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

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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 It also does not represent cash actually withdrawn by the owner.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:**

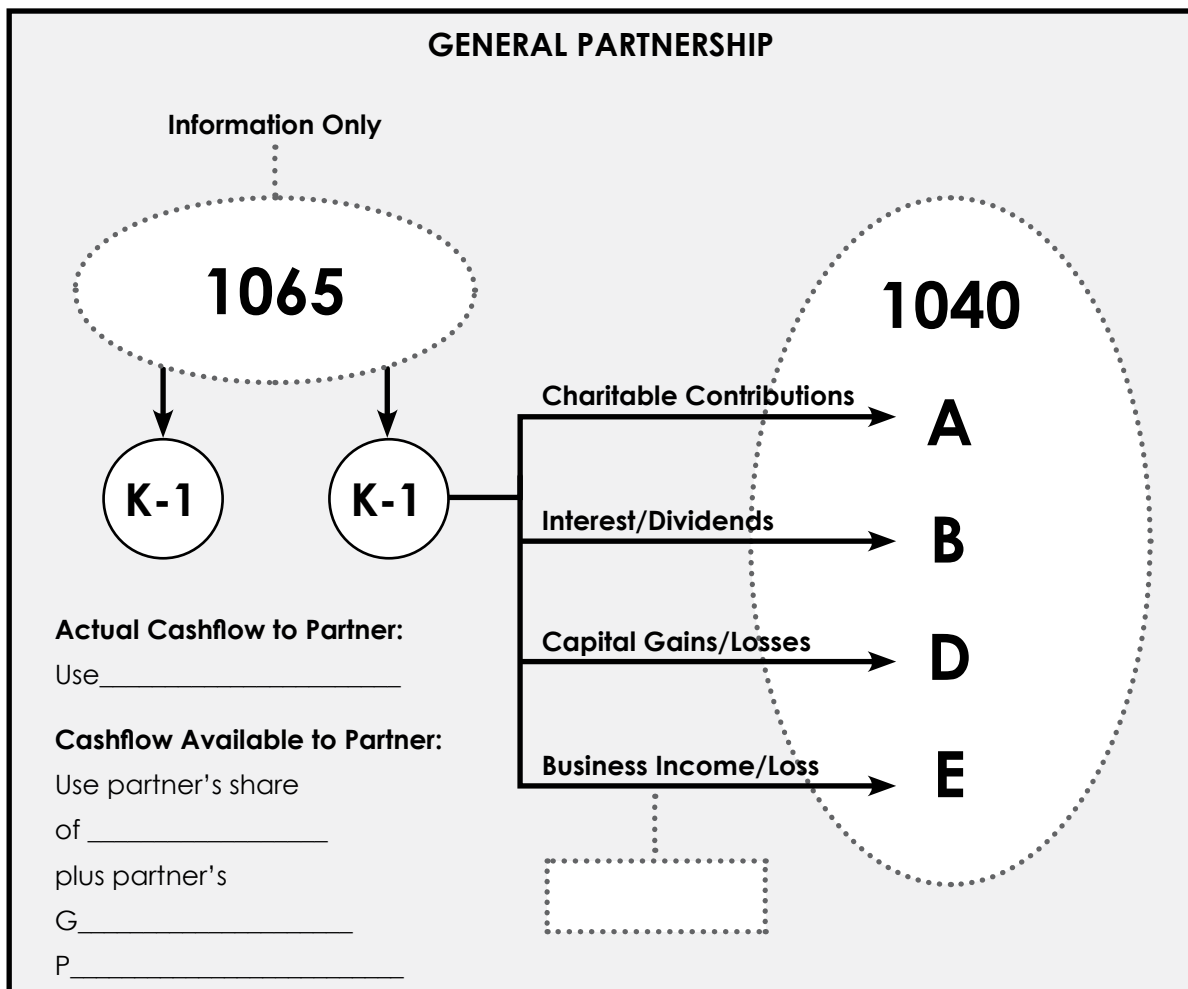
Your primary interest is whether the cashflow from operations is sufficient to adequately service current and proposed debt. Equally important is whether the business appears to be healthy. Watch for major changes or a shift from a stable to a fast-growing or declining business.

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 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**

S Corporations

Page #s are from full manual.

Form <b>1040</b> Department of the Treasury—Internal Revenue Service (99)		U.S. Individual Income Tax Return		OMB No. 1545-0074	IRS Use Only—Do not write or staple in this space.
For the year Jan. 1–Dec. 31, other tax year beginning ending				See separate instructions.	
Your first name and initial Bill		Last name Bailey		Your social security number 888-77-6666	
If a joint return, spouse's first name and initial Barnum Ann		Last name Bailey		Spouse's social security number 666-77-8888	
Home address (number and street). If you have a P.O. box, see instructions. 3 Ring Circle				Apt. no.	▲ 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). Bailey WA 98000				Presidential Election Campaign	
Foreign country name		Foreign province/state/county		Foreign postal code	
				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	
<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) (see instructions)					
<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 . . . . .					
c Dependents:					
(1) First name		(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)
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"/>
d Total number of exemptions claimed . . . . .					
7 48,600.					
<b>Income</b>					
7 Wages, salaries, tips, etc. Attach Form(s) W-2 . . . . .					
8a Taxable interest. Attach Schedule B if required . . . . .					
8a 1,861.					
b Tax-exempt interest. Do not include on line 8a . . . . .					
8b					
9a Ordinary dividends. Attach Schedule B if required . . . . .					
9a					
b Qualified dividends . . . . .					
9b					
10 Taxable refunds, credits, or offsets of state and local income taxes . . . . .					
10					
11 Alimony received . . . . .					
11					
12 Business income or (loss). Attach Schedule C or C-EZ . . . . .					
12					
13 Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶ <input type="checkbox"/>					
13					
14 Other gains or (losses). Attach Form 4797 . . . . .					
14					
15a IRA distributions . . . . .					
15a					
b Taxable amount . . . . .					
15b					
16a Pensions and annuities . . . . .					
16a					
b Taxable amount . . . . .					
16b					
17 Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E . . . . .					
17 122,733.					
18 Farm income or (loss). Attach Schedule F . . . . .					
18					
19 Unemployment compensation . . . . .					
19					
20a Social security benefits . . . . .					
20a					
b Taxable amount . . . . .					
20b					
21 Other income. List type and amount . . . . .					
21					
22 Combine the amounts in the far right column for lines 7 through 21. This is your total income ▶					
22 173,194.					
<b>Adjusted Gross Income</b>					
23 Educator expenses . . . . .					
23					
24 Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106 or 2106-EZ . . . . .					
24					
25 Health savings account deduction. Attach Form 8889 . . . . .					
25					
26 Moving expenses. Attach Form 3903 . . . . .					
26					
27 Deductible part of self-employment tax. Attach Schedule SE . . . . .					
27 5,713.					
28 Self-employed SEP, SIMPLE, and qualified plans . . . . .					
28					
29 Self-employed health insurance deduction . . . . .					
29					
30 Penalty on early withdrawal of savings . . . . .					
30					
31a Alimony paid b Recipient's SSN ▶					
31a					
32 IRA deduction . . . . .					
32					
33 Student loan interest deduction . . . . .					
33					
34 Reserved for future use . . . . .					
34					
35 Domestic production activities deduction. Attach Form 8903 . . . . .					
35					
36 Add lines 23 through 35 . . . . .					
36 5,713.					
37 Subtract line 36 from line 22. This is your adjusted gross income ▶					
37 167,481.					

Form <b>W-2</b>	<b>Wage and Tax Statement</b> ▶ Keep for your records	
Name Bill Bailey		Social Security Number 888-77-6666
<input type="checkbox"/> <b>Spouse's W-2</b> <input type="checkbox"/> <b>Do not transfer this W-2 to next year</b>		<b>Military:</b> Complete <b>Part VI</b> on Page 2 below
<b>a</b> Employee's social security No . _____ <b>b</b> Employer's ID number . . . . . 92-7778888 <b>c</b> Employer's name, address, and ZIP code Bailey's Fisheries  Street 123 Trout Lane City Bailey State WA ZIP Code 98000  Foreign Province _____ Foreign Postal Code _____ Foreign Country _____  <b>d</b> Control number _____  <input type="checkbox"/> <b>Transfer employee information from the Federal Information Worksheet</b> <b>e</b> Employee's name First _____ M.I. _____ Last _____ Suff. _____ <b>f</b> Employee's address and ZIP code Street _____ City _____ State _____ ZIP Code _____ Foreign Province _____	<b>1</b> Wages, tips, other compensation 48,600.00 <b>3</b> Social security wages 48,600.00 <b>5</b> Medicare wages and tips 48,600.00 <b>7</b> Social security tips _____ ▶ Enter unreported tips in Part VII on Page 2 below.  Verification Code _____  <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 4,860.00 <b>4</b> Social security tax withheld 3,013.00 <b>6</b> Medicare tax withheld 705.00 <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!

SCHEDULE B (Form 1040A or 1040)		Interest and Ordinary Dividends		OMB No. 1545-0074
Department of the Treasury Internal Revenue Service (99)		<p>► Attach to Form 1040A or 1040.</p> <p>► Go to <a href="http://www.irs.gov/ScheduleB">www.irs.gov/ScheduleB</a> for instructions and the latest information.</p>		
Name(s) shown on return Bill & Barnum Ann Bailey		Your social security number 888-77-6666		
<b>Part I</b>	<b>1</b>	List name of payer. If any interest is from a seller-financed mortgage and the buyer used the property as a personal residence, see the instructions and list this interest first. Also, show that buyer's social security number and address ►	<b>Amount</b>	
<b>Interest</b>  (See instructions and the instructions for Form 1040A, or Form 1040, line 8a.)  <b>Note:</b> 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 form.		Our Favorite Bank	830.	
		Bailey Drug Stores	712.	
		Bailey Fisheries	319.	
		<< Might Say "K-1 Interest" or "Interest from a K-1".		
		<p>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.</p> <p>If you cannot tell if it is K-1 pass-through or actual payments from a company, ask.</p>		
	<b>2</b>	Add the amounts on line 1 . . . . .	<b>2</b>	1,861.
	<b>3</b>	Excludable interest on series EE and I U.S. savings bonds issued after 1989. Attach Form 8815 . . . . .	<b>3</b>	

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)

Attachment Sequence No. **13**Page **2**

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

Bill &amp; Barnum Ann Bailey

Your social security number

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"/>	93-0000001	<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 loss 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					
29a Totals					125,225.
b Totals			2,492.		
30 Add columns (g) and (j) of line 29a.					125,225.
31 Add columns (f), (h), and (i) of line 29b.					( 2,492. )
32 Total partnership and S corporation income or (loss). Combine lines 30 and 31. Enter the result here and on Form 1040, line 17, or Form 1040NR, line 18.					22,733.

**Part III Income****33****A****B**

(c) Passive deduction (attach Form 8582)

**A****B****34a Totals****b Totals****35 Add columns (c) and (d) of line 34a.****36 Add columns (c) and (d) of line 34b.****37 Total estate and trust income or (loss). Include the result from line 36.****Part IV Income****38 (a) Name****39 Combine columns (a) and (b) of line 38.****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	

**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 &amp; 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.)

Form <b>1120S</b>		U.S. Income Tax Return for an S Corporation		OMB No. 1545-0123	
Department of the Treasury Internal Revenue Service		<p>▶ Do not file this form unless the corporation has filed or is attaching Form 2553 to elect to be an S corporation.</p> <p>▶ Go to <a href="http://www.irs.gov/Form1120S">www.irs.gov/Form1120S</a> for instructions and the latest information.</p>			
For calendar year		or tax year beginning		, ending , 20	
<b>A</b> S election effective date 01/01/1995		<b>TYPE</b> Name Bailey's Fisheries		<b>D</b> Employer identification number 92-7778888	
<b>B</b> Business activity code number (see instructions) 811111		<b>OR</b> Number, street, and room or suite no. If a P.O. box, see instructions. 123 Trout Lane		<b>E</b> Date incorporated 07/07/1987	
<b>C</b> Check if Sch. M-3 attached <input type="checkbox"/>		<b>PRINT</b> City or town, state or province, country, and ZIP or foreign postal code Bailey WA 98000		<b>F</b> Total assets (see instructions) \$ 317,894.	
<b>G</b> Is the corporation electing to be an S corporation beginning with this tax year? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No If "Yes," attach Form 2553 if not already filed					
<b>H</b> Check if: (1) <input type="checkbox"/> Final return (2) <input type="checkbox"/> Name change (3) <input type="checkbox"/> Address change (4) <input type="checkbox"/> Amended return (5) <input type="checkbox"/> S election termination or revocation					
<b>I</b> Enter the number of shareholders who were shareholders during any part of the tax year . . . . . ▶ 2					
<b>Caution:</b> Include <b>only</b> trade or business income and expenses on lines 1a through 21. See the instructions for more information.					
<b>Income</b>					
1a Gross receipts or sales . . . . .		1a		1,013,619.	
b Returns and allowances . . . . .		1b			
c Balance. Subtract line 1b from line 1a . . . . .		1c		1,013,619.	
2 Cost of goods sold (attach Form 1125-A) . . . . .		2		738,408.	
3 Gross profit. Subtract line 2 from line 1c . . . . .		3		275,211.	
4 Net gain (loss) from Form 4797, line 17 (attach Form 4797) . . . . .		4			
5 Other income (loss) (see instructions—attach statement) . . . . .		5			
6 <b>Total income (loss).</b> Add lines 3 through 5 . . . . . ▶		6		275,211.	
<b>Deductions</b> (see instructions for limitations)					
7 Compensation of officers (see instructions—attach Form 1125-E) . . . . .		7		48,600.	
8 Salaries and wages (less employment credits) . . . . .		8		16,200.	
9 Repairs and maintenance . . . . .		9		52,058.	
10 Bad debts . . . . .		10			
11 Rents . . . . .		11		21,492.	
12 Taxes and licenses . . . . .		12		13,534.	
13 Interest . . . . .		13		20,262.	
14 Depreciation not claimed on Form 1125-A or elsewhere on return . . . . .		14		40,819.	
15 Depletion ( <b>Do not deduct oil and gas depletion.</b> ) . . . . .		15			
16 Advertising . . . . .		16		405.	
17 Pension, profit-sharing, etc., plans . . . . .		17			
18 Employee benefit programs . . . . .		18			
19 Other deductions (attach statement) . . . . .		19		64,956.	
20 <b>Total deductions.</b> Add lines 7 through 19 . . . . . ▶		20		278,326.	
21 <b>Ordinary business income (loss).</b> Subtract line 20 from line 6 . . . . .		21		-3,115.	
<b>Tax and Payments</b>					
22a Excess net passive income or LIFO recapture tax (see instructions) . . . . .		22a			
b Tax from Schedule D (Form 1120S) . . . . .		22b			
c Add lines 22a and 22b (see instructions for additional taxes) . . . . .		22c			
23a 2017 estimated tax payments and 2016 overpayment credited to 2017 . . . . .		23a			
b Tax deposited with Form 7004 . . . . .		23b			
c Credit for federal tax paid on fuels (attach Form 4136) . . . . .		23c			
d Add lines 23a through 23c . . . . .		23d			
24 Estimated tax penalty (see instructions). Check if Form 2220 is attached . . . . . <input type="checkbox"/>		24			
25 <b>Amount owed.</b> If line 23d is smaller than the total of lines 22c and 24, enter amount owed . . . . .		25			
26 <b>Overpayment.</b> If line 23d is larger than the total of lines 22c and 24, enter amount overpaid . . . . .		26			
27 Enter amount from line 26 <b>Credited to 2018 estimated tax</b> ▶ <b>Refunded</b> ▶		27			
<b>Sign Here</b> 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 _____ President _____ Title _____ May the IRS discuss this return with the preparer shown below (see instructions)? <input type="checkbox"/> Yes <input type="checkbox"/> No					
<b>Paid Preparer Use Only</b> Print/Type preparer's name _____ Preparer's signature _____ Date _____ Firm's name ▶ I.R. Ess, CPA Firm's address ▶ 123 Lane Street, Everytown MI 11223 Check <input type="checkbox"/> if self-employed PTIN _____ Firm's EIN ▶ 99-9999999 Phone no. (123) 456-7890					

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.



Form 1120S

Page **2****Schedule B Other Information** (see instructions)

	Yes	No		
<b>1</b> Check accounting method: <b>a</b> <input checked="" type="checkbox"/> Cash <b>b</b> <input type="checkbox"/> Accrual <b>c</b> <input type="checkbox"/> Other (specify) ▶ _____				
<b>2</b> See the instructions and enter the: <b>a</b> Business activity ▶ <u>Commercial Fishing</u> <b>b</b> Product or service ▶ <u>Seafood</u>				
<b>3</b> 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		
<b>4</b> At the end of the tax year, did the corporation: <b>a</b> 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		
<b>(i)</b> Name of Corporation	<b>(ii)</b> Employer Identification Number (if any)	<b>(iii)</b> Country of Incorporation	<b>(iv)</b> Percentage of Stock Owned	<b>(v)</b> If Percentage in (iv) is 100%, Enter the Date (if any) a Qualified Subchapter S Subsidiary Election Was Made
<b>b</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		
<b>(i)</b> Name of Entity	<b>(ii)</b> Employer Identification Number (if any)	<b>(iii)</b> Type of Entity	<b>(iv)</b> Country of Organization	<b>(v)</b> Maximum Percentage Owned in Profit, Loss, or Capital
<b>5 a</b> At the end of the tax year, did the corporation have any outstanding shares of restricted stock? . . . . . If "Yes," complete lines (i) and (ii) below. <b>(i)</b> Total shares of restricted stock. . . . . ▶ _____ <b>(ii)</b> Total shares of non-restricted stock . . . . . ▶ _____		X		
<b>b</b> At the end of the tax year, did the corporation have any outstanding stock options, warrants, or similar instruments? . . . If "Yes," complete lines (i) and (ii) below. <b>(i)</b> Total shares of stock outstanding at the end of the tax year ▶ _____ <b>(ii)</b> Total shares of stock outstanding if all instruments were executed ▶ _____		X		
<b>6</b> Has this corporation filed, or is it required to file, <b>Form 8918</b> , Material Advisor Disclosure Statement, to provide information on any reportable transaction? . . . . .		X		
<b>7</b> 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 <b>Form 8281</b> , Information Return for Publicly Offered Original Issue Discount Instruments.				
<b>8</b> If the corporation: <b>(a)</b> was a C corporation before it elected to be an S corporation <b>or</b> 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 <b>and</b> <b>(b)</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) . . . . . ▶ \$ _____				
<b>9</b> Enter the accumulated earnings and profits of the corporation at the end of the tax year. \$ _____				
<b>10</b> Does the corporation satisfy <b>both</b> of the following conditions? <b>a</b> The corporation's total receipts (see instructions) for the tax year were less than \$250,000 . . . . . <b>b</b> The corporation's total assets at the end of the tax year were less than \$250,000 . . . . . If "Yes," the corporation is not required to complete Schedules L and M-1.		X		
<b>11</b> 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? . . . . . If "Yes," enter the amount of principal reduction \$ _____		X		
<b>12</b> During the tax year, was a qualified subchapter S subsidiary election terminated or revoked? If "Yes," see instructions . . .		X		
<b>13 a</b> Did the corporation make any payments in 2017 that would require it to file Form(s) 1099? . . . . .	X			
<b>b</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

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

► See back of form and separate instructions.

**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 %

For IRS Use Only

**Line 16 D:** Distributions (both cash and property).

**Line 16 E:** Repayment of Loans from Shareholders

☐ Final K-1

☐ Amended K-1

OMB No. 1545-0123

671117

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

<b>1</b>	Ordinary business income (loss)	<b>13</b>	Credits
	-2,492.		
<b>2</b>	Net rental real estate income (loss)		
<b>3</b>	Other net rental income (loss)		
<b>4</b>	Interest income		
	319.		
<b>5a</b>	Ordinary dividends		
<b>5b</b>	Qualified dividends	<b>14</b>	Foreign transactions
<b>6</b>	Royalties		
<b>7</b>	Net short-term capital gain (loss)		
<b>8a</b>	Net long-term capital gain (loss)		
<b>8b</b>	Collectibles (28%) gain (loss)		
<b>8c</b>	Unrecaptured section 1250 gain		
<b>9</b>	Net section 1231 gain (loss)		
<b>10</b>	Other income (loss)	<b>15</b>	Alternative minimum tax (AMT) items
<b>11</b>	Section 179 deduction	<b>16</b>	Items affecting shareholder basis
			2,396.
<b>12</b>	Other deductions		
		<b>17</b>	Other information
		<b>A</b>	319.

\* See attached statement for additional information.

Passive loss	See the Shareholder's Instructions	P Other credits	
Passive income	Schedule E, line 28, column (g)	<b>14. Foreign transactions</b>	
Nonpassive loss	See the Shareholder's Instructions	<b>A</b> Name of country or U.S. possession	Form 1116, Part I
Nonpassive income	Schedule E, line 28, column (j)	<b>B</b> Gross income from all sources	
<b>2. Net rental real estate income (loss)</b>	See the Shareholder's Instructions	<b>C</b> Gross income sourced at shareholder level	
<b>3. Other net rental income (loss)</b>		<i>Foreign gross income sourced at corporate level</i>	
Net income	Schedule E, line 28, column (g)	<b>D</b> Passive category	Form 1116, Part I
Net loss	See the Shareholder's Instructions	<b>E</b> General category	
<b>4. Interest income</b>	Form 1040, line 8a	<b>F</b> Other	
<b>5a. Ordinary dividends</b>	Form 1040, line 9a	<i>Deductions allocated and apportioned at shareholder level</i>	
<b>5b. Qualified dividends</b>	Form 1040, line 9b	<b>G</b> Interest expense	Form 1116, Part I
<b>6. Royalties</b>	Schedule E, line 4	<b>H</b> Other	Form 1116, Part I
<b>7. Net short-term capital gain (loss)</b>	Schedule D, line 5	<i>Deductions allocated and apportioned at corporate level to foreign source income</i>	
<b>8a. Net long-term capital gain (loss)</b>	Schedule D, line 12	<b>I</b> Passive category	Form 1116, Part I
<b>8b. Collectibles (28%) gain (loss)</b>	28% Rate Gain Worksheet, line 4 (Schedule D instructions)	<b>J</b> General category	
<b>8c. Unrecaptured section 1250 gain</b>	See the Shareholder's Instructions	<b>K</b> Other	
<b>9. Net section 1231 gain (loss)</b>	See the Shareholder's Instructions	<i>Other information</i>	
<b>10. Other income (loss)</b>		<b>L</b> Total foreign taxes paid	Form 1116, Part II
Code		<b>M</b> Total foreign taxes accrued	Form 1116, Part II
<b>A</b> Other portfolio income (loss)	See the Shareholder's Instructions	<b>N</b> Reduction in taxes available for credit	Form 1116, line 12
<b>B</b> Involuntary conversions	See the Shareholder's Instructions	<b>O</b> Foreign trading gross receipts	Form 8873
<b>C</b> Sec. 1256 contracts & straddles	Form 6781, line 1	<b>P</b> Extraterritorial income exclusion	Form 8873
<b>D</b> Mining exploration costs recapture	See Pub. 535	<b>Q</b> Other foreign transactions	See the Shareholder's Instructions
<b>E</b> Other income (loss)	See the Shareholder's Instructions	<b>15. Alternative minimum tax (AMT) items</b>	
<b>11. Section 179 deduction</b>	See the Shareholder's Instructions	<b>A</b> Post-1986 depreciation adjustment	See the Shareholder's Instructions and the Instructions for Form 6251
<b>12. Other deductions</b>		<b>B</b> Adjusted gain or loss	
<b>A</b> Cash contributions (50%)	See the Shareholder's Instructions	<b>C</b> Depletion (other than oil & gas)	
<b>B</b> Cash contributions (30%)		<b>D</b> Oil, gas, & geothermal—gross income	
<b>C</b> Noncash contributions (50%)		<b>E</b> Oil, gas, & geothermal—deductions	
<b>D</b> Noncash contributions (30%)		<b>F</b> Other AMT items	
<b>E</b> Capital gain property to a 50% organization (30%)		<b>16. Items affecting shareholder basis</b>	
<b>F</b> Capital gain property (20%)		<b>A</b> Tax-exempt interest income	Form 1040, line 8b
<b>G</b> Contributions (100%)		<b>B</b> Other tax-exempt income	See the Shareholder's Instructions
<b>H</b> Investment interest expense	Form 4952, line 1	<b>C</b> Nondeductible expenses	
<b>I</b> Deductions—royalty income	Schedule E, line 19	<b>D</b> Distributions	
<b>J</b> Section 59(e)(2) expenditures	See the Shareholder's Instructions	<b>E</b> Repayment of loans from shareholders	
<b>K</b> Deductions—portfolio (2% floor)	Schedule A, line 23		
<b>L</b> Deductions—portfolio (other)	Schedule A, line 28		

## 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**

Call us at **360-455-1569** or go to **[www.LindaKeithCPA.com](http://www.LindaKeithCPA.com)** for great resources to help you **say 'yes' to good loans!**