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2012

Department of the Treasury
Internal Revenue Service

Instructions for Schedule M-3 (Form 1120)

Net Income (Loss) Reconciliation for Corporations With Total Assets of $10 Million or More

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

Future Developments

For the latest information about developments related to Schedule M-3 (Form 1120) and its instructions, such as legislation enacted after they were published, go to *www.irs.gov/form1120.*

General Instructions

Purpose of Schedule

Schedule M-3, Part I, asks certain questions about the corporation's financial statements and reconciles financial statement net income (loss) for the corporation (or consolidated financial statement group, if applicable), as reported on Part I, line 4a, to net income (loss) of the corporation for U.S. taxable income purposes, as reported on Part I, line 11.

Schedule M-3 Parts II and III reconcile financial statement net income (loss) for the U.S. corporation (or consolidated tax group, if applicable), as reported on Schedule M-3, Part I, line 11, to taxable income on Form 1120, page 1, line 28.

Where To File

If the corporation is required to file (or voluntarily files) Schedule M-3 (Form 1120), the corporation **must** file Form 1120 and all attachments and schedules, including Schedule M-3 (Form 1120) at the following address.

Department of the Treasury
Internal Revenue Service Center
Ogden, UT 84201-0012

Who Must File

- Any domestic corporation or group of corporations required to file Form 1120, U.S. Corporation Income Tax Return, that reports on Form 1120, Schedule L, Balance Sheets per Books, total assets at the end of the corporation's tax year that equal or exceed $10 million must complete and file Schedule M-3 instead of Schedule M-1, Reconciliation of Income (Loss) per Books With Income per Return.
- A corporation filing a non-consolidated Form 1120 that reports on Schedule L total assets that equal or exceed $10 million must complete and file Schedule M-3 instead of Schedule M-1 and must check box (1) Non-consolidated return, at the top of page 1 of Schedule M-3.
- Any U.S. consolidated tax group consisting of a U.S. parent corporation and additional includible corporations listed on Form 851, Affiliations Schedule, required to file Form 1120, that reports on Schedule L total consolidated assets at the end of the tax year that equal or exceed $10 million must complete and file Schedule M-3 instead of Schedule M-1, and must check box (2) Consolidated return (Form 1120 only), or box (3) Mixed 1120/L/PC group, as applicable, at the top of page 1 of Schedule M-3.

A U.S. corporation filing Form 1120 that is not required to file Schedule M-3 may voluntarily file Schedule M-3 instead of Schedule M-1. A corporation filing Schedule M-3 must check Item A, box 4, on Form 1120, page 1, indicating that Schedule M-3 is attached, whether required or voluntary. A corporation filing Schedule M-3 must not file Schedule M-1.

Example 1.

1. U.S. corporation A owns U.S. subsidiary B and foreign subsidiary F. For its 2012 tax year, A prepares consolidated financial statements with B and F that report total assets of $12 million. A files a consolidated U.S. income tax return with B and reports total consolidated assets on Schedule L of $8 million. A's U.S. consolidated tax group is not required to file Schedule M-3 for the 2012 tax year.

2. U.S. corporation C owns U.S. subsidiary D. For its 2012 tax year, C prepares consolidated financial statements with D, but C and D file separate U.S. income tax returns. The consolidated accrual basis financial statements for C and D report total assets at the end of the tax year of $12 million after intercompany eliminations. C reports separate company total year-end assets on its Schedule L of $7 million. D reports separate company total year-end assets on its Schedule L of $6 million. Neither C nor D is required to file Schedule M-3 for the 2012 tax year.

3. Foreign corporation A owns 100 percent of both U.S. corporation B and U.S. corporation C. C owns 100 percent of U.S. corporation D. For its 2012 tax year, A prepares a consolidated worldwide financial statement for the ABCD consolidated group. The ABCD consolidated financial statement reports total year-end assets of $25 million. A is not required to file a U.S. income tax return. B files a separate U.S. income tax return and reports separate company total year-end assets on its Schedule L of $12 million. C files a consolidated U.S. income tax return with D and, after eliminating intercompany transactions between C and D, reports consolidated total year-end assets on Schedule L of $8 million. B is required to file Schedule M-3 because its total year-end assets reported on Schedule L exceed $10 million. The CD U.S. consolidated tax group is not required to file Schedule M-3 because its total year-end assets do not exceed $10 million.

Special Filing Requirements for Certain Groups

Mixed groups. If the parent corporation of a U.S. consolidated tax group files Form 1120 and files Schedule M-3, each member of the group must file a Schedule M-3. However, if the parent corporation of a U.S. consolidated tax group files Form 1120 and any member of the group files Form 1120-PC, U.S. Property and Casualty Insurance Company Income Tax Return, or Form 1120-L, U.S. Life Insurance Company Income Tax Return, that member must file Schedule M-3 (Form 1120-PC) or Schedule M-3 (Form 1120-L), respectively, and the group must

comply with the mixed group consolidated Schedule M-3 instructions under *Schedule M-3 Consolidation for Mixed Groups (1120/L/PC)*, below. A mixed group must also file Form 8916, Reconciliation of Schedule M-3 Taxable Income with Tax Return Taxable Income for Mixed Groups and, if applicable, Form 8916-A, Supplemental Attachment to Schedule M-3.

If the parent company of a U.S. consolidated tax group files Form 1120 and any member of the group files Form 1120-PC or Form 1120-L and the consolidated Schedule L reported in the return includes the assets of all of the companies (the insurance companies as well as the non-insurance companies), in order to determine if the group meets the $10 million threshold test for the requirement to file Schedule M-3, use the amount of total assets reported on Schedule L of the consolidated return. If the parent company of a U.S. consolidated tax group files Form 1120 and any member of the group files Form 1120-PC or Form 1120-L and the consolidated Schedule L reported in the return does not include the assets of one or more of the insurance companies in the U.S. consolidated tax group, in order to determine if the group meets the $10 million threshold test, use the sum of the amount of total assets reported on the consolidated Schedule L plus the amounts of all assets reported on Forms 1120-PC and 1120-L that are included in the consolidated return but not included on the consolidated Schedule L.

Other entities. There is a unique separate Schedule M-3 for taxpayers required to file Form 1065, U.S. Return of Partnership Income; Form 1120S, U.S. Income Tax Return for an S Corporation; Form 1120-F, U.S. Income Tax Return of a Foreign Corporation; and for Forms 1120-PC or 1120-L. For more information, see the instructions for the applicable Schedule M-3.

Cooperatives filing Form 1120-C, U.S. Income Tax Return for Cooperative Associations, that report end of year assets of $10 million or more must complete Schedule M-3 (Form 1120) instead of Schedule M-1.

For insurance companies included in the consolidated U.S. income tax return, see the instructions for Part I, lines 10 and 11, and Part II, line 7, for guidance on Schedule M-3 reporting of intercompany dividends and statutory accounting adjustments.

Note. No Schedule M-3 is required for taxpayers filing Form 1120-REIT, U.S. Income Tax Return for Real Estate Investment Trusts; Form 1120-RIC, U.S. Income Tax Return for Regulated Investment Companies; Form 1120-H, U.S. Income Tax Return for Homeowners Associations; and Form 1120-SF, U.S. Income Tax Return for Settlement Funds.

Other Issues Affecting Schedule M-3 Filing Requirements

If a corporation was required to file Schedule M-3 for the preceding tax year, but reports on Form 1120, page 1, Item D, and on Form 1120, Schedule L, total consolidated assets at the end of the current tax year of less than $10 million, the corporation is not required to file Schedule M-3 for the current tax year. The corporation may either (a) file Schedule M-3, or (b) file Schedule M-1, for the current tax year. However, if the corporation chooses to file Schedule M-1 for the current tax year, and for a subsequent tax year the corporation is required to file Schedule M-3, the corporation must complete Schedule M-3 in its entirety (Part I and all columns in Parts II and III) for that subsequent tax year.

In the case of a U.S. consolidated tax group, total assets at the end of the tax year must be determined based on the total year-end assets of all includible corporations listed on Form 851, net of eliminations for intercompany transactions and balances between the includible corporations. In addition, for purposes of determining whether the corporation (or U.S. consolidated tax group) has total assets at the end of the current tax year of $10 million or more, the corporation's total consolidated assets must be determined on an overall accrual method of accounting unless both of the following apply: (a) the tax returns of all includible corporations in the U.S. consolidated tax group are prepared using an overall cash method of accounting, and (b) no includible corporation in the U.S. consolidated tax group prepares or is included in financial statements prepared on an accrual basis.

Note. See the instructions for Part I, line 1, for a discussion of non-tax-basis income statements and related non-tax-basis balance sheets to be used in the preparation of Schedule M-3 and of Form 1120, Schedule L.

Other Form 1120 Schedules Affected by Schedule M-3 Requirements

Schedule B

A corporation or group of corporations that files a Form 1120 and is required to file Schedule M-3, must also file Schedule B (Form 1120), Additional Information for Schedule M-3 Filers. In the case of a consolidated group, a parent corporation files one Schedule B (Form 1120) for the entire consolidated group.

Schedule L

If a non-tax-basis income statement and related non-tax-basis balance sheet is prepared for any purpose for a period ending with or within the tax year, Schedule L must be prepared showing non-tax-basis amounts. See the instructions for Part I, line 1, for the discussion of non-tax-basis income statements and related non-tax-basis balance sheets prepared for any purpose and the impact on the selection of the income statement used for Schedule M-3 and the related non-tax-basis balance sheet amounts that must be used for Schedule L.

Total assets shown on Schedule L, line 15, column (d) (or, in the case of some consolidated mixed groups with a Form 1120 parent and an insurance subsidiary, the assets reported on Form 1120, page 1, Item D), must equal the total assets of the corporation (or, in the case of a U.S. consolidated tax group, the total assets of all members of the group listed on Form 851) as of the last day of the tax year, and must be the same total assets reported by the corporation (or by each member of the U.S. consolidated tax group) in the non-tax-basis financial statements, if any, used for Schedule M-3. If the corporation prepares non-tax-basis financial statements, Schedule L must equal the sum of the financial statement total assets for each corporation listed on Form 851 and included in the consolidated U.S. income tax return (includible corporation) net of eliminations for intercompany transactions between includible corporations. If the corporation does not prepare non-tax-basis financial statements, Schedule L must be based on the corporation's books and records. The Schedule L balance sheet can show tax-basis balance sheet amounts if the corporation is allowed to use books and records for Schedule M-3

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and the corporation's books and records reflect only tax-basis amounts.

Generally, total assets at the beginning of the year (Schedule L, line 15, column (b)) must equal total assets at the close of the prior year (Schedule L, line 15, column (d)). For each Schedule L balance sheet item reported for which there is a difference between the current opening balance sheet amount and the prior closing balance sheet amount; attach a schedule that reports the balance sheet item, the prior closing amount, the current opening amount, and a short explanation of the change. Such reasons for these differences include mergers and acquisitions.

For purposes of measuring total assets at the end of the year, the corporation's assets may not be netted or reduced by the corporation's liabilities. In addition, total assets may not be reported as a negative amount. If Schedule L is prepared on a non-tax-basis method, an investment in a partnership may be shown as appropriate under the corporation's non-tax-basis method of accounting, including, if required by the corporation's reporting methodology, the equity method of accounting for investments. If Schedule L is prepared on a tax-basis, an investment by the corporation in a partnership must be shown as an asset and measured by the corporation's adjusted basis in its partnership interest. Any liabilities contributing to such adjusted basis must be shown on Schedule L as corporate liabilities.

Schedule M-2

The amount shown on Schedule M-2, line 2, Net income (loss) per books, must equal the amount shown on Schedule M-3, Part I, line 11. Schedule M-2 must reflect activity only of corporations included in the consolidated U.S. income tax return.

Consolidated Return (Form 1120, Page 1)

Report on Form 1120, page 1, each item of income, gain, loss, expense, or deduction net of elimination entries for intercompany transactions between includible corporations. The corporation must not report as dividends on Form 1120, Schedule C, any amounts received from an includible corporation. In general, dividends received from an includible corporation must be eliminated in consolidation rather than offset by the dividends-received deduction.

Entity Considerations for Schedule M-3

For purposes of Schedule M-3, references to the classification of an entity (for example, as a corporation, a partnership, or a trust) are references to the treatment of the entity for U.S. income tax purposes. An entity that generally is disregarded as separate from its owner for U.S. income tax purposes (disregarded entity) must not be separately reported on Schedule M-3 except, if required, on Part I, line 7a or 7b. On Schedule M-3, Parts II and III, any item of income, gain, loss, deduction, or credit of a disregarded entity must be reported as an item of its owner. In particular, the income or loss of a disregarded entity must not be reported on Part II, lines 9, 10, or 11 as from a separate partnership or other pass-through entity. The financial statement income or loss of a disregarded entity is included on Part I, line 7a or 7b, only if its financial statement income or loss is included on Part I, line 11, but not on Part I, line 4a.

Reportable Entity Partner Reporting Responsibilities

A reportable entity partner with respect to a partnership filing Form 1065 is an entity that:

- Owns or is deemed to own, directly or indirectly, under these instructions a 50 percent or greater interest in the income, loss or capital of the partnership on any day of the tax year; and
- Was required to complete Schedule M-3 on its most recently filed U.S. income tax return or return of income filed prior to that day.

For the purposes of these instructions, the following rules apply.

1. The parent corporation of a consolidated tax group is deemed to own all corporate and partnership interests owned or deemed to be owned under these instructions by any member of the tax consolidated group.

2. The owner of a disregarded entity is deemed to own all corporate and partnership interests owned or deemed to be owned under these instructions by the disregarded entity.

3. The owner of 50 percent or more of a corporation by vote on any day of its tax year is deemed to own all corporate and partnership interests owned or deemed to be owned under these instructions by the corporation during its tax year.

4. The owner of 50 percent or more of partnership income, loss, or capital on any day of the partnership tax year is deemed to own all corporate and partnership interests owned or deemed to be owned under these instructions by the partnership during the partnership tax year.

5. The beneficial owner of 50 percent or more of the beneficial interest of a trust or nominee arrangement on any day of the trust or nominee arrangement tax year is deemed to own all corporate and partnership interests owned or deemed to be owned under these instructions by the trust or nominee arrangement.

A reportable entity partner with respect to a partnership (as defined above) must report the following to the partnership within 30 days of first becoming a reportable entity partner and, after first reporting to the partnership under these instructions, thereafter within 30 days of the date of any change in the interest it owns or is deemed to own, directly or indirectly, under these instructions, in the partnership.

1. Name.

2. Mailing address.

3. Taxpayer identification number (TIN or EIN), if applicable.

4. Entity or organization type.

5. State or country in which it is organized.

6. Date on which it first became a reportable entity partner.

7. Date with respect to which it is reporting a change in its ownership interest in the partnership, if applicable.

8. The interest in the partnership it owns or is deemed to own in the partnership, directly or indirectly (as defined under these instructions) as of the date with respect to which it is reporting.

9. Any change in that interest as of the date with respect to which it is reporting.

The reportable entity partner must retain copies of required reports it makes to partnerships under these instructions. Each partnership must retain copies of the required reports it receives under these instructions from reportable entity partners.

Example 2.

1. A, an LLC filing a Form 1065 for 2012, is owned 50 percent by U.S. corporation Z. A owns 50 percent of B, C, D, and E, which are also LLCs filing a

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Form 1065 for calendar year 2012. Z was first required to complete Schedule M-3 (Form 1120) for its corporate tax year ended December 31, 2011, and filed its Form 1120 with Schedule M-3 for 2011 on September 15, 2012. As of September 16, 2012, Z was a reportable entity partner with respect to A and, through A, with respect to B, C, D, and E. On October 5, 2012, Z reports to A, B, C, D, and E, as it is required to do within 30 days of September 16, that Z is a reportable entity partner directly owning (with respect to A) or deemed to own indirectly (with respect to B, C, D, and E) a 50 percent interest. Therefore, because Z was a reportable entity partner for 2012, each of A, B, C, D, and E is required to complete Schedule M-3 (Form 1065) for 2012, regardless of whether they would otherwise be required to complete Schedule M-3 for that year.

2. P, a U.S. corporation, is the parent of a financial consolidation group with 50 domestic subsidiaries DS1 through DS50 and 50 foreign subsidiaries FS1 through FS50, all 100 percent owned on September 16, 2012. On September 15, 2012, P filed a consolidated tax return on Form 1120 and was required to complete Schedule M-3 for the tax year ending December 31, 2011. On September 16, 2012, DS1, DS2, DS3, FS1, and FS2 each acquires a 10 percent partnership interest in partnership K which files Form 1065 for the tax year ending December 31, 2012. P is deemed to own, directly or indirectly (under these instructions) all corporate and partnership interests of DS1, DS2, DS3, as the parent of the tax consolidation group and therefore is deemed to own 30 percent of K on September 16, 2012. P is deemed to own, directly or indirectly, (under these instructions) all corporate and partnership interests of FS1 and FS2 as the owner of 50 percent or more of each corporation by vote and therefore is deemed to own 20 percent of K on September 16, 2012. P is therefore deemed to own 50 percent of K on September 16, 2012. Since P owns or is deemed to own, directly or indirectly, (under these instructions) 50 percent or more of K on September 16, 2012, and was required to complete Schedule M-3 on its most recently filed U.S. income tax return filed prior to that date, P is a reportable entity partner of K as of September 16, 2012. On October 5, 2012, P reports to K, as it is required to do, that P is a reportable entity partner as of September 16, 2012, deemed to own (under these instructions) a 50 percent interest in K. K is therefore required to complete Schedule M-3 when it files its Form 1065 for its tax year ending December 31, 2012.

Consolidated Schedule M-3 Versus Consolidating Schedules M-3 for Form 1120 Groups

A consolidated tax return group with a parent corporation that files a Form 1120 is a mixed group if any member is a life insurance company (files using Form 1120-L) or a property and casualty insurance company (files using 1120-PC). See *Schedule M-3 Consolidation for Mixed Groups (1120/L/PC)* below.

A U.S. consolidated tax group must file a consolidated Schedule M-3. Parts I, II, and III of the consolidated Schedule M-3 must reflect the activity of the entire U.S. consolidated tax group. The parent corporation also must complete Parts II and III of a separate Schedule M-3 to reflect the parent's own activity. In addition, Parts II and III of a separate Schedule M-3 must be completed by each includible corporation to reflect the activity of that includible corporation. Lastly, it generally will be necessary to complete Parts II and III of a separate Schedule M-3 for consolidation eliminations.

If a U.S. consolidated tax group that is not a mixed group consists of four includible corporations (the parent and three subsidiaries) all filing Form 1120, the U.S. consolidated tax group must complete six Schedules M-3 as follows:

- One consolidated Schedule M-3 with Parts I, II, and III completed to reflect the activity of the entire U.S. consolidated tax group.
- Parts II and III of a separate Schedule M-3 for each of the four includible corporations to reflect the activity of each includible corporation.
- Parts II and III of a separate Schedule M-3 to eliminate intercompany transactions between includible corporations and to include limitations on deductions (charitable contribution limitations and capital loss limitations) and carryover amounts (charitable contribution carryovers and capital loss carryovers).

See *Completion of Schedule M-3 and Certain Allocations, Limitations, and Carryovers,* below.

Note. Complete only one Schedule M-3, Part I, for each consolidated group. A subsidiary of a consolidated group does not complete Schedule M-3, Part I. Enter on Schedule M-3, Part I, the name and EIN of the common parent of the consolidated group. Indicate on Schedule M-3, Parts II and III, on the line after the common parent's name and EIN, whether the Schedule M-3, Parts II and III, is for the: (1) consolidated group; (2) parent corporation; (3) consolidation eliminations; or (4) subsidiary corporation, by checking the appropriate box. If Schedule M-3, Parts II and III, are for a subsidiary in a consolidated return, also enter the name and EIN of the subsidiary.

Schedule M-3 Consolidation for Mixed Groups (1120/L/PC)

Special Schedule M-3 consolidation rules apply to a mixed group, that is, a consolidated tax group that includes: (a) both a corporation that is an insurance company and a corporation that is not an insurance company; or (b) both a life insurance company and a property and casualty insurance company; or (c) a life insurance company, a property and casualty insurance company, and a corporation that is not an insurance company.

Mixed group consolidation for Schedule M-3, Parts II and III, requires (a) subgroup sub-consolidation of the 1120 subgroup, the 1120-PC subgroup, and the 1120-L subgroup, each with its own sub-consolidated Schedule M-3, Parts II and III, and (b) consolidation of the subgroup sub-consolidation totals on a consolidated Schedule M-3, Part II that ties to a consolidated Schedule M-3, Part I, and a consolidated Form 8916, Reconciliation of Schedule M-3 Taxable Income with Tax Return Taxable Income for Mixed Groups.

In addition to one Schedule M-3, Part II, and one Schedule M-3, Part III, for each corporation in the three subgroup sub-consolidations, there will be generally a total of six additional Schedule M-3, Parts II, and six additional Schedule M-3, Parts III, for the subgroup sub-consolidations. Specifically, there must be one Part II and one Part III for each subgroup's sub-consolidated amounts and one Part II and one Part III for each subgroup's sub-consolidation eliminations amounts.

At the mixed group consolidated level, there must be a consolidated Schedule M-3, Part II, and, if applicable, a Part II for consolidation eliminations

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not includible in the subgroup eliminations. At the consolidated level, there must also be a consolidated Schedule M-3, Part I, and a consolidated Form 8916. For a mixed group, there is no Schedule M-3, Part III, at the consolidated level.

The corporation must check the applicable mixed group checkboxes on all Schedules M-3, Parts I, II, and III, as discussed below.

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Subgroup Sub-Consolidation: 1120 Subgroup, 1120-PC Subgroup, and 1120-L Subgroup

A subgroup Schedule M-3, Parts II and III, sub-consolidation must be prepared with all necessary eliminations within the subgroup for each of the three possible subgroups that are in fact present: one subgroup for those corporations reporting on Form 1120; one subgroup for those corporations reporting on Form 1120-PC; and one subgroup for those reporting on Form 1120-L. The parent corporation is included in the subgroup that corresponds to the form on which it reports and the entire consolidated group files. For example, in the case of a Form 1120 parent and Form 1120 consolidated group, the parent is included in the Form 1120 subgroup sub-consolidation. Each subgroup uses its own Schedule M-3 (Forms 1120, 1120-PC, or 1120-L), Parts II and III, for each corporation within the subgroup and for the subgroup sub-consolidation and the subgroup eliminations.

The three subgroup sub-consolidation taxable income calculations on Schedule M-3 must follow the separate return requirements of the regulation under Section 1502 and all other applicable regulations taking into account the amounts separately reported on Form 8916. Capital loss limitation and carryforward used and charitable deduction limitation and carryforward used are not taken into account in the determination of the three subgroup sub-consolidated taxable incomes on Schedule M-3, but are reflected on Form 8916 and in the calculation of the life/non-life loss limitation and carryforward used. See *Life/Non-Life Loss Limitation and Carryforward Used Calculations*, later.

The reconciliation totals for book, temporary difference, permanent difference, and taxable income for each subgroup are reported on Forms 1120, 1120-PC, or 1120-L, as applicable, Schedule M-3, Part II, line 29a, columns (a), (b), (c), and (d), and equal the sum of the line amounts on Part II, lines 26 through 28. For a mixed group, Schedule M-3, Part II, lines 29b, 29c, and 30 are blank on the Forms 1120, 1120-PC, or 1120-L, as applicable, for the separate corporations (parent and subsidiary) and for the three subgroup sub-consolidations.

Note. A sub-consolidation is required for every subgroup, even if the subgroup consists of only one corporation. In addition, Form 8916-A, if applicable, is required at the sub-consolidated level and the sub-consolidated elimination level.

Reconciliation of Mixed Group Subgroup Sub-Consolidation Amounts to Schedule M-3, Part I, line 11, and to Tax Return Taxable Income

At the consolidated level, use the Schedule M-3 (Forms 1120, 1120-PC, or 1120-L), Parts I and II, that matches the form on which the parent corporation reports and the entire consolidated group files. For a mixed group, the consolidated Schedule M-3, Part II, lines 29a, 29b, and 29c, report the applicable amounts from the three subgroup sub-consolidation Part II, line 29a, amounts. (If a consolidated level Part II for consolidation eliminations not includible in the subgroup eliminations is applicable, the applicable amounts must be adjusted by the applicable elimination amounts.) The consolidated Schedule M-3, Part II, line 30, amounts are the sum of the applicable amounts on the consolidated Part II, lines 29a, 29b, and 29c. For a mixed group, the consolidated Part II, lines 1 through 28, are blank and no consolidated Part III is required to be completed.

For mixed groups, the consolidated Part II, line 30, column (a), must equal Part I, line 11, with appropriate adjustments for statutory accounting requirements reflected on Part I, lines 10a and 10b. The consolidated taxable income indicated on Part II, line 30, column (d), must equal the amount shown on Form 8916, line 1. Form 8916, line 8, must equal taxable income reported on the tax return.

Completion of Mixed Group Checkboxes for Schedule M-3, Part II and Part III

Note. The following discussion of checkboxes will assume that the 1120 subgroup includes the corporate parent of the mixed group.

Forms 1120, 1120-PC, and 1120-L, Schedule M-3, Parts II and III, each have a checkbox (5) at the top indicating a mixed group. Checkbox (5) and one or more other applicable checkboxes must be checked.

For example, an 1120 parent corporation included in the 1120 subgroup must check Schedule M-3 (Form 1120), Parts II and III, box (2) Parent corporation, and box (5) Mixed 1120/L/PC group. An 1120 subsidiary corporation within the 1120 subgroup must check Schedule M-3 (Form 1120), Parts II and III, box (4) Subsidiary corporation, and box (5) Mixed 1120/L/PC group. An 1120-PC subsidiary corporation within the 1120-PC subgroup must check Schedule M-3 (Form 1120-PC), Parts II and III, box (4) Subsidiary corporation, and box (5) Mixed 1120/L/PC group. An 1120-L subsidiary corporation within the 1120-L subgroup must check Schedule M-3 (Form 1120-L), Parts II and III, box (4) Subsidiary corporation, and box (5) Mixed 1120/L/PC group.

The 1120 subgroup sub-consolidation Schedule M-3 (Form 1120), Parts II and III, must be indicated by checking box (5) Mixed 1120/L/PC group, and box (6) 1120 group for the sub-consolidation, and by checking box (5) Mixed 1120/L/PC group, and box (7) 1120 eliminations for the eliminations. The 1120-PC subgroup sub-consolidation Form 1120-PC, Schedule M-3, Parts II and III, must be indicated by checking box (5) Mixed 1120/L/PC group, and box (6) 1120-PC group for the sub-consolidation, and by checking box (5) Mixed 1120/L/PC group, and box (7) 1120-PC eliminations for the eliminations. The 1120-L subgroup sub-consolidation Schedule M-3 (Form 1120-L), Parts II and III, must be indicated by checking box (5) Mixed 1120/L/PC group, and box (6) 1120-L group for the sub-consolidation, and by checking box (5) Mixed 1120/L/PC group, and box (7) 1120-L eliminations for the eliminations.

A mixed group with a Form 1120 parent corporation completes a

consolidated level Schedule M-3 (Form 1120), Parts I and II, and a consolidated Form 8916. The mixed group consolidated Schedule M-3, Part II, must be indicated by checking box (1) Consolidated group, and box (5) Mixed 1120/L/PC group. (If a consolidated level Part II for consolidation eliminations not includible in the subgroup eliminations is applicable, that Part II must be indicated by checking box (3) Consolidated eliminations, and box (5) Mixed 1120/L/PC group.)

Life/Non-Life Loss Limitation and Carryforward Used Calculations

The applicable life/non-life loss limitation and all carryforward used calculations are made using the amounts determined for taxable income in the three subgroup sub-consolidations and other applicable amounts separately reported on Form 8916. The calculated life/non-life loss limitation or carryforward used amounts, if any, are not entered on Schedule M-3. The calculated amounts, if any, are entered on Form 8916.

Completion of Schedule M-3 and Certain Allocations, Limitations, and Carryovers

A corporation (or any member of a U.S. consolidated tax group) required to file Schedule M-3 must complete the form in its entirety. In particular, a corporation filing a nonconsolidated return that meets the filing requirements for Schedule M-3 must complete Parts I, II, and III. Such a corporation does not check any of the checkboxes at the top of Parts II and III. In the case of a U.S. consolidated tax group, Part I must be completed once, on the consolidated Schedule M-3, by the parent corporation. Parts II and III must be completed by the parent corporation, each includible corporation, and a consolidating eliminations entity.

At the time the Form 1120 is filed, all applicable questions must be answered on Part I, all columns must be completed on Parts II and III, and all numerical data required by Schedule M-3 must be provided. Any statement required to support a line item on Schedule M-3 must be attached at the time Schedule M-3 is filed and must provide the information required for that line item.

All detailed statements for Part II and Part III of Schedule M-3 must be attached for each separate entity included in the consolidated Part II and Part III, including those for the parent company and the eliminations entity, if applicable. It is not required that the same supporting detailed information be presented for Part II and Part III of the consolidated Schedule M-3.

If an item attributable to an includible corporation is not shared by or allocated to the appropriate member of the group but is retained in the parent corporation's financial statements (or books and records, if applicable), then the item must be reported by the parent corporation in its separate Schedule M-3. For example, if the parent of a U.S. consolidated tax group prepares financial statements that include all members of the U.S. consolidated tax group and the parent does not allocate the group's income tax expense as reflected in the financial statements among the members of the group but retains it in the parent corporation, the parent corporation must report on its separate Schedule M-3 the U.S. consolidated tax group's income tax expense as reflected in the financial statements.

Any adjustments made at the consolidated group level that are not attributable to any specific member of the U.S. consolidated tax group (for example, disallowance of net capital losses, contribution deduction carryovers, and limitation of contribution deductions) must not be reported on the separate consolidating parent or subsidiary Schedules M-3 but rather on the consolidated Schedule M-3 and on the consolidating Schedule M-3 for consolidation eliminations (or on Form 8916 in the case of a mixed group).

If an includible corporation has: (1) no activity for the tax year (for example, because the corporation is a dormant or inactive corporation); (2) no amount for the corporation to include in Part I, line 11; and (3) no amounts to report on Part II and Part III of Schedule M-3 for the tax year; the parent corporation of the U.S. consolidated tax group may attach to the consolidated Schedule M-3 a statement that provides the name and EIN of the includible corporation in lieu of filing a blank Part II and Part III of Schedule M-3 for such entity. On Part I, check box (4), Dormant subsidiaries schedule attached.

Specific Instructions for Part I

Part I. Financial Information and Net Income (Loss) Reconciliation

When To Complete Part I

Part I must be completed for any tax year for which the corporation files Schedule M-3. Check either box (1) Non-consolidated return, (2) Consolidated return (Form 1120 only), or (3) Mixed 1120/L/PC group, as applicable. In addition, check box (4), Dormant subsidiaries schedule attached, if applicable.

Line 1. Questions Regarding the Type of Income Statement Prepared

For Part I, lines 1 through 12, use only the financial statements of the U.S. corporation filing the U.S. income tax return (the consolidated financial statements for the U.S. parent corporation of a U.S. consolidated tax group). If the U.S. corporation filing a U.S. income tax return (or the U.S. parent corporation of a U.S. consolidated tax group) prepares its own financial statements but is controlled by another corporation (U.S. or foreign) that prepares financial statements that include the U.S. corporation, the U.S. corporation (or the U.S. parent corporation of a U.S. consolidated tax group) must use for its Schedule M-3, Part I, its own financial statements and not the financial statements of the controlling corporation.

If a non-publicly traded U.S. parent corporation of a U.S. consolidated tax group prepares financial statements and that group includes a publicly traded subsidiary that files financial statements with the Securities and Exchange Commission (SEC), the consolidated financial statements of the parent corporation are the appropriate financial statements for purposes of completing Part I. Do not use any separate company financial statements that might be prepared for publicly traded subsidiaries.

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Non-Tax-Basis Financial Statements and Tax-Basis Financial Statements

A tax-basis income statement is allowed for Schedule M-3, and a tax-basis balance sheet for Schedule L, only if no non-tax-basis income statement and no non-tax-basis balance sheet were prepared for any purpose and the books and records of the corporation reflect only tax-basis amounts. The corporation is deemed to have non-tax-basis income statements and the related non-tax-basis balance sheets for the current tax year for purposes of Schedule M-3 and Schedule L if such non-tax-basis financial statements were prepared for and presented to management, creditors, shareholders, government regulators, or any other third parties for a period ending with or within the tax year.

If a Form 10-K is filed with the SEC for the period ending with or within the tax year, the corporation must check "Yes" for Part I, line 1a, and use that income statement for Schedule M-3. If Form 10-K is not filed and a non-tax-basis income statement is prepared that is a certified non-tax-basis income statement for the period ending with or within the tax year, the corporation must check "Yes" for Part I, line 1b, and use that income statement for Schedule M-3. If Form 10-K is not filed and no certified non-tax-basis income statement is prepared but an unaudited non-tax-basis income statement is prepared for the period ending with or within the tax year, the corporation must check "Yes" for Part I, line 1c, and use that income statement for Schedule M-3.

Order of priority in accounting standards. If no Form 10-K is filed and two or more non-tax-basis income statements are both certified non-tax-basis income statements for the period, the income statement prepared according to the following order of priority in accounting standards shall be used.

1. U.S. Generally Accepted Accounting Principles (GAAP).

2. International Financial Reporting Standards (IFRS).

3. Any other International Accounting Standards (IAS).

4. Statutory accounting for insurance companies.

5. Other regulatory accrual accounting.

6. Any other accrual accounting standard.

7. Any fair market value standard.

8. Any cash basis standard.

If no non-tax-basis income statement is certified and two or more non-tax-basis income statements are prepared, the income statement prepared according to the first listed of the accounting standards listed above shall be used.

If no non-tax-basis financial statements are prepared for a U.S. corporation (or, in the case of a U.S. consolidated tax group, for the U.S. parent corporation's consolidated group) filing Schedule M-3 (Form 1120), the U.S. corporation (or the U.S. parent corporation of a U.S. consolidated tax group) must check "No" on questions 1a, 1b, and 1c, skip Part I, lines 2a through 3c, and enter the net income (loss) per the books and records of the U.S. corporation (or U.S. consolidated tax group) on Part I, line 4a.

If no non-tax-basis financial statements are prepared for a U.S. corporation (or, in the case of a U.S. consolidated tax group, for the U.S. parent corporation's consolidated group) filing Schedule M-3 (Form 1120), and the U.S. corporation is owned by a foreign corporation that prepares financial statements that includes the U.S. corporation (or the U.S. parent corporation's consolidated group), the U.S. corporation (or the U.S. parent corporation of the U.S. consolidated tax group) must enter "No" on questions 1a, 1b, and 1c, skip Part I, lines 2a through 3c, and enter the net income (loss) per the books and records of the U.S. corporation (or U.S. consolidated tax group) on Part I, line 4a.

Line 2. Questions Regarding Income Statement Period and Restatements

Enter the beginning and ending dates on line 2a for the corporation's annual income statement period ending with or within the current tax year.

The questions on Part I, lines 2b and 2c, regarding income statement restatements refer to the worldwide consolidated income statement issued by the corporation filing the U.S. income tax return (the consolidated financial statements for the U.S. parent corporation of a U.S. consolidated tax group) and used to prepare Schedule M-3. Answer "Yes" on lines 2b and/or 2c if the corporation's annual income statement has been restated for any reason. Attach a short explanation of the reasons for the restatement in net income for each annual income statement period that is restated, including the original amount and restated amount of each annual statement period's net income. The attached statement is not required to report restatements on an entity-by-entity basis.

Line 3. Questions Regarding Publicly Traded Voting Common Stock

The primary U.S. publicly traded voting common stock class is the most widely held or most heavily traded within the U.S. as determined by the corporation. If the corporation has more than one class of publicly traded voting common stock, attach a list of the classes of publicly traded voting common stock and the trading symbol and the nine-digit CUSIP number of each class.

Line 4a. Worldwide Consolidated Net Income (Loss) per Income Statement

Report on Part I, line 4a, the worldwide consolidated net income (loss) per the income statement (or books and records, if applicable) of the corporation. A corporation filing a non-consolidated Form 1120 for itself must report its worldwide income on Part I, line 4a.

In completing Schedule M-3, the corporation must use financial statement amounts from the financial statement type checked "Yes" on Part I, line 1, or from its books and records if Part I, line 1c is checked "No." If Part I, line 1a, is checked "Yes," report on Part I, line 4a, the net income amount reported in the income statement presented to the SEC on the corporation's Form 10-K (the Form 10-K for the security identified on Part I, line 3b, if applicable).

If a corporation prepares non-tax-basis financial statements, the amount on line 4a must equal the financial statement net income (loss) for the income statement period ending with or within the tax year as indicated on Part I, line 2a.

If the corporation prepares non-tax-basis financial statements and the income statement period differs from the corporation's tax year, the income statement period indicated on Part I, line 2a, applies for purposes of Part I, lines 4a through 8.

If the corporation does not prepare non-tax-basis financial statements and has checked "No" on Part I, line 1c, enter the net income (loss) per the books and records of the U.S. corporation or the U.S. consolidated tax group on Part I, line 4a.

Indicate on Part 1, line 4b, which of the following accounting standards were used for line 4a.

1. U.S. Generally Accepted Accounting Principles (GAAP).

2. International Financial Reporting Standards (IFRS).

3. Statutory.

4. Tax Basis.

5. Other (Specify).

Report on Part I, lines 5a through 10, as instructed below, all adjustment amounts required to adjust worldwide net income (loss) reported on this Part I, line 4a (whether from financial statements or books and records), to net income (loss) of includible corporations that must be reported on Part I, line 11.

Report on line 12a the worldwide consolidated total assets and total liabilities amounts for the corporation using the same financial statements (or books and records) used for the worldwide consolidated income (loss) amount reported on Part 1, line 4a.

If a U.S. corporation: (a) has net income (loss) included on Part I, line 4a, and removed on Part I, line 6a or 6b, on another U.S. corporation's Schedule M-3; (b) files its own Form 1120 (separate or consolidated); (c) does not have a separate non-tax-basis financial statement (certified or otherwise) of its own; and (d) reports on Schedule L of its own Form 1120 total consolidated assets that equal or exceed $10 million at the end of the corporation's tax year, the corporation must answer questions 1a, 1b, and 1c of Part I as appropriate for its own Form 1120 and must report on Part I, line 4a, the amount for the corporation's net income (loss) that is removed on Part I, line 6a or 6b, of the other corporation's Schedule M-3. However, if in the circumstances described immediately above, the corporation does have separate non-tax-basis financial statements (certified or otherwise) of its own, independent of the amount of the corporation's net income included in Part I, line 4a, of the other U.S. corporation, the corporation must answer questions 1a, 1b, and 1c of Part I, as appropriate, for its own Form 1120, based on its own separate income statement, and must report on Part I, line 4a, the net income amounts shown on its separate income statement.

If line 4a includes net income (loss) for a corporation that files Form 1120-PC or Form 1120-L, see the instructions for Part I, line 10, for adjustments that may be necessary to reconcile financial statement income to statutory income.

Line 5. Net Income (Loss) of Nonincludible Foreign Entities

Remove the financial net income (line 5a) or loss (line 5b) of each foreign entity that is included on line 4a and is not an includible corporation in the U.S. consolidated tax group (nonincludible foreign entity). In addition, on Part I, line 8, adjust for consolidation eliminations and correct for minority interest and intercompany dividends between any nonincludible foreign entity and any includible corporation. Do not remove in Part I the financial net income (loss) of any nonincludible foreign entity accounted for on line 4a using the equity method.

Attach a supporting statement that provides the name, EIN (if applicable), and net income (loss) included on line 4a that is removed on this line 5 for each separate nonincludible foreign entity. Also state the total assets and total liabilities for each such separate nonincludible foreign entity and include those assets and liabilities amounts in the total assets and total liabilities reported on Part 1, line 12b. The amounts of income (loss) detailed on the supporting statement should be reported for each separate nonincludible foreign entity without regard to the effect of consolidation or elimination entries. If there are consolidation or elimination entries relating to nonincludible foreign entities whose income (loss) is reported on the attached statement that are not reportable on Part I, line 8, the net amounts of all such consolidation and elimination entries must be reported on a separate line on the attached statement, so that the separate financial accounting income (loss) of each nonincludible foreign entity remains separately stated.

For example, if the net income (after consolidation and elimination entries) of a nonincludible foreign sub-consolidated group is being reported on line 5a, the attached supporting statement should report the income (loss) of each separate nonincludible foreign legal entity from each such entity's own financial accounting net income statement or books and records, and any consolidation or elimination entries (for intercompany dividends, minority interests, etc.) not reportable on Part I, line 8, should be reported on the attached supporting statement as a net amount on a line separate and apart from lines that report each nonincludible foreign entity's separate net income (loss).

Line 6. Net Income (Loss) of Nonincludible U.S. Entities

Remove the financial net income (line 6a) or loss (line 6b) of each U.S. entity that is included on line 4a and is not an includible corporation in the U.S. consolidated tax group (nonincludible U.S. entity). In addition, on Part I, line 8, adjust for consolidation eliminations and correct for minority interest and intercompany dividends between any nonincludible U.S. entity and any includible corporation. Do not remove in Part I the financial net income (loss) of any nonincludible U.S. entity accounted for on line 4a using the equity method.

Attach a supporting statement that provides the name, EIN, and net income (loss) included on line 4a that is removed on this line 6 for each separate nonincludible U.S. entity. Also, state the total assets and total liabilities for each such separate nonincludible U.S. entity and include those assets and liabilities amounts in the total assets and total liabilities reported on Part I, line 12c. The amounts of income (loss) detailed on the supporting statement should be reported for each separate nonincludible U.S. entity without regard to the effect of consolidation or elimination entries. If there are consolidation or elimination entries relating to nonincludible U.S. entities whose income (loss) is reported on the attached statement that are not reportable on Part I, line 8, the net amounts of all such consolidation and elimination entries must be reported on a separate line on the attached statement, so that the separate financial accounting income (loss) of each nonincludible U.S. entity remains separately stated. For example, if the net income (after consolidation and elimination entries) of a nonincludible U.S. sub-consolidated group is being reported on line 6a, the attached supporting statement should report the income (loss) of each separate nonincludible U.S. legal entity from each such entity's own financial accounting

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net income statement or books and records, and any consolidation or elimination entries (for intercompany dividends, minority interests, etc.) not reportable on Part I, line 8, should be reported on the attached supporting statement as a net amount on a line separate and apart from lines that report each nonincludible U.S. entity's separate net income (loss).

Line 7. Net Income (Loss) of Other Includible Foreign Disregarded Entities, Other Includible U.S. Disregarded Entities, and Other Includible Entities

Include on line 7a, 7b, or 7c, the financial net income or (loss) of each foreign or U.S. disregarded entity or other includible entity that is not included in the consolidated financial group and therefore not included in the income reported on Part I, line 4a. Include on line 7a or 7b financial income of any disregarded entity that is not included in the income reported on Part I, line 4a, but is included in Part I, line 11 (other disregarded entities). Include on line 7c the financial income of any entity not a disregarded entity that is not included in the income reported on line 4a, but is included on line 11 (other includible entities). In addition, on Part I, line 8, adjust for consolidation eliminations and correct for minority interest and intercompany dividends for any other disregarded entity or other includible entities.

Attach a supporting statement that provides the name, EIN, and net income (loss) per the financial statement or books and records on lines 7a, 7b, and 7c for each separate other U.S. disregarded entity or other includible entity. Also, state the total assets and total liabilities for each such separate included entity and include those asset and liability amounts in the total assets and total liabilities reported on Part I, line 12d. The amounts of income (loss) detailed on the supporting statement should be reported for each separate other disregarded entity or other includible entity without regard to the effect of consolidation or elimination entries solely between or among the entities listed. If there are consolidation or elimination entries relating to such disregarded entity or other includible entities whose income (loss) is reported on the attached statement that are not reportable on Part I, line 8, the net amounts of all such consolidation and elimination entries must be reported on a separate line on the attached statement, so that the separate financial accounting income (loss) of each other disregarded entity or other includible entity remains separately stated. For example, if the net income (after consolidation and elimination entries) of a sub-consolidated group of other U.S. disregarded entities is being reported on line 7b, the attached supporting statement should report the income (loss) of each separate other U.S. disregarded entity from each entity's own financial accounting net income statement or books and records, and any consolidation or elimination entries (for intercompany dividends, minority interests, etc.) not reportable on Part I, line 8, should be reported on the attached supporting statement as a net amount on a line separate and apart from lines that report each other includible corporation's or entity's separate net income (loss).

Line 8. Adjustment to Eliminations of Transactions Between Includible Entities and Nonincludible Entities

Adjustments on Part I, line 8, to reverse certain financial accounting consolidation or elimination entries are necessary to ensure that transactions between includible entities and nonincludible U.S. or foreign entities are not eliminated, in order to report the correct total amount on Part I, line 11. Also, additional consolidation entries and elimination entries may be necessary on Part I, line 8, related to transactions between includible entities that are in the consolidated financial group and other disregarded entities and other includible entities that are not in the consolidated financial group but that are reported on Part I, line 7a, 7b, or 7c, in order to report the correct total amount on Part I, line 11.

Include on Part I, line 8, the total of the following: (a) amounts of any adjustments to consolidation entries and elimination entries that are contained in the amount reported on Part I, line 4a, required as a result of removing amounts on Part I, line 5 or 6; and (b) amounts of any additional consolidation entries and elimination entries that are required as a result of including amounts on Part I, line 7a, 7b, or 7c. This is necessary in order that the consolidation entries and intercompany elimination entries included in the amount reported on Part I, line 11, are only those applicable to the financial net income (loss) of includible entities for the financial statement period. For example, adjustments must be reported on line 8 to remove minority interest and to reverse the elimination of intercompany dividends included on Part I, line 4a, that relate to the net income of entities removed on Part I, line 5 or 6, because the income to which the consolidation or elimination entries relate has been removed. Also, for example, consolidation or elimination entries must be reported on line 8 to reflect any minority interest ownership in the net income of other disregarded entities or other includible entities reported on Part I, line 7a, 7b, or 7c; and to eliminate any intercompany dividends between entities whose income is included on Part I, line 7a, 7b, or 7c, and other entities included in the consolidated U.S. income tax return. See Examples 3, 4, and 5 in the instructions for line 11.

If a corporate owner of an interest in another entity: (a) accounts for the interest in entity in the owner corporation's separate general ledger on the equity method, and (b) fully consolidates entity in the owner corporation's consolidated financial statements, but entity is not includible in the owner corporation's consolidated U.S. income tax return, then, as part of reversing all consolidation and elimination entries for the nonincludible entity, the corporate owner must reverse on Schedule M-3, Part I, line 8, the elimination of the equity income inclusion from entity. If the owner corporation does not account for entity on the equity method on its own general ledger, it will not have eliminated the equity income for consolidated financial statement purposes, and therefore will have no elimination of equity income to reverse.

The attached supporting statement for Part I, line 8, must identify the type (for example, minority interest, intercompany dividends, etc.) and amount of consolidation or elimination entries reported, as well as the names of the entities to which they pertain. It is not necessary, but it is permitted, to report intercompany eliminations that net to zero on Part I, line 8, such as intercompany interest income and expense.

Line 9. Adjustment To Reconcile Income Statement Period To Tax Year

Include on line 9 any adjustments necessary to the income (loss) of includible corporations to reconcile differences between the corporation's

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income statement period reported on line 2a and the corporation's tax year. Attach a statement describing the adjustment.

Statutory accounting for an insurance company subsidiary acquired or merged may require the use of a financial statement period for income reported on Part I, line 11, that differs from the period reported on Part I, line 4a or line 7. Report on Part I, line 10b, adjustments to income because of such differences in accounting period.

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Line 10a. Intercompany Dividend Adjustments To Reconcile to Line 11, Line 10b. Other Statutory Accounting Adjustments To Reconcile to Line 11, and Line 10c. Other Adjustments To Reconcile to Amount on Line 11

Include on lines 10a, 10b, and 10c, any other adjustments to reconcile net income (loss) on Part I, line 4a, through Part I, line 9, with net income (loss) on Part I, line 11. Include on line 10a the amount of any intercompany dividend adjustment required by statutory accounting. Include on line 10b the amount of any other required statutory accounting adjustment. Include on line 10c the amount of any other adjustment not required by statutory accounting.

Normally, all intercompany dividends will have been eliminated or excluded from the financial accounting consolidated net income (loss) reported on Part I, line 4a. However, an insurance company may be required to include certain intercompany dividends on Part I, line 11, so that the amount reported on Part I, line 11, agrees with statutory accounting net income (Annual Statement). If the net income (loss) of a corporation that files Form 1120-PC or Form 1120-L is included on Part I, line 4a or line 7, and is computed on a basis other than statutory accounting, include on line 10a the adjustments necessary such that Part I, line 11, includes intercompany dividends in the net income (loss) for such corporation to the extent required by statutory accounting principles. (For insurance companies included in the consolidated U.S. income tax return, see instructions for Part I, line 11, and Part II, line 7.)

Statutory accounting for an insurance company subsidiary acquired or merged may require the use of a financial statement period for income reported on Part I, line 11, that differs from the period reported on Part I, line 4a or line 7. Report on Part I, line 10b, adjustments to income because of such differences in accounting period.

For any adjustments reported on Part I, lines 10a, 10b, and 10c, attach a supporting statement that provides, for each corporation to which an adjustment relates: the name and EIN of the corporation; the amount of net income included in Part I before any adjustments on line 10; the amount of net income included on Part I, line 11; the amount of the net adjustment that is attributable to intercompany dividend adjustments required to be reported by statutory accounting and included on Part I, line 10a; the amount of the net adjustment attributable to other statutory accounting requirements and included on Part I, line 10b; and the amount of the remainder of the net adjustment not required because of statutory accounting and included on Part I, line 10c. If any net adjustment is included for the corporation on Part I, lines 10b or 10c, attach a supplemental supporting statement identifying the line (10b or 10c), the type, and the amount of each adjustment included in the net adjustment.

Line 11. Net Income (Loss) per Income Statement of Includible Corporations

Report on line 11 the net income (loss) per the income statement (or books and records, if applicable) of the corporation. In the case of a U.S. consolidated tax group, report the consolidated income statement net income (loss) of all corporations listed on Form 851 and included in the consolidated U.S. income tax return for the tax year. Amounts reported in column (a) of Parts II and III (see instructions later) must be reported on the same accounting method used to report the amount of net income (loss) per income statement of includible corporations on Part I, line 11, which for insurance companies is statutory accounting. If an insurance company is included in a consolidated Form 1120, the amount of net income reported on Part I, Line 11, will include the statutory accounting net income for the insurance corporation and the GAAP net income for the non-insurance corporations included in the U.S. consolidated tax group. (For insurance companies included in the consolidated U.S. income tax return, see instructions for Part I, line 10, and Part II, line 7.)

Do not, in any event, report on this line 11 the net income of entities not listed on Form 851 and not included in the consolidated U.S. income tax return for the tax year. For example, it is not permissible to remove the income of nonincludible entities on lines 5 and/or 6, discussed earlier; then to add back such income on lines 7 through 10, such that the amount reported at line 11 includes the net income of entities not includible in the consolidated U.S. income tax return. A principal purpose of Schedule M-3 is to report on this Part I, line 11, only the financial accounting net income of only the corporations included in the consolidated U.S. income tax return.

Whether or not the corporation prepares financial statements, Part I, line 11, must include all items that impact the net income (loss) of the corporation even if they are not recorded in the profit and loss accounts in the corporation's general ledger, including, for example, all post-closing adjusting entries (including workpaper adjustments) and dividend income or other income received from nonincludible corporations.

Example 3.

1. U.S. corporation P is publicly traded and files Form 10-K with the SEC. P owns 80% or more of the stock of 75 U.S. corporations, DS1 through DS75, between 51% and 79% of the stock of 25 U.S. corporations DS76 through DS100, and 100% of the stock of 50 foreign subsidiaries FS1 through FS50. P eliminates all dividend income from DS1 through DS100 and FS1 through FS50 in financial statement consolidation entries. Furthermore, P eliminates the minority interest ownership, if any, of DS1 through DS100 in financial statement consolidation entries. P's SEC Form 10-K includes P, DS1 through DS100 and FS1 through FS50 on a fully consolidated basis. P files a consolidated U.S. income tax return with DS1 through DS75.

P must check “Yes” on Part I, line 1a. On Part I, line 4a, P must report the consolidated net income from the SEC Form 10-K for the consolidated financial statement group of P, DS1 through DS100, and FS1 through FS50. P must remove the net income (loss) of FS1 through FS50 on Part I, line 5a or 5b, as applicable. P must remove the net income (loss) before minority interests of DS76 through DS100 on Part I, line 6a or 6b, as applicable. P must reverse on Part I, line 8:

a. The elimination of dividends received by P and DS1 through DS75 from DS76 through DS100 and FS1 through FS50; and

b. The recognition of minority interests' share of the net income (loss) of DS76 through DS100. (Note: The minority interests' share, if any, of the income of DS1 through DS75 must be reported in Part II, line 8, Minority interest for includible corporations.)

P reports on Part I, line 11, the consolidated financial statement net income (loss) attributable to the includible corporations. Intercompany transactions between the includible corporations that had been eliminated in the net income amount on line 4a remain eliminated in the net income amount on line 11. Transactions between the includible corporations and the nonincludible entities that are eliminated in the net income amount on line 4a are included in the net income amount on line 11 since the elimination of those transactions was reversed on line 8.

2. Foreign corporation F owns 100% of the stock of U.S. corporation P. P owns 100% of the stock of DS1, 60% of the stock of DS2, and 100% of the stock of FS1. F prepares certified audited financial statements. P does not prepare any financial statements. P files a consolidated U.S. income tax return with DS1.

P must not complete Schedule M-3, Part I, with reference to the financial statements of its foreign parent F. P must check “No” on Part I, lines 1a, 1b, and 1c, skip lines 2a through 3c of Part I, and enter worldwide net income (loss) per the books and records of the includible corporations (P and DS1) on Part I, line 4a. P must enter any necessary adjustments on lines 5a through 10 in order for Part I, line 11, to report the net income (loss) of includible corporations P and DS1, net of eliminations for transactions between P and DS1.

Example 4.

1. U.S. corporation P owns 60% of corporation DS1 which is fully consolidated in P's financial statements. P does not account for DS1 in P's separate general ledger on the equity method. DS1 has net income of $100 (before minority interests) and pays dividends of $50, of which P receives $30. The dividend is eliminated in the consolidated financial statements. In its financial statements, P consolidates DS1 and includes $60 of net income ($100 less the minority interest of $40) on Part I, line 4a.

P must remove the $100 net income of DS1 on Part I, line 6a. P must reverse on Part I, line 8, the elimination of the $40 minority interest net income of DS1. In addition, P reverses its elimination of the $30 intercompany dividend in its financial statements on Part I, line 8. The net result is that P includes the $30 dividend from DS1 at Part I, line 11, and on Part II, line 7, column (a). P's taxable dividend income from DS1 must be reported on Part II, line 7, column (d).

2. U.S. corporation C owns 60% of the capital and profits interests in U.S. LLC N. C does not account for N in C's separate general ledger on the equity method. N has net income of $100 (before minority interests) and makes no distributions during the tax year. C treats N as a corporation for financial statement purposes; and as a partnership for U.S. income tax purposes. In its financial statements, C consolidates N and includes $60 of net income ($100 less the minority interest of $40) on Part I, line 4a.

C must remove the $100 net income of N on Part I, line 6a. C must reverse on Part I, line 8, the elimination of the $40 minority interest net income of N. The result is that C includes no income for N either on Part I, line 11, or on Part II, line 9, column (a). C's taxable income from N must be reported by C on Part II, line 9, column (d).

3. U.S. corporation P owns 60% of corporation DS1, which is fully consolidated in P's financial statements. P accounts for DS1 in P's separate general ledger on the equity method. DS1 has net income of $100 (before minority interests) and pays dividends of $50, of which P receives $30. The dividend reduces P's investment in DS1 for equity method reporting on P's separate general ledger where P includes its 60% equity share of DS1 income, which is $60. In its financial statements, P eliminates the DS1 equity method income of $60 and consolidates DS1, including $60 of net income ($100 less the minority interest of $40) on Part I, line 4a.

P must remove the $100 net income of DS1 on Part I, line 6a. P must reverse on Part I, line 8, the elimination of the $40 minority interest net income of DS1 and the elimination of the $60 of DS1 equity income. The net result is that P includes the $60 of equity method income from DS1 at Part I, line 11, and on Part II, line 6, column (a). P's taxable dividend income from its investment in DS1 must be reported on Part II, line 7, column (d).

4. U.S. corporation C owns 60% of the capital and profits interests in U.S. LLC N. C accounts for N in C's separate general ledger on the equity method. N has net income of $100 (before minority interests) and makes no distributions during the tax year. C treats N as a corporation for financial statement purposes and as a partnership for U.S. income tax purposes. For equity method reporting on C's separate general ledger, C includes its 60% equity share of N income, which is $60. In its financial statements, C eliminates the $60 of N equity method income and consolidates N, including $60 of net income ($100 less the minority interest of $40) on Part I, line 4a.

C must remove the $100 net income of N on Part I, line 6a. C must reverse on Part I, line 8, the elimination of the $40 minority interest net income of N and the elimination of the $60 of N equity method income. The result is that C includes the $60 of equity method income for N on Part I, line 11, and on Part II, line 9, column (a). C's taxable income from N must be reported by C on Part II, line 9, column (d).

5. U.S. corporation C owns 60% of the capital and profits interests in U.S. LLC N. C accounts for N in C's separate general ledger on the equity method. N has net income of $100 (before minority interests) and pays a $50 cash distribution, of which C receives $30. The distribution reduces C's investment in N for equity method reporting on C's separate general ledger. C treats N as a corporation for financial statement purposes and as a partnership for U.S. income tax purposes. For equity method reporting on C's separate general ledger, C includes its 60% equity share of N income, which is $60. In its financial statements, C eliminates the $60 of N equity method income and consolidates N and includes $60 of net income ($100 less the minority interest of $40) on Part I, line 4a.

C must remove the $100 net income of N on Part I, line 6a. C must reverse on Part I, line 8, the elimination of the $40 minority interest net income of N and the elimination of the $60 of N equity method income. The result is that C includes the $60 of equity method income for N on Part I, line 11, and on Part II, line 9, column (a). C's taxable income from N must be reported by C on Part II, line 9, column (d).

Example 5. U.S. corporation P owns 80% of the stock of corporation

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DS1. DS1 is included in P's consolidated income tax return, even though DS1 is not included in P's consolidated financial statements on either a consolidated basis or on the equity method. DS1 has current year net income of $100 after taking into account its $40 interest payment to P. P has net income of $1,040 after recognition of the interest income from DS1. Because DS1 is an includible corporation, 100% of the net income of both P and DS1 must be reported on Form 1120, page 1, of the PDS consolidated U.S. income tax return, and the intercompany interest income and expense must be removed by consolidation elimination entries.

P must report its financial statement net income of $1,040 on Part I, line 4a, and reports DS1's net income of $100 on Part I, line 7c. Then, in order to reflect the full consolidation of the financial accounting net income of P and DS1 at Part I, line 11, the following consolidation and elimination entries are reported on Part I, line 8: (a) offsetting entries to remove the $40 of interest income received from DS1 included by P on line 4a, and to remove the $40 of interest expense of DS1 included in line 7c for a net change of zero; and (b) an entry to reflect the $20 minority interest in the net income of DS1 (DS1 net income of $100 times 20% minority interest). The result is that Part I, line 11, reports $1,120: $1,040 from line 4a, $100 from line 7c, and ($20) from line 8. Stated another way, Part I, line 11, includes the entire $1,000 net income of P, measured before recognition of the intercompany interest income from DS1 and the consolidation of DS1 operations, plus the entire $140 net income of DS1, measured before interest expense to P, less the minority interest ownership of $20 in DS1's separate net income ($100). The consolidated U.S. income tax group is required to include on the attached supporting statement for Part I, line 8, the details of the adjustment to the minority interest in the net income of DS1, but is not required to report the offsetting adjustment to the intercompany elimination of interest income and interest expense (though it is permitted to do so).

Line 12. Total Assets and Liabilities of Entities Included or Removed on Part I, Lines 4, 5, 6, and 7

Line 12 must be completed by all corporations that file Schedule M-3. Report on lines 12a, 12b, 12c, and 12d the total amount (not just the corporation's share) of assets and liabilities of entities included or removed on Part I, lines 4, 5, 6, and 7. All assets and liabilities reported for Schedule M-3, Part I, lines 12a, 12b, 12c, and 12d must be entered as positive amounts.

On line 12a, enter the worldwide consolidated total assets and total liabilities of all of the entities included in completing Part I, line 4a. On line 12b, enter the total assets and total liabilities of the entities removed in completing Part I, line 5. On line 12c, enter the total assets and total liabilities removed in completing Part I, line 6. On line 12d, enter total assets and total liabilities included in completing Part I, line 7.

Specific Instructions for Parts II and III

For consolidated U.S. income tax returns, file supporting statements for each includible corporation. See the instructions for consolidated returns in the Instructions for Form 1120.

General Format of Parts II and III

Check the applicable box(es) at the top of pages 2 and 3 of Schedule M-3 to indicate whether the Schedule M-3 is for the:

1. Consolidated group;
2. Parent corporation;
3. Consolidated eliminations;
4. Subsidiary corporation; or
5. Mixed 1120/L/PC group.

Also check the applicable box to indicate whether the Schedule M-3 is for a sub-consolidated: (6) 1120 group; or (7) 1120 eliminations. See *Consolidated Schedule M-3 Versus Consolidating Schedules M-3 for Form 1120 Groups* and *Schedule M-3 Consolidation for Mixed Groups (1120/L/PC)*, earlier.

For each line item in Parts II and III, report in column (a) the amount of net income (loss) included in Part I, line 11, and report in column (d) the amount included in taxable income on Form 1120, page 1, line 28.

Note. A statement or explanation may be attached to any line even if none is required.

When To Complete Columns (a) and (d)

A corporation is not required to complete columns (a) and (d) of Parts II and III for the first tax year the corporation is required to file Schedule M-3. However, the corporation must complete columns (a) and (d) for all tax years subsequent to the first tax year the corporation is required to file Schedule M-3. For example, if a corporation was required to file Schedule M-3 as a member of a U.S. consolidated tax group and the corporation leaves the U.S. consolidated tax group, the corporation is required to complete Schedule M-3 in its entirety in any succeeding tax year that the corporation is required to complete Schedule M-3. However, if the corporation joins in filing a different consolidated U.S. income tax return, then the corporation must complete its Schedule M-3 in its entirety in any year that the U.S. consolidated tax group must complete its Schedule M-3 in its entirety.

If, for any tax year (or tax years) prior to the first tax year a corporation is required to file Schedule M-3, a corporation voluntarily files Schedule M-3 instead of Schedule M-1, then in those voluntary filing years the corporation is not required to complete columns (a) and (d) of Parts II and III. In addition, in the first tax year the corporation is required to file Schedule M-3, the corporation is not required to complete columns (a) and (d) of Parts II and III.

If a corporation that is not a mixed group chooses not to complete columns (a) and (d) of Parts II and III in the first tax year the corporation is required to file Schedule M-3 (or in any year in which the corporation voluntarily files Schedule M-3), then Part II, line 30, is reconciled by the corporation (or, in the case of a U.S. consolidated tax group, by the group's parent corporation on Part II, line 30, of the group's consolidated Schedule M-3) in the following manner:

1. Report the amount from Part I, line 11, on Part II, line 30, column (a);
2. Leave blank Part II, lines 1 through 29, columns (a) and (d);
3. Leave blank Part III, columns (a) and (d); and
4. Report on Part II, line 30, column (d), the sum of Part II, line 30, columns (a), (b), and (c).

Note. Mixed groups should see *Schedule M-3 Consolidation for Mixed Groups (1120/L/PC),* earlier.

In the case of a U.S. consolidated tax group that is not a mixed group, the reconciliation described in the

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preceding paragraph must be performed by each member of the U.S. consolidated tax group. However, because Part I must be completed only once on the consolidated Schedule M-3 by the parent corporation of the U.S. consolidated tax group, the amount reported on Part II, line 30, column (a), by each member of the U.S. consolidated tax group on its respective Schedule M-3 is the amount attributable to that member that is reported on the consolidated Schedule M-3, Part I, line 11, completed by the parent corporation. Accordingly, the amount reported on Part II, line 30, columns (a) through (d), of the consolidated Schedule M-3 is the sum of the amounts reported by each member of the U.S. consolidated tax group on its respective Schedule M-3 (including a Schedule M-3 for consolidation eliminations, if necessary). Note that the amount reported on Part II, line 30, column (a), of the consolidated Schedule M-3 must equal the amount reported on Part I, line 11, of the consolidated Schedule M-3, and that the amount reported on Part II, line 30, column (d), of the consolidated Schedule M-3 must equal the amount reported on the consolidated Form 1120, page 1, line 28.

When To Complete Columns (b) and (c)

Columns (b) and (c) of Parts II and III must be completed for any tax year for which the corporation files Schedule M-3.

For any item of income, gain, loss, expense, or deduction for which there is a difference between columns (a) and (d), the portion of the difference that is temporary must be entered in column (b) and the portion of the difference that is permanent must be entered in column (c).

If financial statements are prepared by the corporation in accordance with generally accepted accounting principles (GAAP), differences that are treated as temporary for GAAP must be reported in column (b) and differences that are permanent (that is, not temporary for GAAP) must be reported in column (c). Generally, pursuant to GAAP, a temporary difference affects (creates, increases, or decreases) a deferred tax asset or liability.

If the corporation does not prepare financial statements, or the financial statements are not prepared in accordance with GAAP, report in column (b) any difference that the corporation believes will reverse in a future tax year (that is, have an opposite effect on taxable income in a future tax year (or years) due to the difference in timing of recognition for financial accounting and U.S. income tax purposes) or is the reversal of such a difference that arose in a prior tax year. Report in column (c) any difference that the corporation believes will not reverse in a future tax year (and is not the reversal of such a difference that arose in a prior tax year).

If the corporation is unable to determine whether a difference between column (a) and column (d) for an item will reverse in a future tax year or is the reversal of a difference that arose in a prior tax year, report the difference for that item in column (c).

Example 6. For the 2010, 2011, and 2012 tax years, corporation A has total consolidated assets on the last day of the tax year as reported on Schedule L, line 15, column (d), of $8 million, $11 million, and $12 million, respectively. A is required to file Schedule M-3 for its 2011 and 2012 tax years.

For its 2010 tax year, A voluntarily filed Schedule M-3 instead of Schedule M-1 and did not complete columns (a) and (d) of Parts II and III.

For A's 2011 tax year, the first tax year that A was required to file Schedule M-3, A was only required to complete Part I and columns (b) and (c) of Parts II and III.

For A's 2012 tax year, A is required to complete Schedule M-3 in its entirety.

Example 7. Corporation B is a U.S. publicly traded corporation that files a consolidated U.S. income tax return and prepares consolidated GAAP financial statements. In prior years, B acquired intellectual property (IP) and goodwill through several corporate acquisitions. The IP is amortizable for both U.S. income tax and financial statement purposes. In the current year, B's annual amortization expense for IP is $9,000 for U.S. income tax purposes and $6,000 for financial statement purposes. In its financial statements, B treats the difference in IP amortization as a temporary difference. The goodwill is not amortizable for U.S. income tax purposes and is subject to impairment for financial statement purposes. In the current year, B records an impairment charge on the goodwill of $5,000. In its financial statements, B treats the goodwill impairment as a permanent difference. B must report the amortization attributable to the IP on Part III, line 28, and report $6,000 in column (a), a temporary difference of $3,000 in column (b), and $9,000 in column (d). B must report the goodwill impairment on Part III, line 26, and report $5,000 in column (a), a permanent difference of ($5,000) in column (c), and $0 in column (d).

Reporting Requirements for Parts II and III

Except for mixed group consolidation, the number of Parts II must equal the number of Parts III filed by the corporation. Mixed groups should see *Schedule M-3 Consolidation for Mixed Groups (1120/L/PC),* earlier.

General Reporting Requirements

If an amount is attributable to a reportable transaction described in Regulations section 1.6011-4(b), the amount must be reported in columns (a), (b), (c), and (d), as applicable, of Part II, line 12, regardless of whether the amount would otherwise be reported on Part II or Part III of Schedule M-3. Thus, if a taxpayer files Form 8886, Reportable Transaction Disclosure Statement, the amounts attributable to that reportable transaction must be entered on Part II, line 12.

A corporation is required to report in column (a) of Parts II and III the amount of any item specifically listed on Schedule M-3 that is in any manner included in the corporation's current year financial statement net income (loss) or in an income or expense account maintained in the corporation's books and records, even if there is no difference between that amount and the amount included in taxable income unless (a) otherwise provided in these instructions or (b) the amount is attributable to a reportable transaction described in Regulations section 1.6011-4(b) and is therefore reported on Part II, line 12. For example, with the exception of interest income reflected on a Schedule K-1 received by a corporation as a result of the corporation's investment in a partnership or other pass-through entity, all interest income, included on Part I, line 11, whether from unconsolidated affiliated companies, third parties, banks, or other entities, whether from foreign or domestic sources, whether taxable or exempt from tax, and whether classified as some other type of income for U.S. income tax purposes (such as dividends), must be included on Part II, line 13, column (a). Likewise, all fines

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and penalties included in Part I, line 11, paid to a government or other authority for the violation of any law for which fines or penalties are assessed must be included on Part III, line 12, column (a), regardless of the government authority that imposed the fines or penalties, regardless of whether the fines or penalties are civil or criminal, regardless of the classification, nomenclature, or terminology attached to the fines or penalties by the imposing authority in its actions or documents.

If a corporation would be required to report in column (a) of Parts II and III the amount of any item specifically listed on Schedule M-3 in accordance with the preceding paragraph, except that the corporation has capitalized the item of income or expense and reports the amount in its financial statement balance sheet or in asset and liability accounts maintained in the corporation's books and records, the corporation must report the proper tax treatment of the item in columns (b), (c), and (d), as applicable.

Furthermore, in applying the two preceding paragraphs, a corporation is required to report in column (a) of Parts II and III the amount of any item specifically listed on Schedule M-3 that is included in the corporation's financial statements or exists in the corporation's books and records, regardless of the nomenclature associated with that item in the financial statements or books and records. Accurate completion of Schedule M-3 requires reporting amounts according to the substantive nature of the specific line items included in Schedule M-3 and consistent reporting of all transactions of like substantive nature that occurred during the tax year. For example, all expense amounts that are included in the financial statements or exist in the books and records that represent some form of “Bad debt expense,” must be reported on Part III, line 32, in column (a), regardless of whether the amounts are recorded or stated under different nomenclature in the financial statements or the books and records such as: “Provision for doubtful accounts;”“Expense for uncollectible notes receivable;” or “Impairment of trade accounts receivable.” Likewise, as stated in the preceding paragraph, all fines and penalties must be included on Part III, line 12, column (a), regardless of the terminology or nomenclature attached to them by the corporation in its books and records or financial statements.

With limited exceptions, Part II includes lines for specific items of income, gain, or loss (income items). (See Part II, lines 1 through 24.) If an income item is described in Part II, lines 1 through 24, report the amount of the item on the applicable line, regardless of whether there is a difference for the item. If there is a difference for the income item, or only a portion of the income item has a difference and a portion of the item does not have a difference, and the item is not described in Part II, lines 1 through 24, report and describe the entire amount of the item on Part II, line 25.

With limited exceptions, Part III includes lines for specific items of expense or deduction (expense items). (See Part III, lines 1 through 36.) If an expense item is described on Part III, lines 1 through 36, report the amount of the item on the applicable line, regardless of whether there is a difference for the item. If there is a difference for the expense item, or only a portion of the expense item has a difference and a portion of the item does not have a difference and the item is not described in Part III, lines 1 through 36, report and describe the entire amount of the item on Part III, line 37.

If there is no difference between the financial accounting amount and the taxable amount of an entire item of income, loss, expense, or deduction and the item is not described or included in Part II, lines 1 through 25, or Part III, lines 1 through 37, report the entire amount of the item in columns (a) and (d) of Part II, line 28.

Special instructions for Part II, lines 25 and 28, and Part III, line 37. Whether a given income (loss) item is reported on Part II, line 25, or on Part II, line 28, or a given expense/deduction item on Part III, line 37, or on Part II, line 28, is determined separately by each member of the U.S. consolidated tax group and not at the U.S. consolidated tax group level. For example, U.S. corporation P has two subsidiaries, A and B, that are included in P's consolidated financial statements and in P's consolidated U.S. income tax return. For financial statement purposes, P, A, and B recognize real estate tax expense when accrued. For U.S. income tax purposes, P and A recognize such expense consistent with the method used for financial statement purposes, whereas B recognizes such deduction based on a method different from that used for financial statement purposes. P and A must report this expense/deduction in column (a) and (d) on Part II, line 28. B must report the following on Part III, line 37: in column (a), B's expense recognized in the financial statements when accrued; in column (d), B's real estate tax expense recognized for U.S. income tax purposes; and in column (b) or (c), as applicable, the difference between B's real estate tax expense in its financial statements and its real estate tax deduction recognized for U.S. taxable income purposes.

Separately stated and adequately disclosed. Each difference reported in Parts II and III must be separately stated and adequately disclosed. In general, a difference is adequately disclosed if the difference is labeled in a manner that clearly identifies the item or transaction from which the difference arises. For further guidance about adequate disclosure, see Regulations section 1.6662-4(f). If a specific item of income, gain, loss, expense, or deduction is described on Part II, lines 9 through 24, or Part III, lines 1 through 37, and the line does not indicate to “attach statement” and the specific instructions for the line do not call for an attachment of a statement, then the item is considered separately stated and adequately disclosed if the item is entered on the applicable line and the amount(s) of the item(s) are entered in the applicable columns of the applicable line. See the instructions for Part II, lines 1 through 8, for specific additional information required to be provided for these particular lines.

Note. A statement or explanation may be attached to any line even if none is required.

Except as otherwise provided, differences for the same item must be combined or netted together and reported as one amount on the applicable line of Schedule M-3. However, differences for separate items must not be combined or netted together. Each item (and corresponding amount attributable to that item) must be separately stated and adequately disclosed on the applicable line of Schedule M-3, or any statement required to be attached, even if the amounts are below a certain dollar amount.

Required statements for Part II, line 25, and Part III, line 37. A separate statement must be attached to Schedule M-3 (Form 1120) that includes a detailed description of each item and

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adjustment entered on Part II, line 25, and Part III, line 37.

The description for each amount entered in column (a) must be readily identifiable to the name of the account in the financial statements or books and records of the taxpayer, under which the amount in column (a) was recorded in the accounting records. Also, the description for each amount entered in column (a) must include detailed information supporting each adjustment reported in columns (b) and (c), including how the adjustment is identified in the accounting records. The entire description is considered the tax description for the amount reported in column (d) for each item reported on Part II, line 25, or Part III, line 37.

Each description should adequately describe all four columns of Part II, line 25, or Part III, line 37. If additional information is required to provide an acceptable description, provide a supporting statement.

Example 8. Corporation C is a calendar year taxpayer that placed in service ten depreciable fixed assets in 2006. C was required to file Schedule M-3 for its 2011 tax year and is required to file Schedule M-3 for its 2012 tax year. C's total depreciation expense for its 2012 tax year for five of the assets is $50,000 for income statement purposes and $70,000 for U.S. income tax purposes. C's total annual depreciation expense for its 2012 tax year for the other five assets is $40,000 for income statement purposes and $30,000 for U.S. income tax purposes. In its financial statements, C treats the differences between financial statement and U.S. income tax depreciation expense as giving rise to temporary differences that will reverse in future years. C must combine all of its depreciation adjustments. Accordingly, C must report on Part III, line 31, for its 2012 tax year income statement depreciation expense of $90,000 in column (a), a temporary difference of $10,000 in column (b), and U.S. income tax depreciation expense of $100,000 in column (d).

Example 9. Corporation D is a calendar year taxpayer that was required to file Schedule M-3 for its 2011 tax year and is required to file Schedule M-3 for its 2012 tax year. On December 31, 2012, D establishes three reserve accounts in the amount of $100,000 for each account. One reserve account is an allowance for accounts receivable that are estimated to be uncollectible. The second reserve is an estimate of coupons outstanding that may have to be paid. The third reserve is an estimate of future warranty expenses. In its financial statements, D treats the three reserve accounts as giving rise to temporary differences that will reverse in future years. The three reserves are expenses in D's 2012 financial statements but are not deductions for U.S. income tax purposes in 2012. D must not combine the Schedule M-3 differences for the three reserve accounts. D must report the amounts attributable to the allowance for uncollectible accounts receivable on Part III, line 32, Bad debt expense, and must separately state and adequately disclose the amounts attributable to each of the other two reserves, coupons outstanding and warranty costs, on a required, attached statement that supports the amounts at Part III, line 37. D must also provide a description for each reserve that meets the requirements for Part III, line 37, discussed earlier under *Required statements for Part II, line 25, and Part III, line 37.* In this example, an acceptable description would be "Coupon Issue Reserves — Rewards Expense" and "Future Warranty Expense Reserve."

Note. There is no need to add the title of the reserve account to the description if the account name for the amount in column (a) is already part of the adjustment description.

Example 10. Corporation E is a calendar year taxpayer that was required to file Schedule M-3 for its 2011 tax year and is required to file Schedule M-3 for its 2012 tax year. On January 2, 2012, E establishes an allowance for uncollectible accounts receivable (bad debt reserve) of $100,000. During 2012, E increased the reserve by $250,000 for additional accounts receivable that may become uncollectible. Additionally, during 2012, E decreases the reserve by $75,000 for accounts receivable that were discharged in bankruptcy during 2012. The balance in the reserve account on December 31, 2012, is $275,000. The $100,000 amount to establish the reserve account and the $250,000 to increase the reserve account are expenses on E's 2012 financial statements but are not deductible for U.S. income tax purposes in 2012. However, the $75,000 decrease to the reserve is deductible for U.S. income tax purposes in 2012. In its financial statements, E treats the reserve account as giving rise to a temporary difference that will reverse in future tax years. E must report on Part III, line 32, for its 2012 tax year income statement bad debt expense of $350,000 in column (a), a temporary difference of ($275,000) in column (b), and U.S. income tax bad debt expense of $75,000 in column (d).

Example 11. Corporation F is a calendar year taxpayer that was required to file Schedule M-3 for its 2011 tax year and is required to file Schedule M-3 for its 2012 tax year. During 2012, F incurs $200 of meals and entertainment expenses that F deducts in computing net income per the income statement. $50 of the $200 is subject to the 50% limitation under section 274(n). In its financial statements, F treats the limitation on deductions for meals and entertainment as a permanent difference. Because meals and entertainment expenses are specifically described in Part III, line 11, F must report all of its meals and entertainment expenses on this line, regardless of whether there is a difference. Accordingly, F must report $200 in column (a), $25 in column (c), and $175 in column (d). F must not report the $150 of meals and entertainment expenses that are deducted in F's financial statement net income and are fully deductible for U.S. income tax purposes on Part II, line 28, Other items with no differences, and the $50 subject to the limitation under section 274(n) on Part III, line 11.

Part II. Reconciliation of Net Income (Loss) per Income Statement of Includible Corporations With Taxable Income per Return

For any item reported on Part II, lines 1, 3 through 6, or 8, attach a supporting statement that provides the name of the entity for which the item is reported, the entity's EIN (if applicable), the type of entity (corporation, partnership, etc.), and the item amounts for columns (a) through (d). See the instructions for Part II, lines 2 and 7, for the specific information required for those particular lines.

Line 1. Income (Loss) From Equity Method Foreign Corporations

Report on line 1, column (a), the financial income (loss) included in Part I, line 11, for any foreign corporation accounted for on the equity method and

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remove such amount in column (b) or (c), as applicable. Report the amount of dividends received and other taxable amounts received or includible from foreign corporations on Part II, lines 2 through 5, as applicable.

Line 2. Gross Foreign Dividends Not Previously Taxed

Except as otherwise provided in this paragraph, report on line 2, column (d), the amount (before any withholding tax) of any foreign dividends included in current year taxable income on Form 1120, page 1, line 28, and report on line 2, column (a), the amount of dividends from any foreign corporation included in Part I, line 11. Do not report on line 2 any amounts that must be reported on Part II, line 3 or 4, or dividends that were previously taxed and must be reported on Part II, line 5. (See the instructions below for Part II, lines 3, 4, and 5.)

For any dividends reported on Part II, line 2, that are received on a class of voting stock of which the corporation directly or indirectly owned 10% or more of the outstanding shares of that class at any time during the tax year, report on an attached supporting statement; (1) the name of the dividend payer, (2) the payer's EIN (if applicable), (3) the class of voting stock on which the dividend was paid, (4) the percentage of the class directly or indirectly owned, and (5) the amounts for columns (a) through (d).

Line 3. Subpart F, QEF, and Similar Income Inclusions

Report on line 3, column (d), the amount included in taxable income under section 951 (relating to Subpart F), gains or other income inclusions resulting from elections under sections 1291(d)(2) and 1298(b)(1), and any amount included in taxable income pursuant to section 1293 (relating to qualified electing funds). The amount of Subpart F income corresponds to the total of the amounts reported by the corporation on line 6, Schedule I, of all Forms 5471, Information Return of U.S. Persons With Respect To Certain Foreign Corporations. The amount of qualified electing fund income corresponds to the total of the amounts reported by the corporation on line 3(a), Part II, of all Forms 8621, Information Return by a Shareholder of a Passive Foreign Investment Company (PFIC) or Qualified Electing Fund.

Also include on line 3 PFIC mark-to-market gains and losses under section 1296. Do not report such gains and losses on Part II, line 16.

Line 4. Section 78 Gross-Up

Report on line 4, column (d), the amount of any section 78 gross-up not included in column (d) of Part II, lines 9, 10, and 11, Income (loss) from U.S. partnerships, foreign partnerships, and other pass-through entities. The section 78 gross-up amount on this line 4 must correspond to the total section 78 gross-up amounts reported by the corporation on all Forms 1118, Foreign Tax Credit—Corporations, excluding the amounts reported in column (d) of Part II, lines 9, 10, and 11.

Line 5. Gross Foreign Distributions Previously Taxed

Report on line 5, column (a), any distributions received from foreign corporations that were included in Part I, line 11, and that were previously taxed for U.S. income tax purposes. For example, include in column (a) amounts that are excluded from taxable income under sections 959 and 1293(c). Remove such amount in column (b) or (c), as applicable. Report the full amount of the distribution before any withholding tax. Since previously taxed foreign distributions are not currently taxable, line 5, column (d), is shaded. (Also, see the instructions for Part II, line 2.)

Line 6. Income (Loss) From Equity Method U.S. Corporations

Report on line 6, column (a), the financial income (loss) included in Part I, line 11, for any U.S. corporation accounted for on the equity method and remove such amount in column (b) or (c), as applicable. Report on Part II, line 7, dividends received from any U.S. corporation accounted for on the equity method.

Line 7. U.S. Dividends Not Eliminated in Tax Consolidation

Report on line 7, column (a), the amount of dividends included in Part I, line 11, that were received from any U.S. corporation. Report on line 7, column (d), the amount of any U.S. dividends included in taxable income on Form 1120, page 1, line 28.

Usually, the amounts included on line 7, columns (a) and (d) include only dividends received from U.S. corporations that are not included in the U.S. consolidated tax group because intercompany dividends (dividends received from includible corporations listed on Form 851) are eliminated or excluded for financial accounting purposes and eliminated for the calculation of U.S. taxable income. In the case of an insurance company included in the consolidated U.S. income tax return required to report intercompany dividends as part of statutory accounting net income, include such intercompany dividends on Part II, line 7, column (a) and the taxable amount of those dividends on Part II, line 7, column (d). (For insurance companies included in the consolidated U.S. income tax return, see the instructions for Part I, lines 10 and 11.)

For any intercompany dividends (dividends received from includible corporations listed on Form 851) included on Part II, line 7, report on an attached supporting statement: (1) the name of the dividend payer, (2) the payer's EIN, (3) the class of stock or security on which the dividends were paid, (4) the amount of any net adjustment included on Part I, line 10a, for such dividends, and (5) the item amounts for columns (a) through (d).

For any dividends included on Part II, line 7, that are not intercompany dividends (dividends received from includible corporations listed on Form 851) that are received on classes of voting stock in which the corporation directly or indirectly owned 10% or more of the outstanding shares of that class at any time during the tax year, report on an attached supporting statement for Part II, line 7, (1) the name of the dividend payer, (2) the payer's EIN (if applicable), (3) the class of voting stock on which the dividend was paid, (4) the percentage of the class directly or indirectly owned, and (5) the item amounts for columns (a) through (d).

Line 8. Minority Interest for Includible Corporations

Report on line 8, column (a), the minority interest included in the financial income (loss) on Part I, line 11, for any member of the U.S. consolidated tax group that is less than 100% owned.

Example 12. Corporation G is a calendar year taxpayer that was required to file Schedule M-3 for its 2011 tax year and is required to file Schedule M-3 for its 2012 tax year. G owns 90% of the stock of U.S. corporation DS1. G files a consolidated U.S. income tax return with DS1 as the GDS1 U.S. consolidated group. G prepares certified GAAP financial

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statements for the consolidated financial statement group consisting of G and DS1. G has no net income of its own, and G does not report its equity interest in the income of DS1 on its separate financial statements. DS1 has financial statement net income (before minority interests) and taxable income of $1,000 ($2,500 of revenue less $1,500 cost of goods sold).

On the consolidated Schedule M-3, Part I, line 4, Worldwide consolidated net income (loss) per income statement, and on line 11, Net income (loss) per income statement of includible corporations, the U.S. consolidated tax group GDS1 must report $900 of financial statement net income ($1,000 net income less $100 minority interest).

The GDS1 group must prepare one consolidated Schedule M-3, Parts II and III, and three additional Schedules M-3, Parts II and III: one for G, one for DS1, and one for consolidation eliminations.

On the Schedule M-3, Parts II and III, for DS1, $1,000 is reported on Part II, line 28 and line 30, in both columns (a) and (d). On G's Schedule M-3, Parts II and III, zero is reported on Part II, line 30, in both columns (a) and (d). On the consolidation eliminations Schedule M-3, Parts II and III, on Part II, line 8 and line 30, the minority interest elimination for the U.S. consolidated tax group is reported as ($100) in column (a), $100 in column (c), and $0 in column (d).

On the Schedule M-3, Parts II and III, for the U.S. consolidated tax group, on Part II, line 8, Minority interest for includible corporations, ($100) is reported in column (a), $100 in column (c), and $0 in column (d). On Part II, line 28, the U.S. consolidated tax group reports $1,000 in both columns (a) and (d). As a result, financial statement net income on Part II, line 30, column (a), will total $900, net permanent differences on Part II, line 30, column (c), will total $100, and taxable income on line 30, column (d), will total $1,000.

Line 9. Income (Loss) From U.S. Partnerships and Line 10. Income (Loss) From Foreign Partnerships

For any interest owned by the corporation or a member of the U.S. consolidated tax group that is treated as an investment in a partnership for U.S. income tax purposes (other than an interest in a disregarded entity), report amounts on Part II, line 9 or 10, as described below:

1. In column (a) the sum of the corporation's distributive share of income or loss from a U.S. or foreign partnership that is included in Part I, line 11;

2. In column (b) or (c), as applicable, except for amounts described in item 4, below, the sum of all differences, if any, attributable to the corporation's distributive share of income or loss from a U.S. or foreign partnership; and

3. In column (d), except for amounts described in item 4, below, the sum of all amounts of income, gain, loss, or deduction attributable to the corporation's distributive share of income or loss from a U.S. or foreign partnership (that is, the sum of all amounts reportable on the corporation's Schedule(s) K-1 received from the partnership (if applicable)), without regard to any limitations computed at the partner level (for example, limitations on utilization of charitable contributions, capital losses, and interest expense).

4. Do not report on Part II, line 9 or 10, as applicable, any portion of a corporation's domestic production activities deduction under section 199 even if some or all of the corporation's deduction is attributable to a partnership interest held by the corporation. A corporation must report this deduction only on Part III, line 22.

For each partnership reported on line 9 or 10, attach a supporting statement that provides the name, EIN (if applicable), end of year profit-sharing percentage (if applicable), end of year loss-sharing percentage (if applicable), and the amount reported in column (a), (b), (c), or (d) of lines 9 or 10, as applicable.

Example 13. U.S. corporation H is a calendar year taxpayer that was required to file Schedule M-3 for its 2011 tax year and is required to file Schedule M-3 for its 2012 tax year. H has an investment in a U.S. partnership USP. H prepares financial statements in accordance with GAAP. In its financial statements, H treats the difference between financial statement net income and taxable income from its investment in USP as a permanent difference. For its 2012 tax year, H's financial statement net income includes $10,000 of income attributable to its share of USP's net income. H's Schedule K-1 from USP reports $5,000 of ordinary income, $7,000 of long-term capital gains, $4,000 of charitable contributions, and $200 of section 179 expense. H must report on Part II, line 9, $10,000 in column (a), a permanent difference of ($2,200) in column (c), and $7,800 in column (d).

Example 14. Same facts as *Example 13* except that corporation H's charitable contribution deduction is wholly attributable to its partnership interest in USP and is limited to $90 pursuant to section 170(b)(2) due to other investment losses incurred by H. In its financial statements, H treated this limitation as a temporary difference. H must not report the charitable contribution limitation of $3,910 ($4,000 -$90) on Part II, line 9. H must report the limitation on Part III, line 21, and report the disallowed charitable contributions of ($3,910) in columns (b) and (d).

Line 11. Income (Loss) From Other Pass-Through Entities

For any interest in a pass-through entity (other than an interest in a partnership reportable on Part II, line 9 or 10, as applicable) owned by a member of the U.S. consolidated tax group (other than an interest in a disregarded entity), report the following on line 11:

1. In column (a) the sum of the corporation's distributive share of income or loss from the pass-through entity that is included in Part I, line 11;

2. In column (b) or (c), as applicable, except for amounts described in item 4, below, the sum of all differences, if any, attributable to the pass-through entity; and

3. In column (d), except for amounts described in item 4, below, the sum of all taxable amounts of income, gain, loss, or deduction reportable on the corporation's Schedule K-1 received from the pass-through entity (if applicable).

4. Do not report on Part II, line 11, any portion of a corporation's domestic production activities deduction even if some or all of the corporation's deduction is attributable to an interest in a pass-through entity held by the corporation. A corporation must report this deduction only on Part III, line 22.

For each pass-through entity reported on line 11, attach a supporting statement that provides that entity's name, EIN (if applicable), the corporation's end of year profit-sharing percentage (if applicable), the corporation's end of year loss-sharing percentage (if applicable), and the amounts reported by the corporation in column (a), (b), (c), or (d) of line 11, as applicable.

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Line 12. Items Relating to Reportable Transactions

Any amounts attributable to any reportable transactions (as described in Regulations section 1.6011-4) must be included on Part II, line 12, regardless of whether the difference, or differences, would otherwise be reported elsewhere in Part II or Part III. Thus, if a taxpayer files Form 8886 for any reportable transaction described in Regulations section 1.6011-4, the amounts attributable to that reportable transaction must be reported on Part II, line 12. In addition, all income and expense amounts attributable to a reportable transaction must be reported on Part II, line 12, columns (a) and (d) even if there is no difference between the financial amounts and the taxable amounts.

Each difference attributable to a reportable transaction must be separately stated and adequately disclosed. A corporation will be considered to have separately stated and adequately disclosed a reportable transaction on line 12 if the corporation sequentially numbers each Form 8886 and lists by identifying number on the supporting statement for Part II, line 12, each sequentially numbered reportable transaction and the amounts required for Part II, line 12, columns (a) through (d).

In lieu of the requirements of the preceding paragraph, a corporation will be considered to have separately stated and adequately disclosed a reportable transaction if the corporation attaches a supporting statement that provides the following for each reportable transaction:

1. A description of the reportable transaction disclosed on Form 8886 for which amounts are reported on Part II, line 12;

2. The name and tax shelter registration number, if applicable, as reported on lines 1a and 1b, respectively, of Form 8886; and

3. The type of reportable transaction (that is, listed transaction, confidential transaction, transaction with contractual protection, etc.) as reported on line 2 of Form 8886.

If a transaction is a listed transaction described in Regulations section 1.6011-4(b)(2), the description also must include the description provided on line 3 of Form 8886. In addition, if the reportable transaction involves an investment in the transaction through another entity such as a partnership, the description must include the name and EIN (if applicable) of that entity as reported on line 5 of Form 8886.

Example 15. Corporation J is a calendar year taxpayer that was required to file Schedule M-3 for its 2011 tax year and is required to file Schedule M-3 for its 2012 tax year. J incurred seven different abandonment losses during its 2012 tax year. One loss of $12 million results from a reportable transaction described in Regulations section 1.6011-4(b)(5), another loss of $5 million results from a reportable transaction described in Regulations section 1.6011-4(b)(4), and the remaining five abandonment losses are not reportable transactions. J discloses the reportable transactions giving rise to the $12 million and $5 million losses on separate Forms 8886 and sequentially numbers them X1 and X2, respectively. J must separately state and adequately disclose the $12 million and $5 million losses on Part II, line 12. The $12 million loss and the $5 million loss will be adequately disclosed if J attaches a supporting statement for line 12 that lists each of the sequentially numbered forms, Form 8886-X1 and Form 8886-X2, and with respect to each reportable transaction reports the appropriate amounts required for Part II, line 12, columns (a) through (d). Alternatively, J's disclosures will be adequate if the description provided for each loss on the supporting statement includes the names and tax shelter registration numbers, if any, disclosed on the applicable Form 8886, identifies the type of reportable transaction for the loss, and reports the appropriate amounts required for Part II, line 12, columns (a) through (d). J must report the losses attributable to the other five abandonment losses on Part II, line 23e, regardless of whether a difference exists for any or all of those abandonment losses.

Example 16. Corporation K is a calendar year taxpayer that was required to file Schedule M-3 for its 2011 tax year and is required to file Schedule M-3 for its 2012 tax year. K enters into a transaction with contractual protection that is a reportable transaction described in Regulations section 1.6011-4(b)(4). This reportable transaction is the only reportable transaction for K's 2012 tax year and results in a $7 million capital loss for both financial accounting purposes and U.S. income tax purposes. Although the transaction does not result in a difference, K is required to report on Part II, line 12, the following amounts: ($7 million) in column (a), zero in columns (b) and (c), and ($7 million) in column (d). The transaction will be adequately disclosed if K attaches a supporting statement for line 12 that (a) sequentially numbers the Form 8886 and refers to the sequentially-numbered Form 8886-X1 and (b) reports the applicable amounts required for line 12, columns (a) through (d). Alternatively, the transaction will be adequately disclosed if the supporting statement for line 12 includes a description of the transaction, the name and tax shelter registration number, if any, and the type of reportable transaction disclosed on Form 8886.

Line 13. Interest Income

Report on Part II, line 13, column (a), the total amount of interest income included on Part I, line 11, and report on Part II, line 13, column (d), the total amount of interest income included on Form 1120, page 1, line 28, that is not required to be reported elsewhere on Schedule M-3. In columns (b) or (c), as applicable, adjust for any amounts treated for U.S. income tax purposes as interest income that are treated as some other form of income for financial accounting purposes, or vice versa. For example, adjustments to interest income resulting from adjustments made in accordance with the instructions for Part II, line 18, should be made in columns (b) and (c) of this line 13.

Complete Part II of Form 8916-A. Enter the amounts from line 6, columns (a) through (d) of Form 8916-A, on Schedule M-3, Part II, line 13, columns (a) through (d), as applicable. Attach Form 8916-A.

Do not report on this line 13 or include on Form 8916-A amounts reported in accordance with the instructions for Part II, lines 9, 10, 11, 12, and 22.

Line 14. Total Accrual to Cash Adjustment

This line is completed by a corporation that prepares financial statements (or books and records, if permitted) using an overall accrual method of accounting and uses an overall cash method of accounting for U.S. income tax purposes (or vice versa). With the exception of amounts required to be reported on Part II, line 12, the corporation must report on Part II, line 14, a single amount net of all adjustments attributable solely to the use of the different overall methods of accounting (for example, adjustments

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related to accounts receivable, accounts payable, compensation, accrued liabilities, etc.), regardless of whether a separate line on Schedule M-3 corresponds to an item within the accrual to cash reconciliation. Differences not attributable to the use of the different overall methods of accounting must be reported on the appropriate lines of Schedule M-3 (for example, a depreciation difference must be reported on Part III, line 31).

Example 17. Corporation L is a calendar year taxpayer that was required to file Schedule M-3 for its 2011 tax year and is required to file Schedule M-3 for its 2012 tax year. L prepares financial statements in accordance with GAAP using an overall accrual method of accounting. L uses an overall cash method of accounting for U.S. income tax purposes. L's financial statements for the year ending December 31, 2012, report accounts receivable of $35,000, an allowance for bad debts of $10,000, and accounts payable of $17,000 related to current year acquisition and reorganization legal and accounting fees. In addition, for L's year ending December 31, 2012, L reported financial statement depreciation expense of $15,000 and depreciation for U.S. income tax purposes of $25,000. For L's 2012 tax year using an overall cash method of accounting, L does not recognize the $35,000 of revenue attributable to the accounts receivable, cannot deduct the $10,000 allowance for bad debt, and cannot deduct the $17,000 of accounts payable. In its financial statements, L treats both the difference in overall accounting methods used for financial statement and U.S. income tax purposes and the difference in depreciation expense as temporary differences. L must combine all adjustments attributable to the differences related to the overall accounting methods on Part II, line 14. As a result, L must report on Part II, line 14, $8,000 in column (a) ($35,000 -$10,000 - $17,000), ($8,000) in column (b), and zero in column (d). L must not report the accrual to cash adjustment attributable to the legal and accounting fees on Part III, line 24, Current year acquisition or reorganization legal and accounting fees. Because the difference in depreciation expense does not relate to the use of the cash or accrual method of accounting, L must report the depreciation difference on Part III, line 31, Depreciation, and report $15,000 in column (a), $10,000 in column (b), and $25,000 in column (d).

Line 15. Hedging Transactions

Report on line 15, column (a), the net gain or loss from hedging transactions included on Part I, line 11. Report in column (d) the amount of taxable income from hedging transactions as defined in section 1221(b)(2). Use columns (b) and (c) to report all differences caused by treating hedging transactions differently for financial accounting purposes and for U.S. income tax purposes. For example, if a portion of a hedge is considered ineffective under GAAP but still is a valid hedge under section 1221(b)(2), the difference must be reported on line 15. The hedge of a capital asset, which is not a valid hedge for U.S. income tax purposes but may be considered a hedge for GAAP purposes, must also be reported here.

Report hedging gains and losses computed under the mark-to-market method of accounting on line 15 and not on Part II, line 16.

Report any gain or loss from inventory hedging transactions on line 15 and not on Part II, line 17.

Line 16. Mark-to-Market Income (Loss)

Report on line 16 any amount representing the mark-to-market income or loss for any securities held by a dealer in securities, a dealer in commodities having made a valid election under section 475(e), or a trader in securities or commodities having made a valid election under section 475(f). “Securities” for these purposes are securities described in section 475(c)(2) and commodities described in section 475(e)(2). “Securities” do not include any items specifically excluded from sections 475(c)(2) and 475(e)(2), such as certain contracts to which section 1256(a) applies.

Report hedging gains and losses computed under the mark-to-market method of accounting on Part II, line 15, Hedging transactions, and not on line 16.

Traders in securities and commodities. For a trader in securities or commodities that made a valid election under section 475(f) to use the mark-to-market method to account for securities or commodities held in connection with a trading business that files Form 4797, any Schedule M-3 entries required as a result of marking to market these securities or commodities are reported as follows: (a) mark-to-market gains and losses from Form 4797, line 10, are included on Part II, line 16, of Schedule M-3 (Form 1120); (b) any other Schedule M-3 entries required based on other results (non mark-to-market gains and losses) included in the total reported on Form 4797, line 17, should be reported on Part II, line 23d, of Schedule M-3 (Form 1120), unless the instructions for Schedule M-3 require the amounts to be reported on another line.

Line 17. Cost of Goods Sold

Report on line 17 any amounts deducted as part of cost of goods sold during the tax year, regardless of whether the amounts would otherwise be reported elsewhere in Part II or Part III.

Examples of amounts that must be included as cost of goods sold items are amounts attributable to inventory valuation, such as amounts attributable to cost-flow assumptions, additional costs required to be capitalized (including depreciation) such as section 263A costs, inventory shrinkage accruals, inventory obsolescence reserves, and lower of cost or market (LCM) write-downs.

Complete Part I of Form 8916-A. Enter the amounts from line 8, columns (a) through (d) of Form 8916-A, on Schedule M-3, Part II, line 17, columns (a) through (d), as applicable. Attach Form 8916-A.

Note. The entries in columns (a) and (d) of Schedule M-3, line 17, are negative amounts.

Do not report the following on this line 17 or on Form 8916-A:

- Amounts reportable on Part II, line 12;
- Any gain or loss from inventory hedging transactions reportable on Part II, line 15;
- Amounts reportable on Part II, line 18;
- Amounts reportable on Part II, line 21;
- Mark-to-market income or (loss) associated with the inventories of dealers in securities under section 475, reportable on Part II, line 16;
- Section 481(a) adjustments related to cost of goods sold or inventory valuation, reportable on Part II, line 19;
- Fines and penalties reportable on Part III, line 12;
- Judgments, damages, awards, and similar costs, reportable on Part III, line 13; and
- Amounts included on Part III, line 34.

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Example 18. Corporation C is a calendar year taxpayer that placed in service ten depreciable fixed assets in 2006. C was required to file Schedule M-3 for its 2011 tax year and is required to file Schedule M-3 for its 2012 tax year. C's total depreciation expense for its 2012 tax year for five of the assets is $50,000 for financial accounting purposes and $70,000 for U.S. income tax purposes. C's total annual depreciation expense for its 2012 tax year for the other five assets is $40,000 for financial accounting purposes and $30,000 for U.S. income tax purposes. In addition, C incurs $200 of meals and entertainment expenses that C deducts in computing net income for financial accounting purposes. All $200 of the meals and entertainment expenses is subject to the 50% limitation under section 274(n). In its financial statements, C treats the $50,000 depreciation and $100 of the meals and entertainment as other costs in computing cost of goods sold. C must include on Form 8916-A and on Schedule M-3, Part II, line 17, in column (a), the $50,000 of depreciation and $100 of meals and entertainment. C must also include a temporary difference of $20,000 in column (b), a permanent difference of ($50) in column (c), and $70,050 in column (d) ($70,000 depreciation and $50 meals and entertainment expenses). In addition, C must report on Part III, line 31, for its 2012 tax year income statement, depreciation expense of $40,000 in column (a), a temporary difference of ($10,000) in column (b) and $30,000 in column (d); and on Part III, line 11, meals and entertainment expense of $100 in column (a), a permanent difference of ($50) in column (c), and $50 in column (d). All other cost of goods sold items would be added to the amounts included on Part II, line 17, detailed in this example and reported on Form 8916-A and on Part II, line 17, in the appropriate columns.

Line 18. Sale Versus Lease (for Sellers and/or Lessors)

Note. Also see the instructions at Part III, line 34, Purchase Versus Lease (for Purchasers and/or Lessees).

Asset transfer transactions with periodic payments characterized for financial accounting purposes as either a sale or a lease may, under some circumstances, be characterized as the opposite for tax purposes. If the transaction is treated as a lease, the seller/lessor reports the periodic payments as gross rental income and also reports depreciation expense. If the transaction is treated as a sale, the seller/lessor computes gain from the sale of assets and reports the periodic payments as payments of principal and interest income.

On Part II, line 18, column (a), report the gross profit or gross rental income for financial accounting purposes for all sale or lease transactions that must be given the opposite characterization for U.S. income tax purposes. On Part II, line 18, column (d), report the gross profit or gross rental income for federal income tax purposes. Interest income amounts for such transactions must be reported on Part II, line 13, in column (a) or (d), as applicable. Depreciation expense for such transactions must be reported on Part III, line 31, in column (a) or (d), as applicable. Use columns (b) and (c) of Part II, lines 13 and 18, and Part III, line 31, as applicable to report the differences between column (a) and (d).

Example 19. Corporation M sells and leases property to customers. M is a calendar year taxpayer that was required to file Schedule M-3 for its 2011 tax year and is required to file Schedule M-3 for its 2012 tax year. For financial accounting purposes, M accounts for each transaction as a sale. For U.S. income tax purposes, each of M's transactions must be treated as a lease. In its financial statements, M treats the difference in the financial accounting and the U.S. income tax treatment of these transactions as temporary. During 2012, M reports in its financial statements $1,000 of sales and $700 of cost of goods sold with respect to 2012 lease transactions. M receives periodic payments of $500 in 2012 with respect to these 2012 transactions and similar transactions from prior years and treats $400 as principal and $100 as interest income. For financial accounting purposes, M reports gross profit of $300 ($1,000 -$700) and interest income of $100 from these transactions. For U.S. income tax purposes, M reports $500 of gross rental income (the periodic payments) and (based on other facts) $200 of depreciation deduction on the property. On its 2012 Schedule M-3, M must report on Part II, line 13, $100 in column (a), ($100) in column (b), and zero in column (d). In addition, M must report on Part II, line 18, $300 of gross profit in column (a), $200 in column (b), and $500 of gross rental income in column (d). Lastly, M must report on Part III, line 31, $200 in column (b) and (d).

Line 19. Section 481(a) Adjustments

With the exception of a section 481(a) adjustment that is required to be reported on Part II, line 12, for reportable transactions, any difference between an income or expense item attributable to an authorized (or unauthorized) change in method of accounting made for U.S. income tax purposes that results in a section 481(a) adjustment must be reported on Part II, line 19, regardless of whether a separate line for that income or expense item exists in Part II or Part III.

Example 20. Corporation N is a calendar year taxpayer that was required to file Schedule M-3 for its 2011 tax year and is required to file Schedule M-3 for its 2012 tax year. N was depreciating certain fixed assets over an erroneous recovery period and, effective for its 2012 tax year, N receives IRS consent to change its method of accounting for the depreciable fixed assets and begins using the proper recovery period. The change in method of accounting results in a positive section 481(a) adjustment of $100,000 that is required to be spread over four tax years, beginning with the 2012 tax year. In its financial statements, N treats the section 481(a) adjustment as a temporary difference. N must report on Part II, line 19, $25,000 in columns (b) and (d) for its 2012 tax year and each of the subsequent three tax years (unless N is otherwise required to recognize the remainder of the 481(a) adjustment earlier). N must not report the section 481(a) adjustment on Part III, line 31.

Line 20. Unearned/Deferred Revenue

Report on line 20, column (a), amounts of revenues included in Part I, line 11, that were deferred from a prior financial accounting year. Report on line 20, column (d), amounts of revenues recognizable for U.S. income tax purposes in the current tax year that are recognized for financial accounting purposes in a different year. Also, report on line 20, column (d), any amount of revenues reported on line 20, column (a), that are recognizable for U.S. income tax purposes in the current tax year. Use columns (b) and (c) of line 20, as applicable, to report the differences between column (a) and (d).

Line 20 must not be used to report income recognized from long-term contracts. Instead, use line 21.

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Line 21. Income Recognition From Long-Term Contracts

Report on line 21 the amount of net income or loss for financial statement purposes (or books and records, if applicable) or U.S. income tax purposes for any contract accounted for under a long-term contract method of accounting.

Line 22. Original Issue Discount and Other Imputed Interest

Report on line 22 any amounts of original issue discount (OID) and other imputed interest. The term "original issue discount and other imputed interest" includes, but is not limited to:

1. The excess of a debt instrument's stated redemption price at maturity over its issue price, as determined under section 1273;

2. Amounts that are imputed interest on a deferred sales contract under section 483;

3. Amounts treated as interest or OID under the stripped bond rules under section 1286; and

4. Amounts treated as OID under the below-market interest rate rules under section 7872.

Line 23a. Income Statement Gain/Loss on Sale, Exchange, Abandonment, Worthlessness, or Other Disposition of Assets Other Than Inventory and Pass-Through Entities

Report on line 23a, column (a), all gains and losses on the disposition of assets except for (a) gains and losses on the disposition of inventory, and (b) gains and losses allocated to the corporation from a pass-through entity (for example, on Schedule K-1) that are included in the net income (loss) of includible corporations reported on Part I, line 11. Reverse the amount reported in column (a) in column (b) or (c), as applicable. The corresponding gains and losses for U.S. income tax purposes are reported on Part II, lines 23b through 23g, as applicable.

Line 23b. Gross Capital Gains From Schedule D, Excluding Amounts From Pass-Through Entities

Report on line 23b gross capital gains reported on Schedule D (Form 1120), Capital Gains and Losses, excluding capital gains from pass-through entities, which must be reported on Part II, lines 9, 10, or 11, as applicable.

Line 23c. Gross Capital Losses From Schedule D, Excluding Amounts From Pass-Through Entities, Abandonment Losses, and Worthless Stock Losses

Report on line 23c gross capital losses reported on Schedule D (Form 1120), excluding capital losses from (a) pass-through entities, which must be reported on Part II, lines 9, 10, or 11, as applicable; (b) abandonment losses, which must be reported on Part II, line 23e; and (c) worthless stock losses, which must be reported on Part II, line 23f. Do not report on line 23c capital losses carried over from a prior tax year and utilized in the current tax year. See the instructions for Part II, line 24, regarding the reporting requirements for capital loss carryovers utilized in the current tax year.

Line 23d. Net Gain/Loss Reported on Form 4797, Line 17, Excluding Amounts From Pass-Through Entities, Abandonment Losses, and Worthless Stock Losses

Report on line 23d the net gain or loss reported on line 17 of Form 4797, Sales of Business Property, excluding amounts from (a) pass-through entities, which must be reported on Part II, lines 9, 10, or 11, as applicable; (b) abandonment losses, which must be reported on Part II, line 23e; and (c) worthless stock losses, which must be reported on Part II, line 23f.

Note. Traders in securities or commodities that have made a valid election under section 475(f) to use the mark-to-market method to account for securities or commodities, see the instructions for Part II, line 16, earlier.

Line 23e. Abandonment Losses

Report on line 23e any abandonment losses, regardless of whether the loss is characterized as an ordinary loss or a capital loss.

Line 23f. Worthless Stock Losses

Report on line 23f any worthless stock loss, regardless of whether the loss is characterized as an ordinary loss or a capital loss. Attach a statement that separately states and adequately discloses each event that gives rise to a worthless stock loss and the amount of each loss.

Line 23g. Other Gain/Loss on Disposition of Assets Other Than Inventory

Report on line 23g any gains or losses from the sale or exchange of property other than inventory that are not reported on lines 23b through 23f.

Line 24. Capital Loss Limitation and Carryforward Used

Report as a positive amount on line 24, columns (b) or (c), as applicable, and (d) the excess of the net capital losses over the net capital gains reported on Schedule D (Form 1120) by the corporation. For a U.S. consolidated tax group, the Schedule M-3 adjustment for the amount of the consolidated net capital loss that is disallowed should not be made on the separate consolidating Schedules M-3 of the includible corporations, but on the separate Schedule M-3 for consolidated eliminations (or on Form 8916 in the case of a mixed group) as described under *Completion of Schedule M-3 and Certain Allocations, Limitations, and Carryovers*, earlier.

If the corporation utilizes a capital loss carryforward on Schedule D in the current tax year, report the carryforward utilized as a negative amount on Part II, line 24, columns (b) or (c), as applicable, and column (d). For a U.S. consolidated tax group, the Schedule M-3 adjustment for the amount of the consolidated capital loss carryforward should not be made on the separate consolidating Schedules M-3 of the includible corporations, but on the separate Schedule M-3 for consolidation eliminations (or on Form 8916 in the case of a mixed group) as described under *Completion of Schedule M-3 and Certain Allocations, Limitations, and Carryovers*, earlier.

Line 25. Other Income (Loss) Items With Differences

Separately state and adequately disclose on Part II, line 25, all items of income (loss) with differences that are not otherwise listed on Part II, lines 1 through 24. Attach a statement that itemizes the type of income (loss) and the amount of each item and provides a description that states the income (loss) name for book purposes for the amount recorded in column (a) and describes the adjustment being recorded in column (b) or (c). The entire description completes the tax description for the amount included in column (d) for each item separately stated on this line.

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The attached statement should have five columns. The first column has the description for the next four columns. The second column is column (a) income (loss) per income statement, third column is column (b) temporary difference, the fourth column is column (c) permanent difference, and the fifth column is column (d) income (loss) per tax return. Every item listed on the attached statement for line 25 must always have columns (a) + (b) + (c) = (d). Each item with amounts in columns (a), (b), (c), and (d) will be totaled and included as one line on line 25 of the face of the schedule.

If any "comprehensive income" as defined by Statement of Financial Accounting Standards (SFAS) No. 130 is reported on this line, describe the item(s) in detail. Examples of sufficiently detailed descriptions include "foreign currency translation adjustments — comprehensive income" and "gains and losses on available-for-sale securities — comprehensive income."

Whether an item of income (loss) is reported on line 25, or is reported on Part II, line 28, is determined separately by each member of the U.S. consolidated tax group and not at the U.S. consolidated tax group level.

Example 21. U.S. corporation P has two subsidiaries, corporations A and B, that are included in P's consolidated financial statements and in P's consolidated U.S. income tax return. For financial statement purposes, P, A, and B recognize revenue from the sale of inventory upon delivery to the customer. For U.S. income tax purposes, P and A recognize such revenue consistent with the method used for financial statement purposes, whereas B recognizes such revenue based upon customer acceptance. P and A must report this revenue in column (a) and (d) on Part II, line 28. B must report the following on Part II, line 25: in column (a), B's revenue recognized in the financial statements based upon delivery to the customer; in column (d), B's revenue recognized for U.S. income tax purposes based upon customer acceptance; and in column (b) or (c), as applicable, the difference between B's revenue recognized in its financial statements and in its U.S. taxable income.

Note. In this example, the first column of the attached statement for Part II, line 25, discussed earlier, must include an adequate description, such as, "Inventory Sales Revenue recognized upon acceptance, not delivery."

Line 26. Total Income (Loss) Items

Combine lines 1 through 25 and enter the total on line 26.

Note. Line 17, Cost of goods sold, columns (a) and (d), are negative amounts which will affect the totals entered on line 26.

Line 27. Total Expense/ Deduction Items

Report on Part II, line 27, columns (a) through (d), as applicable, the negative of the amounts reported on Part III, line 38, columns (a) through (d), as applicable. Report positive amounts as negative and negative amounts as positive. For example, if Part III, line 38, column (a), reflects an amount of $1 million, then report on Part II, line 27, column (a), ($1 million). Similarly, if Part III, line 38, column (b), reflects an amount of ($50,000), then report on Part II, line 27, column (b), $50,000.

Line 28. Other Items With No Differences

If there is no difference between the financial accounting amount and the taxable amount of an entire item of income, gain, loss, expense, or deduction and the item is not described or included in Part II, lines 1 through 25, or Part III, lines 1 through 37, report the entire amount of the item in columns (a) and (d) of line 28. If a portion of an item of income, loss, expense, or deduction has a difference and a portion of the item does not have a difference, do not report any portion of the item on line 28. Instead, report the entire amount of the item (that is, both the portion with a difference and the portion without a difference) on the applicable line of Part II, lines 1 through 25, or Part III, lines 1 through 37. See *Example 11*, earlier.

Line 29a. 1120 Subgroup Reconciliation Totals

For filers other than a mixed group, combine lines 26 through 28 and skip lines 29b and 29c. On the sub-consolidated Schedule M-3 for a mixed group, combine lines 26 through 28 and skip lines 29b and 29c. For the consolidated Schedule M-3 of a mixed group, complete only lines 29a through 29c and line 30 of Part II. No Part III is required to be completed for the consolidated Schedule M-3 of a mixed group.

Line 29b. PC Insurance Subgroup Reconciliation Totals

Line 29b is only used by mixed groups. See *Schedule M-3 Consolidation for Mixed Groups (1120/L/PC)*, earlier.

Line 29c. Life Insurance Subgroup Reconciliation Totals

Line 29c is only used by mixed groups. See *Schedule M-3 Consolidation for Mixed Groups (1120/L/PC)*, earlier.

Line 30. Reconciliation Totals

If a corporation that is not a mixed group chooses not to complete columns (a) and (d) of Parts II and III in the first tax year the corporation is required to file Schedule M-3 (or for any year in which the corporation voluntarily files Schedule M-3), Part II, line 30, is reconciled by the corporation (or, in the case of a U.S. consolidated tax group, on the group's consolidated Schedule M-3) in the following manner:

1. Report the amount from Part I, line 11, on Part II, line 30, column (a);

2. Leave blank Part II, lines 1 through 29, columns (a) and (d);

3. Leave blank Part III, columns (a) and (d); and

4. Report on Part II, line 30, column (d), the sum of Part II, line 30, columns (a), (b), and (c).

Note. Mixed groups see *Schedule M-3 Consolidation for Mixed Groups (1120/L/PC)*, earlier.

Part III. Reconciliation of Net Income (Loss) per Income Statement of Includible Corporations With Taxable Income per Return—Expense/ Deduction Items

Note. Expense amounts that reduce financial accounting income must be reported on Part III, column (a), as positive amounts. Deduction amounts that reduce taxable income must be reported on Part III, column (d), as positive amounts. Amounts reported on Part II, line 27, must be the negative of the amounts reported on Part III, line 38.

Lines 1 Through 6. Income Tax Expense

If the corporation does not distinguish between current and deferred income tax expense in its financial statements (or its books and records, if applicable), report income tax expense as current

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income tax expense using lines 1, 3, and 5, as applicable.

A U.S. consolidated tax group must complete lines 1 through 6 in accordance with the allocation of tax expense among the members of the U.S. consolidated tax group in the financial statements (or its books and records, if applicable). If the current and deferred U.S., state, and foreign income tax expense for the U.S. consolidated tax group (income tax expense) is allocated among the members of the U.S. consolidated tax group in the group's financial statements (or its books and records, if applicable), then each member must report its allocated income tax expense on Part III, lines 1 through 6, of that member's separate Schedule M-3. However, if the income tax expense is not shared or allocated among members of the U.S. consolidated tax group but is retained in the parent corporation's financial statements (or books and records, if applicable), then amounts are reported only on Part III, lines 1 through 6, of the parent's separate Schedule M-3.

Line 7. Foreign Withholding Taxes

Report on line 7, column (a), the amount of foreign withholding taxes included in financial accounting net income on Part I, line 11. If the corporation is deducting foreign tax, use column (b) or (c), as applicable, to correct for any difference between foreign withholding tax included in financial accounting net income and the amount of foreign withholding taxes being deducted in the return. If the corporation is crediting foreign withholding taxes against the U.S. income tax liability, use column (b) or (c), as applicable, to negate the amount reported in column (a).

Line 8. Interest Expense

Report on Part III, line 8, column (a), the total amount of interest expense included on Part I, line 11, and report on Part III, line 8, column (d), the total amount of interest deduction included on Form 1120, page 1, line 28, that is not required to be reported elsewhere on Schedule M-3. In columns (b) or (c), as applicable, include any adjustments for any amounts treated for U.S. income tax purposes as interest deduction that are treated as some other form of expense for financial accounting purposes, or vice versa. For example, adjustments to interest expense/deduction resulting from adjustments made in accordance with the instructions for Part III, line 34, Purchase versus lease (for purchasers and/or lessees), should be made in columns (b) and (c), as applicable, on this line 8.

Complete Part III of Form 8916-A. Enter the amounts from line 5, columns (a) through (d) of Form 8916-A, on Schedule M-3, Part III, line 8, columns (a) through (d), as applicable. Attach Form 8916-A.

Do not report on Form 8916-A and this line 8 amounts reported in accordance with the instructions for Part II, lines 9, 10, 11, and 12.

Line 9. Stock Option Expense

Report on line 9, column (a), amounts expensed on Part I, line 11, net income per the income statement, that are attributable to all stock options. Report on line 9, column (d), deduction amounts attributable to all stock options.

Line 10. Other Equity-Based Compensation

Report on line 10 any amounts for equity-based compensation or consideration that are reflected as expense for financial accounting purposes (column (a)) or deducted in the U.S. income tax return (column (d)) other than amounts reportable elsewhere on Schedule M-3, Parts II and III (for example, on Part III, line 9, for stock options expense). Examples of amounts reportable on line 10 include payments attributable to employee stock purchase plans (ESPPs), phantom stock options, phantom stock units, stock warrants, stock appreciation rights, and restricted stock, regardless of whether such payments are made to employees or non-employees, or as payment for property or compensation for services.

Line 11. Meals and Entertainment

Report on line 11, column (a), any amounts paid or accrued by the corporation during the tax year for meals, beverages, and entertainment that are accounted for in financial accounting income, regardless of the classification, nomenclature, or terminology used for such amounts, and regardless of how or where such amounts are classified in the corporation's financial income statement or the income and expense accounts maintained in the corporation's books and records. Report only amounts not otherwise reportable elsewhere on Schedule M-3, Parts II and III (for example, Part II, line 17).

Line 12. Fines and Penalties

Report on line 12 any fines or similar penalties paid to a government or other authority for the violation of any law for which fines or penalties are assessed. All fines and penalties expensed in financial accounting income (paid or accrued) must be included on this line 12, column (a), regardless of the government or other authority that imposed the fines or penalties, regardless of whether the fines and penalties are civil or criminal, regardless of the classification, nomenclature, or terminology used for the fines or penalties by the imposing authority in its actions or documents, and regardless of how or where the fines or penalties are classified in the corporation's financial income statement or the income and expense accounts maintained in the corporation's books and records. Also report on line 12, column (a), the reversal of any overaccrual of any amount described in this paragraph. See section 162(f) for additional guidance.

Report on line 12, column (d), any such amounts as described in the preceding paragraph that are includible in taxable income, regardless of the financial accounting period in which such amounts were or are included in financial accounting net income. Complete columns (b) and (c) as appropriate.

Do not report on this Part III, line 12, amounts required to be reported in accordance with instructions for Part III, line 13.

Do not report on this Part III, line 12, amounts recovered from insurers or any other indemnitors for any fines and penalties described above.

Line 13. Judgments, Damages, Awards, and Similar Costs

Report on line 13, column (a), the amount of any estimated or actual judgments, damages, awards, settlements, and similar costs, however named or classified, included in financial accounting income, regardless of whether the amount deducted was attributable to an estimate of future anticipated payments or actual payments. Also report on line 13, column (a), the reversal of any overaccrual of any amount described in this paragraph.

Report on line 13, column (d), any such amounts as are described in the preceding paragraph that are includible in taxable income, regardless of the

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financial accounting period in which such amounts were or are included in financial accounting net income. Complete columns (b) and (c) as appropriate.

Do not report on this Part III, line 13, amounts required to be reported in accordance with instructions for Part III, line 12.

Do not report on this Part III, line 13, amounts recovered from insurers or any other indemnitors for any judgments, damages, awards, or similar costs described above.

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Line 14. Parachute Payments

Report on line 14, column (a), the total expense included in financial accounting net income on Part I, line 11, that is subject to section 280G. Report in column (b) or (c), as applicable, the amount of nondeductible parachute payments pursuant to section 280G, and report in column (d) the deductible amount of compensation after any excess parachute payment limitations under section 280G. If a payment is subject to limitation under both sections 162(m) and 280G, report the total payment on this line 14.

Line 15. Compensation With Section 162(m) Limitation

Report on line 15, column (a), the total amount of non-performance-based current compensation expense for the corporate officers to whom section 162(m) applies. Report in column (b) or (c) as applicable, the nondeductible amount of current compensation in excess of $1 million ($500,000 if the corporation receives or has received financial assistance under the Treasury Troubled Asset Relief Program (TARP)). Report the deductible compensation in column (d). If a payment is subject to limitation under both sections 162(m) and 280G, report the total payment on Part III, line 14, Parachute payments. See Regulations section 1.162-27(g) for the interaction between sections 162(m) and 280G.

Line 16. Pension and Profit-Sharing

Report on line 16 any amounts attributable to the corporation's pension plans, profit-sharing plans, and any other retirement plans.

Line 17. Other Post-Retirement Benefits

Report on line 17 any amounts attributable to other post-retirement benefits not otherwise includible on Part III, line 16 (for example, retiree health and life insurance coverage, dental coverage, etc.).

Line 18. Deferred Compensation

Report on line 18, column (a), any compensation expense included in the net income (loss) amount reported in Part I, line 11, that is not deductible for U.S. income tax purposes in the current tax year and that was not reported elsewhere on Schedule M-3, column (a). Report on line 18, column (d), any compensation deductible in the current tax year that was not included in the net income (loss) amount reported in Part I, line 11, for the current tax year and that is not reportable elsewhere on Schedule M-3. For example, report originations and reversals of deferred compensation subject to section 409A on line 18.

Line 20. Charitable Contribution of Intangible Property

Report on line 20 any charitable contribution of intangible property, for example, contributions of:

- Intellectual property, patents (including any amounts of additional contributions allowable by virtue of income earned by donees subsequent to the year of donation), copyrights, trademarks;
- Securities (including stocks and their derivatives, stock options, and bonds);
- Conservation easements (including scenic easements or air rights);
- Railroad rights of way;
- Mineral rights; and
- Other intangible property.

Line 21. Charitable Contribution Limitation/ Carryforward

Report as a negative amount on this line 21, columns (b), (c), and (d), as applicable, the excess of charitable contributions made during the tax year over the amount of the charitable contribution limitation amount.

If the corporation utilizes a contribution carryforward in the current tax year, report the carryforward utilized as a positive amount on columns (b), (c), and (d), as applicable.

When a consolidated income tax return is being filed, Schedule M-3 adjustments for the amount of charitable contributions in excess of the limitation, or for charitable contribution carryforward utilized, should not be made on the separate consolidating Schedules M-3 of the includible corporations, but on the separate consolidating Schedule M-3 for consolidation eliminations (or on Form 8916 in the case of a mixed group). See *Completion of Schedule M-3 and Certain Allocations, Limitations, and Carryovers*, earlier.

Line 22. Domestic Production Activities Deduction

Report on Part III, line 22, column (d), the corporation's domestic production activities deduction under section 199 that is reported on Form 1120, page 1, line 25. Complete columns (b) and (c) as appropriate. Do not report any portion of the corporation's domestic production activities deduction on any other line of Schedule M-3.

Line 23. Current Year Acquisition or Reorganization Investment Banking Fees

Report on line 23 any investment banking fees paid or incurred in connection with a taxable or tax-free acquisition of property (for example, stock or assets) or a tax-free reorganization. Report on this line any investment banking fees incurred at any stage of the acquisition or reorganization process including, for example, fees paid or incurred to evaluate whether to investigate an acquisition, fees to conduct an actual investigation, and fees to consummate the acquisition. Also include on this line 23 investment banking fees incurred in connection with the liquidation of a subsidiary, a spin-off of a subsidiary, or an initial public stock offering.

Line 24. Current Year Acquisition or Reorganization Legal and Accounting Fees

Report on line 24 any legal and accounting fees paid or incurred in connection with a taxable or tax-free acquisition of property (for example, stock or assets) or tax-free reorganization. Report on this line any legal and accounting fees incurred at any stage of the acquisition or reorganization process including, for example, fees paid or incurred to evaluate whether to investigate an acquisition, fees to conduct an actual investigation, and fees to consummate the acquisition. Also include on this line legal and accounting fees incurred in connection with the liquidation of a subsidiary, a spin-off of a subsidiary, or an initial public stock offering.

Line 25. Current Year Acquisition/Reorganization Other Costs

Report on line 25 any other fees paid or incurred in connection with a taxable or tax-free acquisition of property (for example, stock or assets) or a tax-free reorganization not otherwise reportable on Schedule M-3 (for example, Part III, line 23 or 24). Report on this line any fees paid or incurred at any stage of the acquisition or reorganization process including, for example, fees paid or incurred to evaluate whether to investigate an acquisition, fees to conduct an actual investigation, and fees to consummate the acquisition. Also include on this line other acquisition/reorganization costs incurred in connection with the liquidation of a subsidiary, a spin-off of a subsidiary, or an initial public stock offering.

Line 26. Amortization/ Impairment of Goodwill

Report on line 26 amortization of goodwill or amounts attributable to the impairment of goodwill.

Line 27. Amortization of Acquisition, Reorganization, and Start-Up Costs

Report on line 27 amortization of acquisition, reorganization, and start-up costs. For purposes of column (b), (c), and (d), include amounts amortizable under section 167, 195, or 248.

Line 28. Other Amortization or Impairment Write-Offs

Report on line 28 any amortization or impairment write-offs not otherwise includible on Schedule M-3.

Line 29. Section 198 Environmental Remediation Costs

Report on line 29, column (a), any amounts attributable to environmental remediation costs included on Part I, line 11. Report in columns (b), (c), and (d), as applicable, any deductible amounts attributable to environmental remediation costs described in section 198 that are paid or incurred during the current tax year.

Line 31. Depreciation

Report on line 31 any depreciation expense that is not required to be reported elsewhere on Schedule M-3 (for example, on Part II, line 9, 10, 11, or 17).

Line 32. Bad Debt Expense

Report on line 32, column (a), any amounts attributable to an allowance for uncollectible accounts receivable or actual write-offs of accounts receivable included on Part I, line 11. Report in column (d) the amount of bad debt expense deductible for federal income tax purposes under section 166.

Line 33. Corporate Owned Life Insurance Premiums

Report on line 33 all amounts of insurance premiums attributable to any life insurance policy if the corporation is directly or indirectly a beneficiary under the policy or if the policy has a cash value. Report in column (d) the amount of the premiums that are deductible for federal income tax purposes.

Line 34. Purchase Versus Lease (for Purchasers and/or Lessees)

Note. Also see the instructions for sellers and/or lessors in the instructions for Part II, line 18.

Asset transfer transactions with periodic payments characterized for financial accounting purposes as either a purchase or a lease may, under some circumstances, be characterized as the opposite for tax purposes.

If a transaction is treated as a lease, the purchaser/lessee reports the periodic payments as gross rental expense. If the transaction is treated as a purchase, the purchaser/lessee reports the periodic payments as payments of principal and interest and also reports depreciation expense or deduction with respect to the purchased asset.

Report in column (a), gross rent expense for a transaction treated as a lease for financial accounting purposes but as a sale for U.S. income tax purposes. Report in column (d), gross rental deductions for a transaction treated as a lease for U.S. income tax purposes but as a purchase for financial accounting purposes. Report interest expense for such transactions on Part III, line 8, column (a) or (d), as applicable. Report depreciation expense or deductions for such transactions on Part III, line 31, column (a) or (d), as applicable. Use columns (b) and (c) of Part III, lines 8, 31, and 34, as applicable, to report the differences between column (a) and (d) for such recharacterized transactions.

Example 22. U.S. corporation X acquired property in a transaction that, for financial accounting purposes, X treats as a lease. X is a calendar year taxpayer that was required to file Schedule M-3 for its 2011 tax year and is required to file Schedule M-3 for its 2012 tax year. Because of its terms, the transaction is treated for U.S. income tax purposes as a purchase and X must treat the periodic payments it makes partially as payment of principal and partially as payment of interest. In its financial statements, X treats the difference between the financial accounting and U.S. income tax treatment of this transaction as a temporary difference. During 2012, X reports in its financial statements $1,000 of gross rental expense that, for U.S. income tax purposes, is recharacterized as a $700 payment of principal and a $300 payment of interest, accompanied by a depreciation deduction of $1,200 (based on other facts). On its 2012 Schedule M-3, X must report the following on Part III, line 34: column (a) $1,000, its financial accounting gross rental expense; column (b), ($1,000); and column (d), zero. On Part III, line 8, X reports zero in column (a) and $300 in columns (b) and (d) for the interest deduction. On Part III, line 31, X reports zero in column (a) and $1,200 in columns (b) and (d) for the depreciation deduction.

Line 35. Research and Development Costs

Report in column (a) the amount of expenses included in net income reported on Part I, line 11, that are related to research and development expense. Report in column (d) the amount of deductions included in Form 1120, page 1, line 27 that are recognized and reported as Section 174 research and experimental expenditures consistent with the corporation's adopted method of accounting for such expenditures. In column (c), as applicable, include any adjustments for any amounts treated for U.S. income tax purposes as research or experimental expenditures that are treated as some other form of expense for financial accounting purposes, or vice versa. Report any difference in timing recognition in column (b). For example, if the taxpayer's financial accounting method does not specify otherwise, column (b) adjustments include adjustments for timing differences between financial and tax accounting for: (1) deferral and amortization of research expenditures, (2) a section 59(e) election, (3) reduction of section 174 expenditures

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under section 280C or section 482, (4) costs attributable to obtaining a patent, (5) research in social sciences, and (6) cost elements for property of a character subject to depreciation.

Section 174 provides two methods for the treatment of research and experimental expenditures paid or incurred by a taxpayer in connection with the taxpayer's trade or business. These expenditures may be treated as expenses not chargeable to a capital account and deducted in the year in which they are paid or incurred, or they may be deferred and amortized. Since the method for treatment of research and experimental expenditures is adopted at the subsidiary level, the expense/deduction item is determined separately by each member of a U.S. consolidated tax group and not at the U.S. consolidated tax group level. For example, U.S. Corporation P has two subsidiaries, A and B, which are included in P's consolidated financial statements and in P's consolidated U.S. income tax return. For financial purposes, P, A, and B recognize research and development cost as an expense when accrued. For U.S. income tax purposes, P and A recognize such costs consistent with the method used for financial purposes, whereas B capitalizes and amortizes such costs. P and A must report these expenses in columns (a) and (d). B must report its expense recognized in the financial statements when accrued in column (a); in column (d), B's research and development expenditures recognized for U.S. income tax purposes; and in columns (b) and (c), as applicable, the difference between B's research and development costs in its financial statements and its research and experimental expenditures for U.S. taxable income purposes.

Example 23. Corporation X is a calendar year taxpayer that was required to file Schedule M-3 for its 2011 tax return and is required to file Schedule M-3 for its 2012 tax year. During 2012, X incurred $100,000 of research and development costs that X recognized as an expense in its financial statements. Also, X incurred $20,000 in attorney fees in obtaining a patent application that X capitalized and amortized in its financial statements. X recognized a $2,000 amortization deduction. In compliance with its adopted method of accounting under section 174, X deducts research and experimental expenditures for U.S. income tax purposes. Accordingly, X must report $100,000 in column (a), $20,000 in column (b), and $120,000 in column (d). X must also report $2,000 in column (a), ($2,000) in column (b), and $0 in column (d) on Part III, line 28, Other amortization or impairment write-offs.

Example 24. Assume the same facts as *Example 22* except Corporation X makes an annual election under section 59(e) to deduct $80,000 of its $120,000 of research and experimental expenditures over a 10-year period. Accordingly, X must report $100,000 in column (a), a temporary difference of ($52,000) ($20,000 less ($80,000/10 years X 9 years)) in column (b), and $48,000 in column (d). X must also report $2000 in column (a), ($2000) in column (b), and $0 in column (d) on Part III, line 28, Other amortization or impairment write-offs.

Example 25. Assume the same facts as *Example 23* except Corporation X elected to capitalize and amortize its research and expenditures over 60 months with respect to all its research programs for U.S. tax purposes. X first realized benefits from such expenditures on August 1. Accordingly, X must report $100,000 in column (a), a temporary difference of ($90,000) ($20,000 less ($120,000/60 months X 55 months)) in column (b), and $10,000 in column (d).

Example 26. Corporation X is a calendar year taxpayer that was required to file Schedule M-3 for its 2011 tax return and is required to file Schedule M-3 for its 2012 tax year. X adopted the current expense method to research and experimental expenditures for U.S. income tax purposes. During 2012, X incurred $50,000 of research and development costs that X recognized as an expense in its financial statements. Also, X undertook to develop a new machine for its business. X expended $30,000 on the project of which $10,000 represents actual costs of material, labor, and component cost to construct the machine, and $20,000 represents research costs not attributable to the machine itself. X capitalized $30,000 of costs related to the machine and recognized $6,000 of depreciation expense in its financial statements. X's depreciation expense on the $10,000 of costs related to the machine itself was $2,000 for U.S. income tax purposes. Accordingly, X must report $50,000 in column (a), $20,000 (research costs which are not attributable to the machine itself) in column (b), and $70,000 in column (d). X must also report $6,000 in column (a), ($4,000) in column (b), and $2,000 in column (d) on Part III, line 31, Depreciation.

Example 27. Corporation X is a calendar year taxpayer that was required to file Schedule M-3 for its 2011 tax return and is required to file Schedule M-3 for its 2012 tax year. During 2012, X incurred $10,000 of research and development costs related to social sciences that it recognized as an expense in its financial statements. X adopted the current expense method to research and experimental expenditures for U.S. income tax purposes. Because such costs are not allowable costs under section 174, X must report $10,000 in column (a), permanent difference ($10,000) in column (c), and $0 in column (d). If such costs are otherwise deductible for U.S. income tax purposes, X must report this item of expense on Part III, line 37, Other expense/deduction items with differences.

Example 28. Corporation X is a calendar year taxpayer that was required to file Schedule M-3 for its 2011 tax return and is required to file Schedule M-3 for its 2012 tax year. During 2012, X paid $75,000 to acquire or in-license intangible assets under a collaborative arrangement with another company that X recognized as a research and development expense in its financial statements. X adopted the current expense method to research and experimental expenditures for U.S. income tax purposes. Because payments made to acquire rights to a product or technology are excluded costs from the definition of research and experimental expenditures, X must report $75,000 in column (a), ($75,000) in column (c), and $0 in column (d). X must report any amortization otherwise allowable related to the payments on Part III, line 28, Other amortization or impairment write-offs.

Line 36. Section 118 exclusion

Report on line 36 any inducements received in the current year and treated as contributions to the capital of a corporation by a non-shareholder. Report in column (a) any income amount as a negative number and any expense amount as a positive number.

Corporations must identify on an accompanying statement referencing line 36 the fair market value of land or other property (including cash) provided to the corporation by any non-shareholder, including a

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governmental unit or civic group, as an inducement, or for any other purpose. Include inducements for the corporation to locate its business in a particular state, municipality, community, or locality for the purpose of enabling the corporation to expand its existing operating facilities, including corporate headquarters, distribution center(s), or factory(ies) ("inducements").

On the accompanying statement also identify any inducements that include refundable or transferable tax credits, including transferable credits that were sold.

The statement must separately state, adequately disclose, and identify all of the dollar amounts summarized by this line. An accompanying statement is required even if there are no dollar amounts reported on line 36.

Line 37. Other Expense/ Deduction Items With Differences

Separately state and adequately disclose on Part III, line 37, all items of expense/deduction that are not otherwise listed on Part III, lines 1 through 36.

Attach a statement that describes and itemizes the type of expense/ deduction and the amount of each item, and provides a description that states the expense/deduction name for book purposes for the amount recorded in column (a) and describes the adjustment being recorded in column (b) or (c). The entire description completes the tax description for the amount included in column (d) for each item separately stated on this line.

The statement attached to the Schedule M-3 for line 37 must separately state and adequately disclose the nature and amount of the expense related to each reserve and/or contingent liability. The appropriate level of disclosure depends upon each taxpayer's operational activity and the nature of its accounting records. For example, if a corporation's net income amount reported in the income statement includes anticipated expenses for a discontinued operation as a single amount, and its general ledger or other books, records, and workpapers provide details for the anticipated expenses under more explanatory and defined categories such as employee termination costs, lease cancellation costs, loss on sale of equipment, etc., a supporting statement that lists those categories of expenses and their details will satisfy the requirement to separately state and adequately disclose. In order to separately state and adequately disclose the employee termination costs, it is not required that an anticipated termination cost amount be listed for each employee, or that each asset (or category of asset) be listed along with the anticipated loss on disposition.

The attached statement should have five columns. The first column has the description for the next four columns. The second column is column (a) expense per income statement, the third column is column (b) temporary difference, the fourth column is column (c) permanent difference, and the fifth column is column (d) deduction per tax return. Every item listed on the attached statement for line 37 must always have columns (a) + (b) + (c) = (d). Each item with amounts in columns (a), (b), (c), and (d) will be totaled and included as one line on Part III, line 37.

Comprehensive income. If any "comprehensive income" as defined by SFAS No. 130 is reported on this line, describe the item(s) in detail as, for example, "Foreign currency translation adjustments—comprehensive income" and "Gains and losses on available-for-sale securities—comprehensive income."

Reserves and contingent liabilities. Report on line 37 amounts related to the change in each reserve or contingent liability that is not required to be reported elsewhere on Schedule M-3. For example: (1) amounts relating to changes in reserves for litigation must be reported on Part III, line 13, Judgments, damages, awards, and similar costs; and (2) amounts relating to changes in reserves for uncollectible accounts receivable must be reported on Part III, line 32, Bad debt expense. See Examples 9 and 30.

Report on line 37 the amortization of various items of prepaid expense, such as prepaid subscriptions and license fees, prepaid insurance, etc.

Report on line 37, column (a), expenses included in net income reported on Part I, line 11, that are related to reserves and contingent liabilities. Report on line 37, column (d), amounts related to liabilities for reserves and contingent liabilities that are deductible in the current tax year for U.S. income tax purposes. Examples of reserves that are allowed for book purposes, but not for tax purposes, include warranty reserves, restructuring reserves, reserves for discontinued operations, and reserves for acquisitions and dispositions. Only report on line 37 items that are not required to be reported elsewhere on Schedule M-3, Parts II and III.

Example 29. Corporation Q is a calendar year taxpayer that was required to file Schedule M-3 for its 2011 tax year and is required to file Schedule M-3 for its 2012 tax year. On July 1 of each year, Q has a fixed liability for its annual insurance premiums on its home office building that provides a 12-month coverage period beginning July 1 through June 30. In addition, Q historically prepays 12 months of advertising expense on July 1. On July 1, 2012, Q prepays its insurance premium of $500,000 and advertising expenses of $800,000. For statutory accounting purposes, Q capitalizes and amortizes the prepaid insurance and advertising over 12 months. For U.S. income tax purposes, Q deducts the insurance premium when paid and amortizes the advertising over the 12-month period. In its annual statement, Q treats the differences attributable to the annual statement treatment and U.S. income tax treatment of the prepaid insurance and advertising as temporary differences.

Q also has a Legal reserve where $300,000 was expensed for financial accounting purposes and a ($100,000) temporary difference was calculated to arrive at the income tax deduction of $200,000. The statement attached to Q's return for Part III, line 37 must be separately stated and adequately disclosed as follows:

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Line 37—Example 29
Statement Concerning Other Expense/Deduction Items With Differences

Description	Column (a) Expense per Income Statement	Column (b) Temporary Difference	Column (c) Permanent Difference	Column (d) Deduction per Tax Return
Prepaid insurance premium expensed not capitalized	$250,000	$250,000	-0-	$500,000
Legal expense reserve	$300,000	($100,000)	-0-	$200,000
Total line 37	**$550,000**	**$150,000**	**-0-**	**$700,000**

Line 38. Total Expense/ Deduction Items

Report on Part II, line 27, columns (a) through (d), as applicable, the negative of the amounts reported on Part III, line 38, columns (a) through (d), as applicable. Report positive amounts as negative and negative amounts as positive. For example, if Part III, line 38, column (a), reflects an amount of $1 million, then report on Part II, line 27, column (a), ($1 million). Similarly, if Part III, line 38, column (b), reflects an amount of ($50,000), then report on Part II, line 27, column (b), $50,000.

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To help us develop a more useful index, please let us know if you have ideas for index entries. See “Comments and Suggestions” in the “Introduction” for the ways you can reach us.

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