18 C Corporations

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C Corporation Income Tax Rates, Form 1120

A C corporation, including a personal service corporation, computes its tax by multiplying taxable income by 21%. See *C Corporation Tax Rates,* page 18-4.

A C corporation that is a personal holding company must pay the personal holding company tax in addition to the regular corporate income tax. See *Personal Holding Company (PHC),* page 18-19.

Where to File

For filing addresses for Form 1120, see *Where to File Business Returns*, page 24-1.

New for 2025

- **Penalties.** The minimum penalty for filing a return that is over 60 days late is the lesser of the tax due or $525. See *Penalties,* below.
- **Accounting methods.** The threshold for a small business taxpayer to meet the gross receipts test has increased to $31 million. See *Accounting Methods,* page 18-14.

Common Elections

- Election to reduce adjusted basis to fair market value in an IRC section 351 transaction, page 18-6.
- Election to choose entity classification, page 18-18.
- Election for homeowners' association to file Form 1120-H, page 18-21.
- Election to treat stock purchase as asset acquisition, page 18-23.

Filing Requirements

Unless exempt under IRC section 501, all domestic corporations in existence for any part of a year (including corporations in bankruptcy) must file a return whether or not the corporation has any taxable income.

Form 1120, *U.S. Corporation Income Tax Return,* is filed by C corporations. For S corporation returns, see *S Corporations,* Tab 19.

Filing Deadline

Generally, a corporation must file its income tax return by the 15th day of the fourth month after the end of its tax year (April 15 for a calendar year corporation).

Exception: A corporation with a fiscal tax year ending June 30 must file by the 15th day of the third month after the end of its tax year. A corporation with a short tax year ending anytime in June will be treated as if the short year ended on June 30.

Extension of Time to File

File Form 7004, *Application for Automatic Extension of Time to File Certain Business Income Tax, Information, and Other Returns,* to request a 6-month extension (October 15 for a calendar year corporation). C corporations with tax years ending June 30 are eligible for an automatic 7-month extension of time to file.

Penalties

Late filing. The late filing penalty is 5% of unpaid tax for each month or part of a month the return is late, up to a maximum of 25% of the unpaid tax. The late filing penalty is reduced by any late payment penalty for the same period. The minimum penalty for a return that is over 60 days late is the smaller of 100 percent of the tax due or $525. [IRC §6651(a)]

Late payment. The late payment penalty is 0.5% of unpaid tax for each month or part of a month the tax is not paid, up to a maximum of 25% of the unpaid tax.

The late filing or late payment penalties will not be imposed if the corporation has reasonable cause for the failure to file or pay on time.

Estimated tax. Penalties may apply if required installments are not paid. See *C Corporation Estimated Tax,* page 18-4.

Other penalties. See *Taxpayer Penalties* and *Return Preparer Penalties,* page 15-2.

Electronic Filing

Corporations can generally e-file income tax returns with related forms, schedules, and attachments, as well as extensions, employment tax, and other information returns. Returns for the current tax year, as well as two prior tax years, may be e-filed.

Amended returns. Corporations may e-file both superseding and amended returns for Forms 1120, 1120-S, and 1120-F. If the taxpayer is required to e-file an original return and needs to file an amended or superseding return, that return must also be e-filed.

Ineligible to e-file. Modernized e-File (MeF) does not accept and process certain corporate returns. For current exclusions, see IRS Pub. 4163, *Modernized e-File (MeF) Information for Authorized IRS e-file Providers for Business Returns.*

Mandatory e-filers. Certain corporations must file their returns electronically. See *Waivers from required e-filing,* below.

Return Type	*Annual Return Filings**
1120, 1120-S, Amended Returns	10 or more returns

* Annual return filings mean corporations that file 10 or more federal returns a year in the aggregate, including excise tax, employment tax, and information returns such as Forms W-2 and 1099.

Information Returns Intake System (IRIS). The IRS has developed a free on-line portal (IRIS) to help taxpayers file Form 1099 series information returns electronically.

Failure to comply with e-file requirements. If a corporate taxpayer fails to e-file an income tax return when required to do so by regulations, the IRS may determine that the taxpayer failed to file the return. The taxpayer then becomes subject to IRC section 6651 additions to tax, typically resulting in monetary penalties on the amount of underpayment. Additionally, any return not in compliance with the e-filing requirement will be considered to not have been timely filed, rendering any elections invalid.

Waivers from required e-filing. Final regulations provide waiver guidance for corporations that cannot meet e-filing requirements due to technology constraints or where compliance would result in undue financial burden. (TD 9972)

For more information about electronic filing, see *Corporations, Partnerships, Estates, and Trusts,* page 15-14.

Special Returns for Certain Organizations

Certain organizations must file special returns. These returns include, but are not limited to the following.

If the organization is a(n):	File Form
Subchapter T cooperative association (including a farmers' cooperative).	1120-C
Exempt organization with unrelated trade or business income.	990-T
Interest charge domestic international sales corporation. (IRC §992)	1120-IC-DISC
Foreign corporation (other than life or property and casualty insurance company filing Form 1120-L or Form 1120-PC).	1120-F
Condominium management, residential real estate management, or timeshare association that elects to be treated as a homeowners' association. (IRC §528)	1120-H
Life insurance company. (IRC §801)	1120-L
Property and casualty insurance company. (IRC §831)	1120-PC
Political organization. (IRC §527)	1120-POL
Real estate investment trust. (IRC §856)	1120-REIT
Regulated investment company. (IRC §851)	1120-RIC
S corporation. (IRC §1361)	1120-S

Amended C Corporation Return

Use Form 1120-X, *Amended U.S. Corporation Income Tax Return,* to correct a previously filed Form 1120.

When to file. File Form 1120-X only after the corporation has filed its original return. A return filed before the due date is considered filed on the due date.

- File Form 1120-X within three years after filing the original return or within two years after the tax was paid, whichever is later.
- If filing because of a carryback of an NOL, capital loss, or general business credit, file within three years after the due date (including extensions) of the return that generated the NOL, capital loss, or unused credit.
- If filing based on a bad debt or worthless security, file within seven years after the due date of the return for the tax year in which the debt or security became worthless.

Corporations

Cross References

- Form 1120, *U.S. Corporation Income Tax Return*
- IRS Pub. 542, *Corporations*

Related Topics

- Business Deductions, Tab 8
- Start-Up/Organizational Costs, page 8-22
- Accounting Periods and Methods, page 8-23
- Principal Business or Professional Activity Codes for Corporations and Partnerships, page 25-6
- Business Entity Comparison Chart, page 27-3
- Business Agreements, page 27-5
- Corporate Transparency Act, page 27-6

Businesses Taxed as Corporations

The following businesses are taxed as corporations.

- A business formed under a federal or state law that refers to it as a corporation, body corporate, or body politic.
- A business formed under a state law that refers to it as a joint-stock company or joint-stock association.
- An insurance company.
- Certain banks.
- A business wholly owned by a state or local government.
- A business specifically required to be taxed as a corporation by the Internal Revenue Code (such as a publicly traded partnership).
- Certain foreign businesses.
- Any other business that elects to be taxed as a corporation by filing Form 8832. See *Entity Classification Election,* page 18-17.

Legal Aspects of Corporations

Legal entity. A corporation is a legal entity formed under state law. Often referred to as an "artificial person," a corporation can enter into contracts, sue or be sued, incur debt, own property, and earn income. Issues involving formation and liability protection of corporations are determined under state law. Issues involving issuance of stock and taxation fall under federal law.

Certain entities, other than corporations, can elect to be taxed as corporations. For more information about the election, see *Entity Classification Election,* page 18-17.

Note: Liability protection is determined under state law. Electing to be taxed as a corporation under federal law does not in itself provide any liability protection.

Liability. One of the main functions of a corporation is to shield a shareholder's personal assets from liability. Since a corporation is treated as an artificial person, financial liability will not transfer from the corporation to the shareholder. A shareholder's risk of loss in a corporation is generally limited to the amount invested in stock or money loaned. However, certain conditions can lead to personal liability for the shareholder, including:

- ***A shareholder acting on behalf of the corporation.*** For example, if a shareholder is involved in an auto accident while conducting the corporation's business, the shareholder could be personally liable for damages.
- ***Trust fund penalties.*** If an employee of a corporation is responsible for failing to remit payroll taxes to the appropriate government agency, the employee can be liable for payment of those taxes. See *Trust Fund Recovery Penalty,* page 23-7.
- ***Loans.*** Most lending institutions require personal guarantees for corporate small business loans. If the corporation defaults on the loan, the guarantor will be personally liable.
- ***Failure to adhere to corporate formalities.*** If a shareholder does not maintain a clear delineation between personal activities and business activities, an adverse party may "pierce the corporate veil." Small corporations are particularly vulnerable to this problem because of intermingling personal and business money and other assets and failing to create a clear line between personal and corporate activities. If the corporate veil is pierced, the shareholder's personal assets may be at risk to satisfy liabilities of the corporation. For more information on business liability protection, see *Internal Control, Accounting Procedures, and Insurance,* page 27-10.

Court Case: During the taxpayer's time as chief administrator of a hospital, the hospital suffered severe financial setbacks. As chief administrator, the taxpayer was responsible for prioritizing payments that she deemed essential for operation of the hospital. During this time, the hospital failed to remit to the IRS the full amounts of employment taxes and tax withholdings reported on Form 941. Following an investigation, the IRS found that the taxpayer was liable for these unpaid withheld funds.

The court determined that the taxpayer exercised requisite control over payments and was a responsible person. In addition, the taxpayer was found to have willfully failed to pay over the withheld taxes. Willful failure means a voluntary, conscious, and intentional failure to pay over the taxes. In this case, the taxpayer paid other creditors instead of the taxes due to the federal government. (*Cashaw,* T.C. Memo. 2021-123, October 27, 2021)

Court Case: Unreported amounts received by an individual were properly reported in her taxable income rather than in that of her solely-owned corporation. The taxpayer regularly paid personal expenses from the corporate checking account and used personal funds to pay for corporate expenses. Additionally, the taxpayer could produce no meaningful corporate records or evidence that the corporation engaged in business as a separate entity. The Tax Court found that the taxpayer's business functioned merely as an alter ego of the taxpayer and was therefore a sham corporation. The existence of the corporation was disregarded for purposes of federal taxation and the income at issue was taxed to the taxpayer personally. (*Pappas,* T.C. Memo. 2002-127)

Author's Comment: Shareholders in single-shareholder corporations can be difficult to convince of the importance of maintaining corporate formalities, but the liability protection of a corporation can vanish if the shareholder is not cautious. Adjustments can be made in the client's books to fix problems caused by intermingling funds. However, the behavior can put the client's personal assets at risk by blurring the line between personal and corporation activities. Corporate liability protection is no substitute for a liability insurance policy.

Corporate expenses. Generally, a corporation is a taxable entity separate from its shareholders. Consequently, a shareholder is not entitled to a deduction for the payment of corporate expenses.

Payments to Shareholders

Funds can be transferred from a C corporation to a shareholder in any of the following ways.

Employee wages. Shareholders who provide services to a corporation are paid wages and issued a Form W-2 in the same manner as any other employee. See *Shareholder Wages,* page 18-14.

Fringe benefits. Employee-shareholders of C corporations are eligible for fringe benefits based on employee wages paid. Access to tax-favored fringe benefits is one advantage of doing business as a C corporation. See *Fringe Benefits,* page 18-8, and *Business Entity Comparison Chart,* page 27-3.

Dividends. Distributions from earnings and profits of a C corporation are generally taxable to the shareholder but not deductible by the corporation. See *Dividends,* page 18-15.

Loans. Loans to a shareholder from a corporation may be reclassified as constructive dividends by the IRS if it determines the loans do not have the characteristics of an arms-length transaction. See *Shareholder Loans,* page 18-8.

Rents. A shareholder may charge a C corporation rent for the use of personally owned property. See *Rents and Royalty Payments,* page 18-8.

Stock redemptions. A C corporation may buy stock back from a shareholder. See *Stock Redemptions,* page 18-21.

Controlled Groups

In order to prevent an owner or group of owners from splitting one corporation into multiple corporations for the sole purpose of lowering their tax liability, IRC section 1561 limits certain tax benefit items to the amounts that would be allowed as if they were one corporation. See Instructions for Schedule O (Form 1120). [Reg. §1.1561-1(a)]

Parent-subsidiary group. This term means one or more chains of corporations connected through stock ownership with a common parent. [Reg. §1.1563-1(a)(2)]

Consolidated return. Members of a parent-subsidiary group may file a consolidated tax return. For more information, see Instructions for Form 1120.

Brother-sister group. This term refers to two or more corporations owned by the same five or fewer shareholders. [Reg. §1.1563-1(a)(3)]

Combined group. A combined group is any group of three or more corporations if each corporation is a member of either a parent-subsidiary controlled group or a brother-sister controlled group, and at least one of such corporations is the common parent of a parent-subsidiary controlled group and is also a member of a brother-sister controlled group. [Reg. §1.1563-1(a)(4)]

C Corporation Taxation

Cross References

- Form 1120, *U.S. Corporation Income Tax Return*
- Form 1120-X, *Amended U.S. Corporation Income Tax Return*
- IRS Pub. 542, *Corporations*

Related Topics

- S Corporations, Tab 19
- Partnerships and LLCs, Tab 20
- Where to File Business Returns, page 24-1
- Learning to Prepare Income Tax Returns for Partnerships/ Corporations, page 25-1

C Corporation Income Tax

A C corporation earns income, incurs expenses, shows a profit or loss, and pays income tax. Profits remaining after payment of taxes are available for distribution to shareholders, usually in the form of dividends.

A C corporation as a taxpaying entity differs from the flow-through character of an S corporation or a partnership, where profits and losses flow directly through to the shareholders or partners without being taxed at the corporate level.

Double taxation. Profits from a C corporation are subject to taxation first at the corporate level, then at the shareholder level.

Example: Ed is a 100% shareholder in Edcorp, which has a net profit of $100,000 for the year.

$100,000 corporate earnings × 21% tax rate = $21,000 corporate tax

After subtracting corporate tax from the earnings, there is $79,000 available for a dividend distribution to Ed. Ed will pay the capital gain tax rate of 15% for qualified dividends on his individual federal return.

$79,000 dividend × 15% tax rate = $11,850 individual tax

On the C corporation profit of $100,000, there is $32,850 in tax ($21,000 + $11,850).

Character of income. In a C corporation, income does not retain its character when distributed to shareholders. For example, tax-exempt income realized by a C corporation may be available for dividend distributions, but the income will result in a fully-taxable dividend upon distribution to the shareholder. This is in contrast to an S corporation or partnership where income retains its character when passed through to shareholders or partners.

C Corporation Tax Rates

All taxable income of a C corporation is taxed at a flat tax rate of 21%. There is no separate tax rate for personal service corporations. There is no separate maximum tax rate on net capital gains.

C Corporation Estimated Tax

A C corporation may be subject to an underpayment penalty if it does not make quarterly estimated tax payments. See *Form 2220, Underpayment of Estimated Tax by Corporations,* next column.

An estimated tax penalty will not apply to a C corporation if the tax due is less than $500.

Due dates. Installments for corporations are due by the 15th day of the 4th, 6th, 9th, and 12th months of the tax year (April 15, June 15, September 15, and December 15 for a calendar year corporation).

Methods of computing required installments. The corporation may use the method that results in the smallest installment.

Method 1: Each installment equals 25% of the income tax the corporation will show on its return for the current year.

Method 2: Each installment equals 25% of the income tax shown on the corporation's return for the previous year. Method 2 is not allowed unless the following conditions apply.

- The corporation filed a return the previous year, and
- The return was for a full 12 months, and
- The return showed a positive tax liability (not zero).

Large corporation. A corporation with at least $1 million of modified taxable income in any of the prior three years (taxable income computed without NOLs or capital loss carrybacks or carryovers) may use Method 2 for the first installment only. [IRC §6655(d)(2)]

Other methods:

- *Adjusted seasonal installment method.* This method may be advantageous if a large percentage of income is realized over a short portion of the year.
- *Annualized income installment method.* This method may be advantageous if income varies throughout the year. Corporations must file Form 8842, *Election to Use Different Annualization Periods for Corporate Estimated Tax,* to elect calculation of estimated tax using an annualized income installment method.

Form 2220, *Underpayment of Estimated Tax by Corporations.* The penalty for underpayment of estimated corporate tax is computed on Form 2220. Complete Form 2220 and attach to the corporation's tax return if any of the following apply.

- The adjusted seasonal installment method was used to calculate any required installment.
- The annualized income installment method was used to calculate any required installment.
- The corporation is a large corporation calculating its first required installment based on the prior year's tax.

Depositing Taxes

Corporations generally must use the Electronic Federal Tax Payment System (EFTPS) to make deposits of all tax liabilities. This includes Social Security, Medicare, withheld income, excise, and corporate income taxes. For more information on EFTPS, see *Electronic Federal Tax Payment System (EFTPS),* page 23-2.

Quick Refund of Overpayment of Estimated Tax

Form 4466, *Corporation Application for Quick Refund of Overpayment of Estimated Tax.* This form may be filed if a corporation's overpayment is at least 10% of the expected tax liability and at least $500. File Form 4466 after the end of the corporation's tax year, and no later than the due date for filing the corporation's tax return, not including extensions. Form 4466 must be filed before the corporation files its tax return. An extension of time to file the tax return does not extend the time for filing Form 4466.

Form 1139, *Corporation Application for Tentative Refund.* A C corporation may file Form 1139 to apply for a quick refund of taxes from the following.

- The carryback of a net operating loss (NOL) from a farming loss or a loss of an insurance company,
- The carryback of a net capital loss,
- The carryback of an unused general business credit,
- An overpayment of tax due to a claim of right adjustment under IRC section 1341(b)(1).

Change of Name or Address

If the corporation's name or address has changed since it last filed a return, include the correct information in the heading and check the appropriate box on Item E, Form 1120. If a change in address occurs after the return is filed, use Form 8822-B, *Change of Address or Responsible Party—Business,* to notify the IRS of the new address.

Capital Contributions

Cross References

- IRS Pub. 542, *Corporations*
- IRC §118, *Contributions to the capital of a corporation*
- IRC §351, *Transfer to corporation controlled by transferor*

Related Topics

- Shareholder Basis, page 19-9
- Business Agreements, page 27-5

Capital Contributions

Stock. Ownership in a corporation is represented by shares of stock. See *Stock,* page 18-7.

Capital contributions. A corporation does not recognize gain or loss on the receipt of money or other property paid in exchange for stock.

Paid-in capital. Contributions to the capital of a corporation, whether or not by shareholders, are paid-in capital. These contributions are not taxable to the corporation. See *Contributions by non-shareholders,* below.

Basis

Contributions of cash. A shareholder does not recognize gain or loss upon a cash contribution in exchange for stock. The shareholder's basis in stock is the amount of cash contributed.

Contributions of property. The basis of property contributed to the capital of a corporation is the same as the basis the shareholder had in the property, increased by any gain the shareholder recognized on the exchange. This amount is also the shareholder's basis in the corporation's stock.

Exception: If capital contributions are made to a corporation, and the shareholder (or shareholders) controls the corporation immediately after the exchange, no gain or loss results. See *IRC Section 351—Nontaxable Transfers,* next column.

Services in exchange for stock. The FMV of services rendered in exchange for corporate stock is taxable to the service provider. The taxable amount is the shareholder's basis in the stock.

Contributions by non-shareholders. Contributions to capital made by non-shareholders have a basis to the corporation of zero. If a corporation receives a cash contribution from a person other than a shareholder, the corporation must reduce the basis of any property acquired with that contribution during the 12-month period following the date of the contribution by the amount of the contribution (not below zero).

Contributions to capital. After December 22, 2017, the following non-shareholder contributions to the capital of a corporation are not considered nontaxable paid-in capital.

- Any contribution by any civic group.
- Any contribution in aid of construction or any other contribution as a customer or potential customer.
- Any contribution by any government entity. Special rules apply for water and sewage disposal utilities. [IRC §118(c)]

For example, a contribution of municipal land by a municipality that is not in exchange for stock is not considered a contribution to capital and is includible in the corporation's gross income.

IRC Section 351—Nontaxable Transfers

General rule. No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation, and, immediately after the exchange, such person or persons are in control of the corporation. [IRC §351(a)]

Control defined. The term "control" means the ownership of stock possessing at least 80% of the total combined voting power of all classes of stock entitled to vote and at least 80% of the total number of shares of all other classes of stock of the corporation. [IRC §368(c)]

Notes:

- The term "one or more persons" may include individuals, trusts, estates, partnerships, associations, or corporations. [Reg. §1.351-1(a)(1)]
- Money is treated as property for purposes of IRC section 351.
- Services do not qualify as "property" for purposes of IRC section 351.
- Technical know-how, such as trade secrets or processes, may be considered property for purposes of IRC section 351, depending on the importance of the underlying services. (Rev. Rul. 64-56)

Nonqualified transactions. IRC section 351 nonrecognition treatment does not apply to transfers to investment companies, transfers in a bankruptcy or similar proceeding in exchange for stock used to pay creditors, or if stock is received in exchange for the corporation's debt.

Immediately after the exchange. Simultaneous exchanges are not necessary to meet the qualifications for purposes of IRC section 351. Control of the corporation "immediately after the exchange" includes agreements where the rights of the parties have been previously defined, and execution of the agreement proceeds in a timely manner consistent with the agreement. [Reg. §1.351-1(a)(1)]

Money or other property received. If the transferor receives property other than stock in the exchange (referred to as "boot"), gain is realized to the extent of the money or other property received [IRC §351(b)]. Boot includes debt obligations issued by the corporation.

Nonqualified preferred stock. Transfer of nonqualified preferred stock is treated as boot and does not count for purposes of the 80% control qualification for an IRC section 351 transfer [IRC §351(g)]. The term "nonqualified preferred stock" means preferred stock if:

- The holder of the stock has the right to require the issuer or a related person to redeem or purchase the stock,
- The issuer or a related person is required to redeem or purchase the stock,
- The issuer or a related person has the right to redeem or purchase the stock and, as of the issue date, it is more likely than not that such right will be exercised, or
- The dividend rate on such stock varies in whole or in part (directly or indirectly) with reference to interest rates, commodity prices, or other similar indices.

Example #1: Tom owns a widget maker with a FMV of $50,000 and an adjusted basis of $22,000. Tom and Dustin decide to go into business together and form a corporation. Tom contributes the widget maker to the corporation in exchange for $50,000 of the corporation's stock. Dustin contributes $50,000 in cash. Because Tom and Dustin's combined stock is 80% or more of the corporation's stock immediately after the exchange, the requirements for IRC section 351 are met and no gain is recognized. The corporation's basis in the widget maker is $22,000. Tom's basis in stock is $22,000. Dustin's basis in stock is $50,000.

Example #2: Assume the same facts as Example #1, except the corporation has been in existence for several years and has several shareholders. Tom contributes his widget maker to the corporation in exchange for $50,000 in stock, which represents 50% ownership in the corporation. Because the 80% ownership requirement is not met, the transaction does not qualify under IRC section 351. Tom recognizes gain of $28,000 ($50,000 FMV less $22,000 basis). The corporation does not recognize gain or loss on a capital contribution. The corporation's basis in the widget maker is $50,000 (shareholder's basis plus gain recognized on the exchange). Tom's basis in stock is $50,000.

Group control. A group of investors can combine to meet the 80% control requirement. However, minimal transfers of property by shareholders do not qualify if the reason is merely to qualify other individuals for an IRC section 351 transfer. Regulations refer to "…property which is of relatively small value in comparison to the value of the stock…." Revenue Procedure 77-37 explains that the property transferred will not be considered of relatively small value "if the fair market value of the property transferred is equal to, or in excess of, 10% of the fair market value of the stock and securities already owned (or to be received for service) by such person."

Assumption of liabilities in an IRC section 351 exchange. In most areas of tax law, liability relief is treated the same as if cash had changed hands. However, in an IRC section 351 transfer, a corporation can assume liability without triggering gain if the liability is less than the contributor's adjusted basis. [IRC §357(a)]

The shareholder's basis in stock is reduced by the amount of liability transferred.

If the liability assumed by the corporation is more than the contributing shareholder's adjusted basis, the excess is treated as gain.

Exception: If the liability assumed is deductible when paid, such as a trade account payable or interest, no gain is recognized.

Example #1: Alan transferred property to a corporation in an exchange that qualified under IRC section 351. The property's FMV was $20,000, and Alan's adjusted basis in the property was $8,000. The property was subject to a liability of $6,000, which was transferred to the corporation. Alan's basis in the stock received is $2,000 ($8,000 adjusted basis of property contributed minus $6,000 liability transferred).

Example #2: Assume the same facts as Example #1, except the property was subject to a liability of $10,000. Because Alan's adjusted basis in the property was $8,000, he would report a gain of $2,000 on the transaction. Alan's basis in the stock received would be $0.

Relief of liability not required to trigger gain. Assumption of liability by the corporation does not necessarily mean the shareholder must be relieved of liability.

Court Case: The corporation assumed liabilities associated with contributed assets. However, the taxpayers remained personally liable for the debts as secondarily liable guarantors. The liability was greater than the basis of property contributed. Therefore, even though the taxpayers were not relieved of liability, the amount was subtracted from basis and gain was recognized. (*Seggerman Farms Inc.*, 7th Cir., October 24, 2002)

Basis—IRC §351 Transfer

Shareholder's Basis in Stock	*Corporation's Basis in Property*
Adjusted basis of property + Gain recognized + Cash paid – Cash received – FMV of property received – Liabilities transferred	Adjusted basis of property in hands of the shareholder + Gain recognized by the shareholder on the transfer

Election to reduce basis. In an IRC section 351 transaction, if the adjusted basis of the property transferred exceeds the property's fair market value, the transferor and transferee may make an irrevocable election to treat the basis of the stock received by the transferor as having a basis equal to the fair market value of the property transferred. The transferor and transferee make this election by attaching a statement to their tax returns filed by the due date (including extensions) for the tax year in which the transaction occurred. (Notice 2005-70)

Holding period. The holding period for stock received in an IRC section 351 transfer includes the time the shareholder held the property before the exchange. The corporation's holding period for the contributed property includes the time the property was held by the shareholder.

Reporting an IRC Section 351 Transfer

Both the corporation and every significant transferor involved in an IRC section 351 transfer must attach a statement to their income tax returns. See *Significant transferor,* below.

Shareholder. Every significant transferor must attach a statement entitled, "Statement pursuant to §1.351-3(a) by [insert name and taxpayer identification number of taxpayer], a significant transferor," to his or her tax return for the taxable year of the exchange. The statement must include the following information.

- The name and employer identification number of the transferee corporation,
- The date of the transfer of assets,
- The aggregate FMV and basis, determined immediately before the exchange, of the transferred assets, and
- The date and control number of any private letter ruling issued by the IRS in connection with the exchange.

Significant transferor. A significant transferor is a person that transferred property to a corporation in an IRC section 351 exchange if, immediately after the exchange, such person:

- Owned at least 5% (by vote or by value) of the total outstanding stock of a publicly traded corporation, or
- Owned at least 1% (by vote or by value) of the total outstanding stock of a privately held corporation.

Transferee corporation. Every transferee corporation must attach a statement entitled, "Statement pursuant to §1.351-3(b) by [insert name and employer identification number of taxpayer], a transferee corporation," to its tax return for the taxable year of the exchange. The statement must include the following information.

- The name and taxpayer identification number of every significant transferor,
- The date of the transfer of assets,
- The aggregate FMV and basis, determined immediately before the exchange, of all the property received in the exchange, and
- The date and control number of any private letter ruling issued by the IRS in connection with the exchange.

Substantiation. In connection with an IRC section 351 transfer, taxpayers should retain in their permanent records information regarding the amount, basis, and fair market value of all transferred property, and relevant facts regarding any liabilities assumed or extinguished as part of such exchange.

Use Caution When Transferring Personal Assets

Transferring real estate or low-basis assets to a corporation in an IRC section 351 exchange can cause negative tax consequences. Corporations do not receive the same favorable tax rates on capital gains as individuals. If assets are transferred into a corporation, the assets will produce taxable income if sold, or if transferred back out of the corporation to the shareholder, to the extent that FMV exceeds basis. This can convert what would have been capital

gains at favorable rates into regular corporation income, or trigger double taxation on the asset.

Example: Joan owned a nonresidential building with FMV of $200,000 and basis of $120,000. In 2022, Joan created Cactus Corporation and contributed the building in an IRC section 351 transfer in exchange for 100% of the corporation's stock. After the transfer, Joan's basis in stock was $120,000, and the corporation's basis in the building was $120,000.

Cactus Corporation used the building for operations. In 2025, the corporation outgrew the building and moved to a new location.

The corporation transferred ownership of the property back to Joan. At the time of the transfer, the FMV of the property was $230,000.

The corporate tax rate is 21%. Assume a negative basis adjustment of $10,000 from depreciation claimed. In the process of Joan transferring ownership of the building to the corporation, and ownership of the building subsequently being transferred back to Joan, the following tax effects occurred.

Corporation

Transfer of building back to Joan at FMV	$230,000
Corporation's basis in building	(110,000)
Gain	$120,000
Corporate tax at 21%	$ 25,200

With Joan transferring the building to the corporation and back out again, tax on the building's appreciation is triggered, resulting in a tax liability of $25,200. The transactions also increase the corporation's earnings and profits by $94,800 ($120,000 gain less tax of $25,200). In addition, the transactions do not increase Joan's basis in corporate stock. See *Earnings and Profits (E&P),* page 18-17.

Alternative. If Joan had kept the building in her name and rented it to the corporation, the following tax benefits would have occurred.

- Rental payments made by the corporation would be deductible and reduce the corporation's earnings and profits. See *Rents and Royalty Payments,* page 18-8.
- Appreciation on the building would not have triggered current tax liability.
- A sale by Joan may have resulted in tax at favorable individual capital gain tax rates instead of corporation tax rates.

Example #1: Bill owns a building he uses in his sole proprietorship. The building's basis is $80,000, and FMV is $230,000. Bill is considering forming a C corporation. He runs projections to see if forming a C corporation will provide him with any tax benefit from ownership of the building. Fair rental value of the building is $24,000 per year. Bill's effective tax rate is 21%, and the corporation's tax rate is 21%. The projections compare the tax effects of $24,000 in profits received as earned income from a sole proprietorship compared to that received from rent.

Use in sole proprietorship. $24,000 in profits.

SE tax	$3,391
Income tax at 21%	5,040
Total	$8,431

Rent to C corporation. $24,000 deducted by C corporation, reported as rental income on Bill's Form 1040.

SE tax	$ 0
Income tax at 21%	5,040
Total	$5,040

Bill saves $3,391 in SE tax by forming a C corporation and renting the building to the corporation.

Example #2: Assume the same facts as Example #1, except Bill transferred the building to the corporation in exchange for stock. After one year, cash flow problems require Bill to go out of business and liquidate the corporation.

The corporation owned the building, therefore, there was no deduction for rent paid.

$24,000 profit × 21% corporate tax rate = $5,040 corporate tax.

Remaining $18,960 distributed × 15% dividend rate = $2,844.

In a liquidation, the corporation recognizes gain or loss on distributions of property as if the property had been sold at FMV.

FMV $230,000 less $80,000 basis = $150,000 gain × 21% corporate tax = $31,500.

By transferring the real estate into the corporation, Bill paid an extra $2,844 in income tax and had to pay $31,500 tax on the property's appreciation when he liquidated the corporation.

Stock

Cross References

- IRC §302, *Distributions in redemption of stock*
- IRC §307, *Basis of stock and stock rights acquired in distributions*

Related Topics

- Capital Gains and Losses (Schedule D), page 6-8
- Sale of a Business, page 28-2

Stock

Stock represents a shareholder's ownership interest in a corporation. A corporation does not recognize gain or loss when a shareholder contributes capital in exchange for stock.

For shareholder's and corporation's basis of stock and contributed property, see *Capital Contributions,* page 18-5.

The amount of paid-in capital is reflected on the equity section of the corporation's balance sheet. The amount will be listed as "capital stock" or similar designation, and will not change unless additional stock is issued or redeemed by the corporation.

A C corporation distributes profits by declaring a dividend. See *Dividends,* page 18-15.

Common stock. Common stock is a class of stock that gives the shareholder rights to dividends and voting power in proportion to the number of shares held. Certain states allow issuance of nonvoting common stock. Common stock is subordinate to preferred stock in areas such as preference for dividends and liquidation proceeds.

Preferred stock. Preferred stock is a class of stock that holds preference over common stock for dividend distributions and liquidation proceeds. Preferred stock generally carries no voting rights. Corporations will often issue preferred stock in order to attract investors without giving up operational control.

Outstanding stock. Outstanding stock is stock issued and held by shareholders. The capital contributed in exchange for stock is reflected in the balance sheet under "capital stock" or similar designation.

Authorized shares. Authorized shares are the total number of shares the corporation may issue to shareholders, determined at the time of incorporation. Authorized shares are not required to be issued and do not affect the corporation's balance sheet until the shares are issued. In most states, there is no limit on the number of shares authorized. Most corporations set the number of authorized shares well in excess of the number of shares expected to be issued to avoid the necessary board action and paperwork required to increase authorized shares at a later date.

Par value. Par value is an amount per share set by incorporators, the main purpose of which is to assign each share a dollar value so the shares can be entered on the books. Par value is usually set well below market value because most state laws prohibit selling stock below par value. For this reason, some corporations

set par value at 1¢ per share. The difference between par value and the actual amount paid to the corporation for the stock is often shown on the balance sheet as "additional paid-in capital" or similar designation.

Stated value. Stated value is an amount assigned to shares of stock for accounting purposes when no par value has been assigned.

Market value. Market value is the fair market value (FMV) of shares. Market value is usually higher than par value or stated value.

Treasury stock. Treasury stock is stock originally issued to shareholders that has been reacquired and is held by the corporation.

C Corporation Advantages

Cross References

- IRS Pub. 15-B, *Employer's Tax Guide to Fringe Benefits*
- IRC §1045, *Rollover of gain from qualified small business stock to another qualified small business stock*
- IRC §1202, *Partial exclusion for gain from certain small business stock*
- IRC §1244, *Losses on small business stock*

Related Topics

- Sole Proprietorships, Tab 5
- Retirement, Social Security, and Medicare, Tab 13
- S Corporations, Tab 19
- Partnerships and LLCs, Tab 20

Fringe Benefits

Nontaxable fringe benefits are allowed to C corporation shareholders who perform services for the corporation. Fringe benefits can include health insurance and reimbursement, educational assistance, life insurance, etc. This is in contrast to a partner or more than 2% S corporation shareholder who must include the value of fringe benefits in taxable income. For more information about fringe benefits for C corporation shareholders, see *Employee Benefits,* Tab 22.

Rents and Royalty Payments

Rents. If a taxpayer owns property that can be used by the corporation, the taxpayer can charge the corporation rent for use of the property. This type of rental arrangement can shield income from payroll tax and double taxation in a C corporation.

Personal property. Renting personal property, such as equipment or vehicles, may be considered a trade or business subject to self-employment tax. See *Rental of personal property,* page 7-2.

IRS challenges. The following situations represent some areas where the IRS may challenge rental arrangements between a shareholder and a corporation.

- If the rent has the character of a distribution of profits from the corporation, the IRS may attempt to recharacterize the payments as taxable dividends. See *Constructive Dividends (Taxable Distributions),* page 18-16.
- If the rent is paid to an employee, the IRS may attempt to recharacterize the payments as wages for services rendered and assess employment tax.
- A self-rental rule blocks the taxpayer from offsetting passive losses with income from rental property. See *Self-Rental Rule,* page 7-8.
- Payments made to employees for equipment that is required as a condition of employment are taxable wages, unless the amount is paid under an accountable plan. (Rev. Rul. 2002-35)
- Rental of personal property, such as tools and equipment, to employers must be part of an activity clearly separate from the employment relationship.

Court Case: A construction contractor in a highly competitive and specialized market entered into equipment rental arrangements with its controlling shareholders who were not employees. The rental rates were at or below market rates. The court found the taxpayer had valid business reasons for the arrangements and allowed a full rental expense deduction. (*Yearout Mechanical & Engineering, Inc.,* T.C. Memo. 2008-217)

Royalties. A corporation can pay royalties to a shareholder for the use of intangible property such as copyrights and patents. However, the royalties must be paid for use of the property. If services are provided in association with use of the property, the IRS is likely to reclassify the royalty payments as wages.

Employer-Provided Living Expenses (IRC §119)

Meals and lodging provided to an employee are excluded from income if the items are (1) provided on the business premises of the employer, and (2) furnished for the convenience of the employer. For lodging, an additional requirement is that the employee is required to accept such lodging as a condition of employment. See *Meals and Lodging (IRC §119),* page 22-7.

In lieu of compensation. If the employee has an option to receive additional compensation in lieu of meals or lodging, the value is not excludable from income. [Reg. §1.119-1(e)]

Shareholder accommodations. The issue of meals and lodging provided tax free to corporate employee-shareholders has generated much litigation, especially in the area of farming. The main issue in these cases is whether the meals and lodging are required as a condition of employment or if the benefits represent disguised shareholder compensation. There have been mixed results, but several decisions have found in favor of the taxpayer. In one case, the court noted that the corporation needed someone on the premises at all times to provide security and supervision of after-hours activities. The tasks had been previously performed by a foreman. Tax-free status for the meals and lodging was allowed. (*Maschmeyer's Nursery, Inc.,* T.C. Memo. 1996-78)

Shareholder Loans

A shareholder can receive a loan from a corporation. However, the loan must be bona fide. The IRS can reclassify a loan as a taxable dividend if it determines that the loan is actually a distribution of profits or does not have the characteristics of an arms-length transaction.

A shareholder can also loan money to a corporation and receive interest payments. However, if the loan is not properly structured, the interest payments by the corporation can be recharacterized by the IRS as return of capital, which eliminates the corporation's deduction for interest.

Court Case: Since the 1970's, shareholders of a family-owned corporation had advanced funds to the corporation at a 10% interest rate. The corporation deducted the interest payments, and the shareholders reported taxable interest on their individual returns. The Tax Court determined that the advanced funds were capital contributions, not loans. Therefore, the corporation's interest deductions were not allowed.

The Sixth Circuit Court overturned the Tax Court. In an analysis of facts and circumstances, the Sixth Circuit Court determined that the loans had a fixed interest rate, written debt instruments were issued, and the transactions had other arms-length characteristics of bona fide loans. The payments in question were interest and were therefore deductible by the corporation. (*Indmar,* 6th Cir., April 14, 2006)

Factors considered by the IRS in determining whether a loan is bona fide include the following:

- To what extent does the shareholder control the corporation?
- Was security given?
- Is the shareholder in a position to repay the loan?
- Are there adequate earnings and profits (E&P)?
- Was a certificate of indebtedness given to the corporation?
- Is there a repayment schedule or an attempt to repay?
- Is there a set maturity date?
- Does the corporation charge interest?
- Has the corporation made systematic efforts to obtain repayment?
- What is the magnitude of the advances?
- Does a ceiling exist to limit how much the corporation can advance?
- What is the dividend history of the corporation?

Losses on Small Business Stock (IRC §1244)

Taxpayers who invest in section 1244 small business stock can deduct an ordinary loss on the sale, trade, or worthlessness of the stock. Losses from section 1244 stock are not subject to the $3,000 annual loss limitation for capital losses. The amount that can be deducted as an ordinary loss is limited to $50,000 ($100,000 MFJ) each year. Any loss that is above the ordinary loss limitation is treated as a capital loss. See *Losses on Small Business Stock (IRC §1244),* page 6-11.

Designation. The only mandatory requirements for section 1244 recordkeeping by the corporation are when such capitalization goes above $1 million. When capital goes above $1 million in the "transitional year," the corporation must designate which shares of stock are section 1244 stock [Reg. §1.1244(c)-2(b)(2)]. However, the regulations do require that the taxpayer have records sufficient to establish that the stock qualifies for section 1244 treatment.

Gain Exclusion on Small Business Stock (IRC §1202)

IRC section 1202 allows a taxpayer other than a corporation an exclusion of up to 100% of the gain on the sale or exchange of qualified small business stock held more than five years. The exclusion is up to 50% for stock acquired after August 10, 1993, up to 75% for stock acquired after February 17, 2009, and up to 100% for stock acquired after September 27, 2010. See *Gains on Small Business Stock,* page 6-11.

C vs. S Corporation Comparison

Cross References

- IRC §301 – 385, Corporate distributions and adjustments
- IRC §1361 – 1379, Tax treatment of S corporations and their shareholders

Related Topics

- Interest and Dividends (Schedule B), page 6-5
- S Corporations, Tab 19
- Business Entity Comparison Chart, page 27-3

A C corporation is a separate taxpaying entity. Taxable income of a C corporation is taxed first at the corporate level. Distributions of remaining profits of a C corporation are then taxed again at the shareholder level when distributed as dividends.

In contrast, an S corporation is a flow-through entity. Taxable income of an S corporation flows through directly to shareholders, along with other separately stated items on Schedule K-1 (Form 1120-S).

Taxation Summary – C vs. S Corporations

	C Corporation	*S Corporation*
Taxation	Income is taxed at the corporate level. Profits are distributed to shareholders as taxable dividends, creating "double tax."	Income and deductions are passed through to shareholders, avoiding corporate-level tax. An S corporation generally does not pay income tax at the entity level.
Income	After-tax profits of a C corporation are distributed to shareholders as dividends. Qualified dividends are generally taxed to the individual shareholder at long-term capital gain rates (0%, 15%, or 20%).	Business income from an S corporation is passed through to shareholders and taxed as ordinary income.
Losses	A C corporation does not pass losses through to shareholders.	Business losses passing through to an S corporation shareholder are treated as ordinary losses.
Capital Gains and Losses	Capital gains earned by a C corporation are taxable to the corporation at the same rate as ordinary income. Losses are not passed through to shareholders.	Capital gains and losses pass through to shareholders as separately stated items on Schedule K-1 (Form 1120-S).
Fringe Benefits	Shareholder/employees are eligible for excludable fringe benefits, generally to the same extent as any other employee, with exceptions under the non-discrimination rules. Benefits can include health insurance and reimbursement, educational assistance, life insurance, etc.	Shareholder/employees are eligible for some excludable fringe benefits. Benefits added to taxable wages on Form W-2 of more than 2% shareholders include accident and health plans, up to $50,000 of group health insurance, and meals and lodging furnished for the employer's convenience.
Personal Holding Company Tax	A higher tax rate applies if at least 60% of the company's income is personal holding income. See *Personal Holding Company (PHC),* page 18-19.	Not applicable.

For more comparisons between tax reporting for C and S corporations, see the *C Corporation Example,* page 18-23, and the *S Corporation Example,* page 19-17.

Planning Tip: C corporations are subject to a flat 21% tax rate. S corporation shareholders may be eligible to take a 20% qualified business income (QBI) deduction on their distributive share of profits that are not wage equivalents for services rendered. A taxpayer in the 37% individual tax bracket would effectively pay a tax rate of 29.6% on S corporation profits. If the corporation is trying to retain profits for future use (and not pay dividends or distributions to shareholders), there may be incentive for the S corporation to elect to convert to a C corporation.

Income and Expenses of a Corporation

Cross References

- Form 1120, *U.S. Corporation Income Tax Return*
- IRS Pub. 542, *Corporations*
- IRC §61, *Gross income defined*

Related Topics

- Business Deductions, Tab 8
- Depreciation, Tab 9
- Employee Fringe Benefits, page 22-2
- Business Entity Comparison Chart, page 27-3

Meals and Entertainment Expense

Meals expense. Business meals are subject to a 50% limitation. See *Meals,* page 8-9.

Entertainment expense. No deduction for entertainment expense is allowed with respect to:

- An activity generally considered to be entertainment, amusement, or recreation,
- Membership dues with respect to any club organized for business, pleasure, recreation, or other social purposes, or
- A facility or portion thereof used in connection with any of the above items.

See *Entertainment,* page 8-9.

Business Interest Expense

The deduction for interest expense on business debt for taxpayers with average annual gross receipts in excess of $31 million (2025) is limited to the sum of:

- Business interest income for the year,
- 30% of the adjusted taxable income of the taxpayer for the tax year (but not below zero), and
- The floor plan financing interest (interest paid on debt used to finance the acquisition of certain motor vehicles) of the taxpayer for the year.

Generally, a taxpayer must file Form 8990, *Limitation on Business Interest Expense Under Section 163(j),* to claim a deduction for business interest. For more information, see *Business Interest Expense Limitation,* Tab 20.

Tax Rules for Corporations

Unless otherwise stated in the tax code, rules on income and deductions for corporations are the same as for individuals. This section identifies differences between taxation of individuals and corporations.

Capital Losses

A C corporation can deduct capital losses only up to the amount of its capital gains for the tax year. A net capital loss is carried back three years and forward up to five years as a short-term capital loss. Carry back a capital loss to the extent it does not increase or produce a net operating loss in the tax year to which it is carried.

Short-term losses. When a corporation's capital loss is carried to another tax year, it is treated as a short-term loss. It does not retain its identity as a long-term or short-term loss.

Example: In 2025, Butter Corporation had a net short-term capital gain of $3,000 and a net long-term capital loss of $9,000. The short-term gain offsets some of the long-term loss, leaving a net capital loss of $6,000. The corporation cannot deduct the net capital loss of $6,000 in 2025.

In 2022, Butter Corporation had a net short-term capital gain of $8,000 and a net long-term capital gain of $5,000. The corporation carries the $6,000 net capital loss from 2025 back three years to 2022 and applies it to the $8,000 net short-term capital gain. This results in a net capital gain for 2022 of $7,000 ($8,000 – $6,000 short-term + $5,000 long-term).

S corporations. Capital gains and losses from an S corporation are passed through to shareholders. See *Separately Stated S Corporation Items,* Tab 19.

A C corporation cannot carry a capital loss from, or to, any year that it was an S corporation.

Refunds. When carrying back a capital loss to an earlier year, use either Form 1139, *Corporation Application for Tentative Refund,* or Form 1120-X, *Amended U.S. Corporation Income Tax Return,* to apply for a refund. Form 1139 will allow the corporation to receive a faster refund, but it can be filed no later than one year after the year the corporation sustains the loss. Form 1120-X must be filed within three years of the due date, including extensions, for filing the loss year return.

Capital Gains

C corporations pay tax on net capital gain at the same rate as other corporation income. The favorable capital gains tax rates for individuals do not apply to C corporations.

Capital assets. Capital assets do not include patents, inventions, models or designs, secret formulas or processes, or similar property held by the following.

1) A taxpayer whose personal efforts created such property,
2) In the case of a letter, memorandum, or similar property, a taxpayer for whom such property was prepared or produced, or
3) A taxpayer whose basis for determining gain from sale or exchange of such asset is determined by reference to the basis of the taxpayer described in items (1) or (2), above.

Charitable Contributions

A C corporation can deduct charitable contributions up to 10% of taxable income. For this purpose, taxable income is computed without taking into consideration the following.

- The deduction for charitable contributions.
- The dividends-received deduction.
- The deduction of bond premium under IRC section 249.
- Any net operating loss carryback to the tax year.
- Any capital loss carryback to the tax year.

Carryover. Charitable contributions unused because of the income limit can be carried forward for a maximum of five years. Contributions made in the carryover years are deducted before the carryover for purposes of the income limit. The corporation cannot carry over excess contributions to the extent they increase a net operating loss (NOL) carryover.

Substantiation. Corporations have the same substantiation requirements as individuals. See *Substantiation Requirements for Charitable Contributions,* page 4-20.

Form 8283. Closely held or personal service corporations must complete and attach Form 8283, *Noncash Charitable Contributions,* to their returns if they claim a deduction of more than $500 for noncash contributions. All other corporations must complete and attach Form 8283 if the claimed deduction exceeds $5,000. For more information, see *Contributions of Property,* page 4-17.

Appraisals. All C corporations must obtain a qualified appraisal for donations of property other than cash, certain vehicles, inventory, or publicly traded securities, if the value exceeds $5,000. The donor must attach the appraisal to the tax return when the charitable deduction exceeds $500,000 ($20,000 for donated art work).

Accrual method corporations. An accrual method corporation can choose to deduct unpaid charitable contributions for the tax year if the board of directors authorizes the contributions, and the contributions are made by the due date of the tax returns, not including extensions. A declaration stating that the board of directors adopted the resolution during the tax year, including the date the resolution was adopted, must accompany the return.

Deductible amount. The amount deductible for contributions of property is defined as fair market value (FMV) of the property

reduced by the amount that would not be long-term capital gain (including ordinary income) if the property were sold at FMV. Under this rule, the deductible amount is generally the corporation's adjusted basis in the property. For more information, see *Reductions to Fair Market Value,* page 4-17.

Exception for contributions of inventory to certain organizations. The amount deductible by a C corporation for a contribution of inventory to certain organizations is reduced by only 50% of the amount that would have been ordinary income if sold at FMV. This deduction is limited to twice the corporation's basis. It is allowed for certain contributions of:

- Certain inventory and other property made to a donee organization and used solely for the care of the ill, the needy, and infants. Special rules apply to qualified contributions of food inventory. See *Food inventory,* below.
- Scientific property constructed by the corporation and donated no later than two years after substantial completion of the construction. The property must be donated to a qualified organization and its original use must be by the donee for research, experimentation, or research training within the United States in the area of physical or biological science.

The contribution must be to a 501(c)(3) organization, the property must be used by the organization solely for the care of the ill, the needy, or infants, the donee organization cannot transfer the property in exchange for money, other property, or services, and the donee organization must provide the corporation with a statement to that effect. [IRC §170(e)(3)]

Example: Blanket Corporation donates inventory to a homeless shelter, a 501(c)(3) organization. Blanket's basis in the inventory is $450, and FMV is $1,600. If sold at FMV, the amount that would have been ordinary income is $1,150 ($1,600 – $450). Reducing the FMV by 50% of the amount that would be ordinary income brings the amount to $1,025. Since the deduction is limited to twice the corporation's cost in the property, the deductible amount is $900 ($450 × 2).

Food inventory. The aggregate amount of contributions of food inventory may not exceed 15% of a C corporation's taxable income determined without regard to deductions for charitable contributions or capital loss carrybacks.

- The general income contribution limitation for a C corporation does not apply to these contributions, but is reduced by the amount of these contributions.
- Qualifying food inventory contributions in excess of the 15% limitation may be carried forward and treated as qualifying food inventory contributions in each of the five succeeding tax years.

To qualify, the food must meet the definition of "apparently wholesome food." [IRC §170(e)(3)(C)]

Charitable contribution for state tax credit safe harbor. A C corporation may make a charitable contribution to a state or local government, in exchange for a tax credit that reduces a state or local tax imposed on the corporation. The IRS created a safe harbor for C corporations regarding this issue to clarify the deductibility of such charitable payments. The safe harbor provisions state that a corporation may treat a contribution as an ordinary and necessary business expense under IRC section 162, to the extent of the tax credit received. (Rev. Proc. 2019-12)

Example #1: A C corporation engaged in a trade or business makes a charitable payment of $1,000 to a state or local government. In return for the payment, the C corporation receives a dollar-for-dollar state tax credit to be applied to its state corporate tax liability. Under the safe harbor provisions, the C corporation may treat the $1,000 payment as meeting the requirements of an ordinary and necessary business expense.

Example #2: A C corporation engaged in a trade or business makes a charitable payment of $1,000 to a state or local government. In return for the payment, the C corporation receives a tax credit equal to 80% of the payment ($800) to be applied against its state corporate tax liability. The $800 may be treated as meeting the requirements of an ordinary and necessary business expense. The treatment of the remaining $200 will depend upon the facts and circumstances, and is not affected by this revenue procedure.

Start-Up Costs and Organizational Costs

Elections. A taxpayer may elect to deduct up to $5,000 of start-up costs and $5,000 of organizational costs in the year the corporation begins business. The deduction is phased out dollar-for-dollar when start-up costs (or organizational costs) exceed $50,000. Remaining costs must be amortized over a 180-month period.

In lieu of the deduction, taxpayers may elect to capitalize and amortize all costs.

Capitalization. A taxpayer may choose to forgo the election to deduct the expenses or the election to amortize the expenses and instead, affirmatively elect to capitalize start-up or organizational costs. See *Making the Election,* page 8-22.

Author's Comment: A taxpayer filing a past-due return with start-up and/or organizational costs must capitalize the expenses and can recover them only upon the sale of the business.

Start-up costs. Start-up costs are amounts paid or incurred for creating or investigating the creation or purchase of an active trade or business. The costs are incurred before the active trade or business begins.

Organizational costs. The costs to organize a corporation are the direct costs of creating the corporation. A cost must meet the following tests.

- It is for the creation of the corporation.
- It is chargeable to a capital account.
- It could be amortized over the life of the corporation if the corporation had a fixed life.
- It is incurred before the end of the first tax year in which the corporation is in business.

Qualifying Costs	Nonqualifying Costs
• Temporary directors. • Organizational meetings. • State incorporation fees. • Accounting services for setting up the corporation. • Legal fees for drafting the charter, bylaws, terms of the original stock certificates, and minutes of organizational meetings.	• Issuing and selling stock or securities (commissions, professional fees, printing costs, etc.). • Transferring assets to the corporation.

Cash method corporation. A corporation using the cash method of accounting can amortize organizational costs incurred within the first tax year, even if it does not pay them in that year.

For more information, see *Start-Up/Organizational Costs,* page 8-22.

Dividends-Received Deduction

A C corporation can deduct a percentage of dividends received from other corporations during the tax year.

Dividends-Received Deduction—Domestic Corporations

Stock Ownership	*Dividends-Received Deduction*
20% or more.	65% dividends-received deduction.
Less than 20%.	50% dividends-received deduction.
• Small business investment company. • Corporate member of same affiliated group.	100% dividends-received deduction.

No deduction. A corporation cannot take a deduction for dividends received from the following entities.

- A real estate investment trust (REIT).
- A corporation exempt under IRC sections 501 or 521 for the tax year or the preceding tax year.
- A corporation whose stock was held less than 46 days during the 91-day period beginning 45 days before the stock became ex-dividend with respect to the dividend. Ex-dividend means the holder has no rights to the dividend.
- A corporation whose preferred stock was held less than 91 days during the 181-day period beginning 90 days before the stock became ex-dividend with respect to the dividend if the dividends received are for a period or periods totaling more than 366 days.
- Any corporation that is under an obligation (short sale or otherwise) to make related payments with respect to positions in substantially similar or related property.

Taxable income limit. The total dividends received deduction is limited to 50% or 65% of taxable income, as applicable. The taxable income limit does not apply if the recipient corporation has an NOL.

Computing the deduction. The deduction for dividends received is computed and reported on Form 1120 (Schedule C).

Extraordinary dividends. If a corporation receives an extraordinary dividend on stock held two years or less before the dividend announcement date, it generally must reduce its basis in the stock by the nontaxed part of the dividend (allowable dividends received deduction). An extraordinary dividend is any dividend that equals or exceeds the corporation's adjusted basis in the stock by 5% for stock preferred as to dividends, or 10% for other stock. (IRC §1059)

Dividends from foreign corporations. A domestic corporation may generally deduct 100% of the foreign-source portion of dividends received from a specified 10%-owned foreign corporation. The stock must meet a special 365-day holding period and does not include certain hybrid dividend payments. (IRC §245A)

Foreign-derived intangible income (FDII). FDII is income earned by domestic corporations from exporting products related to U.S. based intangible assets, such as copyrights, patents, and trademarks.

Global intangible low-taxed income (GILTI). A U.S. shareholder who directly or indirectly owns 10% or more of a controlled foreign corporation must include GILTI in gross income. GILTI is income from intangible assets, such as copyrights, patents, and trademarks, earned by foreign affiliates of U.S. companies. A taxpayer who owns an interest in a domestic pass-through entity that is a U.S. shareholder of a controlled foreign corporation may have a GILTI inclusion, even if the taxpayer is not a U.S. shareholder of the controlled foreign corporation (IRC §951A). For more information, see the instructions for Form 8992, *U.S. Shareholder Calculation of Global Intangible Low Taxed-Income (GILTI).*

Deduction for FDII and GILTI. For tax years 2018 through 2025, certain domestic corporations are allowed a deduction equal to 37.5% of FDII and 50% of GILTI (IRC §250). For more information, see the instructions for Form 8993, *Section 250 Deduction for Foreign-Derived Intangible Income (FDII) and Global Intangible Low-Taxed Income (GILTI).*

Deduction limitation. If the sum of FDII and GILTI exceeds taxable income, the deduction is limited to taxable income.

Corporate Net Operating Loss (NOL)

A corporation computes an NOL in the same way it computes taxable income. It starts with its gross income and subtracts its deductions. However, the following rules for computing the NOL apply.

- A corporation cannot increase its current-year NOL by carrybacks or carryovers from other years,
- A corporation can take the deduction for dividends received without regard for the taxable income limit (see *Dividends Received Deduction,* page 18-11),
- A corporation can compute the deduction for dividends paid on certain preferred stock of public utilities without regard for the taxable income limit, and
- The deduction for foreign-derived intangible income (FDII) under IRC section 250 is not allowed. See *Foreign-derived intangible income (FDII),* previous column.

NOL deduction, carryback, and carryforward. The NOL deduction, carryback, and carryforward rules depend on when a tax year begins.

Tax year beginning before 2018. An NOL from a tax year beginning before 2018 may offset 100% of taxable income.

NOL carryback. The NOL from a tax year beginning before 2018 must be carried back:

- Two years for a general NOL,
- Three years for eligible losses, including federal disasters for small businesses and farmers,
- Five years for farming losses, and
- 10 years for specified liability losses.

The entire NOL must be carried to the earliest possible year in which taxable income is generated.

NOL carryforward. Any remaining NOL from a tax year beginning before 2018 must be carried forward for 20 years.

Election to waive carryback. An irrevocable election may have been made to waive the carryback period.

Tax year beginning in 2018, 2019, or 2020. An NOL from a tax year beginning in 2018, 2019, or 2020 may offset 100% of taxable income for tax years beginning before 2021 but may only offset 80% of taxable income for tax years beginning after 2020. The entire NOL must be carried to the earliest possible year in which taxable income is generated.

NOL carryback. An NOL arising in a tax year beginning in 2018, 2019, or 2020 must be carried back five years.

NOL carryforward. Any remaining NOL from a tax year beginning in 2018, 2019, or 2020 has an unlimited carryforward period and is carried forward until used up.

Election to waive carryback. An irrevocable election may have been made to waive the carryback period.

Author's Comment: The 5-year carryback for 2018 and 2019 NOLs was a retroactive mandatory tax law change, unless the taxpayer elected not to carry back the NOL. A taxpayer with an NOL occurring in 2018 or 2019 was required to either carry back the NOL, or attach a statement to the 2020 tax return electing to not carry back the NOL. If a taxpayer ignored these rules and continues to carry a 2018 or 2019 NOL forward without making the election, the NOL carryover will be reduced by any amounts that could have been used to offset income during the 5-year carry back period.

Tax year beginning after 2020. The following rules apply to any NOL deduction for a tax year beginning after 2020.

- An NOL from a tax year beginning after 2017 may offset up to 80% of taxable income.
- The NOL deduction must be reduced by any:
  - IRC section 250 FDII deduction, and
  - NOLs from tax years beginning before 2018. An NOL arising prior to 2018 is carried forward only 20 years, and must be tracked separately from NOLs arising in later tax years.

NOL carryback. For losses that occur in tax years beginning after 2020, the 2-year NOL carryback applies only to farming losses and losses from insurance companies, other than life insurance companies. The entire NOL must be carried to the earliest possible year in which taxable income is generated. The NOL carryback period for all other corporations is eliminated after 2020.

NOL carryforward. Generally, NOLs must be carried forward to future years. The corporation may carry the losses forward indefinitely. Special rules apply to certain farming losses and NOLs of insurance companies other than life insurance companies. See *NOL carryback,* page 18-12.

Election to waive carryback. A corporation with farming losses or insurance company, other than life insurance companies, may make an irrevocable election to waive the carryback period by attaching a statement to its tax return.

Short tax year. A short tax year is treated as a full year for determining NOL carryover periods.

Claiming an NOL carryback. Qualifying corporations can file for a refund using Form 1139, *Corporation Application for Tentative Refund,* or Form 1120-X, *Amended U.S. Corporation Income Tax Return.* A corporation can get a refund faster by using Form 1139, but it cannot file the form before filing the return for the corporation's NOL year. The corporation must file Form 1139 no later than one year after the year it sustains the NOL.

Form 1138, *Extension of Time for Payment of Taxes by a Corporation Expecting a Net Operating Loss Carryback.* If a corporation expects to have an NOL in its current year, it can automatically extend the time for paying all or part of its income tax for the immediately preceding year by filing Form 1138. The extension is in effect until the end of the month in which the return for the NOL year is due (including extensions).

Ownership change can limit NOL. If a corporation with cumulative losses undergoes a significant ownership shift, the amount of NOL carryforward yearly deduction is limited to the value of the old corporation times the long-term tax-exempt rate. A significant ownership shift occurs when there is more than a 50 percentage point change in ownership by one or more 5% owners. The purpose of the limitation is to discourage purchase of a corporation for purposes of deducting a tax loss. (IRC §382)

Miscellaneous Corporate Topics

Cross References

- Form 4626, *Alternative Minimum Tax—Corporations*
- Form 8827, *Credit for Prior Year Minimum Tax—Corporations*
- Form 8996, *Qualified Opportunity Fund*
- IRS Pub. 542, *Corporations*
- IRC§1400Z-2, *Special rules for capital gains invested in opportunity zones*

Related Topics

- Qualified Opportunity Fund Deferral Election, page 6-14
- Accounting Periods and Methods, page 8-23
- Business Credits, Tab 31

Corporate Alternative Minimum Tax (CAMT)

The tentative minimum tax for applicable corporations is renewed at a rate of 15% of the adjusted financial statement income (AFSI) over the corporate AMT foreign tax credit for the year.

Applicable corporation. An applicable corporation is any corporation other than an S corporation, regulated investment company, or real estate investment trust with average annual AFSI that exceeds $800 million in 2025, averaged over three consecutive years. For U.S. corporations that have foreign parents, the CAMT would only apply to income earned in the U.S. of $80 million or more in 2025.

The IRS has waived the underpayment of estimated tax penalty for CAMT liabilities for tax years beginning after December 31, 2024 and before January 1, 2026.

Form 4626. For more information about the corporate minimum tax, see Form 4626, *Alternative Minimum Tax—Corporations* and its instructions.

Form 3800. Form 3800, *General Business Credit,* contains checkbox "A" to be answered yes if the taxpayer is both an applicable corporation for the CAMT and the base erosion anti-abuse tax (BEAT).

Foreign Asset Reporting (Form 8938)

A domestic corporation, partnership, or trust must file Form 8938, *Statement of Specified Foreign Assets,* with its tax return if the total value of foreign financial assets was more than $50,000 on the last day of the tax year or more than $75,000 at any time during the year. See *Foreign Accounts and Trusts,* page 6-4.

Base Erosion Minimum Tax

A base erosion and anti-abuse tax (BEAT) applies to multinational corporations with gross receipts of $500 million or more that make payments of more than 3% (2% for certain financial firms) of total deductions to related foreign corporations. The tax operates as a minimum tax of 10% of modified taxable income. See Form 8991, *Tax on Base Erosion Payments of Taxpayers With Substantial Gross Receipts* and instructions.

Research and Experimental Expenditures

New for 2025 A deduction is allowed for any domestic research or experimental expenditures paid or incurred during the tax year. The deduction is taken in full without the need to amortize the expenses over a number of years. A taxpayer may elect to charge research or experimental expenditures to a capital account and amortize the deduction ratably over a period of not less than 60 months. Research conducted outside the U.S. requires 15-year amortization. See *Research and Experimental Costs,* page 8-8.

Qualified Opportunity Zone (QOZ)

Corporations and partnerships use Form 8996, *Qualified Opportunity Fund,* to certify that they are organized to invest in QOZ property. In addition, corporations and partnerships file Form 8996 annually with their tax returns to report that the QOZ property meets the 90% investment standard of IRC section 1400Z-2 or to calculate the penalty if it fails to meet the investment standard.

QOZs. For a complete list of QOZs, see Notice 2025-50.

Qualified opportunity fund (QOF). A QOF is an investment vehicle organized as a corporation or a partnership for the purpose of investing in QOZ property (other than another QOF). To be eligible to be a QOF, such an investment vehicle must be organized under the laws of one of the 50 states, a federally recognized Indian tribe, the District of Columbia, or a U.S. possession.

90% investment standard. The 90% investment standard for a QOF is determined by the average percentage of QOZ property held in the QOF.

Self-certification. When Form 8996 is filed the corporation or partnership is self-certifying that it is a QOF. If the entity does not satisfy IRC section 1400Z-2(d)(3), the QOF may be subject to penalties.

Accounting Methods

Accrual method required. Generally, a corporation, other than a qualified personal service corporation, must use an accrual method of accounting if it is not a small business taxpayer.

Small business taxpayer. A small business taxpayer is a taxpayer that:
- Meets the gross receipts test, below, and
- Is not a tax shelter.

Gross receipts test. The gross receipts test allows taxpayers with average annual gross receipts that do not exceed $31 million (2025) for the three prior tax-year period to use the cash method. Average annual gross receipts are calculated by taking the prior year gross receipts plus the gross receipts from the two preceding tax years and dividing the total by three. If an entity was not in existence for the entire 3-year period, the gross receipts test is applied on the basis of the period during which such entity (or trade or business) was in existence.

Cash method allowed. Any farming C corporation (or farming partnership with a C corporation partner) that meets the gross receipts test may use the cash method of accounting.

Qualified personal service corporations, partnerships without C corporation partners, S corporations, and other pass-through entities are allowed to use the cash method without regard to whether they meet the gross receipts test, as long as the use of such method clearly reflects income.

Taxpayers that meet the gross receipts test are not required to account for inventories, but rather may use a method of accounting for inventories that either:
- Treats inventories as non-incidental materials and supplies, or
- Conforms to the taxpayer's financial accounting treatment of inventories.

Any producer or reseller that meets the gross receipts test is exempted from the application of the uniform capitalization rules of IRC section 263A. The provision retains the exemptions from the uniform capitalization rules that are not based on a taxpayer's gross receipts. [IRC §263A(i)]

A taxpayer that fails the gross receipts test is not eligible for any of these exceptions for such tax year.

Change in accounting method. Application of the provisions to expand taxpayers eligible to use the cash method, exempt certain taxpayers from the requirement to keep inventories, and expand the exception from the uniform capitalization rules is a change in the taxpayer's method of accounting for purposes of IRC section 481.

Automatic consent. If a taxpayer changes its accounting method due to the small business taxpayer provisions, the taxpayer can receive automatic consent from the IRS by following the procedures outlined in Revenue Procedure 2025-23, Section 15.17, and using that information to file Form 3115, *Application for Change in Accounting Method.*

For more information, see *Change in Accounting Method,* page 8-25.

Tax Credits

For a discussion of tax credits available to businesses, see *Business Credits,* Tab 31.

Shareholder Wages

Cross References

- IRS Pub. 525, *Taxable and Nontaxable Income*
- IRS Pub. 542, *Corporations*
- IRC §162(a)(1), *Trade or business expenses*

Related Topics

- Family Businesses—Employing Family Members, Tab 5
- Employee Benefits, Tab 22
- Payroll and Labor Laws, Tab 23

Employee/Shareholder

A corporation is a legal entity separate from its owners. Shareholders who perform services for a corporation are paid wages and issued Forms W-2 in the same manner as any other employee. For purposes of wages and withholding, the term employee also includes an officer of a corporation. [IRC §3401(c)]

Reasonable Compensation

Wages are deductible by a corporation in computing taxable income, but dividends are not. In a closely held corporation, the owners might decide to take dividends in the form of salary in order to avoid the corporate income tax.

The Internal Revenue Code allows a business to deduct from its taxable income a reasonable allowance for salaries or other compensation for personal services actually rendered. If a corporation pays an employee who is also a shareholder a salary that is unreasonably high considering the services actually performed, the IRS may deem the excessive part of the salary to be a constructive distribution to the shareholder-employee. See *Constructive Dividends (Taxable Distributions),* page 18-16.

Reasonableness is determined based on the facts and circumstances that exist when the services are contracted. In determining reasonable compensation, courts rely heavily on the amount that an unrelated party would be paid for similar work at a similar company. Factors considered are:
- Duties performed by the employee.
- The volume of business handled.
- The character and amount of responsibility.
- The complexities of the business.
- The amount of time required.
- The cost of living in the locality.
- The ability and achievements of the employee performing the service.
- The pay compared to the gross and net income of the business and distributions to shareholders.
- The policy regarding pay for all employees.
- The history of pay for each employee.

A common scenario for the reclassification of salary as dividends is of a closely held corporation with shareholders who all draw salary but do not all perform services for the company.

The form or method of computing the pay does not affect its deductibility. Bonuses and commissions based on sales or earnings, and paid under an agreement made before the services were performed, are both deductible.

Court Case: The taxpayer was a C corporation owned solely by Mr. Hood and his wife with ultimate decision-making control over the taxpayer as members of its board of directors. During 2009 through 2011, the taxpayer sustained losses but was kept operational by the actions of Mr. Hood. Starting in 2011, the taxpayer's revenue growth and financial performance greatly improved due to Mr. Hoods decisions.

In 2014, using an outside CPA firm, the taxpayer determined it had undercompensated Mr. Hood. As a result, Mr. Hood was awarded bonuses of $5 million in addition to his base salary for 2015 and 2016. Under audit, the IRS allowed $517,964 as reasonable compensation for 2015 and $700,792 for 2016.

The court used a multiple factor approach to determine reasonable compensation. The taxpayer argued that the court should follow the independent investor test in determining whether the compensation was reasonable.

The court considered the totality of the factors and determined that reasonable compensation was $3,681,269 for 2015 and $1,362,831 for 2016. The court found that the corporation's distribution history and Mr. Hood's business involvement were some of the most relevant factors. (*Clary Hood, Inc.,* T.C. Memo. 2022-15)

Court Case: For 1998, Menard, Inc., paid its president/CEO a base salary of $157,500, a bonus (5% of net earnings before taxes) of over $17 million, and over $3 million in instant profit sharing. Of the $20.6 million total compensation, the Tax Court ruled that only $7.1 million was reasonable compensation and the remainder was a disguised dividend. The main focus of the Tax Court's decision was whether Menard's compensation exceeded that of comparable CEOs.

The Seventh Circuit U.S. Court of Appeals reversed the Tax Court decision because it disregarded differences in the full compensation packages, including risk, for executives in comparable companies. The Seventh Circuit Court stated that risk was of particular importance in this case. If the corporation had lost money in 1998, Mr. Menard's income would have only been $157,500. (*Menard, Inc.,* 7th Cir., March 10, 2009)

Assignment of Income

Income received by an agent. Income received by an agent on behalf of a taxpayer is constructively received in the year the agent received it. If a taxpayer agrees by contract that a third party is to receive income for them, the taxpayer must include the amount as income when the third party receives it.

Example: Maureen arranges with her employer that part of her salary will be paid directly to her former spouse. She must include that amount in income when her former spouse receives it.

Shareholder/corporation. Under the anticipatory assignment of income doctrine, a taxpayer cannot exclude an economic gain from gross income by assigning the gain in advance to another party. The doctrine is meant to prevent taxpayers from avoiding taxation through arrangements and contracts devised to prevent income from vesting in the one who earned it.

Substance over form. The courts have consistently ruled that the substance, rather than the form, of a transaction is controlling for tax purposes. The existence of a validly organized and operated corporation does not preclude taxation of income to the service provider instead of the corporation. Deciding whether the corporation or the service provider earned the income requires the determination of whether the corporation or its service-providing agent (shareholder) controls the earning of the income. A corporation earns the income if:

- The service provider is an employee of a corporation which has the right to direct or control that employee in some meaningful sense, and
- There exists a contract or similar arrangement between the corporation and the entity using the services which recognizes the corporation's right to direct or control the work of the service provider.

Alternatively, expenses validly incurred by a corporation cannot be taken by an individual.

Author's Comment: Sometimes, a shareholder will receive a 1099 form for income earned through their corporation and will report that income on Schedule C (Form 1040), with a corresponding deduction stating the income has been reported by the corporation (name and EIN). Clear evidence from the courts has shown that, unless the conditions, above, are met, this practice is not allowed.

Court Case: A taxpayer operated a tax preparation business as a sole proprietor. The taxpayer later incorporated but continued to have clients make checks out to him personally and to treat funds received from the business as his own. No evidence of any employment agreement existed between the taxpayer and his corporation. The court ruled that the taxpayer operated his business as a sole proprietor and the income earned should be treated as earned not by the corporation but by the individual and be subject to self-employment tax. (*Reginald Jarrett, et al,* T.C. Summary 2008-94)

Distributions to Shareholders

Cross References

- IRS Pub. 542, *Corporations*
- IRC §312, *Effect on earnings and profits*

Related Topics

- Investment Income, Tab 6
- Distributions, page 19-12

Dividends

Distributions of earnings and profits (E&P) of a corporation are taxable dividends. See *Earnings and Profits (E&P),* page 18-17.

Effect on E&P. A corporation's E&P is reduced by the amount of cash distributed, or in the case of property, the basis of property distributed.

Exception: Upon distribution of appreciated property, E&P is increased by the excess of fair market value (FMV) over the adjusted basis, then decreased by FMV. [IRC §312(b)]

	Taxable to Shareholder	*Deductible by Corporation*	*No Tax Effect*
Wages	X	X	
Dividends	X		
Fringe benefits		X	
Loan repayments:			
• Principal			X
• Interest	X	X	
Rent payments	X	X	
Return of capital:			
• Up to basis			X
• In excess of basis	X		

Cash distributions. The corporation does not recognize gain or loss upon distribution of cash to a shareholder. A dividend is taxable to the shareholder up to the E&P of the corporation. Distributions in excess of E&P are considered a return of capital and are not taxable up to the shareholder's basis in stock. Distributions in excess of stock basis are taxable as capital gains to the shareholder.

Property distributions. A corporation will recognize a gain on the distribution of property to a shareholder if the FMV of the property is more than its adjusted basis. The property is considered to have been sold at FMV to the shareholder. For this purpose, the FMV is the greater of:

- The actual FMV, or
- The amount of any liabilities the shareholder assumed in connection with the distribution of the property.

If the property was depreciable, the corporation may have to treat all or part of the gain as ordinary income from depreciation recapture.

A corporation will not recognize a loss on the distribution of property to a shareholder unless the distribution is in complete liquidation of the corporation. See *Corporate Liquidations,* page 18-22.

Distributions of stock or stock rights. Distributions by a corporation of its own stock are commonly known as stock dividends. Stock rights, also known as stock options, are distributions by a corporation of rights to acquire its stock. Distributions of stock dividends and stock rights are generally tax free to shareholders. However, if any of the following apply, stock and stock rights are treated as property. See *Property distributions,* page 18-15.

- Any shareholder has the choice to receive cash or other property instead of stock or stock rights.
- The distribution gives cash or other property to some shareholders and an increase in the percentage interest in the corporation's assets or earnings and profits (E&P) to other shareholders.
- The distribution is in convertible preferred stock and has the same result as the previous point.
- The distribution gives preferred stock to some common stock shareholders and gives common stock to other common stock shareholders.
- The distribution is on preferred stock.

Constructive Dividends (Taxable Distributions)

A common IRS adjustment for corporations with E&P is reclassifying distributions to shareholders as constructive dividends. Courts have consistently ruled that a constructive dividend is an economic benefit conferred upon a shareholder by a corporation without an expectation of repayment. Corporate payments to third parties may constitute constructive dividends if they are made on behalf of a shareholder for his economic benefit.

Corporate expenditures constitute constructive dividends only if:

- The expenditures do not give rise to a deduction on behalf of the corporation, and
- The expenditures create economic gain, benefit, or income to the owner-taxpayer.

Court Case: A corporation's expenditures, which were disallowed as deductions, included payments for repairs to the shareholders' personal residences, utilities, swimming pool maintenance, personal insurance policies, automobiles, telephones, health club dues, and restaurant meals. Additionally, the corporation's supposed marketing and promotional payments were for items purchased from stores where consumers commonly buy personal items.

The IRS determined the challenged expenditures were constructive dividends and Tax Court agreed, stating that none of the expenditures advanced the corporation's business purposes and the shareholders had not borne the burden of proving that any particular expenditure did not benefit them personally. (*Luczaj and Associates*, T.C. Memo. 2017-42)

The following items are examples of what may be treated as constructive dividends.

Below-market loans. If a corporation gives a shareholder a loan with interest below the applicable federal rate, the interest not charged may be treated as a constructive dividend taxable to the shareholder.

Cancellation of shareholder's debt. If a corporation cancels a shareholder's debt, the amount of debt cancelled is treated the same as a cash distribution to the shareholder.

Transfers of property to shareholders for less than FMV. If the FMV of property on the date of sale or exchange exceeds the price paid by the shareholder, the excess may be treated as a taxable distribution to the shareholder.

Unreasonable rents. If a corporation pays a shareholder higher rent than what the shareholder would charge an unrelated party, the excess rent can be reclassified as a constructive dividend.

Unreasonable compensation. If shareholder compensation is determined to be unreasonable, the excess amount is reclassified as a constructive dividend and is not deductible by the corporation. See *Reasonable Compensation,* page 18-14.

Hobby expenses. The hobby loss rules under IRC section 183(a) do not apply to C corporations. See *Hobby Loss Rules,* page 5-21. However, the principle behind the hobby loss rules can be applied to a C corporation in the form of reclassifying expenses as constructive dividends.

Court Case: The taxpayer was the sole owner and employee of a C corporation. The principal source of income for the corporation was information technology consulting. For the years in question, the corporation showed a profit. The shareholder also operated a cattery to breed, show, and sell pedigreed show kittens. Before the years in question, she did this as an informal unincorporated venture. During the years in question, she had her corporation reimburse her for $60,968, $66,734, and $68,329, respectively for out-of-pocket expenses associated with the cattery. The cattery produced no income in the first year, $250 in the second, and $1,525 in the third year.

The IRS audited the taxpayer and her corporation, and assessed additional taxes claiming the cattery expenses were not genuine trade or business expenses of the corporation. The court agreed, finding that the cattery expenses paid by the corporation were for no reason other than to finance the shareholder's personal hobby and were, therefore, correctly treated as constructive dividends, taxable to the shareholder and not deductible by the corporation. (*DKD Enterprises,* Inc. 8th Cir., July 17, 2012)

Form 1099-DIV

The corporation files Form 1099-DIV, *Dividends and Distributions,* for the following.

- Dividends, including capital gains dividends, and other distributions on stock of $10 or more.
- To report withholding of federal income tax or foreign tax.
- For payments of $600 or more as part of a corporate liquidation.

Qualified dividends. Qualified dividends are dividends paid during the tax year that meet shareholder holding period requirements from domestic corporations and qualified foreign corporations.

Qualified Dividends

Type of Dividend	*Qualified Dividend*
Capital gain distributions	No.
Constructive	Yes.
Farmer's cooperative dividends	No.
Liquidating	No. See *Corporate Liquidations,* page 18-22.
Ordinary	Yes.
Paid on deposits by credit unions and similar financial institutions	No.
Qualified foreign corporation	Yes.

For additional information and holding period requirements, see the Instructions for Form 1099-DIV, *Dividends and Distributions.* Also see *Qualified Dividends,* page 6-8.

Form 5452, *Corporate Report of Nondividend Distributions*

All C corporations must file Form 5452 when nondividend distributions are made to shareholders. The form reports the corporation's E&P and allocates distributions between taxable dividends and nontaxable distributions. For shareholder treatment of these distributions, see *Nondividend Distributions,* page 6-8.

Nondividend distributions do not include tax-free stock dividends or distributions exchanged for stock in liquidations or redemptions.

Earnings and Profits (E&P)

Cross References

- Form 5452, *Corporate Report of Nondividend Distributions*
- IRC §312, *Effect on earnings and profits*

Related Topics

- Accounting Periods and Methods, page 8-23
- S Corporations With No Earnings and Profits (E&P), page 19-12
- Earnings and profits (E&P), page 27-16

Earnings and Profits (E&P) Defined

For a C corporation, E&P determines the taxability of distributions. A distribution is a taxable dividend up to the amount of the corporation's E&P. Distributions in excess of E&P are nontaxable up to a shareholder's basis in stock. Distributions in excess of a shareholder's basis represent capital gain.

Exception: A liquidating distribution is not taxable as a dividend. See *Partial liquidation,* page 18-21.

Although IRC section 312 provides guidance on computing E&P for certain items, it does not provide comprehensive definitions. The general concept of E&P is to identify distributions that represent return on a shareholder's investment, while distributions in excess of E&P represent a return of capital. For example, if a corporation earns tax-exempt income, that amount increases E&P since it represents a shareholder's return on investment, even though the amount is not included in taxable income.

The computation of E&P represents an accounting method different than that used in computing taxable income or GAAP. A corporation can have negative E&P.

Computation of E&P. The starting point for computing current-year E&P is taxable income (or loss).

Negative Adjustments	Positive Adjustments
• Federal income taxes paid or accrued. • Expenses of producing tax-exempt income. • Nondeductible fines and penalties. • Political contributions and lobbying expenses. • Nondeductible life insurance premiums, including interest on debt. • Nondeductible current capital losses. • Nondeductible charitable contributions. • Nondeductible meal expenses.	• Refunds of federal income tax. • Tax-exempt income. • Net operating loss deductions. • Nontaxable life insurance proceeds. • Dividends received deductions used to compute taxable income. • Capital loss carryovers used to compute taxable income. • Charitable contribution carryovers used to compute taxable income. • Deferred gains on installment sales. • Cancellation of debt not reflected in taxable income.

Depreciation. For purposes of E&P, tangible assets are depreciated using the straight-line method over the asset's ADS recovery period. [IRC §312(k)(3)]

Section 179 expense. If the Section 179 expense was claimed in computing taxable income, for E&P purposes depreciation is computed straight line over fi ve years.

For more information about ADS recovery periods, see *Regular MACRS (GDS)/Alternative Depreciation System (ADS),* page 9-4.

For an example of the E&P adjustments for depreciable assets, see *C Corporation Example,* page 18-23.

Reporting and recordkeeping for earnings and profi ts. There is no place on Form 1120, *U.S. Corporation Income Tax Return,* to report E&P. However, the E&P balance is needed for the following.

- Determining taxable dividends.
- Determining taxable distributions if the C corporation elects to switch to an S corporation.
- Determining taxable liquidation proceeds.

Entity Classification Election

Cross References

- Form 8832, *Entity Classification Election*
- Reg. §301.7701-1, *Classification of organizations for federal tax purposes*
- Rev. Proc. 2009-41

Related Topics

- S Corporations, Tab 19
- Partnerships and LLCs, Tab 20
- Business Entity Comparison Chart, page 27-3

Entity Classification Rules

- A business entity that is classified as a corporation under state law cannot elect out of corporate tax treatment.
- A business entity that is not a corporation can make the election to be taxed as a corporation by filing Form 8832, *Entity Classification Election.* Once the election is made, the entity can be taxed as a C corporation, or it can elect to be taxed as an S corporation.

Did You Know? If an entity elects to be taxed as a corporation under the entity classification election, the entity is subject to corporate liquidation rules if it ever wants to unelect and go back to being treated as a partnership or sole proprietorship. See *Corporate Liquidations,* page 18-22.

Default classification. A business that is not a corporation under state law, or has not made an election to be taxed as a corporation, falls under default classification rules. [Reg. §301.7701-3(b)]

Single owner. The entity is considered one and the same with the owner and is referred to as a "disregarded entity." See *Disregarded entity,* below. For example, in the case of an individual, the disregarded entity would file as a Schedule C (Form 1040) sole proprietorship for a business, Schedule E (Form 1040) for real estate rental, or Schedule F (Form 1040) for farming.

More than one owner. The entity is classified as a partnership.

Disregarded entity. A disregarded entity is an eligible entity that is treated as an entity not separate from its single owner for income tax purposes. A disregarded entity is treated as separate from its owner for:

- Employment tax purposes, and
- Excise taxes.

A disregarded entity must obtain an EIN to file and pay these taxes. See *Employer Identification Number (EIN),* page 5-1.

Limited liability companies (LLCs). Limited liability companies combine the tax aspects of partnerships or sole proprietors with the liability protection of corporations. See *LLC Classification,* page 20-20.

Both single-member LLCs and multiple-member LLCs are eligible to make the entity classification election to be taxed as a corporation.

Entity Classification Elections			
Entity	***Default Filing***	***Entity Options***	***Cannot Be Taxed as:***
Individual	Sole proprietor, Schedule C (Schedule E for rental or Schedule F for farming)	Corporation	Partnership
Partnership	Partnership, Form 1065	Corporation	Sole proprietor
Corporation (formed as a corporation under state law)	C corporation, Form 1120, or S corporation, Form 1120-S (with S election)	N/A	Sole proprietor, Partnership
LLC (single-member)	Disregarded entity—owner files as if LLC did not exist.	Corporation	Partnership
LLC (multiple-member)	Partnership, Form 1065	Corporation	Sole proprietor

S corporations. Eligible entities that choose to be taxed as S corporations do not need to file Form 8832. If the entity makes a valid election to be treated as an S corporation, it is considered to have made the election to be taxed as a corporation. See *Form 2553, Election by a Small Business Corporation,* page 19-5.

60-month limitation. Once an eligible entity makes an election to change its classification, the entity generally cannot change the election during the 60 months after the effective date. However, if there is more than a 50% change in ownership, the IRS may allow a change in the election by means of a private letter ruling. Also, the 60-month limitation does not apply if the previous election was made by a newly formed entity, and the election was effective on the date of formation.

Election. The election can take effect no more than 75 days prior to the date that Form 8832 is filed and cannot take effect later than 12 months after the date on which the election is filed.

Late election. An entity is eligible for relief for a late entity classification election if the following are true. (Rev. Proc. 2009-41)

- The entity failed to obtain the classification as of the date of its formation (or requested change in classification) solely because Form 8832 was not timely filed,
- The entity and all affected persons have filed all required federal tax and information returns consistent with the entity's requested classification within six months of the returns' original due dates (or the entity has not filed a federal tax or information return for the first year in which the election was intended because the due date has not passed),
- The eligible entity has reasonable cause for failure to timely make the election, and
- The entity files for relief within three years and 75 days of the requested effective date.

Requesting relief. Entities seeking relief under Revenue Procedure 2009-41 must complete Part II, Form 8832, explaining the reason for the failure to file a timely entity classification election. The form must be signed by an authorized representative of the entity and each affected person. The form must be filed within three years and 75 days from the requested effective date of the election.

If Revenue Procedure 2009-41 does not apply, an entity may seek relief for a late entity election by requesting a private letter ruling and paying a user fee.

Accumulated Earnings Tax

Cross References

- IRS Pub. 542, *Corporations*
- IRC §531 – 537

Related Topics

- Passive investment violation, page 19-7

Accumulated Earnings Tax

A corporation is not allowed to accumulate earnings beyond the amount needed for bona fide business reasons. If earnings accumulate beyond the reasonable needs of the business, and the purpose is determined to be tax avoidance, an additional tax applies to the excess. The tax results from an IRS audit of the corporation. (Reg. §1.532-1)

Tax rate. The tax is 20% of the excess accumulated taxable income.

Accumulated taxable income. For purposes of the accumulated earnings tax, accumulated taxable income equals taxable income, adjusted for tax expense and disallowed deductions, minus the dividends-paid deduction and the accumulated earnings credit.

Accumulated earnings credit. For a corporation other than a mere holding or investment company, the accumulated earnings credit is:

- The amount of the earnings and profits (E&P) for the taxable year that are retained for the reasonable needs of the business, less
- The amount of net capital gains for the taxable year deducted in calculating accumulated taxable income.

Safe harbor. Accumulated earnings up to $250,000 are considered to be within reasonable needs of most corporations. The safe harbor is $150,000 for service corporations in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting. [IRC §535(c)(2)]

Reasonable needs. Although the determination of reasonable needs is made based on facts and circumstances, the following items are identified in regulations as reasonable or not reasonable for purposes of accumulating profits (Reg. §1.537-2).

Reasonable/Unreasonable Needs	
Reasonable Needs	***Unreasonable Needs***
• To provide for expansion of the business. • To acquire a business enterprise through purchase of stock or assets. • To provide for retirement of indebtedness. • To provide necessary working capital, such as for procurement of inventories. • To provide for investments or loans to suppliers or customers if necessary to maintain the business of the corporation. • To provide for the payment of reasonably anticipated product liability losses.	• Loans to shareholders. • Distributions for the personal benefit of shareholders. • Loans having no reasonable relation to the conduct of business. • Loans to related corporations for nonbusiness reasons. • Investments in properties or securities that are unrelated to the business of the corporation. • Retention of E&P to provide against unrealistic hazards.

Did You Know? Although amounts set aside for self-insurance cannot be deducted, a C corporation's self-insurance reserve can be treated as part of reasonable needs for purposes of the accumulated earnings tax.

Court Case: A dairy operating as a C corporation did not have commercial herd insurance. Over a period of years, the corporation accumulated a large self-insurance reserve, significantly reducing the amounts on which the accumulated earnings tax was computed for those years. The IRS argued that the risks to the herd were remote and that the large reserve had the purpose of tax evasion, but the Tax Court disagreed. The dairy owner was able to show that the threat of disease or other loss and the consequences for his dairy business justified the large reserve. (*Gustafson's Dairy, Inc.*, T.C. Memo. 1997-519)

Personal Service Corporations

Personal service corporations are generally corporations that perform services in the fields of health (including veterinarians and physical therapy services of nonphysicians), law, engineering, architecture, accounting, actuarial science, performing arts, and consulting.

Definition of Personal Service Corporation	*IRC §*	*Tax Rule*
The principal activity is the performance of personal services, with the services substantially performed by employee-owners. An employee-owner is an employee who on any day during the tax year owns more than 10% of the corporation's outstanding stock.	IRC §269A	If the principal purpose of the corporation is tax avoidance or tax evasion, the IRS can reallocate income and tax attributes to the employee-owners.
The principal activity is the performance of personal services, with the services substantially performed by employee-owners who as a group own more than 10% of the outstanding stock. An employee-owner can be any employee who owns stock in the corporation.	IRC §469(j)(2)	The PSC is subject to passive loss limitation rules.
The principal activity is the performance of personal services, with the services substantially performed by employee-owners who as a group own more than 10% of the outstanding stock. An employee-owner is defined as any employee who owns stock in the corporation. All members of an affiliated group filing a consolidated return are taken into account in determining if the corporation is a PSC.	IRC §441(i) IRC §280H	The PSC must file as a calendar-year taxpayer unless a fiscal year is elected under IRC section 444, or a business purpose is established for a fiscal year. If the PSC elected a fiscal year under IRC section 444, and did not meet the minimum distribution requirements of IRC section 280H(c), the PSC cannot take a deduction for accrued salaries of employee-owners. The deduction is limited to the amount actually paid by year end.
Substantially all of the PSC activities are in the performance of personal services. At least 95% of the corporation's stock is held directly or indirectly by one or more of the employees performing services. This includes retired employees and employee's estates, and any person who acquired an employee's stock within two years of the employee's death.	IRC §448 IRC §11(b)	Generally, C corporations are not allowed to use the cash method of accounting with gross receipts that exceed $31 million (2025). The PSCs are not subject to this limitation (except in the case of a tax shelter). The PSC is subject to tax at a flat rate of 21%.
The principal function of the corporation is the performance of personal services.	IRC §535(c)(2)(B)	The PSCs that accumulate more than $150,000 of E&P may be subject to accumulated earnings tax. Other corporations are allowed a safe harbor up to $250,000.
An affiliated service organization is a service organization and one or more affiliated service organizations which is either a shareholder or partner in the first organization, or if 10% or more of the interest in the affiliated service organization is owned by highly-compensated employees of the first organization, or any of the other affiliated services organizations.	IRC §414(m)	Affiliated service organizations are deemed to be a single employer for purposes of employee benefit program requirements for a qualified retirement plan under section 401(a).

Personal Service Corporation (PSC)

Cross References

- Schedule H (Form 1120), *Section 280H Limitations for a Personal Service Corporation (PSC)*
- Form 1120 (Schedule J), *Tax Computation and Payment*
- IRC §269A, *Personal service corporations formed or availed of to avoid or evade income tax*
- IRC §448, *Limitation on use of cash method of accounting*

Related Topics

- Passive Activity Losses, page 7-7
- Excess Net Passive Income Tax (IRC §1375), Tab 19
- Required Tax Year for S Corporations and PSCs, page 19-15

PSC Defined

The Internal Revenue Code sets forth special rules for certain professionals to prevent corporate tax benefits for what would otherwise be wages paid for services. Although the definition of PSC will vary depending on the tax issue involved, for these rules personal services are generally in the fields of accounting, actuarial science, architecture, consulting, engineering, health (including veterinary services), law, and the performing arts.

Tax rate. A corporation, including a personal service corporation, computes its tax at a flat rate of 21% of taxable income.

Subject to passive loss rules. Passive loss limits apply to a corporation if personal services are substantially performed by employee-owners who as a group own more than 10% of the outstanding stock of the corporation. [IRC §469(j)(2)]

Form 8810, *Corporate Passive Activity Loss and Credit Limitations.* Form 8810 must be filed by personal service corporations and closely held corporations that have losses or credits from passive activities, including prior year unallowed losses and credits. For details, see Form 8810 instructions.

Accumulated earnings tax. C corporations are generally allowed a safe harbor of $250,000 of accumulated earnings. The safe harbor for a PSC is $150,000. See *Accumulated Earnings Tax,* page 18-18.

Accounting method and tax year. Special restrictions apply for PSCs with regard to allowable accounting methods and tax years. See *Required Tax Year for S Corporations and PSCs,* page 19-15.

Personal Holding Company (PHC)

Cross References

- Schedule PH (Form 1120), *U.S. Personal Holding Company (PHC) Tax*
- IRC §541 – 547

Related Topics

- Installment note, page 28-6

PHC Defined

Generally, a corporation is a PHC if it meets both of the following tests.

1) **PHC income test.** At least 60% of the corporation's AGI for the tax year is PHC income, defined on page 18-20. See IRC section 543(b)(2) for the definition of adjusted ordinary gross income.

continued on next page

2) **Stock ownership requirement.** At any time during the last half of the tax year, more than 50% in value of the corporation's outstanding stock is directly or indirectly owned by five or fewer individuals. For purposes of this requirement, the following organizations are considered individuals.
   - A qualified pension, profit sharing, or stock bonus plan described in IRC section 401(a).
   - A trust that provides for the payment of supplemental unemployment compensation under certain conditions. [IRC §501(c)(17)]
   - A private foundation. [IRC §509(a)]
   - A part of a trust permanently set aside or exclusively used for the purposes described in IRC section 642(c).

Exceptions: The term personal holding company does not include tax-exempt corporations and certain other corporations listed in the instructions for Schedule PH (Form 1120).

Personal Holding Company Income

Personal holding company income consists of the following types of income. [IRC §543(a)]

- Dividends.
- Interest.
- Annuities.
- Income from estates and trusts.
- Amounts received under certain personal service contracts.
- Amounts received as compensation for use of property of the corporation if, at any time during the year, 25% or more of the corporation's stock is owned by an individual who uses the property.
- Rents and royalties, unless the income exceeds 50% of gross income of the corporation.
- Certain mineral, oil, and gas royalties.

Personal Holding Company Tax

A C corporation that is a PHC, defined on page 18-19, must pay the personal holding company tax in addition to the regular corporate income tax.

Tax rate. The tax on undistributed personal holding company income is 20%. [IRC §541]

Schedule PH (Form 1120), *U.S. Personal Holding Company (PHC) Tax.* Attach Schedule PH to Form 1120 if the corporation is a PHC.

Homeowners' Associations Form 1120, 1120-H, or 990 Series

Cross References

- Form 1120-H, *U.S. Income Tax Return for Homeowners' Associations*
- Rev. Rul. 74-99
- IRC §528, *Certain homeowners' associations*

Related Topics

- Tax-Exempt Organization Overview, page 25-4

Homeowners' Associations (IRC §528)

Homeowners' associations are organizations formed by a group of homeowners for the purpose of preserving and maintaining the appearance of an area and the ownership and maintenance of common property and facilities, such as recreational facilities, streets, and sidewalks. Because most homeowners' associations operate for the benefit of a specific group of people, rather than the community at large, they have difficulty meeting the tax-exempt purposes required under IRC section 501(c)(4) and IRC section 501(c)(7). Congress enacted IRC section 528 with the view that it is not appropriate to tax revenues of an association of homeowners who act together if an individual homeowner acting alone would not be taxed on the same activity.

Types of Homeowners' Associations

There are three types of homeowners' associations that qualify under IRC section 528.

1) A condominium management association organized and operated to acquire, build, manage, maintain, and care for the property in a condominium project substantially all of whose units are homes for individuals.
2) A residential real estate management association organized and operated to acquire, build, manage, maintain, and care for a subdivision, development, or similar area substantially all of whose lots or buildings are homes for individuals.
3) A timeshare association (other than a condominium management association) organized and operated to acquire, build, manage, maintain, and care for the property that has members who hold a timeshare right to use, or a timeshare ownership interest in, real property of the timeshare association. A timeshare association cannot be a condominium management association.

Qualifications for homeowners' associations. To qualify as a homeowners' association, the following must apply.

- At least 60% of the association's gross income for the tax year consists solely of membership fees, dues, or assessments from property owners,
- At least 90% of the association's expenses for the tax year consist of expenses to acquire, build, manage, maintain, or care for association property, or in the case of a timeshare association, for activities provided to, or on behalf of, members of the timeshare association, and
- No private shareholder or individual can profit from the association's net earnings except by acquiring, building, managing, or caring for association property, or by a rebate of excess membership dues, fees, or assessments.

Choice of Tax Form

A qualified homeowners' association has two choices.

- File Form 1120 and pay tax as if it were a C corporation.
- Elect to file Form 1120-H, *U.S. Income Tax Return for Homeowners' Associations.* See *Election,* page 18-21.

Why elect to file Form 1120-H?

- Net exempt-function income is not subject to tax.
- Not required to pay estimated taxes.
- A specific deduction of $100 is allowed.
- No balance sheet is required on the tax return.
- One-page form to prepare.

Why file Form 1120 instead of Form 1120-H?

- Take advantage of lower tax rates. Form 1120-H is a flat 30% rate (32% for timeshare associations). Corporations filing Form 1120 are taxed at a flat rate of 21%.
- If there is a net operating loss (NOL), it can be used to offset income in another tax year. An NOL is not allowed on Form 1120-H.

Exempt-function income. Exempt-function income consists of dues, fees, or assessments paid by property owner-members for maintenance and improvement of the property. Income that is not considered exempt-function income includes interest, dividends, coin laundry income, vending machine income, rental of units owned by the association, rental of garage parking and storage areas, party room rentals, etc. If Form 1120-H is filed, net income attributable to exempt-function income is tax free. All other income is taxed at a flat rate of 30% (32% for timeshare associations).

Expenses. If Form 1120-H is filed, expenses must be allocated between exempt-function income and other income. For example, management fees may include services for maintenance of common areas, as well as fees for managing the association's investments. Only the amounts allocable to taxable income are deductible on Form 1120-H.

Election. The election under IRC section 528 is made by filing Form 1120-H. The election is made separately for each tax year and generally must be made by the due date, including extensions, of the income tax return. Once Form 1120-H is filed, the association cannot revoke its election for that year unless the IRS consents.

Stock Redemptions

Cross References

- Form 5452, *Corporate Report of Nondividend Distributions*
- IRC §302, *Distributions in redemption of stock*

Related Topics

- Capital Gains and Losses, page 6-8
- Sale of a Business, page 28-2

Stock Redemptions

A stock redemption occurs when a corporation buys stock back from a shareholder. Unlike a complete liquidation, a corporation continues to exist after a stock redemption. Upon redemption of stock, the corporation can cancel, hold, or resell the stock.

A stock redemption will be reclassified as a fully-taxable dividend if certain factors are present. The classification can have significant tax effects since a dividend is generally taxable to the extent of the corporation's E&P, but a stock redemption is treated as a sale of stock by the shareholder and any gains are eligible for favorable capital gain tax rates. See *Dividends,* page 18-15.

Qualifying transactions. The following transactions are treated as stock redemptions, and qualify for capital gain treatment at the shareholder level.

The distribution is not essentially equivalent to a dividend. This is a facts and circumstances test. For example, in the case of a distribution that creates a meaningful reduction in the shareholder's interest in the corporation, the distribution is not essentially equivalent to a dividend, and the transaction is therefore treated as a stock redemption. A corporation with only one class of stock that makes proportional distributions to shareholders that do not reduce the shareholder's ownership interest will be treated as having made a distribution equivalent to a dividend, and the distribution will not be treated as a stock redemption. (Reg. §1.302-2)

There is a substantially disproportionate redemption of stock. Under this rule, the shareholder must, after the distribution, hold less than 50% of voting stock and less than 80% of the interest in the corporation that the shareholder held before the redemption. (Reg. §1.302-3)

Termination of a shareholder's interest. Complete termination of a shareholder's interest in the corporation will be treated as a stock redemption. Family stock attribution rules can be waived if the individual does not acquire an interest in the corporation (other than a creditor) for 10 years after the redemption. The shareholder must file an agreement with the IRS. (Reg. §1.302-4)

Partial liquidation. Stock redemption treatment shall apply to a distribution if the distribution is in redemption of stock held by a shareholder who is not a corporation and is in partial liquidation of the distributing corporation. A distribution shall be treated as a partial liquidation if the distribution is not essentially equivalent to a dividend (determined at the corporate level rather than the shareholder level), and the distribution is pursuant to a plan and occurs within the taxable year in which the plan is adopted, or within the succeeding taxable year. [IRC §302(e)]

Redemption to pay death taxes. Stock that is included in a decedent's estate is treated as a stock redemption to the extent the distribution does not exceed the estate, inheritance, legacy, and succession taxes, and the amount of funeral and administrative expenses. The value of the stock of the corporation must exceed 35% of the decedent's estate, and the redemption must occur within three years and 90 days after the later of the date the estate tax return is filed or the due date, whichever is later. (IRC §303)

Earnings and profits. In a qualified stock redemption, a portion of the distribution to the shareholder can reduce the corporation's E&P. The reduction in the corporation's E&P cannot exceed the ratable share attributable to the E&P of the stock redeemed. The ratable share is determined by the FMV of the stock redeemed and the FMV of all the corporation's stock. [IRC §312(n)(7)]

Example: Cheryl and Tom are shareholders in Catcher Corporation. They each own 500 shares of stock with FMV of $100 per share. The capital account of Catcher Corporation is $80,000. The corporation redeems 200 shares of Cheryl's stock which has a FMV of $20,000. The corporation can reduce its E&P by $4,000 attributable to the stock redemption.

$$\frac{\$20{,}000 \text{ (FMV of stock redeemed)}}{\$100{,}000 \text{ (FMV of all stock)}} = 20\% \text{ ratable share}$$

$20,000 × 20% = $4,000 reduction in E&P.

Stock redemption expenses. A corporation cannot deduct expenses paid in connection with the reacquisition of its stock or the stock of related parties. [IRC §162(k)]

Exceptions: Deductions for reacquisition of stock are allowed for:

- Interest deduction.
- Deductions for amounts properly allocable to indebtedness and amortized over the term of the indebtedness.
- Deduction for dividends paid.

Tax Planning with Stock Redemptions and Liquidations

Stock redemptions can accomplish the transfer of corporate ownership with a minimal amount of disruption at the individual shareholder level. Corporate funds are used to buy the stock of existing shareholders, as compared to conducting separate transactions among shareholders. Stock redemptions are also effective in buy-sell agreements. See *Buy-sell agreements,* page 27-7.

Selling the corporation. A stock redemption can be an attractive option if shareholders want to sell the corporation to a party or group with limited funds. Corporate assets can be distributed by means of a stock redemption, lowering the value of the corporation and the purchase price.

Buying out shareholders. A stock redemption plan can be used to buy out an existing shareholder. This can happen with a retiring or deceased shareholder, or a shareholder who wants to go his or her separate way. Corporate funds are used to redeem the shareholder's stock. Additional redemptions can be made to maintain each remaining shareholder's pro-rata share of stock in the corporation.

Low-value assets. Since a corporation is allowed to take a loss on a liquidating distribution of property, but not on a dividend distribution, there can be tax benefits with distributing low-value assets in a liquidating distribution.

Installment obligations. If an installment obligation is distributed to a shareholder in a liquidating distribution, the shareholder does not pay tax until payments on the obligation are received.

The corporation must compute gain on the FMV of the obligation, but the shareholder can defer tax. [IRC §453(h)]

Related party rules. Constructive ownership rules apply in the case of stock redemptions. The shareholder's interest is not considered terminated if the shareholder or a related party acquires stock in the corporation within 10 years from the date of distribution [IRC §302(c)(2)]. This can create difficulty in structuring a stock redemption in a family-owned corporation.

Corporate Reorganizations

Cross References

- IRC §355, *Distribution of stock and securities of a controlled corporation*
- IRC §368, *Definitions relating to corporate reorganizations*

Related Topics

- Sale of a Business, page 28-2

Corporate Reorganizations

The purpose of corporate reorganization provisions in the Internal Revenue Code is to provide tax-free treatment in allowing corporations to adapt their structures to changing business realities. Tax-free reorganizations must conform to IRC section 368 and related provisions. Distributions of stock or securities of a controlled corporation fall under the provisions of IRC section 355.

Qualifications for Tax-Free Reorganization

The following characteristics must be present in order for a reorganization to qualify for tax-free treatment.

Continuity of business enterprise (COBE). Under this test, the issuing corporation must either continue the target corporation's historic business or use a significant portion of the target's historic business assets in a business. [Reg. §1.368-1(d)]

Continuity of interest requirement (COI). The purpose of the COI is to prevent transactions that resemble sales from qualifying for nonrecognition treatment. Continuity of interest requires that, in substance, a substantial part of the value of the proprietary interests in the target corporation be preserved in the reorganization. [Reg. §1.368-1(e)]

Business purpose requirement. A reorganization must have a legitimate business purpose to qualify for tax-free treatment. Avoidance of federal income tax does not qualify as a legitimate business purpose under these rules. [Reg. §1.355-2(b)]

Distributions of Stock Under Reorganization

Distribution of stock resulting from a corporate reorganization generally falls into one of three categories.

Spin-off. The corporation transfers assets to another corporation that it controls and then distributes the controlled corporation's stock to its shareholders.

Tax-free treatment is denied to certain "cash rich" spin-offs where either the distributing corporation or the controlled corporation is a disqualified investment corporation, defined as having investment assets that are two-thirds or more (75% or more under a first-year transition rule) of the value of the corporation's total assets.

Split-off. The corporation transfers assets to another corporation that it controls, then the shareholders surrender some of their stock in the distributing corporation for stock in the controlled corporation.

Split-up. The corporation transfers all its assets to two or more controlled corporations. After distributing stock in the controlled corporations to its shareholders, the distributing corporation dissolves.

Form 8937

Corporations file Form 8937, *Report of Organizational Actions Affecting Basis of Securities,* when an organizational action affects the basis of holders of a security or holders of a class of the security.

Actions that would require filing Form 8937 include:

- Nontaxable cash distribution to shareholders,
- Nontaxable stock distribution to shareholders including a stock split,
- Conversion rate adjustments on a convertible debt instrument that results in a distribution under IRC §305(c), or
- Issuance of a debt instrument in a recapitalization, including a recapitalization resulting from a significant modification or a bankruptcy organization.

Form 8937 is not required for:

- Distributions of stock to someone exercising a previously granted right to purchase the stock,
- Initial public offerings, or
- Issuance of debt instruments not related to a recapitalization.

Corporate Liquidations

Cross References

- Form 966, *Corporate Dissolution or Liquidation*
- IRC §331 – 346

Related Topics

- S Corporations, Tab 19
- Sale of a Business, page 28-2

Complete Liquidation—C or S Corporations

A corporation will terminate upon complete liquidation of the corporation's assets.

Note: A complete liquidation can occur even though the corporation retains a small amount of assets to settle debts and pay final administrative costs. Amounts remaining are then distributed to shareholders.

In a complete liquidation, the corporation distributes all assets to shareholders and recognizes gain or loss as if the property was sold to the distributees at FMV. (IRC §336)

Amounts received by shareholders in a complete liquidation are treated as full payment in exchange for the shareholders' stock. (IRC §331)

Liabilities. For distributed property subject to a liability, if the liability is greater than FMV, the amount of liability is treated as FMV. [IRC §336(b)]

Example: Bruce receives a liquidating distribution of property from Lawn Corporation. The corporation's basis in the property is $4,000, the FMV is $10,000, and the property is subject to a liability of $12,000, which Bruce assumes. Because the liability is greater than FMV, the amount of liability is treated as FMV. The corporation recognizes gain of $8,000 ($12,000 – $4,000). Bruce is treated as having received a liquidating distribution of $12,000.

Post-termination expenses. Expenses of a corporation incurred by a shareholder after a complete liquidation are treated as capital expenses (additions to stock basis).

Loss limitations. In a complete liquidation, losses are not recognized on property distributed to a related person (defined in IRC section 267) if the distribution is not pro rata, or if the property is "disqualified property." Disqualified property means any property which is acquired by the liquidating corporation in an IRC section 351 exchange, or as a contribution to capital, during

the 5-year period ending on the date of the distribution. See *IRC Section 351—Nontaxable Transfers,* page 18-5.

Form 966, *Corporate Dissolution or Liquidation.* A corporation must file Form 966 if it adopts a plan to dissolve the corporation or liquidate any of its stock. Exempt organizations and qualified S subsidiaries are not required to file Form 966.

Note: Do not file Form 966 for a deemed liquidation (such as an IRC section 338 election to treat acquisition of stock as a purchase of assets) or an election to be treated as a disregarded entity.

File Form 966 within 30 days after the corporation adopts its plan to dissolve the corporation or liquidate any of its stock. If the plan is amended or supplemented after Form 966 is filed, file another Form 966 within 30 days after the amended plan is adopted. The form is filed at the address where the corporation files its income tax return. Attach a certified copy of the resolution or plan to liquidate the corporation to Form 966. See *Sale of a Business,* page 28-2.

Form 1099-DIV, *Dividends and Distributions.* Form 1099-DIV must be filed to report liquidation distributions of $600 or more ($10 or more for other corporate distributions). For more information, see *Dividends,* page 18-15.

Election to Treat Stock Purchase as Asset Acquisition

A corporation that purchases stock of another corporation can make an election to treat the acquisition as a purchase of assets. Gain or loss is recognized by the target corporation as if it has sold all its assets on the date of acquisition. The acquiring corporation receives a stepped-up basis in the assets. (IRC §338)

Revenue Procedure 2011-35 describes methods a corporation may use to establish its basis in the stock of another corporation.

C Corporation Example

Greener Pastures, Inc. This example is part of a series that follows the business cycle of "Greener Pastures" from concept to inception, start-up to the end of the first year, then through completion of the tax return and reporting income to owners. The example illustrates how business transactions are reported for a C corporation and includes books, financial statements, and line-by-line illustrations of how to complete Form 1120, *U.S. Corporation Income Tax Return.*

Also compare this example with the corresponding examples using the same business transactions for S corporations in Tab 19, and for partnerships in Tab 20.

Differences in reporting for a C corporation. The following items are reported differently for C corporations as compared with S corporations and partnerships.

Employee-shareholders. Employee-shareholders of corporations are paid wages by the corporation the same as any other employee.

Fringe benefits. Fringe benefits are generally tax free to employee-shareholders in a C corporation. In S corporations and partnerships, fringe benefits are usually taxable to the shareholders (more than 2% ownership) or partners.

C corporation taxation. A C corporation pays income tax at the corporate level, unlike S corporations and partnerships that pass taxable income through to the owners. After-tax profits remaining in a C corporation may be retained by the corporation or distributed to shareholders as dividend distributions, which are taxable to the individual up to the amount of the corporation's accumulated earnings and profits (E&P).

Section 179 deduction. In a C corporation, the Section 179 deduction is allowed for tax purposes only and is not allowed for purposes of computing E&P. In computing E&P, any amount taken as a Section 179 deduction is depreciated straight-line over five years.

Depreciation. MACRS depreciation is allowed for tax purposes only. For E&P, depreciation is computed straight-line over the asset's alternative depreciation system (ADS) recovery period. See *Regular MACRS (GDS)/Alternative Depreciation System (ADS),* page 9-4.

Scenario

Nate owned a lawn and garden implement store. Tyler owned a hydroseeding business. Nate and Tyler decided to go into business together under the name "Greener Pastures."

Creating a C corporation. Nate and Tyler consulted an attorney for advice about the choice of business entity. The attorney recommended that they operate their business as a C corporation and began the process of filing the necessary documents with the Secretary of State. The attorney also assisted them in drafting an incorporation agreement. See *Incorporation Agreement,* below. Upon creation of the corporation, the official name of the company became "Greener Pastures, Inc."

- The attorney's fee was $2,000.

Tax advice. The tax consultant for Greener Pastures, Inc. obtained an employer identification number (EIN) for the business. For information about obtaining an EIN, see *Employer Identification Number (EIN),* page 5-1. The tax consultant then instructed Nate and Tyler to open a business checking account and to make cash contributions to capital. The bookkeeping system was set up, and procedures were put in place to provide compensation and benefits for the shareholders.

- The tax consultant's fee was $2,500.

Business start date. Greener Pastures, Inc., started doing business on April 1, 2025.

Incorporation Agreement

The incorporation agreement for Greener Pastures, Inc. contains the following provisions.

Stock authorized. The corporation authorized 500,000 shares of stock at par value of $1.00 per share.

Capital contributions. Nate made a capital contribution in the amount of $55,000 in exchange for 55,000 shares of stock. Tyler made a capital contribution in the amount of $45,000 in exchange for 45,000 shares of stock. After the capital contributions, the corporation has 100,000 shares of outstanding stock.

Note: No gain or loss is recognized when cash is contributed to a corporation in exchange for stock.

Shareholder wages. The C corporation will pay base wages of $55,755 for Nate, and $44,245 for Tyler.

Employee benefits. The corporation will pay health insurance premiums of $3,900 for each employee. It will also contribute to both HSA and SIMPLE plans for each employee.

Health savings accounts. The corporation will contribute $4,300 to an HSA for each individual. See *Line 24, Employee benefit programs,* page 18-27, for how to report on Form 1120. For more information about HSAs, see *Health Savings Accounts (HSAs) (IRC §223),* page 22-6.

SIMPLE plan. The corporation will contribute to Savings Incentive Match Plans for Employees (SIMPLE plans) by means of establishing SIMPLE IRAs. The corporation will match employee elective deferrals dollar-for-dollar up to 3% of each employee's wages. See *Savings Incentive Match Plans for Employees (SIMPLE),* page 13-14.

Employee-shareholder expenses. Shareholders are personally responsible for paying for their own professional publications, association dues, and sanctioning fees. As corporation shareholders, these amounts are treated as employee business expenses.

continued on page 18-25

Payroll Report for Year Ended December 31, 2025

Employee	*Gross Earnings*	*Social Security 6.20%*	*Medicare 1.45%*	*Federal Withholding*	*State Withholding*	*SIMPLE Elective Deferrals*	*Net Pay*
Nate	$ 55,755.00	$ 3,456.81	$ 808.45	$ 9,204.00	$ 3,336.00	$ 5,500.00	$ 33,449.74
Tyler	$ 44,245.00	$ 2,743.19	$ 641.55	$ 6,324.00	$ 1,924.00	$ 4,500.00	$ 28,112.26
Evan	$ 31,200.00	$ 1,934.40	$ 452.40	$ 2,493.00	$ 1,635.00	$ 3,120.00	$ 21,565.20
Cyndi	$ 27,300.00	$ 1,692.60	$ 395.85	$ 2,007.00	$ 1,369.00	$ 2,730.00	$ 19,105.55
Tristan	$ 23,400.00	$ 1,450.80	$ 339.30	$ 1,521.00	$ 1,104.00	$ 2,340.00	$ 16,644.90
Jordan	$ 23,400.00	$ 1,450.80	$ 339.30	$ 1,521.00	$ 1,104.00	$ 2,340.00	$ 16,644.90
Totals	$205,300.00	$12,728.60	$2,976.85	$23,070.00	$10,472.00	$20,530.00	$135,522.55

Final Pay Period—Taxes Deposited January 2026

	Gross Earnings	*Social Security 6.20%*	*Medicare 1.45%*	*Federal Withholding*	*State Withholding*	*SIMPLE Elective Deferrals*	*Net Pay*
	$ 5,264.10	$ 326.37	$ 76.33	$ 592.00	$ 269.00	$ 526.00	$ 3,474.40

2025 Tax Depreciation Schedule—Greener Pastures, Inc.

Asset	*Placed in Service*	*Basis*	*Section 179*	*Depreciable Basis*	*Recovery Period*	*Method*
Equipment	April 1, 2025	$49,900.00	$ 0.00	$49,900.00	7 yr.	200DB
Display shelving	April 1, 2025	$10,000.00	$10,000.00	$ 0.00	7 yr.	200DB
Office furniture	April 1, 2025	$ 5,000.00	$ 0.00	$ 5,000.00	7 yr.	200DB
Computers	April 1, 2025	$ 4,500.00	$ 0.00	$ 4,500.00	5 yr.	200DB
	Totals	$69,400.00	$10,000.00	$59,400.00		

Regular Tax Depreciation—Short Tax Year 200DB

Equipment..... $49,900 × 1/7 × 200% × 4.5/12 = $5,346
Office furniture..... $5,000 × 1/7 × 200% × 4.5/12 = $ 536
Computers..... $4,500 × 1/5 × 200% × 4.5/12 = $ 675
Total regular tax depreciation..... $6,557

See *Depreciation Worksheet—Greener Pastures, Inc.*, page 18-30.

Balance Sheet—Greener Pastures, Inc.

December 31, 2025

Assets:

Cash	$ 85,824.53	
Inventory	14,500.00	
Equipment	49,900.00	
Display shelving	10,000.00	
Office furniture	5,000.00	
Computers	4,500.00	
Accumulated depreciation	(5,669.00)	
Organizational costs	4,500.00	
Start-up costs	1,660.00	
Total assets		$170,215.53

Liabilities:

Payroll withholding payable	$ 1,263.70	
Employer's Social Security and Medicare payable	402.70	
Sales tax payable	2,028.14	
SIMPLE employee deferrals payable	526.00	
Loan payable	43,943.66	
Rounding adjustment	.01	
Total liabilities		$ 48,164.21

Equity:

Common stock	$100,000.00	
Current earnings	32,051.32	
Distributions	(10,000.00)	
Total equity		$122,051.32
Total liabilities plus equity		$170,215.53

Income Statement—Greener Pastures, Inc.

Year ended December 31, 2025

Revenue:

Lawn and garden implement sales	$265,500.00	
Hydroseeding services	288,300.00	
Dividends earned	665.00	
Gross income		$554,465.00

Cost of goods sold:

Beginning inventory	$ 0.00	
Purchases	218,730.77	
Ending inventory	(14,500.00)	
Cost of goods sold		$204,230.77
Gross profit		$350,234.23

Expenses:

Advertising	$ 3,000.00	
Bookkeeping	2,800.00	
Depreciation	5,669.00	
Employee benefit programs		
HSA contributions	25,800.00	
Health insurance	23,400.00	
SIMPLE employer match	6,159.00	
Foreign tax paid	99.00	
Insurance—business	3,250.00	
Interest expense	1,577.02	
Meals and entertainment	1,100.00	
Office expenses	2,325.00	
Payroll taxes	19,553.89	
Rent	10,800.00	
Utilities	2,850.00	
Wages	205,300.00	
Income tax: federal	3,000.00	
Income tax: state	1,500.00	
Total expenses		$318,182.91
Net income per books		$ 32,051.32

Cash Flow Reconciliation

Business Name: Greener Pastures, Inc.	**Period:** 4/1/25 to 12/31/25	**EIN:** 31 – 2345678

1) Starting cash balance		1)	0.00
Cash In			
2) Customer receipts: categories			
Lawn and garden implement sales	265,500.00		
Hydroseeding services	288,300.00		
Sales tax collected	18,253.13		
Total customer receipts		2)	572,053.13
3) Investment income: interest, dividends, etc.			
Dividend income	665.00		
Total investment income		3)	665.00
4) Cash received from accounts receivable not listed elsewhere		4)	
5) Cash received from sale of assets		5)	
6) Cash received from loan repayments		6)	
7) Cash received from loan proceeds		7)	49,900.00
8) Contributions to capital		8)	100,000.00
9) Other receipts		9)	
Total starting cash balance plus cash in			722,618.13
Cash Out			
10) Business expenses: categories			
Accounting (organizational costs)	2,500.00		
Advertising	3,000.00		
Attorney fees (organizational costs)	2,000.00		
Bookkeeping	2,800.00		
Employee benefit programs:			
HSA contributions	25,800.00		
Health insurance	23,400.00		
SIMPLE plan employer match	6,159.00		
SIMPLE plan employee elective deferrals	20,004.00		
Estimated tax payments: Federal	3,000.00		
State	1,500.00		
Foreign tax paid	99.00		
Insurance—business	3,250.00		
Meals and entertainment	1,100.00		
Office expenses	2,325.00		
Payroll taxes:			
Federal unemployment (FUTA)	252.00		
Federal quarterly (Form 941)	53,083.49		
State unemployment	3,596.44		
State withholding	10,203.00		
Rent	10,800.00		
Sales tax	16,224.99		
Travel (start-up costs)	1,660.00		
Utilities	2,850.00		
Wages/net	135,522.55		
Total business expenses		10)	331,129.47
11) Purchases of inventory		11)	218,730.77
12) Loans payable:			
Asset Equipment			
Principal 5,956.34 Interest 1,577.02 = Total	7,533.36		
Total loans payable		12)	7,533.36
13) Paid on accounts payable		13)	
14) Cash disbursements on loans receivable		14)	
15) Cash distributions to owners		15)	10,000.00
16) Cash paid for asset purchases		16)	69,400.00
17) Other cash out		17)	
Total cash out for period			636,793.60
Ending cash balance			85,824.53

continued from page 18-23

These expenses are not tax deductible for the shareholder. Compare to the same expenses in the *Partnership Example,* page 20-23, which are fully deductible and also reduce self-employment taxes.

Tax year. The corporation adopts a calendar tax year. The first tax year is a short tax year beginning on April 1, 2025 and ending on December 31, 2025. The corporation will establish its calendar tax year with the IRS when it files its first income tax return. See *Accounting Periods and Methods,* page 8-23, for more information about the short tax year and *Short Tax Year Depreciation,* page 9-6.

Accounting method. The corporation will use the cash method of accounting.

Inventory. The corporation will hold inventory consisting of lawn and garden implements and hydroseeding materials. Under the general rule, if a company carries inventory, the accrual method of accounting must be used for purchases and sales. However, businesses with average gross receipts of $31 million or less (2025) are eligible to use the cash method of accounting. Even though Greener Pastures, Inc. will use the cash method of accounting, the cost of inventory will not be deducted until sold. For more information about accounting for inventory, see *Inventory/Cost of Goods Sold,* page 8-13.

Corporation books. The corporation's books will be computed using the rules for E&P. See *Earnings and Profits (E&P),* page 18-17.

Organizational Costs and Start-Up Costs

For tax purposes. Organizational costs and start-up costs are capital expenses. An election is available to deduct up to $5,000 in organizational costs and $5,000 in start-up costs for tax purposes. Amortization is available for excess amounts. Greener Pastures, Inc. elects to deduct its organizational costs and start-up costs in 2025. See *Start-Up Costs and Organizational Costs,* page 18-11.

For E&P purposes. A deduction for organizational costs is specifically referred to in IRC section 312(n)(3) as not being allowed in computing E&P. However, IRC section 312 does not specifically address start-up costs. For purposes of this example, organizational costs and start-up costs will be fully deducted in 2025 for tax purposes, but neither will be deducted for purposes of computing earnings and profits. See *Earnings and Profits (E&P),* page 18-17.

Organizational costs. The attorney's fee of $2,000 and the tax consultant's fee of $2,500 are organizational costs. Because the organizational costs are less than the $5,000 limit, Greener Pastures, Inc. will deduct the entire amount in 2025 for tax purposes. There will be no deduction for organizational costs for purposes of computing E&P.

Start-up costs. The corporation incurred $1,660 in travel expenses for visiting prospective suppliers in advance of the business start date of April 1, 2025. Because the travel expenses were incurred before the business started operating, they are classified as start-up costs. Because the start-up costs are less than the $5,000 limit, Greener Pastures, Inc. will deduct the entire amount in 2025 for tax purposes. There will be no deduction for start-up costs for purposes of computing E&P.

Purchase of Assets

Greener Pastures Inc. took out a bank loan of $49,900 to purchase equipment for hydroseeding. It paid cash for display shelving, office furniture, and computers totaling $19,500.

Equipment	$49,900
Display shelving	10,000
Office furniture	5,000
Computers	4,500
Total	$69,400

The corporation elects out of the special depreciation allowance.

Section 179 deduction and depreciation. A Section 179 deduction of up to $2,500,000 is available for tax year 2025. Greener Pastures, Inc. elects to claim a Section 179 deduction for the display shelving only. The remaining assets will be depreciated for tax purposes under regular MACRS using a short tax year.

For E&P purposes, any amount claimed as a Section 179 deduction is depreciated using the straight-line method over five years. Any depreciable amount not claimed as a Section 179 deduction is depreciated using the straight-line method over the asset's ADS life.

Short tax year depreciation. Since the C corporation's first year is less than 12 months, depreciation cannot be computed using the MACRS percentage tables. See *Short Tax Year Depreciation,* page 9-6.

See *2025 Tax Depreciation Schedule—Greener Pastures, Inc.,* page 18-24, and *Depreciation Worksheet—Greener Pastures, Inc.,* page 18-30.

Payroll

Employees. Greener Pastures, Inc. hired Evan to assist Tyler with hydroseeding, Cyndi as an assistant store manager, and Tristan and Jordan as salespeople. In addition to wages, the corporation will provide health benefits through health insurance and HSAs, and retirement benefits through a SIMPLE plan. See *Payroll Report for Year Ended December 31, 2025,* page 18-24.

Draft

Form **1120** Department of the Treasury Internal Revenue Service

U.S. Corporation Income Tax Return

For calendar year 2025 or tax year beginning 4/1, 2025, ending 12/31, 20 25

Go to *www.irs.gov/Form1120* for instructions and the latest information.

OMB No. 1545-0123 **2025**

A Check if: 1a Consolidated return (attach Form 851) ☐ b Life/nonlife consolidated return ☐ 2 Personal holding co. (attach Sch. PH) ☐ 3 Personal service corp. (see instructions) ☐ 4 Schedule M-3 attached ☐

Name: Greener Pastures, Inc.

B Employer identification number: 31-2345678

Number and street. If a P.O. box, see instructions.: 123 Prairie Point

Room or suite no.

C Date incorporated: 4/1/25

City or town: Farmdale | State or province: MN | Country: United States | ZIP or foreign postal code: 55555

D Total assets (see instructions): $ 160,216

E Check if: (1) ☒ Initial return (2) ☐ Final return (3) ☐ Name change (4) ☐ Address change

Income	1a	Gross receipts or sales	1a 553,800	
	b	Returns and allowances	1b	
	c	Balance. Subtract line 1b from line 1a	1c	553,800
	2	Cost of goods sold (attach Form 1125-A)	2	204,231
	3	Gross profit. Subtract line 2 from line 1c	3	349,569
	4	Dividends and inclusions (Schedule C, line 23)	4	665
	5	Interest	5	
	6	Gross rents	6	
	7	Gross royalties	7	
	8	Capital gain net income (attach Schedule D (Form 1120))	8	
	9	Net gain or (loss) from Form 4797, Part II, line 17 (attach Form 4797)	9	
	10	Other income (see instructions—attach statement)	10	
	11	**Total income.** Add lines 3 through 10	11	350,234
Deductions (See instructions for limitations on deductions.)	12	Compensation of officers (see instructions—attach Form 1125-E)	12	90,000
	13	Salaries and wages (less employment credits)	13	94,770
	14	Repairs and maintenance	14	
	15	Bad debts	15	
	16	Rents	16	10,800
	17	Taxes and licenses	17	21,054
	18	Interest (see instructions)	18	1,577
	19	Charitable contributions	19	
	20	Depreciation from Form 4562 not claimed on Form 1125-A or elsewhere on return (attach Form 4562)	20	16,557
	21	Depletion	21	
	22	Advertising	22	3,000
	23	Pension, profit-sharing, etc., plans	23	26,689
	24	Employee benefit programs	24	49,200
	25	Energy efficient commercial buildings deduction (attach Form 7205)	25	
	26	Other deductions (attach statement)	26	17,735
	27	**Total deductions.** Add lines 12 through 26	27	331,382
	28	Taxable income before net operating loss deduction and special deductions. Subtract line 27 from line 11.	28	18,852
	29a	Net operating loss deduction (see instructions)	29a	
	b	Special deductions (Schedule C, line 24)	29b	
	c	Add lines 29a and 29b	29c	
Tax, Refundable Credits, and Payments	30	**Taxable income.** Subtract line 29c from line 28. See instructions	30	18,852
	31	Total tax (Schedule J, line 12)	31	3,860
	32	Reserved for future use	32	
	33	Total payments and credits (Schedule J, line 23)	33	3,000
	34	Estimated tax penalty. See instructions. Check if Form 2220 is attached ☐	34	
	35	**Amount owed.** If line 33 is smaller than the total of lines 31 and 34, enter amount owed	35	
	36	**Overpayment.** If line 33 is larger than the total of lines 31 and 34, enter amount overpaid	36	860
	37	Enter amount from line 36 you want: **a Credited to 2026 estimated tax** **b Refunded**	37b	
		c Routing number; d Type: ☐ Checking ☐ Savings; e Account number		

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.

Nate — Signature of officer | Date | CEO — Title

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

Paid Preparer Use Only Preparer's name | Preparer's signature | Date | Check ☐ if self-employed | PTIN

Firm's name | Firm's EIN

Firm's address | Phone no.

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 11450Q Form **1120** (2025) Created 3/25/25

Dividends

In December 2025, Greener Pastures, Inc. distributed profits by making dividend distributions in the amount of $0.10 per share. Nate, who owns 55,000 shares of stock, received a dividend of $5,500. Tyler, who owns 45,000 shares, received a dividend of $4,500.

Financial Statements

The balance sheet and income statement for the short year ended December 31, 2025, along with the depreciation schedule and payroll report for Greener Pastures, Inc. can be found on page 18-24. A cash flow reconciliation statement for the short year is found on page 18-25.

Line-by-Line Explanation of C Corporation Example—Page 1, Form 1120

Heading information:

Item B. For information about how to apply for an EIN, see page 5-1.

Item D. Enter the corporation's total assets at the end of the tax year. If there are no assets at the end of the tax year, enter -0-. If the corporation is required to complete Schedule L, total assets from Form 1120 (Schedule L, line 15, column d) should match item D, page 1, Form 1120.

Principal business activity code. A C corporation does not report a principal activity code on page 1 of its tax return like an

Form 1120 (2025) *Draft* Page 6

Schedule L Balance Sheets per Books	Beginning of tax year (a)	(b)	End of tax year (c)	(d)
Assets				
1 Cash				85,825
2a Trade notes and accounts receivable				
b Less allowance for bad debts	( )		( )	
3 Inventories				14,500
4 U.S. government obligations				
5 Tax-exempt securities (see instructions)				
6 Other current assets (attach statement)				
7 Loans to shareholders				
8 Mortgage and real estate loans				
9 Other investments (attach statement)				
10a Buildings and other depreciable assets			69,400	
b Less accumulated depreciation	( )		(5,669)	63,731
11a Depletable assets				
b Less accumulated depletion	( )		( )	
12 Land (net of any amortization)				
13a Intangible assets (amortizable only)				
b Less accumulated amortization	( )		( )	
14 Other assets (attach statement)				6,160
15 Total assets				170,216
Liabilities and Shareholders' Equity				
16 Accounts payable				
17 Mortgages, notes, bonds payable in less than 1 year				
18 Other current liabilities (attach statement)				4,221
19 Loans from shareholders				
20 Mortgages, notes, bonds payable in 1 year or more				43,944
21 Other liabilities (attach statement)				
22 Capital stock: a Preferred stock				
b Common stock			100,000	100,000
23 Additional paid-in capital				
24 Retained earnings—Appropriated (attach statement)				
25 Retained earnings—Unappropriated				22,051
26 Adjustments to shareholders' equity (attach statement)				
27 Less cost of treasury stock		( )		( )
28 Total liabilities and shareholders' equity				170,216

Schedule M-1 Reconciliation of Income (Loss) per Books With Income per Return

Note: The corporation may be required to file Schedule M-3. See instructions.

1	Net income (loss) per books	32,051	7	Income recorded on books this year not included on this return (itemize): Tax-exempt interest $	
2	Federal income tax per books	3,000			
3	Excess of capital losses over capital gains				
4	Income subject to tax not recorded on books this year (itemize):		8	Deductions on this return not charged against book income this year (itemize):	
5	Expenses recorded on books this year not deducted on this return (itemize):		a	Depreciation $ 10,888	
a	Depreciation $		b	Charitable contributions $	
b	Charitable contributions $			Organizational costs 4,500	
c	Travel and entertainment $			Start-up costs 1,660	17,048
	Meals & entertainment 750; Foreign tax paid 99	849	9	Add lines 7 and 8	17,048
6	Add lines 1 through 5	35,900	10	Income (page 1, line 28)—line 6 less line 9	18,852

Schedule M-2 Analysis of Unappropriated Retained Earnings per Books (Schedule L, Line 25)

1	Balance at beginning of year	0	5	Distributions: a Cash	10,000
2	Net income (loss) per books	32,051		b Stock	
3	Other increases (itemize):			c Property	
			6	Other decreases (itemize):	
			7	Add lines 5 and 6	10,000
4	Add lines 1, 2, and 3	32,051	8	Balance at end of year (line 4 less line 7)	22,051

Form **1120** (2025)

S corporation or partnership. Instead, the principal business activity code is entered on Form 1120 (Schedule K, line 2). See *Principal Business or Professional Activity Codes for Corporations and Partnerships,* page 25-6.

Income

Line 1. Gross receipts or sales. Enter gross receipts or sales from all trade or business operations except those entered on lines 4 through 10.

In this example, lawn and garden implement sales of $265,500 and hydroseeding sales of $288,300 add up to $553,800 total sales.

Line 2. Cost of goods sold (COGS). The COGS is computed on Form 1125-A, *Cost of Goods Sold,* and carried to line 2.

In this example, COGS equals $204,231 (rounded).

Line 4. Dividends and inclusions. Dividend income is reported on Form 1120 (Schedule C), and carried to line 4.

In this example, dividend income is $665.

Deductions

Line 12. Compensation of officers. Enter the deductible portion of each officer's compensation. If the corporation's total receipts are $500,000 or more, complete Form 1125-E, *Compensation of Officers,* and attach to Form 1120.

In this example, the compensation of officers is $90,000, which represents Nate's wages of $55,755 minus $5,500 SIMPLE elective deferrals and Tyler's wages of $44,245 minus $4,500 elective deferrals.

Line 13. Salaries and wages. Enter salaries and wages not reported on line 12. Do not include salaries and wages deductible elsewhere on the return, such as amounts included in the COGS and 401(k) and SIMPLE elective deferrals.

If the corporation claims a credit for any wages paid or incurred, it may need to reduce its deduction for officers' compensation and salaries and wages. See *Reducing Certain Expenses for Which Credits Are Allowable,* page 31-6.

In this example, the deductible salaries and wages amount is $94,770, which consists of gross salaries of nonshareholder employees of $105,300, less their respective SIMPLE elective deferrals of $10,530.

Line 16. Rents. Enter rent paid on business property used in a trade or business.

In this example, the corporation paid $10,800 during the year for facility rental.

Line 17. Taxes and licenses. Enter taxes paid or accrued during the tax year, but do not include the following.

- Federal income taxes.
- Foreign or U.S. possession income taxes if a tax credit is claimed.
- Taxes not imposed on the corporation.
- Taxes attributable to cost of property that must be capitalized.
- Taxes deducted elsewhere on the return, such as those reflected in the COGS.

In this example, taxes of $21,054 (rounded) consists of employer Social Security tax of $12,728.60, employer Medicare tax of $2,976.85, FUTA of $252.00, state unemployment taxes of $3,596.44, and state estimated taxes of $1,500.00.

Line 18. Interest. Include only interest incurred in the corporation's trade or business activities that is not deducted elsewhere on the return. See *Business Interest Expense,* page 18-10.

In this example, interest expense of $1,577 on the equipment loan is deducted.

Line 20. Depreciation. Report on line 20 the amount of depreciation computed on Form 4562. See *2025 Tax Depreciation Schedule—Greener Pastures, Inc.,* page 18-24, and *Depreciation Worksheet—Greener Pastures, Inc,* page 18-30.

Line 23. Pension, profit-sharing, etc. plans. In this example, the corporation paid $6,159 in employer matching contributions to a SIMPLE retirement plan for employees. This is added to the employee voluntary deferrals of $20,530 for a total deduction of $26,689.

For more information about retirement plans, see *Retirement, Social Security, and Medicare,* Tab 13.

Line 24. Employee benefit programs. Enter contributions to employee benefit programs not included on other lines on the return. In this example, the deduction of $49,200 includes $23,400 for health insurance and $25,800 for contributions

to employees' health savings accounts (HSAs).

Line 26. Other deductions. Attach a schedule of other deductions not itemized on other lines on Form 1120.

Meals and entertainment. Meals and entertainment expense of $1,100 represents $700 of meals and $400 of entertainment. The meals were meetings with the shareholders and potential clients. The corporation can deduct 50% of the business meals paid or incurred during 2025. The entertainment expense is not deductible.

Following is a statement of other deductions for this example.

Statement of Other Deductions—Line 26, Form 1120	
Accounting (organizational costs)	$2,500
Attorney fees (organizational costs)	2,000
Bookkeeping	2,800
Insurance-business	3,250
Meals ($700 × 50%)	350
Office expenses	2,325
Travel and lodging (start-up costs)	1,660
Utilities	2,850
Total other deductions	$17,735

Schedule J, Tax Computation and Payment

Line 31. Total tax. Compute tax on Form 1120 (Schedule J).

In this example, the corporate income tax is $3,959 (taxable income of $18,852 × 21% tax rate). The foreign tax credit is computed on Form 1118, *Foreign Tax Credit – Corporations,* and carried to line 5a. In this example, a foreign tax credit of $99 is allowed. Total tax is $3,860.

Schedule L, Balance Sheet per Books

The balance sheet should agree with the corporation's books and records. Corporations with total receipts and total assets at the end of the year less than $250,000 are not required to complete Schedules L, M-1, and M-2 if the "Yes" box on question 13, Schedule K, is checked.

Author's Comment: A corporation that is not required to complete Schedules L, M-1, and M-2 still must maintain adequate books and records for income tax purposes. Adequate books and records generally consist of a general ledger, trial balance, balance sheet, and income statement. Completing Schedules L, M-1, and M-2, even when not required, may be beneficial in assuring that the tax return has been prepared properly based on book income.

Line 10b. Accumulated depreciation. Schedule L reflects book depreciation. See *Depreciation Worksheet—Greener Pastures, Inc.,* page 18-30.

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Schedule J **Tax Computation and Payment** (see instructions)

1a	Income tax (see instructions)	1a	3,959		
b	Tax from Form 1120-L (see instructions)	1b			
c	Section 1291 tax from Form 8621	1c			
d	Tax adjustment from Form 8978	1d			
e	Additional tax under section 197(f)	1e			
f	Base erosion minimum tax from Form 8991	1f			
g	Amount from Form 4255, Part I, line 3, column (q)	1g			
z	Other chapter 1 tax	1z			
2	Total income tax. Add lines 1a through 1z			2	3,959
3	Corporate alternative minimum tax from Form 4626, Part II, line 13 (attach Form 4626)			3	
4	Add lines 2 and 3			4	3,959
5a	Foreign tax credit (attach Form 1118)	5a	99		
b	Credit from Form 8834 (see instructions)	5b			
c	General business credit (see instructions—attach Form 3800)	5c			
d	Credit for prior year minimum tax (attach Form 8827)	5d			
e	Bond credits from Form 8912	5e			
f	Adjustment from Form 8978	5f			
6	**Total credits.** Add lines 5a through 5f			6	99
7	Subtract line 6 from line 4			7	3,860
8	Personal holding company tax (attach Schedule PH (Form 1120))			8	
10	**Total.** Add lines 9a through 9z			10	
11a	Total tax before deferred taxes. Add lines 7, 8, and 10	11a	3,860		
b	Deferred tax on the corporation's share of undistributed earnings of a qualified electing fund	11b			
c	Deferred LIFO recapture tax (section 1363(d))	11c			
12	Total tax. Subtract the sum of lines 11b and 11c from 11a. Enter here and on page 1, line 31			12	3,860
13	Preceding year's overpayment credited to the current year			13	
14	Current year's estimated tax payments			14	3,000
15	Current year's refund applied for on Form 4466			15	( )
16	Reserved for future use			16	
17	Tax deposited with Form 7004			17	
18	Withholding (see instructions)			18	
19	**Total payments.** Combine lines 13 through 18			19	3,000
21	**Total credits.** Add lines 20a through 20z			21	
22	Elective payment election amount from Form 3800			22	
23	**Total payments and credits.** Add lines 19, 21, and 22. Enter here and on page 1, line 33			23	3,000

Form **1120** (2025)

Line 14. Other assets. In this example, other assets consist of $4,500 organizational costs and $1,660 of start-up costs for a total of $6,160. See *Organizational Costs and Start-Up Costs,* page 18-25.

Line 18. Other current liabilities. In this example, other current liabilities of $4,221 (rounded) represent employee withholding payable of $1,263.70 (Social Security $326.37, Medicare $76.33, federal income tax $592.00, and state income tax $269.00), Employer's Social Security and Medicare payable of $402.70 ($326.37 + $76.33), SIMPLE employee deferrals payable of $526.00, and sales tax payable of $2,028.14.

Schedule M-1, Reconciliation of Income (Loss) per Books With Income per Return

Corporations with total receipts and total assets at the end of the tax year less than $250,000 are not required to complete Schedules L, M-1, and M-2 if the "Yes" box on Schedule K, question 13, is checked.

Corporations with total assets of $10 million or more on the last day of the tax year must complete Schedule M-3 instead of Schedule M-1. See the separate Schedule M-3 and instructions for completing the form.

For more information, see *Schedule M-1, Reconciliation of Income (Loss) per Books With Income (Loss) per Return,* page 27-16, and *Net Income (Loss) Reconciliation—Schedule M-3,* page 27-17.

Line 5c. Expenses recorded on books this year not deducted on this return. In this example, expenses not deducted on this return include the nondeductible meals and entertainment of $750 and foreign tax paid of $99 for a total of $849.

Line 8. Deductions on this return not charged against book income this year. In this example, line 8a, Depreciation, $10,888 is the difference between $16,557 depreciation deducted on the return (Section 179 deduction of $10,000 plus regular depreciation of $6,557) and book depreciation of $5,669. See *Depreciation Worksheet—Greener Pastures, Inc.,* page 18-30.

Line 8b consists of organizational costs of $4,500 and start-up costs of $1,660 which are deducted on the tax return but are capitalized for book purposes. See *Organizational Costs and Start-Up Costs,* page 18-25.

Schedule M-2, Analysis of Unappropriated Retained Earnings per Books (Line 25, Schedule L)

Line 5. Distributions. In this example, the corporation distributed dividends to shareholders in the amount of $10,000. See *Dividends,* page 18-26. Dividends are generally taxable income to the recipients but not deductible for the corporation. See *Distributions to Shareholders,* page 18-15.

Form **4562**

Department of the Treasury
Internal Revenue Service

Depreciation and Amortization
(Including Information on Listed Property)

Attach to your tax return.
Go to *www.irs.gov/Form4562* for instructions and the latest information.

OMB No. 1545-0172

2025

Attachment Sequence No. **179**

Name(s) shown on return	Business or activity to which this form relates	Identifying number
Greener Pastures, Inc.	Retail Sales — Form 1120	31-2345678

Part I **Election To Expense Certain Property Under Section 179**
Note: If you have any listed property, complete Part V before you complete Part I.

1	Maximum amount (see instructions)	1	2,500,000
2	Total cost of section 179 property placed in service (see instructions)	2	69,400
3	Threshold cost of section 179 property before reduction in limitation (see instructions)	3	4,000,000
4	Reduction in limitation. Subtract line 3 from line 2. If zero or less, enter -0-	4	0
5	Dollar limitation for tax year. Subtract line 4 from line 1. If zero or less, enter -0-. If married filing separately, see instructions	5	

6	(a) Description of property	(b) Cost (business use only)	(c) Elected cost
	Display shelving	10,000	10,000

7	Listed property. Enter the amount from line 29	7	
8	Total elected cost of section 179 property. Add amounts in column (c), lines 6 and 7	8	10,000
9	Tentative deduction. Enter the **smaller** of line 5 or line 8	9	10,000
10	Carryover of disallowed deduction from line 13 of your 2024 Form 4562	10	
11	Business income limitation. Enter the smaller of business income (not less than zero) or line 5. See instructions	11	28,852
12	Section 179 expense deduction. Add lines 9 and 10, but don't enter more than line 11	12	10,000
13	Carryover of disallowed deduction to 2026. Add lines 9 and 10, less line 12	13	

Note: Don't use Part II or Part III below for listed property. Instead, use Part V.

Part II **Special Depreciation Allowance and Other Depreciation (Don't** include listed property. See instructions.)

14	Special depreciation allowance for qualified property (other than listed property) placed in service during the tax year. See instructions	14	
15	Property subject to section 168(f)(1) election	15	
16	Other depreciation (including ACRS)	16	

Part III **MACRS Depreciation (Don't** include listed property. See instructions.)

Section A

17	MACRS deductions for assets placed in service in tax years beginning before 2025	17	
18	If you are electing to group any assets placed in service during the tax year into one or more general asset accounts, check here ☐		

Section B—Assets Placed in Service During 2025 Tax Year Using the General Depreciation System

Lorem ipsum

(a) Classification of property (see instructions)	(b) Month and year placed in service	(c) Basis for depreciation (business/investment use only—see instructions)	(d) Recovery period	(e) Convention	(f) Method	(g) Depreciation deduction
19a 3-year property						
b 5-year property		4,500	5 Yr.	HY	200DB	675
c 7-year property		54,900	7 Yr.	HY	200DB	5,882
d 10-year property						
e 15-year property						
f 20-year property						
g 25-year property			25 yrs.		S/L	
h 50-year property			50 yrs.	MM	S/L	
i Residential rental property			27.5 yrs.	MM	S/L	
			27.5 yrs.	MM	S/L	
j Nonresidential real property			39 yrs.	MM	S/L	
				MM	S/L	

Section C—Assets Placed in Service During 2025 Tax Year Using the Alternative Depreciation System

20a Class life					S/L	
b 12-year			12 yrs.		S/L	
c 30-year			30 yrs.	MM	S/L	
d 40-year			40 yrs.	MM	S/L	
e 50-year			50 yrs.	MM	S/L	

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Form 4562 (2025) Page **2**

Part IV **Summary** (See instructions.)

21	Listed property. Enter amount from line 28	21	
22	**Total.** Add amounts from line 12, lines 14 through 17, lines 19 and 20 in column (g), and line 21. Enter here and on the appropriate lines of your return. Partnerships and S corporations—see instructions	22	16,557
23a	For assets shown in Part III that are placed in service during the current tax year, and have costs capitalized under section 263A, enter the amount of the basis attributable to interest costs capitalized under section 263A(f)	23a	

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Form **1040** Department of the Treasury—Internal Revenue Service **U.S. Individual Income Tax Return** 2025 OMB No. 1545-0074 IRS Use Only—Do not write or staple in this space.

For the year Jan. 1–Dec. 31, 2025, or other tax year beginning , 2025, ending , 20 See separate instructions.

☐ Filed pursuant to section 301.9100-2 ☐ Combat zone ☐ Deceased MM / DD / YYYY Spouse MM / DD / YYYY

☐ Other

Your first name and middle initial	Last name	Your social security number
Nate		xxx xx xxx1
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. Check here if your main home, and your spouse's if filing a joint return, was in the U.S. for more than half of 2025. ☒

City, town, or post office. If you have a foreign address, also complete spaces below. State ZIP 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

Foreign country name Foreign province/state/county Foreign postal code

Filing Status ☒ Single ☐ Head of household (HOH)

Digital Assets At any time during 2025, 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

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.

1a	Total amount from Form(s) W-2, box 1 (see instructions)			1a	50,255
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 31			1f	
g	Wages from Form 8919, line 6			1g	
h	Other earned income (see instructions). Enter type and amount:			1h	
i	Nontaxable combat pay election (see instructions)	1i			
z	Add lines 1a through 1h			1z	50,255
2a	Tax-exempt interest	2a	b Taxable interest	2b	
3a	Qualified dividends	3a 5,500	b Ordinary dividends	3b	5,500
c	Check if your child's dividends are included in 1 ☐ Line 3a		2 ☐ Line 3b		
4a	IRA distributions	4a	b Taxable amount	4b	
c	Check if (see instructions) 1 ☐ Rollover		2 ☐ QCD 3 ☐		
5a	Pensions and annuities	5a	b Taxable amount	5b	
c	Check if (see instructions) 1 ☐ Rollover		2 ☐ PSO 3 ☐		
6a	Social security benefits	6a	b Taxable amount	6b	
c	If you elect to use the lump-sum election method, check here (see instructions) ☐				
d	If you are married filing separately and lived apart from your spouse the entire year (see inst.), check here ☐				
7a	Capital gain or (loss). Attach Schedule D if required			7a	
b	Check if: ☐ Schedule D not required ☐ Includes child's capital gain or (loss)				
8	Additional income from Schedule 1, line 10			8	
9	Add lines 1z, 2b, 3b, 4b, 5b, 6b, 7a, and 8. This is your **total income**			9	55,755
10	Adjustments to income from Schedule 1, line 26			10	
11a	Subtract line 10 from line 9. This is your **adjusted gross income**			11a	55,755

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Form 1040 (2025) Page **2**

Tax and Credits

11b	Amount from line 11a (adjusted gross income)	11b	55,755
12a	Someone can claim ☐ You as a dependent ☐ Your spouse as a dependent		
b	☐ Spouse itemizes on a separate return c ☐ You were a dual-status alien		
d	**You:** ☐ Were born before January 2, 1961 ☐ Are blind		
	Spouse: ☐ Was born before January 2, 1961 ☐ Is blind		
e	**Standard deduction or itemized deductions** (from Schedule A)	12e	15,750
13a	Qualified business income deduction from Form 8995 or Form 8995-A	13a	
b	Additional deductions from Schedule 1-A, line 38	13b	
14	Add lines 12e, 13a, and 13b	14	15,750
15	Subtract line 14 from line 11b. If zero or less, enter -0-. This is your **taxable income**	15	40,005
16	**Tax** (see instructions). Check if any from Form(s): 1 ☐ 8814 2 ☐ 4972 3 ☐	16	
17	Amount from Schedule 2, line 3	17	
18	Add lines 16 and 17	18	
19	Child tax credit or credit for other dependents from Schedule 8812	19	

tandard eduction for—
Single or Married filing separately, $15,750
Married filing jointly or Qualifying surviving spouse, $31,500
Head of household,

Depreciation Worksheet—Greener Pastures, Inc.

Description of Property		Date Placed in Service	Cost or Other Basis (less land)	Business/ Investment Use Percentage	Section 179 Deduction and Special Allowance	Basis for Depreciation	Method Convention	Recovery Period	Depreciation Prior Years	%	2025 Tax Year Depr. Amount	%	Tax Year Depr. Amount	%	Tax Year Depr. Amount	%	Tax Year Depr. Amount
Equipment	*Tax*	4/1/25	49,900	100%	0	49,900	200DB/HY	7 yr.			5,346						
	Books	4/1/25	49,900	100%	0	49,900	SL	12 yr.			3,119						
Display shelving	*Tax*	4/1/25	10,000	100%	10,000	0	200DB/HY	7 yr.			0						
	Books	4/1/25	10,000	100%	0	10,000	SL	5 yr.			1,500						
Office furniture	*Tax*	4/1/25	5,000	100%	0	5,000	200DB/HY	7 yr.			536						
	Books	4/1/25	5,000	100%	0	5,000	SL	10 yr.			375						
Computers	*Tax*	4/1/25	4,500	100%	0	4,500	200DB/HY	5 yr.			675						
	Books	4/1/25	4,500	100%	0	4,500	SL	5 yr.			675						
	Tax																
	Books																
	Tax																
	Books																
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	Books																
Totals	*Tax*		69,400		10,000	59,400					6,557						
	Books		69,400		0	69,400					5,669						

Depreciation Summary

Tax	Section 179 Expense	$10,000	Depreciation	$6,557	Total	$16,557
Books (E&P)	Section 179 Expense	$ 0	Depreciation	$5,669	Total	$ 5,669

Notes:

- Any amount taken as a Section 179 expense for tax purposes is depreciated for E&P purposes SL over five years. [IRC §312(k)(3)(B)]
- Amounts not taken as a Section 179 expense are eligible for regular MACRS for tax purposes.
- Depreciation for E&P purposes is computed using SL over the asset's ADS recovery period (except for Section 179 expense items as shown above).

~ End ~