

Instructions for Form 1120-S

2023

U.S. Income Tax Return for an S Corporation

Volume 2 of 5



Department of the Treasury
Internal Revenue Service

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Portfolio Income

Generally, portfolio income includes all gross income, other than income derived in the ordinary course of a trade or business, that is attributable to interest; dividends; royalties; income from a real estate investment trust, a regulated investment company, a real estate mortgage investment conduit, a common trust fund, a controlled foreign corporation, a qualified electing fund, or a cooperative; income from the disposition of property that produces income of a type defined as portfolio income; and income from the disposition of property held for investment. See *Self-Charged Interest*, later, for an exception.

Solely for purposes of the preceding paragraph, gross income derived in the ordinary course of a trade or business includes (and portfolio income, therefore, doesn't include) the following types of income.

- Interest income on loans and investments made in the ordinary course of a trade or business of lending money.
- Interest on accounts receivable arising from the performance of services or the sale of property in the ordinary course of a trade or business of performing such services or selling such property, but only if credit is customarily offered to customers of the business.
- Income from investments made in the ordinary course of a trade or business of furnishing insurance or annuity contracts or reinsuring risks underwritten by insurance companies.
- Income or gain derived in the ordinary course of an activity of trading or dealing in any property if such activity constitutes a trade or business (unless the dealer held the property for investment at any time before such income or gain is recognized).

- Royalties derived by the taxpayer in the ordinary course of a trade or business of licensing intangible property.
- Amounts included in the gross income of a patron of a cooperative by reason of any payment or allocation to the patron based on patronage occurring with respect to a trade or business of the patron.
- Other income identified by the IRS as income derived by the taxpayer in the ordinary course of a trade or business.

See Temporary Regulations section 1.469-2T(c)(3) for more information on portfolio income.

Report portfolio income and related deductions on Schedule K rather than on page 1 of Form 1120-S.

Self-Charged Interest

Certain self-charged interest income and deductions may be treated as passive activity

gross income and passive activity deductions if the loan proceeds are used in a passive activity. Generally, self-charged interest income and deductions result from loans between the corporation and its shareholders. Self-charged interest also occurs in loans between the corporation and another S corporation or partnership if each owner in the borrowing entity has the same proportional ownership interest in the lending entity.

The self-charged interest rules don't apply to a shareholder's interest in an S corporation if the S corporation makes an election under Regulations section 1.469-7(g) to avoid the application of these rules. To make the election, the S corporation must attach to its original or amended Form 1120-S a statement that includes the name, address, EIN of the S corporation, and a declaration that the election is being made under Regulations section 1.469-7(g). The election

will apply to the tax year for which it was made and all subsequent tax years. Once made, the election can only be revoked with the consent of the IRS.

For more details on the self-charged interest rules, see Regulations section 1.469-7.

Grouping Activities

Generally, one or more trade or business or rental activities may be treated as a single activity if the activities make up an appropriate economic unit for measurement of gain or loss under the passive activity rules. Whether activities make up an appropriate economic unit depends on all the relevant facts and circumstances. The factors given the greatest weight in determining whether activities make up an appropriate economic unit are:

- Similarities and differences in types of trades or businesses,
- The extent of common control,

- The extent of common ownership,
- Geographical location, and
- Reliance between or among the activities.

Example. The corporation has a significant ownership interest in a bakery and a movie theater in Baltimore and a bakery and a movie theater in Philadelphia. Depending on the relevant facts and circumstances, there may be more than one reasonable method for grouping the corporation's activities. For instance, the following groupings may or may not be permissible.

- A single activity.
- A movie theater activity and a bakery activity.
- A Baltimore activity and a Philadelphia activity.
- Four separate activities.

- Once the corporation chooses a grouping under these rules, it must continue using that grouping in later tax years unless either:
- The corporation determines that the original grouping was clearly inappropriate, or
- A material change in the facts and circumstances makes that grouping clearly inappropriate.

The IRS may regroup the corporation's activities if the corporation's grouping isn't an appropriate economic unit and one of the primary purposes for the grouping (or failure to regroup as required under Regulations section 1.469-4(e)) is to avoid the passive activity limitations. If you group your activities under these rules for section 469 purposes, check the appropriate box in item J.

Limitation on grouping certain activities.

The following activities may not be grouped together.

1. A rental activity with a trade or business activity unless the activities being grouped together make up an appropriate economic unit and:
 - a. The rental activity is insubstantial relative to the trade or business activity or vice versa; or
 - b. Each owner of the trade or business activity has the same proportionate ownership interest in the rental activity. If so, the portion of the rental activity involving the rental of property to be used in the trade or business activity can be grouped with the trade or business activity.

2. An activity involving the rental of real property with an activity involving the rental of personal property (except personal property provided in connection with the real property or vice versa).
3. Any activity with another activity in a different type of business and in which the corporation holds an interest as a limited partner or as a limited entrepreneur (as defined in section 461(k)(4)) if that other activity is holding, producing, or distributing motion picture films or videotapes; farming; leasing section 1245 property; or exploring for or exploiting oil and gas resources or geothermal deposits.

Activities conducted through partnerships. Once a partnership determines its activities under these rules,

the corporation as a partner can use these rules to group those activities with:

- Each other,
- Activities conducted directly by the corporation, or
- Activities conducted through other partnerships.

The corporation can't treat as separate activities those activities grouped together by a partnership.

Recharacterization of Passive Income

Under Temporary Regulations section 1.469-2T(f) and Regulations section 1.469-2(f), net passive income from certain passive activities must be treated as nonpassive income. Net passive income is the excess of an activity's passive activity gross income over its passive activity deductions (current year deductions and prior year unallowed losses).

Any net passive income recharacterized as nonpassive income is treated as investment income for purposes of figuring investment interest expense limitations if it is from (a) an activity of renting substantially nondepreciable property from an equity-financed lending activity, or (b) an activity related to an interest in a pass-through entity that licenses intangible property.

The amount of income from the activities in items (1) through (3) below that any shareholder will be required to recharacterize as nonpassive income may be limited under Temporary Regulations section 1.469-2T(f)(8). Because the corporation won't have information regarding all of a shareholder's activities, it must identify all corporate activities meeting the definitions in items (2) and (3) as activities that may be subject to recharacterization.

Income from the following six sources is subject to recharacterization.

1. **Significant participation passive activities.** A significant participation passive activity is any trade or business activity in which the shareholder participated for more than 100 hours during the tax year but didn't materially participate. Because each shareholder must determine the shareholder's level of participation, the corporation won't be able to identify significant participation passive activities.
2. **Certain nondepreciable rental property activities.** Net passive income from a rental activity is nonpassive income if less than 30% of the unadjusted basis of the property used or held for use by customers in the activity is subject to depreciation under section 167.
3. **Passive equity-financed lending activities.** If the corporation has net

income from a passive equity-financed lending activity, the smaller of the net passive income or the equity-financed interest income from the activity is nonpassive income.

4. **Rental of property incidental to a development activity.** Net rental activity income is the excess of passive activity gross income from renting or disposing of property over passive activity deductions (current year deductions and prior year unallowed losses) that are reasonably allocable to the rented property. Net rental activity income is nonpassive income for a shareholder if all of the following apply.
 - a. The corporation recognizes gain from the sale, exchange, or other disposition of the rental property during the tax year.

- b. The use of the item of property in the rental activity started less than 12 months before the date of disposition. The use of an item of rental property begins on the first day on which (a) the corporation owns an interest in the property, (b) substantially all of the property is either rented or held out for rent and ready to be rented, and (c) no significant value-enhancing services remain to be performed.
- c. The shareholder materially or significantly participated for any tax year in an activity that involved performing services to enhance the value of the property (or any other item of property, if the basis of the property disposed of is determined in whole or in part by

reference to the basis of that item of property).

Because the corporation can't determine a shareholder's level of participation, the corporation must identify net income from property described above (without regard to the shareholder's level of participation) as income that may be subject to recharacterization.

5. **Rental of property to a nonpassive activity.** If a taxpayer rents property to a trade or business activity in which the taxpayer materially participates, the taxpayer's net rental activity income (defined in item (4)) from the property is nonpassive income.
6. **Acquisition of an interest in a pass-through entity that licenses intangible property.** Generally, net royalty income from intangible property is nonpassive income if the taxpayer acquired an interest in the

pass-through entity after the pass-through entity created the intangible property or performed substantial services or incurred substantial costs in developing or marketing the intangible property. Net royalty income is the excess of passive activity gross income from licensing or transferring any right in intangible property over passive activity deductions (current year deductions and prior year unallowed losses) that are reasonably allocable to the intangible property. See Temporary Regulations section 1.469-2T(f)(7)(iii) for exceptions to this rule.

Passive Activity Reporting Requirements

To allow shareholders to correctly apply the passive activity loss and credit limitation rules, the corporation must do the following.

1. If the corporation carries on more than one activity, provide an attached

statement for each activity conducted through the corporation that identifies the type of activity conducted (trade or business, rental real estate, or rental activity other than rental real estate). See Grouping Activities, earlier.

2. The attachment(s) must identify each group. The attached group activity description must be sufficient for the shareholders to determine if their other activities qualify to be added to any groups provided by the corporation.
3. On the attached statement for each activity, provide a statement using the same box numbers as shown on Schedule K-1 and detailing the net income (loss), credits, and all items required to be separately stated under section 1366(a)(1) from each trade or business activity, from each rental real

estate activity, from each rental activity other than a rental real estate activity, and from investments.

4. Identify the net income (loss) and the shareholder's share of corporation interest expense from each activity of renting a dwelling unit that any shareholder uses for personal purposes during the year for more than the greater of 14 days or 10% of the number of days that the residence is rented at fair rental value.
5. Identify the net income (loss) and the shareholder's share of interest expense from each activity of trading personal property conducted through the corporation.
6. For any gain (loss) from the disposition of an interest in an activity or of an interest in property used in an activity (including dispositions before

1987 from which gain is being recognized after 1986):

- a. Identify the activity in which the property was used at the time of disposition;
- b. If the property was used in more than one activity during the 12 months preceding the disposition, identify the activities in which the property was used and the adjusted basis allocated to each activity; and
- c. For gains only, if the property was substantially appreciated at the time of the disposition and the applicable holding period specified in Regulations section 1.469-2(c)(2)(iii) (A) wasn't satisfied, identify the amount of the nonpassive gain and indicate whether or not the gain is investment income under

Regulations section 1.469-
2(c)(2)(iii)(F).

7. Specify the amount of gross portfolio income, the interest expense properly allocable to portfolio income, and expenses other than interest expense that are clearly and directly allocable to portfolio income.
8. Identify the ratable portion of any section 481 adjustment (whether a net positive or a net negative adjustment) allocable to each corporate activity.
9. Identify any gross income from sources specifically excluded from passive activity gross income, including:
 - a. Income from intangible property, if the shareholder is an individual whose personal efforts significantly contributed to the creation of the property;

- b. Income from state, local, or foreign income tax refunds; and
 - c. Income from a covenant not to compete, if the shareholder is an individual who contributed the covenant to the corporation.
- 10. Identify any deductions that aren't passive activity deductions.
- 11. If the corporation makes a full or partial disposition of its interest in another entity, identify the gain (loss) allocable to each activity conducted through the entity, and the gain allocable to a passive activity that would have been recharacterized as nonpassive gain had the corporation disposed of its interest in property used in the activity (because the property was substantially appreciated at the time of the disposition, and the gain represented more than 10% of

the shareholder's total gain from the disposition).

12. Identify the following items from activities that may be subject to the recharacterization rules (see *Recharacterization of Passive Income*, earlier).
 - a. Net income from an activity of renting substantially nondepreciable property.
 - b. The smaller of equity-financed interest income or net passive income from an equity-financed lending activity.
 - c. Net rental activity income from property developed (by the
 - d. shareholder or the corporation), rented, and sold within 12 months after the rental of the property commenced.
 - e. Net rental activity income from the rental of property by the

corporation to a trade or business activity in which the shareholder had an interest (either directly or indirectly).

13. Net royalty income from intangible property if the shareholder acquired the shareholder's interest in the corporation after the corporation created the intangible property or performed substantial services, or incurred substantial costs in developing or marketing the intangible property.
14. Identify separately the credits from each activity conducted by or through the corporation.
15. Identify the shareholder's pro rata share of the corporation's self-charged interest income or expense (see Self-Charged Interest, earlier).
 - a. **Loans between a shareholder and the corporation.** Identify

the lending or borrowing shareholder's share of the self-charged interest income or expense. If the shareholder made the loan to the corporation, also identify the activity in which the loan proceeds were used. If the proceeds were used in more than one activity, allocate the interest to each activity based on the amount of the proceeds used in each activity.

- b. **Loans between the corporation and another S corporation or partnership.** If the corporation's shareholders have the same proportional ownership interest in the corporation and the other S corporation or partnership, identify each shareholder's share of the interest income or expense from the loan. If the corporation

was the borrower, also identify the activity in which the loan proceeds were used. If the proceeds were used in more than one activity, allocate the interest to each activity based on the amount of the proceeds used in each activity.

Net Investment Income Tax Reporting Requirements



The information described in this section should be given directly to the shareholder and shouldn't be reported by the corporation to the IRS.

To allow shareholders to correctly figure the net investment income tax where a shareholder disposes of stock in the corporation during the tax year, the corporation may be required to provide the shareholder with certain information. The net investment income tax is a tax imposed on an individual's, trust's, or estate's net investment

income. Net investment income includes the net gains or losses from the sale of stock in the corporation. A shareholder who is actively involved in one or more of the corporation or subsidiary pass-through entities' trades or businesses (other than trading in financial instruments or commodities) can reduce the amount of the gain or loss included in its net investment income. However, to figure its net investment income, the active shareholder needs certain information from the corporation.

Generally, the corporation must provide certain information to the shareholder if the corporation knows, or has reason to know, the following.

1. The shareholder disposed of stock in the corporation.
2. The shareholder materially participates (within the meaning of the passive activity loss rules (section 469)) in one or more of the trades or businesses

(within the meaning of section 162) of the corporation or a subsidiary pass-through entity (other than trading in financial instruments or commodities).

3. The shareholder doesn't qualify for the optional simplified reporting method for figuring its net investment income associated with the disposition of the stock. For more information, see the instructions for Form 8960, line 5c.

Information to be provided to shareholder. Generally, the corporation must provide the shareholder with its pro rata share of the net gain and loss from the deemed sale for fair market value of the corporation's property, other than property that relates to the trades or businesses in which the shareholder materially participates, as determined under the passive activity loss rules applicable to the transfer of an interest in a pass-through entity. For more

information, see the instructions for Form 8960, line 5c.



If a shareholder, who qualifies for the optional simplified reporting method, prefers to determine net gain or loss under the general calculation, the corporation may, but isn't obligated to, provide the information to the shareholder at the shareholder's request.

Specific Instructions

Period Covered

File the 2023 return for calendar year 2023 and fiscal years that begin in 2023 and end in 2024. For a fiscal or short tax year return, fill in the tax year space at the top of the form. The 2023 Form 1120-S can also be used if:

- The corporation has a tax year of less than 12 months that begins and ends in 2024, and

- The 2024 Form 1120-S isn't available at the time the corporation is required to file its return.

The corporation must show its 2024 tax year on the 2023 Form 1120-S and take into account any tax law changes that are effective for tax years beginning after December 31, 2023.

Name and Address

Enter the corporation's true name (as set forth in the charter or other legal document creating it) and address on the appropriate lines. Enter the address of the corporation's principal office or place of business. Include the suite, room, or other unit number after the street address. If the post office doesn't deliver mail to the street address and the corporation has a P.O. box, show the box number instead.



Don't use the address of the registered agent for the state in which

the corporation is incorporated. For example, if a business is incorporated in Delaware or Nevada and the corporation's principal office is located in Little Rock, Arkansas, the corporation should enter the Little Rock address.

If the corporation receives its mail in care of a third party (such as an accountant or an attorney), enter "C/O" on the street address line, followed by the third party's name and street address or P.O. box.

If the corporation has a foreign address, include the city or town, state or province, country, and foreign postal code. Don't abbreviate the country name. Follow the country's practice for entering the name of the state or province and postal code.

Item B. Business Code

See Principal Business Activity Codes, later. For nonstore retailers, select the principal business activity (PBA) code by the primary

product that your establishment sells. For example, establishments primarily selling prescription and non-prescription drugs, select PBA code 456110 Pharmacies & Drug Retailers.

Item C. Schedule M-3 Information

For 2023, a corporation that (a) is required to file Schedule M-3 (Form 1120-S), Net Income (Loss) Reconciliation for S Corporations With Total Assets of \$10 Million or More, and has less than \$50 million total assets at the end of the tax year, or (b) isn't required to file Schedule M-3 (Form 1120-S) and voluntarily files Schedule M-3 (Form 1120-S), must either complete Schedule M-3 (Form 1120-S) entirely or complete Schedule M-3

(Form 1120-S) through Part I and complete Form 1120-S, Schedule M-1, instead of completing Parts II and III of Schedule M-3 (Form 1120-S). If a corporation chooses to complete Form 1120-S, Schedule M-1, instead of completing Parts II and III of

Schedule M-3 (Form 1120-S), line 1, of Form 1120-S, Schedule M-1, must equal line 11 of Part I of Schedule M-3 (Form 1120-S).

Any corporation that completes Parts II and III of Schedule M-3 (Form 1120-S) must complete all columns, without exception.

If you are filing Schedule M-3, check the “Check if Sch. M-3 attached” box. See the Instructions for Schedule M-3 for more details.

Item D. Employer Identification Number (EIN)

Enter the corporation's EIN. If the corporation doesn't have an EIN, it must apply for one. An EIN can be applied for in the following ways.

- Online—Go to [IRS.gov/EIN](https://www.irs.gov/ein). The EIN is issued immediately once the application information is validated.

- By faxing or mailing Form SS-4, Application for Employer Identification Number.

If the corporation hasn't received its EIN by the time the return is due, enter "Applied for" and the date the corporation applied in the space for the EIN. However, if the corporation is filing its returns electronically, an EIN is required at the time the return is filed. For more information, see the Instructions for Form SS-4.

Item F. Total Assets

Enter the corporation's total assets (as determined by the accounting method regularly used in keeping the corporation's books and records) at the end of the tax year. If there were no assets at the end of the tax year, enter -0-.

If the corporation is required to complete Schedule L, enter total assets from Schedule L, line 15, column (d), on page 1, item F. If

the S election terminated during the tax year, see the instructions for Schedule L, later, for special rules that may apply when figuring the corporation's year-end assets.

Item G. Electing To Be an S Corporation

If “Yes,” attach Form 2553 if not already filed. Form 2553 must generally be filed no more than 2 months and 15 days after the beginning of the tax year the election is to take effect. A Form 2553 filed with Form 1120-S will generally be a late election. But with reasonable cause you may be able to request relief for the late election on Form 2553. See “Relief for Late Elections” in the Instructions for Form 2553.

Item H. Final Return, Name Change, Address Change, Amended Return, or S Election Termination

- If this is the corporation's final return and it will no longer exist, check the “Final

return” box. Also check the “Final K-1” box on each Schedule K-1.

- If the corporation changed its name since it last filed a return, check the “Name change” box. Generally, a corporation must also have amended its articles of incorporation and filed the amendment with the state in which it was incorporated.
- If the corporation has changed its address since it last filed a return (including a change to an “in care of” address), check the “Address change” box.
- If this amends a previously filed return, check the “Amended return” box. If Schedules K-1 are also being amended, check the “Amended K-1” box on each Schedule K-1.
- If the corporation has terminated its S election, check the “S election termination” box. See Termination of Election, earlier.



If a change in address or responsible party occurs after the return is filed, use Form 8822-B, Change of Address or Responsible Party — Business, to notify the IRS. See the Instructions for Form 8822-B for details.

Item J. Aggregation or Grouping of Certain Activities

For information about aggregating at-risk activities, see Aggregation of Activities under *At-Risk Limitations*, earlier. For information about grouping passive activities, see Grouping Activities under *Passive Activity Limitations*, earlier.

Income



Report only trade or business activity income on lines 1a through 5. Don't report rental activity income or portfolio income on these lines. See Passive Activity Limitations, earlier, for definitions of rental income and portfolio income. Rental

activity income and portfolio income are reported on Schedules K and K-1. Rental real estate activities are also reported on Form 8825.

Tax-exempt income. Don't include any tax-exempt income on lines 1a through 5. A corporation that receives any tax-exempt income other than interest, or holds any property or engages in any activity that produces tax-exempt income, reports this income on line 16b of Schedule K and in box 16 of Schedule K-1 using code B.

Report tax-exempt interest income, including exempt-interest dividends received as a shareholder in a mutual fund or other regulated investment company, on line 16a of Schedule K and in box 16 of Schedule K-1 using code A.

See *Deductions*, later, for information on how to report expenses related to tax-exempt income.

Canceled debt exclusion. If the corporation has had debt discharged resulting from a title 11 bankruptcy proceeding or while insolvent, see Form 982, Reduction of Tax Attributes Due to Discharge of Indebtedness, and Pub. 908, Bankruptcy Tax Guide.

Line 1a. Gross Receipts or Sales

Enter on line 1a gross receipts or sales from all business operations except for amounts that must be reported on lines 4 and 5. If a cost offset method under section 451(b) or (c) is elected, the resulting gross income is reported on line 1a.

Special rules apply to certain income, as discussed below.

Advance payments. In general, advance payments are reported in the year of receipt. For exceptions to this general rule for corporations that use an accrual method of accounting, see the following.

- To report income from long-term contracts, see section 460. For rules that allow a limited deferral of advance payments beyond the current tax year, see section 451(c) and Regulations section 1.451-8.
- For information on adopting or changing to a permissible method for reporting advance payments for goods and services by an accrual method corporation, see the Instructions for Form 3115.

Installment sales. Generally, the installment method can't be used for dealer dispositions of property. A "dealer disposition" is any disposition of:

- Personal property by a person who regularly sells or otherwise disposes of personal property of the same type on the installment plan, or

- Real property held for sale to customers in the ordinary course of the taxpayer's trade or business.

These restrictions on using the installment method don't apply to dispositions of property used or produced in a farming business or sales of timeshares and residential lots for which the corporation elects to pay interest under section 453(l)(3).

For sales of timeshares and residential lots reported under the installment method, each shareholder's income tax is increased by the shareholder's pro rata share of the interest payable under section 453(l)(3).

Enter on line 1a the gross profit on collections from installment sales for any of the following.

- Dispositions of property used or produced in the trade or business of farming.

- Certain dispositions of timeshares and residential lots reported under the installment method.

Attach a statement showing the following information for the current and the 3 preceding years.

- Gross sales.
- Cost of goods sold.
- Gross profits.
- Percentage of gross profits to gross sales.
- Amount collected.
- Gross profit on the amount collected.

Line 1b. Returns and Allowances

Enter cash and credit refunds the corporation made to customers for returned merchandise, rebates, and other allowances made on gross receipts or sales.

Line 2. Cost of Goods Sold

Complete and attach Form 1125-A, Cost of Goods Sold, if applicable. Enter on line 2 the amount from Form 1125-A, line 8. See Form 1125-A and its instructions.

Line 4. Net Gain (Loss) From Form 4797



Include only ordinary gains or losses from the sale, exchange, or involuntary conversion of assets used in a trade or business activity. Ordinary gains or losses from the sale, exchange, or involuntary conversion of rental activity assets are reported separately on line 19 of Form 8825, or line 3 of Schedule K, and box 3 of Schedule K-1, generally as a part of the net income (loss) from the rental activity.

A corporation that is a partner in a partnership must include on Form 4797, Sales of Business Property, its share of ordinary gains (losses) from sales, exchanges, or involuntary conversions (other than casualties

or thefts) of the partnership's trade or business assets.

Corporations shouldn't use Form 4797 to report the sale or other disposition of property if a section 179 expense deduction was previously passed through to any of its shareholders for that property. Instead, report it in box 17 of Schedule K-1 using code K. See *Dispositions of property with section 179 deductions (code K)*, later, for details.

Line 5. Other Income (Loss)

Enter any other trade or business income (loss) not included on lines 1a through 4. List the type and amount of income on an attached statement. Examples of other income include the following.

- Interest income derived in the ordinary course of the corporation's trade or business, such as interest charged on receivable balances. See Temporary Regulations section 1.469-2T(c)(3).

- Recoveries of bad debts deducted in prior years under the specific charge-off method.
- Taxable income from insurance proceeds.
- Any amount included in income from line 2 of Form 6478, Biofuel Producer Credit.
- Any amount included in income from line 10 of Form 8864, Biodiesel, Renewable Diesel, or Sustainable Aviation Fuels Credit.
- The recapture amount under section 280F if the business use of listed property drops to 50% or less. To figure the recapture amount, complete Part IV of Form 4797.
- The ratable portion of any positive section 481(a) adjustments resulting from changes in accounting methods. Show the computation of the positive section 481(a) adjustments on an attached statement. In the statement, include, for each section 481(a) adjustment, the total section

481(a) adjustment, the ratable portion included in current year taxable income, and a brief description of the changes in methods of accounting to which the section 481(a) adjustment relates. See Rev. Proc. 2015-13, 2015-5 I.R.B. 419, available at [IRS.gov/irb/ 2015-5 IRB#RP-2015-13](https://www.irs.gov/irb/2015-5_IRB#RP-2015-13).

- Part or all of the proceeds received from certain corporate-owned life insurance contracts issued after August 17, 2006. Corporations that own one or more employer-owned life insurance contracts issued after this date must file Form 8925, Report of Employer-Owned Life Insurance Contracts. See Form 8925.
- Any payroll tax credit taken by an employer on its 2023 employment tax returns (Forms 941, 943, and 944) for qualified paid sick and qualified paid family leave under FFCRA and ARP (both the nonrefundable and refundable

portions). The corporation must include the full amount of the credit for qualified sick and family leave wages in gross income for the tax year that includes the last day of the calendar quarter in which the credit is allowed.

Note. A credit is available only if the leave was taken after March 31, 2020, and before October 1, 2021, and only after the qualified leave wages were paid, which might, under certain circumstances, not occur until a quarter after September 30, 2021, including quarters in 2023.

Don't include items requiring separate computations by shareholders that must be reported on Schedules K and K-1. See the instructions for Schedules K and K-1 later in these instructions.

Ordinary Income (Loss) From a Partnership, Estate, or Trust

Enter the ordinary income (loss) shown on Schedule K-1 (Form 1065) or Schedule K-1 (Form 1041), or other ordinary income (loss) from a foreign partnership, estate, or trust. Show the partnership's, estate's, or trust's name, address, and EIN on a separate statement attached to this return. If the amount entered is from more than one source, identify the amount from each source.

Don't include portfolio income or rental activity income (loss) from a partnership, estate, or trust on this line. Instead, report these amounts on Schedules K and K-1, or on line 20a of Form 8825 if the amount is from a rental real estate activity.

Ordinary income or loss from a partnership that is a publicly traded partnership isn't reported on this line. Instead, report the amount separately on line 10 of Schedule K and in box 10 of Schedule K-1 using code ZZ.

Treat shares of other items separately reported on Schedule K-1 issued by the other entity as if the items were realized or incurred by this corporation.

If there is a loss from a partnership, the amount of the loss that may be claimed by the S corporation is subject to the basis limitations.

If the tax year of the S corporation doesn't coincide with the tax year of the partnership, estate, or trust, include the ordinary income (loss) from the other entity in the tax year in which the other entity's tax year ends.

Deductions



Report only trade or business activity deductions on lines 7 through 20.

Don't report the following expenses on lines 7 through 20.

- Rental activity expenses. Report these expenses on Form 8825 or line 3b of Schedule K.
- Deductions allocable to portfolio income. Report these deductions on line 12d of Schedule K and in box 12 of Schedule K-1 using code I or L.
- Nondeductible expenses (for example, expenses connected with the production of tax-exempt income). Report nondeductible expenses on line 16c of Schedule K and in box 16 of Schedule K-1 using code C.
- Qualified expenditures to which an election under section 59(e) may apply. The instructions for line 12c of Schedule K and for Schedule K-1, box 12, code J, explain how to report these amounts.
- Items the corporation must state separately that require separate computations by the shareholders.

Examples include expenses incurred for the production of income instead of in a trade or business, charitable contributions, foreign taxes paid or accrued, intangible drilling and development costs, soil and water conservation expenditures, amortizable basis of reforestation expenditures, and exploration expenditures. The pro rata shares of these expenses are reported separately to each shareholder on Schedule K-1. **Limitations on Deductions**

Section 263A uniform capitalization rules. The uniform capitalization rules of section 263A generally require corporations to capitalize, or include in inventory, certain costs incurred in connection with the following.

- The production of real property and tangible personal property held in

inventory or held for sale in the ordinary course of business.

- Real property or personal property (tangible and intangible) acquired for resale.
- The production of real property and tangible personal property by a corporation for use in its trade or business or in an activity engaged in for profit.

Tangible personal property produced by a corporation includes a film, sound recording, videotape, book, or similar property.

The costs required to be capitalized under section 263A aren't deductible until the property to which the costs relate is sold, used, or otherwise disposed of by the corporation. ***Exceptions.*** Section 263A doesn't apply to the following.

- Inventoriable items accounted for in the same manner as materials and supplies

that aren't incidental. See Form 1125-A and its instructions for more details.

- A small business taxpayer (defined earlier) isn't required to capitalize costs under section 263A. A taxpayer that wants to discontinue capitalizing costs under section 263A must change its method of accounting. See section 263A(i) and the Instructions for Form 3115.
- Timber.
- Most property produced under a long-term contract.
- Certain property produced in a farming business. See Special rules for certain corporations engaged in farming, later.
- Geological and geophysical costs amortized under section 167(h).
- Certain plants bearing fruits and nuts depreciated under section 168(k)(5).

The corporation must report the following costs separately to the shareholders for purposes of determinations under section 59(e).

- Research and experimental costs under section 174.
- Intangible drilling costs for oil, gas, and geothermal property.
- Mining exploration and development costs.

Indirect costs. Corporations subject to the uniform capitalization rules are required to capitalize not only direct costs but an allocable part of most indirect costs (including taxes) that benefit the assets produced or acquired for resale, or are incurred because of the performance of production or resale activities.

For inventory, indirect costs that must be capitalized include the following.

- Administration expenses.
- Taxes.
- Depreciation.
- Insurance.
- Compensation paid to officers attributable to services.
- Rework labor.
- Contributions to pension, stock bonus, and certain profit-sharing, annuity, or deferred compensation plans.

Regulations section 1.263A-1(e)(3) specifies other indirect costs that relate to production or resale activities that must be capitalized and those that may be currently deductible.

Interest expense paid or incurred during the production period of designated property must be capitalized and is governed by special rules. For more details, see

Regulations sections 1.263A-8 through 1.263A-15.

For more details on the uniform capitalization rules, see Regulations sections 1.263A-1 through 1.263A-3.

Special rules for certain corporations engaged in farming. For S corporations not required to use an accrual method of accounting, the rules of section 263A don't apply to expenses of raising any:

- Animal, or
- Plant that has a preproductive period of 2 years or less.

Shareholders of S corporations not required to use an accrual method of accounting may elect to currently deduct the preproductive period expenses of certain plants that have a preproductive period of more than 2 years. Because each shareholder makes the election to deduct these expenses, the corporation shouldn't capitalize them. Instead, the

corporation should report the expenses separately on line 12d of Schedule K and report each shareholder's pro rata share in box 12 of Schedule K-1 using code M.

See *Uniform Capitalization Rules* in chapter 6 of Pub. 225, *Farmer's Tax Guide*, sections 263A(d) and (e), and Regulations section 1.263A-4 for definitions and other details.

Transactions between related taxpayers.

Generally, an accrual basis S corporation can deduct business expenses and interest owed to a related party (including any shareholder) only in the tax year of the corporation that includes the day on which the payment is includible in the income of the related party. See section 267 for details.

Business interest. Business interest expense may be limited. See section 163(j) and Form 8990. Also see Schedule B, questions 9 and 10, and the related instructions for question 9 and question 10, later.

Section 291 limitations. If the S corporation was a C corporation for any of the 3 immediately preceding years, the corporation may be required to adjust items such as deductions for depletion of iron ore and coal, and the amortizable basis of pollution control facilities. If this applies, see section 291 to figure the adjustment.

Business start-up and organizational costs. A corporation can elect to deduct a limited amount of start-up and organizational costs it paid or incurred. Any remaining costs must generally be amortized over a 180-month period. See sections 195 and 248 and the related regulations.

Time for making an election. The corporation generally elects to deduct start-up or organizational costs by claiming the deduction on its income tax return filed by the due date (including extensions) for the tax year in which the active trade or business

begins. For more details, see the Instructions for Form 4562.

If the corporation timely filed its return for the year without making an election, it can still make an election by filing an amended return within 6 months of the due date of the return (excluding extensions). Clearly indicate the election on the amended return and enter "Filed pursuant to section 301.9100-2" at the top of the amended return. File the amended return at the same address the corporation filed its original return. The election applies when figuring taxable income for the current tax year and all subsequent years.

The corporation can choose to forgo the elections above by clearly electing to capitalize its start-up or organizational costs on its income tax return filed by the due date (including extensions) for the tax year in which the active trade or business begins.



The election to either amortize or capitalize start-up costs is irrevocable and applies to all start-up costs that are related to the trade or business.

Report the deductible amount of start-up and organizational costs and any amortization on line 20. For amortization that begins during the current tax year, complete and attach Form 4562, Depreciation and Amortization.

Reducing certain expenses for which credits are allowable. If the corporation claims certain credits, it may need to reduce the otherwise allowable deductions for expenses used to figure the credit. This applies to credits such as the following.

- Work opportunity credit (Form 5884).
- Credit for increasing research activities (Form 6765).
- Orphan drug credit (Form 8820).
- Disabled access credit (Form 8826).

- Empowerment zone employment credit (Form 8844).
- Credit for employer social security and Medicare taxes paid on certain employee tips (Form 8846).
- Credit for small employer pension plan startup costs, auto-enrollment, and military spouse participation (Form 8881).
- Credit for employer-provided childcare facilities and services (Form 8882).
- Low sulfur diesel fuel production credit (Form 8896).
- Credit for employer differential wage payments (Form 8932).
- Credit for small employer health insurance premiums (Form 8941).
- Employer credit for paid family and medical leave (Form 8994).

If the corporation has any of the credits listed above, figure the current year credit before figuring the deduction for expenses on which the credit is based. If the corporation capitalized any costs on which it figured the credit, it may need to reduce the amount capitalized by the credit attributable to these costs.

See the instructions for the form used to figure the applicable credit for more details.

Line 7. Compensation of Officers and Line 8. Salaries and Wages



Distributions and other payments by an S corporation to a corporate officer must be treated as wages to the extent the amounts are reasonable compensation for services rendered to the corporation.

Enter on line 7 the total compensation of all officers paid or incurred in the trade or business activities of the corporation. The

corporation determines who is an officer under the laws of the state where it is incorporated.

Enter on line 8 the total salaries and wages paid or incurred to employees (other than officers) during the tax year.



If the corporation claims a credit for any wages paid or incurred, it may need to reduce the amounts on lines 7 and 8. See Reducing certain expenses for which credits are allowable, earlier.

Don't include salaries and wages reported elsewhere on the return, such as amounts included in cost of goods sold, elective contributions to a section 401(k) cash or deferred arrangement, or amounts contributed under a salary reduction SEP agreement or a SIMPLE IRA plan.

If the corporation's total receipts (page 1, line 1a, plus lines 4 and 5; income reported on Schedule K, lines 3a, 4, 5a, and 6; income or

net gain reported on Schedule K, lines 7, 8a, 9, and 10; and income or net gain reported on Form 8825, lines 2, 19, and 20a) are \$500,000 or more, complete Form 1125-E, Compensation of Officers. Enter on Form 1120-S, line 7, the amount from Form 1125-E, line 4.

Include fringe benefit expenditures made on behalf of officers and employees owning more than 2% of the corporation's stock. Also report these fringe benefits as wages in box 1 of Form W-2. Don't include amounts paid or incurred for fringe benefits of officers and employees owning 2% or less of the corporation's stock. These amounts are reported on line 18. See the instructions for that line for information on the types of expenditures that are treated as fringe benefits and for the stock ownership rules.

Report amounts paid for health insurance coverage for a more-than-2% shareholder (including that shareholder's spouse,

dependents, and any children under age 27 who aren't dependents) as an information item in box 14 of that shareholder's Form W-2. A more-than-2% shareholder may be allowed to deduct such amounts on Schedule 1 (Form 1040), line 17.

If a shareholder or a member of the family of one or more shareholders of the corporation renders services or furnishes capital to the corporation for which reasonable compensation isn't paid, the IRS may make adjustments in the items taken into account by such individuals to reflect the value of such services or capital. See section 1366(e).

Line 9. Repairs and Maintenance

Enter the cost of repairs and maintenance not claimed elsewhere on the return, such as labor and supplies, that don't add to the value of the property or appreciably prolong its life. The corporation can deduct these repairs only to the extent they relate to a trade or business activity. See Regulations section

1.162-4. The corporation may elect to capitalize certain repair and maintenance costs consistent with its books and records. See Regulations section 1.263(a)-3(n) for information on how to make the election.

New buildings, machinery, or permanent improvements that increase the value of the property aren't deductible as repair and maintenance expenses. These expenses must be capitalized and depreciated or amortized. However, amounts paid for routine maintenance on property, including buildings, may be deductible. See Regulations section 1.263(a)-3(i).

Line 10. Bad Debts

Enter the total debts that became worthless in whole or in part during the tax year, but only to the extent such debts relate to a trade or business activity. Report deductible nonbusiness bad debts as a short-term capital loss on Form 8949, Sales and Other Dispositions of Capital Assets. A corporation

that uses the cash method of accounting can't claim a bad debt deduction unless the amount was previously included in income.

Line 11. Rents

Enter rent paid on business property used in a trade or business activity. Don't deduct rent for a dwelling unit occupied by any shareholder for personal use.

If the corporation rented or leased a vehicle, enter the total annual rent or lease expense paid or incurred in the trade or business activities of the corporation during the tax year. Also complete Part V of Form 4562. If the corporation leased a vehicle for a term of 30 days or more, the deduction for vehicle lease expense may have to be reduced by including in gross income an amount called the "inclusion amount." The corporation may have an inclusion amount if:

The lease term began:	And the vehicle's FMV on the first day of the lease exceeded:
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Cars (excluding trucks and vans)

After 12/31/22 but before 1/1/24	\$60,000
After 12/31/21 but before 1/1/23	\$56,000
After 12/31/20 but before 1/1/22	\$51,000
After 12/31/17 but before 1/1/21	\$50,000
After 12/31/12 but before 1/1/18	\$19,000

Trucks and vans

After 12/31/22 but before 1/1/24	\$60,000
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After 12/31/21 but before 1/1/23	\$56,000
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After 12/31/20 but before 1/1/22	\$51,000
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After 12/31/17 but before 1/1/21	\$50,000
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After 12/31/13 but before 1/1/18	\$19,500
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After 12/31/09 but before 1/1/14	\$19,000
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See Pub. 463, Travel, Gift, and Car Expenses,
for instructions on figuring the inclusion
amount.

Note. The inclusion amount for lease terms beginning in 2024 will be published in the Internal Revenue Bulletin in early 2024.

Line 12. Taxes and Licenses

Enter taxes and licenses paid or incurred in the trade or business activities of the corporation, unless they are reflected elsewhere on the return. Federal import duties and federal excise and stamp taxes are deductible only if paid or incurred in carrying on the trade or business of the corporation.

Foreign taxes are included on line 12 only if they are deductible and not creditable taxes under sections 901 and 903. See Schedule K-2 (Form 1120-S), Part II, Section 2, line 45, column (g).



Do not reduce the corporation's deduction for social security and Medicare taxes by the nonrefundable and refundable portions of any FFCRA and ARP credits for qualified sick and family leave

wages claimed on its employment tax returns. Instead, report this amount as income on line 5.

Don't deduct the following taxes on line 12.

- Federal income taxes (except for the portion of built-in gains tax allocable to ordinary income) or taxes reported elsewhere on the return.
- Creditable foreign taxes under sections 901 and 903. Report these taxes on line 16f of Schedule K and in box 16 of Schedule K-1 using code F.
- Taxes allocable to a rental activity. Report taxes allocable to a rental real estate activity on Form 8825. Report taxes allocable to a rental activity other than a rental real estate activity on line 3b of Schedule K.
- Taxes paid or incurred for the production or collection of income, or for the management, conservation, or

maintenance of property held to produce income. Report these taxes separately on line 12d of Schedule K and in box 12 of Schedule K-1 using code ZZ.

See section 263A(a) for rules on capitalization of allocable costs (including taxes) for any property.

- Taxes not imposed on the corporation.
- Taxes, including state or local sales taxes, that are paid or incurred in connection with an acquisition or disposition of property (these taxes must be treated as a part of the cost of the acquired property or, in the case of a disposition, as a reduction in the amount realized on the disposition).
- Taxes assessed against local benefits that increase the value of the property assessed (such as for paving, etc.).

See section 164(d) for information on apportionment of taxes on real property between seller and purchaser.

Line 13. Interest

Include only interest incurred in the trade or business activities of the corporation that isn't claimed elsewhere on the return. Don't include interest expense on the following.

- On debt used to purchase rental property or debt used in a rental activity. Interest allocable to a rental real estate activity is reported on Form 8825 and is used in arriving at net income (loss) from rental real estate activities on line 2 of Schedule K and in box 2 of Schedule K-1. Interest allocable to a rental activity other than a rental real estate activity is included on line 3b of Schedule K and is used in arriving at net income (loss) from a rental activity (other than a rental real estate activity). This net amount is reported on

line 3c of Schedule K and in box 3 of Schedule K-1.

- On debt used to buy property held for investment. Interest that is clearly and directly allocable to interest, dividend, royalty, or annuity income not derived in the ordinary course of a trade or business is reported on line 12b of Schedule K and in box 12 of Schedule K-1 using code H. See the instructions for line 12b of Schedule K; for box 12, code H, of Schedule K-1; and Form 4952, Investment Interest Expense Deduction, for more information on investment property.
- On debt proceeds allocated to distributions made to shareholders during the tax year. Instead, report such interest on line 12d of Schedule K and in box 12 of Schedule K-1 using code AC. To determine the amount to allocate to distributions to

shareholders, see Notice 89-35, 1989-1 C.B. 675.

- On debt required to be allocated to the production of designated property. Designated property includes real property, personal property that has a class life of 20 years or more, and other tangible property requiring more than 2 years (1 year in the case of property with a cost of more than \$1 million) to produce or construct. Interest allocable to designated property produced by a corporation for its own use or for sale must be capitalized. In addition, a corporation must also capitalize any interest on debt allocable to an asset used to produce designated property. A shareholder may have to capitalize interest that the shareholder incurs during the tax year for the S corporation's production expenditures. Similarly, interest incurred by an S corporation may

have to be capitalized by a shareholder for the shareholder's own production expenditures. The information required by the shareholder to properly capitalize interest for this purpose must be provided by the corporation on an attachment for box 17 of Schedule K-1 using code P. See section 263A(f) and Regulations sections 1.263A-8 through 1.263A-15. Special rules apply to the following.

- Allocating interest expense among activities so that the limitations on passive activity losses, investment interest, and personal interest can be properly figured. Generally, interest expense is allocated in the same manner as debt is allocated. Debt is allocated by tracing disbursements of the debt proceeds to specific expenditures. Temporary Regulations section 1.163-8T gives rules for tracing debt proceeds to expenditures.

- Prepaid interest, which can generally only be deducted over the term of the debt. See Regulations sections 1.163-7, 1.446-2, and 1.1273-2(g) for details. Also see section 461(g).
- Interest that is allocable to unborrowed policy cash values of life insurance, endowment, or annuity contracts issued after June 8, 1997. See section 264(f). Attach a statement showing the computation of the deduction.
- Forgone interest on below-market-rate loans (see section 7872).

Limitation on deduction. Business interest expense is generally limited to the sum of business interest income, 30% of adjusted taxable income, and floor plan financing interest. See Form 8990, Limitation on Business Interest Expense Under Section 163(j), and its instructions for more information. The limitation applies at the S corporation level, and any excess business

interest expense is carried over at the corporate level.

Business interest expense includes any interest paid or accrued on indebtedness properly allocable to a trade or business. A small business taxpayer is a taxpayer that isn't a tax shelter (as defined in section 448(d)(3)) and has average annual gross receipts of \$29 million or less for the 3 prior tax years under the gross receipts test of section 448(c). Gross receipts include the aggregate gross receipts from all persons treated as a single employer, such as a controlled group of corporations, commonly controlled partnerships or proprietorships, and affiliated service groups. If the corporation fails to meet the gross receipts test, Form 8990 is generally required. Also see Schedule B, questions 9 and 10.

Line 14. Depreciation

Enter the depreciation claimed on assets used in a trade or business activity less any

depreciation reported elsewhere (for example, on Form 1125-A). See the Instructions for Form 4562, or Pub. 946, How To Depreciate Property, to figure the amount of depreciation to enter on this line.

Complete and attach Form 4562 only if the corporation placed property in service during the tax year or claims depreciation on any car or other listed property.

Don't include any section 179 expense deduction on this line. This amount isn't deducted by the corporation. Instead, it is passed through to the shareholders in box 11 of Schedule K-1. However, reduce the basis of any asset of the S corporation by the amount of section 179 expense elected by the S corporation, even if a portion of that amount can't be passed through to its shareholders this year and must be carried forward because of limitations at the S corporation level. See Regulations section 1.179-1(f)(2).

Line 15. Depletion

If the corporation claims a deduction for timber depletion, complete and attach Form T (Timber), Forest Activities Schedule.



Don't deduct depletion for oil and gas properties. Each shareholder figures depletion on oil and gas properties.

See the instructions for Schedule K-1, box 17, code R, for the information on oil and gas depletion that must be supplied to the shareholders by the corporation.

Line 17. Pension, Profit-Sharing, etc., Plans

Enter the deductible contributions not claimed elsewhere on the return made by the corporation for its employees under a qualified pension, profit-sharing, annuity, or simplified employee pension (SEP) or SIMPLE IRA plan, or any other deferred compensation plan.

If the corporation contributes to an individual retirement arrangement (IRA) for employees, include the contribution in salaries and wages on page 1, line 8, or Form 1125-A, line 3, and not on line 17.

Employers who maintain a pension, profit-sharing, or other funded deferred compensation plan, whether or not the plan is qualified under the Internal Revenue Code and whether or not a deduction is claimed for the current tax year, must generally file the applicable form listed below.

- Form 5500, Annual Return/Report of Employee Benefit Plan.
- Form 5500-SF, Short Form Annual Return/Report of Small Employee Benefit Plan. File this form instead of Form 5500 generally if there were under 100 participants at the beginning of the plan year.