Introduction to Business and Rental Property Tax Returns

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Ground Rules!

Participate
- But don't share your institutions specific approaches or secrets!

There may be more than one correct approach
- This is more of an art than a science

We're going to be judgmental!
- Because your institution's resources are at stake

We'll use the "Roommate Test" as a guide
- Students with similar resources should get similar aid packages, without regard to non-financial, tax code, or timing artifacts

This program was prepared for the Pennsylvania Association of Student Financial Aid Administrators (PASFAA) for the benefit of its members
- Distribution to non-members is strictly prohibited

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What Can You Learn from Business Returns?

Without Reviewing Business Tax Returns	After Reviewing Business Tax Returns
Taxable income after *some* untaxed income addbacks	Estimated **cash flow** available to the business or property owner
Information about what happened in the **base year**	Estimate of what might be available in the **academic year**
Business value may be under-reported at **book value**	Estimate of business **market value**
Is the business owner paying him/herself fairly	Estimate of available income vs. distributed income
Has the taxpayer stored wealth in the business?	Business resources that may be available to the owner

For this presentation, all cases are based on 2018 tax returns and the 2020-2021 academic year.

Case 1 – Tax Deductions that Don't Represent Cash Flow Reductions

Should These EFCs be Different?

Your candidate's parent runs a machine shop. They need to replace a metal press that has become too costly to maintain and repair.

Consider the impact on the student's EFC and eligibility for financial aid based solely on the timing of this purchase:

Case 1 Purchase before the base year	Case 2 Purchase in the base year	Case 3 Purchase after the student enrolls
Parent 1 purchased a $50,000 metal press on **December 15th, 2017** because their older machine had worn out and became too expensive to repair	Parent 2 purchased a $50,000 metal press on **January 15th, 2018** because their older machine had worn out and became too expensive to repair	Parent 3 purchased a $50,000 metal press on **December 15th, 2019** because their older machine had worn out and became too expensive to repair. They ask you to take this cost into account on appeal

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Adjusted Gross Income by Year

If the business generated $100,000 of taxable profit *before* purchasing the metal press, the AGI in each year *might be:*

	Sample AGIs 2017	Sample AGIs 2018	Sample AGIs 2019
Metal Press Purchased in 2017	$50,000 $75,000 $90,000	$100,000 $92,000 $84,000	$100,000 $95,200 $90,400
Metal Press Purchased in 2018	$100,000	$50,000 $75,000 $90,000	$100,000 $92,000 $84,000
Metal Press Purchased in 2019	$100,000	$100,000	$50,000 $75,000 $90,000

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Schedule C – Depreciation

Part I	Income		
1	Gross receipts or sales. See instructions for line 1 and check the box if this income was reported to you on form W-2 and the "Statutory employee" box on that form was checked. ▶ ☐	1	150,000
2	Returns and allowances	2	
3	Subtract line 2 from line 1	3	150,000
4	Cost of goods sold (from line 42)	4	0
5	**Gross profit.** Subtract line 4 from line 3	5	150,000
6	Other income, including federal and state gasoline or fuel tax credit or refund (see instructions)	6	
7	**Gross income.** Add lines 5 and 6 ▶	7	150,000

Part II — Expenses. Enter expenses for business use of your home **only** on line 30.

8	Advertising	8	1,000	18	Office expense (see instructions)	18	500
9	Car and truck expenses (see instructions)	9	0	19	Pension and profit-sharing plans	19	
10	Commissions and fees	10		20	Rent or lease (see instructions):		
11	Contract labor (see instructions)	11		a	Vehicles, machinery, and equipment	20a	0
12	Depletion	12		b	Other business property	20b	12,000
13	Depreciation and section 179 expense deduction (not included in Part III) (see instructions)	13	50,000	21	Repairs and maintenance	21	1,600
				22	Supplies (not included in Part III)	22	
				23	Taxes and licenses	23	2,400
				24	Travel and meals:		
14	Employee benefit programs (other than on line 19)	14		a	Travel	24a	0
15	Insurance (other than health)	15	3,000	b	Deductible meals (see instructions)	24b	1,000
16	Interest (see instructions):			25	Utilities	25	
a	Mortgage (paid to banks, etc.)	16a		26	Wages (less employment credits)	26	25,000
b	Other	16b		27a	Other expenses (from line 48)	27a	2,500
17	Legal and professional services	17	1,000	b	**Reserved for future use**	27b	

28	**Total expenses** before expenses for business use of home. Add lines 8 through 27a ▶	28	100,000
29	Tentative profit or (loss). Subtract line 28 from line 7	29	50,000

- Evidence of asset purchases (including real estate) that may be from the current year or past years
- Assets worth up to $5,000 per item may be expensed on this line instead
  - But that's not the only item expensed here

Asset Purchases on the Return – Form 4562

Form **4562** — Department of the Treasury, Internal Revenue Service (99)

Depreciation and Amortization
(Including Information on Listed Property)
▶ Attach to your tax return.
▶ Go to *www.irs.gov/Form4562* for instructions and the latest information.

OMB No. 1545-0172 — **2018** — Attachment Sequence No. 179

Name(s) shown on return	Business or activity to which this form relates	Identifying number
	SCH C 1	

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

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

6 (a) Description of property	(b) Cost (business use only)	(c) Elected cost
Metal Press	50,000	50,000

7	Listed property. Enter the amount from line 29	7	0
8	Total elected cost of section 179 property. Add amounts in column (c), lines 6 and 7	8	50,000
9	Tentative deduction. Enter the **smaller** of line 5 or line 8	9	50,000
10	Carryover of disallowed deduction from line 13 of your 2017 Form 4562	10	
11	Business income limitation. Enter the smaller of business income (not less than zero) or line 5. See instructions	11	1,000,000
12	Section 179 expense deduction. Add lines 9 and 10, but don't enter more than line 11	12	50,000
13	Carryover of disallowed deduction to 2019. Add lines 9 and 10, less line 12 ▶	13	0

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

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

14	Special depreciation allowance for qualified property (other than listed property) placed in service during the tax year. See instructions	14	0
15	Property subject to section 168(f)(1) election	15	
16	Other depreciation (including ACRS)	16	

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

Section A

17	MACRS deductions for assets placed in service in tax years beginning before 2018	17	

- Deductions for assets purchased in the current tax year
  - The business owner's income was reduced by the whole cost, or half the cost, of the item
- Deduction for assets purchased in the current year and/or past years
  - The business owner is expensing the item over time

Dealing with Depreciation

To eliminate the distortion caused by large depreciation expenses and the reduction in income that depreciation allows for *purchases made in the past*

- You can add the depreciation back to the taxpayer's income

This treatment does not consider that these asset purchases are real business expenses and may need to occur during while your student is enrolled.

- If you determine that the business needed to make a large purchase during the aid year and/or if the business took a large deduction for the purchase, you can Add back the actual depreciation deduction taken for the item and
  - Allow a fraction of the purchase against any addbacks *for each year the student will be enrolled*
    OR
  - Review a depreciation schedule to determine the average spending on *non-durable goods that wear out*, and reduce the addback by this average

Case 3
Purchase after the student enrolls

Parent 3 purchased a $50,000 metal press on
December 15th, 2019
because their older machine had worn out and became too expensive to repair. They ask you to take this cost into account on appeal

Adjusting for Asset Spending

Basic Approach

Summary of Unadjusted Basis of Depreciable Property (4562) 12/31/2018

Detail of Depreciable Property

	Activity	Asset Description	Date In Service	Recovery Period	Years in Service	Total Cost or Basis	Business/Time Use Percent	Unadjusted Cost or Basis
10	1120S	Metal Press	6/17/2018	7	1	50,000	100.00%	50,000

Since the IRS has set a recovery period for this asset of 7 years, allow 1/7th of the cost each year

- In 2018, add back $50,000, but allow $7,143 ($50,000 ÷ 7) *each year* because the $50,000 is a real cost to the business that is likely to be repeated

Adjusting for Asset Spending

Advanced Approach

Summary of Unadjusted Basis of Depreciable Property (4562) 12/31/2018

Detail of Depreciable Property

	Activity	Asset Description	Date In Service	Recovery Period	Years in Service	Total Cost or Basis	Business/Time Use Percent	Unadjusted Cost or Basis
2	1120S	Office Furniture	3/15/2014	7	5	10,000	100.00%	10,000
3	1120S	Computer System	2/15/2014	5	5	5,000	100.00%	5,000
4	1120S	Leasehold Improvements	4/1/2014	15	5	35,000	100.00%	35,000
5	1120S	Rugs	7/12/2016	7	3	1,850	100.00%	1,850
6	1120S	Medical Record Software	8/22/2017	3	2	2,500	100.00%	2,500
7	1120S	Refrigerator	12/14/2017	7	2	1,200	100.00%	1,200
8	1120S	Fireproof Safe	4/15/2015	7	4	3,000	100.00%	3,000
9	1120S	Secure Medical Records File S	4/15/2016	7	3	11,000	100.00%	11,000
10	1120S	Metal Press	6/17/2018	7	1	50,000	100.00%	50,000

Identify assets that wear out and can be expected to be replaced

- The company has **$58,700** in non-durable goods on its books
- The oldest non-durable item on the list was purchased on 2/15/2014 – four years ago
- Allow **$14,675** ($58,700 ÷ 4) after adding back all the depreciation

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Case 2 – Available Resources vs. Potential Resources

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Reviewing Schedule E Part I

Your student's parent owns a rental property

You reviewed the income and expenses on the Schedule E

- All expenses seemed reasonable and directly related to rental activities: maintenance, tenant acquisition, utilities
- There did not appear to be any one-time large expenses to push the property into a one-time loss, and you have determined that the property consistently shows a tax loss

Example 2 – Less than Market Rate Income

You looked the property up on an on-line real estate website, and learned that the estimated rental income for the property is $1,500 per month ($18,000 per year)

Which of these parents should have the highest EFC? Which of these parents will have the highest EFC?		
Parent 1 received **$18,000** in rents in 2018. After expenses, the property produced a **rental tax loss of $3,123** for the year	Parent 2 received **$9,000** in rents in 2018. After expenses, the property produced a **rental loss of $12,123** for the year. When you asked, the parents told you they rent to the **student's uncle,** who is down-on-his-luck **so they give him a break on rents**	Parent 3 received **$18,000** in rents in 2018. After expenses, the property produced a **rental tax loss of $3,123** for the year. They submitted an appeal telling you that they pay $9,000 in rents to another landlord to **cover the costs of the student's uncle,** who is down-on-his-luck

Learning from Schedule E

PASFAA 2019
Harvesting Knowledge

Income: Properties:		A	B
3 Rents received	3	18,000	9,000
4 Royalties received	4	0	0
Expenses:			
5 Advertising	5	500	500
6 Auto and travel (see instructions)	6	0	0
7 Cleaning and maintenance	7	1,200	1,200
8 Commissions	8	0	0
9 Insurance	9	2,250	2,250
10 Legal and other professional fees	10	0	0
11 Management fees	11	0	0
12 Mortgage interest paid to banks, etc. (see instructions)	12	5,530	5,530
13 Other interest	13	0	0
14 Repairs	14	1,000	1,000
15 Supplies	15	0	0
16 Taxes	16	3,300	3,300
17 Utilities	17	850	850
18 Depreciation expense or depletion	18	9,091	9,091
19 Other (list) ▶	19	0	0
20 Total expenses. Add lines 5 through 19	20	23,721	23,721
21 Subtract line 20 from line 3 (rents) and/or 4 (royalties). If result is a (loss), see instructions to find out if you must file **Form 6198**	21	-5,721	-14,721
22 Deductible rental real estate loss after limitation, if any, on **Form 8582** (see instructions)	22	(5,721)	(14,721)

Are the rental properties creating paper losses or real losses?

Approximately how large are the mortgages?

Learning from Schedule E?

PASFAA 2019
Harvesting Knowledge

Income: Properties:		A	B
3 Rents received	3	18,000	9,000
4 Royalties received	4	0	0
Expenses:			
5 Advertising	5	500	500
6 Auto and travel (see instructions)	6	0	0
7 Cleaning and maintenance	7	1,200	1,200
8 Commissions	8	0	0
9 Insurance	9	2,250	2,250
10 Legal and other professional fees	10	0	0
11 Management fees	11	0	0
12 Mortgage interest paid to banks, etc. (see instructions)	12	5,530	5,530
13 Other interest	13	0	0
14 Repairs	14	1,000	1,000
15 Supplies	15	0	0
16 Taxes	16	3,300	3,300
17 Utilities	17	850	850
18 Depreciation expense or depletion	18	9,091	9,091
19 Other (list) ▶	19	0	0
20 Total expenses. Add lines 5 through 19	20	23,721	23,721
21 Subtract line 20 from line 3 (rents) and/or 4 (royalties). If result is a (loss), see instructions to find out if you must file **Form 6198**	21	-5,721	-14,721
22 Deductible rental real estate loss after limitation, if any, on **Form 8582** (see instructions)	22	(5,721)	(14,721)

Approximately how much did they pay for the building?

Are there any one-time expenses that reduced the income in the base year but won't in the academic year?

Case 3 – Business Structures

Different Business Structures

There are four business four business structures

- Sole Proprietorships
- Partnerships
- S Corporations
- C Corporations

Depending on the business structure, the owners may be able to divide the business profits into different kinds of income

- Earned income to the owners (wages or guaranteed payments to partners)
- Dividends or distributions
- Retained earnings (for business reinvestment or *future distributions or dividends to owners)*

You have four students whose parents produce exactly the same income in exactly the same manner but – they have selected different tax structures for their businesses

Should the parents have different EFCs?

Different Business Structures

Your student's mother runs a jewelry shop which posted a taxable profit of about $72,000 in 2018. She would like to buy the building that houses her business, so she paid herself $50,000 and left the remaining profit in a business savings account (where she is building the down payment)

She has asked you to evaluate her child's eligibility for financial aid as though she'd only earned $50,000

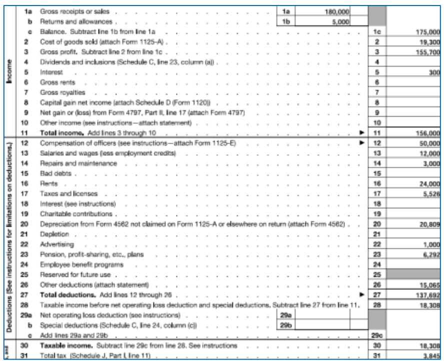
Based on this information, would you exclude the $22,000 that she saved from her income when you calculate the Parent Contribution?

Business Structures and the AGI

	Sole Proprietorship (Schedule C)	Partnership (Form 1065)	S Corporation (Form 1120-S)	C Corporation (Form 1120)
Wages	$0	$0	$50,000	$50,000
Interest Income	$300	$300	$300	$0
Line 12 (Schedule C)	$72,000	$0	$0	$0
Passthrough Income*	$0	$72,000	$18,009	$0
Total Income	$72,300	$72,300	$68,309	$0
½ Self Employment Tax Deduction	$5,087	$5,087	$0	$0
AGI	**$67,213**	**$67,213**	**$68,309**	**$50,000**

*Partnerships and S corporations calculate their taxable income, losses, deductions, and credits on an informational tax return each year. They then report each owner's share of these tax items and the owners report them on their personal return as they would if they had earned them directly.

Form 1120 (C Corporation Tax Return)



1a	Gross receipts or sales	1a	180,000		
b	Returns and allowances	1b	5,000		
c	Balance. Subtract line 1b from line 1a			1c	175,000
2	Cost of goods sold (attach Form 1125-A)			2	19,300
3	Gross profit. Subtract line 2 from line 1c			3	155,700
4	Dividends and inclusions (Schedule C, line 23, column (a))			4	
5	Interest			5	300
6	Gross rents			6	
7	Gross royalties			7	
8	Capital gain net income (attach Schedule D (Form 1120))			8	
9	Net gain or (loss) from Form 4797, Part II, line 17 (attach Form 4797)			9	
10	Other income (see instructions—attach statement)			10	
11	**Total income.** Add lines 3 through 10			11	156,000
12	Compensation of officers (see instructions—attach Form 1125-E)			12	50,000
13	Salaries and wages (less employment credits)			13	12,000
14	Repairs and maintenance			14	3,000
15	Bad debts			15	
16	Rents			16	24,000
17	Taxes and licenses			17	5,526
18	Interest (see instructions)			18	
19	Charitable contributions			19	
20	Depreciation from Form 4562 not claimed on Form 1125-A or elsewhere on return (attach Form 4562)			20	20,809
21	Depletion			21	
22	Advertising			22	1,000
23	Pension, profit-sharing, etc., plans			23	6,292
24	Employee benefit programs			24	
25	Reserved for future use			25	
26	Other deductions (attach statement)			26	15,065
27	**Total deductions.** Add lines 12 through 26			27	137,692
28	Taxable income before net operating loss deduction and special deductions. Subtract line 27 from line 11.			28	18,308
29a	Net operating loss deduction (see instructions)	29a			
b	Special deductions (Schedule C, line 24, column (c))	29b			
c	Add lines 29a and 29b			29c	
30	**Taxable income.** Subtract line 29c from line 28. See instructions			30	18,308
31	Total tax (Schedule J, Part I, line 11)			31	3,845

All business tax returns contain information about expenses that you can use to estimate the business's cash flow

- Schedule C
- Form 1065 (Partnerships)
- Form 1120S (S Corporations)
- Form 1120 (C Corporations)

Form 1120 shows a C corporation's after-tax profit that does not appear on the owner's personal Form 1040 (and therefore, is not part of their AGI)
($18,308 – $3,845 = $14,463)

Note line 20 (Depreciation) of $20,809

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Business Structures and Total Income

	Sole Proprietorship (Schedule C)	Partnership (Form 1065)	S Corporation (Form 1120-S)	C Corporation (Form 1120)
Wages	$0	$0	$50,000	$50,000
Interest Income	$300	$300	$300	$0
Line 12	$72,000	$0	$0	$0
Passthrough Income	$0	$72,000	$18,008	$0
Total Income	$72,300	$72,300	$68,308	$0
½ SE Tax Deduction	$5,087	$5,087	$0	$0
AGI	**$67,213**	**$67,213**	**$68,308**	**$50,000**
C Corp Profit				**$18,308**
TOTAL PROFIT	**$67,213**	**$67,213**	**$68,308**	**$68,308**

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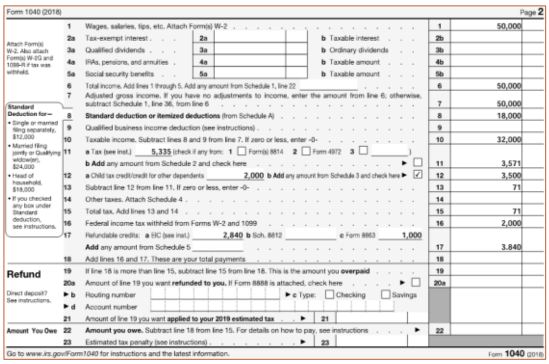
Why Does this Matter?



Form 1040 (2018) Page 2

1	Wages, salaries, tips, etc. Attach Form(s) W-2	50,000
2a / 2b	Tax-exempt interest 2a / b Taxable interest	
3a / 3b	Qualified dividends 3a / b Ordinary dividends	
4a / 4b	IRAs, pensions, and annuities 4a / b Taxable amount	
5a / 5b	Social security benefits 5a / b Taxable amount	
6	Total income. Add lines 1 through 5. Add any amount from Schedule 1, line 22	50,000
7	Adjusted gross income. If you have no adjustments to income, enter the amount from line 6; otherwise, subtract Schedule 1, line 36, from line 6	50,000
8	Standard deduction or itemized deductions (from Schedule A)	18,000
9	Qualified business income deduction (see instructions)	
10	Taxable income. Subtract lines 8 and 9 from line 7. If zero or less, enter -0-	32,000
11	a Tax (see inst.) 5,335 (check if any from: 1 Form(s) 8814 2 Form 4972 3) b Add any amount from Schedule 2 and check here	3,571
12	a Child tax credit/credit for other dependents 2,000 b Add any amount from Schedule 3 and check here ☑	3,500
13	Subtract line 12 from line 11. If zero or less, enter -0-	71
14	Other taxes. Attach Schedule 4	
15	Total tax. Add lines 13 and 14	71
16	Federal income tax withheld from Forms W-2 and 1099	2,000
17	Refundable credits: a EIC (see inst.) 2,840 b Sch. 8812 c Form 8863 1,000 Add any amount from Schedule 5	3.840
18	Add lines 16 and 17. These are your total payments	
19	Refund: If line 18 is more than line 15, subtract line 15 from line 18. This is the amount you overpaid	
20a	Amount of line 19 you want refunded to you. If Form 8888 is attached, check here	
b / c / d	Direct deposit? See instructions. Routing number; c Type: Checking Savings; d Account number	
21	Amount of line 19 you want applied to your 2019 estimated tax	
22	Amount You Owe: Amount you owe. Subtract line 18 from line 15. For details on how to pay, see instructions	
23	Estimated tax penalty (see instructions)	

Standard Deduction for—
- Single or married filing separately, $12,000
- Married filing jointly or Qualifying widow(er), $24,000
- Head of household, $18,000
- If you checked any box under Standard deduction, see instructions.

Attach Form(s) W-2. Also attach Form(s) W-2G and 1099-R if tax was withheld.

Go to www.irs.gov/Form1040 for instructions and the latest information. Form 1040 (2018)

This is the Form 1040 for the C Corporation owner in this example

Based on the Form 1120, this parent might have as much as **$89,117** in available income in the academic year

- AGI = $50,000
- Business profit = $18,308
- Depreciation = $20,809

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Case 4 – What is the Business Worth?

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Reviewing a Balance Sheet

Assets at Book Value

Debts

Schedule L	Balance Sheets per Books	Beginning of tax year		End of tax year	
	Assets	(a)	(b)	(c)	(d)
1	Cash		717,124		523,152
2a	Trade notes and accounts receivable				
b	Less allowance for bad debts	( )	0	( )	0
3	Inventories				
4	U.S. government obligations				
5	Tax-exempt securities (see instructions)				
6	Other current assets (attach statement)				
7	Loans to shareholders				
8	Mortgage and real estate loans				
9	Other investments (attach statement)				
10a	Buildings and other depreciable assets	1,805,000		2,502,500	
b	Less accumulated depreciation	(1,192,253)	612,747	(1,988,650)	513,850
11a	Depletable assets				
b	Less accumulated depletion	( )	0	( )	0
12	Land (net of any amortization)		20,000		20,000
13a	Intangible assets (amortizable only)	150,000		150,000	
b	Less accumulated amortization	(33,333)	116,667	(43,333)	106,667
14	Other assets (attach statement)				
15	Total assets		1,466,538		1,163,669
	Liabilities and Shareholders' Equity				
16	Accounts payable		425,021		310,029
17	Mortgages, notes, bonds payable in less than 1 year				
18	Other current liabilities (attach statement)				
19	Loans from shareholders		150,000		150,000
20	Mortgages, notes, bonds payable in 1 year or more		275,555		480,488
21	Other liabilities (attach statement)				
22	Capital stock: a Preferred stock				
	b Common stock	100	100	100	100
23	Additional paid-in capital		99,000		99,000
24	Retained earnings—Appropriated (attach statement)		500,000		
25	Retained earnings—Unappropriated		16,862		124,052
26	Adjustments to shareholders' equity (attach statement)				
27	Less cost of treasury stock		( )		( )
28	Total liabilities and shareholders' equity		1,466,538		1,163,669

$1,163,669

$940,517

Part of the tax return for all but the smallest businesses and sole proprietorships

Designed to show **Book Value: $223,152 ($1,163,669 – $940,517)**

Can be used to estimate market value

Assets on The Balance Sheet

Schedule L	Balance Sheets per Books	Beginning of tax year		End of tax year	
	Assets	(a)	(b)	(c)	(d)
1	Cash		717,124		523,152
2a	Trade notes and accounts receivable				
b	Less allowance for bad debts	( )	0	( )	0
3	Inventories				
4	U.S. government obligations				
5	Tax-exempt securities (see instructions)				
6	Other current assets (attach statement)				
7	Loans to shareholders				
8	Mortgage and real estate loans				
9	Other investments (attach statement)				
10a	Buildings and other depreciable assets	1,805,000		2,502,500	
b	Less accumulated depreciation	(1,192,253)	612,747	(1,988,650)	513,850
11a	Depletable assets				
b	Less accumulated depletion	( )	0	( )	0
12	Land (net of any amortization)		20,000		20,000
13a	Intangible assets (amortizable only)	150,000		150,000	
b	Less accumulated amortization	(33,333)	116,667	(43,333)	106,667
14	Other assets (attach statement)				
15	Total assets		1,466,538		1,163,669

Assets on the Balance Sheet

PASFAA 2019
Harvesting Knowledge

Schedule L	Balance Sheets per	End of tax year	
	Assets	(c)	(d)
1	Cash		523,152
2a	Trade notes and accounts receivable . .		
b	Less allowance for bad debts	( )	0
3	Inventories		
4	U.S. government obligations		
5	Tax-exempt securities (see instructions) .		
6	Other current assets (attach statement) .		
7	Loans to shareholders		
8	Mortgage and real estate loans		
9	Other investments (attach statement) . .		
10a	Buildings and other depreciable assets .	2,502,500	
b	Less accumulated depreciation	(1,988,650)	513,850
11a	Depletable assets		
b	Less accumulated depletion	( )	0
12	Land (net of any amortization)		20,000
13a	Intangible assets (amortizable only) . .	150,000	
b	Less accumulated amortization	(43,333)	106,667
14	Other assets (attach statement)		
15	Total assets		1,163,669

This business is

- Cash Rich
- Does not keep an inventory
  - The market value of inventories can be estimated based on the *Cost of Goods Sold* deduction
- Has assets that may be worth more than their book value
  - In this example based on an actual tax return, the market value of these assets was estimated to be $1,800,000
- Has "intangible assets" that at one time had a definable value
  - In the business on which this case is based, this company purchased another company, and this was the "goodwill," or amount of the purchase price not attributable to depreciable assets

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Debts on the Balance Sheet

PASFAA 2019
Harvesting Knowledge

	Liabilities and Shareholders' Equity				
16	Accounts payable		425,021		310,029
17	Mortgages, notes, bonds payable in less than 1 year .				
18	Other current liabilities (attach statement)				
19	Loans from shareholders		150,000		150,000
20	Mortgages, notes, bonds payable in 1 year or more . .		275,555		480,488
21	Other liabilities (attach statement)				

Notable Observations

- This business holds a lot of cash – but much of it is committed to repayments of accounts payable
- The business owes it owners money
  - **This is a personal asset that should be reported as an investment on both the FAFSA and the CSS Profile**
- The debt increased
  - The business probably borrowed money to purchase a new asset

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Book Value vs. Market Value

Schedule L	Balance Sheets per	End of tax year
	Assets	(d)
1	Cash	* 523,152
2a	Trade notes and accounts receivable	
b	Less allowance for bad debts	0
3	Inventories	
4	U.S. government obligations	
5	Tax-exempt securities (see instructions)	
6	Other current assets (attach statement)	
7	Loans to shareholders	
8	Mortgage and real estate loans	
9	Other investments (attach statement)	
10a	Buildings and other depreciable assets	
b	Less accumulated depreciation	513,850
11a	Depletable assets	
b	Less accumulated depletion	0
12	Land (net of any amortization)	20,000
13a	Intangible assets (amortizable only)	
b	Less accumulated amortization	106,667
14	Other assets (attach statement)	
15	Total assets	1,163,669

	Liabilities and Shareholders' Equity	
16	Accounts payable	* 310,029
17	Mortgages, notes, bonds payable in less than 1 year	
18	Other current liabilities (attach statement)	
19	Loans from shareholders	150,000
20	Mortgages, notes, bonds payable in 1 year or more	480,488
21	Other liabilities (attach statement)	

Total Liabilities $940,517

This business is

- * Still cash rich, but much of the cash is committed to short term liabilities
- **Book value** of Business = **$223,152** ($1,163,669 – $940,517)
- Estimated Market Value of **Assets** = **$2,445,631** ($1,163,669 – $513,850 + $1,795,812)
- Estimated Market Value of **Business** = **$1,505,114** ($2,445,631 – $940,517)

From slide 27

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Thought Question – What Do We Mean by "Business Value"?

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What Does "Business Value Mean?

Which of these businesses is worth more? Each parent is self-employed, rents their workspace, and reliably earns $100,000 per year.		
Parent 1 owns a dry cleaner business. He owns six industrial washers, four of which use organic solvents instead of water, four driers, four presses, eighty feet of electronic racks with movable hangers, chemicals, hangers and plastic covers, and office equipment	Parent 2 is a self-employed accountant. She owns a laptop computer, a license to use commercial tax software, and some office furniture	Parent 3 had earned about $100,000 each year as a self-employed accountant but is planning to retire and sell their business. They have asked you to use their retirement income, not their work income, to calculate their parent contribution. Their business assets are identical to those of Parent 2

Summary

Deductions like depreciation, amortization, and large one-time spending (repairs, maintenance, supplies) can make a generally profitable business or rental property look less profitable

Depending on the owner's business structure, income available to the owner may or may not appear in their AGI

Many business owners are aware of their business's book value (it's right there on their tax return), but this may not be equal to their market value

The sum-of-its-parts valuation defined in the *Application and Verification Guide* underestimates the actual value of asset-poor businesses and can be very different from the "amount you could get for the business if you sold it today" value preferred by many institutions

PASFAA Tax Webinars for Aid Officers

OCTOBER 31, 2019, AT 10:00 AM
VERIFICATION IN THE NEW TAX WORLD

2020-2021 Key Concepts

Verifying Tax Filers

The 2018 Form 1040 and the 2020-2021 FAFSA

Schedule 1 and the Simplified Formula/Automatic Zero EFC

Rollovers

NOVEMBER 13, 2019 AT 10:00 AM
CONFLICTING INFORMATION IN THE NEW TAX WORLD

Verifying Non-filers

Who is Required to File a Tax Return?

What is the Correct Filing Status for a Person?

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Thank You PASFAA!

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