

TAX DETECTIVE:

The Carter Case Study

Handout

- **Reading Tax Returns**
- **Following the Money**
- **Finding the Estate**

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For the year Jan. 1–Dec. 31, 2025, or other tax year beginning _____, 2025, ending _____, 20____.

See separate instructions.

Your first name and middle initial David	Last name Carter EXAMPLE / TRAINING	Your social security number XXX-XX-XXXX
If joint return, spouse's first name and middle initial	Last name Carter	Spouse's social security number YYY-YY-YYYY

Home address (number and street). If you have a P.O. box, see instructions.

DO NOT FILE

Apt. no.

Presidential Election Campaign
Check here if you, or your spouse if filing jointly,
want \$3 to go to this fund. ☐ You ☐ Spouse

City, town, or post office. If you have a foreign address, also complete spaces below.

State

ZIP code

Foreign country name / province / postal code

**Filing
Status**

Check only one box.

☐ Single☐ Head of household (HOH)☐ Qualifying surviving spouse
(QSS)☒ **Married filing jointly** (even if only one had income)☐ Married filing separately (MFS). Enter spouse's SSN above

If you checked the HOH or QSS box, enter the child's name if the qualifying person is a child but not your dependent

**Digital
Assets**

At any time during 2025, did you: (a) receive (as a reward, award, or payment for property or services); or (b) sell, exchange, or otherwise dispose of a digital asset (or a financial interest in a digital asset)? (See instructions.)

☒ **Yes** ☐ **No****Dependents**
(see instructions)

(1) First name Last name	(2) Social security number	(3) Relationship to you	(4) Check if qualifies for: Child tax credit / Credit for other dependents
None reported in this example			☐ ☐
			☐ ☐

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

1a	Total amount from Form(s) W-2, box 1 (see instructions)	1a	175,000
b	Household employee wages not reported on Form(s) W-2	1b	
c	Tip income not reported on line 1a (see instructions)	1c	
d	Medicaid waiver payments not reported on Form(s) W-2 (see instructions)	1d	
e	Taxable dependent care benefits from Form 2441, line 26	1e	
f	Employer-provided adoption benefits from Form 8839, line 31	1f	
g	Wages from Form 8919, line 6	1g	
h	Other earned income (see instructions)	1h	
z	Add lines 1a through 1h	1z	175,000
2a	Tax-exempt interest b Taxable interest (Attach Sch. B if required)	2b	12,000
3a	Qualified dividends b Ordinary dividends	3b	18,000
4a	IRA distributions b Taxable amount	4b	
5a	Pensions and annuities b Taxable amount	5b	
6a	Social security benefits b Taxable amount	6b	
7a	Capital gain or (loss). Attach Schedule D if required	7a	125,000
8	Additional income from Schedule 1, line 10	8	325,000
9	Add lines 1z, 2b, 3b, 4b, 5b, 6b, 7a, and 8. This is your total income	9	655,000
10	Adjustments to income from Schedule 1, line 26	10	
11a	Subtract line 10 from line 9. This is your adjusted gross income	11a	655,000

Teaching note. W-2 wages from the S corporation, interest, dividends, capital gain, and Schedule 1 pass-through income total to adjusted gross income of \$655,000 with no adjustments. Every one of those figures has a source document later in this packet.

Tax and Credits	11b	Amount from line 11a (adjusted gross income)	11b	655,000
	12a	Someone can claim: ☐ You as a dependent ☐ Your spouse as a dependent		
	b	☐ Spouse itemizes on a separate return c ☐ You were a dual-status alien		
	e	Standard deduction or itemized deductions (from Schedule A)	12e	
	13a	Qualified business income deduction from Form 8995 or Form 8995-A	13a	
	b	Additional deductions from Schedule 1-A, line 38	13b	
	14	Add lines 12e, 13a, and 13b	14	
	15	Subtract line 14 from line 11b. If zero or less, enter -0-. This is your taxable income	15	
	16	Tax (see instructions). Check if any from Form(s): ☐ 8814 ☐ 4972	16	
	17	Amount from Schedule 2, line 3	17	
	19	Child tax credit or credit for other dependents from Schedule 8812	19	
	22	Subtract line 21 from line 18. If zero or less, enter -0-	22	
	24	Add lines 22 and 23. This is your total tax	24	
Payments and Refundable Credits	25a	Federal income tax withheld from Form(s) W-2	25a	
	b	Federal income tax withheld from Form(s) 1099	25b	
	c	Other forms (see instructions)	25c	
	d	Add lines 25a through 25c	25d	
	26	2025 estimated tax payments and amount applied from 2024 return	26	
	32	Add lines 27a, 28, 29, 30, and 31. These are your total other payments and refundable credits	32	
	33	Add lines 25d, 26, and 32. These are your total payments	33	
Refund Direct deposit? See instructions.	34	If line 33 is more than line 24, subtract line 24 from line 33. This is the amount you overpaid	34	
	35a	Amount of line 34 you want refunded to you . If Form 8888 is attached, check here ☐	35a	
	b	Routing number _____ c Type: ☐ Checking ☐ Savings d Account number _____		
	36	Amount of line 34 you want applied to your 2026 estimated tax	36	
Amount You Owe	37	Subtract line 33 from line 24. This is the amount you owe	37	
	38	Estimated tax penalty (see instructions)	38	

Third Party Designee Do you want to allow another person to discuss this return with the IRS? See instructions. ☐ **Yes.** Complete below. ☐ **No**

Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Sign Here	Your signature	Date	Your occupation
	Spouse's signature. If a joint return, both must sign.		
		Date	Spouse's occupation

Caution — electronic filing. Lines 35a and 36 are the fork in the road. An overpayment can be refunded to a bank account or rolled forward to next year's estimated tax. On an e-filed return, the routing and account numbers at 35b-d and the carryforward election at line 36 are where a spouse's separate access to funds shows up. Ask for the e-file acknowledgment and the account detail, not just the printed return.

SCHEDULE B
(Form 1040)

Department of the
Treasury
Internal Revenue Service

Interest and Ordinary Dividends
Attach to Form 1040 or 1040-SR. Go to www.irs.gov/ScheduleB for instructions.

TRAINING — DO NOT FILE
OMB No. 1545-0074
Attachment
Sequence No. 08
2025

Name(s) shown on return
David Carter

Your social security number
XXX-XX-XXXX

Part I
Interest

- 1** List name of payer. If any interest is from a seller-financed mortgage and the buyer used the property as a personal residence, see the instructions and list this interest first. Also, show that buyer's social security number and address:

First National Bank

Helvetia Private Bank, Zurich

Amount

2,000

10,000

12,000

12,000

- 2** Add the amounts on line 1
- 3** Excludable interest on series EE and I U.S. savings bonds issued after 1989. Attach Form 8815
- 4** Subtract line 3 from line 2. Enter the result here and on Form 1040 or 1040-SR, line 2b

Note: If line 4 is over \$1,500, you must complete Part III.

Part II
Ordinary
Dividends

- 5** List name of payer:

Morgan Stanley

Amount

18,000

- 6** Add the amounts on line 5. Enter the total here and on Form 1040 or 1040-SR, line 3b

18,000

Note: If line 6 is over \$1,500, you must complete Part III.

Part III
Foreign
Accounts
and Trusts

You must complete this part if you (a) had over \$1,500 of taxable interest or ordinary dividends; (b) had a foreign account; or (c) received a distribution from, or were a grantor of, or a transferor to, a foreign trust.

- 7a** At any time during 2025, did you have a financial interest in or signature authority over a financial account (such as a bank account, securities account, or brokerage account) located in a foreign country? See instructions

☒ **Yes** ☐ **No**

If "Yes," are you required to file FinCEN Form 114, **Report of Foreign Bank and Financial Accounts (FBAR)**, to report that financial interest or signature authority? See FinCEN Form 114 and its instructions for filing requirements and exceptions to those requirements

- b** **(If you are required to file FinCEN Form 114, list the name(s) of the foreign country(-ies) where the financial account(s) is (are) located: [left blank on the return])**

- 8** During 2025, did you receive a distribution from, or were you the grantor of, or transferor to, a foreign trust? If "Yes," you may have to file Form 3520

Caution: If required, failure to file FinCEN Form 114 may result in substantial penalties. Additionally, you may be required to file Form 8938, Statement of Specified Foreign Financial Assets.

Teaching thread. The Zurich payer on line 1 is what drives the "Yes" at line 7a — and line 7b, where the country must be named, is blank. An unreported foreign account is both a disclosure problem and, in a family law case, a marital asset nobody has valued.

☐ CORRECTED (if checked)

FILER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no. Coinbase	Applicable checkbox on Form 8949 G *	OMB No. 1545-2330 2025 Form 1099-DA		Digital Asset Proceeds From Broker Transactions
	1a Code for digital asset			
		1b Name of digital asset BTC	Copy B For Recipient	
FILER'S TIN	1c Number of units 0.50 BTC			
RECIPIENT'S name David Carter	1d Date acquired	1e Date sold or disposed		
Street address (including apt, no.)	1f Proceeds \$ 35,000	1g Cost or other basis \$ 20,000		
City or town, state or province, country, and ZIP or foreign postal code	1h Accrued market discount \$	1i Wash sales loss disallowed \$		
Account number [blank]	2 Check if basis reported to IRS ☒	3a Check if proceeds reported as ☒ Gross proceeds ☐ Net proceeds		
CUSIP number	3b Check if proceeds from ☐ Reserved ☐ QOF	4 Federal income tax withheld \$		
5 Check if loss is not allowed based on amount in 1f ☐	6 Gain or loss: ☒ Short-term ☐ Long-term ☐ Ordinary	7 Check if 1f is only cash ☐	8 Check if broker relied on customer-provided acquisition information ☐	
9 Check if digital asset is a noncovered security ☐	10	11a Check if gross proceeds reported in 1f is an aggregate amount for: ☐ Qualifying stablecoins ☐ Specified NFTs		
11b If 11a checked, number of transactions	11c Aggregate gross proceeds attributable to first sales by creator or minter \$	12a Number of units transferred in	12b If transferred in, provide transfer-in date	
14 State name NC	15 State identification no. —	16 State tax withheld \$ —		

Form **1099-DA** (Keep for your records) www.irs.gov/Form1099DA Department of the Treasury - Internal Revenue Service

New for 2025. Form 1099-DA is the broker's report of digital asset dispositions.

* The applicable checkbox of **G** ties this statement to the Form 8949 at Handout Page 5A, which carries to Schedule D and then to Form 1040.

The Form 1099-DA itself is not part of the Form 1040. It is a third-party information return — obtain it in discovery directly, or by subpoena to the broker. Do not assume the return alone will disclose the crypto activity.

Name(s) shown on return
David Carter

Social security number or taxpayer identification number
XXX-XX-XXXX

Before you check Box A, B, C, G, H, or I below, see whether you received any Form(s) 1099-B, Form(s) 1099-DA, or substitute statement(s) from your broker. They will show whether your basis was reported to the IRS by your broker and may even tell you which box to check.

Part I Short-Term. Transactions involving capital assets you held 1 year or less are generally short-term (see instructions). For long-term transactions, see page 2.

Note: You may aggregate all short-term transactions reported on Form(s) 1099-B and Form(s) 1099-DA showing basis was reported to the IRS and for which no adjustments or codes are required. Enter the totals directly on Schedule D, line 1a.

You must check Box A, B, C, G, H, or I below. Check only one box. If more than one box applies for your short-term transactions, complete a separate Form 8949, page 1, for each applicable box.

- ☐ **(A)** Short-term transactions reported on Form(s) 1099-B showing basis **was** reported to the IRS
- ☐ **(B)** Short-term transactions reported on Form(s) 1099-B showing basis **was not** reported to the IRS
- ☐ **(C)** Short-term transactions, other than digital asset transactions, not reported to you on Form 1099-B or Form 1099-DA
- ☒ **(G)** Short-term transactions reported on Form(s) 1099-DA showing basis **was** reported to the IRS
- ☐ **(H)** Short-term transactions reported on Form(s) 1099-DA showing basis **was not** reported to the IRS
- ☐ **(I)** Short-term digital asset transactions not reported to you on Form 1099-DA or Form 1099-B

(a) Description of property	(b) Date acquired (Mo., day, yr.)	(c) Date sold or disposed of (Mo., day, yr.)	(d) Proceeds (sales price)	(e) Cost or other basis	(f) Code(s)	(g) Amount of adjustment	(h) Gain or (loss)
0.50 BTC			35,000	20,000			15,000
2 Totals. Add the amounts in columns (d), (e), (g), and (h) (subtract negative amounts). Enter each total here and include on your Schedule D, line 1b (Box A or G), line 2 (Box B or H), or line 3 (Box C or I)			35,000	20,000			15,000

Note on this packet: the Form 8949 page 2 reporting long-term gains in the Carter example is omitted from these materials.

SCHEDULE
D
(Form 1040)

Department of the
Treasury
Internal Revenue Service

Capital Gains and Losses
Attach to Form 1040, 1040-SR, or 1040-NR. Use Form 8949 to list your transactions for lines 1b, 2, 3, 8b, 9, and 10.

Name(s) shown on return
David Carter
Your social security number
XXX-XX-XXXX

Did you dispose of any investment(s) in a qualified opportunity fund during the tax year? [] Yes [] No

Part I Short-Term Capital Gains and Losses — Generally Assets Held One Year or Less (see instructions)

Table with 5 columns: Description, (d) Proceeds (sales price), (e) Cost (or other basis), (g) Adjustments to gain or loss from Form(s) 8949, Part I, line 2, column (g), and (h) Gain or (loss). Rows include instructions, 1a, 1b, 2, 3, 4, 5, 6, and 7.

Part II Long-Term Capital Gains and Losses — Generally Assets Held More Than One Year (see instructions)

Table with 2 columns: Description and (h) Gain or (loss). Rows include 8a, 8b, 9, 10, 11, 12, 13, 14, and 15.

Crosswalk. Handout Page 5A (Box G, digital asset) feeds line 1b. Handout Page 4 (Box B, brokerage) feeds line 2. The two combine on line 7 — proceeds \$400,000, basis \$275,000, net short-term gain \$125,000 — which carries to Form 1040, line 7a.

SCHEDULE E
(Form 1040)

Department of the
Treasury
Internal Revenue Service

Supplemental Income and Loss
(From rental real estate, royalties, partnerships, S corporations, estates, trusts, REMICs, etc.)
Attach to Form 1040, 1040-SR, 1040-NR, or 1041.

TRAINING — DO NOT FILE
2025
OMB No. 1545-0074
Attachment
Sequence No. 13

Name(s) shown on return
David Carter

Your social security number
XXX-XX-XXXX

Part I Income or Loss From Rental Real Estate and Royalties

Note: If you are in the business of renting personal property, use Schedule C. If you are an individual, report farm rental income or loss from Form 4835 on page 2, line 40.

- A Did you make any payments in 2025 that would require you to file Form(s) 1099? See instructions ☐ Yes ☒ No
- B If "Yes," did you or will you file required Form(s) 1099? ☐ Yes ☐ No

1a Physical address of each property (street, city, state, ZIP code)

	Physical address	1b Type of property	2 Fair Rental Days	Personal Use Days	QJV
A	Not applicable — no rental real estate or royalty activity in this example				☐
B					☐
C					☐

Type of Property: 1 Single Family Residence 2 Multi-Family Residence 3 Vacation/Short-Term Rental 4 Commercial 5 Land 6 Royalties 7 Self-Rental 8 Other

	Income:	A	B	C
3	Rents received			
4	Royalties received			
	Expenses:			
5	Advertising			
6	Auto and travel (see instructions)			
7	Cleaning and maintenance			
8	Commissions			
9	Insurance			
10	Legal and other professional fees			
11	Management fees			
12	Mortgage interest paid to banks, etc. (see instructions)			
13	Other interest			
14	Repairs			
15	Supplies			
16	Taxes			
17	Utilities			
18	Depreciation expense or depletion			
19	Other (list)			
20	Total expenses. Add lines 5 through 19			
21	Subtract line 20 from line 3 (rents) and/or 4 (royalties)			
22	Deductible rental real estate loss after limitation, if any, on Form 8582			

24 Income. Add positive amounts shown on line 21. Do not include any losses

24

25 Losses. Add royalty losses from line 21 and rental real estate losses from line 22

25

26 Total rental real estate and royalty income or (loss). Combine lines 24 and 25

26

Presenter note. Part I is blank in the Carter example. Do not skip past it in a real case: this is where a rental property, a vacation home, or a self-rental to the closely held business would appear, along with the depreciation that reduces reported income without reducing cash.

— THE BRIDGE —

Schedule E (Form 1040) 2025

Attachment Sequence No. 13

Page 2

Name(s) shown on return. Do not enter name and social security number if shown on other side.

David Carter — Carter Medical Technologies, LLC (S corporation)

Your social security number

XXX-XX-XXXX

Caution: The IRS compares amounts reported on your tax return with amounts shown on Schedule(s) K-1.

Part II Income or Loss From Partnerships and S Corporations

Note: If you report a loss, receive a distribution, dispose of stock, or receive a loan repayment from an S corporation, you **must** check the box in column (e) on line 28 and attach the required basis computation. If you report a loss from an at-risk activity for which any amount is **not** at risk, you **must** check the box in column (f) on line 28 and attach Form 6198.

- 27 Are you reporting any loss not allowed in a prior year due to the at-risk or basis limitations, a prior year unallowed loss from a passive activity, or unreimbursed partnership expenses? If you answered "Yes," see instructions before completing this section ☐ Yes ☒ No

28	(a) Name	(b) Enter P for partnership; S for S corporation	(c) Check if foreign partnership	(d) Employer identification number	(e) Check if basis computation is required	(f) Check if any amount is not at risk
A	Carter Medical Technologies, LLC	S	☐	XX-XXXXXXX	☐	☐
B			☐		☐	☐
C			☐		☐	☐

Passive Income and Loss			Nonpassive Income and Loss		
	(g) Passive loss allowed (attach Form 8582 if required)	(h) Passive income from Schedule K-1	(i) Nonpassive loss allowed (see Schedule K-1)	(j) Section 179 expense deduction from Form 4562	(k) Nonpassive income from Schedule K-1
A					325,000
B					
C					
29a	Totals				325,000
b	Totals				

30	Add columns (h) and (k) of line 29a	30	325,000
31	Add columns (g), (i), and (j) of line 29b	31	
32	Total partnership and S corporation income or (loss). Combine lines 30 and 31	32	325,000

Part III Income or Loss From Estates and Trusts

35	Add columns (d) and (f) of line 34a	35	
36	Add columns (c) and (e) of line 34b	36	
37	Total estate and trust income or (loss). Combine lines 35 and 36	37	

Part V Summary

40	Net farm rental income or (loss) from Form 4835. Also, complete line 42 below	40	
41	Total income or (loss). Combine lines 26, 32, 37, 39, and 40. Enter the result here and on Schedule 1 (Form 1040), line 5	41	325,000

This is the bridge. Schedule E, page 2 is the only place on the individual return where the S corporation's income crosses over from the business return. Column (k) picks up Schedule K-1, box 1; line 41 carries to Schedule 1, line 5; Schedule 1 carries to Form 1040, line 8. Note what does not cross the bridge: distributions.

For calendar year 2025 or tax year beginning 2025, ending 2025, 20

A S election effective date	Name Carter Medical Technologies, LLC	D Employer identification number XX-XXXXXXX
B Business activity code number	Number and street, if a P.O. box, see instructions. Room or suite no.	E Date incorporated
C Check if Sch. M-3 attached ☐	City or town State or province Country ZIP or foreign postal code Greensboro, North Carolina	F Total assets (see instructions) \$ 1,285,000

G Is the corporation electing to be an S corporation beginning with this tax year? See instructions ☐ Yes ☐ No

H Check if: (1) ☐ Final return (2) ☐ Name change (3) ☐ Address change (4) ☐ Amended return

I Enter the number of shareholders who were shareholders during any part of the tax year **1**

Caution: Include only trade or business income and expenses on lines 1a through 21. See the instructions for more information.

Income	1a	Gross receipts or sales	b Less returns and allowances	c Balance	1c	1,850,000
	2	Cost of goods sold (attach Form 1125-A)			2	
	3	Gross profit. Subtract line 2 from line 1c			3	1,850,000
	4	Net gain (loss) from Form 4797, Part II, line 17 (attach Form 4797)			4	
	5	Other income (loss) (see instructions—attach statement)			5	
	6	Total income (loss). Add lines 3 through 5			6	1,850,000
Deductions (see instructions for limitations)	7	Compensation of officers (see instructions—attach Form 1125-E)			7	175,000
	8	Salaries and wages (less employment credits)			8	
	9	Repairs and maintenance			9	
	10	Bad debts			10	
	11	Rents			11	
	12	Taxes and licenses			12	
	13	Interest (see instructions)			13	
	14	Depreciation from Form 4562 not claimed on Form 1125-A or elsewhere on return (attach Form 4562)			14	200,000
	17	Pension, profit-sharing, etc., plans			17	
	20	Other deductions (attach statement) — operations, for this example			20	675,000
	21	Total deductions. Add lines 7 through 20			21	1,050,000
Tax and Payments	22	Ordinary business income (loss). Subtract line 21 from line 6			22	325,000
	23c	Add lines 23a and 23b (see instructions for additional taxes)			23c	
	24z	Add lines 24a through 24d			24z	
	26	Amount owed. If line 24z is smaller than the total of lines 23c and 25, enter amount owed			26	
	27	Overpayment. If line 24z is larger than the total of lines 23c and 25, enter amount overpaid			27	
	28	Enter amount from line 27: Credited to 2026 estimated tax b Refunded			28b	

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete.

Sign Here

Signature of officer	Date	Title
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Note on this packet: pages 2 and 3 of Form 1120-S are omitted from this training example.

Ties to check: line 7 compensation of officers (\$175,000) is the wage figure on Form 1040, line 1a. Line 22 ordinary business income (\$325,000) is Schedule K-1, box 1. Line 14 depreciation of \$200,000 is a non-cash deduction — it reduces taxable income without reducing what the business can distribute.

Schedule K Shareholders' Pro Rata Share Items (continued)

17a Investment income	17a	
b Investment expenses	17b	
c Dividend distributions paid from accumulated earnings and profits	17c	
18 Income (loss) reconciliation. Combine the total amounts on lines 1 through 10. From the result, subtract the sum of the amounts on lines 11 through 12e and 16f	18	325,000

Schedule L Balance Sheets per Books

Assets	Beginning of tax year (a)	(b)	End of tax year (c)	(d)
1 Cash	210,000			190,000
2a Trade notes and accounts receivable				
b Less allowance for bad debts	()		()	
3 Inventories				
4 U.S. government obligations				
5 Tax-exempt securities (see instructions)				
6 Other current assets (attach statement)				
7 Loans to shareholders	25,000			275,000
8 Mortgage and real estate loans				
9 Other investments (attach statement)				
10a Buildings and other depreciable assets				
b Less accumulated depreciation	()		()	
12 Land (net of any amortization)				
13a Intangible assets (amortizable only)				
14 Other assets (attach statement)	420,000			610,000
15 Total assets	1,050,000			1,285,000
Liabilities and Shareholders' Equity				
16 Accounts payable				
17 Mortgages, notes, bonds payable in less than 1 year				
18 Other current liabilities (attach statement)				
19 Loans from shareholders				
20 Mortgages, notes, bonds payable in 1 year or more				
21 Other liabilities (attach statement)				
22 Capital stock				
23 Additional paid-in capital				
24 Retained earnings				
25 Adjustments to shareholders' equity (attach statement)				
26 Less cost of treasury stock	()		()	
27 Total liabilities and shareholders' equity				

Line 7 versus line 19 — direction matters. "Loans to shareholders" is money that left the company and went to the owner. "Loans from shareholders" is money the owner put in. Here line 7 grows from **\$25,000 to \$275,000** — a \$250,000 increase in a single year. The balance sheet tells you the amount. It does not tell you what the money bought. That takes the general ledger (Handout Page 12).

Carter Medical Technologies, LLC

Sample General Ledger Detail | Year ended December 31, 2025

Account 1350 — Loans to Shareholder — David Carter

Date	Reference	Description	Debit	Credit	Running balance
01/01/25	BB	Beginning balance			\$25,000
02/12/25	AMEX-0212	Piedmont Country Club	\$12,000		\$37,000
03/18/25	VISA-0318	Four Seasons — family trip	\$18,500		\$55,500
04/04/25	ACH-0404	Carter residence — landscaping	\$14,000		\$69,500
05/22/25	AMEX-0522	Personal credit card payment	\$31,000		\$100,500
06/15/25	ACH-0615	Piedmont Country Club	\$12,000		\$112,500
07/09/25	VISA-0709	Family travel	\$16,000		\$128,500
08/12/25	ACH-0812	Carter residence expenses	\$15,000		\$143,500
09/20/25	AMEX-0920	Personal credit card payment	\$44,000		\$187,500
10/14/25	ACH-1014	Piedmont Country Club	\$12,000		\$199,500
11/07/25	VISA-1107	Family travel	\$13,500		\$213,000
11/25/25	ACH-1125	Carter residence expenses	\$13,000		\$226,000
12/05/25	AMEX-1205	Personal credit card payment	\$49,000		\$275,000
Total 2025 activity			\$250,000	—	\$275,000

Discovery point. The general ledger is not part of the tax return and will not arrive with it. Request the shareholder loan account detail, the supporting invoices, and the underlying credit-card and bank statements by name.

Tax Detective Reconciliation

What the shareholder loan ledger reveals

Personal expenditures charged to the company

Personal benefit category	2025 amount
Country club	\$36,000
Family travel	\$48,000
Home expenses	\$42,000
Personal credit-card payments	\$124,000
Total 2025 charges	\$250,000

Tie to Form 1120-S, Schedule L

Beginning loans to shareholder \$25,000 + 2025 personal charges \$250,000 = Ending loans to shareholder \$275,000
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Teaching point

Schedule L shows only that the shareholder-loan balance increased by \$250,000. The general ledger identifies what the company actually paid: club, travel, home, and personal credit-card expenses. The investigative question is whether the balance is a bona fide loan or a record of personal lifestyle funded by the corporation.

Questions for the audience

- Was there a note, stated interest rate, maturity date, repayment schedule, or collateral?
- Did David Carter make any repayments, and were interest payments reported?
- Were these expenditures also treated as wages, distributions, or constructive dividends?
- Do the general-ledger descriptions tie to invoices, bank statements, and credit-card records?

Schedule M-1 Reconciliation of Income (Loss) per Books With Income (Loss) per Return

Note: The corporation may be required to file Schedule M-3. See instructions.

1	Net income (loss) per books	525,000	5	Income recorded on books this year not included on Schedule K, lines 1 through 10 (itemize):	
2	Income included on Schedule K, lines 1, 2, 3c, 4, 5a, 6, 7, 8a, 9, and 10, not recorded on books this year (itemize)		a	Tax-exempt interest \$	
			6	Deductions included on Schedule K, lines 1 through 12e and 16f, not charged against book income this year (itemize):	
3	Expenses recorded on books this year not included on Schedule K, lines 1 through 12e and 16f (itemize):		a	Depreciation \$ 200,000	200,000
a	Depreciation \$		7	Add lines 5 and 6	200,000
b	Travel and entertainment \$		8	Income (loss) (Schedule K, line 18). Subtract line 7 from line 4	325,000
4	Add lines 1 through 3	525,000			

Schedule M-2 Analysis of Accumulated Adjustments Account, Shareholders' Undistributed Taxable Income Previously Taxed, Accumulated Earnings and Profits, and Other Adjustments Account (see instructions)

	(a) Accumulated adjustments account	(b) Shareholders' undistributed taxable income previously taxed	(c) Accumulated earnings and profits	(d) Other adjustments account
1 Balance at beginning of tax year	575,000			
2 Ordinary income from page 1, line 22	325,000			
3 Other additions				
4 Loss from page 1, line 22	()			
5 Other reductions	()			()
6 Combine lines 1 through 5	900,000			
7 Distributions	(450,000)			
8 Balance at end of tax year. Subtract line 7 from line 6	450,000			

Closing questions.

- Where did the \$450,000 go?
- Why is the \$450,000 not on the Form 1040?

Schedule M-2, line 7 reports \$450,000 of distributions — the same figure carried at Schedule K-1, box 16, Code D. Distributions from an S corporation are a return of previously taxed income; they are not reported again as income on the Form 1040. The individual return shows \$175,000 of wages and \$325,000 of pass-through income. It never shows the \$450,000 that actually reached the shareholder's hands. That gap is the point of this case study.

Carter Detective Test Questions

Select the best answer for each question

1 The K 1

Carter's W-2 shows salary of \$200,000. His S corporation K-1 also reports income and shows a \$300,000 distribution. What should the family lawyer conclude?

- A. Carter's income is automatically \$500,000.
- B. The \$300,000 distribution should be ignored because it is not necessarily taxable.
- C. Investigate both the K-1 income and the distribution to determine taxable income, cash flow, basis, and whether the distribution represents additional available cash.
- D. Only the W-2 matters for support.

2 Schedule B

Carter reports \$6,000 of interest income from an account that was never disclosed on his financial affidavit. What is the best next step?

- A. Ignore it because \$6,000 is immaterial.
- B. Request statements and records for the account producing the interest.
- C. Assume the account contains \$6,000.
- D. Treat the entire \$6,000 as marital property.

3 Depreciation

Carter Medical Technologies reports \$200,000 of depreciation. Which statement is most accurate?

- A. Carter necessarily spent \$200,000 in cash that year.
- B. The \$200,000 must always be added back for support.
- C. Depreciation is a noncash tax deduction, but additional facts are needed before determining its significance to actual cash flow.
- D. Depreciation is irrelevant in family law.

4 Cryptocurrency

Carter's Schedule D shows a sale of cryptocurrency. What is the most important detective question?

- A. Which cryptocurrency does Carter like best?
- B. Did Bitcoin increase after he sold it?
- C. Where did the sale proceeds go, and what assets or accounts hold the proceeds now?
- D. Was the transaction reported on a K-1?

5 The Big Finish

You have Carter's complete federal income tax return. Which statement is most accurate?

- A. You now know all of Carter's assets.
- B. You now know Carter's actual cash flow.
- C. You have enough information to value Carter Medical Technologies.
- D. You have a roadmap for determining what additional documents and information you need.

Carter Detective Answer Key

Answers and teaching points

Question	Answer	Teaching point
1	C	Investigate both the K-1 income and the distribution. Taxable income, cash flow, basis, and economic benefit are separate questions.
2	B	Schedule B income can be a breadcrumb leading to a much larger underlying asset. Request the records for the account producing the interest.
3	C	Depreciation is generally a noncash tax deduction, but it should not automatically be subtracted or added back without understanding the underlying facts.
4	C	Schedule D identifies the transaction. Discovery must trace where the proceeds went and what asset or account holds them now.
5	D	A tax return is not the end of financial discovery. It is a roadmap showing where additional documents and questions may uncover income, cash flow, and assets.

Closing thought

A tax return is not the end of financial discovery. It is the map that tells you where to dig.