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Commitment

NATP exists to be the most reliable resource for gaining and developing professional tax expertise. The design of this publication is to provide accurate and authoritative information on the subject matter covered, presented with the understanding that the National Association of Tax Professionals is not engaged in rendering legal or accounting services.

This text has been prepared with due diligence but may not address every possible situation. If there is a change or update needed due to legislation or the discovery of an error, NATP will create and post an addendum at natptax.com. Search "addendum" to see a listing of available changes.

NATP updated this material to 2024. At the time of updating, the most recent authorized forms are for 2023. Therefore, we used 2023 forms throughout the text for examples and illustrations.

Acknowledgment

We thank UltraTax CS for providing the 2023 forms used to complete the examples included in this text.

Course Description

Tax planning is an essential part of the services you offer. This course covers common situations you'll need to fully understand to develop appropriate tax strategies for your clients. Trending topics include how to correct missed depreciation on rental properties, handling the first year of an estate, how to use the home office deduction for different business owners as well as common issues tax pros encounter with both S corporations and partnerships. To help clarify the practical application of tax strategies, we'll include examples that demonstrate how tax planning can be customized to meet the unique needs of different clients.

Objectives

Upon completion of this course

- Identify when a taxpayer has missed depreciation
- Prepare Form 3115
- Summarize the requirements for a home office deduction
- Prepare Form 8829
- Outline common S corporation issues including making a late S election, determining reasonable shareholder compensation and handling asset ownership issues
- Summarize common partnerships issues including W-2 wages incorrectly paid to partners, and the requirements and reporting procedures for unreimbursed partnership expenses (UPE)
- Outline the reporting requirements for an estate during the first year
- Determine when to file Form 706 to utilize DSUE portability

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Filing Form 3115

Case study

Meet Fred Jones who bought a residential rental property for $210,000 (exclusive of land) that is 27.5-year MACRS property. When filing his Year 3 tax return, Fred discovered that he never claimed depreciation on the property. Fred determines that his missed depreciation for the property is $11,773. Fred wants to claim this missed depreciation.

How does Fred accomplish this?

This situation, as well as others involving the use of Form 3115, *Application for Change in Accounting Method*, to resolve these issues will be discussed in this section.

Overview

Missed depreciation, wrong depreciation or accounting method changes often require filing Form 3115. However, many taxpayers are not aware of the form or how it affects their tax returns. As tax professionals, we are tasked with preparing Form 3115 to help the taxpayer file a correct tax return. Looking at how the Form 3115 works and examples of filling it out for the various uses will ensure we are giving the taxpayer the most accurate tax return.

Change in accounting method

An accounting method is a set of rules used to determine when and how income and expenses are reported on the tax return. This includes the taxpayer's overall method of accounting and the accounting treatment used for any material item. A material item is one that affects the proper time for inclusion of income or the allowance of a deduction, such as depreciation. In determining whether a taxpayer's accounting practice for an item involves timing, the relevant question is whether the practice permanently changes the amount of the taxpayer's lifetime income. If the practice does not permanently affect the taxpayer's lifetime income but does or could change the taxable year in which income is reported, it involves timing and is therefore a method of accounting (Rev. Proc. 97-37).

The following corrections or adjustments of an income or deduction item do not involve timing issues and therefore are not a change in accounting method.

- Where taxpayers didn't materially participate in a nursing home activity, and failed to treat it as a passive activity, their correction of that error by recharacterization of the activity as a passive activity wasn't an accounting method change.

- A taxpayer's change in the method it used for measuring the volume of harvested timber didn't involve the time for inclusion of income and, therefore, wasn't a change of accounting method.
- Where the issue involved the amount of gain or loss realized on the sale of preferred stock, rather than when the gain or loss was realized, the change was not an accounting method change.

Businesses choose an accounting method when they file their first tax return. This method must be used consistently from year to year, and it must clearly reflect income. After adopting an accounting method, taxpayers must receive approval from the IRS before changing it. Some changes are automatic, while others are not. Either way, taxpayers generally must file Form 3115 to request a change in method of accounting.

Note: Even when the tax law changes and mandates a change in method of accounting, the taxpayer needs to file Form 3115 to affect the change.

Form 3115

Form 3115 is the form that taxpayers file to change their overall method of accounting or the accounting treatment of any item. First, we'll provide a general overview of the form, then we will expand on the need and use.

Form 3115 is an eight-page form; however, not all eight pages are required to be filled out. The instructions have a table indicating which sections and schedules are needed. All filers must complete Parts I and II. Part III is for non-automatic change requests. Part IV is the §481(a) Adjustment.

After Part IV, the form has five schedules:

- Schedule A – *Change in Overall Method of Accounting*
  - Part I, *Change in Overall Method*
  - Part II, *Change to the Cash Method for Non-Automatic Change Request*
- Schedule B – *Changes Related to the Deferral Method for Advance Payments, Cost Offset Methods, and/or the Applicable Financial Statement Income Inclusion Rule*
  - There is nothing on this schedule to complete; it lists statements that must be attached to the form to show the changes.
- Schedule C – *Changes within the LIFO Inventory Method*
  - There is nothing on this schedule to complete. It is a listing of the information to attach to the form to show the changes.
  - Part I, *General LIFO Information*

  - Part II, *Change in Pooling Inventory*
- Schedule D – *Change in the Treatment of Long-Term Contracts Under Section 460, Inventories, or Other Section 263A Assets*
  - It contains some questions and calculations in Parts I-III
  - Part I, *Change in Reporting Income From Long-Term Contracts*
  - Part II, *Change in Valuing Inventories Including Cost Allocation Changes*
  - Part III, *Method of Cost Allocation*
    - Section A, *Allocation and Capitalization Methods*
    - Section B, *Direct and Indirect Costs Required To Be Allocated*
    - Section C, *Other Costs Not Required To Be Allocated*
- Schedule E – *Change in Depreciation or Amortization*
  - These questions need to be answered when filling out Form 3115 for missed depreciation.

Reasons to file Form 3115

The most common accounting method changes include changing:

- From accrual-to-cash accounting
- From cash-to-accrual accounting
- Depreciation methods from impermissible to a permissible method
  - Missed depreciation

Changing the accounting method

Often taxpayers qualify for an automatic approval change or else request a non-automatic change in their method of accounting.

Automatic approval

An automatic change is a change for which IRS approval is not needed. These are listed as designated change numbers, or DCNs. The instructions for Form 3115 contain a 19-page table of DCNs.

Common DCNs include changing:

- Depreciation accounting methods
- Cash method accounting to accrual method

- Timing of liabilities for employee compensation, workers' compensation and payroll taxes
- Change from LIFO method

The automatic change procedure may be used if all the following are met:

- Described in list – change is in the list of DCNs at the time of filing
- Taxpayer meets requirements – taxpayer meets any requirements in the list at the time of filing.
- No liquidation or reorganization – taxpayer does not liquidate or reorganize in a transaction to which §381 applies (refers mainly to controlled groups)
- Not final year – business is not in its final year, unless the change is for depreciation
- Five-year lookback – taxpayer has neither made, nor requested, a change of overall method in the prior five taxable years
    - If the change is only for an item, they have not made, nor have they requested, a change in the method for that item

Note: If taxpayers do not qualify to use the automatic consent procedures, they can use the non-automatic consent request procedures covered in Rev. Proc. 2015-13, Section 5.01.

Non-automatic change request

If a taxpayer does not qualify for automatic approval, there may be another option. Any change request that does not qualify as an automatic change is a non-automatic change request.

Non-automatic changes require affirmative consent from the IRS before the taxpayer files their original return. Consent is given through a letter ruling. This is costly, time-consuming, and runs a risk of rejection.

The user fee for a timely filed request is $11,500 with no guarantee of a positive result for the taxpayer.

If the taxpayer needs to make a non-automatic change, Form 3115 should be filed as early as possible during the year of the requested change, as a response will take months.

There are requirements to apply for a non-automatic change. The taxpayer must not be eligible to use automatic change procedures and it must not be the final year of the trade or business.

The primary difference in the process of the two types of requests is the costs of a non-automatic change versus an automatic change, in terms of both time and money. A non-automatic change is expensive and slow. If the IRS consents, it will issue a letter ruling. This takes time and there is a risk that the IRS will reject the change. On the other hand, an automatic change is free to file, and fast, because there is no wait for approval.

While the form appears to be complicated, it is meant to be helpful. The Internal Revenue Manual states that the IRS will contact the taxpayer for appropriate modifications if errors are found upon review.

Both types of changes provide audit protection for prior years and the change year. Generally, the IRS will not require the taxpayer to change the accounting method for the same item in a prior year.

Audit protection is not available if:

- Taxpayer is under examination (although there are exceptions to this)
- Change is expressly excluded
- Change is not made or is made improperly
- Changes in sub-methods of accounting
- Change is for certain corporations
- Taxpayer is, or will be, under criminal investigation for a prior year
- Accounting method is an issue under consideration
- Change is because of an earlier IRS-initiated change

Accounting methods

An accounting method is the way that a taxpayer determines when income, deductions and expenses are taken into consideration. The types of changes considered for Form 3115 include the overall method of accounting.

Overall methods of accounting

Briefly reviewed, there are four different accounting methods.

- Cash method: Under the cash method of accounting or cash basis, income is reported in the year actually or constructively received, and expenses are deducted or capitalized in the year paid.
- Accrual method: The accrual method of accounting or accrual basis is meant to match income and expenses in the correct year. Under the accrual basis, income is reported in the tax year earned even if payment is received later and expenses are deducted or capitalized in the tax year incurred even if they are not paid.
- Special methods: The special methods are used in combination with cash or accrual methods: the long-term contract method and the installment method.
- Hybrid method: Where cash is used for sales and purchases, but accrual for everything else.

Small business taxpayers

For 2024, a small business taxpayer is a business (other than a tax shelter) that had average annual gross receipts of $30 million or less for the prior three tax years.

Small business taxpayers can use the cash method of accounting and are also exempt from the requirement to keep inventories and the uniform capitalization (UNICAP) rules.

Example

Water LLC is a partnership that installs plumbing fixtures in customers' homes and businesses. Water's gross receipts at the end of the three preceding years are $6 million for 2021, $9 million for 2022, and $12 million for 2023.

Water's average annual gross receipts for 2024 are $9 million [($6 million + $9 million + $12 million) / 3]. Water can use the cash method for all its trades or businesses for its 2024 tax year because its average annual gross receipts for the prior three tax years are $30 million or less.

If the business has not been in existence for the entire three-year period, the gross receipts test will be based on the period the business was in existence.

Warning: A tax shelter does not qualify as a small business taxpayer. A tax shelter includes a syndicate, which is any entity (other than a C corporation) that allocates more than 35% of its losses during the tax year to limited partners or limited entrepreneurs. A limited entrepreneur is a person who has an interest in the entity, but not as a limited partner, and does not actively participate in the management of such entity. Thus, a partnership or an S corporation could be a syndicate if they have losses that are allocated as mentioned.

Cash method

If the cash method is used to record income, it must also be used for expenses. To use any method, it must "clearly reflect income." The cash method can be used by anyone not prohibited.

In general, the accrual method of accounting is required if the business has inventory in order to account for purchases and sales of merchandise. However, small business taxpayers are not required to maintain inventory. Furthermore, even if a business maintains inventory and uses the accrual method for purchases and sales, they can use the cash method for all other items of income and expenses (hybrid method).

Any business that qualifies as a small business taxpayer can use the cash method.

In general, §446(a) provides that taxable income shall be computed under the same method of accounting the taxpayer regularly uses in keeping their books. A new business chooses an overall method of accounting by using it on their first income tax return.

Inventory

When the production, purchase or sale of merchandise is an income-producing factor, an inventory is necessary to clearly reflect income. In general, businesses (other than small business taxpayers) must use the accrual method of accounting for purchases and sales if they must account for an inventory.

A small business taxpayer is not required to account for inventories under §471. Instead, the taxpayer will not be treated as failing to clearly reflect income if the taxpayer accounts for inventory using one of the following:

- Nonincidental materials and supplies - Treat as inventory under Reg. §1.162-3, which means the amount paid to acquire or produce such items are deductible in the taxable year in which the materials and supplies are first used or consumed in the taxpayer's operations.
- Method of accounting - Conform to the taxpayer's method of accounting reflected in its applicable financial statement (AFS) for the tax year, or if the taxpayer does not have an AFS for the tax year, the taxpayer's books and records prepared in accordance with the taxpayer's accounting procedures.

Note: An applicable financial statement (AFS) is an audited financial statement that is required to be filed with the Securities and Exchange Commission (SEC) or is required to be provided to the federal or state government or any federal or state agency other than the SEC or IRS.

An AFS is accompanied by the independent CPAs audit report that is used for credit purposes, reporting to shareholders or any other substantial non-tax purpose.

Example

Corporation Z, an S corporation, is a roofing business that is eligible to use the cash method of accounting. Z chooses to use the cash method and accounts for inventoriable items as nonincidental materials and supplies under Reg. §1.162-3.

Z enters a contract with a homeowner in December 2023 to replace the homeowner's roof. Z purchases roofing shingles from a local supplier and has them delivered to the homeowner's residence. Z pays the supplier $5,000 for the shingles upon their delivery later that month. Z replaces the homeowner's roof in January 2024 and gives the homeowner a bill for $15,000 at that time. Z receives a check from the homeowner in March 2024.

The shingles are nonincidental materials and supplies. The cost of the shingles is deductible in the year Z uses and consumes the shingles or pays for the shingles, whichever is later. Z does not use the shingles until 2024 and as such, Z can deduct their cost only on its 2024 Form 1120-S, *U.S. Income Tax Return for an S Corporation*, even though Z paid for the shingles in 2023. Z must report $15,000 of income and $5,000 of deductions on its 2024 Form 1120-S.

UNICAP

In general, the UNICAP rules require certain direct and indirect costs allocable to real or tangible personal property produced by the taxpayer to be included in either inventory or capitalized into the basis of such property, as applicable. Likewise, for real or personal property acquired by the taxpayer for resale, §263A generally requires certain direct and indirect costs allocable to such property to be included in inventory.

A small business taxpayer who meets the gross receipts test is not required to capitalize costs under §263A.

Material items

As with many scenarios in the tax business, a material item depends on the facts and circumstances of the case and often includes income, deductions, depreciation or capital outlay.

Examples of material items include:

- Deferrals for advanced payments
- Materials and supplies versus depreciation
- Prepaid expenses
- Accrued interest on nonqualified deferred compensation
- Capitalize versus repair
- FIFO versus LIFO
- Vacation pay

Treatment becomes "method"

When does a "method" become the taxpayer's method, necessitating a request for change? Generally, there is a two-year rule.

- If the taxpayer files two tax returns using the method, it becomes the method, even if the method utilized is not allowed, such as not taking depreciation

If the method is **permissible**, one filed return may be enough to consider it chosen.

- The taxpayer must request the change if they have filed even one return

If the method is **impermissible**, and a second return has **not** been filed, the taxpayer can amend the first year.

- This saves time, effort and money
- The taxpayer has one year to amend

Note: Using Form 3115 allows a correction to reach beyond open years without extending the statute of limitations.

Making a change

There are several steps to take in making the change:

- Step 1: Determine the current accounting method
- Step 2: Determine the change to be made
- Step 3: Calculating the §481(a) adjustment
- Step 4: Complete Form 3115

Determining the method

To determine the current accounting method and whether it has been employed consistently, first ascertain if the method used impacts when an item is reported, or if it is reported. If it is dependent on the passage of time, then it is an accounting method. The reported item requiring the change may be any item on the profit and loss statement, balance sheet or the overall accounting method. Review what has been done consistently, even if improperly. Court cases have held that haphazard inventory tracking was a method because it was done consistently.

Determining the change

The next step is to determine what should have been done, or what treatment you wish to utilize. Should an item be capitalized instead of expensed? Do you wish to deduct a prepaid expense before using it, change from cash-to-accrual, or perhaps begin depreciating an item? Most changes are made as if the taxpayer had used the new method the entire time, and the change applies to current and future years, unlike an amendment. Once the change method has been identified, the appropriate change number must be found. Always search for the most up-to-date information for the list of automatic and non-automatic changes.

Tax research subscriptions, if available to you, are the best option, because these services usually provide alerts if the revenue procedure has been superseded. A search may also be conducted on the IRS.gov website. If searching using other options, consider your source.

There is a special rule for qualified small taxpayers. This involves a reduced filing requirement. A qualified small taxpayer is a taxpayer whose average annual gross receipts for the preceding three taxable years is no more than $30 million. There may be a lookback provision or more information about audit protection, therefore it is important to review the revenue procedure carefully.

Depreciation

A taxpayer may indicate that depreciation was not taken because they did not know how to correctly depreciate property, were unaware of the concept of depreciation or worried about recapture. This can be remedied by requesting a change in accounting.

Taxpayers can get automatic approval from the IRS to change their method of accounting for depreciation under Rev. Procs. 2015-13 and 2019-43. Taxpayers can recoup missed or understated allowable depreciation from open and closed years using these revenue procedures, and the approval is automatic. Thus, no user fee applies.

Note: If taxpayers do not qualify to use the automatic consent procedures, they can use the advance consent request procedures covered in Rev. Proc. 2015-13; in which case, a user fee of up to $11,500 for 2024 could apply (Rev. Proc. 2024-1).

Rev. Proc. 2019-43, which provides a list of automatic DCNs, applies to taxpayers who are changing from an impermissible to a permissible method of accounting for depreciation for any item of depreciable property that meets all the following basic requirements:

- The taxpayer used the impermissible method of accounting for depreciation in at least two taxable years immediately preceding the year of change (one year for property placed in service in the taxable year immediately preceding the year of change).
- The taxpayer must own the property at the beginning of the year of change, except for property disposed of before the year of change.
- The property must be depreciable under §56(a)(1) (AMT depreciation), §56(g)(4)(A) (ACE depreciation), §§167 and 168 (ACRS and MACRS), §197 (amortization), §1400I (commercial revitalization deduction) or §1400L (New York Liberty Zone property), or under any first-year bonus depreciation provisions.
- The change in depreciation is a change in method of accounting under Reg. §1.446-1(e)(2)(ii)(d).

To make an automatic change under Rev. Procs. 2015-13 and 2019-43, the taxpayer must attach the original Form 3115 to a timely filed (including extensions) tax return for the year of change. The original Form 3115 attachment does not need to be signed. In addition, the taxpayer must file a copy of the signed Form 3115 with the IRS Ogden, UT, service center no earlier than the first day of the year of change and no later than when the taxpayer files Form 3115 with their federal income tax return for the year of change. This signed Form 3115 may be a photocopy.

Note: The Form 3115 instructions provide that the automatic change number is “7” for changes from an impermissible method to a permissible method of depreciation for depreciable property owned at the beginning of the year of change, unless it is property disposed of in the year of change.

An automatic six-month extension from the due date of the return (excluding any extensions) for the year of change is available if the taxpayer (Reg. §301.9100-2):

- Timely filed their federal income tax return for the year of change
- Filed an amended return within the six-month extension period in a manner consistent with the new method of accounting
- Attached the original Form 3115 to the amended return
- File a copy of Form 3115 with the IRS Ogden, UT, office no later than when they file the original with the amended return
- Attached a statement to Form 3115 that they are filing it pursuant to Reg. §301.9100-2
- There are generally no other extensions of time to file Form 3115, except in unusual and compelling circumstances
    - See Reg. §301.9100-3 for the standards that a taxpayer must meet

In general, taxpayers must complete Form 3115, Parts I, II, and IV, and Schedule E for an automatic change in depreciation.

However, under Rev. Proc. 2018-31, Section 6.01, a qualified small taxpayer qualifies for a reduced filing requirement and completes only the following information on Form 3115 (Rev. December 2022):

- The identification section of Page 1 (above Part I)
- The signature section at the bottom of Page 1
- Part I
- Part II, all lines except Lines 13, 15b, 16c, 17, and 19
- Part IV, all lines except Line 25
- Schedule E

Note: A qualified small taxpayer for this purpose is one whose average annual gross receipts for the three preceding taxable years is $10 million or less.

Method of accounting – depreciation

In the year a depreciable asset is placed in service, the taxpayer must determine the depreciation method and useful life to be used, as provided under tax law. Future year depreciation deductions for this asset will be computed consistently based on the methods elected in the first year. If the method and life used in the first year are impermissible under tax law, the taxpayer should correct the method and/or life by the due date of the taxpayer's return for the second year of the asset's life.

In general, a method of accounting has been adopted when a permissible method of determining depreciation was used on the first tax return, or when the same impermissible method of determining depreciation has been used on two or more consecutively filed tax returns.

A change in method of accounting for depreciation includes the following [Reg. §1.446-1(e)(2)(ii)(d)(2)]:

- A change from an impermissible method of determining depreciation to a permissible method, if the method was used in two or more consecutively filed tax returns
- A change in the treatment of an asset from non-depreciable to depreciable or vice versa
- A change in the depreciation method, recovery period or convention of a depreciable asset
- A change from not claiming to claiming bonus depreciation if the taxpayer did not make the election not to claim any bonus depreciation
- A change from claiming a 50% special depreciation allowance to claiming a 100% special depreciation allowance for qualified property acquired and placed in service after Sept. 27, 2017, (if the election under §168(k)(10) was not made to claim the 50% special depreciation allowance)

Example

In August, Year 1, Frankie, a calendar year taxpayer, purchased and placed in service a copier for use in their trade or business. Frankie incorrectly classified the copier as seven-year property, Frankie elected not to deduct bonus depreciation on their Year 1 federal tax return. As a result, on its Year 1 and Year 2 federal tax returns, Frankie depreciated the copier under the general depreciation system (GDS) under §168(a), using the 200% declining balance method, a seven-year recovery period and the half-year convention. In Year 3, Frankie realizes that the copier is five-year property and should have been depreciated on their Year 1 and Year 2 federal tax returns under the GDS using a five-year recovery period rather than a seven-year recovery period.

Frankie's change in recovery period from seven to five years is a change in method of accounting. The useful life exception does not apply because the copier is depreciated under §168 [Reg. §1.446-1(e)(2)(iii), Example (14)].

A change in method of accounting for depreciation **does not** include the following [Reg. §1.446-1(e)(2)(ii)(b) and (d)(3)]:

- The taxpayer claimed an incorrect amount of depreciation due to a mathematical or posting error
- An adjustment in the useful life of an asset for which depreciation is determined under §167
- A change in the use of an asset in the hands of the same taxpayer
- Making a late depreciation election or revoking a timely valid depreciation election (including the election not to claim bonus depreciation)

  - If the taxpayer elected not to claim bonus depreciation, a change from not claiming to claiming bonus depreciation is a revocation of the election and is not an accounting method change
  - In general, to make a late depreciation election or revoke a depreciation election, the taxpayer must get IRS approval by requesting a letter ruling
- Any change in the placed-in-service date of a depreciable asset

Example

HEB placed new stores in service between 1987 and 1992 and divided the stores components into asset classes. As a result of a cost-segregation study, HEB believed that it incorrectly classified some of the components and sought to take additional depreciation deductions based on their correct classifications. Specifically, HEB argued that some fixtures and equipment (with a five-year recovery period and a 200% declining balance method of depreciation) and some site materials (with a 15-year recovery period and a 150% declining balance method of depreciation) were erroneously classified as non-residential real property (with either a 31.5 2 or 39-year recovery period and with the straight-line method of depreciation). Accordingly, HEB sought the additional depreciation deductions it would have taken had these items been properly classified.

To the extent that some of the errors were caused by data entry errors (entering the wrong asset code), HEB's corrections were not changes in its method of accounting because correction of mathematical and posting errors is not a change in method of accounting. Therefore, those corrections did not require the Commissioner's approval, and the United States was not entitled to summary judgment on these items.

Additionally, the IRS could not really argue that by reclassifying some of its assets, HEB changed its overall method of accounting. HEB was correct when it stated that its overall method of accounting remained the same.

Instead, the focus turned to whether HEB's change in the treatment of various assets was a change in the treatment of a material item. The IRS argued that the reclassification "involves the proper time for taking of a deduction." Therefore, according to the IRS, the reclassification resulted in a change in HEB's treatment of a material item. Relevant to this determination is whether the change affects the total amount of lifetime income (which would not involve the proper time to take a deduction) or whether it just changes the tax year in which income is reported.

There was no question that HEB's changes involved the timing of deductions. The total amount of depreciation did not change. Rather, HEB sought to shorten the time over which the deductions were taken and to increase the percentage of the cost it could recover in a year. This change affected the year in which deductions are taken, rather than the overall amount of deductions. Therefore, the change was a change in the treatment of a material item [H.E. Butt Grocery Co. v. U.S., 86 AFTR 2d 2000-5209].

Missed depreciation

One of the more common mistakes is missed depreciation. For example, taxpayers report residential rental activities on Schedule E, (Form 1040), *Supplemental Income and Loss*, but sometimes do not claim any depreciation for the building. Since the basis of the building must be reduced by depreciation allowed or allowable, the basis of the building is reduced by allowable depreciation the taxpayer never deducted. Thus, taxpayers want to claim all the missed depreciation deductions for prior years. Claiming missed depreciation for two or more prior years is a change in method of accounting that generates a negative §481(a) adjustment.

Case study

Remember Fred from our introduction? In Year 1, Fred Jones bought residential rental property for $210,000 (exclusive of land) that was 27.5-year MACRS property. When filing his Year 3 tax return, Fred determined that he never claimed depreciation on the property. Fred determines that his missed depreciation for the property is $11,773. Fred wants to claim this missed depreciation.

Since depreciation was missed on two consecutively filed tax returns, Fred must request a change in method of accounting for depreciation. He can claim the missed depreciation by filing Form 3115 with his Year 3 return, the year of change and claiming a negative §481(a) adjustment of ($11,773).

Taxpayers could also miss depreciation if they incorrectly classified an asset as inventory instead of depreciable property.

Example

In May, Year 1, Camilla, a calendar year taxpayer, purchased and placed in service equipment for use in her trade or business. Camilla never held this equipment for sale. However, Camilla incorrectly treated the equipment as inventory on her Year 1 and Year 2 federal tax returns. In Year 3, Camilla realizes that the equipment should have been treated as a depreciable asset.

Camilla’s change in the treatment of the equipment from inventory to a depreciable asset is a change in method of accounting [Reg. §1.446-1(e)(2)(iii), Example (11)].

Incorrect basis allocation

When a taxpayer allocates too little or none of the purchase price of real property to nondepreciable land causing excess depreciation deductions, the reallocation requires a change in method of accounting. Claiming too much depreciation results in a positive §481(a) adjustment.

Example

Gary and Janice Pinkston, petitioners, in 2003 and 2010 acquired rental properties in Hawaii, upon which they claimed depreciation deductions under MACRS. Upon examination of petitioners' 2012 return, the IRS adjusted these depreciation deductions downward. It did so by reallocating a larger portion of their cost basis to nondepreciable land (for the property purchased in 2003) and by reclassifying most of their cost basis into a MACRS class with a much longer recovery period (for the property purchased in 2010).

During 2012, the Pinkstons owned and rented two real estate properties in Hawaii. They purchased the first property — a beach house in Kahuku, Hawaii (beach house) — in September 2003 for $1.6 million. They purchased the second property — a condominium unit in Honolulu, Hawaii (condo unit) — in November 2010 for $2,692,900.

For the beach house, they allocated $400,000 of their cost basis to land and the balance — $1,205,137 as of 2012 — to land improvements. They had used the same allocation to land on their Schedule E every year since placing the property in service in 2003. This allocation yielded a depreciation deduction of $43,819 for the beach house for 2012.

For the condo unit, they reported a total cost basis of $2,720,729. As they had done for 2010 and 2011, they allocated $27,830 of their reported cost basis to land and the balance to the following MACRS classes of depreciable property, claiming depreciation for 2012 as shown below:

Description	Class life	Depreciable basis	Depreciation
Distributive trade & services	5 years	$2,091,123	$476,776
Information systems	5 years	4,345	991
Residential rental property	27.5 years	597,431	21,723
Total		**$2,692,899**	**$499,490**

Upon examination of petitioners' 2012 return, the IRS significantly reduced their reported depreciation deductions. For the beach house, the IRS increased the allocation to nondepreciable land from $400,000 to $1,400,462, reducing the depreciation deduction from $43,819 to $7,443.

For the condo unit the IRS:

- Decreased petitioners' cost basis by $27,829 (the amount of closing costs they had classified as "land")
- Determined an allocation to nondepreciable land of $291,800; and
- Reallocated the bulk of petitioners' basis to nonresidential real property, which is depreciated using a straight-line method over a 39-year recovery period

The IRS's basis reclassifications for the condo unit are shown below:

Asset class	Petitioners' allocation	IRS's allocation	Increase (decrease)
Land	$27,830	$291,800	$263,970
5-year property	2,095,468	90,537	(2,004,931)
Residential rental property	597,431	0	(597,431)
Nonresidential real property	0	2,310,563	2,310,563
Total	$2,720,729	$2,692,900	($27,829)

These reclassifications led the IRS to reduce petitioners' Schedule E depreciation deduction for the condo unit from $499,490 to $79,887 for 2012.

The IRS further concluded that its basis reallocations for depreciation purposes constituted a change in petitioners' method of accounting. It therefore invoked §481 and determined additional adjustments to income for 2012 equal to the difference between the amounts of depreciation petitioners had previously claimed on the two rental properties and the amounts that the IRS would have allowed consistent with its reallocations for 2012 [Gary Pinkson, TC Memo 2020-44].

Cost segregation study

A taxpayer may conduct a cost segregation study on used property and then re-compute its depreciation deductions for prior years. The underlying incentive for preparing these studies for federal income tax purposes is the significant tax benefits derived from utilizing shorter recovery periods and accelerated depreciation methods for computing depreciation deductions. In general, a change in computing depreciation under §168 for prior years due to a cost segregation study requires a change in method of accounting.

However, for depreciable property that is treated as a capital asset and placed in service in taxable years ending before Dec. 30, 2003, the service will no longer litigate the issue of whether such a change in computing depreciation is a change in method of accounting.

Example

In Year 1, Alpha, a calendar year taxpayer engaged in the trade or business of manufacturing knitted goods, purchased and placed in service a building and its components at a total cost of $10 million for use in its manufacturing operations. Alpha classified the $10 million as nonresidential real property under §168(e). Alpha elected not to deduct the bonus depreciation provided by §168(k) on its Year 1 federal tax return. As a result, on its Year 1, Year 2 and Year 3 federal tax returns, Alpha depreciated the $10 million under the GDS of §168(a), using the straight-line method of depreciation, a 39-year recovery period and the mid-month convention. In Year 4, Alpha completes a cost segregation study on the building and its components and identifies items that cost a total of $1.5 million as §1245 property. As a result, the $1.5 million should have been classified in Year 1 as five-year property under §168(e) and depreciated on Alpha›s Year 1, Year 2 and Year 3 federal tax returns under the GDS, using the 200% declining balance method of depreciation, a five-year recovery period and the half-year convention.

Alpha›s change to this depreciation method, recovery period and convention is a change in method of accounting. The useful life exception does not apply because the assets are depreciated under §168 [Reg. §1.446-1(e)(2)(iii), Example (9)].

Asset acquisition under §1060

Taxpayers must file Form 8594, *Asset Acquisition Statement Under Section 1060*, when there is a transfer of a group of assets that make up a trade or business and the purchaser's basis in such assets is determined wholly by the amount paid for the assets. The purchase price is allocated among different classes of assets by the seller and the purchaser using the same allocation. This purchase allocation cannot be modified pursuant to a cost segregation study, so a change in method of accounting is not allowed.

Example

In Peco Foods, Inc., TC Memo. 2012-18, the taxpayer purchased two poultry processing plants in applicable asset acquisitions under §1060. As part of the acquisitions, Peco Foods entered into written agreements with the seller allocating the purchase price among the acquired assets. Peco Foods then hired an outside consulting firm to perform a cost segregation study on the plants and filed a Form 3115 with its return to change its accounting method and reclassify certain property from nonresidential real property to tangible property. The IRS disputed these changes, arguing that the taxpayer could not modify the purchase price allocations and subdivide them into component assets in a manner at odds with those schedules.

The Tax Court held that Peco Foods was bound by the clear and unambiguous terms of the original allocation schedules and could not deviate from its characterization of those assets. Thus, the taxpayer was not allowed to change its method of accounting for the acquired assets pursuant to its cost segregation study.

Understated depreciation on disposed assets

Rev. Proc. 2007-16, or any successor modification (Rev. Procs. 2019-43, 2022-14, 2023-24) allows taxpayers to change their method of accounting for depreciation for property that has been disposed of if they used an impermissible method of accounting under which they did not claim any depreciation, or depreciation less than the amount allowable in the "year of change" or any prior years. For this purpose, the year of change is the year the property was disposed of by the taxpayer.

Under Rev. Proc. 2019-43, make this automatic change:

- On a timely filed (including extensions) original tax return for the year the property was disposed of by the taxpayer
- On an amended tax return for the year the property was disposed of if the taxpayer files the original Form 3115 with the amended return prior to the expiration of the statute of limitations for such year (generally three years from the due date, including extensions). A copy of Form 3115 must be filed with the IRS national office no later than when the original Form 3115 is filed with the amended return. The amended return must include the adjustments to taxable income and any collateral adjustments to taxable income or tax liability resulting from this change in the method of accounting.

Note: The instructions to Form 3115 provide that the change number for post-disposition depreciation is "107."

Example

On Jan. 1, Year 1, Sammie Smith bought commercial rental property for $300,000 (exclusive of land) that was 39-year MACRS property. Sammie sold this rental on June 1, Year 5. She reported the sale on her Year 5 tax return using her adjusted basis in the property (cost less allowable depreciation), even though no actual depreciation was claimed for the property. Sammie did not discover the missed depreciation until Year 6.

Sammie can claim the missed depreciation by filing Form 3115 with an amended return for Year 5. Since it is a change for depreciable property that has been disposed of, Sammie uses DCN 107 instead of DCN 7. The amended return will include a negative §481(a) adjustment for the missed depreciation on Schedule E, Line 19, Other expense.

Bonus depreciation

The first-year bonus depreciation deduction is 60% for qualified property acquired and placed in service in tax year 2024. Thus, businesses can write off 60% of the cost of qualified property in the first year using bonus depreciation instead of §179. However, taxpayers claim §179, if any, before claiming bonus depreciation.

Preparer note: Bonus depreciation for qualified property is automatic unless taxpayers elect out of bonus depreciation for a class of property under §168(k)(7). In general, taxpayers must make the election on a timely filed tax return (including extensions) for the year in which they placed the property in service, and they cannot revoke the election without IRS consent.

If taxpayers timely filed their return for the year without making this election, they can still make the election by filing an amended return within six months of the due date of the original return (not including extensions). Attach the election statement to the amended return. On the amended return, write "Filed pursuant to §301.9100-2."

Eligible property

In general, qualified property includes depreciable tangible personal property that has a recovery period of 20 years or less.

Note: Qualified improvement property (QIP) placed in service after 2017 qualifies for bonus depreciation.

Used property may be eligible for bonus depreciation. Previously, qualified property had to be new (original use began with the taxpayer) to be eligible for bonus depreciation.

Certain used property acquired and placed in service after Sept. 27, 2017, is also eligible for bonus depreciation if such property meets the following acquisition requirements:

- Was not used by the taxpayer at any time before the acquisition
- Meets the acquisition requirements of §179(d)(2)(A), (2)(B), and (2)(C):
    - Under §179(d)(2)(A), the property cannot be acquired from a related party
    - Under §179(d)(2)(B), the property cannot be acquired from a member of the same controlled group
    - Under §179(d)(2)(C), the property cannot be acquired with a carryover basis (for example, a gift) or inherited from a decedent

Example

On Aug. 1, Year 1, S corporation A buys a new machine for $35,000 from an unrelated party for use in A's trade or business. On July 1, Year 3, partnership B (unrelated to S corporation A) buys that machine from A for $20,000 for use in B's trade or business. On Oct. 1, Year 3, B makes a $5,000 capital expenditure to recondition the machine. B did not have any depreciable interest in the machine before B acquired it on July 1, Year 3.

A's purchase price of $35,000 satisfies the original use requirement and, assuming all other requirements are met, qualifies for bonus depreciation.

B's purchase price of $20,000 does not satisfy the original use requirement but it does satisfy the used property acquisition requirements. Assuming all other requirements are met, the $20,000 purchase price qualifies for bonus depreciation. Further, B's $5,000 expenditure satisfies the original use requirement and, assuming all other requirements are met, qualifies for bonus depreciation, regardless of whether the $5,000 is added to the basis of the machine or is capitalized as a separate asset [Reg. §1.168(k)-2(b)(3)(vii) Example (1)].

Example

K is in the trade or business of leasing equipment to others. During Year 1, K buys a new machine (Machine #1) and then leases it to L for use in L's trade or business. The lease between K and L for Machine #1 is a true lease for federal income tax purposes.

During Year 3, L enters a written binding contract with K to buy Machine #1 at its fair market value (FMV) on May 15, Year 3. L did not have any depreciable interest in Machine #1 before L acquired it on May 15, Year 3. As a result, L's acquisition of Machine #1 satisfies the used property acquisition requirements. Assuming all other requirements are met, L's purchase price of Machine #1 qualifies for bonus depreciation [Reg. §1.168(k)-2(b)(3)(vii) Example (6)].

On the other hand, if K and L are related parties, L's acquisition of Machine #1 does not satisfy the used property acquisition requirements. Thus, Machine #1 is not eligible for bonus depreciation [Reg. §1.168(k)-2(b)(3)(vii) Example (7)].

Qualified property placed in service after Sept. 27, 2017, includes qualified film, television and live theatrical productions for which a deduction generally would have been allowable under §181. A production is considered placed in service at the time of initial release, broadcast or live staged performance.

Missed bonus depreciation

A taxpayer that failed to make the proper election out of bonus depreciation for eligible property and did not deduct bonus depreciation on its tax return is using an impermissible method of accounting. If the taxpayer only filed a tax return for the year the asset was placed in service but no tax returns since then, the taxpayer can file an amended return to claim the bonus depreciation. On the other hand, if the taxpayer already filed a tax return for the succeeding tax year, the taxpayer must file Form 3115 to claim the missed bonus depreciation.

Example

In May, Year 1, Houston, a calendar year taxpayer, purchased and placed in service new office furniture for use in his trade or business. Houston classified the furniture as seven-year property under the GDS, which qualifies for bonus depreciation. However, Houston failed to claim bonus depreciation, did not elect out of bonus depreciation and claimed regular MACRS depreciation on their Year 1 and Year 2 tax returns.

In Year 3, Houston realizes that no bonus depreciation was claimed for the furniture. A change from not claiming to claiming bonus depreciation for the furniture is a change in method of accounting since Houston did not elect out of bonus depreciation. Houston must file Form 3115.

Cost segregation study

Cost segregation studies performed contemporaneously with the taxable year that qualified property is placed in service should allow enough time before the tax return for that year is filed to determine the amount of bonus depreciation and depreciation allowable on that property. On the other hand, when a cost segregation study is performed after the tax return is filed for the year the qualified property is placed in service, the taxpayer probably did not claim bonus depreciation on that property, and, as a consequence, is using an impermissible method of accounting.

Generally, taxpayers can file an amended tax return for the property's placed-in-service year to claim the bonus depreciation and adjust the depreciation allowable on the qualified property, provided that the amended tax return is filed before the taxpayer files its tax return for the first taxable year succeeding the placed-in-service year. However, if the first taxable year succeeding the placed-in-service year is already filed before the cost segregation study is performed and the qualified property is identified, the taxpayer has adopted an impermissible method of accounting and must change from an impermissible method to a permissible method by filing a Form 3115.

Qualified improvement property

In general, QIP is any improvement to an interior portion of a building that is **nonresidential** real property if the improvement is placed in service after the date the building was first placed in service.

QIP does not include the cost of any improvement attributable to the following:

- Enlargement of the building
- Any elevator or escalator
- Internal structural framework of the building

In addition to being eligible for bonus depreciation, QIP also qualifies for §179.

Correcting depreciation

Taxpayers correct depreciation errors either by filing an amended tax return or Form 3115. As mentioned earlier, if the taxpayer has **not** adopted a method of accounting, they can file an amended return. On the other hand, if they have adopted a method of accounting, they must file Form 3115.

Filing an amended return

Taxpayers can file an amended return to correct the amount of depreciation claimed if they:

- Do not have a change in their method of accounting

- Did not adopt a method of accounting for property placed in service in tax years ending after Dec. 29, 2003
- Claimed the incorrect amount on property placed in service in tax years ending before Dec. 30, 2003

Note: The CARES Act allows amended returns to be filed in certain circumstances for qualified improvement property, even though an accounting method has been adopted.

File an amended return, if allowable, by the latter of the following:

- Three years (including extensions) from the date the taxpayer filed the original return for the year in which the taxpayer did not deduct the correct amount. Consider a return filed before the original due date as filed on the original due date.
    - If the due date is April 15 and the return was filed March 1, the return is considered filed on April 15.
    - If the return is extended to Oct. 15 and filed July 1, the return is considered filed on July 1.
- Two years from the time the taxpayer paid the tax for that year.

Example

In Year 1, Jose bought residential rental property for $520,000 (exclusive of land) that was 27.5-year MACRS property. When filing his Year 2 tax return, Jose determined that he never claimed depreciation on the property in Year 1.

Since depreciation was only missed on one filed tax return, Jose can amend the Year 1 tax return to claim the missed depreciation. He claims Year 2 depreciation on his Year 2 tax return as usual.

Depreciation conclusion

The opportunity to correct missed depreciation deductions means taxpayers do not permanently lose this tax benefit. However, it could result in some taxpayers deliberately not claiming depreciation in a year when they have low income so they can fix it later when their income is higher. Rev. Rul. 56-407 states a taxpayer cannot choose not to claim deductions. Knowing a deduction is available and not claiming it would be a violation of this revenue ruling.

Computing §481(a) adjustment

The adjustment for §481(a) is made to prevent the duplication or omission of an item of income or expense such as, missed depreciation or accounts receivable.

The adjustment becomes either a:

- Negative adjustment, which is an additional expense deduction or
- Positive adjustment, which is additional income

The §481(a) adjustment retains the character of the original item.

The effect the negative or positive change has on income is the same as it would have been had it been made on the original return. A positive §481(a) adjustment of $50,000 or more is spread ratably over four years beginning with the year of the change. With adjustments that are less than $50,000, the taxpayers may choose to include it in their income fully in the year of change. A negative change, such as taking missed depreciation, decreases taxable income, and is taken entirely in the year of change.

If a taxpayer does not regularly employ a method of accounting that clearly reflects its income, the IRS may change the taxpayer's method of accounting to one that, in the opinion of the IRS, does clearly reflect income. In that case, a change in method of accounting resulting in a positive image §481(a) adjustment ordinarily will be made in the earliest taxable year under examination with a one-year image §481(a) adjustment period [§446(b) and Reg. §1.446-1(b)(1)].

In order to make the adjustment, taxpayers will need the original method and when use of it began. A taxpayer must go back a "reasonable" amount of time; however, reasonable is not defined. Generally, for depreciable assets, reasonable is when the asset was first placed in service. Subjectively, materiality may be considered.

Change accounting method

When taxpayers change their method of accounting, §481 prescribes the rules to be followed in computing taxable income for the year of change, the year for which taxable income is computed under a different method of accounting than the one used for the preceding taxable year. As mentioned above, in computing taxable income for the year of change, taxpayers must consider all adjustments, namely §481(a) adjustments, that are necessary to prevent income or expenses from being duplicated or omitted due to the change in method of accounting. Positive adjustments increase taxable income, while negative adjustments decrease taxable income.

The adjustments specified in §481(a) include [Reg §1.481-1(b)]:

- Inventories
- Accounts receivable
- Accounts payable
- Any other item that prevents amounts from being duplicated or omitted

Consolidate all adjustments to determine the net amount of the adjustments:

- Deduct a net negative adjustment in full in the year of change

- Include a net positive adjustment in income over a four-year period beginning in the year of change, unless the positive §481(a) adjustment is less than $50,000 and the taxpayer makes the one-year de minimis election to take 100% of it into account in the year of change

Note: Make the election by checking 'yes' on Form 3115, Part IV, Line 27, and checking the box $50,000 de minimis election.

Eligible taxpayers changing from the accrual method to the cash method must compute a §481(a) adjustment. For example, accounts receivable has already been included in income under the accrual method, but they must be included in income again when collected under the cash method. Thus, income will be duplicated, so the change generates a negative §481(a) adjustment.

When changing from the accrual method to the cash method, start with the accrual basis balance sheet at the beginning of the year. Net all adjustments (increases or decreases in income or expenses) that have been accounted for in previous years under the accrual method that are not accounted for under the cash method.

In general, to compute the net §481(a) adjustment when changing from the accrual method to the cash method, complete the following steps as of the beginning of the year of change:

- Subtract accounts receivable or income items that were included in income but have not been received
- Add accounts payable or accrued expenses that were deducted from income but have not been paid

Depreciation

The adjusted basis of the depreciable property is changed when the taxpayer changes from an impermissible method of depreciation to a permissible method. This change results in a positive or negative §481(a) adjustment. A positive adjustment is usually taken into account over a four-year period, beginning in the year of change. However, if the entire positive §481(a) adjustment is less than $50,000, a de minimis rule permits taxpayers to take 100% of the amount into account in the year of change. A negative adjustment (in the taxpayer's favor) is taken in full in the year of change.

The §481(a) adjustment equals the difference between the total depreciation taken in prior years under the old method and the total depreciation allowable for those years under the new method. As of the beginning of the year of change, the basis of the depreciable property must reflect the §481(a) adjustment.

Attach a statement to Form 3115 showing the net §481(a) adjustment for each change in method of accounting. Include a summary of how the adjustment was computed and an explanation of the methodology used to determine it. This summary must be sufficient to demonstrate that the adjustment is computed correctly.

Completing Form 3115

The actual form is eight pages long and has four parts. Taxpayers requesting an automatic change need to complete Parts I and II and other parts as required based on the change. Taxpayers requesting a non-automatic change need to complete Parts II, III and IV.

Table A: Parts To Complete on Form 3115 for Accounting Method Changes

Information to be completed for automatic and non-automatic change requests

	Part I	Part II	Part III	Part IV
Automatic Change	X	X		X
Non-Automatic Change		X	X	X

When filing Form 3115 for automatic change requests, taxpayers must:

- Attach the original Form 3115 to a timely filed (including extensions) federal income tax return for the year of the change. The original Form 3115 attachment does not need to be signed.
- In addition, the taxpayer must file a copy of Form 3115 with the IRS national office no earlier than the first day of the year of change and no later than when Form 3115 is filed with the federal income tax return for the year of change. See Form 3115 instructions for a list of applicable addresses.

Table B: Schedules To Complete on Form 3115 for Common Accounting Method Changes

Information to be completed for common method change requests

Common Method Changes	Schedule A		Schedule B	Schedule C		Schedule D			Schedule E
	Part I	Part II		Part I	Part II	Part I	Part II	Part III	
Accrual to Cash	X	X							
Cash to Accrual	X		X**						
Capitalize to Expense									
Expense to Capitalize								X*	X*
Depreciation									X
Long-Term Contracts						X		X	
Inventory Valuation Change							X	X*	
LIFO Change—Including Pooling				X	X				
Revenue Recognition Change for Deferral Method for Advance Payments, Cost Offset Methods, and/or Applicable Financial Statement Income Inclusion Rule			X						

X Must fully complete section

Section does not need to be completed.

X* To be completed if applicable—See instructions regarding Schedules D and E, later

X** To be completed if applicable—See instructions regarding Schedule B, later.

An automatic six-month extension from the due date of the return (excluding extensions) for the year of change is available if the taxpayer:

- Timely filed their federal income tax return for the year of change
- Files an amended return within the six-month extension period in a manner consistent with the new method of accounting
- Attaches the original Form 3115 to the amended return
- Files a signed copy of Form 3115 with the national office no later than when the original is filed with the amended return
- Attaches a statement to Form 3115 that it is being filed pursuant to Reg. §301.9100-2(b)

In general, there are no other extensions of time to file Form 3115, except in unusual and compelling circumstances. See Reg. §301.9100-3 for the standards that must be met.

The form is sent independently, for a non-automatic change, to Washington, D.C. A request for a non-automatic change should be made as soon as possible. Although acknowledgement of receipt is sent within 60 days, processing takes months and the request may be rejected.

Form 3115, Pages 1-8:

Page 1:

Form 3115, Page 1, begins with the heading. The first part of the form is the information about the filer. The taxpayer enters their personal information, information about their business and the change requested. It is important to realize that the "tax year the change begins" is the tax year that the form is filed, not the original year being adjusted.

Part I: Information for an Automatic Change Request

- Line 1:
    - a: Enter the DCN
    - b: Other - If the accounting method change is not included in *the List of Automatic Changes* or assigned a number in the published guidance providing the automatic accounting method change, check the box for "Other" on Line 1b and identify the revenue procedure or other published guidance under which the automatic accounting method change is being requested.
- Line 2: Generally, taxpayers will answer no to this question
- Line 3: Check yes to this question
    - Only file the schedules that are required for the DCN

Part II: Information for All Requests

- Line 4: Reports whether the business is in its final year
- Line 5: Is the applicant requesting to change to the principal method in the tax year of change under Regs. §1.381(c)(4)-1(d)(1) or §1.381(c)(5)-1(d)(1)
    - If no, go to Line 6a
    - If yes, Form 3115 cannot be filed for this change

Note: Reference to regulations above.

Reg. §1.381(c)(4)-1(d)(1), *Method of accounting, Procedures for changing a method of accounting, Change made to principal method*, refers to the §481(a) adjustment with examples. Applies to most changes made to impose a **common accounting method** on trades or businesses combined after a §381(a) transaction.

Reg. §1.381(c)(5)-1(d)(1), *Inventory method, Procedures for changing a method of accounting, Change made to principal method*, refers to the §481(a) adjustment with examples. It applies to changes made to impose a **common inventory method** on trades or businesses combined after a §381(a) transaction.

§381(a) refers to carryovers in certain corporate acquisitions.

Form 3115, Page 1

Form **3115** (Rev. December 2022) Department of the Treasury Internal Revenue Service

Application for Change in Accounting Method

Go to *www.irs.gov/Form3115* for instructions and the latest information.

OMB No. 1545-2070

Attachment Sequence No. **315**

Name of filer (name of parent corporation if a consolidated group) (see instructions)	**Identification number** (see instructions)
	Principal business activity code number (see instructions)
Number, street, and room or suite no. If a P.O. box, see the instructions.	Tax year of change begins (MM/DD/YYYY) Tax year of change ends (MM/DD/YYYY)
City or town, state, and ZIP code	Name of contact person (see instructions)
Name of applicant(s) (if different than filer) and identification number(s) (see instructions)	Contact person's telephone number

Does the filer want to receive a copy of the change in method of accounting letter ruling or other correspondence related to this Form 3115 by fax or encrypted email attachment? If "Yes," see instructions . . . . ☐ **Yes** ☐ **No**

If the applicant is a member of a consolidated group, check this box . . . . ☐

If **Form 2848**, Power of Attorney and Declaration of Representative, is attached (see instructions for when Form 2848 is required), check this box . . . . ☐

Check the box to indicate the type of applicant.

- ☐ Individual
- ☐ Corporation
- ☐ Controlled foreign corporation (Sec. 957)
- ☐ 10/50 corporation (Sec. 904(d)(2)(E))
- ☐ Qualified personal service corporation (Sec. 448(d)(2))
- ☐ Exempt organization. Enter Code section:
- ☐ Cooperative (Sec. 1381)
- ☐ Partnership
- ☐ S corporation
- ☐ Insurance co. (Sec. 816(a))
- ☐ Insurance co. (Sec. 831)
- ☐ Other (specify):________________

Check the appropriate box to indicate the type of accounting method change being requested. See instructions.

- ☐ Depreciation or Amortization
- ☐ Financial Products and/or Financial Activities of Financial Institutions
- ☐ Other (specify):________________

Caution: To be eligible for approval of the requested change in method of accounting, the taxpayer must provide all information that is relevant to the taxpayer or to the taxpayer's requested change in method of accounting. This includes (**1**) all relevant information requested on this Form 3115 (including its instructions), and (**2**) any other relevant information, even if not specifically requested on Form 3115.
The taxpayer must attach all applicable statements requested throughout this form.

Part I Information for Automatic Change Request

		Yes	No
1	Enter the applicable designated automatic accounting method change number ("DCN") for the requested automatic change. Enter only one DCN, except as provided for in guidance published by the IRS. If the requested change has no DCN, check "Other," and provide both a description of the change and a citation of the IRS guidance providing the automatic change. See instructions.		
a	(1) DCN: ______ (2) DCN: ______ (3) DCN: ______ (4) DCN:______ (5) DCN:______ (6) DCN:______ (7) DCN: ______ (8) DCN: ______ (9) DCN: ______ (10) DCN:______ (11) DCN:______ (12) DCN:______		
b	Other ☐ Description:________________		
2	Do any of the eligibility rules restrict the applicant from filing the requested change using the automatic change procedures (see instructions)? If "Yes," attach an explanation		
3	Has the filer provided all the information and statements required (**a**) on this form and (**b**) by the List of Automatic Changes under which the applicant is requesting a change? See instructions		
	Note: Complete Part II and Part IV of this form, and, Schedules A through E, if applicable.		

Part II Information for All Requests

		Yes	No
4	During the tax year of change, did or will the applicant (**a**) cease to engage in the trade or business to which the requested change relates, or (**b**) terminate its existence? See instructions		
5	Is the applicant requesting to change to the principal method in the tax year of change under Regulations section 1.381(c)(4)-1(d)(1) or 1.381(c)(5)-1(d)(1)? . . . . If "No," go to line 6a. If "Yes," the applicant cannot file a Form 3115 for this change. See instructions.		

Sign Here

Under penalties of perjury, I declare that I have examined this application, including accompanying schedules and statements, and to the best of my knowledge and belief, the application contains all the relevant facts relating to the application, and it is true, correct, and complete. Declaration of preparer (other than applicant) is based on all information of which preparer has any knowledge.

Signature of filer (and spouse, if joint return)	Date	Name and title (print or type)

Preparer (other than filer/applicant)

Print/Type preparer's name	Preparer's signature	Date
Firm's name		

For Privacy Act and Paperwork Reduction Act Notice, see the instructions. Cat. No. 19280E Form **3115** (Rev. 12-2022)

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Part II, Continued

- Lines 6a-10: Concern audits and audit protection
- Lines 11a-11c: Relates to the five-year lookback period for making a change
- Line 12: Discloses whether the taxpayer has any other pending letter rulings, changes or technical advice
  - If yes, for each request, attach a statement providing the:
    - Name(s) of the taxpayer
    - Identification number(s)
    - Type of request (private letter ruling, change in method of accounting, or technical advice), and
    - Specific issue(s) in the request(s)
- Line 13: Reports whether the change is to an overall method of accounting or a material item.
  - If yes, complete Form 3115, Page 4, Schedule A

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Part II Information for All Requests (*continued*)

		Yes	No
6a	Does the applicant (or any present or former consolidated group in which the applicant was a member during the applicable tax year(s)) have any federal income tax return(s) under examination (see instructions)? . . . . . . If "No," go to line 7a.		
b	Is the method of accounting the applicant is requesting to change an issue under consideration (with respect to either the applicant or any present or former consolidated group in which the applicant was a member during the applicable tax year(s))? See instructions		
c	Enter the name and telephone number of the examining agent and the tax year(s) under examination. Name ____ Telephone number ____ Tax year(s) ____		
d	Has a copy of this Form 3115 been provided to the examining agent identified on line 6c?		
7a	Does audit protection apply to the applicant's requested change in method of accounting? See instructions . . If "No," attach an explanation.		
b	If "Yes," check the applicable box and attach the required statement. ☐ Not under exam ☐ 3-month window ☐ 120 day: Date examination ended ____ ☐ Method not before director ☐ Negative adjustment ☐ CAP: Date member joined group ____ ☐ Audit protection at end of exam ☐ Other		
8a	Does the applicant (or any present or former consolidated group in which the applicant was a member during the applicable tax year(s)) have any federal income tax return(s) before Appeals and/or a federal court? . . . . . . If "No," go to line 9.		
b	Is the method of accounting the applicant is requesting to change an issue under consideration by Appeals and/or a federal court (for either the applicant or any present or former consolidated group in which the applicant was a member for the tax year(s) the applicant was a member)? See instructions . . . . If "Yes," attach an explanation.		
c	If "Yes," enter the name of the (check the box) ☐ Appeals officer and/or ☐ counsel for the government, telephone number, and the tax year(s) before Appeals and/or a federal court. Name ____ Telephone number ____ Tax year(s) ____		
d	Has a copy of this Form 3115 been provided to the Appeals officer and/or counsel for the government identified on line 8c?		
9	If the applicant answered "Yes" to line 6a and/or 8a with respect to any present or former consolidated group, attach a statement that provides each parent corporation's (**a**) name, (**b**) identification number, (**c**) address, and (**d**) tax year(s) during which the applicant was a member that is under examination, before an Appeals office, and/or before a federal court.		
10	If for federal income tax purposes, the applicant is either an entity (including a limited liability company) treated as a partnership or an S corporation, is it requesting a change from a method of accounting that is an issue under consideration in an examination, before Appeals, or before a federal court, with respect to a federal income tax return of a partner, member, or shareholder of that entity?		
11a	Has the applicant, its predecessor, or a related party requested or made (under either an automatic or non-automatic change procedure) a change in method of accounting within any of the 5 tax years ending with the tax year of change? . . . . If "No," go to line 12.		
b	If "Yes," for each trade or business, attach a description of each requested change in method of accounting (including the tax year of change) and state whether the applicant received consent.		
c	If any application was withdrawn, not perfected, or denied, or if a Consent Agreement granting a change was not signed and returned to the IRS, or the change was not made or not made in the requested year of change, attach an explanation.		
12	Does the applicant, its predecessor, or a related party currently have pending any request (including any concurrently filed request) for a private letter ruling, change in method of accounting, or technical advice? . . . If "Yes," for each request attach a statement providing (**a**) the name(s) of the taxpayer, (**b**) identification number(s), (**c**) the type of request (private letter ruling, change in method of accounting, or technical advice), and (**d**) the specific issue(s) in the request(s).		
13	Is the applicant requesting to change its **overall** method of accounting? . . . . If "Yes," complete Schedule A on page 4 of the form.		

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Part II, Continued

- Line 14: Requires an attachment describing the items being changed, the present method, the proposed method and current overall method. This is for taxpayers **not** changing the overall method only.
- Lines 15a and 15b: Require a detailed description of the taxpayer's business under §446(d)
- Lines 16a-16c: Require an attachment of the legal basis for the change
- Line 17: Discloses whether the method will be used for the applicant's books and records, and financial statements
    - If no, attach an explanation
- Line 18: Allows the taxpayer to request a conference in the event of rejection
- Line 19:
    - a: Requires that if the applicant is changing to cash or accrual, or under certain other scenarios, they must report the gross receipts for the prior three years.
    - b: If change is for any long-term contract subject to §460 enter the fourth preceding tax year gross receipts

Part III: Information for Non-Automatic Change Request

- Lines 20-24b: Contains a few questions for taxpayers making a non-automatic change request. The taxpayer must disclose why the request is not an automatic change request, whether they are a member of a consolidated group, and the amount of the user fee to be paid through www.pay.gov. Remember, while an automatic change is free, a non-automatic request is costly.

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Part II Information for All Requests (*continued*) **Yes No**

14 If the applicant is either (**i**) **not** changing its overall method of accounting, or (**ii**) changing its overall method of accounting **and** changing to a special method of accounting for one or more items, attach a detailed and complete description for each of the following (see instructions):

a The item(s) being changed.

b The applicant's present method for the item(s) being changed.

c The applicant's proposed method for the item(s) being changed.

d The applicant's present overall method of accounting (cash, accrual, or hybrid).

15a Attach a detailed and complete description of the applicant's trade(s) or business(es). See section 446(d).

b If the applicant has more than one trade or business, as defined in Regulations section 1.446-1(d), describe (**i**) whether each trade or business is accounted for separately; (**ii**) the goods and services provided by each trade or business and any other types of activities engaged in that generate gross income; (**iii**) the overall method of accounting for each trade or business; and (**iv**) which trade or business is requesting to change its accounting method as part of this application or a separate application.

Note: If you are requesting an automatic method change, see the instructions to see if you are required to complete lines 16a–16c.

16a Attach a full explanation of the legal basis supporting the proposed method for the item being changed. Include a detailed and complete description of the facts that explains how the law specifically applies to the applicant's situation and that demonstrates that the applicant is authorized to use the proposed method.

b Include all authority (statutes, regulations, published rulings, court cases, etc.) supporting the proposed method.

c Include either a discussion of the contrary authorities or a statement that no contrary authority exists.

17 Will the proposed method of accounting be used for the applicant's books and records and financial statements? For insurance companies, see the instructions . . . .

If "No," attach an explanation.

18 Does the applicant request a conference with the IRS National Office if the IRS National Office proposes an adverse response? . . . .

19a If the applicant is changing to either the overall cash method, an overall accrual method, or is changing its method of accounting for any property subject to section 263A, any long-term contract subject to section 460 (see 19b), or inventories subject to section 471 or 474, enter the applicant's gross receipts for the 3 tax years preceding the tax year of change.

1st preceding year ended: mo. yr.	2nd preceding year ended: mo. yr.	3rd preceding year ended: mo. yr.
$	$	$

b If the applicant is changing its method of accounting for any long-term contract subject to section 460, in addition to completing 19a, enter the applicant's gross receipts for the 4th tax year preceding the tax year of change:
4th preceding year ended: mo. ________ yr. _____ $ ____________

Part III Information for Non-Automatic Change Request **Yes No**

20 Is the applicant's requested change described in any revenue procedure, revenue ruling, notice, regulation, or other published guidance as an automatic change request? . . . .

If "Yes," attach an explanation describing why the applicant is submitting its request under the non-automatic change procedures.

21 Attach a copy of all documents related to the proposed change (see instructions).

22 Attach a statement of the applicant's reasons for the proposed change.

23 If the applicant is a member of a consolidated group for the year of change, do all other members of the consolidated group use the proposed method of accounting for the item being changed? . . . .

If "No," attach an explanation.

24a Enter the amount of **user fee** attached to this application (see instructions) . . . . . . $ ____________

b If the applicant qualifies for a reduced user fee, attach the required information or certification (see instructions).

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Part IV: Section 481(a) Adjustment

- Line 25: The taxpayer must report whether cut-off is allowed; if so, the balance of Part IV is to be completed. "Cut-off" means the change can be made without making a §481(a) adjustment. Only items arising during the year of change and after are accounted for with the new method.
- Line 26: Reports the §481(a) adjustment. The taxpayer must attach a summary with the calculation and method used.
- Line 27: Including a prior year §481(a) adjustment in income
  - If yes, enter the amount included in income for the current year
- Line 28: Allows the taxpayer to elect to report the entire amount in one year if it is a de minimis amount. In this case, that would be an amount less than $50,000. Answering this question can be counterintuitive. If the adjustment is reducing tax, an election is not being made; it is the only option. An election is made when tax is increased, and the taxpayer chooses to pay it all in the current year instead of spreading it over four years.
- Line 29: Is the §481(a) adjustment attributable to transactions between members of an affiliated group, a consolidated group, a controlled group or other related parties
  - If yes, attach an explanation

Schedule A – Change in Overall Method of Accounting

Taxpayers complete Schedule A to change the overall method of accounting, not just a material item. On Schedule A, Part 1, the taxpayer must report the present and proposed methods, as well as information about the finances as of the close of the prior year.

The net §481(a) adjustment is reported. Also, copies of the profit and loss statements and balance sheets must be attached along with an explanation if numbers do not match. If the taxpayer is changing to the cash method, a description of the inventory must also be attached, along with an explanation of whether the accrual method must be used.

Schedule A, Part II, is used to report non-automatic change requests. Attach information describing inventory items, materials and supplies used in carrying out the business. Also attach an explanation as to whether the applicant is required to use an accrual method under any section of the Tax Code or regulations.

Schedule A, Part I – Change in Overall Method

- Line 1: Check the appropriate boxes below to indicate the applicant's present and proposed methods of accounting.
  - Present method – cash, accrual or hybrid
  - Proposed method – cash, accrual or hybrid

- Lines 2a-g: Enter the following amounts as of the close of the tax year preceding the year of change. If none, state "None." Also, attach a statement providing a breakdown of the amounts entered on Lines 2a-2g.
  - 2a: Income accrued but not received (such as accounts receivable)
  - 2b: Income received or reported before it was earned (such as advanced payments)
    - Attach a description of the income and the legal basis for the proposed method
  - 2c: Expenses accrued but not paid (such as accounts payable)
  - 2d: Prepaid expenses previously deducted
  - 2e: Supplies on hand previously deducted and/or not previously reported
  - 2f: Inventory on hand previously deducted and/or not previously reported
    - Complete Schedule D, Part II
  - 2g: Other amounts (specify)
    - Attach a description of the item and the legal basis for its inclusion in the calculation of the §481(a) adjustment
  - 2h: Net §481(a) adjustment (combine Lines 2a-2g.)
    - Indicate whether the adjustment is an increase (+) or decrease (-) in income. Also enter the net amount of this §481(a) adjustment amount on Part IV, Line 26.
- Line 3: Check yes or no if the applicant is also requesting the recurring item exception under §461(h)(3)?
- Line 4: Attach copies of the profit and loss statement and the balance sheet, if applicable, as of the close of the tax year preceding the year of change. Also attach a statement specifying the accounting method used when preparing the balance sheet. If books of account are not kept, attach a copy of the business schedules submitted with the federal income tax return or other return (such as tax-exempt organization returns) for that period. If the amounts in Part I, Lines 2a-g, do not agree with the amounts shown on the balance sheet, attach a statement explaining the differences.
- Line 5: Check yes or no if the applicant is making a change to the overall cash method or to a method in which a taxpayer uses an accrual method for purchases and sales of inventory, and uses the cash method for computing all other items of income and expense (see instructions)?

Schedule A, Part II – Change to the Cash Method for Non-Automatic Change Request

Applicants requesting a change to the cash method must attach the following information:

- Line 1: A description of inventory items (items whose production, purchase or sale is an income-producing factor) and materials and supplies used in carrying out the business
- Line 2: An explanation as to whether the applicant is required to use an accrual method under any section of the Tax Code or regulations

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Part IV Section 481(a) Adjustment — Yes | No

25 Does published guidance require the applicant (or permit the applicant and the applicant is electing) to implement the requested change in method of accounting on a cut-off basis? . . . .
If "Yes," attach an explanation and do not complete lines 26, 27, 28, and 29 below.

26 Enter the section 481(a) adjustment. Indicate whether the adjustment is an increase (+) or a decrease (-) in income. $________________ Attach a summary of the computation and an explanation of the methodology used to determine the section 481(a) adjustment. If it is based on more than one component, show the computation for each component. If the applicant waived any deductions with respect to the method of accounting pursuant to Regulations section 1.59A-3(c)(6)(i), include a summary of the waived deductions. If more than one applicant is applying for the method change on the application, attach a list of the (**a**) name, (**b**) identification number, and (**c**) the amount of the section 481(a) adjustment attributable to each applicant.

27 Is the applicant required to take into account in the year of change any remaining portion of a section 481(a) adjustment from a prior change (see instructions)? If "Yes," enter the amount. $ ______________ . . . . . .

28 Is the applicant making an election to take the entire amount of the adjustment into account in the tax year of change?
If "Yes," check the box for the applicable elective provision used to make the election (see instructions).
☐ $50,000 de minimis election ☐ Eligible acquisition transaction election

29 Is any part of the section 481(a) adjustment attributable to transactions between members of an affiliated group, a consolidated group, a controlled group, or other related parties? . . . .
If "Yes," attach an explanation.

Schedule A—Change in Overall Method of Accounting (If Schedule A applies, Part I below must be completed.)

Part I Change in Overall Method (see instructions)

1 Check the appropriate boxes below to indicate the applicant's present and proposed methods of accounting.

Present method:	☐ Cash	☐ Accrual	☐ Hybrid (attach description)
Proposed method:	☐ Cash	☐ Accrual	☐ Hybrid (attach description)

2 Enter the following amounts as of the close of the tax year preceding the year of change. If none, state "None." Also, attach a statement providing a breakdown of the amounts entered on lines 2a through 2g.

		Amount
a	Income accrued but not received (such as accounts receivable)	$
b	Income received or reported before it was earned (such as advanced payments). Attach a description of the income and the legal basis for the proposed method	
c	Expenses accrued but not paid (such as accounts payable)	
d	Prepaid expenses previously deducted	
e	Supplies on hand previously deducted and/or not previously reported	
f	Inventory on hand previously deducted and/or not previously reported. Complete Schedule D, Part II .	
g	Other amounts (specify). Attach a description of the item and the legal basis for its inclusion in the calculation of the section 481(a) adjustment. --	
h	**Net section 481(a) adjustment** (Combine lines 2a–2g.) Indicate whether the adjustment is an increase (+) or decrease (-) in income. Also enter the net amount of this section 481(a) adjustment amount on Part IV, line 26	$

3 Is the applicant also requesting the recurring item exception under section 461(h)(3)? . . . . ☐ **Yes** ☐ **No**

4 Attach copies of the profit and loss statement (Schedule F (Form 1040) for farmers) and the balance sheet, if applicable, as of the close of the tax year preceding the year of change. Also attach a statement specifying the accounting method used when preparing the balance sheet. If books of account are not kept, attach a copy of the business schedules submitted with the federal income tax return or other return (such as tax-exempt organization returns) for that period. If the amounts in Part I, lines 2a through 2g, do not agree with the amounts shown on the balance sheet, attach a statement explaining the differences.

5 Is the applicant making a change to the overall cash method or to a method in which a taxpayer uses an accrual method for purchases and sales of inventory and uses the cash method for computing all other items of income and expense (see instructions)? . . . . ☐ **Yes** ☐ **No**

Part II Change to the Cash Method for Non-Automatic Change Request (see instructions)

Applicants requesting a change to the cash method must attach the following information:

1 A description of inventory items (items whose production, purchase, or sale is an income-producing factor) and materials and supplies used in carrying out the business.

2 An explanation as to whether the applicant is required to use an accrual method under any section of the Code or regulations.

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Schedule B – Changes Related to the Deferral Method for Advance Payments, Cost Offset Methods, and/or the Applicable Financial Statement Income Inclusion Rule

Schedule B reports a change to the deferral method for advance payments, cost offset methods, and/or the applicable financial statement income inclusion rule. This schedule does not have any information on the Form 3115 itself but is a list of statements that must be filed.

- Line 1: If the applicant is requesting to change to the deferral method for advance payments under Reg. §1.451-8(c) or (d), as described in the instructions, attach the information specified in the instructions.
- Line 2: If the applicant is requesting to change to or within a cost offset method under Reg. §1.451-3(c) and/or Reg. §1.451-8(e), as described in the instructions, attach the information specified in the instructions.
- Line 3: If the applicant is requesting to change to or within a method to conform to the applicable financial statement (AFS) income inclusion rule under §451(b) and Reg. §1.451-3, as described in the instructions, attach a detailed description of the proposed method including the information specified in the instructions.

Schedule C – Changes Within the LIFO Inventory Method

Schedule C covers changes within the LIFO inventory method in two parts:

- Part I: *General LIFO Information*
- Part II: *Change in Pooling Inventories*

Attach Form 970, *Application to Use LIFO Inventory Method*, to Form 3115. There is no information transmitted on Form 3115 itself, but the schedule contains a list of attachments that are required for making the change. The taxpayer must attach a description of the current and proposed methods and a list of any items that use a different method.

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Schedule B—Changes Related to the Deferral Method for Advance Payments, Cost Offset Methods, and/or the Applicable Financial Statement Income Inclusion Rule (see instructions)

1 If the applicant is requesting to change to the deferral method for advance payments under Regulations section 1.451-8(c) or (d), as described in the instructions, attach the information specified in the instructions.

2 If the applicant is requesting to change to or within a cost offset method under Regulations section 1.451-3(c) and/or Regulations section 1.451-8(e), as described in the instructions, attach the information specified in the instructions.

3 If the applicant is requesting to change to or within a method to conform to the applicable financial statement (AFS) income inclusion rule under section 451(b) and Regulations section 1.451-3, as described in the instructions, attach a detailed description of the proposed method including the information specified in the instructions.

Schedule C—Changes Within the LIFO Inventory Method (see instructions)

Part I General LIFO Information

Complete this section if the requested change involves changes within the LIFO inventory method. Also, attach a copy of all **Forms 970**, Application To Use LIFO Inventory Method, filed to adopt or expand the use of the LIFO method.

1 Attach a description of the applicant's present and proposed LIFO methods and submethods for each of the following items:

a Valuing inventory (for example, unit method or dollar-value method).

b Pooling (for example, by line or type or class of goods, natural business unit, multiple pools, raw material content, simplified dollar-value method, inventory price index computation (IPIC) pools, vehicle-pool method, etc.).

c Pricing dollar-value pools (for example, double-extension, index, link-chain, link-chain index, IPIC method, etc.).

d Determining the current-year cost of goods in the ending inventory (such as, most recent acquisitions, earliest acquisitions during the current year, average cost of current-year acquisitions, rolling-average cost, or other permitted method).

2 If any present method or submethod used by the applicant is not the same as indicated on Form(s) 970 filed to adopt or expand the use of the method, attach an explanation.

3 If the proposed change is not requested for all the LIFO inventory, attach a statement specifying the inventory to which the change is and is not applicable.

4 If the proposed change is not requested for all of the LIFO pools, attach a statement specifying the LIFO pool(s) to which the change is applicable.

5 Attach a statement addressing whether the applicant values any of its LIFO inventory on a method other than cost. For example, if the applicant values some of its LIFO inventory at retail and the remainder at cost, identify which inventory items are valued under each method.

6 If changing to the IPIC method, attach a completed Form 970.

Part II Change in Pooling Inventories

1 If the applicant is proposing to change its pooling method or the number of pools, attach a description of the contents of, and state the base year for, each dollar-value pool the applicant presently uses and proposes to use.

2 If the applicant is proposing to use natural business unit (NBU) pools or requesting to change the number of NBU pools, attach the following information (to the extent not already provided) in sufficient detail to show that each proposed NBU was determined under Regulations sections 1.472-8(b)(1) and (2):

a A description of the types of products produced by the applicant. If possible, attach a brochure.

b A description of the types of processes and raw materials used to produce the products in each proposed pool.

c If all of the products to be included in the proposed NBU pool(s) are not produced at one facility, state the reasons for the separate facilities, the location of each facility, and a description of the products each facility produces.

d A description of the natural business divisions adopted by the taxpayer. State whether separate cost centers are maintained and if separate profit and loss statements are prepared.

e A statement addressing whether the applicant has inventories of items purchased and held for resale that are not further processed by the applicant, including whether such items, if any, will be included in any proposed NBU pool.

f A statement addressing whether all items including raw materials, goods-in-process, and finished goods entering into the entire inventory investment for each proposed NBU pool are presently valued under the LIFO method. Describe any items that are not presently valued under the LIFO method that are to be included in each proposed pool.

g A statement addressing whether, within the proposed NBU pool(s), there are items both sold to unrelated parties and transferred to a different unit of the applicant to be used as a component part of another product prior to final processing.

3 If the applicant is engaged in manufacturing and is proposing to use the multiple pooling method or raw material content pools, attach information to show that each proposed pool will consist of a group of items that are substantially similar. See Regulations section 1.472-8(b)(3).

4 If the applicant is engaged in the wholesaling or retailing of goods and is requesting to change the number of pools used, attach information to show that each of the proposed pools is based on customary business classifications of the applicant's trade or business. See Regulations section 1.472-8(c).

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Schedule D – Change in the Treatment of Long-Term Contracts Under Section 460, Inventories, or Other Section 263A Assets

Schedule D reports a change in the treatment of long-term contracts, inventories or other §263A assets (costs of producing or attaining inventory). When the taxpayer makes a change in reporting income from long-term contracts, for example from the completed contract or percentage of completion method, Schedule D, Parts I and III must be completed. Taxpayers making a change to the valuation of inventories complete Schedule D, Part II.

Part I – Change in Reporting Income From Long-Term Contracts

- Line 1: To the extent not already provided, attach a description of the applicant's present and proposed methods for reporting income and expenses from long-term contracts.
- Lines 2a-e: Are the applicant's contracts long-term contracts as defined in §460(f)(1)?
- Lines 3a-b: Does the applicant have long-term manufacturing contracts as defined in §460(f)(2)?
- Line 4:
  - 4a: Does the applicant enter into cost-plus long-term contracts?
  - 4b: Does the applicant enter into federal long-term contracts?

Part II – Change in Valuing Inventories Including Cost Allocation Changes

- Line 1: Attach a description of the inventory goods being changed.
- Line 2: Attach a description of the inventory goods (if any) **not** being changed.
- Line 3:
  - 3a: Is the applicant subject to §263A? If "No," go to Line 4a
  - 3b: Is the applicant's present inventory valuation method in compliance with §263A (see instructions)? If "No," attach a detailed explanation
- Line 4:
  - Line 4a: Check the appropriate boxes in the chart.
  - Line 4b: Enter the value at the end of the tax year preceding the year of change.
- Lines 5a-c: If the applicant is changing from the LIFO inventory method to a non-LIFO method, attach the following information (see instructions).
- Line 6: Is the applicant presently using the AFS cost offset method as described in Reg. §1.451-3(c) and/or the advance payment cost offset method described in Reg. §1.451-8(e), or is the applicant changing to such methods for the same year of change as the requested change in inventory method?

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Schedule D—Change in the Treatment of Long-Term Contracts Under Section 460, Inventories, or Other Section 263A Assets (see instructions)

Part I Change in Reporting Income From Long-Term Contracts (Also complete Part III on pages 7 and 8.)

1 To the extent not already provided, attach a description of the applicant's present and proposed methods for reporting income and expenses from long-term contracts. Also, attach a representative actual contract (without any deletions) for the requested change. If the applicant is a construction contractor, attach a detailed description of its construction activities.

2a Are the applicant's contracts long-term contracts as defined in section 460(f)(1) (see instructions)? ☐ Yes ☐ No

b If "Yes," do all the contracts qualify for the exception under section 460(e) (see instructions)? ☐ Yes ☐ No
If line 2b is "No," attach an explanation.

c Is the applicant requesting to use the percentage-of-completion method using cost-to-cost under Regulations section 1.460-4(b)? ☐ Yes ☐ No

d If line 2c is "Yes," in computing the completion factor of a contract, will the applicant use the simplified cost-to-cost method described in Regulations section 1.460-5(c)? ☐ Yes ☐ No

e If line 2c is "No," is the applicant requesting to use the exempt-contract percentage-of-completion method under Regulations section 1.460-4(c)(2)? ☐ Yes ☐ No
If line 2e is "Yes," attach an explanation of what method the applicant will use to determine a contract's completion factor.
If line 2e is "No," attach an explanation of what method the applicant is using and the authority for its use.

3a Does the applicant have long-term manufacturing contracts as defined in section 460(f)(2)? ☐ Yes ☐ No

b If "Yes," attach a description of the applicant's manufacturing activities, including any required installation of manufactured goods.

4a Does the applicant enter into cost-plus long-term contracts? ☐ Yes ☐ No

b Does the applicant enter into federal long-term contracts? ☐ Yes ☐ No

Part II Change in Valuing Inventories Including Cost Allocation Changes (Also complete Part III on pages 7 and 8.)

1 Attach a description of the inventory goods being changed.

2 Attach a description of the inventory goods (if any) NOT being changed.

3a Is the applicant subject to section 263A? If "No," go to line 4a ☐ Yes ☐ No

b Is the applicant's present inventory valuation method in compliance with section 263A (see instructions)? If "No," attach a detailed explanation ☐ Yes ☐ No

4a Check the appropriate boxes in the chart.

	Inventory Method Being Changed		Inventory Method Not Being Changed
	Present method	Proposed method	Present method
Identification methods:			
Specific identification			
FIFO			
LIFO			
Other (attach explanation)			
Valuation methods:			
Cost			
Cost or market, whichever is lower			
Retail cost			
Retail, lower of cost or market			
Other (attach explanation)			
b Enter the value at the end of the tax year preceding the year of change.	$	$	

5 If the applicant is changing from the LIFO inventory method to a non-LIFO method, attach the following information (see instructions).

a Copies of Form(s) 970 filed to adopt or expand the use of the method.

b **Only for applicants requesting a non-automatic change.** A statement describing whether the applicant is changing to the method required by Regulations section 1.472-6(a) or (b), or whether the applicant is proposing a different method.

c **Only for applicants requesting an automatic change.** The statement required by section 23.01(5) of Rev. Proc. 2022-14 (or its successor).

6 Is the applicant presently using the AFS cost offset method as described in Regulations section 1.451-3(c) and/or the advance payment cost offset method described in Regulations section 1.451-8(e), or is the applicant changing to such methods for the same year of change as the requested change in inventory method? If "Yes," see the instructions for rules regarding concurrent changes ☐ Yes ☐ No

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Page 7:

Schedule D – Continued

Part III of Schedule D has an exhaustive list of costs. Changes must be reported using the present and proposed method.

Part III – Method of Cost Allocation

Section A – Allocation and Capitalization Methods

Attach a description (including sample computations) of the present and proposed method(s) the applicant uses to capitalize direct and indirect costs properly allocable to real or tangible personal property produced and property acquired for resale, or to allocate direct and indirect costs required to be allocated to long-term contracts. Include a description of the method(s) used for allocating indirect costs to intermediate cost objectives such as departments or activities prior to the allocation of such costs to long-term contracts, real or tangible personal property produced, and property acquired for resale.

The description must include the following:

1. The method of allocating direct and indirect costs (for example, specific identification, burden rate, standard cost or other reasonable allocation method).
2. The method of allocating mixed service costs (for example, direct reallocation, step-allocation, simplified service cost using the labor-based allocation ratio, simplified service cost using the production cost allocation ratio or other reasonable allocation method).
3. Except for long-term contract accounting methods, the method of capitalizing additional §263A costs (for example, simplified production with or without the historic absorption ratio election, modified simplified production with or without the historic absorption ratio election, simplified resale with or without the historic absorption ratio election including permissible variations, the U.S. ratio, or other reasonable allocation method).

Section B – Direct and Indirect Costs Required To Be Allocated

Check the appropriate boxes showing the costs that are or will be fully included, to the extent required, in the cost of real or tangible personal property produced or property acquired for resale under §263A or allocated to long-term contracts under §460. Mark "N/A" in a box if the applicant does not incur those costs. If a box is not checked, it is assumed that those costs are not fully included to the extent required.

Attach an explanation for boxes that are not checked on Lines 1-28.

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Part III **Method of Cost Allocation** (Complete this part if the requested change involves either property subject to section 263A or long-term contracts as described in section 460.) See instructions.

Section A—Allocation and Capitalization Methods

Attach a description (including sample computations) of the present and proposed method(s) the applicant uses to capitalize direct and indirect costs properly allocable to real or tangible personal property produced and property acquired for resale, or to allocate direct and indirect costs required to be allocated to long-term contracts. Include a description of the method(s) used for allocating indirect costs to intermediate cost objectives such as departments or activities prior to the allocation of such costs to long-term contracts, real or tangible personal property produced, and property acquired for resale. The description must include the following:

1. The method of allocating direct and indirect costs (for example, specific identification, burden rate, standard cost, or other reasonable allocation method).
2. The method of allocating mixed service costs (for example, direct reallocation, step-allocation, simplified service cost using the labor-based allocation ratio, simplified service cost using the production cost allocation ratio, or other reasonable allocation method).
3. Except for long-term contract accounting methods, the method of capitalizing additional section 263A costs (for example, simplified production with or without the historic absorption ratio election, modified simplified production with or without the historic absorption ratio election, simplified resale with or without the historic absorption ratio election including permissible variations, the U.S. ratio, or other reasonable allocation method).

Section B—Direct and Indirect Costs Required To Be Allocated

Check the appropriate boxes showing the costs that are or will be fully included, to the extent required, in the cost of real or tangible personal property produced or property acquired for resale under section 263A or allocated to long-term contracts under section 460. Mark "N/A" in a box if those costs are not incurred by the applicant. If a box is not checked, it is assumed that those costs are not fully included to the extent required. Attach an explanation for boxes that are not checked.

		Present method	Proposed method
1	Direct material		
2	Direct labor		
3	Indirect labor		
4	Officers' compensation (not including selling activities)		
5	Pension and other related costs		
6	Employee benefits		
7	Indirect materials and supplies		
8	Purchasing costs		
9	Handling, processing, assembly, and repackaging costs		
10	Offsite storage and warehousing costs		
11	Depreciation, amortization, and cost recovery allowance for equipment and facilities placed in service and not temporarily idle		
12	Depletion		
13	Rent		
14	Taxes other than state, local, and foreign income taxes		
15	Insurance		
16	Utilities		
17	Maintenance and repairs that relate to a production, resale, or long-term contract activity		
18	Engineering and design costs (not including section 174 research and experimental expenses)		
19	Rework labor, scrap, and spoilage		
20	Tools and equipment		
21	Quality control and inspection		
22	Bidding expenses incurred in the solicitation of contracts awarded to the applicant		
23	Licensing and franchise costs		
24	Capitalizable service costs (including mixed service costs)		
25	Administrative costs (not including any costs of selling or any return on capital)		
26	Research and experimental expenses attributable to long-term contracts		
27	Interest		
28	Other costs (Attach a list of these costs.)		

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Schedule D – Continued

Part III of Schedule D has an exhaustive list of costs.

Section C – Other Costs Not Required To Be Allocated

Complete Section C only if the applicant is requesting to change its method for these costs. Mark "N/A" in a box if the applicant does not incur those costs. If a box is not checked, it is assumed that those costs are not fully included to the extent required.

Attach an explanation for boxes that are not checked on Lines 1-11.

Schedule E, Change in Depreciation or Amortization

Schedule E is the most used schedule. This schedule contains several questions and requires attachments. First, taxpayers must report how the property is depreciated currently, even if depreciation has not been taken, if the depreciation or amortization is required to be capitalized, and whether any elections have been made. The statement must include information regarding the property that is the subject of the change, as well as the information needed to determine the correct depreciation. The taxpayer must clearly explain how the property was treated before, and how they are proposing to treat the property in the future. If the property is not currently depreciated, a statement of fact supporting that depreciation is allowed must be attached. The information must include the code section under which the asset is amortized or depreciated, and the asset class, as well as supporting information for those determinations.

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Part III **Method of Cost Allocation** (*continued*) See instructions.

Section C—Other Costs Not Required To Be Allocated (Complete Section C only if the applicant is requesting to change its method for these costs.)

		Present method	Proposed method
1	Marketing, selling, advertising, and distribution expenses		
2	Research and experimental expenses not included in Section B, line 26		
3	Bidding expenses not included in Section B, line 22		
4	General and administrative costs not included in Section B		
5	Income taxes		
6	Cost of strikes		
7	Warranty and product liability costs		
8	Section 179 costs		
9	On-site storage		
10	Depreciation, amortization, and cost recovery allowance not included in Section B, line 11		
11	Other costs (Attach a list of these costs.)		

Schedule E—Change in Depreciation or Amortization (see instructions)

Applicants requesting approval to change their method of accounting for depreciation or amortization complete this section. Applicants ***must*** provide this information for each item or class of property for which a change is requested.

Note: See the ***Summary of the List of Automatic Accounting Method Changes*** in the instructions for information regarding automatic changes under sections 56, 167, 168, or 197, or former sections 168, 1400I, or 1400L. **Do not** file Form 3115 with respect to certain late elections and election revocations. See instructions.

1 Is depreciation for the property determined under Regulations section 1.167(a)-11 (CLADR)? ☐ **Yes** ☐ **No**
If "Yes," the only changes permitted are under Regulations section 1.167(a)-11(c)(1)(iii).

2 Is any of the depreciation or amortization required to be capitalized under any Code section, such as section 263A? ☐ **Yes** ☐ **No**
If "Yes," enter the applicable section ______

3 Has a depreciation, amortization, expense, or disposition election been made for the property, such as the election under sections 168(f)(1), 168(i)(4), 179, 179C, or Regulations section 1.168(i)-8(d)? ☐ **Yes** ☐ **No**
If "Yes," state the election made ______

4a Attach a statement describing the property subject to the change. Include the property's description, type, placed-in-service year, and use in the applicant's trade or business or income-producing activity. Also include the type and amount of any federal tax credit claimed or grant received, along with any necessary adjustments to basis required under the Internal Revenue Code, with respect to the property.

b If the property is residential rental property, did the applicant live in the property before renting it? ☐ **Yes** ☐ **No**

c Is the property public utility property? ☐ **Yes** ☐ **No**

5 To the extent not already provided in the applicant's description of its present method, attach a statement explaining how the property is treated under the applicant's present method (for example, depreciable property, inventory property, supplies under Regulations section 1.162-3, nondepreciable section 263(a) property, property deductible as a current expense, etc.).

6 If the property is not currently treated as depreciable or amortizable property, attach a statement of the facts supporting the proposed change to depreciate or amortize the property.

7 If the property is currently treated and/or will be treated as depreciable or amortizable property, provide the following information for both the present (if applicable) and proposed methods:

a The Code section under which the property is or will be depreciated or amortized (for example, section 168(g)).

b The applicable asset class from Rev. Proc. 87-56, 1987-2 C.B. 674, for each asset depreciated under section 168 (MACRS) or under former section 1400L; the applicable asset class from Rev. Proc. 83-35, 1983-1 C.B. 745, for each asset depreciated under former section 168 (ACRS); an explanation why no asset class is identified for each asset for which an asset class has not been identified by the applicant.

c The facts to support the asset class for the proposed method.

d The depreciation or amortization method of the property, including the applicable Code section (for example, 200% declining balance method under section 168(b)(1)).

e The useful life, recovery period, or amortization period of the property.

f The applicable convention of the property.

g Whether the additional first-year special depreciation allowance (for example, as provided by section 168(k), 168(l), 168(m), or former section 168(n), 1400L(b), or 1400N(d)) was or will be claimed for the property. If not, also provide an explanation as to why no special depreciation allowance was or will be claimed.

h Whether the property was or will be in a single asset account, a multiple asset account, or a general asset account.

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Comprehensive Examples

Example 1: Wrong depreciation method used in prior year

On Jan. 1, 2020, Bentley purchased residential rental property for $760,000 (exclusive of land) that is 27.5-year MACRS property. When Bentley started to prepare his 2023 tax return, he discovered that he incorrectly depreciated the property as 39-year MACRS property.

Bentley can correct the depreciation by filing Form 3115 with his 2023 tax return using DCN 7 since he still owns the property. His §481(a) adjustment on Form 3115, Part IV, Line 26, equals the difference between the depreciation claimed and the amount that should have been claimed.

His actual accumulated depreciation using a 39-year recovery period for 2020-2022 is only $57,677, but his allowable accumulated depreciation using a 27.5-year recovery period for 2020-2022 should be $81,753.

Thus, he has a negative §481(a) adjustment of ($24,076), [$57,677 - $81,753]. Bentley reports the negative §481(a) adjustment in full on his 2023 Schedule E, Line 19, other expense.

The rental property income and expenses for 2023 are as follows:

- Income
  - Rent collected $36,000
- Expenses
  - Insurance $3,000
  - Mortgage interest $12,000
  - Real estate taxes $18,000
  - Depreciation other assets $27,636

Bentley's Form 3115 and Schedule E are completed as follows:

Form **3115** (Rev. December 2022)
Department of the Treasury Internal Revenue Service

Application for Change in Accounting Method

Go to *www.irs.gov/Form3115* for instructions and the latest information.

OMB No. 1545-2070
Attachment Sequence No. **315**

Name of filer (name of parent corporation if a consolidated group) (see instructions): Bentley	Identification number (see instructions)
	Principal business activity code number (see instructions)
Number, street, and room or suite no. If a P.O. box, see the instructions.: 1234 Robin Rd	Tax year of change begins (MM/DD/YYYY) 01/01/2023; Tax year of change ends (MM/DD/YYYY) 12/31/2023
City or town, state, and ZIP code: Appleton WI 54912	Name of contact person (see instructions)
Name of applicant(s) (if different than filer) and identification number(s) (see instructions): Bentley	Contact person's telephone number

Does the filer want to receive a copy of the change in method of accounting letter ruling or other correspondence related to this Form 3115 by fax or encrypted email attachment? If "Yes," see instructions ☐ Yes ☒ No

If the applicant is a member of a consolidated group, check this box ☐

If **Form 2848**, Power of Attorney and Declaration of Representative, is attached (see instructions for when Form 2848 is required), check this box ☐

Check the box to indicate the type of applicant.

- ☒ Individual
- ☐ Corporation
- ☐ Controlled foreign corporation (Sec. 957)
- ☐ 10/50 corporation (Sec. 904(d)(2)(E))
- ☐ Qualified personal service corporation (Sec. 448(d)(2))
- ☐ Exempt organization. Enter Code section:
- ☐ Cooperative (Sec. 1381)
- ☐ Partnership
- ☐ S corporation
- ☐ Insurance co. (Sec. 816(a))
- ☐ Insurance co. (Sec. 831)
- ☐ Other (specify):

Check the appropriate box to indicate the type of accounting method change being requested. See instructions.

- ☒ Depreciation or Amortization
- ☐ Financial Products and/or Financial Activities of Financial Institutions
- ☐ Other (specify):

Caution: To be eligible for approval of the requested change in method of accounting, the taxpayer must provide all information that is relevant to the taxpayer or to the taxpayer's requested change in method of accounting. This includes (**1**) all relevant information requested on this Form 3115 (including its instructions), and (**2**) any other relevant information, even if not specifically requested on Form 3115.

The taxpayer must attach all applicable statements requested throughout this form.

Part I Information for Automatic Change Request

		Yes	No
1	Enter the applicable designated automatic accounting method change number ("DCN") for the requested automatic change. Enter only one DCN, except as provided for in guidance published by the IRS. If the requested change has no DCN, check "Other," and provide both a description of the change and a citation of the IRS guidance providing the automatic change. See instructions.		
a	(1) DCN: 07 (2) DCN: ___ (3) DCN: ___ (4) DCN: ___ (5) DCN: ___ (6) DCN: ___ (7) DCN: ___ (8) DCN: ___ (9) DCN: ___ (10) DCN: ___ (11) DCN: ___ (12) DCN: ___		
b	Other ☐ Description:		
2	Do any of the eligibility rules restrict the applicant from filing the requested change using the automatic change procedures (see instructions)? If "Yes," attach an explanation		X
3	Has the filer provided all the information and statements required (**a**) on this form and (**b**) by the List of Automatic Changes under which the applicant is requesting a change? See instructions	X	
	Note: Complete Part II and Part IV of this form, and, Schedules A through E, if applicable.		

Part II Information for All Requests

		Yes	No
4	During the tax year of change, did or will the applicant (**a**) cease to engage in the trade or business to which the requested change relates, or (**b**) terminate its existence? See instructions		X
5	Is the applicant requesting to change to the principal method in the tax year of change under Regulations section 1.381(c)(4)-1(d)(1) or 1.381(c)(5)-1(d)(1)? If "No," go to line 6a. If "Yes," the applicant cannot file a Form 3115 for this change. See instructions.		X

Sign Here

Under penalties of perjury, I declare that I have examined this application, including accompanying schedules and statements, and to the best of my knowledge and belief, the application contains all the relevant facts relating to the application, and it is true, correct, and complete. Declaration of preparer (other than applicant) is based on all information of which preparer has any knowledge.

Signature of filer (and spouse, if joint return)	Date	Name and title (print or type)
		Bentley

Preparer (other than filer/applicant)

Print/Type preparer's name	Preparer's signature	Date
Firm's name: Natl Assn Of Tax Prof		

For Privacy Act and Paperwork Reduction Act Notice, see the instructions.
DAA
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Part II **Information for All Requests** *(continued)*

		Yes	No
6a	Does the applicant (or any present or former consolidated group in which the applicant was a member during the applicable tax year(s)) have any federal income tax return(s) under examination (see instructions)? If "No," go to line 7a.		X
b	Is the method of accounting the applicant is requesting to change an issue under consideration (with respect to either the applicant or any present or former consolidated group in which the applicant was a member during the applicable tax year(s))? See instructions		
c	Enter the name and telephone number of the examining agent and the tax year(s) under examination. Name ______ Telephone number ______ Tax year(s) ______		
d	Has a copy of this Form 3115 been provided to the examining agent identified on line 6c?		
7a	Does audit protection apply to the applicant's requested change in method of accounting? See instructions. If "No," attach an explanation.	X	
b	If "Yes," check the applicable box and attach the required statement. ☒ Not under exam ☐ 3-month window ☐ 20 day: Date examination ended ______ ☐ Method not before director ☐ Negative adjustment ☐ CAP: Date member joined group ______ ☐ Audit protection at end of exam ☐ Other		
8a	Does the applicant (or any present or former consolidated group in which the applicant was a member during the applicable tax year(s)) have any federal income tax return(s) before Appeals and/or a federal court? If "No," go to line 9.		X
b	Is the method of accounting the applicant is requesting to change an issue under consideration by Appeals and/or a federal court (for either the applicant or any present or former consolidated group in which the applicant was a member for the tax year(s) the applicant was a member)? See instructions. If "Yes," attach an explanation.		
c	If "Yes," enter the name of the (check the box) ☐ Appeals officer and/or ☐ counsel for the government, telephone number, and the tax year(s) before Appeals and/or a federal court. Name ______ Telephone number ______ Tax year(s) ______		
d	Has a copy of this Form 3115 been provided to the Appeals officer and/or counsel for the government identified on line 8c?		
9	If the applicant answered "Yes" to line 6a and/or 8a with respect to any present or former consolidated group, attach a statement that provides each parent corporation's (**a**) name, (**b**) identification number, (**c**) address, and (**d**) tax year(s) during which the applicant was a member that is under examination, before an Appeals office, and/or before a federal court.		
10	If for federal income tax purposes, the applicant is either an entity (including a limited liability company) treated as a partnership or an S corporation, is it requesting a change from a method of accounting that is an issue under consideration in an examination, before Appeals, or before a federal court, with respect to a federal income tax return of a partner, member, or shareholder of that entity?		X
11a	Has the applicant, its predecessor, or a related party requested or made (under either an automatic or non-automatic change procedure) a change in method of accounting within any of the 5 tax years ending with the tax year of change? If "No," go to line 12.		X
b	If "Yes," for each trade or business, attach a description of each requested change in method of accounting (including the tax year of change) and state whether the applicant received consent.		
c	If any application was withdrawn, not perfected, or denied, or if a Consent Agreement granting a change was not signed and returned to the IRS, or the change was not made or not made in the requested year of change, attach an explanation.		
12	Does the applicant, its predecessor, or a related party currently have pending any request (including any concurrently filed request) for a private letter ruling, change in method of accounting, or technical advice? If "Yes," for each request attach a statement providing (**a**) the name(s) of the taxpayer, (**b**) identification number(s), (**c**) the type of request (private letter ruling, change in method of accounting, or technical advice), and (**d**) the specific issue(s) in the request(s).		X
13	Is the applicant requesting to change its **overall** method of accounting? If "Yes," complete Schedule A on page 4 of the form.		X

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Part II Information for All Requests *(continued)* | **Yes** | **No**

14 If the applicant is either (**i**) **not** changing its overall method of accounting, or (**ii**) changing its overall method of accounting **and** changing to a special method of accounting for one or more items, attach a detailed and complete description for each of the following (see instructions):

a The item(s) being changed. **See Statement 1**

b The applicant's present method for the item(s) being changed. **See Statement 2**

c The applicant's proposed method for the item(s) being changed. **See Statement 3**

d The applicant's present overall method of accounting (cash, accrual, or hybrid). **Cash**

15a Attach a detailed and complete description of the applicant's trade(s) or business(es). See section 446(d).

b If the applicant has more than one trade or business, as defined in Regulations section 1.446-1(d), describe (**i**) whether each trade or business is accounted for separately; (**ii**) the goods and services provided by each trade or business and any other types of activities engaged in that generate gross income; (**iii**) the overall method of accounting for each trade or business; and (**iv**) which trade or business is requesting to change its accounting method as part of this application or a separate application. **See Statement 4**

Note: If you are requesting an automatic method change, see the instructions to see if you are required to complete lines 16a-16c.

16a Attach a full explanation of the legal basis supporting the proposed method for the item being changed. Include a detailed and complete description of the facts that explains how the law specifically applies to the applicant's situation and that demonstrates that the applicant is authorized to use the proposed method.

b Include all authority (statutes, regulations, published rulings, court cases, etc.) supporting the proposed method.

c Include either a discussion of the contrary authorities or a statement that no contrary authority exists.

17 Will the proposed method of accounting be used for the applicant's books and records and financial statements? For insurance companies, see the instructions . . . . . Yes: **X**
If "No," attach an explanation.

18 Does the applicant request a conference with the IRS National Office if the IRS National Office proposes an adverse response? . . . . . No: **X**

19a If the applicant is changing to either the overall cash method, an overall accrual method, or is changing its method of accounting for any property subject to section 263A, any long-term contract subject to section 460 (see 19b), or inventories subject to section 471 or 474, enter the applicant's gross receipts for the 3 tax years preceding the tax year of change.

1st preceding year ended: mo./yr.	2nd preceding year ended: mo./yr.	3rd preceding year ended: mo./yr.
$	$	$

b If the applicant is changing its method of accounting for any long-term contract subject to section 460, in addition to completing 19a, enter the applicant's gross receipts for the 4th tax year preceding the tax year of change:
4th preceding year ended: mo./yr.________ $ ________

Part III Information for Non-Automatic Change Request | **Yes** | **No**

20 Is the applicant's requested change described in any revenue procedure, revenue ruling, notice, regulation, or other published guidance as an automatic change request? . . . . .
If "Yes," attach an explanation describing why the applicant is submitting its request under the non-automatic change procedures.

21 Attach a copy of all documents related to the proposed change (see instructions).

22 Attach a statement of the applicant's reasons for the proposed change.

23 If the applicant is a member of a consolidated group for the year of change, do all other members of the consolidated group use the proposed method of accounting for the item being changed? . . . . .
If "No," attach an explanation.

24a Enter the amount of **user fee** attached to this application (see instructions) . . . . . $ ________

b If the applicant qualifies for a reduced user fee, attach the required information or certification (see instructions).

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Part IV Section 481(a) Adjustment

		Yes	No
25	Does published guidance require the applicant (or permit the applicant and the applicant is electing) to implement the requested change in method of accounting on a cut-off basis? If "Yes," attach an explanation and do not complete lines 26, 27, 28, and 29 below.		X
26	Enter the section 481(a) adjustment. Indicate whether the adjustment is an increase (+) or a decrease (-) in income. $ -24,076 Attach a summary of the computation and an explanation of the methodology used to determine the section 481(a) adjustment. If it is based on more than one component, show the computation for each component. If the applicant waived any deductions with respect to the method of accounting pursuant to Regulations section 1.59A-3(c)(6)(i), include a summary of the waived deductions. If more than one applicant is applying for the method change on the application, attach a list of the (**a**) name, (**b**) identification number, and (**c**) the amount of the section 481(a) adjustment attributable to each applicant. See Statement 5		
27	Is the applicant required to take into account in the year of change any remaining portion of a section 481(a) adjustment from a prior change (see instructions)? If "Yes," enter the amount. $ ______		X
28	Is the applicant making an election to take the entire amount of the adjustment into account in the tax year of change? If "Yes," check the box for the applicable elective provision used to make the election (see instructions). ☐ $50,000 de minimis election ☐ Eligible acquisition transaction election		X
29	Is any part of the section 481(a) adjustment attributable to transactions between members of an affiliated group, a consolidated group, a controlled group, or other related parties? If "Yes," attach an explanation.		X

Schedule A — Change in Overall Method of Accounting (If Schedule A applies, Part I below must be completed.)

Part I Change in Overall Method (see instructions)

1 Check the appropriate boxes below to indicate the applicant's present and proposed methods of accounting.

Present method: ☐ Cash ☐ Accrual ☐ Hybrid (attach description)

Proposed method: ☐ Cash ☐ Accrual ☐ Hybrid (attach description)

2 Enter the following amounts as of the close of the tax year preceding the year of change. If none, state "None." Also, attach a statement providing a breakdown of the amounts entered on lines 2a through 2g.

		Amount
a	Income accrued but not received (such as accounts receivable)	$ None
b	Income received or reported before it was earned (such as advanced payments). Attach a description of the income and the legal basis for the proposed method	None
c	Expenses accrued but not paid (such as accounts payable)	None
d	Prepaid expenses previously deducted	None
e	Supplies on hand previously deducted and/or not previously reported	None
f	Inventory on hand previously deducted and/or not previously reported. Complete Schedule D, Part II	None
g	Other amounts (specify). Attach a description of the item and the legal basis for its inclusion in the calculation of the section 481(a) adjustment.	None
h	**Net section 481(a) adjustment** (Combine lines 2a–2g.) Indicate whether the adjustment is an increase (+) or decrease (-) in income. Also enter the net amount of this section 481(a) adjustment amount on Part IV, line 26	$ 0

3 Is the applicant also requesting the recurring item exception under section 461(h)(3)? ☐ Yes ☒ No

4 Attach copies of the profit and loss statement (Schedule F (Form 1040) for farmers) and the balance sheet, if applicable, as of the close of the tax year preceding the year of change. Also attach a statement specifying the accounting method used when preparing the balance sheet. If books of account are not kept, attach a copy of the business schedules submitted with the federal income tax return or other return (such as tax-exempt organization returns) for that period. If the amounts in Part I, lines 2a through 2g, do not agree with the amounts shown on the balance sheet, attach a statement explaining the differences.

5 Is the applicant making a change to the overall cash method or to a method in which a taxpayer uses an accrual method for purchases and sales of inventory and uses the cash method for computing all other items of income and expense (see instructions)? ☐ Yes ☒ No

Part II Change to the Cash Method for Non-Automatic Change Request (see instructions)

Applicants requesting a change to the cash method must attach the following information:

1 A description of inventory items (items whose production, purchase, or sale is an income-producing factor) and materials and supplies used in carrying out the business.

2 An explanation as to whether the applicant is required to use an accrual method under any section of the Code or regulations.

Form **3115** (Rev. 12-2022)

Form 3115 (Rev. 12-2022) **Bentley** Page **8**

Part III **Method of Cost Allocation** *(continued)* See instructions.

Section C — Other Costs Not Required To Be Allocated (Complete Section C only if the applicant is requesting to change its method for these costs.)

		Present method	Proposed method
1	Marketing, selling, advertising, and distribution expenses	N/A	N/A
2	Research and experimental expenses not included in Section B, line 26	N/A	N/A
3	Bidding expenses not included in Section B, line 22	N/A	N/A
4	General and administrative costs not included in Section B	N/A	N/A
5	Income taxes	N/A	N/A
6	Cost of strikes	N/A	N/A
7	Warranty and product liability costs	N/A	N/A
8	Section 179 costs	N/A	N/A
9	On-site storage	N/A	N/A
10	Depreciation, amortization, and cost recovery allowance not included in Section B, line 11	N/A	N/A
11	Other costs (Attach a list of these costs.)	N/A	N/A

Schedule E — Change in Depreciation or Amortization (see instructions)

Applicants requesting approval to change their method of accounting for depreciation or amortization complete this section. Applicants ***must*** provide this information for each item or class of property for which a change is requested.

Note: See the ***Summary of the List of Automatic Accounting Method Changes*** in the instructions for information regarding automatic changes under sections 56, 167, 168, or 197, or former sections 168, 1400I, or 1400L. **Do not** file Form 3115 with respect to certain late elections and election revocations. See instructions.

1 Is depreciation for the property determined under Regulations section 1.167(a)-11 (CLADR)? ☐ Yes ☒ No
If "Yes," the only changes permitted are under Regulations section 1.167(a)-11(c)(1)(iii).

2 Is any of the depreciation or amortization required to be capitalized under any Code section, such as section 263A? ☐ Yes ☒ No
If "Yes," enter the applicable section

3 Has a depreciation, amortization, expense, or disposition election been made for the property, such as the election under sections 168(f)(1), 168(i)(4), 179, 179C, or Regulations section 1.168(i)-8(d)? ☐ Yes ☒ No
If "Yes," state the election made

4a Attach a statement describing the property subject to the change. Include the property's description, type, placed-in-service year, and use in the applicant's trade or business or income-producing activity. Also include the type and amount of any federal tax credit claimed or grant received, along with any necessary adjustments to basis required under the Internal Revenue Code, with respect to the property. **See Statement 6**

b If the property is residential rental property, did the applicant live in the property before renting it? ☐ Yes ☒ No

c Is the property public utility property? ☐ Yes ☒ No

5 To the extent not already provided in the applicant's description of its present method, attach a statement explaining how the property is treated under the applicant's present method (for example, depreciable property, inventory property, supplies under Regulations section 1.162-3, nondepreciable section 263(a) property, property deductible as a current expense, etc.). **See Statement 7**

6 If the property is not currently treated as depreciable or amortizable property, attach a statement of the facts supporting the proposed change to depreciate or amortize the property.

7 If the property is currently treated and/or will be treated as depreciable or amortizable property, provide the following information for both the present (if applicable) and proposed methods: **See Statement 8**

a The Code section under which the property is or will be depreciated or amortized (for example, section 168(g)).

b The applicable asset class from Rev. Proc. 87-56, 1987-2 C.B. 674, for each asset depreciated under section 168 (MACRS) or under section 1400L; the applicable asset class from Rev. Proc. 83-35, 1983-1 C.B. 745, for each asset depreciated under former section 168 (ACRS); an explanation why no asset class is identified for each asset for which an asset class has not been identified by the applicant.

c The facts to support the asset class for the proposed method. **See Statement 9**

d The depreciation or amortization method of the property, including the applicable Code section (for example, 200% declining balance method under section 168(b)(1)).

e The useful life, recovery period, or amortization period of the property.

f The applicable convention of the property.

g Whether the additional first-year special depreciation allowance (for example, as provided by section 168(k), 168(l), 168(m), or former section 168(n), 1400L(b), or 1400N(d)) was or will be claimed for the property. If not, also provide an explanation as to why no special depreciation allowance was or will be claimed. **See Statement 10**

h Whether the property was or will be in a single asset account, a multiple asset account, or a general asset account.

Form **3115** (Rev. 12-2022)

Bentley

Federal Statements

Statement 1 - Form 3115, Page 3, Part II, Line 14a

Item Changed

Depreciation for residential rental purchased in 2020

Statement 2 - Form 3115, Page 3, Part II, Line 14b

Present Method

MACRS depreciation under §168 using MM SL method over 39 years

Statement 3 - Form 3115, Page 3, Part II, Line 14c

Proposed Method

M**ACRS depreciation under §168 using MM SL method over 27.5 years**

Statement 4 - Form 3115, Page 3, Part II, Line 15 - Description of Trade(s) or Business(es)

Description

Residential rental real estate

Statement 5 - Form 3115, Page 4, Part IV, Line 26 - Computation & Explanation for Sec. 481(a) Adj.

Description

Correct depreciation using 27.5 years:

2020 deprecation $760,000 x 3.485% = $26,486
2021 & 2022 deprecation $760,000 x 3.636% = $55,267
Total depreciation for 2020-2022 = $81,753

Incorrect depreciation using 39 years:

2020 deprecation $760,000 x 2.461% = $18,704
2021 & 2022 deprecation $760,000 x 2.564% = $38,973
Total depreciation for 2020-2022 = $57,677

Section 481(a) adjustment:
$57,677 - $81,753 = ($24,706)

Bentley

Federal Statements

Statement 6 - Form 3115, Page 8, Part III, Schedule E, Line 4a - Description of Property Being Changed

Type of Property	Year Property Placed in Service	Trade/Business Use
Residential Rental	**2020**	**Rental**

Bentley

Federal Statements

Statement 7 - Form 3115, Page 8, Part III, Schedule E, Line 5 - Treatment of Property Under Present Method

Description
Depreciated under §168 MM SL 39 years

Statement 8 - Form 3115, Pg 8, Pt III, Sch E, Ln 7 - Information Under Present/Proposed Method

Description	Present Method	Proposed Method
Code section property is depreciated/amortized	**168**	**168**
Asset class under §168	**nonresidential**	**residential**
Depreciation/amortization method	**SL**	**SL**
Useful life or recovery period of property	**39**	**27.5**
Applicable convention of property	**MM**	**MM**

Statement 9 - Form 3115, Page 8, Part III, Schedule E, Line 7c - Facts to Support Asset Class

Description
Property is residential rental property 100% gross rental income is from renting the house on a long-term basis

Statement 10 - Form 3115, Page 8, Part III, Schedule E, Line 7g - Statement Regarding Additional First-Year Depreciation

Description
Not eligible for bonus depreciation

SCHEDULE E (Form 1040)
Department of the Treasury Internal Revenue Service

Supplemental Income and Loss

(From rental real estate, royalties, partnerships, S corporations, estates, trusts, REMICs, etc.)
Attach to Form 1040, 1040-SR, 1040-NR, or 1041.
Go to *www.irs.gov/ScheduleE* for instructions and the latest information.

OMB No. 1545-0074
2023
Attachment Sequence No. **13**

Name(s) shown on return: Bentley
Your social security number

Part I **Income or Loss From Rental Real Estate and Royalties**

Note: If you are in the business of renting personal property, use **Schedule C**. See instructions. If you are an individual, report farm rental income or loss from **Form 4835** on page 2, line 40.

A Did you make any payments in 2023 that would require you to file Form(s) 1099? See instructions ☐ Yes ☒ No
B If "Yes," did you or will you file required Form(s) 1099? ☐ Yes ☐ No

1a	Physical address of each property (street, city, state, ZIP code)
A	145B Townline Rd, Appleton, WI 54911
B	
C	

1b	Type of Property (from list below)	2 For each rental real estate property listed above, report the number of fair rental and personal use days. Check the QJV box only if you meet the requirements to file as a qualified joint venture. See instructions.		Fair Rental Days	Personal Use Days	QJV
A	1		A	365		☐
B			B			☐
C			C			☐

Type of Property:
1 Single Family Residence 3 Vacation/Short-Term Rental 5 Land 7 Self-Rental
2 Multi-Family Residence 4 Commercial 6 Royalties 8 Other (describe)

		Properties: A	B	C
Income:				
3 Rents received	3	36,000		
4 Royalties received	4			
Expenses:				
5 Advertising	5			
6 Auto and travel (see instructions)	6			
7 Cleaning and maintenance	7			
8 Commissions	8			
9 Insurance	9	3,000		
10 Legal and other professional fees	10			
11 Management fees	11			
12 Mortgage interest paid to banks, etc. (see instructions)	12	12,000		
13 Other interest	13			
14 Repairs	14			
15 Supplies	15			
16 Taxes	16	18,000		
17 Utilities	17			
18 Depreciation expense or depletion	18	27,636		
19 Other (list) See Statement 1	19	24,076		
20 Total expenses. Add lines 5 through 19	20	84,712		
21 Subtract line 20 from line 3 (rents) and/or 4 (royalties). If result is a (loss), see instructions to find out if you must file **Form 6198**	21	-48,712		
22 Deductible rental real estate loss after limitation, if any, on **Form 8582** (see instructions)	22	(25,000)	( )	( )

23a Total of all amounts reported on line 3 for all rental properties	23a	36,000
b Total of all amounts reported on line 4 for all royalty properties	23b	
c Total of all amounts reported on line 12 for all properties	23c	12,000
d Total of all amounts reported on line 18 for all properties	23d	27,636
e Total of all amounts reported on line 20 for all properties	23e	84,712
24 **Income.** Add positive amounts shown on line 21. **Do not** include any losses	24	0
25 **Losses.** Add royalty losses from line 21 and rental real estate losses from line 22. Enter total losses here	25	(25,000)
26 **Total rental real estate and royalty income or (loss).** Combine lines 24 and 25. Enter the result here. If Parts II, III, IV, and line 40 on page 2 do not apply to you, also enter this amount on Schedule 1 (Form 1040), line 5. Otherwise, include this amount in the total on line 41 on page 2	26	-25,000

For Paperwork Reduction Act Notice, see the separate instructions. **Schedule E (Form 1040) 2023**
DAA

Bentley

Federal Statements

Residential Rental Property

Statement 1 - Schedule E, Line 19 - Other Expenses

Description	Gross Amount	Business Use Percentage	Net Amount
Section 481(a) adjustment	$ **24,076**		$ **24,076**
Total	$ **24,076**		$ **24,076**

Example 2: Changing from Accrual to Cash

Electric Avenue, Inc., an engineering company, is an S corporation that has been using the accrual method of accounting since 2019. Its gross receipts were $5 million for 2020, $8 million for 2021 and $15 million for 2022, so its average annual gross receipts for the prior three years are $9,333,333. It would like to change to the cash method of accounting starting in 2023 since it met the small business requirements. Electric Avenue has accounts receivable of $1,200,000, accounts payable of $230,000 and accrued expenses of $150,000 as of Jan. 1, 2023.

At the beginning of 2023, Electric Avenue has a negative §481(a) adjustment of ($820,000), which is computed by netting accounts receivable with accounts payable and accrued expenses ($230,000 + $150,000 - $1,200,000). It can take the entire negative adjustment into account on its 2023 tax return.

For negative §481(a) adjustments resulting from changes in accounting methods, show the computation of the negative §481(a) adjustments on an attached statement. In the statement, for each §481(a) adjustment, include the total §481(a) adjustment and a brief description of the changes in methods of accounting to which the §481(a) adjustment relates (Rev. Proc. 2015-13). Report the negative §481(a) adjustment on Form 1120-S, Page 1, Line 20, *other deductions*.

Electric Avenue completes Form 3115 and Form 1120-S as follows:

Form **3115** (Rev. December 2022)
Department of the Treasury Internal Revenue Service

Application for Change in Accounting Method

Go to *www.irs.gov/Form3115* for instructions and the latest information.

OMB No. 1545-2070
Attachment Sequence No. **315**

Name of filer (name of parent corporation if a consolidated group) (see instructions): Electric Avenue, Inc	**Identification number** (see instructions):
	Principal business activity code number (see instructions): 541330
Number, street, and room or suite no. If a P.O. box, see the instructions.: 456 Higher Street	Tax year of change begins (MM/DD/YYYY): 01/01/2023 Tax year of change ends (MM/DD/YYYY): 12/31/2023
City or town, state, and ZIP code: Appleton WI 54912	Name of contact person (see instructions):
Name of applicant(s) (if different than filer) and identification number(s) (see instructions): Electric Avenue, Inc	Contact person's telephone number:

Does the filer want to receive a copy of the change in method of accounting letter ruling or other correspondence related to this Form 3115 by fax or encrypted email attachment? If "Yes," see instructions ☐ **Yes** ☐ **No**

If the applicant is a member of a consolidated group, check this box ☐

If **Form 2848**, Power of Attorney and Declaration of Representative, is attached (see instructions for when Form 2848 is required), check this box ☐

Check the box to indicate the type of applicant.

- ☐ Individual
- ☐ Corporation
- ☐ Controlled foreign corporation (Sec. 957)
- ☐ 10/50 corporation (Sec. 904(d)(2)(E))
- ☐ Qualified personal service corporation (Sec. 448(d)(2))
- ☐ Exempt organization. Enter Code section:
- ☐ Cooperative (Sec. 1381)
- ☐ Partnership
- ☒ S corporation
- ☐ Insurance co. (Sec. 816(a))
- ☐ Insurance co. (Sec. 831)
- ☐ Other (specify):

Check the appropriate box to indicate the type of accounting method change being requested. See instructions.

- ☐ Depreciation or Amortization
- ☐ Financial Products and/or Financial Activities of Financial Institutions
- ☒ Other (specify): Overall Acctg Method

Caution: To be eligible for approval of the requested change in method of accounting, the taxpayer must provide all information that is relevant to the taxpayer or to the taxpayer's requested change in method of accounting. This includes (**1**) all relevant information requested on this Form 3115 (including its instructions), and (**2**) any other relevant information, even if not specifically requested on Form 3115.

The taxpayer must attach all applicable statements requested throughout this form.

Part I Information for Automatic Change Request

		Yes	No
1	Enter the applicable designated automatic accounting method change number ("DCN") for the requested automatic change. Enter only one DCN, except as provided for in guidance published by the IRS. If the requested change has no DCN, check "Other," and provide both a description of the change and a citation of the IRS guidance providing the automatic change. See instructions.		
a	(1) DCN: 233 (2) DCN: ____ (3) DCN: ____ (4) DCN: ____ (5) DCN: ____ (6) DCN: ____ (7) DCN: ____ (8) DCN: ____ (9) DCN: ____ (10) DCN: ____ (11) DCN: ____ (12) DCN: ____		
b	Other ☐ Description: ____		
2	Do any of the eligibility rules restrict the applicant from filing the requested change using the automatic change procedures (see instructions)? If "Yes," attach an explanation		X
3	Has the filer provided all the information and statements required (**a**) on this form and (**b**) by the List of Automatic Changes under which the applicant is requesting a change? See instructions	X	
	Note: Complete Part II and Part IV of this form, and, Schedules A through E, if applicable.		

Part II Information for All Requests

		Yes	No
4	During the tax year of change, did or will the applicant (**a**) cease to engage in the trade or business to which the requested change relates, or (**b**) terminate its existence? See instructions		X
5	Is the applicant requesting to change to the principal method in the tax year of change under Regulations section 1.381(c)(4)-1(d)(1) or 1.381(c)(5)-1(d)(1)? If "No," go to line 6a. If "Yes," the applicant cannot file a Form 3115 for this change. See instructions.		X

Sign Here

Under penalties of perjury, I declare that I have examined this application, including accompanying schedules and statements, and to the best of my knowledge and belief, the application contains all the relevant facts relating to the application, and it is true, correct, and complete. Declaration of preparer (other than applicant) is based on all information of which preparer has any knowledge.

Signature of filer (and spouse, if joint return)	Date	Name and title (print or type)

Preparer (other than filer/applicant)

Print/Type preparer's name	Preparer's signature	Date
Firm's name: Natl Assn Of Tax Prof		

For Privacy Act and Paperwork Reduction Act Notice, see the instructions. Form **3115** (Rev. 12-2022)
DAA

Form 3115 (Rev. 12-2022) **Electric Avenue, Inc** Page **2**

Part II Information for All Requests *(continued)*

		Yes	No
6a	Does the applicant (or any present or former consolidated group in which the applicant was a member during the applicable tax year(s)) have any federal income tax return(s) under examination (see instructions)? If "No," go to line 7a.		X
b	Is the method of accounting the applicant is requesting to change an issue under consideration (with respect to either the applicant or any present or former consolidated group in which the applicant was a member during the applicable tax year(s))? See instructions		
c	Enter the name and telephone number of the examining agent and the tax year(s) under examination. Name ______ Telephone number ______ Tax year(s) ______		
d	Has a copy of this Form 3115 been provided to the examining agent identified on line 6c?		
7a	Does audit protection apply to the applicant's requested change in method of accounting? See instructions. If "No," attach an explanation.	X	
b	If "Yes," check the applicable box and attach the required statement. ☒ Not under exam ☐ 3-month window ☐ 20 day: Date examination ended ______ ☐ Method not before director ☐ Negative adjustment ☐ CAP: Date member joined group ______ ☐ Audit protection at end of exam ☐ Other		
8a	Does the applicant (or any present or former consolidated group in which the applicant was a member during the applicable tax year(s)) have any federal income tax return(s) before Appeals and/or a federal court? If "No," go to line 9.		X
b	Is the method of accounting the applicant is requesting to change an issue under consideration by Appeals and/or a federal court (for either the applicant or any present or former consolidated group in which the applicant was a member for the tax year(s) the applicant was a member)? See instructions. If "Yes," attach an explanation.		
c	If "Yes," enter the name of the (check the box) ☐ Appeals officer and/or ☐ counsel for the government, telephone number, and the tax year(s) before Appeals and/or a federal court. Name ______ Telephone number ______ Tax year(s) ______		
d	Has a copy of this Form 3115 been provided to the Appeals officer and/or counsel for the government identified on line 8c?		
9	If the applicant answered "Yes" to line 6a and/or 8a with respect to any present or former consolidated group, attach a statement that provides each parent corporation's (**a**) name, (**b**) identification number, (**c**) address, and (**d**) tax year(s) during which the applicant was a member that is under examination, before an Appeals office, and/or before a federal court.		
10	If for federal income tax purposes, the applicant is either an entity (including a limited liability company) treated as a partnership or an S corporation, is it requesting a change from a method of accounting that is an issue under consideration in an examination, before Appeals, or before a federal court, with respect to a federal income tax return of a partner, member, or shareholder of that entity?		X
11a	Has the applicant, its predecessor, or a related party requested or made (under either an automatic or non-automatic change procedure) a change in method of accounting within any of the 5 tax years ending with the tax year of change? If "No," go to line 12.		X
b	If "Yes," for each trade or business, attach a description of each requested change in method of accounting (including the tax year of change) and state whether the applicant received consent.		
c	If any application was withdrawn, not perfected, or denied, or if a Consent Agreement granting a change was not signed and returned to the IRS, or the change was not made or not made in the requested year of change, attach an explanation.		
12	Does the applicant, its predecessor, or a related party currently have pending any request (including any concurrently filed request) for a private letter ruling, change in method of accounting, or technical advice? If "Yes," for each request attach a statement providing (**a**) the name(s) of the taxpayer, (**b**) identification number(s), (**c**) the type of request (private letter ruling, change in method of accounting, or technical advice), and (**d**) the specific issue(s) in the request(s).		X
13	Is the applicant requesting to change its **overall** method of accounting? If "Yes," complete Schedule A on page 4 of the form.	X	

Form **3115** (Rev. 12-2022)

Form 3115 (Rev. 12-2022) **Electric Avenue, Inc** Page **3**

Part II Information for All Requests *(continued)*

		Yes	No
14	If the applicant is either (**i**) **not** changing its overall method of accounting, or (**ii**) changing its overall method of accounting **and** changing to a special method of accounting for one or more items, attach a detailed and complete description for each of the following (see instructions):		
a	The item(s) being changed.		
b	The applicant's present method for the item(s) being changed.		
c	The applicant's proposed method for the item(s) being changed.		
d	The applicant's present overall method of accounting (cash, accrual, or hybrid).		
15a	Attach a detailed and complete description of the applicant's trade(s) or business(es). See section 446(d).		
b	If the applicant has more than one trade or business, as defined in Regulations section 1.446-1(d), describe (**i**) whether each trade or business is accounted for separately; (**ii**) the goods and services provided by each trade or business and any other types of activities engaged in that generate gross income; (**iii**) the overall method of accounting for each trade or business; and (**iv**) which trade or business is requesting to change its accounting method as part of this application or a separate application. **See Statement 1**		
	Note: If you are requesting an automatic method change, see the instructions to see if you are required to complete lines 16a-16c.		
16a	Attach a full explanation of the legal basis supporting the proposed method for the item being changed. Include a detailed and complete description of the facts that explains how the law specifically applies to the applicant's situation and that demonstrates that the applicant is authorized to use the proposed method.		
b	Include all authority (statutes, regulations, published rulings, court cases, etc.) supporting the proposed method.		
c	Include either a discussion of the contrary authorities or a statement that no contrary authority exists.		
17	Will the proposed method of accounting be used for the applicant's books and records and financial statements? For insurance companies, see the instructions. If "No," attach an explanation.	X	
18	Does the applicant request a conference with the IRS National Office if the IRS National Office proposes an adverse response?		X
19a	If the applicant is changing to either the overall cash method, an overall accrual method, or is changing its method of accounting for any property subject to section 263A, any long-term contract subject to section 460 (see 19b), or inventories subject to section 471 or 474, enter the applicant's gross receipts for the 3 tax years preceding the tax year of change.		

1st preceding year ended: mo./yr. 12/31/20	2nd preceding year ended: mo./yr. 12/31/21	3rd preceding year ended: mo./yr. 12/31/22
$ 5,000,000	$ 8,000,000	$ 15,000,000

b If the applicant is changing its method of accounting for any long-term contract subject to section 460, in addition to completing 19a, enter the applicant's gross receipts for the 4th tax year preceding the tax year of change:
4th preceding year ended: mo./yr.______________ $ ____________________

Part III Information for Non-Automatic Change Request

		Yes	No
20	Is the applicant's requested change described in any revenue procedure, revenue ruling, notice, regulation, or other published guidance as an automatic change request? If "Yes," attach an explanation describing why the applicant is submitting its request under the non-automatic change procedures.		
21	Attach a copy of all documents related to the proposed change (see instructions).		
22	Attach a statement of the applicant's reasons for the proposed change.		
23	If the applicant is a member of a consolidated group for the year of change, do all other members of the consolidated group use the proposed method of accounting for the item being changed? If "No," attach an explanation.		
24a	Enter the amount of **user fee** attached to this application (see instructions) $ ____________________		
b	If the applicant qualifies for a reduced user fee, attach the required information or certification (see instructions).		

Form **3115** (Rev. 12-2022)

Form 3115 (Rev. 12-2022) **Electric Avenue, Inc** Page **4**

Part IV Section 481(a) Adjustment

		Yes	No
25	Does published guidance require the applicant (or permit the applicant and the applicant is electing) to implement the requested change in method of accounting on a cut-off basis? If "Yes," attach an explanation and do not complete lines 26, 27, 28, and 29 below.		X
26	Enter the section 481(a) adjustment. Indicate whether the adjustment is an increase (+) or a decrease (-) in income. $ -820,000 Attach a summary of the computation and an explanation of the methodology used to determine the section 481(a) adjustment. If it is based on more than one component, show the computation for each component. If the applicant waived any deductions with respect to the method of accounting pursuant to Regulations section 1.59A-3(c)(6)(i), include a summary of the waived deductions. If more than one applicant is applying for the method change on the application, attach a list of the (**a**) name, (**b**) identification number, and (**c**) the amount of the section 481(a) adjustment attributable to each applicant See Statement 2		
27	Is the applicant required to take into account in the year of change any remaining portion of a section 481(a) adjustment from a prior change (see instructions)? If "Yes," enter the amount. $		X
28	Is the applicant making an election to take the entire amount of the adjustment into account in the tax year of change? If "Yes," check the box for the applicable elective provision used to make the election (see instructions). ☐ $50,000 de minimis election ☐ Eligible acquisition transaction election		X
29	Is any part of the section 481(a) adjustment attributable to transactions between members of an affiliated group, a consolidated group, a controlled group, or other related parties? If "Yes," attach an explanation.		X

Schedule A — Change in Overall Method of Accounting (If Schedule A applies, Part I below must be completed.)

Part I Change in Overall Method (see instructions)

1 Check the appropriate boxes below to indicate the applicant's present and proposed methods of accounting.

Present method: ☐ Cash ☒ Accrual ☐ Hybrid (attach description)

Proposed method: ☒ Cash ☐ Accrual ☐ Hybrid (attach description)

2 Enter the following amounts as of the close of the tax year preceding the year of change. If none, state "None." Also, attach a statement providing a breakdown of the amounts entered on lines 2a through 2g.

		Amount
a	Income accrued but not received (such as accounts receivable) See Statement 3	$ -1,200,000
b	Income received or reported before it was earned (such as advanced payments). Attach a description of the income and the legal basis for the proposed method	None
c	Expenses accrued but not paid (such as accounts payable) See Statement 4	380,000
d	Prepaid expenses previously deducted	None
e	Supplies on hand previously deducted and/or not previously reported	None
f	Inventory on hand previously deducted and/or not previously reported. Complete Schedule D, Part II	None
g	Other amounts (specify). Attach a description of the item and the legal basis for its inclusion in the calculation of the section 481(a) adjustment.	None
h	**Net section 481(a) adjustment** (Combine lines 2a–2g.) Indicate whether the adjustment is an increase (+) or decrease (-) in income. Also enter the net amount of this section 481(a) adjustment amount on Part IV, line 26	$ -820,000

3 Is the applicant also requesting the recurring item exception under section 461(h)(3)? ☐ Yes ☐ No

4 Attach copies of the profit and loss statement (Schedule F (Form 1040) for farmers) and the balance sheet, if applicable, as of the close of the tax year preceding the year of change. Also attach a statement specifying the accounting method used when preparing the balance sheet. If books of account are not kept, attach a copy of the business schedules submitted with the federal income tax return or other return (such as tax-exempt organization returns) for that period. If the amounts in Part I, lines 2a through 2g, do not agree with the amounts shown on the balance sheet, attach a statement explaining the differences.

5 Is the applicant making a change to the overall cash method or to a method in which a taxpayer uses an accrual method for purchases and sales of inventory and uses the cash method for computing all other items of income and expense (see instructions)? ☒ Yes ☐ No

Part II Change to the Cash Method for Non-Automatic Change Request (see instructions)

Applicants requesting a change to the cash method must attach the following information:

1 A description of inventory items (items whose production, purchase, or sale is an income-producing factor) and materials and supplies used in carrying out the business.

2 An explanation as to whether the applicant is required to use an accrual method under any section of the Code or regulations.

Form **3115** (Rev. 12-2022)

Electric Avenue, Inc

Federal Statements

FYE: 12/31/2023

Accrual to Cash

Statement 1 - Form 3115, Page 3, Part II, Line 15 - Description of Applicant's Trade or Business

Engineering services

Accrual to Cash

Statement 2 - Form 3115, Page 4, Part IV, Line 26 - Section 481(a) Adjustment Computation/Methodology

Balance as of January 1, 2023:

Accounts payable	**$230,000**
Accrued expense	**150,000**
Accounts receivable	**(1,200,000)**
Total §481(a) adjustment	**($820,000)**

Accrual to Cash

Statement 3 - Form 3115, Page 4, Part I, Line 2a - Income Accrued But Not Received

Description	Amount
Accounts receivable	**$ -1,200,000**
Total	**$ -1,200,000**

Accrual to Cash

Statement 4 - Form 3115, Page 4, Part I, Line 2c - Expenses Accrued But Not Paid

Description	Amount
Accounts payable	**$ 230,000**
Accrued expenses	**150,000**
Total	**$ 380,000**

Form **1120-S** | **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.
Go to *www.irs.gov/Form1120S* for instructions and the latest information.

2023

For calendar year 2023 or tax year beginning , ending

A S election effective date	TYPE OR PRINT — Name: Electric Avenue, Inc	**D** Employer identification number
B Business activity code number (see instructions)	Number, street, and room or suite no. If a P.O. box, see instructions.: 456 Higher Street	**E** Date incorporated
C Check if Sch. M-3 attached ☐	City or town, state or province, country, and ZIP or foreign postal code: Appleton WI 54912	**F** Total assets (see instructions) $

G Is the corporation electing to be an S corporation beginning with this tax year? See instructions. ☐ Yes ☐ No

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

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

J Check if corporation: **(1)** ☐ Aggregated activities for section 465 at-risk purposes **(2)** ☐ Grouped activities for section 469 passive activity purposes

Caution: Include **only** trade or business income and expenses on lines 1a through 22. See the instructions for more information.

Income	1a	Gross receipts or sales ____ **b** Less Returns and allowances ____ **c** Balance	1c	
	2	Cost of goods sold (attach Form 1125-A)	2	
	3	Gross profit. Subtract line 2 from line 1c	3	
	4	Net gain (loss) from Form 4797, line 17 (attach Form 4797)	4	
	5	Other income (loss) (see instructions—attach statement)	5	
	6	**Total income (loss).** Add lines 3 through 5	6	
Deductions (see instructions for limitations)	7	Compensation of officers (see instructions–attach Form 1125-E)	7	
	8	Salaries and wages (less employment credits)	8	
	9	Repairs and maintenance	9	
	10	Bad debts	10	
	11	Rents	11	
	12	Taxes and licenses	12	
	13	Interest (see instructions)	13	
	14	Depreciation from Form 4562 not claimed on Form 1125-A or elsewhere on return (attach Form 4562)	14	
	15	Depletion **(Do not deduct oil and gas depletion.)**	15	
	16	Advertising	16	
	17	Pension, profit-sharing, etc., plans	17	
	18	Employee benefit programs	18	
	19	Energy efficient commercial buildings deduction (attach Form 7205)	19	
	20	Other deductions (attach statement) See Stmt 1	20	820,000
	21	**Total deductions.** Add lines 7 through 20	21	820,000
	22	**Ordinary business income (loss).** Subtract line 21 from line 6	22	-820,000
Tax and Payments	23a	Excess net passive income or LIFO recapture tax (see instructions) — 23a		
	b	Tax from Schedule D (Form 1120-S) — 23b		
	c	Add lines 23a and 23b (see instructions for additional taxes)	23c	
	24a	Current year's estimated tax payments & preceding year's overpayment credited to the current year — 24a		
	b	Tax deposited with Form 7004 — 24b		
	c	Credit for federal tax paid on fuels (attach Form 4136) — 24c		
	d	Elective payment election amount from Form 3800 — 24d		
	z	Add lines 24a through 24d	24z	
	25	Estimated tax penalty (see instructions). Check if Form 2220 is attached ☐	25	
	26	**Amount owed.** If line 24z is smaller than the total of lines 23c and 25, enter amount owed	26	
	27	**Overpayment.** If line 24z is larger than the total of lines 23c and 25, enter amount overpaid	27	
	28	Enter amount from line 27: **Credited to 2024 estimated tax** **Refunded**	28	

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.

May the IRS discuss this return with the preparer shown below? See instructions. ☐ Yes ☐ No

Signature of officer | Date | Title

Paid Preparer Use Only

Print/Type preparer's name	Preparer's signature	Date	Check ☐ if self-employed	PTIN
Firm's name Natl Assn Of Tax Prof			Firm's EIN	
Firm's address PO Box 8002 Appleton, WI 54912			Phone no.	

For Paperwork Reduction Act Notice, see separate instructions. Form **1120-S** (2023)

Electric Avenue, Inc
FYE: 12/31/2023

Federal Statements

Statement 1 - Form 1120-S, Page 1, Line 20 - Other Deductions

Description	Amount
§481(a) adjustment	$ **820,000**
Total	$ **820,000**

Example 3: Changing from Cash to Accrual

Bob the Builder is using the cash method of accounting in his sole proprietorship construction business. He has $250,000 for gross receipts. He wants to change to the accrual method of accounting. Bob has accounts receivable on his balance sheet of $245,000 that he has not reported as income due to the cash method of accounting. He also has accounts payable of $105,000.

By changing from cash to accrual the §481(a) adjustment is $140,000 ($245,000 - $105,000), a net increase to income due to receivables that have not been reported as income under the cash method but will be omitted if the cash is received under the accrual method. If the accounts payable were more than the accounts receivable, the adjustment would be negative and picked up in one year.

Note: If the taxpayer does not keep a balance sheet take the outstanding invoices and bills to determine what the receivables and payables outstanding are.

The $140,000 will be recognized in $35,000 increments in Years 1-4, Year 1 being the year of change.

Bob the Builder completes Form 3115 and Schedule C (Form 1040) , *Profit or Loss from Business (Sole Proprietorship)*, as follows:

Form **3115** (Rev. December 2022)
Department of the Treasury Internal Revenue Service

Application for Change in Accounting Method

Go to *www.irs.gov/Form3115* for instructions and the latest information.

OMB No. 1545-2070
Attachment Sequence No. **315**

Name of filer (name of parent corporation if a consolidated group) (see instructions): Bob the Builder	**Identification number** (see instructions):
	Principal business activity code number (see instructions): 236100
Number, street, and room or suite no. If a P.O. box, see the instructions.: 825 Tool Way	Tax year of change begins (MM/DD/YYYY): 01/01/2023 Tax year of change ends (MM/DD/YYYY): 12/31/2023
City or town, state, and ZIP code: Appleton WI 54911	Name of contact person (see instructions): Bob Builder
Name of applicant(s) (if different than filer) and identification number(s) (see instructions):	Contact person's telephone number: 920-555-1212

Does the filer want to receive a copy of the change in method of accounting letter ruling or other correspondence related to this Form 3115 by fax or encrypted email attachment? If "Yes," see instructions ☐ Yes ☒ No

If the applicant is a member of a consolidated group, check this box ☐

If **Form 2848**, Power of Attorney and Declaration of Representative, is attached (see instructions for when Form 2848 is required), check this box ☐

Check the box to indicate the type of applicant.

- ☒ Individual
- ☐ Corporation
- ☐ Controlled foreign corporation (Sec. 957)
- ☐ 10/50 corporation (Sec. 904(d)(2)(E))
- ☐ Qualified personal service corporation (Sec. 448(d)(2))
- ☐ Exempt organization. Enter Code section:
- ☐ Cooperative (Sec. 1381)
- ☐ Partnership
- ☐ S corporation
- ☐ Insurance co. (Sec. 816(a))
- ☐ Insurance co. (Sec. 831)
- ☐ Other (specify):

Check the appropriate box to indicate the type of accounting method change being requested. See instructions.

- ☐ Depreciation or Amortization
- ☐ Financial Products and/or Financial Activities of Financial Institutions
- ☒ Other (specify): Cash to Accrual

Caution: To be eligible for approval of the requested change in method of accounting, the taxpayer must provide all information that is relevant to the taxpayer or to the taxpayer's requested change in method of accounting. This includes (**1**) all relevant information requested on this Form 3115 (including its instructions), and (**2**) any other relevant information, even if not specifically requested on Form 3115.

The taxpayer must attach all applicable statements requested throughout this form.

Part I Information for Automatic Change Request

		Yes	No
1	Enter the applicable designated automatic accounting method change number ("DCN") for the requested automatic change. Enter only one DCN, except as provided for in guidance published by the IRS. If the requested change has no DCN, check "Other," and provide both a description of the change and a citation of the IRS guidance providing the automatic change. See instructions.		
a	(1) DCN: 123 (2) DCN: ___ (3) DCN: ___ (4) DCN: ___ (5) DCN: ___ (6) DCN: ___ (7) DCN: ___ (8) DCN: ___ (9) DCN: ___ (10) DCN: ___ (11) DCN: ___ (12) DCN: ___		
b	Other ☐ Description:		
2	Do any of the eligibility rules restrict the applicant from filing the requested change using the automatic change procedures (see instructions)? If "Yes," attach an explanation		X
3	Has the filer provided all the information and statements required (**a**) on this form and (**b**) by the List of Automatic Changes under which the applicant is requesting a change? See instructions	X	
	Note: Complete Part II and Part IV of this form, and, Schedules A through E, if applicable.		

Part II Information for All Requests

		Yes	No
4	During the tax year of change, did or will the applicant (**a**) cease to engage in the trade or business to which the requested change relates, or (**b**) terminate its existence? See instructions		X
5	Is the applicant requesting to change to the principal method in the tax year of change under Regulations section 1.381(c)(4)-1(d)(1) or 1.381(c)(5)-1(d)(1)? If "No," go to line 6a. If "Yes," the applicant cannot file a Form 3115 for this change. See instructions.		X

Sign Here

Under penalties of perjury, I declare that I have examined this application, including accompanying schedules and statements, and to the best of my knowledge and belief, the application contains all the relevant facts relating to the application, and it is true, correct, and complete. Declaration of preparer (other than applicant) is based on all information of which preparer has any knowledge.

Signature of filer (and spouse, if joint return)	Date	Name and title (print or type)
		Bob the Builder

Preparer (other than filer/applicant)

Print/Type preparer's name	Preparer's signature	Date
		03/25/24
Firm's name: Natl Assn Of Tax Prof		

For Privacy Act and Paperwork Reduction Act Notice, see the instructions.
DAA
Form **3115** (Rev. 12-2022)

Form 3115 (Rev. 12-2022) Bob the Builder Page 2

Part II Information for All Requests *(continued)*

		Yes	No
6a	Does the applicant (or any present or former consolidated group in which the applicant was a member during the applicable tax year(s)) have any federal income tax return(s) under examination (see instructions)? If "No," go to line 7a.		X
b	Is the method of accounting the applicant is requesting to change an issue under consideration (with respect to either the applicant or any present or former consolidated group in which the applicant was a member during the applicable tax year(s))? See instructions		
c	Enter the name and telephone number of the examining agent and the tax year(s) under examination. Name ______ Telephone number ______ Tax year(s) ______		
d	Has a copy of this Form 3115 been provided to the examining agent identified on line 6c?		
7a	Does audit protection apply to the applicant's requested change in method of accounting? See instructions. If "No," attach an explanation.	X	
b	If "Yes," check the applicable box and attach the required statement. ☒ Not under exam ☐ 3-month window ☐ 20 day: Date examination ended ______ ☐ Method not before director ☐ Negative adjustment ☐ CAP: Date member joined group ______ ☐ Audit protection at end of exam ☐ Other		
8a	Does the applicant (or any present or former consolidated group in which the applicant was a member during the applicable tax year(s)) have any federal income tax return(s) before Appeals and/or a federal court? If "No," go to line 9.		X
b	Is the method of accounting the applicant is requesting to change an issue under consideration by Appeals and/or a federal court (for either the applicant or any present or former consolidated group in which the applicant was a member for the tax year(s) the applicant was a member)? See instructions If "Yes," attach an explanation.		
c	If "Yes," enter the name of the (check the box) ☐ Appeals officer and/or ☐ counsel for the government, telephone number, and the tax year(s) before Appeals and/or a federal court. Name ______ Telephone number ______ Tax year(s) ______		
d	Has a copy of this Form 3115 been provided to the Appeals officer and/or counsel for the government identified on line 8c?		
9	If the applicant answered "Yes" to line 6a and/or 8a with respect to any present or former consolidated group, attach a statement that provides each parent corporation's (**a**) name, (**b**) identification number, (**c**) address, and (**d**) tax year(s) during which the applicant was a member that is under examination, before an Appeals office, and/or before a federal court.		
10	If for federal income tax purposes, the applicant is either an entity (including a limited liability company) treated as a partnership or an S corporation, is it requesting a change from a method of accounting that is an issue under consideration in an examination, before Appeals, or before a federal court, with respect to a federal income tax return of a partner, member, or shareholder of that entity?		X
11a	Has the applicant, its predecessor, or a related party requested or made (under either an automatic or non-automatic change procedure) a change in method of accounting within any of the 5 tax years ending with the tax year of change? If "No," go to line 12.		X
b	If "Yes," for each trade or business, attach a description of each requested change in method of accounting (including the tax year of change) and state whether the applicant received consent.		
c	If any application was withdrawn, not perfected, or denied, or if a Consent Agreement granting a change was not signed and returned to the IRS, or the change was not made or not made in the requested year of change, attach an explanation.		
12	Does the applicant, its predecessor, or a related party currently have pending any request (including any concurrently filed request) for a private letter ruling, change in method of accounting, or technical advice? If "Yes," for each request attach a statement providing (**a**) the name(s) of the taxpayer, (**b**) identification number(s), (**c**) the type of request (private letter ruling, change in method of accounting, or technical advice), and (**d**) the specific issue(s) in the request(s).		X
13	Is the applicant requesting to change its **overall** method of accounting? If "Yes," complete Schedule A on page 4 of the form.	X	

Form **3115** (Rev. 12-2022)

Form 3115 (Rev. 12-2022) **Bob the Builder** Page **3**

Part II Information for All Requests *(continued)*

		Yes	No
14	If the applicant is either (**i**) **not** changing its overall method of accounting, or (**ii**) changing its overall method of accounting **and** changing to a special method of accounting for one or more items, attach a detailed and complete description for each of the following (see instructions):		
a	The item(s) being changed.		
b	The applicant's present method for the item(s) being changed.		
c	The applicant's proposed method for the item(s) being changed.		
d	The applicant's present overall method of accounting (cash, accrual, or hybrid).		
15a	Attach a detailed and complete description of the applicant's trade(s) or business(es). See section 446(d).		
b	If the applicant has more than one trade or business, as defined in Regulations section 1.446-1(d), describe (**i**) whether each trade or business is accounted for separately; (**ii**) the goods and services provided by each trade or business and any other types of activities engaged in that generate gross income; (**iii**) the overall method of accounting for each trade or business; and (**iv**) which trade or business is requesting to change its accounting method as part of this application or a separate application.		
	Note: If you are requesting an automatic method change, see the instructions to see if you are required to complete lines 16a-16c.		
16a	Attach a full explanation of the legal basis supporting the proposed method for the item being changed. Include a detailed and complete description of the facts that explains how the law specifically applies to the applicant's situation and that demonstrates that the applicant is authorized to use the proposed method.		
b	Include all authority (statutes, regulations, published rulings, court cases, etc.) supporting the proposed method.		
c	Include either a discussion of the contrary authorities or a statement that no contrary authority exists.		
17	Will the proposed method of accounting be used for the applicant's books and records and financial statements? For insurance companies, see the instructions . . . . . If "No," attach an explanation.	X	
18	Does the applicant request a conference with the IRS National Office if the IRS National Office proposes an adverse response?		X
19a	If the applicant is changing to either the overall cash method, an overall accrual method, or is changing its method of accounting for any property subject to section 263A, any long-term contract subject to section 460 (see 19b), or inventories subject to section 471 or 474, enter the applicant's gross receipts for the 3 tax years preceding the tax year of change.		

1st preceding year ended: mo./yr.	2nd preceding year ended: mo./yr.	3rd preceding year ended: mo./yr.
$	$	$

b If the applicant is changing its method of accounting for any long-term contract subject to section 460, in addition to completing 19a, enter the applicant's gross receipts for the 4th tax year preceding the tax year of change:
4th preceding year ended: mo./yr.________ $ ________

Part III Information for Non-Automatic Change Request

		Yes	No
20	Is the applicant's requested change described in any revenue procedure, revenue ruling, notice, regulation, or other published guidance as an automatic change request? . . . . . If "Yes," attach an explanation describing why the applicant is submitting its request under the non-automatic change procedures.		
21	Attach a copy of all documents related to the proposed change (see instructions).		
22	Attach a statement of the applicant's reasons for the proposed change.		
23	If the applicant is a member of a consolidated group for the year of change, do all other members of the consolidated group use the proposed method of accounting for the item being changed? . . . . . If "No," attach an explanation.		
24a	Enter the amount of **user fee** attached to this application (see instructions) . . . . . $ ________		
b	If the applicant qualifies for a reduced user fee, attach the required information or certification (see instructions).		

Form **3115** (Rev. 12-2022)

Form 3115 (Rev. 12-2022) **Bob the Builder** Page **4**

Part IV Section 481(a) Adjustment

		Yes	No
25	Does published guidance require the applicant (or permit the applicant and the applicant is electing) to implement the requested change in method of accounting on a cut-off basis? If "Yes," attach an explanation and do not complete lines 26, 27, 28, and 29 below.		X
26	Enter the section 481(a) adjustment. Indicate whether the adjustment is an increase (+) or a decrease (-) in income. $ 140,000 Attach a summary of the computation and an explanation of the methodology used to determine the section 481(a) adjustment. If it is based on more than one component, show the computation for each component. If the applicant waived any deductions with respect to the method of accounting pursuant to Regulations section 1.59A-3(c)(6)(i), include a summary of the waived deductions. If more than one applicant is applying for the method change on the application, attach a list of the (**a**) name, (**b**) identification number, and (**c**) the amount of the section 481(a) adjustment attributable to each applicant.		
27	Is the applicant required to take into account in the year of change any remaining portion of a section 481(a) adjustment from a prior change (see instructions)? If "Yes," enter the amount. $ ______		X
28	Is the applicant making an election to take the entire amount of the adjustment into account in the tax year of change? If "Yes," check the box for the applicable elective provision used to make the election (see instructions). ☐ $50,000 de minimis election ☐ Eligible acquisition transaction election		X
29	Is any part of the section 481(a) adjustment attributable to transactions between members of an affiliated group, a consolidated group, a controlled group, or other related parties? If "Yes," attach an explanation.		X

Schedule A — Change in Overall Method of Accounting (If Schedule A applies, Part I below must be completed.)

Part I Change in Overall Method (see instructions)

1 Check the appropriate boxes below to indicate the applicant's present and proposed methods of accounting.

Present method: ☒ Cash ☐ Accrual ☐ Hybrid (attach description)

Proposed method: ☐ Cash ☒ Accrual ☐ Hybrid (attach description)

2 Enter the following amounts as of the close of the tax year preceding the year of change. If none, state "None." Also, attach a statement providing a breakdown of the amounts entered on lines 2a through 2g.

		Amount
a	Income accrued but not received (such as accounts receivable)	$ 245,000
b	Income received or reported before it was earned (such as advanced payments). Attach a description of the income and the legal basis for the proposed method	None
c	Expenses accrued but not paid (such as accounts payable)	-105,000
d	Prepaid expenses previously deducted	None
e	Supplies on hand previously deducted and/or not previously reported	None
f	Inventory on hand previously deducted and/or not previously reported. Complete Schedule D, Part II	None
g	Other amounts (specify). Attach a description of the item and the legal basis for its inclusion in the calculation of the section 481(a) adjustment.	None
h	**Net section 481(a) adjustment** (Combine lines 2a–2g.) Indicate whether the adjustment is an increase (+) or decrease (-) in income. Also enter the net amount of this section 481(a) adjustment amount on Part IV, line 26	$ 140,000

3 Is the applicant also requesting the recurring item exception under section 461(h)(3)? ☐ **Yes** ☒ **No**

4 Attach copies of the profit and loss statement (Schedule F (Form 1040) for farmers) and the balance sheet, if applicable, as of the close of the tax year preceding the year of change. Also attach a statement specifying the accounting method used when preparing the balance sheet. If books of account are not kept, attach a copy of the business schedules submitted with the federal income tax return or other return (such as tax-exempt organization returns) for that period. If the amounts in Part I, lines 2a through 2g, do not agree with the amounts shown on the balance sheet, attach a statement explaining the differences.

5 Is the applicant making a change to the overall cash method or to a method in which a taxpayer uses an accrual method for purchases and sales of inventory and uses the cash method for computing all other items of income and expense (see instructions)? ☐ **Yes** ☒ **No**

Part II Change to the Cash Method for Non-Automatic Change Request (see instructions)

Applicants requesting a change to the cash method must attach the following information:

1 A description of inventory items (items whose production, purchase, or sale is an income-producing factor) and materials and supplies used in carrying out the business.

2 An explanation as to whether the applicant is required to use an accrual method under any section of the Code or regulations.

Form **3115** (Rev. 12-2022)

SCHEDULE C (Form 1040)
Department of the Treasury
Internal Revenue Service

Profit or Loss From Business
(Sole Proprietorship)

Attach to Form 1040, 1040-SR, 1040-SS, 1040-NR, or 1041; partnerships must generally file Form 1065.
Go to *www.irs.gov/ScheduleC* for instructions and the latest information.

OMB No. 1545-0074
2023
Attachment Sequence No. **09**

Name of proprietor: Bob the Builder		Social security number (SSN)
A	Principal business or profession, including product or service (see instructions): Construction	B Enter code from instructions: 236100
C	Business name. If no separate business name, leave blank.: Bob the Builder	D Employer ID number (EIN) (see instr.)
E	Business address (including suite or room no.): 825 Tool Way	
	City, town or post office, state, and ZIP code: Appleton WI 54911	
F	Accounting method: (1) [X] Cash (2) [ ] Accrual (3) [ ] Other (specify)	
G	Did you "materially participate" in the operation of this business during 2023? If "No," see instructions for limit on losses	[X] Yes [ ] No
H	If you started or acquired this business during 2023, check here	[ ]
I	Did you make any payments in 2023 that would require you to file Form(s) 1099? See instructions	[ ] Yes [ ] No
J	If "Yes," did you or will you file required Form(s) 1099?	[ ] Yes [ ] No

Part I Income

1	Gross receipts or sales. See instructions for line 1 and check the box if this income was reported to you on Form W-2 and the "Statutory employee" box on that form was checked [ ]	1	250,000
2	Returns and allowances	2	
3	Subtract line 2 from line 1	3	250,000
4	Cost of goods sold (from line 42)	4	
5	**Gross profit.** Subtract line 4 from line 3	5	250,000
6	Other income, including federal and state gasoline or fuel tax credit or refund (see instructions) See Stmt 1	6	35,000
7	**Gross income.** Add lines 5 and 6	7	285,000

Part II Expenses. Enter expenses for business use of your home **only** on line 30.

8	Advertising	8		18	Office expense (see instructions)	18	
9	Car and truck expenses (see instructions)	9		19	Pension and profit-sharing plans	19	
				20	Rent or lease (see instructions):		
10	Commissions and fees	10		a	Vehicles, machinery, and equipment	20a	
11	Contract labor (see instructions)	11		b	Other business property	20b	
12	Depletion	12		21	Repairs and maintenance	21	
13	Depreciation and section 179 expense deduction (not included in Part III) (see instructions)	13		22	Supplies (not included in Part III)	22	
				23	Taxes and licenses	23	
				24	Travel and meals:		
14	Employee benefit programs (other than on line 19)	14		a	Travel	24a	
				b	Deductible meals (see instructions)	24b	
15	Insurance (other than health)	15		25	Utilities	25	
16	Interest (see instructions):			26	Wages (less employment credits)	26	
a	Mortgage (paid to banks, etc.)	16a		27a	Other expenses (from line 48)	27a	
b	Other	16b		b	Energy efficient commercial bldgs deduction (attach Form 7205)	27b	
17	Legal and professional services	17					

28	**Total expenses** before expenses for business use of home. Add lines 8 through 27b	28	0
29	Tentative profit or (loss). Subtract line 28 from line 7	29	285,000
30	Expenses for business use of your home. Do not report these expenses elsewhere. Attach Form 8829 unless using the simplified method. See instructions. **Simplified method filers only:** Enter the total square footage of (a) your home: ______ and (b) the part of your home used for business: ______ . Use the Simplified Method Worksheet in the instructions to figure the amount to enter on line 30	30	
31	**Net profit or (loss).** Subtract line 30 from line 29. • If a profit, enter on both **Schedule 1 (Form 1040), line 3,** and on **Schedule SE, line 2.** (If you checked the box on line 1, see instructions.) Estates and trusts, enter on **Form 1041, line 3.** • If a loss, you **must** go to line 32.	31	285,000
32	If you have a loss, check the box that describes your investment in this activity. See instructions. • If you checked 32a, enter the loss on both **Schedule 1 (Form 1040), line 3,** and on **Schedule SE, line 2.** (If you checked the box on line 1, see the line 31 instructions.) Estates and trusts, enter on **Form 1041, line 3.** • If you checked 32b, you **must** attach **Form 6198.** Your loss may be limited.	32a [ ] All investment is at risk. 32b [ ] Some investment is not at risk.	

For Paperwork Reduction Act Notice, see the separate instructions. **Schedule C (Form 1040) 2023**
DAA

Bob the Builder

Federal Statements

Construction

Statement 1 - Schedule C, Line 6 - Other Income

Description	Amount
481(a) adjustment	$ 35,000
Total	$ 35,000

Example 4: Missed depreciation discovered year of sale

On Jan. 1, 2020, Robert purchased residential rental property for $800,000 (exclusive of land) that was 27.5-year MACRS property. Robert prepared his own return and did not claim depreciation. He sold the property on March 1, 2023, for $780,000. With the sale of the rental, he decided to get some help preparing his 2023 tax return. He was informed that he needed to file Form 3115 for the missed depreciation.

Robert can correct the depreciation by filing Form 3115 with his 2023 tax return using DCN 107 since he sold the property in 2023. His §481(a) adjustment on Form 3115, Part IV, Line 26, equals the amount of the depreciation that should have been claimed.

His allowable accumulated depreciation using a 27.5-year recovery period for 2020-2022 should be $85,976. Thus, he has a negative §481(a) adjustment of $85,976. Robert reports the negative §481(a) adjustment in full on his 2023 Schedule E, Line 19, other expense.

Robert's Form 3115, Schedule E and Form 4797, *Sale of Business Property*, are completed as follows:

Form **3115** (Rev. December 2022)
Department of the Treasury
Internal Revenue Service

Application for Change in Accounting Method

Go to *www.irs.gov/Form3115* for instructions and the latest information.

OMB No. 1545-2070
Attachment Sequence No. **315**

Name of filer (name of parent corporation if a consolidated group) (see instructions) Robert	**Identification number** (see instructions) Principal business activity code number (see instructions)
Number, street, and room or suite no. If a P.O. box, see the instructions. 4562 Midway Rd	Tax year of change begins (MM/DD/YYYY) 01/01/2023 Tax year of change ends (MM/DD/YYYY) 12/31/2023
City or town, state, and ZIP code Appleton WI 54911	Name of contact person (see instructions)
Name of applicant(s) (if different than filer) and identification number(s) (see instructions)	Contact person's telephone number

Does the filer want to receive a copy of the change in method of accounting letter ruling or other correspondence related to this Form 3115 by fax or encrypted email attachment? If "Yes," see instructions ☐ Yes ☒ No

If the applicant is a member of a consolidated group, check this box ☐

If **Form 2848**, Power of Attorney and Declaration of Representative, is attached (see instructions for when Form 2848 is required), check this box ☐

Check the box to indicate the type of applicant.

- ☒ Individual
- ☐ Corporation
- ☐ Controlled foreign corporation (Sec. 957)
- ☐ 10/50 corporation (Sec. 904(d)(2)(E))
- ☐ Qualified personal service corporation (Sec. 448(d)(2))
- ☐ Exempt organization. Enter Code section:
- ☐ Cooperative (Sec. 1381)
- ☐ Partnership
- ☐ S corporation
- ☐ Insurance co. (Sec. 816(a))
- ☐ Insurance co. (Sec. 831)
- ☐ Other (specify):

Check the appropriate box to indicate the type of accounting method change being requested. See instructions.

- ☒ Depreciation or Amortization
- ☐ Financial Products and/or Financial Activities of Financial Institutions
- ☐ Other (specify):

Caution: To be eligible for approval of the requested change in method of accounting, the taxpayer must provide all information that is relevant to the taxpayer or to the taxpayer's requested change in method of accounting. This includes (**1**) all relevant information requested on this Form 3115 (including its instructions), and (**2**) any other relevant information, even if not specifically requested on Form 3115.

The taxpayer must attach all applicable statements requested throughout this form.

Part I Information for Automatic Change Request

		Yes	No
1	Enter the applicable designated automatic accounting method change number ("DCN") for the requested automatic change. Enter only one DCN, except as provided for in guidance published by the IRS. If the requested change has no DCN, check "Other," and provide both a description of the change and a citation of the IRS guidance providing the automatic change. See instructions.		
a	(1) DCN: 107 (2) DCN: ___ (3) DCN: ___ (4) DCN: ___ (5) DCN: ___ (6) DCN: ___ (7) DCN: ___ (8) DCN: ___ (9) DCN: ___ (10) DCN: ___ (11) DCN: ___ (12) DCN: ___		
b	Other ☐ Description:		
2	Do any of the eligibility rules restrict the applicant from filing the requested change using the automatic change procedures (see instructions)? If "Yes," attach an explanation		X
3	Has the filer provided all the information and statements required (**a**) on this form and (**b**) by the List of Automatic Changes under which the applicant is requesting a change? See instructions	X	
	Note: Complete Part II and Part IV of this form, and, Schedules A through E, if applicable.		

Part II Information for All Requests

		Yes	No
4	During the tax year of change, did or will the applicant (**a**) cease to engage in the trade or business to which the requested change relates, or (**b**) terminate its existence? See instructions		X
5	Is the applicant requesting to change to the principal method in the tax year of change under Regulations section 1.381(c)(4)-1(d)(1) or 1.381(c)(5)-1(d)(1)? If "No," go to line 6a. If "Yes," the applicant cannot file a Form 3115 for this change. See instructions.		X

Sign Here

Under penalties of perjury, I declare that I have examined this application, including accompanying schedules and statements, and to the best of my knowledge and belief, the application contains all the relevant facts relating to the application, and it is true, correct, and complete. Declaration of preparer (other than applicant) is based on all information of which preparer has any knowledge.

Signature of filer (and spouse, if joint return)	Date	Name and title (print or type)
		Robert

Preparer (other than filer/applicant)

Print/Type preparer's name	Preparer's signature	Date
		03/26/24
Firm's name Natl Assn Of Tax Prof		

For Privacy Act and Paperwork Reduction Act Notice, see the instructions. Form **3115** (Rev. 12-2022)
DAA

Form 3115 (Rev. 12-2022) **Robert** Page **2**

Part II Information for All Requests *(continued)*

		Yes	No
6a	Does the applicant (or any present or former consolidated group in which the applicant was a member during the applicable tax year(s)) have any federal income tax return(s) under examination (see instructions)? If "No," go to line 7a.		X
b	Is the method of accounting the applicant is requesting to change an issue under consideration (with respect to either the applicant or any present or former consolidated group in which the applicant was a member during the applicable tax year(s))? See instructions		
c	Enter the name and telephone number of the examining agent and the tax year(s) under examination. Name ______ Telephone number ______ Tax year(s) ______		
d	Has a copy of this Form 3115 been provided to the examining agent identified on line 6c?		
7a	Does audit protection apply to the applicant's requested change in method of accounting? See instructions. If "No," attach an explanation.	X	
b	If "Yes," check the applicable box and attach the required statement. ☒ Not under exam ☐ 3-month window ☐ 20 day: Date examination ended ______ ☐ Method not before director ☐ Negative adjustment ☐ CAP: Date member joined group ______ ☐ Audit protection at end of exam ☐ Other		
8a	Does the applicant (or any present or former consolidated group in which the applicant was a member during the applicable tax year(s)) have any federal income tax return(s) before Appeals and/or a federal court? If "No," go to line 9.		X
b	Is the method of accounting the applicant is requesting to change an issue under consideration by Appeals and/or a federal court (for either the applicant or any present or former consolidated group in which the applicant was a member for the tax year(s) the applicant was a member)? See instructions. If "Yes," attach an explanation.		
c	If "Yes," enter the name of the (check the box) ☐ Appeals officer and/or ☐ counsel for the government, telephone number, and the tax year(s) before Appeals and/or a federal court. Name ______ Telephone number ______ Tax year(s) ______		
d	Has a copy of this Form 3115 been provided to the Appeals officer and/or counsel for the government identified on line 8c?		
9	If the applicant answered "Yes" to line 6a and/or 8a with respect to any present or former consolidated group, attach a statement that provides each parent corporation's (**a**) name, (**b**) identification number, (**c**) address, and (**d**) tax year(s) during which the applicant was a member that is under examination, before an Appeals office, and/or before a federal court.		
10	If for federal income tax purposes, the applicant is either an entity (including a limited liability company) treated as a partnership or an S corporation, is it requesting a change from a method of accounting that is an issue under consideration in an examination, before Appeals, or before a federal court, with respect to a federal income tax return of a partner, member, or shareholder of that entity?		X
11a	Has the applicant, its predecessor, or a related party requested or made (under either an automatic or non-automatic change procedure) a change in method of accounting within any of the 5 tax years ending with the tax year of change? If "No," go to line 12.		X
b	If "Yes," for each trade or business, attach a description of each requested change in method of accounting (including the tax year of change) and state whether the applicant received consent.		
c	If any application was withdrawn, not perfected, or denied, or if a Consent Agreement granting a change was not signed and returned to the IRS, or the change was not made or not made in the requested year of change, attach an explanation.		
12	Does the applicant, its predecessor, or a related party currently have pending any request (including any concurrently filed request) for a private letter ruling, change in method of accounting, or technical advice? If "Yes," for each request attach a statement providing (**a**) the name(s) of the taxpayer, (**b**) identification number(s), (**c**) the type of request (private letter ruling, change in method of accounting, or technical advice), and (**d**) the specific issue(s) in the request(s).		X
13	Is the applicant requesting to change its **overall** method of accounting? If "Yes," complete Schedule A on page 4 of the form.		X

Form **3115** (Rev. 12-2022)

Form 3115 (Rev. 12-2022) **Robert** Page **3**

Part II **Information for All Requests** *(continued)*

		Yes	No
14	If the applicant is either (**i**) **not** changing its overall method of accounting, or (**ii**) changing its overall method of accounting **and** changing to a special method of accounting for one or more items, attach a detailed and complete description for each of the following (see instructions):		
a	The item(s) being changed.		
b	The applicant's present method for the item(s) being changed.		
c	The applicant's proposed method for the item(s) being changed.		
d	The applicant's present overall method of accounting (cash, accrual, or hybrid).		
15a	Attach a detailed and complete description of the applicant's trade(s) or business(es). See section 446(d).		
b	If the applicant has more than one trade or business, as defined in Regulations section 1.446-1(d), describe (**i**) whether each trade or business is accounted for separately; (**ii**) the goods and services provided by each trade or business and any other types of activities engaged in that generate gross income; (**iii**) the overall method of accounting for each trade or business; and (**iv**) which trade or business is requesting to change its accounting method as part of this application or a separate application.		
	Note: If you are requesting an automatic method change, see the instructions to see if you are required to complete lines 16a-16c.		
16a	Attach a full explanation of the legal basis supporting the proposed method for the item being changed. Include a detailed and complete description of the facts that explains how the law specifically applies to the applicant's situation and that demonstrates that the applicant is authorized to use the proposed method.		
b	Include all authority (statutes, regulations, published rulings, court cases, etc.) supporting the proposed method.		
c	Include either a discussion of the contrary authorities or a statement that no contrary authority exists.		
17	Will the proposed method of accounting be used for the applicant's books and records and financial statements? For insurance companies, see the instructions. If "No," attach an explanation.	X	
18	Does the applicant request a conference with the IRS National Office if the IRS National Office proposes an adverse response?		X
19a	If the applicant is changing to either the overall cash method, an overall accrual method, or is changing its method of accounting for any property subject to section 263A, any long-term contract subject to section 460 (see 19b), or inventories subject to section 471 or 474, enter the applicant's gross receipts for the 3 tax years preceding the tax year of change.		

1st preceding year ended: mo./yr.	2nd preceding year ended: mo./yr.	3rd preceding year ended: mo./yr.
$	$	$

b If the applicant is changing its method of accounting for any long-term contract subject to section 460, in addition to completing 19a, enter the applicant's gross receipts for the 4th tax year preceding the tax year of change:
4th preceding year ended: mo./yr.________ $ ________

Part III **Information for Non-Automatic Change Request**

		Yes	No
20	Is the applicant's requested change described in any revenue procedure, revenue ruling, notice, regulation, or other published guidance as an automatic change request? If "Yes," attach an explanation describing why the applicant is submitting its request under the non-automatic change procedures.		
21	Attach a copy of all documents related to the proposed change (see instructions).		
22	Attach a statement of the applicant's reasons for the proposed change.		
23	If the applicant is a member of a consolidated group for the year of change, do all other members of the consolidated group use the proposed method of accounting for the item being changed? If "No," attach an explanation.		
24a	Enter the amount of **user fee** attached to this application (see instructions) $ ________		
b	If the applicant qualifies for a reduced user fee, attach the required information or certification (see instructions).		

Form **3115** (Rev. 12-2022)

Form 3115 (Rev. 12-2022) Robert Page 4

Part IV Section 481(a) Adjustment

		Yes	No
25	Does published guidance require the applicant (or permit the applicant and the applicant is electing) to implement the requested change in method of accounting on a cut-off basis? If "Yes," attach an explanation and do not complete lines 26, 27, 28, and 29 below.		X
26	Enter the section 481(a) adjustment. Indicate whether the adjustment is an increase (+) or a decrease (-) in income. $ 85,976 Attach a summary of the computation and an explanation of the methodology used to determine the section 481(a) adjustment. If it is based on more than one component, show the computation for each component. If the applicant waived any deductions with respect to the method of accounting pursuant to Regulations section 1.59A-3(c)(6)(i), include a summary of the waived deductions. If more than one applicant is applying for the method change on the application, attach a list of the (**a**) name, (**b**) identification number, and (**c**) the amount of the section 481(a) adjustment attributable to each applicant.		
27	Is the applicant required to take into account in the year of change any remaining portion of a section 481(a) adjustment from a prior change (see instructions)? If "Yes," enter the amount. $ ______		X
28	Is the applicant making an election to take the entire amount of the adjustment into account in the tax year of change? If "Yes," check the box for the applicable elective provision used to make the election (see instructions). ☐ $50,000 de minimis election ☐ Eligible acquisition transaction election		X
29	Is any part of the section 481(a) adjustment attributable to transactions between members of an affiliated group, a consolidated group, a controlled group, or other related parties? If "Yes," attach an explanation.		X

Schedule A — Change in Overall Method of Accounting (If Schedule A applies, Part I below must be completed.)

Part I Change in Overall Method (see instructions)

1 Check the appropriate boxes below to indicate the applicant's present and proposed methods of accounting.

Present method: ☐ Cash ☐ Accrual ☐ Hybrid (attach description)

Proposed method: ☐ Cash ☐ Accrual ☐ Hybrid (attach description)

2 Enter the following amounts as of the close of the tax year preceding the year of change. If none, state "None." Also, attach a statement providing a breakdown of the amounts entered on lines 2a through 2g.

		Amount
a	Income accrued but not received (such as accounts receivable)	$ None
b	Income received or reported before it was earned (such as advanced payments). Attach a description of the income and the legal basis for the proposed method	None
c	Expenses accrued but not paid (such as accounts payable)	None
d	Prepaid expenses previously deducted	None
e	Supplies on hand previously deducted and/or not previously reported	None
f	Inventory on hand previously deducted and/or not previously reported. Complete Schedule D, Part II	None
g	Other amounts (specify). Attach a description of the item and the legal basis for its inclusion in the calculation of the section 481(a) adjustment.	None
h	**Net section 481(a) adjustment** (Combine lines 2a–2g.) Indicate whether the adjustment is an increase (+) or decrease (-) in income. Also enter the net amount of this section 481(a) adjustment amount on Part IV, line 26	$ 0

3 Is the applicant also requesting the recurring item exception under section 461(h)(3)? ☐ Yes ☒ No

4 Attach copies of the profit and loss statement (Schedule F (Form 1040) for farmers) and the balance sheet, if applicable, as of the close of the tax year preceding the year of change. Also attach a statement specifying the accounting method used when preparing the balance sheet. If books of account are not kept, attach a copy of the business schedules submitted with the federal income tax return or other return (such as tax-exempt organization returns) for that period. If the amounts in Part I, lines 2a through 2g, do not agree with the amounts shown on the balance sheet, attach a statement explaining the differences.

5 Is the applicant making a change to the overall cash method or to a method in which a taxpayer uses an accrual method for purchases and sales of inventory and uses the cash method for computing all other items of income and expense (see instructions)? ☐ Yes ☒ No

Part II Change to the Cash Method for Non-Automatic Change Request (see instructions)

Applicants requesting a change to the cash method must attach the following information:

1 A description of inventory items (items whose production, purchase, or sale is an income-producing factor) and materials and supplies used in carrying out the business.

2 An explanation as to whether the applicant is required to use an accrual method under any section of the Code or regulations.

Form **3115** (Rev. 12-2022)

Form 3115 (Rev. 12-2022) **Robert** Page **8**

Part III Method of Cost Allocation *(continued)* See instructions.

Section C — Other Costs Not Required To Be Allocated (Complete Section C only if the applicant is requesting to change its method for these costs.)

		Present method	Proposed method
1	Marketing, selling, advertising, and distribution expenses	N/A	N/A
2	Research and experimental expenses not included in Section B, line 26	N/A	N/A
3	Bidding expenses not included in Section B, line 22	N/A	N/A
4	General and administrative costs not included in Section B	N/A	N/A
5	Income taxes	N/A	N/A
6	Cost of strikes	N/A	N/A
7	Warranty and product liability costs	N/A	N/A
8	Section 179 costs	N/A	N/A
9	On-site storage	N/A	N/A
10	Depreciation, amortization, and cost recovery allowance not included in Section B, line 11	N/A	N/A
11	Other costs (Attach a list of these costs.)	N/A	N/A

Schedule E — Change in Depreciation or Amortization (see instructions)

Applicants requesting approval to change their method of accounting for depreciation or amortization complete this section. Applicants ***must*** provide this information for each item or class of property for which a change is requested.

Note: See the ***Summary of the List of Automatic Accounting Method Changes*** in the instructions for information regarding automatic changes under sections 56, 167, 168, or 197, or former sections 168, 1400I, or 1400L. **Do not** file Form 3115 with respect to certain late elections and election revocations. See instructions.

1 Is depreciation for the property determined under Regulations section 1.167(a)-11 (CLADR)? ☐ **Yes** ☒ **No**
If "Yes," the only changes permitted are under Regulations section 1.167(a)-11(c)(1)(iii).

2 Is any of the depreciation or amortization required to be capitalized under any Code section, such as section 263A? ☐ **Yes** ☒ **No**
If "Yes," enter the applicable section

3 Has a depreciation, amortization, expense, or disposition election been made for the property, such as the election under sections 168(f)(1), 168(i)(4), 179, 179C, or Regulations section 1.168(i)-8(d)? ☐ **Yes** ☒ **No**
If "Yes," state the election made

4a Attach a statement describing the property subject to the change. Include the property's description, type, placed-in-service year, and use in the applicant's trade or business or income-producing activity. Also include the type and amount of any federal tax credit claimed or grant received, along with any necessary adjustments to basis required under the Internal Revenue Code, with respect to the property. **See Statement 1**

b If the property is residential rental property, did the applicant live in the property before renting it? ☐ **Yes** ☒ **No**

c Is the property public utility property? ☐ **Yes** ☒ **No**

5 To the extent not already provided in the applicant's description of its present method, attach a statement explaining how the property is treated under the applicant's present method (for example, depreciable property, inventory property, supplies under Regulations section 1.162-3, nondepreciable section 263(a) property, property deductible as a current expense, etc.). **See Statement 2**

6 If the property is not currently treated as depreciable or amortizable property, attach a statement of the facts supporting the proposed change to depreciate or amortize the property. **See Statement 3**

7 If the property is currently treated and/or will be treated as depreciable or amortizable property, provide the following information for both the present (if applicable) and proposed methods: **See Statement 4**

a The Code section under which the property is or will be depreciated or amortized (for example, section 168(g)).

b The applicable asset class from Rev. Proc. 87-56, 1987-2 C.B. 674, for each asset depreciated under section 168 (MACRS) or under section 1400L; the applicable asset class from Rev. Proc. 83-35, 1983-1 C.B. 745, for each asset depreciated under former section 168 (ACRS); an explanation why no asset class is identified for each asset for which an asset class has not been identified by the applicant.

c The facts to support the asset class for the proposed method. **See Statement 5**

d The depreciation or amortization method of the property, including the applicable Code section (for example, 200% declining balance method under section 168(b)(1)).

e The useful life, recovery period, or amortization period of the property.

f The applicable convention of the property.

g Whether the additional first-year special depreciation allowance (for example, as provided by section 168(k), 168(l), 168(m), or former section 168(n), 1400L(b), or 1400N(d)) was or will be claimed for the property. If not, also provide an explanation as to why no special depreciation allowance was or will be claimed. **See Statement 6**

h Whether the property was or will be in a single asset account, a multiple asset account, or a general asset account.

Form **3115** (Rev. 12-2022)

DAA

Robert

Federal Statements

Residential Rental Property

Statement 1 - Schedule E, Line 19 - Other Expenses

Description	Gross Amount	Business Use Percentage	Net Amount
481(a) adjustment	$ **85,976**		$ **85,976**
Total	$ **85,976**		$ **85,976**

Robert

Federal Statements

Residential rental property

Statement 1 - Form 3115, Page 8, Part III, Schedule E, Line 4a - Description of Property Being Changed

Type of Property	Year Property Placed in Service	Trade/Business Use
Residential Rental	**2020**	**Rental**

Robert

Federal Statements

Residential rental property

Statement 2 - Form 3115, Page 8, Part III, Schedule E, Line 5 - Treatment of Property Under Present Method

Description

Correct depreciation using 27.5 years:

2020 deprecation $800,000 x 3.485% = $27,800

2021 & 2022 deprecation $800,000 x 3.636% = $58,176

Total depreciation for 2020-2022 = $85,976

Residential rental property

Statement 3 - Form 3115, Page 8, Part III, Schedule E, Line 6 - Proposed Change to Amortize/Depreciate

Description

Depreciable property purchased in 2020 failed to depreciate

Residential rental property

Statement 4 - Form 3115, Pg 8, Pt III, Sch E, Ln 7 - Information Under Present/Proposed Method

Description	Present Method	Proposed Method
Code section property is depreciated/amortized	NONE	**168**
Asset class under Section 168	NONE	**Residential**
Depreciation/amortization method	NONE	**SL**
Useful life or recovery period of property	NONE	**27.5**
Applicable convention of property	MM	**MM**

Residential rental property

Statement 5 - Form 3115, Page 8, Part III, Schedule E, Line 7c - Facts to Support Asset Class

Description

Property is residential rental property 100% gross rental income is from renting the house on a long-term basis

Residential rental property

Statement 6 - Form 3115, Page 8, Part III, Schedule E, Line 7g - Statement Regarding Additional First-Year Depreciation

Description

Not eligible for bonus depreciation

SCHEDULE E (Form 1040)

Department of the Treasury Internal Revenue Service

Supplemental Income and Loss

(From rental real estate, royalties, partnerships, S corporations, estates, trusts, REMICs, etc.)

Attach to Form 1040, 1040-SR, 1040-NR, or 1041.

Go to *www.irs.gov/ScheduleE* for instructions and the latest information.

OMB No. 1545-0074

2023

Attachment Sequence No. **13**

Name(s) shown on return: Robert

Your social security number

Part I **Income or Loss From Rental Real Estate and Royalties**

Note: If you are in the business of renting personal property, use **Schedule C**. See instructions. If you are an individual, report farm rental income or loss from **Form 4835** on page 2, line 40.

A Did you make any payments in 2023 that would require you to file Form(s) 1099? See instructions ☐ Yes ☒ No

B If "Yes," did you or will you file required Form(s) 1099? ☐ Yes ☐ No

1a	Physical address of each property (street, city, state, ZIP code)
A	1234 Patten Lane, Appleton, WI 54912
B	
C	

1b	Type of Property (from list below)		Fair Rental Days	Personal Use Days	QJV
A	1	A	185		☐
B		B			☐
C		C			☐

2 For each rental real estate property listed above, report the number of fair rental and personal use days. Check the QJV box only if you meet the requirements to file as a qualified joint venture. See instructions.

Type of Property:

1 Single Family Residence 3 Vacation/Short-Term Rental 5 Land 7 Self-Rental

2 Multi-Family Residence 4 Commercial 6 Royalties 8 Other (describe)

		Properties: A	B	C
Income:				
3 Rents received	3	35,000		
4 Royalties received	4			
Expenses:				
5 Advertising	5			
6 Auto and travel (see instructions)	6			
7 Cleaning and maintenance	7			
8 Commissions	8			
9 Insurance	9	450		
10 Legal and other professional fees	10			
11 Management fees	11			
12 Mortgage interest paid to banks, etc. (see instructions)	12			
13 Other interest	13			
14 Repairs	14	1,025		
15 Supplies	15			
16 Taxes	16	4,563		
17 Utilities	17	2,512		
18 Depreciation expense or depletion	18	6,061		
19 Other (list) See Statement 1	19	85,976		
20 Total expenses. Add lines 5 through 19	20	100,587		
21 Subtract line 20 from line 3 (rents) and/or 4 (royalties). If result is a (loss), see instructions to find out if you must file **Form 6198**	21	-65,587		
22 Deductible rental real estate loss after limitation, if any, on **Form 8582** (see instructions)	22	(65,587)	( )	( )

23a Total of all amounts reported on line 3 for all rental properties	23a	35,000
b Total of all amounts reported on line 4 for all royalty properties	23b	
c Total of all amounts reported on line 12 for all properties	23c	
d Total of all amounts reported on line 18 for all properties	23d	6,061
e Total of all amounts reported on line 20 for all properties	23e	100,587

24 **Income.** Add positive amounts shown on line 21. **Do not** include any losses	24	0
25 **Losses.** Add royalty losses from line 21 and rental real estate losses from line 22. Enter total losses here	25	(65,587)
26 **Total rental real estate and royalty income or (loss).** Combine lines 24 and 25. Enter the result here. If Parts II, III, IV, and line 40 on page 2 do not apply to you, also enter this amount on Schedule 1 (Form 1040), line 5. Otherwise, include this amount in the total on line 41 on page 2	26	-65,587

For Paperwork Reduction Act Notice, see the separate instructions. **Schedule E (Form 1040) 2023**

DAA

Robert

Federal Asset Report

FYE: 12/31/2023

Residential Rental Property

Asset	Description	Date In Service	Cost	Bus %	Sec 179	Bonus	Basis for Depr	Per	Conv	Meth	Prior	Current
Prior MACRS:												
1	Residential Rental Sold/Scrapped: 3/01/23	1/01/20	800,000				800,000	27	MM	S/L	85,976	6,061
			800,000				800,000				85,976	6,061
	Grand Totals		800,000				800,000				85,976	6,061
	Less: Dispositions and Transfers		800,000				800,000				85,976	6,061
	Less: Start-up/Org Expense		0				0				0	0
	Net Grand Totals		0				0				0	0

Form 4797 (2023) Robert Page 2

Part III **Gain From Disposition of Property Under Sections 1245, 1250, 1252, 1254, and 1255** (see instructions)

19	(a) Description of section 1245, 1250, 1252, 1254, or 1255 property:	(b) Date acquired (mo., day, yr.)	(c) Date sold (mo., day, yr.)
A	Residential Rental	01/01/20	03/01/23
B			
C			
D			

	These columns relate to the properties on lines 19A through 19D.		Property A	Property B	Property C	Property D
20	Gross sales price (**Note:** *See line 1a before completing.)*	20	780,000			
21	Cost or other basis plus expense of sale	21	800,000			
22	Depreciation (or depletion) allowed or allowable	22	92,037			
23	Adjusted basis. Subtract line 22 from line 21	23	707,963			
24	Total gain. Subtract line 23 from line 20	24	72,037			
25	**If section 1245 property:**					
a	Depreciation allowed or allowable from line 22	25a				
b	Enter the **smaller** of line 24 or 25a	25b				
26	**If section 1250 property:** If straight line depreciation was used, enter -0- on line 26g, except for a corporation subject to section 291.					
a	Additional depreciation after 1975. See instructions	26a				
b	Applicable percentage multiplied by the **smaller** of line 24 or line 26a. See instructions	26b				
c	Subtract line 26a from line 24. If residential rental property **or** line 24 isn't more than line 26a, skip lines 26d and 26e	26c				
d	Additional depreciation after 1969 and before 1976	26d				
e	Enter the **smaller** of line 26c or 26d	26e				
f	Section 291 amount (corporations only)	26f				
g	Add lines 26b, 26e, and 26f	26g	0			
27	**If section 1252 property:** Skip this section if you didn't dispose of farmland or if this form is being completed for a partnership.					
a	Soil, water, and land clearing expenses	27a				
b	Line 27a multiplied by applicable percentage. See instructions	27b				
c	Enter the **smaller** of line 24 or 27b	27c				
28	**If section 1254 property:**					
a	Intangible drilling and development costs, expenditures for development of mines and other natural deposits, mining exploration costs, and depletion. See instructions	28a				
b	Enter the **smaller** of line 24 or 28a	28b				
29	**If section 1255 property:**					
a	Applicable percentage of payments excluded from income under section 126. See instructions	29a				
b	Enter the **smaller** of line 24 or 29a. See instructions	29b				

Summary of Part III Gains. Complete property columns A through D through line 29b before going to line 30.

30	Total gains for all properties. Add property columns A through D, line 24	30	72,037
31	Add property columns A through D, lines 25b, 26g, 27c, 28b, and 29b. Enter here and on line 13	31	
32	Subtract line 31 from line 30. Enter the portion from casualty or theft on Form 4684, line 33. Enter the portion from other than casualty or theft on Form 4797, line 6	32	72,037

Part IV **Recapture Amounts Under Sections 179 and 280F(b)(2) When Business Use Drops to 50% or Less** (see instructions)

			(a) Section 179	(b) Section 280F(b)(2)
33	Section 179 expense deduction or depreciation allowable in prior years	33		
34	Recomputed depreciation. See instructions	34		
35	Recapture amount. Subtract line 34 from line 33. See the instructions for where to report	35		

Form **4797** (2023)

DAA

Sample Statements

Here are examples of the type of statements that must be attached. The IRS provides no set guidelines or standard work paper.

Statement X, Form 3115, Part IV, Line 26

Statement X, Form 3115, Part II, Line 14							
	Basis		2020	2021	2022	**TOTAL**	
	Old Method- Not depreciated						
Building	$ 60,900		0	0	0	**0**	
Land	$108,267		0	0	0	**0**	
Total	**$169,167**		**0**	**0**	**0**	**0**	(A)
	New Method- MACRS under §168						
Building	$ 60,900		2215	2215	2215	**6645**	
Land	$108,267		0	0	0	**0**	
Total	**$169,167**		**2215**	**2215**	**2215**	**6645**	(B)
Net negative §481(a) adjustment (A)-(B)						**-6,645**	

Statement X, Form 3115, Part IV, Line 26

The taxpayer computed the required §481(a) adjustment required by Rev. Proc. 2019-43, Section 15.01. The adjustment includes accounts receivable, accounts payable, and any other items of income and deductions that are includible under the accrual method of accounting. The books were analyzed as of Dec. 31, 2023, to include any items of income or deductions that would be duplicated or omitted in 2024 and future years.

Note: This statement offers a reasonable amount of information for a cash method to accrual method change.

Statement X, Form 3115, Part IV, Line 26

The taxpayer computed the required §481(a) adjustment required by Rev. Proc. 2019-43, Section 6.01. The adjustment includes a comparison of the depreciation taken to the depreciation allowed. The difference between the two for all assets is the net §481(a) adjustment. This includes all assets that were depreciated using an improper method. Each assets' basis will be adjusted in the year of change as required by Rev. Proc. 2019-43, Section 6.01.

Note: This statement is an example of one involving missed depreciation.

Statement X, Form 3115, Schedule E, Line 7

Line 7a	Code section under which the property will be depreciated: §168 and Regulations
Line 7b	Asset Class: residential rental property
Line 7c	Facts to support the asset class: Residential rental property is defined in §168(e)(2)(a)(i). Property that derives 80% or more of its gross revenue from the rental of a dwelling is defined as residential rental property. The building is leased to a family for living quarters, thus meeting the definition of residential rental property.
Line 7d	Depreciation method: Mid-month
Line 7e	Useful life: 27.5 years.
Line 7f	Convention: Mid-month
Line 7g	First-year special depreciation: no, property does not qualify.
Line 7h	Account: single asset account.

Note: This statement would be attached for a change in depreciation.

It is often helpful to save a file document of the various required statements then simply adjust for each client's numbers, since this is the basic information needed when filing the Form 3115.

Filing Form 3115 review questions

1. _____ Which of the following is a **true** statement?

   A. To change from the cash-to-accrual method of accounting, just check the accrual box on the tax return in the first year of the change.
   B. Year 1 depreciation was missed on a rental property. In Year 2 this is discovered. This is fixed by filing a Form 3115 with the timely filed Year 2 return.
   C. Years 1-5 depreciation was missed for business property sold in year 5. It is now Year 6. The taxpayer is out of luck.
   D. Years 1-3 depreciation was missed on a piece of equipment on Form 1120-S. This is fixed by filing a Form 3115 with the current year's return.

2. _____ Which of the following is **not** a feature of an Automatic Change?

   A. There is no user fee
   B. The taxpayer can assume permission is granted providing the request was timely filed with the original return by the due date, including extensions.
   C. The taxpayer can assume permission is granted providing the request was timely filed with the original return by the due date, excluding extensions.
   D. The taxpayer can enjoy specific procedural steps for completing an automatic change through guidance provided by the IRS.

3. _____ A positive §481(a) adjustment of $100,000 for incorrect depreciation will have what impact on the current year tax return of the taxpayer?

   A. It will increase expenses by $100,000 in the current year.
   B. It will decrease expenses by $100,000 in the current year.
   C. It will increase income by $25,000 in the current year.
   D. It will decrease expenses by $25,000 in the current year.

4. _____ What is a DCN?

   A. A Document Control Number used for each page of Form 3115.
   B. A Designated Change Number used to report which automatic changes are being made.
   C. A Designated Control Number used to report which automatic changes are being made.
   D. A Designated Change Number used to report which nonautomatic changes are being made.

5. _____ Nolan purchased a rental property in 2021 and never deducted depreciation. What is the DCN code to correct an impermissible method to a permissible method of depreciation for property that is currently owned?

   A. 6
   B. 7
   C. 106
   D. 107

6. _____ Which of the following is a change in accounting method for tax purposes?

   A. Cash-to-accrual
   B. Accrual-to-cash
   C. Impermissible method of depreciation to a permissible one
   D. All the above

Filing Form 3115 review answers

1.

A. Incorrect. Just checking the box does not take into account the request for approval from the commissioner, nor does it take the tax consequences for the change into account.
B. Incorrect. For only one year of a mistake, the accounting method is not yet considered adopted; therefore, it is appropriate to amend the Year 1 return.
C. Incorrect. DCN 107 is specifically used in this situation to claim missed depreciation for property disposed of before the start of the current year.
D. **Correct.** An impermissible accounting method has been adopted; therefore, the correction is made by filing a Form 3115 with the timely filed current year return.

[Computing §481(a) adjustment]

2.

A. Incorrect. There is no user fee for an automatic change.
B. Incorrect. Taxpayers can assume permission is granted providing the request was timely filed with the original return by the due date, including extensions.
C. **Correct.** The Form 3115 can be filed up to the original return due date of the return *including* extensions.
D. Incorrect. There are specific steps in revenue procedures, instructions and regulations for all the automatic change procedures.

[Completing Form 3115]

3.

A. Incorrect. A positive §481(a) adjustment increases taxable income in the current year. However, amounts over $50,000 are prorated evenly over four years.
B. Incorrect. A positive §481(a) adjustment increases income and needs to be spread over four years if it is over $50,000.
C. **Correct.** A positive §481(a) adjustment increases income. If it is greater than $50,000, it is spread over four years, so $25,000 ($100,000 / 4) is included in income in the current year.
D. Incorrect. A positive §481(a) adjustment increases taxable income.

[Computing §481(a) adjustment]

4.

A. Incorrect. No, it is not a document control number and the DCN is reported on Form 3115, Page 1.
B. **Correct.** A designated change number or DCN used to report which automatic changes are being made.
C. Incorrect. The C is change, not control.
D. Incorrect. DCNs are only used for automatic changes.

[Automatic approval]

5.

A. Incorrect. DCN 6 is for bad debt conformity for banks.
B. **Correct.** DCN 7 is to correct a method of depreciation that is impermissible.
C. Incorrect. DCN 106 is for timing of certain liabilities.
D. Incorrect. DCN 107 corrects depreciation, but for property that has been disposed of.

[Depreciation]

6.

A. Incorrect. Cash-to-accrual is one of the reasons, more than one applies.
B. Incorrect. Accrual-to-cash is one of the reasons; more than one applies.
C. Incorrect. Impermissible method of depreciation to a permissible one is one of the reasons, more than one applies.
D. **Correct.** Cash-to-accrual and accrual-to-cash are overall methods of accounting changes, and impermissible to a permissible method of depreciation is an accounting method change for tax purposes.

[Form 3115]

Business Use of Home

Issue: can anyone just set up an office in their home and realize tax benefits for doing so? Maybe or maybe not…

Taxpayers who use a portion of their home for business may be eligible to deduct expenses related to that business use if they meet certain requirements.

Primarily the business use of home deduction relates to sole proprietors, including daycare providers, filing Schedule C. The business use of home deduction is calculated on Form 8829, *Expenses for Business Use of Your Home*, and deducted on Schedule C, Line 30.

Taxpayers such as farmers filing Schedule F (Form 1040), Profit or Loss From Farming, rental property owners, including real estate professionals filing Schedule E and even partners and shareholders could also be eligible for a business use of home deduction or reimbursement.

Note: The ability for W-2 employees to deduct the business use of home deduction is currently suspended under the *Tax Cut and Jobs Act* (TCJA) through 2025.

Eligibility

Note: The text presumes a general understanding of the business use of home deduction. The following is a brief overview of the requirements.

To qualify for the business use of home deduction, the taxpayer must meet several tests:

- Use a portion or area of their home *exclusively* and *regularly* either as:
  - Their principal place of business
  - A place to meet with clients, patients or customers in the normal course of their trade or business
- Have net business income (see business income limitation below)

Exclusive and regular

To meet the exclusive *and* regular use test taxpayers must:

- *Exclusively* use an area, such as a room or other separately identifiable space specifically for their trade or business. The taxpayer does not need to mark off the space by a permanent partition such as walls. For example, the office space can simply be the top of a desk.
- *Regularly* use this specific area for business. Incidental or occasional business use is not regular use. Consider all facts and circumstances in determining whether the taxpayer uses the area or room on a regular basis.

Example – not regular use

A dentist used his home office to treat emergency patients only failed to meet the regular use requirement because the use was only occasional and not to meet with patients in the normal course of his business (Pearson).

Principal place of business

Taxpayers can have several business locations including their home for a single trade or business. But to qualify for the business use of home deduction, their home must be their principal place of business.

To determine if the taxpayer's home is their principal place of business consider the:

- Relative importance of the activities performed at each place the taxpayer conducts business
- Amount of time the taxpayer spends at each place where they conduct business

Additionally, a taxpayer's home office will be considered their principal place of business if they meet both of the following requirements:

- Use their home office exclusively and regularly for *administrative or management* activities such as billing, bookkeeping, ordering supplies, setting up appointments and such
- Have no other fixed location to conduct substantial *administrative and management* activities of the trade or business

Place to meet with clients, patients or customers

To meet this test, taxpayers meeting with patients, clients or customers in their home in the normal course of their business:

- Must physically meet with clients, patients or customers at their home even if the taxpayer has another business location
- The use of the office is *substantial* and *integral* to the business

Doctors, dentists, attorneys and other professionals who maintain offices in their homes to meet or deal with patients, clients or customers generally meet this requirement. Occasional meetings or phone calls do not qualify for the business use of home deduction [Prop. Reg. §1.280A-2(c)].

When a taxpayer meets this criterion, the home does not need to be the taxpayer's principal place of business.

Example – meets with clients

Ashley, a self-employed attorney, works three days a week at her office in the city. She also uses a portion of her home exclusively for business two days a week where she regularly meets with clients. Ashley's home office qualifies for the business use of home deduction because she meets clients there in the normal course of her business (Pub. 587, *Business Use of Your Home*).

Exceptions to exclusive use

There are several exceptions to the exclusive use test, meaning, taxpayers do not have to meet the exclusive use test if they use their home for:

- Storage of inventory or product samples
- A daycare facility

Storage of inventory or product samples

Taxpayers using part of their home for inventory or product sample storage can claim a business use of home deduction without meeting the exclusive use test if they meet all the following:

- Sells product at wholesale or retail in their trade or business
- Keeps the inventory or product samples in their home for use in the trade or business
- Home is the only fixed location of the trade or business
- Use the storage space on a *regular* basis
- Space used is a separately identifiable space suitable for storage

Example – storage of inventory or product samples

Sharon's home is the only fixed location for her business of selling mechanic's tools at retail. She regularly uses half of her basement for storage of inventory and product samples. Sharon sometimes uses the area for personal purposes.

The expenses for the storage space are deductible even though Sharon does not use this part of her basement exclusively for business (Pub. 587).

Daycare facility

Taxpayers using their home for daycare are allowed a deduction for the space used by prorating the space based on the number of hours the home is used for business. Rev. Rul. 92-3 states that a daycare provider is not required to keep records of the specific hours of usage of rooms that are available for daycare use throughout each business day and are regularly used as part of the routine provision of daycare. Daycare facilities are discussed later in this section.

Business income limitation

The business use of home deduction is limited to the net income of the business. In general, the deduction of normally nondeductible expenses, such as insurance, utilities and depreciation (with depreciation taken last), that are allocable to the business are limited to the gross income from the business use of the home minus the sum of the:

- Business part of deductible expenses, such as mortgage interest, real estate taxes, and qualified casualty and theft losses that are allowable as itemized deductions on Schedule A (Form 1040), *Itemized Deductions*
- Business expenses that relate to the business activity in the home, such as a business phone, supplies and depreciation on equipment

Meaning, if the business has a net income, the business use of home deduction is deductible up to the amount of net income. Any business use of home deduction in excess of the net business income is carried over for use in future years. If the business has a net loss, none of the business use of home deduction is allowable and it is completely carried over for use in future years.

Note: Business expenses do not include the deduction for a portion of the taxpayer's self-employment (SE) tax.

Gross income

For purposes of the gross income limitation on deductions, consider only gross income from the business use of the home.

The following criteria defines gross income:

- If the taxpayer engages in a business in the dwelling unit and in one or more other locations, the taxpayer determines the portion of the gross income from the business that is attributable to business activity in the unit. In making this determination, the taxpayer considers the amount of time that the taxpayer engages in business activity at each location and any other facts and circumstances that are relevant [Prop. Reg. §1.280A-2(i)(2)(i)].

- Gross income derived from use of a unit means gross income from the business activity in the unit reduced by expenditures required for the activity but not allocable to the use of the unit itself, such as expenditures for supplies and compensation paid to other persons. For example, a physician who uses a portion of a dwelling for treating patients subtracts from gross income expenditures for nursing and secretarial services, supplies, etc. [Prop. Reg. §1.280A-2(i)(2)(ii)].

Types of expenses

The portion of home operating expense used to determine the business use of home deduction depends on *both* of the following:

- Whether the expense is direct, indirect or unrelated to the area
- The percentage of home used for business

Direct, indirect or unrelated

The differentiation between whether an expense is direct, indirect or unrelated to the business use of the home is summarized as follows:

- *Direct expenses:* are those expenses that directly benefit only the business part of the home such as painting and repairs in the home office. These are deductible in full.
- *Indirect expenses:* are those that benefit the entire home and allocated to the business based on the business use percentage of the home. The business use percentage is calculated on Form 8829, Part I.
- *Unrelated expenses:* have no impact on the business use of home and are not included in the business use of home calculation

Example – direct or indirect expenses

Expenses not directly or indirectly relating to the home-based trade are business are not deductible. However, there are several expenses such as lawn care, snow removal and landscaping that could fall into either the direct, indirect or unrelated expense categories.

For example, in George R. Graves, TC Memo 1961-32, the Court allowed the deduction of lawn care, snow removal and other necessary expenses incurred to maintain the home office entrance for clients Graves regularly met with at his home office.

Additionally, in Cecil D. Rhoads, TC Memo 1987-335, the Court allowed a deduction equal to the one-third business use of home percentage for landscaping around the building where he met with patients.

Below is a chart summarizing direct, indirect and unrelated expenses:

Category of Expense	**Description**	**Deductibility**	**Examples**
Direct	Expenses only for the business part of the home	Deductible in full	Painting or repairs but only for the area used for business
Indirect	Expenses for keeping up and running the entire home	Deductible based on the percentage of the home used for business	Mortgage interest, real estate taxes, insurance, utilities, qualified casualty loss and general repairs
Unrelated	Expenses for parts of the home not used for business	Not deductible	Lawn care or painting a room not used for the business

Mortgage interest, real estate taxes and casualty losses

Some expenses are deductible regardless of the taxpayer's business use of home.

These expenses include:

- *Home mortgage interest:* The business portion of the qualified mortgage interest and points are used to calculate the business use of home deduction. The interest on a second mortgage can also be included in this calculation.
- *Real estate taxes: The Tax Cut and Jobs Act of 2017* (TCJA), $10,000 state and local tax (SALT) limitation has an impact on business use of home expenses. The taxes in the §280A(b) expenses are limited to the SALT limitation. Any excess taxes disallowed by the SALT limit are not lost but are recategorized to §280A(c) expenses, which are limited to gross income of business.
- *Casualty losses:* treat casualty losses as either a direct expense, an indirect expense or an unrelated expense depending on the property affected.
    - *Direct expense:* if the loss is on the portion of the property used only for business purposes, use the entire loss to calculate the business use of the home deduction
    - *Indirect expense:* if the loss is on the property used for both business and personal purposes, use only the business portion to calculate the business use of home deduction
    - *Unrelated expense:* if a loss is on property not used for any business purpose, do not use any of the loss to figure the business use of home deduction

These expenses are deductible on the taxpayer's Schedule A, regardless of business use of home. When the taxpayer qualifies to deduct business use of home, these expenses are allocated between Schedule A and Form 8829.

If the business use of home deductions are limited due to gross income from the trade or business, these expenses remain fully deductible providing the taxpayer itemizes. Meaning these expenses can create a business loss if the taxpayer itemizes.

However, if the taxpayer uses the standard deduction, the mortgage interest and property taxes are treated as other expenses and cannot create a loss.

Note: The IRS issued Program Manager Technical Advice (PMTA) 2019-01 to explain the interplay between the SALT limit and the deductibility of the business use portion of taxes under §280A(b).

Depreciation

Taxpayers owning their own home can claim a deduction for depreciaiton on the portion of their home used for business.

To calculate the taxpayer's depreciation allowance the following information will be needed:

- Month and year the home was placed in service for business
- Adjusted basis and FMV of the home on the day business use began (excluding land)
- Costs of any improvements before and after business use began
- Percentage of the home used for business

Improvements include permanent improvements that increase the value of the property, adds to its life or gives it a new or different use. Improvements include items such as replacing electric wiring or plumbing, adding a new roof or addition, paneling or remodeling. These costs are added to the basis of the property and depreciated. They are not currently expensed such as repairs. Therefore it is important to be able to distinguish between between what is an expendable repair and a capitalizable improvement.

Example – repair

Abby has a home office. She paid $500 to repair her furnace, which benefits the entire home. She uses 10% of her home for business, therefore she can deduct $50 or 10% ($500 x 10%) of the cost of the furnace repair.

Example – permanent improvement

Jack purchased an older home and fixed up two rooms to be used as his beauty salon. He patched the plaster on the ceilings and walls, painted, repaired the floor, installed an outside door and installed new wiring, plumbing and other equipment. Normally, the patching, painting and floor work are treated as repairs and the other expenses are permanent improvements.

However, because the work gives Jack's property a new use, the entire remodeling job is a permanent improvement, and its cost is added to the basis of the property and depreciated. Jack cannot deduct any portion of this improvement as a repair expense.

Percentage business use

Taxpayers may use any reasonable method to determine the business use percentage. The two more commonly used methods are:

- *Area of use:* divide the area (length x width) used for business by the total area of the home.
- *Number of rooms:* if all the rooms in the home are about the same size, divide the number of rooms used for business by the total number of rooms in the home.

Example – area of use

Joey's home office for her plumbing business is 240 square feet (12 feet × 20 feet). The total area of her home is 1,200 square feet. Therefore, the business use percentage of her office is 20% (240 / 1,200) of the total area of her home.

Example – number of rooms

Ann, an attorney, uses one room in her home exclusively for business. Her home has 10 rooms that are all about the same size. Therefore, Ann's home office is 10% (1/10) of the total area of her home. Ann's business use percentage is 10%.

Carryover

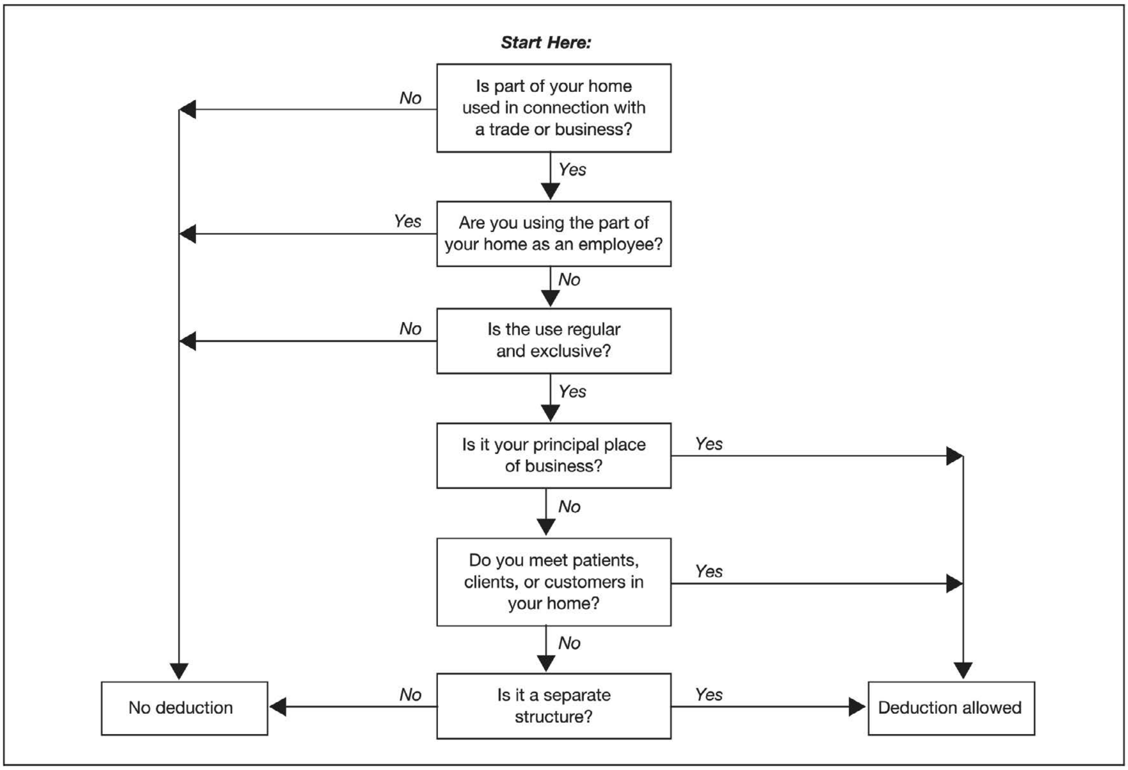
If the expenses relating to the business use of home area are greater than the current year's income, the taxpayer carries the excess over for use in future years. They are deductible in future years only when actual expenses are used to calculate the business use of home deduction as opposed to the simplified method (discussed later). Each carryover year they are subject to the income limitations for that year whether or not the taxpayer lives in the same home during the year.

Note: If the taxpayer sells or moves out of the residence that generated the carryover, the carryover expenses are not lost. They are available to the business as long as the business is in operation.

Eligibility chart

Use the following chart as a quick reference to help determine if the taxpayer has business use of home (Pub 587):

Figure A. **Can You Deduct Business Use of the Home Expenses?** Do not use this chart if you use your home for the storage of inventory or product samples, or to operate a daycare facility. See *Exceptions to Exclusive Use,* earlier, and *Daycare Facility,* later.



Form 8829

Form 8829 calculates the business use of home deduction for sole proprietors filing a Schedule C. Others should use the worksheet in Pub. 587, *Worksheet To Figure the Deduction for Business Use of Your Home,* to calculate their business use of home deduction. The worksheet goes through the same calculations and has the same layout as Form 8829.

Form 8829 is broken down into four parts:

- Part I: *Part of Your Home Used for Business*
- Part II: *Figure Your Allowable Deduction*
- Part III: *Depreciation of Your Home*
- Part IV: *Carryover of Unallowed Expenses*

The representation of expenses on Form 8829 can change depending on whether the taxpayer itemizes or uses the standard deduction.

Example 1 – itemizing

Andrew McCabe is a self-employed financial advisor. He uses an office in his home on a regular basis as a place of business to meet with his clients. Andrew makes no other use of the office during the tax year and uses no other premises for the consulting activity.

His home is 3,000 square feet and his office space is 300 square feet. Using the square footage method, his home office is 10% (300 / 3,000) of his total home.

Andrew itemizes and has home mortgage interest paid of $5,000 and real estate taxes paid of $2,000. Because he itemizes, the mortgage interest and real estate taxes are reported on Form 8829, Lines 10 and 11 respectively, which allow them to create a loss with the business use of home deduction.

He also has insurance of $600 and utilities of $900. Andrew's adjusted basis in the home is $130,245.

His gross income from the business is $1,900 and his total miscellaneous business expenses are $850 for a net business income of $1,050.

He determined that 10% of the general expenses for the dwelling unit are allocable to his office.

Below is Andrew's Form 8829:

Form 8829 — Department of the Treasury, Internal Revenue Service

Expenses for Business Use of Your Home

File only with Schedule C (Form 1040). Use a separate Form 8829 for each home you used for business during the year.

Go to *www.irs.gov/Form8829* for instructions and the latest information.

OMB No. 1545-0074 — **2023** — Attachment Sequence No. 176

Name(s) of proprietor(s)	Your social security number
Andrew McCabe	377-77-7777

Part I — Part of Your Home Used for Business

1	Area used regularly and exclusively for business, regularly for daycare, or for storage of inventory or product samples (see instructions)				1	300
2	Total area of home				2	3000
3	Divide line 1 by line 2. Enter the result as a percentage				3	10.00%
	For daycare facilities not used exclusively for business, go to line 4. All others, go to line 7.					
4	Multiply days used for daycare during year by hours used per day	4		hr.		
5	If you started or stopped using your home for daycare during the year, see instructions; otherwise, enter 8,760	5		hr.		
6	Divide line 4 by line 5. Enter the result as a decimal amount	6				
7	Business percentage. For daycare facilities not used exclusively for business, multiply line 6 by line 3 (enter the result as a percentage). All others, enter the amount from line 3				7	10.00%

Part II — Figure Your Allowable Deduction

			(a) Direct expenses	(b) Indirect expenses		
8	Enter the amount from Schedule C, line 29, **plus** any gain derived from the business use of your home, **minus** any loss from the trade or business not derived from the business use of your home. See instructions.				8	1,050
	See instructions for columns (a) and (b) before completing lines 9-22.					
9	Casualty losses (see instructions)	9				
10	Deductible mortgage interest (see instructions)	10		5,000		
11	Real estate taxes (see instructions)	11		2,000		
12	Add lines 9, 10, and 11	12		7,000		
13	Multiply line 12, column (b), by line 7	13		700		
14	Add line 12, column (a), and line 13				14	700
15	Subtract line 14 from line 8. If zero or less, enter -0-				15	350
16	Excess mortgage interest (see instructions)	16				
17	Excess real estate taxes (see instructions)	17				
18	Insurance	18		600		
19	Rent	19				
20	Repairs and maintenance	20				
21	Utilities	21		900		
22	Other expenses (see instructions)	22				
23	Add lines 16 through 22	23		1,500		
24	Multiply line 23, column (b), by line 7	24		150		
25	Carryover of prior year operating expenses (see instructions)	25				
26	Add line 23, column (a), line 24, and line 25				26	150
27	Allowable operating expenses. Enter the **smaller** of line 15 or line 26				27	150
28	Limit on excess casualty losses and depreciation. Subtract line 27 from line 15				28	200
29	Excess casualty losses (see instructions)	29				
30	Depreciation of your home from line 42 below	30		320		
31	Carryover of prior year excess casualty losses and depreciation (see instructions)	31				
32	Add lines 29 through 31				32	320
33	Allowable excess casualty losses and depreciation. Enter the **smaller** of line 28 or line 32				33	200
34	Add lines 14, 27, and 33				34	1,050
35	Casualty loss portion, if any, from lines 14 and 33. Carry amount to **Form 4684**. See instructions				35	
36	**Allowable expenses for business use of your home.** Subtract line 35 from line 34. Enter here and on Schedule C, line 30. If your home was used for more than one business, see instructions.				36	1,050

Part III — Depreciation of Your Home

37	Enter the **smaller** of your home's adjusted basis or its fair market value. See instructions	37	130,245
38	Value of land included on line 37	38	
39	Basis of building. Subtract line 38 from line 37	39	130,245
40	Business basis of building. Multiply line 39 by line 7	40	13,025
41	Depreciation percentage (see instructions)	41	2.461%
42	Depreciation allowable (see instructions). Multiply line 40 by line 41. Enter here and on line 30 above	42	320

Part IV — Carryover of Unallowed Expenses to 2024

43	Operating expenses. Subtract line 27 from line 26. If less than zero, enter -0-	43	0
44	Excess casualty losses and depreciation. Subtract line 33 from line 32. If less than zero, enter -0-	44	120

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Part I: *Part of Your Home Used for Business*

Line 1: total area used for business, 300 square feet

Line 2: total area of the home, 3,000 square feet

Line 3: percentage of home office to entire home, 10%

Lines 4-6: for daycares and not applicable in this example.

Line 7: the business percentage from Line 3 or 10%

Part II: *Figure Your Allowable Deduction*

Line 8: total business income from Schedule C, Line 29, $1,050 ($1,900 gross income - $850 expenses)

7	**Gross income.** Add lines 5 and 6						7	1,900
Part II	**Expenses.** Enter expenses for business use of your home **only** on line 30.							
8	Advertising	8		18	Office expense (see instructions)		18	
9	Car and truck expenses (see instructions)	9		19	Pension and profit-sharing plans		19	
				20	Rent or lease (see instructions):			
10	Commissions and fees	10		a	Vehicles, machinery, and equipment		20a	
11	Contract labor (see instructions)	11		b	Other business property		20b	
12	Depletion	12		21	Repairs and maintenance		21	
13	Depreciation and section 179 expense deduction (not included in Part III) (see instructions)	13		22	Supplies (not included in Part III)		22	
				23	Taxes and licenses		23	
				24	Travel and meals:			
14	Employee benefit programs (other than on line 19)	14		a	Travel		24a	
15	Insurance (other than health)	15		b	Deductible meals (see instructions)		24b	
16	Interest (see instructions):			25	Utilities		25	
a	Mortgage (paid to banks, etc.)	16a		26	Wages (less employment credits)		26	
b	Other	16b		27a	Other expenses (from line 48)		27a	850
17	Legal and professional services	17		b	Energy efficient commercial bldgs deduction (attach Form 7205)		27b	
28	**Total expenses** before expenses for business use of home. Add lines 8 through 27b						28	850
29	Tentative profit or (loss). Subtract line 28 from line 7						29	1,050

Line 10: mortgage interest paid for the entire home, treated as an indirect expense, $5,000

Line 11: real estate taxes paid for the entire home, treated as an indirect expense, $2,000 (SALT limitations did not apply)

Line 12: total of Lines 10 and 11, $7,000

Line 13: Business use percentage of the total expenses on Line 12 or $700 ($7,000 x 10%). Because Andrew itemizes, he may claim the remaining $6,300 ($5,000 + $2,000 - $700) paid for mortgage interest and real estate taxes as itemized deductions on Schedule A.

Line 15: The remaining business income able to be offset against the remaining business use of home expenses, including depreciation, $350 ($1,050 (Line 8) – $700 (Line 14)).

Lines 16 and 17: If the taxpayer had not been itemizing, the mortgage interest and real estate taxes would have been reported on these lines, respectively. However, in this example, because the taxpayer is itemizing, the mortgage interest and real estate taxes are reported on Lines 10 and 11, respectively.

Line 18: insurance paid for entire home, treated as an indirect expense, $600

Line 21: utilities paid for the entire home, treated as an indirect expense, $900

Line 23: total of Line 16-22, $1,500

Line 24: business percentage of Line 23, $150 ($1,500 x 10%)

Line 26: total of Line 24 and Line 25, $150 ($150 + $0)

Line 27: allowable operating expenses, the smaller of Line 15 ($350) or Line 26 ($150), Line 26, $150

Line 28: limit on excess casualty losses and depreciation or the difference between Line 15 ($350) and Line 27 ($150), $200

Line 30: depreciation of the home, $320, calculated in Part III

Line 32: total of Lines 29-31, $320 depreciation

Line 33: the smaller of Line 28 ($200), excess casualty losses and depreciation or Line 32 ($320), Line 28, $200

Line 34: sum of Line 14 ($700) + Line 27 ($150) + Line 33 ($200) = $1,050

Line 36: allowable expenses for business use of home, $1,050

Part III: *Depreciation of Your Home*

Line 37: the smaller of the home's adjusted basis or FMV, $130,245 (excluding land)

Line 38: because the value of the land was not part of Line 37, this line is blank

Line 39: depreciable basis of the building, $130,245

Line 40: business percentage of the building $130,245 x 10% = $13,025

Line 42: allowable depreciation, $320. This amount carries up to Line 30

Part IV: *Carryover of Unallowed Expenses*

Line 43: carryover of operating expenses, $0

Line 44: carryover of excess losses and depreciation, the difference between Lines 33 and 32, $120. The $120 excess depreciation expense carries over to next year.

Example 2 – standard deduction

Andrew does not itemize and has home mortgage interest of $5,000 and real estate taxes of $2,000. Because he does not itemize, the mortgage interest and property taxes are reported on Form 8829, Lines 16 and 17, respectively. In this case, they cannot create a loss.

Below is Andrew's Form 8829, Parts II, III and IV, Part I is the same as the previous example.

Part II Figure Your Allowable Deduction

			(a) Direct expenses	(b) Indirect expenses		
8	Enter the amount from Schedule C, line 29, **plus** any gain derived from the business use of your home, **minus** any loss from the trade or business not derived from the business use of your home. See instructions.				8	1,050
	See instructions for columns (a) and (b) before completing lines 9-22.		(a) Direct expenses	(b) Indirect expenses		
9	Casualty losses (see instructions)	9				
10	Deductible mortgage interest (see instructions)	10				
11	Real estate taxes (see instructions)	11				
12	Add lines 9, 10, and 11	12				
13	Multiply line 12, column (b), by line 7		13			
14	Add line 12, column (a), and line 13				14	
15	Subtract line 14 from line 8. If zero or less, enter -0-				15	1,050
16	Excess mortgage interest (see instructions)	16		5,000		
17	Excess real estate taxes (see instructions)	17		2,000		
18	Insurance	18		600		
19	Rent	19				
20	Repairs and maintenance	20				
21	Utilities	21		900		
22	Other expenses (see instructions)	22				
23	Add lines 16 through 22	23		8,500		
24	Multiply line 23, column (b), by line 7		24	850		
25	Carryover of prior year operating expenses (see instructions)		25			
26	Add line 23, column (a), line 24, and line 25				26	850
27	Allowable operating expenses. Enter the **smaller** of line 15 or line 26				27	850
28	Limit on excess casualty losses and depreciation. Subtract line 27 from line 15				28	200
29	Excess casualty losses (see instructions)		29			
30	Depreciation of your home from line 42 below		30	320		
31	Carryover of prior year excess casualty losses and depreciation (see instructions)		31			
32	Add lines 29 through 31				32	320
33	Allowable excess casualty losses and depreciation. Enter the **smaller** of line 28 or line 32				33	200
34	Add lines 14, 27, and 33				34	1,050
35	Casualty loss portion, if any, from lines 14 and 33. Carry amount to **Form 4684.** See instructions				35	
36	**Allowable expenses for business use of your home.** Subtract line 35 from line 34. Enter here and on Schedule C, line 30. If your home was used for more than one business, see instructions.				36	1,050

Part III Depreciation of Your Home

37	Enter the **smaller** of your home's adjusted basis or its fair market value. See instructions	37	130,245
38	Value of land included on line 37	38	
39	Basis of building. Subtract line 38 from line 37	39	130,245
40	Business basis of building. Multiply line 39 by line 7	40	13,025
41	Depreciation percentage (see instructions)	41	2.461%
42	Depreciation allowable (see instructions). Multiply line 40 by line 41. Enter here and on line 30 above	42	320

Part IV Carryover of Unallowed Expenses to 2024

43	Operating expenses. Subtract line 27 from line 26. If less than zero, enter -0-	43	0
44	Excess casualty losses and depreciation. Subtract line 33 from line 32. If less than zero, enter -0-	44	120

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As mentioned earlier, if the taxpayer itemizes, a loss is allowed if it is due to real estate taxes, mortgage interest or a casualty loss deduction. If they use the standard deduction, then those expenses cannot generate a loss.

Example 3 – itemizing, loss generated

Andrew itemizes and his business use of home expenses, mortgage interest and real estate taxes remain the same as Example 1. However, his gross income from the business is $1,000 and his total miscellaneous business expenses are $850 for a net business income of $150.

Below is Andrew's Form 8829, Parts II, III and IV, Part I remains the same:

			(a) Direct expenses	(b) Indirect expenses		
Part II	**Figure Your Allowable Deduction**					
8	Enter the amount from Schedule C, line 29, **plus** any gain derived from the business use of your home, **minus** any loss from the trade or business not derived from the business use of your home. See instructions.				8	150
	See instructions for columns (a) and (b) before completing lines 9-22.		(a) Direct expenses	(b) Indirect expenses		
9	Casualty losses (see instructions)	9				
10	Deductible mortgage interest (see instructions)	10		5,000		
11	Real estate taxes (see instructions)	11		2,000		
12	Add lines 9, 10, and 11	12		7,000		
13	Multiply line 12, column (b), by line 7	13		700		
14	Add line 12, column (a), and line 13				14	700
15	Subtract line 14 from line 8. If zero or less, enter -0-				15	0
16	Excess mortgage interest (see instructions)	16				
17	Excess real estate taxes (see instructions)	17				
18	Insurance	18		600		
19	Rent	19				
20	Repairs and maintenance	20				
21	Utilities	21		900		
22	Other expenses (see instructions)	22				
23	Add lines 16 through 22	23		1,500		
24	Multiply line 23, column (b), by line 7	24		150		
25	Carryover of prior year operating expenses (see instructions)	25				
26	Add line 23, column (a), line 24, and line 25				26	150
27	Allowable operating expenses. Enter the **smaller** of line 15 or line 26				27	0
28	Limit on excess casualty losses and depreciation. Subtract line 27 from line 15				28	0
29	Excess casualty losses (see instructions)	29				
30	Depreciation of your home from line 42 below	30		320		
31	Carryover of prior year excess casualty losses and depreciation (see instructions)	31				
32	Add lines 29 through 31				32	320
33	Allowable excess casualty losses and depreciation. Enter the **smaller** of line 28 or line 32				33	0
34	Add lines 14, 27, and 33				34	700
35	Casualty loss portion, if any, from lines 14 and 33. Carry amount to **Form 4684.** See instructions				35	
36	**Allowable expenses for business use of your home.** Subtract line 35 from line 34. Enter here and on Schedule C, line 30. If your home was used for more than one business, see instructions.				36	700
Part III	**Depreciation of Your Home**					
37	Enter the **smaller** of your home's adjusted basis or its fair market value. See instructions				37	130,245
38	Value of land included on line 37				38	
39	Basis of building. Subtract line 38 from line 37				39	130,245
40	Business basis of building. Multiply line 39 by line 7				40	13,025
41	Depreciation percentage (see instructions)				41	2.461%
42	Depreciation allowable (see instructions). Multiply line 40 by line 41. Enter here and on line 30 above				42	320
Part IV	**Carryover of Unallowed Expenses to 2024**					
43	Operating expenses. Subtract line 27 from line 26. If less than zero, enter -0-				43	150
44	Excess casualty losses and depreciation. Subtract line 33 from line 32. If less than zero, enter -0-				44	320

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Line 8: total business income from Schedule C, Line 29, $150

Lines 9-14: total of Lines 9-11 = $7,000 at the business percentage of 10% = $700

Line 15: remaining business income to offset other business use of home expenses, $0

Lines 16-26: total of the other expenses (insurance and utilities) at their business percentage of $150

Lines 27 and 28: other expenses of $150 disallowed due to business income limitation, making Lines 27 and 28 $0

Lines 29-33: depreciation of $320 is disallowed due to business income limitation, making Line 33 $0

Line 34: sum of Line 14, 27 and 33 or allowable business use of home deductions, $700

Lines 43 and 44: carryover of operating expenses of $150 and depreciation of $320.

Schedule C:

Because Andrew itemizes, business percentage of his mortgage interest and real estate taxes can create the business loss of $550.

28	**Total expenses** before expenses for business use of home. Add lines 8 through 27b	28	850
29	Tentative profit or (loss). Subtract line 28 from line 7	29	150
30	Expenses for business use of your home. Do not report these expenses elsewhere. Attach Form 8829 unless using the simplified method. See instructions. **Simplified method filers only:** Enter the total square footage of (a) your home: ___________ and (b) the part of your home used for business:___________ . Use the Simplified Method Worksheet in the instructions to figure the amount to enter on line 30	30	700
31	**Net profit or (loss).** Subtract line 30 from line 29. • If a profit, enter on both **Schedule 1 (Form 1040), line 3,** and on **Schedule SE, line 2.** (If you checked the box on line 1, see instructions.) Estates and trusts, enter on **Form 1041, line 3.** • If a loss, you **must** go to line 32.	31	-550
32	If you have a loss, check the box that describes your investment in this activity. See instructions. • If you checked 32a, enter the loss on both **Schedule 1 (Form 1040), line 3,** and on **Schedule SE, line 2.** (If you checked the box on line 1, see the line 31 instructions.) Estates and trusts, enter on **Form 1041, line 3.** • If you checked 32b, you **must** attach **Form 6198.** Your loss may be limited.	32a 32b	[X] All investment is at risk. [ ] Some investment is not at risk.

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Example 4 – standard deduction, no Schedule C loss

Andrew uses the standard deduction. All other facts remain the same as Example 3.

Below is Andrew's Form 8829, Parts II, III and IV, Part I remains the same:

Part II Figure Your Allowable Deduction

			(a) Direct expenses	(b) Indirect expenses		
8	Enter the amount from Schedule C, line 29, **plus** any gain derived from the business use of your home, **minus** any loss from the trade or business not derived from the business use of your home. See instructions.				8	150
	See instructions for columns (a) and (b) before completing lines 9-22.					
9	Casualty losses (see instructions)	9				
10	Deductible mortgage interest (see instructions)	10				
11	Real estate taxes (see instructions)	11				
12	Add lines 9, 10, and 11	12				
13	Multiply line 12, column (b), by line 7		13			
14	Add line 12, column (a), and line 13				14	
15	Subtract line 14 from line 8. If zero or less, enter -0-				15	150
16	Excess mortgage interest (see instructions)	16		5,000		
17	Excess real estate taxes (see instructions)	17		2,000		
18	Insurance	18		600		
19	Rent	19				
20	Repairs and maintenance	20				
21	Utilities	21		900		
22	Other expenses (see instructions)	22				
23	Add lines 16 through 22	23		8,500		
24	Multiply line 23, column (b), by line 7		24	850		
25	Carryover of prior year operating expenses (see instructions)		25			
26	Add line 23, column (a), line 24, and line 25				26	850
27	Allowable operating expenses. Enter the **smaller** of line 15 or line 26				27	150
28	Limit on excess casualty losses and depreciation. Subtract line 27 from line 15				28	0
29	Excess casualty losses (see instructions)		29			
30	Depreciation of your home from line 42 below		30	320		
31	Carryover of prior year excess casualty losses and depreciation (see instructions)		31			
32	Add lines 29 through 31				32	320
33	Allowable excess casualty losses and depreciation. Enter the **smaller** of line 28 or line 32				33	0
34	Add lines 14, 27, and 33				34	150
35	Casualty loss portion, if any, from lines 14 and 33. Carry amount to **Form 4684.** See instructions				35	
36	**Allowable expenses for business use of your home.** Subtract line 35 from line 34. Enter here and on Schedule C, line 30. If your home was used for more than one business, see instructions.				36	150

Part III Depreciation of Your Home

37	Enter the **smaller** of your home's adjusted basis or its fair market value. See instructions	37	130,245
38	Value of land included on line 37	38	
39	Basis of building. Subtract line 38 from line 37	39	130,245
40	Business basis of building. Multiply line 39 by line 7	40	13,025
41	Depreciation percentage (see instructions)	41	2.461%
42	Depreciation allowable (see instructions). Multiply line 40 by line 41. Enter here and on line 30 above	42	320

Part IV Carryover of Unallowed Expenses to 2024

43	Operating expenses. Subtract line 27 from line 26. If less than zero, enter -0-	43	700
44	Excess casualty losses and depreciation. Subtract line 33 from line 32. If less than zero, enter -0-	44	320

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Lines 16-26: Because Andrew uses the standard deduction, the mortgage interest and real estate taxes are reported here along with the other business use of home expenses. The total of $8,500 is multiplied by the business use percentage of 10% to allow $850 of business use of home expenses on Line 26.

Lines 27 and 28: Allows $150 of the $850 expenses to offset Andrew's income of $150, leaving Andrew with $0 business income on Schedule C. The remaining $700 is carried forward in Part IV, Line 43.

Lines 29-33: Depreciation of $320 is disallowed due to business income limitation, making Line 33 $0. The disallowed $320 is carried forward in Part IV, Line 44.

Lines 34-36: allowable business use of home expenses of $150

Below is Andrew's Schedule C showing net business income of $0 after the allowable Form 8829 deduction of $150.

28	**Total expenses** before expenses for business use of home. Add lines 8 through 27b	28	850
29	Tentative profit or (loss). Subtract line 28 from line 7	29	150
30	Expenses for business use of your home. Do not report these expenses elsewhere. Attach Form 8829 unless using the simplified method. See instructions. **Simplified method filers only:** Enter the total square footage of (a) your home: ________ and (b) the part of your home used for business: ________ . Use the Simplified Method Worksheet in the instructions to figure the amount to enter on line 30	30	150
31	**Net profit or (loss).** Subtract line 30 from line 29. • If a profit, enter on both **Schedule 1 (Form 1040), line 3,** and on **Schedule SE, line 2.** (If you checked the box on line 1, see instructions.) Estates and trusts, enter on **Form 1041, line 3.** • If a loss, you **must** go to line 32.	31	0
32	If you have a loss, check the box that describes your investment in this activity. See instructions. • If you checked 32a, enter the loss on both **Schedule 1 (Form 1040), line 3,** and on **Schedule SE, line 2.** (If you checked the box on line 1, see the line 31 instructions.) Estates and trusts, enter on **Form 1041, line 3.** • If you checked 32b, you **must** attach **Form 6198.** Your loss may be limited.	32a 32b	☐ All investment is at risk. ☐ Some investment is not at risk.

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Home office quirks

Now that we have reviewed the basics about the business use of home deduction, let's look at some quirky examples such as:

- A separate structure
- More than one trade or business
- Daycare facility
- §121 exclusion with a home office
- §1031 exchanges
- Farmers
- Real estate owners or professionals
- Partnership partners
- S corporation shareholders
- C corporation shareholders

Separate structure

A separate structure is a separate freestanding structure located on the taxpayer's property but not attached to the home such as a studio, garage, workshop, barn or greenhouse. Taxpayers can deduct expenses for a separate free-standing structure if it is used exclusively and regularly for business. The structure does not have to be the principal place of business or a place to meet clients, patients or customers [Prop. Reg. §1.280A-2(d)].

Example

Lily operates a floral shop in town. However, she grows some of the plants for her shop in a greenhouse behind her home. She uses the greenhouse exclusively and regularly in her business; therefore, Lily can deduct the expenses for its use, subject to the income deduction limit.

More than one trade or business

The same home office can be the principal place of business for two or more separate business activities. Whether the home office is the principal place of business for more than one business activity is determined separately for each trade or business activity of the taxpayer.

If the taxpayer is both an employee and a sole proprietor, using a home office for employee/employer purposes will taint the business use of home deduction for their Schedule C business.

Example

Tracy is a CPA and is employed by a local firm where she physically works each day. During the busy season she occasionally brings work home for her convenience, not her employer's.

She also sells jewelry on the side and reports the income on a Schedule C as a sole proprietor. She has a separate room in her home set up as an office to operate and manage her jewelry sales. She uses this room for the work she brings home from the CPA firm.

Since she uses her home office both for her jewelry sales business and occasionally for her accounting job, the office is not considered used exclusively for the sole proprietorship and no business use of home deduction is allowed. Use of the room for employee duties tainted the room use.

For taxpayers who share a home (roommates or spouses, regardless of their filing status), cannot use the same portion of the home for their respective home office deduction. Meaning, they cannot share the desk. The space must be allocated between the taxpayers using it (see the example under the simplified method).

Daycare facility

Taxpayers who use space in their home on a regular basis for providing daycare, may be able to claim a deduction for that part of their home even if they use the same space for nonbusiness purposes if they meet *both* of the following requirements:

- The taxpayer is in the trade or business of providing daycare for:
  - Children
  - Persons age 65 or older

  - Persons who are physically or mentally unable to care for themselves [Prop. Reg. §1.280A-2(f)(1)]

- The taxpayer must have applied for, been granted, or be exempt from having a license, certification, registration, or approval as a daycare center or as a family or group daycare home under state law. Taxpayers do not meet this requirement if their application was rejected, or license or other authorization was revoked [Prop. Reg. §1.280A-2(f)(3)].

Calculating the deduction

Taxpayers who regularly use part of their home for daycare, should determine the portion of the home used for daycare purposes. If the taxpayer uses that portion exclusively for daycare, they can deduct all the allocable expenses, subject to the deduction limit.

If the portion of the taxpayer's home used as a daycare facility is regular, but not exclusive, the taxpayer must calculate the percentage of time that portion of the home is used for daycare. A room that is available for use throughout each business day and regularly used in the daycare business is deemed used for daycare throughout each business day.

The taxpayer does not have to keep records to show the specific hours a certain area is used for the daycare business. The taxpayer can use the area occasionally for personal reasons. However, a room used only occasionally for the daycare business does not qualify for the deduction.

To find the percentage of time the home was used for the daycare business, compare the total time used for the daycare business to the total time that part of the home was used for all purposes by using one of the following methods:

- Compare the hours of daycare business use in a week with the number of hours in a week (168 total hours)
- Compare the hours of daycare business use for the year with the number of hours in the year (8,760 total hours)

If the taxpayer started or stopped using the home for daycare during the year, prorate the number of hours based on the number of days the home was available for daycare.

Example – daycare

Mary Lake uses her basement to operate a daycare business for children. Her home is 3,200 square feet and her basement is 1,600 square feet. Her business percentage use of her home is 50% (1,600 / 3,200).

In addition, Mary uses the basement for daycare an average of 12 hours a day, five days a week, for 50 weeks a year. During the other 12 hours a day, her family uses the basement. The percentage of time the basement was used for daycare is determined as follows:

Hours used for daycare (12 x 5 x 50)	3,000
Total hours in the year (24 x 365)	÷ 8,760
Percentage use based on hours	= 34.25%

Mary can deduct 34.25% of any direct expenses for the basement. However, because her indirect expenses are for the entire house, she can deduct only 17.13% of the indirect expenses. The percentage for her indirect expenses is determined as follows:

Business use of home percentage	50%
Daycare use percentage	x 34.25%
Hour usage	= 17.13%

This is calculated on Form 8829, Part I.

Mary's tentative profit from her business is $25,000 ($50,000 gross income - $25,000 business expenses).

She owns her home. The home has a basis of $100,000 (including $20,000 land basis). The FMV of the home is $150,000 (including $30,000 land). She used her home all year for her daycare business. Her mortgage interest is $6,400 and she paid property taxes of $2,000. However, she uses the standard deduction.

Her other expenses include repairs directly related to the business use of home of $171 and utilities of $850.

Below is Mary's Form 8829:

Form **8829** Department of the Treasury Internal Revenue Service	**Expenses for Business Use of Your Home** File only with Schedule C (Form 1040). Use a separate Form 8829 for each home you used for business during the year. Go to *www.irs.gov/Form8829* for instructions and the latest information.	OMB No. 1545-0074 **2023** Attachment Sequence No. **176**

Name(s) of proprietor(s)	Your social security number
MARY LAKE	xxx-xx-xxxx

Part I Part of Your Home Used for Business

1	Area used regularly and exclusively for business, regularly for daycare, or for storage of inventory or product samples (see instructions)			1	1600
2	Total area of home			2	3200
3	Divide line 1 by line 2. Enter the result as a percentage			3	50.00%
	For daycare facilities not used exclusively for business, go to line 4. All others, go to line 7.				
4	Multiply days used for daycare during year by hours used per day	4	3000 hr.		
5	If you started or stopped using your home for daycare during the year, see instructions; otherwise, enter 8,760	5	hr.		
6	Divide line 4 by line 5. Enter the result as a decimal amount	6	0.3425		
7	Business percentage. For daycare facilities not used exclusively for business, multiply line 6 by line 3 (enter the result as a percentage). All others, enter the amount from line 3			7	17.13%

Part II Figure Your Allowable Deduction

			(a) Direct expenses	(b) Indirect expenses		
8	Enter the amount from Schedule C, line 29, **plus** any gain derived from the business use of your home, **minus** any loss from the trade or business not derived from the business use of your home. See instructions.				8	25,000
	See instructions for columns (a) and (b) before completing lines 9-22.					
9	Casualty losses (see instructions)	9				
10	Deductible mortgage interest (see instructions)	10				
11	Real estate taxes (see instructions)	11				
12	Add lines 9, 10, and 11	12				
13	Multiply line 12, column (b), by line 7	13				
14	Add line 12, column (a), and line 13				14	
15	Subtract line 14 from line 8. If zero or less, enter -0-				15	25,000
16	Excess mortgage interest (see instructions)	16		6,400		
17	Excess real estate taxes (see instructions)	17		2,000		
18	Insurance	18				
19	Rent	19				
20	Repairs and maintenance	20	171			
21	Utilities	21		850		
22	Other expenses (see instructions)	22				
23	Add lines 16 through 22	23	171	9,250		
24	Multiply line 23, column (b), by line 7	24		1,585		
25	Carryover of prior year operating expenses (see instructions)	25				
26	Add line 23, column (a), line 24, and line 25				26	1,756
27	Allowable operating expenses. Enter the **smaller** of line 15 or line 26				27	1,756
28	Limit on excess casualty losses and depreciation. Subtract line 27 from line 15				28	23,244
29	Excess casualty losses (see instructions)	29				
30	Depreciation of your home from line 42 below	30		337		
31	Carryover of prior year excess casualty losses and depreciation (see instructions)	31				
32	Add lines 29 through 31				32	337
33	Allowable excess casualty losses and depreciation. Enter the **smaller** of line 28 or line 32				33	337
34	Add lines 14, 27, and 33				34	2,093
35	Casualty loss portion, if any, from lines 14 and 33. Carry amount to **Form 4684.** See instructions				35	
36	**Allowable expenses for business use of your home.** Subtract line 35 from line 34. Enter here and on Schedule C, line 30. If your home was used for more than one business, see instructions.				36	2,093

Part III Depreciation of Your Home

37	Enter the **smaller** of your home's adjusted basis or its fair market value. See instructions	37	100,000
38	Value of land included on line 37	38	20,000
39	Basis of building. Subtract line 38 from line 37	39	80,000
40	Business basis of building. Multiply line 39 by line 7	40	13,704
41	Depreciation percentage (see instructions)	41	2.461%
42	Depreciation allowable (see instructions). Multiply line 40 by line 41. Enter here and on line 30 above	42	337

Part IV Carryover of Unallowed Expenses to 2024

43	Operating expenses. Subtract line 27 from line 26. If less than zero, enter -0-	43	0
44	Excess casualty losses and depreciation. Subtract line 33 from line 32. If less than zero, enter -0-	44	0

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DAA

Part I calculates the business use of her home using both square footage and hours of operation.

Note: Line 4 is to be used by daycares only.

Part II, because Mary does not itemize her mortgage interest and real estate taxes paid is reported on Lines 16 and 17 instead of Lines 10 and 11.

She has sufficient business income where her entire business use of home deduction of $2,093 ($1,756 expenses + $337 depreciation) is allowed. There are no carryovers in Part IV.

§121 exclusion with a home office

Taxpayers are generally able to exclude up to $250,000 ($500,000 MFJ) of the gain on the sale or exchange of their principal residence when they meet the ownership and use tests. However taxpayers using their property partly as a home and partly for business, the treatment of any gain will vary depending on whether the property used for business is (1) part of the home or (2) separate from it.

Part of the home

When the business use of home is within the home, such as a room, taxpayers do not need to allocate gain on the sale of the property between the business and personal parts of the property. In addition, the sale of the business portion is Reported on Form 8949, *Sale and Other Dispositions of Capital Assets*, not on Form 4797 regardless of whether the taxpayer was entitled to claim any depreciation.

However, any portion of the gain equal to any depreciation allowed or allowable cannot be excluded.

Generally, taxpayers only report the sale of their home on Form 8949 if they:

- Receive a Form 1099-S, *Proceeds From Real Estate Transactions*,
- Have a gain and are not able to exclude it all,
- Have a gain and choose not to exclude it or
- Have a loss from the sale that is deductible.

Example – depreciation deducted

Becky sold her home on June 30 and has a gain of $200,000. She meets the ownership and use tests to be able to exclude the full gain; however, she has been depreciating her home office for several years and has incurred $2,000 of deductible depreciation. She must pick up the depreciation as taxable gain. She reports the sale of her home on Form 8949 as follows:

Name(s) shown on return. Name and SSN or taxpayer identification no. not required if shown on other side	**Social security number or taxpayer identification number**
Becky	xxx-xx-xxxx

Before you check Box D, E, or F below, see whether you received any Form(s) 1099-B or substitute statement(s) from your broker. A substitute statement will have the same information as Form 1099-B. Either will show whether your basis (usually your cost) was reported to the IRS by your broker and may even tell you which box to check.

Part II **Long-Term.** Transactions involving capital assets you held more than 1 year are generally long-term (see instructions). For short-term transactions, see page 1.

Note: You may aggregate all long-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS and for which no adjustments or codes are required. Enter the totals directly on Schedule D, line 8a; you aren't required to report these transactions on Form 8949 (see instructions).

You *must* check Box D, E, *or* F below. Check only one box. If more than one box applies for your long-term transactions, complete a separate Form 8949, page 2, for each applicable box. If you have more long-term transactions than will fit on this page for one or more of the boxes, complete as many forms with the same box checked as you need.

☐ **(D)** Long-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS (see **Note** above)
☐ **(E)** Long-term transactions reported on Form(s) 1099-B showing basis **wasn't** reported to the IRS
☑ **(F)** Long-term transactions not reported to you on Form 1099-B

1 **(a)** Description of property (Example: 100 sh. XYZ Co.)	**(b)** Date acquired (Mo., day, yr.)	**(c)** Date sold or disposed of (Mo., day, yr.)	**(d)** Proceeds (sales price) (see instructions)	**(e)** Cost or other basis See the **Note** below and see *Column (e)* in the separate instructions.	Adjustment, if any, to gain or loss If you enter an amount in column (g), enter a code in column (f). See the separate instructions. **(f)** Code(s) from instructions	**(g)** Amount of adjustment	**(h)** Gain or (loss) Subtract column (e) from column (d) and combine the result with column (g).
Sale of home with home office depreciation	01/05/17	06/30/24	400,000	200,000	H	198,000	2,000

Example – depreciation not allowed as a deduction

Due to business income limitations Becky was unable to deduct her allowable depreciation as part of her business use of home deduction. Therefore, the disallowed depreciation of $2,000 is added back to the adjusted basis and the full gain of now $198,000 is eligible for the §121 exclusion.

Separate from the home

When the portion of the home used for business is a separate structure or building from the main home, the sale of the separate structure and the home will need to be reported separately.

Prior to reporting the sale, the first step is to determine if the taxpayer meets the use test for the separate structure. Meaning, did the taxpayer use the property personally for two of the last five years ending on the date of sale or was it always used for business purposes.

Use test not met

Taxpayers cannot exclude gain on a separate part of their property used for business unless they owned and lived in that part for at least two of the last five years ending on the date of sale.

Taxpayers not meeting the use test must allocate the basis of the property and the amount realized at its sale between the business part and the part used as a home. Report the sale of the business portion on Form 4797 and the personal portion on Form 8949.

Use test met

If the taxpayer used the separate portion of the property for business in the year of sale, treat the sale as the sale of two separate properties even if meeting the use test for the business part. Again, the sale of the business portion is reported on Form 4797.

Allocate the selling price, selling expenses and basis between the business use and personal portions. Divide the maximum gain exclusion between both portions using the same allocation method.

§1031 exchanges

It is not uncommon for taxpayers to exchange properties under §1031 with both business and personal use. When this occurs, the gain relating to the personal use can be excluded; however, the gain relating to the business use can be deferred.

Example

Maria buys a home for $210,000. From Year 1 to Year 6, she used the property 2/3 as a principal residence and 1/3 as a home office. Her depreciation claimed and allowed on the business use of home portion is $10,500. In Year 6, Maria exchanges the home for another home that is used in the same manner. The value of the old and new home at the time of exchange is $360,000. The example assumes the same allocation of 2/3 used as a principal residence and 1/3 as an office in the home for the property acquired, thereby allocating $240,000 purchase price to the principal residence portion and $120,000 to the business portion.

	Total Property	**2/3 Principal Residence**	**1/3 Business Property**
Exchange value realized	$360,000	$240,000	$120,000
Basis	$210,000	$140,000	$70,000
Depreciation	$10,500		$10,500
Adjusted basis	$199,500	$140,000	$59,500
Realized gain	$160,500	$100,000	$60,500
Gain excluded under §121	$150,000	$100,000	$50,000
Gain deferred under §1031	$10,500		$10,500

Maria's basis in the residential property acquired is $240,000 and $109,500 for the business property (total basis is $349,500). The $109,500 basis in the business property consists of the $59,500 exchange basis and the $50,000 gain excluded under §121.

Form 8824, *Like-Kind Exchanges*, is filled out three times with this example, two times as a worksheet, and together those amounts are added to the form that is filed with the return.

Form 8824 used as worksheet for the part of the property used as a home:

Part III Realized Gain or (Loss), Recognized Gain, and Basis of Like-Kind Property Received

Before you Begin:

- **If you are e-filing Form 8824 and completing line 12, 15, or 25, see the instructions for important information regarding a separate statement you must attach.**
- If you transferred **and** received **(a)** more than one group of like-kind properties, or **(b)** cash or other (not like-kind) property, see ***Reporting of multi-asset exchanges*** in the instructions.

Note: Complete lines 12 through 14 **only** if you gave up property that was not like-kind. Otherwise, go to line 15.

12	Fair market value (FMV) of other property given up. See instructions	12			
a	Description of other property given up				
13	Adjusted basis of other property given up	13			
14	Gain or (loss) recognized on other property given up. Subtract line 13 from line 12. Report the gain or (loss) in the same manner as if the exchange had been a sale			14	
	Caution: If the property given up was used previously or partly as a home, see ***Property used as home*** in the instructions.				
15	Cash received, FMV of other property received, plus net liabilities assumed by other party, reduced (but not below zero) by any exchange expenses you incurred. See instructions			15	
a	Description of other property received				
16	FMV of like-kind property you received			16	240,000
17	Add lines 15 and 16			17	240,000
18	Adjusted basis of like-kind property you gave up, net amounts paid to other party, plus any exchange expenses **not** used on line 15. See instructions			18	140,000
19	**Realized gain or (loss).** Subtract line 18 from line 17 Section 121 exclusion 100,000			19	
20	Enter the smaller of line 15 or line 19, but not less than zero			20	0
21	Ordinary income under recapture rules. Enter here and on Form 4797, line 16. See instructions			21	
22	Subtract line 21 from line 20. If zero or less, enter -0-. If more than zero, enter here and on Schedule D or Form 4797, unless the installment method applies. See instructions			22	0
23	**Recognized gain.** Add lines 21 and 22			23	
24	Deferred gain or (loss). Subtract line 23 from line 19. If a related party exchange, see instructions			24	
25	**Basis of like-kind property received.** Subtract line 15 from the sum of lines 18 and 23. See instructions **Note:** Complete lines 25a, 25b, and 25c if you received like-kind section 1250 property, like-kind section 1245 property, or like-kind intangible property in the exchange.			25	240,000
a	Basis of like-kind section 1250 property received	25a	240,000		
b	Basis of like-kind section 1245 property received	25b			
c	Basis of like-kind intangible property received	25c			

Form 8824 used as worksheet for the part of the property used for business:

Part III Realized Gain or (Loss), Recognized Gain, and Basis of Like-Kind Property Received

Before you Begin:

- **If you are e-filing Form 8824 and completing line 12, 15, or 25, see the instructions for important information regarding a separate statement you must attach.**
- If you transferred **and** received **(a)** more than one group of like-kind properties, or **(b)** cash or other (not like-kind) property, see ***Reporting of multi-asset exchanges*** in the instructions.

Note: Complete lines 12 through 14 **only** if you gave up property that was not like-kind. Otherwise, go to line 15.

12	Fair market value (FMV) of other property given up. See instructions	12			
a	Description of other property given up				
13	Adjusted basis of other property given up	13			
14	Gain or (loss) recognized on other property given up. Subtract line 13 from line 12. Report the gain or (loss) in the same manner as if the exchange had been a sale			14	
	Caution: If the property given up was used previously or partly as a home, see ***Property used as home*** in the instructions.				
15	Cash received, FMV of other property received, plus net liabilities assumed by other party, reduced (but not below zero) by any exchange expenses you incurred. See instructions			15	
a	Description of other property received				
16	FMV of like-kind property you received			16	120,000
17	Add lines 15 and 16			17	120,000
18	Adjusted basis of like-kind property you gave up, net amounts paid to other party, plus any exchange expenses **not** used on line 15. See instructions			18	59,500
19	**Realized gain or (loss).** Subtract line 18 from line 17 Section 121 exclusion 50,000			19	10,500
20	Enter the smaller of line 15 or line 19, but not less than zero			20	0
21	Ordinary income under recapture rules. Enter here and on Form 4797, line 16. See instructions			21	
22	Subtract line 21 from line 20. If zero or less, enter -0-. If more than zero, enter here and on Schedule D or Form 4797, unless the installment method applies. See instructions			22	0
23	**Recognized gain.** Add lines 21 and 22			23	
24	Deferred gain or (loss). Subtract line 23 from line 19. If a related party exchange, see instructions			24	10,500
25	**Basis of like-kind property received.** Subtract line 15 from the sum of lines 18 and 23. See instructions. **Note:** Complete lines 25a, 25b, and 25c if you received like-kind section 1250 property, like-kind section 1245 property, or like-kind intangible property in the exchange.			25	109,500
a	Basis of like-kind section 1250 property received	25a	109,500		
b	Basis of like-kind section 1245 property received	25b			
c	Basis of like-kind intangible property received	25c			

Form 8824 combined worksheet amounts reported on the return:

Before you Begin:
- **If you are e-filing Form 8824 and completing line 12, 15, or 25, see the instructions for important information regarding a separate statement you must attach.**
- If you transferred **and** received **(a)** more than one group of like-kind properties, or **(b)** cash or other (not like-kind) property, see ***Reporting of multi-asset exchanges*** in the instructions.

Note: Complete lines 12 through 14 **only** if you gave up property that was not like-kind. Otherwise, go to line 15.

12	Fair market value (FMV) of other property given up. See instructions	12			
a	Description of other property given up				
13	Adjusted basis of other property given up	13			
14	Gain or (loss) recognized on other property given up. Subtract line 13 from line 12. Report the gain or (loss) in the same manner as if the exchange had been a sale			14	
	Caution: If the property given up was used previously or partly as a home, see ***Property used as home*** in the instructions.				
15	Cash received, FMV of other property received, plus net liabilities assumed by other party, reduced (but not below zero) by any exchange expenses you incurred. See instructions			15	
a	Description of other property received				
16	FMV of like-kind property you received			16	360,000
17	Add lines 15 and 16			17	360,000
18	Adjusted basis of like-kind property you gave up, net amounts paid to other party, plus any exchange expenses **not** used on line 15. See instructions			18	199,500
19	**Realized gain or (loss).** Subtract line 18 from line 17 Section 121 exclusion		150,000	19	10,500
20	Enter the smaller of line 15 or line 19, but not less than zero			20	0
21	Ordinary income under recapture rules. Enter here and on Form 4797, line 16. See instructions			21	
22	Subtract line 21 from line 20. If zero or less, enter -0-. If more than zero, enter here and on Schedule D or Form 4797, unless the installment method applies. See instructions			22	0
23	**Recognized gain.** Add lines 21 and 22			23	
24	Deferred gain or (loss). Subtract line 23 from line 19. If a related party exchange, see instructions			24	10,500
25	**Basis of like-kind property received.** Subtract line 15 from the sum of lines 18 and 23. See instructions **Note:** Complete lines 25a, 25b, and 25c if you received like-kind section 1250 property, like-kind section 1245 property, or like-kind intangible property in the exchange.			25	349,500
a	Basis of like-kind section 1250 property received	25a	349,500		
b	Basis of like-kind section 1245 property received	25b			
c	Basis of like-kind intangible property received	25c			

Farmers, partners, rental property owners

Other taxpayers who meet the eligibility requirements may also be able to claim a business use of home deduction. These include:

- Farmers
- Partners
- Rental owners (including real estate professionals)

However, as mentioned earlier, in lieu of using Form 8829 to calculate their business use of home deduction, they should use the worksheet in Pub. 587.

Farmers

Farmers filing Schedule F, report their entire deduction for business use of the home on Schedule F, Lines 32a-f. Enter "Business Use of Home" on the dotted line beside the entry.

Partners

Partners cannot deduct expenses they incur on behalf of the partnership if the partnership would reimburse them. However, if under the partnership agreement or established partnership practice, partners must pay certain partnership expenses with their own funds, they can deduct those expenses on their Schedule E, Line 28 as unreimbursed partnership expenses (UPE).

Therefore, partners who are not reimbursed by their partnership may deduct their business use of home expenses on Schedule E, Line 28, as UPE, including the allowable depreciation for the home. For depreciation purposes, if this is the first year the home is placed in service, attach Form 4562, *Depreciation and Amortization*, to the partner's tax return. In subsequent years Form 4562 is not required.

UPE deductions on Schedule E also reduce the partner's SE tax.

> **Note:** If a partnership pays the partner rent for the use of their home office, the partner apparently cannot deduct any home office expenses because the partner will be treated as an employee for purposes of the "rental to an employer" rule of §280A(c)(6). This conclusion is based on the Committee Reports to P.L. 99-514 (The *Tax Reform Act of 1986*), which specify that independent contractors are treated as employees for the purposes of this limit.

Rental owners

Rental owners, if they meet the eligibility requirements of regular and exclusive use and their rental activity raises to the level of a trade or business, can deduct a business use of home deduction on Schedule E, Line 19 as part of the other expenses.

Farmer, partner, rental owner examples

Example

Jeri owns her own home which is 1,200 square feet. She regularly and exclusively uses a 120 square foot room for business purposes. The basis of the home is $220,000 (including $20,000 for land). The FMV is $350,000 (including $30,000 land).

Though she paid $10,000 for mortgage interest and $5,000 for property taxes, she uses the standard deduction. In addition, she paid $1,000 for insurance and $800 for utilities on the entire home. Specifically for her office she incurred repair expenses of $200.

She has business related income of $40,000. Below is her Pub. 587, worksheet:

Worksheet To Figure the Deduction for Business Use of Your Home *Keep for Your Records*

Use this worksheet if you file Schedule **F** (Form 1040) or you are a partner, and you are using actual expenses to figure your deduction for business use of the home. Use a separate worksheet for each qualified business use of your home.

Line	Description	(a) Direct Expenses	(b) Indirect Expenses	Amount
	PART 1-Part of Your Home Used for Business:			
1)	Area of home used for business			120
2)	Total area of home			1,200
3)	Percentage of home used for business (divide line 1 by line 2 and show result as percentage)			10 %
	PART 2-Figure Your Allowable Deduction			
4)	Gross income from business (see instructions)			40,000
5)	Casualty losses			
6)	Deductible mortgage interest			
7)	Real estate taxes			
8)	Total of lines 5 through 7			
9)	Multiply line 8, column (b), by line 3			
10)	Add line 8, column (a), and line 9			
11)	Business expenses not from business use of home (see instructions)			
12)	Add lines 1O and 11			
13)	Deduction limit. Subtract line 12 from line 4			40,000
14)	Excess mortgage interest		10,000	
15)	Excess real estate taxes		5,000	
16)	Insurance		1,000	
17)	Rent			
18)	Repairs and maintenance	200		
19)	Utilities		800	
20)	Other expenses			
21)	Add lines 14 through 20	200	16,800	
22)	Multiply line 21, column (b), by line 3		1,680	
23)	Carryover of operating expenses from prior year (see instructions)		0	
24)	Add line 21, column (a), line 22, and line 23			1,880
25)	Allowable operating expenses. Enter the **smaller** of line 13 or line 24			1,880
26)	Limit on excess casualty losses and depreciation. Subtract line 25 from line 13			38,120
27)	Excess casualty losses (see instructions)			
28)	Depreciation of your home from line 40 below		513	
29)	Carryover of excess casualty losses and depreciation from prior year (see instructions)		0	
30)	Add lines 27 through 29			513
31)	Allowable excess casualty losses and depreciation. Enter the **smaller** of line 26 or line 30			513
32)	Add lines 10, 25, and 31			2,393
33)	Casualty losses included on lines 10 and 31 (see instructions)			
34)	Allowable expenses for business use of your home. (Subtract line 33 from line 32.) See instructions for where to enter on your return			2,393
	PART 3-Depreciation of Your Home			
35)	Smaller of adjusted basis or fair market value of home (see instructions)			220,000
36)	Basis of land			20,000
37)	Basis of building (subtract line 36 from line 35)			200,000
38)	Business basis of building (multiply line 37 by line 3)			20,000
39)	Depreciation percentage (from applicable table or method)			2.564 %
40)	Depreciation allowable (multiply line 38 by line 39)			513
	PART 4-Carryover of Unallowed Expenses to Next Year			
41)	Operating expenses. Subtract line 25 from line 24. If less than zero, enter -0-			
42)	Excess casualty losses and depreciation. Subtract line 31 from line 30. If less than zero, enter -0-			

After preparing the worksheet, Jeri has a total business use of home deduction of $2,393 ($1,880 operating expenses and $513 depreciation).

How she reports the activity will depend on the nature of her business.

Farmer

Jeri's Schedule F, Line 32 showing business use of home.

9	**Gross income.** Add amounts in the right column (lines 1c, 2, 3b, 4b, 5a, 5c, 6b, 6d, 7, and 8). If you use the accrual method, enter the amount from Part III, line 50. See instructions	9	40,000

Part II Farm Expenses – Cash and Accrual Method. Do not include personal or living expenses. See instructions.

10	Car and truck expenses (see instructions). Also attach **Form 4562**	10		23	Pension and profit-sharing plans	23	
				24	Rent or lease (see instructions):		
11	Chemicals	11		a	Vehicles, machinery, equipment	24a	
12	Conservation expenses (see instructions)	12		b	Other (land, animals, etc.)	24b	
13	Custom hire (machine work)	13		25	Repairs and maintenance	25	
14	Depreciation and section 179 expense (see instructions)	14		26	Seeds and plants	26	
				27	Storage and warehousing	27	
15	Employee benefit programs other than on line 23	15		28	Supplies	28	
				29	Taxes	29	
16	Feed	16		30	Utilities	30	
17	Fertilizers and lime	17		31	Veterinary, breeding, and medicine	31	
18	Freight and trucking	18		32	Other expenses (specify):		
19	Gasoline, fuel, and oil	19		a	Busn Use of Home	32a	2,393
20	Insurance (other than health)	20		b		32b	
21	Interest (see instructions):			c		32c	
a	Mortgage (paid to banks, etc.)	21a		d		32d	
b	Other	21b		e		32e	
22	Labor hired (less employment credits)	22		f		32f	

33	**Total expenses.** Add lines 10 through 32f. If line 32f is negative, see instructions	33	2,393
34	**Net farm profit or (loss).** Subtract line 33 from line 9	34	37,607
	If a profit, stop here and see instructions for where to report. If a loss, complete line 36.		
35	Reserved for future use.		
36	Check the box that describes your investment in this activity and see instructions for where to report your loss:		
	a ☐ All investment is at risk. b ☐ Some investment is not at risk.		

For Paperwork Reduction Act Notice, see the separate instructions. **Schedule F (Form 1040) 2023**

Partner

Jeri's Schedule E, Part II, Page 2, Line 28, showing "UPE."

Name(s) shown on return. Do not enter name and social security number if shown on other side.	**Your social security number**
JERI	XXX-XX-XXXX

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

Part II Income or Loss From Partnerships and S Corporations

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

27 Are you reporting any loss not allowed in a prior year due to the at-risk 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 basis computation is required	(f) Check if any amount is not at risk
A	PARTNERSHIP	P	☐		☐	☐
B	UPE	P	☐		☐	☐
C			☐		☐	☐
D			☐		☐	☐

	Passive Income and Loss		Nonpassive Income and Loss		
	(g) Passive loss allowed (attach **Form 8582** if required)	(h) Passive income from **Schedule K-1**	(i) Nonpassive loss allowed (see **Schedule K-1**)	(j) Section 179 expense deduction from **Form 4562**	(k) Nonpassive income from **Schedule K-1**
A			0		40,000
B			2,393		
C					
D					
29a Totals					40,000
b Totals			2,393		

30	Add columns (h) and (k) of line 29a	30	40,000
31	Add columns (g), (i), and (j) of line 29b	31	(2,393)
32	**Total partnership and S corporation income or (loss).** Combine lines 30 and 31	32	37,607

The business use of home deduction will also reduce the self-employment taxes.

Rental property owner

Jeri's Schedule E, Part I, Page 1, Line 19 as other expenses, showing a business use of home deduction.

		Properties: A	B	C
Income:				
3 Rents received	3	40,000		
4 Royalties received	4			
Expenses:				
5 Advertising	5			
6 Auto and travel (see instructions)	6			
7 Cleaning and maintenance	7			
8 Commissions	8			
9 Insurance	9			
10 Legal and other professional fees	10			
11 Management fees	11			
12 Mortgage interest paid to banks, etc. (see instructions)	12			
13 Other interest	13			
14 Repairs	14			
15 Supplies	15			
16 Taxes	16			
17 Utilities	17			
18 Depreciation expense or depletion	18			
19 Other (list) See Statement	19	2,393		
20 Total expenses. Add lines 5 through 19	20	2,393		
21 Subtract line 20 from line 3 (rents) and/or 4 (royalties). If result is a (loss), see instructions to find out if you must file **Form 6198**	21	37,607		
22 Deductible rental real estate loss after limitation, if any, on **Form 8582** (see instructions)	22	(0)	( )	( )

23a Total of all amounts reported on line 3 for all rental properties	23a	40,000
b Total of all amounts reported on line 4 for all royalty properties	23b	
c Total of all amounts reported on line 12 for all properties	23c	
d Total of all amounts reported on line 18 for all properties	23d	
e Total of all amounts reported on line 20 for all properties	23e	2,393
24 **Income.** Add positive amounts shown on line 21. **Do not** include any losses	24	37,607
25 **Losses.** Add royalty losses from line 21 and rental real estate losses from line 22. Enter total losses here	25	( )
26 **Total rental real estate and royalty income or (loss).** Combine lines 24 and 25. Enter the result here. If Parts II, III, IV, and line 40 on page 2 do not apply to you, also enter this amount on Schedule 1 (Form 1040), line 5. Otherwise, include this amount in the total on line 41 on page 2	26	37,607

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DAA

Statement 1 - Schedule E, Line 19 - Other Expenses

Description	Gross Amount	Business Use Percentage	Net Amount
BUSINESS USE OF HOME/HOME OFF	$ 2,393		$ 2,393
Total	$ 2,393		$ 2,393

S corporation shareholders

S corporation shareholders are employees and as such cannot deduct business expenses on Schedule E. Instead, they would normally deduct unreimbursed employee business expenses on Form 2106, *Employee Business Expenses*. Consequently, as mentioned earlier, under the TCJA, the ability for employees to deduct unreimbursed business expenses on Form 2106, with the exception of armed forces reservists, qualified performing artists, fee-basis state or local government official or and employee with impairment-related work expenses, is suspended until 2026.

However, if the S corporation has an accountable plan in place, and the shareholder is an employee and meets the eligibility requirements (exclusive and regular use) for business use of the home, the shareholder can submit an expense report to the S corporation for a tax-free reimbursement of the business use of home expenses and the S corporation receives a deduction for them.

Under an accountable plan the expenses must have a business purpose, the shareholder must be able to substantiate them and any excess reimbursements (advancements) over the actual expenses must be repaid promptly or within 120 days of the receipt of the payment.

Note: A copy of an accountable plan can be found in Appendix A.

Generally, the shareholder can submit reimbursement for expenses such as maintenance expenses, mortgage interest, real estate taxes, insurance, utilities, home internet, trash removal and repairs and maintenance both direct and indirect. They should use the worksheet from Pub. 587 or Form 8829 to calculate their business use of home reimbursement.

Any amount of the mortgage interest and real estate taxes not reimbursed can be deducted on the shareholder's Schedule A.

Note: Shareholders who receive rent for renting their home office to the S corporation are not eligible to use the accountable plan reimbursement method [§280A(c)(6)]. Instead, they report the rental income on their Schedule E with no expense deductions. Additional discussion about renting office space to an employer is outside the scope of this text.

C corporation shareholders

C corporation shareholders are considered employees and under the TCJA are currently ineligible for the home office deduction.

However, as with S corporation employee shareholders, C corporation employees would be eligible for reimbursement under an accountable plan if they meet the home office deduction requirements.

Simplified method – Rev. Proc. 2013-13

In lieu of keeping track of actual expenses for calculating the business use of home deduction, the IRS offers, under Rev. Proc. 2013-13, a safe harbor option called the simplified method. In essence, the simplified method eliminates the calculation, allocation and substantiation of actual expenses for the business use of home deduction.

However, to be eligible to elect to use the safe harbor simplified method, taxpayers must still satisfy the requirements of §280A, by using the portion of their home on an exclusive and regular basis as: (a) the taxpayer›s principal place of business for any trade or business, (b) as a place to meet with the taxpayer›s patients, clients, or customers in the normal course of the taxpayer›s trade or business, or (c) in the case of a separate structure that is not attached to the dwelling unit, in connection with the taxpayer›s trade or business.

Under the simplified method, taxpayer's allowable business use of home deduction is determined by multiplying the area of the home used for business purposes (limited to a maximum of 300 square feet) by the prescribed rate of $5, resulting in a maximum allowable deduction of $1,500.

Example

Marissa, a sole proprietor, uses a room in her home exclusively and regularly for business purposes. The room is 100 square feet. If she uses the simplified method, her business use of home deduction is $500 (100 square feet x $5).

Variation

Marissa's room is 400 square feet. Using the simplified method, she would like to deduct $2,000 (400 x $5) as her business use of home deduction. Unfortunately, her deduction is limited to $1,500 (300 square feet x $5). The additional $500 ($2,000 - $1,500) is permanently lost.

Expenses and depreciation

Taxpayers electing the simplified method cannot deduct any actual expenses for the business except for business expenses not relating to the use of the home. In the years the simplified method is used, depreciation on the home is deemed to be zero. In subsequent years, if using the actual expenses for the business use of home deduction, depreciation is then calculated using the appropriate optional depreciation table for MACRS.

However, taxpayers may still claim depreciation and §179 on other business assets such as furniture and equipment. In addition, when using the simplified method, taxpayers may still deduct their mortgage interest, real estate taxes and casualty losses in full on Schedule A.

Example

Bonnie, a sole proprietor, uses a room in her residence regularly and exclusively to meet with clients in the normal course of her trade or business. The room is 300 square feet and has a cost basis of $10,000. The room was placed in service in January three years ago, in Year 1. The room is depreciated over 39 years, using the SL depreciation method and the MM convention.

Table A-7a. **Nonresidential Real Property Mid-Month Convention Straight Line—39 Years**

Year	Month property placed in service											
	1	2	3	4	5	6	7	8	9	10	11	12
1	2.461%	2.247%	2.033%	1.819%	1.605%	1.391%	1.177%	0.963%	0.749%	0.535%	0.321%	0.107%
2–39	2.564	2.564	2.564	2.564	2.564	2.564	2.564	2.564	2.564	2.564	2.564	2.564
40	0.107	0.321	0.535	0.749	0.963	1.177	1.391	1.605	1.819	2.033	2.247	2.461

Bonnie uses actual expenses for her home office duction Years 1-3.

The adjusted basis of the room as of Dec. 31, Year 3, is $9,242 ($10,000 – $246 – $256 – $256).

In Year 4, Bonnie elects to use the simplified method and deducts $1,500 ($5 x 300 square feet). The depreciation deduction allowable for the room for Year 4 is deemed to be zero. Accordingly, Bonnie's adjusted basis in the room as of Dec. 31 Year 4, remains at $9,242.

In Year 5, Bonnie resumes calculating and substantiating actual expenses. Bonnie must use the appropriate optional depreciation table for determining the depreciation deduction allowable for the room for Year 5 because she used the simplified method for Year 4.

The nonresidential real property mid-month convention straight line – 39 years table, from Pub. 946, provides that the depreciation rate for Year 5 is 2.564%. Accordingly, on Bonnie's Year 5 income tax return she deducts depreciation for the room of $256 ($10,000 X 2.564%). Consequently, her adjusted basis in the room at the end of year five is $8,986 ($9,242 - $256).

The simplified method does not apply to an employee who receives an advance, allowance or reimbursement of expenses under a reimbursement or other expense allowance arrangement with their employer.

Reporting

If the simplified method is elected taxpayers must complete the additional entry spaces on Schedule C, Line 30, for that home only. Include the amount from the *Simplified Method Worksheet*, Line 5 on Line 30.

Example – continued

Bonnie has $60,000 of tentative (Line 29) business income and reports her business use of home deduction using the simplified method on her Schedule C as follows:

28	**Total expenses** before expenses for business use of home. Add lines 8 through 27b	28	40,000
29	Tentative profit or (loss). Subtract line 28 from line 7	29	60,000
30	Expenses for business use of your home. Do not report these expenses elsewhere. Attach Form 8829 unless using the simplified method. See instructions. **Simplified method filers only:** Enter the total square footage of (a) your home: 2,300 and (b) the part of your home used for business: 300. Use the Simplified Method Worksheet in the instructions to figure the amount to enter on line 30	30	1,500
31	**Net profit or (loss).** Subtract line 30 from line 29. • If a profit, enter on both **Schedule 1 (Form 1040), line 3,** and on **Schedule SE, line 2.** (If you checked the box on line 1, see instructions.) Estates and trusts, enter on **Form 1041, line 3.**	31	58,500

Simplified Method Worksheet

Use this worksheet if you file Schedule F (Form 1040) or you are a partner, and you are using the simplified method to figure your deduction for business use of the home. Use a separate worksheet for each qualified business use of your home.

1. Enter the amount of the gross income limitation. See the *Instructions for the Simplified Method Worksheet*	1.	60,000
2. Allowable square footage for the qualified business use. Do not enter more than 300 square feet. See the *Instructions for the Simplified Method Worksheet*	2.	300
3. Simplified method amount		
a. Maximum allowable amount	3a.	$5
b. For daycare facilities not used exclusively for business, enter the decimal amount from the Daycare Facility Worksheet; otherwise, enter 1.0	3b.	1.0
c. Multiply line 3a by line 3b and enter result to 2 decimal places	3c.	$5
4. Multiply line 2 by line 3c	4.	1,500
5. **Allowable expenses using the simplified method.** Enter the smaller of line 1 or line 4. If zero or less, enter -0-. See Where To Deduct, earlier, for where to enter this amount on your return	5.	1,500
6. **Carryover of unallowed expenses from a prior year that are not allowed in 2023.**		
a. Operating expenses. Enter the amount, if any, from your last Worksheet To Figure the Deduction for Business Use of Your Home, line 41 (line 40 if before 2018). See the *Instructions for the Simplified Method Worksheet*	6a.	
b. Excess casualty losses and depreciation. Enter the amount, if any, from your last Worksheet To Figure the Deduction for Business Use of Your Home, line 42 (line 41 if before 2018). See the *Instructions for the Simplified Method Worksheet*	6b.	

Carryovers

The simplified method is still subject to the income limitation of the business. Any amount not deducted due to the business income limitation is lost. It is not carried forward as the actual expense deduction is.

Additionally, in a year using the simplified method, any actual expense deduction carryovers cannot be used, they continue to be carried over for future use.

Simplified method election

The election to use the simplified method is made each year, on a timely filed return including extensions meaning taxpayers can alternate between using actual expenses and the simplified method annually. However, once the election is made for the tax year, the election is irrevocable. The election to use the simplified method one year and actual expenses in a succeeding taxable year, or vice versa, is not a change of accounting and does not require the consent of the commissioner.

Allowable area

In most cases, the allowable area is the smaller of the actual square footage or 300 square feet. However, there may be instances where the area needs to be adjusted due to sharing, multiple businesses, multiple homes, rental use or part-year use or area changes.

Sharing use

Taxpayers sharing a home, such as roommates or spouses, who also uses the home in a business that qualifies for the business use of home deduction will each independently determine whether to use the actual or simplified method. They do not have to use the same method. However, if they both use the simplified method, they cannot use it for qualified business use of the same portion of the home.

Example

Jack and Jill, spouses, each operate their own sole proprietor businesses out of their home. Each may use the simplified method up to 300 square feet, but for different portions of the home.

Variation

Jack uses 200 square feet and Jill uses 300 square feet with 100 square feet of each total being shared evenly. In this situation, allocated both Jack and Jill 50 square feet of the shared space adjusting their separate home office use for Jack to 150 square feet (200 – 100 + 50) and for Jill 250 square feet (300 – 100 + 50).

Multiple businesses

If the taxpayer conducts more than one business that qualifies for the business use of home deduction, the election to use the simplified method applies to all the taxpayers qualified businesses. They cannot report one using actual expenses and another using the simplified method. Additionally, the 300 square foot maximum must be allocated between the businesses. Each business does not get its own 300 square feet.

Multiple homes

Taxpayers using more than one home for their business during the year can elect to use the simplified method for only one of the homes. The deduction for the other home must be calculated using actual expenses on Form 8829. On Schedule C, Line 30, enter the combined amount calculated using the simplified method and the amount calculated using Form 8829.

Rental use

The simplified method does not apply to rental use. A rental use that qualifies for the business use of home deduction must be calculated using actual expenses. If the rental use and a qualified business use share the same area, the taxpayer will need to allocate the actual area used between the two uses. Taxpayers cannot use the same area to calculate a deduction for the qualified business use as they are using to calculate the deduction for the rental use.

Part-year use or area changes

For the simplified method, if the qualified business use was for a portion of the taxable year, such as a seasonal business or a business that began during the year, or there was a change in the square footage used for the business, the business use of home deduction is limited to the average monthly allowable square footage. The average monthly amount is calculated by adding the amount of allowable square footage used each month and dividing the sum by 12.

When determining the average monthly allowable square footage, no more than 300 square feet can be considered for any one month. Additionally, if qualified business use was less than 15 days in a month, use zero for the square feet for that month.

Example

Katrina files her federal income tax return on a calendar basis. On May 1, she began using 500 square feet of her home for qualified business use. Katrina continued to use the 500 square feet until the end of the year. Katrina's average monthly allowable square footage is 200 square feet [300 square feet for May through December divided by the number of months in a taxable year (0 + 0 + 0 + 0 + 300 + 300 + 300 + 300 + 300 + 300 + 300 + 300) ÷ 12)].

Katrina will enter this average monthly allowable square footage on Line 2 of the *Simplified Method Worksheet* from the Schedule C instructions or Pub. 587.

Business Use of Home review questions

1. _____ To be eligible for the business use of home deduction, taxpayers must use the space:

   A. Exclusively, but not regularly
   B. Regularly, but not exclusively
   C. Exclusively and regularly
   D. Sporadically

2. _____ When taxpayers have a business use of home deduction, their mortgage interest, real estate taxes and casualty losses can create a Schedule C loss when they:

   A. Itemize their deductions
   B. Use their standard deduction
   C. Either use their standard deduction or itemized their deduction
   D. File a Schedule C

3. _____ Under the simplified method of calculating the business use of home deduction, taxpayers may use the prescribed rate of ______ up to a maximum of 300 square feet for at maximum total deduction of ________?

   A. $2; $600
   B. $3; $900
   C. $4; $1,200
   D. $5; $1,500

Business Use of Home review answers

1.

A. Incorrect. Taxpayers must use the space both exclusively and regularly, not just exclusively.
B. Incorrect. Taxpayers must use the space both exclusively and regularly, not just regularly.
C. **Correct.** Taxpayers must use the space both exclusively and regularly to be eligible for the business use of home deduction.
D. Incorrect. Taxpayers must use the space both exclusively and regularly, not sporadically to be eligible for the business use of home deduction.

[Eligibility]

2.

A. **Correct.** Taxpayers who actually itemize their deductions are able to generate a Schedule C loss using their home mortgage interest, real estate taxes and casualty losses as part of their business use of home deduction.
B. Incorrect. Taxpayers must actually itemize to be able to generate a Schedule C loss, using the standard deduction will not generate a Schedule C loss.
C. Incorrect. Taxpayers actually itemizing can generate a Schedule C loss, not those using the standard deduction.
D. Incorrect. Only taxpayers who actually itemize may generate a Schedule C loss using their home mortgage interest, real estate taxes and casualty losses as part of their business use of home deduction.

[Types of expenses]

3.

A. Incorrect. The prescribed rate is $5 per square foot not $2, for a maximum deduction of $1,500, not $600.
B. Incorrect. The prescribed rate is $5 per square foot not $3, for a maximum deduction of $1,500, not $900.
C. Incorrect. The prescribed rate is $5 per square foot not $4, for a maximum deduction of $1,500, not $1,200.
D. **Correct.** The prescribed rate is $5 per square foot for a maximum deduction of $1,500.

[Simplified method]

S Corporation Issues

Case study

Aaron comes into your office in February 2024 to have his 2023 tax return prepared. He tells you he formed a corporation (A&A, Inc.) last year on Sept. 15, 2023, and wants to be an S corporation. However, A&A never filed the S election. Aaron is the sole shareholder. Assuming the corporation meets all the requirements to make a valid S election, let's discuss A&A's options for tax year 2023 and what steps need to be taken to be an S corporation. Aaron also tells you he did not receive any wages from this corporation in 2023. Is that going to be a problem?

In addition, Aaron bought a vehicle for the corporation but titled it in his name. How do you handle business use of this vehicle?

Finally, if A&A is a C corporation for 2023, will it be subject to the built-in gains tax if it becomes an S corporation for 2024?

What questions should you ask? Let's start with the S election.

Observation: Whether an S corporation is best for this business depends on several factors. For example, consider the intention of the business (short-term or long-term), sources of capital (outside investors or loans from shareholder), asset ownership, the complexities and administrative burden of an S corporation, etc.

Late S election

In general, a domestic *small business corporation* that meets certain requirements can elect to be an S corporation. However, it cannot be an *ineligible corporation*.

Note: A domestic corporation is a corporation that is created or organized in the United States or under federal or state law [§7701(a)(4)]. The term *corporation* also includes an entity that is classified as an association taxable as a corporation under Reg. §301.7701-2(b), such as a limited liability company (LLC).

Under §1361(b)(1), a small business corporation **cannot** have:

- More than 100 shareholders
- Any shareholder who is not an individual or an estate
  - Partnerships, corporations and trusts generally cannot be shareholders

    - Certain trusts described in §1361(c)(2)(A) and certain exempt organizations described in §401(a) or §501(c)(3) may be shareholders

- Any shareholder who is a nonresident alien
- More than one class of stock (membership interest for an LLC)

The following corporations cannot make the S election because they are ineligible corporations under §1361(b)(2):

- A financial institution such as a bank, including mutual savings banks, cooperative banks and domestic building, and loan associations that use the reserve method of accounting for bad debts or losses from bank loans
- An insurance company taxed under Subchapter L of the Internal Revenue Code (IRC)
- A domestic international sales corporation (DISC) or former DISC

An eligible corporation must file Form 2553, *Election by a Small Business Corporation*, to make a valid S election [Reg. §1.1362-6(a)(2)].

Note: A single-member or multi-member LLC typically files Form 8832, *Entity Classification Election*, to make the election to be taxed as a corporation in accordance with Reg. §301.7701-3(c). However, if an LLC is eligible to make the S election and timely files Form 2553, the LLC is deemed to have made the election to be taxed as a corporation [Reg. §301.7701-3(c)(1)(v)(C)]. In this case, the LLC need not file Form 8832, only Form 2553.

Form **2553**
(Rev. December 2017)
Department of the Treasury
Internal Revenue Service

Election by a Small Business Corporation

(Under section 1362 of the Internal Revenue Code)
(Including a late election filed pursuant to Rev. Proc. 2013-30)
▶ You can fax this form to the IRS. See separate instructions.
▶ Go to *www.irs.gov/Form2553* for instructions and the latest information.

OMB No. 1545-0123

Note: This election to be an S corporation can be accepted only if all the tests are met under *Who May Elect* in the instructions, all shareholders have signed the consent statement, an officer has signed below, and the exact name and address of the corporation (entity) and other required form information have been provided.

Part I Election Information

Type or Print	Name (see instructions)	**A Employer identification number**
	Number, street, and room or suite no. If a P.O. box, see instructions.	**B** Date incorporated
	City or town, state or province, country, and ZIP or foreign postal code	**C** State of incorporation

D Check the applicable box(es) if the corporation (entity), after applying for the EIN shown in **A** above, changed its ☐ name or ☐ address

E Election is to be effective for tax year beginning (month, day, year) (see instructions) . . . . . . ▶ ____

Caution: A corporation (entity) making the election for its first tax year in existence will usually enter the beginning date of a short tax year that begins on a date other than January 1.

F Selected tax year:
(1) ☐ Calendar year
(2) ☐ Fiscal year ending (month and day) ▶ ____
(3) ☐ 52-53-week year ending with reference to the month of December
(4) ☐ 52-53-week year ending with reference to the month of ▶ ____
If box (2) or (4) is checked, complete Part II.

G If more than 100 shareholders are listed for item J (see page 2), check this box if treating members of a family as one shareholder results in no more than 100 shareholders (see test 2 under *Who May Elect* in the instructions) ▶ ☐

H Name and title of officer or legal representative whom the IRS may call for more information | Telephone number of officer or legal representative

I If this S corporation election is being filed late, I declare I had reasonable cause for not filing Form 2553 timely. If this late election is being made by an entity eligible to elect to be treated as a corporation, I declare **I** also had reasonable cause for not filing an entity classification election timely and the representations listed in Part IV are true. See below for my explanation of the reasons the election or elections were not made on time and a description of my diligent actions to correct the mistake upon its discovery. See instructions.

Sign Here

Under penalties of perjury, I declare that I have examined this election, including accompanying documents, and, to the best of my knowledge and belief, the election contains all the relevant facts relating to the election, and such facts are true, correct, and complete.

▶ **Signature of officer** **Title** **Date**

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Form 2553 (Rev. 12-2017) Page **2**

Name	Employer identification number

Part I **Election Information** *(continued)* **Note:** If you need more rows, use additional copies of page 2.

J Name and address of each shareholder or former shareholder required to consent to the election. (see instructions)	K **Shareholder's Consent Statement** Under penalties of perjury, I declare that I consent to the election of the above-named corporation (entity) to be an S corporation under section 1362(a) and that I have examined this consent statement, including accompanying documents, and, to the best of my knowledge and belief, the election contains all the relevant facts relating to the election, and such facts are true, correct, and complete. I understand my consent is binding and may not be withdrawn after the corporation (entity) has made a valid election. If seeking relief for a late filed election, I also declare under penalties of perjury that I have reported my income on all affected returns consistent with the S corporation election for the year for which the election should have been filed (see beginning date entered on line E) and for all subsequent years.		L Stock owned or percentage of ownership (see instructions)		M Social security number or employer identification number (see instructions)	N Shareholder's tax year ends (month and day)
	Signature	Date	Number of shares or percentage of ownership	Date(s) acquired		

Form **2553** (Rev. 12-2017)

General due date

Form 2553 generally must be filed:

- By the 15th day of the third month after the beginning of the tax year the election is to take effect, or
- At any time during the tax year preceding the tax year it is to take effect [§1362(b)(1)]

Note: If the S election is filed in the current year but after the 15th day of the third month, the S election is generally effective on Jan. 1 of the following tax year [§1362(b)(3)]. However, this rule does not apply if the corporation qualifies for late S election relief.

For a new corporation, the first tax year begins on the *earliest* of the date the corporation has shareholders, acquires assets or begins doing business [Reg. §1.1362-6(a)(2)(ii)(C)]. To determine the first date the corporation has shareholders, look to state law and the articles of incorporation. For example, in Rev. Rul. 72-257, stock subscribers were deemed to be shareholders as of the date of incorporation under state law, even though no corporate stock had been issued.

Case study

In response to your questions, you discover Aaron formed A&A, Inc. on Sept. 15, 2023, by filing articles of incorporation with the state. Under state law, he was the only shareholder on Sept. 15, 2023, and continues to be the only shareholder. On Sept. 20, 2023, Aaron opened a checking account for A&A and deposited $5,000. The corporation began doing business on Oct. 5, 2023. When was A&A's S election due?

Since Aaron was a shareholder on Sept. 15, 2023, A&A's first tax year began on that date. If Aaron wants the corporation to be an S corporation as of Sept. 15, 2023, the S election should have been filed by Nov. 29, 2023 (15th day of third month after Sept. 15, 2023). The S election was not timely filed, so the effective date cannot be Sept. 15, 2023, unless the corporation qualifies for late relief under Rev. Proc. 2013-30 (discussed below).

If A&A files the S election by Mar. 15, 2024, it could make the S election effective on Jan. 1, 2024. However, it would have to file a C corporation tax return for 2023, and the S corporation could be subject to the built-in gains tax (discussed later).

Late S election relief

Taxpayers may request relief for a late S election under Rev. Proc. 2013-30 if they meet certain conditions. If they do not qualify for relief under this revenue procedure, they may request a private letter ruling under certain circumstances (discussed later).

Rev Proc. 2013-30

When a corporation fails to file the S election by the deadline, relief may be available under Rev. Proc. 2013-30. This revenue procedure also provides relief for late corporation classification elections intended to be effective on the same date as the S election.

To qualify for late S election relief under this revenue procedure, all the following requirements must be satisfied:

- The corporation intended to be classified as an S corporation as of the effective date requested on Form 2553, Item E.
- The corporation requests relief under Rev. Proc. 2013-30 within three years and 75 days after the intended effective date of the S election unless the corporation meets the exception to this rule (discussed below).
- The failure to qualify as an S corporation as of the intended effective date was solely because the S election was not filed by the due date of Form 2553.
- The corporation has reasonable cause for its failure to timely file Form 2553 and has acted diligently to correct the mistake upon its discovery.
- The corporation is able to provide statements from all shareholders for the period beginning on the intended effective date of the S election and ending on the date Form 2553 is filed stating they have reported their income on all affected returns consistent with the S election for the year the election should have been filed and for all subsequent years.

Reasonable cause

The IRS used to issue private letter rulings (PLRs) regarding reasonable cause for late S elections. For example, reasonable cause was established in the following situations:

- The sole shareholder of the corporation thought the corporation's tax advisor had filed Form 2553 (PLR 200302025)
- An employee failed to mail Form 2553 to the IRS because they accidentally mailed it to the state department of revenue with the state S election (PLR 9720019)
- The shareholders intended that the corporation be treated as an S corporation (PLR 201048027)

The IRS no longer issues PLRs with respect to reasonable cause and late S elections (Rev. Proc. 2023-3). However, these PLRs give tax professionals examples of reasonable cause that the IRS accepted in the past. Thus, if the corporation fails to timely file Form 2553 due to inadvertence or because it thought someone else filed it, presumably, the IRS will continue to accept these explanations as reasonable cause.

Note: Reasonable cause for this purpose is generally more lenient than establishing reasonable cause for penalty abatement. However, taxpayers must provide some reason for filing late to establish reasonable cause. If taxpayers do not provide any reason for not filing Form 2553 on time, the IRS will not accept a late S election.

Case study

Aaron's corporation cannot make the S election effective on Sept. 15, 2023, solely because the S election was not timely filed. However, can it make a late S election?

In general, if Aaron's corporation has reasonable cause for failing to timely file Form 2553 (e.g., due to inadvertence), it meets all the requirements for late S election relief under Rev. Proc. 2013-30. It has only been a couple months since the intended effective date of the S election, so it has not been more than three years and 75 days. In addition, the corporation has not filed a C corporation tax return for 2023. Thus, if it files an S corporation return for 2023, it can provide the required statement from Aaron (only shareholder) stating he reported the corporation's income on his 2023 income tax return consistent with the S election.

Exception to three-year and 75-day time limit

In general, a corporation is not subject to the three-year and 75-day time limit where all returns were filed as an S corporation. However, all the following conditions must be met to qualify for this exception:

- The corporation is not seeking late corporate classification election relief (e.g., for a limited liability company) concurrently with a late S election under this revenue procedure.
- The corporation fails to qualify as an S corporation solely because it did not timely file Form 2553.
- The corporation and all its shareholders reported their income consistent with S corporation status for the year the corporation should have made the S election, and for every subsequent taxable year (if any).
- At least six months have elapsed since the date on which the corporation filed its tax return for the first year the corporation intended to be an S corporation.
- Neither the corporation nor any of its shareholders received notification from the IRS of any problem regarding the S corporation status within six months of the date on which the first Form 1120-S was timely filed.
- The completed Form 2553 includes statements from all shareholders that they have reported their income on all affected returns consistent with the year the corporation should have filed the S election and for all subsequent years.

Note: Typically, this exception applies when corporations have been filing S corporation returns for years without a valid S election, but the IRS never said anything.

Filing requirements

A corporation requests relief from a late S election by properly completing Form 2553 as follows:

- Form 2553 must state at the top “Filed Pursuant to Rev. Proc. 2013-30.”
- Form 2553, Part I, Item I, must include a statement from the corporation describing its reasonable cause for failure to timely file the S election and its diligent actions to correct the mistake upon its discovery, or the information can be provided on an attached Reasonable Cause/Inadvertence Statement.
- Form 2553, Part I, Column K, must be completed by all shareholders during the period between the date entered on Form 2553, Item E, and the date Form 2553 is filed declaring under penalties of perjury that they have reported their income on all affected returns consistent with the S election for the year for which the election should have been filed and for all subsequent years, or this information can be provided in a similar document attached to Form 2553.

File Form 2553 with the applicable IRS Service Center by:

- Attaching it to the S corporation’s current year Form 1120-S
- Attaching it to one of the S corporation’s late-filed prior year Forms 1120-S
- Filing the form independent of Form 1120-S

Note: If filing Form 2553 with the S corporation’s current year or late-filed prior year Form 1120-S, the top of Form 1120-S must state “Includes Late Election(s) Filed Pursuant to Rev. Proc. 2013-30.”

An officer of the corporation authorized to sign must sign each supporting statement under penalties of perjury.

In addition, Form 2553 must be signed by an officer of the corporation authorized to sign as well as each person who was a shareholder at any time during the period beginning on the first day of the taxable year for which the election is to be effective and ending on the day the corporation files the completed election form.

Case study

A&A makes a late S election effective on Sept. 15, 2023, by filing Form 2553 with its 2023 Form 1120-S. The top of Form 2553 says, “Filed Pursuant to Rev. Proc. 2013-30,” and the top of Form 1120-S says, “Includes Late Election(s) Filed Pursuant to Rev. Proc. 2013-30,” as shown below.

Filed Pursuant to Rev. Proc. 2013-30

Form **2553** (Rev. December 2017) Department of the Treasury Internal Revenue Service

Election by a Small Business Corporation

(Under section 1362 of the Internal Revenue Code)
(Including a late election filed pursuant to Rev. Proc. 2013-30)
▶ You can fax this form to the IRS. See separate instructions.
▶ Go to *www.irs.gov/Form2553* for instructions and the latest information.

OMB No. 1545-0123

Note: This election to be an S corporation can be accepted only if all the tests are met under *Who May Elect* in the instructions, all shareholders have signed the consent statement, an officer has signed below, and the exact name and address of the corporation (entity) and other required form information have been provided.

Part I Election Information

Type or Print		
	Name (see instructions) A&A, Inc.	**A Employer identification number** **-***1111
	Number, street, and room or suite no. If a P.O. box, see instructions. 1515 Wisconsin Ave.	**B** Date incorporated 09/15/2023
	City or town, state or province, country, and ZIP or foreign postal code Anytown WI 55555	**C** State of incorporation WI

D Check the applicable box(es) if the corporation (entity), after applying for the EIN shown in **A** above, changed its ☐ name or ☐ address

E Election is to be effective for tax year beginning (month, day, year) (see instructions) ▶ 09/15/23

Caution: A corporation (entity) making the election for its first tax year in existence will usually enter the beginning date of a short tax year that begins on a date other than January 1.

F Selected tax year:

(1) ☒ Calendar year
(2) ☐ Fiscal year ending (month and day) ▶ __________
(3) ☐ 52-53-week year ending with reference to the month of December
(4) ☐ 52-53-week year ending with reference to the month of ▶ ____________________

If box (2) or (4) is checked, complete Part II.

G If more than 100 shareholders are listed for item J (see page 2), check this box if treating members of a family as one shareholder results in no more than 100 shareholders (see test 2 under *Who May Elect* in the instructions) ▶ ☐

H Name and title of officer or legal representative who the IRS may call for more information: Aaron Masters CEO
Telephone number of officer or legal representative: 555-555-5555

I If this S corporation election is being filed late, I declare I had reasonable cause for not filing Form 2553 timely. If this late election is being made by an entity eligible to elect to be treated as a corporation, I declare I also had reasonable cause for not filing an entity classification election timely and the representations listed in Part IV are true. See below for my explanation of the reasons the election or elections were not made on time and a description of my diligent actions to correct the mistake upon its discovery. See instructions.

Corporation inadvertently failed to timely file Form 2553 and filed Form 2553 as soon as it discovered the mistake.

Sign Here Under penalties of perjury, I declare that I have examined this election, including accompanying documents, and, to the best of my knowledge and belief, the election contains all the relevant facts relating to the election, and such facts are true, correct, and complete.

▶ Signature of officer Title Date

For Paperwork Reduction Act Notice, see separate instructions. Form **2553** (Rev. 12-2017)

DAA

Form 2553 (Rev. 12-2017) Page **2**

Name	Employer identification number
A&A, Inc.	**-***1111

Part I **Election Information** *(continued)* **Note:** If you need more rows, use additional copies of page 2.

J Name and address of each shareholder or former shareholder required to consent to the election. (see instructions)	K Shareholder's Consent Statement Under penalties of perjury, I declare that I consent to the election of the above-named corporation (entity) to be an S corporation under section 1362(a) and that I have examined this consent statement, including accompanying documents, and, to the best of my knowledge and belief, the election contains all the relevant facts relating to the election and such facts are true, correct, and complete. I understand my consent is binding and may not be withdrawn after the corporation (entity) has made a valid election. If seeking relief for a late filed election, I also declare under penalties of perjury that I have reported my income on all affected returns consistent with the S corporation election for the year for which the election should have been filed (see beginning date entered on line E) and for all subsequent years.		L Stock owned or percentage of ownership (see instructions)		M Social security number or employer identification number (see instructions)	N Shareholder's tax year ends (month and day)
	Signature	Date	Number of shares or percentage of ownership	Date(s) acquired		
Aaron Masters 1515 Wisconsin Ave. Anytown WI 55555			100.000	09/15/23	***-**-1111	12/31

Form **1120-S** Department of the Treasury Internal Revenue Service

Includes Late Election(s) Filed Pursuant to Rev Proc 2013-30

U.S. Income Tax Return for an S Corporation

Do not file this form unless the corporation has filed or is attaching Form 2553 to elect to be an S corporation.

Go to *www.irs.gov/Form1120S* for instructions and the latest information.

OMB No. 1545-0123 **2023**

For calendar year 2023 or tax year beginning 09/15/23 , ending 12/31/23

	TYPE OR PRINT		
A S election effective date 09/15/23		Name A&A, Inc.	D Employer identification number **-***1111
B Business activity code number (see instructions) 541511		Number, street, and room or suite no. If a P.O. box, see instructions. 1515 Wisconsin Ave.	E Date incorporated 09/15/2023
C Check if Sch. M-3 attached ☐		City or town, state or province, country, and ZIP or foreign postal code Anytown WI 55555	F Total assets (see instructions) $

G Is the corporation electing to be an S corporation beginning with this tax year? See instructions. ☒ Yes ☐ No

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

I Enter the number of shareholders who were shareholders during any part of the tax year 1

J Check if corporation: (1) ☐ Aggregated activities for section 465 at-risk purposes (2) ☐ Grouped activities for section 469 passive activity purposes

Caution: Include **only** trade or business income and expenses on lines 1a through 22. See the instructions for more information.

Private letter ruling

If an entity does not qualify for relief from a late S election under Rev. Proc. 2013-30, the entity may request relief for certain errors or omissions by requesting a private letter ruling (PLR) and paying a user fee.

Note: Rev. Proc. 2024-1 explains how to request a PLR.

The IRS will only consider issuing a PLR when relief under Rev. Proc. 2013-30 is unavailable and the corporation has no other means to request relief with respect to (1) a missing shareholder consent, (2) an error with regard to a permitted year, and/or (3) a missing officer's signature.

For all other administrative errors or omissions on Form 2553, taxpayers cannot request a PLR. Instead, they must submit a written explanation containing the error(s) or omission(s) and the necessary correction(s). The written explanation should be mailed to the IRS processing center with which the S corporation files its income tax return (Rev. Proc. 2022-19).

Reasonable compensation

S corporation shareholders must receive reasonable compensation for services provided to their S corporation (other than minor services) before they can receive any other payments (such as nontaxable distributions) from the S corporation. Reasonable compensation depends on all the facts and circumstances, but it never exceeds the amount received by the shareholder either directly or indirectly (Fact Sheet 2008-25). In other words, if shareholders do not take reasonable compensation but do not receive any payments from the S corporation, the IRS has nothing to recharacterize as reasonable compensation.

In general, if an S corporation shareholder performs services for the corporation as an officer and receives remuneration in any form, treat them as an employee of the corporation [Rev. Rul. 73-361, §3121(d)(1) and Reg. §31.3306(b)-1(c)]. Employees receive wages reported on Form W-2, *Wage and Tax Statement*. Thus, wages received by an officer of the corporation are subject to the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act (FUTA) and federal income tax withholding (FITW). Do not report compensation paid to S corporation shareholders as self-employment income on Form 1099-NEC, *Nonemployee Compensation*, unless they only perform minor services for the corporation (e.g., as a member of the board of directors).

Oftentimes, shareholders take little or no compensation at all because S corporation distributions and pass-through income are not subject to self-employment (SE) tax (Rev. Rul. 59-221). Thus, they enjoy the benefits of pass-through taxation with reduced payroll tax withholdings. On the other hand, sometimes compensation is unreasonably high if, for example, the S corporation is trying to reduce the built-in gains tax.

In general, compensation includes wages, fringe benefits (Rev. Rul. 92-93) and retirement plan contributions. Reasonable compensation is described in Reg. §1.162-7(b)(3) as such amount that would ordinarily be paid for like services by like enterprises under like circumstances. The regulation is vague at best, and the courts have provided several factors to use in determining reasonable compensation.

Factors

In Elliotts, Inc., 52 AFTR 2d 83-5976, the court presented a list of five broad categories of factors to consider when determining reasonable compensation:

- The shareholder's role in the corporation, considering the position held, hours worked and duties performed
- External comparison of wages paid for similar services by similar companies
- The character and financial condition of the corporation
- Conflicts of interest in setting compensation levels when an exploitable relationship exists between the corporation and the employee

- Internal consistency, meaning the corporation's compensation policy for all employees is reasonable, longstanding and consistently applied

Other cases involving reasonable compensation looked at additional factors. For example, Boca Construction, Inc., TC Memo 1995-5 reviewed the following factors:

- Employee's qualifications
- Nature, extent and scope of employee's work
- Size and complexity of the business
- Salaries paid in comparison to gross and net income
- General economic conditions
- Salaries paid in comparison to distributions to shareholders and retained earnings
- Salary policy to all employees
- Corporation's financial condition
- Prevailing rates of compensation for comparable positions in comparable companies
- Compensation paid in prior years
- Whether the shareholder and S corporation dealt at arm's length
- Whether the shareholder guaranteed the S corporation's debt

Some courts have even looked to whether investors would conclude there is an appropriate return on investment after taking the shareholder's wages into account.

Note: Analyze all these factors to determine reasonable compensation. One factor alone generally does not establish reasonable compensation.

IRS guidance

The IRS also provided some information on its website (https://www.irs.gov/businesses/small-businesses-self-employed/s-corporation-compensation-and-medical-insurance-issues), which states the key to establishing reasonable compensation is determining what the shareholder-employee did for the S corporation and determining the source of the S corporation's gross receipts.

The three major sources include:

- Services of the shareholder
- Services of nonshareholder-employees
- Capital and equipment

In general, to the extent the S corporation's gross receipts are generated by the shareholder's personal services, payments to such shareholder should be classified as wages. This shareholder should also receive wages if they perform administrative work for other income-producing employees or assets. On the other hand, payments to a shareholder should not be treated as wages to the extent gross receipts are generated by the services of non-shareholder employees or capital and equipment.

The IRS also listed the following factors to use in determining reasonable compensation:

- Training and experience
- Duties and responsibilities
- Time and effort devoted to the business
- Dividend history
- Payments to non-shareholder employees
- Timing and manner of paying bonuses to key people
- What comparable businesses pay for similar services
- Compensation agreements
- Use of a formula to determine compensation

Court case

JD & Associates, Ltd. v. United States, No. 3:04-cv-59 (D.N.D. May 2006), highlights which factors were analyzed by the North Dakota District Court. JD & Associates, Ltd. (JDA) was an accounting firm taxed as an S corporation that was owned by a single shareholder. The S corporation's sole shareholder was a CPA with more than 20 years of experience and was responsible for JDA's hiring decisions, maintaining its books, preparing its tax returns, and preparing and reviewing tax returns for JDA's clients.

Despite the shareholder's responsibilities, he only had a salary of $19,000 in 1997 and $30,000 in both 1998 and 1999. In addition to his salary, the shareholder took tax-free distributions of $47,000 in 1997 and $50,000 in both 1998 and 1999.

The IRS determined the shareholder's compensation was unreasonably low in comparison with his responsibilities as the managing shareholder of JDA. The IRS hired an expert, a certified valuation engineer, to determine reasonable compensation for the shareholder. The IRS expert used a national survey of financial ratios published by Risk Management Associates (RMA) and compared them to the financial ratios of JDA. The expert found that JDA's after-tax profit as a percentage of net sales was 208%-374% more profitable than its peers during 1997-1999. Furthermore, the shareholder's salary as a percentage of net sales was 166%-266% less than that of his peers during the same years.

The court reached a decision in favor of the IRS. The court grouped numerous factors into the following three broad groups:

- Performance of employee. The court found that his performance as managing shareholder of JDA was exemplary. JDA had profits far in excess of the profits generated by comparable accounting firms. Thus, his compensation was not congruent to his performance.
- Salary comparisons. The court found that the shareholder's salary compared to other employees was unreasonable. Despite the additional duties, his compensation was slightly above that of his employees.
- Company conditions. The conditions of the company would dictate a higher pay for the managing shareholder. JDA was a small enterprise that required little in terms of reinvestment. That fact contributed to a generally low overhead, which would free up capital for employee compensation, which would have allowed for a higher salary for the shareholder. Furthermore, JDA saw continuous growth in every subsequent year.

Steps to establish reasonable compensation

After analyzing the previously mentioned factors, an S corporation can take the following steps to prove the shareholder's salary is reasonable.

- Use resources such as O*NET OnLine (www.onetonline.org) or the Bureau of Labor Statistics (BLS) to establish wages paid for like services by like enterprises under like circumstances. The BLS website (www.bls.gov) contains national and state-specific information regarding average annual wages paid for different occupations.
- Analyze and document the following:
    - Nature of the S corporation's business – A personal service business generally has higher profits generated by the personal efforts of its employees, including shareholder-employees. As a result, a significant portion of its profits should be paid out in compensation rather than distributions.
    - Shareholder's qualifications, responsibilities, time devoted to the business and salary – preferably, do this at the beginning of the year through an employment contract or the corporate minutes. Generally, corporations have been more successful when compensation is set by minority shareholders or independent compensation committees based on predetermined formulas tied to performance.
    - Shareholder's compensation in comparison to nonshareholder compensation – A shareholder-employee, who has greater responsibilities than the highest paid nonshareholder-employee, should receive higher wages than the nonshareholder-employees.
    - Shareholder's compensation in current year as compared to compensation received in prior years – Generally, the shareholder-employee's salary should increase as the S corporation's revenue increases. Otherwise, the shareholder's wages may be unreasonably low.

- ◦ Financial ratios published by RMA or other industry-specific publications in comparison to the S corporation's financial ratios – The shareholder's compensation may be unreasonably low if the:
    - ▪ S corporation's after-tax profit as a percentage of net sales is much higher than that of similar companies in the same geographic location
    - ▪ Shareholder's compensation as a percentage of the S corporation's net sales is much lower than that of their peers
- Avoid making any distributions or loan payments if the shareholder receives no wages. If an S corporation does not have the cash to pay wages to the shareholder, it should document the cash flow issues in the corporate minutes. Once the S corporation has a positive cash flow, it should resume paying the shareholder reasonable compensation.

Improper methods

Some tax professionals use a fraction of net income (50/50 or 60/40) to establish reasonable compensation for S corporation shareholders. However, this is a haphazard method done in practice, which may not equal reasonable compensation. For example, it might not equal wages paid for like services by like businesses under like circumstances. It is an "easy" measure of compensation, but there is no legal authority for such an arbitrary split.

In addition, many sole shareholders depend on the S corporation's cash inflow to pay their personal living expenses. It may be difficult to track these personal expenses and report them as wages throughout the year. Some tax professionals simply treat amounts withdrawn throughout the year for personal expenses as a loan to the shareholder. Then they reclassify the loan to wages at year-end in the fourth quarter. This is an arbitrary solution that leaves both the tax professional and the taxpayer subject to significant penalties if they fail to file and deposit payroll taxes throughout the year.

Example

Gerald is a tax professional who advises his client, Ronaldo, to use a 60/40 split in determining reasonable compensation. In this case, 60% of net income will be classified as wages and 40% will be considered a distribution.

Throughout the year, Ronaldo withdrew $30,000 for personal living expenses. During the year, Gerald classified these payments as a loan to the shareholder. At year-end, Gerald determines the net profit is $60,000. Thus, reasonable compensation is $36,000 ($60,000 x 60%). Gerald reclassifies the $30,000 loan amount to wages and Ronaldo takes another $6,000 in wages at the end of the fourth quarter, so his total compensation is $36,000 ($30,000 + 6,000). The S corporation files the applicable payroll tax return and pays the payroll taxes.

Not only is this arbitrary, but it does not reflect economic reality. The personal expenses paid throughout the year should not be classified as a loan because Ronaldo never intended to repay such amount. Furthermore, no analysis was done to determine if $36,000 is reasonable compensation. Based on these facts, this is an improper method of determining compensation.

Tax consequences if compensation unreasonable

If an S corporation shareholder performs more than minor services for the corporation and does not receive reasonable compensation, the IRS can recharacterize payments to such shareholder as wages, but only to the extent the IRS determines such payments are disguised compensation. For example, all or part of the shareholder's nontaxable distributions may be recharacterized as wages subject to payroll taxes, even if the shareholder received wages but they were unreasonably low.

Shareholders also attempt to receive tax-free money from S corporations by using loans from the S corporation to the shareholder. However, the IRS can also reclassify loan payments as wages if they represent reasonable compensation for services provided to the corporation. To avoid this reclassification, it must be a bona fide loan. For example, there should be a loan agreement in place specifying an appropriate interest rate, repayment amount and repayment terms.

If an S corporation shareholder received payments of cash or property from an S corporation during the year but did not receive any wages for services provided to the corporation, the corporation must determine a reasonable salary for the year based on the facts and circumstances. In addition, the corporation should correct the mistake by filing Form W-2 and the applicable payroll tax return(s) for such year, even if filed late.

The tax consequences could be even more significant if the IRS reclassifies distributions, loans or similar payments from the S corporation to the shareholder as wages. For example, the corporation is subject to payroll taxes on the wages, but it could also be subject to the failure to file penalty under §6651(a)(1) and the failure to deposit penalty under §6656(b)(1) if payroll tax returns were not filed.

Case study

A&A, Inc. made a late S election effective on Sept. 15, 2023. The business started in October 2023, so Aaron should have received reasonable compensation for services provided to A&A in 2023. It's time to ask Aaron if he received any payments from the S corporation in 2023. For example, did he take any distributions or use S corporation funds to pay his personal living expenses.

If Aaron received any payments, he needs to determine how much should be treated as reasonable compensation using the factors previously mentioned (FS-2008-25). Report the wages on Form W-2 and file the applicable payroll tax return.

If Aaron did not receive any payments, his wages for such year may be zero, even if he provided substantial services to the corporation, because reasonable compensation cannot exceed the amount received, directly or indirectly, from the corporation. This could happen in the early years when the corporation is not profitable or has cash flow problems.

Court cases

The following court cases provide the factors, ratios and data the IRS analyzed to determine reasonable compensation for an S corporation shareholder-employee and the payments that were recharacterized as wages. All S corporations should do the same analysis to determine a reasonable salary for their shareholder-employees.

Watson

In David E. Watson, P.C. v. U.S., 109 AFTR 2d 2012-1059, the court, citing the shareholder's 20 years of experience, advanced degree and hours worked per week, held that the shareholder received an unreasonably low salary and reclassified a portion of his distributions as salary.

David Watson, the shareholder of David E. Watson, P.C., was a CPA and received his bachelor's degree in business administration, as well as a specialization in accounting and a master's degree in taxation. He was the sole shareholder, employee, officer and director of David E. Watson, P.C.

In addition, Watson owned an interest in Larson, Watson, Bartling & Eastman, a successful accounting firm. Through an employment agreement with David E. Watson, P.C., he provided services exclusively to Larson, Watson, Bartling & Eastman. During 2002 and 2003, the accounting firm exceeded $2 million in gross revenues.

As the sole shareholder, officer and director of David E. Watson, P.C., Watson authorized for himself a salary from the S corporation of $24,000 annually at the shareholder meetings. In addition to his $24,000 salary, Watson received $118,159 and $221,577 of distributions in 2002 and 2003, respectively.

The IRS maintained that Watson's compensation was unreasonably low based on the services he provided and reclassified a portion of his distributions as compensation. In doing so, the IRS assessed the S corporation employment taxes on the reclassified salary.

David E. Watson, P.C. contended that it clearly intended to pay compensation of $24,000 per year to Watson and the amounts distributed in excess of the compensation were properly classified as distributions and/or loans. Furthermore, it argued that the United States does not have the authority to require David E. Watson, P.C. to pay any sort of minimum salary to its shareholder before it can pay distributions and the United States' ability to assess additional employment taxes is limited to taxing payments that were intended to be compensation. Based on the minutes of the shareholder meetings, David E. Watson, P.C. stated that it was the corporation's intent to pay Watson an annual salary of $24,000. The court disagreed with the argument and stated that an analysis must be done to determine whether the payment of distributions was made as remuneration for services performed.

Using RMA annual statement studies, the IRS expert determined the health of David E. Watson, P.C. and found the corporation was at least three times more profitable than comparably sized firms in the accounting field. Additionally, the IRS expert determined that individuals in positions secondary to Watson were paid significantly more in compensation.

To determine reasonable compensation, the IRS expert used a Management of an Accounting Practice (MAP) survey conducted by the AICPA that was specific to the corporation's location. Based on the survey, the IRS expert determined that, on average, owners of an accounting firm billed at a rate approximately 33% higher than a director. The IRS expert grossed up the average director compensation of $70,000 by 33% to arrive at a reasonable annual compensation of $93,000. However, Watson only received $24,000 in wages, so $69,000 of his distributions were reclassified as wages.

Glass Blocks

In Glass Blocks Unlimited, TC Memo 2013-180, the court reclassified all purported loan repayments and distributions as compensation.

Fredrick Blodgett was the sole shareholder and only employee of Glass Blocks Unlimited, an S corporation. The corporation sold and distributed glass blocks for the real estate market in North America. Blodgett was responsible for all operational and financial decisions of the corporation and performed nearly all the work necessary to run the business.

Over a two-year period, Glass Blocks Unlimited made cash payments totaling $62,488 to Blodgett. Glass Blocks Unlimited did not treat the payments as wages. Instead, the payments were in part loan repayments and in part distributions. The IRS contended that the payments represented wages and assessed a payroll tax deficiency of $9,560.64 and $3,605.50 in penalties under §§6651(a)(1) and 6656.

Glass Blocks Unlimited did not dispute that Blodgett was an employee. However, they argued Blodgett had to transfer funds to the corporation to keep the corporation operating. The funds transferred were treated as loans on Glass Blocks Unlimited's books and, as such, a majority of the payments represented nontaxable repayments of the loans.

Based on the following four factors, the court found that the transfers to the corporation were not bona fide loans but capital contributions instead:

- There was no written agreement or promissory note as evidence of the loan.
- The shareholder did not charge interest.
- The corporation did not provide security for the loan.
- There was no fixed payment schedule.

Since the transfers were not bona fide loans, the court found it appropriate to treat the cash payments as distributions instead of loan repayments. Blodgett was the only employee and worked more than 2,080 hours per year. Based on the corporation's determined hourly rate, Blodgett's reasonable compensation exceeded the amount the corporation actually paid him. Since the IRS could only treat the amount actually paid as reasonable compensation, the court determined the entire amount of distributions should be reclassified as wages.

Asset ownership issues

Oftentimes, an S corporation shareholder purchases an asset for use in the S corporation's trade or business, but they title the asset in their name for various reasons (e.g., banking) and never transfer ownership of the asset to the S corporation. This occurs frequently with vehicles but may happen with other assets as well (e.g., equipment or buildings, including the shareholder's home office).

A corporation is a separate legal entity. Thus, an S corporation does not own any assets that its shareholder owns (and vice versa), unless the substance-over-form doctrine applies (discussed below). For example, if the shareholder owns a vehicle personally but uses it 100% of the time in the S corporation's trade or business, the S corporation cannot depreciate such vehicle on its tax return because the corporation doesn't own it. In that case, it's necessary to determine how to handle the expenses for business use of a vehicle owned personally by the shareholder.

Note: In this section, we're only discussing vehicles, but these rules also apply to other assets, including equipment and real estate. The home office chapter covers how to handle the expenses for business use of the shareholder's home office.

In determining whether the S corporation or the shareholder should own the asset, the intention of the business is important. For example, an S corporation should avoid owning appreciable real estate if it intends to distribute such property to its shareholder(s).

S corporation owns

S corporations can deduct ordinary and necessary business expenses, including depreciation, related to vehicles used in the S corporation's trade or business. However, the S corporation must own the vehicle to claim depreciation, which generally means the S corporation has legal title to it.

Note: Ideally, if an S corporation shareholder buys a vehicle in their name but only plans to use it in the S corporation's trade or business, they should transfer title to the S corporation (if possible). If title isn't transferred, the S corporation should consider establishing an accountable plan to reimburse the shareholder for their employee business expenses with respect to that vehicle (discussed later).

If the S corporation owns the vehicle, it deducts all the actual business expenses paid or incurred by the corporation that are associated with that vehicle, including depreciation.

The S corporation can deduct 100% of the vehicle expenses, even if an employee (including an S corporation shareholder) uses the employer-provided vehicle personally. However, the fair market value (FMV) of any personal use must be included in the employee's income as wages. For this purpose, personal use includes any other use of the employer-provided vehicle besides use in that employer's trade or business [Reg. §1.132-5(a)(2), Temp. Reg. §1.274-6T(e)(5)].

Note: The business use of an employer-provided vehicle may be excluded from the employee's income as a working condition fringe benefit if the business use is properly substantiated [Reg. §1.132-5(c)].

Substance-over-form doctrine

Even if the S corporation does not have legal title to the vehicle, it might be the equitable owner under state law. For tax purposes, the equitable owner depreciates the property. In this case, substance (equitable ownership) over form (lack of legal title) controls.

In general, the equitable owner bears all the benefits and burdens of ownership (e.g., investment in the property, risk of loss, duties and obligations with respect to the property, possession, etc.) For example, the S corporation may have an equitable interest in the property under state law if S corporation funds were used to purchase the property, even though it is titled in the name of the shareholder [Conroe Office Building, Ltd., TC Memo 1991-224]. On the other hand, if the S corporation cannot prove it had a capital investment in the property, it might not have an equitable interest in the property even though it paid for all the operating expenses of such property.

Note: Equitable ownership is a legal issue that depends on the facts and circumstances. Consult state law or an attorney.

Case study

Aaron purchased a vehicle for the corporation but titled it in his name. A&A, Inc. is not the legal owner. However, A&A might be the equitable owner if it bears all the benefits and burdens of ownership under state law.

If Aaron used S corporation funds to purchase the vehicle and A&A pays all the operating expenses of the vehicle, check state law to determine if the S corporation is the equitable owner. If so, A&A can deduct all the vehicle expenses it paid, including depreciation, under the substance-over-form doctrine. To avoid any controversy, Aaron should transfer the title to the S corporation, so A&A is the legal owner.

Shareholder owns

If an S corporation shareholder-employee owns the vehicle personally but uses it in the S corporation's trade or business, any expenses attributable to the business use of the vehicle are unreimbursed employee business expenses (assuming the S corporation does not reimburse corporate expenses paid by the employee). In this case, the expenses are nondeductible because unreimbursed employee business expenses are miscellaneous itemized deductions subject to the 2%-of AGI limitation, which are suspended through 2025 under the TCJA.

Note: S corporation shareholders are employees for this purpose. They **cannot** deduct unreimbursed employee business expenses on Schedule E, Page 2, Line 28, like partners can deduct unreimbursed partnership expenses (UPE).

Accountable plan

S corporations can reimburse shareholder-employees for business expenses they paid on behalf of the corporation. If shareholders are reimbursed under an accountable plan, the S corporation deducts the reimbursement as a business expense and the shareholder excludes the reimbursement from gross income.

An accountable plan must meet all the following requirements [Reg. §1.62-2(c)(2)]:

- Reimburses employees for deductible business-related expenses
- Requires employees to adequately substantiate expenses within a reasonable period of time
- Requires employees to return excess reimbursements (amount by which reimbursement exceeds actual business expenses) within a reasonable period of time

Note: A sample accountable plan policy is provided in Appendix A.

An S corporation can reimburse the shareholder-employee's actual vehicle expenses (such as gas, oil, insurance, depreciation, etc.), or it can use the standard mileage rate (67¢/mile for 2024) to reimburse business miles if the employee substantiates the time, place and business purpose of the trip.

Note: Reimbursements under a nonaccountable plan are taxable wages to the employee, so the S corporation deducts them as compensation.

Case study

Assuming A&A, Inc. is not the equitable owner of the vehicle, Aaron owns the vehicle used in the S corporation's trade or business. A&A can establish an accountable plan to reimburse Aaron for his business-related vehicle expenses. This way, A&A deducts the reimbursement as a business expense, and Aaron excludes it from gross income.

Built-in gains tax

In general, the built-in gains (BIG) tax is assessed when an existing C corporation makes the election to be an S corporation and during a five-year recognition period disposes of an appreciated asset (one that had a FMV more than its adjusted basis on the date the S election became effective).

Note: In general, the BIG tax does not apply to assets acquired after the effective date of the S election. In addition, if an S corporation was never a C corporation, it usually is not subject to the BIG tax.

Typically, the recognition period is five years and starts on the first day of the first tax year for which the corporation is an S corporation [§1374(d)(7)]. In general, when the S corporation recognizes gain upon the disposition of an appreciated asset within this recognition period, the built-in gain is taxed at the highest corporate tax rate, currently 21%, whether the gain is capital or ordinary.

Case study

If A&A makes a late S election effective on Sept. 15, 2023, it will not be subject to the BIG tax since it was never a C corporation. However, what if A&A makes the S election effective on Jan. 1, 2024, and files a C corporation tax return for 2023? Will A&A be subject to the BIG tax when it is an S corporation?

It depends. In general, start by asking Aaron if A&A acquired any assets in 2023 as a C corporation that the S corporation still owned on Jan. 1, 2024. If he replies, "Yes," let's examine which assets may be subject to the BIG tax.

Assets subject to BIG tax

If an S corporation was previously a C corporation, the following appreciated assets may be subject to the BIG tax if they were on hand when the S election became effective:

- Fixed assets
- Cash-basis receivables
- Inventory

- Intangible assets, including goodwill

Fixed assets

In general, if the FMV of an asset exceeds its adjusted basis on the date the S election became effective, the difference is subject to the BIG tax if the S corporation disposes of such asset within the recognition period. However, if the asset is disposed of at a gain, the recognized built-in gain is limited to the lesser of the: [§1374(d)(3)]:

- Actual gain recognized, or
- Amount by which the FMV of the asset exceeded its adjusted basis on the date the S election became effective

Note: To avoid the BIG tax on fixed assets, the S corporation should hold onto them for more than five years from the date the S election became effective.

Case study

Let's assume A&A is a C corporation for 2023, and the S election is effective on Jan. 1, 2024. Aaron tells you the corporation purchased a piece of equipment on Nov. 1, 2023, for $4,000. The corporation claimed §179 for this asset, so the adjusted basis of this equipment is zero on Jan. 1, 2024, when the FMV was $3,500. If the S corporation sells this equipment for $3,000 in 2024, will it be subject to the BIG tax?

Yes, it is subject to the BIG tax. The equipment has a built-in gain of $3,500 ($3,500 FMV less $0 adjusted basis on S election effective date), and it was sold within the five-year recognition period. However, the actual gain on sale is only $3,000 ($3,000 sales price less $0 adjusted basis). Thus, the recognized built-in gain is limited to $3,000.

Variation

If the S corporation sells the equipment for $3,800 in 2024, the actual gain on sale is $3,800. In this case, only $3,500 of the gain is subject to the BIG tax, while $300 ($3,800 sales price - $3,500 built-in gain) is taxed as ordinary §1245 depreciation recapture.

Cash-basis receivables

Cash-basis receivables on hand when the S election became effective are taken into consideration when calculating the BIG tax because they would have been included in the C corporation's gross income if it had been accrual basis. Therefore, when income is recognized as the receivable is collected or sold, such income is subject to the BIG tax. This is very common.

Case study

Let's assume A&A is a cash-basis C corporation for 2023, and the S election is effective on Jan. 1, 2024. A&A has receivables with a face value of $10,000 on Jan. 1, 2024, and its basis in these receivables is zero. During 2024, A&A collects all the receivables that were outstanding on Jan. 1, 2024.

The income from the collection of these receivable is subject to the BIG tax because such income would have been included in the C corporation's gross income had it been accrual basis. In 2024, A&A recognizes a built-in gain of $10,000 on the collection of these receivables.

Inventory

In general, inventory with a relatively quick turnover will not have significant built-in gains. However, slower moving inventory may appreciate between the time it was purchased and the date the S election became effective. In this case, income from the sale of such inventory is subject to the BIG tax.

Case study

Let's assume A&A is a C corporation for 2023, and the S election is effective on Jan. 1, 2024. According to Aaron, A&A is a service business that did not have any inventory on Jan. 1, 2024. Are there any BIG tax issues with respect to inventory?

There is no BIG tax regarding inventory. Even if A&A acquires inventory in 2024, the sale of such inventory will not be subject to the BIG tax because it was not on hand when the S election became effective.

Goodwill and intangibles

If an S corporation sells assets constituting a trade or business, it may be subject to the BIG tax from the sale of goodwill or other intangible assets, including not only purchased goodwill but also goodwill that was created by the corporation when it was a C corporation. Self-created goodwill has no basis, so the FMV of such goodwill on the effective date of the S election is subject to the BIG tax. Determining the FMV of goodwill is somewhat subjective, so the corporation should consider getting an appraisal.

Note: The corporation must own the goodwill for it to be subject to the BIG tax. Goodwill owned by the shareholder (discussed below in the Martin Ice Cream Case) is not subject to the BIG tax because it belongs to the shareholder, not the corporation.

Case study

Let's assume A&A is a C corporation for 2023, and the S election is effective on Jan. 1, 2024. A&A was formed on Sept. 15, 2023, and the business began on Oct. 5, 2023. If the S corporation sells all its assets, including goodwill, within the recognition period, does the S corporation have any goodwill subject to the BIG tax?

It depends. Most likely, the C corporation did not create much, if any, goodwill as of Jan. 1, 2024. However, if the corporation has any self-created goodwill on Jan. 1, 2024, the FMV on that date is subject to the BIG tax. Also, find out if the C corporation purchased any goodwill, which is amortized over 15 years. In that case, the difference between the FMV and the adjusted basis on Jan. 1, 2024, is subject to the BIG tax. Finally, make sure any goodwill belongs to A&A, not Aaron.

Martin Ice Cream case

Martin Ice Cream Co. v. Commissioner [Tax Court Docket No. 1477-93 (3/17/98)], also known as the Martin Ice Cream Case or simply the Ice Cream Case, is an often-cited case supporting the position that goodwill is an asset of the shareholder-employee, not of the corporation.

In the Ice Cream Case, the taxpayer's corporation was in the business of ice cream distribution. The taxpayer had a longstanding relationship with owners and managers of supermarkets. The taxpayer owned 51% of the corporation and did not have an employment contract or a covenant not to compete with his corporation. The court ruled favorably, stating that the intangible belonged to the taxpayer, not the corporation. The taxpayer merely allowed the corporation to use his goodwill while he worked for the company.

While there is no bulletproof set of guidelines, the following items should be addressed in making the S corporation election (or in selling the assets) when there is BIG tax involved in order to substantiate that the intangible belongs to the taxpayer/shareholder:

- The negotiation and terms should reflect a consulting arrangement with the seller.
- The facts and agreement should reflect that the goodwill belongs to the selling shareholder.
- The selling shareholder should not have entered into a non-compete with the selling corporation. Furthermore, there should have been no employment contract that would give the rights of the goodwill to the selling corporation. Either one of these would show the goodwill belongs to the selling corporation, thereby negating any argument that the goodwill belongs to the shareholder.
- The parties should obtain separate appraisals that separate the personal goodwill from the total value of the company.

Warning: The burden to prove this is on the taxpayer, not on the IRS. §1374(d)(3) simply states all gain is considered built-in gain unless it is shown otherwise.

Net unrealized built-in gain

The net unrealized built-in gain is the maximum amount of gain subject to the BIG tax. This amount equals the aggregate FMV of the S corporation's assets over the aggregate adjusted bases of such assets on the date the S election became effective [§1374(d)(1)]. When computing net unrealized built-in gain, offset built-in gains with any built-in losses (e.g., accounts payable for cash-basis taxpayers) [Reg. §1.1374-3(a)]. If the net result is an unrealized built-in loss, the S corporation is not subject to the BIG tax.

Case study

Let's assume A&A is a cash basis C corporation for 2023, and the S election is effective on Jan. 1, 2024. The corporation purchased a piece of equipment on Nov. 1, 2023, for $4,000 and claimed §179, so the adjusted basis of this equipment is zero on Jan. 1, 2024, when the FMV was $3,500. A&A also has accounts receivable with a face value of $10,000 on Jan. 1, 2024, and its basis in these receivables is zero. A&A did not have any inventory or goodwill on Jan. 1, 2024. Finally, A&A has accounts payable of $5,000 on Jan. 1, 2024. What is A&A's net unrealized built-in gain?

A&A's net unrealized built-in gain is $8,500 ($3,500 from equipment + $10,000 from cash-basis receivables - $5,000 of accounts payable). This is the maximum amount of gain subject to the BIG tax.

S corporations report the net unrealized built-in gain each year on Form 1120-S, Schedule B, *Other Information*, Line 8.

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 . . . . $

The net recognized built-in gain from prior years, if any, reduces the amount reported on Line 8.

Note: Any other discussion regarding the BIG tax is beyond the scope of this course. To learn how to calculate and report the BIG tax, see NATP's self-study course *Tax Implications of Built-in Gains (BIG) Tax*.

Note: Form 7203, *S Corporation Shareholder Stock and Debt Basis*, is a common S corporation shareholder issue. For more information, see NATP's *Basis for S Corporation Shareholders* self-study book. Another issue is Form 7206, *Self-Employed Health Insurance Deduction*, which is covered in Day 1 of NATP's Tax Season Updates: *Essential Tax Law for Individuals and Businesses*. Both forms are provided in the Appendix B and Appendix C.

S Corporation Issues review questions

1. _____ If the exception to the general rule does not apply, a late S election under Rev. Proc. 2013-30 must be filed:

   A. At any time
   B. By the due date, including extensions of the current year Form 1120-S
   C. Within 12 months after the intended effective date of the S election
   D. Within three years and 75 days after the intended effective date of the S election

2. _____ Which of the following should **not** be used or taken into consideration when determining reasonable compensation?

   A. Bureau of Labor Statistics
   B. Financial ratios published by RMA
   C. Fraction of net income
   D. Compensation agreements

3. _____ If an existing C corporation makes the S election, which of the following assets is subject to the BIG tax if it was on hand on the effective date of the S election?

   A. Accounts receivable of accrual basis C corporation
   B. Fixed asset with FMV more than its adjusted basis
   C. Fixed asset with FMV less than its adjusted basis
   D. Goodwill owned by the S corporation shareholder

S Corporation Issues review answers

1.

A. Incorrect. It cannot be filed at any time unless the corporation meets all the conditions for the exception to the general rule.
B. Incorrect. It does not have to be filed by the due date, including extensions, of the current year Form 1120-S.
C. Incorrect. It does not have to be filed within 12 months after the intended effective date of the S election.
D. **Correct.** It must be filed within three years and 75 days after the intended effective date of the S election.

[Late S elections]

2.

A. Incorrect. Use resources such as the Bureau of Labor Statistics to establish wages paid for like services by like enterprises under like circumstances.
B. Incorrect. Use financial ratios published by RMA or other industry-specific publications in comparison to the S corporation's financial ratios.
C. **Correct.** This is a haphazard method done in practice, which may not equal wages paid for like services by like businesses under like circumstances (reasonable compensation). There is no legal authority for this method.
D. Incorrect. Compensation agreements is one factor taken into consideration when determining reasonable compensation.

[Reasonable compensation]

3.

A. Incorrect. Accounts receivable of a cash basis C corporation are subject to the BIG tax. An accrual basis C corporation already recognized the income as a C corporation.
B. **Correct.** An appreciated fixed asset with a FMV more than its adjusted basis is subject to the BIG tax.
C. Incorrect. Appreciated assets are subject to the BIG tax, so an asset with a FMV less than its adjusted basis is not subject to the BIG tax.
D. Incorrect. The corporation must own goodwill to be subject to the BIG tax.

[Built-in gains tax]

Partnership Issues

For some practitioners, navigating the complexities of transactions between partners and partnerships can be daunting. Many partners provide services to their partnership and also receive benefits (health insurance and retirement savings) from the partnership. Questions arise as to how these items are treated by the partnership and the partner. Also, many times the partner pays for partnership expenses but is not reimbursed for those items by the partnership. The question then becomes how or if they are deductible by the partner.

We will be covering the treatment, both from a partnership and partner perspective, of:

- Guaranteed payments
- Accident or health plans
- Unreimbursed partnership expenses
- Retirement plans

Examples will be provided when appropriate, and we will weave a comprehensive case study throughout. Partnership and individual income tax return forms will be used to illustrate the above concepts. The material will conclude with the completed partnership and partner forms for the case study.

Case study

Night Gates Cleaning, a partnership, owned equally by Amy Watts and Chip Daley, provides commercial and residential cleaning services to local businesses and individuals. Both partners materially participate in the business, as their involvement in the business is regular, continuous and substantial [§469(h)(1)]. Amy and Chip both provide services to the entity and have been receiving guaranteed payments for their services. In addition to the partners providing services, the business employs five full-time employees. Each of them makes less than $100,000.

Night Gates Cleaning has been in business for several years, has been operating profitably and is expected to remain profitable in the foreseeable future. The partners have been paying themselves guaranteed payments for the services they are providing to the partnership; however, Chip is getting tired of making estimated payments and would like to be put on a salary to make his life easier. Amy has no issue with making the estimated payments.

Both partners also incur unreimbursed partnership expenses (UPE) for business miles on their personal vehicles.

Also, to aid in employee retention, Night Gates Cleaning started offering medical insurance and established a retirement plan at the beginning of the year.

All five employees and partners are covered by the medical plan.

All five employees participate in the retirement plan and the business provides a matching contribution for all participants, including the partners.

The material will include a discussion of a key issue facing the business:

- Can Chip pay himself a salary to avoid having to deal with estimated payments?

Guaranteed Payments

Before we can get into a discussion about guaranteed payments, we need to discuss what types of payments a partnership can make to its partners. It is helpful to explore the various types of payments that a partnership can make to its partners. This exploration can aid practitioners in distinguishing between what is and what is not a guaranteed payment.

Payments made from a partnership to the partners can generally be classified as a payment:

- Made in the partner's capacity as a non-partner [§707(a)]
- Made in the partner's capacity as a partner [§707(c)]
- Made as the partner's distributive share of the partnership income [§731]

Whether the partner is acting in a partner or non-partner capacity is determined by all the facts and circumstances of the transaction. Relevant clauses of the partnership agreement will also factor in. If a partner is providing services as required by the partnership agreement, the partner is generally considered to be acting in their capacity as a partner. Other items to look at include the nature, scope and continuity of the services provided by the partner to the partnership, and if the payments depend on partnership income. Many times, it may be difficult to determine in what capacity the partner is acting. The courts have generally ruled that facts and circumstances will determine if a partner is acting in a non-partner or partner capacity.

Non-partner payments

Generally, if a partner performs the same or similar services for other businesses, the transaction is treated as if it were between the partnership and a stranger (non-partner).

Note: When the transaction is treated as engaged in with a non-partner, the partner realizes income in accordance with the partner's accounting method, rather than when the partnership is entitled to a deduction. This is different than how the partner recognizes income when the transaction is treated as one between a partner and the partnership (guaranteed payment). If a payment is treated as a guaranteed payment to a partner, the partnership's year of deduction controls when the partner recognizes the income on their return.

Example: performance of services by a partner in a non-partner capacity

Sadie, a cash basis taxpayer, is a partner in LSP. In addition to performing services for LSP, she performs the same or similar services for several other businesses. At the end of the year, LSP, who is an accrual basis taxpayer, accrues a $15,000 payment to Sadie and makes the payment in January of the following year.

Because Sadie provides the same or similar services to several other businesses, the payment is treated as made to a non-partner. Sadie is a cash-basis partner and does not recognize the income until she receives it. She would recognize the income in the following year when she receives the payment.

However, LSP generally will not be able to deduct the payment until the year Sadie includes it in income (receives payment) even though it is an accrual basis taxpayer.

Also, because LSP made payments to Sadie other than in her capacity as a partner, the partnership should issue a Form 1099-NEC to her to report the amount paid.

Note: A partner cannot be both an employee and a member of the same partnership [Rev. Rul. 69-184]. A partnership cannot pay a salary to a partner like they can to a non-partner employee.

Partner payments (guaranteed payments)

When a partner performs services for, or advances capital to, their partnership *within their capacity as a partner* and the payment for such is determined *without regard to partnership income*, the payments are guaranteed payments [§707(c)].

The amount of the guaranteed payment cannot be contingent on the partnership's **net income**. However, the partnership can base a guaranteed payment on the **gross income** of the partnership and is not required to state a fixed amount.

A payment for services determined by reference to gross income is a guaranteed payment if, based on the facts and circumstances, the payment is compensation rather than a share of the partnership profits. Relevant facts include (Rev. Rul. 81-300):

- The reasonableness of the payment for services provided
- Whether the method used to decide the payment amount would have been used for an unrelated party

The most common type of guaranteed payment is a payment to a partner for their services to the partnership. Guaranteed payments for the performance of services are not subject to any type of payroll tax withholding at the partnership level, but in the hands of the partner (general or limited), they are self-employment (SE) income and subject to SE tax.

Example: guaranteed payments for services

Sara is a limited partner in a partnership. She receives a guaranteed payment of $25,000 for the performance of services to the partnership. The guaranteed payment is included in her net earnings from SE. She is not subject to SE tax on her distributive share of the income from the partnership.

If Sara were a general partner, she would be subject to SE tax on any guaranteed payments for services rendered to the partnership and on her distributive share of the income of the partnership.

Note: When a partnership is engaged in a trade or business, a general partner's total earnings subject to SE tax generally include their distributive share of the partnership income and any guaranteed payments for services they provided to the partnership or for use of capital, whether or not distributed. A limited partner's distributive share of the partnership income is not subject to SE tax. Guaranteed payments for limited partners are subject to SE tax to the extent the payments are for services they provided to the partnership [§1402(a)(13)].

Distributive share payments

If a payment is made to a partner acting in their capacity as a partner and the payment is not a guaranteed payment, it is treated as a distribution. Usually, it is also accompanied by an income allocation.

Partnership treatment (guaranteed payments)

The partnership deducts (or capitalizes) the guaranteed payment, provided the payment is an ordinary and necessary business expense under the partnership's accounting method. The partnership must be able to substantiate the business purpose of the guaranteed payment. Although the payment to a partner is ordinarily a business deduction under §162 for the partnership, a guaranteed payment is subject to the §263 capitalization rules.

Practitioner reminder: An accrual method partnership may not deduct any amount accrued to a partner until the partner recognizes the income under the partner's method of accounting. What this means is that an accrual method partnership uses the cash method for transactions with partners who are using the cash method of accounting. This applies regardless of the percentage of ownership of the partner. However, this rule only applies to amounts determined to be §707(a) payments to a non-partner (see example above under non-partner payments). If a payment is treated as a guaranteed payment to a partner under §707(c), the partnership's year of deduction controls when the partner recognizes the income on their tax return [see example below under partner treatment (guaranteed payments)].

Return presentation

Note: There are other parts of the partnership return where guaranteed payment items are reported (Schedule M-1, *Reconciliation of Income (Loss) per Books With Analysis of Net Income (Loss) per Return*) but those items are not relevant for our discussion and will not be included. This applies throughout the material with the return presentation sections. A complete partnership and individual return are presented at the end based on the case study.

Case study

Night Gates Cleaning made guaranteed payments of $60,000 to each of its partners for the services the partners performed for the partnership within their capacity as a partner, and the payments were determined without regard to partnership income.

The relevant parts of the tax return are below.

Form 1065, U.S. Return of Partnership Income

Report guaranteed payments to partners on Line 10.

Form **1065**
Department of the Treasury
Internal Revenue Service

U.S. Return of Partnership Income

For calendar year 2023, or tax year beginning ...., ending ....

Go to *www.irs.gov/Form1065* for instructions and the latest information.

OMB No. 1545-0123

2023

A Principal business activity: Cleaning	Name of partnership: Night Gates Cleaning	D Employer identification number: **-***5565
B Principal product or service: Service	Type or Print — Number, street, and room or suite no. If a P.O. box, see instructions.: 789 Main Street	E Date business started: 01/01/2021
C Business code number: 561720	City or town, state or province, country, and ZIP or foreign postal code: Any Town WI 54315	F Total assets (see instructions) $ 0

G Check applicable boxes: (1) ☐ Initial return (2) ☐ Final return (3) ☐ Name change (4) ☐ Address change (5) ☐ Amended return

H Check accounting method: (1) ☒ Cash (2) ☐ Accrual (3) ☐ Other (specify):

I Number of Schedules K-1. Attach one for each person who was a partner at any time during the tax year: 2

J Check if Schedules C and M-3 are attached ☐

K Check if partnership: (1) ☐ Aggregated activities for section 465 at-risk purposes (2) ☐ Grouped activities for section 469 passive activity purposes

Caution: Include **only** trade or business income and expenses on lines 1a through 23 below. See instructions for more information.

Income	1a	Gross receipts or sales; b Less returns and allowances; c Balance	1c	
	2	Cost of goods sold (attach Form 1125-A)	2	
	3	Gross profit. Subtract line 2 from line 1c	3	
	4	Ordinary income (loss) from other partnerships, estates, and trusts (attach statement)	4	
	5	Net farm profit (loss) (attach Schedule F (Form 1040))	5	
	6	Net gain (loss) from Form 4797, Part II, line 17 (attach Form 4797)	6	
	7	Other income (loss) (attach statement)	7	
	8	**Total income (loss).** Combine lines 3 through 7	8	
Deductions (see instructions for limitations)	9	Salaries and wages (other than to partners) (less employment credits)	9	
	10	Guaranteed payments to partners	10	120,000
	11	Repairs and maintenance	11	
	12	Bad debts	12	
	13	Rent	13	
	14	Taxes and licenses	14	
	15	Interest (see instructions)	15	
	16a	Depreciation (if required, attach Form 4562) — 16a		
	b	Less depreciation reported on Form 1125-A and elsewhere on return — 16b	16c	
	17	Depletion **(Do not deduct oil and gas depletion.)**	17	
	18	Retirement plans, etc.	18	
	19	Employee benefit programs	19	
	20	Energy efficient commercial buildings deduction (attach Form 7205)	20	
	21	Other deductions (attach statement)	21	
	22	**Total deductions.** Add the amounts shown in the far right column for lines 9 through 21	22	120,000
	23	**Ordinary business income (loss).** Subtract line 22 from line 8	23	-120,000
Tax and Payment	24	Interest due under the look-back method—completed long-term contracts (attach Form 8697)	24	
	25	Interest due under the look-back method—income forecast method (attach Form 8866)	25	
	26	BBA AAR imputed underpayment (see instructions)	26	
	27	Other taxes (see instructions)	27	
	28	**Total balance due.** Add lines 24 through 27	28	
	29	Elective payment election amount from Form 3800	29	
	30	Payment (see instructions)	30	
	31	**Amount owed.** If the sum of line 29 and line 30 is smaller than line 28, enter amount owed	31	
	32	**Overpayment.** If the sum of line 29 and line 30 is larger than line 28, enter overpayment	32	

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 partner or limited liability company member) is based on all information of which preparer has any knowledge.

Signature of partner or limited liability company member — Date

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 ☐ if self-employed	PTIN
		03/28/24		

Firm's name: Natl Assn Of Tax Prof — Firm's EIN

Firm's address: PO Box 8002, Appleton, WI 54912 — Phone no. 920-749-1040

For Paperwork Reduction Act Notice, see separate instructions. Form **1065** (2023)

DAA

Schedule K

Guaranteed payments are specific to each partner. Report guaranteed payments for services on Line 4a, and guaranteed payments for use of capital on Line 4b. The total of Lines 4a and 4b is reported on Line 4c.

Form 1065 (2023) Night Gates Cleaning **-***5565 Page 5

Schedule K Partners' Distributive Share Items

						Total amount
Income (Loss)	1	Ordinary business income (loss) (page 1, line 23)			1	-120,000
	2	Net rental real estate income (loss) (attach Form 8825)			2	
	3a	Other gross rental income (loss)	3a			
	b	Expenses from other rental activities (attach statement)	3b			
	c	Other net rental income (loss). Subtract line 3b from line 3a			3c	
	4	Guaranteed payments: a Services	4a	120,000 b Capital 4b		
		c Total. Add lines 4a and 4b			4c	120,000
	5	Interest income			5	
	6	Dividends and dividend equivalents: a Ordinary dividends			6a	
		b Qualified dividends 6b	c Dividend equivalents 6c			
	7	Royalties			7	
	8	Net short-term capital gain (loss) (attach Schedule D (Form 1065))			8	
	9a	Net long-term capital gain (loss) (attach Schedule D (Form 1065))			9a	
	b	Collectibles (28%) gain (loss)	9b			
	c	Unrecaptured section 1250 gain (attach statement)	9c			
	10	Net section 1231 gain (loss) (attach Form 4797)			10	
	11	Other income (loss) (see instructions) Type:			11	
Deductions	12	Section 179 deduction (attach Form 4562)			12	
	13a	Cash contributions			13a	
	b	Noncash contributions			13b	
	c	Investment interest expense			13c	
	d	Section 59(e)(2) expenditures (1) Type:	(2) Amount:		13d(2)	
	e	Other deductions (see instructions) Type:			13e	
Self-Employment	14a	Net earnings (loss) from self-employment			14a	
	b	Gross farming or fishing income			14b	
	c	Gross nonfarm income			14c	
Credits	15a	Low-income housing credit (section 42(j)(5))			15a	
	b	Low-income housing credit (other)			15b	
	c	Qualified rehabilitation expenditures (rental real estate) (attach Form 3468, if applicable)			15c	
	d	Other rental real estate credits (see instructions)	Type:		15d	
	e	Other rental credits (see instructions)	Type:		15e	
	f	Other credits (see instructions)	Type:		15f	
International	16	Attach Schedule K-2 (Form 1065), Partners' Distributive Share Items—International, and check this box to indicate that you are reporting items of international tax relevance ☐				
Alternative Minimum Tax (AMT) Items	17a	Post-1986 depreciation adjustment			17a	
	b	Adjusted gain or loss			17b	
	c	Depletion (other than oil and gas)			17c	
	d	Oil, gas, and geothermal properties–gross income			17d	
	e	Oil, gas, and geothermal properties–deductions			17e	
	f	Other AMT items (attach statement)			17f	
Other Information	18a	Tax-exempt interest income			18a	
	b	Other tax-exempt income			18b	
	c	Nondeductible expenses			18c	
	19a	Distributions of cash and marketable securities			19a	
	b	Distributions of other property			19b	
	20a	Investment income			20a	
	b	Investment expenses			20b	
	c	Other items and amounts (attach statement)	See Statement 1			
	21	Total foreign taxes paid or accrued			21	

Form **1065** (2023)

Statement 1 - Form 1065, Schedule K, Line 20c - Other Items and Amounts

Description	Amount
Qualifies for exception to filing Schedule K-2	$

Note: Guaranteed payments for services are included in net earnings (loss) from self-employment (Box 14), but not when the net SE income is zero (-$120,000 + $120,000 = $0).

Partner treatment (guaranteed payments)

Guaranteed payments are treated as ordinary income for the partner who receives them. If a partnership deducts guaranteed payments as ordinary necessary business expenses in a particular tax year, those payments are considered taxable income for the partner for the year that includes or ends with the partnership's tax year [§706(a)]. Inclusion of a guaranteed payment as income to a partner does not depend on actual payment to the partner.

Example: accrual method partnership

Tony is a calendar year taxpayer and is a partner in a partnership using a fiscal year end. The partnership's fiscal year ends May 31, 2024 (June 1, 2023-May 31, 2024). As payment for the services Tony provides to the partnership, he receives guaranteed payments. Tony received guaranteed payments totaling $7,000 between June 1 and Dec. 31, 2023. He received guaranteed payments totaling $5,000 between Jan. 1 and May 31, 2024.

Tony includes the entire amount of the guaranteed payments received ($12,000) in income on his calendar year 2024 tax return. Also included in his 2024 tax return income would be his distributive share of partnership income for the partnership year ending May 31, 2024.

Example: income inclusion

Sullivan is a cash method partner in an accrual basis partnership. The partnership has a June 30, 2024, year-end and accrues a $25,000 guaranteed payment to Sullivan. Sullivan does not receive the $25,000 payment by Dec. 31, 2024. He must include the payment in income even if he does not receive payment during 2024.

Return presentation

Case study

Amy receives the following Schedule K-1 (Form 1065), *Partner's Share of Income, Deductions, Credits, etc*. Chip would receive the exact same one. In the interest of space, we will only provide Amy's Schedule K-1.

Schedule K-1

Guaranteed payments for services are entered in Box 4a. Enter guaranteed payments for use of capital in Box 4b. Total guaranteed payments are entered in Box 4c.

Partner# 1 651123

Final K-1 ☐ Amended K-1 ☐ OMB No. 1545-0123

Schedule K-1 (Form 1065) **2023**

Department of the Treasury
Internal Revenue Service

For calendar year 2023, or tax year beginning ______ ending ______

Partner's Share of Income, Deductions, Credits, etc.

See separate instructions.

Part I Information About the Partnership

A Partnership's employer identification number
-*5565

B Partnership's name, address, city, state, and ZIP code
Night Gates Cleaning
789 Main Street
Any Town WI 54315

C IRS Center where partnership filed return:
Kansas City, MO 64999-0011

D ☐ Check if this is a publicly traded partnership (PTP)

Part II Information About the Partner

E Partner's SSN or TIN (Do not use TIN of a disregarded entity. See instructions.)
***-**-1111

F Name, address, city, state, and ZIP code for partner entered in E. See instructions.
Amy Watts
54 Rolling Place
Any City WI 54315

G [X] General partner or LLC member-manager ☐ Limited partner or other LLC member

H1 [X] Domestic partner ☐ Foreign partner

H2 ☐ If the partner is a disregarded entity (DE), enter the partner's:
TIN ______
Name ______

I1 What type of entity is this partner? Individual

I2 If this partner is a retirement plan (IRA/SEP/Keogh/etc.), check here ☐

J Partner's share of profit, loss, and capital (see instructions):

	Beginning	Ending
Profit	50.000000%	50.000000%
Loss	50.000000%	50.000000%
Capital	50.000000%	50.000000%

Check if decrease is due to:
☐ Sale or ☐ Exchange of partnership interest. See instructions.

K1 Partner's share of liabilities:

	Beginning	Ending
Nonrecourse	$	$
Qualified nonrecourse financing	$	$
Recourse	$	$

K2 Check this box if item K1 includes liability amounts from lower-tier partnerships ☐

K3 Check if any of the above liability is subject to guarantees or other payment obligations by the partner. See instructions ☐

L **Partner's Capital Account Analysis**

Beginning capital account	$
Capital contributed during the year	$
Current year net income (loss)	$ -60,000
Other increase (decrease) (attach explanation)	$
Withdrawals and distributions	$ ( )
Ending capital account	$ -60,000

M Did the partner contribute property with a built-in gain (loss)?
☐ Yes [X] No If "Yes," attach statement. See instructions.

N **Partner's Share of Net Unrecognized Section 704(c) Gain or (Loss)**
Beginning $
Ending $

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

1	Ordinary business income (loss) -60,000	14	Self-employment earnings (loss)
2	Net rental real estate income (loss)		
3	Other net rental income (loss)	15	Credits
4a	Guaranteed payments for services 60,000		
4b	Guaranteed payments for capital	16	Schedule K-3 is attached if checked ☐
4c	Total guaranteed payments 60,000	17	Alternative minimum tax (AMT) items
5	Interest income		
6a	Ordinary dividends		
6b	Qualified dividends	18	Tax-exempt income and nondeductible expenses
6c	Dividend equivalents		
7	Royalties		
8	Net short-term capital gain (loss)	19	Distributions
9a	Net long-term capital gain (loss)		
9b	Collectibles (28%) gain (loss)	20	Other information
9c	Unrecaptured section 1250 gain	ZZ*	STMT
10	Net section 1231 gain (loss)		
11	Other income (loss)		
12	Section 179 deduction	21	Foreign taxes paid or accrued
13	Other deductions		

22 ☐ More than one activity for at-risk purposes*
23 ☐ More than one activity for passive activity purposes*

*See attached statement for additional information.

For IRS Use Only

For Paperwork Reduction Act Notice, see the Instructions for Form 1065. www.irs.gov/Form1065 Schedule K-1 (Form 1065) 2023
DAA

Schedule K-1, Line 20ZZ - Additional Other Information

Description
Schedule K-3 will not be distributed to you unless requested

Note: Guaranteed payments for services are included in net earnings (loss) from self-employment (Box 14), but not when the net SE income is zero (-$60,000 + $60,000 = $0).

Schedule E

The partner treats the guaranteed payment as ordinary income. A partner reports guaranteed payments on Schedule E, Part II, Line 28, Column (k), along with their distributive share of the partnership's ordinary income (loss) (from Schedule K-1 (Form 1065), Box 1).

Assuming Amy has enough basis, she is able to deduct ordinary losses from the partnership. A discussion of basis is beyond the scope of this material.

Schedule E (Form 1040) 2023 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**

Amy Watts | ***-**-1111

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

Part II **Income or Loss From Partnerships and S Corporations**

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

27 Are you reporting any loss not allowed in a prior year due to the at-risk 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 basis computation is required	**(f)** Check if any amount is not at risk
A	Night Gates Cleaning	P	☐	**-***5565	☐	☐
B	Guaranteed payments – services	P	☐	**-***5565	☐	☐
C			☐		☐	☐
D			☐		☐	☐

	Passive Income and Loss		Nonpassive Income and Loss		
	(g) Passive loss allowed (attach **Form 8582** if required)	**(h)** Passive income from **Schedule K-1**	**(i)** Nonpassive loss allowed (see **Schedule K-1**)	**(j)** Section 179 expense deduction from **Form 4562**	**(k)** Nonpassive income from **Schedule K-1**
A			60,000		
B			0		60,000
C					
D					
29a Totals					60,000
b Totals			60,000		

30	Add columns (h) and (k) of line 29a	30	60,000
31	Add columns (g), (i), and (j) of line 29b	31	(60,000)
32	**Total partnership and S corporation income or (loss).** Combine lines 30 and 31	32	0

Part III **Income or Loss From Estates and Trusts**

33	**(a)** Name	**(b)** Employer identification number
A		
B		

	Passive Income and Loss		Nonpassive Income and Loss	
	(c) Passive deduction or loss allowed (attach **Form 8582** if required)	**(d)** Passive income from **Schedule K-1**	**(e)** Deduction or loss from **Schedule K-1**	**(f)** Other income from **Schedule K-1**
A				
B				
34a Totals				
b Totals				

35	Add columns (d) and (f) of line 34a	35	
36	Add columns (c) and (e) of line 34b	36	( )
37	**Total estate and trust income or (loss).** Combine lines 35 and 36	37	

Part IV **Income or Loss From Real Estate Mortgage Investment Conduits (REMICs)—Residual Holder**

38 (a) Name	**(b)** Employer identification number	**(c)** Excess inclusion from **Schedules Q,** line 2c (see instructions)	**(d)** Taxable income (net loss) from **Schedules Q,** line 1b	**(e)** Income from **Schedules Q,** line 3b

39	Combine columns (d) and (e) only. Enter the result here and include in the total on line 41 below	39	

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 Schedule 1 (Form 1040), line 5	41	
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 1120-S), box 17, code AN; and Schedule K-1 (Form 1041), box 14, code F. See instructions	42	
43	**Reconciliation for real estate professionals.** If you were a real estate professional (see instructions), enter the net income or (loss) you reported anywhere on Form 1040, Form 1040-SR, or Form 1040-NR from all rental real estate activities in which you materially participated under the passive activity loss rules	43	

DAA **Schedule E (Form 1040) 2023**

Discussion of Chip's issue over guaranteed payments

Case study

Night Gates Cleaning has been in business for several years, has been operating profitably and is expected to remain profitable in the foreseeable future. The partners have been paying themselves guaranteed payments for the services they are providing to the partnership; however, Chip is getting tired of making estimated payments and would like to be put on a salary to make his life easier. Amy has no issue with making the estimated payments.

Would Chip be allowed to receive a W-2 instead of guaranteed payments?

No, because of Rev. Rul. 69-184 that states members of a partnership cannot be employees of the partnership for employment tax purposes. According to the ruling, "remuneration received by a partner from the partnership is not "wages" with respect to "employment" and, therefore, is not subject to the taxes imposed by the Federal Insurance Contributions Act and the Federal Unemployment Tax Act. Such remuneration also is not subject to Federal income tax withholding."

What about avoiding this rule by hiring a certified professional employer organization (CPEO) to treat partners as employees?

A CPEO is an employee leasing company that handles various administrative and tax reporting responsibilities for their business clients. Under §3511, a CPEO can be treated as the sole employer for employment tax purposes for any work site employee who performs services under a contract between the business (customer) and the CPEO.

A partner would not be included in the definition of worksite employee. An individual with net earnings from SE derived from the trade or business of a CPEO's customer (including a partner in a partnership that is a customer) is not considered a worksite employee for employment tax purposes as to remuneration paid by the CPEO [§3511(f)].Therefore, any payment by a CPEO to a partner in a partnership under a contract between the partnership and the CPEO must always be treated as a payment to a self-employed individual and reported as such.

Potential solution

To solve his issue, Chip could set up recurring payments using EFTPS, Direct Pay or through his tax professional if they provide the service. Chip would need to make sure he has sufficient funds in his account to cover the withdrawal, or the withdrawal could possibly come from the business account and be classified as a distribution to him. Amy could receive a distribution equal to Chip's estimated tax payment distribution to keep things equal; although, she is under no obligation to receive one if money is an issue for the partnership. As mentioned above, the entire year of payments could be set up for Chip when his return is prepared. This could be accomplished a number of ways, including the partnership making the payments and treating the payments as a distribution to Chip.

Accident or health plans

Benefits under an accident or health plan (medical insurance) are an example of one fringe benefit not excludable from the income of a partner. When a partnership pays health or accident insurance premiums or makes health savings account (HSA) contributions on behalf of a partner for services provided to the partnership, the payments may be treated as guaranteed payments that are subject to SE tax.

Generally, guaranteed payments also include amounts paid for health insurance for the partner and the partner's spouse, dependents and children under age 27 who are not dependents. When the partnership pays health insurance premiums, under the partnership's health plan, for the partner for services rendered without regard to partnership income, report the premium payments as guaranteed payments. The partnership deducts these payments, and the recipient partner includes them in gross income [Rev. Rul. 91-26].

The partnership can choose to account for the payment of health insurance premiums paid on behalf of a partner, under the partnership's health plan, as a distribution to the partner [Rev. Rul. 91-26]. In this case, the partnership cannot deduct the health insurance premiums, so they do not affect the partner's distributive share of partnership income and deduction. Instead, the partner reduces their basis by all distributions, including the amount paid for health insurance premiums.

Note: Partners who receive their insurance through the Marketplace may not receive the benefit of both the premium tax credit (PTC) and the self-employed health insurance (SEHI) deduction for the same premium. Rev. Proc. 2014-41 provides optional instructions on how to resolve the difficulty performing the computation. The difficulty is with the fact that the PTC is determined by modified adjusted gross income (MAGI), and the SEHD reduces MAGI.

Partnership treatment

Generally, partnerships can deduct the cost of employee benefits as ordinary and necessary business expenses in the year in which they are paid (for cash basis partnerships) or accrued (for accrual basis partnerships).

For partners who provide services to the partnership, many, but not all, fringe benefits are treated as guaranteed payments if they are paid for services provided by the partner in their capacity as a partner and if the payments are made without regard to partnership income. Payments by the partnership on behalf of the partner for accident or health plan fringe benefits are generally treated as guaranteed payments.

Payments that qualify as guaranteed payments are deductible by the partnership on Line 10 of Form 1065 or capitalized if required. They are reported on the partner's Schedule K-1 (Form 1065) as a guaranteed payment in Box 4 and as net SE income in Box 14, Code A.

There may be situations where the partnership treats the payments as distributions and reports them on the Schedule K-1 (Form 1065) rather than as guaranteed payments [§731]. If health insurance premiums are not for services rendered in the capacity of a partner or the payment depends upon the partnership having income, the partnership treats the premiums paid as a distribution to the partner. The partnership does not get a deduction for the distribution, and if the partner has basis, they do not pay tax on the distribution. However, the partner may still take a SEHI deduction if the requirements of §162(l) are met. In this situation the amount of the premiums should be shown on the partner's Schedule K-1 (Form 1065), Box 20, Code ZZ, Other information. Since the amount was not treated as income to the partner, it will not increase SE income.

See 'Partner treatment' for a §162(l) discussion.

For medical insurance payments made for employees (non-partners), the partnership can report and deduct the payments on Line 19 (Employee benefit programs) of Form 1065.

HSA contributions

Contributions by a partnership to a partner's HSA for services performed to the partnership that are treated as guaranteed payments are deductible by the partnership and are included in the partner's gross income and net earnings from self-employment. The contributions are reported as guaranteed payments on Schedule K-1 (Form 1065) and the partner, if an eligible individual, is entitled to deduct the amount of the contributions as an adjustment to gross income.

On the other hand, contributions by a partnership to an HSA of a partner that are treated as distributions to the partner are not deductible by the partnership, do not affect the distributive shares of the partnership income and deductions, and are not included in the partner's net income from self-employment. The contributions are reported as distributions of money on Schedule K-1 (Form 1065) and the partner, if an eligible individual, is entitled to deduct the amount of the contribution as an adjustment to gross income.

Return presentation

Case study

Night Gates Cleaning began offering medical plan coverage in the current year. All five employees, including the two partners, are covered by the plan. The business covered 50% of the premium for all employees and contributed $2,000 to each employee's health savings account (HSA), as the medical plan was a high deductible health plan, and all the requirements were met. The partnership paid 100% of the health insurance premiums for the partners and also contributed $4,000 to each partner's HSA. No other HSA contributions were made by or on behalf of the partners. Both partners are over the age of 55.

Note: Disregard any guaranteed payments paid to the partners for services in the guaranteed payments section. We are only discussing medical coverage in this section. See the case study at the end for the return presentation that includes all guaranteed payments.

The health plan expenses paid by Night Gates Cleaning is as follows:

Health insurance premiums for employees	$6,000
HSA contributions for employees	10,000
Health insurance premiums for partners	4,800
HSA contributions for partners	8,000
Total	**$28,800**

The relevant part of the Form 1065 would look as follows:

Form 1065

Partner and employee (non-partner) insurance and HSA premiums are reported as follows:

Line 10: $12,800 ($4,800 + $8,000) paid by the partnership for the partner health insurance premiums and their HSA contributions are reported as guaranteed payments, as the partners provided services to the partnership in their capacity as a partner and the payments were made without regard to partnership income.

Line 19: $16,000 ($6,000 + $10,000) employee benefit programs (fringe benefits) paid to employees (non-partners).

Line 22: Corresponds to the total dollars the employer spent for health insurance and HSA contributions for all eligible workers.

Form **1065** Department of the Treasury Internal Revenue Service

U.S. Return of Partnership Income

For calendar year 2023, or tax year beginning ...., ending ....

Go to *www.irs.gov/Form1065* for instructions and the latest information.

OMB No. 1545-0123 **2023**

A Principal business activity: Cleaning	Name of partnership: Night Gates Cleaning	D Employer identification number: **-***5565
B Principal product or service: Service	Number, street, and room or suite no. If a P.O. box, see instructions.: 789 Main Street	E Date business started: 01/01/2021
C Business code number: 561720	City or town, state or province, country, and ZIP or foreign postal code: Any Town WI 54315	F Total assets (see instructions) $ 0

Type or Print

G Check applicable boxes: (1) ☐ Initial return (2) ☐ Final return (3) ☐ Name change (4) ☐ Address change (5) ☐ Amended return

H Check accounting method: (1) ☒ Cash (2) ☐ Accrual (3) ☐ Other (specify):

I Number of Schedules K-1. Attach one for each person who was a partner at any time during the tax year: 2

J Check if Schedules C and M-3 are attached ☐

K Check if partnership: (1) ☐ Aggregated activities for section 465 at-risk purposes (2) ☐ Grouped activities for section 469 passive activity purposes

Caution: Include **only** trade or business income and expenses on lines 1a through 23 below. See instructions for more information.

Income	1a	Gross receipts or sales ___ **b** Less returns and allowances ___ **c** Balance	1c	
	2	Cost of goods sold (attach Form 1125-A)	2	
	3	Gross profit. Subtract line 2 from line 1c	3	
	4	Ordinary income (loss) from other partnerships, estates, and trusts (attach statement)	4	
	5	Net farm profit (loss) (attach Schedule F (Form 1040))	5	
	6	Net gain (loss) from Form 4797, Part II, line 17 (attach Form 4797)	6	
	7	Other income (loss) (attach statement)	7	
	8	**Total income (loss).** Combine lines 3 through 7	8	
Deductions (see instructions for limitations)	9	Salaries and wages (other than to partners) (less employment credits)	9	
	10	Guaranteed payments to partners	10	12,800
	11	Repairs and maintenance	11	
	12	Bad debts	12	
	13	Rent	13	
	14	Taxes and licenses	14	
	15	Interest (see instructions)	15	
	16a	Depreciation (if required, attach Form 4562) 16a		
	b	Less depreciation reported on Form 1125-A and elsewhere on return 16b	16c	
	17	Depletion **(Do not deduct oil and gas depletion.)**	17	
	18	Retirement plans, etc.	18	
	19	Employee benefit programs	19	16,000
	20	Energy efficient commercial buildings deduction (attach Form 7205)	20	
	21	Other deductions (attach statement)	21	
	22	**Total deductions.** Add the amounts shown in the far right column for lines 9 through 21	22	28,800
	23	**Ordinary business income (loss).** Subtract line 22 from line 8	23	-28,800
Tax and Payment	24	Interest due under the look-back method—completed long-term contracts (attach Form 8697)	24	
	25	Interest due under the look-back method—income forecast method (attach Form 8866)	25	
	26	BBA AAR imputed underpayment (see instructions)	26	
	27	Other taxes (see instructions)	27	
	28	**Total balance due.** Add lines 24 through 27	28	
	29	Elective payment election amount from Form 3800	29	
	30	Payment (see instructions)	30	
	31	**Amount owed.** If the sum of line 29 and line 30 is smaller than line 28, enter amount owed	31	
	32	**Overpayment.** If the sum of line 29 and line 30 is larger than line 28, enter overpayment	32	

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 partner or limited liability company member) is based on all information of which preparer has any knowledge.

Signature of partner or limited liability company member ____ Date ____

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 ☐ if self-employed	PTIN
		03/21/24		

Firm's name: Natl Assn Of Tax Prof — Firm's EIN:

Firm's address: PO Box 8002 Appleton, WI 54912 — Phone no. 920-749-1040

For Paperwork Reduction Act Notice, see separate instructions. Form **1065** (2023)

DAA

Schedule K

Guaranteed payments include health insurance paid for by the partnership for the partners. Report guaranteed payments for health insurance on Line 4a as part of services. The total of Lines 4a and 4b is reported on Line 4c. This amount is also reported in Box 13e, with a statement attached, and in Box 14a, net earnings (loss) from SE. Detailed information should be provided in Box 20c, other items and amounts, with an attached statement.

Form 1065 (2023) Night Gates Cleaning **-***5565 Page **5**

Schedule K	Partners' Distributive Share Items			Total amount
Income (Loss)	1	Ordinary business income (loss) (page 1, line 23)	1	-28,800
	2	Net rental real estate income (loss) (attach Form 8825)	2	
	3a	Other gross rental income (loss) 3a		
	b	Expenses from other rental activities (attach statement) 3b		
	c	Other net rental income (loss). Subtract line 3b from line 3a	3c	
	4	Guaranteed payments: a Services 4a 12,800 b Capital 4b		
		c Total. Add lines 4a and 4b	4c	12,800
	5	Interest income	5	
	6	Dividends and dividend equivalents: a Ordinary dividends	6a	
		b Qualified dividends 6b c Dividend equivalents 6c		
	7	Royalties	7	
	8	Net short-term capital gain (loss) (attach Schedule D (Form 1065))	8	
	9a	Net long-term capital gain (loss) (attach Schedule D (Form 1065))	9a	
	b	Collectibles (28%) gain (loss) 9b		
	c	Unrecaptured section 1250 gain (attach statement) 9c		
	10	Net section 1231 gain (loss) (attach Form 4797)	10	
	11	Other income (loss) (see instructions) Type:	11	
Deductions	12	Section 179 deduction (attach Form 4562)	12	
	13a	Cash contributions	13a	
	b	Noncash contributions	13b	
	c	Investment interest expense	13c	
	d	Section 59(e)(2) expenditures: (1) Type: (2) Amount:	13d(2)	
	e	Other deductions (see instructions) Type: See Statement 1	13e	12,800
Self-Employment	14a	Net earnings (loss) from self-employment	14a	-16,000
	b	Gross farming or fishing income	14b	
	c	Gross nonfarm income	14c	
Credits	15a	Low-income housing credit (section 42(j)(5))	15a	
	b	Low-income housing credit (other)	15b	
	c	Qualified rehabilitation expenditures (rental real estate) (attach Form 3468, if applicable)	15c	
	d	Other rental real estate credits (see instructions) Type:	15d	
	e	Other rental credits (see instructions) Type:	15e	
	f	Other credits (see instructions) Type:	15f	
International	16	Attach Schedule K-2 (Form 1065), Partners' Distributive Share Items—International, and check this box to indicate that you are reporting items of international tax relevance ☐		
Alternative Minimum Tax (AMT) Items	17a	Post-1986 depreciation adjustment	17a	
	b	Adjusted gain or loss	17b	
	c	Depletion (other than oil and gas)	17c	
	d	Oil, gas, and geothermal properties–gross income	17d	
	e	Oil, gas, and geothermal properties–deductions	17e	
	f	Other AMT items (attach statement)	17f	
Other Information	18a	Tax-exempt interest income	18a	
	b	Other tax-exempt income	18b	
	c	Nondeductible expenses	18c	
	19a	Distributions of cash and marketable securities	19a	
	b	Distributions of other property	19b	
	20a	Investment income	20a	
	b	Investment expenses	20b	
	c	Other items and amounts (attach statement) See Statement 2		
	21	Total foreign taxes paid or accrued	21	

Form **1065** (2023)

NGMEDICAL Night Gates Cleaning
-*5565
FYE: 12/31/2023

Federal Statements

8/13/2024 12:26 PM

Statement 1 - Form 1065, Schedule K, Line 13e - Other Deductions

Description	Amount
Health Insurance for Partners	$ 12,800
Total	$ 12,800

Statement 2 - Form 1065, Schedule K, Line 20c - Other Items and Amounts

Description	Amount
Qualifies for exception to filing Schedule K-2	$
Medical Insurance paid by partnership for partners	4,800
HSA contributions paid by partnership for partners	8,000

Practitioner pointer: In most software, the preparer will need to break the amount of health insurance premiums the employer paid by type (premiums, HSA contributions) and attach a statement to the partnership return. A similar statement will need to be provided to each partner, attached to their Schedule K-1 (Form 1065) so they will have the necessary information to complete their individual return.

Partner treatment

Partners may claim a SEHI deduction for premiums paid on a medical insurance policy in either the partner's name or the name of the partnership. The partnership must either establish the medical plan that covers the partner or be deemed to have established the plan under one of the following situations:

- The partnership directly pays the premiums and the partnership paid premiums are reported on the partner's Schedule K-1 (Form 1065) as guaranteed payments includable in the partner's income [Rev. Rul. 91-26].
- The partner pays the premiums, furnishes proof of the premium payments to the partnership, and then the partnership reimburses the partner and reports the premium amounts on the partner's Schedule K-1 (Form 1065) as guaranteed payments includable in the partner's income [Form 1040 (and 1040-SR) instructions].

Note: For a partner's medical premiums to be deductible, the policy must be considered as established under the partner's business [§162(l)]. There is currently no authoritative guidance, other than the instructions to Form 1040, for a situation when a partner pays the premiums personally. In this situation, the second bullet above is the only way to have the policy considered as established under the partner's business.

Medicare

All Medicare parts are considered premiums paid on a medical insurance policy. A partner may pay the premiums directly and be reimbursed by the partnership, or the premiums may be paid by the partnership. In either scenario, the premiums must be reported to the partner as guaranteed payments, and the partner must report the guaranteed payments as gross income on their Form 1040 [CCA 201228037]. If the requirements of §162(l) are met, Medicare premiums may be deducted for coverage of the partner's spouse, dependent, or child who is under age 27 as of the end of the tax year.

Earned income

A partner's health insurance premiums are only eligible for the above-the-line deduction to the extent they are less than the partner's earned income from the business that established the health insurance plan. When a partner has more than one source of income subject to SE tax, only use the earned income from the business that established the plan for the earned income limitation.

Earned income equals net SE earnings less two deductions to the extent they relate to the business that established the health insurance plan on Schedule 1 (Form 1040):

- The deduction for the employer equivalent portion of the SE tax, and
- The deduction for a qualified retirement plan, SEP, or SIMPLE IRA

Reporting the deduction

A partner's SEHI deduction is calculated on Form 7206. A self-employed taxpayer is allowed a deduction for all, or a portion of, health insurance premiums paid during the year for the taxpayer, the taxpayer's spouse, dependents and children under age 27.

Note: If there is a situation where a plan is established under more than one trade or business, a separate Form 7206 should be completed for each plan. There is no clear guidance in situations where a taxpayer is operating more than one trade or business and each business establishes a health plan. A simple option would be to make the designation on the policy or pay the health insurance premiums out of the checking account of the business establishing the plan.

Return presentation

Case study

Amy receives a Schedule K-1 (Form 1065) from Night Gates Cleaning. This is a Schedule K-1 reporting the health insurance and HSA contributions only. The guaranteed payments from the prior discussion are not included. The example at the end will be all encompassing.

The relevant parts of Amy's Form 1040 would look as follows:

Schedule K-1

Partner# 1

651123

Final K-1 | Amended K-1

OMB No. 1545-0123

Schedule K-1 (Form 1065) **2023**

Department of the Treasury
Internal Revenue Service

For calendar year 2023, or tax year

beginning ______ ending ______

Partner's Share of Income, Deductions, Credits, etc. See separate instructions.

Part I Information About the Partnership

A Partnership's employer identification number
-*5565

B Partnership's name, address, city, state, and ZIP code
Night Gates Cleaning

789 Main Street
Any Town WI 54315

C IRS Center where partnership filed return:
Kansas City, MO 64999-0011

D ☐ Check if this is a publicly traded partnership (PTP)

Part II Information About the Partner

E Partner's SSN or TIN (Do not use TIN of a disregarded entity. See instructions.)
***-**-1111

F Name, address, city, state, and ZIP code for partner entered in E. See instructions.
Amy Watts

54 Rolling Place
Any City WI 54315

G ☒ General partner or LLC member-manager ☐ Limited partner or other LLC member

H1 ☒ Domestic partner ☐ Foreign partner

H2 ☐ If the partner is a disregarded entity (DE), enter the partner's:
TIN ______
Name ______

I1 What type of entity is this partner? Individual

I2 If this partner is a retirement plan (IRA/SEP/Keogh/etc.), check here ☐

J Partner's share of profit, loss, and capital (see instructions):

	Beginning	Ending
Profit	50.000000%	50.000000%
Loss	50.000000%	50.000000%
Capital	50.000000%	50.000000%

Check if decrease is due to:
☐ Sale or ☐ Exchange of partnership interest. See instructions.

K1 Partner's share of liabilities:

	Beginning	Ending
Nonrecourse	$	$
Qualified nonrecourse financing	$	$
Recourse	$	$

K2 Check this box if item K1 includes liability amounts from lower-tier partnerships ☐

K3 Check if any of the above liability is subject to guarantees or other payment obligations by the partner. See instructions ☐

L **Partner's Capital Account Analysis**

Beginning capital account	$
Capital contributed during the year	$
Current year net income (loss)	$ -14,400
Other increase (decrease) (attach explanation)	$
Withdrawals and distributions	$ ( )
Ending capital account	$ -14,400

M Did the partner contribute property with a built-in gain (loss)?
☐ Yes ☒ No If "Yes," attach statement. See instructions.

N **Partner's Share of Net Unrecognized Section 704(c) Gain or (Loss)**
Beginning $
Ending $

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

1	Ordinary business income (loss)		-14,400
2	Net rental real estate income (loss)		
3	Other net rental income (loss)		
4a	Guaranteed payments for services		6,400
4b	Guaranteed payments for capital		
4c	Total guaranteed payments		6,400
5	Interest income		
6a	Ordinary dividends		
6b	Qualified dividends		
6c	Dividend equivalents		
7	Royalties		
8	Net short-term capital gain (loss)		
9a	Net long-term capital gain (loss)		
9b	Collectibles (28%) gain (loss)		
9c	Unrecaptured section 1250 gain		
10	Net section 1231 gain (loss)		
11	Other income (loss)		
12	Section 179 deduction		
13	Other deductions	M	6,400
14	Self-employment earnings (loss)	A	-8,000
15	Credits		
16	Schedule K-3 is attached if checked ☐		
17	Alternative minimum tax (AMT) items		
18	Tax-exempt income and nondeductible expenses		
19	Distributions		
20	Other information	ZZ*	STMT
21	Foreign taxes paid or accrued		

22 ☐ More than one activity for at-risk purposes*
23 ☐ More than one activity for passive activity purposes*

*See attached statement for additional information.

For IRS Use Only

For Paperwork Reduction Act Notice, see the Instructions for Form 1065. www.irs.gov/Form1065 **Schedule K-1 (Form 1065) 2023**
DAA

Schedule K-1, Line 20ZZ - Additional Other Information

Description	
Schedule K-3 will not be distributed to you unless requested	
Medical Insurance paid by partnership for partners	2,400
HSA contributions paid by partnership for partners	4,000

The partnership reports the amount of the health insurance premiums on the recipient partner's Schedule K-1, Box 13, Code M, under other deductions. A statement should be attached to provide the details necessary for the partner to determine the amount eligible for the SEHI deduction.

Schedule E

Her $6,400 in guaranteed payments for medical premiums and HSA contributions are reported on Line 28, Column (k). Assuming she has enough basis, she reports the $14,400 ordinary loss on Line 28, Column (i). The form calculates her Night Gates Cleaning loss of $8,000 ($6,400 - $14,400) and this will flow to Schedule 1 (Form 1040), Line 5.

Schedule E (Form 1040) 2023 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**

Amy Watts ***-**-1111

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

Part II Income or Loss From Partnerships and S Corporations

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

27 Are you reporting any loss not allowed in a prior year due to the at-risk 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 basis computation is required	(f) Check if any amount is not at risk
A	Night Gates Cleaning	P	☐	**-***5565	☐	☐
B	Guaranteed payments - services	P	☐	**-***5565	☐	☐
C			☐		☐	☐
D			☐		☐	☐

	Passive Income and Loss		Nonpassive Income and Loss		
	(g) Passive loss allowed (attach Form 8582 if required)	(h) Passive income from Schedule K-1	(i) Nonpassive loss allowed (see Schedule K-1)	(j) Section 179 expense deduction from Form 4562	(k) Nonpassive income from Schedule K-1
A			14,400		
B			0		6,400
C					
D					
29a Totals					6,400
b Totals			14,400		

30	Add columns (h) and (k) of line 29a	30	6,400
31	Add columns (g), (i), and (j) of line 29b	31	(14,400)
32	**Total partnership and S corporation income or (loss).** Combine lines 30 and 31	32	-8,000

Part III Income or Loss From Estates and Trusts

33	(a) Name	(b) Employer identification number
A		
B		

	Passive Income and Loss		Nonpassive Income and Loss	
	(c) Passive deduction or loss allowed (attach Form 8582 if required)	(d) Passive income from Schedule K-1	(e) Deduction or loss from Schedule K-1	(f) Other income from Schedule K-1
A				
B				
34a Totals				
b Totals				

35	Add columns (d) and (f) of line 34a	35	
36	Add columns (c) and (e) of line 34b	36	( )
37	**Total estate and trust income or (loss).** Combine lines 35 and 36	37	

Part IV Income or Loss From Real Estate Mortgage Investment Conduits (REMICs)—Residual Holder

38	(a) Name	(b) Employer identification number	(c) Excess inclusion from Schedules Q, line 2c (see instructions)	(d) Taxable income (net loss) from Schedules Q, line 1b	(e) Income from Schedules Q, line 3b

39	Combine columns (d) and (e) only. Enter the result here and include in the total on line 41 below	39	

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 Schedule 1 (Form 1040), line 5	41	-8,000
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 1120-S), box 17, code AN; and Schedule K-1 (Form 1041), box 14, code F. See instructions	42	
43	**Reconciliation for real estate professionals.** If you were a real estate professional (see instructions), enter the net income or (loss) you reported anywhere on Form 1040, Form 1040-SR, or Form 1040-NR from all rental real estate activities in which you materially participated under the passive activity loss rules	43	

DAA **Schedule E (Form 1040) 2023**

Form 7206

Because Amy does not have any net profit from Night Gates Cleaning, the business under which the insurance plan is established, she is unable to take the SEHI deduction. The case study forms at the end will show how the SE tax is computed if she had net profit from the business.

The Form 7206 reflects the fact she is unable to take the SEHI deduction. If she itemizes, the medical premiums would be included as medical and dental expenses.

Form **7206**
Department of the Treasury
Internal Revenue Service

Self-Employed Health Insurance Deduction

Attach to Form 1040, 1040-SR, or 1040-NR.
Go to *www.irs.gov/Form7206* for instructions and the latest information.

OMB No. 1545-0074
2023
Attachment Sequence No. **206**

Name(s) shown on return: Amy Watts
Your taxpayer identification number: 512-36-1111

Note: Use a separate Form 7206 for each trade or business under which an insurance plan is established.

1	Enter the total amount paid in 2023 for health insurance coverage established under your business (or the S corporation in which you were a more-than-2% shareholder) for 2023 for you, your spouse, and your dependents. But **don't** include the following. See instructions • Amounts for any month you were eligible to participate in a health plan subsidized by your employer or your spouse's employer or the employer of either your dependent or your child who was under the age of 27 at the end of 2023. • Any amounts paid, not to exceed $3,000, from retirement plan distributions that were **nontaxable** because you are a retired public safety officer. See instructions. • Any payments for qualified long-term care insurance (see line 2).	1	2,400
2	For coverage under a qualified long-term care insurance contract, enter for each person covered the **smaller** of (a) or (b). **(a)** Total payments made for that person during the year. **(b)** The amount shown below. Use the person's age at the end of the tax year. $480 ----if that person is age 40 or younger $890 ----if age 41 to 50 $1790 ----if age 51 to 60 $4770 ----if age 61 to 70 $5960 ----if age 71 or older **Note:** The amount of long-term care premiums that can be included as a medical expense is limited by the person's age. **Don't** include payments for any month you were eligible to participate in a long-term care insurance plan subsidized by your employer or your spouse's employer, or the employer of either your dependent or your child who was under the age of 27 at the end of 2023. If more than one person is covered, figure separately the amount to enter for each person. Then enter the total of those amounts	2	
3	Add lines 1 and 2	3	2,400
4	Enter your net profit* and any other earned income** from the trade or business under which the insurance plan is established. Don't include Conservation Reserve Program payments exempt from self-employment tax. If the business is an S corporation, skip to line 11	4	0
5	Enter the total of all net profits* from Schedule C (Form 1040), line 31; Schedule F (Form 1040), line 34; or Schedule K-1 (Form 1065), box 14, code A, plus any other income allocable to the profitable businesses. Don't include Conservation Reserve Program payments exempt from self-employment tax. See the Instructions for Schedule SE (Form 1040). **Don't** include any net losses shown on these schedules	5	
6	Divide line 4 by line 5	6	
7	Multiply Schedule 1 (Form 1040), line 15, deductible part of self-employment tax, by the percentage on line 6	7	
8	Subtract line 7 from line 4	8	
9	Enter the amount, if any, from Schedule 1 (Form 1040), line 16, self-employed SEP, SIMPLE, and qualified plans, attributable to the same trade or business in which the insurance plan is established	9	
10	Subtract line 9 from line 8	10	
11	Enter your Medicare wages (box 5 of Form W-2) from an S corporation in which you are a more-than-2% shareholder and in which the insurance plan is established	11	
12	Enter any amount from Form 2555, line 45, attributable to the amount entered on line 4 or 11 above	12	
13	Subtract line 12 from line 10 or 11, whichever applies	13	
14	**Self-employed health insurance deduction.** Enter the **smaller** of line 3 or line 13 here and on Schedule 1 (Form 1040), line 17. **Don't** include this amount when figuring any medical expense deduction on Schedule A (Form 1040)	14	

* If you used either optional method to figure your net earnings from self-employment from any business, don't enter your net profit from the business Instead, enter the amount attributable to that business from Schedule SE (Form 1040), Part I, line 4b.

****Earned income** includes net earnings and gains from the sale, transfer, or licensing of property you created. However, it doesn't include capital gain income.

For Privacy Act and Paperwork Reduction Act Notice, see separate instructions. Form **7206** (2023)

Form 8889

The $4,000 the business paid HSA contributions are reported on Form 8889, *Health Savings Accounts (HSAs)*, and Schedule 1 (Form 1040). Form 8889 would also report any contributions Amy made or payments made on her behalf (family member) up to the limit.

Form **8889**

Department of the Treasury
Internal Revenue Service

Health Savings Accounts (HSAs)

Attach to Form 1040, 1040-SR, or 1040-NR.

Go to *www.irs.gov/Form8889* for instructions and the latest information.

OMB No. 1545-0074

2023

Attachment Sequence No. **52**

Name(s) shown on Form 1040, 1040-SR, or 1040-NR: Amy Watts

Social security number of HSA beneficiary. If both spouses have HSAs, see instructions.: ***-**-1111

Before you begin: Complete Form 8853, Archer MSAs and Long-Term Care Insurance Contracts, if required.

Part I **HSA Contributions and Deduction.** See the instructions before completing this part. If you are filing jointly and both you and your spouse each have separate HSAs, complete a separate Part I for each spouse.

Line	Description		
1	Check the box to indicate your coverage under a high-deductible health plan (HDHP) during 2023. See instructions		X Self-only ☐ Family
2	HSA contributions you made for 2023 (or those made on your behalf), including those made by the unextended due date of your tax return that were for 2023. **Do not** include employer contributions, contributions through a cafeteria plan, or rollovers. See instructions	2	4,000
3	If you were under age 55 at the end of 2023 and, on the first day of **every** month during 2023, you were, or were considered, an eligible individual with the **same** coverage, enter $3,850 ($7,750 for family coverage). **All others,** see the instructions for the amount to enter	3	4,850
4	Enter the amount you and your employer contributed to your Archer MSAs for 2023 from Form 8853, lines 1 and 2. If you or your spouse had family coverage under an HDHP at any time during 2023, also include any amount contributed to your spouse's Archer MSAs	4	
5	Subtract line 4 from line 3. If zero or less, enter -0-	5	4,850
6	Enter the amount from line 5. But if you and your spouse each have separate HSAs and had family coverage under an HDHP at any time during 2023, see the instructions for the amount to enter	6	4,850
7	If you were age 55 or older at the end of 2023, married, and you or your spouse had family coverage under an HDHP at any time during 2023, enter your additional contribution amount. See instructions	7	
8	Add lines 6 and 7	8	4,850
9	Employer contributions made to your HSAs for 2023 — 9		
10	Qualified HSA funding distributions — 10		
11	Add lines 9 and 10	11	
12	Subtract line 11 from line 8. If zero or less, enter -0-	12	4,850
13	**HSA deduction.** Enter the **smaller** of line 2 or line 12 here and on Schedule 1 (Form 1040), Part II, line 13	13	4,000
	Caution: If line 2 is more than line 13, you may have to pay an additional tax. See instructions.		

Part II **HSA Distributions.** If you are filing jointly and both you and your spouse each have separate HSAs, complete a separate Part II for each spouse.

Line	Description		
14a	Total distributions you received in 2023 from all HSAs (see instructions)	14a	
b	Distributions included on line 14a that you rolled over to another HSA. Also include any excess contributions (and the earnings on those excess contributions) included on line 14a that were withdrawn by the due date of your return. See instructions	14b	
c	Subtract line 14b from line 14a	14c	
15	Qualified medical expenses paid using HSA distributions (see instructions)	15	
16	**Taxable HSA distributions.** Subtract line 15 from line 14c. If zero or less, enter -0-. Also, include this amount in the total on Schedule 1 (Form 1040), Part I, line 8f	16	
17a	If any of the distributions included on line 16 meet any of the **Exceptions to the Additional 20% Tax** (see instructions), check here ☐		
b	**Additional 20% tax** (see instructions). Enter 20% (0.20) of the distributions included on line 16 that are subject to the additional 20% tax. Also, include this amount in the total on Schedule 2 (Form 1040), Part II, line 17c	17b	

Part III **Income and Additional Tax for Failure To Maintain HDHP Coverage.** See the instructions before completing this part. If you are filing jointly and both you and your spouse each have separate HSAs, complete a separate Part III for each spouse.

Line	Description		
18	Last-month rule	18	
19	Qualified HSA funding distribution	19	
20	**Total income.** Add lines 18 and 19. Include this amount on Schedule 1 (Form 1040), Part I, line 8f	20	
21	**Additional tax.** Multiply line 20 by 10% (0.10). Include this amount in the total on Schedule 2 (Form 1040), Part II, line 17d	21	

For Paperwork Reduction Act Notice, see your tax return instructions. Form **8889** (2023)

Form 1040

The $8,000 loss is reported on Form 1040, Line 8 and her HSA deduction is reported on Line 10.

Form **1040** Department of the Treasury—Internal Revenue Service
U.S. Individual Income Tax Return **2023** OMB No. 1545-0074 IRS Use Only–Do not write or staple in this space.

For the year Jan. 1–Dec. 31, 2023, or other tax year beginning ...., 2023, ending ...., 20 .... See separate instructions.

Your first name and middle initial	Last name	Your social security number
Amy	Watts	***-**-1111
If joint return, spouse's first name and middle initial	Last name	Spouse's social security number

Home address (number and street). If you have a P.O box, see instructions.		Apt. no.	Presidential Election Campaign
54 Rolling Place			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.
City, town or post office. If you have a foreign address, also complete spaces below.	State	ZIP code	
Any City	WI	54315	
Foreign country name	Foreign province/state/county	Foreign postal code	☐ You ☐ Spouse

Filing Status Check only one box.
☒ Single
☐ Married filing jointly (even if only one had income)
☐ Married filing separately (MFS)
☐ Head of household (HOH)
☐ Qualifying surviving spouse (QSS)
If you checked the MFS box, enter the name of your spouse. If you checked the HOH or QSS box, enter the child's name if the qualifying person is a child but not your dependent: ....

Digital Assets At any time during 2023, did you: (a) receive (as a reward, award, or payment for property or services); or (b) sell, exchange, or otherwise dispose of a digital asset (or a financial interest in a digital asset)? (See instructions.) ... ☐ Yes ☒ No

Standard Deduction **Someone can claim:** ☐ You as a dependent ☐ Your spouse as a dependent
☐ Spouse itemizes on a separate return or you were a dual-status alien

Age/Blindness **You:** ☐ Were born before January 2, 1959 ☐ Are blind **Spouse:** ☐ Was born before January 2, 1959 ☐ Is blind

Dependents (see instructions):
If more than four dependents, see instr. and check here ☐

(1) First name Last name	(2) Social security number	(3) Relationship to you	(4) Check the box if qualifies for (see instructions): Child tax credit	Credit for other dependents
			☐	☐
			☐	☐
			☐	☐
			☐	☐

Income
Attach Form(s) W-2 here. Also attach Forms W-2G and 1099-R if tax was withheld.
If you did not get a Form W-2, see instructions.
Attach Sch. B if required.
Standard Deduction for –
• Single or Married filing separately, $13,850
• Married filing jointly or Qualifying surviving spouse, $27,700
• Head of household, $20,800
• If you checked any box under Standard Deduction, see instructions.

Line	Description		Line	Amount
1a	Total amount from Form(s) W-2, box 1 (see instructions)		1a	
b	Household employee wages not reported on Form(s) W-2		1b	
c	Tip income not reported on line 1a (see instructions)		1c	
d	Medicaid waiver payments not reported on Form(s) W-2 (see instructions)		1d	
e	Taxable dependent care benefits from Form 2441, line 26		1e	
f	Employer-provided adoption benefits from Form 8839, line 29		1f	
g	Wages from Form 8919, line 6		1g	
h	Other earned income (see instructions)		1h	
i	Nontaxable combat pay election (see instructions)	1i		
z	Add lines 1a through 1h		1z	
2a	Tax-exempt interest	2a	b Taxable interest 2b	
3a	Qualified dividends	3a	b Ordinary dividends 3b	
4a	IRA distributions	4a	b Taxable amount 4b	
5a	Pensions and annuities	5a	b Taxable amount 5b	
6a	Soc. sec. ben.	6a	b Taxable amount 6b	
c	If you elect to use the lump-sum election method, check here (see instructions) ☐			
7	Capital gain or (loss). Attach Schedule D if required. If not required, check here ☐		7	
8	Other income from Schedule 1, line 10		8	-8,000
9	Add lines 1z, 2b, 3b, 4b, 5b, 6b, 7, and 8. This is your **total income**		9	-8,000
10	Adjustments to income from Schedule 1, line 26		10	4,000
11	Subtract line 10 from line 9. This is your **adjusted gross income**		11	-12,000
12	**Standard deduction or itemized deductions** (from Schedule A)		12	13,850
13	Qualified business income deduction from Form 8995 or Form 8995-A		13	
14	Add lines 12 and 13		14	13,850
15	Subtract line 14 from line 11. If zero or less, enter -0-. This is your **taxable income**		15	0

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see separate instructions. Form **1040** (2023)

Unreimbursed partnership expenses (UPE)

A partner may deduct expenses paid out of their own funds on behalf of the partnership's business that they are required to pay by the partnership agreement.

Partnership treatment

The partnership agreement needs to have the appropriate language requiring the partner to pay partnership expenses under certain circumstances.

If the partnership agreement states that the partnership has a reimbursement policy when expenses are incurred outside of the partnership or that it does not specifically require partners to pay for certain expenses, the deduction may be disallowed at the partner level.

If the partnership agreement provides no direction, the IRS will also consider the routine of the partnership. There is no deduction for these expenses at the partner level if the partnership would have honored the partner's request for reimbursement.

Other than having the appropriate wording in the partnership agreement, the partnership is not otherwise involved in the transaction.

Partner treatment

A partner may deduct UPE if the following requirements are met:

- The operating agreement requires the partner to pay certain expenses on behalf of the partnership without a right of reimbursement or by established partnership practice
- The expenses are ordinary and necessary business expenses
    - The partner should keep records that substantiate the expense, including time, place, business purpose, etc.

The partner takes the deduction on Form 1040, Schedule E, Line 28, as an unreimbursed partnership expense (UPE). The expense is then carried over to Schedule 1 (Form 1040), Line 5.

When the unreimbursed expenses are deductible by the partner, they generally reduce a partner's net earnings from self-employment. This will not only reduce the amount of SE tax a partner may be liable for, but it may also affect the amount of pension contributions a partner may be able to make.

> **Note:** Partners deduct their UPE on Schedule E, Line 28, Column (g) or (i), depending on if the activity is a passive activity (with allowed losses) or nonpassive activity. In Column (a), label the expense "UPE." Do not combine these expenses with, or net them against, any other amounts from the partnership.

Return presentation

Case study

Amy had unreimbursed business miles related to Night Gates Cleaning. She drove 20,000 miles during the year and her business miles were 5,000, which she can support via her mileage log. She can claim a UPE of $3,275 (5,000 miles x .655). The partnership agreement allows the partners to incur unreimbursed expenses for unreimbursed business miles. For this piece of the example, ignore the previous discussion on guaranteed payments. A complete partnership and individual return are presented at the end based on the case study.

> **Note:** The standard mileage rate for 2023 is 65.5 cents-per-mile and for 2024 it is 67 cents-per-mile.

Schedule E for the UPE would look as follows:

Schedule E

Amy takes the deduction on Form 1040, Schedule E, Line 28, as an unreimbursed partnership expense (UPE). The expense is then carried over to Schedule 1 (Form 1040), Line 5.

Schedule E (Form 1040) 2023 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
Amy Watts	***-**-1111

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

Part II Income or Loss From Partnerships and S Corporations

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

27 Are you reporting any loss not allowed in a prior year due to the at-risk 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 basis computation is required	(f) Check if any amount is not at risk
A	Night Gates Cleaning	P	☐	**-***5565	☐	☐
B	UPE	P	☐	**-***5565	☐	☐
C			☐		☐	☐
D			☐		☐	☐

	Passive Income and Loss		Nonpassive Income and Loss		
	(g) Passive loss allowed (attach Form 8582 if required)	(h) Passive income from Schedule K-1	(i) Nonpassive loss allowed (see Schedule K-1)	(j) Section 179 expense deduction from Form 4562	(k) Nonpassive income from Schedule K-1
A			0		
B			3,275		
C					
D					
29a Totals					
b Totals			3,275		

30	Add columns (h) and (k) of line 29a	30	0
31	Add columns (g), (i), and (j) of line 29b	31	(3,275)
32	**Total partnership and S corporation income or (loss).** Combine lines 30 and 31	32	-3,275

Part III Income or Loss From Estates and Trusts

33	(a) Name	(b) Employer identification number
A		
B		

	Passive Income and Loss		Nonpassive Income and Loss	
	(c) Passive deduction or loss allowed (attach Form 8582 if required)	(d) Passive income from Schedule K-1	(e) Deduction or loss from Schedule K-1	(f) Other income from Schedule K-1
A				
B				
34a Totals				
b Totals				

35	Add columns (d) and (f) of line 34a	35	
36	Add columns (c) and (e) of line 34b	36	( )
37	**Total estate and trust income or (loss).** Combine lines 35 and 36	37	

Part IV Income or Loss From Real Estate Mortgage Investment Conduits (REMICs)—Residual Holder

38 (a) Name	(b) Employer identification number	(c) Excess inclusion from Schedules Q, line 2c (see instructions)	(d) Taxable income (net loss) from Schedules Q, line 1b	(e) Income from Schedules Q, line 3b

39	Combine columns (d) and (e) only. Enter the result here and include in the total on line 41 below	39	

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 Schedule 1 (Form 1040), line 5	41	-3,275
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 1120-S), box 17, code AN; and Schedule K-1 (Form 1041), box 14, code F. See instructions	42	
43	**Reconciliation for real estate professionals.** If you were a real estate professional (see instructions), enter the net income or (loss) you reported anywhere on Form 1040, Form 1040-SR, or Form 1040-NR from all rental real estate activities in which you materially participated under the passive activity loss rules	43	

DAA Schedule E (Form 1040) 2023

Office in home

See the 'Business Use of Home' section of the text for more information.

Retirement

Partnerships can establish retirement plans for partners and employees. The partnership itself must establish the retirement plan and make contributions to the plan. Partners cannot set up a qualified plan personally, such as a §401(k), SEP or SIMPLE, and make contributions on their own.

The *Secure 2.0 Act of 2022* (SECURE 2.0) enacted as part of the *Consolidated Appropriations Act, 2023* (CAA) on Dec. 29, 2022, contains provisions that focus on expanding coverage and increasing retirement savings for Americans. New provisions of SECURE 2.0 include the increased small employer pension plan startup costs credit and the employer contribution credit, which are both effective for taxable years beginning after Dec. 31, 2022.

Form 8881, *Credit for Small Employer Pension Plan Startup Costs, Auto-Enrollment, and Military Spouse Participation*, is used to claim these credits. A discussion of these credits is beyond the scope of the material. The comprehensive example at the end of the material has a completed Form 8881 and illustrates the impact of the credit on the deductions.

Partnership treatment

Retirement plan contributions for employees are entered on Line 18 of Form 1065. Do not deduct contributions made for partners on this line.

All of each partner's contributions (employee contribution and partnership match) are considered to be guaranteed payments. These retirement plan contributions are treated as made by the partnership for tax reporting purposes. They are reported on:

- Form 1065, Schedule K, Line 4a
  - Each partner's portion is reported on their Schedule K-1 (Form 1065), Part III, Box 4a
- Form 1065, Schedule K, Line 13e, Code R
  - Each partner's portion is reported on their Schedule K-1 (Form 1065), Part III, Box 13, Code R.

Note: Contributions to a qualified plan for partners are limited to their SE income from the trade or business conducted by the partnership [§404(a)(8)].

Partner treatment

The partner enters the deductible contribution on Schedule 1 (Form 1040), Line 16.

Compensation

For general partners, compensation is defined as the partner's distributive share of income (loss) on Schedule K-1, Box 1, and guaranteed payments paid for services on Schedule K-1, Box 4a, reduced by any allowable business deductions taken on Schedule E, Page 2, and the deduction for one-half the SE tax reported on Schedule 1 (Form 1040), Line 15.

The limit on compensation for any one employee or partner that can be considered for retirement plan purposes is $345,000 (2024) [IRS Notice 2023-75].

Note: Contributions for partners can be made only if the partners provide services to the partnership and have SE income from guaranteed payments for those services. Generally, the partnership cannot contribute to a retirement plan on behalf of a limited partner because a limited partner does not have SE income from the partnership.

Return presentation

Case study

Night Gates Cleaning has a retirement plan. All five employees participated in the retirement plan and Night Gates Cleaning made $7,200 in employer contributions on their behalf. The total contributions (partner and partnership match) for the partners equaled $29,122.

Form 1065

Form **1065** Department of the Treasury Internal Revenue Service

U.S. Return of Partnership Income

For calendar year 2023, or tax year beginning ...., ending ....

Go to *www.irs.gov/Form1065* for instructions and the latest information.

OMB No. 1545-0123 **2023**

A Principal business activity: Cleaning	Name of partnership: Night Gates Cleaning	D Employer identification number: **-***5565
B Principal product or service: Service	Number, street, and room or suite no. If a P.O. box, see instructions.: 789 Main Street	E Date business started: 01/01/2021
C Business code number: 561720	City or town, state or province, country, and ZIP or foreign postal code: Any Town WI 54315	F Total assets (see instructions): $ 89,878

Type or Print

G Check applicable boxes: (1) ☐ Initial return (2) ☐ Final return (3) ☐ Name change (4) ☐ Address change (5) ☐ Amended return

H Check accounting method: (1) ☒ Cash (2) ☐ Accrual (3) ☐ Other (specify):

I Number of Schedules K-1. Attach one for each person who was a partner at any time during the tax year: 2

J Check if Schedules C and M-3 are attached ☐

K Check if partnership: (1) ☐ Aggregated activities for section 465 at-risk purposes (2) ☐ Grouped activities for section 469 passive activity purposes

Caution: Include **only** trade or business income and expenses on lines 1a through 23 below. See instructions for more information.

Income	1a	Gross receipts or sales ____ b Less returns and allowances ____ c Balance	1c	
	2	Cost of goods sold (attach Form 1125-A)	2	
	3	Gross profit. Subtract line 2 from line 1c	3	
	4	Ordinary income (loss) from other partnerships, estates, and trusts (attach statement)	4	
	5	Net farm profit (loss) (attach Schedule F (Form 1040))	5	
	6	Net gain (loss) from Form 4797, Part II, line 17 (attach Form 4797)	6	
	7	Other income (loss) (attach statement)	7	
	8	**Total income (loss).** Combine lines 3 through 7	8	
Deductions (see instructions for limitations)	9	Salaries and wages (other than to partners) (less employment credits)	9	
	10	Guaranteed payments to partners	10	29,122
	11	Repairs and maintenance	11	
	12	Bad debts	12	
	13	Rent	13	
	14	Taxes and licenses	14	
	15	Interest (see instructions)	15	
	16a	Depreciation (if required, attach Form 4562)	16a	
	b	Less depreciation reported on Form 1125-A and elsewhere on return	16b	
			16c	
	17	Depletion **(Do not deduct oil and gas depletion.)**	17	
	18	Retirement plans, etc.	18	7,200
	19	Employee benefit programs	19	
	20	Energy efficient commercial buildings deduction (attach Form 7205)	20	
	21	Other deductions (attach statement)	21	
	22	**Total deductions.** Add the amounts shown in the far right column for lines 9 through 21	22	36,322
	23	**Ordinary business income (loss).** Subtract line 22 from line 8	23	-36,322
Tax and Payment	24	Interest due under the look-back method—completed long-term contracts (attach Form 8697)	24	
	25	Interest due under the look-back method—income forecast method (attach Form 8866)	25	
	26	BBA AAR imputed underpayment (see instructions)	26	
	27	Other taxes (see instructions)	27	
	28	**Total balance due.** Add lines 24 through 27	28	
	29	Elective payment election amount from Form 3800	29	
	30	Payment (see instructions)	30	
	31	**Amount owed.** If the sum of line 29 and line 30 is smaller than line 28, enter amount owed	31	
	32	**Overpayment.** If the sum of line 29 and line 30 is larger than line 28, enter overpayment	32	

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 partner or limited liability company member) is based on all information of which preparer has any knowledge.

Signature of partner or limited liability company member | Date

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 ☐ if self-employed	PTIN
		04/03/24		

Firm's name: Natl Assn Of Tax Prof | Firm's EIN

Firm's address: PO Box 8002, Appleton, WI 54912 | Phone no. 920-749-1040

For Paperwork Reduction Act Notice, see separate instructions. Form **1065** (2023)

DAA

Schedule K

Form 1065 (2023) Night Gates Cleaning **-***5565 Page 5

Schedule K Partners' Distributive Share Items

			Total amount
Income (Loss)	1 Ordinary business income (loss) (page 1, line 23)	1	-36,322
	2 Net rental real estate income (loss) (attach Form 8825)	2	
	3a Other gross rental income (loss) — 3a		
	b Expenses from other rental activities (attach statement) — 3b		
	c Other net rental income (loss). Subtract line 3b from line 3a	3c	
	4 Guaranteed payments: a Services 4a 29,122 b Capital 4b		
	c Total. Add lines 4a and 4b	4c	29,122
	5 Interest income	5	
	6 Dividends and dividend equivalents: a Ordinary dividends	6a	
	b Qualified dividends 6b c Dividend equivalents 6c		
	7 Royalties	7	
	8 Net short-term capital gain (loss) (attach Schedule D (Form 1065))	8	
	9a Net long-term capital gain (loss) (attach Schedule D (Form 1065))	9a	
	b Collectibles (28%) gain (loss) — 9b		
	c Unrecaptured section 1250 gain (attach statement) — 9c		
	10 Net section 1231 gain (loss) (attach Form 4797)	10	
	11 Other income (loss) (see instructions) Type:	11	
Deductions	12 Section 179 deduction (attach Form 4562)	12	
	13a Cash contributions	13a	
	b Noncash contributions	13b	
	c Investment interest expense	13c	
	d Section 59(e)(2) expenditures: (1) Type: (2) Amount:	13d(2)	
	e Other deductions (see instructions) Type: See Statement 1	13e	29,122
Self-Employment	14a Net earnings (loss) from self-employment	14a	-7,200
	b Gross farming or fishing income	14b	
	c Gross nonfarm income	14c	
Credits	15a Low-income housing credit (section 42(j)(5))	15a	
	b Low-income housing credit (other)	15b	
	c Qualified rehabilitation expenditures (rental real estate) (attach Form 3468, if applicable)	15c	
	d Other rental real estate credits (see instructions) Type:	15d	
	e Other rental credits (see instructions) Type:	15e	
	f Other credits (see instructions) Type:	15f	
International	16 Attach Schedule K-2 (Form 1065), Partners' Distributive Share Items—International, and check this box to indicate that you are reporting items of international tax relevance ☐		
Alternative Minimum Tax (AMT) Items	17a Post-1986 depreciation adjustment	17a	
	b Adjusted gain or loss	17b	
	c Depletion (other than oil and gas)	17c	
	d Oil, gas, and geothermal properties–gross income	17d	
	e Oil, gas, and geothermal properties–deductions	17e	
	f Other AMT items (attach statement)	17f	
Other Information	18a Tax-exempt interest income	18a	
	b Other tax-exempt income	18b	
	c Nondeductible expenses	18c	
	19a Distributions of cash and marketable securities	19a	
	b Distributions of other property	19b	
	20a Investment income	20a	
	b Investment expenses	20b	
	c Other items and amounts (attach statement) See Statement 2		
	21 Total foreign taxes paid or accrued	21	

Form **1065** (2023)

Statement 1 - Form 1065, Schedule K, Line 13e - Other Deductions

Description	Amount
Pensions and IRA's	$ 29,122
Total	$ 29,122

Statement 2 - Form 1065, Schedule K, Line 20c - Other Items and Amounts

Description	Amount
Qualifies for exception to filing Schedule K-2	$

Schedule K-1

Partner# 1

651123

Final K-1 | Amended K-1 | OMB No. 1545-0123

Schedule K-1 (Form 1065) **2023**

Department of the Treasury
Internal Revenue Service

For calendar year 2023, or tax year

beginning ______ ending ______

Partner's Share of Income, Deductions, Credits, etc. **See separate instructions.**

Part I Information About the Partnership

A Partnership's employer identification number
-*5565

B Partnership's name, address, city, state, and ZIP code
Night Gates Cleaning

789 Main Street
Any Town WI 54315

C IRS Center where partnership filed return:
Kansas City, MO 64999-0011

D ☐ Check if this is a publicly traded partnership (PTP)

Part II Information About the Partner

E Partner's SSN or TIN (Do not use TIN of a disregarded entity. See instructions.)
***-**-1111

F Name, address, city, state, and ZIP code for partner entered in E. See instructions.
Amy Watts

54 Rolling Place
Any City WI 54315

G X General partner or LLC member-manager ☐ Limited partner or other LLC member

H1 X Domestic partner ☐ Foreign partner

H2 ☐ If the partner is a disregarded entity (DE), enter the partner's:
TIN ______
Name ______

I1 What type of entity is this partner? Individual

I2 If this partner is a retirement plan (IRA/SEP/Keogh/etc.), check here ☐

J Partner's share of profit, loss, and capital (see instructions):

	Beginning	Ending
Profit	50.000000%	50.000000%
Loss	50.000000%	50.000000%
Capital	50.000000%	50.000000%

Check if decrease is due to:
☐ Sale or ☐ Exchange of partnership interest. See instructions.

K1 Partner's share of liabilities:

	Beginning	Ending
Nonrecourse	$	$
Qualified nonrecourse financing	$	$
Recourse	$	$

K2 Check this box if item K1 includes liability amounts from lower-tier partnerships ☐

K3 Check if any of the above liability is subject to guarantees or other payment obligations by the partner. See instructions ☐

L **Partner's Capital Account Analysis**

Beginning capital account	$
Capital contributed during the year	$
Current year net income (loss)	$ -18,161
Other increase (decrease) (attach explanation)	$
Withdrawals and distributions	$ ( )
Ending capital account	$ -18,161

M Did the partner contribute property with a built-in gain (loss)?
☐ Yes X No If "Yes," attach statement. See instructions.

N **Partner's Share of Net Unrecognized Section 704(c) Gain or (Loss)**
Beginning $
Ending $

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

Line	Item	Amount
1	Ordinary business income (loss)	-18,161
2	Net rental real estate income (loss)	
3	Other net rental income (loss)	
4a	Guaranteed payments for services	14,561
4b	Guaranteed payments for capital	
4c	Total guaranteed payments	14,561
5	Interest income	
6a	Ordinary dividends	
6b	Qualified dividends	
6c	Dividend equivalents	
7	Royalties	
8	Net short-term capital gain (loss)	
9a	Net long-term capital gain (loss)	
9b	Collectibles (28%) gain (loss)	
9c	Unrecaptured section 1250 gain	
10	Net section 1231 gain (loss)	
11	Other income (loss)	
12	Section 179 deduction	
13	Other deductions	R 14,561
14	Self-employment earnings (loss)	A -3,600
15	Credits	
16	Schedule K-3 is attached if checked ☐	
17	Alternative minimum tax (AMT) items	
18	Tax-exempt income and nondeductible expenses	
19	Distributions	
20	Other information	ZZ* STMT
21	Foreign taxes paid or accrued	
22	☐ More than one activity for at-risk purposes*	
23	☐ More than one activity for passive activity purposes*	

*See attached statement for additional information.

For IRS Use Only

For Paperwork Reduction Act Notice, see the Instructions for Form 1065. www.irs.gov/Form1065 **Schedule K-1 (Form 1065) 2023**
DAA

Schedule K-1, Line 20ZZ - Additional Other Information

Description
Schedule K-3 will not be distributed to you unless requested

Form 1040

In this scenario, there would be no deduction for retirement plan contributions, as there is no income from self-employment. A complete partnership and individual return are presented at the end based on the case study.

Return presentation credits

Case study

Night Gates Cleaning established a retirement plan at the beginning of the year. The requirements for the auto-enrollment credit are met and the business incurred $5,000 in qualified startup costs.

All five employees participated in the retirement plan and Night Gates Cleaning made $7,200 in employer contributions on their behalf. The total contributions (partner and partnership match) for the partners equaled $29,122.

The partners would not be included in the definition of an employee when calculating the qualified start-up costs credit because they are included in the definition of highly compensated employee. The partners would be included in the calculation of the credit for employer contributions.

Form 8881

Form **8881** (Rev. December 2023) Department of the Treasury Internal Revenue Service

Credit for Small Employer Pension Plan Startup Costs, Auto-Enrollment, and Military Spouse Participation

Attach to your tax return.

Go to *www.irs.gov/Form8881* for instructions and the latest information.

OMB No. 1545-1810 Attachment Sequence No. **130**

Name(s) shown on return: Night Gates Cleaning | Identifying number: **-***5565

Part I Credit for Small Employer Pension Plan Startup Costs (Including Employer Contributions)

A	Enter the number of qualifying employees. See instructions 5		
1	Qualified startup costs incurred during the tax year . . . 1 5,000		
2	Employers with 1-50 employees enter the amount from line 1. Employers with 51-100 employees enter 50% (0.50) of line 1	2	5,000
3	Enter the number of employees eligible to participate in the pension plan. See instructions. 5 X $250	3	1,250
4	Enter the greater of $500 or the amount from line 3 (Do not enter more than $5,000)	4	1,250
5	Enter the smaller of line 2 or line 4	5	1,250
6a	Enter the number of employees from the preceding tax year. See instructions	6a	5
b	Enter employer contributions made to the plan, but don't include (i) elective deferrals, (ii) contributions made to employees whose wages paid to the employee were in excess of $100,000 and (iii) any amount of contributions to an employee to whom you made contributions of more than $1,000	6b	
c	For employees for whom you made matching and nonelective contributions of more than $1,000, (and who are not disqualified because they meet 6b(ii) above), see the instructions for information on how to determine the amount to enter on line 6c. If you did not make this type of contributions, enter -0-	6c	7,000
d	Add lines 6b and 6c	6d	7,000
	If the number of employees entered on line 6a is 50 or less, enter the amount from line 6d on line 6f. If the number of employees entered on line 6a is 51-100, continue to line 6e(1).		
e	(1) Subtract 50 (50.0) from the number of employees entered on line 6a	6e(1)	
	(2) Multiply line 6e(1) by 2% (0.02)	6e(2)	
	(3) Multiply line 6e(2) by line 6d	6e(3)	
	(4) Subtract line 6e(3) from line 6d	6e(4)	
f	If you did NOT complete line 6e, enter the amount from line 6d. If you completed line 6e, enter the amount from line 6e(4)	6f	7,000
g	Applicable percentages. See instructions • If this is treated as the first or second year of the plan, enter the amount from line 6f. • If this is treated as the third year of the plan, multiply line 6f by 75% (0.75). • If this is treated as the fourth year of the plan, multiply line 6f by 50% (0.50). • If this is treated as the fifth year of the plan, multiply the amount on line 6f by 25% (0.25).	6g	7,000
7	Credit for small employer pension plan startup costs from partnerships and S corporations	7	
8	Add lines 5, 6g, and 7. Partnerships and S corporations, report this amount on Schedule K. All others, report this amount on Form 3800, Part III, line 1j	8	8,250

Part II Small Employer Auto-Enrollment Credit

9	Enter $500 if an auto-enrollment option is provided for retirement savings	9	500
10	Small employer auto-enrollment credit from partnerships and S corporations	10	
11	Add lines 9 and 10. Partnerships and S corporations, report this amount on Schedule K. All others, report this amount on Form 3800, Part III, line 1dd	11	500

Part III Military Spouse Participation Credit

Caution: You can't claim the credit if you had more than 100 employees in the preceding tax year.

12	Enter the number of military spouse employees participating in an eligible plan. See instructions. ______ X $200	12	
13	Amount of contributions paid by employer for each eligible military spouse employee. Do not enter more than $300 per employee. See instructions	13	
14	Credit for small employer military spouse retirement plan from partnerships and S corporations	14	
15	Add lines 12, 13, and 14. Partnerships and S corporations, report this amount on Schedule K. All others, report this amount on Form 3800, Part III, line 1ee	15	

For Paperwork Reduction Act Notice, see separate instructions. Form **8881** (Rev.12-2023)

Note: A complete partnership and individual return are presented at the end based on the case study.

Complete partnership and individual return

Case study

Night Gates Cleaning, a partnership owned equally by Amy Watts and Chip Daley, provides commercial and residential cleaning services to local businesses and individuals. Both partners materially participate in the business as their involvement in the business is regular, continuous and substantial [§469(h)(1)].

Amy and Chip both provide services to the entity, and each received $60,000 during the year in guaranteed payments for their services. In addition to the partners providing services, the business employs five full-time employees, each of them were paid $45,000 for the year.

Both partners also incurred $3,275 in UPE for business miles using their personal vehicles.

Also to aid in employee retention, Night Gates Cleaning started offering medical insurance and established a retirement plan at the beginning of the year. The requirements for the auto-enrollment credit are met and the business incurred $5,000 in qualified startup costs.

All five employees, and partners, are covered by the medical plan. Night Gates Cleaning covers 50% of the premium for all employees and 100% for the partners. The business also contributed $2,000 to each employee's health savings account (HSA) as the medical plan was a high deductible plan and all requirements were met. The partnership paid 100% of the health insurance premiums for the partners, and also contributed $4,000 to each partner's HSA. No other HSA contributions were made by or on behalf of the partners. Both partners are over the age of 55.

The health plan expenses paid by Night Gates Cleaning is as follows:

Health insurance premiums paid for employees	$6,000
HSA contributions for employees	10,000
Health insurance premiums for partners	4,800
HSA contributions for partners	8,000
Total	**$28,800**

All five employees participated in the retirement plan and Night Gates Cleaning made $7,200 in employer contributions on their behalf. The total contributions (partner and partnership match) for the partners equaled $29,122.

Night Gates Cleaning Income Statement: January - December 2023	
Revenue	$505,000
Expenses:	
Guaranteed payments – services	$120,000
Wages	225,000
Health insurance benefits (employees)	16,000
Health insurance (partners)	12,800
Retirement contributions (employees)	7,200
Retirement contributions (partner and partnership match)	29,122
Start-up costs (retirement plan)	5,000
Total expenses	$415,122
Profit	**$ 89,878**
Book to tax adjustment (for expenses not deductible on tax return):	
Small employer pension plan start up credit ($250 x 5)	$1,250
Employer contribution credit ($1,000 x 7)	7,000
Book-to-tax adjustment	**$8,250**
Total ordinary business income (Line 23)	**$98,128**

Night Gates Cleaning Balance Sheet 2023	
Cash	$89,878
Partner capital	($89,878)

Partnership return

Amy's Schedule K-1(Form 1065) is included with the return. In the interest of space, Chip's was not included but it would be the same as Amy's. The return discusses only the items mentioned in this material. There are other items (qualified business income) that the partnership could pass through to its partners; however, those items are not included in the return presentation.

Form **1065** Department of the Treasury Internal Revenue Service

U.S. Return of Partnership Income

For calendar year 2023, or tax year beginning ...., ending ....

Go to *www.irs.gov/Form1065* for instructions and the latest information.

OMB No. 1545-0123 **2023**

A Principal business activity: Cleaning	Name of partnership: Night Gates Cleaning	D Employer identification number: **-***5565
B Principal product or service: Service	Type or Print — Number, street, and room or suite no. If a P.O. box, see instructions.: 789 Main Street	E Date business started: 01/01/2021
C Business code number: 561720	City or town, state or province, country, and ZIP or foreign postal code: Any Town WI 54315	F Total assets (see instructions): $ 89,878

G Check applicable boxes: (1) ☐ Initial return (2) ☐ Final return (3) ☐ Name change (4) ☐ Address change (5) ☐ Amended return

H Check accounting method: (1) ☒ Cash (2) ☐ Accrual (3) ☐ Other (specify):

I Number of Schedules K-1. Attach one for each person who was a partner at any time during the tax year: 2

J Check if Schedules C and M-3 are attached ☐

K Check if partnership: (1) ☐ Aggregated activities for section 465 at-risk purposes (2) ☐ Grouped activities for section 469 passive activity purposes

Caution: Include **only** trade or business income and expenses on lines 1a through 23 below. See instructions for more information.

Income	1a	Gross receipts or sales 505,000 **b** Less returns and allowances **c** Balance	1c	505,000
	2	Cost of goods sold (attach Form 1125-A)	2	
	3	Gross profit. Subtract line 2 from line 1c	3	505,000
	4	Ordinary income (loss) from other partnerships, estates, and trusts (attach statement)	4	
	5	Net farm profit (loss) (attach Schedule F (Form 1040))	5	
	6	Net gain (loss) from Form 4797, Part II, line 17 (attach Form 4797)	6	
	7	Other income (loss) (attach statement)	7	
	8	**Total income (loss).** Combine lines 3 through 7	8	505,000
Deductions (see instructions for limitations)	9	Salaries and wages (other than to partners) (less employment credits)	9	225,000
	10	Guaranteed payments to partners	10	161,922
	11	Repairs and maintenance	11	
	12	Bad debts	12	
	13	Rent	13	
	14	Taxes and licenses	14	
	15	Interest (see instructions)	15	
	16a	Depreciation (if required, attach Form 4562) — 16a		
	b	Less depreciation reported on Form 1125-A and elsewhere on return — 16b	16c	
	17	Depletion **(Do not deduct oil and gas depletion.)**	17	
	18	Retirement plans, etc.	18	7,200
	19	Employee benefit programs	19	16,000
	20	Energy efficient commercial buildings deduction (attach Form 7205)	20	
	21	Other deductions (attach statement) See Statement 1	21	-3,250
	22	**Total deductions.** Add the amounts shown in the far right column for lines 9 through 21	22	406,872
	23	**Ordinary business income (loss).** Subtract line 22 from line 8	23	98,128
Tax and Payment	24	Interest due under the look-back method—completed long-term contracts (attach Form 8697)	24	
	25	Interest due under the look-back method—income forecast method (attach Form 8866)	25	
	26	BBA AAR imputed underpayment (see instructions)	26	
	27	Other taxes (see instructions)	27	
	28	**Total balance due.** Add lines 24 through 27	28	
	29	Elective payment election amount from Form 3800	29	
	30	Payment (see instructions)	30	
	31	**Amount owed.** If the sum of line 29 and line 30 is smaller than line 28, enter amount owed	31	
	32	**Overpayment.** If the sum of line 29 and line 30 is larger than line 28, enter overpayment	32	

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 partner or limited liability company member) is based on all information of which preparer has any knowledge.

Signature of partner or limited liability company member Date

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 04/02/24	Check ☐ if self-employed	PTIN
Firm's name Natl Assn Of Tax Prof			Firm's EIN	
Firm's address PO Box 8002 Appleton, WI 54912			Phone no. 920-749-1040	

For Paperwork Reduction Act Notice, see separate instructions. Form **1065** (2023)

DAA

Form 1065 (2023) **Night Gates Cleaning** **-***5565 Page **2**

Schedule B Other Information

		Yes	No
1	What type of entity is filing this return? Check the applicable box: a [X] Domestic general partnership b [ ] Domestic limited partnership c [ ] Domestic limited liability company d [ ] Domestic limited liability partnership e [ ] Foreign partnership f [ ] Other:		
2	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, or any foreign government own, directly or indirectly, an interest of 50% or more in the profit, loss, or capital of the partnership? For rules of constructive ownership, see instructions. If "Yes," attach Schedule B-1, Information on Partners Owning 50% or More of the Partnership		X
b	Did any individual or estate own, directly or indirectly, an interest of 50% or more in the profit, loss, or capital of the partnership? For rules of constructive ownership, see instructions. If "Yes," attach Schedule B-1, Information on Partners Owning 50% or More of the Partnership	X	
3	At the end of the tax year, did the partnership:		
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? 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

		Yes	No
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 Percentage Owned in Profit, Loss, or Capital

		Yes	No
4	Does the partnership satisfy **all four** of the following conditions?		
a	The partnership's total receipts for the tax year were less than $250,000.		
b	The partnership's total assets at the end of the tax year were less than $1 million.		
c	Schedules K-1 are filed with the return and furnished to the partners on or before the due date (including extensions) for the partnership return.		
d	The partnership is not filing and is not required to file Schedule M-3		X
	If "Yes," the partnership is not required to complete Schedules L, M-1, and M-2; item F on page 1 of Form 1065; or item L on Schedule K-1.		
5	Is this partnership a publicly traded partnership, as defined in section 469(k)(2)?		X
6	During the tax year, did the partnership have any debt that was canceled, was forgiven, or had the terms modified so as to reduce the principal amount of the debt?		X
7	Has this partnership filed, or is it required to file, Form 8918, Material Advisor Disclosure Statement, to provide information on any reportable transaction?		X
8	At any time during calendar year 2023, did the partnership have an interest in or a signature or other authority over a financial account in a foreign country (such as a bank account, securities account, or other financial account)? See instructions for exceptions and filing requirements for FinCEN Form 114, Report of Foreign Bank and Financial Accounts (FBAR). If "Yes," enter the name of the foreign country ______		X
9	At any time during the tax year, did the partnership receive a distribution from, or was it the grantor of, or transferor to, a foreign trust? If "Yes," the partnership may have to file Form 3520, Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts. See instructions		X
10a	Is the partnership making, or had it previously made (and not revoked), a section 754 election? If "Yes," enter the effective date of the election ______ See instructions for details regarding a section 754 election.		X
b	For this tax year, did the partnership make an optional basis adjustment under section 743(b)? If "Yes," enter the total aggregate net positive amount $______ and the total aggregate net negative amount $ (______) of such section 743(b) adjustments for all partners made in the tax year. The partnership must also attach a statement showing the computation and allocation of each basis adjustment. See instructions		X

DAA Form **1065** (2023)

Form 1065 (2023) Night Gates Cleaning **-***5565 Page 3

Schedule B Other Information *(continued)*		Yes	No
c	For this tax year, did the partnership make an optional basis adjustment under section 734(b)? If "Yes," enter the total aggregate net positive amount $ ____ and the total aggregate net negative amount $(____) of such section 734(b) adjustments for all partnership property made in the tax year. The partnership must also attach a statement showing the computation and allocation of each basis adjustment. See instructions		X
d	For this tax year, is the partnership required to adjust the basis of partnership property under section 743(b) or 734(b) because of a substantial built-in loss (as defined under section 743(d)) or substantial basis reduction (as defined under section 734(d))? If "Yes," enter the total aggregate amount of such section 743(b) adjustments and/or section 734(b) adjustments for all partners and/or partnership property made in the tax year $ ____ . The partnership must also attach a statement showing the computation and allocation of the basis adjustment. See instructions		X
11	Check this box if, during the current or prior tax year, the partnership distributed any property received in a like-kind exchange or contributed such property to another entity (other than disregarded entities wholly owned by the partnership throughout the tax year) ☐		
12	At any time during the tax year, did the partnership distribute to any partner a tenancy-in-common or other undivided interest in partnership property?		X
13	If the partnership is required to file Form 8858, Information Return of U.S. Persons With Respect to Foreign Disregarded Entities (FDEs) and Foreign Branches (FBs), enter the number of Forms 8858 attached. See instructions 0		
14	Does the partnership have any foreign partners? If "Yes," enter the number of Forms 8805, Foreign Partner's Information Statement of Section 1446 Withholding Tax, filed for this partnership		X
15	Enter the number of Forms 8865, Return of U.S. Persons With Respect to Certain Foreign Partnerships, attached to this return 0		
16a	Did you make any payments in 2023 that would require you to file Form(s) 1099? See instructions		X
b	If "Yes," did you or will you file required Form(s) 1099?		
17	Enter the number of Forms 5471, Information Return of U.S. Persons With Respect to Certain Foreign Corporations, attached to this return 0		
18	Enter the number of partners that are foreign governments under section 892 0		
19	During the partnership's tax year, did the partnership make any payments that would require it to file Forms 1042 and 1042-S under chapter 3 (sections 1441 through 1464) or chapter 4 (sections 1471 through 1474)?		X
20	Was the partnership a specified domestic entity required to file Form 8938 for the tax year? See the Instructions for Form 8938		X
21	Is the partnership a section 721(c) partnership, as defined in Regulations section 1.721(c)-1(b)(14)?		X
22	During the tax year, did the partnership pay or accrue any interest or royalty for which one or more partners are not allowed a deduction under section 267A? See instructions		X
	If "Yes," enter the total amount of the disallowed deductions $ ____		
23	Did the partnership have an election under section 163(j) for any real property trade or business or any farming business in effect during the tax year? See instructions		X
24	Does the partnership satisfy one or more of the following? See instructions		X
a	The partnership owns a pass-through entity with current, or prior year carryover, excess business interest expense.		
b	The partnership's aggregate average annual gross receipts (determined under section 448(c)) for the 3 tax years preceding the current tax year are more than $29 million and the partnership has business interest expense.		
c	The partnership is a tax shelter (see instructions) and the partnership has business interest expense. If "Yes" to any, complete and attach Form 8990.		
25	Is the partnership attaching Form 8996 to certify as a Qualified Opportunity Fund?		X
	If "Yes," enter the amount from Form 8996, line 15 $ ____		
26	Enter the number of foreign partners subject to section 864(c)(8) as a result of transferring all or a portion of an interest in the partnership or of receiving a distribution from the partnership 0 Complete Schedule K-3 (Form 1065), Part XIII, for each foreign partner subject to section 864(c)(8) on a transfer or distribution.		
27	At any time during the tax year, were there any transfers between the partnership and its partners subject to the disclosure requirements of Regulations section 1.707-8?		X
28	Since December 22, 2017, did a foreign corporation directly or indirectly acquire substantially all of the properties constituting a trade or business of your partnership, and was the ownership percentage (by vote or value) for purposes of section 7874 greater than 50% (for example, the partners held more than 50% of the stock of the foreign corporation)? If "Yes," list the ownership percentage by vote and by value. See instructions. Percentage: By vote: By value:		X
29	Is the partnership required to file Form 7208 relating to the excise tax on repurchase of corporate stock (see instructions):		
a	Under the applicable foreign corporation rules?		X

Form **1065** (2023)

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Form 1065 (2023) Night Gates Cleaning **-***5565 Page 4

Schedule B Other Information *(continued)*		Yes	No
b	Under the covered surrogate foreign corporation rules? If "Yes" to either (a) or (b), complete Form 7208, Excise Tax on Repurchase of Corporate Stock. See the Instructions for Form 7208.		X
30	At any time during this tax year, did the partnership (a) receive (as a reward, award, or payment for property or services); or (b) sell, exchange, or otherwise dispose of a digital asset (or financial interest in a digital asset)? See instructions		X
31	Is the partnership electing out of the centralized partnership audit regime under section 6221(b)? See instructions If "Yes," the partnership must complete Schedule B-2 (Form 1065). Enter the total from Schedule B-2, Part III, line 3 2 If "No," complete Designation of Partnership Representative below.	X	

Designation of Partnership Representative (see instructions)

Enter below the information for the partnership representative (PR) for the tax year covered by this return.

Name of PR	
U.S. address of PR	U.S. phone number of PR
If the PR is an entity, name of the designated individual for the PR	
U.S. address of designated individual	U.S. phone number of designated individual

Form **1065** (2023)

Form 1065 (2023) Night Gates Cleaning **-***5565 Page 5

Schedule K Partners' Distributive Share Items

				Total amount
Income (Loss)	1	Ordinary business income (loss) (page 1, line 23)	1	98,128
	2	Net rental real estate income (loss) (attach Form 8825)	2	
	3a	Other gross rental income (loss) — 3a		
	b	Expenses from other rental activities (attach statement) — 3b		
	c	Other net rental income (loss). Subtract line 3b from line 3a	3c	
	4	Guaranteed payments: a Services 4a 161,922 b Capital 4b		
		c Total. Add lines 4a and 4b	4c	161,922
	5	Interest income	5	
	6	Dividends and dividend equivalents: a Ordinary dividends	6a	
		b Qualified dividends 6b c Dividend equivalents 6c		
	7	Royalties	7	
	8	Net short-term capital gain (loss) (attach Schedule D (Form 1065))	8	
	9a	Net long-term capital gain (loss) (attach Schedule D (Form 1065))	9a	
	b	Collectibles (28%) gain (loss) — 9b		
	c	Unrecaptured section 1250 gain (attach statement) — 9c		
	10	Net section 1231 gain (loss) (attach Form 4797)	10	
	11	Other income (loss) (see instructions) Type:	11	
Deductions	12	Section 179 deduction (attach Form 4562)	12	
	13a	Cash contributions	13a	
	b	Noncash contributions	13b	
	c	Investment interest expense	13c	
	d	Section 59(e)(2) expenditures: (1) Type: (2) Amount:	13d(2)	
	e	Other deductions (see instructions) Type: See Statement 2	13e	41,922
Self-Employment	14a	Net earnings (loss) from self-employment	14a	260,050
	b	Gross farming or fishing income	14b	
	c	Gross nonfarm income	14c	505,000
Credits	15a	Low-income housing credit (section 42(j)(5))	15a	
	b	Low-income housing credit (other)	15b	
	c	Qualified rehabilitation expenditures (rental real estate) (attach Form 3468, if applicable)	15c	
	d	Other rental real estate credits (see instructions) Type:	15d	
	e	Other rental credits (see instructions) Type:	15e	
	f	Other credits (see instructions) Type: See Statement 3	15f	8,750
International	16	Attach Schedule K-2 (Form 1065), Partners' Distributive Share Items—International, and check this box to indicate that you are reporting items of international tax relevance ☐		
Alternative Minimum Tax (AMT) Items	17a	Post-1986 depreciation adjustment	17a	
	b	Adjusted gain or loss	17b	
	c	Depletion (other than oil and gas)	17c	
	d	Oil, gas, and geothermal properties–gross income	17d	
	e	Oil, gas, and geothermal properties–deductions	17e	
	f	Other AMT items (attach statement)	17f	
Other Information	18a	Tax-exempt interest income	18a	
	b	Other tax-exempt income	18b	
	c	Nondeductible expenses See Statement 4	18c	8,250
	19a	Distributions of cash and marketable securities	19a	
	b	Distributions of other property	19b	
	20a	Investment income	20a	
	b	Investment expenses	20b	
	c	Other items and amounts (attach statement) See Statement 5		
	21	Total foreign taxes paid or accrued	21	

Form 1065 (2023)

Form 1065 (2023) Night Gates Cleaning **-***5565 Page 6

Analysis of Net Income (Loss) per Return

1	Net income (loss). Combine Schedule K, lines 1 through 11. From the result, subtract the sum of Schedule K, lines 12 through 13e, and 21					1	218,128
2	Analysis by partner type:	(i) Corporate	(ii) Individual (active)	(iii) Individual (passive)	(iv) Partnership	(v) Exempt Organization	(vi) Nominee/Other
a	General partners		218,128				
b	Limited partners						

Schedule L Balance Sheets per Books

Assets	Beginning of tax year (a)	(b)	End of tax year (c)	(d)
1 Cash				89,878
2a Trade notes and accounts receivable				
b Less allowance for bad debts				
3 Inventories				
4 U.S. Government obligations				
5 Tax-exempt securities				
6 Other current assets (attach statement)				
7a Loans to partners (or persons related to partners)				
b Mortgage and real estate loans				
8 Other investments (attach statement)				
9a Buildings and other depreciable assets				
b Less accumulated depreciation				
10a Depletable assets				
b Less accumulated depletion				
11 Land (net of any amortization)				
12a Intangible assets (amortizable only)				
b Less accumulated amortization				
13 Other assets (attach statement)				
14 Total assets				89,878
Liabilities and Capital				
15 Accounts payable				
16 Mortgages, notes, bonds payable in less than 1 year				
17 Other current liabilities (attach statement)				
18 All nonrecourse loans				
19a Loans from partners (or persons related to partners)				
b Mortgages, notes, bonds payable in 1 year or more				
20 Other liabilities (attach statement)				
21 Partners' capital accounts				89,878
22 Total liabilities and capital				89,878

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

Note: The partnership may be required to file Schedule M-3. See instructions.

1 Net income (loss) per books	89,878	6 Income recorded on books this year not included on Schedule K, lines 1 through 11 (itemize):	
2 Income included on Schedule K, lines 1, 2, 3c, 5, 6a, 7, 8, 9a, 10, and 11, not recorded on books this year (itemize):		a Tax-exempt interest $	
3 Guaranteed payments (other than health insurance)	149,122	7 Deductions included on Schedule K, lines 1 through 13e, and 21, not charged against book income this year (itemize):	
4 Expenses recorded on books this year not included on Schedule K, lines 1 through 13e, and 21 (itemize):		a Depreciation $ See Statement 7 29,122	29,122
a Depreciation $ b Travel and entertainment $ See Statement 6 8,250	8,250	8 Add lines 6 and 7	29,122
5 Add lines 1 through 4	247,250	9 Income (loss) (Analysis of Net Income (Loss), line 1). Subtract line 8 from line 5	218,128

Schedule M-2 Analysis of Partners' Capital Accounts

1 Balance at beginning of year		6 Distributions: a Cash	
2 Capital contributed: a Cash		b Property	
b Property		7 Other decreases (itemize): See Stmt 8 120,000	120,000
3 Net income (loss) (see instructions)	209,878		
4 Other increases (itemize):		8 Add lines 6 and 7	120,000
5 Add lines 1 through 4	209,878	9 Balance at end of year. Subtract line 8 from line 5	89,878

DAA Form **1065** (2023)

Partner# 1

651123

Final K-1 ☐ Amended K-1 ☐ OMB No. 1545-0123

Schedule K-1 (Form 1065) **2023**

Department of the Treasury
Internal Revenue Service

For calendar year 2023, or tax year beginning ______ ending ______

Partner's Share of Income, Deductions, Credits, etc. See separate instructions.

Part I Information About the Partnership

A Partnership's employer identification number
-*5565

B Partnership's name, address, city, state, and ZIP code
Night Gates Cleaning
789 Main Street
Any Town WI 54315

C IRS Center where partnership filed return:
Kansas City, MO 64999-0011

D ☐ Check if this is a publicly traded partnership (PTP)

Part II Information About the Partner

E Partner's SSN or TIN (Do not use TIN of a disregarded entity. See instructions.)
***-**-1111

F Name, address, city, state, and ZIP code for partner entered in E. See instructions.
Amy Watts
54 Rolling Place
Any City WI 54315

G [X] General partner or LLC member-manager ☐ Limited partner or other LLC member

H1 [X] Domestic partner ☐ Foreign partner

H2 ☐ If the partner is a disregarded entity (DE), enter the partner's:
TIN ______
Name ______

I1 What type of entity is this partner? Individual

I2 If this partner is a retirement plan (IRA/SEP/Keogh/etc.), check here ☐

J Partner's share of profit, loss, and capital (see instructions):

	Beginning	Ending
Profit	50.000000%	50.000000%
Loss	50.000000%	50.000000%
Capital	50.000000%	50.000000%

Check if decrease is due to: ☐ Sale or ☐ Exchange of partnership interest. See instructions.

K1 Partner's share of liabilities:

	Beginning	Ending
Nonrecourse	$	$
Qualified nonrecourse financing	$	$
Recourse	$	$

K2 Check this box if item K1 includes liability amounts from lower-tier partnerships ☐

K3 Check if any of the above liability is subject to guarantees or other payment obligations by the partner. See instructions ☐

L Partner's Capital Account Analysis

Beginning capital account	$
Capital contributed during the year	$
Current year net income (loss)	$ 44,939
Other increase (decrease) (attach explanation)	$
Withdrawals and distributions	$ ( )
Ending capital account	$ 44,939

M Did the partner contribute property with a built-in gain (loss)?
☐ Yes [X] No If "Yes," attach statement. See instructions.

N Partner's Share of Net Unrecognized Section 704(c) Gain or (Loss)
Beginning $
Ending $

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

Line	Item	Amount
1	Ordinary business income (loss)	49,064
2	Net rental real estate income (loss)	
3	Other net rental income (loss)	
4a	Guaranteed payments for services	80,961
4b	Guaranteed payments for capital	
4c	Total guaranteed payments	80,961
5	Interest income	
6a	Ordinary dividends	
6b	Qualified dividends	
6c	Dividend equivalents	
7	Royalties	
8	Net short-term capital gain (loss)	
9a	Net long-term capital gain (loss)	
9b	Collectibles (28%) gain (loss)	
9c	Unrecaptured section 1250 gain	
10	Net section 1231 gain (loss)	
11	Other income (loss)	
12	Section 179 deduction	
13	Other deductions	M 6,400
		R 14,561
14	Self-employment earnings (loss)	A 130,025
		C 252,500
15	Credits	AE 4,125
		AF 250
16	Schedule K-3 is attached if checked ☐	
17	Alternative minimum tax (AMT) items	
18	Tax-exempt income and nondeductible expenses	C* 4,125
19	Distributions	
20	Other information	ZZ* STMT
21	Foreign taxes paid or accrued	

22 ☐ More than one activity for at-risk purposes*
23 ☐ More than one activity for passive activity purposes*

*See attached statement for additional information.

For IRS Use Only

For Paperwork Reduction Act Notice, see the Instructions for Form 1065. www.irs.gov/Form1065 Schedule K-1 (Form 1065) 2023
DAA

Schedule K-1, Line 18 - Tax-Exempt Income and Nondeductible Expenses

Code	Description	Amount
C	Tax Credit Adjustment	$ 4,125

Schedule K-1, Line 20ZZ - Additional Other Information

Description	
Schedule K-3 will not be distributed to you unless requested	
Medical Insurance paid by partnership for partners	2,400
HSA contributions paid by partnership for partners	4,000

SCHEDULE B-1
(Form 1065)

(Rev. August 2019)

Department of the Treasury
Internal Revenue Service

Information on Partners Owning 50% or More of the Partnership

▶ **Attach to Form 1065.**

▶ **Go to *www.irs.gov/Form1065* for the latest information.**

OMB No. 1545-0123

Name of partnership: Night Gates Cleaning

Employer identification number (EIN): **-***5565

Part I **Entities Owning 50% or More of the Partnership** (Form 1065, Schedule B, Question 2a (Question 3a for 2009 through 2017))

Complete columns (i) through (v) below for any foreign or domestic corporation, partnership (including any entity treated as a partnership), trust, tax-exempt organization, or any foreign government that owns, directly or indirectly, an interest of 50% or more in the profit, loss, or capital of the partnership (see instructions).

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

Part II **Individuals or Estates Owning 50% or More of the Partnership** (Form 1065, Schedule B, Question 2b (Question 3b for 2009 through 2017))

Complete columns (i) through (iv) below for any individual or estate that owns, directly or indirectly, an interest of 50% or more in the profit, loss, or capital of the partnership (see instructions).

(i) Name of Individual or Estate	(ii) Identifying Number (if any)	(iii) Country of Citizenship (see instructions)	(iv) Maximum Percentage Owned in Profit, Loss, or Capital
Amy Watts	***-**-1111	United States	50.000000
Chip Daley	***-**-1111	United States	50.000000

For Paperwork Reduction Act Notice, see the Instructions for Form 1065. **Schedule B-1 (Form 1065) (Rev. 8-2019)**

SCHEDULE B-2 (Form 1065) (December 2018) Department of the Treasury Internal Revenue Service	**Election Out of the Centralized Partnership Audit Regime** ▶ Attach to Form 1065 or Form 1066. ▶ Go to *www.irs.gov/Form1065* for instructions and the latest information.	OMB No. 1545-0123

Name of Partnership	Employer Identification Number (EIN)
Night Gates Cleaning	**-***5565

Certain partnerships with 100 or fewer partners can elect out of the centralized partnership audit regime if each partner is an individual, a C corporation, a foreign entity that would be treated as a C corporation were it domestic, an S corporation, or an estate of a deceased partner. For purposes of determining whether the partnership has 100 or fewer partners, the partnership must include all shareholders of any S corporation that is a partner. By completing Part I, you are making an affirmative statement that all of the partners in the partnership are eligible partners under section 6221(b)(1)(C) and you have provided all of the information on this schedule. See the instructions, including the instructions for the treatment of real estate mortgage investment conduits (REMICs), for more details.

Part I **List of Eligible Partners**

Use the following codes under Type of Eligible Partner:

I – Individual C – Corporation E – Estate of Deceased Partner F – Eligible Foreign Entity S – S corporation

	Name of Partner	Taxpayer Identification Number (TIN)	Type of Eligible Partner (Code)
1	Amy Watts	***-**-1111	I
2	Chip Daley	***-**-1111	I
3			
4			
5			
6			
7			
8			
9			
10			
11			
12			
13			
14			
15			

Continued on Part IV

Part II **List of S Corporation Shareholders** (For each S corporation partner, complete a separate Part II and separate Part V, if needed.)

Use the following codes under Type of Person:

I – Individual E – Estate of Deceased Shareholder T – Trust O – Other

Name of S Corporation Partner ▶	TIN of Partner ▶

	Name of Shareholder	Shareholder TIN	Type of Person (Code)
1			
2			
3			
4			
5			
6			
7			
8			
9			
10			
11			
12			

Continued on Part V

Part III **Total Number of Schedules K-1 Required To Be Issued.** See instructions.

1	Total of Part I and all Parts IV Schedules K-1 required to be issued by the partnership	1	2
2	Total of Part II and all Parts V Schedules K-1 required to be issued by any S corporation partners	2	
3	**Total.** Add line 1 and line 2	3	2

Note: If line 3 is more than 100, the partnership cannot make the election under section 6221(b).

For Paperwork Reduction Act Notice, see the Instructions for Form 1065. **Schedule B-2 (Form 1065) (12-2018)**

DAA

Form **8881**
(Rev. December 2023)
Department of the Treasury
Internal Revenue Service

Credit for Small Employer Pension Plan Startup Costs, Auto-Enrollment, and Military Spouse Participation

Attach to your tax return.
Go to *www.irs.gov/Form8881* for instructions and the latest information.

OMB No. 1545-1810
Attachment Sequence No. **130**

Name(s) shown on return: Night Gates Cleaning
Identifying number: **-***5565

Part I Credit for Small Employer Pension Plan Startup Costs (Including Employer Contributions)

A	Enter the number of qualifying employees. See instructions 5		
1	Qualified startup costs incurred during the tax year — 1: 5,000		
2	Employers with 1-50 employees enter the amount from line 1. Employers with 51-100 employees enter 50% (0.50) of line 1	2	5,000
3	Enter the number of employees eligible to participate in the pension plan. See instructions. 5 X $250	3	1,250
4	Enter the greater of $500 or the amount from line 3 (Do not enter more than $5,000)	4	1,250
5	Enter the smaller of line 2 or line 4	5	1,250
6a	Enter the number of employees from the preceding tax year. See instructions	6a	5
b	Enter employer contributions made to the plan, but don't include (i) elective deferrals, (ii) contributions made to employees whose wages paid to the employee were in excess of $100,000 and (iii) any amount of contributions to an employee to whom you made contributions of more than $1,000	6b	
c	For employees for whom you made matching and nonelective contributions of more than $1,000, (and who are not disqualified because they meet 6b(ii) above), see the instructions for information on how to determine the amount to enter on line 6c. If you did not make this type of contributions, enter -0-	6c	7,000
d	Add lines 6b and 6c	6d	7,000
	If the number of employees entered on line 6a is 50 or less, enter the amount from line 6d on line 6f. If the number of employees entered on line 6a is 51-100, continue to line 6e(1).		
e	(1) Subtract 50 (50.0) from the number of employees entered on line 6a	6e(1)	
	(2) Multiply line 6e(1) by 2% (0.02)	6e(2)	
	(3) Multiply line 6e(2) by line 6d	6e(3)	
	(4) Subtract line 6e(3) from line 6d	6e(4)	
f	If you did NOT complete line 6e, enter the amount from line 6d. If you completed line 6e, enter the amount from line 6e(4)	6f	7,000
g	Applicable percentages. See instructions • If this is treated as the first or second year of the plan, enter the amount from line 6f. • If this is treated as the third year of the plan, multiply line 6f by 75% (0.75). • If this is treated as the fourth year of the plan, multiply line 6f by 50% (0.50). • If this is treated as the fifth year of the plan, multiply the amount on line 6f by 25% (0.25).	6g	7,000
7	Credit for small employer pension plan startup costs from partnerships and S corporations	7	
8	Add lines 5, 6g, and 7. Partnerships and S corporations, report this amount on Schedule K. All others, report this amount on Form 3800, Part III, line 1j	8	8,250

Part II Small Employer Auto-Enrollment Credit

9	Enter $500 if an auto-enrollment option is provided for retirement savings	9	500
10	Small employer auto-enrollment credit from partnerships and S corporations	10	
11	Add lines 9 and 10. Partnerships and S corporations, report this amount on Schedule K. All others, report this amount on Form 3800, Part III, line 1dd	11	500

Part III Military Spouse Participation Credit

Caution: You can't claim the credit if you had more than 100 employees in the preceding tax year.

12	Enter the number of military spouse employees participating in an eligible plan. See instructions. ______ X $200	12	
13	Amount of contributions paid by employer for each eligible military spouse employee. Do not enter more than $300 per employee. See instructions	13	
14	Credit for small employer military spouse retirement plan from partnerships and S corporations	14	
15	Add lines 12, 13, and 14. Partnerships and S corporations, report this amount on Schedule K. All others, report this amount on Form 3800, Part III, line 1ee	15	

For Paperwork Reduction Act Notice, see separate instructions. Form **8881** (Rev.12-2023)

NG Night Gates Cleaning
-*5565
FYE: 12/31/2023

Federal Statements

4/8/2024 10:53 AM

Statement 1 - Form 1065, Page 1, Line 21 - Other Deductions

Description	Amount
Start-up costs - retirement	$ 5,000
Pension Plan Startup Cr	-8,250
Total	$ -3,250

Statement 2 - Form 1065, Schedule K, Line 13e - Other Deductions

Description	Amount
Health Insurance for Partners	$ 12,800
Pensions and IRA's	29,122
Total	$ 41,922

Statement 3 - Form 1065, Schedule K, Line 15f - Other Credits

Description	Amount
Pension Plan Startup Cr	$ 8,250
Auto-Enrollment Cr	500
Total	$ 8,750

Statement 4 - Form 1065, Schedule K, Line 18c - Nondeductible Expenses

Description	Amount
Tax Credit Adjustment	$ 8,250
Total	$ 8,250

Statement 5 - Form 1065, Schedule K, Line 20c - Other Items and Amounts

Description	Amount
Qualifies for exception to filing Schedule K-2	$
Medical Insurance paid by partnership for partners	4,800
HSA contributions paid by partnership for partners	8,000

Statement 6 - Form 1065, Schedule M-1, Line 4 - Expenses Recorded on Books, Not on Sch K

Description	Amount
Tax Credit Adjustment	$ 8,250
Total	$ 8,250

NG Night Gates Cleaning
-*5565
FYE: 12/31/2023

Federal Statements

4/2/2024 4:34 PM

Statement 7 - Form 1065, Schedule M-1, Line 7 - Deductions Included on Sch K, Not on Books

Description	Amount
Pensions and IRAs Considered Guaranteed Payments	$ 29,122
Total	$ 29,122

Statement 8 - Form 1065, Schedule M-2, Line 7 - Other Decreases

Description	Amount
Guaranteed Payments	$ 120,000
Total	$ 120,000

Partner return

Form **1040** Department of the Treasury—Internal Revenue Service
U.S. Individual Income Tax Return **2023** OMB No. 1545-0074 IRS Use Only–Do not write or staple in this space.

For the year Jan. 1–Dec. 31, 2023, or other tax year beginning ...., 2023, ending ...., 20 .... See separate instructions.

Your first name and middle initial	Last name	Your social security number
Amy	Watts	***-**-1111
If joint return, spouse's first name and middle initial	Last name	Spouse's social security number

Home address (number and street). If you have a P.O box, see instructions.	Apt. no.	
54 Rolling Place		
City, town or post office. If you have a foreign address, also complete spaces below.	State	ZIP code
Any City	WI	54315
Foreign country name / Foreign province/state/county		Foreign postal code

Presidential Election Campaign 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. ☐ You ☐ Spouse

Filing Status Check only one box.
- ☒ Single
- ☐ Married filing jointly (even if only one had income)
- ☐ Married filing separately (MFS)
- ☐ Head of household (HOH)
- ☐ Qualifying surviving spouse (QSS)

If you checked the MFS box, enter the name of your spouse. If you checked the HOH or QSS box, enter the child's name if the qualifying person is a child but not your dependent: ....

Digital Assets At any time during 2023, did you: (a) receive (as a reward, award, or payment for property or services); or (b) sell, exchange, or otherwise dispose of a digital asset (or a financial interest in a digital asset)? (See instructions.) ☐ Yes ☒ No

Standard Deduction **Someone can claim:** ☐ You as a dependent ☐ Your spouse as a dependent
☐ Spouse itemizes on a separate return or you were a dual-status alien

Age/Blindness **You:** ☐ Were born before January 2, 1959 ☐ Are blind **Spouse:** ☐ Was born before January 2, 1959 ☐ Is blind

Dependents (see instructions): If more than four dependents, see instr. and check here ☐

(1) First name	Last name	(2) Social security number	(3) Relationship to you	(4) Child tax credit	(4) Credit for other dependents

Income

Attach Form(s) W-2 here. Also attach Forms W-2G and 1099-R if tax was withheld. If you did not get a Form W-2, see instructions.

1a	Total amount from Form(s) W-2, box 1 (see instructions)	1a	
b	Household employee wages not reported on Form(s) W-2	1b	
c	Tip income not reported on line 1a (see instructions)	1c	
d	Medicaid waiver payments not reported on Form(s) W-2 (see instructions)	1d	
e	Taxable dependent care benefits from Form 2441, line 26	1e	
f	Employer-provided adoption benefits from Form 8839, line 29	1f	
g	Wages from Form 8919, line 6	1g	
h	Other earned income (see instructions)	1h	
i	Nontaxable combat pay election (see instructions) 1i		
z	Add lines 1a through 1h	1z	
2a	Tax-exempt interest 2a ; b Taxable interest	2b	
3a	Qualified dividends 3a ; b Ordinary dividends	3b	
4a	IRA distributions 4a ; b Taxable amount	4b	
5a	Pensions and annuities 5a ; b Taxable amount	5b	
6a	Soc. sec. ben. 6a ; b Taxable amount	6b	
c	If you elect to use the lump-sum election method, check here (see instructions) ☐		
7	Capital gain or (loss). Attach Schedule D if required. If not required, check here ☐	7	
8	Other income from Schedule 1, line 10	8	126,750
9	Add lines 1z, 2b, 3b, 4b, 5b, 6b, 7, and 8. This is your **total income**	9	126,750
10	Adjustments to income from Schedule 1, line 26	10	29,916
11	Subtract line 10 from line 9. This is your **adjusted gross income**	11	96,834
12	**Standard deduction or itemized deductions** (from Schedule A)	12	13,850
13	Qualified business income deduction from Form 8995 or Form 8995-A	13	
14	Add lines 12 and 13	14	13,850
15	Subtract line 14 from line 11. If zero or less, enter -0-. This is your **taxable income**	15	82,984

Attach Sch. B if required.

Standard Deduction for –
- Single or Married filing separately, $13,850
- Married filing jointly or Qualifying surviving spouse, $27,700
- Head of household, $20,800
- If you checked any box under *Standard Deduction*, see instructions.

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see separate instructions. Form **1040** (2023)

Form 1040 (2023) **Amy Watts** ***-**-1111 Page **2**

Tax and Credits	16	**Tax** (see instructions). Check if any from Form(s): 1 ☐ 8814 2 ☐ 4972 3 ☐			16	13,562
	17	Amount from Schedule 2, line 3			17	
	18	Add lines 16 and 17			18	13,562
	19	Child tax credit or credit for other dependents from Schedule 8812			19	
	20	Amount from Schedule 3, line 8			20	4,375
	21	Add lines 19 and 20			21	4,375
	22	Subtract line 21 from line 18. If zero or less, enter -0-			22	9,187
	23	Other taxes, including self-employment tax, from Schedule 2, line 21			23	17,910
	24	Add lines 22 and 23. This is your **total tax**			24	27,097
Payments	25	Federal income tax withheld from:				
	a	Form(s) W-2	25a			
	b	Form(s) 1099	25b			
	c	Other forms (see instructions)	25c			
	d	Add lines 25a through 25c			25d	
If you have a qualifying child, attach Sch. EIC.	26	2023 estimated tax payments and amount applied from 2022 return			26	
	27	Earned income credit (EIC)	27			
	28	Additional child tax credit from Schedule 8812	28			
	29	American opportunity credit from Form 8863, line 8	29			
	30	Reserved for future use	30			
	31	Amount from Schedule 3, line 15	31			
	32	Add lines 27, 28, 29 and 31. These are your **total other payments and refundable credits**			32	
	33	Add lines 25d, 26, and 32. These are your **total payments**			33	
Refund	34	If line 33 is more than line 24, subtract line 24 from line 33. This is the amount you **overpaid**			34	
	35a	Amount of line 34 you want **refunded to you.** If Form 8888 is attached, check here ☐			35a	
Direct deposit? See instructions.	b	Routing number	c Type: ☐ Checking ☐ Savings			
	d	Account number				
	36	Amount of line 34 you want **applied to your 2024 estimated tax**	36			
Amount You Owe	37	Subtract line 33 from line 24. This is the **amount you owe.** For details on how to pay, go to *www.irs.gov/Payments* or see instructions			37	27,097
	38	Estimated tax penalty (see instructions)	38			

Third Party Designee Do you want to allow another person to discuss this return with the IRS? See instructions ☐ **Yes.** Complete below. ☐ **No**

Designee's name | Phone no. | Personal identification number (PIN)

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

Joint return? See instructions. Keep a copy for your records.

Your signature	Date	Your occupation	If the IRS sent you an Identity Protection PIN, enter it here (see instr.)
Spouse's signature. If a joint return, **both** must sign.	Date	Spouse's occupation	If the IRS sent your spouse an Identity Protection PIN, enter it here (see instr.)
Phone no.	Email address		

Paid Preparer Use Only

Preparer's name	Preparer's signature	Date	PTIN	Check if:
		04/08/24		☐ Self-employed
Firm's name **Natl Assn Of Tax Prof**			Phone no. 920-749-1040	
Firm's address **PO Box 8002 Appleton WI 54912**			Firm's EIN	

Go to *www.irs.gov/Form1040* for instructions and the latest information. Form **1040** (2023)

SCHEDULE 1
(Form 1040)
Department of the Treasury
Internal Revenue Service

Additional Income and Adjustments to Income

Attach to Form 1040, 1040-SR, or 1040-NR.
Go to *www.irs.gov/Form1040* for instructions and the latest information.

OMB No. 1545-0074
2023
Attachment Sequence No. **01**

Name(s) shown on Form 1040, 1040-SR, or 1040-NR: Amy Watts
Your social security number: ***-**-1111

Part I Additional Income

1	Taxable refunds, credits, or offsets of state and local income taxes			1	
2a	Alimony received			2a	
b	Date of original divorce or separation agreement (see instructions):				
3	Business income or (loss). Attach Schedule C			3	
4	Other gains or (losses). Attach Form 4797			4	
5	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E			5	126,750
6	Farm income or (loss). Attach Schedule F			6	
7	Unemployment compensation			7	
8	Other income:				
a	Net operating loss	8a	( )		
b	Gambling	8b			
c	Cancellation of debt	8c			
d	Foreign earned income exclusion from Form 2555	8d	( )		
e	Income from Form 8853	8e			
f	Income from Form 8889	8f			
g	Alaska Permanent Fund dividends	8g			
h	Jury duty pay	8h			
i	Prizes and awards	8i			
j	Activity not engaged in for profit income	8j			
k	Stock options	8k			
l	Income from the rental of personal property if you engaged in the rental for profit but were not in the business of renting such property	8l			
m	Olympic and Paralympic medals and USOC prize money (see instructions)	8m			
n	Section 951(a) inclusion (see instructions)	8n			
o	Section 951A(a) inclusion (see instructions)	8o			
p	Section 461(l) excess business loss adjustment	8p			
q	Taxable distributions from an ABLE account (see instructions)	8q			
r	Scholarship and fellowship grants not reported on Form W-2	8r			
s	Nontaxable amount of Medicaid waiver payments included on Form 1040, line 1a or 1d	8s	( )		
t	Pension or annuity from a nonqualified deferred compensation plan or a nongovernmental section 457 plan	8t			
u	Wages earned while incarcerated	8u			
z	Other income. List type and amount:	8z			
9	Total other income. Add lines 8a through 8z			9	
10	Combine lines 1 through 7 and 9. This is your **additional income.** Enter here and on Form 1040, 1040-SR, or 1040-NR, line 8			10	126,750

For Paperwork Reduction Act Notice, see your tax return instructions. **Schedule 1 (Form 1040) 2023**

Amy Watts ***-**-1111

Schedule 1 (Form 1040) 2023 Page 2

Part II Adjustments to Income

11	Educator expenses	11	
12	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106	12	
13	Health savings account deduction. Attach Form 8889	13	4,000
14	Moving expenses for members of the Armed Forces. Attach Form 3903	14	
15	Deductible part of self-employment tax. Attach Schedule SE	15	8,955
16	Self-employed SEP, SIMPLE, and qualified plans	16	14,561
17	Self-employed health insurance deduction	17	2,400
18	Penalty on early withdrawal of savings	18	
19a	Alimony paid	19a	
b	Recipient's SSN		
c	Date of original divorce or separation agreement (see instructions):		
20	IRA deduction	20	
21	Student loan interest deduction	21	
22	Reserved for future use	22	
23	Archer MSA deduction	23	
24	Other adjustments:		
a	Jury duty pay (see instructions) — 24a		
b	Deductible expenses related to income reported on line 8l from the rental of personal property engaged in for profit — 24b		
c	Nontaxable amount of the value of Olympic and Paralympic medals and USOC prize money reported on line 8m — 24c		
d	Reforestation amortization and expenses — 24d		
e	Repayment of supplemental unemployment benefits under the Trade Act of 1974 — 24e		
f	Contributions to section 501(c)(18)(D) pension plans — 24f		
g	Contributions by certain chaplains to section 403(b) plans — 24g		
h	Attorney fees and court costs for actions involving certain unlawful discrimination claims (see instructions) — 24h		
i	Attorney fees and court costs you paid in connection with an award from the IRS for information you provided that helped the IRS detect tax law violations — 24i		
j	Housing deduction from Form 2555 — 24j		
k	Excess deductions of section 67(e) expenses from Schedule K-1 (Form 1041) — 24k		
z	Other adjustments. List type and amount: — 24z		
25	Total other adjustments. Add lines 24a through 24z	25	
26	Add lines 11 through 23 and 25. These are your **adjustments to income.** Enter here and on Form 1040, 1040-SR, or 1040-NR, line 10	26	29,916

Schedule 1 (Form 1040) 2023

SCHEDULE 2 (Form 1040)
Department of the Treasury Internal Revenue Service

Additional Taxes

Attach to Form 1040, 1040-SR, or 1040-NR.
Go to *www.irs.gov/Form1040* for instructions and the latest information.

OMB No. 1545-0074
2023
Attachment Sequence No. **02**

Name(s) shown on Form 1040, 1040-SR, or 1040-NR: Amy Watts
Your social security number: ***-**-1111

Part I Tax

1	Alternative minimum tax. Attach Form 6251	1	
2	Excess advance premium tax credit repayment. Attach Form 8962	2	
3	Add lines 1 and 2. Enter here and on Form 1040, 1040-SR, or 1040-NR, line 17	3	

Part II Other Taxes

4	Self-employment tax. Attach Schedule SE			4	17,910
5	Social security and Medicare tax on unreported tip income. Attach Form 4137	5			
6	Uncollected social security and Medicare tax on wages. Attach Form 8919	6			
7	Total additional social security and Medicare tax. Add lines 5 and 6			7	
8	Additional tax on IRAs or other tax-favored accounts. Attach Form 5329 if required. If not required, check here ☐			8	
9	Household employment taxes. Attach Schedule H			9	
10	Repayment of first-time homebuyer credit. Attach Form 5405 if required			10	
11	Additional Medicare Tax. Attach Form 8959			11	
12	Net investment income tax. Attach Form 8960			12	
13	Uncollected social security and Medicare or RRTA tax on tips or group-term life insurance from Form W-2, box 12			13	
14	Interest on tax due on installment income from the sale of certain residential lots and timeshares			14	
15	Interest on the deferred tax on gain from certain installment sales with a sales price over $150,000			15	
16	Recapture of low-income housing credit. Attach Form 8611			16	

(continued on page 2)

For Paperwork Reduction Act Notice, see your tax return instructions. **Schedule 2 (Form 1040) 2023**

Amy Watts ***-**-1111

Schedule 2 (Form 1040) 2023 Page 2

Part II Other Taxes *(continued)*

17	Other additional taxes:				
a	Recapture of other credits. List type, form number, and amount:	17a			
b	Recapture of federal mortgage subsidy, if you sold your home see instructions	17b			
c	Additional tax on HSA distributions. Attach Form 8889	17c			
d	Additional tax on an HSA because you didn't remain an eligible individual. Attach Form 8889	17d			
e	Additional tax on Archer MSA distributions. Attach Form 8853	17e			
f	Additional tax on Medicare Advantage MSA distributions. Attach Form 8853	17f			
g	Recapture of a charitable contribution deduction related to a fractional interest in tangible personal property	17g			
h	Income you received from a nonqualified deferred compensation plan that fails to meet the requirements of section 409A	17h			
i	Compensation you received from a nonqualified deferred compensation plan described in section 457A	17i			
j	Section 72(m)(5) excess benefits tax	17j			
k	Golden parachute payments	17k			
l	Tax on accumulation distribution of trusts	17l			
m	Excise tax on insider stock compensation from an expatriated corporation	17m			
n	Look-back interest under section 167(g) or 460(b) from Form 8697 or 8866	17n			
o	Tax on non-effectively connected income for any part of the year you were a nonresident alien from Form 1040-NR	17o			
p	Any interest from Form 8621, line 16f, relating to distributions from, and dispositions of, stock of a section 1291 fund	17p			
q	Any interest from Form 8621, line 24	17q			
z	Any other taxes. List type and amount:	17z			
18	Total additional taxes. Add lines 17a through 17z			18	
19	Reserved for future use			19	
20	Section 965 net tax liability installment from Form 965-A	20			
21	Add lines 4, 7 through 16, and 18. These are your **total other taxes.** Enter here and on Form 1040 or 1040-SR, line 23, or Form 1040-NR, line 23b			21	17,910

Schedule 2 (Form 1040) 2023

SCHEDULE 3 (Form 1040)

Department of the Treasury Internal Revenue Service

Additional Credits and Payments

Attach to Form 1040, 1040-SR, or 1040-NR.

Go to *www.irs.gov/Form1040* for instructions and the latest information.

OMB No. 1545-0074

2023

Attachment Sequence No. **03**

Name(s) shown on Form 1040, 1040-SR, or 1040-NR: Amy Watts

Your social security number: ***-**-1111

Part I Nonrefundable Credits

1	Foreign tax credit. Attach Form 1116 if required			1	
2	Credit for child and dependent care expenses from Form 2441, line 11. Attach Form 2441			2	
3	Education credits from Form 8863, line 19			3	
4	Retirement savings contributions credit. Attach Form 8880			4	
5a	Residential clean energy credit from Form 5695, line 15			5a	
b	Energy efficient home improvement credit from Form 5695, line 32			5b	
6	Other nonrefundable credits:				
a	General business credit. Attach Form 3800	6a	4,375		
b	Credit for prior year minimum tax. Attach Form 8801	6b			
c	Adoption credit. Attach Form 8839	6c			
d	Credit for the elderly or disabled. Attach Schedule R	6d			
e	Reserved for future use	6e			
f	Clean vehicle credit. Attach Form 8936	6f			
g	Mortgage interest credit. Attach Form 8396	6g			
h	District of Columbia first-time homebuyer credit. Attach Form 8859	6h			
i	Qualified electric vehicle credit. Attach Form 8834	6i			
j	Alternative fuel vehicle refueling property credit. Attach Form 8911	6j			
k	Credit to holders of tax credit bonds. Attach Form 8912	6k			
l	Amount on Form 8978, line 14. See instructions	6l			
m	Credit for previously owned clean vehicles. Attach Form 8936	6m			
z	Other nonrefundable credits. List type and amount:	6z			
7	Total other nonrefundable credits. Add lines 6a through 6z			7	4,375
8	Add lines 1 through 4, 5a, 5b, and 7. Enter here and on Form 1040, 1040-SR, or 1040-NR, line 20			8	4,375

(continued on page 2)

For Paperwork Reduction Act Notice, see your tax return instructions. **Schedule 3 (Form 1040) 2023**

Schedule E (Form 1040) 2023 Attachment Sequence No. **13** Page **2**

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

Your social security number ***-**-1111

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

Part II Income or Loss From Partnerships and S Corporations

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

27 Are you reporting any loss not allowed in a prior year due to the at-risk 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 basis computation is required	(f) Check if any amount is not at risk
A	Night Gates Cleaning	P	☐	**-***5565	☐	☐
B	UPE	P	☐	**-***5565	☐	☐
C	Guaranteed payments - services	P	☐	**-***5565	☐	☐
D			☐		☐	☐

	Passive Income and Loss		Nonpassive Income and Loss		
	(g) Passive loss allowed (attach Form 8582 if required)	(h) Passive income from Schedule K-1	(i) Nonpassive loss allowed (see Schedule K-1)	(j) Section 179 expense deduction from Form 4562	(k) Nonpassive income from Schedule K-1
A			0		49,064
B			3,275		
C			0		80,961
D					
29a Totals					130,025
b Totals			3,275		

30	Add columns (h) and (k) of line 29a	30	130,025
31	Add columns (g), (i), and (j) of line 29b	31	(3,275)
32	**Total partnership and S corporation income or (loss).** Combine lines 30 and 31	32	126,750

Part III Income or Loss From Estates and Trusts

33	(a) Name	(b) Employer identification number
A		
B		

	Passive Income and Loss		Nonpassive Income and Loss	
	(c) Passive deduction or loss allowed (attach Form 8582 if required)	(d) Passive income from Schedule K-1	(e) Deduction or loss from Schedule K-1	(f) Other income from Schedule K-1
A				
B				
34a Totals				
b Totals				

35	Add columns (d) and (f) of line 34a	35	
36	Add columns (c) and (e) of line 34b	36	( )
37	**Total estate and trust income or (loss).** Combine lines 35 and 36	37	

Part IV Income or Loss From Real Estate Mortgage Investment Conduits (REMICs)—Residual Holder

38	(a) Name	(b) Employer identification number	(c) Excess inclusion from Schedules Q, line 2c (see instructions)	(d) Taxable income (net loss) from Schedules Q, line 1b	(e) Income from Schedules Q, line 3b

39	Combine columns (d) and (e) only. Enter the result here and include in the total on line 41 below	39	

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 Schedule 1 (Form 1040), line 5	41	126,750
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 1120-S), box 17, code AN; and Schedule K-1 (Form 1041), box 14, code F. See instructions	42	
43	**Reconciliation for real estate professionals.** If you were a real estate professional (see instructions), enter the net income or (loss) you reported anywhere on Form 1040, Form 1040-SR, or Form 1040-NR from all rental real estate activities in which you materially participated under the passive activity loss rules	43	

DAA **Schedule E (Form 1040) 2023**

SCHEDULE SE (Form 1040)
Department of the Treasury
Internal Revenue Service

Self-Employment Tax

Attach to Form 1040, 1040-SR, 1040-SS, or 1040-NR.
Go to *www.irs.gov/ScheduleSE* for instructions and the latest information.

OMB No. 1545-0074
2023
Attachment Sequence No. **17**

Name of person with self-employment income (as shown on Form 1040, 1040-SR, 1040-SS, or 1040-NR): Amy Watts
Social security number of person with **self-employment** income: ***-**-1111

Part I Self-Employment Tax

Note: If your only income subject to self-employment tax is **church employee income,** see instructions for how to report your income and the definition of church employee income.

A If you are a minister, member of a religious order, or Christian Science practitioner **and** you filed Form 4361, but you had $400 or more of **other** net earnings from self-employment, check here and continue with Part I ☐

Skip lines 1a and 1b if you use the farm optional method in Part II. See instructions.

1a	Net farm profit or (loss) from Schedule F, line 34, and farm partnerships, Schedule K-1 (Form 1065), box 14, code A	1a	
b	If you received social security retirement or disability benefits, enter the amount of Conservation Reserve Program payments included on Schedule F, line 4b, or listed on Schedule K-1 (Form 1065), box 20, code AQ	1b	( )

Skip line 2 if you use the nonfarm optional method in Part II. See instructions.

2	Net profit or (loss) from Schedule C, line 31; and Schedule K-1 (Form 1065), box 14, code A (other than farming). See instructions for other income to report or if you are a minister or member of a religious order	2	126,750
3	Combine lines 1a, 1b, and 2	3	126,750
4a	If line 3 is more than zero, multiply line 3 by 92.35% (0.9235). Otherwise, enter amount from line 3	4a	117,054
	Note: If line 4a is less than $400 due to Conservation Reserve Program payments on line 1b, see instructions.		
b	If you elect one or both of the optional methods, enter the total of lines 15 and 17 here	4b	
c	Combine lines 4a and 4b. If less than $400, **stop;** you don't owe self-employment tax. **Exception:** If less than $400 and you had **church employee income,** enter -0- and continue	4c	117,054
5a	Enter your **church employee income** from Form W-2. See instructions for definition of church employee income — 5a		
b	Multiply line 5a by 92.35% (0.9235). If less than $100, enter -0-	5b	0
6	Add lines 4c and 5b	6	117,054
7	Maximum amount of combined wages and self-employment earnings subject to social security tax or the 6.2% portion of the 7.65% railroad retirement (tier 1) tax for 2023	7	160,200
8a	Total social security wages and tips (total of boxes 3 and 7 on Form(s) W-2) and railroad retirement (tier 1) compensation. If $160,200 or more, skip lines 8b through 10, and go to line 11 — 8a		
b	Unreported tips subject to social security tax from Form 4137, line 10 — 8b		
c	Wages subject to social security tax from Form 8919, line 10 — 8c		
d	Add lines 8a, 8b, and 8c	8d	
9	Subtract line 8d from line 7. If zero or less, enter -0- here and on line 10 and go to line 11	9	160,200
10	Multiply the **smaller** of line 6 or line 9 by 12.4% (0.124)	10	14,515
11	Multiply line 6 by 2.9% (0.029)	11	3,395
12	**Self-employment tax.** Add lines 10 and 11. Enter here and on **Schedule 2 (Form 1040), line 4**, or **Form 1040-SS, Part I, line 3**	12	17,910
13	**Deduction for one-half of self-employment tax.** Multiply line 12 by 50% (0.50). Enter the result here and on **Schedule 1 (Form 1040), line 15** — 13: 8,955		

For Paperwork Reduction Act Notice, see your tax return instructions. **Schedule SE (Form 1040) 2023**

Form **3800**

Department of the Treasury
Internal Revenue Service

General Business Credit

Go to *www.irs.gov/Form3800* for instructions and the latest information.
You must include all pages of Form 3800 with your return.

OMB No. 1545-0895
2023
Attachment Sequence No. **22**

Name(s) shown on return	Identifying number
Amy Watts	***-**-1111

A **Corporate Alternative Minimum Tax (CAMT) and Base Erosion Anti-Abuse Tax (BEAT).** Are you both (a) an "applicable corporation" within the meaning of section 59(k)(1) for the CAMT, and (b) an "applicable taxpayer" within the meaning of section 59A(e) for the BEAT? See instructions ☐ Yes ☐ No

Part I Current Year Credit for Credits Not Allowed Against Tentative Minimum Tax (TMT)

Go to Part III before Parts I and II. See instructions.

1	Non-passive credits from Part III, line 2: combine column (e) with non-passive amounts from column (g). See instructions			1	4,375
2	Passive credits from Part III, line 2: combine column (f) with passive amounts in column (g). See instructions	2			
3	Enter the applicable passive activity credits allowed for 2023. See instructions			3	
4	Carryforward of general business credit to 2023. See instructions for statement to attach			4	
	Check this box if the carryforward was changed or revised from the original reported amount ☐				
5	Carryback of general business credit from 2024. See instructions			5	
6	Add lines 1, 3, 4, and 5			6	4,375

Part II Allowable Credit

7	Regular tax before credits: • Individuals. Enter the sum of the amounts from Form 1040, 1040-SR, or 1040-NR, line 16; and Schedule 2 (Form 1040), line 2. • Corporations. Enter the amount from Form 1120, Schedule J, Part I, line 1; or the applicable line of your return. • Estates and trusts. Enter the sum of the amounts from Form 1041, Schedule G, lines 1a and 1b, plus any Form 8978 amount included on line 1d; or the amount from the applicable line of your return.			7	12,594
8	Alternative minimum tax: • Individuals. Enter the amount from Form 6251, line 11. • Corporations. Enter the amount from Form 4626, Part II, line 13. • Estates and trusts. Enter the amount from Schedule I (Form 1041), line 54.			8	
9	Add lines 7 and 8			9	12,594
10a	Foreign tax credit	10a			
b	Certain allowable credits (see instructions)	10b			
c	Add lines 10a and 10b			10c	
11	**Net income tax.** Subtract line 10c from line 9. If zero, skip lines 12 through 15 and enter -0- on line 16			11	12,594
12	**Net regular tax.** Subtract line 10c from line 7. If zero or less, enter -0-	12	12,594		
13	Enter 25% (0.25) of the excess, if any, of line 12 (line 11 for corporations) over $25,000. See instructions	13			
14	Tentative minimum tax: • Individuals. Enter the amount from Form 6251, line 9. • Corporations. Enter -0-. • Estates and trusts. Enter the amount from Schedule I (Form 1041), line 52.	14	2,894		
15	Enter the greater of line 13 or line 14			15	2,894
16	Subtract line 15 from line 11. If zero or less, enter -0-			16	9,700
17	Enter the **smaller** of line 6 or line 16 **C corporations:** See the line 17 instructions if there has been an ownership change, acquisition, or reorganization.			17	4,375

For Paperwork Reduction Act Notice, see separate instructions. Form **3800** (2023)

Amy Watts ***-**-1111

Form 3800 (2023) Page **2**

Part II **Allowable Credit** *(continued)*

Note: If you are not required to report any amounts on line 22 or line 24 below, skip lines 18 through 25 and enter -0- on line 26.

18	Multiply line 14 by 75% (0.75). See instructions	18	
19	Enter the greater of line 13 or line 18	19	
20	Subtract line 19 from line 11. If zero or less, enter -0-	20	
21	Subtract line 17 from line 20. If zero or less, enter -0-	21	
22	Combine the amounts from line 3 of Part III, column (e), with the sum of the non-passive activity credit amounts in Part IV, line 3, column (e) plus column (f)	22	
23	Passive activity credit from line 3 of Part III, column (f) plus the sum of the passive activity credit amounts in Part IV, line 3, column (e) plus column (f) — 23		
24	Enter the applicable passive activity credit allowed for 2023. See instructions	24	
25	Add lines 22 and 24	25	
26	Empowerment zone and renewal community employment credit allowed. Enter the smaller of line 21 or line 25	26	0
27	Subtract line 13 from line 11. If zero or less, enter -0-	27	12,594
28	Add lines 17 and 26	28	4,375
29	Subtract line 28 from line 27. If zero or less, enter -0-	29	8,219
30	Enter the general business credit from line 5 of Part III: combine column (e) with non-passive amounts in column (g). See instructions	30	
31	Reserved	31	
32	Passive activity credits from line 5 of Part III: combine column (f) with passive amounts in column (g). See instructions — 32		
33	Enter the applicable passive activity credits allowed for 2023. See instructions	33	
34	Carryforward of business credit to 2023. Enter the amount from line 5 of Part IV, column (f), and line 6 of Part IV, column (g). See instructions for statement to attach Check this box if the carryforward was changed or revised from the original reported amount ☐	34	
35	Carryback of business credit from 2024. Enter the amount from line 5 of Part IV, column (e). See instructions	35	
36	Add lines 30, 33, 34, and 35	36	
37	Enter the **smaller** of line 29 or line 36	37	
38	**Credit allowed for the current year.** Add lines 28 and 37. Report the amount from line 38 (if smaller than the sum of Part I, line 6, and Part II, lines 25 and 36; see instructions) as indicated below or on the applicable line of your return. • Individuals. Schedule 3 (Form 1040), line 6a. • Corporations. Form 1120, Schedule J, Part I, line 5c. • Estates and trusts. Form 1041, Schedule G, line 2b.	38	4,375

Form **3800** (2023)

Form 3800 (2023) Amy Watts ***-**-1111 Page 3

Part III Current Year General Business Credits (GBCs) (see instructions). If there is more than one credit amount to report on lines 1a through 1zz, line 3, or lines 4a through 4z, enter the number of items you have for that line in column (c) and complete Part V.

	(a) Current year credits from:	(b) Elective payment or transfer registration number	(c) # items	(d) Pass-through or transfer credit entity EIN	(e) Credits from non-passive activities	(f) Credits from passive activities	(g) Credit transfer election amount (enter amounts transferred out as a negative amount	(h) Gross elective payment election amount	(i) Net elective payment election amount	(j) Combine columns (e), (f), and (g), less column (i)
1a	Form 3468, Part II									
b	Form 7207									
c	Form 6765									
d	Form 3468, Part III									
e	Form 8826									
f	Form 8835, Part II									
g	Form 7210									
h	Form 8820									
i	Form 8874									
j	Form 8881, Part I			**-***5565	4,125					4,125
k	Form 8882									
l	Form 8864 (diesel)									
m	Form 8896									
n	Form 8906									
o	Form 3468, Part IV									
p	Form 8908									
q	Reserved (45Z)									
r	Form 8910									
s	Form 8911, Part II									
t	Form 8830									
u	Form 7213, Part II									
v	Form 3468, Part V									
w	Form 8932									
x	Form 8933									
y	Form 8936, Part II									
z	Reserved									
aa	Form 8936, Part V									
bb	Form 8904									
cc	Form 7213, Part I									
dd	Form 8881, Part II			**-***5565	250					250
ee	Form 8881, Part III									
ff	Form 8864, line 8									
gg	Reserved (1gg)									
hh	Reserved (1hh)									
ii	Reserved (1ii)									
jj	Reserved (1jj)									
zz	Other credits									
2	Add lines 1a through 1zz				4,375					4,375

DAA Form **3800** (2023)

Form 3800 (2023) Amy Watts ***-**-1111 Page 4

Part III Current Year General Business Credits (GBCs) (see instructions). If there is more than one credit amount to report on lines 1a through 1zz, line 3, or lines 4a through 4z, enter the number of items you have for that line in column (c) and complete Part V. *(continued)*

	(a) Current year credits from:	(b) Elective payment or transfer registration number	(c) # items	(d) Pass-through or transfer credit entity EIN	(e) Credits from non-passive activities	(f) Credits from passive activities	(g) Credit transfer election amount (enter amounts transferred out as a negative amount	(h) Gross elective payment election amount	(i) Net elective payment election amount	(j) Combine columns (e), (f), and (g), less column (i)
3	Form 8844									
4	**Specified credits:**									
a	Form 3468, Part VI									
b	Form 5884									
c	Form 6478									
d	Form 8586									
e	Form 8835, Part II									
f	Form 8846									
g	Form 8900									
h	Form 8941									
i	Form 6765 ESB credit									
j	Form 8994									
k	Form 3468, Part VII									
l	Reserved (4l)									
m	Reserved (4m)									
z	Other specified credits									
5	Add lines 4a through 4z									
6	Add lines 2, 3, and 5				4,375					4,375

Form **3800** (2023)

Form **8889**

Department of the Treasury
Internal Revenue Service

Health Savings Accounts (HSAs)

Attach to Form 1040, 1040-SR, or 1040-NR.

Go to *www.irs.gov/Form8889* for instructions and the latest information.

OMB No. 1545-0074

2023

Attachment Sequence No. **52**

Name(s) shown on Form 1040, 1040-SR, or 1040-NR: Amy Watts

Social security number of HSA beneficiary. If both spouses have HSAs, see instructions. ***-**-1111

Before you begin: Complete Form 8853, Archer MSAs and Long-Term Care Insurance Contracts, if required.

Part I **HSA Contributions and Deduction.** See the instructions before completing this part. If you are filing jointly and both you and your spouse each have separate HSAs, complete a separate Part I for each spouse.

1	Check the box to indicate your coverage under a high-deductible health plan (HDHP) during 2023. See instructions			X Self-only ☐ Family
2	HSA contributions you made for 2023 (or those made on your behalf), including those made by the unextended due date of your tax return that were for 2023. **Do not** include employer contributions, contributions through a cafeteria plan, or rollovers. See instructions		2	4,000
3	If you were under age 55 at the end of 2023 and, on the first day of **every** month during 2023, you were, or were considered, an eligible individual with the **same** coverage, enter $3,850 ($7,750 for family coverage). **All others,** see the instructions for the amount to enter		3	4,850
4	Enter the amount you and your employer contributed to your Archer MSAs for 2023 from Form 8853, lines 1 and 2. If you or your spouse had family coverage under an HDHP at any time during 2023, also include any amount contributed to your spouse's Archer MSAs		4	
5	Subtract line 4 from line 3. If zero or less, enter -0-		5	4,850
6	Enter the amount from line 5. But if you and your spouse each have separate HSAs and had family coverage under an HDHP at any time during 2023, see the instructions for the amount to enter		6	4,850
7	If you were age 55 or older at the end of 2023, married, and you or your spouse had family coverage under an HDHP at any time during 2023, enter your additional contribution amount. See instructions		7	
8	Add lines 6 and 7		8	4,850
9	Employer contributions made to your HSAs for 2023	9		
10	Qualified HSA funding distributions	10		
11	Add lines 9 and 10		11	
12	Subtract line 11 from line 8. If zero or less, enter -0-		12	4,850
13	**HSA deduction.** Enter the **smaller** of line 2 or line 12 here and on Schedule 1 (Form 1040), Part II, line 13 **Caution:** If line 2 is more than line 13, you may have to pay an additional tax. See instructions.		13	4,000

Part II **HSA Distributions.** If you are filing jointly and both you and your spouse each have separate HSAs, complete a separate Part II for each spouse.

14a	Total distributions you received in 2023 from all HSAs (see instructions)	14a	
b	Distributions included on line 14a that you rolled over to another HSA. Also include any excess contributions (and the earnings on those excess contributions) included on line 14a that were withdrawn by the due date of your return. See instructions	14b	
c	Subtract line 14b from line 14a	14c	
15	Qualified medical expenses paid using HSA distributions (see instructions)	15	
16	**Taxable HSA distributions.** Subtract line 15 from line 14c. If zero or less, enter -0-. Also, include this amount in the total on Schedule 1 (Form 1040), Part I, line 8f	16	
17a	If any of the distributions included on line 16 meet any of the **Exceptions to the Additional 20% Tax** (see instructions), check here ☐		
b	**Additional 20% tax** (see instructions). Enter 20% (0.20) of the distributions included on line 16 that are subject to the additional 20% tax. Also, include this amount in the total on Schedule 2 (Form 1040), Part II, line 17c	17b	

Part III **Income and Additional Tax for Failure To Maintain HDHP Coverage.** See the instructions before completing this part. If you are filing jointly and both you and your spouse each have separate HSAs, complete a separate Part III for each spouse.

18	Last-month rule	18	
19	Qualified HSA funding distribution	19	
20	**Total income.** Add lines 18 and 19. Include this amount on Schedule 1 (Form 1040), Part I, line 8f	20	
21	**Additional tax.** Multiply line 20 by 10% (0.10). Include this amount in the total on Schedule 2 (Form 1040), Part II, line 17d	21	

For Paperwork Reduction Act Notice, see your tax return instructions. Form **8889** (2023)

Form **7206** Department of the Treasury Internal Revenue Service

Self-Employed Health Insurance Deduction

Attach to Form 1040, 1040-SR, or 1040-NR.
Go to *www.irs.gov/Form7206* for instructions and the latest information.

OMB No. 1545-0074
2023
Attachment Sequence No. **206**

Name(s) shown on return: Amy Watts

Your taxpayer identification number: ***-**-1111

Note: Use a separate Form 7206 for each trade or business under which an insurance plan is established.

Line	Description	Line	Amount
1	Enter the total amount paid in 2023 for health insurance coverage established under your business (or the S corporation in which you were a more-than-2% shareholder) for 2023 for you, your spouse, and your dependents. But **don't** include the following. See instructions • Amounts for any month you were eligible to participate in a health plan subsidized by your employer or your spouse's employer or the employer of either your dependent or your child who was under the age of 27 at the end of 2023. • Any amounts paid, not to exceed $3,000, from retirement plan distributions that were **nontaxable** because you are a retired public safety officer. See instructions. • Any payments for qualified long-term care insurance (see line 2).	1	2,400
2	For coverage under a qualified long-term care insurance contract, enter for each person covered the **smaller** of (a) or (b). **(a)** Total payments made for that person during the year. **(b)** The amount shown below. Use the person's age at the end of the tax year. $480 ----if that person is age 40 or younger $890 ----if age 41 to 50 $1790 ----if age 51 to 60 $4770 ----if age 61 to 70 $5960 ----if age 71 or older **Note:** The amount of long-term care premiums that can be included as a medical expense is limited by the person's age. **Don't** include payments for any month you were eligible to participate in a long-term care insurance plan subsidized by your employer or your spouse's employer, or the employer of either your dependent or your child who was under the age of 27 at the end of 2023. If more than one person is covered, figure separately the amount to enter for each person. Then enter the total of those amounts	2	
3	Add lines 1 and 2	3	2,400
4	Enter your net profit* and any other earned income** from the trade or business under which the insurance plan is established. Don't include Conservation Reserve Program payments exempt from self-employment tax. If the business is an S corporation, skip to line 11	4	126,750
5	Enter the total of all net profits* from Schedule C (Form 1040), line 31; Schedule F (Form 1040), line 34; or Schedule K-1 (Form 1065), box 14, code A, plus any other income allocable to the profitable businesses. Don't include Conservation Reserve Program payments exempt from self-employment tax. See the Instructions for Schedule SE (Form 1040). **Don't** include any net losses shown on these schedules	5	126,750
6	Divide line 4 by line 5	6	1.0000
7	Multiply Schedule 1 (Form 1040), line 15, deductible part of self-employment tax, by the percentage on line 6	7	8,955
8	Subtract line 7 from line 4	8	117,795
9	Enter the amount, if any, from Schedule 1 (Form 1040), line 16, self-employed SEP, SIMPLE, and qualified plans, attributable to the same trade or business in which the insurance plan is established	9	14,561
10	Subtract line 9 from line 8	10	103,234
11	Enter your Medicare wages (box 5 of Form W-2) from an S corporation in which you are a more-than-2% shareholder and in which the insurance plan is established	11	
12	Enter any amount from Form 2555, line 45, attributable to the amount entered on line 4 or 11 above	12	
13	Subtract line 12 from line 10 or 11, whichever applies	13	103,234
14	**Self-employed health insurance deduction.** Enter the **smaller** of line 3 or line 13 here and on Schedule 1 (Form 1040), line 17. **Don't** include this amount when figuring any medical expense deduction on Schedule A (Form 1040)	14	2,400

* If you used either optional method to figure your net earnings from self-employment from any business, don't enter your net profit from the business Instead, enter the amount attributable to that business from Schedule SE (Form 1040), Part I, line 4b.

Earned income includes net earnings and gains from the sale, transfer, or licensing of property you created. However, it doesn't include capital gain income.

For Privacy Act and Paperwork Reduction Act Notice, see separate instructions. Form **7206** (2023)

Partnership Issues review questions

1. _____ When a partner performs services for or advances capital to their partnership within their capacity as a partner, and receives a payment that is determined without regard to partnership income, what are these payments called?

   A. Non-partner payments
   B. Guaranteed payments
   C. Wages
   D. Non-employee compensation

2. _____ Which of the following statements is correct regarding the treatment of health or accident insurance premiums paid by a partnership on behalf of a partner for services provided to a partnership?

   A. These payments may be treated as guaranteed payments that are subject to SE tax.
   B. The premiums are considered wages to the partner.
   C. These payments are not subject to SE tax.
   D. These payments are reported to the partner on a Form 1099-MISC.

3. _____ Which of the following statements is correct regarding a partner establishing a qualified retirement plan?

   A. Partners must seek approval from the partnership management before establishing a qualified retirement plan
   B. Partners can establish a qualified retirement plan and make contributions personally
   C. The qualified retirement plan must be established by the partnership
   D. Partners cannot establish a qualified plan, however, they can make contributions personally to one established by the partnership

Partnership Issues review answers

1.

A. Incorrect. Generally, if a partner performs the same or similar services for other businesses, the transaction is treated as if it were between the partnership and a stranger (non-partner). This is not a guaranteed payment.
B. **Correct.** When a partner performs services for, or advances capital to, their partnership *within their capacity as a partner* and the payment for such is determined *without regard to partnership income*, the payments are guaranteed payments [§707(c)]
C. Incorrect. A partnership cannot pay a partner a salary and issue a Form W-2, *Wage and Tax Statement*, to them.
D. Incorrect. Certain payments to a partner, other than in their capacity as a partner, would be considered non-employee compensation and would require the partnership to issue a Form 1099-NEC, *Nonemployee Compensation.*

[Guaranteed payments]

2.

A. **Correct.** When a partnership pays health or accident insurance premiums on behalf of a partner for services provided to the partnership, the payments may be treated as guaranteed payments that are subject to SE tax.
B. Incorrect. The payments may be treated as guaranteed payments, not wages.
C. Incorrect. The payments may be treated as guaranteed payments that are subject to SE tax.
D. Incorrect. The payments may be treated as guaranteed payments, not as miscellaneous income.

[Accident or health plans]

3.

A. Incorrect. Partners cannot set up a qualified plan personally.
B. Incorrect. Partners cannot set up a qualified plan personally, such as a §401(k), SEP or SIMPLE, and make contributions on their own.
C. **Correct.** The partnership itself must establish the retirement plan.
D. Incorrect. The partnership itself must establish the retirement plan and make contributions to the plan.

[Retirement]

Death of a Taxpayer

Introduction

Case study

Maria Sanchez, age 71, passed away on July 23, 2023. She was married to Sam Sanchez, age 74, at the time of her death. Her daughter, Lily Jones, has been named executrix of the estate. Lily has a copy of the will. Lily meets with her trusted tax advisor, as she doesn't know where to begin to address issues she has been tasked with.

Maria and Sam are both residents of Arizona, a community property state.

Where do we begin?

Upon death of the taxpayer, a new entity — the estate — is created and it is deemed that the taxpayer lived through the day of death [Reg. §1.451-1(d)]. When a taxpayer dies, there are three different federal tax forms that may be required to be filed:

- Final Form 1040, *U.S. Individual Income Tax Return*, is a short tax year ending on the taxpayer's date of death (DOD). Complete prior to Form 1041, since some income may need to be carved out of Form 1040 to be reported on Form 1041.
- Form 1041, *U.S. Income Tax Return for Estates and Trusts*, reports the income and tax liability of the decedent's estate. Occasionally this form is not necessary if there is less than $600 of gross income in the estate or if the taxpayer died with no income-producing assets.
- Form 706, *United States Estate (and Generation-Skipping Transfer) Tax Return*, reports and pays the estate and generation skipping transfer taxes for estates over $13.61 million (2024).

Although a taxpayer is deceased, a final tax return is required. In general, the final Form 1040 of a decedent is prepared and filed in the same manner as when they were alive. For purposes of paying any tax and filing the final Form 1040, the due date remains April 15 for calendar year taxpayers, which is typically the case. If the taxpayer is using the fiscal year calendar, it is deemed that the taxpayer lived throughout the full fiscal year for tax filing purposes and paying any tax [Reg. §1.443-1(a)(2)]. For all other purposes, such as income and deductions, include only the amount received or constructively received through the date of death. The first step prior to starting the final Form 1040 is to determine who is responsible for filing and signing.

How property passes

Upon the death of a taxpayer, all their interest in property passes to a beneficiary. Generally, there are four ways that property can pass at death:

- **By operation of law.** This is property that is owned by joint tenants with rights of survivorship, tenancy of the entireties, transfer on death (TOD) or payable on death (POD).
- **By beneficiary designation.** This is property that is payable to an individual designated in an asset such as a retirement account or a life insurance policy. These assets are not included in the fiduciary income tax return unless the estate is the beneficiary.
- **By contract.** This includes property that is held in a trust. Generally, property that has been transferred to a trust is not included in the probate estate. Occasionally, a trust will elect to be treated as the estate, which is discussed later in the text.
- **Probate.** Property owned individually or as tenants in common (TIC) passes through the probate system. This is the focus of this textbook.

For income to be reportable on the Form 1041, the income must pass through the estate, oftentimes through **probate**. If assets transfer directly to beneficiaries or are held in trusts, it is possible for no taxable income to be payable by the estate.

Title to assets

It is important to know how the decedent titled their assets in order to properly report the income. Following are some common types of ownership:

- Sole ownership
- Jointly-held property:
  - Tenants in common (TIC)
  - Community property
  - Payable on death (POD) account
  - Transfer on death (TOD) account
  - Totten trusts
  - Joint tenants with right of survivorship (JTWROS)

Sole ownership

The sole owner titles their assets in their name only and holds all rights to the property. Sole ownership is the simplest form of ownership. One person owns all the interest in the property. The owner may lease, mortgage or transfer the property during their lifetime. At the owner's death, this solely-owned property becomes part of the owner's probate estate and passes to those entitled to it by inheritance laws or under the owner's will.

Income

Income from property owned solely by the decedent is attributable to the final Form 1040 or decedent's estate, depending on when paid.

Jointly held property

The titling of jointly held property governs the disposition of such property at death, not the decedent's will. Common types of joint titling are TIC, community property, POD, TOD, Totten trusts and JTWROS. As a result, the ownership of property jointly held with right of survivorship passes automatically to the surviving joint owner(s). Prior to death, each joint owner owns an undivided interest in the asset. Upon death, the decedent's interest passes immediately to the surviving owner(s).

In addition, the decedent's relationship to the other joint owner(s) determines how to treat the property for estate tax purposes. For example, include one-half of the value of the property held jointly by spouses in the estate of the spouse who dies first. The ownership of the property automatically passes to the surviving spouse tax-free due to the marital deduction.

Note: For property held in a community property state, include one-half the value in the estate. However, the basis of the asset receives a full step-up at death. Unlike JTWROS, title generally does not transfer immediately and is includable in probate.

Property held jointly by spouses before 1977 is 100% includable in the estate of the first to die and receives a fair market value (FMV) basis for the entire property, if the decedent furnished all the consideration (M. Lee Gallenstein v. U.S., 975 F2d 286, 1992).

If holding the property jointly with an individual other than a spouse, the entire value of the property is includable in the estate of the first owner to die, unless the estate can show that the co-owner(s) was responsible for purchasing a specific portion of the property. As a result, it is important to have proof of the co-owner's participation in the purchase of the property, so their portion is excludable from the decedent's estate.

The following table summarizes whether or not jointly owned property is subject to probate, the basis of the property, whether or not is it included in the estate and where to report income generated from the property.

	Subject to Probate	Basis Step-Up	Included in Estate	Form to Report Post-Death Income
JTWROS	No	Decedent's portion only (except IRD assets)	Decedent's share based on contri-bution	Surviving owner's Form 1040
TIC	Yes	Decedent's portion only (except IRD assets)	Decedent's share based on contri-bution	Estate Form 1041 (decedent's share)
Community Property	Yes (decedent's share)	Both halves (except IRD assets)	Decedent's half	Half on Form 1041, half on surviving spouse's Form 1040
Community Property with Right of Survivorship	No	Both halves (except IRD assets) [consult state law]	Decedent's half	Surviving owner's Form 1040
Separate Property	Yes	All	All	Estate Form 1041
POD & TOD	No	All	All	Beneficiary's Form 1040
Beneficiary Designation (IRA, Life Insurance, Annuity, and Pension Plans)	No (unless estate named)	No, if IRD asset	Generally, all	Beneficiary's Form 1040
Grantor Trusts (including Totten Trusts)	No	Generally, yes (except IRD assets)	Yes, if revocable, retained life estate, transfer taking effect at death or retained general power of appointment	Trust Form 1041 (or Estate Form 1041 if §645 election is made)
Nongrantor Trust	No	No	No, unless decedent had general power of appointment	Trust Form 1041

Probate

Probate is a judicial procedure by which an estate distributes the decedent's property to legal heirs after the payment of any debts, taxes or other claims against the decedent.

As noted above, not all property is distributable through probate. In recent years, there has been a steady rise in the use of revocable trusts. Many taxpayers try to avoid probate by placing their assets in a revocable trust, which distributes assets after death according to instructions in the trust document.

Taxpayers should still have a will to place assets, inadvertently left out or acquired later, into the trust. The trust cannot control assets not titled in its name. In that case, a pour-over will directs those assets into the trust. If there are no assets subject to the pour-over will, then the will does nothing. Assets that the decedent does not properly transfer into a trust prior to death, and are thereby subject to a pour-over will, do not avoid probate.

Note: There is a common misconception that if no assets are subject to probate, there is no estate. However, an estate is comprised of all assets owned or controlled at the time of death, whether they are distributable through the probate process or an alternate way.

Certain types of assets are not usually subject to probate because the interest passes by beneficiary designation. Thus, these types of assets normally are not subject to probate unless the decedent named the estate the beneficiary, or the beneficiary designation is invalid or incomplete. Although they are not subject to probate, they are typically includable in the estate of the decedent for Form 706 tax purposes.

These assets typically include:

- Life insurance proceeds
- Annuity policies
- Pension and profit-sharing plans
- IRA accounts
- POD and TOD accounts

During probate, the court determines the validity of the decedent's will. The court officially appoints the executor or personal representative (often called the fiduciary). The fiduciary arranges for the appraisal of assets, inventories the assets, and pays the taxes, claims and debts of the estate. If required, the fiduciary files personal income tax, fiduciary income tax, gift and estate tax returns, and sells assets if empowered or directed by the will. Courts generally have to approve the sale of assets held in probate. Finally, the fiduciary distributes the assets to the heirs and files accountings with the court. The probate court judge or other official reviews all documents filed for accuracy and completeness.

If the decedent dies without a valid will, they are said to be intestate, and the state law of intestacy determines who inherits their property.

Case study

As a reminder, Maria Sanchez, age 71, passed away on July 23, 2023. She was married to Sam Sanchez, age 74, at the time of her death. Her daughter, Lily Jones, has been named executrix of the estate. Lily has a copy of the will.

Information gathered during the client interview includes:

- Her §401(k) should be liquidated and distributed to her children Lily and Jonathan
  - The beneficiary listed on the account is Sam, not the children
- Sam is listed as a direct beneficiary of an IRA established by Maria
- She had a savings account at The Credit Union that did not have a POD or TOD
- Joint bank account titled as JTWROS held at Big Bank will be inherited by Sam
- A charitable contribution of $5,000 should be made to Happy Paws, a local animal shelter
- Maria's portion of their primary residence goes to Sam
- Maria solely owned a condo located in Bozeman, Montana. The condo was placed in a revocable trust after the death of her first spouse, Jorge Lopez. Both Lily and Jonathan are beneficiaries of the trust. Jonathan was listed as the successor trustee upon the death of Maria.
  - Maria would rent out the condo during peak tourist months
  - No personal use of the condo in 2023
- Maria held stock in XYZ company. The shares are to be sold and net proceeds divided equally between Lily, Jonathan and Sam.
- Any property not jointly owned with Sam is to be sold and proceeds divided equally between Lily, Jonathan and Sam.

Lily followed the instructions of their family attorney and had already obtained an employer identification number (EIN) for the estate.

Sam is anticipating a large inheritance within a few years. He is hoping for some tax planning to save on potential federal estate taxes upon his death.

In addition to the will, Sam and Lily provide the informational documents necessary to prepare both Form 1040 and Form 1041.

Informing the IRS of a Fiduciary Duty

When the estate is created and the personal representative appointed, the personal representative is required to notify the IRS of the fiduciary relationship (§6903). Use Form 56, *Notice Concerning Fiduciary Relationship*, for this purpose. Thereafter, the fiduciary assumes the powers, rights and duties of the taxpayer with respect to all related federal tax matters.

Note: The Form 56 instructions indicate a separate form should be filed for each person acting in their capacity as a fiduciary. For example, if the person is filing the decedent's final Form 1040 and is the executor of the decedent's estate, file separate forms for the final Form 1040 and the estate Form 1041. Use the name of the decedent on Form 56 for the final Form 1040 and the name of the estate on Form 56 for the Form 1041.

Mail Form 56 to the IRS service center where the decedent was required to file their final Form 1040. File Form 56 again when the fiduciary relationship has ended.

Do not sign this form unless you are the representative of the estate.

Note: File Form 56 and complete Part II if the fiduciary is revoking or terminating a prior notice of fiduciary relationship.

Failing to file Form 56 can be detrimental. If the fiduciary does not file the notice of the fiduciary relationship with the IRS before the IRS sends a Notice of Deficiency, the IRS will not send the Notice of the Deficiency to the fiduciary. In such a case, when the IRS sends the notice to the last known address of the taxpayer, transferee or other person, it is deemed sufficient compliance with the requirements of the code, even if such person is deceased. In that case, if the taxpayer (transferee or other person) does not file a petition with the Tax Court within 90 days after the mailing of the Notice of Deficiency, the IRS assesses the tax immediately upon the expiration of such 90-day period and makes the demand for payment [Reg. §301.6903-1(c)]. Thus, the benefit to the fiduciary of Form 56 is to ensure that the IRS directs all correspondence, including notices of deficiency, to the fiduciary.

Note: Tax professionals representing the estate as an authorized representative should file Form 2848, *Power of Attorney and Declaration of Representative*, not Form 56.

If a tax professional has a power of attorney in place for the decedent, they will need a new one from the fiduciary to handle matters of the decedent's return.

Case study

Lily Jones was named the executrix of the estate per her mother's will. A Form 56 is necessary for both the estate of Maria Sanchez and for the final Form 1040 that will be filed on her behalf. The completed forms are as follows:

Form **56**
(Rev. November 2022)
Department of the Treasury
Internal Revenue Service

Notice Concerning Fiduciary Relationship
(Internal Revenue Code sections 6036 and 6903)
Go to *www.irs.gov/Form56* for instructions and the latest information.

OMB No. 1545-0013

Part I Identification

Name of person for whom you are acting (as shown on the tax return)	Identifying number	Decedent's social security no.
Maria Sanchez		***-**-9012

Address of person for whom you are acting (number, street, and room or suite no.)
1234 West Fake Street

City or town, state, and ZIP code (If a foreign address, see instructions.)
Flagstaff AZ 85001

Fiduciary's name
Lily Jones

Address of fiduciary (number, street, and room or suite no.)
45 East Fake Street

City or town, state, and ZIP code	Telephone number (optional)
Flagstaff AZ 85001	555-555-5555

Section A. Authority

1 Authority for fiduciary relationship. Check applicable box:
- a [X] Court appointment of testate estate (valid will exists)
- b [ ] Court appointment of intestate estate (no valid will exists)
- c [ ] Court appointment as guardian or conservator
- d [ ] Fiduciary of intestate estate
- e [ ] Valid trust instrument and amendments
- f [ ] Bankruptcy or assignment for the benefit or creditors
- g [ ] Other. Describe:

2a If box 1a, 1b, or 1d is checked, enter the date of death 07/23/23
b If box 1c, 1e, 1f, or 1g is checked, enter the date of appointment, taking office, or assignment or transfer of assets:

Section B. Nature of Liability and Tax Notices

3 Type of taxes (check all that apply): [X] Income [ ] Gift [ ] Estate [ ] Generation-skipping transfer [ ] Employment [ ] Excise [ ] Other (describe):

4 Federal tax form number (check all that apply): a [ ] 706 series b [ ] 709 c [ ] 940 d [ ] 941, 943, 944
e [X] 1040 or 1040-SR f [ ] 1041 g [ ] 1120 h [ ] Other (list):

5 If your authority as a fiduciary does not cover all years or tax periods, check here [ ]
and list the specific years or periods within your authority:

For Paperwork Reduction Act and Privacy Act Notice, see separate instructions. Form **56** (Rev. 11-2022)

Form **56**
(Rev. November 2022)
Department of the Treasury
Internal Revenue Service

Notice Concerning Fiduciary Relationship
(Internal Revenue Code Sections 6036 and 6903)
Go to *www.irs.gov/Form56* for instructions and the latest information.

OMB No. 1545-0013

Part I Identification

Name of person for whom you are acting (as shown on the tax return)	Identifying number	Decedent's social security no.
Estate of Maria Sanchez	**-***8912	***-**-9012

Address of person for whom you are acting (number, street, and room or suite no.)
45 East Fake Street

City or town, state, and ZIP code (If a foreign address, see instructions.)
Flagstaff AZ 85001

Fiduciary's name
Lily Jones

Address of fiduciary (number, street, and room or suite no.)
45 East Fake Street

City or town, state, and ZIP code	Telephone number (optional)
Flagstaff AZ 85001	555-555-5555

Section A. Authority

1 Authority for fiduciary relationship. Check applicable box:
a [X] Court appointment of testate estate (valid will exists)
b [ ] Court appointment of intestate estate (no valid will exists)
c [ ] Court appointment as guardian or conservator
d [ ] Fiduciary of intestate estate
e [ ] Valid trust instrument and amendments
f [ ] Bankruptcy or assignment for the benefit or creditors
g [ ] Other. Describe:
2a If box 1a, 1b, or 1d is checked, enter the date of death: 07/23/23
b If box 1c, 1e, 1f, or 1g is checked, enter the date of appointment, taking office, or assignment or transfer of assets:

Section B. Nature of Liability and Tax Notices

3 Type of taxes (check all that apply): [X] Income [ ] Gift [X] Estate [ ] Generation-skipping transfer [ ] Employment
[ ] Excise [ ] Other (describe):
4 Federal tax form number (check all that apply): a [X] 706 series b [ ] 709 c [ ] 940 d [ ] 941, 943, 944
e [ ] 1040 or 1040-SR f [X] 1041 g [ ] 1120 h [ ] Other (list):
5 If your authority as a fiduciary does not cover all years or tax periods, check here [ ]
and list the specific years or periods within your authority:

For Paperwork Reduction Act and Privacy Act Notice, see separate instructions. Form **56** (Rev. 11-2022)

Final Return and Estate Form 1041 Considerations

During the year of death, income must be allocated between the taxpayer's final Form 1040 and Form 1041. Additionally, when dealing with a deceased taxpayer, a filing status must be determined. The status to use is dependent on several facts and circumstances.

Married decedent's filing status

In the year of a spouse's death, the survivor and decedent spouse generally are married for the entire year for tax purposes. Therefore, the surviving spouse can file a joint return with the decedent spouse. This rule also applies if both spouses die during the same tax year or when a spouse dies after a tax year without having filed a return for that year [Reg. §1.6013-1(d)]. If the surviving spouse is eligible, they may find it more tax beneficial to claim the filing status of the qualifying surviving spouse (QSS).

However, if the surviving spouse remarries before year-end, use married filing separately (MFS) status for the decedent's final return.

Married filing separately

If the surviving spouse is not filing a joint return, insert the decedent's name in the name box and the personal representative's name and address in the address box (Pub. 559, *Survivors, Executors, and Administrators*). As discussed previously, sometimes taxpayers choose to file separately in the year of death to avoid any past-due income tax or current income tax of the decedent. One of the goals of doing this is that the IRS cannot collect from the deceased.

There may be another advantage to the surviving spouse and the decedent filing separately in the year of death. Deductions subject to a percentage limitation of adjusted gross income (AGI) (for example, medical or casualty deductions) may be more if the surviving spouse is filing a return with only one spouse's income.

If a surviving spouse, personal representative or executor originally filed a separate return for the decedent and the due date for filing the return has passed, only the personal representative or executor can file an amended return to change a joint return [§6013(b)(1)]. Thus, when there is no personal representative or executor appointed, a joint return filed cannot replace the separate return. Also, the personal representative or executor must make a change from a separate return to a joint return within three years from the last date prescribed by law for filing the return for such taxable year (determined without regard to any extension of time granted to either spouse) [§6013(b)(2)(A)].

A personal representative or executor cannot change from a separate return to a joint return if:

- The IRS has mailed a Notice of Deficiency to either spouse, with respect to such taxable year, under §6212, if the spouse, as to such notice, files a petition with the Tax Court within the time prescribed in §6213
- Either spouse has commenced a suit in any court for the recovery of any part of the tax for such taxable year
- Either spouse has entered into a closing agreement under §7121 with respect to such taxable year
- Any civil or criminal case arising against either spouse with respect to such taxable year has been compromised under §7122

Married filing jointly

Generally, a married filing joint (MFJ) return can be made only with the cooperation of the executor or administrator of the decedent's estate [§6013(a)(3)]. A personal representative other than the surviving spouse should sign the return on behalf of the decedent with the words "Personal Representative" next to their signature. If the court or will has not appointed a personal representative, the signer should indicate their capacity (trustee, guardian, etc.) or relationship to the decedent (spouse, son, daughter, etc.). However, a surviving spouse, acting alone, can file a joint return with the decedent spouse under the following conditions:

- The decedent has not filed a tax return for the tax year. This includes the current year of death as well as the prior year if the decedent died before filing the prior year's tax return.
- The court or will has not appointed an executor or administrator by the latter of the time the surviving spouse filed the return or the due date of the return, including extensions.

If a surviving spouse files a joint return acting alone, an executor or administrator appointed after the filing of the joint return can disaffirm the joint return if they do so within one year of the due date, including extensions, for filing the surviving spouse's return [§6013(a)(3) and Reg. §1.6013-1(d)(5)].

Case study

Maria Sanchez passed away on July 23, 2023. She was married to Sam at the time of her death. They have no qualifying dependents. What filing status can be used on their return?

During 2023, an MFJ return can be filed with Sam or an MFS return can be filed. Lily (the executor) and Sam agree to file as MFJ for 2023.

Allocating Income

In the year of a taxpayer's death, report income received on or before the date of death on the decedent's final Form 1040 and report income received after the date of death on the estate's Form 1041. A taxpayer's tax year ends as of the day of death [Reg. §1.451-1(d)(1)].

Checks for income received but not cashed before the date of death are income taxable on the decedent's final Form 1040. This is true even if the payor issues another check after death to replace it.

Income earned at the time of death but not includable in the decedent's income under their accounting method is income in respect of a decedent (IRD). IRD is generally included in the taxable income of the decedent's estate (Form 1041) and is also subject to estate tax on Form 706 [§691(a)(1)]. Common examples are accrued interest and dividend income, unpaid compensation for personal services, accrued vacation pay, installment sales, annuities, and individual retirement account (IRA) or retirement plan distributions made after the participant's death. Treat certain deductions accrued at the time of death in a similar manner [§691(b)].

The final return filed on behalf of an accrual-basis decedent includes their income and deductions under the accrual method. Any amount of income or deduction accrued solely by reason of their death is not includable in the final return [§451(b); §461(b); Reg. §1.451-1(b); Reg. §1.461-1(b)]. However, it is a part of the decedent's after-death income, as is any purely contingent income claim [Reg. §1.691(a)-1(b)].

Note: Appendix D contains a chart to help identify where to report both income and expenses.

Matching issues

Especially in the year of death, there are going to be matching issues with informational returns. Ideally, the estate's representative notifies financial institutions, brokerage firms, etc., of the change in taxpayer identification numbers as soon as possible. This is the job of the fiduciary, such as the executor or personal representative. Unfortunately, performing this task on a timely basis is sometimes difficult, such as when a death occurs late in the year.

Even if the personal representative obtains an EIN using Form SS-4, *Application for Employer Identification Number*, for the estate and notifies the payors of income (financial institutions, brokerage firms, etc.) of the change in taxpayer identification number as soon as possible, there will more than likely be information returns that have the combined income for the year of death.

Under normal circumstances, when a taxpayer receives an information return, such as a Form 1099, and it belongs to another individual, the taxpayer must issue an information return as a nominee/middleman. However, no nominee reporting on Form 1099 is required by the fiduciary when Form 1041 filed by the estate reports the interest or dividend income and discloses the name, address, and identifying number of both the record owner and actual owner [Reg. §1.6042-2(a)(1)(ii)(A) and Reg. §1.6049-4(c)(2)(i)].

One solution to avoid a matching issue is to enter the entire amount shown on the Form 1099 under the decedent's Social Security number (SSN) on their final personal income tax return and back out the portion reported on the estate's Form 1041 (showing the name of the estate and the estate's EIN). This helps prevent IRS matching problems.

Practitioner pointer: Although the regulations state that nominee reporting is not required for interest and dividend income if disclosing the estate's information, the regulations for other Form 1099 related items are silent.

Alternatively, attach a common schedule that allocates dividends and interest reported on Form 1099 between the decedent's final Form 1040 and the estate's initial Form 1041 to both returns. Pub. 559 contains a worksheet to reconcile the amounts reported under the decedent's SSN and shows which taxpayer (decedent, estate or beneficiary) is reporting the amounts.

Note: Ideally, the payor of the information reporting, such as banks and brokers, properly issues two information reports (Form 1099s): one to the estate (or beneficiary) and one to the decedent. Oftentimes, payors simply report the full amount in one report. Properly disclosing the total amount and backing out what belongs to the estate will save time in writing correspondence to the IRS explaining the reason for the amount reported on Form 1040, which does not show the full amount reported to the IRS.

Table B. Worksheet To Reconcile Amounts Reported in Name of Decedent on Information Returns (Forms W-2, 1099-INT, 1099-DIV, etc.)

Keep for Your Records

Name of Decedent	Date of Death	Decedent's Social Security Number		
Name of Personal Representative, Executor, or Administrator		Estate's Employer Identification Number (If Any)		
Source (list each payer)	A. Enter total amount shown on information return	B. Enter part of amount in column A reportable on decedent's final return	C. Amount reportable on estate's or beneficiary's income tax return (column A minus column B)	D. Part of column C that is *income in respect of a decedent*
1. Wages				
2. Interest income				
3. Dividends				
4. State income tax refund				
5. Capital gains				
6. Pension income				
7. Rents, royalties				
8. Taxes withheld*				
9. Other items, such as social security, business and farm income or loss, unemployment compensation, etc.				

* List each withholding agent (employer, etc.).

Practitioner tip: Sometimes, the estate receives Forms 1099 issued in the decedent's SSN in years after death and the estate never obtained an EIN. The IRS does not give guidance on how to handle these types of situations. Because the taxpayer's taxable year ended in a prior year, it would be incorrect to file Form 1040 in a year after death, as deductions and income would not be consistent with Subchapter J of the IRC. On the other hand, there is a legitimate concern that the IRS will improperly match the Form 1099 with the deceased's SSN, thus resulting in a CP2000 notice being issued. Without specific guidance, it is best to obtain an EIN for the estate, file Form 1041 with a statement explaining what happened, and issue a Schedule K-1 *(Form 1041), Beneficiary's Share of Income, Deductions, Credits, etc.*, to the beneficiary who received the money, if applicable.

Interest

If a decedent used the cash-basis method of accounting, their final return includes only those items of income that they actually or constructively received up to the end of the day of their death.

Case study

Neither Sam nor Lilly notified the bank of Maria's death before The Credit Union issued a Form 1099-INT, *Interest Income*, for 2023. As such, it was issued in Maria's SSN. Without a transfer upon death, the account is an asset of the estate; therefore, interest income must be allocated between Form 1040 and Form 1041. Prior to death, interest earned on the account was $85.

To avoid IRS matching issues, report the full amount on the Form 1099-INT on Schedule B on one line, then on the next line, remove the $50, which is taxable to the estate. The interest that was earned, but unpaid, at the time of her death is IRD. The following illustrates the allocation between the decedent's final return and the initial Form 1041 on Schedule B (Form 1040), *Interest and Ordinary Dividends*.

SCHEDULE B (Form 1040)
Department of the Treasury
Internal Revenue Service

Interest and Ordinary Dividends
Attach to Form 1040 or 1040-SR.
Go to *www.irs.gov/ScheduleB* for instructions and the latest information.

OMB No. 1545-0074
2023
Attachment Sequence No. **08**

Name(s) shown on return	Your social security number
Maria & Sam Sanchez	***-**-9012

Part I Interest				Amount
(See instructions and the Instructions for Form 1040, line 2b.) **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 form.	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 the instructions and list this interest first. Also, show that buyer's social security number and address:		
		The Credit Union		135
		Big Bank		200
		** Subtotal **		335
		Nominee Distribution (see EIN 41-4141414)	1	-50
	2	Add the amounts on line 1	2	285
	3	Excludable interest on series EE and I U.S. savings bonds issued after 1989. Attach Form 8815	3	
	4	Subtract line 3 from line 2. Enter the result here and on Form 1040 or 1040-SR, line 2b	4	285

Capital gains and losses

Take care in determining what sales the decedent made on and before, or the estate made after, the date of death. If the brokers do not begin reporting these transactions to the estate's EIN as of the day after the date of death on Form 1099-B, *Proceeds From Broker and Barter Exchange Transactions*, examination of brokers' statements is necessary to determine the correct taxpayer and appropriate tax return to report them. If the sale date (also called the date of disposition or trade date) is on or before the date of death, the sale is reportable on the final Form 1040. The settlement date is not relevant (Rev. Rul. 93-84).

Similar to how banks can issue Form 1099-INT for interest to the decedent's SSN, the same can occur with Form 1099-B. To avoid matching issues with capital transactions, report the full amount of Form 1099-B on the final Form 1040, then report a negative amount to remove the transactions that occurred on behalf of the estate.

The decedent's capital loss carryovers that arose before death are lost if not used on the decedent's final personal income tax return (Rev. Rul. 74-175). Even if the decedent is married, the decedent's capital loss does not pass on to the surviving spouse to any years after death.

Case study

Maria purchased 500 shares of XYZ Company on April 15, 2002, for $3,000. Maria sold 100 shares of XYZ Company on March 1, 2023, for $5,500. The remaining 400 shares were sold on Sept. 1, 2023, for $30,000. Her basis in the 100 shares sold prior to her death is $600 [100 ($3,000 / 500)]. The FMV of the remaining shares was $22,800 on Maria's date of death. Lily did not have the shares transferred to the estate prior to sale; therefore, all sales were reported to Maria under her SSN on Form 1099-B.

To avoid matching issues and properly report gains and losses, Lily must reconcile the transactions to determine the gains reportable on the final Form 1040 and Form 1041. The sales are reported on Form 8949 as follows:

Form 8949 (2023) Attachment Sequence No. **12A** Page **2**

Name(s) shown on return. Name and SSN or taxpayer identification no. not required if shown on other side: Maria & Sam Sanchez

Social security number or taxpayer identification number: ***-**-9012

Before you check Box D, E, or F below, see whether you received any Form(s) 1099-B or substitute statement(s) from your broker. A substitute statement will have the same information as Form 1099-B. Either will show whether your basis (usually your cost) was reported to the IRS by your broker and may even tell you which box to check.

Part II **Long-Term.** Transactions involving capital assets you held more than 1 year are generally long-term (see instructions). For short-term transactions, see page 1.

Note: You may aggregate all long-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS and for which no adjustments or codes are required. Enter the totals directly on Schedule D, line 8a; you aren't required to report these transactions on Form 8949 (see instructions).

You *must* check Box D, E, *or* F below. Check only one box. If more than one box applies for your long-term transactions, complete a separate Form 8949, page 2, for each applicable box. If you have more long-term transactions than will fit on this page for one or more of the boxes, complete as many forms with the same box checked as you need.

- [X] **(D)** Long-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS (see **Note** above)
- [ ] **(E)** Long-term transactions reported on Form(s) 1099-B showing basis **wasn't** reported to the IRS
- [ ] **(F)** Long-term transactions not reported to you on Form 1099-B

1 (a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold or disposed of (Mo., day, yr.)	(d) Proceeds (sales price) (see instructions)	(e) Cost or other basis See the **Note** below and see *Column (e)* in the separate instructions.	Adjustment, if any, to gain or loss If you enter an amount in column (g), enter a code in column (f). **See the separate instructions.** (f) Code(s) from instructions	(g) Amount of adjustment	(h) **Gain or (loss)** Subtract column (e) from column (d) and combine the result with column (g).
100.000 sh XYZ Company	04/15/02	03/01/23	5,500	600			4,900
400.000 sh XYZ Company	04/15/02	09/01/23	30,000	2,400	N	-27,600	0
2 Totals. Add the amounts in columns (d), (e), (g), and (h) (subtract negative amounts). Enter each total here and include on your Schedule D, **line 8b** (if **Box D** above is checked), **line 9** (if **Box E** above is checked), or **line 10** (if **Box F** above is checked)			35,500	3,000		-27,600	4,900

Note: If you checked Box D above but the basis reported to the IRS was incorrect, enter in column (e) the basis as reported to the IRS, and enter an adjustment in column (g) to correct the basis. See *Column (g)* in the separate instructions for how to figure the amount of the adjustment.

Form **8949** (2023)

Rental real estate

A transfer of rental property due to death is a disposition for purposes of the passive activity rules. Generally, apply passive activity losses and credits, including rental expenses, against passive income for the tax year or subsequent tax years from that passive activity or other passive activities. Do not use passive activity losses and credits as deductions or credits against nonpassive income.

Passive losses

Passive losses are deductible when the taxpayer disposes of the entire interest in the passive activity (a complete disposition) in a fully taxable transaction [§469(g)(1)]. Then, both current and suspended losses generated by that activity (as well as any loss on disposition) become fully deductible.

However, the benefit of a transfer of rental property due to death, which is treated as a disposition, is limited. On a decedent's final return, claim suspended passive losses after reducing suspended losses by any §1014 step-up in basis attributable to the passive activity property [§469(g)(2)].

Example

Baily owned rental property. Prior to her death, there were suspended losses of $100,000 and the property's basis was $285,000. FMV on date of death was $350,000. Claim $35,000 [$100,000 - $65,000 ($350,000 - $285,000)] in suspended losses on Baily's final 1040.

If suspended passive losses are not allowable and not deductible on the decedent's final Form 1040 due to the restrictions, they are lost.

Depreciation

Depreciation on the property is prorated through the date of death and reported on the final return for the decedent. The remainder of the year's depreciation deduction is apportioned to the estate and its heirs based on the share of the estate's income allocated to each of them [Prop. Reg. §1.168-5(f)(4); Prop. Reg. §1.168-2(f)(1)]. The date of receipt of the property is the placed-in-service date for depreciation as a new asset to the estate and/or heirs. If the decedent and the heir held depreciable real estate as joint tenants, the depreciation starts all over again with the new basis on the decedent's share [§1014; Reg. §1.167(g)-1; §1011].

Practitioner tip: Unless tax preparation software has input for situations when the taxpayer dies, overriding depreciation may be necessary. Simply marking the property "out of service" is insufficient. Most preparation software computes depreciation as disposed using mid-month or half-year depreciation instead of prorating the depreciation throughout the year.

Case study

The Bozeman condo, located at 444 Big Sky Way, was rented during the summer months and a few weeks in winter. Maria would use a management company to handle booking renters a month or more at a time, scheduling repair services if necessary and cleaning of the property between renters. Neither Maria nor her family personally used the property in 2023, and did not have prior suspended losses on the property. For reporting purposes, while the condo is held in a trust since it was revocable prior to Maria's death, income, expenses and depreciation are allocated between Form 1040 and what is includible on the trust's Form 1041. The condo does not end up in probate as it was held in the trust. Lily provides you with the following information to prepare Schedule E, *Supplemental Income and Loss*.

	Jan. 1-July 23	July 24-Dec. 31	Totals
Income	$17,170	$14,110	$31,280
Expenses			
Cleaning Services	875	625	1,500
Insurance	1,000	1,000	2,000
Tax Prep Fees	250		
Management Fees	1,750	1,250	3,000
Repairs	700	150	850
Property Taxes	6,965		6,965
Utilities	2,475	2,695	5,170
Depreciation			
Association Fees	2,100	1,500	3,600
Internet	420	300	720
Cable	1,120	800	1,920
Total Expenses	$17,405	$8,320	$25,725
Profit/Loss	$(485)	$5,790	$5,305

Deprecation for the property must be manually calculated. The condo was placed into service on Jan. 1, 2019. Her cost basis at the time the property was converted to a rental was $400,000. Yearly depreciation on the property is $14,545 (3.636% x $400,000), therefore $8,089 [$14,545 x (203/365)] is allocated to her Form 1040.

Maria's and Sam's Schedule E for Form 1040 is as follows:

SCHEDULE E (Form 1040) — Department of the Treasury, Internal Revenue Service

Supplemental Income and Loss

(From rental real estate, royalties, partnerships, S corporations, estates, trusts, REMICs, etc.)

Attach to Form 1040, 1040-SR, 1040-NR, or 1041.

Go to *www.irs.gov/ScheduleE* for instructions and the latest information.

OMB No. 1545-0074 — **2023** — Attachment Sequence No. **13**

Name(s) shown on return: Maria & Sam Sanchez — Your social security number: ***-**-9012

Part I — Income or Loss From Rental Real Estate and Royalties

Note: If you are in the business of renting personal property, use **Schedule C**. See instructions. If you are an individual, report farm rental income or loss from **Form 4835** on page 2, line 40.

A Did you make any payments in 2023 that would require you to file Form(s) 1099? See instructions ☐ Yes ☐ No

B If "Yes," did you or will you file required Form(s) 1099? ☐ Yes ☐ No

1a	Physical address of each property (street, city, state, ZIP code)
A	444 Big Sky Way, Bozeman, MT 59715
B	
C	

1b	Type of Property (from list below)	2	Fair Rental Days	Personal Use Days	QJV
A	1	A	170		☐
B		B			☐
C		C			☐

2 For each rental real estate property listed above, report the number of fair rental and personal use days. Check the QJV box only if you meet the requirements to file as a qualified joint venture. See instructions.

Type of Property:
1 Single Family Residence 3 Vacation/Short-Term Rental 5 Land 7 Self-Rental
2 Multi-Family Residence 4 Commercial 6 Royalties 8 Other (describe)

	Line	A	B	C
Income:				
3 Rents received	3	17,170		
4 Royalties received	4			
Expenses:				
5 Advertising	5			
6 Auto and travel (see instructions)	6			
7 Cleaning and maintenance	7	875		
8 Commissions	8			
9 Insurance	9	1,000		
10 Legal and other professional fees	10	250		
11 Management fees	11	1,750		
12 Mortgage interest paid to banks, etc. (see instructions)	12			
13 Other interest	13			
14 Repairs	14	700		
15 Supplies	15			
16 Taxes	16	6,965		
17 Utilities	17	2,475		
18 Depreciation expense or depletion	18	8,089		
19 Other (list) See Statement 1	19	3,640		
20 Total expenses. Add lines 5 through 19	20	25,744		
21 Subtract line 20 from line 3 (rents) and/or 4 (royalties). If result is a (loss), see instructions to find out if you must file **Form 6198**	21	-8,574		
22 Deductible rental real estate loss after limitation, if any, on **Form 8582** (see instructions)	22	(8,574)	( )	( )

	Line	Amount
23a Total of all amounts reported on line 3 for all rental properties	23a	17,170
b Total of all amounts reported on line 4 for all royalty properties	23b	
c Total of all amounts reported on line 12 for all properties	23c	
d Total of all amounts reported on line 18 for all properties	23d	8,089
e Total of all amounts reported on line 20 for all properties	23e	25,744
24 **Income.** Add positive amounts shown on line 21. **Do not** include any losses	24	0
25 **Losses.** Add royalty losses from line 21 and rental real estate losses from line 22. Enter total losses here	25	(8,574)
26 **Total rental real estate and royalty income or (loss).** Combine lines 24 and 25. Enter the result here. If Parts II, III, IV, and line 40 on page 2 do not apply to you, also enter this amount on Schedule 1 (Form 1040), line 5. Otherwise, include this amount in the total on line 41 on page 2	26	-8,574

For Paperwork Reduction Act Notice, see the separate instructions. — Schedule E (Form 1040) 2023

DAA

MARIATSU Sanchez, Maria & Sam 7/8/2024 11:54 AM
***-**-9012 **Federal Statements**

444 Big Sky Way

Statement 1 - Schedule E, Line 19 - Other Expenses

Description	Gross Amount	Business Use Percentage	Net Amount
Internet	$ 420		$ 420
Cable	1,120		1,120
Association Fees	2,100		2,100
Total	$ 3,640		$ 3,640

Form 1041

Form 1041 is the primary form for reporting fiduciary income tax due. It is required when a domestic estate has any of the following:

- Gross income of $600 or more (Form 1041, Line 9)
- A beneficiary who is a nonresident alien
- A qualified investment held in a qualified opportunity fund (QOF) at any time during the year (Form 8897, *Initial and Annual Statement of Qualified Opportunity Fund (QOF) Investments*, must be attached)

Note: Decedents' estates have an exemption ($600) but do not have a standard deduction.

Accounting period

An estate is not required to use a calendar year.

Determine an estate's year-end by the:

- Tax year on which the estate maintains the books
- Year the estate establishes by filing the initial return

An estate's tax year begins on the day after the day of death. An estate's year-end can be the last day of any month within 12 months of the date of death, beginning with the month of death. The initial fiscal year cannot end more than 12 months after the date of death.

Note: If the estate selects a fiscal year, determine the proper tax year forms based on the beginning of the taxable year. For fiscal years beginning in Year 1, file a Year 1 Form 1041, even though the beneficiaries report their income in Year 2. Reconcile Form 1099s to determine the proper year to include them since Form 1099s are reportable on a calendar year basis.

Once the estate establishes the tax year, the estate cannot change it without IRS consent. The estate uses Form 1128, *Application to Adopt, Change, or Retain a Tax Year*, to request the IRS's approval to change; however, the estate must have a business purpose for requesting the change [Reg. §1.442-1(b)(2)]. It is especially important to consider the effects of the estate's year-end before choosing the year-end on the initial return.

> **Note:** Filing Form SS-4 does **not** bind an estate to an accounting period [Reg. §1.441-1(c)(1)].

The year-end of the estate determines the year the beneficiary reports taxable income. However, if the estate chooses a fiscal year-end so the beneficiaries do not pick up taxable income until the following year, the fiduciary should consider whether the estate should terminate before Jan. 1. If it does, the beneficiaries pick up taxable income in the current year from two Schedule K-1s. In contrast, the final return could have expenses or losses that offset income. Consider an estate terminated when the estate has distributed all assets to the beneficiaries.

The beneficiaries' tax brackets can also affect the selection of the estate's fiscal year-end.

When choosing a year-end, it is also important to look at the timing of the income and expenses of the estate. It can be helpful to chart the estate's income, distributions and expenses paid to see if bunching thereof would affect the choice of fiscal year, as they may affect the distributable net income (DNI) carried out to the beneficiaries.

Noncash distributions can cause beneficiaries to be treated as if they received taxable income. Minimize this problem through the selection of the fiscal year.

Case study

Maria Sanchez, age 71, passed away on July 23, 2023. The estate can either have a calendar year-end covering the time period of July 24, 2023-Dec. 31, 2023, or elect a fiscal year of July 24, 2023-June 30, 2024.

If a fiscal year is elected, use the 2023 Form 1041 for the estate. The beneficiaries will report any income, deductions or credits on their 2024 Form 1040.

> **Practitioner tip:** Encourage the fiduciary to talk to the beneficiaries about their need to report estate income on their personal returns. Many beneficiaries file their personal returns and then are surprised to receive a Schedule K-1 (Form 1041) with additional estate income, requiring them to file amended returns.

The below table summarizes pros and cons of selecting a fiscal year estate.

Pros	Cons
Allows a longer period to wrap up estate operations	Can be confusing for beneficiaries
Could allow for a first and final estate return	Could delay distributions to beneficiaries
Opportunities to reduce income by expenses incurred in a different calendar year	Increased administrative fees
	Increased filing complexities

Due date – Form 1041

Form 1041 is due by the 15th day of the fourth month after the end of the estate's tax year. For estates choosing a calendar year, the due date is generally April 15. If preparing Form 706, prepare Form 706 at the same time as Form 1041 to determine where to report certain deductions.

Election to treat trust as part of estate

It is sometimes confusing to prepare two Form 1041s if there is both an estate and a trust. Income from assets inside a trust is reportable on the trust's Form 1041, while other income paid to the estate is reportable on the estate Form 1041.

A revocable trust becomes irrevocable upon the grantor's death. From that point on, do not report income on the grantor's individual income tax return, but on the trust's Form 1041.

Instead of filing two separate returns, the executor of the estate and the trustee of the trust can elect under §645 to treat a qualified revocable trust (QRT) as part of the estate. File one estate Form 1041 under the name and EIN of the estate during the administration period of the estate.

Other benefits of making the election include:

- The trust can claim a charitable deduction without the requirement that it pays the amounts from amounts permanently set aside for charity.
- The trust can use a fiscal tax year (limited to first two years).
- If the decedent actively participated before death, the active participation requirements with regard to the $25,000 rental real estate allowance under the passive loss rules are waived in the case of estates (and trusts making the §645 election) for two years after death [§469(i)(4)].
- The trust can own S corporation stock without endangering the S corporation election because the estate is treated as the holder [§1361(b)(1)(B) and (c)(2)(A)(ii)].
- The trust need not pay estimated taxes for up to two years following the date of death.

- Distributions are taxable to the beneficiaries in the year in which the estate's fiscal year ends, rather than in the calendar year in which the trust makes the distribution.

The trustee (and executor) makes the election on Form 8855, *Election To Treat a Qualified Revocable Trust as Part of an Estate*, no later than the due date, including extensions, of the estate's initial Form 1041. The box in the heading on Form 1041, Page 1, Item G, should be checked. The executor must also attach a statement to Form 1041 providing the name and taxpayer identification number (TIN) of each electing trust, and the name and address of the trustee for each electing trust. Once made, the election is irrevocable.

If the trust files a short-year return, the trustee can still make the election to treat the trust as part of the estate before the due date, including extensions, of the estate's initial Form 1041 (if no executor, before the qualified revocable trust's tax return due date). File an amended Form 1041 for the trust, excluding all items of income, deduction and credit. Then, include those same items on the combined electing trust and related estate's initial Form 1041.

The election remains in effect until the earlier of the day the electing trust and related estate have distributed all assets or the day before the applicable date.

The applicable date is either:

- The day that is two years after the date of the decedent's death, if Form 706 is not required
- If Form 706 is required, the latter of:
  - The day that is two years after the date of decedent's death
  - The day that is six months after the date of final determination of liability for estate tax
    - The final determination date can be based on:
      - The date the estate tax closing letter is issued
      - The execution of a settlement agreement fixing the estate liability
      - A court decree resolves the estate tax liability

Upon the death of the grantor, both the electing trust and the related estate obtain EINs. If there is no executor because there is no probate proceeding, only the trust needs to obtain an EIN [Reg. §1.645-1(d)(1)]. However, the trust must file Form 1041 for its short taxable year beginning with the decedent's date of death and ending Dec. 31 of that year if it does not make the §645 election [Reg. §1.645-1(d)(2)].

Case study

Maria transferred the Bozeman condo to a revocable trust after the death of her first husband. Lily and Jonathan are beneficiaries of the trust. Upon Maria's death, the trust is irrevocable. Jonathan is listed as the successor trustee.

If Lily and Jonathan do **not** make a §645 election, the trust must file an initial return for the period from July 24, 2023, to Dec. 31, 2023, and file annual calendar year returns thereafter, until the trust terminates.

They can make the §645 election and choose a fiscal year ending as late as June 30, 2024. This allows streamlined filing of only one Form 1041 until the estate for Maria has been closed. Lily and Jonathan agree to make the election.

Form 8855 is as follows:

Form **8855** (Rev. December 2020) Department of the Treasury Internal Revenue Service

Election To Treat a Qualified Revocable Trust as Part of an Estate

OMB No. 1545-1881

Part I Estate (or Filing Trust) Information

Name of estate (or the filing trust, if applicable (see instructions)) Estate of Maria Sanchez	**Employer identification number** (see instructions) **-***8912
Name of executor (or the filing trustee, if applicable) Lily Jones Executix	Type of entity prior to the election: ☒ Domestic estate ☐ Foreign estate ☐ Domestic trust ☐ Foreign trust
Number, street, and room or suite no. (or P.O. box number if mail is not delivered to street address) 45 East Fake Street	
City or town, state, and ZIP code (if a foreign address, see instructions) Flagstaff AZ 85001	Date of executor's appointment 08/01/23

Under penalties of perjury, I, as executor (or filing trustee):

- Confirm that under applicable local law or the governing document, I have the authority to make this election for the estate (if executor) or trust (if filing trustee) and to agree to the conditions of the election;
- Elect the treatment provided under section 645 for the above-named estate (or filing trust, if applicable);
- Confirm that an agreement has been reached with the trustees of each qualified revocable trust (QRT) joining in the election to allocate the tax burden of the combined electing trusts and related estate, if any, for each tax year during the election period in a manner that reasonably reflects each entity's tax obligation;
- Agree to ensure that the related estate's (or filing trust's, if applicable) share of the tax obligations of the combined electing trust(s) and related estate, if any, is timely paid to the United States Treasury;
- Agree to accept responsibility for filing a complete, accurate, and timely income tax return, when required by law, for the combined electing trust(s) and related estate, if any, for each tax year during the election period;
- (If I am the filing trustee) confirm that if there is more than one QRT making this election, that I have been appointed by the trustees of each QRT making this election to be the filing trustee and I agree to accept the responsibility of filing the appropriate income tax return for the combined electing trust(s) for each tax year during the election period and all other responsibilities of the filing trustee;
- (If I am the filing trustee) represent that no executor has been appointed for a related estate and to the best of my knowledge and belief, one will not be appointed;
- (If I am the filing trustee) agree that, if an executor is appointed for the related estate after this Form 8855 is filed, that I will complete and file an amended Form 8855 if the late appointed executor agrees to the election, and I agree to cooperate with the executor in filing any amended returns required to be filed as a result of the executor's appointment; and
- Confirm to the best of my knowledge and belief, that all information contained in this election and any accompanying statements or schedules is true, correct, and complete.

Signature of executor (or filing trustee)	Date

Part II Decedent Information

Name of decedent	SSN of the decedent	Date of death
Maria Sanchez	***-**-9012	07/24/2023

For Paperwork Reduction Act Notice, see page 4. Form **8855** (Rev. 12-2020)

Form 8855 (Rev. 12-2020) **Estate of Maria Sanchez** **-***8912 Page **2**

Part III **Qualified Revocable Trust Information**

Name of trust **Maria Sanchez Irrevocable Trust**

Employer identification number (see instructions) **-***9999

Name of trustee
Jonathan Aguirre

Number, street, and room or suite no. (or P.O. box number if mail is not delivered to street address)
123 North Fake Street

City or town, state, and ZIP code (if a foreign address, see instructions)
Flagstaff AZ 85001

Under penalties of perjury, I, as trustee of the above-named trust:

- Confirm that under applicable local law or the governing instrument, I have the authority to make this election for the trust and to agree to the conditions of the election;
- Elect the treatment provided under section 645 for this trust;
- Agree to timely provide the executor (or filing trustee if there is no executor) with all the trust information necessary to permit the executor (or filing trustee, if applicable) to file a complete, accurate, and timely Form 1041 (or Form 1040-NR for a foreign estate) for the combined electing trust(s) and the related estate, if any, for each tax year during the election period;
- Confirm that an agreement has been reached with the trustees of each QRT joining in the election, and the executor of the related estate, if any, to allocate the tax burden of the combined electing trust(s) and related estate, if any, for each tax year during the election period in a manner that reasonably reflects each entity's tax obligation;
- Agree to ensure that this trust's share of the tax obligations of the combined electing trust(s) and related estate, if any, is timely paid to the United States Treasury;
- Confirm that if a filing trustee (and not an executor for a related estate) has completed Part I of this Form 8855, the trustee that completed Part I has been appointed the filing trustee, and to the best of my knowledge and belief, an executor has not been appointed to administer a related estate and one will not be appointed;
- Agree that if a filing trustee (and not an executor for a related estate) has completed Part I of this Form 8855 and an executor is appointed for the related estate after this Form 8855 is filed, that I will complete and file an amended Form 8855 if the later appointed executor agrees to the election, and I agree to cooperate with the executor in filing any amended returns required to be filed as a result of the executor's appointment; and
- Confirm to the best of my knowledge and belief, that all information of the electing trust contained in this election and any accompanying statements or schedules is true, correct, and complete.

Signature of trustee	Date

Name of trust

Employer identification number (see instructions)

Name of trustee

Number, street, and room or suite no. (or P.O. box number if mail is not delivered to street address)

City or town, state, and ZIP code (if a foreign address, see instructions)

Under penalties of perjury, I, as trustee of the above-named trust:

- Confirm that under applicable local law or the governing instrument, I have the authority to make this election for the trust and to agree to the conditions of the election;
- Elect the treatment provided under section 645 for this trust;
- Agree to timely provide the executor (or filing trustee if there is no executor) with all the trust information necessary to permit the executor (or filing trustee, if applicable) to file a complete, accurate, and timely Form 1041 (or Form 1040-NR for a foreign estate) for the combined electing trust(s) and the related estate, if any, for each tax year during the election period;
- Confirm that an agreement has been reached with the trustees of each QRT joining in the election, and the executor of the related estate, if any, to allocate the tax burden of the combined electing trust(s) and related estate, if any, for each tax year during the election period in a manner that reasonably reflects each entity's tax obligation;
- Agree to ensure that this trust's share of the tax obligations of the combined electing trust(s) and related estate, if any, is timely paid to the United States Treasury;
- Confirm that if a filing trustee (and not an executor for a related estate) has completed Part I of this Form 8855, the trustee that completed Part I has been appointed the filing trustee, and to the best of my knowledge and belief, an executor has not been appointed to administer a related estate and one will not be appointed;
- Agree that if a filing trustee (and not an executor for a related estate) has completed Part I of this Form 8855 and an executor is appointed for the related estate after this Form 8855 is filed, that I will complete and file an amended Form 8855 if the later appointed executor agrees to the election, and I agree to cooperate with the executor in filing any amended returns required to be filed as a result of the executor's appointment; and
- Confirm to the best of my knowledge and belief, that all information of the electing trust contained in this election and any accompanying statements or schedules is true, correct, and complete.

Signature of trustee	Date

Form **8855** (Rev. 12-2020)

If assets are discovered that were not held in the trust, so that probate proceedings are required, and there is an executor appointed after the trust makes the §645 election, the trustee and the newly appointed executor must file a new Form 8855 within 90 days of the executor's appointment, or the election terminates [Reg. §1.645-1(g)].

Estate Form 706

The personal representative of an estate is responsible for filing Form 706, which is required when the value of the gross estate at the date of death is more than $13.61 million for 2024. Historical information is in Appendix F. This threshold includes the total amount of adjusted taxable gifts made after 1976 and the amount allowed for the specific exemption for gifts made after Sept. 8 and before Jan. 1, 1977.

In general, the estate tax is computed based on the sum of the decedent's taxable estate plus the adjusted taxable gifts made by the decedent after 1976. In other words, the estate tax and the gift tax are part of one unified transfer tax system. However, the estate tax is reduced by any gift tax paid on prior year gifts to avoid double tax. In addition, a certain amount is excluded from estate tax because the estate receives a unified credit against the estate tax equal to the tentative tax on the basic exclusion amount.

There are times when a tax professional may recommend filing Form 706 even when it is not required. Examples include utilizing the DSUE portability election between spouses or establishing basis in assets.

Note: When handling the estate of a nonresident, use Form 706-NA, *United States Estate (and Generation-Skipping Transfer) Tax Return Estate of nonresident not a citizen of the United States*, to compute the estate and generation-skipping transfer tax liability. The filing threshold is $60,000 versus $13.61 million.

Case study

As mentioned previously, Sam expects a large inheritance, expected to pay out in 2025. For planning purposes, Form 706 will be filed to allow for DSUE portability.

Assets of the Maria's estate include:

- §401(k)
- IRA
- Small balance in her saving account at The Credit Union
- Joint bank account held at Big Bank
- Charitable contribution of $5,000 made to Happy Paws, a local animal shelter
- Primary residence and the rental condo
- 400 shares of XYZ Company
- Three classic cars

Valuing an Estate

To determine if a Form 706 must be filed, the value of the estate must be determined. There are different methods to value the property. Some items have a clear-cut value, such as money or stock traded on an established market. However, the valuation of other property may require the services of an expert in that field. The value of some property is relative to the decedent. If a property loses value because the owner is no longer alive, the estate may use a discount factor in determining the value of the property.

The general rules for valuation for estate taxes are based on the FMV of the property on the decedent's date of death or the alternate valuation date. The alternate valuation date is typically six months after the date of death. It can only be used when the value of assets would be less than the date of death value.

There are several definitions of FMV. The most widely accepted is from the regulations that state the FMV is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell (more on that later) and both having reasonable knowledge of relevant facts [Reg. §20.2031-1(b)].

Although FMV seems like a straightforward concept, practitioners, taxpayers and even the IRS have had trouble pinpointing this exact number for both estate and income tax purposes. Before proceeding, the concept of FMV must be adequately discussed.

There are several concepts to address, including the following:

- The willing buyer and willing seller test
- Forced sales
- Timing for FMV determinations
- Tax assessments for real property
- Subsequent events
- Discounts and premiums

In an ideal situation, appraisals and professional valuations are provided to substantiate what is reported on Form 706. However, there are times when appraisals or valuations are not present, or they appear to be incorrect. Normally, it is acceptable to rely on another's professional opinion if they are qualified; however, if there is reason to doubt an amount given, knowing these critical concepts can help find the correct answer.

Once the IRS accepts the tax return, the taxpayer is ordinarily bound to the FMV reported to the IRS for all tax purposes. The value listed in probate inventory should also match the values used on Form 706.

Gross Estate

To determine if a Form 706 is required, determine the amount of the gross estate. The gross estate includes:

- Property in which the decedent had an interest
- Dowery and curtesy interest
- Community property

Property in which decedent had an interest

The gross estate includes the value of all property beneficially owned by the decedent at the time of death (§2033). This includes real or personal property and tangible or intangible property, no matter where such property is located (Reg. §20.2033-1).

This category also includes the value of certain rights the decedent may have had, including the following:

- The right to borrow against a life insurance policy
- Legal ownership, even when the individual is not aware of the right
- A general power of attorney, described below

Include real property whether it came into the possession and control of the executor or administrator or passed directly to heirs or devisees. Various statutory provisions, which exempt bonds, notes, bills, and certificates of indebtedness of the federal government or its agencies and the interest thereon from taxation, are generally not applicable to the estate tax because such tax is an excise tax on the transfer of property at death and is not a tax on the property transferred (Reg. §20.2033-1).

Dower and curtesy interests

Section 2034 requires the value of the gross estate to include the value of a surviving spouse's dower or curtesy interest in the decedent's estate.

A **dower interest** is the part of a deceased husband's real property allowed to his widow for her lifetime.

A **curtesy interest** is a deceased wife's real property that passes upon her death to her husband for his lifetime, provided they have had children capable of inheriting — state law governs.

Note: Because dower and curtesy interests discriminate based on gender, many states do not have such provisions. Check with state law regarding these provisions.

Community property

Currently, nine states follow community property laws: Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin.

In completing Form 706, it is important to know and follow local and state law. Community property rules are different from the rules for common law states. Even within the nine community property states, community property laws differ.

Generally, the full value of the community property is reportable on each applicable schedule and then only the net amount on the bottom line. Some property is subject to federal law, which supersedes state or local law in determining ownership [*Employee Retirement Income Security Act* (ERISA)].

States also differ on what expenses are chargeable against community income or only the decedent's share of community income.

Conflict may also arise in other situations. Spouses in community property states may hold some assets separately. In addition, some couples who move from a community property state to a noncommunity property state may still have some assets that are community property.

The general rule is that half of the community property is includable in the estate. This amount is reported in one of two ways.

- Gross method — showing the full value of the property and reporting a negative amount attributable to the surviving spouse
- Net method — simply reporting half the value

The IRS does not prescribe one method over the other. This is a matter of practitioner preference. A common example of community property is real estate. It is important to note that if debt secures the community property, only deduct half the amount attributable to the property, despite verbiage in the will.

Case study

Maria and Sam's primary residence had an FMV at death of $500,000. The outstanding mortgage on the property was $100,000.

While the Bozeman condo was in a trust, due to §2036 and §2038, the value of the property is includable in Maria's estate. The FMV of the condo was $995,000. The condo did not have outstanding mortgages secured by the property at the time of Maria's death. The condo is not considered community property under state law.

Lily obtained appraisals for both properties to aid in the valuation of the property.

The value of the properties are included on Schedule A, while the outstanding debt allocable to Maria's estate is reported on Schedule K as follows:

Form 706 (Rev. 8-2019)

Estate of: Maria Sanchez

Decedent's social security number ***-**-9012

SCHEDULE A — Real Estate

- For jointly owned property that must be disclosed on Schedule E, see instructions.
- Real estate that is part of a sole proprietorship should be shown on Schedule F.
- Real estate that is included in the gross estate under sections 2035, 2036, 2037, or 2038 should be shown on Schedule G.
- Real estate that is included in the gross estate under section 2041 should be shown on Schedule H.
- If you elect section 2032A valuation, you must complete Schedule A and Schedule A-1.

Note: If the value of the gross estate, together with the amount of adjusted taxable gifts, is less than the basic exclusion amount and Form 706 is being filed solely to elect portability of the DSUE amount, consideration should be given as to whether you are required to report the value of assets eligible for the marital or charitable deduction on this schedule. See the instructions for more information. If you are not required to report the value of an asset, identify the property but make no entries in the last three columns.

Item number	Description	Alternate valuation date	Alternate value	Value at date of death
1	Primary Residence 1234 West Fake Street Flaggstaff AZ			500,000
2	Rental Condo 444 Big Sky Road Bozeman Montana			995,000
	Spouse's Community Property Interest			-250,000
	Total from continuation schedules or additional statements attached to this schedule			
	TOTAL (Also enter on Part 5 — Recapitulation, page 3, at item 1.)			1,245,000

(If more space is needed, attach the continuation schedule from the end of this package or additional statements of the same size.)

DAA There are no continuation schedules attached **Schedule A — Page 5**

In a noncommunity property state, under §2040(a), the presumption is each spouse contributed half, as such, the results would be the same.

Form 706 (Rev. 8-2019)

Estate of: Maria Sanchez

Decedent's social security number ***-**-9012

SCHEDULE K — Debts of the Decedent, and Mortgages and Liens

▶ Use Schedule PC to make a protective claim for refund due to a claim not currently deductible. For such a claim, report the expense on Schedule K but without a value in the last column.

	Yes	No
Are you aware of any actual or potential reimbursement to the estate for any debt of the decedent, mortgage, or lien claimed as a deduction on this schedule?		X
If "Yes," attach a statement describing the items subject to potential reimbursement. See instructions.		
Are any of the items on this schedule deductible under Reg. section 20.2053-4(b) and Reg. section 20.2053-4(c)?		X
If "Yes," attach a statement indicating the applicable provision and documenting the value of the claim.		

Item number	Debts of the Decedent — Creditor and nature of debt, and allowable death taxes	Amount
	There are no continuation schedules attached	
	Total from continuation schedules (or additional statements) attached to this schedule	
	TOTAL (Also enter on Part 5 — Recapitulation, page 3, at item 15.)	0

Item number	Mortgages and Liens — Description	Amount
1	Outstanding mortgage secured by primary residence	100,000
	Spouse's Community Property Interest	-50,000
	There are no continuation schedules attached	
	Total from continuation schedules (or additional statements) attached to this schedule	
	TOTAL (Also enter on Part 5 — Recapitulation, page 3, at item 16.)	50,000

(If more space is needed, attach the continuation schedule from the end of this package or additional statements of the same size.)

DAA

Schedule K — Page 18

Note: When in doubt, review state law regarding what is community property.

Completing Form 706

Schedule A – Real Estate

Report all real property interests titled solely in the decedent's name on Schedule A.

Real property reportable on Schedule A includes the following:

- Land, easements, improvements and permanent fixtures attached to the land and property located outside of the U.S.
    - This includes the decedent's community property interests in real property. Report real property held under joint tenancy and reversionary or remainder interests elsewhere.
- Accrued rentals on land; mineral interests; royalty interests (oil and gas); extra cemetery lots that have an FMV; condominium apartments; and a decedent's interest under a real estate sales contract
- Real property held by TIC
    - The decedent owns a distinct, yet undivided, interest in the property.

Schedule A instructions require an explanation of how the estate determined FMV. Make sure the explanation is included when the return is filed. Listed below are three acceptable appraisal methods:

- Cost — the value of land and the replacement cost of any structures
- Capitalization of income — generally used for income-producing property
- Comparable sales — based on sales of comparable properties for size, area, condition, zoning and use

The estate may discount the value of real property if the decedent did not own 100% (fractional interest discount) or if it would be difficult to liquidate the property in a reasonable period of time (blockage discount).

Describe the real estate in enough detail so the IRS can easily locate it for inspection and valuation.

If any item of real estate is subject to a mortgage for which the decedent's estate is liable, whereas, the indebtedness may be charged against other property of the estate that is not subject to that mortgage, or if the decedent was personally liable for that mortgage, report the full value of the property in the value column. Enter the amount of the mortgage under "Description" on this schedule. Deduct the unpaid amount of the mortgage on Schedule K.

If the decedent's estate is not liable for the mortgage, report only the value of the equity of redemption (or value of the property, less the indebtedness) in the value column as part of the gross estate. Do not enter any amount less than zero. Do not deduct the amount of indebtedness on Schedule K.

Explain how the estate determined the reported values and attach copies of any appraisals.

Practitioner tip: It is apparent that the schedules attached to Form 706 require a lot of detail. Sometimes attaching multiple schedules is necessary. The goal is to give the IRS enough information to determine, without physically seeing everything, what the estate includes.

Schedule B — Stocks and Bonds

Report all stocks and bonds in the decedent's name, all interests held as TIC, and all community property interests on Schedule B.

Stocks and bonds include shares in mutual funds, money market funds, publicly traded and nonpublicly traded common or preferred stock, government bonds, municipal bonds and options to buy stock.

The valuation of publicly traded stocks on an exchange is the FMV on the date of death or the alternate valuation date. This amount is the average of the high and the low price on the valuation day. Do not use the closing price or the high for the day to determine FMV. If the stock trades over the counter, FMV is the average of the bid and the asking price for the valuation date [Reg. §20.2031-2(b)(1)].

Case study

Maria' remaining 400 shares of XYZ Company are includible in her estate. The FMV of the remaining shares were $22,800 (based on average high/low price) on Maria's date of death, which is the valuation date. The completed Schedule B is as follows:

Form 706 (Rev. 8-2019)

Estate of: Maria Sanchez

Decedent's social security number ***-**-9012

SCHEDULE B — Stocks and Bonds

(For jointly owned property that must be disclosed on Schedule E, see instructions.)

Note: If the value of the gross estate, together with the amount of adjusted taxable gifts, is less than the basic exclusion amount and Form 706 is being filed solely to elect portability of the DSUE amount, consideration should be given as to whether you are required to report the value of assets eligible for the marital or charitable deduction on this schedule. See the instructions for more information. If you are not required to report the value of an asset, identify the property but make no entries in the last four columns.

Item number	Description, including face amount of bonds or number of shares and par value for identification. Give CUSIP number. If trust, partnership, or closely held entity, give EIN.	CUSIP number or EIN, where applicable	Unit value	Alternate valuation date	Alternate value	Value at date of death
	400 Shares XYZ Company					
1	400 Shares XYZ Company. Average high/ low cost on 7/23/23 was $57/ share. FMV of total shares was $22,800.					
	400 Shares XYZ Comparny		57.000			22,800
	Total from continuation schedules (or additional statements) attached to this schedule					
	TOTAL (Also enter on Part 5—Recapitulation, page 3, at item 2.)					22,800

(If more space is needed, attach the continuation schedule from the end of this package or additional statements of the same size.)

DAA There are no continuation schedules attached

Schedule B — Page 10

Schedule C — Mortgages, Notes and Cash

On Schedule C, report the following:

- Cash
- Mortgages and notes payable to **the decedent** at the time of death
- Certificates of deposit
- Checking accounts
- Savings accounts
- The amount of interest accrued from the last payment date to the date of death

> **Note:** These amounts include assets the decedent owns, not liabilities of the decedent.

Do not include collectible coins and currency with a value in excess of face value on Schedule C. Instead, report them on Schedule F.

The executor should value cash or cash-like mediums, such as checks or CDs, as of the date of death. There are two different methods available to value a checking account with outstanding checks that the decedent wrote before death. Schedule C should identify the method the executor used in the description section [Reg. §20.2031-5].

> **Note:** The concepts of gross method and net method are similar to the community property rules. Again, neither one is listed as preferred by the IRS.

Net method — If the bank honors the outstanding checks, the value of the account should reflect the reduction for the outstanding checks. If using the net method, do not claim the outstanding check as a deduction for liabilities.

Gross method — If the bank honors the outstanding checks, report the gross balance in the checking account on Schedule C while the outstanding checks are a liability against the estate reportable on Schedule K.

List the items on Schedule C in the following order:

- Mortgages
- Promissory notes
- Contracts by decedent to sell land
- Cash in possession
- Cash in banks, savings and loan associations, and other types of financial organizations

Case study

Maria's had a balance of $11,300 in her savings account located at The Credit Union. Funds used to establish the savings account are from separate property. Her joint bank account held at Big Bank, had $4,500. There was one outstanding payment for a bill in the amount of $125 that has not been processed by Big Bank. The net method is used to report the value of the account.

Form 706 (Rev. 8-2019)

Estate of: Maria Sanchez

Decedent's social security number ***-**-9012

SCHEDULE C—Mortgages, Notes, and Cash

(For jointly owned property that must be disclosed on Schedule E, see instructions.)

Note: If the value of the gross estate, together with the amount of adjusted taxable gifts, is less than the basic exclusion amount and Form 706 is being filed solely to elect portability of the DSUE amount, consideration should be given as to whether you are required to report the value of assets eligible for the marital or charitable deduction on this schedule. See the instructions for more information. If you are not required to report the value of an asset, identify the property but make no entries in the last three columns.

Item number	Description	Alternate valuation date	Alternate value	Value at date of death
1	The Credit Union savings account			11,300
2	Big Bank joint bank account. Net method used for valuation purposes.			4,375
	Spouse's Community Property Interest			-2,188
	Total from continuation schedules (or additional statements) attached to this schedule			
	TOTAL (Also enter on Part 5—Recapitulation, page 3, at item 3.)			13,487

(If more space is needed, attach the continuation schedule from the end of this package or additional statements of the same size.)

DAA There are no continuation schedules attached **Schedule C—Page 11**

Schedule F — Other Miscellaneous Property

Use Schedule F to report all property that is includable in the gross estate and not reportable on any other schedule. Schedule F also has three questions on collectibles, bonuses/awards, and safe deposit boxes. Answer the questions and file the schedule even if there are no assets listed.

Types of property reportable on Schedule F include the following:

- Automobiles
- Boats
- Certain claims due to the decedent
- Coin and stamp collections
- Digital assets
- Firearms
- Farm products and growing crops
- Income tax and other refunds
- Interests in other estates and trusts
- Interest in Archer medical savings account or health savings account (HSA), unless it passes to the surviving spouse
- Jewelry
- Business interests
- Qualified terminable interest property
- Remainder interests
- Tangible personal property including antiques and art objects
- Uncashed checks
- Bankruptcy claims
- Books
- Claims for refunds
- Deferred compensation payments
- Gold and silver bullion
- Household goods and personal effects, including clothing
- Insurance policies owned by the decedent on the life of another
- Livestock

- Leaseholds
- Precious metals
- Real property used as part of a sole proprietorship business
- Royalties and rights
- Unpaid commissions, bonuses and wages

The most common methods for valuing Schedule F property are sales or expert appraisals. Furthermore, absent any market fluctuations, and if sold within a reasonable time, auction prices and classified ads may be a measure of the FMV at the time of death (Rev. Proc. 65-19). Compare personal effects to retail value (not wholesale); thus, auction prices or classified ads create a presumption of FMV.

Consider the value of personal and household items. The value is similar to that of valuing a business (Reg. §20.2031-6):

- The value is what a willing buyer would pay a willing seller without pressure.
- Catalog the items separately, grouping only a number of items in the same room, each of which is under $100. In lieu of an itemized list, the executor may furnish a written statement containing a declaration made under penalties of perjury giving the aggregate value as appraised by competent appraisers or dealers.
- If household goods and personal effects include items with artistic or intrinsic value in excess of $3,000 (jewelry, furs, artwork, collections, etc.), an appraisal must be filed with the return [Reg. §20.2031-6(b)].

Case study

Maria inherited three classic cars from her former spouse, considered separate property under state law. The vehicles were kept in storage. Based on various appraisals, the following values were used.

1957 Chevy Bel Aire: $65,000

1967 Shelby Mustang GT500: $200,000

1970 Dodge Charger RT/SE: $149,900

Schedule F for Maria's estate is as follows:

Form 706 (Rev. 8-2019)

Estate of: Maria Sanchez

Decedent's social security number ***-**-9012

SCHEDULE F — Other Miscellaneous Property Not Reportable Under Any Other Schedule

(For jointly owned property that must be disclosed on Schedule E, see instructions.)

(If you elect section 2032A valuation, you must complete Schedule F and Schedule A-1.)

Note: If the value of the gross estate, together with the amount of adjusted taxable gifts, is less than the basic exclusion amount and Form 706 is being filed solely to elect portability of the DSUE amount, consideration should be given as to whether you are required to report the value of assets eligible for the marital or charitable deduction on this schedule. See the instructions for more information. If you are not required to report the value of an asset, identify the property but make no entries in the last three columns.

		Yes	No
1	Did the decedent own any works of art, items, or any collections whose artistic or collectible value at date of death exceeded $3,000? If "Yes," submit full details on this schedule and attach appraisals.		X
2	Has the decedent's estate, spouse, or any other person received (or will receive) any bonus or award as a result of the decedent's employment or death? If "Yes," submit full details on this schedule.		X
3	Did the decedent at the time of death have, or have access to, a safe deposit box? If "Yes," state location, and if held jointly by decedent and another, state name and relationship of joint depositor. If any of the contents of the safe deposit box are omitted from the schedules in this return, explain fully why omitted.		X

Item number	Description. For securities, give CUSIP number. If trust, partnership, or closely held entity, give EIN	CUSIP number or EIN, where applicable	Alternate valuation date	Alternate value	Value at date of death
1	1957 Chevy Bel Aire				65,000
2	1970 Dodge Charger RT/SE, black all numbers matching, fully restored				149,900
3	1967 Shelby Mustang GT 500, Grey with Black racing strips, numbers matching.				200,000
	Total from continuation schedules (or additional statements) attached to this schedule				
	TOTAL (Also enter on Part 5—Recapitulation, page 3, at item 6.)				414,900

(If more space is needed, attach the continuation schedule from the end of this package or additional statements of the same size.)

DAA There are no continuation schedules attached **Schedule F—Page 14**

Practitioner tip: Filing Form 706 establishes basis in the vehicles listed. If they are sold at a much later date, this value can be used to help determine the gain or loss on the sale.

Schedule I — Annuities

Use Schedule I to disclose annuities (§2039) in which the decedent had an interest. Answer 'Yes' on Form 706, Part 4, Question 16, if the decedent was receiving an annuity immediately before death.

> **Note:** Report all IRAs, Keoghs, pensions, SEPs, §401(k) plans, §403(b) plans, tax-deferred annuities, tax-sheltered annuities, etc., on Form 706, Schedule I.

Include the value of an annuity or other payment receivable by any beneficiary by reason of surviving the decedent, other than life insurance proceeds included under §2042.

A gross estate must include all or part of the value of an annuity receivable by any beneficiary following the death of the decedent under a contract or agreement that satisfies all the following conditions:

- The contract or agreement is not a policy of insurance on the life of the decedent
- The contract or agreement was entered into after March 3, 1931
- The annuity is receivable by the beneficiary following the death of the decedent because they survived the decedent
- The annuity was payable to the decedent, either alone or in conjunction with another, for the decedent's life or for any period not ascertainable without reference to the decedent's death, or for any period that did not in fact end before the decedent's death

For IRAs or other nonannuity type retirement or deferred compensation plans, the fiduciary should obtain a valuation letter from the custodian or trustee of the account.

Case study

Maria had several retirement accounts that she contributed to while married to Sam. Lily obtained a valuation for each and provided the documentation.

The values in the accounts are as follows:

- Trust Company §401(k) - $125,000
- Big Bank IRA - $300,000

Schedule I for Maria's estate is as follows:

Form 706 (Rev. 8-2019)

Estate of: Maria Sanchez

Decedent's social security number ***-**-9012

SCHEDULE I — Annuities

Note: Generally, no exclusion is allowed for the estates of decedents dying after December 31, 1984. See instructions.

Note: If the value of the gross estate, together with the amount of adjusted taxable gifts, is less than the basic exclusion amount and Form 706 is being filed solely to elect portability of the DSUE amount, consideration should be given as to whether you are required to report the value of assets eligible for the marital or charitable deduction on this schedule. See the instructions for more information. If you are not required to report the value of an asset, identify the property but make no entries in the last three columns.

		Yes	No
A	Are you excluding from the decedent's gross estate the value of a lump-sum distribution described in section 2039(f)(2) (as in effect before its repeal by the Deficit Reduction Act of 1984)? If "Yes," you must attach the information required by the instructions.		X

Item number	Description. Show the entire value of the annuity before any exclusions	Alternate valuation date	Includible alternate value	Includible value at date of death
1	Trust Company 401(k)			125,000
2	Big Bank IRA			300,000
	Spouse's Community Property Interest			-212,500
	Total from continuation schedules (or additional statements) attached to this schedule			
	TOTAL (Also enter on Part 5 — Recapitulation, page 3, at item 9.)			212,500

(If more space is needed, attach the continuation schedule from the end of this package or additional statements of the same size.)

DAA There are no continuation schedules attached **Schedule I — Page 16**

In a noncommunity property state, the full amount of $425,000 would be includible in the estate.

Schedule J — Funeral and Administration Expenses

Use Schedule J to report funeral expenses and expenses incurred in administering property subject to claims.

Determine the value of the taxable estate by deducting from the gross estate amounts for funeral expenses, administrative expenses, claims against the estate and unpaid mortgages or other indebtedness on property included in the gross estate that are allowable under the laws of the jurisdiction, whether within or outside of the U.S., under which the estate is being administered (§2053).

Funeral expenses

Funeral expenses are deductible *only* on the federal estate tax return, Form 706. Deductible expenses include the cost of the funeral, a tombstone, a monument, a mausoleum, a burial lot for the decedent and members of their family, reasonable costs for care of the burial lot and the cost of transporting the body and one person to the burial location [§2053(a)(1) and Reg. §20.2053-2].

To the extent that funeral costs are recoverable or paid under the Veterans Administration, Social Security Administration or a legal settlement, reduce the deductible expenses. However, do not reduce the deduction if the surviving spouse receives these payments (Rev. Rul. 66-234).

Administration expenses for property subject to claims

Administration expenses are expenses actually and necessarily incurred in the collection of the decedent's assets, payment of debts and distribution of assets to the persons entitled to it. The estate cannot deduct expenses not essential to the proper settlement of the estate, but incurred for the individual benefit of the heirs, legatees or devisees [Reg. §20.2053-3(a)].

Administration expenses include:

- Fiduciary (executor) fees
- Attorney fees for the estate
- Accountant fees
- Tax return preparer fees
- Miscellaneous expenses, which include court costs, surrogate fees, appraiser fees, clerk hire fees, etc.

If the estate obtains a loan to preserve and care for the decedent's property, report interest paid on this loan on Schedule J as an administrative expense.

The amount deductible for funeral expenses, administrative expenses, claims against the estate and unpaid mortgages is limited. The limit is the value of the property subject to claims included in the gross estate plus amounts paid out of property included in the gross estate but not subject to claims, as long as the estate claims the expense by the due date of the Form 706.

For some expenses, there is a choice between taking them on Form 706, the individual's final Form 1040 or Form 1041. Generally, they are not deductible on more than one form. When the fiduciary deducts executor fees, attorney fees, etc., on Form 1041, the executor must sign an election to waive the deduction on Form 706.

An exception to the rule is DRD. IRD is taxable on both Form 706 as an asset, and on Form 1041 or Form 1040 as income. DRD is allowable on both returns against the income.

When these items are taxable on both, the estate and/or beneficiary gets an estate tax deduction to the extent of the increase in federal estate tax attributable to this IRD on Form 706.

Case study

After death, the estate had to pay the fees listed as follows:

Cremation	$4,000
Funeral services	$6,500
Appraisals	$3,500
Executor fees	$13,000
Attorney fees	$20,000
Accountant fees	$3,000
Court costs	$800
Total	$50,800

The executor makes an election to deduct $5,000 of attorney fees on Form 1041. The estate has paid all expenses. Therefore, the amount of attorney fees is $15,000 ($20,000 - $5,000) on Schedule J.

Schedule J for Maria's estate is as follows:

Form 706 (Rev. 8-2019)

Estate of: Maria Sanchez

Decedent's social security number ***-**-9012

SCHEDULE J — Funeral Expenses and Expenses Incurred in Administering Property Subject to Claims

▶ Use Schedule PC to make a protective claim for refund due to an expense not currently deductible. For such a claim, report the expense on Schedule J but without a value in the last column.

Note: Do not list expenses of administering property not subject to claims on this schedule. To report those expenses, see instructions.

If executors' commissions, attorney fees, etc., are claimed and allowed as a deduction for estate tax purposes, they are not allowable as a deduction in computing the taxable income of the estate for federal income tax purposes. They are allowable as an income tax deduction on Form 1041, U.S. Income Tax Return for Estates and Trusts, if a waiver is filed to forgo the deduction on Form 706. See the Instructions for Form 1041.

	Yes	No
Are you aware of any actual or potential reimbursement to the estate for any expense claimed as a deduction on this schedule? If "Yes," attach a statement describing the expense(s) subject to potential reimbursement. See instructions.		X

Item number	Description	Expense amount	Total amount
	A. Funeral expenses:		
1	Cremation	4,000	
	Funeral Services	6,500	
	Total funeral expenses ▶		10,500
	B. Administration expenses:		
	1 Executors' commissions — . (Strike out the words that do not apply.) Paid		13,000
	2 Attorney fees — . (Strike out the words that do not apply.) Paid		15,000
	3 Accountant fees — . (Strike out the words that do not apply.) Paid		3,000
	4 Miscellaneous expenses:	Expense amount	
	Court Costs	800	
	Appraisals	3,500	
	Total miscellaneous expenses from continuation schedules (or additional statements) attached to this schedule		
	Total miscellaneous expenses ▶		4,300
	TOTAL (Also enter on Part 5—Recapitulation, page 3, at item 14.) ▶		45,800

(If more space is needed, attach the continuation schedule from the end of this package or additional statements of the same size.)

Schedule J — Page 17

DAA There are no continuation schedules attached

Note: If the estate has not yet paid the amounts, but can estimate them with accuracy, the estate can deduct them on Form 706 if paid. If the amount is not ascertainable; no deduction is allowable until it is ascertainable. This may result in extending or amending the tax return [Reg. §20.2053-1(d)(4)].

Schedule K — Debts of the Decedent, and Mortgages and Liens

Schedule K is separated into two parts. The top part of Schedule K is for unsecured debts such as credit cards and the bottom part is for mortgages, liens and secured debts.

For the top part, include notes unsecured by a mortgage or other lien, and give full details, including:

- Name of payee
- Face value and unpaid balance
- Date and term of note
- Interest rate
- Date to which interest was paid before death

Include the exact nature of the claim as well as the name of the creditor. If the claim is for services performed over a period of time, state the period covered by the claim.

The amount of the claim representing personal obligations of the decedent is the outstanding balance at the time of death, even if the executor elects the alternate valuation date.

Reg. §20.2053-4 addresses debts of the decedent including mortgages and liens existing at the time of death and reportable on Schedule K.

For the bottom part, allowable deductions on Schedule K include:

- Claims against the estate, such as taxes, mortgages and liens on estate property
- Unpaid income taxes of the decedent
- Gift taxes on gifts made by the decedent
- Interest on the obligation is also deductible in this section
- Any portion of a claim being contested by the estate is not deductible on Schedule K [Reg. §20.2053-4(d)(1) and (2)]

List obligations secured by mortgages or other liens on property included in the gross estate at its full value, or at a value that was undiminished by the amount of the mortgage or lien. If the debt is enforceable against other property of the estate not subject to the mortgage or lien, or if the decedent was personally liable for the debt, include the full value of the property subject to the mortgage or lien in the gross estate under the appropriate schedule. Deduct the mortgage or lien on the property on Schedule K.

However, if the estate is not liable, include in the gross estate only the value of the equity of redemption (or the value of the property less the amount of the debt), and do not deduct any portion of the indebtedness on Schedule K.

Medical expenses and other debt

Expenses paid prior to death are only deductible on the decedent's final Form 1040. Medical expenses paid after death, but within one year of death, may be deducted on either the final Form 1040 or Form 706 [§213(c)].

The decedent's share of a final state or federal income tax liability is deductible on Schedule K. If the surviving spouse filed a joint return with the decedent in the final year, a special computation is required to determine the decedent's share to report on Form 706.

Alimony and other marital settlements may be includable as debt if they meet certain conditions:

- The decedent and spouse have a written agreement
- The divorce occurred before death and within the three-year period beginning on the date one year before the agreement was entered into
- The property transferred to the spouse was in settlement of spousal rights

Identify real estate on Schedule A and any mortgage identified in the description. Even though identified in the Schedule A description, include it as a deduction on Schedule K.

If the decedent resided in a community property state, include only half the debts on Schedule K. An exception exists if the debt was chargeable only to the decedent's share of community property. This depends on local law.

Schedule M – Bequests, etc., to Surviving Spouse

Report the marital deduction for property interested that pass from the decedent to the spouse on Schedule M (§2056). Only claim a deduction for property interests that are includible in the decedent's gross estate. If any expenses can be deducted, reduce the material property deduction by that amount.

Case study

Sam, Maria's spouse, will inherit the following assets:

- §401(k) – 100%
- IRA – 100%
- Big bank checking account – 100%
- The Credit Union savings account – 33.33%
- Primary residence – 100%
- XYZ stock – 33.33%

Schedule M is as follows:

Form 706 (Rev. 8-2019)

Estate of: Maria Sanchez

Decedent's social security number ***-**-9012

SCHEDULE M—Bequests, etc., to Surviving Spouse

Note: If the value of the gross estate, together with the amount of adjusted taxable gifts, is less than the basic exclusion amount and Form 706 is being filed solely to elect portability of the DSUE amount, consideration should be given as to whether you are required to report the value of assets eligible for the marital or charitable deduction on this schedule. See the instructions for more information. If you are not required to report the value of an asset, identify the property but make no entry in the last column.

		Line	Yes	No
1	Did any property pass to the surviving spouse as a result of a qualified disclaimer? If "Yes," attach a copy of the written disclaimer required by section 2518(b).	1		X
2a	In what country was the surviving spouse born? United States of America			
b	What is the surviving spouse's date of birth?			
c	Is the surviving spouse a U.S. citizen?	2c	X	
d	If the surviving spouse is a naturalized citizen, when did the surviving spouse acquire citizenship?			
e	If the surviving spouse is not a U.S. citizen, of what country is the surviving spouse a citizen?			
3	**Election Out of QTIP Treatment of Annuities.** Do you elect under section 2056(b)(7)(C)(ii) not to treat as qualified terminable interest property any joint and survivor annuities that are included in the gross estate and would otherwise be treated as qualified terminable interest property under section 2056(b)(7)(C)? See instructions	3		X

Item number	Description of property interests passing to surviving spouse. For securities, give CUSIP number. If trust, partnership, or closely held entity, give EIN	Amount
	QTIP property:	
	All other property:	
1	Schedule A, Item 1	200,000
2	Schedule B, Item 1	7,599
3	Schedule C, Item 1	3,766
4	Schedule C, Item 2	2,187
5	Schedule I, Item 1	62,500
6	Schedule I, Item 2	150,000
	Total from continuation schedules (or additional statements) attached to this schedule	

4	**Total** amount of property interests listed on Schedule M			4	426,052
5a	Federal estate taxes payable out of property interests listed on Schedule M	5a	0		
b	Other death taxes payable out of property interests listed on Schedule M	5b	0		
c	Federal and state GST taxes payable out of property interests listed on Schedule M	5c	0		
d	Add items 5a, 5b, and 5c			5d	
6	Net amount of property interests listed on Schedule M (subtract item 5d from item 4). Also enter on Part 5 — Recapitulation, page 3, at item 21			6	426,052

(If more space is needed, attach the continuation schedule from the end of this package or additional statements of the same size.)

Schedule O — Charitable, Public, and Similar Gifts and Bequests

Report all charitable deductions on Schedule O (§2055). This includes property transferred by bequests, legacies, devises, qualified disclaimer or power of appointment.

To be deductible, the executor must be certain that the charitable transfer takes place. Thus, provisions established by the decedent prior to death must make the transfer.

To qualify for the charitable deduction, it must generally be the decedent's entire interest in the property transferred; however, certain partial interests may qualify for the deduction.

No charitable deduction is allowable for a charitable gift of a remainder interest where there is a noncharitable beneficiary, unless the trust is a charitable remainder annuity trust (CRAT), a charitable remainder unitrust (CRUT) or a pooled income fund.

Reduce the estate's charitable deduction by any federal or state death taxes paid out of the charitable bequest. This can happen by the governing instrument, such as the will, or operation of law by the state.

Case study

Maria bequeathed $5,000 to Happy Paws, a §501(c)(3) organization that is an animal shelter. Her estate receives a $5,000 deduction on Schedule O. Maria's last will and testament does not state that estate tax paid reduces the amount.

Form 706 (Rev. 8-2019)

Estate of: Maria Sanchez

Decedent's social security number ***-**-9012

SCHEDULE O — Charitable, Public, and Similar Gifts and Bequests

Note: If the value of the gross estate, together with the amount of adjusted taxable gifts, is less than the basic exclusion amount and Form 706 is being filed solely to elect portability of the DSUE amount, consideration should be given as to whether you are required to report the value of assets eligible for the marital or charitable deduction on this schedule. See the instructions for more information. If you are not required to report the value of an asset, identify the property but make no entry in the last column.

		Yes	No
1a	If the transfer was made by will, has any action been instituted to contest or have interpreted any of its provisions affecting the charitable deductions claimed in this schedule? If "Yes," full details must be submitted with this schedule.		X
b	According to the information and belief of the person or persons filing this return, is any such action planned? If "Yes," full details must be submitted with this schedule.		X
2	Did any property pass to charity as the result of a qualified disclaimer? If "Yes," attach a copy of the written disclaimer required by section 2518(b).		X

Item number	Name and address of beneficiary	Character of institution	Amount
1	Happy Paws Good Boy Lane Flagstaff AZ 85001	Animal Shelter	5,000
	Total from continuation schedules (or additional statements) attached to this schedule		

3	Total			3	5,000
4a	Federal estate tax payable out of property interests listed above	4a	0		
b	Other death taxes payable out of property interests listed above	4b	0		
c	Federal and state GST taxes payable out of property interests listed above	4c	0		
d	Add items 4a, 4b, and 4c			4d	0
5	Net value of property interests listed above (subtract item 4d from item 3). Also enter on Part 5—Recapitulation, page 3, at item 22			5	5,000

(If more space is needed, attach the continuation schedule from the end of this package or additional statements of the same size.)

Schedule O — Page 21

DAA There are no continuation schedules attached

DSUE portability

A surviving spouse can use the deceased spouse's unused estate exclusion, referred to as the portability of the deceased spousal unused exclusion (DSUE). Most taxpayers with small estates do not need to be concerned with this election. Form 706 must be timely filed to elect portability of the DSUE amount, even when there is no filing requirement under §6018(a). However, Rev. Proc. 2022-32 provides simplified relief for late elections.

In order to qualify for relief:

- A complete and properly prepared Form 706 must be filed on or before the fifth annual anniversary of the decedent's date of death; and
- The words "Filed pursuant to Rev. Proc. 2022-32 to elect portability under §2010(c)(5)(A)" must be included at the top of Form 706.

If the requirements are met, Form 706 will be considered to have been filed timely in accordance with §20.2010-2(a)(1). This allows the surviving spouse to use the DSUE.

Note: A nonresident surviving spouse who is not a citizen of the U.S. may not take into account the DSUE amount of a deceased spouse, except to the extent allowed by treaty with their country of citizenship. A qualified domestic trust (QDOT) can be used to help mitigate the tax liability for the nonresident spouse.

Complete all schedules in their entirety. The amount transferred is the deceased spouse's unused exclusion, which is determined after considering estate deductions and the charitable and marital deductions. Form 706, Page 4, Part 6, is used to elect DSUE portability.

Case study

After completing Maria's estate Form 706, there is a remaining $11,538,165 that can be used for the portability election. Form 706, Part 6 is as follows:

Form 706 (Rev. 8-2019)

Estate of: Maria Sanchez

Decedent's social security number ***-**-9012

Part 6—Portability of Deceased Spousal Unused Exclusion (DSUE)

Portability Election

A decedent with a surviving spouse elects portability of the DSUE amount, if any, by completing and timely filing this return. No further action is required to elect portability of the DSUE amount to allow the surviving spouse to use the decedent's DSUE amount.

Section A. Opting Out of Portability

The estate of a decedent with a surviving spouse may opt out of electing portability of the DSUE amount. Check here and do not complete Sections B and C of Part 6 only if the estate opts **NOT** to elect portability of the DSUE amount. ☐

Section B. Qualified Domestic Trust (QDOT)

	Yes	No
Are any assets of the estate being transferred to a QDOT?		X

If "Yes," the DSUE amount portable to a surviving spouse (calculated in Section C, below) is preliminary and shall be redetermined at the time of the final distribution or other taxable event imposing estate tax under section 2056A. See instructions for more details.

Section C. DSUE Amount Portable to the Surviving Spouse (To be completed by the estate of a decedent making a portability election.)

Complete the following calculation to determine the DSUE amount that can be transferred to the surviving spouse.

1	Enter the amount from line 9d, Part 2—Tax Computation	1	12,920,000
2	Reserved	2	
3	Enter the value of the cumulative lifetime gifts on which tax was paid or payable. See instructions	3	
4	Add lines 1 and 3	4	12,920,000
5	Enter amount from line 10, Part 2—Tax Computation	5	
6	Divide amount on line 5 by 40% (0.40) (do not enter less than zero)	6	
7	Subtract line 6 from line 4	7	12,920,000
8	Enter the amount from line 5, Part 2—Tax Computation	8	1,381,835
9	Subtract line 8 from line 7 (do not enter less than zero)	9	11,538,165
10	DSUE amount portable to surviving spouse (Enter lesser of line 9 or line 9a, Part 2—Tax Computation)	10	11,538,165

There is a special rule to simplify reporting on a Form 706 utilizing the DSUE when a Form 706 normally would not have been required per Reg. §20.2010-2(a)(7)(ii). The tables in Appendix E must be used when completing Form 706.

Simplified reporting allows the representative or executor to reasonably estimate values for both of the following:

- Marital deduction property
- Charitable contribution property

Note: Accurately report all other property. The simplified reporting procedure in this sense is limited in application.

Reflect the qualifying property on its appropriate schedule, but do not report a dollar value when using simplified reporting. Instead, the executor estimates the value of this qualifying property and enters the amount from the Table of Estimated Values chart in the Form 706 instructions in Part 5 on Lines 10 and 23. The table can be found in Appendix E of this text.

The surviving spouse uses the DSUE from a predeceased spouse on subsequent taxable gifts made during life and any transfers at death. Use the DSUE acquired from a predeceased spouse before using the surviving spouse's own exclusion. Additionally, the DSUE amount can be used for lifetime gifts made by the surviving spouse.

Note: Keep in mind, if the surviving spouse remarries and dies, they cannot pass any DSUE received from their predeceased spouse onto a new surviving spouse.

The DSUE rules prevent a taxpayer from marrying several times and combining the DSUE from multiple spouses. This is not an issue unless the taxpayer survives a second spouse. If this happens, the old DSUE from the first spouse is gone, except for the amount already used during life via gifts.

Form 706, Page 4, Part 6, Section C, calculates the amount the deceased spouse gives to the surviving spouse, while Section D calculates the amount of DSUE utilized when the surviving spouse dies.

Note: Rarely are both Sections C and D filled out at the same time.

Anti-claw back rules

The TCJA, set to sunset after 2025, increased the basic exclusion amount. The DSUE amount election during the period of the increased basic exclusion amount will not be reduced as a result of the sunset of the increased amount (Preamble to TD 9884, 11/22/2019).

Example

Gordon predeceased his spouse, Veronica, and died before 2026, at a time when the basic exclusion amount was $11.4 million. Gordon made no taxable gifts and had no taxable estate. Gordon's executor elected, pursuant to Reg. §20.2010-2, to allow Veronica to take into account Gordon's $11.4 million DSUE amount. Veronica made no taxable gifts and did not remarry. The basic exclusion amount on Veronica's date of death is $6.8 million. Because the total of the amounts allowable as a credit in computing the gift tax payable on Veronica's post-1976 gifts attributable to the basic exclusion amount (zero) is less than the credit based on the basic exclusion amount allowable on Veronica's date of death, the credit to be applied for purposes of computing Veronica's estate tax is based on Veronica's $18.2 million applicable exclusion amount, consisting of the $6.8 million basic exclusion amount on Veronica's date of death plus the $11.4 million DSUE amount, subject to the limitation of §2010(d) [Reg. §20.2010-1(c)(2), Example 3].

Due date – Form 706

Form 706 is due nine months after the date of death unless the IRS grants an extension of time to file.

> **Note:** Determine date of death in the time zone of the decedent's domicile, not any location the decedent is visiting (Rev. Ruls. 66-85 and 74-424).

Unlike an income tax return, the due date falls on the exact day nine months from the date of death.

Case study

Maria Sanchez, age 71, passed away on July 23, 2023. Absent an extension, her estate Form 706 is due on April 23, 2024.

> **Note:** Marie's completed Form 706 return is in Appendix H.

The statute providing the due date (§6075) uses months, not days. If a decedent dies at the end of a month and the subsequent ninth month is shorter, the due date is the end of the month. If it falls on a weekend or holiday, the return is due the next business day.

Extensions

File Form 4768, *Application for Extension of Time to File a Return and/or Pay U.S. Estate (and Generation-Skipping Transfer) Taxes*, to request an extension of time to file the estate return or pay the estate tax.

The person filing the application must sign the form. If the person filing the return is not the executor, the applicant must sign the form and check the box describing the applicant. If the court appoints co-executors, all must sign the return.

Practical Considerations

Dealing with an estate poses several questions. These questions may include what is deductible, how much the tax is and who must bear the burden of the tax. In addition to these questions, the fiduciary handling the estate's affairs will want to be discharged from liability. If a tax professional is not assisting the fiduciary handling the estate with these sensitive topics, they could be subject to malpractice suits.

Some important items to consider are:

- Tax apportionment
- State death tax deduction
- Request of discharge
- Refund of overpayment
- Gifting

Tax apportionment

Tax apportionment is the concept of allocating the tax burden among the beneficiaries. Although federal tax is not deductible, the executor or beneficiaries may ask the tax professional to assist in determining who bears the burden in the reduction of their inheritance. Beneficiaries (and potentially the fiduciary handling the affairs), can be emotional and dedicated to get their "fair share."

State law is the first place to look to determine the allocation of tax. Many states follow a theory of **equitable apportionment**. Equitable apportionment allocates the tax burden to probate and non-probate assets; however, this happens only if the beneficiary's inheritance creates estate tax liability. Therefore, charitable beneficiaries and spouses would generally not bear any tax apportionment.

Despite state law, if the decedent's last will and testament requires the fiduciary to allocate the tax burden to specific types of bequests, then the fiduciary handling the affairs must respect the will's provision.

> **Warning:** Because this concept depends on state law as well as other legal matters, the tax professional and the fiduciary should be working with an attorney.

Example

Russell is a beneficiary of an estate and inherits 20% of the estate. Calculate this by dividing Russell's bequest by the total estate. The estate tax is $200,000; therefore, Russell's inheritance decreases by $40,000 (20% x $200,000).

Non-probate assets

There may be situations where a taxable estate consists almost entirely of non-probate assets. An example of this would be assets held in a revocable trust prior to death, an IRA or a life insurance policy. These assets pass to the beneficiaries by contract and bypass probate; however, the fiduciary only has access to probate assets. This can be problematic if there is an estate tax due.

Tax law provides provisions that allows a fiduciary to recover taxes from those who inherit non-probate assets (§2206, §2207, §2207A, and §2207B). This right of recovery can be problematic. Since it is a right to recovery, the fiduciary is typically required to pay the tax and subsequently request the beneficiary to reimburse the fiduciary.

Consult with the attorney working with the fiduciary in coordinating these provisions with local law to recover estate taxes, if necessary.

Note: While the fiduciary may be required to apportion taxes for recovery, the IRS is not bound to apportionment. This means that if the IRS needs to collect estate tax from beneficiaries, it can generally pursue any beneficiary for the tax to the extent they received assets.

State death tax deduction

An estate may take a deduction for estate, inheritance, legacy or succession taxes paid to a state or the District of Columbia on property included in the gross estate [§2058(a)]. Enter the state death taxes paid on property included in the gross estate as a deduction on Form 706, Page 1, Part 2, Line 3b.

The deduction is allowable for taxes actually paid before *the latter of* [§2058(b)]:

- Four years after filing the Form 706
- 60 days after the tax court decision becomes final, if the fiduciary timely filed a petition for redetermination of a deficiency with the tax court [6213(a)]
- The date of the expiration of the extension period, if the IRS has granted an extension of time under §6161 or §6166
- If the fiduciary timely filed a claim for refund or credit of an overpayment of estate tax, the latest of the expiration of:
  - 60 days from the date of mailing by the IRS of a notice of the disallowance of any part of such claim
  - 60 days after a decision by any court of competent jurisdiction becomes final with respect to a timely suit instituted upon such a claim
  - Two years after filing a waiver of the notice of disallowance

Request of discharge

The executor is responsible for paying the federal estate tax (§2002), as well as the income and gift tax (§6905). The executor can request a discharge of personal liability for federal estate tax by making a written request before or after filing the estate tax return. The executor can request a discharge of liability of the decedent's income or gift tax using Form 5495, *Request for Discharge From Personal Liability Under Internal Revenue Code Section 2204 or 6905*, which they must file after filing the estate return.

If not using Form 5495, the executor can make the request for discharge from personal liability by letter. Indicate the executor is making the request according to §6905. Attach the request to the estate tax return. If the estate did not file an estate tax return, file the request with the IRS service center where the decedent's final income tax return was filed.

The IRS should notify the executor within nine months of the amount of estate tax due after receiving the application. After payment, the IRS sends a notice of discharge from personal liability.

If necessary, the IRS collects tax from the person who inherited the asset.

Refund of overpayment

An overpayment of taxes may be the result of errors in math, judgment or interpretation of law by either the executor or the IRS.

If the fiduciary makes the overpayment, the refund is recoverable by the fiduciary or their successor. The refund claim includes a statement indicating the fiduciary filed the return on which the estate made an overpayment and that they are still acting in the capacity of a fiduciary [Reg. §301.6402-2(e)].

If the estate has distributed the assets and terminated, the beneficiaries can file a single refund claim for the entire portion, or separate claims based on their respective shares of estate property. The claim should also include the decedent's date of death, certified copies of the court order granting the executor's discharge and an attachment of the order of distribution (Rev. Rul. 73-366).

Gifting

As mentioned earlier, the TCJA increased the basic exclusion amount. Assuming this provision is not extended, taxpayers may want to take advantage of the increased unified gift and estate tax exemption amount before the end of 2025. This is not a one size fits all strategy as such, it is beneficial to review the taxpayer's size of their estate, marital status, cost basis of assets and the taxpayer's health.

Death of a Taxpayer review questions

1. _____ When does a decedent's final tax year end?
   - A. On the day after the date of death
   - B. At 11:59 pm on the date of death
   - C. On the last day of the month preceding the month of death
   - D. It remains the same as if the taxpayer did not die

2. _____ If a taxpayer dies with depreciable property, such as a rental, what is the proper allocation method?
   - A. The full year of depreciation is allowable in the year of death.
   - B. Treat the decedent as disposing of the asset, with mid-month or half-year depreciation being fully allowable under normal disposition rules.
   - C. Depreciation is not allowable in the year of death.
   - D. Allocate depreciation based on the number of days alive to the total number of days in the year.

3. _____ Which of the following is **not** a permissible date for the year-end of an estate of an individual dying on June 14, Year 1?
   - A. March 31, Year 2
   - B. June 13, Year 2
   - C. June 30, Year 1
   - D. Dec. 31, Year 1

4. _____ If an eligible trust elects to be treated as part of the estate, and the estate already has an EIN, what identification number is Form 1041 filed under?
   - A. EIN of the estate
   - B. EIN of the trust
   - C. Either A or B
   - D. TIN of the decedent

5. _____ Without any extensions, Form 706 is due:
   - A. Nine months from the date of death
   - B. Nine months from the day the court appoints an executor
   - C. On the 15th day of the ninth month after the date of death
   - D. On April 15 of the following calendar year

6. _____ David's estate made a portability election. When his spouse Sam passes, what happens to the DSUE from David's estate?

A. If Sam remarried, the DSUE amount passes to the new spouse upon Sam's death
B. The DSUE amount from David's estate is used first and any remaining is lost
C. The DSUE amount is used after using Sam's own exclusion
D. The DSUE amount expires if not used within 10 years

Death of a Taxpayer review answers

1.

A. Incorrect. The decedent's final tax year ends on the date of death, not the day after.
B. **Correct.** The decedent's final tax year ends on the date of death.
C. Incorrect. The decedent's final tax year ends on the date of death, not the last day of the preceding month.
D. Incorrect. The decedent's final tax year ends on the date of death, not the last day as determined if living.

[Introduction]

2.

A. Incorrect. Calculate the depreciation differently when the owner of the depreciable property dies.
B. Incorrect. Although treated as a disposition, make the depreciation allocation on a daily basis, not the normal disposition rules.
C. Incorrect. No provision disallows depreciation in the year of death.
D. **Correct.** In the year of death, calculate depreciation based on the number of days the decedent held the property.

[Rental real estate]

3.

A. Incorrect. March 31, Year 2, is an acceptable tax year-end.
B. **Correct.** The middle date of a month is not a permissible fiscal year-end for an estate. An estate's year-end can be the last day of any month within 12 months of the date of death, beginning with the month of death, but not more than 12 months after the date of death.
C. Incorrect. June 30, Year 1, is an acceptable tax year-end, even though the estate's tax year is only 16 days.
D. Incorrect. Dec. 31, Year 1, is an acceptable tax year-end.

[Accounting period]

4.

A. **Correct.** Use the EIN of the estate when the trust has made an election to be treated as part of the estate.
B. Incorrect. Treat the trust as if it does not exist for filing purposes; therefore, do not use the EIN of the trust.
C. Incorrect. Use the EIN of the estate.
D. Incorrect. Use the decedent's TIN only on the decedent's final Form 1040.

[Election to treat trust as part of the estate]

5.

A. **Correct.** The due date is nine months from the date of death.
B. Incorrect. It is irrelevant when the court appoints an executor.
C. Incorrect. The statute simply states nine months from the date of death. There is no reference to the 15th day of the ninth month.
D. Incorrect. April 15 is irrelevant for Form 706.

[Due date – Form 706]

6.

A. Incorrect. If there is any remaining DSUE amount when Sam passes, it cannot be passed to their current spouse.
B. **Correct.** The DSUE amount from a former spouse is used first. If the full amount is not used, it is lost.
C. Incorrect. Sam's estate will use the DSUE amount from David's estate first before using Sam's exclusion amount.
D. Incorrect. There is not a time limit pertaining to the DSUE amount.

[DSUE portability]

Appendix A – Accountable Plan Sample

Sample Accountable Plan Policy

This document sets out the terms and conditions of the [company name] expense reimbursement policy pursuant to Reg. §1.62-2 upon the following terms and conditions intended to comply with all applicable tax rules.

1. Any person now or hereafter employed by [company name] shall be reimbursed for any ordinary and necessary business and professional expenses incurred on behalf of [company name]. The expenses must be adequately substantiated as required by the Company policy on expense reimbursements. (See policy in Employee Handbook)
2. Under no circumstances will [company name] reimburse employees for business or professional expenses incurred on behalf of [company name] that are not properly substantiated. [Company name] and employees understand that this requirement is necessary to prevent our expense reimbursement plan from being classified as a nonaccountable plan.
3. All expenses must be substantiated within 60 days of the date paid or incurred.
4. All charges to company credit cards must be substantiated in the same manner as the above-mentioned reimbursements.
5. Advances that are not substantiated within 60 days must be returned (paid back) within 120 days after the expense against which the advance was made is paid or incurred.
6. Documentation must include the amount, date, business purpose and business relationship of any person present for each expense. A receipt should accompany the documentation.

Appendix B – Form 7203

Form **7203**
(Rev. December 2022)
Department of the Treasury
Internal Revenue Service

S Corporation Shareholder Stock and Debt Basis Limitations

Attach to your tax return.
Go to *www.irs.gov/Form7203* for instructions and the latest information.

OMB No. 1545-2302
Attachment Sequence No. **203**

Name of shareholder | **Identifying number**

A Name of S corporation | **B** Employer identification number

C Stock block (see instructions):
D Check applicable box(es) to indicate how stock was acquired:
(1) ☐ Original shareholder **(2)** ☐ Purchased **(3)** ☐ Inherited **(4)** ☐ Gift **(5)** ☐ Other:
E Check if you have a Regulations section 1.1367-1(g) election in effect during the tax year for this S corporation . . . . . . ☐

Part I **Shareholder Stock Basis**

1	Stock basis at the beginning of the corporation's tax year			1	
2	Basis from any capital contributions made or additional stock acquired during the tax year			2	
3a	Ordinary business income (enter losses in Part III)	3a			
b	Net rental real estate income (enter losses in Part III)	3b			
c	Other net rental income (enter losses in Part III)	3c			
d	Interest income	3d			
e	Ordinary dividends	3e			
f	Royalties	3f			
g	Net capital gains (enter losses in Part III)	3g			
h	Net section 1231 gain (enter losses in Part III)	3h			
i	Other income (enter losses in Part III)	3i			
j	Excess depletion adjustment	3j			
k	Tax-exempt income	3k			
l	Recapture of business credits	3l			
m	Other items that increase stock basis	3m			
4	Add lines 3a through 3m			4	
5	Stock basis before distributions. Add lines 1, 2, and 4			5	
6	Distributions (excluding dividend distributions)			6	
	Note: If line 6 is larger than line 5, subtract line 5 from line 6 and report the result as a capital gain on Form 8949 and Schedule D. See instructions.				
7	Stock basis after distributions. Subtract line 6 from line 5. If the result is zero or less, enter -0-, skip lines 8 through 14, and enter -0- on line 15			7	
8a	Nondeductible expenses	8a			
b	Depletion for oil and gas	8b			
c	Business credits (sections 50(c)(1) and (5))	8c			
9	Add lines 8a through 8c			9	
10	Stock basis before loss and deduction items. Subtract line 9 from line 7. If the result is zero or less, enter -0-, skip lines 11 through 14, and enter -0- on line 15			10	
11	Allowable loss and deduction items. Enter the amount from line 47, column (c)			11	
12	Debt basis restoration (see net increase in instructions for line 23)			12	
13	Other items that decrease stock basis			13	
14	Add lines 11, 12, and 13			14	
15	**Stock basis at the end of the corporation's tax year.** Subtract line 14 from line 10. If the result is zero or less, enter -0-			15	

Part II **Shareholder Debt Basis**

Section A—Amount of Debt (If more than three debts, see instructions.)

	Description	**(a)** Debt 1 ☐ Formal note ☐ Open account	**(b)** Debt 2 ☐ Formal note ☐ Open account	**(c)** Debt 3 ☐ Formal note ☐ Open account	**(d)** Total
16	Loan balance at the beginning of the corporation's tax year				
17	Additional loans (see instructions)				
18	Loan balance before repayment. Add lines 16 and 17				
19	Principal portion of debt repayment (this line doesn't include interest)				
20	Loan balance at the end of the corporation's tax year. Subtract line 19 from line 18				

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 56396V Form **7203** (Rev. 12-2022)

Form 7203 (Rev. 12-2022) Page **2**

Part II **Shareholder Debt Basis** *(continued)*

Section B—Adjustments to Debt Basis

	Description	(a) Debt 1	(b) Debt 2	(c) Debt 3	(d) Total
21	Debt basis at the beginning of the corporation's tax year				
22	Enter the amount, if any, from line 17				
23	Debt basis restoration (see instructions)				
24	Debt basis before repayment. Add lines 21, 22, and 23				
25	Divide line 24 by line 18				
26	Nontaxable debt repayment. Multiply line 25 by line 19				
27	Debt basis before nondeductible expenses and losses. Subtract line 26 from line 24				
28	Nondeductible expenses and oil and gas depletion deductions in excess of stock basis				
29	Debt basis before losses and deductions. Subtract line 28 from line 27. If the result is zero or less, enter -0-				
30	Allowable losses in excess of stock basis. Enter the amount from line 47, column (d)				
31	**Debt basis at the end of the corporation's tax year.** Subtract line 30 from line 29. If the result is zero or less, enter -0-				

Section C—Gain on Loan Repayment

	Description	(a) Debt 1	(b) Debt 2	(c) Debt 3	(d) Total
32	Repayment. Enter the amount from line 19				
33	Nontaxable repayments. Enter the amount from line 26				
34	**Reportable gain.** Subtract line 33 from line 32				

Part III **Shareholder Allowable Loss and Deduction Items**

	Description	(a) Current year losses and deductions	(b) Carryover amounts (column (e)) from the previous year	(c) Allowable loss from stock basis	(d) Allowable loss from debt basis	(e) Carryover amounts
35	Ordinary business loss					
36	Net rental real estate loss					
37	Other net rental loss					
38	Net capital loss					
39	Net section 1231 loss					
40	Other loss					
41	Section 179 deductions					
42	Charitable contributions					
43	Investment interest expense					
44	Section 59(e)(2) expenditures					
45	Other deductions					
46	Foreign taxes paid or accrued					
47	**Total loss.** Add lines 35 through 46 for each column. Enter the total loss in column (c) on line 11 and enter the total loss in column (d) on line 30					

Form **7203** (Rev. 12-2022)

Appendix C – Form 7206

Form **7206**

Department of the Treasury
Internal Revenue Service

Self-Employed Health Insurance Deduction

Attach to Form 1040, 1040-SR, or 1040-NR.
Go to *www.irs.gov/Form7206* for instructions and the latest information.

OMB No. 1545-0074
2023
Attachment Sequence No. **206**

Name(s) shown on return | **Your taxpayer identification number**

Note: Use a separate Form 7206 for each trade or business under which an insurance plan is established.

1	Enter the total amount paid in 2023 for health insurance coverage established under your business (or the S corporation in which you were a more-than-2% shareholder) for 2023 for you, your spouse, and your dependents. But **don't** include the following. See instructions	**1**	
	• Amounts for any month you were eligible to participate in a health plan subsidized by your employer or your spouse's employer or the employer of either your dependent or your child who was under the age of 27 at the end of 2023. • Any amounts paid, not to exceed $3,000, from retirement plan distributions that were **nontaxable** because you are a retired public safety officer. See instructions. • Any payments for qualified long-term care insurance (see line 2).		
2	For coverage under a qualified long-term care insurance contract, enter for each person covered the **smaller** of (a) or (b). **(a)** Total payments made for that person during the year. **(b)** The amount shown below. Use the person's age at the end of the tax year. $480— if that person is age 40 or younger $890— if age 41 to 50 $1,790— if age 51 to 60 $4,770— if age 61 to 70 $5,960— if age 71 or older **Note:** The amount of long-term care premiums that can be included as a medical expense is limited by the person's age. **Don't** include payments for any month you were eligible to participate in a long-term care insurance plan subsidized by your employer or your spouse's employer, or the employer of either your dependent or your child who was under the age of 27 at the end of 2023. If more than one person is covered, figure separately the amount to enter for each person. Then enter the total of those amounts	**2**	
3	Add lines 1 and 2	**3**	
4	Enter your net profit* and any other earned income** from the trade or business under which the insurance plan is established. Don't include Conservation Reserve Program payments exempt from self-employment tax. If the business is an S corporation, skip to line 11	**4**	
5	Enter the total of all net profits* from Schedule C (Form 1040), line 31; Schedule F (Form 1040), line 34; or Schedule K-1 (Form 1065), box 14, code A, plus any other income allocable to the profitable businesses. Don't include Conservation Reserve Program payments exempt from self-employment tax. See the Instructions for Schedule SE (Form 1040). **Don't** include any net losses shown on these schedules	**5**	
6	Divide line 4 by line 5	**6**	
7	Multiply Schedule 1 (Form 1040), line 15, deductible part of self-employment tax, by the percentage on line 6	**7**	
8	Subtract line 7 from line 4	**8**	
9	Enter the amount, if any, from Schedule 1 (Form 1040), line 16, self-employed SEP, SIMPLE, and qualified plans, attributable to the same trade or business in which the insurance plan is established	**9**	
10	Subtract line 9 from line 8	**10**	
11	Enter your Medicare wages (box 5 of Form W-2) from an S corporation in which you are a more-than-2% shareholder and in which the insurance plan is established	**11**	
12	Enter any amount from Form 2555, line 45, attributable to the amount entered on line 4 or 11 above	**12**	
13	Subtract line 12 from line 10 or 11, whichever applies	**13**	
14	**Self-employed health insurance deduction.** Enter the **smaller** of line 3 or line 13 here and on Schedule 1 (Form 1040), line 17. **Don't** include this amount when figuring any medical expense deduction on Schedule A (Form 1040)	**14**	

* If you used either optional method to figure your net earnings from self-employment from any business, don't enter your net profit from the business. Instead, enter the amount attributable to that business from Schedule SE (Form 1040), Part I, line 4b.

** **Earned income** includes net earnings and gains from the sale, transfer, or licensing of property you created. However, it doesn't include capital gain income.

For Privacy Act and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 56399C Form **7206** (2023)

Appendix D – Where to Report

The following chart compares Form 706, Form 1041, and the decedent's final Form 1040 and summarizes where to report certain items.

	Form 706	Factor	Form 1041	Decedent's final Form 1040
FMV of assets	X	only		
IRD*	X	and	X	
DRD*	X	and	X	
Pensions/annuities*	X	and	X	
Funeral expenses	X	only		
Executor fees	X	or	X	
Attorney fees	X	or	X	
Appraisal fees	X	or	X	
Probate fees	X	or	X	
Doctor bills	X	or		X
Hospital bills	X	or		X
Utility bills incurred prior to death	X	only		

Appendix E – Estimated Values Table

Table of Estimated Values

If the total estimated value of the assets eligible for the special rule under Reg. section 20.2010-2(a)(7)(ii) is more than:	But less than or equal to:	Include this amount on lines 10 and 23:
$0	$250,000	$250,000
$250,000	$500,000	$500,000
$500,000	$750,000	$750,000
$750,000	$1,000,000	$1,000,000
$1,000,000	$1,250,000	$1,250,000
$1,250,000	$1,500,000	$1,500,000
$1,500,000	$1,750,000	$1,750,000
$1,750,000	$2,000,000	$2,000,000
$2,000,000	$2,250,000	$2,250,000
$2,250,000	$2,500,000	$2,500,000
$2,500,000	$2,750,000	$2,750,000
$2,750,000	$3,000,000	$3,000,000
$3,000,000	$3,250,000	$3,250,000
$3,250,000	$3,500,000	$3,500,000
$3,500,000	$3,750,000	$3,750,000
$3,750,000	$4,000,000	$4,000,000
$4,000,000	$4,250,000	$4,250,000
$4,250,000	$4,500,000	$4,500,000
$4,500,000	$4,750,000	$4,750,000
$4,750,000	$5,000,000	$5,000,000
$5,000,000	$5,250,000	$5,250,000
$5,250,000	$5,500,000	$5,500,000
$5,500,000	$5,750,000	$5,750,000
$5,750,000	$6,000,000	$6,000,000
$6,000,000	$6,250,000	$6,250,000
$6,250,000	$6,500,000	$6,500,000
$6,500,000	$6,750,000	$6,750,000
$6,750,000	$7,000,000	$7,000,000
$7,000,000	$7,250,000	$7,250,000
$7,250,000	$7,500,000	$7,500,000
$7,500,000	$7,750,000	$7,750,000
$7,750,000	$8,000,000	$8,000,000
$8,000,000	$8,250,000	$8,250,000
$8,250,000	$8,500,000	$8,500,000
$8,500,000	$8,750,000	$8,750,000
$8,750,000	$9,000,000	$9,000,000
$9,000,000	$9,250,000	$9,250,000
$9,250,000	$9,500,000	$9,500,000
$9,500,000	$9,750,000	$9,750,000
$9,750,000	$10,000,000	$10,000,000
$10,000,000	$10,250,000	$10,250,000
$10,250,000	$10,500,000	$10,500,000
$10,500,000	$10,750,000	$10,750,000
$10,750,000	$11,000,000	$11,000,000

Table of Estimated Values *(continued)*

If the total estimated value of the assets eligible for the special rule under Reg. section 20.2010-2(a)(7)(ii) is more than:	But less than or equal to:	Include this amount on lines 10 and 23:
$11,000,000	$11,180,000	$11,180,000
$11,180,000	$11,400,000	$11,400,000
$11,400,000	$11,580,000	$11,580,000
$11,580,000	$11,700,000	$11,700,000
$11,700,000	$12,060,000	$12,060,000
$12,060,000	$12,920,000	$12,920,000

Appendix F – Basic Exclusion Amounts

Year	Basic Exclusion Amount	Credit Equivalent Amount
2014	$5,340,000	$2,081,800
2015	$5,430,000	$2,117,800
2016	$5,450,000	$2,125,800
2017	$5,490,000	$2,141,800
2018	$11,180,000	$4,417,800
2019	$11,400,000	$4,505,800
2020	$11,580,000	$4,577,800
2021	$ 11,700,000	$4,625,800
2022	$12,060,000	$4,769,800
2023	$12,920,000	$5,113,800
2024	$13,610,000	$5,389,800

Appendix G – Year of Death Checklist

Year of Death Checklist	
Do you have a copy of the will?	
Do you have a copy of the living trust document (if applicable)?	
Did the fiduciary obtain an EIN for the estate income tax return?	
Obtain a list of the beneficiaries which includes their name, address, SSN and citizenship	
Do you have a copy of the domiciliary letter or letter of authority identifying the executor/ personal representative of the estate?	
Do you have a copy of the probate inventory?	

Appendix H – Completed Form 706

Form **706** (Rev. August 2019) Department of the Treasury Internal Revenue Service

United States Estate (and Generation-Skipping Transfer) Tax Return

▶ Estate of a citizen or resident of the United States (see instructions). To be filed for decedents dying after December 31, 2018.
▶ Go to *www.irs.gov/Form706* for instructions and the latest information.

OMB No. 1545-0015

Part 1—Decedent and Executor

1a Decedent's first name and middle initial (and maiden name, if any)	Maria Aguirre
1b Decedent's last name	Sanchez
2 Decedent's SSN	***-**-9012
3a City, town, or post office; county; state or province; country; and ZIP or foreign postal code	Flagstaff AZ 85001
3b Year domicile established	
4 Date of birth	02/23/1952
5 Date of death	07/23/23
6a Name of executor (see instructions)	Lily Sanchez
6b Executor's address (number and street including apartment or suite no.; city, town, or post office; state or province; country; and ZIP or foreign postal code) and phone no.	45 East Fake Street Flagstaff AZ 85001 Phone no. 555-555-5555
6c Executor's social security number (see instructions)	***-**-1234
6d If there are multiple executors, check here ☐ and attach a list showing the names, addresses, telephone numbers, and SSNs of the additional executors.	
7a Name and location of court where will was probated or estate administered	Conconino County Court Flagstaff
7b Case number	2023PR2222
8 If decedent died testate, check here ▶ ☒ and attach a certified copy of the will.	X
9 If you extended the time to file this Form 706, check here ▶ ☐	
10 If Schedule R-1 is attached, check here ▶ ☐	
11 If you are estimating the value of assets included in the gross estate on line 1 pursuant to the special rule of Reg. section 20.2010-2(a)(7)(ii), check here ☐	

Part 2—Tax Computation

1	Total gross estate less exclusion (from Part 5—Recapitulation, item 13)			1	1,908,687
2	Tentative total allowable deductions (from Part 5—Recapitulation, item 24)			2	526,852
3a	Tentative taxable estate (subtract line 2 from line 1)			3a	1,381,835
b	State death tax deduction			3b	
c	Taxable estate (subtract line 3b from line 3a)			3c	1,381,835
4	Adjusted taxable gifts (see instructions)			4	
5	Add lines 3c and 4			5	1,381,835
6	Tentative tax on the amount on line 5 from Table A in the instructions			6	498,534
7	Total gift tax paid or payable (see instructions)			7	
8	Gross estate tax (subtract line 7 from line 6)			8	498,534
9a	Basic exclusion amount	9a	12,920,000		
b	Deceased spousal unused exclusion (DSUE) amount from predeceased spouse(s), if any (from Section D, Part 6–Portability of Deceased Spousal Unused Exclusion)	9b			
c	Restored exclusion amount (see instructions)	9c			
d	Applicable exclusion amount (add lines 9a, 9b, and 9c)	9d	12,920,000		
e	Applicable credit amount (tentative tax on the amount in line 9d from Table A in the instructions)	9e	5,113,800		
10	Adjustment to applicable credit amount (May not exceed $6,000. See instructions.)	10	0		
11	Allowable applicable credit amount (subtract line 10 from line 9e)			11	5,113,800
12	Subtract line 11 from line 8 (but do not enter less than zero)			12	
13	Credit for foreign death taxes (from Schedule P). (Attach Form(s) 706-CE.)	13			
14	Credit for tax on prior transfers (from Schedule Q)	14			
15	Total credits (add lines 13 and 14)			15	
16	Net estate tax (subtract line 15 from line 12)			16	0
17	Generation-skipping transfer (GST) taxes payable (from Schedule R, Part 2, line 10)			17	
18	Total transfer taxes (add lines 16 and 17)			18	0
19	Prior payments (explain in an attached statement)			19	
20	Balance due (or overpayment) (subtract line 19 from line 18)			20	0

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 the executor) is based on all information of which preparer has any knowledge.

Sign Here

▶ Signature of executor ▶ Date

▶ Signature of executor ▶ Date

Paid Preparer Use Only

Print/Type preparer's name	Preparer's signature	Date	Check ☐ if self-employed	PTIN
		06/18/24		

Firm's name ▶ Natl Assn Of Tax Prof — Firm's EIN ▶

Firm's address ▶ PO Box 8002 Appleton , WI 54912 — Phone no. 920-749-1040

For Privacy Act and Paperwork Reduction Act Notice, see instructions. Form **706** (Rev. 8-2019)

Form 706 (Rev. 8-2019)

Estate of: Maria Sanchez	Decedent's social security number ***-**-9012

Part 3—Elections by the Executor

Note: For information on electing portability of the decedent's DSUE amount, including how to opt out of the election, see Part 6—Portability of Deceased Spousal Unused Exclusion.
Note: Some of the following elections may require the posting of bonds or liens.

Please check "Yes" or "No" for each question. See instructions.

		Line	Yes	No
1	Do you elect alternate valuation?	1		X
2	Do you elect special-use valuation? If "Yes," you must complete and attach Schedule A-1	2		X
3	Do you elect to pay the taxes in installments as described in section 6166? If "Yes," you must attach the additional information described in the instructions. **Note: By electing section 6166 installment payments, you may be required to provide security for estate tax deferred under section 6166 and interest in the form of a surety bond or a section 6324A lien.**	3		X
4	Do you elect to postpone the part of the taxes due to a reversionary or remainder interest as described in section 6163?	4		X

Part 4—General Information

Note: Please attach the necessary supplemental documents. **You must attach the death certificate.** See instructions.

Authorization to receive confidential tax information under Reg. section 601.504(b)(2)(i); to act as the estate's representative before the IRS; and to make written or oral presentations on behalf of the estate:

Name of representative (print or type)	State	Address (number, street, and room or suite no., city, state, and ZIP code)
Lily Sanchez		45 East Fake Street Flagstaff AZ 85001

I declare that I am the ☐ attorney/ ☐ certified public accountant/ ☐ enrolled agent (check the applicable box) for the executor. I am not under suspension or disbarment from practice before the Internal Revenue Service and am qualified to practice in the state shown above.

Signature	CAF number	Date	Telephone number
			555-555-5555

1 Death certificate number and issuing authority (attach a copy of the death certificate to this return).
AZ-2023-1 Conconino County Coroner

2 Decedent's business or occupation. If retired, check here ▶ ☐ and state decedent's former business or occupation.
Florist

3a Marital status of the decedent at time of death:
☒ Married ☐ Widow/widower ☐ Single ☐ Legally separated ☐ Divorced

3b For all prior marriages, list the name and SSN of the former spouse, the date the marriage ended, and whether the marriage ended by annulment, divorce, or death. Attach additional statements of the same size if necessary.
Jorge Lopez ***-**-7755 08/01/99 Death

4a Surviving spouse's name	4b Social security number	4c Amount received (see instructions)
Sam Lopez	***-**-0987	426,052

5 Individuals (other than surviving spouse), trusts, or other estates who receive benefits from the estate (do not include charitable beneficiaries shown in Schedule O) (see instructions).

Name of individual, trust, or estate receiving $5,000 or more	Identifying number	Relationship to decedent	Amount (see instructions)
All unascertainable beneficiaries and those who receive less than $5,000 ▶			
Total			0

If you answer "Yes" to any of the following questions, you must attach additional information as described.

		Yes	No
6	Is the estate filing a protective claim for refund? If "Yes," complete and attach two copies of Schedule PC for each claim.		X
7	Does the gross estate contain any section 2044 property (qualified terminable interest property (QTIP) from a prior gift or estate)? See instructions		X
8a	Have federal gift tax returns ever been filed? If "Yes," attach copies of the returns, if available, and furnish the following information.		X
b	Period(s) covered — c Internal Revenue office(s) where filed		
9a	Was there any insurance on the decedent's life that is not included on the return as part of the gross estate?		X
b	Did the decedent own any insurance on the life of another that is not included in the gross estate?		X

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Form 706 (Rev. 8-2019)

Estate of: Maria Sanchez	Decedent's social security number ***-**-9012

Part 4—General Information *(continued)*

	If you answer "Yes" to any of the following questions, you must attach additional information as described.	Yes	No
10	Did the decedent at the time of death own any property as a joint tenant with right of survivorship in which **(a)** one or more of the other joint tenants was someone other than the decedent's spouse, and **(b)** less than the full value of the property is included on the return as part of the gross estate? If "Yes," you must complete and attach Schedule E		X
11a	Did the decedent, at the time of death, own any interest in a partnership (for example, a family limited partnership), an unincorporated business, or a limited liability company; or own any stock in an inactive or closely held corporation?		X
b	If "Yes," was the value of **any** interest owned (from above) discounted on this estate tax return? If "Yes," see the instructions on reporting the total accumulated or effective discounts taken on Schedule F or G		X
12	Did the decedent make any transfer described in sections 2035, 2036, 2037, or 2038? See instructions. If "Yes," you must complete and attach Schedule G		X
13a	Were there in existence at the time of the decedent's death any trusts created by the decedent during his or her lifetime?	X	
b	Were there in existence at the time of the decedent's death any trusts not created by the decedent under which the decedent possessed any power, beneficial interest, or trusteeship?	X	
c	Was the decedent receiving income from a trust created after October 22, 1986, by a parent or grandparent?		X
	If "Yes," was there a GST taxable termination (under section 2612) on the death of the decedent?		X
d	If there was a GST taxable termination (under section 2612), attach a statement to explain. Provide a copy of the trust or will creating the trust, and give the name, address, and phone number of the current trustee(s).		
e	Did the decedent at any time during his or her lifetime transfer or sell an interest in a partnership, limited liability company, or closely held corporation to a trust described in lines 13a or 13b?		X
	If "Yes," provide the EIN for this transferred/sold item. ▶		
14	Did the decedent ever possess, exercise, or release any general power of appointment? If "Yes," you must complete and attach Schedule H		X
15	Did the decedent have an interest in or a signature or other authority over a financial account in a foreign country, such as a bank account, securities account, or other financial account?		X
16	Was the decedent, immediately before death, receiving an annuity described in the "General" paragraph of the instructions for Schedule I or a private annuity? If "Yes," you must complete and attach Schedule I		X
17	Was the decedent ever the beneficiary of a trust for which a deduction was claimed by the estate of a predeceased spouse under section 2056(b)(7) and which is not reported on this return? If "Yes," attach an explanation		X

Part 5—Recapitulation. Note: If estimating the value of one or more assets pursuant to the special rule of Reg. section 20.2010-2(a)(7)(ii), enter on both lines 10 and 23 the amount noted in the instructions for the corresponding range of values. See instructions for details.

Item no.	Gross estate		Alternate value	Value at date of death
1	Schedule A—Real Estate	1		1,245,000
2	Schedule B—Stocks and Bonds	2		22,800
3	Schedule C—Mortgages, Notes, and Cash	3		13,487
4	Schedule D—Insurance on the Decedent's Life (attach Form(s) 712)	4		0
5	Schedule E—Jointly Owned Property (attach Form(s) 712 for life insurance)	5		0
6	Schedule F—Other Miscellaneous Property (attach Form(s) 712 for life insurance)	6		414,900
7	Schedule G—Transfers During Decedent's Life (att. Form(s) 712 for life insurance)	7		0
8	Schedule H—Powers of Appointment	8		0
9	Schedule I—Annuities	9		212,500
10	Estimated value of assets subject to the special rule of Reg. section 20.2010-2(a)(7)(ii)	10		0
11	Total gross estate (add items 1 through 10)	11		1,908,687
12	Schedule U—Qualified Conservation Easement Exclusion	12		0
13	Total gross estate less exclusion (subtract item 12 from item 11). Enter here and on line 1 of Part 2—Tax Computation	13		1,908,687

Item no.	Deductions		Amount
14	Schedule J—Funeral Expenses and Expenses Incurred in Administering Property Subject to Claims	14	45,800
15	Schedule K—Debts of the Decedent	15	
16	Schedule K—Mortgages and Liens	16	50,000
17	Total of items 14 through 16	17	95,800
18	Allowable amount of deductions from item 17 (see the instructions for item 18 of the Recapitulation)	18	95,800
19	Schedule L—Net Losses During Administration	19	
20	Schedule L—Expenses Incurred in Administering Property Not Subject to Claims	20	
21	Schedule M—Bequests, etc., to Surviving Spouse	21	426,052
22	Schedule O—Charitable, Public, and Similar Gifts and Bequests	22	5,000
23	Estimated value of deductible assets subject to the special rule of Reg. section 20.2010-2(a)(7)(ii)	23	0
24	Tentative total allowable deductions (add items 18 through 23). Enter here and on line 2 of the Tax Computation	24	526,852

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Form 706 (Rev. 8-2019)

Estate of: Maria Sanchez | **Decedent's social security number** ***-**-9012

Part 6—Portability of Deceased Spousal Unused Exclusion (DSUE)

Portability Election

A decedent with a surviving spouse elects portability of the DSUE amount, if any, by completing and timely filing this return. No further action is required to elect portability of the DSUE amount to allow the surviving spouse to use the decedent's DSUE amount.

Section A. Opting Out of Portability

The estate of a decedent with a surviving spouse may opt out of electing portability of the DSUE amount. Check here and do not complete Sections B and C of Part 6 only if the estate opts **NOT** to elect portability of the DSUE amount. ☐

Section B. Qualified Domestic Trust (QDOT)

	Yes	No
Are any assets of the estate being transferred to a QDOT?		X

If "Yes," the DSUE amount portable to a surviving spouse (calculated in Section C, below) is preliminary and shall be redetermined at the time of the final distribution or other taxable event imposing estate tax under section 2056A. See instructions for more details.

Section C. DSUE Amount Portable to the Surviving Spouse (To be completed by the estate of a decedent making a portability election.

Complete the following calculation to determine the DSUE amount that can be transferred to the surviving spouse.

1	Enter the amount from line 9d, Part 2—Tax Computation	1	12,920,000
2	Reserved	2	
3	Enter the value of the cumulative lifetime gifts on which tax was paid or payable. See instructions	3	
4	Add lines 1 and 3	4	12,920,000
5	Enter amount from line 10, Part 2—Tax Computation	5	
6	Divide amount on line 5 by 40% (0.40) (do not enter less than zero)	6	
7	Subtract line 6 from line 4	7	12,920,000
8	Enter the amount from line 5, Part 2—Tax Computation	8	1,381,835
9	Subtract line 8 from line 7 (do not enter less than zero)	9	11,538,165
10	DSUE amount portable to surviving spouse (Enter lesser of line 9 or line 9a, Part 2—Tax Computation)	10	11,538,165

Section D. DSUE Amount Received From Predeceased Spouse(s) (To be completed by the estate of a deceased surviving spouse with DSUE amount from predeceased spouse(s))

Provide the following information to determine the DSUE amount received from deceased spouses.

A Name of Deceased Spouse (dates of death after December 31, 2010, only)	B Date of Death (enter as mm/dd/yy)	C Portability Election Made? Yes	C No	D If "Yes," DSUE Amount Received From Spouse	E DSUE Amount Applied by Decedent to Lifetime Gifts	F Year of Form 709 Reporting Use of DSUE Amount Listed in col. E	G Remaining DSUE Amount, if any (subtract col. E from col. D)
Part 1 — DSUE RECEIVED FROM LAST DECEASED SPOUSE							
Part 2 — DSUE RECEIVED FROM OTHER PREDECEASED SPOUSE(S) AND USED BY DECEDENT							
Total (for all DSUE amounts from predeceased spouse(s) applied)							

Add the amount from Part 1, column D, and the total from Part 2, column E. Enter the result on line 9b, Part 2—Tax Computation ▶

DAA

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Form 706 (Rev. 8-2019)

Estate of: Maria Sanchez

Decedent's social security number ***-**-9012

SCHEDULE A — Real Estate

- For jointly owned property that must be disclosed on Schedule E, see instructions.
- Real estate that is part of a sole proprietorship should be shown on Schedule F.
- Real estate that is included in the gross estate under sections 2035, 2036, 2037, or 2038 should be shown on Schedule G.
- Real estate that is included in the gross estate under section 2041 should be shown on Schedule H.
- If you elect section 2032A valuation, you must complete Schedule A and Schedule A-1.

Note: If the value of the gross estate, together with the amount of adjusted taxable gifts, is less than the basic exclusion amount and Form 706 is being filed solely to elect portability of the DSUE amount, consideration should be given as to whether you are required to report the value of assets eligible for the marital or charitable deduction on this schedule. See the instructions for more information. If you are not required to report the value of an asset, identify the property but make no entries in the last three columns.

Item number	Description	Alternate valuation date	Alternate value	Value at date of death
1	Primary Residence 1234 West Fake Street Flaggstaff AZ			500,000
2	Rental Condo 444 Big Sky Road Bozeman Montana			995,000
	Spouse's Community Property Interest			-250,000
	Total from continuation schedules or additional statements attached to this schedule			
	TOTAL (Also enter on Part 5 — Recapitulation, page 3, at item 1.)			1,245,000

(If more space is needed, attach the continuation schedule from the end of this package or additional statements of the same size.)

DAA There are no continuation schedules attached **Schedule A — Page 5**

Form 706 (Rev. 8-2019)

Estate of: Maria Sanchez

Decedent's social security number ***-**-9012

SCHEDULE B — Stocks and Bonds

(For jointly owned property that must be disclosed on Schedule E, see instructions.)

Note: If the value of the gross estate, together with the amount of adjusted taxable gifts, is less than the basic exclusion amount and Form 706 is being filed solely to elect portability of the DSUE amount, consideration should be given as to whether you are required to report the value of assets eligible for the marital or charitable deduction on this schedule. See the instructions for more information. If you are not required to report the value of an asset, identify the property but make no entries in the last four columns.

Item number	Description, including face amount of bonds or number of shares and par value for identification. Give CUSIP number. If trust, partnership, or closely held entity, give EIN.	CUSIP number or EIN, where applicable	Unit value	Alternate valuation date	Alternate value	Value at date of death
	400 Shares XYZ Company					
1	400 Shares XYZ Company. Average high/ low cost on 7/23/23 was $57/ share. FMV of total shares was $22,800. 400 Shares XYZ Comparny		57.000			22,800
	Total from continuation schedules (or additional statements) attached to this schedule					
	TOTAL (Also enter on Part 5—Recapitulation, page 3, at item 2.)					22,800

(If more space is needed, attach the continuation schedule from the end of this package or additional statements of the same size.)

DAA There are no continuation schedules attached

Schedule B — Page 10

Form 706 (Rev. 8-2019)

Estate of: Maria Sanchez | **Decedent's social security number** ***-**-9012

SCHEDULE C—Mortgages, Notes, and Cash

(For jointly owned property that must be disclosed on Schedule E, see instructions.)

Note: If the value of the gross estate, together with the amount of adjusted taxable gifts, is less than the basic exclusion amount and Form 706 is being filed solely to elect portability of the DSUE amount, consideration should be given as to whether you are required to report the value of assets eligible for the marital or charitable deduction on this schedule. See the instructions for more information. If you are not required to report the value of an asset, identify the property but make no entries in the last three columns.

Item number	Description	Alternate valuation date	Alternate value	Value at date of death
1	The Credit Union savings account			11,300
2	Big Bank joint bank account. Net method used for valuation purposes.			4,375
	Spouse's Community Property Interest			-2,188
Total from continuation schedules (or additional statements) attached to this schedule				
TOTAL (Also enter on Part 5—Recapitulation, page 3, at item 3.)				13,487

(If more space is needed, attach the continuation schedule from the end of this package or additional statements of the same size.)

DAA There are no continuation schedules attached **Schedule C—Page 11**

Form 706 (Rev. 8-2019)

Estate of: Maria Sanchez	Decedent's social security number ***-**-9012

SCHEDULE F — Other Miscellaneous Property Not Reportable Under Any Other Schedule

(For jointly owned property that must be disclosed on Schedule E, see instructions.)

(If you elect section 2032A valuation, you must complete Schedule F and Schedule A-1.)

Note: If the value of the gross estate, together with the amount of adjusted taxable gifts, is less than the basic exclusion amount and Form 706 is being filed solely to elect portability of the DSUE amount, consideration should be given as to whether you are required to report the value of assets eligible for the marital or charitable deduction on this schedule. See the instructions for more information. If you are not required to report the value of an asset, identify the property but make no entries in the last three columns.

		Yes	No
1	Did the decedent own any works of art, items, or any collections whose artistic or collectible value at date of death exceeded $3,000? If "Yes," submit full details on this schedule and attach appraisals.		X
2	Has the decedent's estate, spouse, or any other person received (or will receive) any bonus or award as a result of the decedent's employment or death? If "Yes," submit full details on this schedule.		X
3	Did the decedent at the time of death have, or have access to, a safe deposit box? If "Yes," state location, and if held jointly by decedent and another, state name and relationship of joint depositor. If any of the contents of the safe deposit box are omitted from the schedules in this return, explain fully why omitted.		X

Item number	Description. For securities, give CUSIP number. If trust, partnership, or closely held entity, give EIN	CUSIP number or EIN, where applicable	Alternate valuation date	Alternate value	Value at date of death
1	1957 Chevy Bel Aire				65,000
2	1970 Dodge Charger RT/SE, black all numbers matching, fully restored				149,900
3	1967 Shelby Mustang GT 500, Grey with Black racing strips, numbers matching.				200,000
	Total from continuation schedules (or additional statements) attached to this schedule				
	TOTAL (Also enter on Part 5—Recapitulation, page 3, at item 6.)				414,900

(If more space is needed, attach the continuation schedule from the end of this package or additional statements of the same size.)

DAA There are no continuation schedules attached

Schedule F—Page 14

Form 706 (Rev. 8-2019)

Estate of: Maria Sanchez | **Decedent's social security number** ***-**-9012

SCHEDULE I — Annuities

Note: Generally, no exclusion is allowed for the estates of decedents dying after December 31, 1984. See instructions.

Note: If the value of the gross estate, together with the amount of adjusted taxable gifts, is less than the basic exclusion amount and Form 706 is being filed solely to elect portability of the DSUE amount, consideration should be given as to whether you are required to report the value of assets eligible for the marital or charitable deduction on this schedule. See the instructions for more information. If you are not required to report the value of an asset, identify the property but make no entries in the last three columns.

		Yes	No
A	Are you excluding from the decedent's gross estate the value of a lump-sum distribution described in section 2039(f)(2) (as in effect before its repeal by the Deficit Reduction Act of 1984)? If "Yes," you must attach the information required by the instructions.		X

Item number	Description. Show the entire value of the annuity before any exclusions	Alternate valuation date	Includible alternate value	Includible value at date of death
1	Trust Company 401(k)			125,000
2	Big Bank IRA			300,000
	Spouse's Community Property Interest			-212,500
	Total from continuation schedules (or additional statements) attached to this schedule			
	TOTAL (Also enter on Part 5 — Recapitulation, page 3, at item 9.)			212,500

(If more space is needed, attach the continuation schedule from the end of this package or additional statements of the same size.)

DAA There are no continuation schedules attached **Schedule I — Page 16**

Form 706 (Rev. 8-2019)

Estate of: Maria Sanchez	Decedent's social security number ***-**-9012

SCHEDULE I — Annuities

Note: Generally, no exclusion is allowed for the estates of decedents dying after December 31, 1984. See instructions.

Note: If the value of the gross estate, together with the amount of adjusted taxable gifts, is less than the basic exclusion amount and Form 706 is being filed solely to elect portability of the DSUE amount, consideration should be given as to whether you are required to report the value of assets eligible for the marital or charitable deduction on this schedule. See the instructions for more information. If you are not required to report the value of an asset, identify the property but make no entries in the last three columns.

		Yes	No
A	Are you excluding from the decedent's gross estate the value of a lump-sum distribution described in section 2039(f)(2) (as in effect before its repeal by the Deficit Reduction Act of 1984)? If "Yes," you must attach the information required by the instructions.		X

Item number	Description. Show the entire value of the annuity before any exclusions	Alternate valuation date	Includible alternate value	Includible value at date of death
1	Trust Company 401(k)			125,000
2	Big Bank IRA			300,000
	Spouse's Community Property Interest			-212,500
	Total from continuation schedules (or additional statements) attached to this schedule			
	TOTAL (Also enter on Part 5 — Recapitulation, page 3, at item 9.)			212,500

(If more space is needed, attach the continuation schedule from the end of this package or additional statements of the same size.)

DAA There are no continuation schedules attached **Schedule I — Page 16**

Form 706 (Rev. 8-2019)

Estate of: Maria Sanchez | Decedent's social security number ***-**-9012

SCHEDULE K — Debts of the Decedent, and Mortgages and Liens

▶ **Use Schedule PC to make a protective claim for refund due to a claim not currently deductible. For such a claim, report the expense on Schedule K but without a value in the last column.**

	Yes	No
Are you aware of any actual or potential reimbursement to the estate for any debt of the decedent, mortgage, or lien claimed as a deduction on this schedule?		X
If "Yes," attach a statement describing the items subject to potential reimbursement. See instructions.		
Are any of the items on this schedule deductible under Reg. section 20.2053-4(b) and Reg. section 20.2053-4(c)?		X
If "Yes," attach a statement indicating the applicable provision and documenting the value of the claim.		

Item number	Debts of the Decedent — Creditor and nature of debt, and allowable death taxes	Amount
	There are no continuation schedules attached	
	Total from continuation schedules (or additional statements) attached to this schedule	
	TOTAL (Also enter on Part 5 — Recapitulation, page 3, at item 15.)	0

Item number	Mortgages and Liens — Description	Amount
1	Outstanding mortgage secured by primary residence	100,000
	Spouse's Community Property Interest	-50,000
	There are no continuation schedules attached	
	Total from continuation schedules (or additional statements) attached to this schedule	
	TOTAL (Also enter on Part 5 — Recapitulation, page 3, at item 16.)	50,000

(If more space is needed, attach the continuation schedule from the end of this package or additional statements of the same size.)

DAA

Schedule K — Page 18

Form 706 (Rev. 8-2019)

Estate of: Maria Sanchez	Decedent's social security number ***-**-9012

SCHEDULE J — Funeral Expenses and Expenses Incurred in Administering Property Subject to Claims

▶ **Use Schedule PC to make a protective claim for refund due to an expense not currently deductible. For such a claim, report the expense on Schedule J but without a value in the last column.**

Note: Do not list expenses of administering property not subject to claims on this schedule. To report those expenses, see instructions.

If executors' commissions, attorney fees, etc., are claimed and allowed as a deduction for estate tax purposes, they are not allowable as a deduction in computing the taxable income of the estate for federal income tax purposes. They are allowable as an income tax deduction on Form 1041, U.S. Income Tax Return for Estates and Trusts, if a waiver is filed to forgo the deduction on Form 706. See the Instructions for Form 1041.

	Yes	No
Are you aware of any actual or potential reimbursement to the estate for any expense claimed as a deduction on this schedule?		X
If "Yes," attach a statement describing the expense(s) subject to potential reimbursement. See instructions.		

Item number	Description	Expense amount	Total amount
	A. Funeral expenses:		
1	Cremation	4,000	
	Funeral Services	6,500	
	Total funeral expenses ▶		10,500
	B. Administration expenses:		
	1 Executors' commissions — . (Strike out the words that do not apply.) Paid		13,000
	2 Attorney fees — . (Strike out the words that do not apply.) Paid		15,000
	3 Accountant fees — . (Strike out the words that do not apply.) Paid		3,000
	4 Miscellaneous expenses:	Expense amount	
	Court Costs	800	
	Appraisals	3,500	
	Total miscellaneous expenses from continuation schedules (or additional statements) attached to this schedule		
	Total miscellaneous expenses ▶		4,300
	TOTAL (Also enter on Part 5—Recapitulation, page 3, at item 14.) ▶		45,800

(If more space is needed, attach the continuation schedule from the end of this package or additional statements of the same size.)

Schedule J — Page 17

DAA There are no continuation schedules attached

Form 706 (Rev. 8-2019)

Estate of: Maria Sanchez	Decedent's social security number ***-**-9012

SCHEDULE O — Charitable, Public, and Similar Gifts and Bequests

Note: If the value of the gross estate, together with the amount of adjusted taxable gifts, is less than the basic exclusion amount and Form 706 is being filed solely to elect portability of the DSUE amount, consideration should be given as to whether you are required to report the value of assets eligible for the marital or charitable deduction on this schedule. See the instructions for more information. If you are not required to report the value of an asset, identify the property but make no entry in the last column.

		Yes	No
1a	If the transfer was made by will, has any action been instituted to contest or have interpreted any of its provisions affecting the charitable deductions claimed in this schedule? If "Yes," full details must be submitted with this schedule.		X
b	According to the information and belief of the person or persons filing this return, is any such action planned? If "Yes," full details must be submitted with this schedule.		X
2	Did any property pass to charity as the result of a qualified disclaimer? If "Yes," attach a copy of the written disclaimer required by section 2518(b).		X

Item number	Name and address of beneficiary	Character of institution	Amount
1	Happy Paws Good Boy Lane Flagstaff AZ 85001	Animal Shelter	5,000
	Total from continuation schedules (or additional statements) attached to this schedule		

3	Total	3	5,000
4a	Federal estate tax payable out of property interests listed above	4a	0
b	Other death taxes payable out of property interests listed above	4b	0
c	Federal and state GST taxes payable out of property interests listed above	4c	0
d	Add items 4a, 4b, and 4c	4d	0
5	Net value of property interests listed above (subtract item 4d from item 3). Also enter on Part 5—Recapitulation, page 3, at item 22	5	5,000

(If more space is needed, attach the continuation schedule from the end of this package or additional statements of the same size.)

Schedule O — Page 21

DAA There are no continuation schedules attached

MARIA706 Sanchez, Maria
***-**-9012
FYE: 7/23/2023

7/8/2024 12:19 PM

Federal Statements

Form 706, Schedule J - Executor's Commissions

Payment Code	Name	Amount
Paid	Lily Sanchez	$ 13,000
Total		$ 13,000

Form 706, Schedule J - Attorney fees

Payment Code	Description	Amount
Paid	Estate Legal Services	$ 15,000
Total		$ 15,000

Form 706, Schedule J - Accountant Fees

Payment Code	Description	Amount
Paid	Top Notch Tax Firm	$ 3,000
Total		$ 3,000

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