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2012

Department of the Treasury
Internal Revenue Service

Instructions for Schedule H (Form 1120-F)

Deductions Allocated to Effectively Connected Income Under Regulations Section 1.861-8

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

General Instructions

Future Developments

For the latest information about developments related to Schedule H (Form 1120-F) and its instructions, such as legislation enacted after they were published, go to www.irs.gov/form1120f.

Regulations section 1.861-8. Under section 882(c), a foreign corporation's expenses are deductible against its U.S. taxable income only if they are connected with income effectively connected with the conduct of a trade or business in the United States ("ECI"). The proper allocation and apportionment of deductions for this purpose is generally determined under the provisions of Regulations section 1.861-8 and Temporary Regulations section 1.861-8T, with special rules for the allocation and apportionment of research and experimentation expenses at Regulations section 1.861-17. Under these regulations, a taxpayer must allocate deductions to the class of gross income to which the deduction is definitely related and then, if necessary, apportion deductions among the groups of income included in the class. Generally, deductions are allocated and apportioned on the basis of the factual relationship between the deduction and gross income. (Under section 882(c)(1)(B), charitable contributions that are deductible under section 170 reduce ECI whether or not connected with such income.) Use Schedule H (Form 1120-F) to report expenses, other than interest expense and bad debt expense, allocated and apportioned to ECI and non-ECI. Interest expense of a foreign corporation is allocated to ECI exclusively (except to the extent provided in certain tax treaties) under the rules provided in Regulations section 1.882-5 and is reported on Schedule I (Form 1120-F). See Regulations section 1.882-5(a)(2). Bad debt expense allocated to ECI is reported directly on Form 1120-F, Section II, line 15.

Purpose of Schedule

Schedule H (Form 1120-F) is used by a foreign corporation that files Form 1120-F to report the amount of the foreign corporation's deductible expenses that are allocated and apportioned under Regulations sections 1.861-8 and 1.861-17 and Temporary Regulations section 1.861-8T between ECI and non-ECI. The results reported on Schedule H are included on Form 1120-F, Section II, line 26; and, for banks only, on Schedule M-3 (Form 1120-F), Part III, line 31.

Who Must File

Any foreign corporation that is required to file Form 1120-F and is (or is treated as) engaged in a trade or business within the United States at any time during the tax year must complete Schedule H and attach it to its Form 1120-F.

Protective returns. If the foreign corporation files a protective Form 1120-F under Regulations section 1.882-4(a)(3)(vi), Schedule H need not be completed or attached to the protective Form 1120-F.

Treaty-based return reporting of business profits attributable to a U.S. permanent establishment. Do not complete Schedule H if the corporation files Form 1120-F pursuant to an income tax treaty to report business profits attributable to a U.S. permanent establishment and applies OECD Transfer Pricing Guidelines in lieu of the ECI and expense allocation and apportionment rules of section 882(c) and Regulations sections 1.861-8 and 1.861-17 and Temporary Regulations section 1.861-8T. This treaty-based reporting is permitted only if the applicable income tax treaty and accompanying documents (such as Exchange of Notes) expressly provide that attribution of business profits to a U.S. permanent establishment is determined under OECD Transfer Pricing Guidelines applied by analogy. See the Instructions for Schedule M-3 (Form 1120-F) for the reporting of book-tax differences in Parts II and III of that schedule under a treaty-based return position pursuant to OECD Transfer Pricing Guidelines.

Note. Examples of income tax treaties that expressly provide the right to determine the attribution of business profits to a U.S. permanent establishment by application of the OECD Transfer Pricing Guidelines are those with the United Kingdom (2004), Japan (2005), Germany (2008), Belgium (2008), Canada (2009), Bulgaria (2009), and Iceland (2009). See Article 7 (Business Profits) and the accompanying Exchange of Notes.

Specific Instructions

Part I – Home Office Deductible Expenses Definitely Related Solely to ECI or Non-ECI

Part I is used to identify the total expenses, including interest expense and bad debt expense, recorded on the corporation's home office books; to report adjustments made to determine the amounts that are deductible for U.S. tax purposes; and to report the portion of the adjusted expenses that are definitely related to ECI and non-ECI. To the extent included in the home office records used to report total home office expenses, interest expense and bad

debt expense are also identified on Schedule H and removed from expenses allocated and apportioned under Regulations sections 1.861-8 and 1.861-17 and Temporary Regulations section 1.861-8T. Deductions reported on home office books may include expenses incurred outside the foreign corporation's home country (other than in the United States). Home office deductions do not include deductions that are reported on books and records used to complete Form 1120-F, Schedule L ("Schedule L books"). Schedule L books are the set or sets of books of the corporation's U.S. trade or business or books of its U.S. branch (whether maintained within or outside the United States) as defined in Regulations section 1.882-5(d)(2).

Part I may be completed in U.S. dollars or in the foreign corporation's functional currency. If the corporation completes Part I in U.S. dollars, check the box in the Part I heading. If the corporation completes Part I in its foreign functional currency, specify the currency in the space provided in the Part I heading.

Line 1a. Enter on line 1a the total expenses recorded on the non-Schedule L books and records of the home office (including books and records maintained in locations outside the United States other than in the corporation's home country). The books and records may be home office records (e.g., management cost accounting reports) that identify only the expenses included in the corporation's financial statements for the tax year. It is not necessary that the home office records or reports used also include items of income, gain or loss (including bad debt charge-offs), or financial transaction expenses such as interest expense and periodic notional principal contract expense. Alternatively, the expenses reported on line 1a may be derived from audited or unaudited financial statements. The home office books may be books recorded under the Generally Accepted Accounting Principles ("GAAP"), or other applicable accounting standards, including International Financial Reporting Standards, applicable to the corporation's local accounting practices or under U.S. GAAP, at the corporation's choosing. Expenses of other includible entities (i.e., disregarded entities) are included in home office expenses reported on line 1a only if the expenses of such other entities are recorded on the home office's books. However, if the home office's books and records are maintained as part of a foreign, consolidated financial statement, the consolidated group's expenses may be entered on Line 1a, although such amounts are adjusted on Line 2. If the consolidated group's expenses are used, the taxpayer must attach a schedule listing the foreign consolidated group members. Expenses recorded on non-Schedule L books of disregarded entities (and not on the home office books) that are allocated and apportioned to ECI are reported on line 19. If the corporation uses management cost accounting statements for its home office books that include expenses of one or more disregarded entities, and also maintains certified audited third-country GAAP (or other applicable accounting standards) statements for a disregarded entity, the expenses of the disregarded entity must be included in line 1a in either U.S. dollars or the home office's functional currency even if the audited third-country GAAP (or other applicable accounting standards) statements are in another non-dollar functional currency.

Line 2. Enter on line 2 the total of the adjustments necessary to conform the amounts on line 1a to the amounts that are deductible for U.S. tax purposes. These adjustments include temporary and permanent differences of the type applicable in determining the deductions of U.S. corporations that file their income tax returns on Form 1120 (e.g., adjustments eliminating any line 1a expenses of entities whose expenses are includible in the corporation's expenses for book purposes but not for U.S. tax purposes). In addition, include adjustments to loan losses and loss reserves included in line 1a expenses to reflect the amount of bad debt expense that is deductible for U.S. tax purposes. Such adjustments include any amount of bad debt expense included in line 1a that is treated as an involuntary charge-off under Regulations section 1.166-2(d)(2). The deductible amount of bad debt expense remaining after any adjustments on line 2 is eliminated from Schedule H expenses on line 5.

Do not allocate and apportion expenses to ECI and non-ECI on line 2. In addition, do not make adjustments on line 2 to reflect book-to-tax adjustments for any home office interest expense (including interbranch interest expense) included on line 1a. Interest expense included on line 1a is adjusted on line 4. The allocation of deductible interest expense to ECI is reported on Schedule I (Form 1120-F). Attach a statement listing the amount of the adjustment for each of the following categories:

1. Expenses included on line 1a of entities whose expenses are not includible in the corporation's expenses for U.S. tax purposes.

2. Temporary differences (e.g., costs capitalized under section 263A, carrying charges under section 263(g), depreciation and amortization, general loan loss reserves).

3. Permanent differences (e.g., interbranch transactions other than interest, non-deductible meals and entertainment and executive salary compensation).

If the corporation is a foreign bank that charges its U.S. branch office cost reimbursements for services and overhead which are booked by the branch in the third party category of expense actually incurred rather than as a lump sum interbranch amount, list the adjustment for each third party category expense separately on the statement for permanent differences.

Line 3. Combine lines 1a and 2 and enter the result on line 3. The amount reported on line 3 is the total amount of deductible expenses (determined under U.S. tax principles before apportionment between ECI and non-ECI) of the foreign corporation that files Form 1120-F, other than those that are included on the corporation's Schedule L books.

Line 4. Enter on line 4 the total amount of interest expense (including interbranch interest), if any, recorded on the home office books that is included on line 3.

Line 5. Enter on line 5 the bad debt expense, if any, that is included on line 3. Any portion of the amount included on line 5 that is allocable to

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ECI is reported directly on Form 1120-F, Section II, line 15.

Line 7. Subtract line 6 from line 3 and enter the difference on line 7. This is the corporation's remaining home office deductions which are to be allocated and apportioned between ECI and non-ECI in Parts I and II of Schedule H.

Lines 8 through 10. The amounts reported on lines 8 through 10 are deductions that are definitely related to non-ECI under Regulations sections 1.861-8 and 1.861-17 and Temporary Regulations section 1.861-8T. If the corporation has deductions included in line 7 that are definitely related and allocable to ECI that is exempt from tax under the Code or an income tax treaty, the deductions should be treated as allocable to non-ECI for purposes of Schedule H and included in the amounts reported on lines 8 through 10.

Line 8. Enter on line 8 deductions included on line 7 that are definitely related to non-ECI received from subsidiaries (other than disregarded entities whose income and deductions are treated as income and deductions of the corporation filing Form 1120-F). See, for example, Regulations section 1.861-8(e)(4)(ii) and Regulations section 1.861-17 (relating to treatment of stewardship expenses attributable to dividends and research and experimentation expenses).

Line 9. Enter on line 9 deductions included on line 7 (other than amounts included on line 8) that are definitely related under Regulations sections 1.861-8 and 1.861-17 and Temporary Regulations section 1.861-8T to non-ECI of the corporation that is booked in the corporation's home office and in other locations in the corporation's home country. For example, line 9 includes deductions included on line 7 that are definitely related to non-ECI of a banking corporation that is booked in the corporation's home office and in its retail banking branches in the corporation's home country. The amount of any inter-office or interbranch charges from the home office to various locations and departments recorded on the home office books as home office "service" fees for internal management or home office tax accounting purposes (which amounts are eliminated on line 2) is not determinative of the amount of the home office's deductible expense that is definitely related to non-ECI.

Line 10. Enter on line 10 all other deductions included on line 7 that are definitely related solely to non-ECI of the corporation (other than amounts included on lines 8 and 9). For example, if a banking corporation conducts global banking operations through branch offices (including through disregarded entities) in locations outside the corporation's home country, the home office deductions included on line 7 that are definitely related to non-ECI booked in those locations are reportable on line 10. These deductions include home office deductions definitely related to non-ECI of disregarded entities, whether or not the balance sheet from such entity is reportable on Schedule L of Form 1120-F. (For corporations other than banks, such non-ECI may be reflected as income from includible entities on Schedule M-3 (Form 1120-F), Part I, line 5. Foreign banks record such non-ECI on Schedule M-3 (Form 1120-F), Part I, line 5 only if the entity's sets of books are reportable on Form 1120-F, Schedule L.) See the Instructions for Schedule M-3 (Form 1120-F), Part I.

Line 11. Enter on line 11 the portion of the deductions included on line 7 that is definitely related to ECI under Regulations sections 1.861-8 and 1.861-17 and Temporary Regulations section 1.861-8T. Deductions definitely related to ECI may include specifically identifiable personnel and other associated costs incurred in the home office with respect to persons who work on the evaluation and approval of ECI-producing activities of the corporation's trade or business within the United States (e.g., specifically identifiable home office deductions incurred for the evaluation and approval of U.S. loans to customers negotiated and solicited by the corporation's U.S. branch office where a banking, financing, or similar business is carried on). Also include on line 11 deductible research and experimentation expenditures that are definitely related to ECI under Regulations section 1.861-17 and deductible charitable contributions that are included on line 7.

Part II – Home Office Deductible Expenses Allocated and Apportioned to ECI

Line 13. Subtract line 12 from line 7 and enter the difference on line 13. The amount on line 13 is the residual amount of the deductions entered on line 7 that is not definitely related solely to the corporation's ECI or non-ECI. The amount on line 13 is subject to apportionment under Regulations sections 1.861-8 and 1.861-17 and Temporary Regulations section 1.861-8T on Part II, line 16.

Line 14. If the corporation reports expenses and deductions in Part I in the corporation's foreign functional currency, enter the average exchange rate that is used to convert those deductions to U.S. dollars for purposes of lines 15 and 17. The exchange rate must be rounded to at least five places.

Note. You must round the result to more than five places if failure to do so would materially distort the exchange rate or the equivalent amount of U.S. dollars.

If the corporation reports amounts in Part I in U.S. dollars, leave line 14 blank.

Line 15. Enter on line 15 the amount on line 13, converted if necessary to U.S. dollars. If the amount on line 13 is stated in the corporation's foreign functional currency, divide line 13 by the line 14 exchange rate and enter the result on line 15.

Line 16. Enter on line 16 the amount of deductions included on line 15 that is apportioned to ECI under Regulations sections 1.861-8 and 1.861-17 and Temporary Regulations section 1.861-8T. Attach a statement describing the apportionment methods used, identifying the numerator and denominator of any ratio-based method, and listing the amount apportioned under each method to ECI.

Line 17. Enter on line 17 the amount entered on line 11, converted if necessary to U.S. dollars. If the amount on line 11 is stated in the corporation's foreign functional

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currency, divide line 11 by the line 14 exchange rate and enter the result on line 17.

Line 18. Add lines 16 and 17 and enter the total on line 18. The amount on line 18 is the total amount of deductible expenses reported on the home office books that is allocated and apportioned to ECI under Regulations sections 1.861-8 and 1.861-17 and Temporary Regulations section 1.861-8T.

Line 19. Enter on line 19, in U.S. dollars, the amount of deductible expenses allocated and apportioned to ECI under Regulations sections 1.861-8 and 1.861-17 and Temporary Regulations section 1.861-8T that is recorded on non-Schedule L books and records of foreign locations other than those of the home office. Attach a statement listing the amount of deductions allocated and apportioned to ECI from each location.

Line 20. Add lines 18 and 19 and enter the total on line 20. The amount entered on line 20 is the total amount of deductible expenses reported on the corporation's non-Schedule L books that is allocated and apportioned to ECI under Regulations sections 1.861-8 and 1.861-17 and Temporary Regulations section 1.861-8T. This amount is also reported on Form 1120-F, Section II, line 26, and, for banks only, on Schedule M-3 (Form 1120-F), Part III, line 31.

Part III – Allocation and Apportionment Methods and Financial Records Used to Complete Parts I and II

Part III is used to identify the income, asset, and personnel attributes of the U.S. trade or business and to report the methodologies and financial records used to determine the amount of the deductions that are allocated and apportioned to ECI in Parts I and II of Schedule H. The corporation's ratios of effectively connected gross income, U.S. assets, and U.S. personnel to worldwide gross income, worldwide assets, and worldwide personnel are reported on lines 21 through 23. Other ratio-based methods and any non-ratio-based methods the corporation used for the tax year to allocate and apportion deductions to non-ECI on lines 8 through 10 and to ECI on lines 11, 16, and 19 are identified in statements required by the instructions for lines 24 and 25.

Check Boxes Above Line 21

New methods. Check the box to indicate if the corporation used a method to allocate and apportion deductions for the current tax year that was not used in the prior year.

Interbranch amounts in Part IV. Check the box to indicate if an expense in respect of any amount included in Part II, line 20, in the home office allocation and apportionment was recorded on the Schedule L books that are used to complete Part IV of Schedule H. Include the full amount of the interbranch charge in Part IV, line 35.

Lines 21 Through 23. Gross Income, Asset, and Number of Personnel Ratios

The corporation must complete the gross income ratio for line 21 whether or not it used such method to allocate and apportion deductions in Parts I and II. If the corporation used the asset or number of personnel method (whether separately or as components of a multi-factor method), it must report the attributes on lines 22 and 23. If the corporation did not use either the asset or the personnel method to allocate and apportion deductions for the year, then, except as provided for worldwide assets reported on line 22b, only the numerators of each method must be reported on lines 22 and 23. See the instructions for line 22b for disclosure of the asset ratio by corporations that used the actual ratio to allocate interest expense under Regulations section 1.882-5.

Line 21a. Enter on line 21a the corporation's gross ECI reportable on Schedule M-3 (Form 1120-F), Part II, line 25, column (e), plus any additional gross income amounts reportable on line 27, column (e). If the corporation is not required to and does not file Schedule M-3 (Form 1120-F) for the tax year, enter the amount of gross income from Form 1120-F, Section II, line 11.

Line 21b. Enter on line 21b the corporation's worldwide gross income stated in U.S. dollars. Corporations other than banks enter the worldwide gross income amount from Schedule M-3 (Form 1120-F), Part II, line 25, column (a), plus any additional gross income amounts included on line 27, column (a). However, if the corporation's worldwide income is effectively connected to its trade or business within the United States, the corporation should instead enter the gross income amount from Schedule M-3, Part II, line 25, column (e) (plus any additional gross income amounts included on line 27, column (a)), but only if there are no permanent differences for tax-exempt income under section 103 or under a treaty (e.g., force of attraction income not attributable to a U.S. permanent establishment) that would otherwise be removed in column (c). If the corporation is not required to and does not report worldwide gross income in column (a) of Schedule M-3 (Form 1120-F), enter the worldwide gross income from any other reasonable source. Reasonable sources include worldwide income statements used to report allocations of income or capital to other regulatory or non-Federal tax authorities or the worldwide income statements that would be used if the corporation was required to report worldwide gross income in column (a) of Schedule M-3 (Form 1120-F). Worldwide gross income is worldwide gross receipts less only cost of goods sold, if applicable.

Line 22a. Enter on line 22a the average assets reported on Schedule I (Form 1120-F), line 5, column (d). These are the average U.S. assets included in the corporation's Regulations section 1.882-5 interest expense allocation. If the corporation does not have any interest expense for the year and does not file Schedule I (Form 1120-F), enter the average assets derived from the beginning and ending U.S. assets included in the computation of U.S. net equity on Form 1120-F, Section III, lines 4a and 4b. If the corporation is exempt from the branch profits tax under an applicable income tax treaty and is not required to complete Form 1120-F, Section III, Part I, the average U.S. assets should be derived from the beginning and ending U.S. assets

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included on Form 1120-F, Schedule L.

Line 22b. If the corporation used the worldwide actual ratio under Regulations section 1.882-5(c)(2) to allocate interest expense to ECI, enter the amount from Schedule I (Form 1120-F), line 6b. If the corporation did not use the actual ratio, but used a worldwide asset ratio to apportion deductions to ECI for purposes of line 11, 16, or 19, enter the worldwide assets used in that ratio. If a worldwide asset ratio is not available from either Schedule I (Form 1120-F), line 6b or Schedule H, line 11, 16, or 19, leave line 22b blank.

Line 22c. If an amount is entered on line 22b, divide line 22a by line 22b to determine the asset ratio and enter the percentage on line 22c. If line 22b is blank, leave line 22c blank.

Line 23a. Enter on line 23a the number of personnel who worked in the corporation's U.S. trade or business during the tax year. The corporation may use any reasonable method to determine the number of personnel, including data that is already prepared and used by the corporation for a non-tax business purpose. For example, if the corporation maintains headcount data (such as weighted average headcount data) in its personnel records or for other purposes such as budgeting, planning, and control, such numbers may be used in the numerator.

Line 23b. If the corporation used a ratio based on number of personnel to apportion deductions on line 11, 16, or 19, enter the worldwide personnel count used in the denominator of such ratio on line 23b. If the corporation does not apportion deductions using a number of personnel ratio, leave line 23b blank.

Line 23c. If an amount is entered on line 23b, divide line 23a by line 23b to determine the number of personnel ratio and enter the percentage on line 23c. If line 23b is blank, leave line 23c blank.

Line 24. If the corporation used any other ratio-based method to allocate and apportion deductions to ECI and non-ECI on line 8, 9, 10, 11, 16, or 19 of Schedule H, attach a statement describing the ratio used on each line. Include the numerator and denominator of the ratio used for each applicable line.

Line 25. If the corporation used a non-ratio-based method to allocate and apportion deductions to ECI and non-ECI on line 8, 9, 10, 11, 16, or 19 of Schedule H, attach a statement describing each such method and the percentage used, if any, for each applicable line. These may include methods for which percentage allocations to ECI or non-ECI are estimated and documented by questionnaires or home office department interviews (e.g., estimated percent of time spent by employees of particular home office departments or sub-departments on U.S. trade or business activities).

Lines 26 Through 28. Identification of Financial Records Used

Check the “Yes” or “No” box to indicate whether the types of financial books and records indicated were used to complete Parts I and II of Schedule H.

Line 28. If the “Yes” box is checked, attach statement listing the other documentation used to complete Parts I and II of Schedule H (e.g., home country regulatory reports or functional analyses).

Part IV – Allocation and Apportionment of Expenses on Books and Records Used to Prepare Form 1120-F, Schedule L

Use Part IV of Schedule H to report the allocation and apportionment of deductions recorded on the corporation's Schedule L books, other than interest and bad debt expense, to ECI and non-ECI under Regulations sections 1.861-8 and 1.861-17 and Temporary Regulations section 1.861-8T.

Line 29. Enter on line 29 the total expenses recorded on the Schedule L books.

Note. The Schedule L books may be maintained using GAAP, or other applicable accounting standards, other than U.S. GAAP. The Schedule L books may include more than one set of books, including the set(s) of books of disregarded entities. See the instructions for Schedule M-3 (Form 1120-F), Part I, lines 4 and 5, for the Schedule L treatment of disregarded entities and the combined reporting of multiple sets of books. These rules apply to both banks and non-banks for purposes of determining the expenses reportable on Schedule H, line 29. Interbranch income and expenses recorded between separate sets of books must be eliminated in the combined reports.

Line 30. Enter on line 30 the total of the adjustments necessary to conform the amounts on line 29 to the amounts that are deductible for U.S. tax purposes. See the instructions for Part I, line 2, for a general description of the types of temporary and permanent differences that are reportable as adjustments to the book expenses in determining current year tax deductions under U.S. tax principles. However, do not include on line 30 any adjustments that are otherwise reportable on lines 32a through 35. Specifically, third party interest expense and interbranch interest expense included on line 29 is adjusted on lines 32a and 32b, instead of line 30. Bad debt expense included on line 29 is adjusted on line 33, instead of line 30. Other third-party deductible expenses not allocated or apportioned to ECI and non-ECI under Regulations section 1.861-8 are adjusted on line 34, instead of line 30. Interbranch expenses (other than interest expense) included on line 29 (including interbranch book charges for home office services provided to the U.S. trade or business) are adjusted on line 35, instead of line 30. However, if the corporation is a foreign bank that charges its U.S. branch office cost reimbursements for services and overhead which are booked by the branch in the third party category of expense actually incurred rather than as a lump sum interbranch amount, the interbranch amounts charged and recorded by the U.S. branch Schedule L book should not be reported on line 35 as interbranch expenses, but should be left in the third party categories to which they are assigned on the U.S. books and records. If any such amounts require adjustment for U.S. tax principles (e.g., meals and entertainment at 50%), then such

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adjustment should be shown on line 30.

Attach a schedule detailing the items adjusted and amounts of each adjustment.

Line 32a. Enter on line 32a the amount of third-party interest expense (whether owed to unrelated or related parties) that is included in the amount reported on line 31. Interest expense is allocated to ECI under Regulations section 1.882-5 and reported on Schedule I (Form 1120-F).

Line 32b. Enter on line 32b any interbranch interest expense that is included in the amount reported on line 31.

Line 33. Enter on line 33 any bad debt expense that is included in the amount reported on line 31. Any portion of the amount eliminated on line 33 that is allocated and apportioned to ECI is reported directly on Form 1120-F, Section II, line 15.

Line 34. Enter on line 34 other third-party expenses that are included in the amount reported on line 31 and that are not allocated and apportioned between ECI and non-ECI under Regulations sections 1.861-8 and 1.861-17 and Temporary Regulations section 1.861-8T. Periodic expense from a notional principal contract is not allocated and apportioned under Regulations section 1.861-8 and Temporary Regulations section 1.861-8T if the amount is includible in the profits and losses of a global dealing operation and the corporation allocates and apportions such amounts under Proposed Regulations section 1.863-3(h). Such periodic expense is subject to allocation and apportionment under Proposed Regulations section 1.863-3(h) in accordance with the principles of Proposed Regulations section 1.482-8. If such periodic expense is included in line 31, it should be included on line 34 and reported separately on Form 1120-F, Section II, as either part of the global dealing income reported on Form 1120-F, Section II, line 10, or as a separately identified deduction under Form 1120-F, Section II, line 27.

Line 35. Enter on line 35 all interbranch expenses, other than interbranch interest expense, that are included in the amount reported on line 31. The interbranch amounts reportable on line 35 include home office charges reflected on the Schedule L books for home office management services provided to the U.S. trade or business.

Note. Amounts paid or accrued on the Schedule L books to the home office are not determinative of the amount of home office expense allocated and apportioned to ECI on Schedule H, Part II, line 20.

Line 36. Add the amounts on lines 32a through 35 and enter the total on line 36. This amount reflects the deductions included in line 31 for which there are special rules to which the general allocation and apportionment rules under Regulations sections 1.861-8 and 1.861-17 and Temporary Regulations section 1.861-8T do not apply.

Line 37. Subtract the amount on line 36 from the amount on line 31 and enter the difference on line 37. The amount reported on line 37 is allocated and apportioned to ECI and non-ECI under Regulations sections 1.861-8 and 1.861-17 and Temporary Regulations section 1.861-8T and reconciled on lines 38a through 41.

Lines 38a Through 41. Reconciliation of Allocable Expenses on Books Under Regulations Section 1.861-8 (from line 37)

The amount of deductions reported on line 37 that is allocated and apportioned to ECI and non-ECI is reported on lines 38a through 41, columns (a) through (c). With respect to each of lines 38a through 41, enter the amount included in line 37 that is allocated or apportioned to ECI in column (a) and the amount allocated or apportioned to non-ECI in column (b). Add columns (a) and (b) for each line and enter the total amount in column (c).

Line 38a. Enter on line 38a the amount of derivative transaction deductions included in line 37 that are definitely related to ECI or non-ECI under Regulations section 1.861-8 and Temporary Regulations section 1.861-8T. Deductions included on line 38a are periodic expense from notional principal contracts that are sourced under Regulations section 1.863-7 with respect to non-dealer securities hedging transactions or from securities trading or non-global dealing operations. If notional principal contract periodic expense is allocated and apportioned under the global dealing rules of Proposed Regulations section 1.863-3(h), such amounts should be included on line 34 and, therefore, are not definitely related to ECI or non-ECI under Regulations section 1.861-8 and Temporary Regulations section 1.861-8T.

Note. Periodic expenses from notional principal contracts may be allocated and apportioned to ECI and non-ECI in accordance with the ECI and non-ECI treatment of the item(s) the notional principal contract hedges.

Line 38b. Enter on line 38b all other deductions included in the amount reported on line 37 that are definitely related to ECI or non-ECI under Regulations sections 1.861-8 and 1.861-17 and Temporary Regulations section 1.861-8T.

Line 39. Add lines 38a and 38b and enter the total on line 39 for each of columns (a) through (c). The amounts on line 39 are the portion of total deductions reported on line 37 that are definitely related to ECI and non-ECI.

Line 40. Enter on line 40 the deductions included in line 37 that are not definitely related to ECI or non-ECI that are apportioned to ECI and non-ECI under Regulations sections 1.861-8 and 1.861-17 and Temporary Regulations section 1.861-8T. The total on line 40, column (c), must equal line 37 minus line 39, column (c).

Line 41. Add lines 39 and 40 and enter the total on line 41 for each of columns (a) through (c). The amount entered on line 41, column (a) is the total amount of deductions included on line 37 that is allocated and apportioned to ECI. These deductions are included on Form 1120-F, Section II, lines 12, 13, 14, 16, 17, 19 through 25, and 27. The total amount on line 41, column (c) must equal the amount on line 37.

DRAFT AS OF August 8, 2012