

# 1996



Department of the Treasury  
Internal Revenue Service

## Instructions for Forms 1120 and 1120-A

*Section references are to the Internal Revenue Code unless otherwise noted.*

**Paperwork Reduction Act Notice.**— We ask for the information on these forms to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by section 6103.

The time needed to complete and file the following forms will vary depending on individual circumstances. The estimated average times are:

Form	Recordkeeping	Learning about the law or the form	Preparing the form	Copying, assembling, and sending the form to the IRS
1120	71 hr., 31 min.	41 hr., 46 min.	71 hr., 46 min.	7 hr., 47 min.
1120-A	43 hr., 3 min.	24 hr., 8 min.	41 hr., 43 min.	4 hr., 34 min.
Sch. D (1120)	6 hr., 56 min.	3 hr., 31 min.	5 hr., 39 min.	32 min.
Sch. H (1120)	5 hr., 59 min.	35 min.	43 min.	0 min.
Sch. PH (1120)	15 hr., 19 min.	6 hr., 6 min.	8 hr., 29 min.	32 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form and related schedules simpler, we would be happy to hear from you. You can write to the Tax Forms Committee, Western Area Distribution Center, Rancho Cordova, CA 95743-0001. **DO NOT** send the tax form to this office. Instead, see **Where To File** on page 3.

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### Changes To Note

The Small Business Job Protection Act of 1996 ("The Act") made changes to the tax law for corporations. The Act restored several expired credits and also changed the rules for claiming certain credits. These and other changes are highlighted below.

- If the corporation's total deposits of social security, Medicare, and withheld income taxes were more than \$50,000 in 1995, it must make electronic deposits for all depository tax liabilities that occur after June 30, 1997. For details, see **Depository Method of Tax Payment** on page 3.
- Corporations may qualify to claim the research credit figured on **Form 6765**, Credit for Increasing Research Activities. The credit generally applies for qualified research expenses paid or incurred after June 30, 1996, and before June 1, 1997. Get Form 6765 for details.
- Corporations may qualify to claim the orphan drug credit. The credit generally applies for qualified clinical testing expenses paid or

incurred after June 30, 1996, and before June 1, 1997. The credit is part of the general business credit. Get **Form 8820**, Orphan Drug Credit, for more information.

- The targeted jobs credit has been replaced by the work opportunity credit. The credit applies for wages paid to qualified employees who begin work for the employer after September 30, 1996, and before October 1, 1997. Get **Form 5884**, Work Opportunity Credit, for details.
- The credit for employer social security and Medicare taxes paid on certain employee tips has been expanded to include establishments that provide food and beverages for consumption off the premises (if tipping is customary). The new rules apply to tips for services performed after December 31, 1996. For details, get **Form 8846**, Credit for Employer Social Security and Medicare Taxes Paid on Certain Employee Tips.
- Generally, for tax years beginning after December 31, 1995, the possessions tax credit under section 936 has been repealed. Existing credit claimants may qualify for a credit under the transitional rules. New section 30A requires a separate computation of the credit for business income from Puerto Rico. For details, get **Form 5735**, Possessions Corporation Tax Credit (Under Sections 936 and 30A).
- Generally, for tax years beginning after December 31, 1995, the reserve method of accounting for bad debts of thrift institutions under section 593 has been repealed. Generally, thrift institutions that qualify as small banks may use the reserve method for accounting for bad debts under section 585; those that are treated as large banks must use the specific charge-off method. For details, including how to figure the required section 481(a) adjustment, see Act section 1616.
- The Act modified the definition of section 179 property, classified gas station convenience stores as 15-year property, provided a new 25-year recovery period for water utility property, and added new rules for property depreciated under the income forecast method. For details, get **Form 4562**, Depreciation and Amortization.
- The Act changed the rules for replacing business property that was involuntarily converted as a result of a Presidentially declared disaster. For more information, get **Form 4684**, Casualties and Thefts.
- A corporation that received a distribution from a foreign trust after August 20, 1996, must provide additional information. For details, get **Pub. 553**, Highlights of 1996 Tax Changes.
- The Act created the "financial asset securitization investment trust" (FASIT), an entity that facilitates the securitization of revolving, nonmortgage debt. If a corporation holds an ownership interest in a FASIT, it should report all items of income, gain, deductions, losses, and credits on the corporation's income tax return, except as provided in section 860H. The FASIT provisions are generally effective beginning September 1, 1997. See sections 860H through 860L for more information.

The Health Insurance and Portability Act of 1996 changed the rules for deducting interest on loans for company-owned life insurance. Generally, no deduction is allowed for interest paid or accrued after October 13, 1995, on any amount of debt incurred with respect to company-owned life insurance policies, annuities, or endowment contracts that cover corporate officers or employees (or any person who has a financial interest in the corporation). Exceptions and phase-in rules apply. See Act section 501.

## Unresolved Tax Problems

The Problem Resolution Program is for corporations that have been unable to resolve their problems with the IRS. If the corporation has a tax problem it cannot clear up through normal channels, write to the corporation's local IRS District Director or call the corporation's local IRS office and ask for Problem Resolution assistance. Persons who have access to TTY/TDD equipment may call 1-800-829-4059 to ask for help from Problem Resolution. This office cannot change the law or technical decisions. But it can help the corporation clear up problems that resulted from previous contacts.

## How To Make a Contribution To Reduce the Public Debt

To make a contribution to reduce the public debt, send a check made payable to "Bureau of the Public Debt" to Bureau of the Public Debt, Department G, Washington, DC 20239-0601. Or, enclose a check with the income tax return. Contributions to reduce the public debt are deductible subject to the rules and limitations for charitable contributions.

## How To Get Forms and Publications

**By personal computer.**— If you subscribe to an on-line service, ask if IRS information is available and, if so, how to access it. Tax forms, instructions, publications, and other IRS information are available through the Internal Revenue Information Service (IRIS), on FedWorld, a government bulletin board. The IRIS menus offer information on available file formats and software needed to read and print files. You must print the forms to use them; the forms are not designed to be filled out on-screen.

IRIS is directly accessible by modem at 703-321-8020. On the Internet, telnet to [iris.irs.ustreas.gov](http://iris.irs.ustreas.gov) or, for file transfer protocol services, connect to [ftp.irs.ustreas.gov](ftp://ftp.irs.ustreas.gov). If you are using the World Wide Web, connect to <http://www.irs.ustreas.gov>. FedWorld's help desk offers technical assistance on accessing IRIS (not tax help) during regular business hours at 703-487-4608.

Tax forms, instructions, and publications are also available on CD-ROM, including prior-year forms starting with the 1991 tax year. For ordering information and software requirements, contact the Government Printing Office's Superintendent of Documents (202-512-1800) or Federal Bulletin Board (202-512-1387).

**By phone and in person.**— To order forms and publications, call 1-800-TAX-FORM (1-800-829-3676). You can also get most forms and publications at your local IRS office.

# General Instructions

## Purpose of Form

Use **Form 1120**, U.S. Corporation Income Tax Return, and **Form 1120-A**, U.S. Corporation Short-Form Income Tax Return, to report the income, gains, losses, deductions, credits, and to figure the income tax liability of a corporation. Also see **Pub. 542**, Corporations, for more information.

## Who Must File

Unless exempt under section 501, all domestic corporations (including corporations in bankruptcy) must file whether or not they have taxable income. Domestic corporations must file Form 1120, or, if they qualify, Form 1120-A, unless they are required to file a special return (see **Special Returns for Certain Organizations** below).

**Note:** *If an organization resembles a corporation more than it resembles a partnership or trust, it will be considered an association taxed as a corporation.*

**Limited liability companies.**— If an entity was formed as a limited liability company under state law and is treated as a partnership for Federal income tax purposes, it should not file Form 1120 or 1120-A. Instead, it should file **Form 1065**, U.S. Partnership Return of Income. For the definition of a limited liability company, see the Instructions for Form 1065.

## Who May File Form 1120-A

A corporation may file Form 1120-A if it meets **all** of the following requirements:

- Its gross receipts (line 1a, page 1) are under \$500,000.
- Its total income (line 11, page 1) is under \$500,000.
- Its total assets (line 12, column (b), Part III, on page 2) are under \$500,000.
- It does not have any ownership in a foreign corporation.
- It does not have foreign shareholders who own, directly or indirectly, 50% or more of its stock.
- It is not a member of a controlled group of corporations (sections 1561 and 1563).
- It is not a personal holding company (sections 541 through 547).
- It is not a consolidated corporate return filer.
- It is not a corporation undergoing a dissolution or liquidation.
- It is not filing its final tax return.
- Its only dividend income (none of which represents debt-financed securities) is from domestic corporations, and those dividends qualify for the 70% deduction.
- It has no nonrefundable tax credits other than the general business credit and the credit for prior year minimum tax.
- It has no liability for interest under section 453(l)(3) or 453A(c) (relating to certain installment sales) or installment payments of tax under section 1363(d).
- It has no liability for interest due under the look-back method of section 460(b)(2).
- It is not required to file **Form 8621**, Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund.
- It has no liability for tax under section 7518 on a nonqualified withdrawal from a capital construction fund.

- It is not making an election under section 172(b)(3) to forego the carryback period of an NOL.
- It is not electing to pay tax on the gain from the sale of an intangible as described in section 197(f)(9)(B)(ii).
- It is not required to file one of the special tax returns listed below.

## Special Returns for Certain Organizations

Certain organizations, as shown below, have to file special returns.

If the organization is a	File Form
Farmers' cooperative (sec. 1381)	<b>990-C</b>
Exempt organization with unrelated trade or business income	<b>990-T</b>
Entity formed as a limited liability company under state law and treated as a partnership for Federal income tax purposes	<b>1065</b>
Religious or apostolic organization exempt under section 501(d)	<b>1065</b>
Entity that elects to be treated as a real estate mortgage investment conduit (REMIC) under sec. 860D	<b>1066</b>
Settlement fund (sec. 468B)	<b>1120-SF</b>
Interest charge domestic international sales corporation (sec. 992)	<b>1120-IC-DISC</b>
Foreign corporation (other than life and property and casualty insurance company filing Form 1120-L or Form 1120-PC)	<b>1120-F</b>
Foreign sales corporation (sec. 922)	<b>1120-FSC</b>
Condominium management association or residential real estate management association that elects to be treated as a homeowners association under sec. 528	<b>1120-H</b>
Life insurance company (sec. 801)	<b>1120-L</b>
Fund set up to pay for nuclear decommissioning costs (sec. 468A)	<b>1120-ND</b>
Property and casualty insurance company (sec. 831)	<b>1120-PC</b>
Political organization (sec. 527)	<b>1120-POL</b>
Real estate investment trust (sec. 856)	<b>1120-REIT</b>
Regulated investment company (sec. 851)	<b>1120-RIC</b>
S corporation (sec. 1361)	<b>1120S</b>

## When To File

Generally, a corporation must file its income tax return by the 15th day of the 3rd month after the end of the tax year. A new corporation filing a short-period return must generally file by the 15th day of the 3rd month after the short period ends. A corporation that has dissolved must generally file by the 15th day of the 3rd month after the date it dissolved.

If the due date falls on a Saturday, Sunday, or legal holiday, the corporation may file on the next business day.

**Extension.**— File **Form 7004**, Application for Automatic Extension of Time To File Corporation Income Tax Return, to request a 6-month extension of time to file.

## Where To File

File your return at the applicable IRS address listed below.

If the corporation's principal business, office, or agency is located in

Use the following Internal Revenue Service Center address

Alaska, Arizona, California (counties of Alpine, Amador, Butte, Calaveras, Colusa, Contra Costa, Del Norte, El Dorado, Glenn, Humboldt, Lake, Lassen, Marin, Mendocino, Modoc, Napa, Nevada, Placer, Plumas, Sacramento, San Joaquin, Shasta, Sierra, Siskiyou, Solano, Sonoma, Sutter, Tehama, Trinity, Yolo, and Yuba), Colorado, Idaho, Montana, Nebraska, Nevada, North Dakota, Oregon, South Dakota, Utah, Washington, Wyoming	Ogden, UT 84201-0012
California (all other counties), Hawaii	Fresno, CA 93888-0012
New Jersey, New York (New York City and counties of Nassau, Rockland, Suffolk, and Westchester)	Holtsville, NY 00501-0012
New York (all other counties), Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, Vermont	Andover, MA 05501-0012
Florida, Georgia, South Carolina	Atlanta, GA 39901-0012
Indiana, Kentucky, Michigan, Ohio, West Virginia	Cincinnati, OH 45999-0012
Kansas, New Mexico, Oklahoma, Texas	Austin, TX 73301-0012
Illinois, Iowa, Minnesota, Missouri, Wisconsin	Kansas City, MO 64999-0012
Alabama, Arkansas, Louisiana, Mississippi, North Carolina, Tennessee	Memphis, TN 37501-0012
Delaware, District of Columbia, Maryland, Pennsylvania, Virginia	Philadelphia, PA 19255-0012

Corporations with their principal place of business outside the United States or claiming a possessions tax credit (sections 936 and 30A) must file with the Internal Revenue Service Center, Philadelphia, PA 19255-0012.

A group of corporations located in several service center regions will often keep all the books and records at the principal office of the managing corporation. In this case, the income tax returns of the corporations may be filed with the service center for the region in which the principal office is located.

## Who Must Sign

The return must be signed and dated by the president, vice president, treasurer, assistant treasurer, chief accounting officer, or any other corporate officer (such as tax officer) authorized to sign. Receivers, trustees, or assignees must also sign and date any return filed on behalf of a corporation.

If a corporate officer completes Form 1120 or Form 1120-A, the Paid Preparer's space should remain blank. Anyone who prepares Form 1120 or Form 1120-A but does not

charge the corporation should not sign the return. Generally, anyone who is paid to prepare the return must sign it and fill in the Paid Preparer's Use Only area.

The paid preparer must complete the required preparer information and—

- Sign the return, by hand, in the space provided for the preparer's signature (signature stamps and labels are not acceptable).
- Give a copy of the return to the taxpayer.

## Accounting Methods

An accounting method is a set of rules used to determine when and how income and expenses are reported.

Figure taxable income using the method of accounting regularly used in keeping the corporation's books and records. Generally, permissible methods include the cash, accrual, or any other method authorized by the Internal Revenue Code. In all cases, the method used must clearly show taxable income.

Generally, a corporation (other than a qualified personal service corporation) must use the accrual method of accounting if its average annual gross receipts exceed \$5 million. See section 448(c). A corporation engaged in farming operations must also use the accrual method. For exceptions, see section 447.

Under the accrual method, an amount is includable in income when all the events have occurred that fix the right to receive the income and the amount can be determined with reasonable accuracy. See Regulations section 1.451-1(a) for details.

Generally, an accrual basis taxpayer can deduct accrued expenses in the tax year in which (1) all events that determine the liability have occurred, (2) the amount of the liability can be figured with reasonable accuracy, and (3) economic performance takes place with respect to the expense. There are exceptions to the economic performance rule for certain items, including recurring expenses. See section 461(h) and the related regulations for the rules for determining when economic performance takes place.

Long-term contracts (except for certain real property construction contracts) must generally be accounted for using the percentage of completion method described in section 460. See section 460 for general rules on long-term contracts.

**Mark-to-market accounting method for dealers in securities.**— Dealers in securities must use the mark-to-market accounting method described in section 475. Under this method, any security that is inventory to the dealer must be included in inventory at its fair market value. Any security held by a dealer that is not inventory and that is held at the close of the tax year is treated as sold at its fair market value on the last business day of the tax year. Any gain or loss must be taken into account in determining gross income. The gain or loss taken into account is generally treated as ordinary gain or loss. For details, including exceptions, see section 475, the related temporary regulations, and Rev. Rul. 94-7, 1994-1 C.B. 151.

**Change in accounting method.**— Generally, the corporation may change the method of accounting used to report taxable income (for income as a whole or for any material item) only by getting consent on **Form 3115**, Application for Change in Accounting Method. For more information, get **Pub. 538**, Accounting Periods and Methods.

## Accounting Periods

A corporation must figure its taxable income on the basis of a tax year. The tax year is the annual accounting period the corporation uses to keep its records and report its income and expenses. Generally, corporations can use a calendar year or a fiscal year. Personal service corporations, however, must generally use a calendar year (see the instructions for **Item A** on page 6 for exceptions).

If the calendar year is adopted as the annual accounting period, the corporation must maintain its books and records and report its income and expenses for the period from January 1 through December 31 of each year. A fiscal year is 12 consecutive months ending on the last day of any month except December. A 52-53 week year is a fiscal year that varies from 52 to 53 weeks.

A corporation adopts a tax year when it files its first income tax return. It must adopt a tax year by the due date (not including extensions) of its first income tax return.

For more information, see Temporary Regulations section 1.441-2T and **Pub. 538**, Accounting Periods and Methods.

**Change in accounting period.**— Generally, a corporation must get the consent of the IRS before changing its tax year by filing **Form 1128**, Application To Adopt, Change, or Retain a Tax Year. However, under certain conditions, a corporation (other than a personal service corporation) may change its tax year without getting the consent. See Regulations section 1.442-1 and Pub. 538.

## Rounding Off to Whole Dollars

The corporation may show amounts on the return and accompanying schedules as whole dollars. To do so, drop amounts less than 50 cents and increase amounts from 50 cents through 99 cents to the next higher dollar.

## Recordkeeping

Keep the corporation's records for as long as they may be needed for the administration of any provision of the Internal Revenue Code. Usually, records that support an item of income, deduction, or credit on the return must be kept for 3 years from the date the return is due or filed, whichever is later. Keep records that verify the corporation's basis in property for as long as they are needed to figure the basis of the original or replacement property.

The corporation should keep copies of all filed returns. They help in preparing future returns and amended returns.

## Depository Method of Tax Payment

The corporation must pay the tax due in full no later than the 15th day of the 3rd month after the end of the tax year. Some corporations (described below), are required to electronically deposit all depository taxes, including corporation income tax payments.

**Electronic deposit requirement.**— If the corporation's total deposits of social security, Medicare, and withheld income taxes were more than \$50,000 in 1995, it must make electronic deposits for all depository tax liabilities that occur after June 30, 1997. If the corporation was required to deposit by electronic funds transfer in prior years, continue to do so in 1997. The Electronic Federal Tax Payment System (EFTPS) must be used to make electronic deposits. If the corporation is

required to make deposits by electronic funds transfer and fails to do so, it may be subject to a 10% penalty. Corporations that are not required to make electronic deposits may voluntarily participate in EFTPS. For information on EFTPS, call 1-800-945-8400 or 1-800-555-4477. (These numbers are for EFTPS information only.)

**Form 8109, Federal Tax Deposit Coupon.**— If the corporation does not use EFTPS, deposit corporation income tax payments (and estimated tax payments) with Form 8109. Do not send deposits directly to an IRS office. Mail or deliver the completed Form 8109 with the payment to a qualified depository for Federal taxes or to the Federal Reserve bank (FRB) servicing the corporation's geographic area. Make checks or money orders payable to that depository or FRB. To help ensure proper crediting, write the corporation's EIN, the tax period to which the deposit applies, and "Form 1120" on the check or money order. Be sure to darken the "1120" box on the coupon. Records of these deposits will be sent to the IRS.

A penalty may be imposed if the deposits are mailed or delivered to an IRS office rather than to an authorized depository or FRB. For more information on deposits, see the instructions in the coupon booklet (Form 8109) and **Pub. 583, Starting a Business and Keeping Records.**

**Caution:** *If the corporation owes tax when it files Form 1120 or Form 1120-A, do not include the payment with the tax return. Instead, mail or deliver the payment with Form 8109 to a qualified depository or FRB, or use EFTPS, if applicable.*

## Estimated Tax Payments

Generally, a corporation must make installment payments of estimated tax if it expects its estimated tax (income tax minus credits) to be \$500 or more. The installments are due by the 15th day of the 4th, 6th, 9th, and 12th months of the tax year. If any date falls on a Saturday, Sunday, or legal holiday, the installment is due on the next regular business day. Use **Form 1120-W, Estimated Tax for Corporations**, as a worksheet to compute estimated tax. Use the deposit coupons (Forms 8109) to make deposits of estimated tax. For more information on estimated tax payments, including penalties that apply if the corporation fails to make required payments, see the instructions for line 33 on page 11.

**Overpaid estimated tax.**— If the corporation overpaid estimated tax, it may be able to get a quick refund by filing **Form 4466, Corporation Application for Quick Refund of Overpayment of Estimated Tax.** The overpayment must be at least 10% of the corporation's expected income tax liability and at least \$500. To apply for a quick refund, file Form 4466 before the 16th day of the 3rd month after the end of the tax year, but before the corporation files its income tax return. Do not file Form 4466 before the end of the corporation's tax year.

## Interest and Penalties

**Interest.**— Interest is charged on taxes paid late even if an extension of time to file is granted. Interest is also charged on penalties imposed for failure to file, negligence, fraud, gross valuation overstatements, and substantial understatements of tax from the due date (including extensions) to the date of payment. The interest charge is figured at a rate determined under section 6621.

**Penalty for late filing of return.**— A corporation that does not file its tax return by the due date, including extensions, may be

penalized 5% of the unpaid tax for each month or part of a month the return is late, up to a maximum of 25% of the unpaid tax. The minimum penalty for a return that is over 60 days late is the smaller of the tax due or \$100. The penalty will not be imposed if the corporation can show that the failure to file on time was due to reasonable cause. Corporations that file late must attach a statement explaining the reasonable cause.

**Penalty for late payment of tax.**— A corporation that does not pay the tax when due may be penalized 1/2 of 1% of the unpaid tax for each month or part of a month the tax is not paid, up to a maximum of 25% of the unpaid tax. The penalty will not be imposed if the corporation can show that the failure to pay on time was due to reasonable cause.

**Trust fund recovery penalty.**— This penalty may apply if certain excise, income, social security, and Medicare taxes that must be collected or withheld are not collected or withheld, or these taxes are not paid to the IRS. These taxes are generally reported on Forms 720, 941, 943, or 945 (see **Other Forms, Returns, and Statements That May Be Required**, below). The trust fund recovery penalty may be imposed on all persons who are determined by the IRS to have been responsible for collecting, accounting for, and paying over these taxes, and who acted willfully in not doing so. The penalty is equal to the unpaid trust fund tax. See the instructions for Form 720, **Pub. 15** (Circular E), Employer's Tax Guide, or **Pub. 51** (Circular A), Agricultural Employer's Tax Guide, for details, including the definition of responsible persons.

**Other penalties.**— Other penalties can be imposed for negligence, substantial understatement of tax, and fraud. See sections 6662 and 6663.

## Other Forms, Returns, and Statements That May Be Required

### Forms

The corporation may have to file some of the following forms. See the form for more information.

**Form W-2, Wage and Tax Statement**, and **Form W-3, Transmittal of Wage and Tax Statements.**

**Form 720, Quarterly Federal Excise Tax Return.** Use Form 720 to report the luxury tax on passenger vehicles, environmental excise taxes, communications and air transportation taxes, fuel taxes, manufacturers taxes, ship passenger tax, and certain other excise taxes. Also see **Trust fund recovery penalty** above.

**Form 926, Return by a U.S. Transferor of Property to a Foreign Corporation, Foreign Estate or Trust, or Foreign Partnership.** Use this form to report transfers of property to a foreign corporation, foreign estate or trust, or foreign partnership, to pay any excise tax due under section 1491, and to report information required under section 6038B. For details, see Form 926.

**Form 940 or Form 940-EZ, Employer's Annual Federal Unemployment (FUTA) Tax Return.** The corporation may be liable for FUTA tax and may have to file Form 940 or 940-EZ if it paid wages of \$1,500 or more in any calendar quarter during the calendar year (or the preceding calendar year) or one or more employees worked for the corporation for some part of a day in any 20 different weeks during the calendar year (or the preceding calendar year).

**Form 941, Employer's Quarterly Federal Tax Return.** Employers must file this form quarterly to report payroll income tax withheld and employer and employee social security and Medicare taxes. Agricultural employers must file **Form 943, Employer's Annual Tax Return for Agricultural Employees**, instead of Form 941. Also see **Trust fund recovery penalty** above.

**Form 945, Annual Return of Withheld Federal Income Tax.** File Form 945 to report income tax withholding from nonpayroll distributions or payments, such as pensions, annuities, IRAs, military retirement, gambling winnings, Indian gaming profits, and backup withholding. Also see **Trust fund recovery penalty** above.

**Form 952, Consent To Extend Period of Limitation on Assessment of Income Taxes**, is used to extend the period of assessment of all income taxes of the receiving corporation on the complete liquidation of a subsidiary under section 332. File Form 952 if the liquidation will be completed within the 3-year period following the end of the subsidiary's tax year in which the first distribution was made.

**Form 966, Corporate Dissolution or Liquidation.**

**Form 1042, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons**, and **Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding.** Use these forms to report and send withheld tax on certain payments or distributions made to nonresident alien individuals, foreign partnerships, or foreign corporations. For more information, see sections 1441 and 1442, and **Pub. 515, Withholding of Tax on Nonresident Aliens and Foreign Corporations.**

**Form 1096, Annual Summary and Transmittal of U.S. Information Returns.**

**Form 1098, Mortgage Interest Statement.** This form is used to report the receipt from any individual of \$600 or more of mortgage interest and points in the course of the corporation's trade or business for any calendar year.

**Forms 1099-A, B, C, DIV, INT, MISC, OID, PATR, R, and S.** Use these information returns to report abandonments; acquisitions through foreclosure; proceeds from broker and barter exchange transactions; discharges of indebtedness; certain dividends and distributions; interest payments; payments for certain fishing boat crew members; medical and dental health care payments; direct sales of consumer goods for resale; miscellaneous income payments and nonemployee compensation; original issue discount; patronage dividends; distributions from profit-sharing plans, retirement plans, individual retirement arrangements, insurance contracts, etc.; and proceeds from real estate transactions. Also use these returns to report amounts received as a nominee for another person.

For more information, see the Instructions for Forms 1099, 1098, 5498, and W-2G.

**Note:** *Every corporation must file Form 1099-MISC if, in the course of its trade or business, it makes payments of rents, commissions, or other fixed or determinable income (see section 6041) totaling \$600 or more to any one person during the calendar year.*

**Form 2553, Election by a Small Business Corporation.** Corporations use this form to elect to be an S corporation.

**Form 5452, Corporate Report of Nondividend Distributions.**

**Form 5471, Information Return of U.S. Persons With Respect to Certain Foreign Corporations.** The corporation may have to file Form 5471 if any of the following applies:

- It controls a foreign corporation.

● It acquires, disposes of, or owns 5% or more in value of the outstanding stock of a foreign corporation.

● It owns stock in a corporation that is a controlled foreign corporation for an uninterrupted period of 30 days or more during any tax year of the foreign corporation, and it owned that stock on the last day of that year.

**Form 5472**, Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business. A domestic corporation that is 25% or more foreign-owned may have to file this form. See the instructions for question 10 on page 16.

**Form 5498**, Individual Retirement Arrangement Information. Use this form to report contributions (including rollover contributions) to an individual retirement arrangement (IRA) and the value of an IRA or simplified employee pension (SEP) account.

**Form 5713**, International Boycott Report. Corporations that have operations in, or related to, a "boycotting" country, company, or national of a country, must file Form 5713 to report those operations and to figure the loss of certain tax benefits.

**Form 8264**, Application for Registration of a Tax Shelter. Tax shelter organizers are required to file Form 8264 to get a tax shelter registration number from the IRS.

**Form 8271**, Investor Reporting of Tax Shelter Registration Number. Taxpayers who have acquired an interest in a tax shelter that is required to be registered use this form to report the tax shelter's registration number. Form 8271 must be attached to any tax return (including an application for tentative refund (Form 1139) and an amended return (Form 1120X)) on which a deduction, credit, loss, or other tax benefit attributable to a tax shelter is taken or any income attributable to a tax shelter is reported.

**Form 8275**, Disclosure Statement. Taxpayers and income tax return preparers file Form 8275 to disclose items or positions (except those contrary to a regulation—see **Form 8275-R** below) that are not otherwise adequately disclosed on a tax return. The disclosure is made to avoid parts of the accuracy-related penalty imposed for disregard of rules or substantial understatement of tax. Form 8275 is also used for disclosures relating to preparer penalties for understatements due to unrealistic positions or disregard of rules.

**Form 8275-R**, Regulation Disclosure Statement, is used to disclose any item on a tax return for which a position has been taken that is contrary to Treasury regulations.

**Form 8281**, Information Return for Publicly Offered Original Issue Discount Instruments. Issuers of public offerings of debt instruments generally must file this form within 30 days of the issuance of the debt instrument.

**Form 8300**, Report of Cash Payments Over \$10,000 Received in a Trade or Business. File this form to report the receipt of more than \$10,000 in cash or foreign currency in one transaction or in a series of related transactions.

**Form 8594**, Asset Acquisition Statement Under Section 1060, must be filed by both the purchaser and seller of a group of assets constituting a trade or business if section 197 intangibles attach to such assets and if the purchaser's basis in the assets is determined only by the amount paid for the assets.

**Form 8621**, Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund. A corporation that was a shareholder in a passive foreign investment company (as defined in section 1296) at any

time during the tax year must complete and attach this form to its return.

**Form 8697**, Interest Computation Under the Look-Back Method for Completed Long-Term Contracts. Use this form to figure the interest due or to be refunded under the look-back method of section 460(b)(2) on certain long-term contracts accounted for under either the percentage of completion-capitalized cost method or the percentage of completion method.

**Form 8810**, Corporate Passive Activity Loss and Credit Limitations. Closely held corporations and personal service corporations that are subject to the passive activity limitations of section 469 use this form to compute their allowable passive activity loss and credit.

**Form 8817**, Allocation of Patronage and Nonpatronage Income and Deductions. Taxable cooperatives with gross receipts of \$10 million or more that have both patronage and nonpatronage source income and deductions must complete and attach this form to the return.

**Form 8842**, Election To Use Different Annualization Periods for Corporate Estimated Tax. Corporations use Form 8842 for each year they want to elect one of the annualization periods in section 6655(e)(2)(C) for figuring estimated tax payments under the annualized income installment method.

**Form 8849**, Claim for Refund of Excise Taxes. Use this form in the first three quarters of the tax year to claim a refund of excise taxes paid on Form 720, Form 730, or Form 2290. See the instructions to Form 8849 and **Pub. 378**, Fuel Tax Credits and Refunds, for more information.

## Consolidated Return

The parent corporation of an affiliated group of corporations must attach **Form 851**, Affiliations Schedule, to the consolidated return. For the first year a consolidated return is filed, each subsidiary must attach **Form 1122**, Authorization and Consent of Subsidiary Corporation to be Included in a Consolidated Income Tax Return.

File supporting statements for each corporation included in the consolidated return. Do not use Form 1120 as a supporting statement. On the supporting statement, use columns to show the following, both before and after adjustments:

- Items of gross income and deductions.
- A computation of taxable income.
- Balance sheets as of the beginning and end of the tax year.
- A reconciliation of income per books with income per return.
- A reconciliation of retained earnings.

Enter the totals for the consolidated group on Form 1120. Attach consolidated balance sheets and a reconciliation of consolidated retained earnings. For more information on consolidated returns, see the regulations under section 1502.

## Farm Return

Do not file **Schedule F (Form 1040)**, Profit or Loss From Farming. Instead, enter income on lines 1a through 10, and read the related instructions. Forms 1120 and 1120-A have entry lines for many of the expenses deducted by farming corporations. Expenses not listed on the form should be entered on the line for "Other deductions." Attach a schedule, listing by type and amount, all deductions shown on this line. Also, see the instructions for lines 12 through 26, Form 1120 (lines 12 through 22, Form 1120-A).

## Amended Return

Use **Form 1120X**, Amended U.S. Corporation Income Tax Return, to correct any error in a previously filed Form 1120 or Form 1120-A.

## Statements

**Stock ownership in foreign corporations.**— Attach the statement required by section 551(c) if (a) the corporation owned 5% or more in value of the outstanding stock of a foreign personal holding company and (b) the corporation was required to include in its gross income any undistributed foreign personal holding company income from a foreign personal holding company.

**Transfers to a corporation controlled by the transferor.**— If a person receives stock of a corporation in exchange for property, and no gain or loss is recognized under section 351, the person (transferor) and the transferee must each attach to their tax returns the information required by Regulations section 1.351-3.

**Dual consolidated losses.**— If a domestic corporation incurs a dual consolidated loss (as defined in Regulations section 1.1503-2(c)(5)), the corporation (or consolidated group) may need to attach an elective relief agreement and/or an annual certification as provided in Regulations section 1.1503-2(g)(2).

## Attachments

Attach **Form 4136**, Credit for Federal Tax Paid on Fuels, after page 4, Form 1120, or page 2, Form 1120-A. Attach schedules in alphabetical order and other forms in numerical order after Form 4136.

Complete every applicable entry space on Form 1120 or Form 1120-A. Do not write "See attached" instead of completing the entry spaces. If you need more space on the forms or schedules, attach separate sheets, using the same size and format as the printed forms. Show the totals on the printed forms. Attach these separate sheets after all the schedules and forms. Be sure to put the corporation's name and EIN on each sheet.

## Specific Instructions

### Period Covered

File the 1996 return for calendar year 1996 and fiscal years that begin in 1996 and end in 1997. For a fiscal year, fill in the tax year space at the top of the form.

**Note:** *The 1996 Form 1120 may also be used if (1) the corporation has a tax year of less than 12 months that begins and ends in 1997 and (2) the 1997 Form 1120 is not available at the time the corporation is required to file its return. However, the corporation must show its 1997 tax year on the 1996 Form 1120 and incorporate any tax law changes that are effective for tax years beginning after December 31, 1996.*

### Name, Address, and Employer Identification Number (EIN)

Use the label on the postcard or package that was mailed to the corporation. Cross out any errors and print the correct information on the label. If the corporation doesn't have a label, print or type the corporation's true name (as set forth in the charter or other legal document creating it), address, and EIN on the appropriate lines.

**Address.**— Include the suite, room, or other unit number after the street address. If a preaddressed label is used, include this information on the label.

If the Post Office does not deliver mail to the street address and the corporation has a P.O. box, show the box number instead of the street address.

**Note:** *If a change in address occurs after the return is filed, use Form 8822, Change of Address, to notify the IRS of the new address.*

**Employer identification number (EIN).**— Show the correct EIN in item B on page 1 of Form 1120 or Form 1120-A. If the corporation does not have an EIN, it should apply for one on **Form SS-4**, Application for Employer Identification Number. Form SS-4 can be obtained at Social Security Administration (SSA) offices, or by calling 1-800-TAX-FORM. If the corporation has not received its EIN by the time the return is due, write "Applied for" in the space for the EIN. See Pub. 583 for details.

## Item A—Personal Service Corporation

A personal service corporation is a corporation whose principal activity for the testing period (defined below) for the tax year is the performance of personal services. The services must be substantially performed by employee-owners. Employee-owners must own more than 10% of the fair market value of the corporation's outstanding stock on the last day of the testing period.

**Testing period.**— Generally, the testing period for a tax year is the prior tax year. The testing period for a new corporation starts with the first day of its first tax year and ends on the earlier of:

- The last day of its first tax year, or
- The last day of the calendar year in which the first tax year began.

**Principal activity.**— The principal activity of a corporation is considered to be the performance of personal services if, during the testing period, the corporation's compensation costs for the performance of personal services (defined below), are more than 50% of its total compensation costs.

**Performance of personal services.**— Personal services are those performed in the health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting fields (as defined in Temporary Regulations section 1.448-1T(e)). The term "performance of personal services" includes any activity involving the performance of personal services in these fields.

**Substantial performance by employee-owners.**— Personal services are substantially performed by employee-owners if, for the testing period, more than 20% of the corporation's compensation costs for the performance of personal services are for services performed by employee-owners.

**Employee-owner.**— A person is considered to be an employee-owner if the person is an employee of the corporation on any day of the testing period, and owns any outstanding stock of the corporation on any day of the testing period. Stock ownership is determined under the attribution rules of section 318, except that "any" is substituted for "50%" in section 318(a)(2)(C).

**Accounting period.**— A personal service corporation must use a calendar tax year unless:

- It can establish a business purpose for a different tax year (see Rev. Proc. 87-32,

1987-2 C.B. 396, and Rev. Rul. 87-57, 1987-2 C.B. 117), or

- It elects under section 444 to have a tax year other than a calendar year. To make the election, get **Form 8716**, Election To Have a Tax Year Other Than a Required Tax Year.

Personal service corporations that want to change their tax year must also file Form 1128.

If a corporation makes the section 444 election, its deduction for certain amounts paid to employee-owners may be limited. Get **Schedule H (Form 1120)**, Section 280H Limitations for a Personal Service Corporation (PSC), to figure the maximum deduction.

If a section 444 election is terminated and the termination results in a short tax year, type or print at the top of the first page of Form 1120 or 1120-A for the short tax year "SECTION 444 ELECTION TERMINATED." See Temporary Regulations section 1.444-1T(a)(5) for more information.

For more information about personal service corporations, see Temporary Regulations section 1.441-4T.

**Other rules.**— For other rules that apply to personal service corporations, see **Passive activity limitations** on page 7 and **Contributions of property other than cash** on page 8.

## Item D—Total Assets

Enter the corporation's total assets (as determined by the accounting method regularly used in keeping the corporation's books and records) at the end of the tax year. If there are no assets at the end of the tax year, enter the total assets as of the beginning of the tax year.

## Item E—Initial Return, Final Return, or Change of Address

If this is the corporation's first return, check the "Initial return" box. If the corporation ceases to exist, file Form 1120 and check the "Final return" box. Do not file Form 1120-A.

If the corporation has changed its address since it last filed a return, check the box for "Change of address."

## Income

**Note:** *Generally, income from all sources, whether U.S. or foreign, must be included.*

### Line 1

#### Gross Receipts

Enter gross receipts or sales from all business operations except those that must be reported on lines 4 through 10. For reporting advance payments, see Regulations section 1.451-5. To report income from long-term contracts, see section 460.

**Installment sales.**— Generally, the installment method cannot be used for dealer dispositions of property. A "dealer disposition" means any disposition of personal property by a person who regularly sells or otherwise disposes of property of the same type on the installment plan. The disposition of property used or produced in the farming business is not included as a dealer disposition. See section 453(l) for details and exceptions.

Enter on line 1 (and carry to line 3), the gross profit on collections from installment sales for any of the following:

- Dealer dispositions of property before March 1, 1986.

- Dispositions of property used or produced in the trade or business of farming.

- Certain dispositions of timeshares and residential lots reported under the installment method.

Attach a schedule showing the following information for the current and the 3 preceding years: **(a)** gross sales, **(b)** cost of goods sold, **(c)** gross profits, **(d)** percentage of gross profits to gross sales, **(e)** amount collected, and **(f)** gross profit on the amount collected.

For sales of timeshares and residential lots reported under the installment method, the corporation's income tax is increased by the interest payable under section 453(l)(3). To report this addition to the tax, see the instructions for line 10, Schedule J, Form 1120.

Accrual method taxpayers need not accrue certain amounts to be received from the performance of services that, on the basis of their experience, will not be collected (section 448(d)(5)). This provision does not apply to any amount if interest is required to be paid on the amount or if there is any penalty for failure to timely pay the amount. Corporations that fall under this provision should attach a schedule showing total gross receipts, the amount not accrued as a result of the application of section 448(d)(5), and the net amount accrued. Enter the net amount on line 1a. For more information and guidelines on this "non-accrual experience method," see Temporary Regulations section 1.448-2T.

### Line 2

#### Cost of Goods Sold

Enter the cost of goods sold on line 2, page 1. Before making this entry, a Form 1120 filer must complete Schedule A on page 2 of Form 1120. Form 1120-A filers may use the worksheet on page 11 to figure the amount to enter on line 2. All filers should see the instructions for Schedule A and the worksheet.

### Line 4

#### Dividends

**Form 1120 filers.**— See the instructions for Schedule C. Then, complete Schedule C and enter on line 4 the amount from Schedule C, line 19.

**Form 1120-A filers.**— Enter the total dividends received (that are not from debt-financed stock) from domestic corporations that qualify for the 70% dividends-received deduction.

### Line 5

#### Interest

Enter taxable interest on U.S. obligations and on loans, notes, mortgages, bonds, bank deposits, corporate bonds, tax refunds, etc.

Do not offset interest expense against interest income.

Special rules apply to interest income from certain below-market-rate loans. See section 7872 for more information.

### Line 6

#### Gross Rents

Enter the gross amount received for the rent of property. Deduct expenses such as repairs, interest, taxes, and depreciation on the proper lines for deductions. A rental activity held by a closely held corporation or a personal service corporation may be subject to the passive activity loss rules. See Form 8810 and its instructions.

## Line 8

### Capital Gain Net Income

Every sale or exchange of a capital asset must be reported in detail on **Schedule D (Form 1120)**, Capital Gains and Losses, even though no gain or loss is indicated.

## Line 9

### Net Gain or (Loss)

Enter the net gain or (loss) from line 20, Part II, **Form 4797**, Sales of Business Property.

## Line 10

### Other Income

Enter any other taxable income not reported on lines 1 through 9. List the type and amount of income on an attached schedule. If the corporation has only one item of other income, describe it in parentheses on line 10. Examples of other income to report on line 10 are:

- Any adjustment under section 481(a) required to be included in income during the current tax year due to a change in a method of accounting.
- Recoveries of bad debts deducted in prior years under the specific charge-off method.
- The amount of credit for alcohol used as fuel (determined without regard to the limitation based on tax) entered on **Form 6478**, Credit for Alcohol Used as Fuel.
- Refunds of taxes deducted in prior years to the extent they reduced income subject to tax in the year deducted (see section 111). Do not offset current year taxes against tax refunds.
- The amount of any deduction previously taken under section 179A that is subject to recapture. The corporation must recapture the benefit of any allowable deduction for clean-fuel vehicle property (or clean-fuel vehicle refueling property), if the property later ceases to qualify. See Regulations section 1.179A-1 for details.
- Ordinary income from trade or business activities of a partnership (from Schedule K-1 (Form 1065), line 1).

## Deductions

### Limitations on Deductions

#### Section 263A uniform capitalization rules.—

These rules require corporations to capitalize or include in inventory certain costs incurred in connection with the production of real and tangible personal property held in inventory or held for sale in the ordinary course of business. Tangible personal property produced by a corporation includes a film, sound recording, videotape, book, or similar property. The rules also apply to personal property (tangible and intangible) acquired for resale. Corporations subject to the rules are required to capitalize not only direct costs but an allocable portion of most indirect costs (including taxes) that relate to the assets produced or acquired for resale. Interest expense paid or incurred during the production period of certain property must be capitalized and is governed by special rules. For more information, see Regulations sections 1.263A-8 through 1.263A-15. The uniform capitalization rules also apply to the production of property constructed or improved by a taxpayer for use in its trade or business or in an activity engaged in for profit.

Section 263A does not apply to personal property acquired for resale if the taxpayer's annual average gross receipts for the 3 prior tax years are \$10 million or less. It does not apply to timber or to most property produced

under a long-term contract. Special rules apply for farmers. The rules do not apply to property that is produced for use by the corporation if substantial construction occurred before March 1, 1986.

In the case of inventory, some of the indirect costs that must be capitalized are administration expenses; taxes; depreciation; insurance; compensation paid to officers attributable to services; rework labor; and contributions to pension, stock bonus, and certain profit-sharing, annuity, or deferred compensation plans.

The costs that must be capitalized under section 263A are not deductible until the property to which the costs relate is sold, used, or otherwise disposed of by the corporation.

Current deductions may still be claimed for reasonable research and experimental costs under section 174, intangible drilling costs for oil and gas and geothermal property, and mining and exploration and development costs. Regulations section 1.263A-1(e)(3) specifies other indirect costs that may be currently deducted and those that must be capitalized with respect to production or resale activities. For more information, see Regulations sections 1.263A-1 through 1.263A-3.

**Transactions between related taxpayers.—**Generally, an accrual basis taxpayer may only deduct business expenses and interest owed to a related party in the year the payment is included in the income of the related party. See sections 163(e)(3), 163(j), and 267 for limitations on deductions for unpaid interest and expenses.

**Section 291 limitations.—**Corporations may be required to adjust deductions for depletion of iron ore and coal, intangible drilling and exploration and development costs, certain deductions for financial institutions, and the amortizable basis of pollution control facilities. See section 291 to determine the amount of adjustment. Also see section 43.

**Golden parachute payments.—**A portion of the payments made by a corporation to key personnel that exceeds their usual compensation may not be deductible. This occurs when the corporation has an agreement (golden parachute) with these key employees to pay them these excessive amounts if control of the corporation changes. See section 280G.

**Business startup expenses.—**Business startup expenses must be capitalized unless an election is made to amortize them over a period of 60 months. See section 195.

**Passive activity limitations.—**Limitations on passive activity losses and credits under section 469 apply to personal service corporations as defined in Temporary Regulations section 1.441-4T (see **Item A—Personal Service Corporation** on page 6) and closely held corporations.

For this purpose, a corporation is a closely held corporation if at any time during the last half of the tax year more than 50% in value of its outstanding stock is owned, directly or indirectly, by or for not more than five individuals, and the corporation is not a personal service corporation. Certain organizations are treated as individuals for purposes of this test. (See section 542(a)(2).) For rules of determining stock ownership, see section 544 (as modified by section 465(a)(3)).

Generally, there are two kinds of passive activities: trade or business activities in which the corporation did not materially participate (see Temporary Regulations section 1.469-1T(g)(3)) for the tax year, and rental activities regardless of its participation. For exceptions, see Form 8810. An activity is a trade or business activity if the activity involves the conduct of a trade or business (i.e.,

deductions from the activity would be allowable under section 162 if other limitations, such as the passive loss rules, did not apply), or the activity involves research and experimental costs that are deductible under section 174 (or would be deductible if the corporation chose to deduct rather than capitalize them), and the activity is not a rental activity.

Corporations subject to the passive activity limitations must complete Form 8810 to compute their allowable passive activity loss and credit. Before completing Form 8810, see Temporary Regulations section 1.163-8T, which provides rules for allocating interest expense among activities. If a passive activity is also subject to the earnings stripping rules of section 163(j) or the at-risk rules of section 465, those rules apply before the passive loss rules. For more information, see section 469, the related regulations, and **Pub. 925**, Passive Activity and At-Risk Rules.

**Reducing certain expenses for which credits are allowable.—**For each credit listed below, the corporation must reduce the otherwise allowable deductions for expenses used to figure the credit by the amount of the current year credit:

1. The work opportunity credit.
2. The research credit.
3. The enhanced oil recovery credit.
4. The disabled access credit.
5. The empowerment zone employment credit.
6. The Indian employment credit.
7. The employer credit for social security and Medicare taxes paid on certain employee tips.
8. The orphan drug credit.

If the corporation has any of these credits, be sure to figure each current year credit before figuring the deduction for expenses on which the credit is based.

## Line 12

### Compensation of Officers

Enter deductible officers' compensation on line 12. Form 1120 filers must complete Schedule E if their total receipts (line 1a, plus lines 4 through 10) are \$500,000 or more. Do not include compensation deductible elsewhere on the return, such as amounts included in cost of goods sold, elective contributions to a section 401(k) cash or deferred arrangement, or amounts contributed under a salary reduction SEP agreement or a SIMPLE retirement plan (savings incentive match plan).

Include only the deductible part of officers' compensation on Schedule E. (See **Disallowance of deduction for employee compensation in excess of \$1 million**, below.) Complete Schedule E, line 1, columns (a) through (f), for all officers. The corporation determines who is an officer under the laws of the state where incorporated.

If a consolidated return is filed, each member of an affiliated group must furnish this information.

#### Disallowance of deduction for employee compensation in excess of \$1 million.—

Publicly held corporations may not deduct compensation to a "covered employee" to the extent that the compensation exceeds \$1 million. Generally, a covered employee is:

- The chief executive officer of the corporation (or an individual acting in that capacity) as of the end of the tax year, or
- An employee whose total compensation must be reported to shareholders under the Securities Exchange Act of 1934 because the employee is among the four highest compensated officers for that tax year (other than the chief executive officer).

For this purpose, compensation does not include the following:

- Income from certain employee trusts, annuity plans, or pensions;
- Any benefit paid to an employee that is excluded from the employee's income.

The deduction limit does not apply to:

- Commissions based on individual performance;
- Qualified performance-based compensation; and,
- Income payable under a written, binding contract in effect on February 17, 1993.

The \$1 million limit is reduced by amounts disallowed as excess parachute payments under section 280G.

For details, see section 162(m) and Regulations section 1.162-27.

## Line 13

### Salaries and Wages

Enter the amount of salaries and wages paid for the tax year, less the amount of any work opportunity credit from Form 5884, empowerment zone employment credit from Form 8844, and Indian employment credit from Form 8845. See the instructions for these forms for more information. Do not include salaries and wages deductible elsewhere on the return, such as amounts included in cost of goods sold, elective contributions to a section 401(k) cash or deferred arrangement, or amounts contributed under a salary reduction SEP agreement or a SIMPLE retirement plan (savings incentive match plan).

**Caution:** If the corporation provided taxable fringe benefits to its employees, such as personal use of a car, do not deduct as wages the amount allocated for depreciation and other expenses claimed on lines 20 and 26, Form 1120, or lines 20 and 22, Form 1120-A.

## Line 14

### Repairs and Maintenance

Enter the cost of incidental repairs and maintenance not claimed elsewhere on the return, such as labor and supplies, that do not add to the value of the property or appreciably prolong its life. New buildings, machinery, or permanent improvements that increase the value of the property are not deductible. They must be depreciated or amortized.

## Line 15

### Bad Debts

Enter the total debts that became worthless in whole or in part during the tax year. A small bank or thrift institution using the reserve method of section 585 should attach a schedule showing how it arrived at the current year's provision.

**Caution:** A cash basis taxpayer may not claim a bad debt deduction unless the amount was previously included in income.

## Line 16

### Rents

If the corporation rented or leased a vehicle, enter the total annual rent or lease expense paid or incurred during the year. Also complete Part V of **Form 4562**, Depreciation and Amortization. If the corporation leased a vehicle for a term of 30 days or more, the deduction for vehicle lease expense may have to be reduced by an amount called the **inclusion amount**. The corporation may have an inclusion amount if:

**And the vehicle's fair market value on the first**

**The lease term began: day of the lease exceeded:**

After 12/31/94 .....	\$15,500
After 12/31/93 but before 1/1/95 .....	\$14,600
After 12/31/92 but before 1/1/94 .....	\$14,300
After 12/31/91 but before 1/1/93 .....	\$13,700

If the lease term began before January 1, 1992, get **Pub. 463**, Travel, Entertainment, Gift, and Car Expenses, to find out if the corporation has an inclusion amount. Also see Pub. 463 for instructions on figuring the inclusion amount.

## Line 17

### Taxes and Licenses

Enter taxes paid or accrued during the tax year, but do not include the following:

- Federal income taxes.
- Foreign or U.S. possession income taxes if a tax credit is claimed (however, see the Instructions for Form 5735 for special rules for possession income taxes).
- Taxes not imposed on the corporation.
- Taxes, including state or local sales taxes, that are paid or incurred in connection with an acquisition or disposition of property (these taxes must be treated as a part of the cost of the acquired property or, in the case of a disposition, as a reduction in the amount realized on the disposition).
- Taxes assessed against local benefits that increase the value of the property assessed (such as for paving, etc.).
- Taxes deducted elsewhere on the return, such as those reflected in cost of goods sold.

See section 164(d) for apportionment of taxes on real property between seller and purchaser.

## Line 18

### Interest

If the proceeds of a loan were used for more than one purpose (e.g., to purchase a portfolio investment and to acquire an interest in a passive activity), an interest allocation must be made. See Temporary Regulations section 1.163-8T for the interest allocation rules.

Do not include interest on indebtedness incurred or continued to purchase or carry obligations if the interest is wholly exempt from income tax. For exceptions, see section 265(b).

Mutual savings banks, building and loan associations, and cooperative banks can deduct the amounts paid or credited to the accounts of depositors as dividends, interest, or earnings. See section 591.

Generally, a cash basis taxpayer cannot deduct prepaid interest allocable to years following the current tax year. For example, a cash basis calendar year taxpayer who in 1996 prepaid interest allocable to any period after 1996 can deduct only the amount allocable to 1996.

Generally, the interest and carrying charges on straddles cannot be deducted and must be capitalized. See section 263(g).

See section 163(e)(5) for special rules for the disqualified portion of original issue discount on a high yield discount obligation.

The deduction for certain interest paid or accrued by the corporation may be limited if no tax is imposed on that interest. See section 163(j) for more information.

Do not deduct interest on debt allocable to the production of qualified property. Interest that is allocable to property produced by a corporation for its own use or for sale must be capitalized. A corporation must also capitalize any interest on debt allocable to an asset used to produce the above property. See section

263A and Regulations section 1.263A-8 through 1.263A-15 for definitions and more information.

See section 7872 for special rules on the deductibility of forgone interest on certain below-market-rate loans.

## Line 19

### Charitable Contributions

Enter contributions or gifts actually paid within the tax year to or for the use of charitable and governmental organizations described in section 170(c) and any unused contributions carried over from prior years.

The total amount claimed may not be more than 10% of taxable income (line 30, Form 1120, or line 26, Form 1120-A) computed without regard to the following:

- Any deduction for contributions,
- The special deductions on line 29b, Form 1120 (line 25b, Form 1120-A),
- The deduction allowed under section 249,
- Any net operating loss (NOL) carryback to the tax year under section 172, and
- Any capital loss carryback to the tax year under section 1212(a)(1).

Charitable contributions over the 10% limitation may not be deducted for the tax year but may be carried over to the next 5 tax years.

Special rules apply if the corporation has an NOL carryover to the tax year. In figuring the charitable contributions deduction for the tax year, the 10% limit is applied using the taxable income after taking into account any deduction for the NOL.

To figure the amount of any remaining NOL carryover to later years, taxable income must be modified (see section 172(b)). To the extent that contributions are used to reduce taxable income for this purpose and increase an NOL carryover, a contributions carryover is not allowed. See section 170(d)(2)(B).

Corporations on the accrual basis may elect to deduct contributions paid by the 15th day of the 3rd month after the end of the tax year if the contributions are authorized by the board of directors during the tax year. Attach a declaration to the return, signed by an officer, stating that the resolution authorizing the contributions was adopted by the board of directors during the tax year. Also attach a copy of the resolution.

**Substantiation requirements.**— Generally, no deduction is allowed for any contribution of \$250 or more unless the corporation gets a written acknowledgment from the donee organization that shows the amount of cash contributed, describes any property contributed, and gives an estimate of the value of any goods or services provided in return for the contribution. The acknowledgment must be obtained by the due date (including extensions) of the corporation's return, or, if earlier, the date the return is filed. Do not attach the acknowledgment to the tax return, but keep it with the corporation's records. These rules apply in addition to the filing requirements for Form 8283 described below.

For more information on substantiation and recordkeeping requirements, see the regulations under section 170 and **Pub. 526**, Charitable Contributions.

**Contributions of property other than cash.**— If a corporation (other than a closely held or personal service corporation) contributes property other than cash and claims over a \$500 deduction for the property, it must attach a schedule to the return describing the kind of property contributed and the method used to determine its fair market value. Closely held corporations and personal service

corporations must complete **Form 8283**, Noncash Charitable Contributions, and attach it to their returns. All other corporations generally must complete and attach Form 8283 to their returns for contributions of property other than money if the total claimed deduction for all property contributed was more than \$5,000.

If the corporation made a "qualified conservation contribution" under section 170(h), also include the fair market value of the underlying property before and after the donation, as well as the type of legal interest contributed, and describe the conservation purpose benefited by the donation. If a contribution carryover is included, show the amount and how it was determined.

**Special rule for contributions of certain property.**— For a charitable contribution of property, the corporation must reduce the contribution by the sum of:

- The ordinary income, short-term capital gain that would have resulted if the property were sold at its fair market value, and
- For certain contributions, all of the long-term capital gain that would have resulted if the property were sold at its fair market value.

The reduction for the long-term capital gain applies to:

- Contributions of tangible personal property for use by an exempt organization for a purpose or function unrelated to the basis for its exemption, and
- Contributions of any property to or for the use of certain private foundations, except for stock contributed after June 30, 1996, and before June 1, 1997, for which market quotations are readily available (section 170(e)(5)).

For more information, including special rules for contributions of inventory and other property to certain organizations, see section 170(e)(3) and Regulations section 1.170A-4.

**Charitable contributions of scientific property used for research.**— A corporation (other than a personal holding company or a service organization) can receive a larger deduction for contributing scientific property used for research to an institution of higher education. For more details, see section 170(e).

**Contributions to organizations conducting lobbying activities.**— Contributions made to an organization that conducts lobbying activities are not deductible if:

- The lobbying activities relate to matters of direct financial interest to the donor's trade or business, and
- The principal purpose of the contribution was to avoid Federal income tax by obtaining a deduction for activities that would have been nondeductible under the lobbying expense rules if conducted directly by the donor.

## Line 20

### Depreciation

Besides depreciation, include on line 20 the part of the cost that the corporation elected to expense under section 179 for certain tangible property placed in service during tax year 1996 or carried over from 1995. See **Form 4562**, Depreciation and Amortization, and its instructions.

## Line 22 (Form 1120 Only)

### Depletion

See sections 613 and 613A for percentage depletion rates applicable to natural deposits. Also, see section 291 for the limitation on the

depletion deduction for iron ore and coal (including lignite).

Foreign intangible drilling costs and foreign exploration and development costs must either be added to the corporation's basis for cost depletion purposes or be deducted ratably over a 10-year period. See sections 263(i), 616, and 617 for details.

Attach **Form T (Timber)**, Forest Activities Schedules, if a deduction for depletion of timber is taken.

## Line 24 (Form 1120 Only)

### Pension, Profit-Sharing, etc., Plans

Enter the deduction for contributions to qualified pension, profit-sharing, or other funded deferred compensation plans. Employers who maintain such a plan generally must file one of the forms listed below, even if the plan is not a qualified plan under the Internal Revenue Code. The filing requirement applies even if the corporation does not claim a deduction for the current tax year. There are penalties for failure to file these forms on time and for overstating the pension plan deduction. See sections 6652(e) and 6662(f).

**Form 5500.**— File this form for each plan with 100 or more participants.

**Form 5500-C/R.**— File this form for each plan with fewer than 100 participants.

**Form 5500-EZ.**— File this form for a one-participant plan. The term "one-participant plan" also means a plan that covers the owner and his or her spouse, or a plan that covers partners in a business partnership (or the partners and their spouses).

## Line 25 (Form 1120 Only)

### Employee Benefit Programs

Enter contributions to employee benefit programs not claimed elsewhere on the return (e.g., insurance, health and welfare programs, etc.) that are not an incidental part of a pension, profit-sharing, etc., plan included on line 24.

## Line 26, Form 1120 (Line 22, Form 1120-A)

### Other Deductions

**Note:** *Do not deduct fines or penalties paid to a government for violating any law.*

Attach a schedule, listing by type and amount, all allowable deductions that are not deductible elsewhere on Form 1120 or Form 1120-A. Form 1120-A filers should include amounts described in the instructions above for lines 22, 24, and 25 of Form 1120. Enter the total of other deductions on line 26, Form 1120 (line 22, Form 1120-A).

Include on this line the deduction for amortization of pollution control facilities, organization expenses, etc. See Form 4562.

Also include ordinary losses from trade or business activities of a partnership (from Schedule K-1 (Form 1065), line 1).

A corporation may deduct dividends it pays in cash on stock held by an employee stock ownership plan. However, a deduction may only be taken if, according to the plan, the dividends are:

- Paid in cash directly to the plan participants or beneficiaries;
- Paid to the plan, which distributes them in cash to the plan participants or their beneficiaries no later than 90 days after the end of the plan year in which the dividends are paid; or

- Used to make payments on a loan described in section 404(a)(9).

See section 404(k) for more details and the limitation on certain dividends.

Generally, a deduction may not be taken for any amount that is allocable to a class of exempt income. See section 265(b) for exceptions.

### Meals, travel, and entertainment.

Generally, the corporation can deduct only 50% of the amount otherwise allowable for meals and entertainment expenses paid or incurred in its trade or business. Also, meals must not be lavish or extravagant; a bona fide business discussion must occur during, immediately before, or immediately after the meal; and an employee of the corporation must be present at the meal. See section 274(k)(2) for exceptions. If the corporation claims a deduction for unallowable meal expenses, it may have to pay a penalty.

Additional limitations apply to deductions for gifts, skybox rentals, luxury water travel, convention expenses, and entertainment tickets. For details, see section 274 and Pub. 463.

No deduction is allowed for dues paid or incurred for membership in any club organized for business, pleasure, recreation, or other social purpose. This includes country clubs, golf and athletic clubs, airline and hotel clubs, and clubs operated to provide meals under conditions favorable to business discussion. But it does not include civic or public service organizations, professional organizations (such as bar and medical associations), business leagues, trade associations, chambers of commerce, boards of trade, and real estate boards, unless a principal purpose of the organization is to entertain or provide entertainment facilities for members or their guests.

Also, no deduction is allowed for travel expenses paid or incurred for a spouse, dependent, or other individual accompanying an officer or employee of the corporation on business travel, unless that spouse, dependent, or other individual is an employee of the corporation and the travel is for a bona fide business purpose and would otherwise be deductible by that person.

Generally, a corporation can deduct all other ordinary and necessary travel and entertainment expenses paid or incurred in its trade or business. However, it cannot deduct an expense paid or incurred for a facility (such as a yacht or hunting lodge) used for an activity that is usually considered entertainment, amusement, or recreation.

**Note:** *The corporation may be able to deduct otherwise nondeductible meals, travel, and entertainment expenses if the amounts are treated as compensation and reported on Form W-2 for an employee or on Form 1099-MISC for an independent contractor.*

### Deduction for clean-fuel vehicles and certain refueling property.

Section 179A allows a deduction for part of the cost of qualified clean-fuel vehicle property and qualified clean-fuel vehicle refueling property placed in service after June 30, 1993. For more information, see Pub. 535.

**Lobbying expenses.**— Generally, lobbying expenses are not deductible. These expenses include amounts paid or incurred in connection with influencing Federal or state legislation (but not local legislation), or amounts paid or incurred in connection with any communication with certain Federal executive branch officials in an attempt to influence the official actions or positions of the officials. See Regulations section 1.162-29 for the definition of "influencing legislation." If certain in-house

lobbying expenditures do not exceed \$2,000, they are deductible. Dues and other similar amounts paid to certain tax-exempt organizations may not be deductible. See section 162(e)(3). For information on contributions to charitable organizations that conduct lobbying activities, see the instructions for line 19. For more information on lobbying expenses, see section 162(e).

## Line 28, Form 1120 (Line 24, Form 1120-A)

### Taxable Income Before NOL Deduction and Special Deductions

**At-risk rules.**— Generally, special at-risk rules under section 465 apply to closely held corporations (see **Passive activity limitations** on page 7) engaged in any activity as a trade or business or for the production of income. These corporations may have to adjust the amount on line 28, Form 1120, or line 24, Form 1120-A. (See below.)

But the at-risk rules do not apply to:

- Holding real property placed in service by the taxpayer before 1987;
- Equipment leasing under sections 465(c)(4), (5), and (6); or
- Any qualifying business of a qualified corporation under section 465(c)(7).

However, the at-risk rules do apply to the holding of mineral property.

If the at-risk rules apply, adjust the amount on this line for any section 465(d) losses. These losses are limited to the amount for which the corporation is at risk for each separate activity at the close of the tax year. If the corporation is involved in one or more activities, any of which incurs a loss for the year, report the losses for each activity separately. Attach **Form 6198**, At-Risk Limitations, showing the amount at risk and gross income and deductions for the activities with the losses.

If the corporation sells or otherwise disposes of an asset or its interest (either total or partial) in an activity to which the at-risk rules apply, determine the net profit or loss from the activity by combining the gain or loss on the sale or disposition with the profit or loss from the activity. If the corporation has a net loss, it may be limited because of the at-risk rules.

Treat any loss from an activity not allowed for the tax year as a deduction allocable to the activity in the next tax year.

## Line 29a, Form 1120 (Line 25a, Form 1120-A)

### Net Operating Loss Deduction

A corporation may use the net operating loss (NOL) incurred in one tax year to reduce its taxable income in another year. Generally, a corporation may carry an NOL back to each of the 3 years preceding the year of the loss and then carry any remaining amount over to each of the 15 years following the year of the loss (but Form 1120 filers see **Exceptions to carryback rules** below). Enter on line 29a (line 25a, Form 1120-A), the total NOL carryovers from prior tax years, but do not enter more than the corporation's taxable income (after special deductions). An NOL deduction cannot be taken in a year in which the corporation has a negative taxable income. Attach a schedule showing the computation of the NOL deduction.

Form 1120 filers must also complete question 15 on Schedule K.

For details on the NOL deduction, get **Pub. 536**, Net Operating Losses.

**Carryback and carryover rules.**— Generally, an NOL must first be carried back to the third tax year preceding the year of the loss. To carry back the loss and obtain a quick refund of taxes, use **Form 1139**, Corporation Application for Tentative Refund. Form 1139 must be filed within 12 months after the close of the tax year of the loss. See section 6411 for details. Do not attach Form 1139 to the corporation's income tax return. Mail it in a separate envelope to the service center where the corporation files its income tax return.

For carryback claims filed later than 12 months after the close of the tax year of the loss, file **Form 1120X**, Amended U.S. Corporation Income Tax Return, instead of Form 1139.

After the corporation applies the NOL to the first tax year to which it may be carried, the taxable income of that year is modified (as described in section 172(b)) to determine how much of the remaining loss may be carried to other years. See section 172(b) and the related regulations for details.

Special rules apply when an ownership change occurs (i.e., for any tax year ending after a post-1986 ownership change, the amount of the taxable income of a loss corporation that can be offset by pre-change NOL carryovers is limited). See section 382 and the related regulations. Also see Temporary Regulations section 1.382-2T(a)(2)(ii), which requires that a loss corporation file an information statement with its income tax return for each tax year that it is a loss corporation and certain shifts in ownership occurred. Also see Regulations section 1.382-6(b) for details on how to make the closing-of-the-books election.

See section 384 for the limitation on the use of preacquisition losses of one corporation to offset recognized built-in gains of another corporation.

**Note:** See section 383 and the related regulations for limits that apply to net capital losses and credits when an ownership change occurs.

**Exceptions to carryback rules (Form 1120 filers only).**— A corporation may make an irrevocable election to forego the carryback period and instead carry the NOL over to each of the 15 years following the year of the loss. To make this election, check the box in question 14 on Schedule K. The return must be timely filed (including extensions).

Different carryback periods apply for certain losses. The part of an NOL that is attributable to a specified liability loss, including a product liability loss, may be carried back 10 years (section 172(b)(1)(C)). See Regulations section 1.172-13(c) for the statement that must be attached to Form 1120 if the corporation is claiming the 10-year carryback period for a product liability loss.

Special rules apply to the carryback of losses that are attributable to interest paid in connection with corporate equity reduction transactions. The rules apply if a corporation has a corporate equity reduction interest loss in a loss limitation year ending after August 2, 1989. See section 172(b)(1)(E).

Personal service corporations may not carry back an NOL to or from any tax year to which a section 444 election applies.

## Line 29b, Form 1120 (Line 25b, Form 1120-A)

### Special Deductions

**Form 1120 filers.**— See the Instructions for Schedule C.

**Form 1120-A filers.**— Generally, enter 70% of line 4, page 1, on line 25b. However, this deduction may not be more than 70% of line 24, page 1. Compute line 24 without regard to any adjustment under section 1059 and without regard to any capital loss carryback to the tax year under section 1212(a)(1).

In a year in which an NOL occurs, this 70% limitation does not apply even if the loss is created by the dividends-received deduction. See sections 172(d) and 246(b).

## Line 30, Form 1120 (Line 26, Form 1120-A)

### Taxable Income

**Capital construction fund.**— To take a deduction for amounts contributed to a capital construction fund, reduce the amount that would otherwise be entered on line 30 (line 26, Form 1120-A) by the amount of the deduction. On the dotted line next to the entry space, write "CCF" and the amount of the deduction. For more information, get **Pub. 595**, Tax Highlights for Commercial Fishermen.

## Line 32b, Form 1120 (Line 28b, Form 1120-A)

### Estimated Tax Payments

Enter any estimated tax payments the corporation made for the tax year.

**Beneficiaries of trusts.**— If the corporation is the beneficiary of a trust, and the trust makes a section 643(g) election to credit its estimated tax payments to its beneficiaries, include the corporation's share of the payment in the total for line 32b, Form 1120 (line 28b, Form 1120-A). Write "T" and the amount on the dotted line next to the entry space.

**Special estimated tax payments for certain life insurance companies.**— If the corporation is required to make or apply special estimated tax payments (SETP) under section 847 in addition to its regular estimated tax payments, enter on line 32b (line 28b, Form 1120-A), the corporation's total estimated tax payments. On the dotted line next to the entry space, write "SETP" and the amount. Attach a schedule showing your computation of estimated tax payments. See section 847(2) and **Form 8816**, Special Loss Discount Account and Special Estimated Tax Payments for Insurance Companies, for more information.

## Line 32g, Form 1120 (Line 28g, Form 1120-A)

### Credit for Federal Tax on Fuels

Complete **Form 4136**, Credit for Federal Tax Paid on Fuels, if the corporation qualifies to take this credit.

**Credit for ozone-depleting chemicals.**— Include on line 32g (line 28g, Form 1120-A) any credit the corporation is claiming under section 4682(g)(4) for tax on ozone-depleting chemicals. Write "ODC" to the left of the entry space.

**Line 32h, Form 1120  
(Line 28h, Form 1120-A)**

**Total Payments**

On Form 1120, add the amounts on lines 32d through 32g and enter the total on line 32h. On Form 1120-A, add the amounts on lines 28d through 28g and enter the total on line 28h. **Backup withholding.**— If the corporation had income tax withheld from any payments it received, because, for example, it failed to give the payer its correct EIN, include the amount withheld in the total for line 32h, Form 1120 (line 28h, Form 1120-A). This type of withholding is called backup withholding. On Form 1120, show the amount withheld in the blank space in the right-hand column between lines 31 and 32h, and write "backup withholding". On Form 1120-A, show the amount withheld on the dotted line to the left of line 28h, and write "backup withholding".

**Line 33, Form 1120  
(Line 29, Form 1120-A)**

**Estimated Tax Penalty**

A corporation that does not make estimated tax payments when due may be subject to an underpayment penalty for the period of underpayment. Generally, a corporation is subject to the penalty if its tax liability is \$500 or more, and it did not timely pay the smaller of (a) 100% of its tax liability for 1996 or (b) 100% of its prior year's tax. See section 6655 for details and exceptions, including special rules for large corporations.

**Form 2220, Underpayment of Estimated Tax by Corporations,** is used to see if the corporation owes a penalty and to figure the amount of the penalty. Generally, the corporation does not have to file this form because the IRS can figure the amount of any penalty and bill the corporation for it. However, even if the corporation does not owe the penalty you must complete and attach Form 2220 if:

- The annualized income or adjusted seasonal installment method is used, or
- The corporation is a large corporation computing its first required installment based on the prior year's tax. (See the Form 2220 instructions for the definition of a large corporation.)

If you attach Form 2220, check the box on line 33, Form 1120 (line 29, Form 1120-A), and enter the amount of any penalty on this line.

**Schedule A, Form 1120  
(Worksheet, Form 1120-A)**

**Cost of Goods Sold**

Inventories are required at the beginning and end of each tax year if the production, purchase, or sale of merchandise is an income-producing factor. See Regulations section 1.471-1. If inventories are not used, enter zero on lines 1 and 7 of Schedule A, Form 1120, or the worksheet.

All filers should see **Section 263A uniform capitalization rules** on page 7 before completing Schedule A or the worksheet below. The instructions for lines 4 through 7 below apply to Schedule A and the worksheet.

**Cost of Goods Sold Worksheet**

**Form 1120-A**  
(Keep for your records.)

1. Inventory at start of year. Enter here and in Part III, line 3, column (a), Form 1120-A . . . . .	1. _____
2. Purchases. Enter here and in Part II, line 5a(1), Form 1120-A . . . . .	2. _____
3. Cost of labor. Enter here and include in total in Part II, line 5a(3), Form 1120-A . . . . .	3. _____
4. Additional section 263A costs. Enter here and in Part II, line 5a(2), Form 1120-A (see instructions for line 4) . . . . .	4. _____
5. Other costs. Enter here and include in Part II, line 5a(3), Form 1120-A . . . . .	5. _____
6. Total. Add lines 1 through 5 . . . . .	6. _____
7. Inventory at end of year. Enter here and in Part III, line 3, column (b), Form 1120-A . . . . .	7. _____
8. Cost of goods sold. Subtract line 7 from line 6. Enter the result here and on page 1, line 2, Form 1120-A . . . . .	8. _____

**Line 4**

**Additional Section 263A Costs**

An entry is required on this line only for corporations that have elected a simplified method of accounting. For corporations that have elected the simplified production method, additional section 263A costs are generally those costs, other than interest, that were not capitalized under the corporation's method of accounting immediately prior to the effective date of section 263A that are now required to be capitalized under section 263A. For details, see Regulations section 1.263A-2(b).

For corporations that have elected the simplified resale method, additional section 263A costs are generally those costs incurred with respect to the following categories: off-site storage or warehousing; purchasing; handling, processing, assembly, and repackaging; and general and administrative costs (mixed service costs). For details, see Regulations section 1.263A-3(d).

Enter on line 4 the balance of section 263A costs paid or incurred during the tax year not included on lines 2, 3, and 5.

**Line 5**

**Other Costs**

Enter on line 5 any costs paid or incurred during the tax year not entered on lines 2 through 4.

**Line 7**

**Inventory at End of Year**

See Regulations section 1.263A-1 through 1.263A-3 for details on figuring the amount of additional section 263A costs to be included in ending inventory.

**Lines 9a Through 9f (Schedule A)**

**Inventory Valuation Methods**

Inventories can be valued at:

- Cost;
- Cost or market value (whichever is lower); or
- Any other method approved by the IRS that conforms to the requirements of the applicable regulations cited below.

The average cost (rolling average) method of valuing inventories generally does not conform to the requirements of the regulations. See Rev. Rul. 71-234, 1971-1 C.B. 148.

Corporations that use erroneous valuation methods must change to a method permitted for Federal income tax purposes. To make this change, use Form 3115.

On line 9a, check the method(s) used for valuing inventories. Under lower of cost or market, the term "market" (for normal goods) means the current bid price prevailing on the inventory valuation date for the particular merchandise in the volume usually purchased by the taxpayer. For a manufacturer, market applies to the basic elements of cost—raw materials, labor, and burden. If section 263A applies to the taxpayer, the basic elements of cost must reflect the current bid price of all direct costs and all indirect costs properly allocable to goods on hand at the inventory date.

Inventory may be valued below cost when the merchandise is unsaleable at normal prices or unusable in the normal way because the goods are subnormal due to damage, imperfections, shopwear, etc., within the meaning of Regulations section 1.471-2(c). The goods may be valued at the current bona fide selling price, minus direct cost of disposition (but not less than scrap value) if such a price can be established.

If this is the first year the Last-in, First-out (LIFO) inventory method was either adopted or extended to inventory goods not previously valued under the LIFO method provided in section 472, attach **Form 970, Application To Use LIFO Inventory Method**, or a statement with the information required by Form 970. Also check the LIFO box on line 9c. On line 9d, enter the amount or the percent of total closing inventories covered under section 472. Estimates are acceptable.

If the corporation changed or extended its inventory method to LIFO and had to write up the opening inventory to cost in the year of election, report the effect of the writeup as other income (line 10, page 1), proportionately over a 3-year period that begins with the year of the LIFO election (section 472(d)).

**Note:** *Corporations using the LIFO method that make an S corporation election or transfer LIFO inventory to an S corporation in a nonrecognition transaction may be subject to an additional tax attributable to the LIFO recapture amount. See the instructions for line 10, Schedule J.*

For more information on inventory valuation methods, get **Pub. 538, Accounting Periods and Methods**.

**Schedule C  
(Form 1120 Only)**

**Dividends and Special Deductions**

For purposes of the 20% ownership test on lines 1 through 7, the percentage of stock owned by the corporation is based on voting power and value of the stock. Preferred stock described in section 1504(a)(4) is not taken into account. Corporations filing a consolidated return should see Regulations sections 1.1502-13, 1.1502-26, and 1.1502-27 before completing Schedule C.

**Line 1, Column (a)**

Enter dividends (except those received on debt-financed stock acquired after July 18, 1984—see section 246A) that are received from less-than-20%-owned domestic corporations subject to income tax and that are subject to the 70% deduction under section 243(a)(1). Include on this line taxable distributions from an IC-DISC or former DISC that are designated as eligible for the 70% deduction and certain dividends of Federal Home Loan Banks. See section 246(a)(2).

Also include on line 1 dividends (except those received on debt-financed stock acquired after July 18, 1984) from a regulated investment company (RIC). The amount of dividends eligible for the dividends-received deduction under section 243 is limited by section 854(b). The corporation should receive a notice from the RIC specifying the amount of dividends that qualify for the deduction.

Report so-called dividends or earnings received from mutual savings banks, etc., as interest. Do not treat them as dividends.

**Line 2, Column (a)**

Enter dividends (except those received on debt-financed stock acquired after July 18, 1984) that are received from 20%-or-more-owned domestic corporations subject to income tax and that are subject to the 80% deduction under section 243(c). Include on this line taxable distributions from an IC-DISC or former DISC that are considered eligible for the 80% deduction.

**Line 3, Column (a)**

Enter dividends on debt-financed stock acquired after July 18, 1984, received from domestic and foreign corporations subject to income tax that would otherwise be subject to the dividends-received deduction under section 243(a)(1), 243(c), or 245(a). Generally, debt-financed stock is stock that the corporation acquired by incurring a debt (e.g., it borrowed money to buy the stock).

Include on line 3 dividends received from a regulated investment company (RIC) on debt-financed stock. The amount of dividends eligible for the dividends-received deduction is limited by section 854(b). The corporation should receive a notice from the RIC specifying the amount of dividends that qualify for the deduction.

**Line 3, Columns (b) and (c)**

Dividends received on debt-financed stock acquired after July 18, 1984, are not entitled to the full 70% or 80% dividends-received deduction. The 70% or 80% deduction is reduced by a percentage that is related to the amount of debt incurred to acquire the stock. See section 246A. Also see section 245(a) before making this computation for an additional limitation that applies to dividends

**Worksheet for Schedule C, line 9**  
(Keep for your records.)

1. Refigure line 28, page 1, Form 1120, without any adjustment under section 1059 and without any capital loss carryback to the tax year under section 1212(a)(1).	1. _____
2. Complete lines 10, 11, and 12, column (c), and enter the total here . . . . .	2. _____
3. Subtract line 2 from line 1 . . . . .	3. _____
4. Multiply line 3 by 80% . . . . .	4. _____
5. Add lines 2, 5, 7, and 8, column (c), and the part of the deduction on line 3, column (c), that is attributable to dividends from 20%-or-more-owned corporations . . . . .	5. _____
6. Enter the smaller of line 4 or 5. If line 5 is greater than line 4, stop here; enter the amount from line 6 on line 9, column (c), and do not complete the rest of this worksheet . . . . .	6. _____
7. Enter the total amount of dividends from 20%-or-more-owned corporations that are included on lines 2, 3, 5, 7, and 8, column (a).	7. _____
8. Subtract line 7 from line 3 . . . . .	8. _____
9. Multiply line 8 by 70% . . . . .	9. _____
10. Subtract line 5 above from line 9, column (c) . . . . .	10. _____
11. Enter the smaller of line 9 or line 10 . . . . .	11. _____
12. Dividends-received deduction after limitation (sec. 246(b)). Add lines 6 and 11. Enter the result here and on line 9, column (c) . . . . .	12. _____

received from foreign corporations. Attach a schedule to Form 1120 showing how the amount on line 3, column (c), was figured.

**Line 4, Column (a)**

Enter dividends received on the preferred stock of a less-than-20%-owned public utility that is subject to income tax and is allowed the deduction provided in section 247 for dividends paid.

**Line 5, Column (a)**

Enter dividends received on preferred stock of a 20%-or-more-owned public utility that is subject to income tax and is allowed the deduction provided in section 247 for dividends paid.

**Line 6, Column (a)**

Enter the U.S.-source portion of dividends that are received from less-than-20%-owned foreign corporations and that qualify for the 70% deduction under section 245(a). To qualify for the 70% deduction, the corporation must own at least 10% of the stock of the foreign corporation by vote and value. Also include dividends received from a less-than-20%-owned FSC that are attributable to income treated as effectively connected with the conduct of a trade or business within the United States (excluding foreign trade income) and that qualify for the 70% deduction provided in section 245(c)(1)(B).

**Line 7, Column (a)**

Enter the U.S.-source portion of dividends that are received from 20%-or-more-owned foreign corporations that qualify for the 80% deduction under section 245(a). Also include dividends received from a 20%-or-more-owned FSC that are attributable to income treated as effectively connected with the conduct of a trade or business within the United States (excluding foreign trade income) and qualify for the 80% deduction provided in section 245(c)(1)(B).

**Line 8, Column (a)**

Enter dividends received from wholly owned foreign subsidiaries that are eligible for the 100% deduction provided in section 245(b).

In general, the deduction under section 245(b) applies to dividends paid out of the earnings and profits of a foreign corporation for a tax year during which:

- All of its outstanding stock is owned (directly or indirectly) by the domestic corporation receiving the dividends, and
- All of its gross income from all sources is effectively connected with the conduct of a trade or business within the United States.

**Line 9, Column (c)**

**Limitation on Dividends-Received Deduction**

Generally, line 9, column (c) may not exceed the amount from the worksheet above. However, in a year in which an NOL occurs, this limitation does not apply even if the loss is created by the dividends-received deduction. See sections 172(d) and 246(b).

**Line 10, Columns (a) and (c)**

Small business investment companies operating under the Small Business Investment Act of 1958 (15 U.S.C. 661 and following) must enter dividends that are received from domestic corporations subject to income tax even though a deduction is allowed for the entire amount of those dividends. To claim the 100% deduction on line 10, column (c), the company must file with its return a statement that it was a Federal licensee under the Small Business Investment Act of 1958 at the time it received the dividends.

**Line 11, Column (a)**

Enter dividends from FSCs that are attributable to foreign trade income and that are eligible for the 100% deduction provided in section 245(c)(1)(A).

**Line 12, Columns (a) and (c)**

Enter only those dividends that qualify under section 243(b) for the 100% dividends-received deduction described in section 243(a)(3). Corporations taking this deduction are subject to the provisions of section 1561.

**Note:** *The 100% deduction does not apply to affiliated group members that are joining in the filing of a consolidated return.*

**Line 13, Column (a)**

Enter foreign dividends not reportable on lines 3, 6, 7, 8, or 11 of column (a). Include on line 13 the corporation's share of the ordinary earnings of a qualified electing fund from Form 8621, line 6c, or the amount of any excess distribution from a passive foreign investment

company from Form 8621, line 11b. Exclude distributions of amounts constructively taxed in the current year or in prior years under subpart F (sections 951 through 964).

**Line 14, Column (a)**

Include income constructively received from controlled foreign corporations under subpart F. This amount should equal the total subpart F income reported on Schedule I, Form 5471.

**Line 15, Column (a)**

Include gross-up for taxes deemed paid under sections 902 and 960.

**Line 16, Column (a)**

Enter taxable distributions from an IC-DISC or former DISC that are designated as not eligible for a dividends-received deduction.

No deduction is allowed under section 243 for a dividend from an IC-DISC or former DISC (as defined in section 992(a)) to the extent the dividend:

- Is paid out of the corporation's accumulated IC-DISC income or previously taxed income, or
- Is a deemed distribution under section 995(b)(1).

**Line 17, Column (a)**

Include the following:

1. Dividends (other than capital gain dividends and exempt-interest dividends) that are received from regulated investment companies and that are not subject to the 70% deduction.
2. Dividends from tax-exempt organizations.
3. Dividends (other than capital gain dividends) received from a real estate investment trust that, for the tax year of the trust in which the dividends are paid, qualifies under sections 856 through 860.
4. Dividends not eligible for a dividends-received deduction because of the holding period of the stock or an obligation to make corresponding payments with respect to similar stock.

Two situations in which the dividends-received deduction will not be allowed on any share of stock are:

- If the corporation held it 45 days or less (see section 246(c)(1)(A)), or
  - To the extent the corporation is under an obligation to make related payments for substantially similar or related property.
5. Any other taxable dividend income not properly reported above (including distributions under section 936(h)(4)).

If patronage dividends or per-unit retain allocations are included on line 17, identify the total of these amounts in a schedule attached to Form 1120.

**Line 18, Column (c)**

Section 247 allows public utilities a deduction of 40% of the smaller of:

- Dividends paid on their preferred stock during the tax year, or
- Taxable income computed without regard to this deduction.

In a year in which an NOL occurs, compute the deduction without regard to section 247(a)(1)(B). See section 172(d).

**Tax Computation Worksheet for Members of a Controlled Group**

(Keep for your records.)

**Note:** Each member of a controlled group (except a qualified personal service corporation—see below) must compute the tax using this worksheet.

1. Enter taxable income (line 30, page 1, Form 1120) . . . . . 1. \_\_\_\_\_
2. Enter line 1 or the corporation's share of the \$50,000 taxable income bracket, whichever is less . . . . . 2. \_\_\_\_\_
3. Subtract line 2 from line 1 . . . . . 3. \_\_\_\_\_
4. Enter line 3 or the corporation's share of the \$25,000 taxable income bracket, whichever is less . . . . . 4. \_\_\_\_\_
5. Subtract line 4 from line 3 . . . . . 5. \_\_\_\_\_
6. Enter line 5 or the corporation's share of the \$9,925,000 taxable income bracket, whichever is less . . . . . 6. \_\_\_\_\_
7. Subtract line 6 from line 5 . . . . . 7. \_\_\_\_\_
8. Multiply line 2 by 15% . . . . . 8. \_\_\_\_\_
9. Multiply line 4 by 25% . . . . . 9. \_\_\_\_\_
10. Multiply line 6 by 34% . . . . . 10. \_\_\_\_\_
11. Multiply line 7 by 35% . . . . . 11. \_\_\_\_\_
12. If the taxable income of the controlled group exceeds \$100,000, enter this member's share of the smaller of: 5% of the taxable income in excess of \$100,000, or \$11,750 (See the instructions for line 2b below.) . . . . . 12. \_\_\_\_\_
13. If the taxable income of the controlled group exceeds \$15 million, enter this member's share of the smaller of: 3% of the taxable income in excess of \$15 million, or \$100,000 (See the instructions for line 2b below.) . . . . . 13. \_\_\_\_\_
14. Add lines 8 through 13. Enter here and on line 3, Schedule J, Form 1120 . . . . . 14. \_\_\_\_\_

**Schedule J, Form 1120  
Part I, Form 1120-A**

**Tax Computation**

**Note:** Members of a controlled group must attach a statement showing the computation of the tax entered on line 3.

**Lines 1 and 2, Form 1120**

**Members of a controlled group (Form 1120 only).**— A member of a controlled group, as defined in section 1563, must check the box on line 1 and complete lines 2a and 2b of Schedule J, Form 1120.

**Line 2a.**— Members of a controlled group are entitled to one \$50,000, one \$25,000, and one \$9,925,000 taxable income bracket amount (in that order) on line 2a.

When a controlled group adopts or later amends an apportionment plan, each member must attach to its tax return a copy of its consent to this plan. The copy (or an attached statement) must show the part of the amount in each taxable income bracket apportioned to that member. See Regulations section 1.1561-3(b) for other requirements and for the time and manner of making the consent.

**Unequal apportionment plan.**— Members of a controlled group may elect an unequal apportionment plan and divide the taxable income brackets as they want. There is no need for consistency among taxable income brackets. Any member may be entitled to all, some, or none of the taxable income bracket. However, the total amount for all members cannot be more than the total amount in each taxable income bracket.

**Equal apportionment plan.**— If no apportionment plan is adopted, members of a controlled group must divide the amount in each taxable income bracket equally among themselves. For example, Controlled Group AB consists of Corporation A and Corporation B. They do not elect an apportionment plan. Therefore, each corporation is entitled to:

- \$25,000 (one-half of \$50,000) on line 2a(1),
- \$12,500 (one-half of \$25,000) on line 2a(2), and
- \$4,962,500 (one-half of \$9,925,000) on line 2a(3).

**Line 2b.**— Members of a controlled group are treated as one group to figure the applicability of the additional 5% tax and the additional 3% tax. If an additional tax applies, each member will pay that tax based on the part of the amount used in each taxable income bracket to reduce that member's tax. See section 1561(a). If an additional tax applies, attach a schedule showing the taxable income of the entire group and how the corporation figured its share of the additional tax.

**Line 2b(1).**— Enter the corporation's share of the additional 5% tax on line 2b(1).

**Line 2b(2).**— Enter the corporation's share of the additional 3% tax on line 2b(2).

**Line 3, Form 1120  
(Line 1, Form 1120-A)**

Most corporations figure their tax by using the Tax Rate Schedule below. Exceptions apply to members of a controlled group (see worksheet above) and qualified personal service corporations. (See the instructions below for more information.)

**Tax Rate Schedule**

If taxable income (line 30, Form 1120, or line 26, Form 1120-A) on page 1 is:

Over—	But not over—	Tax is:	Of the amount over—
\$0	\$50,000	15%	\$0
50,000	75,000	\$ 7,500 + 25%	50,000
75,000	100,000	13,750 + 34%	75,000
100,000	335,000	22,250 + 39%	100,000
335,000	10,000,000	113,900 + 34%	335,000
10,000,000	15,000,000	3,400,000 + 35%	10,000,000
15,000,000	18,333,333	5,150,000 + 38%	15,000,000
18,333,333	- - - -	35%	0

**Qualified personal service corporation.**— A qualified personal service corporation is taxed at a flat rate of 35% on taxable income. A corporation is a qualified personal service corporation if it meets **BOTH** of the following tests:

- Substantially all of the corporation's activities involve the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting, and

• At least 95% of the corporation's stock, by value, is owned, directly or indirectly, by (1) employees performing the services, (2) retired employees who had performed the services listed above, (3) any estate of the employee or retiree described above, or (4) any person who acquired the stock of the corporation as a result of the death of an employee or retiree (but only for the 2-year period beginning on the date of the employee's or retiree's death). See Temporary Regulations section 1.448-1T(e) for details.

**Note:** If the corporation meets these tests, check the box on line 3, Schedule J, Form 1120 (line 1, Part I, Form 1120-A).

**Mutual savings bank conducting life insurance business.**— The tax under section 594 consists of the sum of (a) a partial tax computed on Form 1120 on the taxable income of the bank determined without regard to income or deductions allocable to the life insurance department, and (b) a partial tax on the taxable income computed on Form 1120-L of the life insurance department. Enter the combined tax on line 3 of Schedule J, Form 1120. Attach Form 1120-L as a schedule and identify it as such.

**Deferred tax under section 1291.**— If the corporation was a shareholder in a passive foreign investment company (PFIC) and received an excess distribution or disposed of its investment in the PFIC during the year, it must include the increase in taxes due under section 1291(c)(2) in the total for line 3, Schedule J, Form 1120. On the dotted line next to line 3, Schedule J, write "Section 1291" and the amount.

Do not include on line 3 any interest due under section 1291(c)(3). Instead, show the amount of interest owed in the bottom margin of page 1, Form 1120, and write "Section 1291 interest". For details, see **Form 8621**, Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund.

**Additional tax under section 197(f).**— A corporation that elects to pay tax on the gain from the sale of an intangible under the related person exception to the anti-churning rules, should include any additional tax due under section 197(f)(9)(B) in the total for line 3. On the dotted line next to line 3, write "Section 197" and the amount. For more information, see **Pub. 535**, Business Expenses.

## Line 4a (Form 1120 Only)

### Foreign Tax Credit

To find out when a corporation can take the credit for payment of income tax to a foreign country or U.S. possession, see **Form 1118**, Foreign Tax Credit—Corporations.

## Line 4b (Form 1120 Only)

### Possessions Tax Credit

The Small Business Job Protection Act of 1996 repealed the possessions credit. However, existing credit claimants may qualify for a credit under the transitional rules. Get **Form 5735**, Possessions Corporation Tax Credit (Under Sections 936 and 30A).

## Line 4c (Form 1120 Only)

Complete line 4c if the corporation can take either of the following credits. Be sure to check the appropriate box.

**Nonconventional source fuel credit.**— A credit is allowed for the sale of qualified fuels produced from a nonconventional source. Section 29 contains a definition of qualified fuels, provisions for figuring the credit, and other special rules. Attach a separate schedule to the return showing the computation of the credit.

**Qualified electric vehicle (QEV) credit.**— Include on line 4c any credit from **Form 8834**, Qualified Electric Vehicle Credit. Vehicles that qualify for this credit are not eligible for the deduction for clean-fuel vehicles under section 179A.

## Line 4d, Form 1120 (Line 2a, Form 1120-A)

### General Business Credit

Complete this line if the corporation can take any of the following credits. Complete **Form 3800**, General Business Credit, if the corporation has two or more of these credits, a credit carryforward or carryback (including an ESOP credit), a trans-Alaska pipeline liability fund credit, or a passive activity credit. Enter the amount of the general business credit on line 4d (line 2a, Form 1120-A), and check the box for Form 3800. If the corporation has only one credit, enter on line 4d (line 2a, Form 1120-A), the amount of the credit from the form. Also be sure to check the appropriate box for that form.

**Form 3468**, Investment Credit. Use Form 3468 to claim a credit for property placed in service that is qualified rehabilitation, energy, timber, or transition property.

**Form 5884**, Work Opportunity Credit. Use Form 5884 to claim a credit for wages paid to qualified employees who began work after September 30, 1996, and before October 1, 1997.

**Form 6478**, Credit for Alcohol Used as Fuel.

**Form 6765**, Credit for Increasing Research Activities. Use Form 6765 to claim a credit for qualified research expenses. Generally, the expenses must be paid or incurred after June 30, 1996, and before June 1, 1997.

**Form 8586**, Low-Income Housing Credit. Corporations that own residential rental buildings providing low-income housing may qualify for this credit.

**Form 8820**, Orphan Drug Credit. Use Form 8820 to claim a credit for qualified clinical testing expenses. Generally, the expenses must be paid or incurred after June 30, 1996, and before June 1, 1997.

**Form 8826**, Disabled Access Credit. Use Form 8826 to take a credit for certain expenditures paid or incurred to help individuals with disabilities.

**Form 8830**, Enhanced Oil Recovery Credit. Use Form 8830 to claim a credit for 15% of qualified enhanced oil recovery costs.

**Form 8835**, Renewable Electricity Production Credit. Use Form 8835 to claim a credit for the sale of electricity produced in the United States or U.S. possessions from qualified energy resources.

**Form 8844**, Empowerment Zone Employment Credit. Use Form 8844 to claim a credit for qualified wages and certain training and educational expenses paid or incurred by the corporation for employees that live in and work for the corporation in areas designated as empowerment zones.

**Note:** The empowerment zone employment credit is a component of the general business credit, but is figured separately and is not carried to Form 3800.

**Form 8845**, Indian Employment Credit. Use Form 8845 to claim a credit based on qualified wages and health insurance costs paid by the corporation for American Indians who are qualified employees.

**Form 8846**, Credit for Employer Social Security and Medicare Taxes Paid on Certain Employee Tips. Food and beverage establishments use Form 8846 to claim a credit for social security and Medicare taxes paid or incurred by the employer on certain employees' tips.

**Form 8847**, Credit for Contributions to Selected Community Development Corporations.

## Line 4e, Form 1120 (Line 2b, Form 1120-A)

### Credit for Prior Year Minimum Tax

To figure the minimum tax credit and any carryforward of that credit, use **Form 8827**, Credit for Prior Year Minimum Tax—Corporations. Also see Form 8827 if any of the corporation's 1995 nonconventional source fuel credit, orphan drug credit, or qualified electric vehicle credit was disallowed solely because of the tentative minimum tax limitation. See section 53(d).

## Line 7 (Form 1120 Only)

### Personal Holding Company Tax

A corporation is taxed as a personal holding company under section 542 if:

- At least 60% of its adjusted ordinary gross income for the tax year is personal holding company income, and
- At any time during the last half of the tax year more than 50% in value of its outstanding stock is owned, directly or indirectly, by five or fewer individuals.

See **Schedule PH (Form 1120)**, U.S. Personal Holding Company Tax, for definitions and details on how to figure the tax.

## Line 8, Form 1120 (Line 5, Form 1120-A)

### Recapture Taxes

**Recapture of investment credit.** If the corporation disposed of investment credit property or changed its use before the end of its useful life or recovery period, it may owe a tax. See **Form 4255**, Recapture of Investment Credit, for details.

**Recapture of low-income housing credit.** If the corporation disposed of property (or there was a reduction in the qualified basis of the property) for which it took the low-income housing credit, it may owe a tax. See **Form 8611**, Recapture of Low-Income Housing Credit.

**Recapture of qualified electric vehicle (QEV) credit.** The corporation must recapture part of the QEV credit it claimed in a prior year, if, within 3 years of the date the vehicle was placed in service, it ceases to qualify for the credit. See Regulations section 1.30-1 for details on how to figure the recapture. Include the amount of the recapture in the total for line 8, Schedule J, Form 1120 (line 5, Part I, Form 1120-A). On the dotted line next to the entry space, write "QEV recapture" and the amount.

**Recapture of Indian employment credit.** Generally, if an employer terminates the employment of a qualified employee less than 1 year after the date of initial employment, any Indian employment credit allowed for a prior tax year by reason of wages paid or incurred to that employee must be recaptured. For details,

see Form 8845 and section 45A. Include the amount of the recapture in the total for line 8, Schedule J, Form 1120 (line 5, Part I, Form 1120-A). On the dotted line next to the entry space, write "45" and the amount.

## Line 9, Form 1120 (Line 6, Form 1120-A)

### Alternative Minimum Tax

The corporation may owe the alternative minimum tax if it has any of the adjustments and tax preference items listed on **Form 4626**, Alternative Minimum Tax—Corporations. The corporation must file Form 4626 if its taxable income (loss) combined with these adjustments and tax preference items is more than the smaller of \$40,000, or the corporation's allowable exemption amount (from Form 4626).

For this purpose, taxable income does not include the NOL deduction. Get Form 4626 for details.

Reduce alternative minimum tax by any amounts from Form 3800, Schedule A, line 36 and Form 8844, line 23. On the dotted line next to line 9a (line 6, Form 1120-A), write "Section 38(c)(2)" ("EZE" if from Form 8844) and the amounts.

## Line 10 (Form 1120 only)

**Interest on tax attributable to payments received on installment sales of certain timeshares and residential lots.** If the corporation elected to pay interest on the amount of tax attributable to payments received on installment obligations arising from the disposition of property under section 453(l)(3), include the interest due in the total for line 10, Schedule J. On the dotted line to the left of line 10, write "Section 453(l)(3) interest" and the amount. Attach a schedule showing the computation.

**Interest on tax deferred under the installment method for certain nondealer installment obligations.** If an obligation arising from the disposition of property to which section 453A applies is outstanding at the close of the tax year, the corporation must include the interest due under section 453A(c) in the total for line 10, Schedule J. Write on the dotted line to the left of line 10, "Section 453A(c) interest" and the amount. Attach a schedule showing the computation.

**Interest under the look-back method for completed long-term contracts.** Use Form 8697 to figure the interest due under the look-back method of section 460(b)(2), and include this amount on line 10, Schedule J. On the dotted line to the left of the entry space, write "From Form 8697" and the amount.

**Deferred tax and interest under section 1294.** Complete Form 8621 to determine the corporation's share of tax attributable to the undistributed earnings of a qualified electing fund, or the deferred tax due, if any, as a result of the termination of a section 1294 election. See the instructions for Form 8621 to figure the amount of tax to include in, or subtract from the total on line 10. The instructions for Form 8621 also explain how to report any interest due under section 1294 on the deferred tax.

**Installment payment of additional tax due to LIFO recapture (section 1363(d)).** A C corporation must include in gross income the LIFO recapture amount (defined below) if:

1. It uses the LIFO method for its last tax year before the first tax year for which an election to be taxed as an S corporation becomes effective, or
2. It transferred LIFO inventory assets to an S corporation in a nonrecognition transaction (within the meaning of section 7701(a)(45)) in which the transferred assets constitute

transferred basis property (within the meaning of section 7701(a)(43)).

The LIFO recapture amount is the amount by which the C corporation's inventory under the FIFO method (determined by using cost or market, whichever is lower) authorized by section 471 exceeds the inventory amount under the LIFO method at the close of the C corporation's last tax year as a C corporation (or for the year of the transfer, if 2 above applies). The additional tax due to LIFO recapture is paid in four equal installments. The corporation must pay the first installment by the due date (not including extensions) of Form 1120 for the corporation's last tax year as a C corporation or for the tax year of the transfer, whichever applies.

To determine the additional tax due to LIFO recapture, complete lines 1 through 9 of Schedule J based on income that includes the LIFO recapture amount. On a separate worksheet, using the Schedule J format, complete the entire worksheet (lines 1 through 10) based on taxable income not including the LIFO recapture amount. Compare the total of lines 1 through 9 of Schedule J to line 10 of the worksheet. The difference is the additional tax due to LIFO recapture.

Since the total of lines 1 through 9 of Schedule J will include all the additional tax due to LIFO recapture, the amount that may be deferred ( $\frac{3}{4}$  of the additional tax) must first be subtracted to arrive at line 10, total tax. On the dotted line to the left of line 10, Schedule J, write "Section 1363(d) deferral" and the amount. Attach a schedule showing the computation. See section 1363(d) for more information.

**Note:** *The remaining three installments of deferred tax must be paid by the due date of Form 1120S for the next 3 tax years. No interest is payable on the deferred tax if paid on time.*

For details, see Regulations section 1.1363-2 and Rev. Proc. 94-61, 1994-2 C.B. 775.

**Tax on a nonqualified withdrawal from a capital construction fund.** If the corporation owes tax under section 7518 on a nonqualified withdrawal from a capital construction fund, include the tax and the interest in the total for line 10. On the dotted line next to line 10, write "CCF" and the amounts of tax and interest. For more information, see Pub. 595.

## Schedule K, Form 1120 (Part II, Form 1120-A)

### Other Information

The following instructions apply to questions 1 through 15 on Form 1120, page 3, Schedule K, or questions 1 through 6 on Form 1120-A, page 2, Part II. Be sure to answer all the questions that apply to the corporation.

### Question 4 (Form 1120 Only)

Check the "Yes" box for question 4 if:

- The corporation is a subsidiary in an affiliated group (defined below), but is not filing a consolidated return for the tax year with that group, or
- The corporation is a subsidiary in a parent-subsidiary controlled group (defined below).

Any corporation that meets either of the requirements above should check the "Yes" box. This applies even if the corporation is a subsidiary member of one group and the parent corporation of another.

**Note:** *If the corporation is an "excluded member" of a controlled group (see section 1563(b)(2)), it is still considered a member of a controlled group for this purpose.*

**Affiliated group.**— The term "affiliated group" means one or more chains of includible corporations (section 1504(a)) connected through stock ownership with a common parent corporation. The common parent must be an includible corporation and the following requirements must be met:

1. The common parent must own directly stock that represents at least 80% of the total voting power and at least 80% of the total value of the stock of at least one of the other includible corporations.
2. Stock that represents at least 80% of the total voting power, and at least 80% of the total value of the stock of each of the other corporations (except for the common parent) must be owned directly by at least one of the other includible corporations.

For this purpose, the term "stock" generally does not include any stock that (a) is nonvoting, (b) is nonconvertible, (c) is limited and preferred as to dividends and does not participate significantly in corporate growth, and (d) has redemption and liquidation rights that do not exceed the issue price of the stock (except for a reasonable redemption or liquidation premium). See section 1504(a)(4).

**Parent-subsidiary controlled group.**— The term "parent-subsidiary controlled group" means one or more chains of corporations connected through stock ownership (section 1563(a)(1)). Both of the following requirements must be met:

1. 80% of the total combined voting power of all classes of stock entitled to vote or at least 80% of the total value of all classes of stock of each corporation in the group (except the parent) must be owned by one or more of the other corporations in the group.
2. The common parent must own at least 80% of the total combined voting power of all classes of stock entitled to vote or at least 80% of the total value of all classes of stock of at least one of the other corporations in the group. Stock owned directly by other members of the group is not counted when computing the voting power or value.

See section 1563(d)(1) for the definition of "stock" for purposes of determining stock ownership above.

## Question 8, Form 1120 (Question 6, Form 1120-A)

**Foreign financial accounts.**— Check the "Yes" box if either 1 or 2 below applies to the corporation. Otherwise, check the "No" box:

1. At any time during the 1996 calendar year the corporation had an interest in or signature or other authority over a bank, securities, or other financial account in a foreign country; and
- The combined value of the accounts was more than \$10,000 at any time during the calendar year, and
- The account was NOT with a U.S. military banking facility operated by a U.S. financial institution.

2. The corporation owns more than 50% of the stock in any corporation that would answer "Yes" to item 1 above.

Get **Form TD F 90-22.1**, Report of Foreign Bank and Financial Accounts, to see if the corporation is considered to have an interest in or signature or other authority over a financial account in a foreign country.

If "Yes" is checked for this question, file Form TD F 90-22.1 by June 30, 1997, with the Department of the Treasury at the address shown on the form. Because Form TD F

90-22.1 is not a tax return, do not file it with Form 1120 (or Form 1120-A).

You can get Form TD F 90-22.1 from an IRS Distribution Center or by calling 1-800-TAX-FORM (1-800-829-3676).

Also, if "Yes" is checked for this question, enter the name of the foreign country or countries. Attach a separate sheet if more space is needed.

### Question 9 (Form 1120 Only)

If the corporation received a distribution from a foreign trust after August 20, 1996, it must provide additional information. For this purpose, a loan of cash or marketable securities generally is considered to be a distribution. Get Pub. 553 for details.

If the corporation was the grantor of, or the transferor to a foreign trust that existed during the tax year, it may have to file **Form 3520**, Creation of or Transfers to Certain Foreign Trusts, **Form 3520-A**, Annual Return of Foreign Trust With U.S. Beneficiaries, or **Form 926**, Return by a U.S. Transferor of Property to a Foreign Corporation, Foreign Estate or Trust, or Foreign Partnership.

### Question 10 (Form 1120 Only)

Check the "Yes" box if one foreign person owned at least 25% of (a) the total voting power of all classes of stock of the corporation entitled to vote or (b) the total value of all classes of stock of the corporation.

The constructive ownership rules of section 318 apply in determining if a corporation is foreign owned. See section 6038A(c)(5) and the related regulations.

Enter on line 10a the percentage owned by the foreign person specified in question 10. On line 10b, write the name of the owner's country.

**Note:** *If there is more than one 25%-or-more foreign owner, complete lines 10a and 10b for the foreign person with the highest percentage of ownership.*

**Foreign person.**— The term "foreign person" means:

- A foreign citizen or nonresident alien.
- An individual who is a citizen of a U.S. possession (but who is not a U.S. citizen or resident).
- A foreign partnership.
- A foreign corporation.
- Any foreign estate or trust within the meaning of section 7701(a)(31).
- A foreign government (or one of its agencies or instrumentalities) to the extent that it is

engaged in the conduct of a commercial activity as described in section 892.

**Owner's country.**— For individuals, the term "owner's country" means the country of residence. For all others, it is the country where incorporated, organized, created, or administered.

**Requirement to file Form 5472.**— If the corporation checked "Yes" to Question 10, it may have to file Form 5472. Generally, a 25% foreign-owned corporation that had a reportable transaction with a foreign or domestic related party during the tax year must file Form 5472.

See Form 5472 for filing instructions and penalties for failure to file.

### Question 12, Form 1120 (Question 3, Form 1120-A)

Show any tax-exempt interest received or accrued. Include any exempt-interest dividends received as a shareholder in a mutual fund or other regulated investment company.

### Question 14 (Form 1120 Only)

Check the box on line 14 if the corporation elects under section 172(b)(3) to forego the carryback period for a net operating loss (NOL). If you check this box, do not attach the statement described in Temporary Regulations section 301.9100-12T(d).

### Question 15 (Form 1120 Only)

Enter the amount of the net operating loss (NOL) carryover to the tax year from prior years, even if some of the loss is used to offset income on this return. The amount to enter is the total of all NOLs generated in prior years but not used to offset income (either as a carryback or carryover) to a tax year prior to 1996. Do not reduce the amount by any NOL deduction reported on line 29a.

Pub. 536 has a worksheet for figuring a corporation's NOL carryover.

## Schedule L, Form 1120 (Part III, Form 1120-A)

### Balance Sheets per Books

The balance sheet should agree with the corporation's books and records. Include certificates of deposit as cash on line 1, Schedule L.

## Line 5

### Tax-Exempt Securities

Include on this line:

1. State and local government obligations, the interest on which is excludable from gross income under section 103(a), and
2. Stock in a mutual fund or other regulated investment company that distributed exempt-interest dividends during the tax year of the corporation.

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## Schedule M-1, Form 1120 (Part IV, Form 1120-A)

### Reconciliation of Income (Loss) per Books With Income per Return Line 5c, Form 1120 (Line 5, Form 1120-A)

#### Travel and Entertainment

Include on line 5c (line 5, Form 1120-A) any of the following:

- 50% of the meals and entertainment not allowed under section 274(n).
- Expenses for the use of an entertainment facility.
- The part of business gifts over \$25.
- Expenses of an individual over \$2,000, which are allocable to conventions on cruise ships.
- Employee achievement awards over \$400.
- The cost of entertainment tickets over face value (also subject to 50% disallowance under section 274(n)).
- The cost of skyboxes over the face value of nonluxury box seat tickets.
- The part of luxury water travel not allowed under section 274(m).
- Expenses for travel as a form of education.
- Other travel and entertainment expenses not allowed as a deduction.

For more information, see Pub. 542.

### Line 7, Form 1120 (Line 6, Form 1120-A)

#### Tax-Exempt Interest

Include as interest on line 7 (line 6, Form 1120-A), any exempt-interest dividends received as a shareholder in a mutual fund or other regulated investment company.

## Codes for Principal Business Activity

These codes for the Principal Business Activity are designed to classify enterprises by the type of activity in which they are engaged to facilitate the administration of the Internal Revenue Code. Though similar in format and structure to the Standard Industrial Classification (SIC) codes, they should not be used as SIC codes.

Using the list below, enter on Form 1120, Schedule K, line 2a (Form 1120-A, Part II, line 1a) the code number for the specific industry group from which the largest percentage of "total receipts" is derived. "Total receipts" means gross receipts (line 1a, page 1) plus all other income (lines 4 through 10, page 1).

On Form 1120, Schedule K, lines 2b and 2c (Form 1120-A, Part II, lines 1b and 1c), state the principal business activity and principal product or service that account for the largest percentage of total receipts. For example, if the principal business activity is "Grain mill products," the principal product or service may be "Cereal preparations."

If, as its principal business activity, the corporation: (1) purchases raw materials, (2) subcontracts out for labor to make a finished product from the raw materials, and (3) retains title to the goods, the corporation is considered to be a manufacturer and must enter one of the codes (2010-3998) under "Manufacturing."

### Agriculture, Forestry, and Fishing

#### Code

0400 Agricultural production  
0600 Agricultural services (except veterinarians), forestry, fishing, hunting, and trapping

### Mining

#### Metal mining

1010 Iron ores  
1070 Copper, lead and zinc, gold and silver ores  
1098 Other metal mining  
1150 Coal mining

#### Oil and gas extraction

1330 Crude petroleum, natural gas, and natural gas liquids  
1380 Oil and gas field services

#### Nonmetallic minerals, except fuels

1430 Dimension, crushed and broken stone; sand and gravel  
1498 Other nonmetallic minerals, except fuels

### Construction

#### General building contractors and operative builders

1510 General building contractors  
1531 Operative builders

#### 1600 Heavy construction contractors

#### Special trade contractors

1711 Plumbing, heating, and air conditioning  
1731 Electrical work  
1798 Other special trade contractors

### Manufacturing

#### Food and kindred products

2010 Meat products  
2020 Dairy products  
2030 Preserved fruits and vegetables  
2040 Grain mill products  
2050 Bakery products  
2060 Sugar and confectionary products  
2081 Malt liquors and malt  
2088 Alcoholic beverages, except malt liquors and malt  
2089 Bottled soft drinks, and flavorings  
2096 Other food and kindred products  
2100 Tobacco manufacturers

#### Textile mill products

2228 Weaving mills and textile finishing  
2250 Knitting mills  
2298 Other textile mill products

#### Apparel and other textile products

2315 Men's and boys' clothing  
2345 Women's and children's clothing  
2388 Other apparel and accessories  
2390 Miscellaneous fabricated textile products

#### Lumber and wood products

2415 Logging, sawmills, and planing mills  
2430 Millwork, plywood, and related products  
2498 Other wood products, including wood buildings and mobile homes  
2500 Furniture and fixtures

#### Code

#### Paper and allied products

2625 Pulp, paper, and board mills  
2699 Other paper products

#### Printing and publishing

2710 Newspapers  
2720 Periodicals  
2735 Books, greeting cards, and miscellaneous publishing  
2799 Commercial and other printing, and printing trade services

#### Chemicals and allied products

2815 Industrial chemicals, plastics materials, and synthetics  
2830 Drugs  
2840 Soap, cleaners, and toilet goods  
2850 Paints and allied products  
2898 Agricultural and other chemical products

#### Petroleum refining and related industries (including those integrated with extraction)

2910 Petroleum refining (including integrated)  
2998 Other petroleum and coal products

#### Rubber and misc. plastics products

3050 Rubber products, plastics footwear, hose and belting  
3070 Misc. plastics products

#### Leather and leather products

3140 Footwear, except rubber  
3198 Other leather and leather products

#### Stone, clay, and glass products

3225 Glass products  
3240 Cement, hydraulic  
3270 Concrete, gypsum, and plaster products  
3298 Other nonmetallic mineral products

#### Primary metal industries

3370 Ferrous metal industries; misc. primary metal products  
3380 Nonferrous metal industries

#### Fabricated metal products

3410 Metal cans and shipping containers  
3428 Cutlery, hand tools, and hardware; screw machine products, bolts, and similar products  
3430 Plumbing and heating, except electric and warm air  
3440 Fabricated structural metal products  
3460 Metal forgings and stampings  
3470 Coating, engraving, and allied services  
3480 Ordnance and accessories, except vehicles and guided missiles  
3490 Misc. fabricated metal products

#### Machinery, except electrical

3520 Farm machinery  
3530 Construction and related machinery  
3540 Metalworking machinery  
3550 Special industry machinery  
3560 General industrial machinery  
3570 Office, computing, and accounting machines  
3598 Other machinery except electrical

#### Code

#### Electrical and electronic equipment

3630 Household appliances  
3665 Radio, television, and communication equipment

3670 Electronic components and accessories

3698 Other electrical equipment

#### 3710 Motor vehicles and equipment

#### Transportation equipment, except motor vehicles

3725 Aircraft, guided missiles and parts  
3730 Ship and boat building and repairing  
3798 Other transportation equipment, except motor vehicles

#### Instruments and related products

3815 Scientific instruments and measuring devices; watches and clocks  
3845 Optical, medical, and ophthalmic goods  
3860 Photographic equipment and supplies

#### 3998 Other manufacturing products

### Transportation and Public Utilities

#### Transportation

4000 Railroad transportation  
4100 Local and interurban passenger transit  
4200 Trucking and warehousing  
4400 Water transportation  
4500 Transportation by air  
4600 Pipe lines, except natural gas  
4700 Miscellaneous transportation services

#### Communication

4825 Telephone, telegraph, and other communication services  
4830 Radio and television broadcasting

#### Electric, gas, and sanitary services

4910 Electric services  
4920 Gas production and distribution  
4930 Combination utility services  
4990 Water supply and other sanitary services

### Wholesale Trade

#### Durable

5008 Machinery, equipment, and supplies  
5010 Motor vehicles and automotive equipment  
5020 Furniture and home furnishings  
5030 Lumber and construction materials  
5040 Sporting, recreational, photographic, and hobby goods, toys and supplies  
5050 Metals and minerals, except petroleum and scrap  
5060 Electrical goods  
5070 Hardware, plumbing and heating equipment and supplies  
5098 Other durable goods

#### Nondurable

5110 Paper and paper products  
5129 Drugs, drug proprietaries, and druggists' sundries  
5130 Apparel, piece goods, and notions  
5140 Groceries and related products  
5150 Farm-product raw materials  
5160 Chemicals and allied products  
5170 Petroleum and petroleum products  
5180 Alcoholic beverages  
5190 Misc. nondurable goods

### Retail Trade

#### Building materials, garden supplies, and mobile home dealers

5220 Building materials dealers  
5251 Hardware stores  
5265 Garden supplies and mobile home dealers

#### 5300 General merchandise stores

#### Food stores

5410 Grocery stores  
5490 Other food stores

#### Automotive dealers and service stations

5515 Motor vehicle dealers  
5541 Gasoline service stations  
5598 Other automotive dealers

#### 5600 Apparel and accessory stores

5700 Furniture and home furnishings stores

#### Code

#### 5800 Eating and drinking places

#### Misc. retail stores

5912 Drug stores and proprietary stores  
5921 Liquor stores  
5995 Other retail stores

### Finance, Insurance, and Real Estate

#### Banking

6030 Mutual savings banks  
6060 Bank holding companies  
6090 Banks, except mutual savings banks and bank holding companies

#### Credit agencies other than banks

6120 Savings and loan associations  
6140 Personal credit institutions  
6150 Business credit institutions  
6199 Other credit agencies

#### Security, commodity brokers and services

6210 Security brokers, dealers, and flotation companies  
6299 Commodity contracts brokers and dealers; security and commodity exchanges; and allied services

#### Insurance

6355 Life insurance  
6356 Mutual insurance, except life or marine and certain fire or flood insurance companies  
6359 Other insurance companies  
6411 Insurance agents, brokers, and service

#### Real estate

6511 Real estate operators and lessors of buildings  
6516 Lessors of mining, oil, and similar property  
6518 Lessors of railroad property and other real property  
6530 Condominium management and cooperative housing associations  
6550 Subdividers and developers  
6599 Other real estate

#### Holding and other investment companies, except bank holding companies

6744 Small business investment companies  
6749 Other holding and investment companies except bank holding companies

### Services

#### 7000 Hotels and other lodging places

#### 7200 Personal services

#### Business services

7310 Advertising  
7389 Business services, except advertising

#### Auto repair; misc. repair services

7500 Auto repair and services  
7600 Misc. repair services

#### Amusement and recreation services

7812 Motion picture production, distribution, and services  
7830 Motion picture theaters  
7900 Amusement and recreation services, except motion pictures

#### Other services

8015 Offices of physicians, including osteopathic physicians  
8021 Offices of dentists  
8040 Offices of other health practitioners  
8050 Nursing and personal care facilities  
8060 Hospitals  
8071 Medical laboratories  
8099 Other medical services  
8111 Legal services  
8200 Educational services  
8300 Social services  
8600 Membership organizations  
8911 Architectural and engineering services  
8930 Accounting, auditing, and bookkeeping  
8980 Miscellaneous services (including veterinarians)

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