

carta

The tax-ready playbook for emerging VC funds

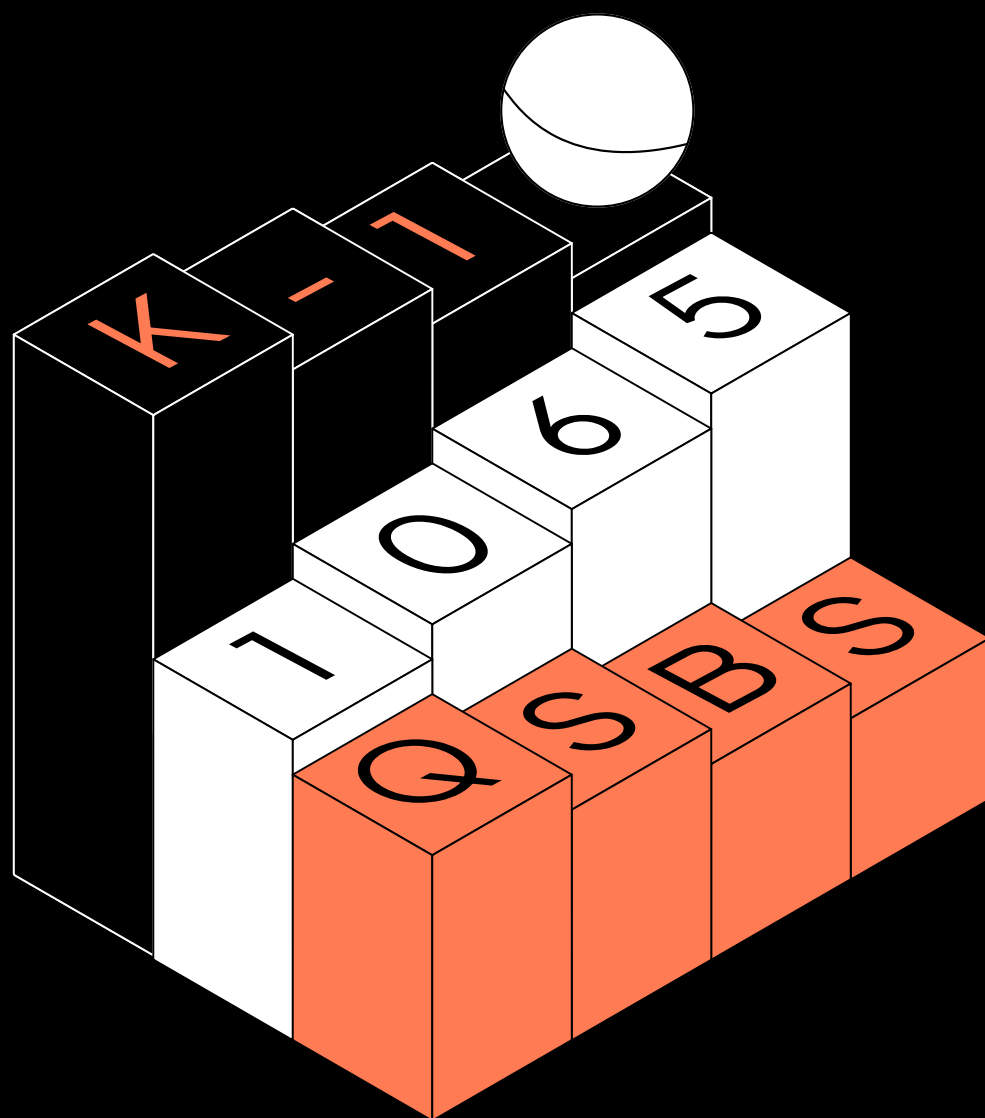


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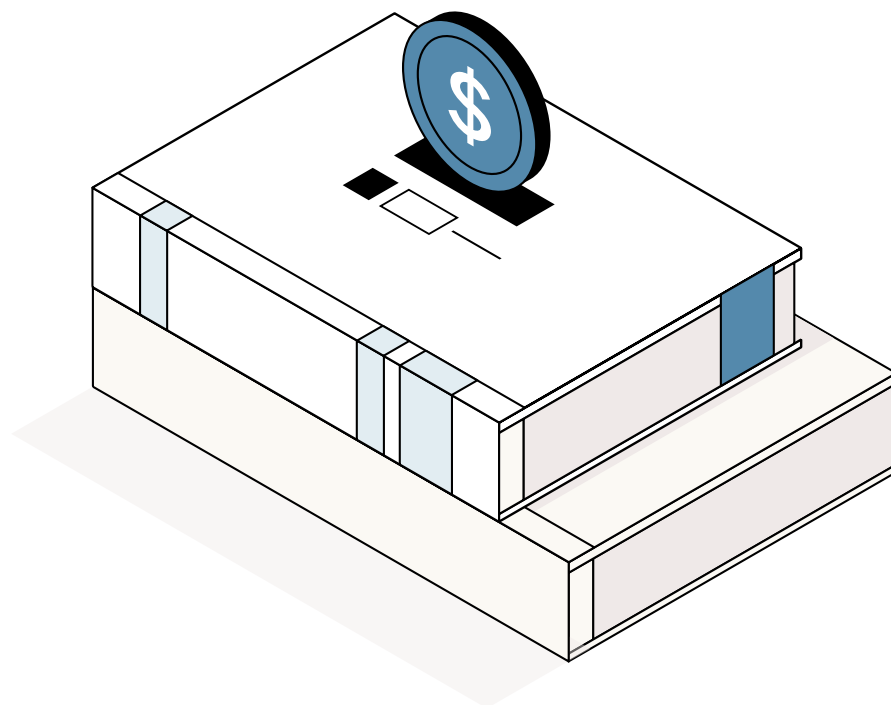
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Summary

Raising your first institutional venture capital fund is a major milestone—but it comes with growing pains, especially when it comes to taxes and audits.

Understanding how venture funds are taxed, what audits entail, and how to manage key tax documents like Schedule K-1s can help you stay compliant, build trust with LPs, and save time.

This playbook is tailored for emerging managers who are confident in the fundamentals of venture capital but new to institutional fund operations. Whether you're gearing up for your first audit or preparing your first tax filings, this guide will walk you through everything you need to know—and how Carta can help you at every step.



An introduction to VC fund tax treatment

Here's a general overview of the foundational concepts of VC fund tax, including the types of income that are taxed and how fund structures affect tax obligations. Most VC funds are structured as Limited Partnerships (LPs), which are pass-through tax entities. That means the fund itself doesn't pay taxes. Instead, investors (LPs) and managers (GPs) are responsible for paying taxes on their shares of the fund's income.

What is taxed?

Partners in VC funds generally are taxed according to three types of taxable income: management fees, realized gains, and carried interest.

Management fees

What it is

The management fee of a VC fund is the fee earned by general partners of venture funds and private equity funds to pay for the general operation of the fund. Usually this fee is 2% of the fund's assets under management each year.

How it works

The fund pays the management fee either to the GP entity or to the fund's management company, according to the terms of the fund's limited partnership agreement (LPA).

How it's taxed

GPs must pay taxes on any net taxable income they receive from the management fee (management fee gross income they receive for managing the fund, minus any management company expenses—such as office rent, employee salaries, legal fees, and other expenses). This tax is subject to **ordinary income tax rates**.

Realized gains

What it is

GPs and LPs all pay taxes on their respective shares of the fund's taxable income from the previous tax year. The fund's LPA spells out what share of the fund's taxable income or loss will be allocated to each GP and LP. A fund's taxable income is equal to interest and dividends from fund investments plus net capital gain from any sale of fund investments, minus the fund's expenses.

How it works

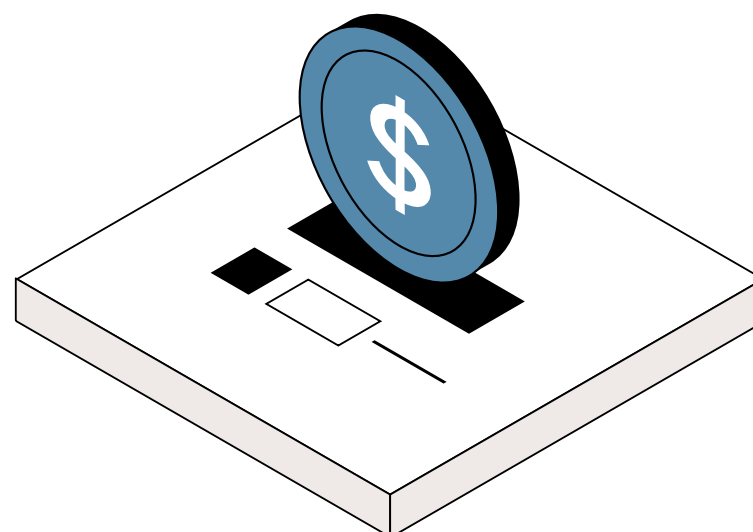
Funds earn most of their profits when the fund liquidates the stock it holds in portfolio companies through an initial public offering (IPO), secondary sale, or another type of liquidity event, such as an acquisition. Interest, dividends, and any other distributions to the fund are also reported as taxable income.

How it's taxed

GPs and LPs both must pay taxes on their share of a fund's taxable income. Typically, the tax rate each partner owes on the capital gains shown on their Schedule K-1 (we'll explain K-1s a bit later) depends on how long the fund has held the underlying investments:

- If the fund holds an asset for one year or less than one year, the associated gains will be treated as **short-term capital gains**, which tops out at 37%. The exact rate you pay in capital gains taxes depends on your adjusted gross income.
- If the fund holds an asset for longer than one year, the associated gains will be treated as **long-term capital gains**, which tops out at 20%. As with short-term capital gains, the rate you pay depends on your adjusted gross income.

Different rules can apply if an investment that was sold by a fund qualifies for qualified small business stock (QSBS) treatment—we'll talk more about QSBS in just a moment.



Carried interest

What it is

Carried interest is the percentage of a private fund's investment profits that the fund manager receives as compensation. Also referred to as “carry,” or a performance fee, carried interest is one of the primary ways that private equity funds, venture capital funds, and hedge funds get paid. Funds use carried interest to compensate and incentivize their fund managers—the better investments they make, the more profitable the investments will become, and the more the fund manager will earn in carried interest.

How it works

Carry is similar to realized gains, but it's not the same thing: Carry is a portion of the fund's realized gains that is specifically allocated to the GP, after returning capital and preferred returns to investors (LPs). One way to understand this is that realized gains stem from a partner's personal investment in a fund, as when a partner co-invests as essentially a limited partner, while carry is separate from any personal investment.

How it's taxed

Profits from carried interest are considered a return on investment for federal tax purposes. This means that carried interest can receive preferential capital gains tax treatment, similar to other investments like stocks or real estate, rather than being taxed as ordinary income.

For tax purposes, there are two types of capital gains:

Short-term capital gains are taxed the same as ordinary income, with a top rate of 37%.

Long-term capital gains are taxed at a lower rate, topping out at 20%. In both cases, the exact tax rate depends on the taxpayer's income bracket.

For carried interest, the holding period for an asset to qualify for the long-term capital gains tax rate is three years.

The fact that carried interest is taxed as a capital gain rather than compensation also means that it is not subject to the 15.3% self-employment tax that is paid by most employees and employers to help finance Medicare and Social Security.

Ready. Set. File.

Carta can help you:

- Deliver the right documents without extra steps or middlemen
- Track due dates in real time, pre-fill investor data, and auto-flag key dependencies
- Centralize all your fund activity

This tax season, plug into the trusted platform that also powers your fund accounting and unlock the easiest path to “filed.”

[Learn more
about Carta
Fund Tax](#) →

QSBS: The four magic letters that could save you millions

Investing in a startup is risky by nature. Fortunately, an extremely important tax incentive exists to encourage private investment, and it can save investors millions of dollars in taxes: The qualified small business stock (QSBS) exclusion.

As set forth in Section 1202 of the U.S. Internal Revenue Code, the exclusion can provide a break on capital gains tax—potentially up to 100% exclusion of tax on capital gains—when shareholders sell or exchange their qualified stock.

How much can I save in taxes?

You could save millions—and possibly even more, thanks to a new law.

Legislation passed and signed into law on July 4, 2025 expanded QSBS to more investors, as well as more founders and employees. Here are the new guidelines:

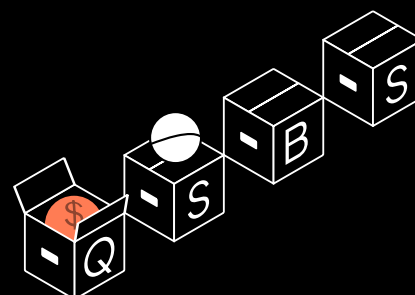
- QSBS protects up to 10x of an investment from long-term capital gains taxes, or \$15 million, whichever is greater. For example, an investor who put in \$15 million could avoid paying federal capital gains tax on up to \$150 million.
- Benefits are phased in: The capital gain exclusion is 50% for shares that have been held for three years, 75% for four years, and 100% after five years.

Note that these changes only apply to shares issued after July 4, 2025—but the QSBS exclusion existed before that, and eligible shares issued previously would fall under the previous and still-favorable guidelines (exclusion up to \$10 million rather than \$15 million, and shares becoming 100% eligible after five years, with no phase-in).

For first-time fund managers beginning to build a fund and issuing shares after July 4, 2025, all shares would be subject to the new, broader exclusion.

Tax savings are already waiting

Learn all about the QSBS tax exclusion, and how Carta can help you uncover potentially huge savings on capital gains.



[Get started](#) →

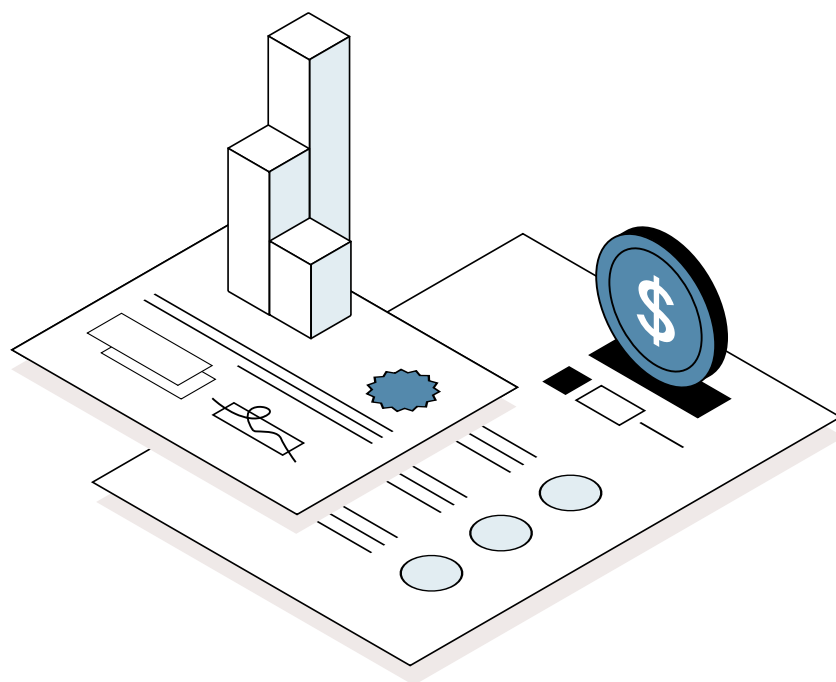
How to know if an investment meets the eligibility requirements

For investors, taking advantage of the QSBS exclusion hinges on understanding when a portfolio company—or a potential one—is eligible as a Qualified Small Business.

A company is known as a qualified small business when it meets the below qualification requirements:

- 1 The company must be an active business that is incorporated as a U.S. C corporation.
- 2 The company must have had gross assets of \$75 million or less at all times before and immediately after the equity was issued (this figure was increased from the previous \$50 million cap as part of the July 2025 federal legislation).
- 3 At least 80% of a company's assets must be actively used in a qualified trade or business. Excluded business types are determined by the IRS and include companies that:
 - Perform services related to health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, finance, banking, insurance, leasing, investing, or brokerage
 - Rely on an employee or owner's reputation (i.e. if it endorses products or services, uses an individual's image, or has an employee make appearances at events or on media outlets.)
 - Produce products, such as fossil fuels, for which percentage depletion (a type of tax deduction) can be claimed
 - Operate a hotel, motel, restaurant, or similar business
 - Are a farming business

A company can be found unqualified for QSBS status after previously qualifying if the requirements above no longer apply. For a full list of requirements, see IRS's Pub. 550 or Section 1202.



Schedule K-1s: How fund managers report their taxes

Most VC funds are structured as Limited Partnerships (LPs), which are pass-through tax entities. That means the fund itself doesn't pay taxes.

Instead, investors (LPs) and managers (GPs) are responsible for paying taxes on their shares of the fund's income. In fact, the IRS requires a fund's GPs and LPs to individually report their respective shares of a fund's profits and losses.

So, how do they do it? Enter the Schedule K-1.

What is a K-1?

Schedule K-1 is a tax form prepared annually by U.S. pass-through entities—such as business partnerships, limited liability companies (LLCs), S corporations, trusts, and estates. Often simply called a “K-1”, this form is used to report each stakeholder's share of the entity's income, losses, and dividends for the tax year to the Internal Revenue Service (IRS).

Partnerships in the U.S. (including venture funds) use this form to “pass through” taxable income to their partners.

Individual stakeholders, such as a venture fund partner, do not fill out K-1s, but they can use the information to prepare their personal income tax return (Form 1040) for that tax year.

How does a K-1 work?

The fund's tax team (whether an internal tax team or an external tax provider) prepares Schedule K-1s for each of the fund's partners, who then use them to determine the taxes they owe on any gains. The tax team also submits a copy of each K-1 to the IRS along with the fund's tax return (on IRS Form 1065).

As K-1 income is often taxable, recipients must also account for it on their personal income tax return (Form 1040).

When must K-1s be filed?

Venture funds, private equity funds, and other alternative asset funds are required to fill out and file Schedule K-1s annually, whether they report taxable income or losses. The deadline for filing a K-1 with the IRS depends on the fiscal year used by your entity and whether it files for an extension, which is common for LLCs.

If the entity follows the calendar year, K-1s must be filed by March 15. If the entity follows a different fiscal year schedule—for example, a fiscal year ending on January 31 to account for a busy calendar year Q4, as is the case with some retail companies—then the K-1 is due to federal tax authorities on the fifteenth day of the third month after the end of the partnership’s tax year.

Many entities request a six-month extension of time to file the return with the IRS in order to have more time for tax planning and to gather documents. This makes the K-1 due date September 15 for entities that follow the calendar year, or the 15th day of the ninth month after the close of the fiscal year for entities that follow other schedules.

These dates may differ from the dates by which LLCs are obligated to share K-1 information with partners; these deadlines may be included in the partnership agreement.

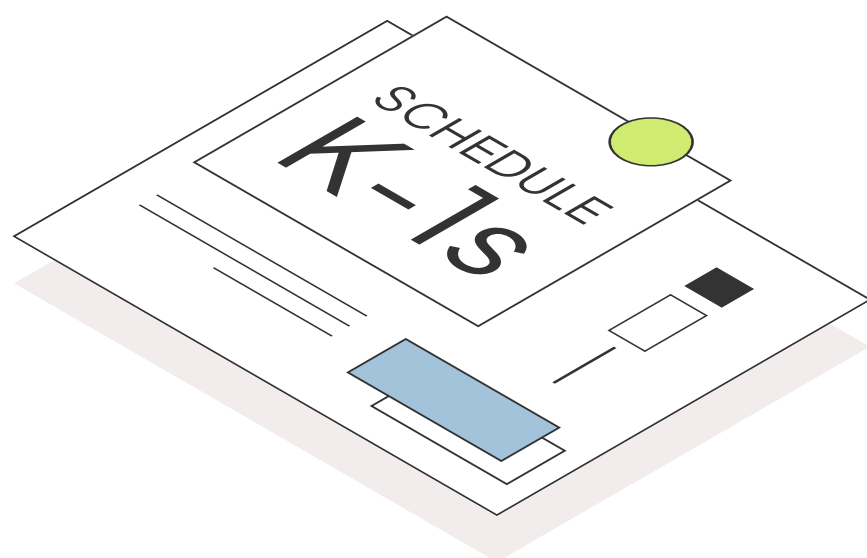
A word about VC fund write-offs

When a VC fund’s portfolio company goes out of business, the partners are allowed to write off that investment—meaning that the value of the investment is zero. Writeoffs reduce the fund’s taxable income and will allow partners to take a capital loss, but they also effectively mean that the portfolio company is worthless, which affects the fund’s performance metrics.

Who needs to file a K-1?

A K-1 form is usually prepared by the accountant who manages the entity’s taxes, before being issued to each partner, shareholder, or beneficiary. The entity must file a copy of the relevant K-1 (Form 1065 for investors) with the IRS.

Sometimes LLCs choose to be taxed like C corporations. In this case, the entity pays taxes rather than passing it on to partners, so partners will not receive a K-1. If you’re not sure how your LLC is taxed, ask your LLC’s accountant whether or not you should expect a K-1.



What is in a K-1 form?

The following information is required when filling out a Schedule K-1 ([Form 1065](#)) for a partnership.

Part I: Information about the partnership • The partnership's EIN • The partnership's address	Part II: Information about the partner [or beneficiary] • The partner's social security number • The partner's address • The type of partner	Part III: Each partner's [or beneficiary's] share of: • Ownership • Income • Liabilities • Deductions • Credits • Dividends • Royalties • Capital gains • Other items
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What to know about getting a K-1 extension

Entities may request an extension of their filing deadline by filing [Form 7004](#) by the regular due date of the return. Because this could affect the ability of partners to file their individual returns with the proper information, it's important to review the partnership agreement closely for any obligations to partners regarding sharing an estimated K-1 by a certain date, regardless of whether the entity has filed for an extension of its federal return.

For partners receiving K-1s from an LLC, they can ask the partnership's accountant when they should expect to receive the Schedule K-1 form. If the LLC is filing for an extension, partners may need to file for a personal income tax extension as well.

Keep in mind that a request for extension of time to file is not an extension of time to pay the tax liability.

Fund audits: How to stay prepared all year round

Many venture firms conduct annual audits of their funds. If you're a first-time fund manager, you might be getting ready to undergo your very first fund audit.

To prepare, you'll want to know how the process will unfold, including the timeline, what auditors look for, and what tax and other documents you'll need. It's also helpful to have an understanding of why audits are conducted in the first place.

What is the purpose of a VC fund audit?

- To confirm that the fund's general partners (GP) are operating in accordance with the fund's limited partnership agreement (LPA), and that the fund's financials reflect this compliance. A clean audit is one that doesn't turn up any surprises: It reassures the fund's limited partners (LPs) that the GPs are managing the fund as agreed.
- To confirm the fund's valuations of its portfolio companies, as well as the fund's ownership position in them. An audit assures your fund's investors that a neutral, third-party accounting firm has confirmed not only the fund's financial statements, but also its assessment of its own success.

When are audits necessary?

Most venture funds go through audits either because it's required by law or because at least one LP requires it as a condition of their investment.

Audits required by law

The U.S. Securities and Exchange Commission (SEC) is a government agency that regulates the venture capital sector. U.S. securities law requires people or firms that manage money for other people to register as investment advisers. However, the SEC's definition of venture capital funds exempts certain VC firms from registering. This exemption lets them skip some regulatory procedures required of registered investment advisers, including audits.

If a fund no longer meets the criteria for exemption, the entity managing it—usually the fund's management company—must register as an investment adviser and begin conducting regular audits. The SEC also requires that any fund formed by a registered investment adviser (RIA) conduct an annual audit. Your firm's legal counsel can help you determine whether your firm is exempt from registering with the SEC as an investment adviser.

Audits required by investors

Many venture fund LPs are institutional investors that manage money on behalf of organizations and groups, like foundations, public pensions, and health care systems. These LPs want fund audits for two reasons:

- They're typically pretty conservative investors; audits can bring greater transparency to riskier private assets.
- They answer to their own management boards. Institutional LPs need to be sure that GPs are executing on the investment strategy that they signed up for.

Regular, required audits are a way for LPs to show fiduciary responsibility to the groups whose money they manage.

Do you need an audit?

Reasons you may not need one

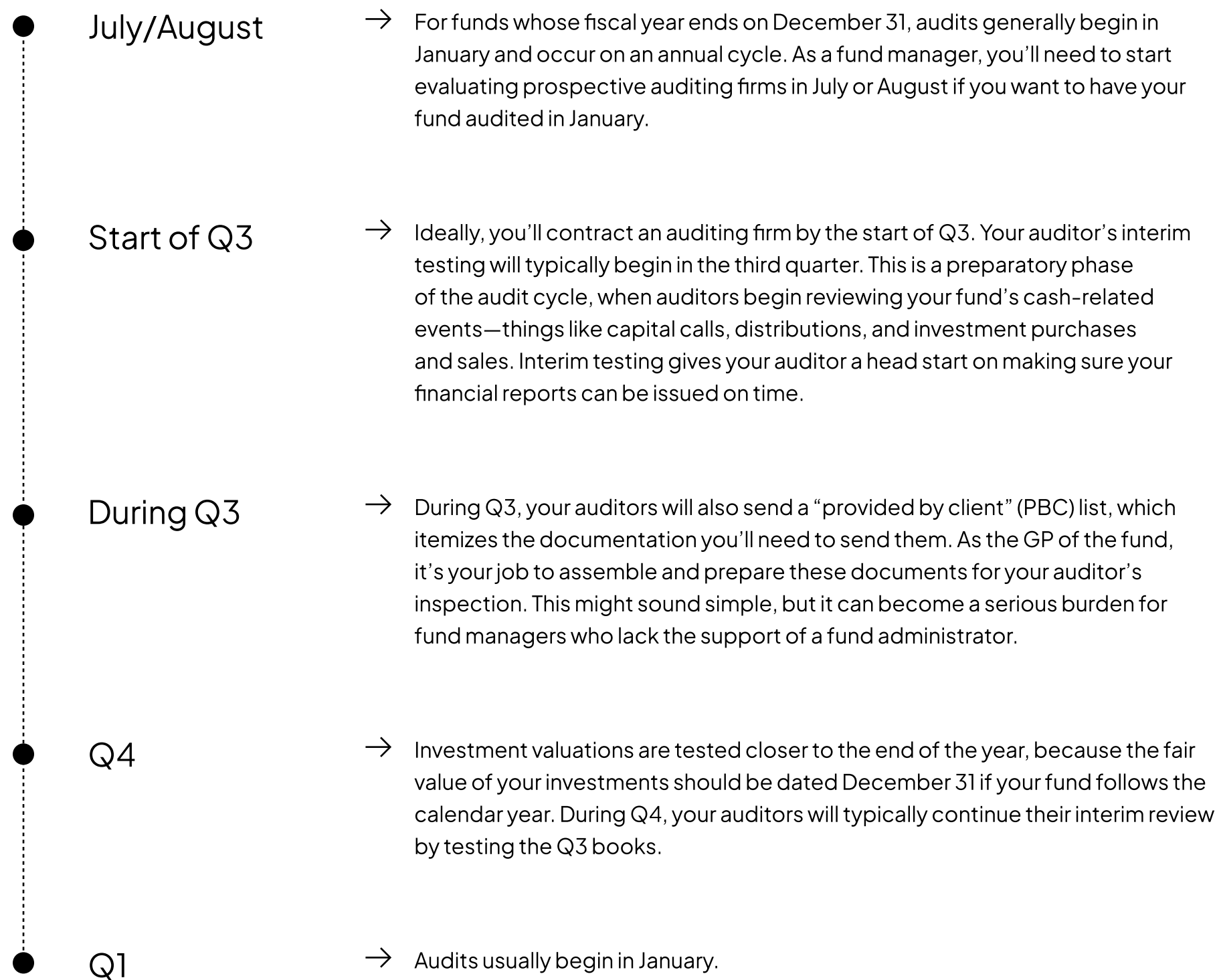
First-time funds without institutional LPs often decide to forgo the expense of an audit when they aren't required by law to conduct one. Exempt funds in their earliest stages, such as those in their first or second year of investment, may also skip the process, so long as none of their LPs have required one.

Reasons to get one

Annual audits are increasingly common across the VC ecosystem. Even when they're not required to audit, fund managers often conduct one anyway—especially if their firm is looking to create a new fund. That's because audited financials show current and prospective future investors that your accounting, valuations, and controls are in order. Larger, more prestigious investors use audited financials to perform in-depth due diligence on firms they're thinking about working with—so VCs will sometimes start auditing their previously unaudited, exempt funds when they're raising their first institutionally backed funds.

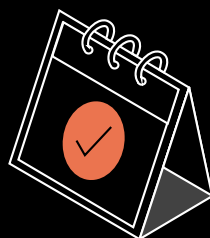
Even when they're not required to audit, fund managers often conduct one anyway—especially if their firm is looking to create a new fund.

A typical timeline for venture fund audits



Be tax-ready, already

See Carta's fund tax and audit checklist for a deeper dive into key dates and deadlines.



[Get the guide](#) →

What do auditors look for?

To evaluate your fund's compliance with its LPA, auditors examine its documentation and records. They look at invoices to make sure you're only charging your LPs for permitted expenses. They also confirm that bank balances, transactions, management fees, capital calls, and distributions are all accurately recorded.

Auditors also confirm that a fund's ownership positions in its portfolio companies match those companies' records—in other words, that you have invested what you say you did. To do this, you'll need to provide updated cap tables from each of the fund's portfolio companies. After confirming ownership, auditors then look at how the fund calculated each portfolio company's valuation. This can reveal misleading or inaccurate representations of a fund's performance, or incorrect calculations of its portfolio company holdings.

Auditors follow U.S. generally accepted accounting principles (GAAP) or the international financial reporting standards to value investments. These guidelines create consistency for how assets are valued across the VC industry. However, since the guidelines permit some flexibility, VC firms benefit from having a clear valuations policy that outlines to auditors how they value their assets.

You and your auditor might disagree about the approach you took for establishing the valuations of some of your assets. That's because there are several different methods VCs use to establish company valuations. One common method calculates the fair value of investment holdings according to the company's most recent primary financing, while other methods do so through comparisons to recent IPOs or acquisitions of similar companies, or through more complex formulas that account for investor liquidation preferences. Depending on the type and stage of the investments in your portfolio, your auditors may prefer a different valuation model than the one you used.

What will auditors need?

Fund documents

- Fund formation documents, including the LPA
- The fund's operating agreement and partner agreements
- LP subscription documents and side letters
- EIN letter
- Article of incorporation
- Statement of assets, liabilities, and partner's capital
- Statement of changes to partners' capital
- Bank account and brokerage account statements
- Schedule of portfolio investments
- Service agreements with third parties
- Expense invoices, including those for the fund's auditor, tax provider, fund administrator, and other outsourced professional services
- Statement of cash flows, i.e., a record of all money movement into and out of the fund, including investment fundings, investor capital calls and distributions, carried interest, and expense payments.

Auditors will use these documents to validate that all transactions have occurred and that your accounting books are accurate.

Portfolio company documents

Documents auditors need to evaluate portfolio investments include:

- A spreadsheet of contacts for each portfolio company, including their name and email address
- Updated portfolio company cap tables
- Most recent financial statements for each portfolio company, dated as close to year-end as possible
- Financing documents related to the most recent round of financing for each portfolio company
- Balance sheets
- Revenue reports

Throughout the audit, your auditors will continue to request any information and documentation they think will help them gain insight into a portfolio company's finances and stress-test the fund's own ASC 820 valuation of its interest in the portfolio company.

How Carta helps you through the audit process

Providing all this evidence of fund and portfolio company performance can take a massive amount of time. With Carta's fund administration services, we can simplify the process, and help save you time and stay efficient. Carta coordinates with the fund and audit teams to make sure everyone is on the same page about document delivery timelines. Our team works with you to fulfill open items on the PBC list and prepares investment and investor confirmation letters as needed.

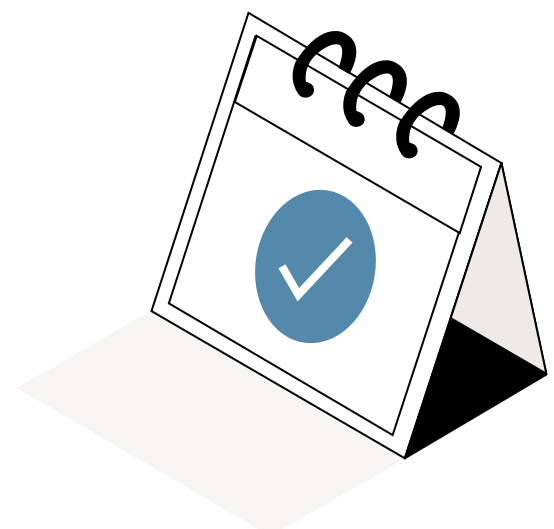
Carta's software lets you add groupings to your statement of investments, among other detailed information you may wish to include in your audit documentation. The Carta fund administration team can generate your fund's annotated quarterly financials with just a few clicks. Carta also provides your audit team with access to your fund's general ledger, and is the first point of contact for any additional support your auditor needs.

This tax season, deliver without detours

There's a lot to keep track of when running a fund, and taxes require careful planning.

Let Carta help: With our full suite of fund admin tools and services, including a Tax Dashboard and Investor Portal, you can centralize fund operations and eliminate intermediaries between you and your data—allowing you to do your taxes quickly and accurately.

To get started, check out our annual tax preparation list on the following pages for pro tips, special considerations, and key deadlines.



The year in taxes: An annual end-to-end prep list

Pro tips for first-time fund managers

- Label invoices and properly track cap calls/distributions from day one. ☐
- Establish open communication between fund admin, legal, tax, and audit. ☐
- Provide documents to fund administrator proactively—not just end-of-year. ☐
- Centralize everything: Use Carta or fund management platform to house docs, flags, and timelines. ☐
- Consider engaging a fund administrator by Q2 at latest to stay on top of obligations. ☐

Special considerations & annual to-dos

- Qualified Small Business Stock (QSBS) strategy: ☐
 - Identify and track QSBS-eligible investments starting at time of purchase.
 - Reassess qualification annually based on latest financials.
 - Document original issuance and holding period.
 - Coordinate with legal/tax team to avoid disqualifying activities.
- Request audit/tax extensions, if needed: ☐
 - IRS Form 7004 extends K-1 deadline to Sept 15.
 - Communicate filing delays transparently with LPs.
- Review LP-side deliverables: ☐
 - Include LP reporting requirements in LPA compliance review.
 - Ensure transparency with estimated K-1s if full return delayed.

Year round: Foundational maintenance and continuous readiness

Do these regularly to make tax filing and audit prep seamless later on

- Track and categorize expenses with appropriate invoice documentation ☐
- Maintain detailed records of capital calls, distributions, and investments ☐
- Update contact and tax information for all LPs (W-9s/W-8BEN or W-8BEN-E) ☐
- Create and follow a standard valuation policy (for ASC 820 compliance) ☐
- Keep portfolio company cap tables up to date ☐
- Organize key fund governance documents (LPA, Operating Agreement, etc.) ☐
- Identify any related-party transactions (for disclosure in audited financials) ☐

Tax calendar

		Yes	No
● July/Aug Prepare for year -end audit cycle (for calendar- year funds)	→ Begin sourcing and evaluating third-party auditors	☐	☐
	→ Engage your selected audit firm (target: contract signed by early Q3)	☐	☐
	→ Start coordinating timelines among fund admin, auditors, and tax team	☐	☐
	→ Confirm who will prepare the notes to the audited financials (Auditor or Fund Admin)	☐	☐
	→ Begin reviewing financial statements sent by fund administrator	☐	☐
● Start of Q3 (July) Kick off pre-audit readiness	→ Auditors begin interim testing (capital calls, cash flow activities, early financial reviews)	☐	☐
	→ Auditors send PBC (Provided By Client) list—start compiling documents now	☐	☐
	→ Share executed fund documents with fund administrator as they become available: • LPA, Subscription Agreements, Side Letters, Line of Credit Agreements	☐	☐
	→ Confirm related-party relationships between LPs and GPs (for GAAP reporting)	☐	☐
	→ Ensure tax team has partner classification details (type of entity, DRE info)	☐	☐
● During Q3 (July - Sept)	→ Continue fulfilling ongoing auditor requests from the PBC list	☐	☐
	→ Deliver the following support documents to the fund administrator: • Vendor W-9 info and email contacts (especially those requiring 1099s) • All expense invoices to date	☐	☐
	→ Identify potential need for loan agreements or intercompany balances	☐	☐

		Yes	No
● Q4 (Oct-Dec)	→ Finalize and update portfolio company valuations as of December 31	☐	☐
	→ Communicate valuation methodology with fund admin and auditor (Level 3 Inputs)	☐	☐
	→ Provide support for ASC 820-compliant fair value assessments	☐	☐
	→ Ensure investment records include: • Purchase agreements • Certificates or Articles of Incorporation • Contact details for each portfolio company (used for audit confirmations)	☐	☐
	→ Settle open LP capital calls and any outstanding fund payables or receivables	☐	☐
	→ Deliver: • Statement of Cash Flows • Capital Account Statement • Schedule of Investments	☐	☐
	→ Audit/tax engagement letters provided to fund administrator for accruals	☐	☐
	→ Share updated W-8s and W-9s with fund administrator (check 3-year expiry of W-8s)	☐	☐
	→ Finalize any amendments to LP subscriptions or commitments	☐	☐
● Dec 31 deadline	→ Lock in valuation date for portfolio companies (typically Dec 31)	☐	☐
	→ Finalize all year-end transactions and reconciliations	☐	☐
	→ Pay any invoices or accrual items affecting current year	☐	☐
● January (Following calendar-year end)	→ Finalize and share valuation updates with fund administrator	☐	☐
	→ Provide support for all Level 3 valuation assumptions	☐	☐
	→ Begin reviewing draft financial statements	☐	☐
	→ Review & approve any 1099s (due to IRS by Jan 31)	☐	☐
	→ Respond to any initial audit team inquiries	☐	☐

		Yes	No
● Feb – Mar	→ Final review and sign-off on audited financials	☐	☐
	→ Schedule internal or LP meetings to review audited results and performance insights	☐	☐
	→ Prepare & distribute Schedule K-1s (Form 1065) to all GPs and LPs: • Deadline: March 15 (or the 15th of the third month post-fiscal year end) • If requesting extension (via Form 7004), notify LPs and share estimate timelines	☐	☐
	→ Audit firm completes tests → issues opinion letters and closes audit	☐	☐
● Apr – Jun	→ Conduct debrief with audit and tax teams to improve next year’s workflow	☐	☐
	→ Analyze K-1 delivery timelines and investor feedback	☐	☐
	→ Use audit findings to optimize bookkeeping, valuation policies, and investor tracking	☐	☐
	→ Prepare for LP reporting, AGM presentations, or data room uploads for next fundraising cycle	☐	☐
Post-mortem and go-forward prep			

At-a-glance deadlines (for calendar-year-end fund)

Date	Action/Deadline
July – August	Engage auditor; compile fund documents & partner info
September – October	Begin audit preparation; receive & fulfill PBC list
December 31	Lock valuation date; clear all year-end documentation
January 31	IRS 1099s due
March 15	Schedule K-1s due to partners + IRS (if no extension)
September 15	Extended K-1 filing due (if Form 7004 submitted)



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