Instructions for Schedule M-3 (Form 1120-L)

(Net Income (Loss) Reconciliation for U.S. Life Insurance Companies With Total Assets of $10 Million or More

Volume 2 of 2

Department of the Treasury
Internal Revenue Service

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A life insurance company 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 life insurance company's current year annual statement net income (loss) or in an income or expense account maintained in the life insurance company'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 life insurance company as a result of the life insurance company's investment in a partnership or other pass-through entity, all interest income, whether from unconsolidated affiliated companies, third parties, banks, or other entities; whether from foreign or domestic sources; whether taxable or exempt from tax; and regardless of how or where the income is classified in the life insurance company's annual statement, must be included on Part II, line 13, column (a). Likewise, all fines and penalties 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; and regardless of how or where the fines or penalties are classified in the life insurance company's summary of operations or the income and expense accounts maintained in the life insurance company's books and records.

If a life insurance company would be required to report in Parts II and III, column (a), the amount of any item specifically listed on Schedule M-3 in accordance with the preceding paragraph, except that the life insurance company has capitalized the item of income or expense and reports the amount in its annual statement or in asset and liability accounts maintained in the life insurance company's books and records, the life insurance company 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 life insurance company is required to report in Parts II and III, column (a), the amount of any item specifically listed on Schedule M-3 that is included in the life insurance company's annual statement or exists in the life insurance company's books and records, regardless of the nomenclature associated with that item in the annual statement 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 annual statement or exist in the books and records that represent some form of “Bad debt expense” must be reported on Part III, line 33, column (a), regardless of whether the amounts are recorded or stated under different nomenclature in the annual statement 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 life insurance company in its books and records or annual statement.

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 38.) If an expense item is described on Part III, lines 1 through 38, 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 38, report and describe the entire amount of the item on Part III, line 39.

If there is no difference between the annual statement 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 24, or Part III, lines 1 through 38, 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 39. Whether an 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 39, 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 columns (a) and (d) on Part II, line 28. B must report the following on Part III, line 39, 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 38, 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 reported on the applicable line and the amount(s) of the item(s) are reported in the applicable columns of the applicable line. See the instructions for Part II, lines 1 through 8, later, for specific additional information 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 39. A separate statement must be attached to Schedule M-3 (Form 1120-L) that includes a detailed description of each item and adjustment entered on Part II, line 25, and Part III, line 39.

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 39.

Each description should adequately describe all four columns of Part II, line 25, or Part III, line 39. If additional information is required to provide an acceptable description, attach a supporting statement.

Example 8. Life insurance company C is a calendar year taxpayer that is required to file Schedule M-3 for its current tax year. C placed in service 10 depreciable fixed assets in previous years. C's total depreciation expense for its current tax year for five of the assets is $50,000 for summary of operations purposes and $70,000 for U.S. income tax purposes. C's total annual depreciation expense for its current tax year for the other five assets is $40,000 for summary of operations purposes and $30,000 for U.S. income tax purposes. In its annual statement, C treats the differences between annual 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 32, for its current 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. Life insurance company D is a calendar year taxpayer that is required to file Schedule M-3 for its current tax year. On December 31 of the current year, D establishes two reserve accounts in the amount of $100,000 for each account. One reserve account is an allowance for agency balances that are estimated to be uncollectible. The second reserve is an estimate of future office closure expenses. In its annual statement, D treats the two reserve accounts as giving rise to temporary differences that will reverse in future years. The two reserves are expenses in D's current annual statement but are not deductions for U.S. income tax purposes in the current year. D must not combine the Schedule M-3 differences for the two reserve accounts. D must report the amounts attributable to the allowance for bad debts on Part III, line 33, Bad debt expense/ agency balances written off, and must separately state and adequately disclose the amount attributable to the other reserve, office closure costs, on a required, attached statement that supports the amounts on Part III, line 39.

D must also provide a description for each reserve that meets the requirements for Part III, line 39, discussed earlier under *Required statements for Part II, line 25, and Part III, line 39.* In this example, an acceptable description would be “Future Office Closure 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. Life insurance company F had $100 of meal expenses and $100 of entertainment expenses. Therefore, F deducted $200 on its income statement. For federal income tax purposes, the entire $100 of meal expenses are subject to the 50% limitation under section 274(n). The $100 of entertainment expenses are nondeductible under section 274(a). F must report on Part III, line 11, $200 in column (a), $150 in column (c), and $50 in column (d). F must report all its meal and entertainment expenses only on this line whether there is a difference or not because meal and entertainment expenses are specifically described.

Part II. Reconciliation of Net Income (Loss) per Income Statement of Life Insurance Companies With Taxable Income per Return

Lines 1 Through 8. Additional Information for Each Life Insurance Company

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 type of entity (corporation, partnership, etc.), the entity's EIN (if applicable), 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 on Part I, line 11, for any foreign corporation accounted for on the equity method and 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 the subtotal on Form 1120-L, page 1, line 20, and report on line 2, column (a), the amount of dividends from any foreign corporation included on Part I, line 11. Do not report on Part II, 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. Report amounts in columns (b) and (c), as applicable.

For any dividends reported on Part II, line 2, that are received on a class of voting stock of which the life insurance company 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 2 (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), the amount included in income under section 951A (relating to global intangible low-taxed income, or GILTI), 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 life insurance company 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 (QEF) income corresponds to the total of the amounts reported by the life insurance company on all Forms 8621, Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund.

Also include on line 3 passive foreign investment company mark-to-market gains and losses under section 1296. Do not report such gains and losses on Schedule M-3, Part II, line 16.

Line 4. Gross-Up for Foreign Taxes Deemed Paid

Report on line 4, column (d), the amount of any gross-up for foreign taxes deemed paid not included on Part II, column (d), of lines 9, 10, and 11, Income (loss) from U.S. partnerships, foreign partnerships, and other pass-through entities. The gross-up amount on line 4 must correspond to the total gross-up amounts for foreign taxes deemed paid reported by the corporation on all Forms 1118, Foreign Tax Credit—Corporations, excluding the amounts reported on Schedule M-3, Part II, column (d), of 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 on 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, earlier.)

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

Report on line 6, column (a), the financial income (loss) included on 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 on 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 the subtotal on Form 1120-L, page 1, line 20.

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 instructions for Part I, lines 10a, 10b, 10c, 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 for Part II, line 7 (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 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 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 11. Life insurance company G is a calendar year taxpayer that is required to file Schedule M-3 for its current 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 SAP/GAAP financial 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 4a, 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 on Part I, line 11;

2. In column (b) or (c), as applicable, 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) 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).

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 line 9 or 10, as applicable.

Example 12. U.S. life insurance company H is a calendar year taxpayer that is required to file Schedule M-3 for its current tax year. H has an investment in a U.S. partnership, USP. H prepares annual statements in accordance with SAP. In its annual statement, H treats the difference between annual statement net income and taxable income from its investment in USP as a permanent difference. For its current tax year, H's annual 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 13. Assume the same facts as *Example 12*, except that life insurance company 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 on Part I, line 11;
2. In column (b) or (c), as applicable, the sum of all differences, if any, attributable to the pass-through entity; and
3. In column (d) the sum of all taxable amounts of income, gain, loss, or deduction reportable on the

corporation's Schedules K-1 received from the pass-through entity (if applicable).

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

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 annual statement amounts and the taxable amounts.

Each difference attributable to a reportable transaction must be separately stated and adequately disclosed. A life insurance company will be considered to have separately stated and adequately disclosed a reportable transaction on line 12 if the life insurance company 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).

Instead of the requirements of the preceding paragraph, a life insurance company will be considered to have separately stated and adequately disclosed a reportable transaction if the life insurance company 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 reportable transaction or tax shelter registration number, if applicable, as reported on Form 8886; and
3. The type of reportable transaction (for example, listed transaction, confidential transaction, transaction

with contractual protection, etc.) as reported on Form 8886.

If a transaction is a listed transaction described in Regulations section 1.6011-4(b)(2), the description must also include the description provided on 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 Form 8886.

Example 14. Life insurance company J is a calendar year taxpayer that is required to file Schedule M-3 for its current tax year. J incurred seven different abandonment losses during its current 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 reportable transaction or 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 15. Life insurance company K is a calendar year taxpayer that is required to file Schedule M-3 for its current 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 current tax year and results in a $7 million capital loss for both statutory 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. Report on Part II, line 13, column (d), the total amount of interest income included on Form 1120-L, page 1, line 20, that is not required to be reported elsewhere on Schedule M-3. In column (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 statutory accounting purposes, or vice versa. For example, adjustments to interest income resulting from adjustments made in accordance with instructions for Part II, line 18, should be made in columns (b) and (c) of line 13.

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

Do not report on line 13 or include on Form 8916-A the amounts reported in accordance with the instructions for Part II, lines 9, 10, 11, 12, and 21.

Line 14. Accrual of Bond Discount

Report on line 14, column (a), the amount of accrued bond discount included on Part I, line 11. Report on line 14, column (d), the amount of accrued bond discount included in the subtotal on Form 1120-L, page 1, line 20. Report amounts in columns (b) and (c), as applicable.

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 statutory accounting purposes and for U.S. income tax purposes. For example, if a portion of a hedge is considered ineffective under SAP 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 SAP 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, Mark-to-market income (loss).

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, and not on line 16.

Traders in securities or 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-L); and (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-L), unless the instructions for Schedule M-3 require the amounts to be reported on another line.

Line 17. Deferred and Uncollected Premiums

Report on line 17, column (a), the amount of deferred and uncollected premiums included on Part I, line 11. Report on line 17, column (d), the amount of deferred and uncollected premiums included in the subtotal on Form 1120-L, page 1, line 20. Report amounts in columns (b) and (c), as applicable.

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

Note. Also see the instructions for Part III, line 35, *Purchase Versus Lease (for Purchasers and/or Lessees)*, later.

Asset transfer transactions with periodic payments characterized for statutory 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 or deduction. If the transaction is treated as a sale, the seller/lessor reports gross profit (sale price less cost of goods sold) 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 statutory 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 U.S. 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 32, in column (a) or (d), as applicable. Use columns (b) and (c) of Part II, lines 13 and 18, and Part III, line 32, as applicable, to report the differences between columns (a) and (d).

Example 16. Life insurance company M sells and leases property to customers. M is a calendar year taxpayer that is required to file Schedule M-3 for its current tax year. For statutory 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 annual statement, M treats the difference in the statutory accounting and the U.S. income tax treatment of these transactions as temporary. During its current tax year, M reports in its annual statement $1,000 of sales and $700 of cost of goods sold with respect to current year lease transactions. M receives periodic payments of $500 in its current year with respect to these current year transactions and similar transactions from prior years and treats $400 as principal and $100 as interest income. For statutory 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 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 32, $200 in column (b) and (d).

Line 19. Section 481(a) Adjustments

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. The following section 481(a) adjustments, however, should not be reported on Part II, line 19.

1. Adjustments for reportable transactions that are required to be reported on Part II, line 12.
2. Section 807(f) adjustments for changes in computing reserves that are required to be reported on Part III, line 25.
3. Reserve Transition Relief adjustments that are required to be reported on Part III, line 25.

Example 17. Life insurance company N is a calendar year taxpayer that is required to file Schedule M-3 for its current tax year. N was depreciating certain fixed assets over an erroneous recovery period and, effective for its current 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 4 tax years, beginning with the current tax year. In its annual statement, 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 current tax year and each of the subsequent 3 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 32.

Line 20. Amortization of Interest Maintenance Reserve

Report on line 20, column (a), the amount of interest maintenance reserve amortization included on Part I, line 11. Report amounts in columns (b) and (c), as applicable.

Line 21. Original Issue Discount and Other Imputed Interest

Report on line 21 any amounts of original issue discount (OID) and 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 22. Market Discount Reclassification

Report on line 22 the amount of market discount reclassification included on Part I, line 11. Report on line 22 the amount of market discount reclassification included in the subtotal on Form 1120-L, page 1, line 20. Report amounts in columns (b) and (c), as applicable.

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

Report on line 23a, column (a), all gains and losses on the disposition of assets except for gains and losses allocated to the life insurance company 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, excluding capital gains from pass-through entities, which must be reported on Part II, line 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, excluding capital losses from (a) pass-through entities, which must be reported on Part II, line 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, line 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 transaction that gives rise to a worthless stock loss and the amount of each loss.

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

Report on line 23g any gains or losses from the sale or exchange of property 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, column (b) or (c), as applicable, and (d) the excess of the net capital losses over the net capital gains reported on Schedule D, Capital Gains and Losses, 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, column (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 describes and 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.

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; the 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 always must 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 II, line 25.

For insurance companies included in the consolidated U.S. income tax return, see instructions for Part I, lines 10a, 10b, 10c, and 11, and Part II, line 7, for guidance on the treatment of intercompany dividends and statutory accounting.

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 18. 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 columns (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 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 40, columns (a) through (d). For example, if Part III, line 40, column (a), reflects an amount of $1 million, then report on Part II, line 27, column (a), ($1 million). Similarly, if Part III, line 40, 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 statutory 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 on Part II, lines 1 through 25, or Part III, lines 1 through 39, 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 (for example, 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 39. See *Example 10*, earlier.

Line 29a. Life Insurance 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. Part III is not required to be completed for the consolidated Schedule M-3 of a mixed group.

Line 29b. 1120 Subgroup Reconciliation Totals

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

Line 29c. PC Insurance Subgroup Reconciliation Totals

Line 29c is used only by 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 40.

Lines 1 Through 6. Income Tax Expense

If the life insurance company does not distinguish between current and deferred income tax expense in its annual statement (or its books and records, if applicable), report income tax expense as current 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 statutory accounting net income on Part I, line 11. If the life insurance company is deducting foreign tax, use column (b) or (c), as applicable, to correct for any difference between foreign withholding tax included in statutory accounting net income and the amount of foreign withholding taxes being deducted in the return. If the life insurance company 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. Equity-Based Compensation

Report on line 8 any amounts for equity-based compensation or consideration that are reflected as expense for statutory 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. Examples of amounts reportable on line 8 include incentive stock options, nonqualified stock options, 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.

If the amounts include incentive stock options or nonqualified stock options, attach a detailed statement separately stating each.

Line 9. Capitalization of Deferred Acquisition Costs

Report on line 9, column (d), the amount of deferred acquisition costs capitalized and taken into account in the subtotal on Form 1120-L, page 1, line 20. Report amounts in columns (b) and (c), as applicable.

Line 10. Amortization of Deferred Acquisition Costs

Report on line 10, column (d), the amount of deferred acquisition costs amortized and taken into account in the subtotal on Form 1120-L, page 1, line 20. Report amounts in columns (b) and (c), as applicable.

Line 11. Meals and Entertainment

Report on line 11, column (a), any amounts paid or accrued by the life insurance company during the tax year for meals, beverages, and entertainment that are accounted for in statutory 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 life insurance company's statutory income statement or the income and expense accounts maintained in the life insurance company's books and records. Report only amounts not otherwise reportable elsewhere on Schedule M-3, Parts II and III.

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 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 Part III, line 12, amounts required to be reported in accordance with instructions for Part III, line 13.

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

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

Line 14. Parachute Payments

Report on line 14, column (a), the total expense included in statutory 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 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 life insurance company'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 on 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. 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 on 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, and 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 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. Change in Section 807(c)(1) Tax Reserves

Report on line 22, column (a), the change in section 807(c)(1) life insurance reserves included on Part I, line 11. Report on line 22, column (d), the change in section 807(c)(1) life insurance reserves included in the subtotal on Form 1120-L, page 1, line 20. Report amounts in columns (b) and (c), as applicable.

Line 23. Change in Section 807(c)(2) Tax Reserves

Report on line 23, column (a), the change in section 807(c)(2) unearned premiums and unpaid losses included on Part I, line 11. Report on line 23, column (d), the change in section 807(c)(2) unearned premiums and unpaid losses included in the subtotal on Form 1120-L, page 1, line 20. Report amounts in columns (b) and (c), as applicable.

Line 24. Change in All Other Section 807(c) Tax Reserves

Report on line 24, column (a), the change in all other section 807(c) reserves included on Part I, line 11. Report on line 24, column (d), the change in all other section 807(c) reserves included in the subtotal on Form 1120-L, page 1, line 20. Report amounts in columns (b) and (c), as applicable.

Line 25. Section 807(f) and Reserve Transition Relief Adjustments for Change in Computing Reserves

Report on line 25, column (d), the section 807(f) and Reserve Transition Relief adjustments included in the subtotal on Form

1120-L, page 1, line 20. Report amounts in columns (b) and (c), as applicable.

Line 26. Section 807(a)(2)(B) Tax Reserve Amount With Respect to Policyholder Share of Tax Exempt Interest

Report on line 26, column (d), the change in section 807(a)(2)(B) tax reserve amount with respect to policyholder share of tax exempt interest included in the subtotal on Form 1120-L, page 1, line 20. Report amounts in columns (b) and (c), as applicable.

Line 27. Current Year Acquisition/ Reorganization Costs

Report on line 27 any investment banking fees, legal and accounting fees, and 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. Report on this line any investment banking fees, legal and accounting fees, and any other 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 complete the acquisition. Also include on this line any investment banking fees, legal and accounting fees, and any other fees paid or incurred in connection with the liquidation of a subsidiary, a spin-off of a subsidiary, or an initial public stock offering. Attach a statement separately stating acquisition/reorganization investment banking fees, legal and accounting fees, and other costs. Report amounts in columns (b) and (c), as applicable.

Line 28. Amortization of Acquisition, Reorganization, and Start-Up Costs

Report on line 28 amortization of acquisition, reorganization, and start-up costs. For purposes of columns (b), (c), and (d), include amounts amortizable under section 167, 195, or 248.

Line 29. Amortization/Impairment of Goodwill, Insurance in Force, and Ceding Commissions

Report on line 29 amortization of goodwill, insurance in force and ceding commissions or amounts attributable to the impairment of goodwill, and insurance in force and ceding commissions. Attach a statement separately stating the amounts for each item.

Line 30. Other Amortization or Impairment Write-Offs

Report on line 30 any amortization or impairment write-offs not otherwise includible on Schedule M-3.

Line 31. Section 846 Amount

Report on line 31, column (d), the section 846 amount included in the subtotal on Form

1120-L, page 1, line 20. Report amounts in columns (b) and (c), as applicable.

Line 32. Depreciation

Report on line 32 any depreciation expense that is not required to be reported elsewhere on Schedule M-3 (for example, on Part II, line 9, 10, or 11).

Line 33. Bad Debt Expense and Agency Balances Written Off

Report on line 33, 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. Also report on this line agency balances written off per the annual statement. Report in column (d) the amount of bad debt expense deductible for federal income tax purposes in accordance with section 166.

Line 34. Corporate-Owned Life Insurance Premiums

Report on line 34 all amounts of insurance premiums attributable to any life insurance policy if the life insurance company 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 35. 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 statutory 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 statutory 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 statutory accounting purposes. Report interest expense for such transactions on Part III, line 36, in column (a) or (d), as applicable. Report such depreciation expense or deductions for such transactions on Part III, line 32, in column (a) or (d), as applicable. Use columns (b) and (c) of Part III, lines 32, 35, and 36, as applicable, to report the differences between columns (a) and (d) for such recharacterized transactions.

Example 19. U.S. life insurance company X acquired property in a transaction that, for statutory accounting purposes, X treats as a lease. X is a calendar year taxpayer that is required to file Schedule M-3 for its current 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 annual statement, X treats the difference between the statutory accounting and U.S. income tax treatment of this transaction as a temporary difference. During its current tax year, X reports in its annual statement $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 Schedule M-3, X must report the following on Part III, line 35: column (a), $1,000, its statutory accounting gross rental expense; column (b), ($1,000); and column (d), zero. On Part III, line 36, X reports $300 in columns (b) and (d) for the interest deduction. On Part III, line 32, X reports $1,200 in columns (b) and (d) for the depreciation deduction.

Line 36. Interest Expense

Report on Part III, line 36, column (a), the total amount of interest expense included on Part I, line 11, and report on Part III, line 36, column (d), the total amount of interest deduction included on

Form 1120-L, page 1, line 20, that is not required to be reported elsewhere on Schedule M-3. In column (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 statutory 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 35, Purchase versus lease (for purchasers and/or lessees), should be made in column (b) or (c), as applicable, on line 36.

Complete Part III of Form 8916-A. Enter the amounts from Form 8916-A, line 5, columns (a) through (d), on Schedule M-3, Part III, line 36, columns (a) through (d), as applicable. Attach Form 8916-A.

Do not report on Form 8916-A and line 36 the amounts reported in accordance with the instructions for Part II, lines 9, 10, 11, and 12.

Line 37. Research and Development Costs

For U.S. income tax purposes, research and experimental expenditures paid or incurred by a taxpayer in connection with the taxpayer's trade or business must be amortized. The expenditures must be amortized ratably over the 5-year period (15-year period for specified expenditures attributable to foreign research), beginning with the midpoint of the tax year in which the expenses are paid or incurred. See section 174.

Report in column (a) the amount of research and development expenditures reported as a deduction in the corporation’s financial statements (or books and records, if applicable). Report in column (d) the amount of amortization deductions of specified research or experimental expenditures and other research or experimental expenditures included on Form 4562, Part VI, line 44, or in the other deductions on Form 1120-L, page1, line 18. If properly adopted or elected under section 174(b) and section 174(f) (prior to amendment by P.L. 115-97) and section 59(e), any amortization otherwise allowable related to such costs is reported in column (b).

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 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.

Example 20. Corporation X is a calendar year taxpayer that is required to file Schedule M-3 for its current tax year. During its current tax year, X incurred $100,000 of research and development costs that X recognized as an expense in its financial statements. In compliance with section 174, X amortizes research and experimental expenditures for U.S. income tax purposes. Accordingly, X must report $100,000 in column (a), ($90,000) in column (b), and $10,000 (($100,000/5 years) x 1/2) in column (d).

Example 21. Corporation X is a calendar year taxpayer that is required to file Schedule M-3 for its current tax year. During its current tax year, X incurred $10,000 of research and development costs related to social sciences that it recognized as an expense in its financial statements. X amortizes 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 39, Other expense/ deduction items with differences.

Example 22. Corporation X is a calendar year taxpayer that is required to file Schedule M-3 for its current tax year. During its current tax year, 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 amortizes 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 30, Other amortization or impairment write-offs.

Line 38. Section 118 Exclusion

Report on line 38 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 38 the fair market value of land or other property (including cash) provided to the corporation by any non-shareholder, including a 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 38.

Line 39. Other Expense/Deduction Items With Differences

Separately state and adequately disclose on Part III, line 39, all items of expense/deduction that are not otherwise listed on Part III, lines 1 through 38.

Attach a statement that describes and itemizes the type of expense/deduction and the amount of each item, and that 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 of details attached to the Schedule M-3 for line 39 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 39 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 39.

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 39 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 33, Bad debt expense/agency balances written off.

Report on Part III, line 39, the amortization of various items of prepaid expense, such as prepaid subscriptions and license fees, prepaid insurance, etc.

Report on line 39, column (a), expenses included in net income reported on Part I, line 11, that are related to reserves and contingent liabilities. Report on line 39, 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 restructuring reserves, reserves for discontinued operations, and reserves for acquisitions and dispositions. Only report on line 39 items that are not required to be reported elsewhere on Schedule M-3, Parts II and III.

Example 23. Life insurance company Q is a calendar year taxpayer that is required to file Schedule M-3 for its current 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, 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 39, must be separately stated and adequately disclosed as follows:

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 39	$550,000	$150,000	-0-	$700,000

Line 40. 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 40, columns (a) through (d), as applicable. Report positive amounts as negative and negative amounts as positive. For example, if Part III, line 40, column (a), reflects an amount of $1 million, then report on Part II, line 27, column (a), ($1 million). Similarly, if Part III, line 40, column (b), reflects an amount of ($50,000), then report on Part II, line 27, column (b), $50,000.

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