

BASIS REPORTING REQUIRED FOR 2018

Draft Form Schedule E

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

Your social security number

Caution: The IRS compares amounts reported on your tax return with amounts shown on Schedule(s) K-1.

Part II Income or Loss From Partnerships and S Corporations – **Note:** If you report a loss, receive a distribution, dispose of stock, or receive a loan repayment from an S corporation, you **must** check the box in column (e) on line 28 and attach the required basis computation. If you report a loss from an at-risk activity for which **any** amount is **not** at risk, you **must** check the box in column (f) on line 28 and attach **Form 6198** (see instructions).

27 Are you reporting any loss not allowed in a prior year due to the at-risk, excess farm loss, or basis limitations, a prior year unallowed loss from a passive activity (if that loss was not reported on Form 8582), or unreimbursed partnership expenses? If you answered "Yes," see instructions before completing this section. **Yes** **No**

	(a) Name	(b) Enter P for partnership; S for S corporation	(c) Check if foreign partnership	(d) Employer identification number	(e) Check if basis computation is required	(f) Check if any amount is not at risk
A			<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
B			<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
C			<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
D			<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>

Check out the new note line in Part II:

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So, let's make sure we understand this – if **any** of the following apply to the shareholder or partner, the shareholder's basis and partner's outside basis worksheets **must** be attached to the 2018 tax return of the individual return:

- Reported a loss from Schedule K-1
- Received a distribution
- Disposed of S Corp stock or interest in the Partnership
- Received a loan repayment from the S Corp

Many tax professionals are going to get caught off guard this upcoming tax season even though tracking basis is not a new requirement. It's always been necessary in order to accurately maintain shareholder and partner outside basis for purposes of determining claiming losses, whether a distribution or loan repayment is taxable, and determine the gain or loss upon disposition of interest in the entity. Let's face it though, a significant amount of entities don't have ANY basis statements so some serious reconstruction is going to be done in the

upcoming months as the IRS already has developed a letter to send to the taxpayer basically saying, *'hey, where is the basis statement? Send us one, or the (loss), (distribution), (repayment), (disposition) is going to be (taxable/not deductible)!*

What is new, is the IRS requiring taxpayers to attach the basis worksheets to the tax returns when the above four situations apply.

October 2017

The IRS Large Business and International (LB&I) division is targeting tax returns claiming losses in excess of basis. This past summer the IRS Forums had sessions focused on S Corporations and Partnerships K-1s, instructions (including updating the IRS basis worksheet to include loan/debt basis for the 1120S shareholder), the draft Schedule E, page 2 and its instructions.

Please note the LB&I campaign is focusing on S Corporations but the rules apply to Partnerships also as it states in the instructions.

The following is posted at irs.gov on the LB&I Compliance Campaigns landing page:

- **S Corporation Distributions**

Practice Area: Pass Through Entities

Executive Leads: Holly Paz, director and Cliff Scherwinski, deputy director, Pass Through Entities

S Corporations and their shareholders are required to properly report the tax consequences of distributions. We have identified three issues that are part of this campaign. The first issue occurs when an S Corporation fails to report gain upon the distribution of appreciated property to a shareholder. The second issue occurs when an S Corporation fails to determine that a distribution, whether in cash or property, is properly taxable as a dividend. **The third issue occurs when a shareholder fails to report non-dividend distributions in excess of their stock basis that are subject to taxation.** The treatment streams for this campaign include issue-based examinations, tax form change suggestions, and stakeholder outreach.

S Corporation Losses Claimed in Excess of Basis Campaign

The Practice Area is Pass-Through Entities

Lead Executive: Holly Paz

S corporation shareholders report income, losses and other items passed through from their corporation. The law limits losses and deductions to their basis in the corporation. LB&I has found that shareholders claim losses and deductions to which they are not entitled because they do not have sufficient stock or debt basis to absorb these items. LB&I has developed technical content for this campaign that will aid revenue agents as they examine the issue. The treatment streams for this campaign will be issue-based examinations, soft letters encouraging voluntary self-correction, conducting stakeholder outreach, and creating a new form for shareholders to assist in properly computing their basis

Practice Units

Another item I found interesting that I never knew of but could come in handy here are Practice Units on the IRS website. You can find them by simply typing in practice units on the search line at www.irs.gov or you can find them here: <https://www.irs.gov/businesses/corporations/practice-units>

The following is taken from the website:

As part of LB&I's knowledge management efforts, Practice Units are developed through internal collaboration and serve as both job aids and training materials on tax issues. For example, Practice Units provide IRS staff with explanations of general tax concepts as well as information about a specific type of transaction. Practice Units will continue to evolve as the compliance environment changes and new insights and experiences are contributed. Please visit this site periodically for new and updated Practice Units which are shared below.

I believe you might find the below practice units helpful for basis as a resource and they were all put on the LB&I site after they launched this campaign:

- Losses Claimed in Excess of Basis dated 04-30-18
- Valid Shareholder Debt Owed by S Corporation dated 03-08-18
- Stock Basis Ordering Rules dated 01-11-18
- Initial Stock Basis dated 12-14-17
- Adjustments to Stock Basis dated 11-20-17

The following is a copy of the soft letter the IRS will be sending to taxpayers that don't include the basis worksheets:



Department of the Treasury
Internal Revenue Service
Large Business & International

Date:

Taxpayer ID number:

Tax periods:

Person to contact:

Contact address:

Employee ID number:

Contact telephone number:

Contact fax number:

Response due by:

[Taxpayer Name]
[Address line 1]
[Address line 2]
[Address line 3]
[Address line 4]

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.

Letter 5969 (8-2017)
Catalog Number 69735M

Draft Instructions

The following is taken from the draft instructions of the Schedule E (1040):

If you are claiming a deduction for your share of an aggregate loss, check the box on the appropriate line in Part II, column (e), and 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).

The instructions to the Schedules K-1 for the Partner and Shareholder have been updated also. You will also find those draft instructions refer to a lot more basis limitation consequences.

The following is taken from the instructions of the Schedule K-1 (1065) page 2. The reason I'm including this section is because of the mistaken belief that Part II Section L of the Partners Schedule K-1 is basis. Many tax professionals believe these numbers, if this section is completed, can be used as the partners outside basis and this is simply not true. Bottom line is partners outside basis is to be computed on a worksheet at the partner level.

Basis Limitations

Generally, you may not claim your share of a partnership loss (including a capital loss) to the extent that it is greater than the adjusted basis of your partnership interest at the end of the partnership'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.

For tax years beginning after 2017 in which excess business interest is allocated to a partner, the partner's basis in its partnership interest is reduced (but not below zero) by the amount of such allocation, even though the carryforward does not give rise to a partner deduction in the year of the basis reduction. If the partner disposes of a partnership interest in which the basis has been reduced before the carryforward was used, the partner increases its basis immediately before sale for the amount not yet deducted.

The partnership isn't responsible for keeping the information needed to figure the basis of your partnership interest. Although the partnership does provide an analysis of the changes to your capital account in item L of Schedule K-1, that information is based on the partnership's books and records and cannot be used to figure your basis.

You can figure the adjusted basis of your partnership interest by adding items that increase your basis and then subtracting items that decrease your basis.

Use the Worksheet for Adjusting the Basis of a Partner's Interest in the Partnership to figure the basis of your interest in the partnership.

For more details on the basis limitations, and special rules for charitable contributions and foreign taxes paid and accrued, see Pub. 541, Partnerships.

Recourse \$		\$
L	Partner's capital account analysis:	
	Beginning capital account	\$ _____
	Capital contributed during the year	\$ _____
	Current year increase (decrease)	\$ _____
	Withdrawals & distributions	\$ (_____)
	Ending capital account	\$ _____
	<input type="checkbox"/> Tax basis	<input type="checkbox"/> GAAP
	<input type="checkbox"/> Other (explain)	<input type="checkbox"/> Section 704(b) book
M	Did the partner contribute property with a built-in gain or loss?	
	<input type="checkbox"/> Yes	<input type="checkbox"/> No
	If "Yes," attach statement (see instructions)	

For Paperwork Reduction Act Notice, see Instructions for Form 1065. www.irs.gov/Fo

