

Partnership Basis & S Corporation (Form 7203)

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Allan "A.J." Reynolds, EA

- Immense experience in various areas of taxation, which encompasses over 30 years
- Practice centers on individual, business, & estate tax preparation
- Specializes in diverse areas of IRS Representation
- Recipient of the 2024 Excellence in Education Award from the National Association of Enrolled Agents

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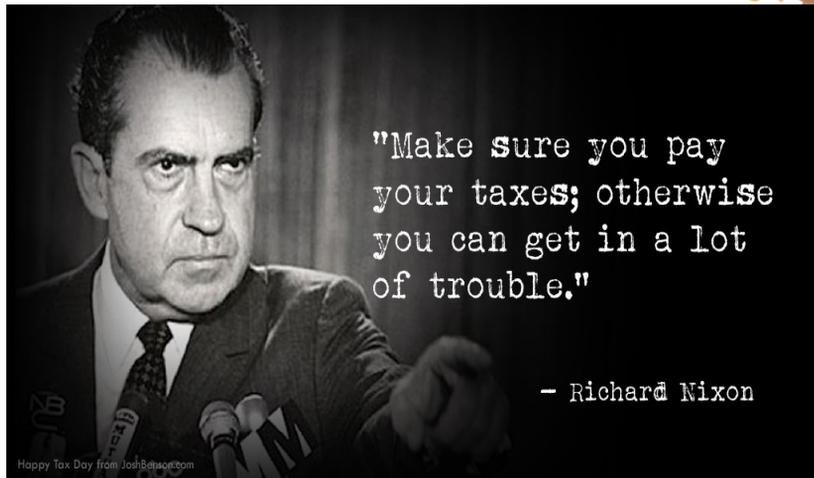
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Sioux City, IA



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Quote of the Session



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Objectives

- Provide a useful and straightforward overview on Partnership and S Corporation Basis



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Partnership & Partner's Basis

- Importance of Basis?
 - ✓ • Are losses deductible
 - ✓ • Are distributions taxable
 - ✓ • Compute gain/loss on disposition
 - ✓ • Needed to properly prepare PTE owner's individual tax return

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Partnership & Partner's Basis



- Significance of Basis
- ✓ • Required to deduct losses
- ✓ • Determine if distributions are taxable
- ✓ • Compute gain or loss on disposition

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Partnership & Partner's Basis



- The partnership isn't responsible for keeping the information needed to figure the basis of your partnership interest
 - **The Partner is responsible.**



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Partnership & Partner's Basis



- Tax basis capital accounts are now required for partner Schedule K-1 reporting

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Partnership & Partner's Basis



- Tax basis capital accounts are now required for partner Schedule K-1 reporting.

L	Partner's Capital Account Analysis
Beginning capital account . . .	\$ _____
Capital contributed during the year . . .	\$ _____
Current year net income (loss) . . .	\$ _____
Other increase (decrease) (attach explanation)	\$ _____
Withdrawals and distributions . . .	\$ (_____)
Ending capital account . . .	\$ _____

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Partnership & Partner's Basis



- Tax basis method is a **transactional approach**
 - Based on tax basis principles
 - ✓ • Contribution or partnership net income increases a partner's capital account
 - ✓ • Distribution or share of losses decreases the capital account

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Capital Account (Inside Basis) vs. Outside Basis



- Two (2) forms of basis for partnership:
- The **inside basis** is partnership tax basis in assets 'or' partner's capital account
- The **outside basis** is individual partner's tax basis in the partnership

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Capital Account (Inside Basis) vs. Outside Basis



- Key discrepancies between Inside and Outside basis is effect of partnership liabilities.
 - **Inside Basis** – No effect
 - **Outside Basis** – Does effect

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Capital Account (Inside Basis) vs. Outside Basis



- Partner's basis in a partnership interest can **NEVER** be negative {**Outside Basis**}
- Partner's capital account **CAN** be negative {**Inside Basis**}

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Polling Question #1

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Partner's Basis – Ordering Rules

- Increases to Basis
- Distributions
- Losses



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Partner's Basis – Ordering Rules - Example



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Partner's Basis – Ordering Rules - Example

- ✓ Harry's beginning basis of **\$26,550**
 - ✓ Receives K-1 reflecting loss of **\$31,850**
 - ✓ K-1 reflects distributions of **\$24,000**
- 1. Increases to Basis**
 - 2. Distributions**
 - 3. Losses**

Ordering Rules

Beginning Basis	\$ 26,550
Increases	\$ 0
minus Distributions	<u>\$ 24,000</u>
Subtotal	\$ 2,550
Losses	\$ 31,850

- Harry will be able to deduct \$2,550 of the \$31,850 of losses on his individual Form 1040. The unused loss carries forward to the following tax year.
- Since distributions are subtracted first, all distributions are tax-free!

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Partnership & Partner's Basis



- Analysis of **Partner's Basis** vs. **Transactional Approach** Capital Accounts

Event	Partner Basis	Capital Account
Contributions	Increase	Increase
Income	Increase	Increase
Loss	Decrease	Decrease
Distributions	Decrease	Decrease
Partnership Liabilities	Increase Decrease	NO Effect

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Partner's Basis – Liabilities of Partnership



- Partner receives basis from any debt
- Partner may not receive debt basis from debt that is not 'at-risk'
 - **Recourse debt**
 - **Non-recourse debt**
 - **Qualified non-recourse debt**

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Partner's Basis – Liabilities of Partnership



- Non-recourse debt
 - ✓ • Partner has no economic risk of loss
 - ✓ • Increases basis, however, does **not** increase amount at-risk
 - ✓ • Could receive distributions tax-free

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Partner's Basis – Liabilities of Partnership



- Recourse debt
 - ✓ • Partner is personally liable
 - ✓ • Increase partner basis
 - ✓ • Considered at-risk

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Partner’s Basis – Liabilities of Partnership



- Qualified Non-recourse debt
- ✓ • **NOT** personally liable
- ✓ • Will increase basis
- ✓ • Increases at-risk basis

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Partner’s Basis



- | | |
|--|-----------------|
| • Sally’s Beginning outside Basis | \$17,500 |
| • Non-recourse liability increased | \$ 8,500 |
| • Partnership allocated loss to Sally | <u>\$26,000</u> |
| • Sally’s Ending outside Basis | \$ 0 |
-
- Non-recourse **does not** increase amount at risk.
 - Let’s discuss.....

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Partner’s Basis – Capital Accounts



- ✓ Capital Accounts adjusted annually
 - Initial Basis @ January 1st
 - + additional money, property contributed
 - + taxable income
 - + tax exempt income {think PPP forgiveness}
 - - distributions
 - - taxable loss
 - - non-deductible expenses {Schedule K-1, 18C}
 - = Ending Basis as of December 31st

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Partnership & Partner’s Basis



- Not required to complete Schedule K-1, Item L or Form 1065, Schedule L (Balance Sheet) if the answer to Question 4 of Schedule B is “Yes.” This means that small partnerships get a pass.
- Item L is the Partner’s Capital Account Analysis
- Question 4 on Schedule B of Form 1065 establishes that a “small partnership” is not required to include any information in Item L.

L	Partner’s Capital Account Analysis	
Beginning capital account	\$	_____
Capital contributed during the year	\$	_____
Current year net income (loss)	\$	_____
Other increase (decrease) (attach explanation)	\$	_____
Withdrawals and distributions	\$(_____)
Ending capital account	\$	_____

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Partnership & Partner's Basis



- **Three Zones:**
 - Basis
 - At Risk
 - Passive

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Partnership & Partner's Basis



- At-Risk rules are **separate** from Basis rules
- ✓ • Calculated on [Form 6198 \(PDF\)](#)

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Polling Question #2



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S Corporation Basis & Form 7203



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S Corporation Basis & Form 7203 - **Example**



- **Sally establishes S Corporation**

✓ Initial Basis	\$ 0
✓ Capital (cash) contribution	\$35,000
✓ Income Box 1, Schedule K-1	\$45,000
✓ Distributions Box 16D, Schedule K-1	<u>\$25,000</u>
✓ Ending Basis @ December 31st	\$55,000

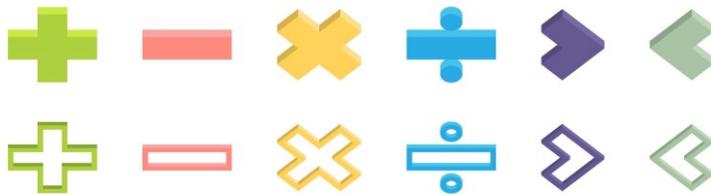
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S Corporation Basis – Ordering Rules



- Increase basis by income of S Corporation
- Decrease basis by distributions taken
- Decrease basis by non-deductible expenses
- Decrease basis by ordinary losses



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S Corporation Basis & Form 7203



- Shareholder is responsible for keeping the information needed to figure the basis of their stock in the corporation.
- [Schedule K-1 \(Form 1120-S\)](#) provides information to help shareholder figure their stock basis at the end of each corporate tax year.

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S Corporation Basis & Form 7203



- **Stock basis is adjusted annually and accounted for as of the last day of the S Corporation tax year in the following manner:**
 - Increased by all income (including tax-exempt income) reported on Schedule K-1 and by excess depletion, if any
 - Decreased by cash and/or property distributions made by the corporation reported on Schedule K-1 in box 16 with a Code D

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S Corporation Basis & Form 7203



- **Stock basis is adjusted annually and accounted for as of the last day of the S Corporation tax year in the following manner:**
 - Decreased by nondeductible (non-capital) expenses
 - Decreased by deductible losses or deduction reporting on Schedule K-1

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S Corporation Basis & Form 7203



- Shareholder may elect to deduct shareholder losses before nondeductible and depletion expenses
 - Basis result is the same, however, this election may allow for a larger deductible loss to be utilized currently
 - Once elected, the method must be made for all future years
 - Election only applies to shareholder making the separate election
 - ✓ • Election is pursuant to [IRC Regulation 1.1367-1\(g\)](#)

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S Corporation Basis & Form 7203



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S Corporation Basis & Form 7203

✓ Skippy's January 1st basis	\$ 27,000
✓ Non-deductible, Box 16C	\$ 5,000
✓ Loss reported Box 1	\$ 32,000

- **Original Ordering Rules for deductible loss**
- $\$27,000 - \$5,000 = \$22,000$ basis available of $\$32,000$ loss reported in Box 1
- **$\$10,000$ loss carryforward**

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S Corporation Basis & Form 7203



§ 1.1367-1(g) election is made

✓ Skippy's January 1st basis	\$ 27,000
✓ Loss reported Box 1	\$ 32,000
✓ Non-deductible, Box 16C	\$ 5,000

New Ordering Rules for deductible loss

- \$27,000 of \$32,000 loss will be available in current year. \$5,000 ordinary + \$5,000 non-deductible = **\$10,000 carried forward**.

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S Corporation Basis



- Determining initial basis in S corporation stock and debt is vital because it determines:

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S Corporation Basis



- Uniquely different from partnerships in a few ways.
- Stock basis and debt basis established under different guidelines.
- Debt basis completely different to partnership debt basis rules.

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S Corporation Debt



- Shareholders receive **no increase** in their basis from entity debt
- However, there is one exception to this rule
 - ✓ • Loans from respective shareholder to corporation will establish basis

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Polling Question #3

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S Corporation Debt

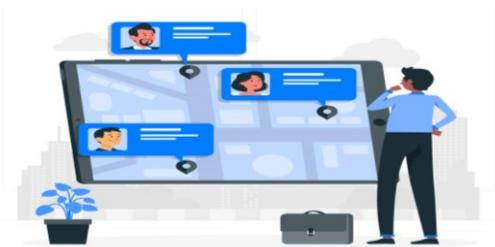
- S-Corporation borrows money from local bank for S Corporation business operations
- ✓ • Loans will NOT establish basis for shareholder
- Shareholder takes personal monies and loans to S-Corporation for business operations
- ✓ • Loan WILL establish (increase) basis for shareholder
- ✓ • Appropriate interest rate needs to be charged
- ✓ • Considered at-risk

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S Corporation Debt

- Regular Shareholder's basis to track



- Shareholder's debt basis to track

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S Corporation Debt

- Types of Shareholder Loans
 - \$25,000 or less
 - ✓ • Open Account
 - ✓ • No formal note
 - ✓ • Netted together
 - Greater than \$25,000
 - ✓ • Needs to be in writing
 - ✓ • Treated separately, unless corporation consolidates
- **Repayments, Box 16E**
- **Distributions vs loan repayments**

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S Corporation Basis & Form 7203



- **What's the big deal**
 - ✓ • Form 7203 and its separate instructions were developed to replace the 3-part *Worksheet for Figuring a Shareholder's Stock and Debt Basis*

- **Purpose of Form**
 - ✓ • Use Form 7203 to figure potential limitations of your share of the S corporation's deductions, credits, and other items that can be deducted on your return

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S Corporation Basis & Form 7203



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
---	-----------------------------

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 allowed loss from a passive activity (if that loss was not reported on Form 8582), or unreimbursed partnership expenses? If answered "Yes," see instructions before completing this section Yes No

	(a) Name	(b) Enter P for partnership; S for S corporation	(c) Check if foreign partnership	(d) Employer identification number	(e) Check if basis computation is required	(f) Check if any amount is not at risk
A	Owners of S corporation stock and debt. If you report a				<input type="checkbox"/>	<input type="checkbox"/>
B	loss, receive a distribution, dispose of stock, or receive a loan				<input type="checkbox"/>	<input type="checkbox"/>
C	repayment from an S corporation, you must check the box in				<input type="checkbox"/>	<input type="checkbox"/>
D	column (e) on line 28 and attach the required basis computa- tion. For more information, see Basis rules for S corporations , earlier.				<input type="checkbox"/>	<input type="checkbox"/>

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S Corporation Basis & Form 7203



- Why does shareholder need Form 7203
 - ✓ • Need basis to deduct loss
 - ✓ • Distributions
 - ✓ • Loan basis and repayments
 - ✓ • Loss carry-forward calculation

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S Corporation Basis & Form 7203



- **Who Must File**
 - ✓ • Form 7203 is filed by S corporation shareholders who:
 - Are claiming a deduction for their share of an aggregate loss from an S corporation (including an aggregate loss not allowed last year because of basis limitations)

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S Corporation Basis & Form 7203

- Allowed to take current year income as distributions even if negative basis.
- Open Accounts
- ✓ • Repayments
- Debt Basis restored, than Stock Basis



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S Corporation Basis & Form 7203

- ✓ It may be beneficial for shareholders to complete and retain Form 7203 even for years it is not required to be filed, as this will ensure their basis are consistently maintained year after year.



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S Corporation Basis & Form 7203

- Form 7203 must be filed by S Corp shareholders who:
 - Want to claim a deduction for an S Corp loss
 - Received a non-dividend distribution from an S Corp
 - Disposed of S Corp stock
 - Received a loan repayment from an S Corp



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S Corporation Basis & Form 7203

- **Form 7203 – 2 pages, 3 Parts**



Recordkeeping.....	2 hr., 10 min.
Learning about the law of the form.....	15 min.
Preparing & sending the form to the IRS.....	1 hr., 21 min.



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S Corporation Basis & Form 7203

- **Three Parts:**
 - ✓ • Part I – Shareholder Stock Basis
 - ✓ • Part II – Shareholder Debt Basis
 - ✓ • Part III – Shareholder Allowable Loss & Deduction Items

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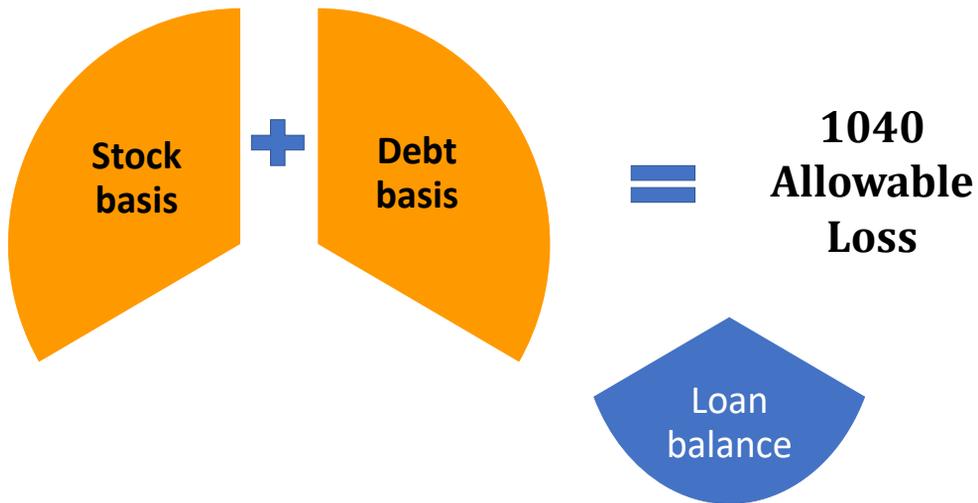
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Polling Question #4

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S Corporation Basis & Form 7203



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S Corporation & Partnership Basis

- Inherited Basis
- ✓ • Partnerships
- ✓ • S Corporations

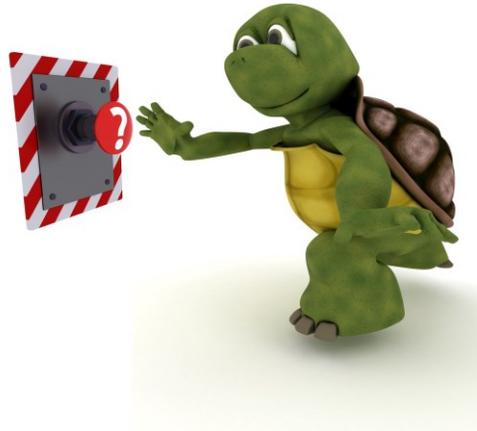


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S Corporation & Partnership Basis

- Reconstructing Basis
- ✓ • Partnerships
- ✓ • S Corporations



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Questions?



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Upcoming Webinars:

- Demystifying the FBAR – DeBlis – Nov. 20th – Noon-2pm ET
- SECURE 1.0 and 2.0 Acts – Miranda – November 21st – 1-3pm ET
- Penalty Abatement – Reynolds – December 17th – 1-2pm ET

November Monthly Newsletter: CPEhours.com/About/Blog

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2024 Year-End Seminar schedule:
(9 am ET / 8 am CT)

\$279 - 8 hrs. CPE Credits
- 6.75 hrs. CLE Credits
(includes 1 hr. CPE/CLE
Credit)

12/3/24
12/6/24
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