

# 2004



Department of the Treasury  
Internal Revenue Service

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

## Shareholder's Share of Income, Deductions, Credits, etc. (For Shareholder's Use Only)

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

### What's New

- Schedule K-1 has been redesigned. Codes are used to identify many of the items on the schedule and, if necessary, statements are attached to provide additional information. See the instructions for Part III on page 4 for more information on the codes and attached statements.
- You can use the new worksheet on page 2 to keep track of the basis of your stock.

### General Instructions

#### Purpose of Schedule K-1

The corporation uses Schedule K-1 (Form 1120S) to report your pro rata share of the corporation's income (reduced by any tax the corporation paid on the income), deductions, credits, etc. Keep it for your records. Do not file it with your tax return. The corporation has filed a copy with the IRS.

Although the corporation may have to pay a built-in gains tax and an excess net passive income tax, you are liable for income tax on your share of the corporation's income, whether or not distributed, and you must include your share on your tax return if a return is required. Your pro rata share of S corporation income is not self-employment income and it is not subject to self-employment tax.

Schedule K-1 does not show the amount of actual dividend distributions the corporation made to you. The corporation must report such amounts totaling \$10 or more for the calendar year on Form 1099-DIV, Dividends and Distributions.

#### Inconsistent Treatment of Items

Generally, you must report subchapter S items shown on your Schedule K-1 (and any attached schedules) the same way that the corporation treated the items on its return.

If the treatment on your original or amended return is inconsistent with the corporation's treatment, or if the corporation has not filed a return, you must file Form 8082, Notice of Inconsistent Treatment or Administrative Adjustment Request (AAR), with your original or amended return to identify and explain any inconsistency (or to note that a corporate return has not been filed).

If you are required to file Form 8082, but fail to do so, you may be subject to the accuracy-related penalty. This penalty is in addition to any tax that results from making your amount or treatment of the item consistent with that shown on the corporation's return.

Any deficiency that results from making the amounts consistent may be assessed immediately.

#### Errors

If you believe the corporation has made an error on your Schedule K-1, notify the corporation and ask for a corrected Schedule K-1. Do not change any items on your copy of Schedule K-1. Be sure that the corporation sends a copy of the corrected Schedule K-1 to the IRS. If you are unable to reach agreement with the corporation regarding the inconsistency, you must file Form 8082.

#### International Boycotts

Every corporation that had operations in, or related to, a boycotting country, company, or national of a country, must file Form 5713, International Boycott Report.

If the corporation cooperated with an international boycott, it must give you a copy of its Form 5713. You must file your own Form 5713 to report the corporation's activities and any other boycott operations that you may have. You may lose certain tax benefits if the corporation participated in, or cooperated with, an international boycott. See Form 5713 and its instructions for more information.

#### Elections

Generally, the corporation decides how to figure taxable income from its operations. For example, it chooses the accounting method and depreciation methods it will use. However, certain elections are made by you separately on your income tax return and not by the corporation. These elections are made under the following code sections:

- Section 59(e) (deduction of certain qualified expenditures ratably over the period of time specified in that section). For more information, see the instructions for code K in box 12.
- Section 263A(d) (preproductive expenses). See the instructions for code M in box 12.
- Section 617 (deduction and recapture of certain mining exploration expenditures), and
- Section 901 (foreign tax credit).

If the corporation attaches a statement to Schedule K-1 indicating that it has changed its tax year and that you may elect to report your pro rata share of the income attributable to that change ratably over 4 tax years, see Rev. Proc. 2003-79, 2003-45 I.R.B. 1036 for details on making the election. To make the election, you must file Form 8082 with your income tax return for each of the 4 tax years. File Form 8082 for this purpose in accordance with Rev. Proc. 2003-79 instead of the Form 8082 instructions.

### Additional Information

For more information on the treatment of S corporation income, deductions, credits, etc., see Pub. 535, Business Expenses; Pub. 550, Investment Income and Expenses; and Pub. 925, Passive Activity and At-Risk Rules.

To get forms and publications, see the instructions for your tax return.

### Limitations on Losses, Deductions, and Credits

There are three separate potential limitations on the amount of losses passed to the shareholder that you may deduct on your return. These limitations and the order in which you must apply them are as follows: the basis rules, the at-risk limitations, and the passive activity limitations. Each of these limitations is discussed separately below.

Other limitations may apply to specific deductions (for example, the section 179 expense deduction). Generally, specific limitations apply before the basis, at-risk, and passive limitations.

#### Basis Rules

Generally, the deduction for your share of aggregate losses and deductions reported on Schedule K-1 is limited to the basis of your stock (determined with regard to distributions received during the tax year) and loans from you to the corporation. The basis of your stock is figured at year-end. Any losses and deductions not allowed this year because of the basis limit can be carried forward indefinitely and deducted in a later year subject to the basis limit for that year.

You are responsible for maintaining records to show the computation of the basis of your stock in the corporation. Schedule K-1 provides information to help you make the computation at the end of each corporate tax year. The basis of your stock (generally, its cost) is adjusted as follows and, except as noted, in the order listed. In addition, basis may be adjusted under other provisions of the Internal Revenue Code. You may use the worksheet on the next page to figure your aggregate stock basis.

1. Basis is increased by (a) all income (including tax-exempt income) reported on Schedule K-1 and (b) the excess of the deduction for depletion (other than oil and gas depletion) over the basis of the property subject to depletion.



You must report the taxable income on your return (if you are required to file one) for it to increase your basis.



Basis is not increased by income from discharge of your indebtedness in the S corporation (nor by the amount included in income with respect to qualified zone academy bonds).

2. Basis is decreased by property distributions (including cash) made by the corporation (excluding dividend distributions reported on Form 1099-DIV and distributions in excess of basis) reported on Schedule K-1, box 16, code D.

3. Basis is decreased by (a) nondeductible expenses and (b) the depletion deduction for any oil and gas property held by the corporation, but only to the extent your pro rata share of the property's adjusted basis exceeds that deduction.

4. Basis is decreased by all deductible losses and deductions reported on Schedule K-1.

You may elect to decrease your basis under 4 above prior to decreasing your basis under 3 above. If you make this election, any amount described under 3 that exceeds the basis of your stock and debt owed to you by the corporation is treated as an amount described under 3 for the following tax year. To make the election, attach a statement to your timely filed original or amended return that states you agree to the carryover rule of Regulations section 1.1367-1(g) and the name of the S corporation to which the rule applies. Once made, the election applies to the year for which it is made and all future tax years for that S corporation, unless the IRS agrees to revoke your election.

The basis of each share of stock is increased or decreased (but not below zero) based on its pro rata share of the above adjustments. If the total decreases in basis attributable to a share exceed that share's basis, the excess reduces (but not below zero) the remaining bases of all other shares of stock in proportion to the remaining basis of each of those shares.

**Basis of loans.** The basis of your loans to the corporation is generally the balance the corporation owes you, adjusted for any reductions and restorations of loan basis (see the instructions for box 16, code E). Any amounts described in 3 and 4 above not used to offset amounts in 1 above, or reduce your stock basis, are used to reduce your loan basis (to the extent of such basis prior to such reduction).



When determining your basis in loans to the corporation, remember that:

- Distributions do not reduce loan basis, and
- Loans that a shareholder guarantees or co-signs are not part of a shareholder's loan basis.

See section 1367 and its regulations for more details.

**Worksheet instructions.** For lines 6 and 7, do not enter more than the aggregate sum of the preceding lines. Any excess of the amounts that would otherwise be entered on lines 6 and 7 without regard to this limit over the amounts actually entered on those lines is a reduction to your basis, if any, in loans you made to the corporation (to the extent of such basis). Any portion of the excess not used to reduce your basis in stock and loans is not deductible in the current year and is carried over to next year and subject to that year's basis limit. See the preceding instructions for more details.

### At-Risk Limitations

Generally, you will have to complete Form 6198, At-Risk Limitations, to figure your allowable loss, if you have:

1. A loss or other deduction from any activity carried on by the corporation as a trade or business or for the production of income, and
2. Amounts in the activity for which you are not at risk.

The at-risk rules generally limit the amount of loss and other deductions that you can claim to the amount you could actually lose in the activity. These losses and deductions include a loss on the disposition of assets and the section 179 expense deduction. However, if you acquired your stock before 1987, the at-risk rules do not apply to losses from an activity of holding real property placed in service before 1987 by the corporation. The activity of holding mineral property does not qualify for this exception. The corporation should identify on an attachment to Schedule K-1 the amount of any losses that are not subject to the at-risk limitations.

Generally, you are not at risk for amounts such as the following:

- The basis of your stock in the corporation or basis of your loans to the corporation if the cash or other property used to purchase the stock or make the loans was from a source (a) covered by nonrecourse indebtedness (except for certain qualified nonrecourse financing, as defined in section 465(b)(6)); (b) protected against loss by a guarantee, stop-loss agreement, or other similar arrangement; or (c) that is covered by indebtedness from a person who has an interest in the activity or from a related person to a person (except you) having such an interest, other than a creditor.
- Any cash or property contributed to a corporate activity, or your interest in the corporate activity, that is (a) covered by nonrecourse indebtedness (except for certain qualified nonrecourse financing, as defined in

section 465(b)(6)); (b) protected against loss by a guarantee, stop-loss agreement, or other similar arrangement; or (c) that is covered by indebtedness from a person who has an interest in such activity or from a related person to a person (except you) having such an interest, other than a creditor.

Any loss from a section 465 activity not allowed for this tax year will be treated as a deduction allocable to the activity in the next tax year.

You should get a separate statement of income, expenses, etc., for each activity from the corporation.

### Passive Activity Limitations

Section 469 provides rules that limit the deduction of certain losses and credits. These rules apply to shareholders who:

- Are individuals, estates, or trusts and
- Have a passive activity loss or credit for the year.

Generally, passive activities include:

1. Trade or business activities in which you did not materially participate and
2. Activities that meet the definition of rental activities under Temporary Regulations section 1.469-1T(e)(3) and Regulations section 1.469-1(e)(3).

Passive activities do not include:

1. Trade or business activities in which you materially participated.
2. Rental real estate activities in which you materially participated if you were a "real estate professional" for the tax year. You were a real estate professional only if you met both of the following conditions:
  - a. More than half of the personal services you performed in trades or businesses were performed in real property trades or businesses in which you materially participated and
  - b. You performed more than 750 hours of services in real property trades or businesses in which you materially participated.

### Worksheet for Determining a Shareholder's Stock Basis (Keep for your records.)

1. Your stock basis at the beginning of the year . . . . .	1. _____
<b>Increases:</b>	
2. Money and your adjusted basis in property contributed to the corporation . . . . .	2. _____
3. Your share of the corporation's income, including tax-exempt income, (reduced by the amount included in income with respect to the qualified zone academy bonds) . . . . .	3. _____
4. Other increases to basis, including your share of the excess of the deductions for depletion (other than oil and gas depletion) over the basis of the property subject to depletion . . . . .	4. _____
<b>Decreases:</b>	
5. Distributions of money and the fair market value of property (excluding dividend distributions reportable on Form 1099-DIV and distributions in excess of basis) . . . . .	5. (      )
6. Enter: <b>(a)</b> Your share of the corporation's nondeductible expenses and the depletion deduction for any oil and gas property held by the corporation (but only to the extent your pro rata share of the property's adjusted basis exceeds the depletion deduction) <b>or</b> <b>(b)</b> If the election under Regulations section 1.1367-1(g) applies, your share of the corporation's deductions and losses (include your entire share of the section 179 expense deduction even if your allowable section 179 expense deduction is smaller) . . . . .	6. (      )
7. If the election under Regulations section 1.1367-1(g) applies, enter the amount from (a) on line 6. Otherwise enter the amount from (b) on line 6 . . . . .	7. (      )
8. Enter the smaller of <b>(a)</b> the excess of the amount you are owed for loans you made to the corporation over your basis in those loans <b>or</b> <b>(b)</b> the sum of lines 1 through 7. This amount increases your loan basis . . . . .	8. (      )
9. Your stock basis in the corporation at end of year. Combine lines 1 through 8 . . . . .	9. _____

For purposes of this rule, each interest in rental real estate is a separate activity, unless you elect to treat all interests in rental real estate as one activity. For details on making this election, see the Instructions for Schedule E (Form 1040).

If you are married filing jointly, either you or your spouse must separately meet both of the above conditions, without taking into account services performed by the other spouse.

A real property trade or business is any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business. Services you performed as an employee are not treated as performed in a real property trade or business unless you owned more than 5% of the stock (or more than 5% of the capital or profits interest) in the employer.

3. The rental of a dwelling unit any shareholder used for personal purposes during the year for more than the greater of 14 days or 10% of the number of days that the residence was rented at fair rental value.

4. Activities of trading personal property for the account of owners of interests in the activities.

The corporation will identify separately each activity that may be passive to you. If the corporation had more than one activity it will attach a statement that (a) identifies each activity (trade or business activity, rental real estate activity, rental activity other than rental real estate, etc.); (b) specifies the income (loss), deductions, and credits from each activity; and (c) provides other details you may need to determine if an activity loss or credit is subject to the passive activity limitations.

If you have a passive activity loss or credit, see Form 8582, *Passive Activity Loss Limitations*, to figure your allowable passive losses, and Form 8582-CR, *Passive Activity Credit Limitations*, to figure your allowable passive credit. See the instructions for these forms for more information.

**Material participation.** You must determine if you materially participated (a) in each trade or business activity held through the corporation and (b), if you were a real estate professional (defined above), in each rental real estate activity held through the corporation. All determinations of material participation are made based on your participation during the corporation's tax year.

Material participation standards for shareholders who are individuals are listed below. Special rules apply to certain retired or disabled farmers and to the surviving spouses of farmers. See the Instructions for Form 8582 for details.

**Individuals.** If you are an individual, you materially participate in a trade or business activity only if one or more of the following apply:

1. You participated in the activity for more than 500 hours during the tax year.

2. Your participation in the activity for the tax year constituted substantially all of the participation in the activity of all individuals (including individuals who are not owners of interests in the activity).

3. You participated in the activity for more than 100 hours during the tax year, and your participation in the activity for the tax year was not less than the participation in the activity of any other individual (including individuals who were not owners of interests in the activity) for the tax year.

4. The activity was a significant participation activity for the tax year, and your

aggregate participation in all significant participation activities (including those outside the corporation) during the tax year exceeded 500 hours. A significant participation activity is any trade or business activity in which you participated for more than 100 hours during the year and in which you did not materially participate under any of the material participation tests (other than this test 4).

5. You materially participated in the activity for any 5 tax years (whether or not consecutive) during the 10 tax years that immediately precede the tax year.

6. The activity was a personal service activity and you materially participated in the activity for any 3 tax years (whether or not consecutive) preceding the tax year. A personal service activity involves the performance of personal services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, or any other trade or business, in which capital is not a material income-producing factor.

7. Based on all of the facts and circumstances, you participated in the activity on a regular, continuous, and substantial basis during the tax year.

**Work counted toward material participation.** Generally, any work that you or your spouse does in connection with an activity held through an S corporation (in which you own stock at the time the work is done) is counted toward material participation. However, work in connection with an activity is not counted toward material participation if either of the following applies:

1. The work is not the type of work that owners of the activity would usually do and one of the principal purposes of the work that you or your spouse does is to avoid the passive loss or credit limitations.

2. You do the work in your capacity as an investor and you are not directly involved in the day-to-day operations of the activity. Examples of work done as an investor that would not count toward material participation include:

- Studying and reviewing financial statements or reports on operations of the activity,
- Preparing or compiling summaries or analyses of the finances or operations of the activity, and
- Monitoring the finances or operations of the activity in a nonmanagerial capacity.

**Effect of determination.** If you determine that you (a) materially participated in a trade or business activity of the corporation or (b) were a real estate professional (defined on page 2) in a rental real estate activity of the corporation, the income (loss), deductions, and credits from the activity are nonpassive. See the specific instructions for each item for reporting information.

If you determine that you did not materially participate in a trade or business activity of the corporation, or you have income (loss), deductions, or credits from a rental activity of the corporation (other than a rental real estate activity in which you materially participated, if you were a real estate professional), the amounts from that activity are passive. Report passive income (losses), deductions, and credits as follows:

1. If you have an overall gain (the excess of income over deductions and losses, including any prior year unallowed loss) from a passive activity, report the income, deductions, and losses from the activity as indicated in these instructions.

2. If you have an overall loss (the excess of deductions and losses, including any prior year unallowed loss, over income) or credits from a passive activity, you must report the income, deductions, losses, and credits from all passive activities using the Instructions for Form 8582 or Form 8582-CR, to see if your deductions, losses, and credits are limited under the passive activity rules.

**Special allowance for a rental real estate activity.** If you actively participated in a rental real estate activity, you may be able to deduct up to \$25,000 of the loss from the activity from nonpassive income. This special allowance is an exception to the general rule disallowing losses in excess of income from passive activities. The special allowance is not available if you were married, are filing a separate return for the year, and did not live apart from your spouse at all times during the year.

Only individuals and qualifying estates can actively participate in a rental real estate activity. Estates (other than qualifying estates) and trusts cannot actively participate.

You are not considered to actively participate in a rental real estate activity if, at any time during the tax year, your interest (including your spouse's interest) in the activity was less than 10% (by value) of all interests in the activity.

Active participation is a less stringent requirement than material participation. You may be treated as actively participating if you participated, for example, in making management decisions or arranging for others to provide services (such as repairs) in a significant and bona fide sense. Management decisions that can count as active participation include approving new tenants, deciding on rental terms, approving capital or repair expenditures, and other similar decisions.

An estate is a qualifying estate if the decedent would have satisfied the active participation requirement for the activity for the tax year the decedent died. A qualifying estate is treated as actively participating for tax years ending less than 2 years after the date of the decedent's death.

**Modified adjusted gross income limitation.** The maximum special allowance that single individuals and married individuals filing a joint return can qualify for is \$25,000. The maximum is \$12,500 for married individuals who file separate returns and who lived apart at all times during the year. The maximum special allowance for which an estate can qualify is \$25,000 reduced by the special allowance for which the surviving spouse qualifies.

If your modified adjusted gross income (defined below) is \$100,000 or less (\$50,000 or less if married filing separately), your loss is deductible up to the amount of the maximum special allowance referred to in the preceding paragraph. If your modified adjusted gross income is more than \$100,000 (more than \$50,000 if married filing separately), the special allowance is limited to 50% of the difference between \$150,000 (\$75,000 if married filing separately) and your modified adjusted gross income. When modified adjusted gross income is \$150,000 or more (\$75,000 or more if married filing separately), there is no special allowance.

Modified adjusted gross income is your adjusted gross income figured without taking into account:

- Any passive activity loss.

- Any rental real estate loss allowed under section 469(c)(7) to real estate professionals (as defined on page 2).
- Any taxable social security or equivalent railroad retirement benefits.
- Any deductible contributions to an IRA or certain other qualified retirement plans under section 219.
- The student loan interest deduction.
- The tuition and fees deduction.
- The deduction for one-half of self-employment taxes.
- The exclusion from income of interest from Series EE or I U.S. Savings Bonds used to pay higher education expenses.
- The exclusion of amounts received under an employer's adoption assistance program.

#### **Commercial revitalization deduction.**

The special \$25,000 allowance for the commercial revitalization deduction from rental real estate activities is not subject to the active participation rules or modified adjusted gross income limits discussed above. See the instructions for box 12, code N, for more information.

**Special rules for certain other activities.** If you have net income (loss), deductions, or credits from any activity to which special rules apply, the corporation will identify the activity and all amounts relating to it on Schedule K-1 or on an attachment.

If you have net income subject to recharacterization under Temporary Regulations section 1.469-2T(f) and Regulations section 1.469-2(f), report such amounts according to the Instructions for Form 8582.

If you have net income (loss), deductions, or credits from either of the following activities, treat such amounts as nonpassive and report them as instructed in these instructions:

1. The rental of a dwelling unit any shareholder used for personal purposes during the year for more than the greater of 14 days or 10% of the number of days that the residence was rented at fair rental value.
2. Trading personal property for the account of owners of interests in the activity.

**Self-charged interest.** The corporation will report any "self-charged" interest income or expense that resulted from loans between you and the corporation (or between the corporation and other S corporation or partnership in which you have an interest). If there was more than one activity, the corporation will provide a statement allocating the interest income or expense with respect to each activity. The self-charged interest rules do not apply to your interest in the S corporation if the corporation made an election under Regulations section 1.469-7(g) to avoid the application of these rules. See the Instructions for Form 8582 for more information.

## Specific Instructions

### Part I. Information about the Corporation

#### Item D

If the corporation is a registration-required tax shelter, it should have completed Item D. Use the information on Schedule K-1 (name of corporation, corporation identifying number, and tax shelter registration number) to complete your Form 8271, Investor Reporting of Tax Shelter Registration Number.

#### Item E

If you claim or report any income, loss, deduction, or credit from a registration-required tax shelter, you must attach Form 8271 to your tax return. If the corporation has invested in a registration-required tax shelter, it will check item E and it must give you a copy of its Form 8271 with Schedule K-1. Use this information to complete your Form 8271.

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

The amounts shown in boxes 1 through 17 reflect your share of income, loss, deductions, credits, and other information from all corporate activities without reference to limitations on losses, credits, or other items that may have to be adjusted because of:

1. The adjusted basis of your stock and debt in the corporation,
2. The at-risk limitations,
3. The passive activity limitations, or
4. Any other limitations that must be taken into account at the shareholder level in figuring taxable income (e.g., the section 179 expense limitation).

For information on these provisions, see *Limitations on Losses, Deductions, and Credits* beginning on page 1. The limitations for 4 are discussed throughout these instructions and in other referenced forms and instructions.

If you are an individual, and your pro rata share items are not affected by any of the limitations, take the amounts shown and enter them on the lines of your tax return as indicated in the summarized reporting information showing on the back of the Schedule K-1. If any of the limitations apply, adjust the amounts for the limitations before you enter them on your return. When applicable, the passive activity limitations on losses are applied after the limitations on losses for a shareholder's basis in stock and debt and the shareholder's at-risk amount.

**Note:** The line number references on page 2 of Schedule K-1 are to forms in use for tax years beginning in 2004. If you are a calendar year shareholder in a fiscal year 2004–2005 corporation, enter these amounts on the corresponding lines of the tax form in use for 2005.

If you have losses, deductions, credits, etc., from a prior year that were not deductible or usable because of certain limitations, such as the basis rules or the at-risk limitations, take them into account in determining your income, loss, etc., for this year. However, except for passive activity losses and credits, do not combine the prior-year amounts with any amounts shown on this Schedule K-1 to get a net figure to report on your return. Instead, report the amounts on your return on a year-by-year basis.



*If you have amounts other than those shown on Schedule K-1 to report on Schedule E (Form 1040), enter each item separately on line 28 of Schedule E.*

**Codes.** In box 10 and boxes 12 through 17, the corporation will identify each item by entering a code in the column to the left of the dollar amount entry space. These codes are identified on the back of Schedule K-1 and in these instructions.

**Attached statements.** The corporation will enter an asterisk (\*) after the code, if any, in the column to the left of the dollar amount entry space for each item for which it has attached a statement providing additional information. For those informational items that cannot be

reported as a single dollar amount, the corporation will enter an asterisk in the left column and write "STMT" in the dollar amount entry space to indicate the information is provided on an attached statement.

### Income (loss)

#### Box 1. Ordinary business income (loss)

The amount reported in box 1 is your share of the ordinary income (loss) from trade or business activities of the corporation. Generally, where you report this amount on Form 1040 depends on whether or not the amount is from an activity that is a passive activity to you. If you are an individual shareholder, find your situation below and report your box 1 income (loss) as instructed after applying the basis and at-risk limitations on losses. If the corporation had more than one trade or business activity, it will attach a statement identifying the amount of income or loss from each activity.

1. Report box 1 income (loss) from trade or business activities in which you materially participated on Schedule E (Form 1040), line 28, column (h) or (j).
2. Report box 1 income (loss) from trade or business activities in which you did not materially participate, as follows:
  - a. If income is reported in box 1, report the income on Schedule E, line 28, column (g).
  - b. If a loss is reported in box 1, follow the Instructions for Form 8582 to determine how much of the loss can be reported on Schedule E, line 28, column (f).

#### Box 2. Net rental real estate income (loss)

Generally, the income (loss) reported in box 2 is a passive activity amount for all shareholders. However, the income (loss) in box 2 is not from a passive activity if you were a real estate professional (defined on page 2) and you materially participated in the activity. If the corporation had more than one rental real estate activity, it will attach a statement identifying the amount of income or loss from each activity.

If you are filing a 2004 Form 1040, use the following instructions to determine where to enter a box 2 amount:

1. If you have a loss from a passive activity in box 2 and you meet all of the following conditions, enter the loss on Schedule E (Form 1040), line 28, column (f):
  - a. You actively participated in the corporate rental real estate activities. (See *Special allowance for a rental real estate activity* on page 3.)
  - b. Rental real estate activities with active participation were your only passive activities.
  - c. You have no prior year unallowed losses from these activities.
  - d. Your total loss from the rental real estate activities was not more than \$25,000 (not more than \$12,500 if married filing separately and you lived apart from your spouse all year).
  - e. If you are a married person filing separately, you lived apart from your spouse all year.
  - f. You have no current or prior year unallowed credits from a passive activity.
  - g. Your modified adjusted gross income was not more than \$100,000 (not more than \$50,000 if married filing separately and you lived apart from your spouse all year).
2. If you have a loss from a passive activity in box 2 and you do not meet all of the conditions in 1 above, follow the Instructions

for Form 8582 to determine how much of the loss can be reported on Schedule E (Form 1040), line 28, column (f).

3. If you have income from a passive activity in box 2, enter the income on Schedule E, line 28, column (g).

4. If you were a real estate professional and you materially participated in the activity, report box 2 income (loss) on Schedule E, line 28, column (h) or (j).

### Box 3. Other net rental income (loss)

The amount in box 3 is a passive activity amount for all shareholders. If the corporation had more than one such rental activity, it will attach a statement identifying the amount of income or loss from each activity. Report the income or loss as follows:

1. If box 3 is a loss, follow the instructions for Form 8582 to figure how much of the loss can be reported on Schedule E, line 28, column (f).

2. If income is reported in box 3, report the income on Schedule E (Form 1040), line 28, column (g).

### Portfolio income

Portfolio income or loss (shown in boxes 4 through 8b and in box 10, code A) is not subject to the passive activity limitations. Portfolio income includes income not derived in the ordinary course of a trade or business from interest, ordinary dividends, annuities, or royalties, and gain or loss on the sale of property that produces such income or is held for investment.

### Box 4. Interest income.

Report taxable interest income on line 8a of Form 1040.

### Box 5a. Ordinary dividends.

Report taxable ordinary dividends on line 9a of Form 1040.

### Box 5b. Qualified dividends.

Report qualified dividends on line 9b of Form 1040.

**Note:** Qualified dividends are excluded from investment income, but you may elect to include part or all of these amounts in investment income. See the instructions for line 4g of Form 4952, Investment Interest Expense Deduction, for important information on making this election.

### Box 6. Royalties.

Report royalties on Schedule E, Part I, line 4.

### Box 7. Net short-term capital gain (loss).

Report the net short-term capital gain or (loss) on Schedule D, line 5, column (f).

### Box 8a. Net long-term capital gain (loss)

Report the net long-term capital gain (loss) on Schedule D, line 12, column (f).

### Box 8b. Collectibles (28%) gain (loss)

This is your share of collectibles gain or loss. Include this amount on line 4 of the 28% Rate Gain worksheet in the instructions for Schedule D (Form 1040), line 18.

### Box 8c. Unrecaptured section 1250 gain.

There are three types of unrecaptured section 1250 gain. Report your share of this unrecaptured gain on the *Unrecaptured Section 1250 Gain Worksheet* in the instructions for Schedule D (Form 1040), as follows:

- Report unrecaptured section 1250 gain from the sale or exchange of the corporation's business assets on line 5.

- Report unrecaptured section 1250 gain from the sale or exchange of an interest in a partnership on line 10.

- Report unrecaptured section 1250 gain from an estate, trust, regulated investment company (RIC), or real estate investment trust (REIT) on line 11.

If the corporation reports only unrecaptured section 1250 gain from the sale or exchange of its business assets, it will enter a dollar amount in box 8c. If it reports the other two types of unrecaptured gain, it will provide an attached statement that shows the amount for each type of unrecaptured section 1250 gain.

### Box 9. Net Section 1231 Gain (Loss)

The amount in box 9 is generally a passive activity amount if it is from a:

- Rental activity or
- Trade or business activity in which you did not materially participate.

However, an amount from a rental real estate activity is not from a passive activity if you were a real estate professional (defined on page 2) and you materially participated in the activity.

If the amount is either (a) a loss that is not from a passive activity or (b) a gain, report it on Form 4797, line 2, column (g). Do not complete columns (b) through (f) on line 2. Instead, write "From Schedule K-1 (Form 1120S)" across these columns.

If the amount is a loss from a passive activity, see *Passive loss limitations* in the Instructions for Form 4797. You will need to report the loss following the Instructions for Form 8582 to determine the amount to enter on Form 4797. If the corporation had net section 1231 gain (loss) from more than one activity, it will attach a statement that will identify the amount of section 1231 gain (loss) from each activity.

### Box 10. Other income (loss)

**Code A. Other portfolio income (loss).** The corporation will attach a schedule to tell you what kind of portfolio income, other than interest, ordinary dividends, royalty and capital gain, is reported.

If the corporation held a residual interest in a real estate mortgage investment conduit (REMIC), it will report on a statement your share of REMIC taxable income or (net loss) that you report on Schedule E (Form 1040), line 38, column (d). The statement will also report your share of any "excess inclusion" that you report on Schedule E, line 38, column (c), and your share of section 212 expenses that you report on Schedule E, line 38, column (e). If you itemize your deductions on Schedule A (Form 1040), you may also deduct these section 212 expenses as a miscellaneous deduction subject to the 2% limit on Schedule A, line 22.

**Code B. Involuntary conversions.** This is your share of net loss from involuntary conversions due to casualty or theft. The corporation will give you a schedule that shows the amounts to be reported on Form 4684, Casualties and Thefts, line 34, columns (b)(i), (b)(ii) and (c).

If there was a gain (loss) from a casualty or theft to property not used in a trade or business or for income-producing purposes, the corporation will provide you with the information you need to complete Form 4684.

**Code C. 1256 contracts & straddles.** The corporation will report any net gain or loss from section 1256 contracts. Report this amount on

line 1 of Form 6781, Gains and Losses From Section 1256 Contracts and Straddles.

### Code D. Mining exploration costs recapture.

The corporation will give you a schedule that shows the information needed to recapture certain mining exploration expenditures (section 617).

**Code E. Other income (loss).** Amounts with code E are other items of income, gain, or loss not included elsewhere on Schedule K-1. The corporation should give you a description and the amount of your pro rata share for each of these items.

Report loss items that are passive activity amounts to you using the Instructions for Form 8582.

Report income or gain items that are passive activity amounts to you as instructed below. The instructions given below also tell you where to report code E items if such items are not passive activity amounts.

Code E items may include:

- Income from recoveries of tax benefit items. A tax benefit item is an amount you deducted in a prior tax year that reduced your income tax. Report this amount on Form 1040, line 21, to the extent it reduced your tax.
- Gambling gains and losses subject to the limitations in section 165(d).
- Gain (loss) from the disposition of an interest in oil, gas, geothermal, or other mineral properties. The corporation will give you an attached statement that provides a description of the property, your share of the amount realized from the disposition, your share of the corporation's adjusted basis in the property (for other than oil or gas properties), and your share of the total intangible drilling costs, development costs, and mining exploration costs (section 59(e) expenditures) passed through for the property. You must determine the amount of gain or loss from the disposition by increasing your share of the adjusted basis by the amount of intangible drilling costs, development costs, or mine exploration costs for the property that you capitalized (i.e., costs that you did not elect to deduct under section 59(e)). Report a loss in Part I of Form 4797. Report a gain in Part III of Form 4797 in accordance with the instructions for line 28. See Regulations section 1.1254-4 for more information.

- Gain from the sale or exchange of qualified small business stock (as defined in the Instructions for Schedule D (Form 1040)) that is eligible for the partial section 1202 exclusion. The corporation should also give you the name of the corporation that issued the stock, your share of the corporation's adjusted basis and sales price of the stock, and the dates the stock was bought and sold. The following additional limitations apply at the shareholder level:

1. You must have held an interest in the corporation when the corporation acquired the qualified small business stock and at all times thereafter until the corporation disposed of the qualified small business stock.

2. Your pro rata share of the eligible section 1202 gain cannot exceed the amount that would have been allocated to you based on your interest in the corporation at the time the stock was acquired.

See the Instructions for Schedule D (Form 1040) for details on how to report the gain and the amount of the allowable exclusion.

- Gain eligible for section 1045 rollover (replacement stock purchased by the corporation). The corporation should also give you the name of the corporation that issued the stock, your share of the corporation's adjusted basis and sales price of the stock, and the

dates the stock was bought and sold. To qualify for the section 1045 rollover:

1. You must have held an interest in the corporation during the entire period in which the corporation held the qualified small business stock (more than 6 months prior to the sale) and

2. Your pro rata share of the gain eligible for the section 1045 rollover cannot exceed the amount that would have been allocated to you based on your interest in the corporation at the time the stock was acquired.

See the Instructions for Schedule D (Form 1040) for details on how to report the gain and the amount of the allowable postponed gain.

- Gain eligible for section 1045 rollover (replacement stock not purchased by the corporation). The corporation should also give you the name of the corporation that issued the stock, your share of the corporation's adjusted basis and sales price of the stock, and the dates the stock was bought and sold. To qualify for the section 1045 rollover:

1. You must have held an interest in the corporation during the entire period in which the corporation held the qualified small business stock (more than 6 months prior to the sale).

2. Your pro rata share of the gain eligible for the section 1045 rollover cannot exceed the amount that would have been allocated to you based on your interest in the corporation at the time the stock was acquired, and

3. You must purchase other qualified small business stock (as defined in the Instructions for Schedule D (Form 1040)) during the 60-day period that began on the date the stock was sold by the corporation.

See the Instructions for Schedule D (Form 1040) for details on how to report the gain and the amount of the allowable postponed gain.

- Net short-term capital gain or loss and net long-term capital gain or loss that is not portfolio income (e.g., gain or loss from the disposition of nondepreciable personal property used in a trade or business activity of the corporation). Report total net short-term gain or loss on Schedule D (Form 1040), line 5, column (f). Report the total net long-term gain or loss on Schedule D (Form 1040), line 12, column (f).

## Deductions

### Box 11. Section 179 deduction

Use this amount, along with the total cost of section 179 property placed in service during the year from all other sources, to complete Part I of Form 4562, Depreciation and Amortization.

Use Part I of Form 4562 to figure your allowable section 179 deduction from all sources. Report the amount on line 12 of Form 4562 allocable to a passive activity using the Instructions for Form 8582. If the amount is not from a passive activity, report it on Schedule E (Form 1040), line 28, column (i).

### Box 12. Other deductions

**Contributions. Codes A through F.** The corporation will give you a schedule that shows the amount of contributions subject to the 50%, 30%, and 20% adjusted gross income limitations. For more details, see Pub. 526, Charitable Contributions, and the Instructions for Schedule A (Form 1040). If your contributions are subject to more than one of the AGI limitations, see the *Filled-in Worksheet for Limit on Deductions* in Pub. 526. Charitable contribution deductions are not taken into account in figuring your passive activity loss for the year. Do not enter them on Form 8582.

**Code A. Cash contributions (50%).** Enter this amount, subject to the 50% AGI limitation, on line 15 of Schedule A (Form 1040).

**Code B. Cash contributions (30%).** Report this amount, subject to the 30% AGI limitation, on line 15 of Schedule A (Form 1040).

**Code C. Noncash contributions (50%).** If property other than cash is contributed, and the claimed deduction for one item or group of similar items of property exceeds \$5,000, the corporation must give you a copy of Form 8283, Noncash Charitable Contributions, to attach to your tax return. Do not deduct the amount shown on Form 8283. It is the corporation's contribution. Instead, deduct the amount identified by code C, box 12, subject to the 50% AGI limitation, on line 16 of Schedule A (Form 1040).

If the corporation provides you with information that the contribution was property other than cash and does not give you a Form 8283, see the Instructions for Form 8283 for filing requirements. Do not file Form 8283 unless the total claimed deduction of all contributed items of property exceeds \$500.

**Code D. Noncash contributions (30%).** Report this amount, subject to the 30% AGI limitation, on line 16 of Schedule A (Form 1040).

**Code E. Capital gain property to a 50% organization (30%).** Report this amount, subject to the 30% AGI limitation, on line 16 of Schedule A (Form 1040). See *Special 30% Limit for Capital Gain Property* in Pub. 526.

**Code F. Capital gain property (20%).** Report this amount, subject to the 20% AGI limitation, on line 16 of Schedule A (Form 1040).

**Code G. Deductions—portfolio (2% floor).** Amounts with this code are deductions that are clearly and directly allocable to portfolio income (other than investment interest expense and section 212 expenses from a REMIC). Generally, you should enter these amounts on Schedule A (Form 1040), line 22. See the instructions for Schedule A, lines 22 and 27, for more information.

These deductions are not taken into account in figuring your passive activity loss for the year. Do not enter them on Form 8582.

**Code H. Deductions—portfolio (other).** Generally, you should enter these amounts on Schedule A (Form 1040), line 27. See the instructions for Schedule A, lines 22 and 27, for more information.

These deductions are not taken into account in figuring your passive activity loss for the year. Do not enter them on Form 8582.

**Code I. Investment Interest Expense.** Enter this amount on Form 4952, line 1.

If the corporation has investment income or other investment expense, it will report your share of these items in box 17 using codes A and B. You will need to include investment income and expenses from all other sources to determine how much of your total investment interest is deductible.

For more information on the special provisions that apply to investment interest expense, see Form 4952 and Pub. 550.

**Code J. Deductions—royalty income.** Enter deductions allocable to royalties on Schedule E (Form 1040), line 18. For this type of expense, write "From Schedule K-1 (Form 1120S)."

These deductions are not taken into account in figuring your passive activity loss for the year. Do not enter them on Form 8582.

**Code K. Section 59(e)(2) Expenditures.** On an attached statement, the corporation will show the type and the amount of qualified

expenditures to which an election under section 59(e) may apply. The statement will also identify the property for which the expenditures were paid or incurred. If there is more than one type of expenditure, the amount of each type will be listed on an attachment.

Generally, section 59(e) allows each shareholder to elect to deduct certain expenses ratably over the number of years in the applicable period rather than deduct the full amount in the current year. Under the election, you may deduct circulation expenditures ratably over a 3-year period. Research and experimental expenditures and mining exploration and development costs qualify for a write-off period of 10 years. Intangible drilling and development costs may be deducted over a 60-month period, beginning with the month in which such costs were paid or incurred.

If you make this election, these items are not treated as adjustments or tax preference items for purposes of the alternative minimum tax. Make the election on Form 4562.

Because each shareholder decides whether to make the election under section 59(e), the corporation cannot provide you with the amount of the adjustment or tax preference item related to the expenses. You must decide how to claim the expenses on your return and how to figure the resulting adjustment or tax preference item.

**Code L. Reforestation expense deduction.** The corporation will provide a statement that describes the qualified timber property for these reforestation expenses. The expense deduction is limited to \$10,000 (\$5,000 if married filing separately) for each qualified timber property, including your pro rata share of the corporation's expense and any reforestation expenses you separately paid or incurred after October 22, 2004, for the property. Follow the instructions for Form 8582 to report a deduction allocable to a passive activity. If you materially participated in the reforestation activity, report the deduction on line 28, column (h), of Schedule E (Form 1040).

**Code M. Preproductive period expenses.** You may elect to deduct these expenses currently or capitalize them under section 263A. See Pub. 225, Farmer's Tax Guide, and Regulations section 1.263A-4 for more information.

**Code N. Commercial revitalization deduction from rental real estate activities.** Follow the instructions for Form 8582 to determine how much of this deduction can be reported on Schedule E, line 28, column (f).

**Code O. Penalty on early withdrawal of savings.** Report this amount on Form 1040, line 33.

**Code P. Other deductions.** Amounts with this code may include:

- Itemized deductions that Form 1040 filers enter on Schedule A (Form 1040).
- Soil and water conservation expenditures. See section 175(b) for limitations on the amount you are allowed to deduct.
- Expenditures for the removal of architectural and transportation barriers to the elderly and disabled that the corporation elected to treat as a current expense. The deductions are limited by section 190(c) to \$15,000 per year from all sources.
- Interest expense allocated to debt-financed distributions. If the proceeds were used in a trade or business activity, report the interest on line 28 of Schedule E (Form 1040). In column (a) enter the name of the corporation and "interest expense." If you materially participated in the trade or business activity, enter the amount of interest expense in column

(h). If you did not materially participate in the activity, follow the instructions for Form 8582 to determine the amount of interest expense you can report in column (f). See page 3 for a definition of material participation. If the proceeds were used in an investment activity, enter the interest on Form 4952. If the proceeds are used for personal purposes the interest is generally not deductible.

• Contributions to a capital construction fund (CCF). The deduction for a CCF investment is not taken on Schedule E (Form 1040). Instead, you subtract the deduction from the amount that would normally be entered as taxable income on line 42 (Form 1040). In the margin to the left of line 42, write "CCF" and the amount of the deduction.

The corporation will give you a description and the amount of your share of each of these items.

### Box 13. Credits & Credit Recapture

If you have credits that are passive activity credits to you, you must complete Form 8582-CR in addition to the credit forms identified below. See *Passive Activity Limitations* on page 2 and the Instructions for Form 8582-CR for more information.

Also, if you are entitled to claim more than one listed general business credit (investment credit, work opportunity credit, welfare-to-work credit, credit for alcohol used as fuel, research credit, low-income housing credit, enhanced oil recovery credit, disabled access credit, renewable electricity and refined coal production credit, Indian employment credit, credit for employer social security and Medicare taxes paid on certain employee tips, orphan drug credit, new markets credit, credit for small employer pension plan start-up costs, credit for employer-provided childcare facilities and services, biodiesel fuels credit, low sulfur diesel fuel production credit, and credit for contributions to selected community development corporations), you must complete Form 3800, General Business Credit, in addition to the credit forms identified. If you have more than one credit, see the Instructions for Form 3800.

**Codes A and B. Low-income housing credit.** The corporation will report your share of the low-income housing credit using code A if section 42(j)(5) applies. If section 42(j)(5) does not apply, your share of the credit will be reported using Code B. Any allowable low-income housing credit (reported as code A or code B) is entered on line 5 of Form 8586, Low-Income Housing Credit.

If the corporation invested in a partnership to which the provisions of section 42(j)(5) apply, it will attach a schedule to identify your share of the credit received from the partnership.

Keep a separate record of the low-income housing credits from each of these sources so that you will be able to correctly figure any recapture that may result from the disposition of all or part of your stock in the corporation. For more information, see the instructions for Form 8611, Recapture of Low-Income Housing Credit.

If part or all of the low-income housing credit reported using code A or B is attributable to additions to qualified basis property placed in service before 1990, the corporation will provide an attached statement that will separately identify these amounts. Amounts placed in service before 1990 are subject to different passive activity limitation rules. See *Passive Activity Limitations* and Form 8582-CR for more information.

**Codes C and D. Qualified rehabilitation expenditures.** The corporation will report your share of the qualified rehabilitation expenditures related to rental real estate activities using code C. Your share of qualified rehabilitation expenditures from property not related to rental real estate activities will be reported using code D. On an attached statement the corporation will indicate the line number on Form 3468, Investment Credit, to report these expenditures (line 1b for pre-1936 buildings or line 1c for certified historic structures). If the corporation is reporting expenditures from more than one activity, the attached statement will separately identify the amount of expenditures from each activity for lines 1b and 1c.

Combine the code C and code D expenditures on lines 1b and 1c of Form 3468. The expenditures related to rental real estate activities (code C) are reported on Schedule K-1 separately from other qualified rehabilitation expenditures (code D) because they are subject to different passive activity limitation rules. See the instructions for Form 8582-CR for details.

**Code E. Basis of energy property.** Report this amount on Form 3468, line 2.

**Code F. Qualified timber property.** Report this amount on Form 3468, line 3.

**Code G. Other rental real estate credits.** The corporation will identify the type of credit and any other information you need to compute credits from rental real estate activities (other than the low-income housing credit and qualified rehabilitation expenditures). These credits may be limited by the passive activity limitations. If the credits are from more than one activity, the corporation will identify the amount of credits from each activity on an attached statement. See *Passive Activity Limitations* on page 2 and Form 8582-CR for details.

**Code H. Other rental credits.** The corporation will identify the type of credit and any other information you need to compute these rental credits. These credits may be limited by the passive activity limitations. If the credits are from more than one activity, the corporation will identify the amount of credits from each activity on an attached statement. See *Passive Activity Limitations* on page 2 and Form 8582-CR for details.

**Code I. Undistributed capital gains credit.** Code I represents taxes paid on undistributed capital gains by a regulated investment company or real estate investment trust. Form 1040 filers, enter your share of these taxes on line 69 of Form 1040, check box 'a' for Form 2439, and add "Form 1120S." Also reduce the basis of your stock by this tax.

**Code J. Work opportunity credit.** Report this amount on line 3 of Form 5884, Work Opportunity Credit.

**Code K. Welfare-to-work credit.** Report this amount on line 3 of Form 8861, Welfare-to-Work Credit.

**Code L. Disabled access credit.** Report this amount on line 7 of Form 8826, Disabled Access Credit.

**Code M. Empowerment zone and renewal community employment credit.** Report this amount on line 3 of Form 8844, Empowerment Zone and Renewal Community Employment Credit.

**Code N. New York Liberty Zone business employee credit.** Report this amount on line 3 of Form 8884, New York Liberty Zone Business Employee Credit.

**Code O. New markets credit.** Report this amount on line 2 of Form 8874, New Markets Credit.

**Code P. Employer social security and Medicare tax paid on certain employee tips.** Report this amount on line 5 of Form 8846, Credit for Employer Social Security and Medicare Taxes Paid on Certain Employee Tips.

**Code Q. Backup withholding.** This is your share of the credit for backup withholding on dividends, interest income, and other types of income. Include the amount the corporation reports to you in the total that you enter on Form 1040, line 63.

**Code R. Credit for alcohol used as fuel.** This is your share of the corporation's credit for alcohol used as fuel from all trade or business activities. Enter this credit on Form 6478, Credit for Alcohol Used as Fuel, to determine your allowed credit for the year.

**Codes S and T. Recapture of low-income housing credit.** The corporation will identify by code S your share of any recapture of a low-income housing credit from its investment in partnerships to which the provisions of section 42(j)(5) apply. All other recapture of low-income housing credits will be identified by code T.

Keep a separate record of each type of recapture so that you will be able to correctly figure any credit recapture that may result from the disposition of all or part of your corporate stock. For more information, see Form 8611.

**Code U. Recapture of investment credit.** The corporation will provide any information you need to figure your recapture tax on Form 4255, Recapture of Investment Credit. See the Form 3468 on which you took the original credit for other information you need to complete Form 4255.

You may also need Form 4255 if you disposed of more than one-third of your stock in the corporation.

**Code V. Other credits.** The corporation will identify your pro rata share of any other credit by code V on an attached schedule. If more than one credit is reported, the credits will be identified on an attached schedule.

Credits that may be reported with code V (depending on the type of activity they relate to) include the following:

- Nonconventional source fuel credit. Attach a schedule to your return showing how you calculated the amount of credit you are allowed to take on your tax return. See section 29 for rules on how to figure the credit. Report this credit on Form 1040, line 54, box c.
- Qualified electric vehicle credit (Form 8834).
- Unused investment credit from cooperatives (Form 3468, line 4).
- Credit for increasing research activities (Form 6765).
- Enhanced oil recovery credit (Form 8830).
- Renewable electricity and refined coal production credit. The corporation will provide a statement showing separately the amount of credit from section A and section B of Form 8835.
- Indian employment credit (Form 8845).
- Orphan drug credit (Form 8820).
- Credit for contributions to selected community development corporations (Form 8847).
- Credit for small employer pension plan start-up costs (Form 8881).
- Credit for employer-provided childcare facilities and services (Form 8882).
- Qualified zone academy bond credit (Form 8860).
- Biodiesel fuels credit (Form 8864).

- Low sulfur diesel fuel production credit (Form 8896).
- General credits from an electing large partnership. Report these credits on Form 3800, line 1t.

**Code W. Recapture of other credits.** On an attachment to Schedule K-1, the corporation will report any information you need to figure the recapture of the new markets credit; qualified electric vehicle credit (see Pub. 535); Indian employment credit (see section 45A(d)); or any credit for employer-provided childcare facilities and services.

#### Box 14. Foreign Transactions

**Codes A through N.** Use the information identified by codes A through N and attached schedules to figure your foreign tax credit. For more information, see Form 1116, Foreign Tax Credit, and its instructions. Also see Pub. 514, Foreign Tax Credit for Individuals.

#### Codes O and P. Extraterritorial income exclusion.

1. *Corporation did not claim the exclusion.* If the corporation reports your pro rata share of foreign trading gross receipts (code O) and the extraterritorial income exclusion (code P), the corporation was not entitled to claim the exclusion because it did not meet the foreign economic process requirements. You may still qualify for your pro rata share of this exclusion if the corporation's foreign trading gross receipts for the tax year were \$5 million or less. To qualify for this exclusion, your foreign trading gross receipts from all sources for the tax year also must have been \$5 million or less. If you qualify for the exclusion, report the exclusion amount in accordance with the instructions beginning on page 4 for boxes 1, 2, or 3, whichever applies. See Form 8873, Extraterritorial Income Exclusion, for more information.

2. *Corporation claimed the exclusion.* If the corporation reports your pro rata share of foreign trading gross receipts but not the amount of the extraterritorial income exclusion, the corporation met the foreign economic process requirements and claimed the exclusion when figuring your pro rata share of corporate income. You also may need to know the amount of your pro rata share of foreign trading gross receipts from this corporation to determine if you met the \$5 million or less exception discussed above for purposes of qualifying for an extraterritorial income exclusion from other sources.

**Note:** Upon request, the corporation should furnish you a copy of the corporation's Form 8873 if there is a reduction for international boycott operations, illegal bribes, kickbacks, etc.

**Code Q. Other foreign transactions.** On an attachment to Schedule K-1, the corporation will report any other information on foreign transactions that you may need using code Q.

#### Box 15. Alternative minimum tax (AMT) items

Use the information reported in box 15 (as well as adjustments and tax preference items from other sources) to prepare your Form 6251, Alternative Minimum Tax—Individuals, or Schedule I of Form 1041, U.S. Income Tax Return for Estates and Trusts.

**Code A.** This amount is your share of the corporation's post-1986 depreciation adjustment. If you are an individual shareholder, report this amount on line 17 of Form 6251.

**Code B.** This amount is your share of the corporation's adjusted gain or loss. If you are

an individual shareholder, report this amount on line 16 of Form 6251.

**Code C.** This amount is your share of the corporation's depletion adjustment. If you are an individual shareholder, report this amount on line 9 of Form 6251.

#### Codes D and E. Oil, gas, & geothermal properties—gross income and deductions.

The amounts reported on these lines include only the gross income from, and deductions allocable to, oil, gas, and geothermal properties included in box 1 of Schedule K-1. The corporation will report separately any income from or deductions allocable to such properties that are included in boxes 2 through 12, and 17. Use the amounts reported here and any other reported amounts to help you determine the net amount to enter on line 25 of Form 6251.

**Code F. Other AMT items.** Enter the information on the statement attached by the corporation, along with items from other sources, on the applicable lines of Form 6251.

#### Box 16. Items Affecting Shareholder Basis

**Code A. Tax-exempt interest income.** You must report on your return, as an item of information, your share of the tax-exempt interest received or accrued by the corporation during the year. Individual shareholders include this amount on Form 1040, line 8b. Generally, you must increase the basis of your stock by this amount.

**Code B. Other tax-exempt income.** Generally, you must increase the basis of your stock by the amount shown, but do not include it in income on your tax return.

**Code C. Nondeductible expenses.** The nondeductible expenses paid or incurred by the corporation are not deductible on your tax return. Generally, you must decrease the basis of your stock by this amount.

**Code D. Property distributions.** Reduce the basis of your stock (as explained on page 2) by these distributions. If these distributions exceed the basis of your stock, the excess is treated as capital gain from the sale or exchange of property and is reported on Schedule D (Form 1040).

**Code E. Repayment of loans from shareholders.** If these payments are made on a loan with a reduced basis, the repayments must be allocated in part to a return of your basis in the loan and in part to the receipt of income. See Regulations section 1.1367-2 for information on reduction in basis of a loan and restoration in basis of a loan with a reduced basis. See Rev. Rul. 64-162, 1964-1 (Part 1) C.B. 304 and Rev. Rul. 68-537, 1968-2 C.B. 372, for other information.

#### Box 17. Other Information

**Code A. Investment income.** Report this amount on line 4a of Form 4952.

**Code B. Investment expenses.** Report this amount on line 5 of Form 4952.

**Code C. Look back interest—completed long-term contracts.** The corporation will report any information you need to figure the interest due or to be refunded under the look-back method of section 460(b)(2) on certain long-term contracts. Use Form 8697, Interest Computation Under the Look-Back Method for Completed Long-Term Contracts, to report any such interest.

**Code D. Look back interest—income forecast method.** The corporation will report any information you need to figure the interest due or to be refunded under the look-back method of section 167(g)(2) for certain property

placed in service after September 13, 1995, and depreciated under the income forecast method.

Use Form 8866, Interest Computation Under the Look-Back Method for Property Depreciated Under the Income Forecast Method, to report any such interest.

#### Code E. Dispositions of property with section 179 deductions.

The corporation will report your pro rata share of gain or loss on the sale, exchange, or other disposition of property for which a section 179 expense deduction was passed through to shareholders. If the corporation passed through a section 179 deduction for the property, you must report the gain or loss and any recapture of the section 179 expense deduction for the property on your income tax return (see the instructions for Form 4797 for details). The corporation will provide all the following information with respect to a disposition of property for which a section 179 expense deduction was passed through to shareholders.

1. Description of the property.
2. Date the property was acquired and placed in service.
3. Date of the sale or other disposition of the property.
4. Your pro rata share of the gross sales price or amount realized.
5. Your pro rata share of the cost or other basis plus the expense of sale (reduced as explained in the instructions for Form 4797, line 21).
6. Your pro rata share of the depreciation allowed or allowable, determined as described in the instructions for Form 4797, line 22, but excluding the section 179 expense deduction.
7. Your pro rata share of the section 179 expense deduction (if any) passed through for the property and the corporation's tax year(s) in which the amount was passed through.

To compute the amount of depreciation allowed or allowable for Form 4797, line 22, add to the amount from item 6 above the amount of your pro rata share of the section 179 expense deduction, reduced by any unused carryover of the deduction for this property. This amount could be different than the amount of section 179 expense you deducted for the property if your interest in the corporation has changed.

8. If the disposition is due to a casualty or theft, a statement providing the information you need to complete Form 4684, Casualties and Thefts.

9. If the sale was an installment sale made during the corporation's tax year, a statement providing the information you need to complete Form 6252, Installment Sale Income. The corporation will separately report your share of all payments received from the property in the following tax years. See the instructions for Form 6252 for details.

#### Code F. Recapture of section 179 deduction.

The corporation will report your pro rata share of any recapture of section 179 expense deduction if business use of any property dropped to 50 percent or less. If this occurs, the corporation must provide the following information.

1. Your pro rata share of the depreciation allowed or allowable (not including the section 179 expense deduction).
2. Your pro rata share of the section 179 expense deduction (if any) passed through for the property and the corporation's tax year(s) in which the amount was passed through. Reduce this amount by the portion, if any, of your unused (carryover) section 179 expense deduction for this property.



**Code G. Section 453(l)(3) information.** The corporation will report any information you need to figure the interest due under section 453(l)(3). If the corporation elected to report the dispositions of certain timeshares and residential lots on the installment method, your tax liability must be increased by the interest on tax attributable to your pro rata share of the installment payments received by the corporation during its tax year. If you are an individual, report the interest on Form 1040, line 62. Write "453(l)(3)" and the amount of the interest on the dotted line to the left of line 62.

**Code H. Section 453A(c) information.** The corporation will report any information you need to figure the interest due under section 453A(c). If you are an individual, report the interest on Form 1040, line 62. Write "453A(c)" and the amount of the interest on the dotted line to the left of line 62. See the instructions for Form 6252 for more information. Also see section 453A(c) for details on making the computation.

**Code I. Section 1260(b) information.** The corporation will report any information you need to figure the interest due under section 1260(b). If the corporation had gain from certain constructive ownership transactions, your tax liability must be increased by the interest charge on any deferral of gain recognition under section 1260(b). If you are an individual, report the interest on Form 1040, line 62. Write "1260(b)" and the amount of the interest on the dotted line to the left of line 62. See section 1260(b) for details, including how to figure the interest.

**Code J. Interest allocable to production expenditures.** To the extent certain production or construction expenditures of the corporation are made from proceeds associated with debt you incur as an owner-shareholder, you must capitalize the interest on this debt. Use the information the corporation gives you to determine the amount of interest you must capitalize. See Regulations sections 1.263A-8 through 1.263A-15 for more information.

**Code K. CCF nonqualified withdrawal.** The corporation will report your pro rata share of nonqualified withdrawals from a capital construction fund (CCF). These withdrawals are taxed separately from your other gross income at the highest marginal ordinary income or capital gains tax rate. Attach a statement to your Federal income tax return to

show your computation of both the tax and interest for a nonqualified withdrawal. Include the tax and interest on Form 1040, line 62. To the left of line 62, write the amount of tax and interest and "CCF."

**Code L. Information needed to figure depletion-oil and gas.** This is your share of gross income from the property, share of production for the tax year, etc., needed to figure your depletion deduction for oil and gas wells. The corporation should also allocate to you a proportionate share of the adjusted basis of each corporate oil or gas property. The corporation should attach a schedule to report all applicable information. See Pub. 535 for how to figure your depletion deduction.

Reduce the basis of your stock by the amount of this deduction up to the extent of your adjusted basis in the property.

**Code M. Amortization of reforestation costs.** The corporation will provide a statement identifying your share of the amortizable basis of reforestation expenditures paid or incurred before October 23, 2004. The corporation will separately report your share of the amortizable basis of reforestation expenditures for the current tax year and the 7 preceding tax years. Your amortizable basis of reforestation expenditures for each tax year from all properties is limited to \$10,000 (\$5,000 if married filing separately), including your pro rata share of the corporation's expenditures and any qualified reforestation expenditures you separately paid or incurred. To figure your allowable amortization, see section 194 and Pub. 535.

Follow the instructions for Form 8582 to report a deduction allocable to a passive activity. If you materially participated in the reforestation activity, report the deduction on line 28, column (h), of Schedule E (Form 1040).

**Code N. Other information** The corporation will report:

1. Any information or statements you need to comply with the registration and disclosure requirements under sections 6111 and 6662(d)(2)(B)(ii) and the list keeping requirements of Regulations section 301.6112-1. See Form 8264 and Notice 2004-80, 2004-50 I.R.B. 963 for more information.

2. Any information you need to complete a disclosure statement for reportable transactions in which the corporation participates. If the corporation participates in a transaction that must be disclosed on Form 8886, Reportable Transaction Disclosure Statement, both you and the corporation may be required to file Form 8886 for the transaction. The determination of whether you are required to disclose a transaction of the corporation is based on the category(s) under which the transaction qualifies for disclosure and is determined by the corporation. See the instructions for Form 8886 for details.

3. Gross farming and fishing income. If you are an individual shareholder, enter this income, as an item of information, on Schedule E (Form 1040), Part V, line 42. Do not report this income elsewhere on Form 1040.

For a shareholder that is an estate or trust, report this income to the beneficiaries, as an item of information, on Schedule K-1 (Form 1041). Do not report it elsewhere on Form 1041.

4. The amount the corporation included in gross income with respect to qualified zone academy bonds. This amount cannot be used to increase your stock basis. However, because this amount is already included in income elsewhere on Schedule K-1, you must reduce your stock basis by this amount.

5. Inversion gain. The corporation will provide a statement showing the amounts of each type of income or gain that is included in inversion gain. The corporation has included inversion gain in income elsewhere on Schedule K-1. Inversion gain is also reported under code N because your taxable income and alternative minimum taxable income cannot be less than the inversion gain. Also, your inversion gain **(a)** is not taken into account in figuring the amount of net operating loss (NOL) for the tax year or the amount of NOL that can be carried over to each tax year, **(b)** may limit the amount of your credits, and **(c)** is treated as income from sources within the U.S. for the foreign tax credit. See section 7874 for details.

6. Any other information you may need to file with your individual tax return that is not shown elsewhere on Schedule K-1.