



# Evaluating Self-Employed Borrowers TAX YEAR 2022

Partnerships and S Corporations



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## Objectives

- Review business structures
- Convert tax entries into cash flow:
  - ▶ S Corporations
    - K-1s
  - ▶ Partnerships
    - K-1s
    - Guaranteed Payments
- Understand business liquidity
- Your questions



# Income calculation tools



## What do I need to start?

### Loan application

- ▶ Tells borrower's story

### Tax returns


- ▶ Personal
- ▶ Business
- ▶ 1 or 2 years of each

### Worksheet

- ▶ Documents your decisions



# Cash flow worksheets

 **Fannie Mae** **Cash Flow Analysis (Form 1084)**

Borrower Name: \_\_\_\_\_

*Business Name (optional):* \_\_\_\_\_

This worksheet may be used to prepare a written evaluation of the analysis of income related to self-employment. The purpose of this written analysis is to determine the amount of stable and continuous income that will be available to the borrower for loan qualifying purposes.


**IRS Form 1040 – Individual Income Tax Return**

	Year _____	Year _____
<b>1. W-2 Income from Self-Employment</b>	(+) _____	(+) _____
<b>2. Schedule B – Interest and Ordinary Dividends</b>		
a. Interest Income from Self-Employment	(+) _____	(+) _____
b. Dividends from Self-Employment	(+) _____	(+) _____
<b>3. Schedule C – Profit or Loss from Business: Sole Proprietorship</b>		
a. Net Profit or (Loss)	(+/-) _____	(+/-) _____
b. Nonrecurring Other (Income) Loss/Expenses	(+/-) _____	(+/-) _____
c. Depletion	(+) _____	(+) _____
d. Depreciation	(+) _____	(+) _____
e. Non-deductible Travel and Meals Expenses	(-) _____	(-) _____
f. Business Use of Home	(+) _____	(+) _____
g. Amortization/Casualty Loss	(+) _____	(+) _____
<b>4. Schedule D – Capital Gains and Losses</b>		
a. Recurring Capital Gains	(+) _____	(+) _____
<b>5. Schedule E – Supplemental Income and Loss</b>		
<b>Note:</b> A lender may use Fannie Mae Rental Income Worksheets (Form 1037 or Form 1038) to calculate individual rental income (loss) reported on Schedule E.		
a. Royalties Received	(+) _____	(+) _____
b. Total Expenses	(-) _____	(-) _____
c. Depreciation	(+) _____	(+) _____
<b>6. Schedule F – Profit or Loss from Farming</b>		
a. Net Farm Profit or (Loss)	(+/-) _____	(+/-) _____
b. Non-Tax Portion Ongoing Coop and CCC Payments	(+) _____	(+) _____
c. Nonrecurring Other (Income) Loss	(+/-) _____	(+/-) _____
d. Depreciation	(+) _____	(+) _____
e. Amortization/Casualty Loss/Depletion	(+) _____	(+) _____
f. Business Use of Home	(+) _____	(+) _____

**Note:** IRS Form 4797 (Sales of Business Property) is not included on this worksheet due to its infrequent use. If applicable, a lender may include analysis of the sale and related recurring capital gains.

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Borrower Name: \_\_\_\_\_

 **Form 91**

**Income Calculations**  
*(Schedule Analysis Method)*

Form 91 is to be used to document the Seller's calculation of the income for a self-employed Borrower. This form is a tool to help the Seller calculate the income for a self-employed Borrower; the Seller's calculations must be based on the requirements and guidance for the determination of stable monthly income in Topic 5300. This form does not replace the requirements and guidance for the analysis and treatment of the income for self-employed Borrowers as described in Chapters 5304 and 5305.

**I. Income Calculations from IRS Form 1040**

IRS Form 1040 Federal Individual Income Tax Return	Year: _____	Year: _____
<b>1. W-2 Income from self-employment (reported on IRS Forms 1040 and 1120 or 1120S)</b>		
Name of business: _____		
IRS Form 1040, W-2 Income – Officer Compensation (Section 5304.1(d)) <sup>1</sup>	(+) _____	(+) _____
<b>Subtotal of W-2 Income from self-employment</b>	\$ _____	\$ _____
<small>Validate with business returns and IRS Form 1125-E, Compensation of Officers, as applicable.</small>		
<b>2. Schedule B – Interest and Ordinary Dividends</b>		
Recurring interest income (Chapter 5305)	(+) _____	(+) _____
Recurring dividend income (Chapter 5305)	(+) _____	(+) _____
Dividend income from self-employment reported on IRS Form 1120	(-) _____	(-) _____
<b>Subtotal of dividends and interest</b>	\$ _____	\$ _____

Freddie Mac Single-Family Seller/Service Guide 05/01/19 Bulletin 2019-9 Page F91-1



# SAM: Schedule Analysis Method

[mgic.com/seb](http://mgic.com/seb)

Need help?  
Line-by-line link to the  
SAM Worksheet Help Document



**SAM Method** **Cash Flow Analysis Worksheet** **MGIC**

BORROWER AND/OR CO-BORROWER NAME: \_\_\_\_\_ DATE: \_\_\_\_\_

YEAR 1: \_\_\_\_\_ YEAR 2: \_\_\_\_\_

SCHEDULE B - INTEREST AND DIVIDENDS FROM SELF-EMPLOYMENT

**S Corporation Cash Flow**

Evaluate business income as required by your investor.

S CORPORATION Name: \_\_\_\_\_

**SCHEDULE K-1**

35	Ordinary Income (Loss): LINE 1 IF > Distributions see additional requirements.		
36	Net Rental Income (Loss): LINES 2 & 3 IF > Distributions see additional requirements.		
	<b>SUBTOTAL</b>	\$ -	\$ -
<b>FORM W-2</b>			
37	Wages: W-2, Box 5 (in general)		
<b>FORM 1120S</b>			
38	Deduct nonrecurring income/add nonrecurring loss: LINES 4 & 5		
39	Depreciation: LINE 14		
40	Depreciation (FORM 8825): LINE 14		
41	Depletion: LINE 15		
42	Amortization/Casualty Loss (only if noted): LINE 19 from attached statement		
43	Mortgages or Notes Payable in Less Than 1 Year: Schedule L, LINE 17, Column d	( )	( )
44	Travel and Entertainment Exclusion: Schedule M-1, LINE 3b	( )	( )
	<b>SUBTOTAL</b>	\$ -	\$ -
45	Multiplied by Ownership Percentage		
	Shareholder's Total Share of Income (Loss)	\$ -	\$ -

**Corporation Cash Flow**

Evaluate business income as required by your investor.

CORPORATION Name: \_\_\_\_\_

CORPORATION Name: \_\_\_\_\_

CORPORATION Name: \_\_\_\_\_

CORPORATION Name: \_\_\_\_\_



SAM cash flow analysis summary



Each business subtotals

SAM Cash Flow Analysis Worksheet with P&L								
PERSONAL CASH FLOW SUBTOTALS:								
	2022		2021		Qualifying Income		Total No. of Months	
	Subtotal	# mo.	Subtotal	# mo.				
Schedule B	\$ 3,700.00	12	\$ 3,600.00	12	\$	304.17		24
Schedule C Tech in a Sec	\$ 49,460.00	12	\$ 36,390.00	12	\$	3,577.08		24
PARTNERSHIP & S CORPORATION CASH FLOW SUBTOTALS:								
Schedule K-1 Tanglewood Realty	\$ (3,800.00)	12	\$ (10,000.00)	12	\$	(575.00)		24
W-2 Wages Tanglewood Realty	\$ -	12	\$ -	12	\$	-		24
Form 1065 Tanglewood Realty	\$ -	12	\$ -	12	\$	-		24
Partnership Tanglewood Realty Subtotal	\$ (3,800.00)		\$ (10,000.00)		\$	(575.00)		
Schedule K-1 Westchester Development	\$ 21,000.00	12	\$ 20,000.00	12	\$	1,708.33		24
W-2 Wages Westchester Development	\$ -	12	\$ -	12	\$	-		24
Form 1065 Westchester Development	\$ 1,200.00	12	\$ 1,000.00	12	\$	91.67		24
Partnership Westchester Development Subtotal	\$ 22,200.00		\$ 21,000.00		\$	1,800.00		
Schedule K-1 Digital Network Systems	\$ 32,550.00	12	\$ 26,900.00	12	\$	2,477.08		24
W-2 Wages Digital Network Systems	\$ -	12	\$ -	12	\$	-		24
Form 1120S Digital Network Systems	\$ 7,000.00	12	\$ 10,000.00	12	\$	708.33		24
S Corporation Digital Network Systems Subtotal	\$ 39,550.00		\$ 36,900.00		\$	3,185.41		
CORPORATION CASH FLOW SUBTOTALS:								
W-2 Wages Interior Innovations	\$ 54,000.00	12	\$ 49,000.00	0	\$	4,500.00		12
Form 1120 Interior Innovations	\$ 9,970.00	12	\$ 15,750.00	0	\$	830.83		12
Corporation Interior Innovations Subtotal	\$ 63,970.00		\$ -		\$	5,330.83		
<b>Average Monthly Cash Flow (Total)</b>					\$	<b>13,622.50</b>		

A large blue rectangular area containing the MGIC logo on the right side. The logo consists of a square divided into four quadrants (top-left blue, top-right white, bottom-left blue, bottom-right white), with the letters 'MGIC' in white on a dark blue horizontal bar across the middle. Below the bar are several horizontal stripes in white, light blue, and dark blue. The entire logo is set against a blue background. On the left side of the blue area, there are three vertical white stripes. In the bottom right corner of the blue area, the number '10' is written in white.

# Business Structures

10

# Business structures



Sole proprietorship	Partnership	S corporation	Corporation
<p>Unincorporated business with one owner with unlimited liability</p> <p>Schedule C</p> <p>(No business returns)</p> <p>Taxed at individual rate</p>	<p>Business arrangement between 2 or more people/partners (General or Limited)</p> <p>Schedule K-1</p> <p>Guaranteed payments</p> <p>Business files IRS Form 1065</p> <p>Each partner pays tax on their share of income</p>	<p>A legal entity that has a limited number of stockholders</p> <p>Schedule K-1</p> <p>SEB W-2</p> <p>Business files IRS Form 1120-S</p> <p>Each stockholder pays tax on their share of income</p>	<p>A legal entity that exists separate from owners who are shareholders</p> <p>IRS Form 1099-DIV</p> <p>SEB W-2</p> <p>Business files IRS Form 1120</p> <p>Corporation pays taxes</p>

\*A limited liability company (LLC) is a hybrid business and can file using the above IRS forms based on structure



# Schedule K-1 (Form 1065)

- Ownership percentage
- Part II: Box J



651121  
OMB No. 1545-0123

2022

Schedule K-1 (Form 1065) Department of the Treasury Internal Revenue Service

For calendar year 2022, or tax year beginning / / 2022 ending / /

**Partner's Share of Income, Deductions, Credits, etc.** See separate instructions.

**Part I Information About the Partnership**

A Partnership's employer identification number

B Partnership's name, address, city, state, and ZIP code

C IRS center where partnership filed return:

D  Check if this is a publicly traded partnership (PTP)

**Part II Information About the Partner**

E Partner's SSN or TIN (Do not use TIN of a disregarded entity. See instructions.)

F Name, address, city, state, and ZIP code for partner entered in E. See instructions.

G  General partner or LLC member-manager  Limited partner or other LLC member

H1  Domestic partner  Foreign partner

H2  If the partner is a disregarded entity (DE), enter the partner's:  
TIN \_\_\_\_\_ Name \_\_\_\_\_

I1 What type of entity is this partner?

I2 If this partner is a retirement plan (IRA/SEP/Keogh/etc.), check here

J Partner's share of profit, loss, and capital (see instructions):

	Beginning	Ending
Profit	%	%
Loss	%	%
Capital	%	%

Check if decrease is due to sale or exchange of partnership interest

K Partner's share of liabilities:

	Beginning	Ending
Nonrecourse	\$	\$
Qualified nonrecourse financing	\$	\$
Recourse	\$	\$

Check this box if item K includes liability amounts from lower-tier partnerships

L **Partner's Capital Account Analysis**

Beginning capital account	\$
Capital contributed during the year	\$
Current year net income (loss)	\$
Other increase (decrease) (attach explanation)	\$
Withdrawals and distributions	\$
Ending capital account	\$

**Part III Partner's Share of Current Year Income, Deductions, Credits, and Other Items**

1 Ordinary business income (loss)	14 Self-employment earnings (loss)
2 Net rental real estate income (loss)	
3 Other net rental income (loss)	15 Credits
4a Guaranteed payments for services	
4b Guaranteed payments for capital	16 Schedule K-3 is attached if checked <input type="checkbox"/>
4c Total guaranteed payments	17 Alternative minimum tax (AMT) items
5 Interest income	
6a Ordinary dividends	
6b Qualified dividends	18 Tax-exempt income and nondeductible expenses
6c Dividend equivalents	
7 Royalties	
8 Net short-term capital gain (loss)	19 Distributions
9a Net long-term capital gain (loss)	
9b Collectibles (28%) gain (loss)	20 Other information
9c Unrecaptured section 1250 gain	
10 Net section 1231 gain (loss)	
11 Other income (loss)	
12 Section 179 deduction	21 Foreign taxes paid or accrued
13 Other deductions	
22 <input type="checkbox"/> More than one activity for at-risk purposes*	
23 <input type="checkbox"/> More than one activity for passive activity purposes*	

\*See attached statement for additional information.

Only

# Schedule K-1 (Form 1120-S)

- Ownership percentage
- Part II: Box G



671121  
OMB No. 1545-0123

Final K-1    Amended K-1

**Schedule K-1 (Form 1120-S)**    **2022**  
Department of the Treasury  
Internal Revenue Service

For calendar year 2022, or tax year  
beginning / / 2022 ending / /

**Shareholder's Share of Income, Deductions, Credits, etc.**  
See separate instructions.

<b>Part I Information About the Corporation</b>		<b>Part III Shareholder's Share of Current Year Income, Deductions, Credits, and Other Items</b>	
<b>A</b> Corporation's employer identification number		<b>1</b> Ordinary business income (loss)	<b>13</b> Credits
<b>B</b> Corporation's name, address, city, state, and ZIP code		<b>2</b> Net rental real estate income (loss)	
<b>C</b> IRS Center where corporation filed return		<b>3</b> Other net rental income (loss)	
<b>D</b> Corporation's total number of shares Beginning of tax year . . . . . End of tax year . . . . .		<b>4</b> Interest income	
		<b>5a</b> Ordinary dividends	
		<b>5b</b> Qualified dividends	<b>14</b> Schedule K-3 is attached if checked . . . . . <input type="checkbox"/>
		<b>6</b> Royalties	<b>15</b> Alternative minimum tax (AMT) items
		<b>7</b> Net short-term capital gain (loss)	
		<b>8a</b> Net long-term capital gain (loss)	
		<b>8b</b> Collectibles (28%) gain (loss)	
		<b>8c</b> Unrecaptured section 1250 gain	
<b>Part II Information About the Shareholder</b>		<b>9</b> Net section 1231 gain (loss)	<b>16</b> Items affecting shareholder basis
<b>E</b> Shareholder's identifying number		<b>10</b> Other income (loss)	
<b>F</b> Shareholder's name, address, city, state, and ZIP code			
<b>G</b> Current year allocation percentage . . . . . %			<b>17</b> Other information
<b>H</b> Shareholder's number of shares Beginning of tax year . . . . . End of tax year . . . . .		<b>11</b> Section 179 deduction	
		<b>12</b> Other deductions	
<b>I</b> Loans from shareholder Beginning of tax year . . . . . \$ End of tax year . . . . . \$			





## Documentation matrix

This matrix identifies the documentation you need from self-employed borrowers to substantiate the various types of income they may receive from different business structures.

Note: All documents must be from the most recent 2-year period. The borrower must sign all tax returns and year-to-date information. Request business tax returns when the borrower has 25% or greater ownership interest in a business.



	Sole Proprietorship	Partnership (General, Limited or LLC)	S Corporation	Corporation
<b>Form 1040:</b> U.S. Individual Income Tax Return) with all applicable schedules and W-2s	X	X	X	X
<b>Schedule C:</b> Profit or Loss from Business	X			
<b>Schedule E, Part II:</b> Income or Loss From Partnerships or S Corporations		X	X	
<b>Schedule K-1 (Form 1065):</b> Partner's Share of Income, Deductions, Credits, etc.		X		
<b>Form 1065:</b> U.S. Return of Partnership Income with all applicable schedules		X		
<b>Schedule K-1 (Form 1120-S):</b> Shareholder's Share of Income, Deductions, Credits, etc.			X	
<b>Form 1120-S:</b> U.S. Income Tax Return for an S Corporation with all applicable schedules			X	
<b>Form 1120:</b> U.S. Corporate Income Tax Return with all applicable schedules				X
<b>Year-to-Date Profit &amp; Loss Statement/Interim Balance Sheet:</b> as applicable	X	X	X	X
<b>Partnership Agreement:</b> may be required		X		
<b>Corporate Resolution:</b> may be required			X	X





# Taxable income vs. cash flow



## Taxable income vs. cash flow

- 3 Key Concepts
  - Non-cash expenses
  - IRS limited expenses
  - Non-recurring income/expenses



# Partnerships & S Corporations How the money flows



## Business structures



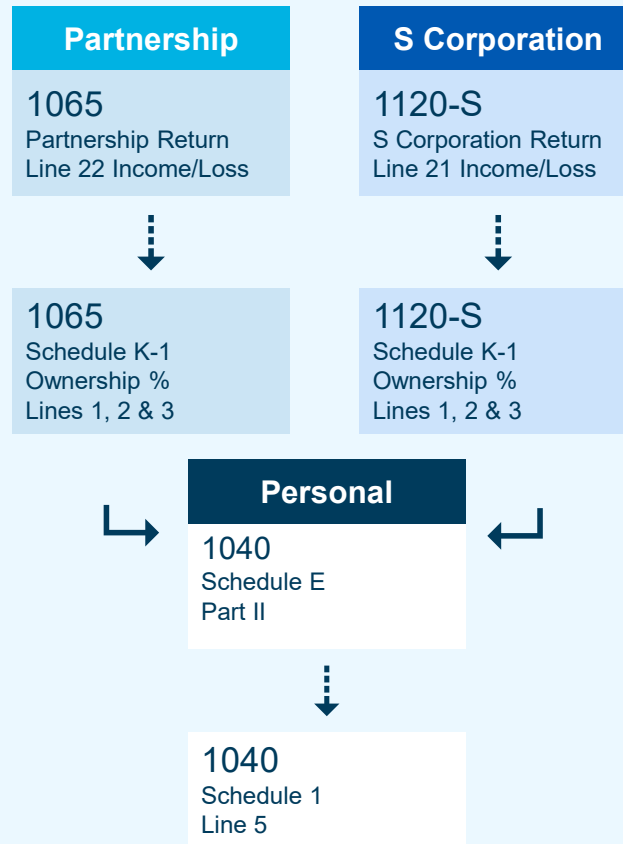
### Partnership

- Form 1065
- Schedule K-1 (Form 1065)
- General, Limited & Limited Liability
- An arrangement between 2+ individuals
- Profit (loss) is passed to individual partners
- Partnership doesn't pay taxes – partners pay on their share

### S Corporation

- Form 1120-S
- Schedule K-1 (Form 1120-S)
- Form W-2
- Can be a single shareholder (or as many as 100)
- Profit (loss) is passed to individual shareholder(s)
- S corporation doesn't pay taxes – shareholder(s) pay on their share

# Flow of partnership and S corporation income/loss



# Personal 1040 Schedule E – Part II

Case study, page 36



Schedule E (Form 1040) 2022 Attachment Sequence No. 13 Page 2

Name(s) shown on return. Do not enter name and social security number if shown on other side.  
John & Ginny Borrower Your social security number 000-00-0000

**Caution:** The IRS compares amounts reported on your tax return with amounts shown on Schedule(s) K-1.

**Part II Income or Loss From Partnerships and S Corporations**  
Note: If you report a loss, receive a distribution, dispose of stock, or receive a loan repayment from an S corporation, you must check the box in column (f) on line 28 and attach the required basis computation. If you report a loss from an at-risk activity for which any amount is not at risk, you must check the box in column (f) on line 28 and attach Form 6198. See instructions.

27 Are you reporting any loss not allowed in a prior year due to the at-risk or basis limitations, or unreimbursed partnership expenses, a prior year unallowed loss from a passive activity (if that loss was not reported on Form 8582), or unreimbursed partnership expenses? If you answered "Yes," see instructions before completing this section  Yes  No

	(a) Name	(b) Enter P for partnership, S for S corporation	(c) Check if foreign partnership	(d) Employer identification number	(e) Check if basis computation is required	(f) Check if any amount is not at risk
A	Tanglewood Realty	P	<input type="checkbox"/>	00-0000000	<input type="checkbox"/>	<input type="checkbox"/>
B	Westchester Development, LLC	P	<input type="checkbox"/>	00-0000000	<input type="checkbox"/>	<input type="checkbox"/>
C	Digital Network Systems	S	<input type="checkbox"/>	00-0000000	<input type="checkbox"/>	<input type="checkbox"/>
D			<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>

Passive Income and Loss		Nonpassive Income and Loss	
(a) Passive loss allowed (attach Form 8582 if required)	(b) Passive income from Schedule K-1	(c) Nonpassive loss allowed (see Schedule K-1)	(d) Section 179 expense deduction from Form 4562
A		5,800.	
B	21,000.		
C	32,550.		
D			
29a Totals	53,550.	5,800.	
b Totals			2,000.
30 Add columns (h) and (k) of line 29a			30 55,550.
31 Add columns (g), (i), and (j) of line 29b			31 ( 5,800. )
32 Total partnership and S corporation income or (loss). Combine lines 30 and 31			32 49,750.

**Part III Income or Loss From Estates and Trusts**

(a) Name	(b) Employer identification number
A	
B	

Passive Income and Loss		Nonpassive Income and Loss	
(c) Passive deduction or loss allowed (attach Form 8582 if required)	(d) Passive income from Schedule K-1	(e) Deduction or loss from Schedule K-1	(f) Other income from Schedule K-1
A			
B			
34a Totals			
b Totals			
35 Add columns (d) and (f) of line 34a			35
36 Add columns (c) and (e) of line 34b			36 ( )
37 Total estate and trust income or (loss). Combine lines 35 and 36			37

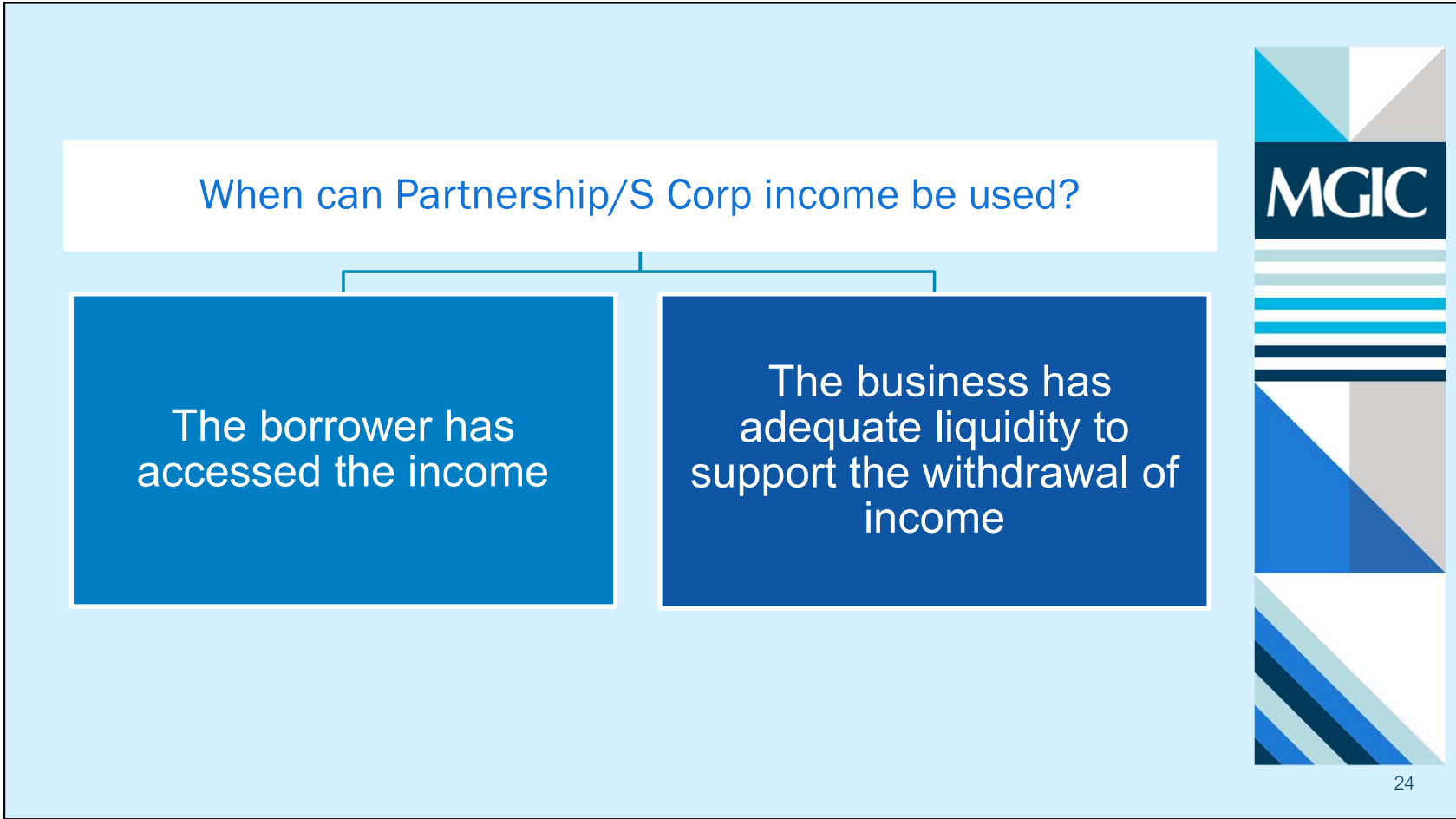
**Part IV Income or Loss From Real Estate Mortgage Investment Conduits (REMICs)—Residual Holder**

(a) Name	(b) Employer identification number	(c) Excess inclusion from Schedule Q, line 2c (see instructions)	(d) Taxable income (net loss) from Schedules Q, line 1b	(e) Income from Schedules Q, line 3b
38				
39 Combine columns (d) and (e) only. Enter the result here and include in the total on line 41 below				39

**Part V Summary**

40 Net farm rental income or (loss) from Form 4835. Also, complete line 42 below	40	
41 Total income or (loss). Combine lines 26, 32, 37, 39, and 40. Enter the result here and on Schedule 1 (Form 1040), line 5	41	53,350.
42 Reconciliation of farming and fishing income. Enter your gross farming and fishing income reported on Form 4835, line 7; Schedule K-1 (Form 1065), box 14, code B; Schedule K-1 (Form 1120-S), box 17, code AD; and Schedule K-1 (Form 1041), box 14, code F. See instructions	42	
43 Reconciliation for real estate professionals. If you were a real estate professional (see instructions), enter the net income or (loss) you reported anywhere on Form 1040, Form 1040-SR, or Form 1040-NR from all rental real estate activities in which you materially participated under the passive activity loss rules	43	

REV 01/28/23 TTW Schedule E (Form 1040) 2022





## Partnership/S Corp K-1s – Scenario 1

IF...

- K-1s reflect history of receiving cash distributions consistent with ordinary income

THEN...

- K-1 ordinary income may be included in borrower's cash flow

STOP...

- Nothing else is required





# Sample Schedule K-1 Form 1065



651121  
OMB No. 1545-0123

Final K-1  Amended K-1

**Schedule K-1 (Form 1065)**  
Department of the Treasury  
Internal Revenue Service

**2022**

For calendar year 2022, beginning / / 2022 ending / / 2022

**Partner's Share of Income, Deductions, Credits, etc.**  
See separate instructions.

**Part I Information About the Partnership**

**A** Partnership's employer identification number

**B** Partnership's name, address, city, state, and ZIP code

**C** IRS center where partnership filed return:

**D**  Check if this is a publicly traded partnership (PTP)

**Part II Information About the Partner**

**E** Partner's SSN or TIN (Do not use TIN of a disregarded entity. See instructions.)

**F** Name, address, city, state, and ZIP code for partner entered in E. See instructions.

**G**  General partner or LLC member-manager  Limited partner or other LLC member

**H1**  Domestic partner  Foreign partner

**H2**  If the partner is a disregarded entity (DE), enter the partner's:  
TIN \_\_\_\_\_ Name \_\_\_\_\_

**I1** What type of entity is this partner?

**I2** If this partner is a retirement plan (IRA/SEP/Keogh/etc.), check here

**J** Partner's share of profit, loss, and capital (see instructions):

	Beginning	Ending
Profit	%	%
Loss	%	%
Capital	%	%

Check if decrease is due to sale or exchange of partnership interest

**K** Partner's share of liabilities:

	Beginning	Ending
Nonrecourse	\$	\$
Qualified nonrecourse financing	\$	\$
Recourse	\$	\$

Check this box if item K includes liability amounts from lower-tier partnerships

**L** **Partner's Capital Account Analysis**

Beginning capital account	\$
Capital contributed during the year	\$
Current year net income (loss)	\$
Other increase (decrease) (attach explanation)	\$
Withdrawals and distributions	\$( )
Ending capital account	\$

**M** Did the partner contribute property with a built-in gain (loss)?  
 Yes  No If "Yes," attach statement. See instructions.

**Part III Partner's Share of Current Year Income, Deductions, Credits, and Other Items**

<b>1</b> Ordinary business income (loss)	\$198000	<b>14</b> Self-employment earnings (loss)	
<b>2</b> Net rental real estate income (loss)		<b>15</b> Credits	
<b>3</b> Other net rental income (loss)		<b>4a</b> Guaranteed payments for services	
<b>4a</b> Guaranteed payments for services		<b>4b</b> Guaranteed payments for capital	
<b>4b</b> Guaranteed payments for capital		<b>16</b> Schedule K-3 is attached if checked <input type="checkbox"/>	
<b>4c</b> Total guaranteed payments		<b>17</b> Alternative minimum tax (AMT) items	
<b>5</b> Interest income		<b>6a</b> Ordinary dividends	
<b>6a</b> Ordinary dividends		<b>6b</b> Qualified dividends	
<b>6b</b> Qualified dividends		<b>18</b> Tax-exempt income and nondeductible expenses	
<b>6c</b> Dividend equivalents		<b>7</b> Royalties	
<b>7</b> Royalties		<b>8</b> Net short-term capital gain (loss)	
<b>8</b> Net short-term capital gain (loss)		<b>9a</b> Net long-term capital gain (loss)	
<b>9a</b> Net long-term capital gain (loss)		<b>9b</b> Collectibles (28%) gain (loss)	
<b>9b</b> Collectibles (28%) gain (loss)		<b>9c</b> Unrecaptured section 1250 gain	
<b>9c</b> Unrecaptured section 1250 gain		<b>10</b> Net section 1231 gain (loss)	
<b>10</b> Net section 1231 gain (loss)		<b>11</b> Other income (loss)	
<b>11</b> Other income (loss)		<b>12</b> Section 179 deduction	
<b>12</b> Section 179 deduction		<b>13</b> Other deductions	
<b>13</b> Other deductions		<b>20</b> Other information	
<b>14</b> Self-employment earnings (loss)		<b>19</b> Distributions	\$198000
<b>15</b> Credits		<b>A</b>	
<b>16</b> Schedule K-3 is attached if checked <input type="checkbox"/>		<b>21</b> Foreign taxes paid or accrued	
<b>17</b> Alternative minimum tax (AMT) items		<b>22</b> <input type="checkbox"/> More than one activity for at-risk purposes*	
<b>18</b> Tax-exempt income and nondeductible expenses		<b>23</b> <input type="checkbox"/> More than one activity for passive activity purposes*	
<b>19</b> Distributions	\$198000	*See attached statement for additional information.	
<b>A</b>			

27

## Partnership/S Corp K-1s – Scenario 2

IF...

K-1s do not reflect history of receiving:

- Cash distributions
- Cash distributions consistent with ordinary income

**OPTION 1: To use total amount of ordinary income...**

- Document that the business has adequate liquidity to support withdrawal of earnings

**OPTION 2: Limit the amount of qualifying income...**

- To the amount of income supported by a history of accessing the income (without getting additional documentation)



# K-1 without distributions



671121  
OMB No. 1545-0123

Final K-1    Amended K-1

**Schedule K-1 (Form 1120-S)**  
Department of the Treasury  
Internal Revenue Service

**2022**  
For calendar year 2022, or

beginning / / 2022    ending / /

**Shareholder's Share of Income, Deductions, Credits, etc.**  
See separate instructions.

<b>Part I Information About the Corporation</b>		<b>Part III Shareholder's Share of Current Year Income, Deductions, Credits, and Other Items</b>	
<b>A</b> Corporation's employer identification number		<b>1</b> Ordinary business income (loss) \$85000	<b>13</b> Credits
<b>B</b> Corporation's name, address, city, state, and ZIP code		<b>2</b> Net rental real estate income (loss)	
<b>C</b> IRS Center where corporation filed return		<b>3</b> Other net rental income (loss)	
<b>D</b> Corporation's total number of shares Beginning of tax year . . . . . End of tax year . . . . .		<b>4</b> Interest income	
		<b>5a</b> Ordinary dividends	
		<b>5b</b> Qualified dividends	<b>14</b> Schedule K-3 is attached if checked . . . . . <input type="checkbox"/>
		<b>6</b> Royalties	<b>15</b> Alternative minimum tax (AMT) items
		<b>7</b> Net short-term capital gain (loss)	
		<b>8a</b> Net long-term capital gain (loss)	
		<b>8b</b> Collectibles (28%) gain (loss)	
		<b>8c</b> Unrecaptured section 1250 gain	
		<b>9</b> Net section 1231 gain (loss)	<b>16</b> Items affecting shareholder basis <b>D</b>
<b>E</b> Shareholder's identifying number		<b>10</b> Other income (loss)	
<b>F</b> Shareholder's name, address, city, state, and ZIP code			
<b>G</b> Current year allocation percentage . . . . . %			<b>17</b> Other information
<b>H</b> Shareholder's number of shares Beginning of tax year . . . . . End of tax year . . . . .		<b>11</b> Section 179 deduction	
		<b>12</b> Other deductions	
<b>I</b> Loans from shareholder Beginning of tax year . . . . . \$ End of tax year . . . . . \$			

# K-1 without consistent distributions



Schedule K-1 (Form 1065) 2022

Department of the Treasury Internal Revenue Service

For calendar year 2022, or other year ending / / 2022

**Part III Partner's Share of Current Year Income, Deductions, Credits, and Other Items**

1	Ordinary business income (loss)	\$95000	14	Self-employment earnings (loss)	
2	Net rental income (loss)		15	Credits	
3	Other net rental income (loss)		16	Schedule K-3 is attached if checked	<input type="checkbox"/>
4	Guaranteed payments for services		17	Alternative minimum tax (AMT) items	
5	Guaranteed payments for capital		18	Tax-exempt income and nondeductible expenses	
6a	Qualified dividends		19	Distributions	A \$25000
6b	Dividend equivalents		20	Other information	
7	Royalties		21	Foreign taxes paid or accrued	
8	Net short-term capital gain (loss)		22	Section 179 deduction	
9a	Net long-term capital gain (loss)		23	Other deductions	

**Part II Information About the Partner**

D  Check if this is a publicly traded partnership (PTP)

E Partner's SSN or TIN (Do not use TIN of a disregarded entity. See instructions.)

F Name, address, city, state, and ZIP code for partner entered in E. See instructions.

G  General partner or LLC  Limited partner or other LLC

**Partner's Capital Account Analysis**

	Beginning	Ending
Nonrecourse	\$	\$
Qualified nonrecourse financing	\$	\$
Recourse	\$	\$

Check this box if item K includes liability amounts from lower-tier partnerships

L Partner's Capital Account Analysis

Beginning capital account \$

Capital contributed during the year \$

22  More than one activity for at-risk purposes\*

23  More than one activity for passive activity purposes\*

\*See attached statement for additional information.

**Option 1: To use total amount of ordinary income,** document that the business has adequate liquidity to support withdrawal of earnings

**Option 2: Limit the amount of qualifying income** to the amount of income supported by a history of accessing the income (without getting additional documentation)

## Partnership/S Corp K-1s

- No history of distributions?
- Distributions < ordinary income

Is it by CHOICE?	Is it by DEFAULT?
<ul style="list-style-type: none"><li>• Business is solvent</li><li>• Positive income trends</li></ul>	<ul style="list-style-type: none"><li>• Business agreement prohibits distributions</li><li>• Business is insolvent – can't afford it</li></ul>







32



## John & Ginny Borrower

- Married, no dependents
- John has an interest in 3 companies
- Ginny has an interest in 2 companies
- Own 3 rental properties
  - ▶ **Schedule E, page 1**

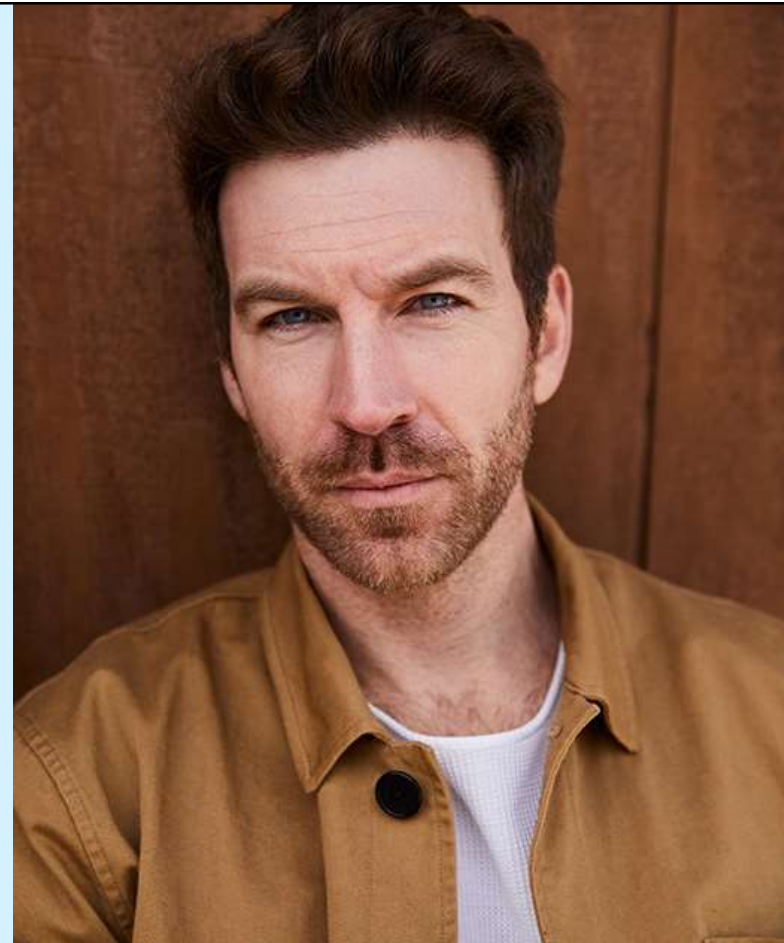
**MGIC**



## Meet John Borrower

- Sole proprietor of Tech in a Sec
  - ▶ Schedule C
- 20% partner in Tanglewood Realty
  - ▶ Schedule E, page 2
  - ▶ Partnership (1065) Schedule K-1
- 50% shareholder of Digital Network Systems, an S Corporation
  - ▶ Schedule E, page 2
  - ▶ S Corporation (1120-S) Schedule K-1
  - ▶ Form 1120-S
  - ▶ SEB W-2 may also be required

**MGIC**



## Meet John Borrower

- Sole proprietor of Tech in a Sec
  - ▶ Schedule C
- 20% partner in Tanglewood Realty
  - ▶ Schedule E, page 2
  - ▶ Partnership (1065) Schedule K-1
- 50% shareholder of Digital Network Systems, an S Corporation
  - ▶ Schedule E, page 2
  - ▶ S Corporation (1120-S) Schedule K-1
  - ▶ Form 1120-S

**MGIC**



**S Corporation Form  
1120-S and Schedule K-1  
(Form 1120-S)**



SAM  
Cash Flow  
Worksheet  
[mgic.com/seb](http://mgic.com/seb)



The screenshot shows a tax worksheet with the following visible text:

35	Ordinary income (Loss)	
36	Net Rental Income (Loss)	
	<b>SUBTOTAL</b>	\$
	FORM W-2	
37	Wages: W-2, Box 5 (in general)	
	FORM 1120S	
38	Deduct nonrecurring income/add nonrecurring loss: LINES 4 & 5	
39	Depreciation: LINE 14	
40	Depreciation (FORM 8825): LINE 14	
41	Depletion: LINE 15	
42	Amortization/Casualty Loss (only if noted): LINE 19 from attached statement	
43	Mortgages or Notes Payable in Less Than 1 Year: Schedule L, LINE 17, Column d	
44	Travel and Entertainment Exclusion: Schedule M-1, LINE 3b	
	<b>SUBTOTAL</b>	
45	Multiplied by Ownership Percentage	
	Shareholder's Total Share of Income (Loss)	

Callout boxes highlight the following items:

- Non-cash expenses**
  - Depreciation
  - Depletion
  - Amortization
- Limited IRS deductions**
  - Meals
  - Travel & entertainment
- Nonrecurring income & expenses**
  - Other income
  - Other expenses



Personal 1040  
Schedule E -  
Part II  
Case study,  
page 36



Schedule E (Form 1040) 2022 Attachment Sequence No. 13 Page 2

Name(s) shown on return. Do not enter name and social security number if shown on other side.  
 John & Ginny Borrower Your social security number 000-00-0000

**Caution:** The IRS compares amounts reported on your tax return with amounts shown on Schedule(s) K-1.

**Part II Income or Loss From Partnerships and S Corporations**  
 Note: If you report a loss, receive a distribution, dispose of stock, or receive a loan repayment from an S corporation, you must check the box in column (e) on line 28 and attach the required basis computation. If you report a loss from an at-risk activity for which any amount is not at risk, you must check the box in column (f) on line 28 and attach Form 6199. See instructions.

27 Are you reporting any loss not allowed in a prior year due to the at-risk or basis limitations, a prior year unallowed loss from a passive activity if that loss was not reported on Form 8582, or unreimbursed partnership expenses? If you answered "Yes," see instructions before completing this section. Yes  No

	(a) Name	(b) Enter P for partnership, S for S corporation	(c) Check if foreign partnership	(d) Employer identification number	(e) Check if basis computation is required	(f) Check if any amount is not at risk
A	Tanglewood Realty	P	<input type="checkbox"/>	00-0000000	<input type="checkbox"/>	<input type="checkbox"/>
B	Westchester Development, LLC	P	<input type="checkbox"/>	00-0000000	<input type="checkbox"/>	<input type="checkbox"/>
C	Digital Network Systems	S	<input type="checkbox"/>	00-0000000	<input type="checkbox"/>	<input type="checkbox"/>
D						

	(g) Passive loss allowed (attach Form 8582 if required)	(h) Passive income from Schedule K-1	(i) Nonpassive loss allowed (see Schedule K-1)	(j) Section 179 expense deduction from Form 4562	(k) Nonpassive income from Schedule K-1
A			5,800.		2,000.
B		21,000.			
C		32,550.			
D					
29a Totals		53,550.	5,800.		2,000.
b Totals			5,800.		

30 Add columns (h) and (k) of line 29a 30 55,550.

31 Add columns (g), (i), and (j) of line 29b. 31 ( 5,800. )

32 Total partnership and S corporation income or (loss). Combine lines 30 and 31 32 49,750.

**Part III Income or Loss From Estates and Trusts**

	(a) Name	(b) Employer identification number
A		
B		

	(c) Passive deduction or loss allowed (attach Form 8582 if required)	(d) Passive income from Schedule K-1	(e) Deduction or loss from Schedule K-1	(f) Other income from Schedule K-1
A				
B				
34a Totals				
b Totals				

35 Add columns (d) and (f) of line 34a 35

36 Add columns (c) and (e) of line 34b 36 ( 36 )

37 Total estate and trust income or (loss). Combine lines 35 and 36 37

**Part IV Income or Loss From Real Estate Mortgage Investment Conduits (REMICs) - Residual Holder**

	(a) Name	(b) Employer identification number	(c) Excess inclusion from Schedules Q, line 2c (see instructions)	(d) Taxable income (net loss) from Schedules Q, line 1b	(e) Income from Schedules Q, line 3b
38					

39 Combine columns (d) and (e) only. Enter the result here and include in the total on line 41 below 39

**Part V Summary**

40 Net farm rental income or (loss) from Form 4835. Also, complete line 42 below 40

41 Total income or (loss). Combine lines 26, 32, 37, 39, and 40. Enter the result here and on Schedule 1 (Form 1040), line 5 41 53,350.

42 Reconciliation of farming and fishing income. Enter your gross farming and fishing income reported on Form 4835, line 7; Schedule K-1 (Form 1065), box 14, code B; Schedule K-1 (Form 1120-S), box 17, code AD; and Schedule K-1 (Form 1041), box 14, code F. See instructions 42

43 Reconciliation for real estate professionals. If you were a real estate professional (see instructions), enter the net income or (loss) you reported anywhere on Form 1040, Form 1040-SR, or Form 1040-NR from all rental real estate activities in which you materially participated under the passive activity loss rules 43

REV 01/28/23 TTW Schedule E (Form 1040) 2022

# Schedule K-1 (Form 1120-S)

Case study, page 53



671121  
OMB No. 1545-0123

**2022**  
For calendar year 2022, or tax year

Final K-1     Amended K-1

**Schedule K-1  
(Form 1120-S)**  
Department of the Treasury  
Internal Revenue Service

beginning 2022 ending \_\_\_\_\_

**Shareholder's Share of Income, Deductions, Credits, etc.**  
See separate instructions.

<b>Part I Information About the Corporation</b>		<b>1</b> Ordinary business income (loss)	<b>13</b> Credits
<b>A</b> Corporation's employer identification number 00-0000000		32,550	
<b>B</b> Corporation's name, address, city, state, and ZIP code DIGITAL NETWORK SYSTEMS 42000 N. EXECUTIVE DR JACKSON, TN 38301		<b>2</b> Net rental real estate income (loss)	
<b>C</b> IRS Center where corporation filed return		<b>3</b> Other net rental income (loss)	
<b>D</b> Corporation's total number of shares Beginning of tax year . . . . . End of tax year . . . . .		<b>4</b> Interest income 1,200	
<b>Part II Information About the Shareholder</b>		<b>5a</b> Ordinary dividends	
<b>E</b> Shareholder's identifying number 000-00-0000		<b>5b</b> Qualified dividends	<b>14</b> Schedule K-3 is attached if checked . . . . . <input type="checkbox"/>
<b>F</b> Shareholder's name, address, city, state, and ZIP code JOHN BORROWER 3412 W. SILVERWOOD DR JACKSON, TN 38305		<b>6</b> Royalties	<b>15</b> Alternative minimum tax (AMT) items
<b>G</b> Current year allocation percentage . . . . . 50.0000 %		<b>7</b> Net short-term capital gain (loss)	
<b>H</b> Shareholder's number of shares Beginning of tax year . . . . . End of tax year . . . . .		<b>8a</b> Net long-term capital gain (loss)	
<b>I</b> Loans from shareholder Beginning of tax year . . . . . \$ End of tax year . . . . . \$		<b>8b</b> Collectibles (28%) gain (loss)	
For IRS Use Only		<b>8c</b> Unrecaptured section 1250 gain	
		<b>9</b> Net section 1231 gain (loss)	<b>16</b> Items affecting shareholder basis C 500
		<b>10</b> Other income (loss)	<b>D</b>
		<b>11</b> Section 179 deduction	<b>17</b> Other information A 1,200
		<b>12</b> Other deductions	

**18** More than one activity for at-risk purposes\*  
**19** More than one activity for passive activity purposes\*

\* See attached statement for additional information.

For Paperwork Reduction Act Notice, see the Instructions for Form 1120-S. www.irs.gov/Form1120S Schedule K-1 (Form 1120-S) 2022  
JSA 2C1600 1.000

## Determine liquidity

- What is liquidity?
  - ▶ Ease of ability to convert business assets to cash
  - ▶ Offers immediate access to funds
- Business liquidity
  - ▶ Measure of financial strength
  - ▶ Indicates ability to pay current debts
  - ▶ Different businesses have different liquidity needs

Inventory-intensive vs. low inventory business





# Liquidity ratios

## Current ratio

The current ratio – also known as the working capital ratio – measures the business’s ability to pay its current liabilities (debt that is due within 1 year of the date of the balance sheet) with its current assets (assets that can reasonably be converted into cash within 1 year of the date of the balance sheet).

$$\frac{\text{Current Assets}}{\text{Current Liabilities}} = \text{Current Ratio}$$

Current Assets  
[Cash & Equivalents + Marketable Securities + Accounts Receivable (Less Bad Debt) + **Inventory**]

Current Liabilities

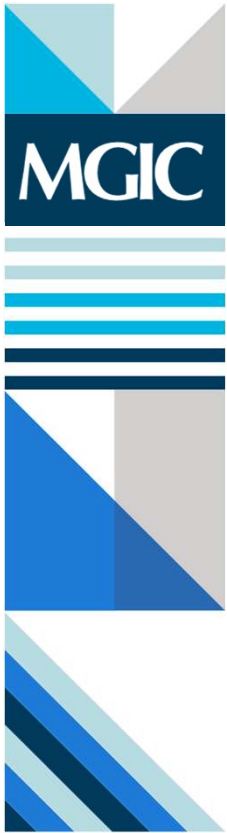
## Quick ratio

The quick ratio – also known as the acid test ratio – measures the business’s ability to meet immediate needs for cash. It is an indicator of a business’s ability to pay back its current liabilities with its most liquid assets (assets that can be converted to cash quickly). Since inventories, in general, take a longer time to convert to cash, they’re excluded from the quick ratio.

$$\frac{\text{Quick Assets}}{\text{Current Liabilities}} = \text{Quick Ratio}$$

Quick Assets  
[Cash & Equivalents + Marketable Securities + Accounts Receivable (Less Bad Debt) – **Inventory Not Included**]

Current Liabilities



# Schedule L Current ratio

Case study,  
page 58

Schedule L Balance Sheets per Books	Beginning of tax year		End of tax year	
	(a)	(b)	(c)	(d)
<b>Assets</b>				
1 Cash . . . . .		15,400		16,100
2a Trade notes and accounts receivable . . . . .	27,600		39,800	
b Less allowance for bad debts . . . . .	(2,760)	24,840	(3,980)	35,820
3 Inventories . . . . .		30,000		25,000
4 U.S. government obligations . . . . .				
5 Tax-exempt securities (see instructions) . . . . .		6,000		6,000
6 Other current assets (attach statement) . . . . .		15,000		17,400
7 Loans to shareholders . . . . .				
8 Mortgage and real estate loans . . . . .		100,400		130,800
9 Other investments (attach statement) . . . . .				
10a Buildings and other depreciable assets . . . . .	190,000		190,000	
b Less accumulated depreciation . . . . .	(32,900)	157,100	(47,900)	142,100

**Liquidity Worksheet** MGIC

Determine business liquidity using tax return or balance sheet and entering the applicable line items below.

**In general:**

- Use the Current Ratio for a business that doesn't rely on inventory to generate its income (i.e., post control company)
- Use the Quick Ratio for a business that relies heavily on inventory to generate its income (i.e., hardware store)

Typically, a result of 1.00 or greater for either ratio demonstrates adequate liquidity. However, it's important to use the most appropriate ratio, based on how the business operates. Investor guidelines may vary and other liquidity methods may apply. FOLLOW INVESTOR GUIDELINES.

NOTE: If there are no business liabilities, results will reflect N/A, indicating adequate liquidity.

Business Name	Completed by	Date

Schedule L - Assets Select the Year(s):

1 Cash: Line 2, Column d		
2 Trade notes and accounts receivable, less bad debt: Line 2b, Column d		
3 Inventories: Line 4, Column d		
4 Other:		
5 Total Current Assets:	\$ -	\$ -

Schedule L - Liabilities

6 Accounts Payable: Form 1120S Line 14/Form 1099 Line 13, Column d		
7 Mortgages, notes, bonds payable < 1 year: Form 1120S Line 17/Form 1099 Line 18, Column d		
8 Other current liabilities: Form 1120S Line 18/Form 1099 Line 17, Column d		
9 Total Current Liabilities:	\$ -	\$ -

**Current Ratio**

Total Current Assets: Row 5 - Assets above	\$ -	\$ -
Total Current Liabilities: Row 9 - Liabilities above	\$ -	\$ -
Current Ratio: In general, a ratio ≥ 1 demonstrates adequate liquidity	N/A	N/A

**Quick Ratio**

Cash, notes, accounts receivable (less bad debt) & other: Rows 1, 2 & 4 - Assets above	\$ -	\$ -
Total Current Liabilities: Row 9 - Liabilities above	\$ -	\$ -
Quick Ratio: In general, a ratio ≥ 1 demonstrates adequate liquidity	N/A	N/A

	348,740	373,220
	18,800	19,200
	22,000	21,900
	1,780	3,000
	119,100	78,660
	13,100	10,000
	2,000	2,000
	50,000	50,000
	121,960	188,460
	348,740	373,220

Form 1120-S (2022)



# MGIC Liquidity Worksheet



## Liquidity Worksheet

Business Name: Digital Network Systems      Completed by:

Schedule L - Assets      Select the Year(s): 2022

1	Cash: Line 1, Column d	\$	16,100.00
2	Trade notes and accounts receivable, less bad debt: Line 2b, Column d	\$	35,820.00
3	Inventories: Line 3, Column d	\$	25,000.00
4	Other:	\$	23,400.00
5	<b>Total Current Assets:</b>	\$	100,320.00

Schedule L - Liabilities      2022

6	Accounts Payable: Form 1120S Line 16/Form 1065 Line 15, Column d	\$	19,200.00
7	Mortgages, notes, bonds payable < 1 year: Form 1120S Line 17/Form 1065 Line 16, Column d	\$	21,900.00
8	Other current liabilities: Form 1120S Line 18/Form 1065 Line 17, Column d	\$	3,000.00
9	<b>Total Current Liabilities:</b>	\$	44,100.00

Current Ratio      2022

	Total Current Assets: Row 5 - Assets above	\$	100,320.00
	Total Current Liabilities: Row 9 - Liabilities above	\$	44,100.00
	<b>Current Ratio:</b> In general, a ratio ≥ 1 demonstrates adequate liquidity		<b>2.27</b>

Quick Ratio      2022

	Cash, notes, accounts receivable (less bad debt) & other: Rows 1, 2 & 4 - Assets above	\$	75,320.00
	Total Current Liabilities: Row 9 - Liabilities above	\$	44,100.00
	<b>Quick Ratio:</b> In general, a ratio ≥ 1 demonstrates adequate liquidity		<b>1.71</b>

# Effect on cash flow analysis



X	S CORPORATION	Name:	Digital Network Systems	2022
<b>SCHEDULE K-1</b>				
35	Ordinary Income (Loss):	LINE 1	If > Distributions see additional requirements.	\$ 32,550.00
36	Net Rental Income (Loss):	LINES 2 & 3	If > Distributions see additional requirements.	
	<b>SUBTOTAL</b>			\$ 32,550.00
<b>FORM W-2</b>				
37	Wages:	W-2, Box 5	(in general)	
<b>FORM 1120S</b>				
38	Deduct nonrecurring income/add nonrecurring loss:	LINES 4 & 5		
39	Depreciation:	LINE 14		
40	Depreciation (FORM 8825):	LINE 14		
41	Depletion:	LINE 15		
42	Amortization/Casualty Loss (only if noted):	LINE 19	from attached statement	
43	Mortgages or Notes Payable in Less Than 1 Year:	Schedule L, LINE 17, Column d		( )
44	Travel and Entertainment Exclusion:	Schedule M-1, LINE 3b		( )
	<b>SUBTOTAL</b>			\$ -
45	Multiplied by Ownership Percentage			
	Shareholder's Total Share of Income (Loss)			\$ -

Form 1120-S

Case study, page 53



671121  
OMB No. 1545-0123

**2022**

**Schedule K-1 (Form 1120-S)**  
Department of the Treasury  
Internal Revenue Service

For calendar year 2022, or tax year beginning 2022 ending 2022

**Part III Shareholder's Share of Current Year Income, Deductions, Credits, and Other Items**

1	Ordinary business income (loss)	13	Credits
2	Net rental real estate income (loss)		
3	Other net rental income (loss)		
4	Interest income		
5	Ordinary dividends		
5a	Qualified dividends	14	Schedule K-3 is attached if checked . . . . .
5b	Other dividends	15	Alternative minimum tax (AMT) items
6	Royalties		
7	Dividends from S corporations		
8	Dividends from trusts		
9	Net section 1231 gain (loss)	16	Items affecting shareholder basis
10	Other income (loss)		
11	Section 179 deduction	A	1,200
12	Other deductions		
13	Other deductions		
14	Other deductions		
15	Other deductions		
16	Other deductions		
17	Other deductions		
18	More than one activity for at-risk purposes*		
19	More than one activity for passive activity purposes*		

\* See attached statement for additional information.

**Part I Information About the Corporation**

A Corporation's employer identification number 00-0000000

B Corporation's name, address, city, state, and ZIP code  
DIGITAL NETWORK SYSTEMS  
42000 N. EXECUTIVE DR  
JACKSON, TN 38301

C IRS Center where corporation filed return

D Corporation's total number of shares  
Beginning of tax year . . . . .  
End of tax year . . . . .

E Shareholder's identifying number 000-00-0000

F Shareholder's name, address, city, state, and ZIP code  
JOHN BORROWER  
3412 W. SILVERWOOD DR  
JACKSON, TN 38305

G Current year allocation percentage . . . . . 50.0000 %

H Shareholder's number of shares  
Beginning of tax year . . . . .  
End of tax year . . . . .

I Loans from shareholder  
Beginning of tax year . . . . . \$  
End of tax year . . . . . \$

**Part II Information About the Shareholder**

E Shareholder's identifying number 000-00-0000

F Shareholder's name, address, city, state, and ZIP code  
JOHN BORROWER  
3412 W. SILVERWOOD DR  
JACKSON, TN 38305

G Current year allocation percentage . . . . . 50.0000 %

H Shareholder's number of shares  
Beginning of tax year . . . . .  
End of tax year . . . . .

I Loans from shareholder  
Beginning of tax year . . . . . \$  
End of tax year . . . . . \$

**For IRS Use Only**

18 More than one activity for at-risk purposes\*  
19 More than one activity for passive activity purposes\*

OMB No. 1545-0123  
**2022**

D Employer identification number 00-0000000  
E Date incorporated 09/01/2011  
F Total assets (see instructions) \$ 373,220

No S election termination  
Section 469 passive activity purposes formation

1c	275,000
2	146,000
3	129,000
4	
5	10,000
6	139,000
7	
8	26,000
9	8,000
10	
11	
12	2,100
13	2,900
14	15,000
15	
16	
17	3,400
18	8,000
19	8,500
20	73,900
21	65,100
22	
22c	
23	
23d	
24	
25	
26	
27	

best of my knowledge and belief, it is true.  
May the IRS discuss this return with the preparer shown below? See instructions.  Yes  No

Employed  or  P/TIN

Firm's EIN 00-0000000

Phone no. Form 1120-S (2022)

For Paperwork Reduction Act Notice, see the Instructions for Form 1120-S. www.irs.gov/Form1120S Schedule K-1 (Form 1120-S) 2022

Form 1120S, Page 1 Detail

Line 5 - Other Income

Sale of refurbished equipment	10,000
<b>Total</b>	<b>10,000</b>



<b>Inc</b>	3	Gross profit. Subtract line 2 from line 1c.	3	129,000
	4	Net gain (loss) from Form 4797, line 17 (attach Form 4797)	4	
	5	Other income (loss) (see instructions - attach statement) <b>SEE STATEMENT</b>	5	10,000
	6	<b>Total income (loss).</b> Add lines 3 through 5	6	139,000
<b>Deductions</b>	7	Compensation of officers (see instructions - attach Form 1125-E)	7	
	8	Salaries and wages (less employment credits)	8	26,000
	9	Repairs and maintenance	9	8,000
	10	Bad debts	10	
	11	Rents	11	
	12	Taxes and licenses	12	2,100
	13	Interest (see instructions)	13	2,900
	14	Depreciation from Form 4562 not claimed on Form 1125-A or elsewhere on return (attach Form 4562)	14	15,000
	15	Depletion (Do not deduct oil and gas depletion.)	15	
	16	Advertising	16	
	17	Pension, profit-sharing, etc., plans	17	3,400
	18	Employee benefit programs	18	8,000
	19	Other deductions (attach statement) <b>INSURANCE 7,500 LEGAL FEES 500</b>	19	8,500
	20	<b>Total deductions.</b> Add lines 7 through 19	20	73,900
	21	<b>Ordinary business income (loss).</b> Subtract line 20 from line 6	21	65,100
<b>Tax and Payments</b>	22a	Excess net passive income or LIFO recapture tax (see instructions)	22a	
	22b	Tax from Schedule D (Form 1120-S)	22b	
	22c	Add lines 22a and 22b (see instructions for additional taxes)	22c	
	23a	2022 estimated tax payments and 2021 overpayment credited to 2022	23a	
	23b	Tax deposited with Form 7004	23b	
	23c	Credit for federal tax paid on fuels (attach Form 4136)	23c	
	23d	Add lines 23a through 23c	23d	
	24	Estimated tax penalty (see instructions). Check if Form 2220 is attached	24	
	25	<b>Amount owed.</b> If line 23d is smaller than the total of lines 22c and 24, enter amount owed	25	
	26	<b>Overpayment.</b> If line 23d is larger than the total of lines 22c and 24, enter amount overpaid	26	
	27	Enter amount from line 26. <b>Credited to 2023 estimated tax</b> Refunded	27	

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

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

Signature of officer \_\_\_\_\_ Date \_\_\_\_\_ Title \_\_\_\_\_

Print/Type preparer's name \_\_\_\_\_ Preparer's signature \_\_\_\_\_ Date \_\_\_\_\_ Check  if self-employed PTIN \_\_\_\_\_

Firm's name V. I. P. TAX INC. Firm's EIN 00-0000000

3 PEACHTREE LANE, JACKSON, TN 38305 Phone no. \_\_\_\_\_

For Paperwork Reduction Act Notice, see separate instructions. Form 1120-S (2022)

<input checked="" type="checkbox"/>	S CORPORATION	Name: Digital Network Systems	2022
SCHEDULE K-1			
35	Ordinary Income (Loss): LINE 1 If > Distributions see additional requirements.	\$	32,550.00
36	Net Rental Income (Loss): LINES 2 & 3 If > Distributions see additional requirements.		
SUBTOTAL		\$	32,550.00
FORM W-2			
37	Wages: W-2, Box 5 (in general)		
FORM 1120S			
38	Deduct nonrecurring income/add nonrecurring loss: LINES 4 & 5		
39	Depreciation: LINE 14		
40	Depreciation (FORM 8825): LINE 14	\$	15,000.00
41	Depletion: LINE 15		
42	Amortization/Casualty Loss (only if noted): LINE 19 from attached statement		
43	Mortgages or Notes Payable in Less Than 1 Year: Schedule L, LINE 17, Column d	(	)
44	Travel and Entertainment Exclusion: Schedule M-1, LINE 3b	(	)
SUBTOTAL		\$	15,000.00
45	Multiplied by Ownership Percentage		
Shareholder's Total Share of Income (Loss)		\$	-

Form 1120-S (2022) Page 4

**Schedule K Shareholders' Pro Rata Share Items (continued)**

17a	Investment income			17a	2,400
b	Investment expenses			17b	
c	Dividend distributions paid from accumulated earnings and profits			17c	
d	Other items and amounts (attach statement)				
18	Income (loss) reconciliation. Combine the amounts on lines 1 through 10 in the far right column. From the result, subtract the sum of the amounts on lines 11 through 12d and 16f.			18	67,500

**Schedule L Balance Sheets per Books**

	Beginning of tax year		End of tax year	
	(a)	(b)	(c)	(d)
<b>Assets</b>				
1 Cash	27,600	15,400	39,800	16,100
2a Trade notes and accounts receivable				
b Less allowance for bad debts	(2,760)	24,840	(3,980)	35,820
3 Investments				
4 U.S. Government securities				
5 Tax-exempt securities				
6 Other securities				
7 Loans				
8 Mortgages				
9 Other				
10a Buildings				
b Less accumulated depreciation				
11a Depreciable assets				
b Less accumulated depreciation				
12 Land				
13a Intangible assets				
b Less accumulated amortization				
14 Other assets (attach statement)				
15 Total assets		348,740		373,220
<b>Liabilities and Shareholders' Equity</b>				
16 Accounts payable		18,800		19,200
17 Mortgages, notes, bonds payable in less than 1 year		22,000		21,900
18 Other current liabilities (attach statement)		1,760		3,000
19 Loans from shareholders				78,660
20 Mortgages, notes, bonds payable in 1 year or more		119,100		13,100
21 Other liabilities (attach statement)				10,000
22 Capital stock		2,000		2,000
23 Additional paid-in capital		50,000		50,000
24 Retained earnings		121,960		188,460
25 Adjustments to shareholders' equity (attach statement)				
26 Less cost of treasury stock				
27 Total liabilities and shareholders' equity		348,740		373,220

Form 1120-S (2022)

- Line of credit
- Regular rollover
- Sufficient liquid assets

X	S CORPORATION	Name:	Digital Network Systems	2022
	<b>SCHEDULE K-1</b>			
35	Ordinary Income (Loss): LINE 1 If > Distributions see additional requirements.		\$	32,550.00
36	Net Rental Income (Loss): LINES 2 & 3 If > Distributions see additional requirements.			
	<b>SUBTOTAL</b>		\$	32,550.00
	<b>FORM W-2</b>			
37	Wages: W-2, Box 5 (in general)			
	<b>FORM 1120S</b>			
38	Deduct nonrecurring income/add nonrecurring loss: LINES 4 & 5			
39	Depreciation: LINE 14			
40	Depreciation (FORM 8825): LINE 14		\$	15,000.00
41	Depletion: LINE 15			
42	Amortization/Casualty Loss (only if noted): LINE 19 from attached statement			
43	Mortgages or Notes Payable in Less Than 1 Year: Schedule L, LINE 17, Column d		( \$	21,900.00 )
44	Travel and Entertainment Exclusion: Schedule M-1, LINE 3b		(	
	<b>SUBTOTAL</b>		\$	(6,900.00)
45	Multiplied by Ownership Percentage			
	Shareholder's Total Share of Income (Loss)		\$	-

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Form 1120-S (2022)		Page 5	
<b>Schedule M-1 Reconciliation of Income (Loss) per Books With Income (Loss) per Return</b>			
<i>Note: The corporation may be required to file Schedule M-3. See instructions.</i>			
1 Net income (loss) per books . . . . .	66,500	5 Income recorded on books this year not included on Schedule K, lines 1, 2, 3c, 4, 5a, 6, 7, 8a, 9, and 10, not recorded on books this year (itemize):	
2 Expenses recorded on books this year not included on Schedule K, lines 1 through 12 and 16f (itemize):		a Tax-exempt interest \$	
a Depreciation \$		b Deductions included on Schedule K, lines 1 through 12 and 16f, not charged against book income this year (itemize):	
b Travel and entertainment \$ 1,000	1,000	a Depreciation \$	
4 Add lines 1 through 3 . . . . .	67,500	7 Add lines 5 and 6 . . . . .	
		8 Income (loss) (Schedule K, line 18)	
		Subtract line 7 from line 4 . . . . .	67,500
<b>Schedule M-2 Analysis of Accumulated Adjustments Account, Shareholders' Undistributed Taxable Income Previously Taxed, Accumulated Earnings and Profits, and Other Adjustments Account</b>			
<i>(see instructions)</i>			
	(a) Accumulated adjustments account	(b) Shareholders' undistributed taxable income previously taxed	(c) Accumulated earnings and profits
1	121,960		
2	65,100		
3	2,400		

**Note:** Per IRS Notice 2021-25, the IRS will temporarily allow for a 100% deduction for expenses paid or incurred in 2021 and 2022 for food or beverages provided by a restaurant. Please consult your internal guidelines as to how to proceed.

X	S CORPORATION	Name: Digital Network Systems	2022
<b>SCHEDULE K-1</b>			
35	Ordinary Income (Loss): LINE 1 If > Distributions see additional requirements.	\$ 32,550.00	
36	Net Rental Income (Loss): LINES 2 & 3 If > Distributions see additional requirements.		
SUBTOTAL		\$ 32,550.00	
<b>FORM W-2</b>			
37	Wages: W-2, Box 5 (in general)		
<b>FORM 1120S</b>			
38	Deduct nonrecurring income/add nonrecurring loss: LINES 4 & 5		
39	Depreciation: LINE 14		
40	Depreciation (FORM 8825): LINE 14	\$ 15,000.00	
41	Depletion: LINE 15		
42	Amortization/Casualty Loss (only if noted): LINE 19 from attached statement		
43	Mortgages or Notes Payable in Less Than 1 Year: Schedule L, LINE 17, Column d	( \$ 21,900.00 )	
44	Travel and Entertainment Exclusion: Schedule M-1, LINE 3b	( \$ 1,000.00 )	
SUBTOTAL		\$ (7,900.00)	
45	Multiplied by Ownership Percentage	50%	
Shareholder's Total Share of Income (Loss)		\$ (3,950.00)	



# Effect on cash flow analysis



S Corporation Cash Flow					
Evaluate business income as required by your investor.					
X	S CORPORATION	Name:	Digital Network Systems	2022	2021
SCHEDULE K-1					
35	Ordinary Income (Loss): LINE 1 If > Distributions see additional requirements.			\$ 32,550.00	\$ 26,900.00
36	Net Rental Income (Loss): LINES 2 & 3 If > Distributions see additional requirements.				
	SUBTOTAL			\$ 32,550.00	\$ 26,900.00
FORM W-2					
37	Wages: W-2, Box 5 (in general)				
FORM 1120S					
38	Deduct nonrecurring income/add nonrecurring loss: LINES 4 & 5				
39	Depreciation: LINE 14				
40	Depreciation (FORM 8825): LINE 14			\$ 15,000.00	\$ 20,000.00
41	Depletion: LINE 15				
42	Amortization/Casualty Loss (only if noted): LINE 19 from attached statement				
43	Mortgages or Notes Payable in Less Than 1 Year: Schedule L, LINE 17, Column d			( )	( )
44	Travel and Entertainment Exclusion: Schedule M-1, LINE 3b			( \$ 1,000.00 )	( )
	SUBTOTAL			\$ 14,000.00	\$ 20,000.00
45	Multiplied by Ownership Percentage			50%	50%
	Shareholder's Total Share of Income (Loss)			\$ 7,000.00	\$ 10,000.00

What is the earnings trend?



S Corporation Cash Flow			
Evaluate business income as required by your investor.			
X	S CORPORATION	Name: Digital Network Systems	
		2022	2021
SCHEDULE K-1			
35	Ordinary Income (Loss): LINE 1 If > Distributions see additional requirements.	\$ 32,550.00	\$ 26,900.00
36	Net Rental Income (Loss): LINES 2 & 3 If > Distributions see additional requirements.		
	<b>SUBTOTAL</b>	\$ 32,550.00	\$ 26,900.00
FORM W-2			
37	Wages: W-2, Box 5 (in general)		
FORM 1120S			
38	Deduct nonrecurring income/add nonrecurring loss: LINES 4 & 5		
39	Depreciation: LINE 14		
40	Depreciation (FORM 8825): LINE 14	\$ 15,000.00	\$ 20,000.00
41	Depletion: LINE 15		
42	Amortization/Casualty Loss (only if noted): LINE 19 from attached statement		
43	Mortgages or Notes Payable in Less Than 1 Year: Schedule L, LINE 17, Column d	( )	( )
44	Travel and Entertainment Exclusion: Schedule M-1, LINE 3b	( \$ 1,000.00 )	( )
	<b>SUBTOTAL</b>	\$ 14,000.00	\$ 20,000.00
45	Multiplied by Ownership Percentage	50%	50%
	<b>Shareholder's Total Share of Income (Loss)</b>	\$ 7,000.00	\$ 10,000.00

\$39,550.00	\$36,900.00
/12 = \$3,296	/12 = \$3,075
/24 = \$3,185	

# Schedule B Interest and Dividends



## Schedule B

- Interest from self-employment
- Dividends from self-employment
- Other interest and dividends
  - ▶ Use tax return as supporting documentation
  - ▶ Follow investor documentation guidelines



# Schedule B

## Case study, page 23



**SCHEDULE B**  
(Form 1040)

Department of the Treasury  
Internal Revenue Service

**Interest and Ordinary Dividends**

Go to [www.irs.gov/ScheduleB](http://www.irs.gov/ScheduleB) for instructions and the latest information.  
Attach to Form 1040 or 1040-SR.

OMB No. 1545-0074  
**2022**  
Attachment  
Sequence No. **08**

Name(s) shown on return  
John & Ginny Borrower

Your social security number  
000-00-0000

**Part I**  
**Interest**  
(See instructions and the Instructions for Form 1040, line 2b.)  
**Note:** If you received a Form 1099-INT, Form 1099-DIV, or substitute statement from a brokerage firm, list the firm's name as the payer and enter the total interest shown on that form.

	Amount
1 List name of payer. If any interest is from a seller-financed mortgage and the buyer used the property as a personal residence, see the instructions and list this interest first. Also, show that buyer's social security number and address: Colonial Federal ..... 500. Digital Network Systems ..... 1,200.	
2 Add the amounts on line 1	1,700.
3 Excludable interest on series EE and I U.S. savings bonds issued after 1989. Attach Form 8815	
4 Subtract line 3 from line 2. Enter the result here and on Form 1040 or 1040-SR, line 2b	1,700.
<b>Note:</b> If line 4 is over \$1,500, you must complete Part III.	<b>Amount</b>

**Part II**  
**Ordinary Dividends**  
(See instructions and the Instructions for Form 1040, line 3b.)  
**Note:** If you received a Form 1099-DIV or substitute statement from a brokerage firm, list the firm's name as the payer and enter the ordinary dividends shown on that form.

5 List name of payer: IBM ..... 500. Interior Innovations, Inc ..... 2,500.	
6 Add the amounts on line 5. Enter the total here and on Form 1040 or 1040-SR, line 3b	3,000.

**Part III**  
**Foreign Accounts and Trusts**  
**Caution:** If required, failure to file FinCEN Form 114 may result in substantial penalties. Additionally, you may be required to file Form 8938, Statement of Specified Foreign Financial Assets. See instructions.

	Yes	No
7a At any time during 2022, did you have a financial interest in or signature authority over a financial account (such as a bank account, securities account, or brokerage account) located in a foreign country? See instructions		X
b If you are required to file FinCEN Form 114, Report of Foreign Bank and Financial Accounts (FBAR), to report that financial interest or signature authority? See FinCEN Form 114 and its instructions for filing requirements and exceptions to those requirements		
8 During 2022, did you receive a distribution from, or were you the grantor of, or transferor to, a foreign trust? If "Yes," you may have to file Form 3520. See instructions		X

For Paperwork Reduction Act Notice, see your tax return instructions. BAA REV 01/28/23 TTW Schedule B (Form 1040) 2022

# Effect on cash flow analysis

671121  
OMB No. 1545-0123

**2022**

**Schedule K-1 (Form 1120-S)**  
Department of the Treasury  
Internal Revenue Service

For calendar year 2022, or tax year beginning 2022 ending 2022

**Shareholder's Share of Income, Deductions, Credits, etc.**  
See separate instructions.

Part I Information About the Corporation		Part III Shareholder's Share of Current Year Income, Deductions, Credits, and Other Items	
<b>A</b> Corporation's employer identification number 00-0000000	<b>5a</b> Ordinary dividends 1,200	<b>1</b> Ordinary business income (loss) 32,550	<b>13</b> Credits
<b>B</b> Corporation's name, address, city, state, and ZIP code DIGITAL NETWORK SYSTEMS 42000 N. EXECUTIVE DR JACKSON, TN 38301	<b>5b</b> Qualified dividends	<b>2</b> Net rental real estate income (loss)	
<b>C</b> IRS Center where corporation filed return	<b>6</b> Royalties	<b>3</b> Other net rental income (loss)	
<b>D</b> Corporation's total number of shares Beginning of tax year . . . . .	<b>7</b> Net short-term capital gain (loss)	<b>4</b> Interest income	
	<b>8a</b> Net long-term capital gain (loss)		
	<b>8b</b> Collectibles (28%) gain (loss)		
	<b>14</b> Schedule K-3 is attached if checked . . . . . <input type="checkbox"/>		
	<b>15</b> Alternative minimum tax (AMT) items		

X	SCHEDULE B - INTEREST AND DIVIDENDS FROM SELF-EMPLOYMENT	2022	2021
1	Recurring Interest Income: <b>LINE 1 or 1040 LINE 2b</b>	\$ 1,200.00	\$ 1,200.00
2	Recurring Dividend Income: <b>LINE 5 or 1040 LINE 3b</b>		
	<b>SUBTOTAL</b>	\$ 1,200.00	\$ 1,200.00

<b>H</b> Shareholder's number of shares Beginning of tax year . . . . . End of tax year . . . . .	<b>12</b> Other deductions		
<b>I</b> Loans from shareholder Beginning of tax year . . . . . \$ End of tax year . . . . . \$			
<b>For IRS Use Only</b>			
	<b>18</b> More than one activity for at-risk purposes*		
	<b>19</b> More than one activity for passive activity purposes*		

\* See attached statement for additional information.



**Partnership Form 1065  
and Schedule K-1  
(Form 1065)**



## Meet John Borrower

- Sole proprietor of Tech in a Sec
  - ▶ Schedule C
- 20% partner in Tanglewood Realty
  - ▶ Schedule E, page 2
  - ▶ Partnership (1065) Schedule K-1
- 50% shareholder of Digital Network Systems, an S Corporation
  - ▶ Schedule E, page 2
  - ▶ S Corporation (1120-S) Schedule K-1
  - ▶ Form 1120-S

**MGIC**





**SAM  
Cash Flow  
Worksheet**  
[mgic.com/seb](http://mgic.com/seb)



Partnership Cash Flow			
Evaluate business income as required by your investor.			
X	PARTNERSHIP	Name:	
<b>SCHEDULE K-1</b>			
22	Ordinary Income (Loss): LINE 1 If > Distributions see additional requirements.		
23	Net Rental Income (Loss): LINES 2 & 3 If > Distributions see additional requirements.		
24	Guaranteed Payments: LINE 4c (2019), LINE 4 (2018 and 2017)		
	<b>SUBTOTAL</b>	\$ -	\$ -
<b>FORM W-2</b>			
25	Wages: W-2, Box 5 (in general)		
<b>FORM 1065</b>			
26	Passthrough (Income) Loss from Other Partnerships: LINE 4		
27	Deduct nonrecurring income/add nonrecurring loss: LINES 5, 6 & 7		
28	Depreciation: LINE 16c		
29	Depreciation (FORM 8825): LINE 14		
30	Depletion: LINE 17		
31	Amortization/Casualty Loss (only if noted): LINE 20 from attached statement		
32	Mortgages or Notes Payable in Less Than 1 Year: Schedule L, LINE 16, Column d	( )	( )
33	Travel and Entertainment Exclusion: Schedule M-1, LINE 4b	( )	( )
	<b>SUBTOTAL</b>	\$ -	\$ -
34	Multiplied by Ownership Percentage		
	<b>Partner's Total Share of Income (Loss)</b>	\$ -	\$ -

Personal 1040  
Schedule E – Part II  
Case study, page 36



Schedule E (Form 1040) 2022 Attachment Sequence No. 13 Page 2

Name(s) shown on return. Do not enter name and social security number if shown on other side.  
John & Ginny Borrower Your social security number 000-00-0000

**Caution:** The IRS compares amounts reported on your tax return with amounts shown on Schedule(s) K-1.

**Part II Income or Loss From Partnerships and S Corporations**  
Note: If you report a loss, receive a distribution, dispose of stock, or receive a loan repayment from an S corporation, you must check the box in column (e) on line 28 and attach the required basis computation. If you report a loss from an at-risk activity for which any amount is not at risk, you must check the box in column (f) on line 28 and attach Form 6198. See instructions.

27 Are you reporting any loss not allowed in a prior year due to the at-risk or basis limitations, a prior year unallowed loss from a passive activity (if that loss was not reported on Form 8582), or unreimbursed partnership expenses? If you answered "Yes," see instructions before completing this section.  Yes  No

	(a) Name	(b) Enter P for partnership; S for S corporation	(c) Check if foreign partnership	(d) Employer identification number	(e) Check if basis computation is required	(f) Check if any amount is not at risk
A	Tanglewood Realty	P	<input type="checkbox"/>	00-0000000	<input type="checkbox"/>	<input type="checkbox"/>
B	Westchester Development, LLC	P	<input type="checkbox"/>	00-0000000	<input type="checkbox"/>	<input type="checkbox"/>
C	Digital Network Systems	S	<input type="checkbox"/>	00-0000000	<input type="checkbox"/>	<input type="checkbox"/>
D						

Passive Income and Loss		Nonpassive Income and Loss		
(g) Passive loss allowed (attach Form 8582 if required)	(h) Passive income from Schedule K-1	(i) Nonpassive loss allowed (see Schedule K-1)	(j) Section 179 expense deduction from Form 4562	(k) Nonpassive income from Schedule K-1
A		5,800.		2,000.
B	21,000.			
C	32,550.			
D				
29a Totals	53,550.	5,800.		2,000.
b Totals		5,800.		
30 Add columns (h) and (k) of line 29a			30	55,550.
31 Add columns (g), (i), and (j) of line 29b.			31	(5,800.)
32 Total partnership and S corporation income or (loss). Combine lines 30 and 31			32	49,750.

**Part III Income or Loss From Estates and Trusts**

(a) Name	(b) Employer identification number
A	
B	

Passive Income and Loss		Nonpassive Income and Loss	
(c) Passive deduction or loss allowed (attach Form 8582 if required)	(d) Passive income from Schedule K-1	(e) Deduction or loss from Schedule K-1	(f) Other income from Schedule K-1
A			
B			
34a Totals			
b Totals			
35 Add columns (d) and (f) of line 34a			35
36 Add columns (c) and (e) of line 34b			36
37 Total estate and trust income or (loss). Combine lines 35 and 36			37

**Part IV Income or Loss From Real Estate Mortgage Investment Conduits (REMICs) – Residual Holder**

(a) Name	(b) Employer identification number	(c) Excess inclusion from Schedules O, line 2c (see instructions)	(d) Taxable income (net loss) from Schedules O, line 1b	(e) Income from Schedules O, line 3b
38				
39 Combine columns (d) and (e) only. Enter the result here and include in the total on line 41 below				39

**Part V Summary**

40 Net farm rental income or (loss) from Form 4835. Also, complete line 42 below	40	
41 Total income or (loss). Combine lines 26, 32, 37, 39, and 40. Enter the result here and on Schedule 1 (Form 1040), line 5	41	53,350.
42 Reconciliation of farming and fishing income. Enter your gross farming and fishing income reported on Form 4835, line 7; Schedule K-1 (Form 1065), box 14, code B; Schedule K-1 (Form 1120-S), box 17, code AD; and Schedule K-1 (Form 1041), box 14, code F. See instructions	42	
43 Reconciliation for real estate professionals. If you were a real estate professional (see instructions), enter the net income or (loss) you reported anywhere on Form 1040, Form 1040-SR, or Form 1040-NR from all real estate activities in which you materially participated under the passive activity loss rules	43	

REV 01/28/23 TTW Schedule E (Form 1040) 2022

# Schedule K-1 (Form 1065)

Case study, page 39



65121  
OMB No. 1545-0123

Final K-1    Amended K-1

**Schedule K-1 (Form 1065) 2022**  
Department of the Treasury  
Internal Revenue Service

For calendar year 2022, or tax year beginning \_\_\_\_\_ ending \_\_\_\_\_

**Partner's Share of Income, Deductions, Credits, etc.**  
See separate instructions.

**Part I Information About the Partnership**

A Partnership's employer identification number  
00-0000000

B Partnership's name, address, city, state, and ZIP code  
TANGLEWOOD REALTY  
42 WILLOW BLVD  
JACKSON, TN 38305

C IRS center where partnership filed return: \_\_\_\_\_

D  Check if this is a publicly traded partnership (PTP)

**Part II Information About the Partner**

E Partner's SSN or TIN (Do not use TIN of a disregarded entity. See instructions.)  
000-00-0000

F Name, address, city, state, and ZIP code for partner entered in E. See instructions.  
JOHN BORROWER  
3412 W. SILVERWOOD DR  
JACKSON, TN 38305

G  General partner or LLC member-manager     Limited partner or other LLC member

H1  Domestic partner     Foreign partner

H2  If the partner is a disregarded entity (DE), enter the partner's:  
TIN \_\_\_\_\_ Name \_\_\_\_\_

I1 What type of entity is this partner? INDIVIDUAL

I2 If this partner is a retirement plan (IRA/SEP/Keogh/etc.), check here:

J Partner's share of profit, loss, and capital (see instructions):

	Beginning	Ending
Profit	20 %	20 %
Loss	20 %	20 %
Capital	20 %	20 %

Check if decrease is due to sale or exchange of partnership interest:

K Partner's share of liabilities:

	Beginning	Ending
Nonrecourse . . . . \$		
Qualified nonrecourse financing . . . . \$		
Recourse . . . . \$		

Check this box if item K includes liability amounts from lower-tier partnerships:

**L Partner's Capital Account Analysis**

Beginning capital account . . . . \$	41,300
Capital contributed during the year . . . \$	2,400
Current year net income (loss) . . . . \$	-5,100
Other increase (decrease) (attach explanation) \$	
Withdrawals and distributions . . . . \$	( )
Ending capital account . . . . \$	38,600

M Did the partner contribute property with a built-in gain (loss)?  
 Yes     No    If "Yes," attach statement. See instructions.

**N Partner's Share of Net Unrecognized Section 704(c) Gain or (Loss)**

Beginning . . . . . \$	
Ending . . . . . \$	

**Part III Partner's Share of Current Year Income, Deductions, Credits, and Other Items**

1 Ordinary business income (loss)	-5,800	14 Self-employment earnings (loss)	
2 Net rental real estate income (loss)		A	-3,800
3 Other net rental income (loss)		15 Credits	
4a Guaranteed payments for services	2,000		
4b Guaranteed payments for capital		16 Schedule K-3 is attached if checked	<input type="checkbox"/>
4c Total guaranteed payments	2,000	17 Alternative minimum tax (AMT) items	
5 Interest income			
6a Ordinary dividends			
6b Qualified dividends		18 Tax-exempt income and nondeductible expenses	500
6c Dividend equivalents		C	STMT
7 Royalties			
8 Net short-term capital gain (loss)			
9a Net long-term capital gain (loss)		19 Distributions	1,100
9b Collectibles (28%) gain (loss)			
9c Unrecaptured section 1250 gain		20 Other information	
10 Net section 1231 gain (loss)			
11 Other income (loss)			
12 Section 179 deduction		21 Foreign taxes paid or accrued	
13 Other deductions			
22 More than one activity for at-risk purposes*			
23 More than one activity for passive activity purposes*			

\*See attached statement for additional information.

For IRS Use Only

For Paperwork Reduction Act Notice, see the Instructions for Form 1065. www.irs.gov/Form1065 Schedule K-1 (Form 1065) 2022  
JSA 3/1/200 1.000

# Schedule K-1 (Form 1065)

Case study, page 39



651121  
OMB No. 1545-0123

2022

Schedule K-1 (Form 1065)  
Department of the Treasury  
Internal Revenue Service

For calendar year 2022, or tax year beginning \_\_\_\_\_ ending \_\_\_\_\_

**Partner's Share of Income, Deductions, Credits, etc.**  
See separate instructions.

**Part I Information About the Partnership**

**A** Partnership's employer identification number  
00-0000000

**B** Partnership's name, address, city, state, and ZIP code  
TANGLEWOOD REALTY  
42 WILLOW BLVD  
JACKSON, TN 38305

**C** IRS center where partnership filed return:

**D**  Check if this is a publicly traded partnership (PTP)

**Part II Information About the Partner**

**E** Partner's SSN or TIN (Do not use TIN of a disregarded entity. See instructions.)  
000-00-0000

**F** Name, address, city, state, and ZIP code for partner entered in E. See instructions.  
JOHN BORROWER  
3412 W. SILVERWOOD DR  
JACKSON, TN 38305

**G**  General partner or LLC member-manager  Limited partner or other LLC member

**H1**  Domestic partner  Foreign partner

**H2** If the partner is a disregarded entity (DE), enter the partner's:  
TIN \_\_\_\_\_ Name \_\_\_\_\_

**I1** What type of entity is this partner? INDIVIDUAL

**I2** If this partner is a retirement plan (IRA/SEP/Keogh/etc.), check here,

**J** Partner's share of profit, loss, and capital (see instructions):

	Beginning	Ending
Profit	20 %	20 %
Loss	20 %	20 %
Capital	20 %	20 %

Check if decrease is due to sale or exchange of partnership interest

**K** Partner's share of liabilities:

	Beginning	Ending
Nonrecourse	\$	\$
Qualified nonrecourse financing	\$	\$
Recourse	\$	\$

Check this box if item K includes liability amounts from lower-tier partnerships

**L Partner's Capital Account Analysis**

Beginning capital account	\$ 41,300
Capital contributed during the year	\$ 2,400
Current year net income (loss)	\$ -5,100
Other increase (decrease) (attach explanation)	\$
Withdrawals and distributions	\$
Ending capital account	\$ 38,600

**M** Did the partner contribute property with a built-in gain (loss)?  
 Yes  No If "Yes," attach statement. See instructions.

**N Partner's Share of Net Unrecognized Section 704(c) Gain or (Loss)**

Beginning	\$
Ending	\$

**Part III Partner's Share of Current Year Income, Deductions, Credits, and Other Items**

Line	Description	Amount	Code
1	Ordinary business income (loss)	-5,100	A
2	Net rental real estate income (loss)		
3	Other net rental income (loss)		
4a	Guaranteed payments for services	2,000	
4b	Guaranteed payments for capital		
4c	Total guaranteed payments	2,000	
5	Interest income		
6a	Ordinary dividends		
6b	Qualified dividends		
6c	Dividend equivalents	500	C
7	Royalties	STMT	
8	Net short-term capital gain (loss)		
9a	Net long-term capital gain (loss)	1,100	A
9b	Collectibles (28%) gain (loss)		
9c	Unrecaptured section 1250 gain		
10	Net section 1231 gain (loss)		
11	Other income (loss)		
12	Section 179 deduction		
13	Other deductions		
14	Self-employment earnings (loss)	-3,800	
15	Credits		
16	Schedule K-3 is attached if checked		<input type="checkbox"/>
17	Alternative minimum tax (AMT) items		
18	Tax-exempt income and nondeductible expenses	500	
19	Distributions		
20	Other information		
21	Foreign taxes paid or accrued		
22	More than one activity for at-risk purposes*		
23	More than one activity for passive activity purposes*		

\*See attached statement for additional information.

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For Paperwork Reduction Act Notice, see the Instructions for Form 1065. www.irs.gov/Form1065  
JSA ZP1200 1.000 Schedule K-1 (Form 1065) 2022

# Effect on cash flow analysis

Partnership Cash Flow					
Evaluate business income as required by your investor.					
X	PARTNERSHIP	Name:	Tanglewood Realty	2022	2021
SCHEDULE K-1					
22	Ordinary Income (Loss): LINE 1 If > Distributions see additional requirements.			\$ (5,800.00)	\$ (12,000.00)
23	Net Rental Income (Loss): LINES 2 & 3 If > Distributions see additional requirements.				
24	Guaranteed Payments: LINE 4c			\$ 2,000.00	\$ 2,000.00
SUBTOTAL				\$ (3,800.00)	\$ (10,000.00)
				/12 = (\$317)	/12 = (\$833)
				/24 = (\$575)	



# Financial Statements



# Documentation matrix



	Sole Proprietorship	Partnership (General, Limited or LLC)	S Corporation	Corporation
<b>Form 1040:</b> U.S. Individual Income Tax Return) with all applicable schedules and W-2s	X	X	X	X
<b>Schedule C:</b> Profit or Loss from Business	X			
<b>Schedule E, Part II:</b> Income or Loss From Partnerships or S Corporations		X	X	
<b>Schedule K-1 (Form 1065):</b> Partner's Share of Income, Deductions, Credits, etc.		X		
<b>Form 1065:</b> U.S. Return of Partnership Income with all applicable schedules		X		
<b>Schedule K-1 (Form 1120-S):</b> Shareholder's Share of Income, Deductions, Credits, etc.			X	
<b>Form 1120-S:</b> U.S. Income Tax Return for an S Corporation with all applicable schedules			X	
<b>Form 1120:</b> U.S. Corporate Income Tax Return with all applicable schedules				X
<b>Year-to-Date Profit &amp; Loss Statement/Interim Balance Sheet:</b> as applicable	X	X	X	X
<b>Partnership Agreement:</b> may be required		X		
<b>Corporate Resolution:</b> may be required			X	X

## Commonly used financial statements

- Income statement
  - ▶ Specific period of time
    - Annual
    - Quarterly
    - YTD
- Balance sheet
  - ▶ Specific date
    - March 31, 2023





## Who prepares the financial statements?

- Accountant
- Tax professional
- Borrower



## Audited or not ... what's the big deal?

- Unaudited statements
  - ▶ Majority of time
  - ▶ Self prepared or third-party prepared
  - ▶ Used for supporting documentation
- Audited statements
  - ▶ Rarely received
  - ▶ Requires third-party verification of information by examining records – costly and time-consuming
  - ▶ May be used for qualifying

Support with LOE/balance sheet/bank statements if needed



## When are financial statements typically needed?

- Loan application is dated > 120 days after the end of the business's tax year
- Tax returns are on extension
- Significant income/loss difference between 2 years of tax returns



## Purpose of cash flow analysis

Verify qualifying income that is:

- ▶ Stable
- ▶ Likely to continue





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## Self-employed borrower and income analysis worksheets

Editable, auto-calculating cash flow analysis worksheets for the 2022 tax year.

MGIC > underwriting >



### Updated self-employed borrower and income analysis worksheets

2022 tax year: Outfitted for speed and accuracy, our editable and auto-calculating worksheets are fitted specifically for loan officers and mortgage pros. MGIC's self-employed borrower (SEB) and income analysis worksheets are uniquely suited for analyzing:

- Cash flow and YTD profit and loss (P&L)
- Comparative income
- Liquidity ratios
- Base/variable income
- Rental income

[Get the worksheets](#)

**"I've been using MGIC worksheets for years and think they're fantastic! I haven't found any other worksheets that are as functional or as easy to use as MGIC's."**

Amanda, Underwriter

01 02

### Request access to the worksheets

Complete this form to gain **instant access** to our SEB worksheets: SAM Cash Flow Analysis with P&L, Comparative Income Analysis and Liquidity. You can also access our Income Analysis and Rental Income worksheets from this page.

First Name:



# MGIC worksheets



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## SEB and income analysis worksheets and resources

Updated for tax year 2022.

MGIC > underwriting > seb >

### Cash flow analysis worksheets for tax year 2022

Choose from MGIC's editable, auto-calculating worksheets to analyze self-employed borrower cash flow, income from employment and non-employment sources, and rental income.\* In addition to our downloadable worksheets, you can link to line-by-line help explanations for personal and business tax returns following the SAM cash flow method by using our [Schedule Analysis Method \(SAM\) Worksheet Help document](#).

Self-employed borrower worksheets | Income and rental worksheets | Additional resources

**PLEASE NOTE: Worksheets must be downloaded and saved before editing.**

#### Self-employed borrower worksheets

Our editable and auto-calculating worksheets are uniquely suited for analyzing cash flow and YTD profit and loss (P&L), comparative income and liquidity. PLEASE NOTE: Self-employed borrower worksheets must be downloaded and saved to your computer before editing them.

**SAM Cash Flow Analysis and P&L**

Review cash flow by business type using tax returns and P&L statements. Auto-fills income (loss) and displays current income trending. (2/13/2023)

Download and save the worksheet >

Download and save for Mac (Excel required) >

**Comparative Income Analysis**

Auto-calculates change percentages from one year to the next. (2/13/2023)

Download and save the worksheet >

Download and save for Mac (Excel required) >

**Liquidity**

Auto-calculates current and quick ratios. (2/13/2023)

Download and save the worksheet >

Download and save for Mac (Excel required) >

#### Income and rental worksheets

Calculate income (base, overtime, bonus, commission, etc.) and review the cash flow of rental and investment properties quickly with our auto-calculating worksheets. PLEASE NOTE: Income Analysis and Rental Income worksheets must be downloaded and saved to your computer before editing them.

Income Analysis | Rental Income

# Infographic: Characteristics of 5 common self-employed businesses



### CHARACTERISTICS OF 5 COMMON SELF-EMPLOYED BUSINESSES



In mortgage lending, a self-employed borrower is a person who owns 25% or more in an active business.\* Review, analysis and calculation of a self-employed borrower's income can be tricky, but understanding business structures is an important first step.

- Sole Proprietorship**
  - An unincorporated business with one owner
  - Unlimited liability
  - All profits flow directly to owner
  - Taxed at an individual rate
  - **Individual:** Files IRS Schedule C
  - **Business:** No returns are filed
- Partnership**
  - A business arrangement between two or more people/partners
  - Profit/loss is passed to individual partners
  - Each partner pays tax on their share of income
  - **Partner:** Receives Schedule K-1 and may receive guaranteed payments
  - **Business:** Files IRS Form 1065
- S Corporation**
  - A legal entity that has a limited number of stockholders
  - Profit/loss is passed to individual stockholders
  - Each stockholder pays tax on their share of income
  - **Stockholder:** Receives Schedule K-1 and may receive W-2 income
  - **Business:** Files IRS Form 1120-S
- Corporation**
  - A legal entity that exists separate from owners who are shareholders
  - Profits are distributed to shareholders via dividends
  - The corporation pays taxes
  - **Shareholder:** Can receive 1099-DIV and/or W-2 income
  - **Business:** Files IRS Form 1120
- LLC**
  - A limited liability company is a hybrid business
  - No associated tax forms
  - Can file using any of the structure-based IRS forms

**TAKE THE NEXT STEP:** Attend an MGIC webinar to gain the critical skills you need to evaluate self-employed borrowers' income.

 **Register now at [mgic.com/training/seb](https://mgic.com/training/seb)**

71-43866 2/23 \*Fannie Mae Selling Guide, December 2022



# Training – SEB webinars

[mgic.com/training/seb](https://mgic.com/training/seb)



<p><b>Skill-based</b> 60 minutes</p> <p><b>Self-Employed Borrowers – Focus on Getting Started and the Sole Proprietor</b></p> <p>Recorded Session Available any time.</p> <p>Register Watch now</p> <p>View training details ▶</p>	<p><b>Skill-based</b> 60 minutes</p> <p><b>Self-Employed Borrowers – Focus on Partnerships and S Corporations</b></p> <p>Recorded Session Available any time.</p> <p>Register Watch now</p> <p>View training details ▶</p>	<p><b>Skill-based</b> 60 minutes</p> <p><b>Self-Employed Borrowers – Focus on Corporations and Financial Statements</b></p> <p>Recorded Session Available any time.</p> <p>Register Watch now</p> <p>View training details ▶</p>
<p><b>Special Event</b> 60 minutes</p> <p><b>*Evaluating Self-Employed Income During Tough Economic Times*</b></p> <p>Recorded Session Available any time.</p> <p>Register Watch now</p> <p>View training details ▶</p>	<p><b>Skill-based</b> 60 minutes</p> <p><b>Self-Employed Borrowers – Focus on Rental Income</b></p> <p>Recorded Session Available any time.</p> <p>Register Watch now</p> <p>View training details ▶</p>	<p><b>Special Event</b> 30 minutes</p> <p><b>Can I Use Rental Income From a Business-Owned Property?</b></p> <p>Recorded Session Available any time.</p> <p>Register Watch now</p> <p>View training details ▶</p>

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