Dear [Taxpayer]:

Our research indicates you may have claimed pass-through loss or deduction items in excess of your basis in stock and debt in [S CORPORATION, TIN].

Section 1366(d)(1) of the Internal Revenue Code (IRC) states that the loss and deduction items taken into account by an S corporation shareholder cannot exceed the shareholder's basis in stock and debt. Generally, loss or deduction items not allowed because of the basis limitation can be carried forward and deducted in a later year, depending on the basis limitation for that later year.

Our records indicate you didn't attach an adjusted basis computation schedule to your federal income tax return. You are required to compute and maintain an adjusted basis computation schedule under IRC Section 1367 and Treasury Regulation Section 1.6001-1(a). You must attach the schedule to your return as directed in the instructions to Form 1040, Schedule E, Supplemental Income and Loss.

Please provide your adjusted basis computation schedule to the address above, along with a copy of this letter, by the response due date. You can refer to the Shareholder's Instructions for Schedule K-1 (Form 1120S), Shareholder's Share of Income, Deductions, Credits, etc., at www.irs.gov/forms-pubs for more information.

If you claimed loss or deduction items in excess of your basis in stock and debt, file Form 1040X, Amended U.S. Individual Income Tax Return or amend Form 1041, U.S. Income Tax Returns for Estates and Trust, whichever is applicable, to correct your errors for the tax periods listed above. Mail the amended form to the address above. You can find Forms 1040X and 1041 at www.irs.gov/forms-pubs.

Please remember that after applying the basis limitation, the deduction amount of your aggregated losses and deductions may be further reduced by the at-risk rules and the passive activity loss rules. For more information, see Publication 925, Passive Activity and At-Risk Rules, at www.irs.gov/forms-pubs.

We enclosed a copy of this letter for your records. This letter is not an audit of your tax return.

If you have questions, contact the person listed at the top of this letter.
Thank you for your cooperation.

Sincerely,

[Name]
[Title]

Enclosures:
Copy of this letter