

# Shareholder's Instructions for 2004 Schedule 5K-1

## General Instructions

**Items to Note** - Schedule 5K-1 now contains a separate column that shows the amounts reportable to Wisconsin by a nonresident or part-year resident of Wisconsin who is a shareholder in a tax-option (S) corporation that does business in and outside Wisconsin. Use the amounts from column e when filling out Wisconsin Form 1NPR, Wisconsin income tax return for nonresidents and part-year residents.

For 2004, increases in taxable income for state and local government bond interest must be reported on line 4. See the line 4 instructions.

**Purpose of Schedule 5K-1** - Similar to federal Schedule K-1, the corporation uses Schedule 5K-1 to report your pro rata share of the corporation's income, deductions, credits, etc., for Wisconsin purposes. **Please keep it for your records. Do not** file it with your tax return unless you are claiming a tax credit passed through from the corporation or you are filing an amended return based on an amended Schedule 5K-1.

Although the corporation may have to pay a built-in gains tax, a franchise tax measured by certain federal, state, and municipal government interest income, and a recycling surcharge, you are liable for Wisconsin income tax on your share of the corporation's income, whether or not distributed, and you must include your share on your Wisconsin income tax return if a return is required.

**Inconsistent Treatment of Items** - Generally, you must report tax-option items shown on your Schedule 5K-1 and any attached schedules the same way that the corporation treated the items on its return. If your treatment is (or may be) inconsistent with the corporation's treatment, attach a statement to your return to identify and explain any inconsistency.

**Errors** - If you believe the corporation has made an error on your Schedule 5K-1, notify the corporation and ask for a corrected Schedule 5K-1. Don't change any items on your copy. Be sure that the corporation sends a copy of the corrected Schedule 5K-1 to the Wisconsin Department of Revenue.

**Elections** - Generally, the corporation decides how to figure taxable income from its operations. For example, it chooses the accounting method and depreciation methods it will use. However, certain elections are made by you separately on your income tax return and not by the corporation. These include elections made under Internal Revenue Code section 59(e)(2), relating to the deduction of certain qualified expenditures ratably over the period of time specified in that section.

## Limitations on Losses, Deductions, and Credits

**Aggregate Losses and Deductions Limited to Basis of Stock and Debt** - Generally, the deduction for your share of aggregate losses and deductions reported on Schedule 5K-1 is limited to the basis of your stock and debt owed to you by the corporation. The basis of your stock is figured at year-end. The basis of loans to the corporation is the balance the

corporation now owes you, less any reduction for losses in a prior year. Any loss not allowed for the taxable year because of this limitation is available for indefinite carryover, limited to the basis of your stock and debt, in each subsequent taxable year.

**Basis of Your Stock** - You are responsible for maintaining records to show the computation of the basis of your stock in the corporation for Wisconsin income tax purposes. Schedule 5K-1 provides information to help you make the computation at the end of each corporate taxable year. The Wisconsin basis of your stock (generally, its cost) is adjusted as follows (this list is not all-inclusive):

Basis is first **increased** by:

- All income, including tax-exempt income, as computed under Wisconsin law, reported on Schedule 5K-1, column d.

**Note:** You must report the taxable income on your Wisconsin income tax return (if you are required to file a return) for it to increase your basis.

Basis is **not** increased by the corporations's excluded discharge of indebtedness income, generally applicable for discharges of indebtedness after October 11, 2001.

Basis is **decreased**, but not below zero, by:

- Property distributions, including cash, made by the corporation, reported on Schedule 5K-1, line 16d, that are not includable in income. (Distributions in excess of Wisconsin basis reported on Schedule 5K-1, line 16d, and dividend distributions reported on Schedule 5K-1, line 17c, don't decrease basis.)
- Nondeductible expenditures, not due to timing differences, as computed under Wisconsin law from Schedule 5K-1, column d.
- All deductible losses and deductions, as computed under Wisconsin law, reported on Schedule 5K-1, column d.

**Note:** You may elect to decrease your basis by deductible losses and deductions prior to decreasing your basis by nondeductible expenses. If you make this election, any nondeductible expenses that exceed the basis of your stock and debt owed to you by the corporation are treated as nondeductible expenses for the following taxable year. To make the election, attach a statement to your timely filed original or amended return, as provided in the federal regulations. Once made, the election applies to the year for which it is made and all future taxable years for that corporation, unless the Department agrees to revoke your election.

- Your share of the supplement to the federal historic rehabilitation tax credit computed.

**Note:** When figuring the Wisconsin basis in stock of a multistate corporation, use your share of the total company amounts, as computed under Wisconsin law from Schedule 5K-1, column d, rather than the income, losses, and deductions attributable to Wisconsin activities from Schedule 5K-1, column e.

**At-Risk Limitations** - For federal purposes, if you have (1) a loss or other deduction from any activity carried on by the corporation as a trade or business

or for the production of income, and (2) amounts in the activity for which you aren't at risk, you generally will have to figure the allowable loss. The at-risk rules generally limit the amount of loss (including loss on the disposition of assets) and other deductions (such as the section 179 expense deduction) that you can claim to the amount you could actually lose in the activity. The at-risk rules also apply for Wisconsin purposes.

**Passive Activity Limitations** - Internal Revenue Code section 469 provides rules that limit the deduction of certain losses. The rules apply to shareholders who are individuals, estates, or trusts and have a passive activity loss for the taxable year. Passive activities include trade or business activities in which you didn't materially participate and rental activities, as defined in the federal regulations. Rental real estate activities in which you materially participated are not passive activities if you meet certain eligibility requirements. The corporation will identify separately each activity that may be passive to you. You must determine whether your losses are limited by the passive activity rules.

The passive activity loss limits also apply for Wisconsin purposes. However, if there are differences between your federal and Wisconsin income, you may have to recompute the amount of passive activity loss deductible for Wisconsin.

There are three types of differences between federal and Wisconsin income: Schedule I adjustments, those resulting from making different elections for federal and Wisconsin purposes, and modifications to federal adjusted gross income prescribed in section 71.05(6) to (12), (19), and (20), Wisconsin Statutes.

A Schedule I adjustment may arise if a provision of the Internal Revenue Code doesn't apply for Wisconsin or if a federal law change becomes effective at a different time for Wisconsin than for federal purposes. Modifications to federal adjusted gross income include the addition of state and local government bond interest income and the subtraction of the 60% capital gain deduction.

For differences resulting from Schedule I adjustments or different elections, you must recompute the passive activity loss limits for Wisconsin. However, you may not recompute the loss limits for modifications. The corporation should tell you the reason for any adjustment in column c so that you will know whether you must recompute the passive activity loss limits.

## Specific Instructions

**Lines 1 through 12 and 15** - The entries on these lines show your pro rata share of the federal amount, adjustment, and amount reportable under Wisconsin law for each of the items. For nonresident and part-year resident shareholders of multistate corporations, the entries also show your share of the amount attributed to Wisconsin. These amounts don't take into account limitations on losses or other items that may have to be adjusted because of (1) the adjusted basis of your stock and debt in the corporation, (2) the at-risk limitations, (3) the passive activity limitations, or (4) any other limitations. If your pro rata share items aren't affected by any

of the limitations, you should have reported the federal amounts on your federal income tax return. If any of the limitations apply, you should have adjusted the federal amounts for the limitations before entering them on your federal return.

If the amount under Wisconsin law for any share item on lines 1 through 12 and 15 differs from the federal amount, you must account for this difference on your Wisconsin income tax return. How you account for the difference depends on the share item, the reason for the difference, and whether you are filing Form 1 (Wisconsin residents), Form 1NPR (nonresidents and part-year residents), or Form 2 (estates and trusts).

If the difference arises because a provision of the Internal Revenue Code doesn't apply for Wisconsin or a federal law change becomes effective for Wisconsin at a different time, you must complete Wisconsin Schedule I (Schedule B for estates and trusts) before filling in your Wisconsin return. If the difference results from the corporation making different elections for federal and Wisconsin purposes, you must recompute the federal adjusted gross income that you report on your Wisconsin return. Finally, if the difference is a modification allowed in computing Wisconsin adjusted gross income, the treatment depends on which share item is affected and the return you are filing.

*Lines 1, 2, 3, 5, 6, 10, 11, 12, and 17d:*

- If you are filing Form 1, account for any modification to one of these share items by combining the amount from Schedule 5K-1, column c, with any other Wisconsin modification and entering the total on the appropriate line of Form 1.
- If you are filing Form 1NPR, include in column B on the appropriate line of Form 1NPR, along with any other Wisconsin income or loss, the Wisconsin amount from column e of any share item reported on one of these lines.
- If you are filing Form 2, account for any modification to one of these share items by entering the amount from Schedule 5K-1, column c, on Form 2, Schedule A.

*Lines 4 and 16a.* Interest income that is exempt from federal income taxes but taxable by Wisconsin, such as state and local government bond interest, is shown as an **addition** on line 4, column c.

- If you are filing Form 1, combine the amount from Schedule 5K-1, column c, with any other interest modification and enter the total on the appropriate line of Form 1.
- If you are filing Form 1NPR, include in column B on Form 1NPR, along with any other Wisconsin interest income, the Wisconsin source amount of interest income from Schedule 5K-1, column e.
- If you are filing Form 2, account for any modification by entering the amount from Schedule 5K-1, column c, on Form 2, Schedule A.

**Note:** Modifications for state and local government bond interest that is taxable by Wisconsin are also shown as **subtractions** on Schedule 5K-1, line 16a, column c.

*Lines 7 and 8:* Enter the Wisconsin amounts from column d (column e for nonresidents and part-year residents) of these share items on the appropriate

lines of Wisconsin Schedule WD (Schedule WD (Form 2) for estates and trusts).

*Line 9:* If the federal and Wisconsin amounts differ, see the instructions for Part II of Wisconsin Schedule T and recompute a federal Form 4797 as instructed.

*Lines 12 and 17b:* If the Wisconsin amount of charitable contributions or the amount of any other itemized deduction differs from the federal amount, adjust the deduction items from federal Schedule A when figuring the Wisconsin itemized deduction credit (Form 1, Schedule 1, or Form 1NPR, Schedule 1). Increase or decrease, as appropriate, the amount from federal Schedule A by the amount on Schedule 5K-1, column c.

**Note:** Rather than including the tax-option items deductible on federal Schedule A in the Wisconsin itemized deduction credit, you may treat these items as subtraction modifications to arrive at Wisconsin adjusted gross income. Your modification is limited to the amount actually deductible for federal purposes. If you are a nonresident of Wisconsin for any part of the corporation's taxable year, your modification is further limited to that portion of the deductible amount which is attributable to Wisconsin based on apportionment or separate accounting, as appropriate.

**Line 13a** – Enter the amount from line 13a, column d or e, on the appropriate line on Wisconsin Schedule MS.

**Line 13b** – Enter the amount from line 13b, column d or e, on the appropriate line on Wisconsin Schedule DI.

**Lines 13c through 13e** – Enter the amounts from lines 13c, 13d, and 13e, column d or e, on the appropriate lines on Wisconsin Schedule DC.

**Line 13f** – Enter the amount from line 13f, column d or e, on the appropriate line on Wisconsin Schedule TC.

**Line 13g** – Enter the amount from line 13g, column d or e, on the appropriate line on Wisconsin Schedule HR.

**Note:** The historic rehabilitation credit reduces your Wisconsin basis in the corporation's stock.

**Line 14** – Enter the total of the amounts from line 14, column d or e, as appropriate, on the "Net income tax paid to another state" line (Form 1, line 45, or Form 1NPR, line 68). **If you claim this credit, you must attach a copy of Schedule 5K-1 to the Form 1 or Form 1NPR that you file with the Department.**

**Line 15** – Enter the net amount from column c of line 15 on Wisconsin Schedule MT, line 8. If you are a nonresident of Wisconsin for any part of the corporation's taxable year, enter the difference between column b and column e on Schedule MT, line 8.

**Lines 16a through 16c** – Differences in the amount of income that is exempt for federal and Wisconsin purposes are shown on lines 16a and 16b, column c. Increases or decreases in the amount of non-deductible expenses are shown on line 16c, column c. Use the amount from column d when computing the Wisconsin basis of your stock.

**Line 16d** – Reduce your Wisconsin basis in stock of the corporation by the Wisconsin distributions on line 16d, column d. If these distributions exceed your Wisconsin basis in stock and you were a Wisconsin resident when you received the distributions, treat the excess as a Wisconsin gain from the sale or exchange of property. Enter any Wisconsin gain on the appropriate line of Wisconsin Schedule WD.

**Line 16e** – If the repayments on line 16e are made on indebtedness with a reduced Wisconsin basis and you received the repayments while you were a Wisconsin resident, the repayments result in income to you to the extent the repayments are more than the adjusted Wisconsin basis of the loan.

If you are filing Form 1, enter the amount of Wisconsin income realized on Wisconsin Schedule WD, if the loan was a capital asset. If the loan wasn't a capital asset, enter the difference between federal income and Wisconsin income on Form 1, line 4 or 11, as appropriate.

If you are filing Form 1NPR, enter the amount of Wisconsin income realized on Wisconsin Schedule WD, if the loan was a capital asset, or in column B of the appropriate line on Form 1NPR, if the loan wasn't a capital asset.

**Line 17c** – You must report the amount from column d or e, as appropriate, as dividend income if you were a Wisconsin resident on the date you received it. The federal amount of the dividend distribution should have been reported to you on Form 1099-DIV.

If you are filing Form 1, enter the amount from line 17c, column c, on Form 1, line 4 or 11, as appropriate. If you are filing Form 1NPR and the dividend distribution is reportable to Wisconsin, enter the amount from line 17c, column e, on Form 1NPR, line 3, column B, along with any other dividend income reportable to Wisconsin.

**Line 17d** – If applicable, the corporation has provided supplemental information or has listed in the space provided, or on attached schedules, your pro rata share of items not included on lines 1 through 17c. This listing should include the federal amount, adjustment, amount under Wisconsin law, and Wisconsin source amount, if applicable, for each item.

Account for any other share items listed on line 17d as necessary to include the taxable or deductible amount of each item as computed under Wisconsin law in your Wisconsin income.

If interest income from United States government obligations is listed, you must make an adjustment on your Wisconsin return since this income is taxable for federal income tax purposes, but not for Wisconsin purposes. If you are filing Form 1, include the federal amount of this interest income on line 7. If you are filing Form 1NPR, don't include this interest income on Form 1NPR, line 2, column B.

**Line 18** – Combine the amount from column d or e, as appropriate, with your gross Wisconsin income from other sources (if any) to determine whether you must file a Wisconsin income tax return. See the instructions for Form 1 or Form 1NPR for information about the filing requirements.