

1994



Department of the Treasury
Internal Revenue Service

Instructions for Form 1120-F

U.S. Income Tax Return of a Foreign Corporation

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

Paperwork Reduction Act Notice

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

The time needed to complete and file this form will vary depending on individual circumstances. The estimated average time is:

Recordkeeping 105 hr., 42 min.

**Learning about
the law or the form** 42 hr., 22 min.

Preparing the form 72 hr., 56 min.

**Copying, assembling,
and sending the form
to the IRS** 7 hr., 47 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. You can write to both the **Internal Revenue Service**, Attention: Tax Forms Committee, PC:FP, Washington, DC 20224; and the **Office of Management and Budget**, Paperwork Reduction Project (1545-0126), Washington, DC 20503. **DO NOT** send the tax form to either of these offices. Instead, see **Where To File** on page 2.

Changes To Note

• Some foreign corporations are required to use a new method of depositing taxes for taxes due after 1994. Generally, the requirement applies to corporations that maintain an office or place of business in the United States and whose total deposits of certain taxes during the calendar year 1993 exceeded \$78 million. Other corporations may use the method voluntarily. For details, see **Depository Method of Tax Payment** on page 3.

• Final regulations under section 263A have been adopted. These regulations, which require the capitalization and inclusion in inventory of certain costs, generally are effective for tax years beginning after 1993. Changes in accounting methods may be necessary as a result of the issuance of the final regulations. These changes must be made under Rev. Proc. 94-49, 1994-30 I.R.B. 31.

The Revenue Reconciliation Act of 1993 (the Act) made changes to the tax law for foreign corporations engaged in a U.S. trade or business. Some of the changes are highlighted below.

- Corporations that are located in an area designated by the Federal government as an "empowerment zone" may be able to claim the credit figured on **Form 8844**, Empowerment Zone Employment Credit. See page 16.
- The deductible portion of business meals and entertainment expenses has been reduced from 80% to 50%. See page 12.
- Generally, a publicly held corporation cannot deduct compensation paid to certain "covered employees" to the extent the compensation exceeds \$1 million. For details and exceptions, see the instructions for Section II, line 12.

General Instructions

Purpose of Form

Form 1120-F is used by a foreign corporation to report its income, gains, losses, deductions, and credits, and to figure its U.S. income tax liability. If a refund is due, Form 1120-F may be used to claim it.

Who Must File

Except for corporations described in **Who Does Not File Form 1120-F** below, every foreign corporation must file Form 1120-F if, during the tax year, it:

- Overpaid income tax that it wants refunded.
- Engaged in a trade or business in the United States, whether or not it had income from that trade or business.
- Had income, gains, or losses treated as if they were effectively connected with that U.S. trade or business. See **Section II**, for the definition of effectively connected income.
- Had income from any U.S. source (even if its income is tax exempt under an income tax treaty or code section).

Note: If the corporation does not owe any tax because it is claiming a treaty exemption, it must still file Form 1120-F to show that the income was exempted by treaty. To show this exemption, complete the identifying information at the top of

page 1 of the form and complete Item W at the bottom of page 5 of the form.

If the foreign corporation does not owe the branch profits tax or the tax on excess interest because it is claiming a treaty exemption, complete Item W and attach a statement explaining why the corporation is a qualified resident or otherwise qualifies for treaty benefits. Note that an exemption from tax under Section II based on the permanent establishment article of an income tax treaty does not necessarily exempt the corporation from the branch profits tax.

A Mexican or Canadian branch of a U.S. mutual life insurance company must file Form 1120-F on the same basis as a foreign corporation if the U.S. company elects to exclude the branch's income and expenses from its own gross income.

A receiver, assignee, or trustee in dissolution or bankruptcy must file Form 1120-F if that person has or holds title to virtually all of a foreign corporation's property or business. Form 1120-F is due whether or not the property or business is being operated.

An agent in the United States must file the return if the foreign corporation has no office or place of business in the United States when the return is due.

Consolidated returns.—A foreign corporation cannot belong to an affiliated group of corporations that files a consolidated return unless it is a Canadian or Mexican corporation maintained solely for complying with the laws of Canada or Mexico for title and operation of property.

Who Does Not File Form 1120-F

A foreign corporation does not need to file Form 1120-F if any of the following apply:

- Its only income is not subject to U.S. taxation under section 881(d).
- It is a beneficiary of an estate or trust engaged in a U.S. trade or business, but would itself otherwise not need to file.
- It files **Form 1120-L**, U.S. Life Insurance Company Income Tax Return, as a foreign life insurance company, or **Form 1120-PC**, U.S. Property and Casualty Insurance Company Income Tax Return, as a foreign property and casualty insurance company.
- It did not engage in a U.S. trade or business during the year, and its full U.S. tax was withheld at source.
- It has filed **Form 8279**, Election To Be Treated as a FSC or as a Small FSC, and the election is still in effect. These corporations must file **Form 1120-FSC**, U.S. Income Tax Return of a Foreign Sales Corporation.

When To File

The requirements for filing Form 1120-F depend on whether the foreign corporation has an office or place of business in the United States.

A foreign corporation that **does not** maintain an office or place of business in the United States must file Form 1120-F by the 15th day of the 6th month after the end of its tax year. A 6-month extension of

time to file can be requested by filing **Form 7004**, Application for Automatic Extension of Time To File Corporation Income Tax Return. However, this extension does not extend the time for payment of tax. Therefore, if the tax is paid after the 15th day of the 6th month after the end of its tax year, the corporation must pay interest on the late payment and is subject to a penalty for late payment of tax. See **Interest and Penalties**.

A foreign corporation that does maintain an office or place of business in the United States must file Form 1120-F by the 15th day of the 3rd month after the end of its tax year. However, the corporation may get an extension of time to file by:

1. Filing Form 7004 by the 15th day of the 3rd month after the end of its tax year to obtain a 6-month extension. However, the extension that is granted by the timely filing of Form 7004 does not extend the time for payment of the tax. Therefore, if the tax is paid after the 15th day of the 3rd month following the close of the corporation's tax year, the corporation must pay interest on the late payment and is subject to the penalty for late payment of tax, **OR**

2. Utilizing the 3-month extension described in Regulations section 1.6081-5 by attaching to Form 1120-F the statement described in those regulations. If this option is chosen, the corporation is not required to file Form 7004 unless it needs additional time beyond the 3-month extension period. If the corporation needs additional time, it must file Form 7004 before the end of the 3-month extension period to obtain up to an additional 3 months to file its return. If the corporation fails to file Form 7004 by the expiration of such 3-month extension period, and files its income tax return after such period, it may be liable for the penalty for failure to file described in **Interest and Penalties**. In no event may the total extension period exceed 6 months from the original due date of the return (i.e., the return must be filed by the 15th day of the 9th month after the end of its tax year). See Rev. Rul. 93-85, 1993-2 C.B. 297.

The corporation is still required to pay the tax due by the 15th day of the 3rd month after the end of its tax year. If it does not, the corporation must pay the interest on the late payment but is not subject to the penalty for late payment of tax if it pays the tax due by the 15th day of the 6th month after the end of its tax year.

The options described in **1** and **2** above are mutually exclusive. Thus, for example, a corporation that chooses the option described in **1** to extend the time to file may not later choose the option described in **2**.

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

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

Form 1120-F must be filed on a timely basis or the foreign corporation may be denied the benefit of certain deductions and credits. A foreign corporation is only allowed to take deductions and credits against its effectively connected income if it timely files Form 1120-F in a true and accurate manner.

For these purposes, Form 1120-F is generally considered to be timely filed if it is filed no later than 18 months after the due date of the current year's return. An exception may apply to foreign corporations that have yet to file Form 1120-F for the preceding tax year.

A foreign corporation is allowed the following deductions and credits regardless of whether Form 1120-F is timely filed:

- The charitable contributions deduction (page 3, Section II, line 19);
- The credit from regulated investment companies (page 1, line 6f);
- The credit for Federal tax on fuels (page 1, line 6g); and
- U.S. income tax paid or withheld at source (page 1, line 6h).

See Regulations section 1.882-4 for details.

Where To File

File Form 1120-F with the Internal Revenue Service Center, Philadelphia, PA 19255.

Who Must Sign

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

If a corporate officer completes Form 1120-F, the Paid Preparer's space should remain blank. Anyone who prepares Form 1120-F but does not charge the corporation should not sign the return. Generally, anyone who is paid to prepare the return must sign it and fill in the Paid Preparer's Use Only area.

The paid preparer must complete the required preparer information and:

- Sign the return, by hand, in the space provided for the preparer's signature (signature stamps or labels are not acceptable).
- Give a copy of Form 1120-F to the taxpayer.

Accounting Methods

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

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

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

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

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

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

Mark-to-market accounting method for dealers in securities.—Dealers in securities must use the "mark-to-market" accounting method described in section 475 for tax years ending on or after December 31, 1993. Under the new rules, any security that is inventory to the dealer must be included in inventory at its fair market value. Any security held by a dealer that is not inventory and that is held at the close of the tax year is treated as sold at its fair market value on the last business day of the tax year, and any gain or loss must be taken into account in determining gross income. The gain or loss taken into account is generally treated as ordinary gain or loss.

Dealers required to change their accounting method to comply with the new law are treated as having initiated the change in accounting method and as having received the consent of the IRS to the change. Generally, the net amount of the section 481(a) adjustment (reported in Section II, line 10) is taken into account ratably over 5 tax years, beginning with the first tax year ending on or after December 31, 1993. For details, including exceptions, see section 475, the related temporary regulations, and Rev. Rul. 94-7, 1994-3 I.R.B. 6.

Change in Accounting Period

Generally, before changing an accounting period, the Commissioner's approval must be obtained (Regulations section 1.442-1) by filing **Form 1128**, Application To Adopt, Change, or Retain a Tax Year. Also see Pub. 538.

Certain Controlled Foreign Corporations and Certain Foreign Personal Holding Companies

The tax year of a specified foreign corporation is generally required to be the tax year of its majority U.S. shareholder (see section 898(c) for details).

A specified foreign corporation is any foreign corporation: **(a)** that is treated as a controlled foreign corporation for any purpose under subpart F (sections 951 through 964) **or** is a foreign personal holding company (as defined in section 552); and **(b)** for which the 50% U.S. ownership requirements of section 898(b)(2) are met.

Foreign Corporations That Are Personal Service Corporations

Personal service corporations (see the instructions for **Item O**), must adopt a calendar year unless: **(a)** the corporation can establish to the satisfaction of the Commissioner that there is a business purpose for having a different tax year, or **(b)** the corporation elects under section 444 to have a tax year other than a calendar year.

Personal service corporations that wish to establish a business purpose for having a different tax year should see Rev. Rul. 87-57, 1987-2 C.B. 117, for more information. Also see Rev. Proc. 87-32, 1987-2 C.B. 396, for procedures to use in adopting, retaining, or changing the corporation's tax year. Personal service corporations that wish to adopt or retain a non-calendar tax year must file requests to do so on Form 1128 using the procedures outlined in Rev. Proc. 87-32.

Personal service corporations that wish to elect under section 444 to have a tax year other than a calendar year must file **Form 8716**, Election To Have a Tax Year Other Than a Required Tax Year. Generally, Form 8716 must be filed by the earlier of **(a)** the 15th day of the 5th month following the month that includes the 1st day of the tax year for which the election will be effective, or **(b)** the due date (not including extensions) of the income tax return resulting from the section 444 election.

Electing corporations are subject to minimum distribution requirements under section 280H(c) for each year the election is in effect. If the corporation fails to make the required minimum distributions, the deduction allowable for certain amounts paid to employee-owners is limited to a maximum deductible amount under section 280H(d). Amounts not allowed as a deduction for the tax year are carried over to the following tax year. Complete

Schedule H (Form 1120), Section 280H Limitations for a Personal Service Corporation (PSC), to figure the required minimum distributions and the maximum deductible amount, if applicable.

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

Rounding Off to Whole Dollars

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

Recordkeeping

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

The corporation should also keep copies of any returns it has filed. They help in preparing future returns and in making computations when filing an amended return.

Payment of Tax Due

The requirements for payment of tax depend on whether the foreign corporation has an office or place of business in the United States.

Foreign corporations that **do not** maintain an office or place of business in the United States must pay the tax due (page 1, line 8) in full when they file their tax return, but not later than the 15th day of the 6th month after the end of the tax year.

The tax must be paid directly to the IRS (i.e., do not use the depositary method of tax payment described below). The tax may be paid by check or money order, payable to the Internal Revenue Service. To help ensure proper crediting, write the corporation's employer identification number, "Form 1120-F," and the tax period to which the payment applies on the check or money order. Enclose the payment when the corporation files Form 1120-F with the Internal Revenue Service Center, Philadelphia, PA 19255.

Foreign corporations that **do** maintain an office or place of business in the United States must pay the tax due (page 1, line 8) in full when they file their tax return, but not later than the 15th day of the 3rd month after the end of the tax year.

Depository Method of Tax Payment.—If the foreign corporation does maintain an office or place of business in the United States, deposit corporate income tax payments (and estimated tax payments) with **Form 8109**, Federal Tax Deposit Coupon. Do not send deposits directly to an IRS office. Mail or deliver the completed Form 8109 with the payment to a qualified depository for Federal taxes or to the Federal Reserve bank (FRB) servicing the corporation's geographic area. Make checks or money orders payable to that depository or FRB.

To help ensure proper crediting, write the corporation's employer identification number, the tax period to which the deposit applies, and "Form 1120-F" on the check or money order. Be sure to darken the "1120" box on the coupon. Records of these deposits will be sent to the IRS.

A penalty may be imposed if the deposits are mailed or delivered to an IRS office rather than to an authorized depository or FRB.

For more information about deposits, see the instructions in the coupon booklet (Form 8109) and **Pub. 583**, Taxpayers Starting a Business.

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

Generally, corporations that maintain an office or place of business in the United States and whose total deposits of withheld income, social security, and Medicare taxes during calendar year 1993 exceeded \$78 million are required to deposit all depository taxes due after 1994 by electronic funds transfer (EFT). TAXLINK, an electronic remittance processing system, must be used to make deposits by EFT. Corporations who are not required to make deposits by EFT may voluntarily participate in TAXLINK. For more details on TAXLINK, see Rev. Proc. 94-48, 1994-29 I.R.B. 31. You may also call the toll-free TAXLINK HELPLINE at 1-800-829-5469.

Estimated Tax Payments

Generally, a foreign corporation must make installment payments of estimated tax if it expects its estimated tax to be \$500 or more. For a calendar or fiscal year corporation, the installments are due by the 15th day of the 4th, 6th, 9th, and 12th months of the tax year. If any date falls on a Saturday, Sunday, or legal holiday, the installment is due on the next regular business day. Use **Form 1120-W**, Estimated Tax for Corporations, as a worksheet to compute estimated tax. Foreign corporations that maintain an office or place of business in the United States must use the deposit coupons (Forms 8109) to make deposits of estimated tax. For more information on estimated tax payments, including penalties that apply if the corporation fails to make required payments, see the instructions for page 1, line 7, of Form 1120-F.

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

Interest and Penalties

Interest.—Interest is charged on taxes not paid by the due date, even if an extension of time to file is granted. Interest is also charged on penalties imposed for failure to file, negligence, fraud, gross valuation overstatements, and substantial understatements of tax from the due date (including extensions) to the date of payment. The interest charge is figured at a rate determined under section 6621.

Late filing of return.—A corporation that does not file its tax return by the due date, including extensions, may have to pay a penalty of 5% of the unpaid tax for each month or part of a month the return is late, up to a maximum of 25% of the unpaid tax. The minimum penalty for a return that is more than 60 days late is the smaller of the tax due or \$100. The penalty will not be imposed if the corporation can show that the failure to file on time was due to reasonable cause. Corporations that file late must attach a statement explaining the reasonable cause.

Late payment of tax.—A corporation that does not pay the tax when due may have to pay a penalty of ½ of 1% of the unpaid tax for each month or part of a month the tax is not paid, up to a maximum of 25% of the unpaid tax. This penalty may also apply to any additional tax not paid within 10 days of the date of the notice and demand for payment. The penalty will not be imposed if the corporation can show that the failure to pay on time was due to reasonable cause.

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

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

Forms, Returns, and Schedules

Form 5471.—Information Return of U.S. Persons With Respect To Certain Foreign Corporations. This form is filed by certain officers, directors, or U.S. shareholders of certain foreign corporations.

If the corporation is a foreign personal holding company, certain shareholders of the corporation are required to attach to their personal returns a statement containing the information required by section 551(c). For more information, see section 552 and Regulations section

1.551-4. In addition, section 6035 (and the related regulations) requires certain officers, directors, and shareholders of a foreign personal holding company to file **Schedule N (Form 5471)** and the appropriate schedules of Form 5471. See the **Instructions for Form 5471** for additional information.

Form 5472.—Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business. This form is filed by a foreign corporation engaged in a U.S. trade or business that had certain reportable transactions with a related party. See section 6038A and the related regulations, section 6038C, and the instructions for Form 5472 for additional information.

Note: A \$10,000 penalty applies for failure to file Form 5472. The penalty also applies for failure to maintain records as required by Regulations section 1.6038A-3. For details, see Form 5472.

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

Form 720.—Quarterly Federal Excise Tax Return. This form is used to report the luxury tax on passenger vehicles, environmental excise taxes, communications and air transportation taxes, fuel taxes, manufacturers taxes, ship passenger tax, and certain other excise taxes.

Caution: The trust fund recovery penalty may apply if certain excise taxes that must be collected are not collected or are not paid to the IRS. The penalty is equal to the unpaid trust fund tax. The trust fund recovery penalty may be imposed on all persons who are determined by the IRS to be responsible for collecting, accounting for, and paying over these taxes, and who acted willfully in not doing so. See the **Instructions for Form 720** for more details, including the definition of responsible person.

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

Form 941.—Employer's Quarterly Federal Tax Return. Employers must file this form quarterly to report income tax withheld and employer and employee social security and Medicare taxes. Agricultural employers must file **Form 943**, Employer's Annual Tax Return for Agricultural Employees, instead of Form 941, to report income tax withheld and employer and employee social security and Medicare taxes for farmworkers.

Caution: The trust fund recovery penalty may apply if income, social security, and Medicare taxes that must be withheld are not withheld or are not paid to the IRS. The penalty is equal to the unpaid trust fund tax. The trust fund recovery penalty may be imposed on all persons who are

determined by the IRS to be responsible for collecting, accounting for, and paying over these taxes, and who acted willfully in not doing so. See **Circular E**, Employer's Tax Guide (or **Circular A**, Agricultural Employer's Tax Guide), for more details, including the definition of responsible person.

Form 945.—Annual Return of Withheld Federal Income Tax. Use this form to report income tax withholding from nonpayroll distributions or payments. Nonpayroll payments include pensions, annuities, IRAs, military retirement, gambling winnings, and backup withholding.

Form 1042, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons, and **Form 1042-S**, Foreign Person's U.S. Source Income Subject to Withholding. Use these forms to report and transmit withheld tax on payments or distributions made to nonresident alien individuals, foreign partnerships, or foreign corporations, to the extent such payments or distributions constitute gross income from U.S. sources. See **Special Rules for Foreign Corporations—Source Rules**. Also, for more information, see sections 1441 and 1442, and **Pub. 515**, Withholding of Tax on Nonresident Aliens and Foreign Corporations.

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

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

Forms 1099-A, B, C, DIV, INT, MISC, R, and S.—These information returns are used to report certain payments, such as dividends and interest. For more information, see the Instructions for Forms 1099, 1098, 5498, and W-2G and **Pub. 937**, Employment Taxes.

Form 5713.—International Boycott Report, for persons having operations in or related to "boycotting" countries. Also, persons who participate in or cooperate with an international boycott may have to complete Schedule A or Schedule B and Schedule C of Form 5713 to compute their loss of the foreign tax credit, the deferral of earnings of a controlled foreign corporation, DISC benefits, and FSC benefits.

Form 8264.—Application for Registration of a Tax Shelter. This form is used by tax shelter organizers to register tax shelters with the IRS in order to receive a tax shelter registration number.

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

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

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

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

Cashier's checks (including treasurer's checks and bank checks), bank drafts, and money orders with face amounts of \$10,000 or less are considered cash under certain circumstances. For more information, see Form 8300 and Regulations section 1.60501-1(c).

Form 8594.—Asset Acquisition Statement Under Section 1060. This form must be filed by both the purchaser and seller of a group of assets that make up a trade or business if goodwill or a going concern value attaches, or could attach, to such assets and if the purchaser's basis in the assets is determined only by the amount paid for the assets.

Form 8621.—Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund. A corporation that was a shareholder in a passive foreign investment company (as defined in section 1296) at any time during the tax year must complete and attach this form to its return.

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

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

Form 8833.—Treaty-Based Return Position Disclosure Under Section 6114 or 7701(b). Use this form to make the treaty-based return position disclosure required by section 6114. Also complete Item W at the bottom of page 5 of Form 1120-F.

Form 8842.—Election To Use Different Annualization Periods for Corporate Estimated Tax. Corporations use this form

for each year they want to elect one of the annualization periods in section 6655(e)(2)(C) for figuring estimated tax payments under the annualized income installment method.

Form 8848.—Consent To Extend the Time To Assess the Branch Profits Tax Under Regulations Sections 1.884-2T(a) and (c). File this form if the foreign corporation has completely terminated all of its U.S. trade or business within the meaning of Regulations section 1.884-2T(a) during the tax year.

Schedule PH (Form 1120).—U.S. Personal Holding Company Tax. See instructions for page 1, line 4 of Form 1120-F.

Statements

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

Statements instead of schedules.—If the foreign corporation has no gross income for the tax year, do not complete the Form 1120-F schedules. Instead, attach a statement to the return showing the types and amounts of income excluded from gross income.

Attachments

Attach **Form 4136**, Credit for Federal Tax Paid on Fuels, after page 6, Form 1120-F. Attach schedules in alphabetical order and other forms in numerical order after Form 4136.

To assist us in processing the return, complete every applicable entry space on Form 1120-F. **Do not** write "See attached" instead of completing the entry spaces. If more space is needed on the forms or schedules, attach separate sheets. Use the same size and format as on the printed forms. But show all totals on the printed forms. Attach these separate sheets after all the schedules and forms. Be sure to put the corporation's name and employer identification number (EIN) on each sheet.

Claim for Refund

If a foreign corporation has only income that is not effectively connected with the conduct of a U.S. trade or business and Form 1120-F is being used as a claim for refund of tax paid or withheld at source, attach Form(s) 1042-S, 8805, 8288-A, etc., to the return to verify the amount(s) of withholding credit reported. Include all income from U.S. sources on the return, even though all tax due on it was paid or withheld at source.

If the refund results from tax that was withheld at source, a statement from the payer/withholding agent (or from an intermediate nominee acting on the corporation's behalf as the foreign recipient of the income) may be substituted for Form 1042-S. The statement should show:

- The amount(s) of tax withheld;

- The name(s) and address(es) of the U.S. withholding agent(s);
- The U.S. tax identification number of the U.S. withholding agent;
- The name in which the tax was withheld, if different from the name of the taxpayer claiming the refund; and
- If applicable, enough information to show that the taxpayer was entitled to a reduced tax rate under a treaty.

Special Rules for Foreign Corporations

Source Rules

Interest Income

The source of interest income is usually determined by the residence of the obligor. For example, interest paid by an obligor who is a resident of the United States is U.S. source income and interest paid by an obligor who is a resident of a country other than the United States is foreign source income.

Exceptions.—The following types of interest income are treated as foreign source income:

1. Interest income received from foreign branches of U.S. banks and savings and loan associations.

2. Interest income received from a U.S. corporation or a resident alien individual, if 80% or more of the U.S. corporation's (or resident alien individual's) gross income is active foreign business income during the testing period.

Active foreign business income is income from sources outside the United States attributable to the active conduct of a trade or business in a foreign country or U.S. possession.

The testing period is generally the 3 tax years of the U.S. corporation or resident alien individual preceding the tax year during which the interest is paid. If the payer existed for less than 3 years before the tax year of the payment, the testing period is the term of the payer's existence before the current year. If the payment is made during the payer's first tax year, that year is the testing period.

3. The interest allowable as a deduction to a foreign corporation (under Regulations section 1.882-5) in computing its effectively connected taxable income is treated as paid by a domestic corporation. This interest is treated as U.S. source interest, although the actual payer of the interest is a foreign corporation. For more details, see the instructions for Section III, Part II.

Look-thru rule.—If the foreign corporation is a related person to a U.S. corporation or resident alien individual that meets the 80% rule described in 2 above, the foreign corporation will have foreign source income only when the income of the payer was from foreign sources. See section 861(c)(2)(B) for more information.

Dividend Income

The source of dividend income is usually determined by the payer. For example, dividends paid by a corporation that was incorporated in the United States are U.S. source income and dividends paid by a corporation that was incorporated in a foreign country are foreign source income.

Exceptions relating to U.S. corporation payers.—Dividends paid by a U.S. corporation are foreign source income:

1. If the U.S. corporation has made a valid election under section 936, relating to certain U.S. corporations operating in a U.S. possession, or

2. To the extent the dividends are from qualified export receipts described in section 993(a)(1) (other than interest and gains described in section 995(b)(1)).

Exceptions relating to foreign corporation payers.—Dividends paid by a foreign corporation are U.S. source income:

1. If the dividend is treated under section 243(e) as a distribution from the accumulated profits of a predecessor U.S. corporation, or

2. To the extent the foreign corporation's effectively connected gross income for the testing period bears to all of the foreign corporation's gross income for the testing period, but only if 25% or more of the foreign corporation's gross income during the testing period was effectively connected with the conduct of a U.S. trade or business.

The testing period is generally the 3 tax years of the foreign corporation payer preceding the tax year during which it declared the dividend. If the foreign corporation existed for less than 3 years before the tax year of declaration, the testing period is the term of the foreign corporation's existence before the current year. If the foreign corporation declared the dividend in its first tax year, that year is the testing period. Regardless of source, however, there is no tax imposed on any dividends paid by a foreign corporation out of earnings and profits for a tax year in which the foreign corporation was subject to the branch profits tax (determined after application of any income tax treaty).

Rent and Royalty Income

The source of rent and royalty income for the use of property is determined based on where the property is located.

Income From the Sale or Exchange of Real Estate

The source of this income is determined based on where property is located.

Income From the Sale or Exchange of Personal Property

Income from the sale of personal property by a foreign corporation is generally sourced under the following sections:

• Income from the purchase and sale of inventory property is generally sourced under sections 861(a)(6) and 862(a)(6);

- Income from the production and sale of inventory property is generally sourced under section 863(b)(2);
- Income from the sale of depreciable property is generally sourced under section 865(c); and
- Income from the sale of intangibles is generally sourced under section 865(d).

Foreign corporations with an office or fixed place of business in the United States.—Income from the sale of personal property attributable to such office or fixed place of business is U.S. source income regardless of any of the above rules relating to the source of income from the sale or exchange of personal property unless the foreign corporation is an export trade corporation (see sections 865(e)(2)(A) and 971).

Exception: Income from the sale of inventory property is foreign source income if the goods were sold for use, disposition, or consumption outside the United States and a foreign office of the corporation materially participated in the sale.

Other Special Rules

Basis of Property and Inventory Costs for Property Imported by a Related Person

If property is imported into the United States by a related person in a transaction and the property has a customs value, the basis or inventory cost to the importer cannot exceed the customs value. For more information, see section 1059A.

Income of Foreign Governments and International Organizations

Income of foreign governments and international organizations from the following sources is generally not subject to taxation:

- Investments in the United States in stocks, bonds, or other domestic securities owned by such foreign government or international organization.
- Interest on deposits in banks in the United States of moneys belonging to such foreign government or international organization.
- Investments in the United States in financial instruments held (by a foreign government) in executing governmental financial or monetary policy. However, the types of income described in section 892(a)(2) that are received directly or indirectly from commercial activities **are** subject to tax. (They are also subject to withholding.)

Specific Instructions

Period covered

File the 1994 return for calendar year 1994 and fiscal years that begin in 1994 and end in 1995. For a fiscal year, fill in the tax year space at the top of the form.

Note: The 1994 Form 1120-F may also be used if (1) the corporation has a tax year of less than 12 months that begins and ends in 1995 and (2) the 1995 Form 1120-F is

not yet available at the time the corporation is required to file its return. However, the corporation must show its 1995 tax year on the 1994 Form 1120-F and incorporate any tax law changes that are effective for tax years beginning after December 31, 1994.

Address and Employer Identification Number (EIN)

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

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

If the corporation's address has changed from the last time Form 1120-F was filed, check the box at the top of page 1.

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

Employer identification number (EIN).—

Show the corporation's correct EIN. If the corporation does not have an EIN, it should apply for one on **Form SS-4, Application for Employer Identification Number**. Form SS-4 can be obtained at most IRS or Social Security Administration offices. If the corporation has not received its EIN by the time the return is due, write "Applied for" in the space for the EIN. See Pub. 583 for more information.

Computation of Tax Due or Overpayment

Line 4. Personal Holding Company Tax

If the corporation is a personal holding company (as defined in section 542) but **not** a foreign personal holding company, it must file Schedule PH (Form 1120) with Form 1120-F and report the personal holding company tax on line 4. See section 542 and Schedule PH (Form 1120) for details.

Line 6b. Estimated Tax Payments

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

Beneficiaries of trusts.—If the corporation is the beneficiary of a trust, and the trust makes a section 643(g) election to credit its estimated tax payments to its beneficiaries, include the corporation's share of the estimated tax payment in the total amount entered on line 6b. Write "T" and the payment amount on the dotted line next to the entry space.

Line 6g. Credit for Federal Tax on Fuels

Complete Form 4136 if the corporation qualifies to take this credit. Attach Form 4136 after page 6 of Form 1120-F.

Credit for ozone-depleting chemicals.—Include on line 6g any credit the corporation is claiming under section 4682(g)(4) for tax paid on ozone-depleting chemicals. Write "ODC" on the dotted line to the left of the entry space.

Line 6i. Total Payments

Backup withholding.—If the corporation had income tax withheld from any payments it received, because, for example, it failed to give the payer its correct EIN, include the amount withheld in the total for line 6i. This type of withholding is called backup withholding. Show the amount withheld in the blank space in the right-hand column between lines 5 and 6i, and write "backup withholding."

Line 7. Estimated Tax Penalty

A corporation that does not make estimated tax payments when due may be subject to an underpayment penalty for the period of underpayment. Generally, a corporation is subject to the penalty if its tax liability is \$500 or more, and it did not timely pay the smaller of (a) 100% of its tax liability for 1994, or (b) 100% of its prior year's tax. See section 6655 for details and exceptions, including special rules for large corporations.

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

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

If you attach Form 2220, check the box on line 7 of Form 1120-F and enter any penalty on that line.

Section I.—Certain Gains, Profits, and Income From U.S. Sources That Are NOT Effectively Connected With the Conduct of a Trade or Business in the United States

Include in Section I amounts received by the foreign corporation that meet all of the following conditions:

- The amount received is fixed or determinable, annual or periodic (FDAP). This includes:

1. Interest (other than original issue discount (OID) as defined in section 1273), dividends, rents, royalties, salaries, wages, premiums, annuities, compensation, and other FDAP gains, profits, and income. Certain portfolio interest is not taxable for obligations issued after July 18, 1984. See section 881(c) for more details.

2. Gains described in section 631(b) or (c), relating to disposal of timber, coal, or domestic iron ore with a retained economic interest.

3. On a sale or exchange of an OID obligation, the OID accruing while the obligation was held by the foreign corporation, unless this amount was taken into account on a payment.

4. On a payment received on an OID obligation, the amount of the OID accruing while the obligation was held by the foreign corporation, if such OID was not previously taken into account and if the tax imposed on the OID does not exceed the payment received less the tax imposed on any interest included in the payment received. This rule applies to payments received for OID obligations issued after March 31, 1972.

Certain OID is not taxable for OID obligations issued after July 18, 1984. See section 881(c) for more details.

For rules that apply to other OID obligations, see Pub. 515.

5. Gains from the sale or exchange of patents, copyrights, and other intangible property if the gains are from payments that are contingent on the productivity, use, or disposition of the property or interest sold or exchanged.

- The amount received is includible in the gross income of the foreign corporation. Therefore, receipts that are excluded from gross income (e.g., interest income received on state and local bonds that is excluded from gross income under section 103) would not be included as income in Section I.
- The amount received is from U.S. sources (see **Source Rules** on page 5).
- The amount received is not effectively connected with the conduct of a U.S. trade or business. The amount received is generally **not** effectively connected if **neither** the asset-use test nor the business-activities test is met. See Section II.

- The amount received is not exempt from taxation. Therefore, receipts that are exempted by code (e.g., interest on deposits that are exempted by section 881(d)) would not be included as income in Section I.

For more information, see section 881(a) and Regulations section 1.881-2.

Note: A corporation created or organized in Guam, American Samoa, the Northern Mariana Islands, or the Virgin Islands will not be treated as a foreign corporation (for purposes of determining whether its income is taxable under section 881(a)) if it meets the rules of section 881(b).

Line 9. Gross Transportation Income

A tax of 4% is imposed on a foreign corporation's U.S. source gross transportation income for the tax year. U.S. source gross transportation income generally is any gross income that is transportation income (defined below) if such income is treated as from U.S. sources (as explained below). However, U.S. source gross transportation income does not include income that is effectively connected with the conduct of a U.S. trade or business (as explained below) **or** income that is taxable in a possession of the

United States under the provisions of the Internal Revenue Code as applied to that possession.

Transportation income is any income from, or connected with (a) the use (or hiring or leasing for use) of a vessel or aircraft or (b) the performance of services directly related to the use of a vessel or aircraft. For purposes of the preceding sentence, the term "vessel or aircraft" includes any container used in connection with a vessel or aircraft.

Generally, 50% of all transportation income that is attributable to transportation that either begins **or** ends in the United States is treated as from U.S. sources. However, see section 863(c)(2)(B) for a special rule for personal service income.

Transportation income of the corporation will not be treated as effectively connected income unless (a) the corporation has a fixed place of business in the United States involved in the earning of transportation income and (b) substantially all of the corporation's U.S. source gross transportation income (determined without regard to the rule that such income does not include effectively connected income) is attributable to regularly scheduled transportation (or, in the case of income from the leasing of a vessel or aircraft, is attributable to a fixed place of business in the United States). For more information, see section 887.

Enter the foreign corporation's U.S. source gross transportation income on line 9, column (b). Also, attach a statement showing the dates the vessels or aircraft entered or left the United States and the amount of gross income for each trip.

Additional Information Required

Be sure to complete all additional information on page 2 that applies to the corporation.

Item O

A personal service corporation is a corporation whose principal activity during the testing period for the tax year is performing personal services that are substantially performed by employee-owners who own more than 10% of the fair market value of the corporation's outstanding stock as of the last day of the testing period for the tax year.

The testing period for a tax year is generally the tax year preceding the tax year. The testing period for a new corporation in its first tax year is the period beginning on the first day of its first tax year and ending on the earlier of the last day of its first tax year or the last day of the calendar year in which the first tax year began.

Personal service activities are those that involve performing services in the health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting fields (as defined in Temporary Regulations section 1.448-1T(e)).

Personal services are substantially performed by employee-owners if more than 20% of the corporation's compensation cost for the testing period for performing the personal services is attributable to personal services performed by employee-owners.

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

For more details, see Temporary Regulations section 1.441-4T.

Item P

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

Item R

Check this box if the corporation elects under section 172(b)(3) to forgo the carryback period for an NOL. If you check this box, do not attach the statement described in Temporary Regulations section 301.9100-12T(d).

Item S

Enter the net operating loss (NOL) carryover to the tax year from prior years, even if any of the loss is used to offset income on this return. The amount to enter is the total of all NOLs generated in prior years but not used to offset income (either as a carryback or carryover) in a tax year prior to 1994. Do not reduce the amount by any NOL deduction reported on page 3, Section II, line 30a.

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

Item T

Check the "Yes" box if the corporation is a subsidiary in a parent-subsidiary controlled group. You must check the "Yes" box even if the corporation is a subsidiary member of one group and the parent corporation of another.

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

A **parent-subsidiary controlled group** is one or more chains of corporations connected through stock ownership (section 1563(a)(1)). Both of the following requirements must be met:

1. 80% of the total combined voting power of all classes of stock entitled to vote or at least 80% of the total value of all classes of stock of each corporation in the group (except the parent) must be owned by one or more of the other corporations in the group.

2. The common parent must own at least 80% of the total combined voting

power of all classes of stock entitled to vote or at least 80% of the total value of all classes of stock of at least one of the other corporations in the group. Stock owned directly by other members of the group is not counted when computing the voting power or value.

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

Section II.—Income Effectively Connected With the Conduct of a Trade or Business in the United States

Foreign Corporations Engaged in a U.S. Trade or Business

These corporations are taxed on their effectively connected income using the same graduated tax rate schedule (see page 15) that applies to domestic corporations. **Effectively connected income** can be U.S. source or foreign source.

U.S. Source Effectively Connected Income

Fixed or determinable, annual or periodic (FDAP) items are generally effectively connected income (and are therefore includible in Section II) if one or both of the following tests is met.

Asset-use test. The FDAP items are from assets used in, or held for use in, the conduct of the U.S. trade or business. For example, interest income earned on a trade or note receivable acquired in the conduct of the U.S. trade or business would be effectively connected income. Also, interest income earned from the temporary investment of funds needed in the foreign corporation's U.S. trade or business would be effectively connected income.

Business-activities test. The activities of the U.S. trade or business were a material factor in the realization of the FDAP items.

If neither test is met, FDAP items are generally not effectively connected income (and are therefore includible in Section I instead of Section II).

For more information, see section 864(c)(2) and Regulations section 1.864-4(c), and the examples therein.

U.S. source income other than FDAP items is effectively connected income.

Foreign Source Effectively Connected Income

Foreign source income is generally not effectively connected income. However, if the foreign corporation has an office or other fixed place of business in the United States, the following types of foreign source income it receives that are from that U.S. office are effectively connected income:

- Rents or royalties received for the use outside the United States of intangible

personal property described in section 862(a)(4) if from the active conduct of a U.S. trade or business;

- Dividends or interest from foreign sources if from the active conduct of a U.S. banking, financing, or similar business, OR if the principal business of the foreign corporation is trading in stocks or securities for its own account; or

- Income derived from the sale or exchange of inventory outside the United States through the U.S. office, unless the property is sold or exchanged for use, consumption, or disposition outside the United States and an office of the foreign corporation in a foreign country participated materially in the sale.

See section 864(c)(5)(A) and Regulations section 1.864-7 for definition of office or other fixed place of business in the United States. See sections 864(c)(5)(B) and (C) and Regulations section 1.864-6 for special rules for determining when foreign source income received by a foreign corporation is from an office or other fixed place of business in the United States.

Foreign insurance companies.—Foreign source income of a foreign insurance company that is attributable to its U.S. trade or business is effectively connected income.

Exceptions.—Foreign source income that would otherwise be effectively connected income under any of the above rules for foreign source income is excluded if:

1. It is foreign source dividends, interest, or royalties paid by a foreign corporation in which the taxpayer owns or is considered to own (within the meaning of section 958) 50% or more of the total combined voting power of all classes of stock entitled to vote; or

2. The taxpayer is a controlled foreign corporation (as defined in section 957) and the foreign source income is subpart F income (as defined in section 952).

For more information, see section 864(c)(4) and Regulations section 1.864-5.

Foreign Corporations NOT Engaged in a U.S. Trade or Business

These corporations will not report income in Section II unless they:

- Have current year income or gain from a sale or exchange of property or from performing services (or any other transaction) in any other tax year and that would have been effectively connected income in that other tax year (see section 864(c)(6));

- Have current year income or gain from disposing of property that is no longer used or held for use in conducting a U.S. trade or business within the 10-year period before the disposition and that would have been effectively connected income immediately before such cessation (see section 864(c)(7));

- Elect to treat real property income as effectively connected income (see below);

- Were created or organized and are conducting a banking business in a U.S.

possession, and receive interest on U.S. obligations that is not portfolio interest (see section 882(e)); or

- Have gain or loss from disposing of a U.S. real property interest (see below).

Election to Treat Real Property Income as Effectively Connected Income

A foreign corporation that receives, during the tax year, any income from real property located in the United States, or from any interest in such real property, may elect, for the tax year, to treat all such income as effectively connected income. Income to which this election applies includes:

- Gains from the sale or exchange of real property or an interest therein;
- Rents or royalties from mines, wells, or other natural deposits; and
- Gain described in sections 631(b) or (c).

The election may be made whether or not the corporation is engaged in a U.S. trade or business during the tax year for which the election is made or whether or not the corporation has income from real property that, for the tax year, is effectively connected with the conduct of a U.S. trade or business.

To make the election, attach a statement that includes the information required in Regulations section 1.871-10(d)(1)(ii) to Form 1120-F for the first tax year for which the election is to apply. Use Section II to figure the tax on this income.

Disposition of U.S. Real Property Interest by a Foreign Corporation

A foreign corporation that disposes of a U.S. real property interest (as defined in section 897(c)) must treat the gain or loss from the disposition as effectively connected income, even if the corporation is not engaged in a U.S. trade or business. This gain or loss must be figured on **Schedule D (Form 1120)**, Capital Gains and Losses, and the result must be carried over to Section II, line 8, on page 3 of Form 1120-F. A foreign corporation may elect to be treated as a domestic corporation for purposes of sections 897 and 1445. See sections 897(i) and 882(d).

See Temporary Regulations section 1.897-5T for the applicability of section 897 to reorganizations and liquidations.

If the corporation had income tax withheld on **Form 8288-A**, Statement of Withholding on Dispositions by Foreign Persons of U.S. Real Property Interests, include the amount withheld in line 6h, page 1.

Income

Line 1. Gross Receipts.—Enter gross income that is effectively connected with the conduct of a U.S. trade or business except those income items that must be reported on lines 4 through 10. For reporting advance payments, see Regulations section 1.451-5. To report income from long-term contracts, see section 460.

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

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

- Dealer dispositions of property before March 1, 1986.
- Dispositions of property used or produced in the trade or business of farming.
- Certain dispositions of timeshares and residential lots reported under the installment method.

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

For sales of timeshares and residential lots reported under the installment method, the corporation's income tax is increased by the interest payable under section 453(l)(3). To report this addition to the tax, see the instructions for Schedule J, line 9.

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

Line 2. Cost of goods sold.—See instructions for Schedule A. Enter the amount from line 8 of Schedule A.

Line 4. Dividends.—See instructions for Schedule C. Enter the amount from line 14 of Schedule C.

Line 5. Interest.—Enter taxable interest on U.S. obligations and on loans, notes, mortgages, bonds, bank deposits, corporate bonds, tax refunds, etc.

Do not offset interest expense against interest income.

Line 6. Gross rents.—Enter the gross amount received for the rent of property. Deduct expenses such as repairs, interest, taxes, and depreciation on the proper lines for deductions. A rental activity held by a closely held corporation or a personal service corporation may be subject to the passive activity loss rules. See Form 8810 and the related instructions.

Line 8. Capital gain net income.—Every sale or exchange of a capital asset must be reported in detail on **Schedule D (Form 1120)**, Capital Gains and Losses, even though no gain or loss is indicated. In computing the adjustments to the accumulated earnings tax under section 535(b)(6), foreign corporations must only include capital gains and losses that are effectively connected with a U.S. trade or business.

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

- Any adjustment under section 481(a) required to be included in income during the current tax year due to a change in a method of accounting.
- Recoveries of bad debts deducted in prior years under the specific charge-off method.
- The credit for alcohol used as fuel (determined regardless of the limitation based on tax) that was entered on **Form 6478**, Credit for Alcohol Used as Fuel.
- Refunds of taxes deducted in prior years if they reduced income subject to tax in the year deducted (see section 111). Do not offset current year taxes against tax refunds.
- Any deduction previously taken under section 179A that is subject to recapture. The corporation must recapture the benefit of any allowable deduction for qualified clean-fuel vehicle property (or clean-fuel vehicle refueling property), if, within 3 years of the date the property was placed in service, the property ceases to qualify. See Pub. 535 for details, including how to figure the recapture.

Deductions

In computing the taxable income of a foreign corporation engaged in a U.S. trade or business, deductions are allowed only if they are connected with income that is effectively connected with the conduct of a trade or business in the United States. Charitable contributions, however, may be deducted whether or not they are so connected. See section 882(c) and Regulations section 1.882-4(b) for more information.

Apportionment of Expenses

Expenses that are directly related to a class of gross income (including tax-exempt income) must be allocated to that class of gross income. Expenses not directly related to a class of gross income should be allocated to all classes of income based on the ratio of gross income in each class of income to total gross income, or some other ratio that clearly relates to the classes of income. See Regulations section 1.861-8 and Temporary Regulations section 1.861-8T for more information.

Attach a schedule showing each class of gross income, and the expenses directly allocable to each class. For expenses that are not directly allocable to a class of gross income, show the computation of the expense allocated to each class.

Limitations on Deductions

Section 263A uniform capitalization rules.—These rules require corporations to capitalize or include in inventory certain costs incurred in producing real and tangible personal property held in inventory or held for sale in the ordinary course of business. Tangible personal property produced by a corporation includes a film, sound recording, video tape, book, or similar property. The rules also apply to personal property (tangible and intangible) acquired for resale. Corporations subject to these rules are required to capitalize not only direct costs but an allocable portion of most indirect costs (including taxes) that relate to the assets produced or acquired for resale. Interest expense paid or incurred during the production period must be capitalized and is governed by special rules. For more information, see Notice 88-99, 1988-2 C.B. 422. The uniform capitalization rules also apply to the production of property constructed or improved by a corporation for use in its trade or business or in an activity engaged in for profit.

Section 263A does not apply to personal property acquired for resale if the taxpayer's annual average gross receipts are \$10 million or less. It does not apply to timber or to most property produced under a long-term contract. Special rules apply for farmers. The rules do not apply to property that is produced for use by the corporation if substantial construction occurred before March 1, 1986.

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

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

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

Transactions between related

taxpayers.—Generally, an accrual basis taxpayer may only deduct business expenses and interest owed to a related party in the year the payment is included in

the income of the related party. See sections 163(e)(3), 163(j), and 267 for limitations on deductions for unpaid interest and expenses.

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

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

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

Passive activity limitations.—Limitations on passive activity losses and credits under section 469 apply to closely held corporations (defined below) and personal service corporations as defined in Temporary Regulations section 1.441-4T. See the instructions for Item O.

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

Generally, there are two kinds of passive activities: trade or business activities in which the corporation did not materially participate (see Temporary Regulations section 1.469-1T(g)(3)) for the tax year, and rental activities regardless of its participation. For exceptions, see Form 8810. An activity is a trade or business activity if the activity involves the conduct of a trade or business (i.e., deductions from the activity would be allowable under section 162 if other limitations, such as the passive loss rules, did not apply), or the activity involves research and experimental costs that are deductible under section 174 (or would be deductible if the corporation chose to deduct rather than capitalize them), and the activity is not a rental activity.

Corporations subject to the passive activity limitations must complete Form 8810 to compute their allowable passive activity loss and credit. Before completing Form 8810, see Temporary Regulations section 1.163-8T, which provides rules for allocating interest expense among activities. If a passive activity is also subject to the at-risk rules of section 465, the at-risk rules apply before the passive

loss rules. For more information, see section 469, the related regulations, and **Pub. 925, Passive Activity and At-Risk Rules.**

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

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

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

Line 12. Compensation of officers.—

Enter deductible officers' compensation on line 12 and complete Schedule E on page 4 if total receipts (line 1a, plus lines 4 through 10, of page 3) are \$500,000 or more. Do not include compensation claimed elsewhere on the return, such as amounts included in cost of goods sold, elective contributions to a section 401(k) cash or deferred arrangement, or amounts contributed under a salary reduction SEP agreement.

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

Disallowance of deduction for employee compensation in excess of \$1 million.—Publicly held corporations may not deduct compensation to a "covered employee" to the extent that the compensation exceeds \$1 million. Generally, a covered employee is:

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

For this purpose, compensation does not include the following:

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

The deduction limit does not apply to:

- Commissions based on individual performance;

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

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

For details, see section 162(m) and Notice 94-68, 1994-1, C.B. 376.

Line 13. Salaries and wages.—Enter the amount of total salaries and wages paid for the tax year, less the amount of any jobs credit from **Form 5884**, empowerment zone credit from **Form 8844**, and Indian employment credit from **Form 8845**. Do not include salaries and wages deductible elsewhere on the return, such as amounts included in cost of goods sold, elective contributions to a section 401(k) cash or deferred arrangement, or amounts contributed under a salary reduction SEP agreement.

Caution: If the corporation provided taxable fringe benefits to its employees, such as personal use of a car, do not deduct as wages the amount allocated for depreciation and other expenses claimed on lines 20 and 27.

Line 14. Repairs and maintenance.—Enter the cost of incidental repairs and maintenance not claimed elsewhere on the return, such as labor and supplies, that do not add to the value of the property or appreciably prolong its life. New buildings, machinery, or permanent improvements that increase the value of the property are not deductible. They must be depreciated or amortized.

Line 15. Bad debts.—Enter the total debts that became worthless in whole or in part during the tax year. A small bank or thrift institution using the reserve method should attach a schedule showing how it arrived at the current year's provision.

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

Line 16. Rents.—If the corporation rented or leased a vehicle, enter the total annual rent or lease expense paid or incurred during the year. Also complete Part V of **Form 4562**, Depreciation and Amortization. If the corporation leased a vehicle for a term of 30 days or more, the deduction for vehicle lease expense may have to be reduced by an amount called the **Inclusion Amount**. The corporation may have an inclusion amount if:

The lease term began:	And the vehicle's fair market value on the first day of the lease exceeded:
After 12/31/93	\$14,900
After 12/31/92 but before 1/1/94	\$14,300
After 12/31/91 but before 1/1/93	\$13,700
After 12/31/90 but before 1/1/92	\$13,400
After 12/31/86 but before 1/1/91	\$12,800

If the lease term began after June 18, 1984, but before January 1, 1987, see **Pub. 917**, Business Use of a Car, to find out if the corporation has an inclusion amount. Also see Pub. 917 for instructions on figuring the inclusion amount.

Line 17. Taxes and licenses.—Enter taxes paid or accrued during the tax year, but do not include any of the following:

1. Federal income taxes (except the environmental tax under section 59A).
2. Foreign or U.S. possession income taxes if a tax credit is claimed (however, see the Instructions for Form 5735 for special rules for possession income taxes).

3. Taxes not imposed on the corporation.

4. Taxes, including state or local sales taxes, that are paid or incurred in acquiring or disposing of property (such taxes must be treated as a part of the cost of the acquired property or, for a disposition, as a reduction in the amount realized on the disposition).

5. Taxes assessed against local benefits that increase the value of the property assessed (such as for paving, etc.).

6. Taxes deducted elsewhere on the return, such as those reflected in cost of goods sold.

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

If the corporation is liable for the environmental tax under section 59A, see **Form 4626**, Alternative Minimum Tax—Corporations, for computation of the environmental tax deduction.

See section 906(b)(1) for rules concerning certain foreign taxes imposed on income from U.S. sources that may not be deducted or credited.

Line 18. Interest.—See section 882(c) and Regulations section 1.882-5 for rules for interest deductions allowed to foreign corporations.

Line 19. Charitable Contributions

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

Note: This deduction is allowed for all contributions, whether or not connected with income that is effectively connected with the conduct of a trade or business in the United States (see section 882(c)(1)(B)).

The total amount claimed may not exceed 10% of taxable income (Section II, line 31) computed without regard to the following:

1. Any deduction for contributions;
2. The special deductions on line 30b;
3. The deduction allowed under section 249;
4. Any net operating loss (NOL) carryback to the tax year under section 172; and
5. Any capital loss carryback to the tax year under section 1212(a)(1).

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

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

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

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

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

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

Contributions of property other than cash.—If a corporation (other than a closely held or personal service corporation) contributes property other than cash and the deduction claimed for the property exceeds \$500, the corporation must attach a schedule to the return describing the kind of property contributed and the method used to determine its fair market value. Closely held corporations and personal service corporations must complete **Form 8283**, Noncash Charitable Contributions, and attach it to Form 1120-F. All other corporations must generally complete and attach Form 8283 for contributions of property other than money if the total claimed deduction for all property contributed was more than \$5,000.

If the corporation made a "qualified conservation contribution" under section 170(h), also include the fair market value of the underlying property before and after the donation, as well as the type of legal interest contributed, and describe the conservation purpose furthered by the

donation. If a contribution carryover is included, show the amount and how it was determined.

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

1. The ordinary income, short-term capital gain that would have resulted if the property were sold at its fair market value; and

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

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

1. Contributions of tangible personal property for use by an exempt organization for a purpose or function unrelated to the basis for its exemption, and

2. Contributions of any property (except stock for which market quotations are readily available—see section 170(e)(5)) to or for the use of certain private foundations. See section 170(e) and Regulations section 1.170A-4.

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

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

Contributions to organizations conducting lobbying activities.—

Contributions made after 1993 to an organization that conducts lobbying activities are not deductible if:

1. The lobbying activities relate to matters of direct financial interest to the donor's trade or business, and

2. The principal purpose of the contribution was to avoid Federal income tax by obtaining a deduction for activities that would have been nondeductible under the lobbying expense rules if conducted directly by the donor.

Line 20. Depreciation.—In addition to depreciation, include on line 20 the part of the cost that the corporation elected to expense under section 179 for certain tangible property placed in service during tax year 1994, or carried over from 1993. See **Form 4562**, Depreciation and Amortization, and its instructions.

Line 23. Depletion.—See sections 613 and 613A for percentage depletion rates applicable to natural deposits. Also, see section 291 for the limitation on the depletion deduction for iron ore and coal (including lignite).

Foreign intangible drilling costs and foreign exploration and development costs must either be added to the corporation's basis for cost depletion purposes or be deducted ratably over a 10-year period.

See sections 263(i), 616, and 617 for details.

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

Line 25. Pension, Profit-sharing, etc., Plans

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

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

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

Form 5500-EZ.—Complete this form for a one-participant plan. A one-participant plan includes plans that cover the owners and their spouses and plans that cover partners in a business partnership (or the partners and their spouses).

Line 26. Employee benefit programs.—Enter contributions to employee benefit programs not claimed elsewhere on the return (e.g., insurance, health, and welfare programs) that are not an incidental part of a pension, profit-sharing, etc., plan included on line 25.

Line 27. Other Deductions

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

Attach a schedule, listing by type and amount, all allowable deductions that are not deductible elsewhere on Form 1120-F.

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

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

- Paid in cash directly to the plan participants or beneficiaries;
- Paid to the plan, which distributes them in cash to the plan participants or their beneficiaries, no later than 90 days after the end of the plan year in which the dividends are paid; or
- Used to make payments on a loan described in section 404(a)(9).

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

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

Meals, travel, and entertainment.—

Generally, the corporation can deduct only

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

Additional limitations apply to deductions for gifts, skybox rentals, luxury water travel, convention expenses, and entertainment tickets. See section 274 and **Pub. 463**, Travel, Entertainment, and Gift Expenses.

No deduction is allowed for dues paid or incurred for membership in any club organized for business, pleasure, recreation, or other social purpose. This rule applies to all types of clubs, including business, social, athletic, luncheon, sporting, airline, and hotel clubs.

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

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

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

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

Lobbying expenses.—Generally, lobbying expenses are not deductible. These expenses include amounts paid or incurred in connection with influencing Federal or state legislation (but not local legislation), or amounts paid or incurred in connection with any communication with certain Federal executive branch officials in an attempt to influence the official actions or positions of the officials. However, if certain in-house expenditures do not exceed \$2,000, they are deductible. Dues and other similar amounts paid to certain tax-exempt organizations may not be deductible. See section 162(e) and Temporary Regulations section 1.162-2OT(d). For information on

contributions to charitable organizations that conduct lobbying activities, see the instructions for line 19. For more information on lobbying expenses, see section 162(e).

Line 29. Taxable Income Before NOL Deduction and Special Deductions

At-risk rules.—Special at-risk rules under section 465 generally apply to closely held corporations (defined under **Passive activity limitations** on page 10) engaged in any activity as a trade or business, or for the production of income. These corporations may have to adjust the amount on line 29. However, the at-risk rules do not apply to: **(a)** holding real property placed in service by the taxpayer before 1987; **(b)** equipment leasing under sections 465(c)(4), (5), and (6); and **(c)** any qualifying business of a qualified corporation described in section 465(c)(7). However, the at-risk rules do apply to holding mineral property.

If the at-risk rules apply, adjust the amount on line 29 for any section 465(d) losses. These losses are limited to the amount for which the corporation is at risk for each separate activity at the close of the tax year. If the corporation is involved in one or more activities, any of which incurs a loss for the year, report the loss for each activity separately. Attach **Form 6198**, At-Risk Limitations, showing the amount at risk and gross income and deductions for the activities with losses.

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

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

Line 30a. Net Operating Loss Deduction

A net operating loss (NOL) incurred by a corporation in one tax year may be used to reduce the corporation's taxable income in another year. Generally, a corporation may carry an NOL back to each of the 3 years preceding the year of the loss and then carry any remaining amount over to each of the 15 years following the year of the loss (but see **Exceptions to carryback rules** below). Enter on line 30a the total NOL carryovers from prior tax years, but do not enter more than the corporation's taxable income (after special deductions). An NOL deduction cannot be taken in a year in which the corporation has a negative taxable income. Attach a schedule showing the computation of the NOL deduction. Also complete Item S at the bottom of page 2 of the form.

For more information about NOLs and the NOL deduction, get **Pub. 536**, Net Operating Losses.

Carryback and carryover rules.—

Generally, an NOL first must be carried

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

For carryback claims filed later than 12 months after the close of the tax year of the loss, file an amended Form 1120-F instead of Form 1139.

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

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

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

Exceptions to carryback rules.—A corporation may make an irrevocable election to forego the carryback period and instead carry the NOL over to each of the 15 years following the year of the loss. To make this election, check the box in Item R at the bottom of page 2 of the form. The return must be timely filed (including extensions).

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

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

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

Line 30b. Special deductions.—See the instructions for Schedule C.

Schedule A—Cost of Goods Sold

See **Section 263A uniform capitalization rules** on page 10 before completing Schedule A.

Note: If inventories are not an income-determining factor, enter zero on lines 1 and 7 of Schedule A.

Line 4. Additional section 263A costs.—An entry is required on this line only for corporations that have elected a simplified method of accounting.

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

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

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

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

Line 7. Inventory at end of year.—See Regulations section 1.263A-1 through 1.263A-3 for details on figuring the amount of additional section 263A costs to be included in ending inventory.

Line 9a. Inventory valuation methods.—Inventories can be valued at **(a)** cost, **(b)** cost or market value (whichever is lower), or **(c)** any other method approved by the IRS that conforms to the provisions of the applicable regulations cited below.

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

On line 9a, check the method(s) used for valuing inventories. Under lower of cost or market, the term "market" generally refers to normal market conditions where there is a current bid price prevailing at the date the inventory is valued. When no regular open market exists or when quotations are nominal because of inactive market conditions, use fair market prices from the most reliable sales or purchase transactions that occurred near the date the inventory is valued.

Inventory may be valued below cost when the merchandise is unsalable at normal prices or unusable in the normal way because the goods are subnormal because of damage, imperfections, shop wear, etc., within the meaning of Regulations section 1.471-2(c). The goods may be valued at a current bona fide

selling price, minus direct cost of disposition (but not less than scrap value) if such a price can be established.

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

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

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

Schedule C—Dividends and Special Deductions

For purposes of the 20% ownership test on lines 1 through 7, the percentage of stock owned by the corporation is based on voting power and value of the stock. Preferred stock described in section 1504(a)(4) is not taken into account.

Line 1, Column (a)

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

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

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

Line 2, Column (a)

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

Line 3, Column (a)

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

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

Line 3, Columns (b) and (c)

Dividends received on debt-financed stock acquired after July 18, 1984, are not entitled to the full 70% or 80% dividends-received deduction. The 70% or 80% deduction is reduced by a percentage that is related to the amount of debt incurred to acquire the stock. See section 246A. Also see section 245(a) before making this computation for an additional limitation that applies to dividends received from foreign corporations. Attach a schedule that shows how the amount on line 3, column (c) was figured.

Line 4, Column (a)

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

Line 5, Column (a)

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

Line 6, Column (a)

Enter the U.S.-source portion of dividends that are received from less-than-20%-owned foreign corporations and that qualify for the 70% deduction under section 245(a). To qualify for the 70% deduction, the corporation must own at least 10% of the stock of the foreign corporation by vote and value.

Line 7, Column (a)

Enter the U.S.-source portion of dividends that are received from 20%-or-more-owned foreign corporations and that qualify for the 80% deduction under section 245(a).

Line 8, Column (c)

Limitation on dividends-received deduction.—Generally, line 8 of column (c) may not exceed the amount from the worksheet that follows. However, in a year in which an NOL occurs, this limitation does not apply even if the loss is created

by the dividends-received deduction. See sections 172(d) and 246(b). Certain financial institutions to which section 593(a) applies should see section 596 for the special limitation on the dividends-received deduction.

1. Refigure Section II, line 29 without any adjustment under section 1059 and without any capital loss carryback to the tax year under section 1212(a)(1)
2. Multiply line 1 by 80%
3. Add lines 2, 5, and 7, column (c) and the part of the deduction on line 3, column (c) that is attributable to dividends received from 20%-or-more-owned corporations
4. Enter the smaller of line 2 or line 3. If line 3 is greater than line 2, stop here; enter the amount from line 4 on line 8, column (c), and do not complete the rest of this worksheet
5. Enter the total amount of dividends received from 20%-or-more-owned corporations that are included on lines 2, 3, 5, and 7, column (a)
6. Subtract line 5 from line 1
7. Multiply line 6 by 70%
8. Subtract line 3 above from line 8, column (c)
9. Enter the smaller of line 7 or line 8
10. Dividends-received deduction after limitation (sec. 246(b)). Add lines 4 and 9. Enter the result here and on line 8, column (c)

Line 9, Column (a)

Enter all other dividends received from foreign corporations that are not reportable on lines 3, 6, or 7 of column (a). Also include on line 9 the corporation's share of the ordinary earnings of a qualified electing fund from Form 8621, line 6c, or the amount of any excess distributions from a passive foreign investment company from Form 8621, line 11b. Exclude distributions constructively taxed in the current year or in prior years under subpart F (sections 951 through 964).

Line 10, Column (a)

If the corporation claims the foreign tax credit, enter the tax that is deemed paid under sections 902 and 960. See sections 78 and 906(b)(4).

Line 11, Column (a)

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

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

1. Is paid out of the corporation's accumulated IC-DISC income or previously taxed income, or

- 2.** Is a deemed distribution under section 995(b)(1).

Line 12, Column (a)

Include the following:

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

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

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

If patronage dividends or per-unit retain allocations are included on line 12, identify the total of these amounts in a schedule and attach it to Form 1120-F.

Line 13, Column (c)

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

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

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

Schedule J—Tax Computation

Lines 1 and 2

Members of a Controlled Group

Members of a controlled group (as defined in section 1563) must check the box on line 1 and complete lines 2a and 2b of Schedule J. They are entitled to one \$50,000, one \$25,000, and one \$9,925,000 taxable income bracket amount (in that order) on line 2a.

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

Equal apportionment plan.—If no apportionment plan is adopted, the

members of the controlled group must divide the amount in each taxable income bracket equally among themselves.

Example. Controlled group AB consists of corporation A and corporation B. They do not elect an apportionment plan. Therefore, both corporation A and corporation B are entitled to \$25,000 (one-half of \$50,000) in the \$50,000 taxable income bracket on line 2a(1), \$12,500 (one-half of \$25,000) in the \$25,000 taxable income bracket on line 2a(2), and \$4,962,500 (one-half of \$9,925,000) in the \$9,925,000 taxable income bracket on line 2a(3).

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

Each member of a controlled group must compute its tax as follows (except qualified personal service corporations):

1. Enter taxable income (Section II, line 31)
2. Enter line 1 or the corporation's share of the \$50,000 taxable income bracket, whichever is less
3. Subtract line 2 from line 1
4. Enter line 3 or the corporation's share of the \$25,000 taxable income bracket, whichever is less
5. Subtract line 4 from line 3
6. Enter line 5 or the corporation's share of the \$9,925,000 taxable income bracket, whichever is less
7. Subtract line 6 from line 5
8. Multiply line 2 by 15%
9. Multiply line 4 by 25%
10. Multiply line 6 by 34%
11. Multiply line 7 by 35%
12. If the taxable income of the controlled group exceeds \$100,000, enter this member's share of the **smaller** of (a) 5% of the excess over \$100,000, or (b) \$11,750. (See **Additional 5% tax** below.)
13. If the taxable income of the controlled group exceeds \$15 million, enter this member's share of the smaller of 3% of the taxable income in excess of \$15 million, or \$100,000 (See **Additional 3% tax** below.)
14. Add lines 8 through 13. Enter here and on line 3, Schedule J

Additional 5% tax.—Members of a controlled group are treated as one corporation in figuring the applicability of the additional 5% tax that must be paid by corporations with taxable income in excess of \$100,000. If the additional tax applies, each member of the controlled group will

pay that tax based on the part of the amount that is used in each taxable income bracket to reduce that member's tax. See section 1561(a). Each member of the group must enter its share of the additional 5% tax on line 2b(1) and attach to its tax return a schedule that shows the taxable income of the entire group as well as how its share of the additional tax was figured.

Additional 3% tax.—Members of a controlled group are treated as one corporation in figuring the additional 3% tax that must be paid by corporations with taxable income in excess of \$15 million. If the additional tax applies, each member of the controlled group will pay that tax based on the part of the amount that is used in each taxable income bracket to reduce that member's tax. See section 1561(a). Each member of the group must enter its share of the additional 3% tax on line 2b(2) and attach to its tax return a schedule that shows the taxable income of the entire group as well as how its share of the additional 3% tax was figured.

Line 3. Income Tax

A corporation that is not a qualified personal service corporation or a member of a controlled group must compute its tax on its taxable income as follows:

Tax Rate Schedule

If its taxable income (Section II, line 31) is:

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

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

- Substantially all of its activities involve performing services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting, and
- At least 95% of its stock, by value, is owned, directly or indirectly, by
 - (1) employees performing the services,
 - (2) retired employees who had performed the services listed above, (3) any estate of an employee or retiree described above, or
 - (4) any person who acquired the stock of the corporation because of the death of an employee or retiree (but only for the 2-year period beginning on the date of the employee's or retiree's death). See Temporary Regulations section 1.448-1T(e) for details.

Note: If the corporation meets these tests, check the box on line 3, Schedule J.

Additional tax under section 197(f).—A corporation that elects to pay tax on the

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

Line 4a. Foreign Tax Credit

A foreign corporation engaged in a U.S. trade or business during the tax year can take a credit for income, war profits, and excess profits taxes paid, accrued, or deemed paid to any foreign country or U.S. possession for income effectively connected with the conduct of a trade or business in the United States. See section 906 and **Form 1118**, Foreign Tax Credit—Corporations, for additional information.

Line 4b. Orphan drug credit.—To find out when a corporation can take this credit and how it is figured, see section 28 and **Form 6765**, Credit for Increasing Research Activities (or for claiming the orphan drug credit).

Line 4c

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

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

Also see Form 8827 if any of the 1993 credit was disallowed solely because of the tentative minimum tax limitation. See section 53(d).

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

Line 4d. General Business Credit

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

Investment credit. This credit was generally repealed for property placed in service after 1985. See **Form 3468**, Investment Credit, for exceptions.

Jobs credit. The corporation may qualify to take this credit if it hired members of special targeted groups during the tax year. See **Form 5884**, Jobs Credit, for more information.

Credit for alcohol used as fuel. A corporation may be able to take a credit for alcohol used as fuel. Use **Form 6478**, Credit for Alcohol Used as Fuel, to figure the credit.

Credit for increasing research activities. See **Form 6765**, Credit for Increasing Research Activities, and section 41.

Low-income housing credit. See **Form 8586**, Low-Income Housing Credit, and section 42.

Enhanced oil recovery credit. A corporation may claim a credit for 15% of its qualified enhanced oil recovery costs. Use **Form 8830**, Enhanced Oil Recovery Credit, to figure the credit.

Disabled access credit. A corporation may be able to take a credit for certain expenditures paid or incurred to assist individuals with disabilities. See **Form 8826**, Disabled Access Credit, and section 44.

Renewable electricity production credit. A corporation may be able to take a credit for electricity produced by the corporation using closed-loop biomass or wind and sold to an unrelated person. See **Form 8835**, Renewable Electricity Production Credit, for details.

Indian employment credit. A corporation may be able to claim a credit of 20% of a limited amount of the wages and health insurance costs paid or incurred by the corporation for qualified employees. A qualified employee is a member of an enrolled Indian tribe (or their spouse), who also meets certain other qualifications. See **Form 8845**, Indian Employment Credit, and section 45A.

Credit for employer social security and Medicare taxes paid on certain employee tips. Food and beverage establishments may claim a credit equal to the employer's social security and Medicare obligations attributable to tips in excess of those treated as wages for purposes of the minimum wage laws. See **Form 8846**, Credit for Employer Social Security and Medicare Taxes Paid on Certain Employee Tips, and section 45B.

Credit for contributions to certain community development corporations. Corporations may claim a credit of 5% of qualified cash contributions to certain community development corporations (CDCs) selected by the Secretary of Housing and Urban Development. See **Form 8847**, Credit for Contributions to Selected Community Development Corporations.

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

Empowerment zone employment credit. A corporation that has employees that live and work for the corporation in an area designated by the Federal government as an "empowerment zone" may be able to take a credit for wages paid to certain employees. The credit is equal to 20% of the first \$15,000 of qualified wages and is limited to \$3,000 per year per employee.

See **Form 8844**, Empowerment Zone Employment Credit, and section 1396.

Line 4e. Credit for Prior Year Minimum Tax

To figure the minimum tax credit and any carryforward of the credit, use **Form 8827**, Credit for Prior Year Minimum Tax—Corporations.

Line 7. Recapture Taxes

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

Recapture of low-income housing credit. If the corporation disposed of property (or there was a reduction in the qualified basis of the property) on which it took the low-income housing credit, it may owe a tax. See **Form 8611**, Recapture of Low-Income Housing Credit, and section 42(j) for details.

Recapture of qualified electric vehicle (QEV) credit. The corporation must recapture part of the QEVE credit it claimed in a prior year, if, within 3 years of the date the vehicle was placed in service, it ceases to qualify for the credit. Get Pub. 535 to see how to figure the recapture. Include the amount of the recapture in the total for line 7, Schedule J. On the dotted line next to the entry space, write "QEVE recapture" and the amount.

Recapture of Indian employment credit. Generally, if an employer terminates a qualified employee less than 1 year after the date of initial employment, any Indian employment credit allowed for a prior year by reason of wages paid or incurred to that employee must be recaptured. For details, see **Form 8845** and section 45A. Include the amount of the recapture in the total for line 7, Schedule J. On the dotted line next to the entry space, write "IEC recapture" and the amount.

Line 8a. Alternative Minimum Tax

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

Reduce alternative minimum tax by the amount on Form 3800, Schedule A, line 34 (or Form 8844, line 20). On the dotted line to the left of the entry space on line 8a, write "Section 38(c)(3)" (or "EZE") and the amounts.

Line 8b. Environmental Tax

The corporation may be liable for the environmental tax if its modified alternative minimum taxable income exceeds \$2 million. See Form 4626 for details.

Line 9

Interest on tax attributable to payments received on installment sales of certain timeshares and residential lots. If the corporation elected to pay interest on the tax attributable to payments received on installment obligations from disposing of certain timeshares and residential lots under section 453(l)(3), it must include the interest due in the amount to be entered on line 9, Schedule J. In the margin below line 9, write "Section 453(l)(3) interest" and the amount. Attach a schedule showing the computation.

Interest on tax deferred under the installment method for certain nondealer installment obligations. If an obligation from the disposition of property to which section 453A applies is outstanding at the close of the tax year, the corporation must include the interest due under section 453A(c) in the amount to be entered on line 9, Schedule J. Write in the margin below line 9, "Section 453A(c) interest" and the amount. Attach a schedule showing the computation.

Interest under the look-back method for completed long-term contracts. Include the interest due under the look-back method of section 460(b)(2) on line 9, Schedule J. In the margin below line 9, write "From Form 8697" and the amount of interest due.

Section III—Branch Profits Tax and Tax on Excess Interest

Part I—Branch Profits Tax

In general, section 884(a) imposes a 30% branch profits tax on the aftertax earnings of a foreign corporation's U.S. trade or business (i.e., effectively connected earnings and profits (ECEP)) that are not reinvested in a U.S. trade or business by the close of the tax year, or are disinvested in a later tax year. Changes in the value of the equity of the foreign corporation's U.S. trade or business (i.e., U.S. net equity) are used as a measure of whether earnings have been reinvested in, or disinvested from, a U.S. trade or business. An increase in U.S. net equity during the tax year is generally treated as a reinvestment of earnings for the current tax year. A decrease in U.S. net equity is generally treated as a disinvestment of prior year's earnings that have not previously been subject to the branch profits tax. The amount subject to the branch profits tax for the tax year is the dividend equivalent amount.

Corporations exempt from the branch profits tax.—In general, a foreign corporation is exempt from the branch profits tax on its dividend equivalent amount if it is a qualified resident of a country listed in Regulations section 1.884-1(g)(3) for the year in which the dividend equivalent arises, if the income tax treaty with that country has not been modified on or after January 1, 1987. See the instructions for Item X for the definition of qualified resident. If the foreign

corporation is exempt from such tax, skip Section III, Part I, but be sure to complete Items W and X at the bottom of page 5 of the form.

Partnerships engaged in a U.S. trade or business.—A foreign corporate partner of a partnership engaged in a U.S. trade or business is subject to the branch profits tax on its ECEP attributable to its distributive share of effectively connected income.

Foreign governments.—A foreign government is subject to both the branch profits tax and the branch-level interest taxes. However, no branch profits tax or branch-level interest taxes will be imposed on ECEP and interest accrued prior to September 11, 1992. See Regulations section 1.884-0.

Line 2

Attach a schedule showing the following adjustments (based on the principles of section 312) to the corporation's line 1 effectively connected taxable income (ECTI) (before the NOL deduction and special deductions) to get ECEP:

1. Positive adjustments for certain effectively connected income items that are excluded from ECTI but must be included in computing ECEP (such as tax-exempt interest income).
2. Positive adjustments for certain items deducted in computing ECTI but cannot be deducted in computing ECEP. Include adjustments for certain deductions claimed in computing ECTI, such as (a) excess of percentage depletion over cost depletion, (b) excess of accelerated depreciation over straight line depreciation (but only if 20% or more of the foreign corporation's gross income from all sources is U.S. source), and (c) capital loss carrybacks and carryovers.

3. Negative adjustments for certain deductible items (that are allocable to effectively connected income) that cannot be deducted in computing ECTI but must be deducted in computing ECEP (such as Federal income taxes, capital losses in excess of capital gains, and interest and expenses that are not deductible under section 265).

Note: Do not reduce ECEP by any dividends or other distributions made by the foreign corporation to its shareholders during the year.

See Temporary Regulations section 1.884-2T for any adjustments to ECEP due to a reorganization, liquidation, or incorporation.

Exceptions. Do not include the following types of income when computing ECEP:

1. Income from the operation of ships or aircraft that is exempt from taxation under section 883(a)(1) or (2).
2. FSC income and distributions treated as effectively connected income under section 921(d) or section 926(b) that are not otherwise effectively connected income.
3. Gain on the disposition of an interest in a domestic corporation that is a U.S. real property interest under section

897(c)(1)(A)(ii) if the gain is not otherwise effectively connected income.

4. Related person insurance company income that a taxpayer elects to treat as effectively connected income under section 953(c)(3)(C) if the income is not otherwise effectively connected income.

5. Income that is exempt from tax under section 892.

6. Interest income derived by a possession bank from U.S. obligations if the interest is treated as effectively connected income under section 882(e) and is not otherwise effectively connected income.

Note: Deductions and other adjustments attributable (under the principles of Regulations section 1.861-8) to the types of income not includible in ECEP listed above do not reduce ECEP.

Lines 4a and 4b. U.S. Net Equity

U.S. net equity is U.S. assets reduced by U.S. liabilities. U.S. net equity may be less than zero. See Temporary Regulations section 1.884-2T for specific rules regarding the computation of the foreign corporation's U.S. net equity in the event of a reorganization, liquidation, or incorporation.

In general, property is a U.S. asset if all income from its use and all gain from its disposition (if used or sold on the last day of the tax year) are or would be effectively connected income. The amount of property taken into account as a U.S. asset is the adjusted basis (for purposes of computing earnings and profits) of the property. Special rules exist for specific types of property, such as depreciable property, inventory, and installment obligations. Special rules also exist to determine the amount of a partnership interest that is treated as a U.S. asset. See Regulations section 1.884-1(d).

In general, U.S. liabilities are U.S.-connected liabilities of a foreign corporation under Regulations section 1.882-5, computed as of the end of the tax year, rather than as an average, as required under Regulations section 1.882-5. Special rules may apply to foreign insurance companies. See Regulations section 1.884-1(e) for more details.

Election to reduce liabilities.—If the corporation is electing to reduce liabilities according to Regulations section 1.884-1(e)(3), attach a statement that it is making the election and indicate the amount of the reduction of U.S. liabilities and the corresponding reduction in interest expense.

Reporting requirements for schedules for lines 4a and 4b.—Report U.S. assets according to the categories of U.S. assets in Regulations section 1.884-1(d).

For U.S. liabilities, show the formula used to calculate the U.S. liabilities figure.

Line 6. Branch Profits Tax

Qualification for treaty benefits.—In general, a foreign corporation must be a qualified resident (see the instructions for Item X) in the tax year in which it has a

dividend equivalent amount to obtain treaty benefits for the branch profits tax. It must also meet the requirements of any limitation on benefits article in the treaty. However, a foreign corporation is not required to be a qualified resident if it meets the requirements of a limitation on benefits article that entered into force after December 31, 1986. Treaties other than income tax treaties do not exempt a foreign corporation from the branch profits tax.

Note: If a foreign corporation claims to be a qualified resident based on the two-part stock ownership and base erosion test, a special rule governs the period during which a foreign corporation must be a qualified resident. (See the instructions for Item X.)

Rate of tax.—If treaty benefits apply, the rate of tax is the rate on branch profits specified in the treaty. If the treaty does not specify a rate for branch profits, the rate of tax is the rate specified in the treaty for dividends paid by a wholly owned domestic corporation to the foreign corporation. See Regulations section 1.884-1(g) for applicable rates of tax. Benefits other than a rate reduction may be available under certain treaties, such as the Canadian income tax treaty.

Effect of complete termination.—If the foreign corporation has completely terminated its U.S. trade or business (within the meaning of Temporary Regulations section 1.884-2T(a)) during the tax year, enter zero on line 6, and complete Item V. In general, a foreign corporation has terminated its U.S. trade or business if it no longer has any U.S. assets, except those retained to pay off liabilities. The foreign corporation (or a related corporation) may not use assets from the terminated U.S. trade or business or the proceeds from their sale in a U.S. trade or business within 3 years after the complete termination.

Coordination with withholding tax.—In general, if a foreign corporation is subject to the branch profits tax in a tax year, it will not be subject to withholding at source (sections 871(a), 881(a), 1441, or 1442) on dividends paid out of earnings and profits for the tax year.

Part II—Tax on Excess Interest

If a foreign corporation is engaged in a U.S. trade or business, has effectively connected gross income, or has U.S. assets for purposes of Regulations section 1.882-5, it is subject to the tax on excess interest. Excess interest is the interest apportioned to effectively connected income of the foreign corporation (including capitalized and nondeductible interest) under Regulations section 1.882-5, less branch interest. Branch interest is the interest paid by the U.S. trade or business of the foreign corporation (including capitalized and other nondeductible interest).

Corporations exempt from the tax on excess interest.—See the instructions for line 10 below to determine if the foreign corporation is exempt. If it is exempt from

the tax, and not simply subject to a reduced rate of tax, skip Section III, Part II, but be sure to complete Items W and X at the bottom of page 5 of the form.

Line 8. Branch Interest

Foreign banks.—In general, branch interest of a foreign bank is limited to (a) interest paid for branch liabilities that are reported to bank regulatory authorities; (b) interest paid for offshore shell branches, if the U.S. branch performs substantially all the activities required to incur the liability; and (c) interest on liabilities that are secured predominantly by U.S. assets or that cause certain nondeductible interest (such as capitalized interest) related to U.S. assets.

All other foreign corporations.—In general, branch interest of foreign corporations (other than banks) includes (a) interest on liabilities shown on the books and records of the U.S. trade or business for purposes of Regulations section 1.882-5; (b) interest on liabilities that are secured predominantly by U.S. assets or that cause certain nondeductible interest (such as capitalized interest) related to U.S. assets; and (c) interest on liabilities identified as liabilities of the U.S. trade or business on or before the earlier of the date on which the first interest payment is made or the due date (including extensions) of the foreign corporation's income tax return for the tax year. However, a liability may not be identified under (c) if the liability is incurred in the ordinary course of the foreign corporation's trade or business, or if the liability is secured predominantly by assets that are not U.S. assets. The interest on liabilities identified in (c) that will be treated as interest paid by the U.S. trade or business is capped at 85% of the interest of the foreign corporation that would be excess interest before considering interest on liabilities identified in (c) above. See Regulations section 1.884-4.

Interbranch interest.—Any interest paid for interbranch liabilities is disregarded in computing branch interest of any corporation.

Eighty-percent rule.—If 80% or more of a foreign corporation's assets are U.S. assets, the foreign corporation's branch interest will generally equal the interest reported on line 7. However, any interest included on line 7 that has accrued but has not been paid will not be treated as branch interest on line 8 unless an election is made under Regulations section 1.884-4(c)(1) to treat such interest as paid in that year for all purposes of the Code. If this 80% rule applies, check the box on line 8.

Note: Branch interest of a foreign corporation is treated as if paid by a domestic corporation. A foreign corporation is thus required to withhold on interest paid by its U.S. trade or business to foreign persons (unless the interest is exempt from withholding under a treaty or the Code) and is required to file Forms 1042 and 1042-S for the payments as required under Regulations sections 1.1461-2 and 35a.9999-5.

Caution: Special treaty shopping rules apply if the recipient of the interest paid by the U.S. trade or business is a foreign corporation.

Line 9b

A foreign bank may treat a percentage of its excess interest as if it were interest on deposits and thus exempt from tax. Multiply the amount on line 9a by the greater of 85% or the ratio of the foreign bank's worldwide interest-bearing deposits to its worldwide interest-bearing liabilities as of the close of the tax year.

Line 10. Tax on Excess Interest

The rate of tax on excess interest is the same rate that would apply to interest paid to the foreign corporation by a wholly owned domestic corporation. The tax on excess interest is not prohibited by any provision in any treaty to which the United States is a party. The corporation may qualify for treaty benefits if it meets certain requirements. See the instructions for line 6 above and **Item X** below. The corporation is exempt from the tax on excess interest if the rate of tax that would apply to interest paid to the foreign corporation by a wholly owned domestic corporation is zero and the foreign corporation qualifies for treaty benefits.

Additional Information Required

Be sure to complete all additional information on page 5 that applies to the corporation.

Item X

Definition of qualified resident.—A foreign corporation is a qualified resident of a country if it meets one of the three tests explained below. See the regulations under section 884 for detailed rules on these tests and certain circumstances in which a foreign corporation that does not meet these tests may obtain a ruling that it will be treated as a qualified resident.

Two-part ownership and base erosion test. A foreign corporation meets this test if (1) more than 50% of its stock (by value) is owned (directly or indirectly) during at least half the number of days in the tax year by qualifying shareholders, and (2) less than 50% of its income is used (directly or indirectly) to meet liabilities to persons who are not residents of such foreign country or U.S. citizens or residents. For this test, individuals resident in the foreign country, U.S. citizens and residents, governments of foreign countries, and foreign corporations that meet the publicly traded test (described later) are treated as qualifying shareholders.

In general, stock owned by a corporation, partnership, trust, or estate is treated as proportionately owned by the individual owners of such entities.

In order to satisfy the 50% stock ownership test described above, a foreign corporation must, before filing Form

1120-F for the tax year, obtain certain written documentation from the requisite number of its direct and indirect shareholders to show that it meets the test, including a certificate of residency from each foreign individual resident signed by the Competent Authority of the individual's country of residence. See Regulations sections 1.884-5(a) through (c).

If a foreign corporation is a qualified resident under this test and a portion of its dividend equivalent amount for the tax year is from ECEP earned in prior tax years, the foreign corporation will be entitled to treaty benefits for the entire dividend equivalent amount only if (a) the foreign corporation was a qualified resident for all tax years within the 36-month period that includes the tax year of the dividend equivalent amount, or (b) the foreign corporation was a qualified resident for the tax year of the dividend equivalent amount and for the years in which the ECEP included in the dividend equivalent amount were earned. If the foreign corporation fails the 36-month test but is a qualified resident for the tax year, the portion of the dividend equivalent amount for ECEP from any prior tax year will not be entitled to treaty benefits if the foreign corporation was not a qualified resident for the tax year in which the ECEP was earned. Thus, in some instances, more than one rate of tax may apply to the dividend equivalent amount reported on line 5, Section III. See Regulations section 1.884-1(g)(2).

Publicly traded test. A foreign corporation meets this test if (1) its stock is primarily and regularly traded on one or more established securities markets in its

country of residence or the United States, or (2) 90% or more of its stock is owned (directly or indirectly) by another corporation that meets the requirements of (1) and is a resident of the same country or is a domestic corporation. See Regulations section 1.884-5(d).

Active trade or business test. A foreign corporation meets this test if it has a substantial presence in its country of residence and its U.S. trade or business is an integral part of an active trade or business conducted by the foreign corporation in its country of residence. See Regulations section 1.884-5(e).

Schedules L, M-1, and M-2

A foreign corporation may limit Schedules L, M-1, and M-2 to:

1. The corporation's U.S. assets and its other assets effectively connected with its U.S. trade or business and liabilities reported on its U.S. books and records; and
 2. Its effectively connected income and its other U.S. source income.
- Do not complete Schedules M-1 and M-2 if total assets at the end of the tax year (line 15, column (d) of Schedule L) are less than \$25,000.

Schedule L—Balance Sheets

Line 5. Tax-exempt securities.—Include:

1. State and local government obligations, the interest on which is excludible from gross income under section 103(a); and

2. Stock in a mutual fund or other regulated investment company that distributed exempt-interest dividends during the tax year of the corporation.

Schedule M-1

Reconciliation of Income or (Loss) per Books With Income per Return

Line 5c. Travel and entertainment expenses.—Include any of the following:

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

For more information, see Pub. 542.

Line 7a. Tax-exempt interest.—Include any exempt-interest dividends received as a shareholder in a mutual fund or other regulated investment company.

Codes for Principal Business Activity

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

Using the list below, enter on page 1, under Question F, the code number for the specific

industry group from which the largest percentage of total receipts is derived. "Total receipts" means gross receipts (line 1a, page 3) plus all other income (lines 4 through 10, page 3).

Also, on page 1, under Question F, state the principal business activity and principal product or service that account for the largest percentage of total receipts. For example, if the principal business

activity is "Grain mill products," the principal product or service may be "Cereal preparations."

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

Agriculture, Forestry, and Fishing	Code	Transportation and Public Utilities	Finance, Insurance, and Real Estate
Code		Code	Code
Chemicals and allied products:		Transportation:	Banking:
2815 Industrial chemicals, plastics materials and synthetics.		4000 Railroad transportation.	6030 Mutual savings banks.
2830 Drugs.		4100 Local and interurban passenger transit.	6060 Bank holding companies.
2840 Soap, cleaners, and toilet goods.		4200 Trucking and warehousing.	6090 Banks, except mutual savings banks and bank holding companies.
2850 Paints and allied products.		4400 Water transportation.	
2898 Agricultural and other chemical products.		4500 Transportation by air.	
Petroleum refining and related industries (including those integrated with extraction):		4600 Pipe lines, except natural gas.	
2910 Petroleum refining (including integrated).		4700 Miscellaneous transportation services.	
2998 Other petroleum and coal products.		Communication:	
Rubber and misc. plastics products:		4825 Telephone, telegraph, and other communication services.	
3050 Rubber products, plastics footwear, hose and belting.		4830 Radio and television broadcasting.	
3070 Miscellaneous plastics products.		Electric, gas, and sanitary services:	
Leather and leather products:		4910 Electric services.	
3140 Footwear, except rubber.		4920 Gas production and distribution.	
3198 Other leather and leather products.		4930 Combination utility services.	
Stone, clay, and glass products:		4990 Water supply and other sanitary services.	
3225 Glass products.		Wholesale Trade	
3240 Cement, hydraulic.		Durable:	
3270 Concrete, gypsum, and plaster products.		5008 Machinery, equipment, and supplies.	
3298 Other nonmetallic mineral products.		5010 Motor vehicles and automotive equipment.	
Primary metal industries:		5020 Furniture and home furnishings.	
3370 Ferrous metal industries: misc. primary metal products.		5030 Lumber and construction materials.	
3380 Nonferrous metal industries.		5040 Sporting, recreational, photographic, and hobby goods, toys and supplies.	
Fabricated metal products:		5050 Metals and minerals, except petroleum and scrap.	
3410 Metal cans and shipping containers.		5060 Electrical goods.	
3428 Cutlery, hand tools, and hardware; screw machine products, bolts, and similar products.		5070 Hardware, plumbing and heating equipment and supplies.	
3430 Plumbing and heating, except electric and warm air.		5098 Other durable goods.	
3440 Fabricated structural metal products.		Nondurable:	
3460 Metal forgings and stampings.		5110 Paper and paper products.	
3470 Coating, engraving, and allied services.		5129 Drugs, drug proprietaries, and druggists' sundries.	
3480 Ordnance and accessories, except vehicles and guided missiles.		5130 Apparel, piece goods, and notions.	
3490 Misc. fabricated metal products.		5140 Groceries and related products.	
Machinery, except electrical:		5150 Farm-product raw materials.	
3520 Farm machinery.		5160 Chemicals and allied products.	
3530 Construction and related machinery.		5170 Petroleum and petroleum products.	
3540 Metalworking machinery.		5180 Alcoholic beverages.	
3550 Special industry machinery.		5190 Miscellaneous nondurable goods.	
3560 General industrial machinery.		Retail Trade	
3570 Office, computing, and accounting machines.		Building materials, garden supplies, and mobile home dealers:	
3598 Other machinery except electrical.		5220 Building materials dealers.	
Electrical and electronic equipment:		5251 Hardware stores.	
3630 Household appliances.		5265 Garden supplies and mobile home dealers.	
3665 Radio, television, and communication equipment.		5300 General merchandise stores.	
3670 Electronic components and accessories.		Food stores:	
3698 Other electrical equipment.		5410 Grocery stores.	
3710 Motor vehicles and equipment.		5490 Other food stores.	
Transportation equipment, except motor vehicles:		Automotive dealers and service stations:	
3725 Aircraft, guided missiles and parts.		5515 Motor vehicle dealers.	
3730 Ship and boat building and repairing.		5541 Gasoline service stations.	
3798 Other transportation equipment, except motor vehicles.		5598 Other automotive dealers.	
Instruments and related products:		5600 Apparel and accessory stores.	
3815 Scientific instruments and measuring devices; watches and clocks.		5700 Furniture and home furnishings stores.	
3845 Optical, medical, and ophthalmic goods.		5800 Eating and drinking places.	
3860 Photographic equipment and supplies.		Misc. retail stores:	
3998 Other manufacturing products.		5912 Drug stores and proprietary stores.	



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