – a “carryover” tax basis of \$1,000,529 and a “new” basis of \$640,000. The company appears to have correctly depreciated the “new” portion of the property over 39 years, beginning in May 2021. Depreciation for this component of the property would be computed as follows:

| | |
|--|-----------------|
| Depreciable basis of the property | \$640,000 |
| Depreciable life | ÷ 39 yrs |
| Depreciation expense per year | <hr/> 16,410 |
| Number of months, using mid-month convention | 7.5 mo/12 mo |
| 2021 depreciation | <hr/> \$ 10,256 |

The carryover basis of the property is also 39-year property. However, as discussed previously, depreciation on this portion must be computed using the straight-line method of depreciation over what would be the remainder of the 39-year property’s life had it been acquired in July 2007. In such a case, the property would have been placed in service 14 years ago (July 2007–May 2021), and would have 25 remaining years in its depreciable life. Using the straight-line method, its depreciation deduction should be calculated as follows:

| | |
|--|-----------------|
| Depreciable basis of the property | \$1,000,529 |
| Depreciable life | ÷ 25 yrs |
| Depreciation expense per year | <hr/> 40,021 |
| Number of months, using mid-month convention | 6.5 mo/12 mo |
| 2021 depreciation | <hr/> \$ 21,678 |

Per Form 4562, it appears that Primrose is claiming a depreciation deduction of \$46,321 for this component of the property’s basis. As noted previously, the depreciation of like-kind property received in a Section 1031 exchange is very complex, and especially so when the like-kind property has a different depreciable life than the property given up in the exchange. In this case, it appears that Primrose is continuing to depreciate the carryover portion of its tax basis in Rorschach Corner over 27 years – the depreciable life of the Starlight Way apartment complex that it traded for Rorschach Corner. This is a substantial error which should be corrected.

Tax Glossary

- 401(k) plan.** A qualified retirement plan to which contributions from salary are made from pre-tax dollars.
- accelerated depreciation.** Computation of depreciation to provide greater deductions in earlier years of equipment and other business or investment property.
- accounting method.** Rules applied in determining when and how to report income and expenses on tax returns.
- accrual method.** Method of accounting that reports income when it is earned, disregarding when it may be received, and expense when incurred, disregarding when it is actually paid.
- acquisition debt.** Mortgage taken to buy, hold, or substantially improve main or second home that serves as security.
- active participation.** Rental real estate activity involving property management at a level that permits deduction of losses.
- adjusted basis.** Basis in property increased by some expenses (for example, by capital improvements) or decreased by some tax benefit (for example, by depreciation).
- adjusted gross income (AGI).** Gross income minus above-the-line deductions (such as deductions other than itemized deductions, the standard deduction, and personal and dependency exemptions).
- alimony.** Payments for the support or maintenance of one's spouse pursuant to a judicial decree or written agreement related to divorce or separation.
- alternative minimum tax (AMT).** System comparing the tax results with and without the benefit of tax preference items for the purpose of preventing tax avoidance.
- amortization.** Write-off of an intangible asset's cost over a number of years.
- applicable federal rate (AFR).** An interest rate determined by reference to the average market yield on U.S. government obligations. Used in Sec. 7872 to determine the treatment of loans with below-market interest rates.
- at-risk rules.** Limits on tax losses to business activities in which an individual taxpayer has an economic stake.
- backup withholding.** Withholding for federal taxes on certain types of income (such as interest or dividend payments) by a payor that has not received required taxpayer identification number (TIN) information.
- bad debt.** Uncollectible debt deductible as an ordinary loss if associated with a business and otherwise deductible as short-term capital loss.

basis. Amount determined by a taxpayer's investment in property for purposes of determining gain or loss on the sale of property or in computing depreciation.

cafeteria plan. Written plan allowing employees to choose among two or more benefits (consisting of cash and qualified benefits) and to pay for the benefits with pretax dollars. Must conform to Sec. 125 requirements.

capital asset. Investments (such as stocks, bonds, and mutual funds) and personal property (such as home).

capital gain/loss. Profit (net of losses) on the sale or exchange of a capital asset or Sec. 1231 property, subject to favorable tax rates, and loss on such sales or exchanges (net of gains) deductible against \$3,000 of ordinary income.

capitalization. Addition of cost or expense to the basis of property.

carryovers (carryforwards) and carrybacks. Tax deductions and credits not fully used in one year are chargeable against prior or future tax years to reduce taxable income or taxes payable.

Conservation Reserve Program (CRP). A voluntary program for soil, water, and wildlife conservation, wetland establishment and restoration and reforestation, administered by the U.S. Department of Agriculture.

credit. Amount subtracted from income tax liability.

deduction. Expense subtracted in computing adjusted gross income.

defined benefit plan. Qualified retirement plan basing annual contributions on targeted benefit amounts.

defined contribution plan. Qualified retirement plan with annual contributions based on a percentage of compensation.

depletion. Deduction for the extent a natural resource is used.

depreciation. Proportionate deduction based on the cost of business or investment property with a useful life (or recovery period) greater than one year.

earned income. Wages, bonuses, vacation pay, and other remuneration, including self-employment income, for services rendered.

earned income credit. Refundable credit available to low-income individuals.

employee stock ownership plan (ESOP). Defined contribution plan that is a stock bonus plan or a combined stock bonus and money purchase plan designed to invest primarily in qualifying employer securities.

estimated tax. Quarterly payments of income tax liability by individuals, corporations, trusts, and estates.

exemption. A deduction against net income based on taxpayer status (such as single, head of household, married filing jointly or separately, trusts, and estates).

fair market value. The price that would be agreed upon by a willing seller and willing buyer, established by markets for publicly-traded stocks, or determined by appraisal.

fiscal year. A 12-month taxable period ending on any date other than December 31.

foreign tax. Income tax paid to a foreign country and deductible or creditable, at the taxpayer's election, against U.S. income tax.

gift. Transfer of money or property without expectation of anything in return, and excludable from income by the recipient. A gift may still be affected by the unified estate and gift transfer tax applicable to the gift's maker.

goodwill. A business asset, intangible in nature, adding a value beyond the business's tangible assets.

gross income. Income from any and all sources, after any exclusions and before any deductions are taken into consideration.

half-year convention. A depreciation rule assuming property other than real estate is placed in service in the middle of the tax year.

head-of-household. An unmarried individual who provides and maintains a household for a qualifying dependent and therefore is subject to distinct tax rates.

health savings account (HSA). A trust operated exclusively for purposes of paying qualified medical expenses of the account beneficiary and thus providing for deductible contributions, tax-deferred earnings, and exclusion of tax on any monies withdrawn for medical purposes.

holding period. The period of time a taxpayer holds onto property, therefore affecting tax treatment on its disposition.

imputed interest. Income deemed attributable to deferred-payment transfers, such as below-market loans, for which no interest or unrealistically low interest is charged.

incentive stock option (ISO). An option to purchase stock in connection with an individual's employment, which defers tax liability until all of the stock acquired by means of the option is sold or exchanged.

income in respect of a decedent (IRD). Income earned by a person, but not paid until after his or her death.

independent contractor. A self-employed individual whose work method or time is not controlled by an employer.

indexing. Adjustments in deductions, credits, exemptions and exclusions, plan contributions, AGI limits, and so on, to reflect annual inflation figures.

individual retirement account (IRA). Tax-exempt trust created or organized in the U.S. for the exclusive benefit of an individual or the individual's beneficiaries.

information returns. Statements of income and other items recognizable for tax purposes provided to the IRS and the taxpayer. Form W-2 and forms in the 1099 series, as well as Schedules K-1, are the prominent examples.

installment method. Tax accounting method for reporting gain on a sale over the period of tax years during which payments are made, such as, over the payment period specified in an installment sale agreement.

intangible property. Items such as patents, copyrights, and goodwill.

inventory. Goods held for sale to customers, including materials used in the production of those goods.

involuntary conversion. A forced disposition (for example, casualty, theft, condemnation) for which deferral of gain may be available.

jeopardy. For tax purposes, a determination that payment of a tax deficiency may be assessed immediately as the most viable means of ensuring its payment.

Keogh plan. A qualified retirement plan available to self-employed persons.

key employee. Officers, employees, and officers defined by the Internal Revenue Code for purposes of determining whether a plan is "top heavy."

Kiddie tax. Application of parents' maximum tax rate to unearned income of their child under age 19. Full-time students under 24 are also subject to the kiddie tax.

lien. A charge upon property after a tax assessment has been made and until tax liability is satisfied.

like-kind exchange. Tax-free exchange of business or investment property for property that is similar or related in service or use.

listed property. Items subject to special restrictions on depreciation (for example, cars, computers, cell phones).

lump-sum distribution. Distribution of an individual's entire interest in a qualified retirement plan within one tax year.

marginal tax rate. The highest tax bracket applicable to an individual's income.

material participation. The measurement of an individual's involvement in business operations for purposes of the passive activity loss rules.

mid-month convention. Assumption, for purposes of computing depreciation, that all real property is placed in service in the middle of the month.

mid-quarter convention. Assumption, for purposes of computing depreciation, that all property other than real property is placed in service in the middle of the quarter, when the basis of

property placed in service in the final quarter exceeds a statutory percentage of the basis of all property placed in service during the year.

minimum distribution. A retirement plan distribution, based on life expectancies, that an individual must take after age 70½ in order to avoid tax penalties.

minimum funding requirements. Associated with defined benefit plans and certain other plans, such as money purchase plans, assuring the plan has enough assets to satisfy its current and anticipated liabilities.

miscellaneous itemized deduction. Deductions for certain expenses (for example, unreimbursed employee expenses) limited to only the amount by which they exceed 2 percent of adjusted gross income.

money purchase plan. Defined contribution plan in which the contributions by the employer are mandatory and established other than by reference to the employer's profits.

net operating loss (NOL). A business or casualty loss for which amounts exceeding the allowable deduction in the current tax year may be carried back two years to reduce previous tax liability and forward 20 years to cover any remaining unused loss deduction.

nonresident alien. An individual who is neither a citizen nor a resident of the United States. Nonresidents are taxed on U.S. source income.

original issue discount (OID). The excess of face value over issue price set by a purchase agreement.

passive activity loss (PAL). Losses allowable only to the extent of income derived each year (such as by means of carryover) from rental property or business activities in which the taxpayer does not materially participate.

passive foreign investment company (PFIC). A foreign based corporation subject to strict tax rules which covers the treatment of investments in Sections 1291 through 1297.

pass-through entities. Partnerships, LLCs, LLPs, S corporations, and trusts and estates whose income or loss is reported by the partner, member, shareholder, or beneficiary.

personal holding company (PHC). A corporation, usually closely-held, that exists to hold investments such as stocks, bonds, or personal service contracts and to time distributions of income in a manner that limits the owner(s) tax liability.

qualified subchapter S trust (QSST). A trust that qualifies specific requirements for eligibility as an S corporation shareholder.

real estate investment trust (REIT). A form of investment in which a trust holds real estate or mortgages and distributes income, in whole or in part, to the beneficiaries (such as investors).

real estate mortgage investment conduit (REMIC). Treated as a partnership, investors purchase interests in this entity which holds a fixed pool of mortgages.

realized gain or loss. The difference between property's basis and the amount received upon its sale or exchange.

recapture. The amount of a prior deduction or credit recognized as income or affecting its characterization (capital gain vs. ordinary income) when the property giving rise to the deduction or credit is disposed of.

recognized gain or loss. The amount of realized gain or loss that must be included in taxable income.

regulated investment company (RIC). A corporation serving as a mutual fund that acts as investment agents for shareholders and customarily dealing in government and corporate securities.

reorganization. Restructuring of corporations under specific Internal Revenue Code rules so as to result in nonrecognition of gain.

resident alien. An individual who is a permanent resident, has substantial presence, or, under specific election rules is taxed as a U.S. citizen.

Roth IRA. Form of individual retirement account that produces, subject to holding period requirements, nontaxable earnings.

S corporation. A corporation that, upon satisfying requirements concerning its ownership, may elect to act as a pass-through entity.

Saver's credit. Term commonly used to describe Sec. 25B credit for qualified contributions to a retirement plan or via elective deferrals.

Sec. 1231 property. Depreciable business property eligible for capital gains treatment.

Sec. 1244 stock. Closely held stock whose sale may produce an ordinary, rather than capital, loss (subject to caps).

split-dollar life insurance. Arrangement between an employer and employee under which the life insurance policy benefits are contractually split, and the costs (premiums) are also split.

statutory employee. An insurance agent or other specified worker who is subject to social security taxes on wages but eligible to claim deductions available to the self-employed.

stock bonus plan. A plan established and maintained to provide benefits similar to those of a profit-sharing plan, except the benefits must be distributable in stock of the employer company.

tax preference items. Tax benefits deemed includable for purposes of the alternative minimum tax.

tax shelter. A tax-favored investment, typically in the form of a partnership or joint venture, that is subject to scrutiny as tax-avoidance device.

tentative tax. Income tax liability before taking into account certain credits, and AMT liability over the regular tax liability.

transportation expense. The cost of transportation from one point to another.

travel expense. Transportation, meals, and lodging costs incurred away from home and for trade or business purposes.

unearned income. Income from investments (such as interest, dividends, and capital gains).

uniform capitalization rules (UNICAP). Rules requiring capitalization of property used in a business or income-producing activity (such as items used in producing inventory) and to certain property acquired for resale.

unrelated business income (UBIT). Exempt organization income produced by activities beyond the organization's exempt purposes and therefore taxable.

wash sale. Sale of securities preceded or followed within 30 days by a purchase of substantially identical securities. Recognition of any loss on the sale is disallowed.



REVIEWING S-CORP RETURNS

**BY ROBERT RICKETTS, PH.D., CPA; AND
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Solutions

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Solutions

Chapter 1

Knowledge check solutions

1.
 - a. Incorrect. The entire gain would not have to be recognized.
 - b. Incorrect. The amount of boot would have to be recognized.
 - c. Correct. The gain is the lesser of boot or gain realized.
 - d. Incorrect. Because he receives boot, he would have to recognize some gain.
2.
 - a. Incorrect. Grace's would be taxable because 80% control wasn't held.
 - b. Incorrect. Maria's would be taxable because it was in exchange for services.
 - c. Incorrect. Both shareholders' exchanges would be taxable.
 - d. Correct. Because the 80% control requirement isn't met, both shareholders' exchanges would be taxable.
3.
 - a. Incorrect. The beginning balances should be included in the calculation, and dividend income goes in AAA.
 - b. Correct. Ordinary income and dividend income are included in AAA. Tax exempt income is included in OAA.
 - c. Incorrect. AAA includes dividend income and is reduced by distributions.
 - d. Incorrect. AAA is reduced by distributions. OAA includes tax exempt income.
4.
 - a. Incorrect. The tax-free amount is limited to basis.
 - b. Incorrect. The tax-free amount is limited to basis. Distributions out of AAA greater than that are capital gains.
 - c. Correct. The return of basis is tax-free, then the rest of AAA results in capital gain, then dividend income.
 - d. Incorrect. All of the AAA should be distributed before distributing from E&P.

- 5.
- a. Incorrect. She does not own her shares for the entire year.
 - b. Correct. $(40\% \text{ of the total } \$270,000 \text{ income for the year}) \times 335 \div 365 = \$99,123$.
 - c. Incorrect. The income for the entire year is allocated to her. When it was earned is irrelevant.
 - d. Incorrect. She owned the interest for 335 out of 365 days.
-

Chapter 2

Knowledge check solutions

- 1.
- a. Incorrect. The capital gains rate is not \$0 if taxable income for a single individual is over \$38,600.
 - b. Correct. The 2020 capital gains rate is 15% if the taxable income for a single individual is over \$38,600 but not over \$425,000.
 - c. Incorrect. The capital gains rate is not 25% under these circumstances at any taxable income level.
 - d. Incorrect. The capital loss must be subtracted before applying the capital gains rate.
- 2.
- a. Incorrect. Form 4797 is used to report the sale of business assets.
 - b. Correct. Capital gains and losses are first entered on Form 8949, then on Schedule D.
 - c. Incorrect. Form 4562 is used to report depreciation.
 - d. Incorrect. Capital gains and losses are reported on Schedule K, not page 1.
- 3.
- a. Incorrect. For someone in the 37% bracket, dividends would not be taxed at 0%.
 - b. Incorrect. The dividends tax rate for someone in the 37% bracket would not be 10%.
 - c. Correct. In 2020 a taxpayer with taxable income of \$700,000 would have their dividends taxed at 20%.
 - d. Incorrect. For someone in the 37% bracket, dividends would not be taxed at 37%. Be aware that the dividends tax rate is no longer tied to the individual income tax brackets under the TCJA.

4.
 - a. Incorrect. Terry is allocated only 10% of the gain and would not be taxed at 39.6%.
 - b. Incorrect. The 28% tax rate is correct, but Terry is allocated only 10% of the gains.
 - c. Incorrect. The gain allocation is correct, but collectibles gains are subject to a maximum rate of 28%.
 - d. Correct. Terry is allocated \$5,000 of the gain, and collectibles gains are subject to a maximum rate of 28%.

 5.
 - a. Correct. The net investment income is \$0, so no investment interest expense is deductible.
 - b. Incorrect. Whether or not the investment interest expense flows through from an S corporation, the deductibility is limited to investment income.
 - c. Incorrect. The dividends are qualified, meaning they don't create net investment income unless an election to treat them that way is made.
 - d. Incorrect. None of the \$10,000 of investment interest expense will be deductible because there was no investment income.
-

Chapter 3

Knowledge check solutions

1.
 - a. Correct. Quinlan's net realized built-in gain for the current year is \$45,000 (\$65,000 – \$20,000), and its taxable income is sufficiently high for the company to also recognize the \$30,000 carryforward.
 - b. Incorrect. The company also has a \$30,000 carryforward from prior years.
 - c. Incorrect. The company also realized a built-in loss of (\$20,000).
 - d. Incorrect. This is the remaining unrecognized built-in gain, but the entire amount has not yet been realized.

2.
 - a. Incorrect. This is the maximum amount that can be deducted under Section 179, but Janice's total Section 179 amount is only \$150,000.
 - b. Incorrect. The Section 179 deduction is limited to Janice's net trade or business income.
 - c. Incorrect. This is Janice's share of the S corporation's net trade or business income, but she also has income from her salary.
 - d. Correct. Janice's available Section 179 deduction is \$150,000, but it is limited to her net trade or business income of \$130,000 (her 50% share of the S corporation's \$150,000 net trade or business income plus her \$55,000 salary).

- 3.
- a. Incorrect. The sum of Jo's tax basis and her share of the corporation's E&P is only \$75,000.
 - b. Incorrect. Each shareholder will recognize \$25,000 in dividend income, but not capital gain.
 - c. Correct. The first \$45,000 of Jo's distribution is a nontaxable return of capital, and the next \$25,000 is deemed to come from E&P. Only the remaining \$5,000 will trigger capital gain.
 - d. Incorrect. The first \$30,000 of each shareholder's distribution will come from AAA, the next \$25,000 from E&P, and the remainder will be applied against tax basis to determine whether capital gain is recognized.
- 4.
- a. Incorrect. The distribution cannot be applied against the tax basis of the N/R.
 - b. Correct. Kyle must account for the distribution before accounting for his share of pass-through loss. Because the distribution exceeds stock basis (before accounting for the pass-through loss), Kyle will recognize a \$5,000 gain. The loss will be accounted for after the distribution; since stock basis has been reduced to zero, the entire loss will be applied against the basis of the N/R.
 - c. Incorrect. The distribution is applied against the stock basis, before making adjustment for the pass-through loss.
 - d. Incorrect. The loss is applied against the basis in the N/R.
-

Chapter 4

Knowledge check solutions

- 1.
- a. Incorrect. Neither the Section 1231 gain nor the charitable contributions are reported on Form 8825.
 - b. Incorrect. The Section 1231 gain is not reported on Form 8825.
 - c. Correct. Charitable contributions and net Section 1231 gain are not reported on Form 8825.
 - d. Incorrect. Depreciation expense is deducted on Form 8825.

2.

- a. Incorrect. The apartment complex was disposed of on May 4. Using the mid-month convention, Primrose would be entitled to four and a half months of depreciation.
- b. Correct. Primrose is entitled to four and a half months of depreciation on this property.
- c. Incorrect. This is a full year's depreciation. Primrose disposed of Starlight Way in May.
- d. Incorrect. The mid-year convention does not apply to residential real estate.

3.

- a. Incorrect. Kay had net rental income of \$10,000 and is allowed to deduct the entire portion of the passive loss carryforward attributable to the property disposed of by the S corporation this year.
- b. Incorrect. Kay can deduct only the portion of the carryforward attributable to the property disposed of by the S corporation this year.
- c. Incorrect. Kay is also allowed to deduct the passive loss carryforward attributable to the property disposed of by the S corporation this year.
- d. Correct. She had \$10,000 of pass-through income from the S corporation and is allowed to deduct \$40,000 of the passive loss carryforward (the portion attributable to the property sold by the S corporation this year).

4.

- a. Incorrect. The distribution to the shareholder is reduced by the amount of the debt shifted to the shareholder.
- b. Correct. The distribution is fully taxable to the S corporation, and the distribution to the shareholder is equal to the net value of the property received.
- c. Incorrect. The debt shifted to the shareholder reduces the amount of the distribution but not the amount of gain recognized by the S corporation.
- d. Incorrect. The corporation's gain is not reduced by the debt transfer.

5.

- a. Incorrect. The property was acquired before Kevin became a shareholder.
- b. Correct. Kevin will not receive a share of the Section 179 deduction if the corporation treats the tax year as two short tax years.
- c. Incorrect. Kevin can refuse to sign the election to treat the tax year as two tax years.
- d. Incorrect. Kevin is an affected shareholder because his share of the Section 179 deduction will change if the S corporation elects to treat the tax year as two years.

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