

**Table of Contents**

**2.0 EXAMINING S-CORPORATION AND SHAREHOLDER RETURNS**

- 2.1 Purpose
- 2.2 S-Corporation Return Assigned
- 2.3 Examining the Return

## **2.1 PURPOSE**

The purpose of this subsection is to provide auditors with key points for examining S-Corporation returns (California Form 100S & Federal 1120S) and shareholder returns (California Form 540 & Federal Form 1040) and other documents that are used in the examination process.

## **2.2 S-CORPORATION RETURN ASSIGNED**

Follow these steps to start the S-Corporation return examination.

1. Gather:
  - a. The S-Corporation's corporate folder.
  - b. The shareholders' personal income tax returns.
  - c. The corporation's corporate transcript to understand the corporation's filing history.
    - I. Are there any amended returns?
    - II. When did the corporation elect Federal S status?
    - III. When did the corporation elect California S status?
2. Scope the return and clarify tax issues.

## CALIFORNIA FRANCHISE TAX BOARD

### 2.3 EXAMINING THE RETURN

- 2.3.1 Form 100S: California S-Corporation Franchise or Income Tax Return
- 2.3.2 Federal Individual Income Tax Return: Form 1040
- 2.3.3 California Resident Income Tax Return: Form 540
- 2.3.4 California Fiduciary Income Tax Return: Form 541

#### 2.3.1 Form 100S: California S-Corporation Franchise or Income Tax Return

2005 CA Form 100S: Side 1

Entity Information	
For Income Year Beginning	If the corporation uses a fiscal year, check the S-Corporation's qualifications for fiscal year treatment.
California Corporation Number	Each corporation incorporated in or qualified to do business in California receives a CCN from the California SOS. This number is used for California purposes only. Use this number to obtain additional information/documents in-house.
Federal Employer Identification Number	This number is a Federal number, also referred to as the FEIN number. Use this number to obtain corporate information from the IRS using FTB 6227 (Request for Federal Tax Information).
Corporation Name	Be aware that the corporation's name may change, but the corporation's CCN does not change.
Schedule Q - Question A.	If any of the boxes are checked, the reasons for filing the final return should be explained. For example, a merger agreement, a stock sale agreement, or the Federal Form 8023 may be attached to the return.

**The information provided in the Franchise Tax Board's internal procedure manuals does not reflect changes in law, regulations, notices, decisions, or administrative procedures that may have been adopted since the manual was last updated.**

**CALIFORNIA FRANCHISE TAX BOARD**

<b>S Corp State NI &amp; Tax Reporting</b>	
Line 1	This amount should be the amount reported on the Federal Form 1120S, line 21 as well as the amount reported on California Form 100S, Sch. F, line 22.
Line 2	Make sure that the corporation added back the correct amount of tax for California Franchise or Income Tax purposes. See California Form 100S, Sch. F, line 12 for reference. Be aware that California Sch. F, line 12 often includes other taxes.
Line 4	Refer to Sch. D, Sections A and B for acquisition dates. Look for potential Built-In Gain or Loss (BIG & BIL) issues.
Line 6	If the corporation retains C corporation Earnings & Profits, look for a potential ENPI issue. See S-Corp Chapter 7.0 for details.
Line 7 - Other Additions	Line 7 may be used to report passive activity income. Line 7 and line 13 may be used to reconcile the Federal/California differences for some items.
Line 11	There is a 10% California net income limitation for the amount of contribution deduction allowed at the corporate level. Be aware of a potential AMT issue at the shareholder level if the corporation contributed appreciated property.
Line 13	See line 7.
Line 18, Line 19, and Line 20	An S-Corporation cannot use NOLs that were generated during the C years. Verify that the computations are correct and the prior year NOL does not exceed the allowed carryover years.
Line 22 - Tax	Make sure that the corporation used the correct tax rate. A financial S-Corporation must use the

**The information provided in the Franchise Tax Board's internal procedure manuals does not reflect changes in law, regulations, notices, decisions, or administrative procedures that may have been adopted since the manual was last updated.**

**CALIFORNIA FRANCHISE TAX BOARD**

---

	3.5% tax rate in accordance with R&TC §23802(b)(2).
Lines 23~26 Tax Credits	Verify the corporation's qualification to take the credit. Verify qualification of the costs included in the credit computation.
Line 28 - Tax from Sch. D	BIG tax computed in Sch. D is reported here. Did the corporation compute the amount of Net Realized BIG correctly? See S-Corp Chapter 5.0 for details.
Line 25 - ENPI Tax	Verify computational accuracy. If the corporation had ENPI more than three consecutive years, its S election is in jeopardy of being revoked.

2005 CA Form 100S: Side 2

<b>Schedule Q Questions (cont. from Side 1)</b>	
Question B.	If the "yes" box is checked, additional information should be attached to the return, such as a reorganization agreement or a Sch. K-1 indicating the shareholder's stock ownership percentage change.
Question C.	Use this code to gain a preliminary understanding of the S-Corporation's business. See Form 100S Instruction for the business code listing.
Question E.	The "yes" box should be checked if the S-Corporation has one or more qualified subchapter S subsidiaries. Verify Sch. Qs attached.
Question F.	This date helps to identify a potential BIG issue.
Question G.	This information, when compared to the number of K-1s prepared, helps to identify stock transactions among the corporation and the shareholders.

**The information provided in the Franchise Tax Board's internal procedure manuals does not reflect changes in law, regulations, notices, decisions, or administrative procedures that may have been adopted since the manual was last updated.**

**CALIFORNIA FRANCHISE TAX BOARD**

Question H.	Compare the date with the dates reported on Form 100s, Side 2, Questions F, and J. Are the dates reasonable?
Question I.	If "yes" was checked, find out the issues examined by the IRS and the result of the audit.
Question J.	This date, when used with the date reported on Question H, helps to identify a potential BIG issue. This date may not be reliable. For the correct date, request a copy of the date stamped Federal Form 2553 and/or a copy of the letter sent by the IRS certifying that the corporation is a Federal S-Corporation. BMF MFTRA (e) transcript from the IRS also is useful.
Question L.	Be aware that a collection on the accounts receivable of a cash basis taxpayer may trigger a BIG tax issue. Find out when the receivable was booked. If it was booked during the C-Corp year, the income recognized during the S-Corp year is subject to the BIG tax. There is no BIG tax issue for an accrual method taxpayer, since the corporation recognized the income when the receivable was booked.
Question O.	If "no" is checked, find out what isn't filed with the FTB.
Question P.	If "yes" is checked, the corporation is an apportioning S-Corporation.

<b>Schedule J - Add-On Taxes or Recapture of Tax Credits</b>	
Line 1 - LIFO Recapture Due to S Election	Verify the amount of LIFO recapture for accuracy.
Line 2 - Look-Back Method Interest	Verify the interest computation for accuracy.
Line 3 - Interest on Tax Attributable to	Verify the amount for accuracy.

**The information provided in the Franchise Tax Board's internal procedure manuals does not reflect changes in law, regulations, notices, decisions, or administrative procedures that may have been adopted since the manual was last updated.**

**CALIFORNIA FRANCHISE TAX BOARD**Internal Procedures Manual  
S-Corporation ManualRev.: December 2007  
Page 8 of 19

Installment	
Line 5 - Credit Recapture	Was the credit generated during the C-Corp years?

2005 CA Form 100S: Side 3

<b>Schedule F - Computation of Trade/Business Income</b>	
Line 1	If the amount of gross receipts is greater than \$50,000,000, the corporation is a "large S." Make sure your Program Manager is aware of this.
Line 2	How did the COGS affect the gross profit? Is the gross profit margin reasonable, consistent each year, and comparable with the industry average? If not, why? Also, consider examining Sch. V to verify that the items included in the inventory account were properly capitalized and deducted as COGS.
Line 4	What is the net gain? Is the gain subject to the BIG tax? If the amount was the result of the IRC §1245 recapture, verify the recapture computation.
Line 5	Check the schedule(s) attached to the return to find out what created other income. Is it subject to the BIG tax?
Line 7	Compare the amount of compensation with the amount of tax-free distributions and/or the amount of loans to shareholders. There may be a reclassification issue.
Line 9	Should the cost be capitalized?
Line 10	Is this a valid bad debt? Refer to IRC §166.
Line 12	The amount of income tax paid for foreign, domestic, or California purposes must be added back to the net income. See California Form 100S, Side 1, line 2.
Line 15	What kind of depletion took place? Federal law

The information provided in the Franchise Tax Board's internal procedure manuals does not reflect changes in law, regulations, notices, decisions, or administrative procedures that may have been adopted since the manual was last updated.

**CALIFORNIA FRANCHISE TAX BOARD**

	is different from California law, especially in the case of intangible drilling.
Line 20	Verify the items of Other Deductions. Are they deductible?

<b>Sch. L - Balance Sheet</b>	
<b>Make sure any increase/decrease on balance sheet accounts is reflected on the tax return.</b>	
Line 2 - Trade Notes & Accounts Receivable	Using the Corporate Folder, examine the history of the receivables account. Be aware of a potential BIG issue for a cash basis taxpayer. See Form 100S, Side 2, Question L.
Line 5 - Other Current Assets	If there is a large increase or decrease in this area, examine the attached schedule/statement. Pay special attention to the disposition of assets. Did the corporation realize and recognize gain or loss? Did the corporation report the recognized net gain? Did the corporation defer the gain? Are there BIG, BIL, or ENPI issues?
Line 6 - Loans to Shareholders	Examine the history of "loans to shareholders." Are the loans bona-fide loans? Is the shareholder paying interest to the corporation? What is the interest rate? Is it "at" or below the AFR? When is the loan payable? Should it be re-characterized as a distribution?
Line 7 - Mortgage and Real Estate Loans Line 8 - Other Investments	"Loans to shareholders" may be reported here as "related party loans" or "advances." If the corporation owns interests in partnerships, verify that the corporation reported its share of flow-through income/loss from each partnership.
Line 10 - Depletable Assets, Line 12 - Land Line 13 - Other Assets	Review the attached schedule/statement for changes in the account balance. Are the changes reflected on the return? Did the corporation sell or distribute assets? How? Consider potential BIG, BIL, and IRC §1245

**The information provided in the Franchise Tax Board's internal procedure manuals does not reflect changes in law, regulations, notices, decisions, or administrative procedures that may have been adopted since the manual was last updated.**

**CALIFORNIA FRANCHISE TAX BOARD**

	recapture issue. Did the corporation defer gain under IRC §453?
Line 18 - Loans from Shareholder	Are the loans bona-fide debts from shareholders? A mere shareholder guarantee on corporate debt does not provide debt basis to the shareholder. The shareholder must make payments as a guarantor. Is the interest rate "at" or below the AFR? If below, is there an imputed interest issue? If the shareholder took flow-through losses on the debt basis and later received loan repayments from the corporation, there may be a taxable loan repayment issue at the shareholder level.
Line 21 - Capital Stock Line 22 - Paid-In or Capital Surplus	Total the figures reported on line 18(b), line 21(b), line 22(b), and Sch. M-2 line 1(a) to estimate the aggregate amount of shareholder basis at BOY. Does each shareholder have enough basis to take the net flow-through losses in the current year? Does each shareholder have enough basis to receive tax-free distributions from the corporation?

2005 CA Form 100S: Side 4

<b>Schedule M-1</b>	
Line 1 - Net Income per Books	Compare this amount with the corporation's net income for financial purposes. If the numbers don't match, find out why. Does the discrepancy result in the understatement of taxable income?
Line 2 & Line 5	Be aware of BIG items such as LIFO recapture. If the amount of debt cancelled was reported, examine whether the corporation meets the requirements for excluding the income and whether the shareholders increased their stock basis by the amount of excluded COD income. (See the Supreme Court decision of <i>Gitlitz v.</i>

**The information provided in the Franchise Tax Board's internal procedure manuals does not reflect changes in law, regulations, notices, decisions, or administrative procedures that may have been adopted since the manual was last updated.**

**CALIFORNIA FRANCHISE TAX BOARD**

	Commissioner (Jan. 2001) and the subsequent law change as of Jan. 2002.)
Line 8	Compare this amount with the amount reported on line 15 of Form 100S. If the discrepancy is material, find out why.

<b>Schedule M-2</b>	
Line 1 - Balance at Beginning of Year	If this is the corporation's first year as an S-Corporation, the balance should be zero. Otherwise, make sure that the corporation has been carrying over ending balances consistently. Be aware that if the corporation's previous year returns have been examined and adjusted, this amount may not be accurate.
Line 3 - Other Additions	This amount can be traced to Side 1 of Form 100S, as well as to any referenced schedules/statements.
Line 5 - Other Reductions	This amount can be traced to Side 1 of Form 100S, as well as to any referenced schedules/statements.
Line 7 - Distributions Other Than Dividend Distributions	This amount may be a plug-in figure, if the distribution is in excess of AAA balance. Otherwise, this amount should equal the amount reported on line 20 of Sch. K, Form 100S and the aggregate amount reported on line 21 of Sch. K-1s of Form 100S. Should any part of distributions be considered dividend distributions or taxable capital gains to the shareholders? Did the corporation distribute AAA before passing through the net loss to shareholders?
C Corp. E&P	If the last box of Sch. M-2 is checked, the amount entered to the right of the box should equal the C corporation E&P balance. Be sure to check the amount if you have an issue such as termination per IRC section 1362(d)(3) of the S-

**The information provided in the Franchise Tax Board's internal procedure manuals does not reflect changes in law, regulations, notices, decisions, or administrative procedures that may have been adopted since the manual was last updated.**

**CALIFORNIA FRANCHISE TAX BOARD**

	Corporation, excess passive income for three consecutive years, or the imposition of ENPI tax per IRC section 1375.
--	---------------------------------------------------------------------------------------------------------------------

<b>Schedule V - Cost of Goods Sold</b> <b>The issues in this schedule depend on the business/industry.</b>	
Line 2 - Purchases	Examine the purchase account with the A/P account. Did the corporation purchase goods for sale? Examine purchase orders and invoices.
Line 3 - Cost of Labor	Did the corporation properly identify the amount of direct labor costs allocable to inventory?
Line 4 - Other IRC Section 263A Costs	Proceed carefully because materiality may prevail.
Line 6 – Total	If this amount is overstated, the cost of goods sold is overstated, and gross profit is understated.
Line 7 – EOY Inventory	If this amount is understated, the cost of goods sold is overstated, and gross profit is understated.
NOTE:	If any of the questions on Sch. V are answered "yes," there is a potential BIG issue for LIFO recapture.

2005 CA Form 100S: Side 5

<b>Schedule K - S-Corporation Shareholder's Share of Income, Deductions, Credits, etc.</b>	
Line 1 - Ordinary Inc/Loss	This amount should match Side 1, line 1 of Form 100S.
Line 4a-4f - Portfolio Income	If the corporation retains C corporation earnings and profits at year-end, there is a potential ENPI tax issue. Compute the amount of excess net passive income. See S Corp Chapter 7.0 for details.

**The information provided in the Franchise Tax Board's internal procedure manuals does not reflect changes in law, regulations, notices, decisions, or administrative procedures that may have been adopted since the manual was last updated.**

**CALIFORNIA FRANCHISE TAX BOARD**

Line 5 - Net gain/loss IRC Section 1231	Verify the corporation's California S election date. Did the corporation sell assets and recognized the gain accumulated during C-Corp years? See S Corp Chapter 5.0 for BIG tax issue.
Line 6 - Other Income/Loss	Determine the nature of other income/loss. Consider BIG, BIL and ENPI issues.
Line 7 - Contributions	There is a potential AMT preference issue at the shareholder level, if the corporation contributed appreciated property.
Line 8-11 - Expenses	Examine the accuracy of expenses reported.
Line 12 & 13 - Credits	A 100% of credit (generated by the corporation) passes through to shareholders, prorated according to stock ownership percentage. The amount of credit allowed at the shareholder's level might be limited. See applicable California tax law for details.
Line 14a~14e - Adjustments & Tax Preferences	If the amount is material, consider examining the adjustments and tax preference items for potential audit adjustments due to Federal and state law differences.
Line 15 - Other State Taxes	In examining the accuracy of the amount reported, consider the pass-through tax effects for other state tax credits.
Line 16a & 16b – IRC §59(e) expenditures	Refer to IRC §59(e)(2) and R&TC §23459. There are Federal and state law differences for circulation expenses and oil and gas intangible drilling/development costs.
Line 20 - Property Distributions (other than dividends)	Compare this amount with the aggregate amount reported on line 21 of Sch. K-1s of Form 100S. Be aware that the amount reported on line 7 of Sch. M-2 of Form 100S may be a plug figure if the amount of distributions is in excess of AAA balance. Are any parts of the distributions dividend distributions or taxable capital gains to the shareholders?

**CALIFORNIA FRANCHISE TAX BOARD**

2005 CA Form 100S: Schedule B/C/D/H: Side 2: Schedule D

<b>California Sch. D - S-Corporation Capital Gains &amp; Losses and Built-In Gains - Section A, Parts I, II, III &amp; IV</b>	
Part I - Short-Term C/G's & C/L's	This part reports short-term C/G's & C/L's. These items are subject to BIG tax, which is computed on Sch. D, Part III. This amount is carried over to line 4d or 6 of Sch. K of Form 100S, for pass-through purposes.
Part II - Long-Term C/G's & C/L's with Consideration for BIG Tax on the Items	This part reports long-term C/G's & C/L's. These items are subject to BIG tax, which is computed on Sch. D, Part IV. This amount is carried over to line 4d or 6 of Sch. K of Form 100S, for pass-through purposes.
Part III - Tax on Built-In Gains	Built-in gains tax is computed in this area and reported on line 28 of Form 100S. In addition to examining the accuracy of the BIG computation, review line 17 of Form 100S to ensure that the corporation deducted the correct amount of BIG deduction for 1.5% purposes. Also, ensure that the amount of BIG tax was treated as a flow-through loss to the shareholders. For the corporation, the amount of BIG tax is not a deductible item. See S-Corp Chapter 5.0 for details.
Part IV	This is the aggregate amount of Capital Gain and Capital Losses, before BIG tax.

<b>California Sch. D - S-Corporation Capital Gains and Losses and Built-In Gains - Section B, Parts I &amp; II</b>	
Part I - Short-Term C/G's & C/L's	This part reports short-term C/G's &

The information provided in the Franchise Tax Board's internal procedure manuals does not reflect changes in law, regulations, notices, decisions, or administrative procedures that may have been adopted since the manual was last updated.

**CALIFORNIA FRANCHISE TAX BOARD**

	C/L's subject to the S-Corporation rate 1.5%. Any C/L carryovers are applied here.
Part II - Long-Term C/G's & C/L's	This part is to report long-term C/G's & C/L's subject to the S-Corporation rate 1.5%.
	The net effect of these parts is carried forward to line 4 of Form 100S. If losses exceed gains, the net loss must be carried forward to the next year.

2005 California Schedule K-1 (100S)

<b>California Schedule K-1</b>	
<p>This schedule reports each shareholder's allocable portion of each flow-through item from the corporation. If flow-through items are not allocated according to the shareholder's stock ownership percentage, the disproportional allocation may create a second class of stock and jeopardize the corporation's S status. Review Sch. K-1 with the shareholder's return (California Form 540 or individual or group Form 540NR) to ensure that the shareholder reported all flow-through items.</p>	
Shareholder's Identifying Number	Usually, this is the shareholder's SSN. Use this number to order shareholder returns. Keep in mind that the number reported here may not be accurate.
Shareholder's name, address & zip code	This section may suggest that shareholders are related: a husband and his wife or parents and children.
A. Shareholder's Percentage of Stock Ownership for Income Year End	If there is a change in the ownership percentage during the year, consider examining the stock transaction issues. A change on line 21 of Sch. L of Form 100S, line 22 of Sch. L of Form 100S, or in AAA account indicates that the shareholder redeemed stock or purchased additional stock from the corporation. If no changes

**The information provided in the Franchise Tax Board's internal procedure manuals does not reflect changes in law, regulations, notices, decisions, or administrative procedures that may have been adopted since the manual was last updated.**

**CALIFORNIA FRANCHISE TAX BOARD**

	are reported on Sch. L or AAA, the shareholder may have sold his/her stock to other shareholders (or a third party) or purchased stock from other shareholders.
B. Tax Shelter Registration Number & Type	This information is provided if the S-Corporation is a registered tax shelter. If a registered shelter the shareholder will attach IRS Form 8271 to their federal return.
C. Check Box - Final/Amended	If the "final" box is checked, consider examining the disposition (redemption or sale) of stock by the shareholder. The "final" could mean that the corporation terminated its S status at the end of year. If the "amended" box is checked, consider examining the shareholder's amended return to ensure that the shareholder correctly reflected the revisions on his/her California Form 540X.
Column (b) - Amount from Federal Sch. K-1	The figures entered in this column should be the figures reported on the Federal Sch. K-1(b). If not, find out why. The shareholder reported the figures in this column on his/her Federal Form 1040, using appropriate forms and schedules, according to the character/type of income/loss. For example, the amount on line 1, Column (b) of Sch. K-1, should be reported on the shareholder's Federal Form 1040, Sch. E., Part II. If the amount of flow-through ordinary loss is in excess of shareholder basis, the amount reported on Federal Form 1040, Sch. E, Part II should be limited. See S-Corp Chapter 9.0 for details.
Column (c) - California Adjustment	These amounts represent the Federal/California tax law differences. Determine whether these adjustments are accurate and properly reflected on the

**The information provided in the Franchise Tax Board's internal procedure manuals does not reflect changes in law, regulations, notices, decisions, or administrative procedures that may have been adopted since the manual was last updated.**

**CALIFORNIA FRANCHISE TAX BOARD**

	shareholder's California Schedule CA(540).
Column (d) - California Amount	Determine whether the figures in this column are the correct California flow-through amounts.
Line 7 - Charitable Contributions	If the corporation contributed appreciated property, the shareholder may have an AMT preference issue.
Line 20 – Total taxable dividend distributions paid out of accumulated earnings & profits	If the shareholder received distributions in excess of his/her stock basis, that amount is taxable income to the shareholder. See S-Corp Chapter 8.0 for details.
Line 21 – Property Distributions	If there is an amount here, verify what was distributed to the shareholder and how the value was determined.
Line 22 – Repayments of "Loans from Shareholders"	If there is an amount here you will need to verify the shareholder's debt basis. If debt basis was used to deduct losses in prior years, the repayment may be taxable income. See S-Corp Chapter 9.0 for details. [Debt basis could be restored]
Line 23	Look for additional information.

**2.3.2 Federal Individual Income Tax Return: Form 1040**

Tracing Flow-Through Ordinary Income on California Form 100S, Sch. K-1, column (b), line 1 to Federal Form 1040, line 17 - Rental Real Estate, Royalties, Partnerships, S-Corporations, Trust, etc.	Flow-through ordinary income/loss from trade or business on California Form 100S, Sch. K-1, column (b), line 1 should be reported on Federal Form 1040, Sch. E, Part II, then on Federal Form 1040, line 17.  The amount of flow-through loss (both separately and non-separately items) deductible on the Federal Form 1040 or California Form 540 is limited. See S-Corp Chapter 9.0 for details. Also,
-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------	-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------

**The information provided in the Franchise Tax Board's internal procedure manuals does not reflect changes in law, regulations, notices, decisions, or administrative procedures that may have been adopted since the manual was last updated.**

**CALIFORNIA FRANCHISE TAX BOARD**

	<p>consider examining Federal Form 6198 (At-Risk) for the at-risk limitation. See S-Corp Chapter 10.0 for details.</p> <p>There may be issues with regard to the character of flow-through ordinary income or loss. For example, passive loss deduction is limited where non-passive loss deduction is not. Are there any incentives for the shareholder to characterize flow-through items as passive or non-passive?</p>
<p>Tracing Flow-Through Portfolio Interest and Dividends on California Form 100S, Sch. K-1, column (b), line 4(a) and line 4(b) to the Federal Form 1040, line 8a and line 9.</p>	<p>Flow-through portfolio interest income and dividends on California Form 100S, Sch. K-1, column (b), line 4(a) and line 4(b) should be reported on Federal Form 1040, Schedule B, then on Federal Form 1040, line 8a and line 9.</p>
<p>Tracing Flow-Through Net Short-Term and Long-Term Capital Gain/Loss on California Form 100S, Sch. K-1, column (b), line 4(d) and line 4(e) to the Federal Form 1040, line 13.</p>	<p>Flow-through net capital gain/loss on California Form 100S, Sch. K-1, column (b), line 4(d) and line 4(e) should be reported on Federal Form 1040, Sch. D, then on Federal Form 1040, line 13.</p> <p>If the corporation paid BIG tax, the amount of BIG tax is treated as a loss to the shareholder. Therefore, the capital gain (that triggered the BIG) should be reduced by the shareholder's allocable portion of the BIG tax. See S-Corp Chapter 5.0 for details.</p>

**CALIFORNIA FRANCHISE TAX BOARD**

**2.3.3 California Resident Income Tax Return: Form 540**

All flow-through items reported on California Form 100S, Sch. K-1(b) are reported on Federal Form 1040 first. Review Federal Form 1040. Then, review the California Form 540 information.	Verify the information using California Form 100S, Sch. K-1(b).
California Form 540, Line 13 - Federal AGI	This amount came from the shareholder's Federal Form 1040, line 37 (Federal AGI), which includes all flow-through items reported in California Form 100S, Sch. K-1, column (b).
California Form 540, line 14 - California Adjustments – Subtraction	This amount includes negative adjustments reported in column (c) of California Form 100S, Sch. K-1.
California Form 540, line 16 – California Adjustments – Additions	This amount includes positive adjustments reported in column (c) of California Form 100S, Sch. K-1.

**2.3.4 California Fiduciary Income Tax Return: Form 541**

<b>Taxpayer Information</b>	<b>Verify the information for accuracy.</b>
Note: If Form 541 is stamped with a statement that this trust is a grantor trust...	Request the grantor's tax return.
	Compare the S Corp Sch. K-1 with Form 541, Sch. K-1 and with the amount reported on the individual's (grantor's) Federal Form 1040, Sch. E.