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BEYOND THE 1040:  
**CORPORATION  
PARTNERSHIP &  
LLC RETURNS**

2014 Forms & Schedules

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Page #s are from full manual.

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**GENERAL PARTNERSHIP**

A business owned by two or more persons.

**ADVANTAGES:**

- Two heads are better than one.
- More resources: capital, contacts, equipment, experience.

**DISADVANTAGES:**

- Agency: All partners can bind the partnership in legal agreements.
- Unlimited liability: ALL partners are jointly and severally liable for partnership debts.
- Conflict among partners: hours worked, direction of company, amount and timing of partner withdrawals, large expenditures.
- More record-keeping, paperwork than proprietorship.

**TAX FORM:**

Form 1065 Partnership Return  
Schedule K-1, Partner's share of income (loss)

**TAX IMPACT ON OWNER:**

Owner is taxed on his/her share of the profits of the business plus guaranteed payments (somewhat equivalent to salary, see page 3-23).

This frequently will be different than the cash withdrawals and will not take into consideration cash contributed to the partnership

**CONSIDERATIONS FOR THE CONSUMER OR MORTGAGE LENDER OR FOR ANALYSIS OF THE PERSONAL GUARANTEE ON A BUSINESS LOAN:**

The amount of income included in the personal tax return on Schedule E is a tax number. It does not represent the cashflow generated by the business. It also does not represent cash actually withdrawn by the owner.

Generally, if the borrower does not have sufficient ownership %, we use the actual cashflow from the K-1 (partner withdrawals plus guaranteed payments ...less capital contributed if recurring).

If the borrower has sufficient ownership % of the partnership use the cashflow available to the borrower/owner.

Your company's internal guidelines, rather than the traditional 51%, determine sufficient ownership %. I have seen this as low as 15% and as high as 35%. We are interested in access to cashflow and exposure to risk.

A 25% ownership is commonly used as a cutoff for determining whether you must review the full partnership return and use cashflow available instead of K-1 actual cashflow

**CONSIDERATIONS FOR THE SECONDARY MARKET RESIDENTIAL MORTGAGE ORIGINATORS:**

Some secondary market lenders use K-1 ordinary income plus guaranteed payments. This is not cashflow. (Sorry Fannie!)

That said, when originating a loan you are going to sell, you need to make a qualifying loan. Understand the requirements to make a qualifying loan and what, if any, flexibility there might be.

**CONSIDERATIONS FOR THE BUSINESS LENDER:**

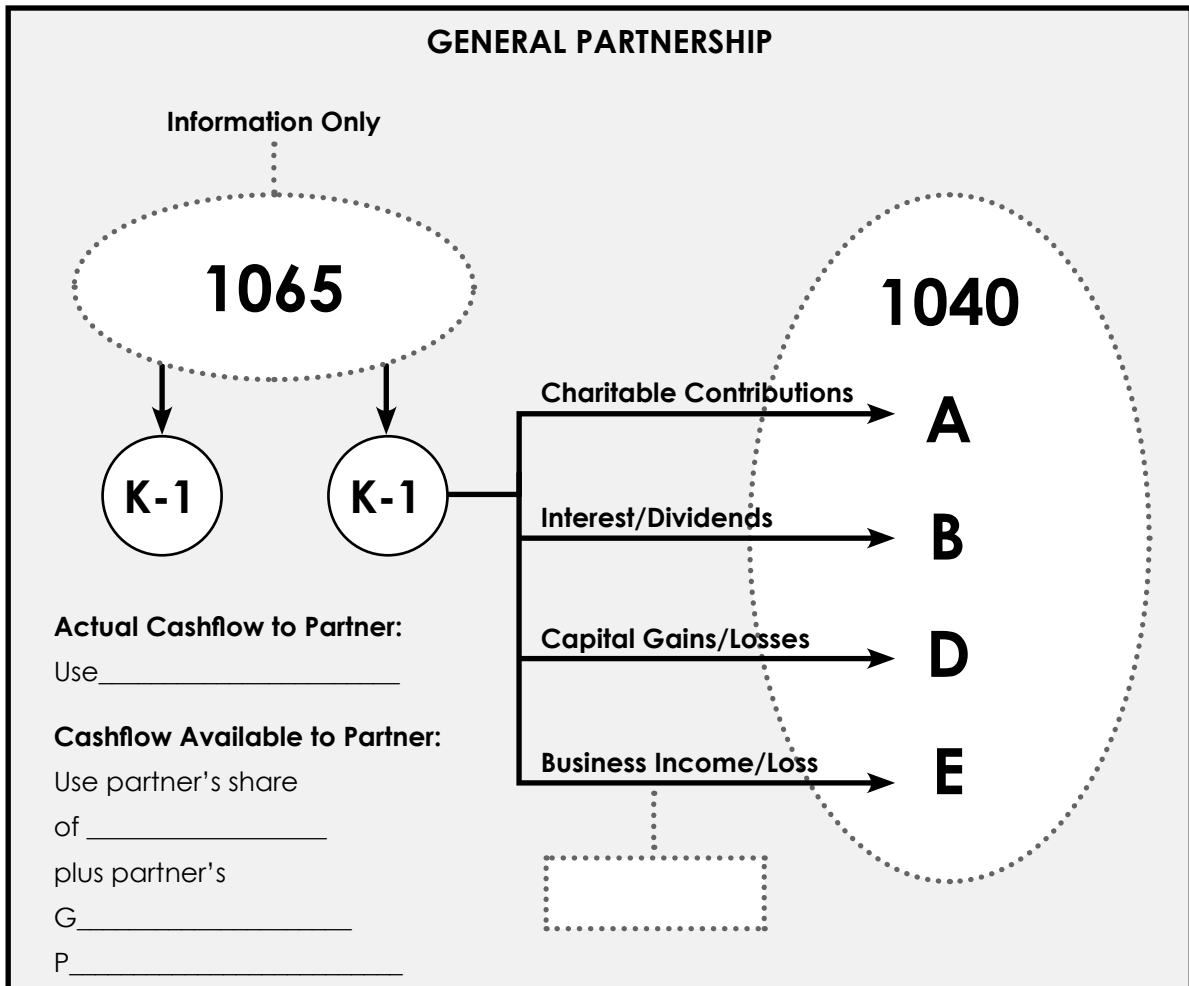
Your primary interest is whether the cashflow from operations is sufficient to adequately service current and proposed debt. Equally important is whether the business appears to be healthy. Watch for major changes or a shift from a stable to a fast-growing or declining business.

Commercial lenders often choose not to assume that excess partnership cashflow will be drawn out in the form of additional partner withdrawals when doing the analysis for the personal guarantee. Consider leaving enough excess cashflow to provide adequate debt coverage (example 1.2 Debt Coverage Ratio) and only assume distribution of the remainder of the excess.

**Self-Study Students**

See page 3-3 to complete diagram on next page.





**LIMITED PARTNERSHIP**

The limited partnership is a business owned by more than one person. In this case, however, some of the partners are allowed to limit their liability to the amount they have invested in the partnership.

You will recall that in a 'regular' (general) partnership each partner is jointly and severally liable for all debts.

In order to have limited liability, however, the limited partners may not be involved in the management of the business. They are investors only.

**ADVANTAGES:**

- Source of additional capital for the business venture.
- Limited liability for 'investor' partners

**DISADVANTAGES:**

- There must be at least one general partner.
- The limited partners do not have control of management. (Of course, this may be an advantage to the general partner!)

**TAX FORMS:**

Same as partnership

**TAX IMPACT ON OWNER:**

They will be allocated their share of income/loss from the partnership. This will not be the same as cashflow. Originally limited partnerships were set up to throw off losses to give tax shelter to the investors.

The Tax Reform Act of 1986 greatly restricted this through the use of passive activity loss rules

**CONSIDERATIONS FOR THE LENDER:**

You will need to see the K-1 to determine if any cash is moving to or from the investor.

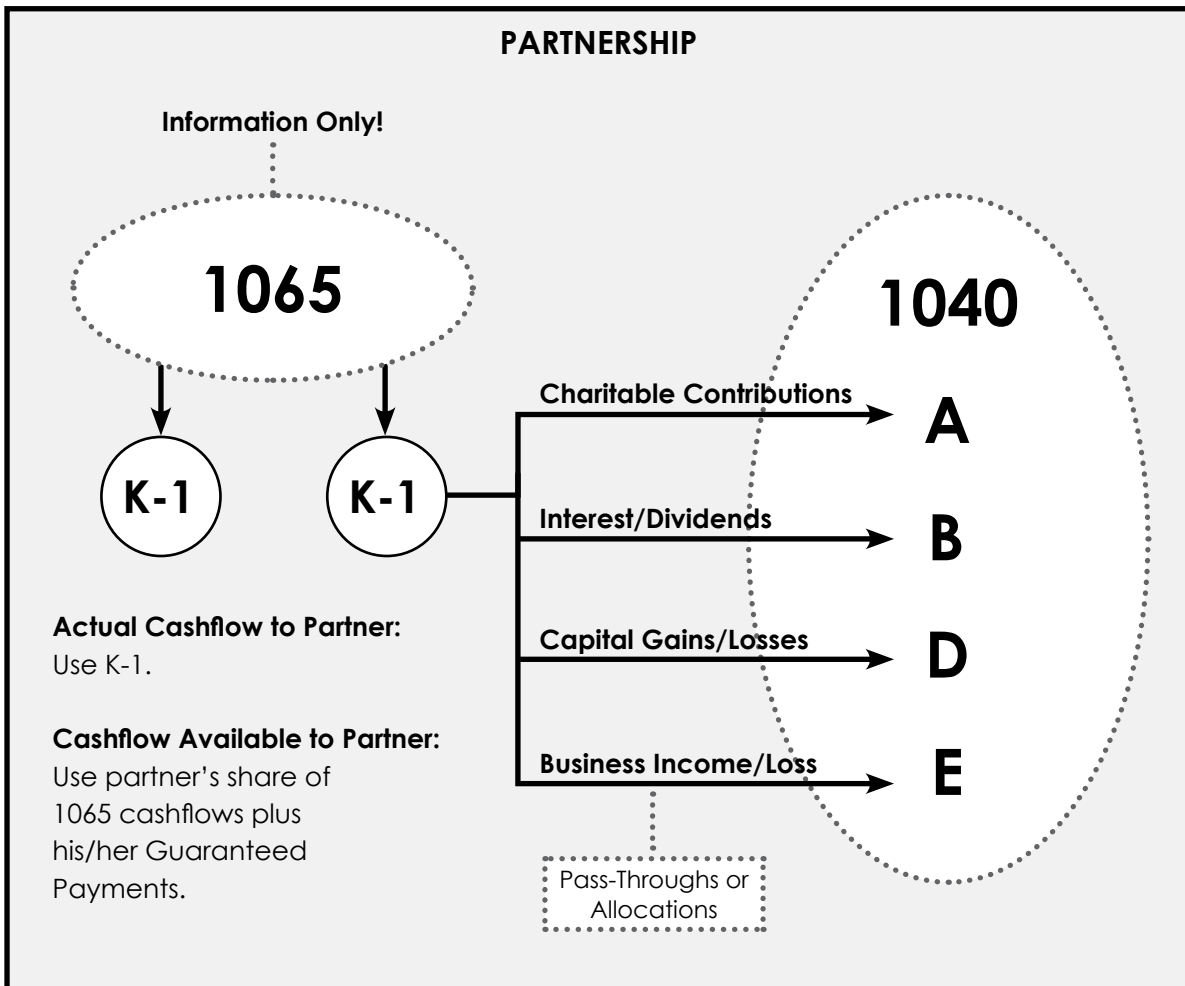
Often, contributions to a limited partnership are a one-time only investment and should not be counted against the borrower any more than you would count a purchase of stock against your borrower's cashflow.

Some limited partners have an obligation to inject capital over a period of time. You must determine if the borrower/ investor will have to continue to make capital contributions.

If cash is being distributed it may not be consistent enough for you to count as recurring cashflow.

When the limited partnership is dissolved because the investment is over (common with real estate and oil & gas partnerships) the gain or loss on the investment will show up on Schedule D as a capital gain. This is often treated as nonrecurring similar to capital gains from stock sales.

The fact that the borrower is a limited partner does not necessarily mean that cashflow is nonrecurring. Consider the circumstances.



**LIMITED LIABILITY COMPANIES**

Limited Liability Companies (LLC's) are a creature of the state and rules/definitions vary somewhat from state to state. Single-owner LLCs file in the 1040. Multi-owner LLCs often choose to file a 1065 return. If so, they are a hybrid entity combining the pass-through attributes of a partnership with limited liability. Sounds like an S corporation? You are absolutely right.

**ADVANTAGES:**

- Pass-thru that does not require a 'general' partner with unlimited liability.
- Avoids double taxation of corporations.
- Fewer limitations on size and types of owners and activities than an S corporation.
- More flexibility in distributions than S Corporations.

**DISADVANTAGES:**

- The earnings of 'active' owners are subject to self-employment tax.
- When used to protect real estate investments (single-asset entities) title, loans, insurance and all documents must be properly drawn to reflect the LLC instead of the 'individual' owner.

**LLC MEMBER-MANAGERS**

A member-manager is any owner of an LLC who, alone or together with others, has the continuing exclusive authority to make the management decisions necessary to conduct the business for which the LLC was formed.

If there are not elected or designated member-managers, each owner is treated as a member-manager.

Member-managers may be the Designated Tax matters Partner and the income from the activity can be included in the non-passive category and therefore, if losses, can offset other types of income for tax considerations.

**LIMITED LIABILITY PARTNERSHIPS**

LLPs or their variations (Professional Limited Liability Partnerships or Professional Limited Liability Companies) are similar to the more familiar Inc, PS designation for corporations. These vary by state, but are opportunities for licensed professionals to enter into practice with other licensed professionals.

Generally available to doctors, attorneys, architects, accountants and the like, these licensed professionals still have personal liability for their own professional actions but have limited liability for the professional actions of their 'partners'.

**TAX FORMS:**

Same as partnership in most cases. To be treated as a partnership, the LLC can only have one of the following:

- Free transferability of assets
- Centralized management
- Continuity of life

If a one-owner LLC is allowed in your state, that entity can file a Schedule C in the owner's 1040.

**COMPARISONS WITH OTHER TYPES OF ENTITIES:****Sole Proprietorships**

LLCs can be a one-person entity but avoids the unlimited liability of the sole proprietor.

**General Partnerships**

A multi-member LLC is often taxed like a partnership but the owners (members) are not personally liable like general partners are, even if active in the business.

**Limited Partnerships**

Taxed the same, but LLC owners can have limited liability even if they are active in the business. Limited Partners cannot be active in the business. And LLCs do not have to have at least one fully liable owner like Limited Partnerships do.

**S Corporations**

LLCs have fewer restrictions than S Corps. LLCs have flexibility in allocating income and expenses disproportionately. S corporations cannot have more than 100 shareholders or shareholders who are nonresident aliens.



**May file Schedule C for Sole Proprietorship, 1120 Corporate Return or 1065 Partnership Return depending on the State, the number of owners and the way the LLC was formed.**

**C Corporations**

LLCs most often choose not to be taxpaying entities: they pass through their income, losses and credits to the individual owners. C Corporations can be doubly taxed when shareholders wish to take capital out in the form of dividends. An LLC can be run less formally than a corporation.

A plus for the corporation, if not all of the income is taken out as wage to the owners, the amount left in for growth is often taxed at a lower rate than the owners rates.

**TAX IMPACT ON OWNER:**

This depends on how the LLC chooses to file. Single-owner LLCs are taxed on the 1040. Multi-owner LLCs often are pass-thru filing the 1065.

**CONSIDERATIONS FOR THE LENDER:**

If reported as a partnership, determine cashflow to the entity and to the owner as you would for any partnership.

Be aware, though, that the 'members' of the LLC have limited liability compared to general partners. Thus, their risk exposure is more like that of a corporate owner.

If reported as a corporation or a sole proprietorship, determine cashflow based on the rules for those types of entities.



EXCERPT FROM THE MANUAL:

BEYOND THE 1040:

# **CORPORATION PARTNERSHIP & LLC RETURNS**

Corporations

Form **1120** U.S. Corporation Income Tax Return  
 Department of the Treasury Internal Revenue Service  
 For calendar year 2014 or tax year beginning 0, 2014, ending \_\_\_\_\_, \_\_\_\_\_  
 Information about Form 1120 and its separate instructions is at [www.irs.gov/form1120](http://www.irs.gov/form1120).  
 OMB No. 1545-0123  
**2014**

**A Check if:**  
 1 a Consolidated return (attach Form 851)   
 b Life/nonlife consolidated return   
 2 Personal holding co. (attach Sch PH)   
 3 Personal service corp (see instrs)   
 4 Schedule M-3 attached

**TYPE OR PRINT**

Name: School Tools, Inc.  
 Employer identification number: 91-000000  
 Number, street, and room or suite number, if a P.O. box, see instructions: 400 Copper Gulch Rd  
 Date incorporated: 03/09/2008  
 City or town, state, or province, country and ZIP or foreign postal code: Learner WA 98502  
 Total assets (see instructions): \$ 94,440.

**E Check if:** (1)  Initial return (2)  Final return (3)  Name change (4)  Address change

INCOME	1 a Gross receipts or sales	1 a	546,333.	
	b Returns and allowances	1 b		<input checked="" type="radio"/>
	c Balance. Subtract line 1b from line 1a	1 c	546,333.	
	2 Cost of goods sold (attach Form 1125-A)	2	293,778.	
	3 Gross profit. Subtract line 2 from line 1c	3	252,555.	
	4 Dividends (Schedule C, line 19)	4		
	5 Interest	5	228.	
	6 Gross rents	6		
	7 Gross royalties	7		
	8 Capital gain net income (attach Schedule D (Form 1120))	8	2,516.	
	9 Net gain or (loss) from Form 4797, Part II, line 17 (attach Form 4797)	9		
10 Other income (see instructions — attach statement)	10			
11 Total income. Add lines 3 through 10	11	255,299.		

DEDUCTIONS	12 Compensation of officers (see instructions — attach Form 1125-E)	12	57,000.	<input checked="" type="radio"/>
	13 Salaries and wages (less employment credits)	13	29,648.	<input checked="" type="radio"/>
	14 Repairs and maintenance	14	3,645.	
	15 Bad debts	15	330.	
	16 Rents	16	63,960.	<input checked="" type="radio"/>
	17 Taxes and licenses	17	18,329.	
	18 Interest	18	8,772.	<input checked="" type="radio"/> DEBT LIST
	19 Charitable contributions	19		
	20 Depreciation from Form 4562 not claimed on Form 1125-A or elsewhere on return (attach Form 4562)	20	4,713.	<input checked="" type="radio"/> EQUIP LIST
	21 Depletion	21		
	22 Advertising	22	14,994.	
23 Pension, profit-sharing, etc, plans	23			
24 Employee benefit programs	24	8,811.		
25 Domestic production activities deduction (attach Form 8903)	25			
26 Other deductions (attach statement) See Other Deductions Statement	26	34,433.		
27 Total deductions. Add lines 12 through 26	27	244,635.		
28 Taxable income before net operating loss deduction and special deductions. Subtract line 27 from line 11	28	10,664.	START HERE >>	

TAXES, CREDITS, AND DEDUCTIONS	29 a Net operating loss deduction (see instructions)	29 a		
	b Special deductions (Schedule C, line 20)	29 b		
	c Add lines 29a and 29b	29 c		
	30 Taxable income. Subtract line 29c from line 28 (see instructions)	30	10,664.	
	31 Total tax (Schedule J, Part I, line 11)	31	1,600.	SUBTRACT FROM CASHFLOW >>
	32 Total payments and refundable credits (Schedule J, Part II, line 21)	32		
33 Estimated tax penalty (see instructions). Check if Form 2220 is attached	33	26.	<input checked="" type="checkbox"/>	
34 Amount owed. If line 32 is smaller than the total of lines 31 and 33, enter amount owed	34	1,626.		
35 Overpayment. If line 32 is larger than the total of lines 31 and 33, enter amount overpaid	35			
36 Enter amount from line 35 you want: Credited to 2015 estimated tax <input type="checkbox"/> Refunded <input type="checkbox"/>	36			

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

Signature of officer \_\_\_\_\_ Date \_\_\_\_\_ Title \_\_\_\_\_

May the IRS discuss this return with the preparer shown below (see instructions)?  Yes  No

**Paid Preparer Use Only**

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

Firm's name Paid Preparers Deluxe Firm's EIN \_\_\_\_\_

Firm's address 123 4th St, Ann City, WA Phone no. \_\_\_\_\_

Is it a significant source of income or risk for the borrower?

### 🕒 Overview

This only takes a few minutes and gives a quick thumbnail sketch of the business...

**Pg 3 Sch K Ln 1:** If cash basis, be careful drawing conclusions from comparison of years. If accrual, OK to compare.

**Pg 3 Sch K Ln 2:** What type of business are they in?

**Pg 3 Sch K Ln 4:** Who are the shareholders with over 50%?

**Pg 4 Sch K Ln 10:** # of shareholders

**Pg 4 Sch K Ln 13:** If yes, there may be no Schedule L or M-1.

**Pg 1:** Top Fiscal or calendar year?

**Pg 1 Box C:** Date Incorporated

**Pg 1 Ln E:** Initial or final return... They may have changed entity type. Partial year?

**Pg 1 Ln 1c:** Gross Receipts

**Pg 1 Ln 12:** Comp of Officers

**Pg 1 Ln 13:** Salaries & wages

**1125-A Ln 3:** Cost of Labor

**Pg 1 Ln 16:** How much is rent?

**Pg 1 Ln 18:** Interest (Need debts. See Page 2-5 for detailed debt list.)

**Pg 1 Ln 20:** Depreciation... Review equipment list if attached for size/scope of business and whether they are replacing as a healthy business would.

### COMMERCIAL LENDERS:

You may wish to consider a Statement of Cashflows Worksheet to highlight the sources, other than operations, of their cashflow. It will also highlight how the cashflow was used.

To maximize business income to more accurately show debt service capabilities, consider the standard personal debt-to-income ratios to calculate the wages the officers really **need** to take.

### Source of Adjustments to Line 28:

1. Page One
2. Other Deductions Schedule [Ln 26]
3. Schedule M-1 [Ln 5 & Ln 7]
4. Schedule M-2 [Commercial Only]

### General Cashflow Formula:

Start	Line 28	Txbl Income B4 NOL
Plus	Line 18	Interest <sup>^</sup>
Minus	Borrower Debt Payments* <sup>^</sup>	
Plus	Line 20	Depreciation
Minus	Line 31	Total Tax

Commercial lenders only:

Minus	M-2, Line 5a	Dividends
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### <sup>^</sup> Shortcut for Debt...two choices:

1) Estimate debt after adding back interest:

Page 1	Line 18 Interest	_____
Sch L	Line 17, Col (d) +	_____
	ESTIMATED DEBT PMTS	= _____

2) OR Do not add back interest and subtract principal (Sch L, 17, Col d).

**\* Debt Coverage: Do not subtract debt.**

### Additional Line-by-Line Instructions:

**1a.** Up, down, sideways?

**2.** Compare COGS% to prior year.

**4-8.** Recurring?

**9.** G/L on disposal of assets or casualty loss. Need to replace assets? Casualty loss impact? Insurance adequate?

**14.** Compare to prior years.

**15.** Bad Debts: Accrual only. May be nonrecurring or noncash.

**17.** Enough? At least 10-40% of Ln 12&13.

**18.** Add back and subtract annual debt. (See page 2-5 for debt list.)\*<sup>^</sup>

**19.** Add back charitable cont's, optional.

**20.** Add back depreciation, noncash.

**24.** Add back if optional. (Digging for \$\$\$)

**26.** Trace [see Pg 2-14]. Adequate insurance? Add back amortization and nonrecurring items, if present.

**31.** Subtract Total Tax.

Page #s are from full manual.

Form 1120 (2014) School Tools, Inc. 91-0000000 Page 2

Schedule C Dividends and Special Deductions (see instructions)	(a) Dividends received	(b) Percentage	(c) Special deductions (a) x (b)
Dividends from less-than-20%-owned domestic corporations (other than debt-financed stock) . . . . .		70	
<b>2</b> Dividends from 20%-or-more-owned domestic corporations (other than debt-financed stock) . . . . .		80	
<b>3</b> Dividends on debt-financed stock of domestic and foreign corporations . . . . .		see instructions	
<b>4</b> Dividends on certain preferred stock of less-than-20%-owned public utilities . . . . .		42	
<b>5</b> Dividends on certain preferred stock of 20%-or-more-owned public utilities . . . . .		48	
<b>6</b> Dividends from less-than-20%-owned foreign corporations and certain FSCs . . . . .		70	
<b>7</b> Dividends from 20%-or-more-owned foreign corporations and certain FSCs . . . . .		80	
<b>8</b> Dividends from wholly owned foreign subsidiaries . . . . .		100	
<b>9 Total.</b> Add lines 1 through 8. See instructions for limitation . . . . .			
<b>10</b> Dividends from domestic corporations received by a small business investment company operating under the Small Business Investment Act of 1958 . . . . .		100	
<b>11</b> Dividends from affiliated group members . . . . .		100	
<b>12</b> Dividends from certain FSCs . . . . .		100	
<b>13</b> Dividends from foreign corporations not included on lines 3, 6, 7, 8, 11, or 12 . . . . .			
<b>14</b> Income from controlled foreign corporations under subpart F (attach Form(s) 5471) . . . . .			
<b>15</b> Foreign dividend gross-up . . . . .			
<b>16</b> IC-DISC and former DISC dividends not included on lines 1, 2, or 3 . . . . .			
<b>17</b> Other dividends . . . . .			
<b>18</b> Deduction for dividends paid on certain preferred stock of public utilities . . . . .			
<b>19 Total dividends.</b> Add lines 1 through 17. Enter here and on page 1, line 4. . . . .			
<b>20 Total special deductions.</b> Add lines 9, 10, 11, 12, and 18. Enter here and on page 1, line 29b . . . . .			

**PAGE TWO**

**Schedule C Dividends**

This is not information lenders need.

If a cash-basis company receives an unusual amount of deposits on contracts it will do early next year, the previous year income will be overstated and the later year will be understated.

**PAGE THREE**

**Schedule J: Tax Computation**

This information does not impact the lending decision. Ignore it.

The problem is if the lender thinks business is declining or growing significantly when it is not. Check Schedule K, Line 1. If it is cash-basis, you cannot draw a conclusion.

**Item 2:** Indicates type of business.

**Schedule K: Other Information**

On the next two pages I take a look at 5 of the 18 items plus any other 'yes'.

**Item 4b:** If yes, the business will attach a Schedule G (see page 2-18).

**Item 1:** Cash-basis means that income is recognized when received and expenses are recognized when paid. This is very close to what is happening in their checkbook, but may not accurately reflect how much their activity earned them in the year.

**Schedule J Tax Computation and Payment** (see instructions)

**Part I – Tax Computation**

1	Check if the corporation is a member of a controlled group (attach Schedule O (Form 1120)) . . . . .	<input type="checkbox"/>		
2	Income tax. Check if a qualified personal service corporation (see instructions) . . . . .	<input type="checkbox"/>	2	1,600.
3	Alternative minimum tax (attach Form 4626) . . . . .		3	
4	Add lines 2 and 3. . . . .		4	1,600.
5a	Foreign tax credit (attach Form 1118) . . . . .		5a	
5b	Credit from Form 8834 (see instructions) . . . . .		5b	
5c	General business credit (attach Form 3800) . . . . .		5c	
5d	Credit for prior year minimum tax (attach Form 8827) . . . . .		5d	
5e	Bond credits from Form 8912 . . . . .		5e	
6	<b>Total credits.</b> Add lines 5a through 5e. . . . .		6	
7	Subtract line 6 from line 4. . . . .		7	1,600.
8	Personal holding company tax (attach Schedule PH (Form 1120)) . . . . .		8	
9a	Recapture of investment credit (attach Form 4253) . . . . .		9a	
9b	Recapture of low-income housing credit (attach Form 3611) . . . . .		9b	
9c	Interest due under the look-back method – completed long-term contracts (attach Form 8697) . . . . .		9c	
9d	Interest due under the look-back method – income forecast method (attach Form 8866) . . . . .		9d	
9e	Alternative tax on qualifying shipping activities (attach Form 8902) . . . . .		9e	
9f	Other (see instructions – attach statement) . . . . .		9f	
10	<b>Total.</b> Add lines 9a through 9f. . . . .		10	
11	<b>Total tax.</b> Add lines 7, 8, and 10. Enter here and on page 1, line 31. . . . .		11	1,600.

**Part II – Payments and Refundable Credits**

12	2013 overpayment credited to 2014. . . . .		12	
13	2014 estimated tax payments. . . . .		13	
14	2014 refund applied for on Form 4466 . . . . .		14	
15	Combine lines 12, 13, and 14. . . . .		15	
16	Tax deposited with Form 7004 . . . . .		16	
17	Withholding (see instructions) . . . . .		17	
18	<b>Total payments.</b> Add lines 15, 16 and 17 . . . . .		18	
19	Refundable credits from:			
19a	Form 2439 . . . . .		19a	
19b	Form 4136 . . . . .		19b	
19c	Form 8827, line 8c . . . . .		19c	
19d	Other (attach statement – see instructions) . . . . .		19d	
20	<b>Total credits.</b> Add lines 19a through 19d. . . . .		20	
21	<b>Total payments and credits.</b> Add lines 18 and 20. Enter here and on page 1, line 32 . . . . .		21	

**Schedule K Other Information** (see instructions)

1	Check accounting method <input checked="" type="radio"/> a <input type="checkbox"/> Cash <input checked="" type="checkbox"/> b <input checked="" type="checkbox"/> Accrual <input type="checkbox"/> c <input type="checkbox"/> Other (specify) ▶ _____	Yes	No
2	See the instructions and enter the:		
a	Business activity code no. ▶ <u>453990</u>		
b	Business activity ▶ <u>Retail Sales</u>		
c	Product or service ▶ <u>Educational</u>		
3	Is the corporation a subsidiary in an affiliated group or a parent-subsidiary controlled group? . . . . . If 'Yes,' enter name and EIN of the parent corporation ▶ _____		X
4	At the end of the tax year:		
a	Did any foreign or domestic corporation, partnership (including any entity treated as a partnership), trust, or tax-exempt organization own directly 20% or more, or own, directly or indirectly, 50% or more of the total voting power of all classes of the corporation's stock entitled to vote? If 'Yes,' complete Part I of Schedule G (Form 1120) (attach Schedule G) . . . . .		X
b	Did any individual or estate own directly 20% or more, or own, directly or indirectly, 50% or more of the total voting power of all classes of the corporation's stock entitled to vote? If 'Yes,' complete Part II of Schedule G (Form 1120) (attach Schedule G) . . . . .	X	

**Schedule K** Other Information continued (see instructions)

5 At the end of the tax year, did the corporation:

	Yes	No
<input type="radio"/> a Own directly 20% or more, or own, directly or indirectly, 50% or more of the total voting power of all classes of stock entitled to vote of any foreign or domestic corporation not included on Form 851, Affiliations Schedule? For rules of constructive ownership, see instructions . . . . . If 'Yes,' complete (i) through (iv) below.		X

(i) Name of Corporation	(ii) Employer Identification Number (if any)	(iii) Country of Incorporation	(iv) Percentage Owned in Voting Stock

b Own directly an interest of 20% or more, or own, directly or indirectly, an interest of 50% or more in any foreign or domestic partnership (including an entity treated as a partnership) or in the beneficial interest of a trust? For rules of constructive ownership, see instructions . . . . .  
If 'Yes,' complete (i) through (iv) below.

	Yes	No
		X

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

6 During this tax year, did the corporation pay dividends (other than stock dividends and distributions in exchange for stock) in excess of the corporation's current and accumulated earnings and profits? (See sections 301 and 316.) . . . . . X  
If 'Yes,' file Form 5452, Corporate Report of Nondividend Distributions.  
If this is a consolidated return, answer here for the parent corporation and on Form 851 for each subsidiary

7 At any time during the tax year, did one foreign person own, directly or indirectly, at least 25% of (a) the total voting power of all classes of the corporation's stock entitled to vote or (b) the total value of all classes of the corporation's stock? . . . . . X  
For rules of attribution, see section 318. If 'Yes,' enter:  
(i) Percentage owned ▶ \_\_\_\_\_ and (ii) Owner's country ▶ \_\_\_\_\_

(c) The corporation may have to file Form 5472, Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business. Enter the number of Forms 5472 attached ▶ \_\_\_\_\_

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

9 Enter the amount of tax-exempt interest received or accrued during the tax year ▶ \$ \_\_\_\_\_

10 Enter the number of shareholders at the end of the tax year (if 100 or fewer) ▶ 4

11 If the corporation has an NOL for the tax year and is electing to forego the carryback period, check here . . . . .   
If the corporation is filing a consolidated return, the statement required by Regulations section 1.1502-21(b)(3) must be attached or the election will not be valid.

12 Enter the available NOL carryover from prior tax years (do not reduce it by any deduction on line 29a.) ▶ \$ \_\_\_\_\_

13 Are the corporation's total receipts (page 1, line 1a, plus lines 4 through 10) for the tax year and its total assets at the end of the tax year less than \$250,000? . . . . . X  
If 'Yes,' the corporation is not required to complete Schedules L, M-1, and M-2. Instead, enter the total amount of cash distributions and the book value of property distributions (other than cash) made during the tax year ▶ \$ \_\_\_\_\_

14 Is the corporation required to file Schedule UTP (Form 1120), Uncertain Tax Position Statement (see instructions)? . . . . . X  
If 'Yes,' complete and attach Schedule UTP.

15a Did the corporation make any payments in 2014 that would require it to file Form(s) 1099? . . . . . X

b If 'Yes,' did or will the corporation file required Forms 1099? . . . . . X

16 During this tax year, did the corporation have an 80% or more change in ownership, including a change due to redemption of its own stock? . . . . . X

17 During or subsequent to this tax year, but before the filing of this return, did the corporation dispose of more than 65% (by value) of its assets in a taxable, non-taxable, or tax deferred transaction? . . . . . X

18 Did the corporation receive assets in a section 351 transfer in which any of the transferred assets had a fair market basis or fair market value of more than \$1 million? . . . . . X



**Item 5:** if this corporation is an owner of another corporation or partnership, you may need to request those tax returns as well. Consider % ownership and your guidelines.

**Item 10:** Tells you how many shareholders at the end of the year.

If your borrower is a 40% owner and there are only two shareholders, the other shareholder has 'control'. If your borrower owns 40% and there are 20 shareholders, your borrower may have 'functional control' of business decisions.

**Item 12:** If this is significant you may want to ask about the prior year's Net Operating Losses. Is it recent or rolling forward? If a recent loss, have they recovered?

**Item 13:** If the corporation has less than \$250,000 receipts and assets, it can get out of filing the last page of the return, Schedule L Balance Sheets and the M-1 and M-2.

So if those pages are missing and it is a small corporation, don't imply to the borrower that their tax return is not complete.

You will be unable to use the shortcut for debt or find nontaxed income or nondeducted expenses. Hopefully those last two will not be material in such a small company.

**Item 16:** If yes, find out about the experience and abilities of the new owners. Do you think they can carry on the profitable operations of the recent past? Or right the ship if the recent past is challenged?

And finally, take a look at any other items with a 'Yes' response.

Schedule L	Balance Sheets per Books	Beginning of tax year		End of tax year	
		(a)	(b)	(c)	(d)
<b>Assets</b>					
1	Cash . . . . .		15,480.		1,455.
2a	Trade notes and accounts receivable . . . . .	6,834.		3,804.	
	b Less allowance for bad debts . . . . .		6,834.		3,804.
3	Inventories . . . . .		81,816.		74,166.
4	U.S. government obligations . . . . .				
5	Tax-exempt securities (see instructions) . . . . .				
6	Other current assets (attach statement) Ln 6 Stmt.		1,866.		1,044.
7	Loans to shareholders . . . . .				
8	Mortgage and real estate loans . . . . .				
9	Other investments (attach statement) . . . . .				
10a	Buildings and other depreciable assets . . . . .	41,052.		34,632.	
	b Less accumulated depreciation . . . . .	23,442.	17,610.	22,527.	12,105.
11a	Depletable assets . . . . .				
	b Less accumulated depletion . . . . .				
12	Land (net of any amortization) . . . . .				
13a	Intangible assets (amortizable only) . . . . .	2,289.		2,289.	
	b Less accumulated amortization . . . . .	1,716.	573.	2,175.	114.
14	Other assets (attach statement) Ln 14 Stmt.		3,552.		1,752.
15	Total assets . . . . .		127,731.		94,440.
<b>Liabilities and Shareholders' Equity</b>					
16	Accounts payable . . . . .		16,203.		17,171.
17	Mortgages, notes, bonds payable in less than 1 year . . . . .		31,540.		24,912.
18	Other current liabilities (attach stmt) Ln 18 Stmt.		35,803.		24,976.
19	Loans from shareholders . . . . .		10,671.		3,129.
20	Mortgages, notes, bonds payable in 1 year or more . . . . .		32,636.		14,355.
21	Other liabilities (attach statement) . . . . .				
22	Capital stock: a Preferred stock . . . . .				
	b Common stock . . . . .	24,000.	24,000.	24,000.	24,000.
23	Additional paid-in capital . . . . .				
24	Retained earnings — Approp (att stmt) . . . . .				
25	Retained earnings — Unappropriated . . . . .		-23,122.		-14,103.
26	Adjmt to shareholders' equity (att stmt) . . . . .				
27	Less cost of treasury stock . . . . .				
28	Total liabilities and shareholders' equity . . . . .		127,731.		94,440.

Principal Due in Next Twelve Months

See alternative method next page if you start with M-1, Line 1 for analysis.

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

Note: The corporation may be required to file Schedule M-3 (see instructions).

1	Net income (loss) per books . . . . .	9,019.	7	Income recorded on books this year not included on this return (itemize):	ADD (RECURRING) CASH RECEIVED, OTHERWISE IGNORE.
2	Federal income tax per books . . . . .	1,600.		Tax-exempt interest \$ _____	
3	Excess of capital losses over capital gains . . . . .				
4	Income subject to tax not recorded on books this year (itemize):				
5	Expenses recorded on books this year not deducted on this return (itemize):		8	Deductions on this return not charged against book income this year (itemize):	
	a Depreciation . . . . \$ 117.			a Depreciation . \$ 474.	
	b Charitable contributions . \$ _____			b Charitable contribns \$ _____	
	c Travel & entertainment . \$ 402.				
		519.			474.
6	Add lines 1 through 5 . . . . .	11,138.	9	Add lines 7 and 8 . . . . .	474.
			10	Income (page 1, line 28) — line 6 less line 9 . . . . .	10,664.

Schedule M-2 Analysis of Unappropriated Retained Earnings per Books (Line 25, Schedule L)

1	Balance at beginning of year . . . . .	-23,122.	5	Distributions . . . . . a Cash . . . . .	Com'l Subtract
2	Net income (loss) per books . . . . .	9,019.		b Stock . . . . . c Property . . . . .	
3	Other increases (itemize):		6	Other decreases (itemize):	
			7	Add lines 5 and 6 . . . . .	
4	Add lines 1, 2, and 3 . . . . .	-14,103.	8	Balance at end of year (line 4 less line 7) . . . . .	-14,103.

**SCHEDULE L: BALANCE SHEETS**

Balance Sheets can be incredibly helpful in determining where the cash is flowing, if not to your borrower.

Increases in assets use up cashflow generated from operations, as do decreases in liability and capital balances. Purchase of equipment uses cashflow. Increasing accounts receivable means the company has not received all the cashflow generated by operations. It is a use of cashflow if the corporation pays off debts or distributes cash to owners.

On the other hand, a decrease in assets is a source of cash. Examples: selling equipment or investments. Reducing inventory levels will free up cash as well. Increasing liabilities ...borrowing money...is a source of cash as is increased capital contributions by the owners.

Tax returns show you history. Cashflow generated from operations used last year to build up cash balances or inventory, or pay down debts, may be used differently next year. If the inventory levels are now stable the cashflow used to build them up last year may be available to your borrower this year for other uses.

Use judgment in how far to delve into the balance sheet. It may be most important if the company is in the midst of strong growth or in a challenged industry. A commercial lender might do a balance sheet analysis every time.

**SHORTCUT FOR DEBT:**

Schedule L, Line 17, column (d) principal due in the next 12 months can be used in debt estimates. This will not be a good estimate when:

1. Debt levels are changing;
2. Line 17 includes an outstanding balance on a commercial line of credit; or
3. Line 17 does not include current portion of long-term debt.

**SCHEDULE M-1: RECONCILIATION**

This schedule is a source of nontaxed income and nondeductible expenses. Any items reported on the M-1 have not been reported elsewhere.

**Line 5:** Subtract (recurring) cash spent, otherwise ignore. School Tools shows expenses on its books that did not reduce taxable income.

Any depreciation listed on Line 5a is a noncash item. Since it is reported on the M-1 (rather than front page) and is not cash spent, I ignored the \$117.

**Line 5b** is charitable contributions. I regard it as optional so do not subtract it.

**Line 5c** includes the disallowed meals of \$402. They spent this, I assume it is recurring and subtract it. If there are other items listed here, such as officer's life insurance premiums, subtract (or include in expenses) if you think it is cash flow rather than a bookkeeping adjustment.

**Line 7:** Add (recurring) cash received, otherwise ignore. If there are nontaxed income items, decide if they are cashflow. If yes, for historical cashflow, add. If you are calculating recurring cashflow, only add if you think it will continue.

**Alternate Method:** If your analysis starts with net income per books rather than taxable income, you need to consider all M-1 items as adjustments.

**SCHEDULE M-2: ANALYSIS**

For cashflow to an owner, be sure you do not give them credit for dividends on the 1040 unless you have subtracted dividends listed on Line 5 from corporate cashflow.

Since dividends are doubly taxed, it is more likely that owners will take excess cash out as a bonus if possible.

For business cashflow, subtract Line 5 Distributions (if typical) to determine business cashflow left in the business to service debt.

**SCHEDULE D**  
**(Form 1120)**

Department of the Treasury  
Internal Revenue Service

**Capital Gains and Losses**

▶ **Attach to Form 1120, 1120-C, 1120-F, 1120-FSC, 1120-H, 1120-IC-DISC, 1120-L, 1120-ND, 1120-PC, 1120-POL, 1120-REIT, 1120-RIC, 1120-SF, or certain Forms 990-T.**  
▶ **Information about Schedule D (Form 1120) and its separate instructions is at [www.irs.gov/form1120](http://www.irs.gov/form1120).**

OMB No. 1545-0123

**2014**

Name

School Tools, Inc.

Employer identification number

91-0000000

**Part I Short-Term Capital Gains and Losses – Assets Held One Year or Less**

See instructions for how to figure the amounts to enter on the lines below.

This form may be easier to complete if you round off cents to whole dollars.

	(d) Proceeds (sales price)	(e) Cost (or other basis)	(g) Adjustments to gain or loss from Form(s) 8949, Part I, line 2, column (g)	(h) Gain or (loss) Subtract column (e) from column (d) and combine the result with column (g)
<b>1a</b> Totals for all short-term transactions reported on Form 1099-B for which basis was reported to the IRS and for which you have no adjustments (see instructions). However, if you choose to report all these transactions on Form 8949, leave this line blank and go to line 1b . . . . .				
<b>1b</b> Totals for all transactions reported on Form(s) 8949 with <b>Box A</b> checked . . . . .				
<b>2</b> Totals for all transactions reported on Form(s) 8949 with <b>Box B</b> checked . . . . .				
<b>3</b> Totals for all transactions reported on Form(s) 8949 with <b>Box C</b> checked . . . . .				
<b>4</b> Short-term capital gain from installment sales from Form 6252, line 26 or 37 . . . . .				<b>4</b>
<b>5</b> Short-term capital gain or (loss) from like-kind exchanges from Form 8824 . . . . .				<b>5</b>
<b>6</b> Unused capital loss carryover (attach computation) . . . . .				<b>6</b>
<b>7</b> Net short-term capital gain or (loss). Combine lines 1a through 6 in column h . . . . .				<b>7</b>

**Part II Long-Term Capital Gains and Losses – Assets Held More Than One Year**

See instructions for how to figure the amounts to enter on the lines below.

This form may be easier to complete if you round off cents to whole dollars.

	(d) Proceeds (sales price)	(e) Cost (or other basis)	(g) Adjustments to gain or loss from Form(s) 8949, Part II, line 2, column (g)	(h) Gain or (loss) Subtract column (e) from column (d) and combine the result with column (g)
<b>8a</b> Totals for all long-term transactions reported on Form 1099-B for which basis was reported to the IRS and for which you have no adjustments (see instructions). However, if you choose to report all these transactions on Form 8949, leave this line blank and go to line 8b . . . . .				
<b>8b</b> Totals for all transactions reported on Form(s) 8949 with <b>Box D</b> checked . . . . .				
<b>9</b> Totals for all transactions reported on Form(s) 8949 with <b>Box E</b> checked . . . . .				
<b>10</b> Totals for all transactions reported on Form(s) 8949 with <b>Box F</b> checked . . . . .				
<b>11</b> Enter gain from Form 4797, line 7 or 9 . . . . .				<b>11</b> 2,516.
<b>12</b> Long-term capital gain from installment sales from Form 6252, line 26 or 37 . . . . .				<b>12</b>
<b>13</b> Long-term capital gain or (loss) from like-kind exchanges from Form 8824 . . . . .				<b>13</b>
<b>14</b> Capital gain distributions (see instructions) . . . . .				<b>14</b>
<b>15</b> Net long-term capital gain or (loss). Combine lines 8a through 14 in column h . . . . .				<b>15</b> 2,516.

**Part III Summary of Parts I and II**

<b>16</b> Enter excess of net short-term capital gain (line 7) over net long-term capital loss (line 15) . . . . .	<b>16</b>	
<b>17</b> Net capital gain. Enter excess of net long-term capital gain (line 15) over net short-term capital loss (line 7) . . . . .	<b>17</b>	2,516.
<b>18</b> Add lines 16 and 17. Enter here and on Form 1120, page 1, line 8, or the proper line on other returns . . . . .	<b>18</b>	2,516.

Like the 1040 Schedule D, you'll now have to go to Form 8949 for the details. Form 8949 is covered in the manual 'Tax Return Analysis: Essentials and 1040 Review'

### Watch For

When they changed the form they also changed line numbers. Line 2 became Line 4, etc. If you are reviewing pre-2012 returns, watch for the names of the lines, not the line numbers.

With Part I Short-term gains and losses, the column (h) gain/loss is the cashflow. With Part II Long-term, we cannot determine cashflow without a broker's statement for stock or closing statements for Real Estate.

### LINE 4 INSTALLMENT SALES

The interest income from the installment sale will be included on Page 1, Line 5. However, you may not have realized part or all of it came from an installment sale. I don't include the interest from page one or the gain from Schedule D Line 4 in cashflow since interest and gain are a part of the amount received on the note.

Form 6252 Line 21 shows us the principal received last year, but does not indicate how much longer the payments will continue. I ask for information on the amount and duration of the payments, subtract the page one interest income and Schedule D, Line 4 gain and add full payments to cashflow if the payments will continue long enough. Form 6252 is covered in detail in the manual 'Tax Return Analysis: Essentials and 1040 Review'.

### LINE 5 LIKE-KIND EXCHANGES

When the borrower has simply exchanged one type of business or investment property for another, and no cash has changed hands, there will be no gain or loss.

Like-Kind Exchanges are reported on Form 8824 which is required to be attached to the return.

If there is gain because the borrower's property was worth more than the property exchanged for and so received cash in addition to the other property, that

amount will come in on Line 3 or 9 of the Schedule D or Line 5 or 16 on Form 4797.

### Tip

Tax on the gain will have to be paid when they finally sell the 'last' property.

### LINE 6 UNUSED CAPITAL LOSS CARRYOVERS

Unused capital loss carryovers are losses from a prior year. Unlike in the 1040, a corporation cannot take a capital loss in excess of capital gains of the same year. Do not count it.

### Watch For

If a loss, do not add back more than the amount on 1120 Pg 1, Line 8.

### LINE 11 GAIN/LOSS ON BUSINESS ASSETS FORM 4797 GAIN/LOSS ON BUSINESS ASSETS

Includes involuntary conversions other than from theft on property held more than one year. We generally do not include it in cashflow as it is unlikely to be recurring. The resulting gain/loss may flow to D or directly to Line 9 of Page One.

### FORM 4684 BUSINESS CASUALTY LOSS

Business Casualty Loss flows through the 4797 and onto page one, line 9. Most often we will not include it since we assume casualty losses are nonrecurring.

### LINE 12 (SEE LINE 4 EXPLANATION)

### LINE 13 (SEE LINE 5 EXPLANATION)

### LINE 14 CAPITAL GAIN DISTRIBUTIONS

These distributions are really dividends.

### To Do

Circle the \$2,516 on Line 7 and trace it to Form 4797 (Page 2-22).

**SCHEDULE G**  
**(Form 1120)**  
(Rev December 2011)

**Information on Certain Persons Owning the Corporation's Voting Stock**

OMB No. 1545-0123

Department of the Treasury  
Internal Revenue Service

► Attach to Form 1120.  
► See instructions.

Name School Tools, Inc.	Employer identification number (EIN) 91-0000000
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**Part II Certain Individuals and Estates Owning the Corporation's Voting Stock.** (Form 1120, Schedule K, Question 4b).  
Complete columns (i) through (iv) below for any individual or estate that owns directly 20% or more, or owns, directly or indirectly, 50% or more of the total voting power of all classes of the corporation's stock entitled to vote (see instructions).

(i) Name of Individual or Estate	(ii) Identifying Number (if any)	(iii) Country of Citizenship (see instructions)	(iv) Percentage Owned in Voting Stock
I.M. Playful	123-45-6789	US	66.60
Too Playful	345-67-8901	US	66.60

Form **1125-A**  
(Rev December 2012)

**Cost of Goods Sold**

OMB No. 1545-2225

Department of the Treasury  
Internal Revenue Service

► Attach to Form 1120, 1120-C, 1120-F, 1120S, 1065, or 1065-B.  
► Information about Form 1125-A and its instructions is at [www.irs.gov/form1125a](http://www.irs.gov/form1125a).

Name School Tools, Inc.	Employer identification number 91-0000000
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1 Inventory at beginning of year	1	81,816.
2 Purchases	2	272,736.
3 Cost of labor	3	
4 Additional section 263A costs (attach schedule)	4	
5 Other costs (attach schedule). See Other Costs Statement	5	13,392.
6 Total. Add lines 1 through 5	6	367,944.
7 Inventory at end of year	7	74,166.
8 Cost of goods sold. Subtract line 7 from line 6. Enter here and on Form 1120, page 1, line 2 or the appropriate line of your tax return (see instructions).	8	293,778.

Form **1125-E**  
(Rev December 2013)

**Compensation of Officers**

OMB No. 1545-2225

Department of the Treasury  
Internal Revenue Service

► Attach to Form 1120, 1120-C, 1120-F, 1120-REIT, 1120-RIC, or 1120S.  
► Information about Form 1125-E and its separate instructions is at [www.irs.gov/form1125e](http://www.irs.gov/form1125e).

Name School Tools, Inc.	Employer identification number 91-0000000
----------------------------	--

**Note.** Complete Form 1125-E only if total receipts are \$500,000 or more. See instructions for definition of total receipts.

1	(a) Name of officer	(b) Social security number	(c) Percent of time devoted to business	Percent of stock owned		(f) Amount of compensation
				(d) Common	(e) Preferred	
	I.M. Playful	123-45-6789	100.0 %	33.3 %	%	16,000.
	Lotta Toyz	234-56-7890	100.0 %	16.7 %	%	24,000.
	Too Playful	345-67-8901	50.0 %	33.3 %	%	17,000.
2	Total compensation of officers					57,000.
3	Compensation of officers claimed on Form 1125-A or elsewhere on return					
4	Subtract line 3 from line 2. Enter the result here and on Form 1120, page 1, line 12 or the appropriate line of your tax return					57,000.

**SCHEDULE G: INFO ON OWNERS**

This schedule is triggered if the answer is 'yes' to Schedule K, Line 4b. (see page 2-11).

Do not be concerned that the combined % is higher than 100%. This is because a husband and wife are listed as shareholders and they each are shown with the combined, indirect % ownership of both.

**1125-A: COST OF GOODS SOLD**

Lines 1 & 7: Watch for a dramatic change in inventory. Generally, the trend in inventory should mirror the trend in sales.

A jump in inventory should usually be accompanied by an increase in sales. If not, are they building up inventory for expansion? If so, that is tying up cashflow.

If this trend continues, not all cashflow generated by operations may be available for owner comp or to the business to service debt unless they are financing through borrowing or capital contributed.

On the other hand, a severe drop in inventory could signal cashflow problems. Is it a permanent drop? Did they have a year-end sale that has been made-up in beginning of the year purchases? If not, will it be? Is the supplier now closer? Did the company adopt "just-in-time" inventory methods that allow it to run on lower inventory levels?

**Line 3:** Will include wages/ payroll taxes/ benefits for people working directly on manufacture of product (including officers) and subcontractors.

**Line 5:** May include insurance. Look here if the insurance on the other deductions schedule (supporting Pg 1, Line 26) does not seem adequate.

**1125-E: COMPENSATION OF OFFICERS**

Percent of stock owned, compensation and % time devoted for each officer. Percentage ownership gives you a sense of who has control over cashflow.

If your borrower is a low % owner, actual wages may be the best number to use for cashflow. (Use your internal guidelines re: % ownership. A 25% cutoff is common.)

If this corporation has a fiscal year other than a calendar year, the wages reported here may not be the same as the wages reported on the Form 1040. Investigate only if a significant difference.

The wages will also not be the same as on the 1040 if the personal taxable wages were reduced by 401K contributions, dependent care benefits or other nontaxable items.

If you are looking at personal loans for consumer or mortgage lending use wages on the 1040, W-2 Line 5 or pay-stub. Just be sure to treat this borrower consistent with other wage earners.

This section is not required if receipts are less than \$500,000.

Part of the officer's wages may be reported here and transferred to 1125-A, Line 3 instead of the front page.

Form 1120, Page 1, Line 26  
**Other Deductions Statement**

Credit card discount	1,568.
Freight	789.
Phone	2,994.
Professional services	1,410.
Postage	1,044.
Utilities	6,759.
Travel	3,444.
Miscellaneous	5,940.
Supplies	402.
Unsalable merchandise	81.
Lease expense	7,620.
Insurance	1,521.
Amortization of organization expense	459.
Meals and entertainment (50%)	402.
<b>Total</b>	<b>34,433.</b>

Always look for noncash and nonrecurring expenses to add back. Also consider if insurance is adequate.

Nondeducted expenses for meals will be on M-1. We are not there yet.

Form 1120, Page 5, Schedule L, Line 6  
**Ln 6 Stmt**

<b>Other Current Assets:</b>	Beginning of tax year	End of tax year
Prepaid Insurance	1,866.	1,044.
<b>Total</b>	<b>1,866.</b>	<b>1,044.</b>

Form 1120, Page 5, Schedule L, Line 14  
**Ln 14 Stmt**

<b>Other Assets:</b>	Beginning of tax year	End of tax year
Rent deposit	3,552.	1,752.
<b>Total</b>	<b>3,552.</b>	<b>1,752.</b>

Form 1120, Page 5, Schedule L, Line 18  
**Ln 18 Stmt**

<b>Other Current Liabilities:</b>	Beginning of tax year	End of tax year
Accrued payroll taxes	3,846.	2,112.
Accrued excise taxes	4,620.	3,858.
Accrued wages	27,196.	16,800.
Travel expense payable	141.	258.
Equipment payable	0.	288.
Federal income tax payable		1,660.
<b>Total</b>	<b>35,803.</b>	<b>24,976.</b>



School Tools, Inc. 91-0000000

2

Form 1125, Line 5

**Other Costs Statement**

---

Freight in	13,392.
Total	13,392.

---

**SUPPORTING SCHEDULES:**

Any lines which say 'attach schedule' will have a supporting schedule after the formal IRS forms.

**PAGE 1, LINE 26 OTHER DEDUCTIONS**

Items reported here simply did not have a line on the front page of the 1120. They have been subtracted from taxable income on Line 26. Check here for nonrecurring items and amortization (\$459) to add back. Also, be sure they have sufficient insurance.

I do not use this schedule as a source for the nondeductible meals adjustment. It is the same amount as on the M-1, but there may be additional nondeductible items there.

Page #s are from full manual.

EXCERPT FROM THE MANUAL:

BEYOND THE 1040:

# **CORPORATION PARTNERSHIP & LLC RETURNS**

S Corporations

Form	1040	Department of the Treasury—Internal Revenue Service (99)	2014	OMB No. 1545-0074	IRS Use Only—Do not write or staple in this space.																														
For the year Jan. 1–Dec. 31, 2014, or other tax year beginning _____, 2014, ending _____, 20																																			
Your first name and initial <b>Bill</b>					Your social security number <b>888-77-6666</b>																														
Last name <b>Bailey</b>					Spouse's social security number <b>666-77-8888</b>																														
If a joint return, spouse's first name and initial <b>Barnum Ann</b>					Last name <b>Bailey</b>																														
Home address (number and street). If you have a P.O. box, see instructions. <b>3 Ring Circle</b>					Apt. no. <b>▲</b> Make sure the SSN(s) above and on line 6c are correct.																														
City, town or post office, state, and ZIP code. If you have a foreign address, also complete spaces below (see instructions). <b>Bailey WA 98000</b>					<b>Presidential Election Campaign</b> Check here if you, or your spouse if filing jointly, want \$3 to go to this fund. Checking a box below will not change your tax or refund. <input type="checkbox"/> You <input type="checkbox"/> Spouse																														
Foreign country name		Foreign province/state/county		Foreign postal code																															
<b>Filing Status</b> 1 <input type="checkbox"/> Single 2 <input checked="" type="checkbox"/> Married filing jointly (even if only one had income) 3 <input type="checkbox"/> Married filing separately. Enter spouse's SSN above and full name here. ▶ 4 <input type="checkbox"/> Head of household (with qualifying person). (See instructions.) If the qualifying person is a child but not your dependent, enter this child's name here. ▶ 5 <input type="checkbox"/> Qualifying widow(er) with dependent child																																			
<b>Exemptions</b> 6a <input checked="" type="checkbox"/> Yourself. If someone can claim you as a dependent, do not check box 6a . . . . . b <input checked="" type="checkbox"/> Spouse . . . . .																																			
<table border="1" style="width:100%; border-collapse: collapse;"> <thead> <tr> <th colspan="2" style="text-align: left;">(1) Dependents:</th> <th style="text-align: center;">(2) Dependent's social security number</th> <th style="text-align: center;">(3) Dependent's relationship to you</th> <th style="text-align: center;">(4) <input checked="" type="checkbox"/> if child under age 17 qualifying for child tax credit (see instructions)</th> </tr> <tr> <th style="text-align: left;">(i) First name</th> <th style="text-align: left;">Last name</th> <th></th> <th></th> <th></th> </tr> </thead> <tbody> <tr> <td>Beatle</td> <td>Bailey</td> <td style="text-align: center;">789-45-6123</td> <td style="text-align: center;">Son</td> <td style="text-align: center;"><input checked="" type="checkbox"/></td> </tr> <tr> <td>Bee Bee</td> <td>Bailey</td> <td style="text-align: center;">321-54-6987</td> <td style="text-align: center;">Daughter</td> <td style="text-align: center;"><input checked="" type="checkbox"/></td> </tr> <tr> <td>Sparkle</td> <td>Bailey</td> <td style="text-align: center;">852-36-9741</td> <td style="text-align: center;">Daughter</td> <td style="text-align: center;"><input checked="" type="checkbox"/></td> </tr> <tr> <td colspan="2"></td> <td></td> <td></td> <td style="text-align: center;"><input type="checkbox"/></td> </tr> </tbody> </table>						(1) Dependents:		(2) Dependent's social security number	(3) Dependent's relationship to you	(4) <input checked="" type="checkbox"/> if child under age 17 qualifying for child tax credit (see instructions)	(i) First name	Last name				Beatle	Bailey	789-45-6123	Son	<input checked="" type="checkbox"/>	Bee Bee	Bailey	321-54-6987	Daughter	<input checked="" type="checkbox"/>	Sparkle	Bailey	852-36-9741	Daughter	<input checked="" type="checkbox"/>					<input type="checkbox"/>
(1) Dependents:		(2) Dependent's social security number	(3) Dependent's relationship to you	(4) <input checked="" type="checkbox"/> if child under age 17 qualifying for child tax credit (see instructions)																															
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Bee Bee	Bailey	321-54-6987	Daughter	<input checked="" type="checkbox"/>																															
Sparkle	Bailey	852-36-9741	Daughter	<input checked="" type="checkbox"/>																															
				<input type="checkbox"/>																															
If more than four dependents, see instructions and check here <input type="checkbox"/>					Boxes checked on 6a and 6b No. of children on 6c who: • lived with you <b>2</b> • did not live with you due to divorce or separation (see instructions) <b>3</b> Dependents on 6c not entered above Add numbers on lines above ▶ <b>5</b>																														
<b>d</b> Total number of exemptions claimed . . . . .																																			
<b>Income</b> 7 Wages, salaries, tips, etc. Attach Form(s) W-2 . . . . . <b>7</b> 48,600. 8a Taxable interest. Attach Schedule B if required . . . . . <b>8a</b> 1,861. b Tax-exempt interest. Do not include on line 8a . . . . . <b>8b</b> 9a Ordinary dividends. Attach Schedule B if required . . . . . <b>9a</b> b Qualified dividends . . . . . <b>9b</b> 10 Taxable refunds, credits, or offsets of state and local income taxes . . . . . <b>10</b> 11 Alimony received . . . . . <b>11</b> 12 Business income or (loss). Attach Schedule C or C-EZ . . . . . <b>12</b> 13 Capital gain or (loss). Attach Schedule D if required. If not required, check here <input type="checkbox"/> <b>13</b> 14 Other gains or (losses). Attach Form 4797 . . . . . <b>14</b> 15a IRA distributions . . . . . <b>15a</b> b Taxable amount . . . . . <b>15b</b> 16a Pensions and annuities <b>16a</b> b Taxable amount . . . . . <b>16b</b> 17 Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E <b>17</b> 122,733. 18 Farm income or (loss). Attach Schedule F . . . . . <b>18</b> 19 Unemployment compensation . . . . . <b>19</b> 20a Social security benefits <b>20a</b> b Taxable amount . . . . . <b>20b</b> 21 Other income. List type and amount . . . . . <b>21</b> 22 Combine the amounts in the far right column for lines 7 through 21. This is your total income ▶ <b>22</b> 173,194.																																			
<b>Adjusted Gross Income</b> 23 Educator expenses . . . . . <b>23</b> 24 Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106 or 2106-EZ <b>24</b> 25 Health savings account deduction. Attach Form 8889 . . . . . <b>25</b> 26 Moving expenses. Attach Form 3903 . . . . . <b>26</b> 27 Deductible part of self-employment tax. Attach Schedule SE . . . . . <b>27</b> 5,713. 28 Self-employed SEP, SIMPLE, and qualified plans . . . . . <b>28</b> 29 Self-employed health insurance deduction . . . . . <b>29</b> 30 Penalty on early withdrawal of savings . . . . . <b>30</b> 31a Alimony paid b Recipient's SSN ▶ <b>31a</b> 32 IRA deduction . . . . . <b>32</b> 33 Student loan interest deduction . . . . . <b>33</b> 34 Tuition and fees. Attach Form 8917 . . . . . <b>34</b> 35 Domestic production activities deduction. Attach Form 8903 <b>35</b> 36 Add lines 23 through 35 . . . . . <b>36</b> 5,713. 37 Subtract line 36 from line 22. This is your adjusted gross income . . . . . ▶ <b>37</b> 167,481.																																			

Attach Form(s) W-2 here. Also attach Forms W-2G and 1099-R if tax was withheld.

If you did not get a W-2, see instructions.

Form <b>W-2</b>	<b>Wage and Tax Statement</b> ▶ Keep for your records	<b>2014</b>
Name <u>Bill Bailey</u>		Social Security Number <u>888-77-6666</u>
<input type="checkbox"/> Spouse's W-2 <input type="checkbox"/> Do not transfer this W-2 to next year		Military: Complete <b>Part VI</b> on Page 2 below
<b>a</b> Employee's social security No . <u>888-77-6666</u> <b>b</b> Employer's ID number . . . . . <u>92-7778888</u> <b>c</b> Employer's name, address, and ZIP code <u>Bailey's Fisheries</u>  Street <u>123 Trout Lane</u> City <u>Bailey</u> State <u>WA</u> ZIP Code <u>98000</u> Foreign Country _____  <b>d</b> Control number . _____  <input checked="" type="checkbox"/> <b>Transfer employee information from the Federal Information Worksheet</b> <b>e</b> Employee's name First <u>Bill</u> M.I. _____ Last <u>Bailey</u> Suff. _____ <b>f</b> Employee's address and ZIP code Street <u>3 Ring Circle</u> City <u>Bailey</u> State <u>WA</u> ZIP Code <u>98000</u> Foreign Country _____	<b>1</b> Wages, tips, other compensation <u>48,600.00</u> <b>3</b> Social security wages <u>48,600.00</u> <b>5</b> Medicare wages and tips <u>48,600.00</u> <b>7</b> Social security tips _____ <b>9</b> _____ <b>11</b> Nonqualified plans _____ <b>12</b> Enter box 12 below _____ <b>13</b> <input type="checkbox"/> Statutory employee <input type="checkbox"/> Retirement plan <input type="checkbox"/> Third-party sick pay <b>14</b> Enter box 14 below <b>after</b> entering boxes 18, 19, and 20. <b>NOTE:</b> Enter box 15 <b>before</b> entering box 14.	<b>2</b> Federal income tax withheld <u>4,860.00</u> <b>4</b> Social security tax withheld <u>3,013.00</u> <b>6</b> Medicare tax withheld <u>705.00</u> <b>8</b> Allocated tips _____ <b>10</b> Dependent care benefits _____ Distributions from sect. 457 and nonqualified plans (Important, see Help) _____

**THE SHAREHOLDER'S 1040**

I have included the owner's 1040 first, to show you how they information from an S corporation flows into the 1040 of the owner.

The Baileys have an active interest in both a partnership and an S corporation. Their 1040 starts at left. I have included just a few of the relevant forms from that return. The worksheet packet has AGI method and Schedule Analysis method (SAM) worksheets completed for this return. If you are not 'in class', use the worksheets on pages 6 & 7. Follow along.

**To Do**

**Wages...**see W-2 Line 5 above. It is also \$48,600.

**AGI:** No adjustment.

**SAM:** Use the \$48,600.

**Interest...**circle and trace to Schedule B.

**Rentals, Partnerships, etc...**DO NOT use the number on the front page, Line 17. It is just a placemaker.

**AGI:** Subtract \$122,733 (you would add it back if it were a loss).

**SAM:** Enter zero.

**Both:** Circle the number and trace it to Schedule E on page 4-11.

**SE tax...**guidelines vary.

**AGI:** I made no adjustment.

**SAM:** I subtracted it. Your financial institution may do the opposite. Check your guidelines!



Page #s are from full manual.

**SCHEDULE B**  
(Form 1040A or 1040)

**Interest and Ordinary Dividends**

OMB No. 1545-0074

**2014**

Attachment  
Sequence No. **08**

Department of the Treasury  
Internal Revenue Service (99)

▶ Attach to Form 1040A or 1040.  
▶ Information about Schedule B and its instructions is at [www.irs.gov/scheduleb](http://www.irs.gov/scheduleb).

Name(s) shown on return

Your social security number

Bill & Barnum Ann Bailey

888-77-6666

**Part I**

**Interest**

**1** List name of payer. If any interest is from a seller-financed mortgage and the buyer used the property as a personal residence, see instructions on back and list this interest first. Also, show that buyer's social security number and address ▶

(See instructions on back and the instructions for Form 1040A, or Form 1040, line 8a.)

**Note.** If you received a Form 1099-INT, Form 1099-OID, or substitute statement from a brokerage firm, list the firm's name as the payer and enter the total interest shown on that

Our Favorite Bank  
Bailey Drug Store  
Bailey Fisheries

<< Might Say "K-1 Interest" or "Interest from a K-1".

Note: This software listed the name of the Partnership and S Corporation passing through the K-1 interest. Often, it will simply say "K-1 Interest" or even "Interest from a K-1". In either case, it is noncash in this 1040 and should not be included in recurring personal cashflow.  
  
If you cannot tell if it is K-1 pass-through or actual payments from a company, ask.

**Amount**

830.  
712.  
319.

**2** Add the amounts on line 1 . . . . .  
**3** Excludable interest on series EE and I U.S. savings bonds issued after 1989. Attach Form 8815 . . . . .

**2** 1,861.  
**3**

This Sch B lists the partnership and S Corporation but does not make it clear the interest is pass-through. Often the listing will say 'Interest from a K-1' or 'K-1 interest expense'.

We can confirm that on the K-1.

**LOW % OWNER:**

Exclude pass-through interest and dividends from cashflow. The owner did not receive this cash. You will determine their actual cashflow by using withdrawals and guaranteed payments from their K-1.

**HIGH % OWNER:**

**Choice one**...exclude pass-through interest/dividends from personal cashflow AND be sure to include it in the cashflow of the partnership or S corporation when you analyze the source entity.

**Choice two**... Include it in personal cashflow. After all, the owner does have access to it if a high enough %. If you do, though, then you cannot add it again when you do the 1065 or 1120S analysis. You'll find it there

on Schedule K. With this choice you cannot also use actual cashflow from a K-1.

**CASE STUDY:**

We'll use choice one. AGI method: Subtract the \$1031 interest (\$712 Drug Store and \$319 Fishery) from cashflow. Schedule Analysis method: Include the \$830 interest from the bank.

**TAX-EXEMPT INTEREST**

May be listed here but will always be listed on Page 1, Line 8b of the 1040. Use 1040, Line 8b as your source for tax-exempt interest.

The tax-exempt interest on Line 8b may include K-1 pass-through interest. We will be able to confirm that on the K-1 when we review it.

It will be important not to add tax-exempt interest at the partnership or S corporation level if you have already included the pass-through in the personal analysis.

Schedule E (Form 1040) 2014

Attachment Sequence No. **13**

Page **2**

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

Your social security number

Bill & Barnum Ann Bailey

888-77-6666

**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 from an at-risk activity for which any amount is not at risk, you must check the box in column (e) 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

28	(a) Name	(b) Enter P for partnership; S for S corporation	(c) Check if foreign partnership	(d) Employer identification number	(e) Check if any amount is not at risk
A	Bailey Drug Store	P	<input type="checkbox"/>	93-0000000	<input type="checkbox"/>
B	Bailey Fisheries	S	<input type="checkbox"/>	92-7778888	<input type="checkbox"/>
C			<input type="checkbox"/>		<input type="checkbox"/>
D			<input type="checkbox"/>		<input type="checkbox"/>

Passive Income and Loss		Nonpassive Income and Loss		
(f) Passive loss allowed (attach Form 8582 if required)	(g) Passive income from Schedule K-1	(h) Nonpassive losses from Schedule K-1	(i) Section 179 expense deduction from Form 4562	(j) Nonpassive income from Schedule K-1
A				125,225.
B		2,492.		
C				
D				
<b>29a</b>	<b>Totals</b>			125,225.
<b>b</b>	<b>Totals</b>		2,492.	
<b>30</b>	Add columns (g) and (j) of line 29a			125,225.
<b>31</b>	Add columns (f), (h), and (i) of line 29b			( 2,492. )
<b>32</b>	<b>Total partnership and S corporation income or (loss).</b> Combine lines 30 and 31. Enter the result here and include in the total on line 41 below			122,733.

**Part III Income or Loss From Other Partnerships and S Corporations**

**33**

A

B

(c) Passive deduction (attach Form 8582 if required)

A

B

**34a** Totals

**b** Totals

**35** Add columns (d)

**36** Add columns (c)

**37** Total estate and include in the total on line 41 below

**NONPASSIVE = Business income of active general partner or active S-Corporation shareholder or active LLC Member (Member-Manager)**

While your guidelines are likely to require that you review all K-1 information, my guess is that in general the greater likelihood of income or risk of loss is on the nonpassive side.

**PASSIVE = Business/investment income if owner isn't active**

Includes Limited Partners and can include LLC Members/SCorp shareholders. Generally not guarantors of debt (although they could be) and therefore losses limited to investment in the activity.

Passive losses can be misleading, since the real loss may be greater than the deductible loss due to passive loss limitations.

The K-1s least likely to be significant are small passive gains from RE and Oil & Gas investments. One of my clients has a guideline that allows ignoring income from any K-1 representing less than 10% of cashflow. (They still subtract the paper loss, though.)

**Part IV Income or Loss From Other Partnerships and S Corporations**

**38** (a) Name

**39** Combine column (a) and (b) and include in the total on line 41 below

**Part V Summary**

**40** Net farm rental income or (loss) from Form 4835. Also, complete line 42 below **40**

**41** Total income or (loss). Combine lines 26, 32, 37, 39, and 40. Enter the result here and on Form 1040, line 17, or Form 1040NR, line 18 **41** 122,733.

**42** Reconciliation of farming and fishing income. Enter your gross farming and fishing income reported on Form 4835, line 7; Schedule K-1 (Form 1065), box 14, code B; Schedule K-1 (Form 1120S), box 17, code V; and Schedule K-1 (Form 1041), box 14, code F (see instructions) **42**

Form 1120S

U.S. Income Tax Return for an S Corporation

OMB No. 1545-0123

Department of the Treasury Internal Revenue Service

Do not file this form unless the corporation has filed or is attaching Form 2553 to elect to be an S corporation. Information about Form 1120S and its separate instructions is at www.irs.gov/form1120s.

2014

For calendar year 2014 or tax year beginning 01/01/14, 2014, ending 12/31/14

Header section containing: A S election effective date (01/01/94), B Business activity code number (811111), C Check if Schedule M-3 attached, D Employer identification number (92-7778888), E Date incorporated (07/07/86), F Total assets (317,894), TYPE OR PRINT Name (Bailey's Fisheries), Number, street, and room or suite no. (123 Trout Lane), City or town, state or province, country, and ZIP or foreign postal code (Bailey WA 98000).

G Is the corporation electing to be an S corporation beginning with this tax year? Yes No [X] If 'Yes,' attach Form 2553 if not already filed

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

I Enter the number of shareholders who were shareholders during any part of the tax year 2

Caution. Include only trade or business income and expenses on lines 1a through 21. See the instructions for more information.

Table with columns for line numbers, descriptions, and amounts. Rows include: 1a Gross receipts or sales (1,013,619), 1b Returns and allowances, 1c Balance (1,013,619), 2 Cost of goods sold (738,408), 3 Gross profit (275,211), 4 Net gain (loss), 5 Other income (loss), 6 Total income (loss) (275,211), 7 Compensation of officers (48,600), 8 Salaries and wages (16,200), 9 Repairs and maintenance (52,058), 10 Bad debts, 11 Rents (21,492), 12 Taxes and licenses (13,534), 13 Interest (20,262), 14 Depreciation (40,819), 15 Depletion, 16 Advertising (405), 17 Pension, profit-sharing, etc, plans, 18 Employee benefit programs, 19 Other deductions (64,956), 20 Total deductions (278,326), 21 Ordinary business income (loss) (-3,115).

Table with columns for line numbers, descriptions, and amounts. Rows include: 22a Excess net passive income or LIFO recapture, 22b Tax from Schedule D, 22c Add lines 22a and 22b, 23a 2014 estimated tax payments and 2013 overpayment credited to 2014, 23b Tax deposited with Form 7004, 23c Credit for federal tax paid on fuels, 23d Add lines 23a through 23c, 24 Estimated tax penalty, 25 Amount owed, 26 Overpayment, 27 Enter amount from line 26 Credited to 2015 estimated tax Refunded.

Sign Here section containing: Signature of officer (I.R. Ess, CPA), Date, Title (President), and a box for 'May the IRS discuss this return with the preparer shown below?' with Yes/No options.



The front page of the 1120S is similar to the Schedule C/F and the front pages of the 1065 and the 1120.

### THE SAME ANALYSIS APPLIES:

- Is it a significant source of income or risk for the borrower?
- Consider type of business, gross receipts and total wages to get a feel for the business. What kind of equipment do they have, how old, how much? How long have they been in business?
- Does the corporation generate enough cashflow from operations to service debt?

### Overview

This only takes a few minutes and gives a quick thumbnail sketch of the business.

**Pg 2 Sch B Ln 1** If cash basis, be careful drawing conclusions from comparison of years.

**Pg 2 Sch B Ln 2** Type of business?

**Pg 1 Top** Fiscal or calendar year

**Pg 1 Box A** Date of S Corp election. Helps to see if initial return is full yr.

**Pg 1 Box E** Date incorporated

**Pg 1 Ln G/H** Final return... They may have changed entity type. If so, you may be looking at a partial year and they are still in business.

**Pg 1 Ln I** # of shareholders

**Pg 1 Ln 1c** Gross receipts

**Pg 1 Ln 7** Compensation of officers

**Pg 1 Ln 8** Salaries & wages

**Form 1125-A Ln 3** Cost of Labor

**Pg 1 Ln 11** How much are the rents?

**Pg 1 Ln 13** Interest (need debts...for this case study we will use the shortcut described at right.)

**Pg 1 Ln 14** Depreciation...Review equipment list if attached for size/scope of business and if they are replacing as a healthy business would be.

### Source of Adjustments:

1. Page One
2. Other Deductions Sch [Ln 19]
3. Sch K [Lns 2-11a]
4. Sch M-1 [Lns 3 & 5]
5. Sch M-2 [Commercial only]

### General Cashflow Formula:

Start	Line 21	Ordinary Income
Add	Line 13	Interest <sup>^</sup>
Minus	Borrower	Loan Payments* <sup>^</sup>
Plus	Line 14	Depreciation

Business-only analysis:

Minus	M-2, Line 7	Distributions
-------	-------------	---------------

### <sup>^</sup> Shortcut for debt... Two choices:

1) To estimate debt after adding back interest:

Page 1	Line 13 Interest	_____
Sch L	Line 17, Col (d)	+ _____
	ESTIMATED DEBT PMTS	= _____

2) OR Do not add back interest and subtract principal (Schedule L, Line 17, Column d).

**\* Debt Coverage: Do not subtract debt.**

### Additional Line-by-Line Instructions:

- 1a. Compare to prior years.
2. Compare COGS% to prior years.
4. G/L disposal of assets or business casualty loss. If casualty loss, impact on cashflow? Insurance?
9. Decline could mean cashflow problems or new equipment.
10. Bad debts. Accrual basis only. If significant & nonrecurring, consider if it is noncash or nonrecurring?
12. Enough? (10-40% of Line 7)
13. Add back interest and subtract loan payments.
14. Add back depreciation.
17. Add back if optional.
19. Trace to supporting schedule.

Schedule B Other Information (see instructions)					Yes	No
1 Check accounting method: a <input checked="" type="checkbox"/> Cash b <input type="checkbox"/> Accrual c <input type="checkbox"/> Other (specify) ▶ _____						
2 See the instructions and enter the:						
a Business activity. ▶ <u>Commercial Fishing</u> b Product or service. ▶ <u>Seafood</u>						
3 At any time during the tax year, was any shareholder of the corporation a disregarded entity, a trust, an estate, or a nominee or similar person? If "Yes," attach Schedule B-1, Information on Certain Shareholders of an S Corporation . . . . .						X
4 At the end of the tax year, did the corporation:						
a Own directly 20% or more, or own, directly or indirectly, 50% or more of the total stock issued and outstanding of any foreign or domestic corporation? For rules of constructive ownership, see instructions. If "Yes," complete (i) through (v) below . . . . .						X
(i) Name of Corporation	(ii) Employer Identification Number (if any)	(iii) Country of Incorporation	(iv) Percentage of Stock Owned	(v) If Percentage in (iv) is 100%, Enter the Date (if any) a Qualified Subchapter S Subsidiary Election Was Made		
b Own directly an interest of 20% or more, or own, directly or indirectly, an interest of 50% or more in the profit, loss, or capital in any foreign or domestic partnership (including an entity treated as a partnership) or in the beneficial interest of a trust? For rules of constructive ownership, see instructions. If "Yes," complete (i) through (v) below . . . . .						X
(i) Name of Entity	(ii) Employer Identification Number (if any)	(iii) Type of Entity	(iv) Country of Organization	(v) Maximum % Owned in Profit, Loss, or Capital		
5a At the end of the tax year, did the corporation have any outstanding shares of restricted stock? . . . . .						X
If "Yes," complete lines (i) and (ii) below.						
(i) Total shares of restricted stock . . . . . ▶ _____						
(ii) Total shares of non-restricted stock . . . . . ▶ _____						
b At the end of the tax year, did the corporation have any outstanding stock options, warrants, or similar instruments? . . . . .						X
If "Yes," complete lines (i) and (ii) below.						
(i) Total shares of stock outstanding at the end of the tax year . . . . . ▶ _____						
(ii) Total shares of stock outstanding if all instruments were executed . . . . . ▶ _____						
6 Has this corporation filed, or is it required to file, Form 8918, Material Advisor Disclosure Statement, to provide information on any reportable transaction? . . . . .						X
7 Check this box if the corporation issued publicly offered debt instruments with original issue discount . . . . . <input type="checkbox"/>						
If checked, the corporation may have to file Form 8281, Information Return for Publicly Offered Original Issue Discount Instruments.						
8 If the corporation: (a) was a C corporation before it elected to be an S corporation or the corporation acquired an asset with a basis determined by reference to the basis of the asset (or the basis of any other property) in the hands of a C corporation and (b) has net unrealized built-in gain in excess of the net recognized built-in gain from prior years, enter the net unrealized built-in gain reduced by net recognized built-in gain from prior years (see instructions) . . . . . ▶ \$ _____						
9 Enter the accumulated earnings and profits of the corporation at the end of the tax year. . . . . \$ _____						
10 Does the corporation satisfy both of the following conditions?						
a The corporation's total receipts (see instructions) for the tax year were less than \$250,000 . . . . .						
b The corporation's total assets at the end of the tax year were less than \$250,000 . . . . .						X
If "Yes," the corporation is not required to complete Schedules L and M-1.						
11 During the tax year, did the corporation have any non-shareholder debt that was canceled, was forgiven, or had the terms modified so as to reduce the principal amount of the debt? . . . . .						X
If "Yes," enter the amount of principal reduction \$ _____						
12 During the tax year, was a qualified subchapter S subsidiary election terminated or revoked? If "Yes," see instructions . . . . .						X
13 a Did the corporation make any payments in 2014 that would require it to file Form(s) 1099? . . . . .					X	
b If "Yes," did the corporation file or will it file required Forms 1099? . . . . .					X	

**SCHEDULE A: COST OF GOODS SOLD**

You must be looking at a 2010 or prior tax return. What used to be Schedule A at the top of page two is now Form 1125-A. (See page 24 of Section 4).

**SCHEDULE B: OTHER INFORMATION**

Only five of the 13 items are usually of interest.

**Item 1:** Cash basis means that income is recognized when received and expenses are recognized when paid. This is very close to what is happening in their checkbook, but may not accurately reflect how much their business activity earned them during the year.

For example, if a cash basis company receives deposits on contracts in December, but does the work in January, the earlier year income will be overstated and the later year will be understated.

The biggest problem with this is if the lender thinks the business is declining and has concerns about it.

Before you draw conclusions about declining or growing businesses, check Schedule B, Line 1. If it is cash basis, you cannot draw a conclusion.

**Item 2:** Type of business.

**Item 4:** If this company owns part of another company, consider if you need to get the tax return of the additional entity. How does this impact your global cashflow calculation?

**Item 10:** If total receipts and assets are less than \$250,000 you may not have a Schedule L (used for the debt shortcut) or an M-1 (used for nondeductible expenses and nontaxed income).

**Item 11:** I love this question. If the answer is yes, you have some questions.

**SCHEDULE K: SHAREHOLDERS'****PRO RATA SHARE ITEMS**

Prior to 2012, Schedule K started at the bottom of Page two for the 1120S. It has now moved to the top of page three.

Schedule K-1 (Form 1120S)

Department of the Treasury Internal Revenue Service

2014

Final K-1

Amended K-1

671113

OMB No. 1545-0123

For calendar year 2014, or tax year beginning ending

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

Part I Information About the Corporation

A Corporation's employer identification number 92-7778888
B Corporation's name, address, city, state, and ZIP code Bailey's Fisheries 123 Trout Lane Bailey, WA 98000
C IRS Center where corporation filed return Ogden, UT 84201-0013

Part II Information About the Shareholder

D Shareholder's identifying number 888-77-6666
E Shareholder's name, address, city, state, and ZIP code Bill Bailey 747 Stone Ave Bailey, WA 98000
F Shareholder's percentage of stock ownership for tax year 80.00000%

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

Table with 4 columns: Line number, Description, Column number, and Amount. Includes rows for Ordinary business income (loss), Net rental real estate income (loss), Other net rental income (loss), Interest income, Ordinary dividends, Qualified dividends, Foreign transactions, Royalties, Net short-term capital gain (loss), Net long-term capital gain (loss), Collectibles (28%) gain (loss), Unrecaptured section 1250 gain, Net section 1231 gain (loss), Other income (loss), Alternative minimum tax (AMT) items, Section 179 deduction, Items affecting shareholder basis, Other deductions, and Other information.

FOR IRS USE ONLY

Line 16 D: Distributions (both cash and property).
Line 16 E: Repayment of Loans from Shareholders

\*See attached statement for additional information.

<p><b>3 Owner net rental income (loss)</b>                  Net income                  Net loss</p> <p><b>4 Interest income</b></p> <p><b>5 a Ordinary dividends</b></p> <p><b>5 b Qualified dividends</b></p> <p><b>6 Royalties</b></p> <p><b>7 Net short-term capital gain (loss)</b></p> <p><b>8 a Net long-term capital gain (loss)</b></p> <p><b>8 b Collectibles (28%) gain (loss)</b></p> <p><b>8 c Unrecaptured section 1250 gain</b></p> <p><b>9 Net section 1231 gain (loss)</b></p> <p><b>10 Other income (loss)</b>                  Code</p> <p><b>A</b> Other portfolio income (loss)</p> <p><b>B</b> Involuntary conversions</p> <p><b>C</b> Sec. 1256 contracts and straddles</p> <p><b>D</b> Mining exploration costs recapture</p> <p><b>E</b> Other income (loss)</p> <p><b>11 Section 179 deduction</b></p> <p><b>12 Other deductions</b></p> <p><b>A</b> Cash contributions (50%)</p> <p><b>B</b> Cash contributions (30%)</p> <p><b>C</b> Noncash contributions (50%)</p> <p><b>D</b> Noncash contributions (30%)</p> <p><b>E</b> Capital gain property to a 50% organization (30%)</p> <p><b>F</b> Capital gain property (20%)</p> <p><b>G</b> Contributions (100%)</p> <p><b>H</b> Investment interest expense</p> <p><b>I</b> Deductions — royalty income</p> <p><b>J</b> Section 59(e)(2) expenditures</p> <p><b>K</b> Deductions — portfolio (2% floor)</p> <p><b>L</b> Deductions — portfolio (other)</p> <p><b>M</b> Preproductive period expenses</p>	<p>Schedule E, line 28, column (g)</p> <p>See the Shareholder's Instructions</p> <p>Form 1040, line 8a</p> <p>Form 1040, line 9a</p> <p>Form 1040, line 9b</p> <p>Schedule E, line 4</p> <p>Schedule D, line 5</p> <p>Schedule D, line 12</p> <p>28% Rate Gain Worksheet, line 4 (Schedule D instructions)</p> <p>See the Shareholder's Instructions</p> <p>See the Shareholder's Instructions</p> <p>See the Shareholder's Instructions</p> <p>See the Shareholder's Instructions</p> <p>Form 4952, line 1</p> <p>Schedule E, line 19</p> <p>See the Shareholder's Instructions</p> <p>Schedule A, line 23</p> <p>Schedule A, line 28</p> <p>See the Shareholder's Instructions</p>	<p><b>4 Gross income from all sources</b></p> <p><b>C</b> Gross income sourced at shareholder level</p> <p><b>Foreign gross income sourced at corporate level</b></p> <p><b>D</b> Passive category</p> <p><b>E</b> General category</p> <p><b>F</b> Other</p> <p><b>Deductions allocated and apportioned at shareholder level</b></p> <p><b>G</b> Interest expense</p> <p><b>H</b> Other</p> <p><b>Deductions allocated and apportioned at corporate level to foreign source income</b></p> <p><b>I</b> Passive category</p> <p><b>J</b> General category</p> <p><b>K</b> Other</p> <p><b>Other information</b></p> <p><b>L</b> Total foreign taxes paid</p> <p><b>M</b> Total foreign taxes accrued</p> <p><b>N</b> Reduction in taxes available for credit</p> <p><b>O</b> Foreign trading gross receipts</p> <p><b>P</b> Extraterritorial income exclusion</p> <p><b>Q</b> Other foreign transactions</p> <p><b>15 Alternative minimum tax (AMT) items</b></p> <p><b>A</b> Post-1986 depreciation adjustment</p> <p><b>B</b> Adjusted gain or loss</p> <p><b>C</b> Depletion (other than oil &amp; gas)</p> <p><b>D</b> Oil, gas, &amp; geothermal — gross income</p> <p><b>E</b> Oil, gas, &amp; geothermal — deductions</p> <p><b>F</b> Other AMT items</p> <p><b>16 Items affecting shareholder basis</b></p> <p><b>A</b> Tax-exempt interest income</p> <p><b>B</b> Other tax-exempt income</p> <p><b>C</b> Nondeductible expenses</p> <p><b>D</b> Distributions</p> <p><b>E</b> Repayment of loans from shareholders</p> <p><b>17 Other information</b></p> <p><b>A</b> Investment income</p>	<p>Form 1116, Part I</p> <p>Form 1116, Part I</p> <p>Form 1116, Part I</p> <p>Form 1116, Part I</p> <p>Form 1116, Part II</p> <p>Form 1116, Part II</p> <p>Form 1116, line 12</p> <p>Form 8873</p> <p>Form 8873</p> <p>See the Shareholder's Instructions</p> <p>See the Shareholder's Instructions and the Instructions for Form 6251</p> <p>Form 1040, line 8b</p> <p>See the Shareholder's Instructions</p> <p>Form 4952 line 4a</p>
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**SCHEDULE K-1: SHAREHOLDER'S SHARE**

This is part of the 1120S, not the 1040. It is similar to the 1065 K-1 and passes thru items of Income, Credits, and Deductions to the owner while retaining their character.

**Question F:**

Look here to determine if your borrower/ shareholder has enough % ownership to require review of the full 1120S.

**Top of right column:**

Notice if this is the final K-1. If so this is not continuing cashflow.

**Line 16, Code D:**

Distributions of cash in addition to wages are often significant and continuing. They may be taking some

compensation as distributions instead of wages to minimize payroll taxes. This may be property.

**Line 16, Code E:**

This is repayment of loans to shareholders. It represents cashflow from the company to the owner.

Some lenders consider that when the loan is paid off, the company may simply shift from loan repayment to distributions, especially with a 100% owner.

**WHERE DID IT GO?**

The next page (back of the K-1) is your cheat sheet for where these entries end up on a 1040.

See also the Bailey's 1040 on pages 4-8 through 4-11. Finally, the K-1 could flow into a Partnership (1065) , a corporation (1120) or another S Corporation (1120S).

# Next Steps:

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### Ask Linda

She'll always answer. Give her a week to get back to you, because she is likely on the road helping lenders say 'yes' to good loans.

"I love the step-by-step approach of your manuals. you take the numbers and explain **what** they are, **why** you use them or not, **what schedule you look** at to find the details of where than number came from and **how** they tie into the overall cash flow analysis."

**Dorothy Wenker, Commercial Lender**  
**MidSouth Bank**

It's great to work **at my own pace** since the course allows you to **stop, review, and go back** over items you may not have understood the first time around. A very helpful feature!

**Linda Wiley, Pacific Western Bank**

"Linda has been extremely helpful with various questions I have had over the years. If I am ever stumped on a question in regards to cash flow, I am confident I can go to her and will receive an accurate, prompt and friendly response. Linda is a fantastic resource to have."

**Ryan Earl, Senior Credit Analyst**  
**Heritage Bank**

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