

Basis Determination

Basis for Bank savings accounts or Stock and Mutual Fund Investments

Basis, simply put, begins with the original value or purchase price of an investment that you pay on the date of acquisition. It is an ongoing value that increases over time if you reinvest the earnings you make on the investment. You have to declare the dividends or interest you earn annually on your tax return, whether you take the earnings out or leave them in the investment account.

Assuming you leave the earnings in your account, it is treated the same as if you had made an additional purchase of the investment. If you take the earnings out after reporting on your tax return it is treated as tax free since you previously reported and paid tax on it. If the original amount of the purchase price or basis is returned to you, then that is treated as a tax free return of capital you originally invested. A capital gain results if the investment went up in market value while you held it, and you sell it. A loss results if you get back less income on the sale of the investment than what you paid for it. An example of stock basis is follows:

Purchase price.....	10,000 (Original Basis, Stock)
+ Annual dividends reinvested.....	100 (Must be declared on your tax return)
Adjusted Basis.....	10,100

Following year sale.....	10,500 (After transaction fee paid)
- Adjusted Basis.....	10,100
Capital Gain on Sale.....	400 (Must be declared on your tax return, if it is a loss is also needs reporting)

Some of our clients forget to report annual earnings of interest from the bank or from stocks and mutual fund investments. The institutions report these earnings every year to the IRS, so eventually the client receives a letter asking them why they forgot to report the earnings and they have to pay additional taxes. The excuse the clients tell me is that they never received the money. That did not get it in their hand, but the IRS still considers it as income because the investment earned it and they could have elected to have the investment company mail them a check for the earnings amount rather than having it reinvested.

An attachment called "Mutual Fund Basis Worksheet" is attached to this article to help you keep track of your stock or mutual fund purchases, sales, distributions, and reinvested dividends and capital gains earnings that you pay tax on annually.

Basis determination for Partnership investments

Some of our clients are involved in partnership or limited liability company investments. Some actually work in the company, while others merely put funds into the company as an investment. They should receive a Form K-1 from the company no later than March 15th each year. If they work in the company, then the earnings are subject to regular income tax as well as social security tax. They do not receive a salary, but may receive a guaranteed distribution. They are treated as a general or managing partner. If they merely invest in the company, then the earnings are subject to income tax and not social security tax. They are treated as limited partners. All partners are permitted to add their current share of the partnership liabilities to their adjusted basis. If you receive a distribution in excess of your adjusted Basis, then you must declare additional income on your tax return. A Partnership Basis example follows:

Original investment amount.....	10,000
Additional cash invested during year.....	2,000
Adjusted Basis.....	12,000
Your share of income earned in year, (Ordinary Income).....	1,000 (You pay tax on this)
Adjusted Basis.....	13,000
Minus distributions.....	3,000 (Tax free return of capital)
Adjusted Basis.....	10,000
Your share of the partnerships liabilities.....	6,000
Adjusted Basis.....	16,000 (End of year)

A complete "Partner's Adjusted Basis Worksheet" is attached.

Basis Determination for S-Corporation Shareholders

S-Corporation basis is similar to Partnership basis tracking in some respects. The primary difference is that you are not allowed to add your share of the current S-Corporation's liabilities to your adjusted basis amount each year. However, if you add capital contributions to the S-corporation, you are permitted to treat the contribution as Additional Paid in Capital which adds to your stock basis. You could treat the contribution as a loan to the Corporation, if it is evidenced by a written agreement. If this is done, then the loan is tracked separately from your stock basis. In effect, you have two basis. The first is your stock basis, while the second is your loan basis. In no case can you add separate loans that the corporation has made in its name to your basis, even if you cosigned for the loan. Your yearly earnings from the S-Corporation are reported on a Form K-1 that you also should receive by March 15th to report on your personal tax return. You will have to declare the earnings, as ordinary income subject to federal tax only, but you will not have to pay social security tax. You should have had the corporation pay you wages if you were actively involved in the management of the business.

A "Shareholder's Basis in an S-Corporation is attached to track both Stock Basis and Separate Loan Basis.

Please use the attachments to track your basis for your investments. It is important because we have received information that the IRS will be looking at this more often in audits. If you have a question, please call. For more complex questions, please consider a consultation appointment. Note that we do charge a fee for appointments.

Mutual Fund Basis Worksheet

Name _____ ID# _____

[illegible][illegible]

NOTE: Taxpayers often choose to reinvest dividends and capital gain distributions by purchasing additional shares in the fund. This can be noted as an additional purchase on this worksheet.

Partner's Adjusted Basis Worksheet (Outside Basis)

Tax Year End

Name of Partner:

TIN:

Name of Partnership:

EIN:

- 1) Adjusted basis from prior year (do not enter less than zero)..... 1) _____
- 2) Cash contributions during the year..... 2) _____
- 3) Adjusted basis of property contributed during the year..... 3) _____
- 4) Gain (if any) recognized on contribution of property from line (3)..... 4) _____
- 5) Ordinary income from line 1, Schedule K-1. **Note:** If a loss, include on line 12, below..... 5) _____
- 6) Other items of income, including separately stated income and tax-exempt income:

_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____

Total line 6..... 6) _____

- 7) Partner's current share of partnership liabilities..... 7) _____
- 8) Liabilities included in adjusted basis from prior year (from line (1), above)..... 8) (_____)
- 9) Other increases to basis:

Includes partner's share of the excess of the deductions for depletion (other than oil and gas depletion) over the basis of the property subject to depletion.

_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____

Total line 9..... 9) _____

- 10) Combine lines 1 through 9 (if less than zero, enter -0-). **Note:** A distribution may be taxable if the amount exceeds the adjusted basis immediately before the distribution..... 10) _____
- 11) Distributions to partner during the year (cash plus adjusted basis of property distributed). **Note:** A distribution may be taxable if the amount exceeds the adjusted basis immediately before the distribution..... 11) _____
- 12) Ordinary loss from line 1, Schedule K-1. **Note:** If a gain, include on line 5, above..... 12) _____
- 13) Other losses passed through to partner, including separately stated items..... 13) _____
- 14) Section 179 deduction (even if not fully deductible because of limitations on the partner's return)..... 14) _____
- 15) Nondeductible partnership expenses (other than capital expenses)..... 15) _____
- 16) Deduction for oil and gas percentage depletion, not to exceed the partner's allocable share of the adjusted basis of that property..... 16) _____
- 17) Other deductions

_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____

Total line 17..... 17) _____

- 18) Add lines 11 through 17..... 18) _____
- 19) Partner's outside basis at end of year: Line 10 minus line 18 (cannot be less than zero)..... 19) _____

If line 18 is more than line 10, the loss is suspended until basis increases.

Suspended loss.....

Losses are also subject to passive activity loss rules and at-risk rules. See *Passive Activity Losses*, page 7-9, *TheTaxBook*, 1040 Edition/Deluxe Edition.

Shareholder's Basis in S Corporation for Tax Year _____

Taxpayer Name/ID:
Prepared By:
Date:

	Total to Stock or Loan Basis	Stock Basis	Loan Basis	Loan Face Amount
1 Beginning Balance	+		xxxxxxx	xxxxxxx
2 Contributions to Capital and/or Stock Purchase	+		xxxxxxx	
3 Loans to Corporation				
4 Subtotal (add lines 1 - 3)				

****Complete Net Increase/Decrease Worksheet on page 2 and use information to complete Part I, II, or III**

Part I Loan Basis Has Not Been Reduced by Post 1982 Losses

5 Subtotal Income and Gains	+		xxxxxxx	xxxxxxx
6 Nondividend distributions	-		xxxxxxx	xxxxxxx
7 Loan repayments (Principal portion only)	-	xxxxxxx		xxxxxxx
8 Nondeductible Expenses*	-			xxxxxxx
9 Subtotal Deductions and Losses	-			xxxxxxx
10 Nondeductible Expenses*	-			xxxxxxx
11 Ending Balance (line 4 + sum of lines 5 - 10)				

Part II Loan Basis Has Been Reduced by Post 1982 Losses and Net Increase**

12 Net Increase**	+			xxxxxxx
13 Loan repayments (Nontaxable principal portion only)***	-	xxxxxxx		
14 Ending Balance (line 4 + sum of lines 12 - 13)				

Part III Loan Basis Has Been Reduced by Post 1982 Losses and Net Decrease**

15 Subtotal Income and Gains	+		xxxxxxx	xxxxxxx
16 Nondividend distributions	-		xxxxxxx	xxxxxxx
17 Loan repayments (Nontaxable principal portion only)***	-	xxxxxxx		xxxxxxx
18 Nondeductible Expenses*	-			xxxxxxx
19 Subtotal Deductions and Losses	-			xxxxxxx
20 Nondeductible Expenses*	-			xxxxxxx
21 Ending Balance (line 4 + sum of lines 15 - 20)				

* Nondeductible expenses decrease basis before deductible losses and deductions. However, the shareholder can make an election to decrease basis by deductible losses and deductions before nondeductible expenses. Therefore, nondeductible expenses are shown on two separate lines (before and after Subtotal Deductions and Losses).

Use the first line if the taxpayer did not make the election. Use the second line if the taxpayer made the election. Do not use both lines!