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Reading Your Schedule K-1

A Line-by-Line Guide to the Form Every Pass-Through Owner Receives

Scenario: A partner or S corporation shareholder receives a Schedule K-1 each year, hands it to a preparer, and wants to actually understand what the boxes mean and which ones drive their tax.

Executive Summary

The Schedule K-1 is how a pass-through entity reports your share of its activity to you and the IRS. A partnership issues K-1s from Form 1065; an S corporation from Form 1120-S. The two are similar but not identical, and the boxes are not all created equal — some drive ordinary income, some are separately stated items with their own tax treatment, and some are informational amounts you carry to other parts of your return. Reading the K-1 correctly means knowing which lines are taxable now, which are limited, and which affect your basis.

Key point

Not everything on a K-1 is ordinary income taxed the same way. "Separately stated items" — capital gains, §1231 gains, charitable contributions, §179 deductions, credits — keep their character and flow to different parts of your return, because their tax treatment depends on *your* overall situation, not the entity's.

The Two Versions

Feature	Partnership K-1 (1065)	S corporation K-1 (1120-S)
Ordinary business income	Box 1	Box 1
Self-employment earnings	Box 14 (general partners)	Not applicable — wages are on a W-2
Guaranteed payments	Box 4	Not applicable
Capital account / basis info	Capital account analysis (Item L)	No capital account; owner tracks stock and debt basis

The Boxes That Drive Ordinary Tax

- **Ordinary business income (Box 1).** Your share of the entity's operating profit — the core taxable number.
- **Rental income (Boxes 2–3).** Real estate and other rental activity, generally passive.

- **Guaranteed payments (partnership Box 4).** Payments for services or capital, ordinary income and often subject to SE tax.

The Separately Stated Items

These keep their character and are reported on the corresponding part of your return, because how they are taxed depends on your personal facts:

Item	Why it's separately stated
Interest, dividends, royalties	Taxed at your rates; qualified dividends get preferential treatment
Capital gains and losses	Netted against your other capital transactions
§1231 gains	May be capital or ordinary depending on your year's netting
§179 expense	Subject to your personal §179 limits and income cap
Charitable contributions	Deducted on your Schedule A under your personal limits
Credits	Applied against your personal tax, subject to your limitations

The Codes and the Statements

Many K-1 boxes — particularly Box 13 (partnership) and Boxes 12/17 (S corporation) — carry alphabetic codes that point to detailed statements. Two that matter most to entrepreneurs today: the codes reporting **§199A / QBI information** (needed to compute the qualified business income deduction) and codes for **§163(j) business-interest limitation** data. A K-1 that omits the QBI statement can cost the owner the 20% deduction, so a missing code is worth chasing down before filing.

The Lines Owners Most Often Misread

- **Distributions are not on the income lines.** Cash distributed to you (partnership Box 19; S corp Box 16 code D) is generally not taxable income — it reduces basis. Owners frequently double-count it as income.
- **A loss in Box 1 is not automatically deductible.** It must clear basis, at-risk, and passive limits first.
- **Box 1 income is not cash.** It is your allocated share of profit, whether or not distributed.

Practical Considerations

Reconcile your K-1 to your capital account and basis schedule each year. Confirm the QBI statement is attached. Watch the arrival timing — K-1s often arrive close to or after the April deadline, which is a common reason pass-through owners extend. Keep every year's K-1; the cumulative basis history it supports is essential when you eventually sell or dissolve your interest.

Next Step: Decode Your K-1 Before It Reaches the Return

A walk-through of your specific K-1 — identifying the ordinary income, the separately stated items, the basis effects, and the QBI codes — ensures nothing is misclassified and no deduction is left on the table. It is worth doing before the figures are keyed into your 1040.

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