S Corporation Shareholder Basis

Losses Claimed in Excess of Basis
S corporation shareholders must track adjustments to their basis in S corporation stock and debt to avoid improperly claiming losses and deductions in excess of basis on their income tax returns.
Treatment Streams

- Issue Based Examinations
- Soft Letters
- Tax Software Vendor Outreach
- Tax Forms and Publications
- Practitioner/Stakeholder Outreach
Requirement to Track Basis

- Treas. Reg. § 1.6001-1(a) requires shareholders to maintain permanent books and records to establish losses and deductions reported on their return,

- IRC § 1366(d)(1) provides that shareholders losses and deductions cannot exceed their basis in stock and debt, and

- IRC § 1367 discusses what items adjust shareholders basis.
Schedule K-1 (Form 1120S) 2017

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

<table>
<thead>
<tr>
<th>Code</th>
<th>Report on</th>
</tr>
</thead>
<tbody>
<tr>
<td>N</td>
<td>Credit for employer social security and Medicare taxes</td>
</tr>
<tr>
<td>O</td>
<td>Backup withholding</td>
</tr>
<tr>
<td>P</td>
<td>Other credits</td>
</tr>
</tbody>
</table>

14. Foreign transactions

- A. Name of country or U.S. possession
- B. Gross income from all sources
- C. Gross income sourced at shareholder level

Foreign gross income sourced at corporate level

- D. Passive category
- E. General category
- F. Other

Deductions allocated and apportioned at shareholder level

- G. Interest expense
- H. Other

Deductions allocated and apportioned at corporate level to foreign source income

- I. Passive category
- J. General category
- K. Other

Other information

- L. Total foreign taxes paid
- M. Total foreign taxes accrued
- N. Reduction in taxes available for credit
- O. Foreign basis losses reported

For detailed reporting and filing information, see the separate Shareholder’s Instructions.
# New Stock & Debt Basis Worksheet

**Worksheet for Figuring a Shareholder’s Stock and Debt Basis**

### Part I—Shareholder Stock Basis

1. Stock basis at the beginning of the corporation’s tax year
2. Basis from any capital contributions made or additional stock acquired during the tax year
3. Ordinary business income (losses go on Part III)
4. Net rental real estate income (losses go on Part III)
5. Other net rental income (losses go on Part III)
6. Interest income
7. Ordinary dividends
8. Royalties
9. Net capital gains (losses go on Part II)
10. Net section 1231 gain (losses go on Part II)
11. Other income (losses go on Part III)
12. Excess depletion adjustment
13. Tax-exempt income
14. Recapture of business credits
15. Other items that increase stock basis
16. Add lines 3 through 15
17. Stock basis before distributions. Add lines 1, 2, and 4

### Part II—Dividends

6. Distributions (excluding dividend distributions)

**Note:** If line 6 is larger than line 5, subtract line 5 from line 6 and report the result as a capital gain on Form 8849 and Schedule D. See instructions.

7. Stock basis after distributions. Subtract line 6 from line 5. If the result is zero or less, enter -0-, skip lines 8 through 14, and enter -0- on line 15

8a. Non-deductible expenses
8b. Depletion for oil and gas
9. Add lines 8a and 8b
10. Stock basis before loss and deduction items. Subtract line 9 from line 7. If the result is zero or less, enter -0-, skip lines 11 through 14, and enter -0- on line 15
11. Allowable loss and deduction items. Enter the amount from Part III, line 13, column (c)
12. Debt basis restoration (see net increase in instructions for Part II, line 8)
13. Other items that decrease stock basis
14. Add lines 11, 12, and 13
15. Stock basis at the end of the corporation’s tax year. Subtract line 14 from line 10. If the result is zero or less, enter -0-
## New Stock & Debt Basis Worksheet (cont’d)

### Part II—Shareholder Debt Basis

<table>
<thead>
<tr>
<th>Amount of Debt:</th>
<th>Debt 1</th>
<th>Debt 2</th>
<th>Debt 3</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Loan balance at the beginning of the corporation’s tax year</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Additional loans (see instructions)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Loan balance before repayment. Combine lines 1 and 2</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Principal portion of debt repayment (this line doesn’t include interest)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. Loan balance at the end of the corporation’s tax year. Combine lines 3 and 4</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Adjustments to Debt Basis:

<table>
<thead>
<tr>
<th></th>
<th>Debt basis at the beginning of the corporation’s tax year</th>
<th>Enter the amount, if any, from line 2</th>
<th>Debt basis restoration (see instructions)</th>
</tr>
</thead>
</table>

### Gain on Loan Repayment:

<table>
<thead>
<tr>
<th></th>
<th>Repayment. Enter the amount from line 4</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Nontaxable repayments. Enter the amount from line 13</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Reportable gain. Subtract line 16 from line 17</th>
</tr>
</thead>
</table>
New Stock & Debt Basis Worksheet (cont’d)

<table>
<thead>
<tr>
<th>Part III—Allowable Loss and Deduction Items</th>
<th>(a) Current year losses and deductions</th>
<th>(b) Carryover amounts (column (c)) from the previous year</th>
<th>(c) Allowable loss from stock basis</th>
<th>(d) Allowable loss from debt basis</th>
<th>(e) Carryover amounts</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Ordinary business loss</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Net rental real estate loss</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Other net rental loss</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Net capital loss</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. Net section 1231 loss</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6. Other loss</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7. Section 179 deductions</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>8. Charitable contributions</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>9. Investment interest expense</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>10. Section 59(e)(2) expenditures</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>11. Other deductions</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>12. Foreign taxes paid or accrued</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>13. Total Loss</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

- Total Loss. Combine lines 1 through 12 for each column. Enter the total loss in column (c) on line 11 of Part I and enter the total loss in column (d) on line 15 of Part II.
Changes to Schedule E Instructions

2017 Instructions for Schedule E (Form 1040)

Supplemental Income and Loss

Limitation on Losses
If you report a loss from rental real estate or royalties in Part I or you report a loss from a partnership or S corporation in Part II, your loss may be reduced or not allowed this year. You must apply the following rules to your loss.

- Basis rules apply to losses from a partnership or S corporation. See Basis rules for partnerships and Basis rules for S corporations, later, in Part II.

Basis rules for S corporations. Generally, the deduction for your share of aggregate losses and deductions reported on Schedule K-1 (Form 1120S) 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 generally figured at the end of the corporation's tax year. 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. To figure your aggregated stock basis, you generally can use the Worksheet for Figuring a Shareholder's Stock & Debt Basis in the Shareholder's Instructions for Schedule K-1 (Form 1120S). For more details on the basis rules for S corporations, see the Shareholder's Instructions for Schedule K-1 (Form 1120S).

If you are claiming a deduction for your share of an aggregate loss, attach to your return a computation of the adjusted basis of your corporate stock and of any debt the corporation owes you. For details, see the Shareholder's Instructions for Schedule K-1 (Form 1120S).
When to Attach the Stock & Debt Basis Worksheet to the Return

- S corporation allocates a loss or deduction item to the shareholder
- S corporation makes a non-dividend distribution to the shareholder
- Shareholder disposes of stock
- S corporation makes a repayment on a loan from shareholder
Computing Basis With Historical Records

To compute basis you need to know –

1. The shareholder’s initial cost of the stock and additional paid in capital,

2. The amount of any bona fide loans made directly from the shareholder to the S corporation as well as any loan repayments, and

3. All the items that increase and decrease stock basis since the corporation has been an S corporation or since the shareholder first acquired stock (i.e. Schedule K-1).
How can you compute the basis for a new client whose basis was never computed and the client does not have the historical records to recompute basis?
In the Absence of Historical Books and Records?

Consider estimating the shareholders basis using information from the S corporation return.

- Shareholders and their representatives should make every attempt to comply with the laws under IRC §§ 1366(d)(1), 1367 and Treas. Reg. § 1.6001-1(a).

- A basis computation should be maintained from the inception of the S corporation or since the shareholder acquired an interest in the S corporation.
Computing Basis When Historical Records are Not Available

Estimate initial basis using the earliest S corporation return available

- Beginning Capital Stock
- Beginning Additional Paid-In Capital
- Beginning Accumulated Adjustments Account (AAA)
- Beginning Other Adjustments Account (OAA).
Example 1 – Estimated Initial Stock Basis Using the Return

<table>
<thead>
<tr>
<th>Balance Sheet</th>
<th>Beginning</th>
<th>Ending</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital Stock</td>
<td>45,000</td>
<td>60,000</td>
</tr>
<tr>
<td>Additional Paid in Capital</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Retained Earnings</td>
<td>(22,000)</td>
<td>(86,000)</td>
</tr>
</tbody>
</table>
### Example 1 – Estimated Initial Stock Basis Using the Return (cont’d)

<table>
<thead>
<tr>
<th>Schedule M-2</th>
<th>AAA</th>
<th>OAA</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Balance at Beginning of the Year</td>
<td>(21,000)</td>
<td>1,000</td>
</tr>
<tr>
<td>2. Ordinary Income from page 1, line 21</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Other Additions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Loss from page 1, line 21</td>
<td>(64,000)</td>
<td></td>
</tr>
<tr>
<td>5. Other Reductions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>6. Combine lines 1 through 5</td>
<td>(85,000)</td>
<td>1,000</td>
</tr>
<tr>
<td>7. Distributions other than Dividends</td>
<td></td>
<td></td>
</tr>
<tr>
<td>8. Balance at End of the Year</td>
<td>(85,000)</td>
<td>1,000</td>
</tr>
</tbody>
</table>
Example 1 – Estimated Initial Stock Basis Using the Return (cont’d)

An estimate of stock basis is computed as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beginning Capital Stock</td>
<td>45,000</td>
</tr>
<tr>
<td>Beginning Additional Pd in Capital</td>
<td>0</td>
</tr>
<tr>
<td>Beginning Stock Cost</td>
<td>45,000</td>
</tr>
<tr>
<td>Beginning AAA and OAA</td>
<td>(20,000)</td>
</tr>
<tr>
<td>Estimated Beginning Stock Basis</td>
<td>25,000</td>
</tr>
</tbody>
</table>
Factors that Distort Estimated Initial Basis

Initial stock basis estimates may not be reliable if:

• The AAA is not computed properly,

• There was a change in shareholders during the years,

• The shareholders contributed uneven amounts to start the corporation, or

• There were disproportionate distributions.
Example 2 – Estimated Initial Stock Basis Using the Return

Balance Sheet
- Capital Stock: 45,000
- Additional Paid in Capital: 0
- Retained Earnings: (22,000)
Example 2 – Estimated Initial Stock Basis Using the Return (cont’d)

Schedule M-2

1. Balance at Beginning of the Year  (98,000)
2. Ordinary Income from page 1, line 21
3. Other Additions
4. Loss from page 1, line 21  (64,000)
5. Other Reductions
6. Combine lines 1 through 5  (162,000)
7. Distributions other than Dividends
8. Balance at End of the Year  (162,000)
Example 2 – Estimated Initial Stock Basis Using the Return (cont’d)

An estimate of stock basis is computed as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beginning Capital Stock</td>
<td>45,000</td>
</tr>
<tr>
<td>Beginning Additional Pd in Capital</td>
<td>0</td>
</tr>
<tr>
<td>Beginning Stock Cost</td>
<td>45,000</td>
</tr>
<tr>
<td>Beginning AAA and OAA</td>
<td>(98,000)</td>
</tr>
<tr>
<td>Estimated Beginning Stock Basis</td>
<td>(53,000)</td>
</tr>
</tbody>
</table>
Suspense Account

Losses claimed in excess of basis are “suspended” for basis purposes only, as indicated in:

• TAM 200619021
• FSA 200230030
• TAM 9304004
Fred is the sole owner of an S corporation. During 2013, the S corporation generated a ($45,000) loss. Fred’s stock basis was only $15,000 at the start of 2013 and Fred had made no loans to the corporation. Fred deducted the entire ($45,000) loss on his 2013 Form 1040. Therefore, Fred claimed a $30,000 loss in excess of his stock and debt basis.
In subsequent years, the S corporation had the following income:

- 2014: $11,000 Ordinary Income
- 2015: $23,000 Ordinary Income
- 2016: ($4,000) ($1,000) Ord. Loss & ($3,000) Rental Loss

In 2014 and 2015, Fred properly reported the S corporation income.

In 2016, Fred received a $28,000 non-dividend distribution.
Fred is a new client and you are preparing his 2016 return.
1. What is Fred’s stock basis?
2. Is the $28,000 distribution taxable?
3. Are any of the ordinary or rental losses deductible?
Example 3 - (cont’d)

Using the rationale of TAM 200619021, at the end of 2013 Fred has a suspense account of ($30,000) [$15,000 basis - $45,000 2013 loss claimed]. As such, Fred’s 2016 stock basis before the $28,000 distribution is only $4,000 computed as follows:

2014 Income 11,000
2015 Income 23,000
Suspense Account from 2013 (30,000)
Stock Basis Before Distributions 4,000
Example 3 - (cont’d)

Since there is a $28,000 distribution, $24,000 is a taxable distribution in excess of stock basis (LTCG).

<table>
<thead>
<tr>
<th>Stock Basis Before Distributions</th>
<th>4,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Distribution</td>
<td>(4,000)</td>
</tr>
<tr>
<td>Stock Basis Before Losses</td>
<td>0</td>
</tr>
<tr>
<td>Allowable Losses</td>
<td>0</td>
</tr>
</tbody>
</table>

Since there is no basis the $4,000 loss ($1,000 in ordinary losses and $3,000 rental losses) is suspended and carried forward to future years.
Summary

Required to attach a basis schedule to the return if:

• Allocated a loss or deduction items
• Receives a non-dividend distribution
• Disposes of stock
• Receives a loan repayment from the S corporation
Summary (cont’d)

To estimate the initial basis for all shareholders, add:

- Beginning Capital Stock
- Beginning Additional Paid-In Capital
- Beginning Accumulated Adjustments Account (AAA) and
- Beginning Other Adjustments Account (OAA)
Additional Information

• www.irs.gov – Key word: S Corporation

• Schedule K-1 (Form 1120S), Shareholder’s Share of Income, Deductions, Credits, etc. and Instructions to Schedule K-1 (1120S)

• www.irs.gov – Key word: Practice Units – Losses Claimed In Excess of Basis