What are separately stated items on a K-1? Why is it necessary to separate these items from ordinary income?

Each partner must fill out a Schedule K-1. It should list the partners distributive share of the ordinary loss or income, deductions, credits, and other pass-through entities. The K-1 helps the taxpayer to show the income they earned when they do their personal taxes. The income that is reported to the individual could affect the alternative minimum tax or affect other issues concerning the business taxable income.

Reference: Investinganswers.com http://www.investinganswers.com/financial-dictionary/tax-center/schedule-k-1-76

Response 2

On the schedule K business income, deductions, and credits are reported separately because these items are transferred to the shareholders. Ordinary income is only included on line 1. This is because the schedule K deals with passive income, not ordinary/operating income. The schedule K affects gains and losses a shareholder is obligated to include in personal income that the corporation earns. Some of the income reported on this form would come from rentals of buildings and land to other businesses or individuals. The rental of equipment can also fall under this income category. Interest income is also considered passive income. The receiving of dividends from an S corporation is different than dividends from a C corporation because it is not a deduction instead it passes to the stockholder as a capital gain.

Deductions consist of depreciation and amortization. Charitable contributions have a limit for C Corporations but not for S corporations. Therefore, shareholders need to determine their deduction at their level because it can reduce their basis. The basis cannot go below zero; any loss or gain that affects the basis has to be carried forward if the basis is zero.

Expenses are those that come from interest expense, fringe benefits, and oil and gas depletions that are not part of ordinary operations, such as those caused from restructuring. Another example of an expense to the shareholder would be a penalty for early withdrawal of funds.