

## Section 5

## Explanation of Terms

This section defines the terms used in the tables in this report, including adjustments made in preparing the statistics and limitations of the data items. These explanations are designed to aid the user in interpreting the statistical content of this report and should not be construed as interpretations of the Internal Revenue Code or policies of the Internal Revenue Service. Code sections cited were those in effect for the Tax Years of the report. Whenever a year is cited, it refers to the calendar year, unless otherwise stated. The line references given for the terms correspond to the Form 1120, unless indicated otherwise; in most tables, items taken from other forms (1120-A, 1120-F, etc.) and attached schedules were conformed to the Form 1120 format. Although many standardizing adjustments were made during statistical processing of the returns, the data presented are unaudited as reported by taxpayers and so are subject to taxpayer errors and misinterpretations, as well as statistical variability and whatever errors may have arisen during processing of the returns (see "Data Limitations and Measures of Variability" in Section 3). Definitions marked with the symbol  $\Delta$  have been revised for 2001 to reflect changes in the law.

### Accounting Periods

In some tables, the data were classified according to the ending dates of the accounting periods covered by the corporations' returns. Returns were generally filed covering an annual accounting period; most of the larger corporations filed returns for accounting periods ending in December (a calendar year period). Returns could also be filed for only part of a year in some circumstances. Part-year returns were filed as a result of business organizations or reorganizations, mergers, liquidations, or changes to new accounting periods. Income and tax data from part-year returns were included in the statistics, but balance sheet data usually were not; see "Balance Sheets" below.

Figure B in Section 1 shows the number of returns filed for each of the accounting periods covered in this report. For a discussion of this classification, see "Time Period Employed" in Section 1, Introduction.

### Accounts and Notes Payable

This balance sheet item appearing in Tables 4 and 5 was the sum of "Accounts Payable" and

"Mortgages, Notes, and Bonds Payable in Less Than One Year." Each of these is described under its own heading below.

### Accounts Payable

[Page 4, Schedule L, Line 16(d)]

This balance sheet account consisted of relatively short-term liabilities arising from the conduct of trade or business and not secured by promissory notes.

### Additional Inventory Costs (Section 263A)

[Page 2, Schedule A, Line 4]

This component of cost of goods sold on the return form included certain inventory costs capitalized by taxpayers electing to use a simplified method of accounting under the uniform capitalization rules of section 263A. However, the statistics in this report do not follow the uniform capitalization rules with respect to several deduction items. Certain accrued expenses that were required to be capitalized under the uniform capitalization rules, such as depreciation, were included in these statistics as current deductions whenever they could be identified. See "Cost of Goods Sold" below.

### Additional Paid-In Capital

[Page 4, Schedule L, Line 23(d)]

This balance sheet item comprised additions to the corporation's capital from sources other than earnings. These sources included receipts from the sale of capital stock in excess of stated value, stock redemptions or conversions, and similar transactions. The amounts shown were after deducting any negative amounts.

### Adjustments to Shareholders' Equity

[Page 4, Schedule L, Line 26(d)]

See "Retained Earnings, Unappropriated."

### Advertising

[Page 1, Line 23]

Advertising expenses were allowed as a deduction under Code section 263(b) if they were ordinary and necessary and bore a reasonable relationship to the trade or business of the corporation. The amount shown in the statistics included advertising identified as part of the cost of goods sold, or capitalized under section 263A, as well as advertising reported separately as a

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business deduction. The statistics include combined amounts reported as advertising and promotion and advertising and publicity. They do not include the costs incurred by publishers, broadcasters, and similar businesses in preparing advertisements for others, which were generally treated as part of the cost of goods sold.

For corporations that filed the short form income tax return, Form 1120-A, advertising identified in other deductions or attached schedules was included in the statistics for advertising.

### Alcohol Fuel Credit [Form 6478]

An income tax credit was available for alcohol (other than alcohol produced from petroleum, natural gas, or coal) used as a motor fuel, either alone or in a mixture. In general, the alcohol fuel credit was the sum of the alcohol mixture credit, the alcohol credit, and the small ethanol producer credit. The amount was 60 cents per gallon for alcohol of at least 190 proof and 45 cents per gallon for alcohol between 150 and 190 proof. No credit was available for alcohol of less than 150 proof. The alcohol mixture credit was for alcohol used in the production of a qualified mixture fuel used by the producer or sold in a trade or business. The small ethanol producer credit was allowable for an ethanol producer in the amount of 10 cents per gallon for up to 15 million gallons per year. The credit was claimed as one of the components of the general business credit. For a discussion of the income tax limitations and carryback and carryforward provisions of the credit, see "General Business Credit" in this section. The components of the general business credit are shown separately in Table 21.

### Allowance for Bad Debts

[Page 4, Schedule L, Line 2b(c)]

This balance sheet account was the allowance or reserve set aside to cover uncollectable or doubtful notes, accounts, and loans, usually shown, as it is on the Form 1120, as an adjustment to notes and accounts receivable. A few corporations, however, reported only net receivables and thus did not show their allowance for bad debts. Many banks and savings and loan associations included reserves for uncollectable mortgages and real estate loans in the allowance for bad debts, and these amounts were also transferred to this item if identified on supporting schedules during statistical processing.

The allowance for bad debts was a book account that was not necessarily related to the deduction for bad debts allowed for tax purposes (see "Bad Debts" in this section).

### Alternative Minimum Tax

[Form 4626, Line 15]

The alternative minimum tax (AMT) was designed to ensure that at least a minimum amount of income tax was paid in spite of the legitimate use of exclusions, deductions, and credits. In effect, it provided a second tax system that curtailed or eliminated many of the means of reducing taxes allowed in the regular tax system and taxed the resulting "alternative" taxable income at a reduced rate.

For Tax Years beginning after 1997, a small corporation was not subject to the Alternative Minimum Tax. Generally, a corporation was considered small for AMT purposes if its average annual gross receipts for three years prior to the 2000 Tax Year (and after Tax Year 1993) was \$7.5 million or less and its average annual gross receipts for 1994 through 1996 did not exceed \$5 million. New corporations were also exempt from the AMT.

The basic computation of the alternative minimum tax is shown in Table 23 in this report. This computation involved recomputing taxable income from the regular tax by adding or subtracting items that were allowable in both systems but in different tax years or under different rules ("adjustment items"), adding back deductions not allowed under the minimum tax ("tax preference items"), and adding or subtracting items from the corporations' books not accounted for elsewhere (the "adjusted current earnings" computation). A net operating loss deduction, computed using the AMT rules for what constitutes a loss, was allowed but limited to 90 percent of alternative minimum taxable income (AMTI). The excess of AMTI over a \$40,000 exemption was taxed at a flat rate of 20 percent. The \$40,000 exemption was phased out at higher income levels; corporations with AMTI of \$310,000 or more were allowed no exemption. The only credit allowed against the AMT was the credit for foreign taxes, recomputed using the rules for computing AMTI; in most cases, it could not offset more than 90 percent of AMT. The result of this computation was the "tentative minimum tax"; the excess of this tentative amount over the regular income tax was the legally defined alternative minimum tax, which was paid in addition to the regular tax.

Most of the following adjustment and preference items could be either additions or subtractions in computing alternative minimum taxable income. The few exceptions are noted.

- (1) **Depreciation of tangible property placed in service after 1986.** This was the difference between the accelerated

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- depreciation allowed under the regular tax rules and the slower depreciation allowed under the AMT. Generally, the adjustment increased AMTI in the early years of a property's life and decreased it in later years. Certain types of property were exempt from refiguring depreciation for AMT purposes.
- (2) **Amortization of certified pollution control facilities.** This was the difference between the rapid amortization of pollution control facilities allowed under the regular tax and the deduction under the depreciation system used for the AMT.
- (3) **Amortization of mining exploration and development costs.** This was the difference between the regular tax deduction allowed for these expenses and that allowed by the AMT rules, which required that the expenses be capitalized and amortized over 10 years.
- (4) **Circulation expenses.** (personal holding companies only). This was the difference between the regular tax deduction allowed these expenses and the AMT requirement that they be capitalized and deducted ratably over 3 years. This was considered a tax preference only for individuals and personal holding companies.
- (5) **Adjusted gain or loss.** Because many of the differences between the regular tax and the AMT affect the calculation of property's basis for determining gain or loss from its sale or exchange, gain or loss had to be recomputed for AMT purposes. This item was the difference (positive or negative) between the two gains or losses.
- (6) **Long-term contracts.** Long-term contracts, except some home construction contracts, were required to use the percentage-of-completion method to determine current income for the AMT. This item was the difference between the current year's income from the contract under this method and the methods allowed for the regular tax.
- (7) **Installment sales.** Generally, this was the negative of installment sale income reported for regular tax.
- (8) **Merchant marine capital construction funds.** For the regular tax, some maritime
- companies were allowed to deduct profits deposited in a fund for constructing new ships, and neither the fund nor the interest it earned was taxed until the money was withdrawn. This deferral was not allowed under the AMT, and any such deductions or interest had to be included in AMTI.
- (9) **Section 833(b) deduction.** Under this section of the Internal Revenue Code, Blue Cross/Blue Shield companies and similar health insurers were allowed a special deduction from their regular taxable income that was not allowed for AMT purposes. This item was the amount of any deduction taken in the current year.
- (10) **Tax shelter farm activities.** (personal service corporations only). This was the difference between farm gains and losses computed under the regular tax rules and those computed using all the AMT accounting rules. It applied only to personal service corporations with farming operations that were "tax shelters" as defined in section 58(a)(2) but not "passive activities."
- (11) **Passive activities.** (closely held and personal service corporations only). This was the difference between gains and losses from passive activities as reported for regular tax purposes and as recomputed using all the AMT accounting rules.
- (12) **Loss limitations.** This was the difference between gains and losses computed under the different rules of the regular tax and AMT systems where the at-risk and partnership limitations applied in the regular tax.
- (13) **Depletion.** The depletion deduction under both the regular tax and the AMT was limited by the net income from the depletable property if percentage depletion was used; in addition, depletion under the AMT was limited to a taxpayer's basis in the property. This item is the difference between depletion figured under the regular tax rules and depletion limited by AMT net income and the AMT basis limitation.
- (14) **Tax-exempt interest from private activity bonds.** Interest from private activity bonds issued after August 7, 1986 used to finance private activity that was still tax exempt under the special exceptions in the regular tax was subject to the AMT and so was an addition to AMTI.

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- (15) **Intangible drilling costs.** Generally, some of the intangible drilling costs for oil, gas, and geothermal wells that were deductible as current expenses for the regular tax had to be capitalized and written off over 10 years for the AMT. If the difference between the two systems exceeded 65 percent of the net income from the properties, the excess was included in AMTI.
- (16) **Accelerated depreciation of real property (pre-1987).** Buildings placed in service in the early 1980s were eligible for accelerated depreciation methods under the regular tax; for AMT purposes, any current depreciation deductions on these buildings had to be recalculated using the straight-line method of depreciation and any positive difference included in AMTI.
- (17) **Accelerated depreciation of leased personal property (pre-1987).** (personal holding companies only). The difference between the more liberal pre-1987 regular tax rules and the current year's AMT rules for depreciation of personal property had to be included in AMTI by personal holding companies if the difference was positive.
- (18) **Other adjustments.** This item covered necessary adjustments to allow for changes made to limitation amounts by AMT calculations, an allowance for the possessions tax credit and the alcohol fuel credit, and AMT adjustments from estates, trusts, large partnerships, or cooperatives.

After all adjustments and preferences had been included in AMTI, a catch-all adjustment, called the **"Adjusted current earnings (ACE) adjustment after excess"** was added to or subtracted from the income base. The ACE adjustment took into account items whose tax treatment offered tax advantages but that were not otherwise included in the AMT (such as tax-exempt interest). The "excess" (if any) was the corporation's total increase in AMTI from the prior year ACE adjustment over its total reductions in AMTI from prior ACE adjustments.

### Amortization D

Amortization was a deduction for the recovery of the costs of long-lived intangible assets similar to the depreciation deduction to recover the costs of tangible assets. It was also used in the IR Code for recovery of the costs of some tangible assets, usually as a tax preference for those assets. Most amortization is calculated on a straight-line basis over recovery periods specified in the IR Code.

Although amortization is not a line item on the corporation income tax return, for statistical purposes, specific types of amortization were edited from attached schedules (for cost of goods sold or other deductions, for example) and included in this item in the tables. Because it is not a separate line item, the statistics for this item may be less reliable than for other deduction items.

Amortization of the following types was included in this heading when identifiable on tax returns:

- (1) **Section 197 intangibles.** Purchased goodwill and other "going concern" intangibles, customer-based intangibles, licenses, franchises, and most other purchased intangible assets not included elsewhere were amortizable over a 15-year life.
- (2) **Pollution control facilities (section 169).** 20 percent of the basis of depreciable property used to reduce pollution could be written off over 5 years instead of being depreciated.
- (3) **Bond premiums (section 171).** Premiums on bonds acquired before 1988 were amortized over the life of the bond; for bonds acquired after 1987, the pro-rata bond premium was an offset to the interest earned and was not included here.
- (4) **Research and experimental expenditures (section 174).** Any such expenditures not expensed or taken as a tax credit could be amortized over 5 years.
- (5) **Lease acquisition costs (section 178).** Such costs could be amortized over the period of the lease.
- (6) **Qualified reforestation expenses (section 194).** Up to \$10,000 of each year's capital expenditures for planting or replanting forests could be deducted ratably over 7 years.
- (7) **Qualified revitalization expenditures (section 1400I).** These are certain capital expenditures that relate to a qualified revitalization building located in an area designated as a renewal community.
- (8) **Business start-up expenditures (section 195).** Taxpayers could elect to write off such expenses over 5 years.

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(9) **Organizational expenditures of corporations (section 248).** These expenditures were amortized over 5 years.

(10) **Optional write-off of certain tax preferences (section 59(e)).** Taxpayers could avoid including some tax preference items in the minimum tax by electing to capitalize and amortize rather than deduct the expenses. These options included 3-year amortization of circulation expenses (section 173), 10-year amortization of research and experimental expenditures (section 174), 5-year amortization of intangible drilling costs (section 263) (but see below), and 10-year amortization of mining exploration and development expenses (sections 616 and 617).

Amortization of intangible drilling costs was excluded from this heading when it could be identified; instead, it was included in "Other deductions" in the statistics.

### Bad Debts

[Page 1, Line 15]

Bad debts occurring during the year were allowed as a deduction under Code section 166. For most businesses, the deduction was allowed only for debts actually written off as uncollectable; additions to reserves, even if that was the taxpayer's normal method of accounting for bad debts, were not deductible. However, "small" banks with total assets of \$500,000,000 or less were allowed under section 585 to deduct additions to bad debt reserves based on their own experience of bad debt losses.

### Balance Sheets

[Page 4, Schedule L]

The balance sheet data presented in this report were the amounts reported by the taxpayer (when available) as of the end of the taxpayer's accounting year. Taxpayers were instructed to provide data that agreed with their books of account but were given very few other guidelines. Thus, the statistics for balance sheets contained considerably more reporting variability than those for the income statement and tax computation items, which were the subject of more detailed instructions and more intense scrutiny during IRS processing.

Since balance sheet data were from the taxpayers' books, they were generally governed by general accounting principles rather than the special rules of tax accounting. Where these rules diverged significantly, the balance sheet statistics could show little relationship to the income statement accounts. Inventories, accumulated depletion, depreciation,

and amortization, accrued tax and other liability accounts, and other capitalized items were often recorded on different bases for tax and book purposes.

A number of steps were taken during statistical processing to reduce the variability due to taxpayer reporting practices. Misreported amounts were transferred to their proper accounts; amounts from attached schedules were edited into the Schedule L format; and missing balance sheets were either supplied from reference books (if possible), or statistically imputed based on other data on the return and the company's characteristics.

Some balance sheets were suppressed (or not imputed) during statistical processing. (These companies appear in the tables in the "zero-assets" category.) The balance sheets of foreign corporations were not included (with one exception) because it was not possible to separate U.S. assets from foreign ones. Foreign insurance companies were the exception; they are required to report U.S. assets segregated from foreign ones. Final returns of corporations going out of existence were not permitted balance sheets, because they should have either had zero assets (if liquidating) or assets included in some other corporation's return (if merging). And balance sheet data were not included from most part-year returns, because the same company's end-of-year data could have been subject to inclusion from its complete return.

### Branch Tax

[Form 1120-F, Page 1, Line 3]

This was an additional tax imposed under Code section 884 on the after-income-tax U.S. earnings and profits of a foreign corporation that were not invested in a U.S. trade or business. The tax also applied to certain interest payments from income that was earned in U.S. operations. The provisions were designed to impose a tax on foreign companies' branches similar to the withholding tax on dividends and interest imposed on foreign-owned subsidiaries incorporated in the U.S. Like the withholding tax, the rate was set in the law at 30 percent, but that rate was only applicable if the U.S. had no tax treaty with the companies' home country setting a different rate (which could be zero).

The branch profits tax was imposed on the "dividend equivalent" amount of the earnings and profits of a U.S. branch of a foreign corporation that was attributable to its income effectively connected (or treated as effectively connected under Code section 897) with a U.S. trade or business. The effectively connected earnings and profits were (1) reduced to reflect any reinvestment of the branch's

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earnings in assets in the U.S. trade or business (or reduce liabilities in the U.S. trade or business) and (2) increased to reflect any prior reinvested earnings that were considered remitted to the home office of the foreign corporation.

Certain earnings and profits attributable to income effectively connected with a U.S. trade or business were exempt from the branch profits tax. The tax exempt earnings included: (1) certain earnings of a foreign sales corporation as described in Code sections 921(d) and 926(b); (2) earnings of foreign transportation carriers (such as ships and aircraft) that were exempt from U.S. tax by reciprocal exemption; (3) earnings derived from the sale of any interest in U.S. real property holding corporations; (4) interest income derived by a possession bank from U.S. obligations as described in Code section 882(e); (5) earnings derived by certain insurance companies which elected to have income treated as effectively connected income; and (6) income of foreign governments and international organizations exempt under Code section 892.

The branch tax was the sum of the tax imposed on the earnings and profits and interest payments of the foreign corporation. The branch tax was reported on the Form 1120-F, U.S. Income Tax Return of a Foreign Corporation. The tax was included in Total Income Tax in the statistics. It was also shown separately in the statistics for foreign corporations with U.S. business operations in Tables 10 and 11.

### **Business Receipts**

[Page 1, Line 1(c)]

Business receipts were the gross operating receipts of the corporation reduced by the cost of returned goods and allowances. Generally, they represented all of a corporation's receipts except investment and incidental income. Business receipts may also have included sales and excise taxes that were included in the sales price of products; some corporations reported this way, while others reported their receipts after adjustment for these taxes.

Business receipts included rents reported by real estate operators as well as by other corporations for which rent made up a significant portion of income. The latter corporations included manufacturers that rented their products, lessors of docks, warehouses, pipelines, and other public utility facilities, and companies engaged in rental services, such as providing lodging places and the rental of automobiles or clothing.

For banks and other financial institutions whose principal income was interest, business receipts consisted of fees, commissions, credit card income, and other operating receipts; interest was reported under that heading and included so in the statistics. Banks' business receipts also included profit from Federal funds transactions; if the bank reported gross sales and purchases, the amounts were netted during statistical processing. Likewise, security dealers included profit from security trades in business receipts; if gross amounts were reported, costs and sales proceeds were netted during statistical processing. Regulated investment companies and real estate investment trusts did not report business receipts; all of their income was included in the investment income categories in the statistics.

Business receipts for insurance companies consisted of premium income. Some small property and casualty insurance companies, however, could elect to be taxed only on investment income and thus would have reported no business receipts, and other, smaller, companies were exempt from tax altogether. Property and casualty insurance companies with premium income of \$1,200,000 or less could elect (under section 831(b)(2)) to be taxed on only investment income; such companies with premiums of \$350,000 or less were exempt from tax under section 501(c)(15).

For all industries, business receipts excluded gains from the sale of assets. See "Net Gain (or Loss), Noncapital Assets" and "Net Capital Gains," below.

### **Capital Gains Tax (1120-RIC) D**

[Form 1120-RIC, Page 2, Sch.J, Line 3b]

Regulated investment companies that did not distribute all of their capital gains to their shareholders were taxed at the regular corporate rates on the undistributed gain. This tax is a component of "Total Income Tax Before Credits."

### **Capital Stock**

[Page 4, Schedule L, Line 22(d)]

This end-of-year balance sheet equity item included amounts shown for outstanding shares of both common and preferred stock.

### **Cash**

[Page 4, Schedule L, Line 1(d)]

This balance sheet asset item included the amount of actual money or instruments and claims which were usable and acceptable as money on

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hand at the end of the taxable year, including certificates of deposit.

### Cash and Property Except Own Stock

[Page 4, Schedule M1, Line 5(a) & 5(c)]

Cash distributions are distributions from the earnings and profits of the distributing corporation, made in cash, to shareholders outside the consolidation. Property distributions, other than corporation's own stock, are distributions made to shareholders outside the consolidation that consist of the actual property of the distributing corporation, other than cash or shares of the distribution corporation's own stock.

### Cash, U.S. Government Obligations, Tax-Exempt Securities, and Other Current Assets

This item shown in Tables 4 and 5 is the sum of "Cash," "U.S. Government Obligations," "Tax-Exempt Securities," and "Other Current Assets." Each of these is described under its own heading in this section.

### Compensation of Officers

[Page 1, Line 12]

Salaries, wages, stock bonuses, bonds, and other forms of compensation were included in this deduction item if they were identified as having been paid to officers for personal services rendered. It did not include qualified deferred compensation, such as contributions to a 401(k) plan or a salary reduction agreement, which were included in the statistics for pensions and profit sharing plans. The item included amounts reported as a part of cost of goods sold or capitalized under section 263A.

The deductible compensation of certain officers of publicly held corporations was limited under section 162(m) to \$1,000,000 or less. However, the limit did not apply to commissions or other compensation based on performance or if the officer worked under a binding contract in effect on February 17, 1993.

### Consolidated Returns

Consolidated returns were income tax returns that contained the combined financial data of two or more corporations meeting the following requirements: (1) a common parent corporation owned at least 80 percent of the voting power of all classes of stock and at least 80 percent of each class of nonvoting stock (except stock which was limited and preferred as to dividends) of at least one member of the group; and (2) these same proportions of stock of each other member of the group were owned within the group.

Corporations electing to file consolidated returns in one year had to file consolidated returns in subsequent years, with certain exceptions. The consolidated filing privilege could be granted to all affiliated domestic corporations connected through stock ownership with a common parent corporation except: (1) regulated investment companies; (2) real estate investment trusts (REITs) who did not consolidate with qualified REIT subsidiaries; (3) corporations for which an election to be treated as a possessions corporation under Code section 936(e) was in effect; (4) corporations designated tax-exempt under Code section 501; (5) Domestic International Sales Corporations (DISC); and (6) S corporations.

Under Code section 1504(c), life insurance companies could file consolidated returns with other life insurance companies without restriction. Also, a non-life insurance parent could include a life insurance subsidiary subject to certain restrictions (e.g., the insurance company must have been a member of the controlled group for at least 5 years).

A consolidated return filed by the common parent company was treated as a unit, each statistical classification being determined on the basis of the combined data of the affiliated group. Therefore, filing changes to or from a consolidated return basis affect year-to-year comparability of certain statistics (such as data classified by industry and size of total assets). Data on consolidated returns are shown in Table 19.

### Constructive Taxable Income from Related Foreign Corporations

This item was the sum of (1) includable income from controlled foreign corporations and (2) foreign dividend gross-up. Includable income was the income of U.S.-owned foreign corporations that was taxable to their U.S. shareholders under sections 951-964 ("Subpart F"). Foreign dividend gross-up was an amount equal to the foreign tax deemed paid by the foreign corporation that the U.S. shareholder could claim as a foreign tax credit. A controlled foreign corporation was one in which more than 50 percent of the voting stock was controlled by U.S. persons, including domestic corporations, each of whom owned at least 10 percent of the voting stock. Any U.S. shareholder owning 10 percent or more of the stock was required to include in taxable income a share of the includable income and dividend gross-up.

Foreign dividend gross-up and includable income from Controlled Foreign Corporations were combined and presented in the statistics as

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Constructive Taxable Income from Related Foreign Corporations. The components are presented separately in Table 20. Neither includable income from Controlled Foreign Corporations nor foreign dividend gross-up was included in the statistics for Total Receipts.

### Includable Income

[Page 2, Schedule C, Line 14(a)]

Generally, the earnings and profits of a controlled foreign corporation (CFC) were subject to U.S. taxation only when the income was actually distributed to the U.S. shareholders or repatriated to the United States. The Subpart F provisions of the Code created an exception to this general rule by requiring that some types of foreign income be included in the income of the U.S. shareholders even if not distributed. The types of income involved are either passive investment income, income from sources thought especially easy to shift between tax jurisdictions, or income from sources contrary to public policy.

Includable income consisted of:

- (1) Subpart F income, defined below;
- (2) any previously excluded Subpart F income which had been invested in qualified assets in less developed countries, and which was either withdrawn from those countries or repatriated to the U.S. shareholders and therefore became taxable;
- (3) any previously excluded Subpart F income which had been withdrawn from foreign base company shipping operations;
- (4) any increase in Controlled Foreign Corporation earnings due to investment in U.S. property; and
- (5) factoring income, or income that arose from the sale or transfer of a receivable.

Subpart F income, defined in Code section 952, included:

- (1) income from insurance issued by CFCs outside the country of incorporation of the CFC;
- (2) "foreign base company income," which included several types of income derived from passive investments or from transactions outside the CFC's country of incorporation;
- (3) income from participation in international boycotts not sanctioned by the United States;
- (4) illegal bribes, kickbacks, or other payments to a government official; and
- (5) income derived from any foreign country during any period for which a foreign tax credit would be denied for taxes paid to those countries, as described in Code section 901(j) (i.e., a government that was not recognized by the United States, with which the United States

severed or did not conduct diplomatic relations, or which provided support for international terrorism).

### Foreign Dividend Income Resulting From Foreign Taxes Deemed Paid

[Page 2, Schedule C, Line 15(a)]

This item, also called "foreign dividend gross-up," was constructive taxable income to corporations that claimed a foreign tax credit. A U.S. corporation could claim a foreign tax credit for a share of the foreign taxes actually paid by its related foreign corporations, including its Controlled Foreign Corporations. The U.S. corporation's share of the foreign taxes depended on the ratio of the dividends and includable income it received to the total earnings and profits of the related foreign corporation. The foreign taxes were treated as deemed paid by the U.S. corporation. In order to receive credit against U.S. tax, the foreign taxes deemed paid needed to be included in the corporation's worldwide income as well. They were included in income as an increase to foreign dividends, called a dividend gross-up. The dividend gross-up was the equivalent amount of the foreign taxes deemed paid by the U.S. corporation.

### Charitable Contributions

[Page 1, Line 19]

Contributions or gifts to charitable, religious, educational, and similar organizations were deductible under Code sections 170(c). In general, the deduction was limited to 10 percent of taxable income computed without regard to:

- (1) the deduction for contributions;
- (2) special deductions for dividends received and for dividends paid on certain preferred stock of public utilities;
- (3) any net operating loss carryback under Code section 172;
- (4) any capital loss carryback to the tax year under Code section 1212(a)(1); and
- (5) the deduction of bond premium on repurchase under Code section 249.

Charitable contributions over the 10 percent limitation could be carried forward to the next 5 tax years; however, the carryover was not allowed if it increased a net operating loss carryover.

A corporation could receive a larger deduction for contributing scientific property used for the care of the ill, needy or infants, for research to an institution of higher education. These applied to all except Personal Holding Companies and corporations whose businesses were the performance of services, and for contributions of computer

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technology and equipment to school (under section 170(e)). Regulated investment companies and real estate investment trusts did not report contributions. Contributions made by S corporations were passed through to the shareholders to be deducted on the shareholders' returns.

The amount shown in the statistics included contributions identified as part of cost of goods sold or capitalized under section 263A, as well as contributions reported as a business deduction.

### Corporation's Own Stock

[Page 4, Schedule M2, Line 5(b)]

Distributions of corporation's own stock were distributions made to shareholders outside the consolidation that consist of shares of the distributing corporation's own stock, in lieu of cash or other property.

### Cost of Goods Sold

[Page 2, Schedule A, Line 8]

Cost of Goods Sold represented the costs incurred by the corporation in producing the goods or providing the services that generated the corporation's business receipts. Included were costs of materials used in manufacturing, costs of goods purchased for resale, direct labor, and a share of overhead expenses, such as rent, utilities, supplies, maintenance, and repairs. (Overhead expenses, however, were not included in these statistics as the taxpayers reported them; see "Uniform Capitalization Rules" below.)

The basic cost of goods sold calculation, shown in Schedule A, consisted of adding beginning inventory to the current year purchases, labor, and other costs and subtracting ending inventory. Each of the individual items included in cost of goods sold is shown separately in Table 2.

For companies engaged in manufacturing or trade activities, if gross receipts were reported, a cost of goods sold was imputed if not reported. The cost was imputed using attachments for "Other Deductions." For other nonfinance industries, a cost was imputed only for companies that reported gross receipts and included inventories on the balance sheet.

Security dealers sometimes reported the cost of securities traded on their own accounts as cost of goods sold (and reported the gross sales proceeds as business receipts). Such amounts were netted during statistical processing, with the net gain reported as receipts and cost of goods made zero. The same handling was given bank returns reporting gross receipts and costs from Federal funds

transactions. Generally, returns of corporations in the finance sector were not expected to have cost of goods sold unless they were consolidated returns including nonfinance subsidiaries.

Insurance companies were made to conform to the Form 1120 format using premium income as gross business receipts and showing benefits paid as cost of goods sold. For most life insurance companies, cost of goods sold was equal to death benefits; for other insurance companies, it was equal to losses incurred. These items are combined and shown as "Insurance cost of goods" in Table 26.

### Uniform Capitalization Rules

A taxpayer reporting of cost of goods sold was governed by the "uniform capitalization rules" of Code section 263A. Most companies producing goods for sale were required to capitalize inventory costs under the uniform capitalization rules. Corporations subject to the rules were required to capitalize direct costs and an allocable portion of most indirect costs that related to the goods produced or acquired for resale. Some of the indirect costs that were required to be allocated to capital accounts were administration expenses, taxes, depreciation, insurance costs, compensation of officers, and contributions to pension, stock bonus, profit sharing, and deferred compensation plans. Special rules were provided for the capitalization of interest expense paid or incurred in the course of production. The rules did not apply to personal property acquired for resale for corporations with annual average gross receipts of \$10,000,000 or less. Special rules were provided for farmers and for timber property.

For statistical purposes, many components of cost of goods sold were moved to the equivalent deduction item and thus appear in the tables as current deductions rather than as components of cost of goods sold. Expenses for advertising, amortization, bad debts, compensation of officers, contributions to charitable organizations, contributions to employee benefit programs, contributions to pension plans, depletion, depreciation, interest, rent of buildings or real estate, and taxes were transferred to their respective deduction categories when identified on attachments for cost of goods sold. Intangible drilling costs were also removed from cost of goods sold and included in other deductions.

In this report, therefore, cost of goods sold appears smaller, and many deduction accounts larger, than reported by taxpayers. However, these are the only accounts affected; inventories were not adjusted and net income or deficit and taxable income were not affected.

## 2001 Corporation Returns - Explanation of Terms

### Cost of Labor

[Page 2, Schedule A, Line 3]

This component of cost of goods sold included the portions of the company's payroll representing direct labor costs and some indirect costs allocated to inventory under the uniform capitalization rules. Some labor costs were included in other accounts, such as Other Costs. See also, "Cost of Goods Sold"

### Cost of Treasury Stock

[Page 4, Schedule L, Line 27(d)]

This item was the total value of issued common or preferred stock that had been reacquired and was held at the end of the accounting year by issuing corporations. The stock, which was available for resale or cancellation, may have been purchased by the corporation or acquired through donation or as settlement of a debt. Treasury stock was a part of capital stock outstanding; it did not include unissued capital stock.

### Credit by Reciprocal

[Form 1120-PC, Page 1, Line 14(h)]

See "Reciprocal Tax."

### Credit for Contributions to Selected Community Development Corporations [Form 8847]

A corporation making qualified cash contributions (including loans or investments) to a community development corporation selected by the Secretary of Housing and Urban Development (HUD) could take a credit against tax. The corporation may claim as a credit 5 percent of the amount contributed for each tax year during a 10-year credit period beginning with the tax year in which the contribution is made as subject to the limitations of the "General Business Credit" (described under that heading in this section). The components of the general business credit are shown separately in Table 21.

### Credit for Employer Social Security and Medicare Tax on Tips [Form 8846]

Food and beverage establishments that paid the employer's social security and Medicare tax on employee tip income in excess of the minimum wage were allowed to receive a refund of the excess in the form of a credit against income tax. This credit was a component of the "General Business Credit" and was subject to the limitations and carryover provisions discussed under that heading. The components of the general business credit are shown separately in Table 21.

### Credit for Federal Tax on Fuels

[Page 1, Line 32g]

Code section 34 allowed a credit in full or in

stated amounts for excise taxes on:

- (1) gasoline used on farms for farming purposes (Code section 6420);
- (2) gasoline used for nonhighway purposes or by local transit systems (Code section 6421); and
- (3) fuel not used for taxable purposes (Code section 6427), such as, on the sale of fuel when tax was imposed under section 4041(a) or (e) and the purchaser used such fuel other than for the use for which sold, or resold such fuel.

This credit was also used to claim the credit for purchase of qualified diesel-powered highway vehicles.

### Credit for Tax Paid on Undistributed Capital Gains

[Page 1, Line 32f]

Regulated investment companies (RIC) and real estate investment trusts (REIT) were required to pay tax on amounts of undistributed net long-term capital gain less net short-term capital loss at the regular corporate tax rate of 35 percent. Stockholder corporations, for their part, were required to include in the computation of their long-term capital gains any such gains designated by the parent as undistributed dividends. The stockholder corporations were then deemed to have paid the tax on the undistributed long-term capital gain dividends and were allowed a credit for the tax they were deemed to have paid.

### Credit to 2002 Estimated Tax

[Page 1, Line 36a]

This item was the amount of the taxpayer's 2001 overpayment applied to his estimated tax for the 2002 Tax Year. See also, "Overpayment or Tax Due."

### Death Benefits

[Form 1120-L, Page 1, Line 9]

See "Cost of Goods Sold."

### Deficit

See "Net Income (or Deficit)."

### Depletable Assets and Accumulated Depletion

[Page 4, Schedule L, Lines 11a and b]

Depletable assets represented, in general, the gross end-of-year value of mineral property, oil and gas wells, other natural deposits, standing timber, intangible development and drilling costs capitalized, and leases and leaseholds, each subject to

## 2001 Corporation Returns - Explanation of Terms

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depletion. Accumulated depletion represented the cumulative adjustment to these assets shown on the corporation's books of account.

The value of depletable assets and accumulated depletion may not be closely related to the current year depletion deduction. The depletable assets and accumulated depletion balance sheet accounts reflected book values; the depletion reflected the amount claimed for tax purposes.

For all Form 1120-A corporations, this amount is included in depreciable assets.

### **Depletion**

[Page 1, Line 22]

This deduction was allowed for the exhaustion of mines, oil and gas wells, other natural deposits, and timber. The Code provided two methods for computing the deduction: cost depletion, in which a share of the cost of acquiring or developing a property was written off each year; and percentage depletion, which involved simply deducting a fixed percentage of the gross income from the property each year. For standing timber, depletion was computed on the basis of cost. In the case of most natural deposits, the depletion was computed either on a cost or percentage basis; for oil and gas wells, however, percentage depletion was allowed only to "independent" producers (producing less than 50,000 barrels of oil or an equivalent amount of gas a day) and then only for the first 1,000 barrels produced each day. All other oil and gas producers were required to use cost depletion.

Generally, for gas and oil wells the gross income was the actual sales price, or representative market or field price if the gas or oil were later converted or manufactured prior to sale. For other natural deposits, gross income was defined to include income from mining or extraction and certain treatment processes as well. Percentage rates for each type of natural deposit were listed in Code section 613 and ranged from 5 to 25 percent of gross income. However, percentage depletion generally could not exceed 50 percent of the taxable income from the property computed without the depletion deduction.

The depletion deduction for natural deposits other than oil and gas could also have been limited by provisions designed to recapture previously deducted mine exploration and development costs. These capital expenditures were deductible when incurred but had to be recaptured if the mine became productive or was sold. One method taxpayers could elect to recapture these deductions was to forego percentage depletion deductions on

the mine until recapture was complete.

The statistics for depletion also did not include amounts shown by the corporation as a deduction in computing net gain or loss from sale of depletable assets under sections 631(a) or 1231. Regulated investment companies and real estate investment trusts did not report depletion.

The amounts shown in the statistics included any identifiable depletion reported as part of the cost of goods sold or capitalized under section 263A. Amortization of intangible drilling costs was not included in the statistics for depletion but was included in Other Deductions. For 1120-A corporations, depletion reported in Other Deductions or an attached schedule was included in this item.

### **Depreciable Assets and Accumulated Depreciation**

[Page 4, Schedule L, Lines 10a and b]

Depreciable assets from the corporation's end-of-year balance sheet were the book value of tangible property subject to depreciation (such as buildings and equipment with a useful life of one year or more). This item could include fully depreciated assets still in use and partially completed assets for which no deduction was yet allowed if the corporation reported them as depreciable on its balance sheet. The amounts shown as accumulated depreciation represented the portion of the assets that were written off in the current year and all prior years.

In general, depreciable assets were the gross amounts before adjustment for accumulated depreciation. Some corporations, however, reported only the net amount of depreciable assets after deducting accumulated depreciation. Certain insurance companies were included among the corporations which reported only a net amount of depreciable assets. Life insurance companies and some property and casualty insurance companies reported their balance sheet information in the format required by State insurance regulations. This format usually provided for the reporting of only net depreciable assets and only the home and branch office buildings and equipment were included. Other real estate holdings of these corporations were reported as "Other Investments."

Except for corporations filing the short-form tax return, Form 1120-A, the statistics for depreciable assets excluded depletable and intangible assets, which were reported in their respective items. The Form 1120-A return provided only one line for all three accounts, so the amount reported for depreciable assets also included depletable and

## 2001 Corporation Returns - Explanation of Terms

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intangible assets. Similarly, the accumulated depreciation field for the 1120-A returns represented the total of accumulated depreciation, accumulated depletion, and accumulated amortization.

Generally, the value of depreciable assets and accumulated depreciation were not closely related to the current-year depreciation deduction. The depreciable assets and accumulated depreciation balance sheet accounts reflected book values; the depreciation deduction reflected the amount claimed in the current year for tax purposes.

### Depreciation D

Depreciation is a method of recovering the cost of investments in tangible assets that lose value as they are used to produce income. The depreciation deduction allowed under Code sections 167 and 168 approximated this loss in value by prescribing the rates at which various types of assets could be depreciated and the period over which the investment could be recovered. The depreciation rules in effect for property placed in service in 2001 were basically those enacted in 1986; however, the tax depreciation rules were changed many times over the years, and some assets were still in use in 2001 that were originally placed in service under prior year rules. So the depreciation claimed on 2001 returns included in these statistics could have represented amounts computed by several different sets of rules.

In 2001, the basic depreciation system was the "Modified Accelerated Cost Recovery System," or MACRS, that provided two systems for computing the depreciation deduction. The "General Depreciation System," or GDS, specified recovery periods of 3, 5, 7, or 10 years for livestock, fruit trees, most machinery, equipment, and tangible personal property, and prescribed the 200-percent declining balance method of determining the amount to be written off each year. Public utility property, water transportation equipment, and farm buildings were placed in either the 15-year, 20-year, or 25-year category and were to be depreciated by the 150-percent declining balance method. Buildings were to be depreciated by the straight-line method and over recovery periods of 27.5 years for residential buildings, 31.5 years for nonresidential buildings placed in service before May 13, 1993, and 39 years for nonresidential buildings placed in service after May 12, 1993. Railroad roadbeds and tunnels were prescribed a recovery period of 50 years and the straight-line depreciation method.

MACRS also provided for an "Alternative Depreciation System," or ADS, that was less accelerated than GDS and thus could help avoid the

alternative minimum tax. Under ADS, the recovery period was generally based on the old "class life" system, which was a set of lives prescribed by IRS and based on studies of actual asset lives. The depreciation method was straight-line. Some types of property could only be depreciated using ADS. These were (1) tangible property used predominantly outside the U.S., (2) tax-exempt property, (3) property financed by tax-exempt bonds, (4) imported property covered by a Presidential order, or (5) farm property placed in service in a year in which the taxpayer had elected to expense preproduction period costs under section 263A.

Also included here were amounts the corporation elected to expense under section 179. For 2001, the maximum deduction was increased to \$24,000 (\$44,000 for enterprise zone businesses and renewal community businesses; \$59,000 for qualified New York Liberty Zone property placed in service after September 10, 2001). The deduction and depreciation allowable on a vehicle (that is not a clean-fuel car) used for business purposes and placed in service in 2001 could not exceed \$3,060. Furthermore, allowable depreciation could not exceed \$4,900 in the second year, \$2,950 in the third year, or \$1,775 for any additional years.

This item included amounts of depreciation reported as a part of cost of goods sold or capitalized under section 263A.

### Disabled Access Credit [Form 8826]

The credit was allowed to small businesses that incurred expenses to make their business accessible to disabled individuals. An eligible small business was one with either gross receipts of less than \$1 million for the preceding tax year or not more than 30 full-time employees in the preceding tax year.

An eligible expenditure was one paid or incurred by an eligible small business in order to comply with the requirements of the Americans with Disabilities Act of 1990. Expenditures included: (1) removing architectural, communication, physical, or transportation barriers; (2) providing qualified interpreters or other methods of delivering materials to individuals with hearing impairments; (3) providing qualified readers, taped texts, or other methods of delivering materials to individuals with visual impairments; (4) acquiring or modifying equipment or devices for individuals with disabilities; or (5) providing other similar services, modifications, materials or equipment. The amount of the credit was 50 percent of the amount of the eligible expenditures for a year that exceeded \$250 but did not exceed \$10,250.

## 2001 Corporation Returns - Explanation of Terms

The disabled access credit was claimed as one of the components of the general business credit. For a discussion of the income tax limitations and carryback and carryforward provisions of the credit, see "General Business Credit", in this section. The components of the general business credit are shown separately in Table 21.

### Dividends Received from Domestic Corporations

Dividends received from domestic corporations was a statistic computed from amounts reported on Schedule C. The amounts making up this statistic are shown in detail in Table 20. The statistic represented most distributions from the earnings and profits of companies incorporated in the United States. Dividends received from domestic corporations were generally those used in computing the special deduction from net income for dividends received, which is discussed under the heading "Statutory Special Deductions" in this section.

Dividends from Interest Charge Domestic International Sales Corporations (IC-DISC's) and from former Domestic International Sales Corporations (DISC's) that were deductible were included as domestic dividends received. Dividends from FSC's and foreign subsidiaries, on the other hand, were included under "Dividends Received from Foreign Corporations."

Dividend distributions among member corporations electing to file a consolidated return were eliminated from the statistics as part of the consolidated reporting of tax accounts. For tax purposes, dividends reported on these returns represented amounts received from corporations that were outside the tax-defined affiliated group.

If portfolio stock was wholly or partially financed by debt, no dividend received deduction was allowed on the debt-financed portion of the stock. There was a separate line item and a separate deduction calculation for dividends on debt-financed portfolio stock. This amount was included as part of domestic dividends even though it also represented debt-financed stock of foreign corporations.

Dividends or other distributions other than those detailed in Table 20 were included in "Other Receipts."

Dividends received by S corporations were passed through to shareholders and reported on the Form 1120S, Schedule K, Shareholders' Share of Income, Deductions, Credits, etc. and are not included in these statistics. These statistics are

presented in Bennett, Kelly, "S Corporation Returns, 2001," *Statistics of Income Bulletin*, Spring 2004, Volume 23, Number 4.

### Dividends Received from Foreign Corporations

These were dividends paid from the earnings and profits of companies incorporated in foreign countries.

Dividends received from foreign corporations out of U.S. source earnings and profits or from Foreign Sales Corporations (FSC's) were usually eligible for the dividends received deduction, described in "Statutory Special Deductions," below. Not eligible were dividends out of foreign earnings and profits and certain gains from the sale, exchange, or redemption of Controlled Foreign Corporation stock.

Because foreign dividend gross-up and includable income from Controlled Foreign Corporations were not actual receipts, for statistical purposes they were excluded from dividends received. Both were combined and presented in the statistics as "Constructive Taxable Income from Related Foreign Corporations," discussed above.

Dividends received from Foreign Corporations by S corporations were not included in these statistics.

### Employee Benefit Programs

[Page 1, Line 25]

Contributions made by employers to such plans as death benefit plans, insurance plans, health plans, accident and sickness plans, and other welfare plans were deductible under Code sections 419 and 419A. Generally, such programs were not an incidental part of a pension, profit sharing plan, or other funded deferred compensation plan. Deductions for a welfare benefit fund were limited to the qualified cost of the fund for the taxable year, as described under Code section 419. Direct payments for employees' welfare were not included as employee benefits; only payments into a fund for employee benefits were included.

Included in the statistics for this item were amounts identified as part of the cost of goods sold, or capitalized under section 263A. Regulated investment companies and real estate investment trusts do not report employee benefits. Some mining companies could have reported an amount for a combination of welfare/retirement plans. When identified, the combined amount was included in the statistics for contributions to employee benefit plans.

For all 1120-A corporations, employee benefit programs identified in other deductions or attached

## 2001 Corporation Returns - Explanation of Terms

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schedules were included in the statistics for employee benefit programs.

### **Empowerment Zone Employment Credit**

[Form 8844, line 24)

The Revenue Reconciliation Act of 1993 allowed an income tax credit for qualified empowerment zone employment (EZE) wages and certain training expenses of qualified zone employees. Although the EZE credit was a component of the general business credit, there was a special tax liability limitation for this credit. A qualified zone employee was any employee who performed substantially all of the services for an employer within an empowerment zone in the employer's trade or business and had his or her principal residence within that empowerment zone while performing those services. Both full and part-time employees could be qualified zone employees. Qualified zone wages were any wages paid or incurred by an employer for services performed by a qualified zone employee. Although a qualified zone employee could earn any amount of wages, only the first \$15,000 of qualified zone wages paid or incurred was taken into account for the credit. The \$15,000 limit was reduced by the amount of wages paid or incurred during the year that was used in figuring the work opportunity credit for that employee. With certain exceptions amounts paid or incurred by an employer for the education or training of the employee were treated as wages paid to an employee. In general, any individual employed for less than 90 days was not a qualified zone employee. However, there were exceptions to this for an employee who was terminated because of misconduct, who became disabled, or who was acquired by another empowerment zone corporation and who continued to be employed by that corporation.

### **Enhanced Oil Recovery Credit [Form 8830]**

This credit was allowed to taxpayers who incurred qualified enhanced oil recovery costs for projects located in the United States using one or more tertiary methods to recover otherwise unrecoverable crude oil. Enhanced oil recovery costs were costs of depreciable property used in the project, intangible drilling costs, and tertiary injectant expenses. The amount of the credit was 15 percent of the taxpayer's qualified enhanced oil recovery costs for the taxable year.

The enhanced oil recovery credit was claimed as one of the components of the general business credit. For a discussion of the income tax limitations and carryback and carryforward provisions of the credit, see "General Business Credit" in this section.

The components of the general business credit were shown separately in Table 21.

### **Estimated Tax Penalty**

See "Penalty for Underpayment of Estimated Tax."

### **Excess Net Passive Income Tax**

[Form 1120S, Page 1, Line 22a]

A Subchapter S corporation that had accumulated earnings and profits from a prior subchapter C status and also had net passive income greater than 25 percent of its gross receipts was taxed on the excess (net of related expenses) at the regular corporate tax rate of 35 percent. Passive investment income, in general, was gross receipts derived from rents, royalties, dividends, interest, annuities, or the sales or exchange of stock or securities.

### **Foreign Dividend Income Resulting from Foreign Taxes Deemed Paid**

[Page 2, Schedule C, Line 15(a)]

See "Constructive Taxable Income."

### **Foreign Tax Credit**

[Page 3, Schedule J, Line 6a]

Code section 901 allowed a credit against U.S. income tax for income taxes paid to foreign countries or U.S. possessions. The credit could be claimed by domestic corporations, except S corporations, and by foreign corporations engaged in trade or business in the United States for foreign taxes paid on income effectively connected with the U.S. business. The U.S. income tax that could be reduced by the credit excluded the recapture taxes for investment credit and low income housing credit, the alternative minimum tax, the personal holding company tax, and the environmental tax. (But a separate foreign tax credit was computed for alternative minimum tax purposes; see "Alternative Minimum Tax" in this section.)

The credit was not allowed for S corporations because their income was primarily taxed through their shareholders; any creditable foreign taxes were also passed through to their shareholders. Regulated investment companies could elect under Code section 853 to allow their shareholders to claim any credit for the foreign taxes paid. However, if the election was not made, the regulated investment company could claim the foreign tax credit.

The foreign tax credit was subject to a limitation that prevented the corporations from using foreign tax credits to reduce U.S. tax liability on U.S.

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sourced income. The credit was limited to a percentage of total U.S. income tax equal to the ratio of taxable income from foreign sources to worldwide taxable income. This limitation was computed separately for foreign taxes paid or accrued with respect to nine categories of income. These were: (1) passive income; (2) high withholding tax interest; (3) financial services income; (4) shipping income; (5) dividends from each noncontrolled section 902 corporation; (6) dividends from a DISC or former DISC; (7) foreign trade income of a FSC; (8) distributions from a FSC or former FSC; and (9) all other income from sources outside the United States. Foreign taxes in excess of the limitation for any one year could be carried back to the 2 preceding years and then carried forward to the 5 succeeding years to reduce income tax, subject to the foreign tax credit limitation of the years to which they were carried.

A corporation that claimed (or passed through) the foreign tax credit could not also claim a business deduction for the same foreign taxes paid. The credit could be reduced for taxes paid on foreign income from operations involving participation or cooperation with an international boycott. The foreign tax credit was not allowed for taxes paid to certain foreign countries whose government was not recognized by the United States, with which the United States severed or did not conduct diplomatic relations, or which provided support for international terrorism.

### General Business Credit

[Form 3800, Line 19]

The general business credit consisted of a combination of several individual credits - investment credit (Form 3468), work opportunity credit (Form 5884), welfare-to-work credit (Form 8861), alcohol fuels credit (Form 6478), research credit (Form 6765), low-income housing credit (Form 8586), enhanced oil recovery credit (Form 8830), disabled access credit (Form 8826), renewable electricity production credit (Form 8835), Indian employment credit (Form 8845), credit for employer social security and Medicare taxes paid on certain employee tips (Form 8846), orphan drug credit (Form 8820), and credit for contributions to certain community development corporations (Form 8847). If a corporation claimed more than one of these credits, reported a carryforward, had credits from a passive activity, or had the Trans-Alaska pipeline liability fund credit, or had the general credits from an electing large partnership (Schedule K-1, Form 1065-B), Form 3800 was to be filed with the income tax return. The empowerment zone employment credit (Form 8844) was included as part of the general business credit total but was not included on

the Form 3800. The separate components of the general business credit are shown in Table 21.

The purpose of the general business credit was to provide a uniform limitation on the amount that could be used to reduce tax liability and to establish uniform rules for carrybacks and carryforwards. Each of the credits was computed separately. The total of the credits became the general business credit for the purpose of applying the maximum tax liability rules and the carryback and carryforward rules.

Except for the investment credits, S corporations computed these credits at the corporate level; the credits were then passed through to the shareholders. For the investment credits, the S corporation reported the basis in the qualifying property to each shareholder. The shareholders themselves computed the credits. However, S corporations that were previously C corporations could use business credit carryforwards from their C-corporation status to reduce tax on their net recognized built-in gains.

According to Code section 38(c), the general business credit reduced the tax liability to the extent of 100 percent of the first \$25,000 of net tax liability and 75 percent of the net tax liability over \$25,000. An additional limitation was also imposed on the general business credit as a result of the alternative minimum tax.

When the credit exceeded the limitation in any year, the excess became an unused business credit that could be carried back 3 years and forward 15 years. (For tax years beginning after December 31, 1997, the carryback period was reduced to 1 year and the carryforward period increased to 20 years.) Carryforwards of the general business credit from prior years are shown separately in Table 21.

### Income Subject to Tax

[Page 1, Line 30]

This was generally the amount of income subject to tax at the corporate level. For most corporations, income subject to tax consisted of net income minus the "Statutory Special Deductions" described in this section. However, there were certain exceptions. S corporations were usually not taxable at the corporate level and so did not have income subject to tax. Some, however, had a limited tax liability on capital gains and so were included in the statistics for this item. Likewise, regulated investment companies and real estate investment trusts generally passed their net income on to be taxed at the shareholder level; but any taxable amounts not distributed were included in income subject to tax.

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Because insurance companies were permitted to use reserve accounting for tax purposes, insurance income subject to tax was based on changes in reserve accounts; life insurance companies could also have been allowed an additional special deduction (discussed in "Statutory Special Deductions"). Consolidated returns that contain life insurance subsidiaries were not allowed to offset all of the life insurance subsidiary's gains by losses from nonlife companies, so it was possible for such a consolidated return to show no net income but still have a positive amount of income subject to tax.

### Income Tax

[Page 3, Schedule J, Line 3]

Income tax was the amount of a corporation's total tax liability calculated at the regular corporate tax rates in Code section 11 (or substitutes for section 11).

The rates of tax on taxable incomes below \$18,333,333 were graduated (with some exceptions). Corporations other than members of a controlled group or personal service corporations used the following tax rate schedule. If taxable income is:

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

The 39 percent and 38 percent rates were imposed to phase out the benefits of the lower brackets for high-income corporations.

Members of controlled groups had to share the lower-bracket amounts, so the rates would have applied at different income levels. Personal service corporations qualified under section 448 to use cash accounting (incorporated professional practices, performing artists, or consultants) were taxed at 35 percent on all of their taxable income.

Most income of S corporations was taxed only at the shareholder level. However, for S corporations that had once been C corporations, the corporate income tax was imposed on certain long-term capital gains, recognized built-in gains, and excess net passive income. The taxes paid on capital gains or recognized built-in gains by S corporations were included in the corporate statistics as "Income Tax." The taxes paid on excess net passive income were excluded from "Income Tax" but were included in

"Total Income Tax."

A small number of corporations without net income had an income tax liability. These were corporations reporting all or part of their income under special life insurance rules, including mutual savings banks with life insurance departments and consolidated returns including a life insurance subsidiary.

Other adjustments made to income tax returns by the taxpayer and included in these statistics for income tax were: (1) deferred tax under section 1291(c)(2), where a corporation was a shareholder in a passive foreign investment company (PFIC) and received an excess distribution or disposed of its investment in the PFIC during the year; and (2) additional tax under section 197(f)(9)(B) where 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.

See also, "Total Income Tax Before Credits" and "Total Income Tax After Credits."

### Indian Employment Credit [Form 8845]

This component of the general business credit was for employing members of American Indian tribes on Indian reservations. The credit was equal to 20 percent of the excess of wages and health benefits for such employees over the amount paid such employees in 1993, limited to \$20,000 per employee.

For the income tax limitations and carryback and carryforward provisions that apply, see "General Business Credit" in this section.

### Intangible Assets and Accumulated Amortization

[Page 4, Schedule L, Line 13a(c)]

Intangible assets represented the total gross value of goodwill, contracts, formulas, licenses, patents, registered trademarks, franchises, covenants not to compete, and similar assets that were amortizable for tax purposes. Thus, specific intangible asset items were included in this category only if amortization (or depreciation) actually had been taken against them.

The amounts shown as accumulated amortization represent the portion of these intangible assets that were written off in the current year as well as in prior years. In general, intangible assets were the gross amounts before adjustments for amounts of accumulated amortization. Some corporations, however, reported only the net amount of intangible assets after adjusting for amortization charges.

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For all Form 1120-A corporations, this amount was included in depreciable assets.

### Interest

[Page 1, Line 5]

Taxable interest, a component of total receipts, included interest on U.S. government obligations, loans, notes, mortgages, arbitrage bonds, nonexempt private activity bonds, corporate bonds, bank deposits, and tax refunds. The statistics also included dividends from savings and loans and mutual savings banks, federal funds sold, finance charges, and sinking funds. The interest received was reduced by the amortizable bond premium under Code section 171.

Interest received from tax-exempt state or municipal bonds and ESOP loans was not included in this item. Corporations were not allowed to offset any interest expense against interest income. However, if the corporation reported only a net amount, this figure was used in the statistics. See also, "Interest Paid."

Interest received by S corporations was passed through to shareholders and reported on the Form 1120S, Schedule K, *Shareholders' Share of Income, Deductions, Credits, etc.*, and are not included in these statistics. These statistics are presented in Bennett, Kelly, "S Corporation Returns, 2001," *Statistics of Income Bulletin*, Spring 2004, Volume 23, Number 4.

### Interest on Government Obligations: State and Local

[Page 4, Schedule M-1, Line 7]

The interest received from certain government obligations was not subject to U.S. income tax. These tax-exempt obligations included those issued by states, municipalities, and other local governments, the District of Columbia, and U.S. possessions, including Puerto Rico.

For statistical presentation, this interest was included in total receipts. However, it was not included in net income (less deficit) or income subject to tax.

Most corporations reported this tax-exempt interest in the Reconciliation of Income per Books with Income per Return (see Schedule M-1 on the Form 1120 in Section 6 of this report). Because of variations in taxpayer reporting, this item may not have always been identified. Therefore, the statistics could be understated for interest received from state and local government obligations.

### Interest Paid

[Page 1, Line 18]

These amounts consisted of interest paid by corporations on all business indebtedness. For banking and savings institutions, the statistics also included interest paid on deposits and withdrawable shares. For mutual savings banks, building and loan associations, and cooperative banks, interest paid included amounts paid or credited to the accounts of depositors as dividends, interest, or earnings under Code section 591. Interest identified as part of the cost of goods sold or capitalized under section 263A was excluded from cost of goods sold and included in the statistics as interest paid.

### Inventories

[Page 4, Schedule L, Line 3(d)]

This was the corporations' end-of-year inventories as reported on their balance sheets. Inventories included such items as finished goods, partially finished goods (work in progress), new materials and supplies acquired for sale, merchandise on hand or in transit, and growing crops reported as assets by agricultural concerns. Inventories reported on balance sheets were book accounts and would not necessarily have corresponded to those reported for tax purposes in cost of goods sold.

Inventories reported on the returns of companies in financial industries were transferred during statistical processing to other balance sheet accounts (unless reported on a consolidated return with nonfinancial subsidiaries). For security brokers and dealers, commodity brokers and dealers, and holding and other investment companies (except bank holding companies), inventories were included in "Other Investments." For the rest of the "Finance, and Insurance", and "Management Holding Companies" sectors, inventories were included in "Other Current Assets". Inventories shown in the statistics for the "Finance and Insurance", and "Management Holding Companies" sectors were those reported by consolidated financial companies with diversified nonfinancial subsidiaries.

See also, "Cost of Goods Sold."

### Inventory, Beginning of Year

[Page 2, Schedule A, Line 1]

### Inventory, End of Year

[Page 2, Schedule A, Line 7]

These were the companies' beginning and ending inventories as calculated for tax purposes. Statistical adjustments made to the current year components of cost of goods sold were not carried

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over into the capitalized inventory accounts, which were shown as reported by taxpayers (except for necessary corrections). See "Cost of Goods Sold."

### Investment Credit [Form 3468]

This component of the General Business Credit, shown separately in Table 21, was composed of three separate, unrelated credits: the rehabilitation tax credit, the solar and geothermal energy tax credit, and the reforestation tax credit. Form 3468 was also used to claim a regular investment credit for transition property.

The **rehabilitation tax credit** was a credit equal to 20 percent of the cost of rehabilitating a certified historic structure or 10 percent of the rehabilitation costs for any nonresidential building originally placed in service before 1936. The rehabilitation had to be "substantial" and meet strict criteria for how much of the original structure was retained. The rehabilitation of historic structures had to be approved by an appropriate State or Federal official.

The **energy tax credit** was allowed for equipment that used solar or geothermal energy to generate electricity or that used solar energy to heat or cool a building or provide heat for a process. The credit was equal to 10 percent of the cost of the equipment.

The **reforestation tax credit** was allowed for a portion of the costs of planting or replanting trees to be grown for timber. The amount of the credit was 10 percent of the costs up to an annual limit of \$10,000.

**Transition Property** was property of certain taxpayers specified under the Tax Reform Act of 1986 (TRA) that was eligible for the regular investment credit under the transitional rules of section 49. Also, certain projects specified under TRA were eligible for the rehabilitation credit under the transitional rules.

The investment credit was subject to recapture if the property was sold or converted to other uses. See "Recapture Taxes" below.

For S corporations, the investment credit was computed at the shareholder, not the corporate, level. The S corporation reported the basis in the qualifying property to each shareholder for this purpose.

For the income tax limitations and carryback and carryforward provisions that apply, see "General Business Credit" in this section.

### Investments in Government Obligations

[Page 4, Schedule L, Line 4(d)]

This balance sheet asset item comprised U.S. obligations, including those of instrumentalities of the Federal Government. State and local government obligations, the interest on which was excluded from gross income under section 103(a), were included in "Tax-Exempt Securities."

Some mutual property and casualty insurance companies included investments in government obligations within other investments on the income tax return, Form 1120-PC. When identified, the amounts were included in the statistics for investments in government obligations and excluded from other investments.

### Land

[Page 4, Schedule L, Line 12(d)]

Land, which was reported as a separate capital asset on the balance sheet, may be understated in this report because it could not always be identified. Some corporations may have included land as part of depreciable or depletable assets or included it in other investments. Whenever corporations included and identified land as part of depreciable assets, the amount was reclassified as land, but land improvements remained as depreciable assets.

### Loans from Shareholders

[Page 4, Schedule L, Line 19(d)]

This balance sheet liability item was regarded as long-term in duration and included loans to the company from holders of the company's stock.

### Loans to Shareholders

[Page 4, Schedule L, Line 7(d)]

This balance sheet asset item was regarded as long-term in duration and included loans to persons who held stock in the corporation.

### Losses Incurred

[Form 1120-PC, Page 2, Line 26]

See "Cost of Goods Sold."

### Low-Income Housing Credit [Form 8586]

The low-income housing credit was a credit for the acquisition of housing units rented to low-income persons allowed over 10 years. The annual credit was designed so that the taxpayer taking it received over the 10 years the present value of 70 percent of the basis of the low-income units in a residential building (30 percent in the case of certain federally subsidized new buildings or rehabilitated existing buildings).

The low-income housing credit could only be

claimed if allocated to a residential rental project by a State housing authority and if it met the strict requirements for rental to low-income renters. If the project was sold or ceased to qualify in the first 15 years, the owner was required to repay a portion of the credit previously taken (see "Recapture Taxes" below).

The low-income housing credit was claimed as one of the components of the general business credit. For a discussion of the income tax limitations and carryback and carryforward provisions of the credit, see "General Business Credit." The components of the general business credit are shown separately in Table 21.

### Mortgage and Real Estate Loans

[Page 4, Schedule L, Line 8(d)]

In general, mortgage and real estate loans were the total amount a corporation loaned on a long-term basis, accepting mortgages, deeds of trust, land contracts, or other liens on real estate as security.

Because the return form did not provide a separate place for reporting any reserve for uncollectable mortgage and real estate loan accounts, such reserves may have been included in the allowance for bad debts, shown in this report as an adjustment to notes and accounts receivable. If a corporation reported an uncollectable mortgage and real estate loan reserve on a separate schedule, that amount was moved during statistical processing to allowance for bad debts.

### Mortgages, Notes, and Bonds Payable

[Page 4, Schedule L, Lines 17(d) and 20(d)]

Mortgages, notes, and bonds payable were separated on the balance sheet according to the length of time to maturity of the obligations. The length of time to maturity was based on the date of the balance sheet rather than on the date of issue of the obligations. Accordingly, long-term obligations maturing within the coming year were reportable with short-term obligations as having a maturity of less than one year. Deposits and withdrawable shares may have been reported in mortgages, notes, and bonds payable by banks and savings institutions. When identified, such amounts were transferred to "other current liabilities."

### Net Capital Gains

[Schedule D, Lines 12 and 13]

In the tables in this report, capital gains net of capital losses were presented divided into two data items: "Net Short-Term Capital Gain Reduced by Net Long-Term Capital Loss" and "Net Long-Term Capital Gain Reduced by Net Short-Term Capital Loss." A gain or loss from the sale or exchange of

capital assets was short-term if the assets had been held for one year or less and long-term if they had been held for longer than one year. The distinction between long-term and short-term assets was maintained in the Code and in the reporting forms even though it did not affect tax liability.

For corporations, capital losses were generally deductible only from capital gains, so only net gains were included in the statistics. Excess net losses could be carried back as short-term losses to be applied against the net capital gains of the 3 preceding years; any losses remaining after carryback were carried over the 5 succeeding years. A net capital loss for a regulated investment company could be carried forward 8 years instead of 5 years. If the unused capital loss carryover was not eliminated within the prescribed span of years, it could not be taken. Regardless of origin, all carrybacks and carryovers were treated as short-term capital losses for carryback and carryover purposes.

In general, capital assets for tax purposes meant property regarded or treated as an investment, such as stocks and bonds. Code section 1221 defined the capital assets as all property held by the corporation except:

- (1) stock in trade or other property included in inventory or held mainly for sale to customers;
- (2) notes and accounts receivable acquired in the ordinary course of business;
- (3) depreciable or real property used in the trade or business;
- (4) copyrights, literary, musical, or artistic compositions, or similar properties not acquired by purchase;
- (5) publications of the United States Government not acquired by purchase;
- (6) certain commodities derivative financial instruments held by a dealer;
- (7) certain hedging transactions entered into in the normal course of trade or business; and
- (8) supplies regularly used in the trade or business.

Gains from constructive ownership transactions entered into after July 11, 1999 that involved any equity interest in pass-through entities such as partnerships, S corporations, trusts, regulated investment companies, and real estate investment trusts that would otherwise be treated as capital gains could be treated instead as ordinary income. Constructive ownership transactions included gains from notional principal contracts with the right to receive substantially all of the investment yield of an equity interest and the obligation to reimburse substantially all of any decline in value of the interest; a forward or futures contract to acquire an

equity interest; and the holding of a call option and writing of a put option at substantially the same strike price and maturity date. A net underlying long-term capital gain had to be established by computing a net capital gain as though the asset were acquired at its fair market value when the transaction was opened and sold at its fair market value when the transaction was closed. If not established, the net underlying long-term capital gain was treated as zero. Any long-term capital gain that exceeded the net underlying long-term capital gain was treated as ordinary income. Gains from constructive ownership transactions that were marked to market were excluded from this provision to be treated as ordinary income.

Although depreciable and real property used in the trade or business was defined as not a capital asset, gain on such property held for more than one year could be treated as long-term capital gain. See "Net Gain (or Loss), Noncapital Assets" below.

The capital gains of S corporations were passed through to their shareholders and not included in the corporations' ordinary income (loss) from trade or business activities but are reported on the Form 1120S, Schedule K, *Shareholder's Shares of Income, Credits, Deductions, etc.* and are not included in these statistics. These statistics are presented in Bennett, Kelly, "S Corporation Returns, 2001," *Statistics of Income Bulletin*, Spring 2004, Volume 23, Number 4.

### **Net Gain (or Loss), Noncapital Assets**

[Page 1, Line 9]

This item includes all losses from the sale or exchange of noncapital assets, but only those gains that were not treated as long-term capital gains. Noncapital assets included property used in a trade or business plus certain other transactions given special treatment by statute. The definition of noncapital assets was expanded after December 16, 1999 to include the following categories of assets:

- 1) certain commodities derivative financial instruments held, acquired, or entered into by commodities derivatives dealers;
- 2) any hedging transaction clearly identified as a hedging transaction before the close of the day on which it was acquired, originated, or entered into; and
- 3) supplies regularly used or consumed in the ordinary course of a trade or business.

A commodities derivative financial instrument is a commodities contract or other financial instrument,

with respect to commodities, for which the value or settlement price is calculated or determined by reference to a specified index (as defined in section 1221(b) of the Internal Revenue Code). A commodities derivative dealer is an entity which regularly offers to enter into, assume, offset, assign, or terminate positions in commodities derivative financial instruments with customers in the ordinary course of a trade or business. A hedging transaction is any transaction entered into in the normal course of a trade or business primarily to manage one of the following: 1) risk of price changes or currency fluctuations involving ordinary property held (or to be held) and 2) risk of interest rate or price changes, or currency fluctuations, involving borrowed funds or ordinary obligations incurred (or to be incurred).

Rules governing the computation of a net gain or loss from noncapital assets were provided under Code section 1231. Transactions treated under these special provisions included:

- (1) the sale or exchange of real or depreciable property used in a trade business;
- (2) the cutting or disposal of timber treated as a sale or exchange under Code section 631(a) and (b);
- (3) the disposal of coal or iron ore treated as a sale under Code section 631(c);
- (4) the sale or exchange of livestock (excluding poultry) used in a trade or business for draft, breeding, dairy, or sporting purposes, if held for at least 12 months (24 months for horses and cattle);
- (5) the sale or exchange of unharvested crops sold with the land; and
- (6) the involuntary conversion of property or capital assets due to partial or total destruction, theft, seizure, requisition, or condemnation.

Long-term gains from section 1231 transactions were treated as long-term capital gains for tax purposes and were included in "Net Capital Gains" in these statistics. Losses under section 1231 were treated as ordinary losses, i.e., fully deductible from ordinary income. Amounts treated as long-term gains were reduced by a number of provisions designed to recapture (as ordinary income) previous benefits. These provisions included: sections 1245 and 1250, recapturing some depreciation taken previously; section 1252, recapturing conservation and land clearing expenses upon the sale of some farmland; section 1254, recapturing certain depletion, intangible drilling, and mine development expenses; and section 1255, recapturing some crop-sharing payments if a farm is sold within 20 years of receiving the payments.

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Gains and losses resulting from involuntary conversions, due mostly to casualty and theft, received special treatment. Such losses were to be included in the computation of net gain or loss, noncapital assets. However, some corporations reported them in other deductions, in which case, the losses were included in the statistics for other deductions. No attempt was made to recompute the net gain or loss from noncapital assets for such returns.

Although this item was a part of corporate-level income for S corporations, the portion of gain treated as long-term capital gain under section 1231 was not a part of the corporations' ordinary income (loss) from trade or business activities but rather was reported on the Form 1120S, Schedule K, *Shareholders' Shares of Income, Credits, Deductions, etc.*

### Net Income (or Deficit)

[Page 1, Line 28]

This was the companies' net profit or loss from taxable sources of income reduced by allowable deductions. It differed from "Total Receipts Less Total Deductions" because it included "Constructive Taxable Income from Related Foreign Corporations" and excluded "Interest on Government Obligations: State and Local." It differed from "Income Subject to Tax" by the "Statutory Special Deductions" allowed corporations. More information can be found under all these headings in this section.

Net income included income from the trade or business activities of S corporations, including ordinary gain from the sale of business property. Although the income was taxable to the shareholders, it was used for the statistics as a measure of corporate business activity for these companies. For tax purposes, net income for S corporations excluded passive income such as rents and portfolio investment income, which was passed through to the shareholders and reported on the Form 1120S, Schedule K, *Shareholders' Share of Income, Credits, Deductions, etc.* Statistics on these items are presented in Bennett, Kelly, "S Corporation Returns, 2001," *Statistics of Income Bulletin*, Spring 2004, Volume 23, Number 4. Although certain long-term capital gains were taxable to S corporations before the gains were passed through to the shareholders, these gains were excluded from net income.

The statistics for net income (or deficit) also included the "effectively connected income" of foreign corporations operating in the United States. Generally, income was considered effectively

connected if the foreign corporation conducted a trade or business in the United States and the income was attributable to that business.

Property and casualty insurance companies with premium income of \$1,200,000 or less could elect to compute income tax on their taxable investment income only, deducting only expenses related to that income. Therefore, the statistics for net income included only net investment income for those companies. (Such a company with premiums of \$350,000 or less was exempt from tax and so does not appear in these statistics.)

### Net Long-Term Capital Gain Reduced by Net Short-Term Capital Loss

See "Net Capital Gains."

### Net Operating Loss Deduction

See "Statutory Special Deductions."

### Net Short-Term Capital Gain Reduced by Net Long-Term Capital Loss

See "Net Capital Gains."

### Net Worth

Net worth represented the shareholders' equity in the corporation (total assets minus the claims of creditors). In the statistics, net worth comprised the net sum of the following items:

- (1) capital stock;
- (2) additional paid-in capital;
- (3) retained earnings, appropriated;
- (4) retained earnings, unappropriated;
- (5) less the cost of treasury stock.

### New Markets Tax Credit D (Form 8874)

The New Markets tax credit has been created to increase investments in low-income communities. The credit was equal to five percent of the investment in a qualified community development entity for the first three allowance dates and six percent of the investment for the next four allowance dates. The total credit available was equal to 39 percent of the investment over seven years.

The New Markets tax credit is a part of and subject to the limitations and carryover rules of the general business credit. The credit was calculated on Form 8874. The credit may not be carried back to tax years ending before January 1, 2001. Any unused credit at the end of the carryforward period will be allowed as a deduction in the following tax year. The components of the general business credit are shown separately in Table 21.

### New York Liberty Zone Credit D (Form 8884)

The New York Liberty Zone business employee credit was treated as a part of the work opportunity credit, and New York Liberty Zone business employees were considered members of a targeted group under the work opportunity credit. A New York Liberty Zone business uses Form 8884 to claim the New York Liberty Zone business employee credit. For tax years that include January 1, 2002, the credit was 40 percent (25 percent for employees who worked fewer than 400 hours) of the qualified wages (up to \$6,000) paid or incurred during the tax year, for work performed after December 31, 2001, to each New York Liberty Zone business employee.

A New York Liberty Zone business was any business that is located in the New York Liberty Zone or in the city of New York, New York, outside of the New York Liberty Zone, as a result of the physical destruction or damage of its place of business by the September 1, 2001, terrorist attack.

### Nonconventional Source Fuel Credit

This credit was allowed for the sale of qualified fuels produced from a nonconventional source. In general, the amount of credit was equal to \$3 (in 1979 dollars) for each quantity of fuel that would yield energy equivalent to that of a barrel of oil, approximately 5.8 million British Thermal Units (BTU's). Only production within the U.S. or a U.S. possession was taken into account.

The credit was available for production and sale of the following:

- (1) fuel produced from shale and tar sands;
- (2) gas produced from geopressed brine, Devonian shale, coal seams, or a tight formation;
- (3) gas produced from biomass; and
- (4) liquid, gaseous, or solid synthetic fuel (including alcohol) produced from coal (including lignite), including such fuels when used as feedstocks.

The tax credit was tied to the wellhead price of domestic oil (the reference price), adjusted for inflation, and was to be eliminated when the price of conventional fuels rose high enough to make the nonconventional fuels competitive.

### Notes and Accounts Receivable

[Page 4, Schedule L, Line 2a(c)]

In general, notes and accounts receivable were the gross amounts arising from business sales or services to customers on credit during the ordinary

course of trade or business. These current assets would normally be converted to cash within 1 year. This category included commercial paper, charge accounts, current intercompany receivables, property improvement loans, and trade acceptances. Current nontrade receivables were generally included in other current assets.

Certain savings and loan associations reported loans and mortgages as notes and accounts receivable. When identified, such mortgage loans were included in the statistics for mortgage and real estate loans, rather than notes and accounts receivable.

The gross amount of the receivables and the corresponding adjustment account, allowance for bad debts, were reported on the balance sheets of most corporation income tax forms. For an explanation of the adjustment account, see "Allowance for Bad Debts." Some corporations, however, reported only the net amount of the accounts receivable.

### Notes and Accounts Receivable, Net

"Notes and accounts receivable, net" were presented in the statistics in Tables 4 and 5. The amount shown was the net sum of "Notes and Accounts Receivable" after the reduction for the "Allowance for Bad Debts." Each of these terms is described separately under its own heading in this section.

### Number of Returns

This was a count of the returns filed by active corporations on one of the Form 1120-series returns. It included ordinary for-profit C corporations filing the Form 1120 or its simplified version, Form 1120-A, S corporations electing to be taxed through their shareholders filing Form 1120S, foreign corporations with U.S. source income filing Form 1120-F, life insurance companies filing Form 1120-L, property and casualty insurance companies filing Form 1120-PC, Real Estate Investment Trusts filing Form 1120-REIT, and Regulated Investment Companies filing Form 1120-RIC. It did not include non-profit corporations, exempt farmers' cooperatives, and many other incorporated organizations that did not file corporation income tax returns. It also did not include the returns of inactive corporations, defined as those reporting no item of income or deductions; returns of inactive corporations were excluded from the statistical sample. See Section 3, Description of the Sample and Limitations of the Data.

Consolidated groups could file a single return covering many corporations, so the number of

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returns was not a count of the number of active corporations.

### Orphan Drug Credit [Form 8820]

This was a credit for 50 percent of the costs of testing drugs to be used for treating rare diseases, defined as those affecting fewer than 200,000 people or those occurring so infrequently that developing a drug to treat them would not be economical. This had been one of the "sunset" provisions (regularly reviewed and extended), but the Taxpayer Relief Act of 1997 made it a permanent part of the tax law.

The orphan drug credit was claimed as one of the components of the general business credit. For a discussion of the income tax limitations and carryback and carryforward provisions of the credit, see "General Business Credit." The components of the general business credit are shown separately in Table 21.

### Other Assets

[Page 4, Schedule L, Line 14(d)]

In general, other assets comprised noncurrent assets, which were not allocable to a specific account on the balance sheet, and certain assets not identified as current or noncurrent. Both tangible and intangible assets were included in this category. Also included were assets such as: deposits on contracts, interest discounts, and guaranty deposits, when reported as noncurrent assets. Other assets of life insurance companies included the market value of real estate and that portion of stock and bond holdings in excess of book value. For statistical purposes, negative balance sheet asset accounts have been moved to, and included in, the computation of other assets. This procedure was adopted to address the increased usage of negative items being reported on corporate balance sheets. This process may cause other assets to become negative in certain situations.

When identified on the tax return, assets held for investment were not included in other assets.

### Other Capital Assets Less Reserves

This item, shown in Tables 4 and 5, consisted of "Depletable Assets" less accumulated depletion, "Land," and "Intangible assets" less accumulated amortization. Each is described separately under its own heading in this section.

### Other Costs

[Page 2, Schedule A, Line 5]

See "Cost of Goods Sold."

### Other Credits and Payments

[Form 1120-PC, Page 1, Line 14i]

See "Overpayment or Tax Due."

### Other Current Assets

[Page 4, Schedule L, Line 6(d)]

Other current assets included assets not allocable to a specific current account listed on the balance sheet of the tax form and assets reported as short-term, but without identification of a specific current account.

Marketable securities, prepaid expenses (unless reported as long-term), nontrade receivables, coupons and dividends receivable, and similar items were included in this asset account. Deposits were included here for banks and deposit institutions. Also included were amounts in excess of billings for contract work in progress reported as current by construction corporations.

When reported by certain nonconsolidated financial companies, inventories were included in the statistics for other current assets, rather than for inventories. Those nonconsolidated financial companies included banks, credit agencies, insurance companies, insurance agents, brokers, real estate operators, lessors, and condominium management and cooperative housing associations. Inventories were included in other current assets if reported by bank holding companies, whether a "pure" consolidated or nonconsolidated. However, if consolidated with nonfinancial subsidiaries, then inventories were not moved to other current assets to the extent they were attributable to the nonfinance subsidiaries.

Some property and casualty insurance companies included investments in government obligations and tax-exempt securities with other current assets on the income tax return, Form 1120-PC. When identified, the amounts were included in the statistics for investments in government obligations and tax-exempt securities, and excluded for other current assets.

### Other Current Liabilities

[Page 4, Schedule L, Line 18(d)]

Other current liabilities included certain amounts due and payable within the coming year. The account was comprised of accrued expenses, as well as current payables not arising from the purchase of goods and services. Examples of other current liabilities were taxes accrued or payable, accrued employee accounts such as for payrolls and contributions to benefit plans, dividends payable, overdrafts, accrued interest or rent, and deposits

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and withdrawable shares of banking and savings institutions, if not reported as long-term by the corporation. For construction corporations, amounts for uncompleted contracts or jobs in progress were included in this item, if reported as current.

### Other Deductions

[Page 1, Line 26]

Other deductions comprised: (1) business expenses which were not allocable to a specific deduction item on the tax return, or which were not included elsewhere on the tax return, and (2) certain amounts which were given special treatment in the course of statistical processing. It also included adjustments reported as deductions.

The first category included such items as administrative, general, and selling expenses; commissions (unless reported as cost of goods or salaries and wages); delivery, freight, and shipping expenses; sales discounts; travel and entertainment expenses; utility expenses not reported as part of the cost of goods sold; and similar items. For meal and entertainment expenses, generally only 50 percent was deductible.

The second category included intangible drilling costs, direct pensions (paid by a company to an individual but not to pension plans), employee welfare (but not payments to welfare or benefit plans), moving expenses (for employees), partnership net losses, and patronage dividends paid. Also included were itemized business deductions and other deductions unique to life and property and casualty insurance companies.

Corporations filing the Form 1120-A were required to report amounts for advertising, depletion, and deductions for pension, profit-sharing, and employee benefit plans on an attached schedule. When these were identified on such a schedule, they were moved to the appropriate item.

Losses from involuntary conversions which were reported as ordinary losses on Form 4797, Supplemental Schedule of Gains and Losses, were included in the statistics for Net Gain (or Loss), Noncapital Assets. However, some taxpayers reported such amounts as deduction items; if so, they were included in the statistics for other deductions. Also included were net foreign currency losses for regulated investment companies, life insurance increases in reserves, and policyholder dividends paid by insurance companies on participating policies (after reduction by the section 809 limitation).

The statistics for other deductions excluded

amounts for amortization (except amortization of intangible drilling costs and from specified policy acquisition expenses of life insurance companies (IR section 848)), which were moved during statistical processing to "Amortization."

### Other Investments

[Page 4, Schedule L, Line 9(d)]

This category generally included long-term non-government investments and certain investments for which no distinction could be made as to their current or long-term nature. Examples of non-government investments included stocks, bonds, loans to subsidiaries, treasury stock reported as assets, and other types of financial securities.

Real estate not reported as a fixed asset could also be included. In certain instances, land and buildings owned by real estate operators (except lessors of real property other than buildings) were reported as other investments. Certain insurance carriers also included their real estate holdings (other than their home and branch office buildings) in this asset category.

When inventories were reported by companies in certain financial industries, the amounts were included in the statistics for other investments and excluded from inventories. For security brokers and dealers, commodity brokers, dealers, and exchanges, and holding and other investment companies (except bank holding companies), inventories were included in other investments unless the return was consolidated and included nonfinance subsidiaries. Inventories attributable to the nonfinance subsidiaries were not moved to other investments.

The statistics may be somewhat overstated by amounts reported for treasury stock. When treasury stock held for resale or for future distribution was reported as an asset, rather than as an offset to capital stock, the treasury stock was included in the statistics for other investments.

Some property and casualty insurance companies included investments in government obligations and tax-exempt securities in other investments on the income tax return, Form 1120-PC. When identified, these amounts were transferred to the appropriate accounts.

### Other Investments and Loans

This item, shown in Tables 4 and 5, was the sum of "Loans to Shareholders," "Mortgage and Real Estate Loans," and "Other Investments." Each is described separately under its own heading in this section.

### Other Liabilities

[Page 4, Schedule L, Line 21(d)]

Other liabilities were obligations which were not allocable to a specific account on the balance sheet and which were either noncurrent accounts, in general not due within 1 year, or accounts which could not be identified as either current or long-term. The excess of reserves for amortization, depreciation, and depletion over the respective asset accounts was included in this balance sheet account.

Examples of other liabilities were deferred or unearned income not reported as part of a current account, provisions for future or deferred taxes based on the effects of either accelerated depreciation or possible income tax adjustments, and principal amounts of employee and similar funds. Accounts and notes payable, borrowed securities, commissions, intercompany accounts, loans, overdrafts, and unearned income were also included. For statistical purposes, negative balance sheet liability accounts have been moved to, and included in, the computation of other liabilities. This procedure was adopted to address the increased usage of negative items being reported on corporate balance sheets. This process may cause other liabilities to become negative in certain situations.

### Other Receipts

Other receipts included amounts not elsewhere reported on the return form, such as: income from minor operations; cash discounts; income from claims, license rights, judgments, and joint ventures; net amount earned under operating agreements; profit from commissaries; profit on prior-years' collections (installment basis); profit on the purchase of a corporation's own bonds; recoveries of losses and bad debts previously claimed for tax purposes; refunds for the cancellation of contracts; auto lease inclusion income; and income from sales of scrap, salvage, or waste.

Also regarded as other receipts were unidentified and certain dividends received, such as from Federal Reserve and Federal Home Loan Banks, and from the following special classes of corporations: corporations deriving a large percent of their gross income from sources within a U.S. possession, when they did not provide detailed attachments; and tax-exempt charitable, educational, religious, scientific and literary organizations, and mutual and cooperative societies including farmers' cooperatives. Also included were any adjustment items reported by corporations and listed in other income, payments with respect to security loans, foreign currency gains for regulated

investment companies, and life insurance decreases in reserves. See also, "Business Receipts."

### Overpayment of Tax

[Page 1, Line 35]

See "Overpayment or Tax Due."

### Overpayment or Tax Due

All corporations with more than minimal tax liability were required to have settled their liability by the time their returns were due for their accounting year, within specified tolerances. They were required to estimate their liability at the beginning of their tax year and make payments on this estimated tax liability at least quarterly. If estimated tax payments were less than final tax liability for the year, within the allowed tolerances, the corporation was assessed a penalty. The corporation could count as tax payments its "Credit for Tax Paid on Undistributed Capital Gain" and any "Credit for Federal Tax on Fuels" (see these headings, above). A property and casualty insurance company could also claim a credit for taxes paid by a reciprocal (see "Reciprocal Tax") and for certain other payments and credits it could have been required to make. A corporation that requested an extension of time to file its tax return was required to pay any final estimated tax liability not already covered (see "Tax Deposited with Form 7004"). When the corporation finally filed its return for the year, it would seldom have paid exactly the final liability; most corporations would have had either an overpayment or a tax due.

Estimated tax payments were required of any corporation expecting to owe a tax liability of \$500 or more for the year. The payments had to be made quarterly, on the fifteenth day of the fourth, sixth, ninth, and twelfth months of the company's accounting year. If the total payments for the year were greater than the liability shown on the return, the overpayment could be either refunded or applied to next year's estimated tax liability. If a corporation realized before it filed its return that it had overpaid, and the overpayment was at least \$500 and at least 10 percent of tax liability for the year, it could apply for an immediate refund of the excess payment. The application had to be made within 2-1/2 months of the close of its taxable year.

If a corporation had \$500 or more of tax liability on the due date of its return and had not made quarterly estimated tax payments of at least 25 percent (each quarter) of the liability shown on its return or 25 percent of the tax it paid in the previous year, it was liable for a penalty for underpayment of estimated tax. This penalty, which was calculated at

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the current interest rate prescribed by IRS, became a part of the tax due when the corporation filed its return. However, the penalty did not apply if there was a legitimate reason for the underpayment.

The components of the tax payment schedule are shown in Tables 18 and 20.

### Overpayments less Refund

[Page 1, Line 32d]

This was the net estimated tax payments, after deducting any amount previously refunded, remaining to be credited when the corporation's tax return was filed. See "Overpayment or Tax Due."

### Passive Activity Credits

[Form 3800, Lines 3 and 5]

The General Business Credit that could be claimed by personal service corporations and closely held corporations was subject to an additional limitation if the component credits were generated in a passive activity. The total amount of such credits and the amount allowed in 2001 are shown in the computation of the general business credit in Table 21. A personal services corporation was one whose principal activity was the performance of personal services that were substantially performed by employee-owners who owned more than 10 percent of the fair market value of the corporation's stock. A closely held corporation was a corporation that at any time during the last half of the tax year had 50 percent or more of the value of its outstanding stock owned directly or indirectly by not more than five individuals and was not an S corporation or a personal service corporation. Passive activities generally included trade or business activities in which the corporation did not materially participate for the tax year and, with exceptions, rental activities regardless of the corporation's participation.

### Penalty for Underpayment of Estimated Tax

[Page 1, Line 33]

See "Overpayment or Tax Due."

### Pension, Profit-Sharing, Stock Bonus, and Annuity Plans D

[Page 1, Line 24]

This deduction was the current year's deductible contributions to qualified pension, profit-sharing, or other funded deferred compensation plans. Contributions made by employers to these plans were deductible under Code section 404 subject to limits on contributions for owners, officers, and highly paid employees. For defined-benefit plans, contributions were also limited based on actuarial

computations of the amount necessary to fund the promised benefits.

The statistics included amounts from "Cost of Goods Sold" and "Other Deductions" identified as pensions (unless clearly direct pensions), annuity plans, 401(k) plans, profit-sharing plans, retirement plans, and stock bonus plans. Any amounts identified as part of cost of goods sold or capitalized under section 263A were excluded from cost of goods sold and included in these statistics. The combined amount for companies other than mining companies that reported an amount for a combination of welfare/retirement plans was included in the statistics for contributions to pension and profit-sharing plans.

Amounts found in other deductions on an 1120-A return and identified as pension and profit-sharing, stock bonus, and annuity plans were included in these statistics.

This item was not reported for regulated investment companies and real estate investment trusts.

### Prior Year Minimum Tax Credit

[Form 8827, Line 8]

Corporations received a credit against their regular income tax liability for alternative minimum taxes paid in prior years to prevent double taxation of the same income. The minimum tax was imposed currently on income for which tax liability was only deferred under the regular tax; when the deferral ended and the income became taxable under the regular tax, credit was given for the taxes already paid on that income. The minimum tax credit thus acted as a mechanism to coordinate the two tax systems. The credit was limited to the excess of regular tax after credits over the current year tentative minimum tax. Any unused portion of the prior year minimum tax credit could be carried forward indefinitely to reduce the regular tax. The credit was not designed to reduce any minimum tax liability. There were no carryback provisions for this tax credit. See also, "Alternative Minimum Tax."

### Purchases

[Page 2, Schedule A, line 2]

This is the total of items purchased during the year for resale or to become a part of goods manufactured or prepared for sale. See "Cost of Goods Sold."

### Qualified Electric Vehicle Credit

[Form 8834, Line 19]

A qualified electric vehicle was a vehicle with at least four wheels powered by an electric motor and

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intended for use on public streets, roads, and highways. To receive the credit, original use of the vehicle had to begin with the taxpayer, and it had to be for the taxpayer's own use and not for resale. The credit was equal to the lesser of \$4,000 or 10 percent of the cost of the vehicle after reduction by any section 179 deduction. The basis of any vehicle for which the credit was allowed was reduced by the amount of the credit. Vehicles qualifying for this credit were not eligible for the deduction for clean-fuel vehicles under section 179A. If the vehicle ceased to qualify within 3 years of the date it was placed in service, some or all of the credit was recaptured.

### **Qualified Zone Academy Bond Credit** [Form 8860]

A qualified zone academy bond is a taxable bond issued by a state or local government, the proceeds of which are used to improve certain eligible public schools. In lieu of receiving periodic interest payments, holders of these bonds are entitled to an annual income tax credit while the bond is outstanding. Eligible holders are (certain financial institutions, including banks, insurance companies, and corporations actively engaged in the lending of money). This credit is allowed on bonds issued after December 31, 1997. For calendar years 2000 and 2001 up to \$400 million of qualified zone academy bonds may be issued. Starting with Tax Year 2000 the credit is now part of total credits on the tax computation schedule.

### **Reciprocal Tax**

[Form 1120PC, Page 1, Line 5]

A property and casualty insurance company with reciprocal or interinsurance arrangements with another entity (an "attorney-in-fact") could elect to allocate to the other entity deductions equal to those actually claimed by the other entity for the allocated insurance. In effect, this caused the net income from the transaction to be taxable to both entities, but since both might not have been taxable at the same rate, section 835 taxed the income to the insurance company at the highest corporate rate and allowed the company to take a credit for any taxes paid by the other entity. The Reciprocal Tax and the Credit by Reciprocal were included in "Total Income Tax After Credits" in the general tables and were shown separately in Table 20.

### **Renewable Electricity Production Credit** [Form 8835]

This was a credit for the domestic production of electricity from wind or "closed-loop" biomass facilities. A "closed-loop" biomass facility was one that used plants grown for the purpose of generating electricity. The credit was 1.5 cents (in 1992 dollars)

per kilowatt-hour of electricity produced during the first ten years of a facility's operation and sold to an unrelated person. The credit amount was adjusted for inflation each year and was 1.7 cents in 2000.

The Tax Relief Extension Act of 1999 extended the time for placing a qualified facility in service until December 31, 2001. However, electricity produced by a qualified wind facility placed in service after June 30, 1999, and sold to a utility under a contract originally entered into before 1987 may not qualify for the credit. The credit was also expanded to include poultry waste facilities placed in service after 1999.

The renewable electricity production credit was included in the general business credit shown in the tables. For a discussion of the income tax limitations and carryback and carryforward provisions of the credit, see "General Business Credit." The components of the general business credit are shown separately in Table 21.

### **Rent Paid on Business Property**

[Page 1, Line 16]

This deduction consisted of rents paid for the use of land, buildings or structures, and rents paid for leased roads, and work equipment for railroad companies. Also included in rents paid was the leasing of vehicles. Auto lease inclusion income, required by law to offset this deduction for businesses that lease luxury automobiles, was reported in other receipts. Some corporations reported taxes paid and other specific expenses with rents paid. When identified, those items were included in the statistics for the respective deductions and excluded from rents paid.

Rent identified as part of the cost of goods sold, or capitalized under section 263A, was excluded from cost of goods sold and included in the statistics as rent paid on business property.

### **Rents**

[Page 1, Line 6]

These were the gross amounts received for the use or occupancy of property by corporations whose principal activities did not involve operating rental properties. Expenses related to rental property, such as depreciation, repairs, interest paid, and taxes paid, were not deducted directly from the rental income, but were reported as business deductions.

When rents were a significant portion of a corporation's operating income, they were included in the statistics for business receipts rather than in rents. These corporations included some

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manufacturers and public utility companies, as well as businesses whose principal operating income was expected to be rents, such as hotels, motels, and other lodging places. For real estate operators, rental income was included in business receipts if the expense schedule indicated that the owner operated the building rather than leased it. No rent was reported for regulated investment companies. S corporations reported income from rents on the Form 1120S, Schedule K, *Shareholders' Shares of Income, Credits, Deductions, etc.* and are not included in these statistics. These statistics are presented in Bennett, Kelly, "S Corporation Returns, 2001," *Statistics of Income Bulletin*, Spring 2004, Volume 23, Number 4.

### Repairs

[Page 1, Line 14]

Repairs reported as an ordinary and necessary business expense were the costs of maintenance and incidental repairs that did not add to the value or appreciably prolong the life of the property. Expenditures for permanent improvements, which increased the basis of the property, were required to be capitalized and depreciated rather than deducted currently. Regulated investment companies did not report repairs.

### Research Activities Credit [Form 6765] D

The research activities tax credit is a credit for qualified research expenses and basic research payments to universities and other qualified organizations paid or incurred after June 30, 1996. The research credit was, in general, 20 percent of the excess of qualified research expenses for the current year over the average research expenses in the base period (1983-1989), calculated as a percentage of gross receipts. A "start-up" company not in existence during the base period could use a fixed 3 percent of gross receipts as its average base period expenditures. Payments for basic research to universities or research organizations in excess of average contributions for the previous three years and 65 percent (or 75 percent) of payments to others for contract research also qualified. The base period research expenses could never comprise less than half of the qualified research expenses for the current tax year. In the case of a short taxable year, research expenditures were annualized.

Research was limited to research undertaken to discover information, technological in nature and useful in the development of a new or improved business component. The research had to be conducted within the United States and could not involve the social sciences or humanities. Research funded by another person, by a grant, or by a government agency was ineligible for the credit.

For tax years beginning after June 30, 1996, an alternative incremental credit could have been elected. This calculation used a base period consisting of the previous 4 tax years, fixed percentages of gross receipts for the base period expenditures, and lower, tiered, credit rates. If base period expenditures were at least 1 percent but less than 1.5 percent of receipts, a credit of 1.65 percent of the excess of current expenditures over that amount was allowed. A rate of 2.2 percent was allowed for expenditures exceeding 1.5 percent but less than 2 percent, and a rate of 2.75 percent was allowed for expenditures exceeding 2 percent.

The Tax Relief Extension Act of 1999 extended the credit for amounts paid or incurred through June 30, 2004, increased the alternative incremental credit rates by one percentage point for tax years beginning after June 30, 1999, included research conducted in Puerto Rico or a U.S. possession, and suspended the research credit attributable to periods after June 30, 1999.

The second suspension period covered October 1, 2000 through September 20, 2001. Any research credit attributable to the second suspension period may not be claimed or otherwise taken into account before October 1, 2001 for the second suspension period. The suspended credit may not be claimed as a carryback or carryforward until the day after the end of the suspension period. The current year research activities credit amount, shown in Table 21, does include the suspended amount. Since the research activities credit was one of the components of the general business credit it must be noted that the suspended amount of the research activities credit is not included in the total amount for general business credit, which is carried to the Schedule J.

For a discussion of the income tax limitations and carryback and carryforward provisions of the credit, see "General Business Credit." The components of the general business credit are shown separately in Table 21.

### Retained Earnings, Appropriated

[Page 4, Schedule L, Line 24(d)]

Earnings set aside for specific purposes and not available for distribution to shareholders were included under this heading. Included were guaranty funds (for certain finance companies), reserves for plant expansion, bond retirements, contingencies for extraordinary losses, and general loss reserves. Also included were the total amount of all the companies' reserves not defined as valuation reserves or reserves included in other liabilities. Specifically excluded were the reserves for bad debts, depreciation, depletion, and

amortization, which were shown separately in this report. Unrealized appreciation was included in retained earnings unappropriated. Unrealized profits were included in other liabilities. Unearned income, if not current, was also included in other liabilities. Any amount of retained earnings not identified as appropriated or unappropriated was considered unappropriated for purposes of these statistics.

### **Retained Earnings, Unappropriated**

[Page 4, Schedule L, Line 25(d)]

Retained earnings, unappropriated, consisted of the retained earnings and profits of the corporation less any reserves (these reserves were shown in the statistics as Retained Earnings, Appropriated). Dividends and distributions to shareholders were paid from this account. These accumulated earnings included income from normal and discontinued operations, extraordinary gains or losses, and prior period adjustments. Also included were undistributed or undivided earnings (income or profits), and earned surplus. For railroads, unappropriated retained earnings included additions to property and funded debt retired through income and surplus. The statistics presented here are net amounts after reduction for negative amounts reported.

Adjustments reported by the taxpayers primarily consisted of unrealized gains and losses from securities held "available for sale." Also included in this item were foreign currency translation adjustments, guarantees of employee stock ownership plan debt, and compensation related to employee stock award plans.

### **Returns of Active Corporations**

These returns were the basis for all financial statistics presented in the report. They comprised the vast majority of the returns filed, and were defined for the statistics as returns of corporations reporting any income or deduction items, including tax-exempt interest. Although corporations in existence during any portion of the taxable year were required to file a return whether or not they had income and deductions (Code section 6012(a)(2)), inactive corporations' returns were excluded from the statistics. See Section 3, Description of the Sample and Limitations of the Data.

### **Returns With Net Income**

See "Net Income (or Deficit)."

### **Royalties**

[Page 1, Line 7]

Royalties were gross payments received, generally on an agreed percentage basis, for the

use of property rights before taking deductions for depletion, taxes, etc. Included were amounts received from such properties as copyrights, patents, and trademarks; and from natural resources such as timber, mineral mines, and oil wells. Expenses relating to royalties, depletion or taxes, were not deducted directly from this income, but were reported among the various business deductions from total gross income. No royalties were included in the statistics for regulated investment companies and real estate investment trusts. S corporations reported this item on the Form 1120S, Schedule K, *Shareholders' Share of Income, Credits, Deductions, etc* and are not included in these statistics. These statistics are presented in Bennett, Kelly, "S Corporation Returns, 2001," *Statistics of Income Bulletin*, Spring 2004, Volume 23, Number 4.

Excluded from the statistics were certain royalties received under a lease agreement on timber, coal deposits, and domestic iron ore deposits, which were allowed special tax treatment. Under elective provisions of Code section 631, the net gain or loss on such royalties was included in the computation of net gain or loss on sales or exchanges of certain business property under section 1231. If the overall result of this computation was a net gain, it was treated as a long-term capital gain. If the overall result was a net loss, it was fully deductible in the current year as an ordinary noncapital loss. See also, the discussions of "Net Capital Gains" and "Net Gain (or Loss), Noncapital Assets."

### **S Corporation Returns**

Form 1120S, U.S. Income Tax Return for an S Corporation, was filed by corporations electing to be taxed through their shareholders under Code section 1362. These companies reported corporate income and deductions from their conduct of trades or businesses, but generally allocated any income or loss to their shareholders to be taxed only at the individual level. Portfolio income (loss), net rental real estate income (loss), net income (loss) from other rental activities, and other income (loss) were not included in net income (loss) from ordinary trade or business but were allocated to shareholders to be reported on their individual returns.

Only corporate-level income of S corporations was included in the statistics in this report. S corporation trade or business income and deductions were included in the general tables and also shown separately in Tables 14 and 15. Data on rental and investment income allocated to shareholders is published annually in the *SOI Bulletin* (Publication 1136) and is also available in the *Corporation Source Book*.

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Subchapter S of the Internal Revenue Code--from which these corporations take their name--provided a set of restrictive criteria which a company had to meet in order to qualify. For tax years beginning after 1996, S corporations had to meet the following criteria:

- (1) no more than 75 shareholders;
- (2) only individuals as shareholders (with an exception for estates and trusts, including charitable remainder trusts);
- (3) no nonresident alien shareholders; and
- (4) only one class of stock.

For tax years beginning after 1997, exempt organizations described in section 401(a) or 501(c)(3) are permitted to be shareholders.

Corporations that were ineligible to be treated as S corporations were:

- (1) banks or similar financial institutions using the reserve method of accounting for bad debts under section 585;
- (2) life insurance companies;
- (3) corporations electing to take the U.S. possessions tax credit;
- (4) Interest-Charge Domestic International Sales Corporations (IC-DISC) or former DISCs; and
- (5) affiliated group members eligible for inclusion on a consolidated return.

The Small Business Job Protection Act of 1996 provided significant reform for S corporations. This legislation contained 17 provisions relating to S corporations. For more information on the impact of this legislation on S corporations see Wittman, Susan, "S Corporation Returns, 1997," *Statistics of Income Bulletin*, Spring 2000, Volume 19, Number 4.

Some S corporations were subject to certain special taxes at the corporate level. See "Excess Net Passive Income Tax" and "Income Tax" in this section.

### Section 857(b)(5) Tax

[Form 1120-REIT, Page 3, Schedule J, Line 3(c)]

Real estate investment trusts were required to derive at least 95 percent of their income from portfolio investments (dividends, interest, capital gains) and real estate and at least 75 percent of their income from real estate investments (rents, interest on mortgage bonds, sales of rental or foreclosure property). If these limits were not met, the shortfall was subject to a special tax under Code section 857(b)(5). This tax is a component of

"Total Income Tax Before Credits" and is shown separately in Table 20.

### Size of Business Receipts

Returns for nonfinance industries were classified by size of gross receipts from sales and operations. Returns of industries within the "Finance and Insurance" and "Management Holding Companies" sectors were classified by size of total receipts (the sum of business receipts and investment income). See also, "Business Receipts" and "Total Receipts."

### Statutory Special Deductions D

[Page 1, line 29c]

Statutory special deductions in the tables was the sum of the deductions for net operating loss carryovers from prior years and the special deductions for dividends and other corporate attributes allowed by the Code. These deductions were in addition to ordinary and necessary business deductions and were shown in the statistics as deductions from net income. In general, net income less statutory special deductions equaled income subject to tax. The following components of Statutory Special Deductions are shown separately in Table 20.

**Net operating loss deduction.** This deduction was the result of prior-year net operating losses. For most corporations, net operating losses (NOLs) could have been carried back to reduce any taxes paid in the 3 years previous to the loss year (2 years for NOLs incurred in tax years beginning after August 5, 1997), and any remaining amounts carried forward for 15 years (20 years for NOLs incurred in tax years beginning after August 5, 1997). Amounts carried back, however, would not have appeared on the returns used for the statistics in this report. This item represents amounts carried forward from previous years and applied to reduce taxable income in the current year.

**Total special deductions** was the sum of the following deductions:

- (1) **Dividends received deduction.** This deduction was based on the type of stock owned and the extent of ownership. Generally, dividends from other domestic members of a company's affiliated group were deducted 100 percent, those from other domestic companies owned 20 percent or more were allowed an 80 percent deduction, and those owned less than 20 percent were allowed a 70 percent deduction. These percentages were reduced if the stock was debt-financed or if it

## 2001 Corporation Returns - Explanation of Terms

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was preferred stock of public utilities that were allowed a deduction for dividends paid. In the case of life insurance companies, the dividend received deduction (other than the 100-percent deduction) was further reduced by the share of the company's investment income attributed to policyholders.

A deduction for dividends received from a foreign corporation was allowed if the foreign corporation had been engaged in a trade or business within the United States for at least 3 years and if at least 50 percent of its gross income was effectively connected U.S. trade or business income. The deduction was allowed only for dividends attributable to income earned in the United States, and only if the U.S. corporation owned at least 10 percent of the stock of the foreign corporation.

The total dividends received deduction was further limited based on net income. Generally, the 70- and 80-percent deductions could not exceed 70 and 80 percent of net income less the 100-percent deductions for dividends received from affiliated groups, foreign sales corporations, and small business investment companies. This limitation did not apply if the corporation had a net operating loss (even if the loss was caused by the dividends received deduction).

The various categories of stock ownership and the percentages that were deductible are shown on Form 1120, Schedule C (reproduced in Section 6). See also, "Dividends Received from Domestic Corporations" and "Dividends Received from Foreign Corporations" in this section.

- (2) **Deduction for dividends paid on certain public utility stock.** This special deduction was for dividends paid on preferred stock issued by regulated telephone, electric, gas, or water companies before October 1, 1942, or issued to replace such stock. Companies were allowed to deduct 40 percent of the smaller of such dividends or taxable income computed without this deduction.
- (3) **Deduction for dividends paid (Forms 1120-RIC and 1120-REIT).** Regulated investment companies (RICs) and real estate investment trusts (REITs) were required to distribute virtually all (90 percent

for both returns types, except 95 percent for REITs for tax years beginning before January 1, 2001) of their taxable income to their shareholders in the form of dividends to qualify for their special status. Their taxable income was reduced by the dividends they paid (which were taxable to the recipients), and they generally paid no corporate tax. This special deduction represented those required distributions.

- (4) **Section 857(b)(2)(E) deduction (Form 1120-REIT).** This deduction was equivalent to the tax imposed on real estate investment trusts (REITs) that failed to meet the restrictions imposed on their sources of income. Generally, at least 75 percent of their income had to come from real estate investments and at least 95 percent from investment sources of all kinds. A tax of 100 percent was imposed on the net income attributable to the greater of the amounts by which the trust failed to meet the 75 or 95 percent income test, and a deduction was allowed to prevent the same income from being taxed under the income tax.
- (5) **Section 806(a) small life insurance company deduction.** A deduction equal to 60 percent of life insurance company taxable income not exceeding \$3,000,000 was allowed for a "small" life insurance company, defined as one with assets less than \$500,000,000. The deduction was phased out for "small" life insurance companies with life insurance company taxable income between \$3,000,000 and \$15,000,000. This item is included in "Statutory Special Deductions, Total," but is not shown separately in Table 20.

## Tax Deposited with Form 7004

[Page 1, Line 32e]

This is the amount of the corporation's estimated tax liability deposited with the filing of Form 7004, Application for Automatic Extension of Time to File Corporation Income Tax Return, as reported on the corporation's income tax return for the year. The automatic extension of time to file a corporate tax return was 6 months, and any remaining tax liability was required to be paid with the request for an extension. See "Overpayment or Tax Due."

## Tax Due at Time of Filing

[Page 1, Line 34]

See "Overpayment or Tax Due."

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### Tax-Exempt Securities

[Page 4, Schedule L, Line 5(d)]

This balance sheet asset item comprised: (1) state and local government obligations, the interest on which was excludable from gross income under section 103(a); and (2) stock in a mutual fund or other regulated investment company that distributed exempt-interest dividends during the tax year of the corporation. Examples included bond anticipation notes, project notes, Public Housing Authority bonds, and state and local revenue bonds.

### Tax from Section I and Tax from Section II

[Form 1120-F, Page 1, Lines 1 and 2]

Foreign corporations with income effectively connected to a trade or business conducted in the U.S. were taxable at U.S. corporation income tax rates on that income, but they could also have been taxable on income not "effectively connected" with a U.S. trade or business (generally, portfolio investment and certain transportation income) just as nonresident foreign corporations were. On the Form 1120-F, the tax on income not effectively connected with a U.S. trade or business was called "Tax from Section I" and the tax on effectively connected income was called "Tax from Section II." Only the "Tax from Section II" is included as a component of "Income Tax" and "Total Income Tax" in the general tables in this report. It is also shown as a separate item in the tables devoted to foreign corporations, Tables 10 and 11.

"Tax from Section II" included income tax calculated at the U.S. corporate tax rates on effectively connected income, recapture taxes, and alternative minimum tax, and was reduced by the foreign tax credit, the nonconventional source fuel credit, the qualified electric vehicle credit, the general business credit, and the credit for prior year minimum tax.

The "Tax from Section I" from returns that also had effectively connected income is shown as a separate item in Tables 10 and 11, but is excluded from all other tables in the report. (Returns of foreign corporations that had no income effectively connected with a U.S. trade or business were excluded from the statistical sample.)

### Tax on Net Income from Foreclosure Property

[Form 1120-REIT, Page 3, Schedule J, Line 3(b)]

Real estate investment trusts that met the income requirements to qualify as REITs (see "Section 857(b)(5) Tax") were generally taxable at the shareholder rather than the corporate level. An exception was sales of certain property they had

acquired by foreclosure; the REIT could elect to be taxed at the top corporate rate of 35 percent on any gain from such transactions. This tax is included as a component of "Total Income Tax" (before and after credits) and is also shown separately in Table 20.

### Tax on Net Income from Prohibited Transactions

[Form 1120-REIT, Page 3, Schedule J, Line 3(d)]

Real estate investment trusts were forbidden to engage in real estate development or sales (except in the course of their rental or financing business). Any profit made in such transactions was subject to a 100 percent tax. This tax is included as a component of "Total Income Tax" (before and after credits) and is also shown separately in Table 20.

### Tax Year

Tax year (income year) in this publication refers to the year covering accounting periods ended July 2001 through June 2002. The corporation returns included span over 23 months between the first-included accounting period, which began on August 1, 2000, and closed on July 31, 2001, and the end of the last-included accounting period, which began on July 1, 2001, and closed on June 30, 2002. Therefore, this report shows income received or expenses incurred during any or all of the months in the 23-month span. This span, in effect defines the tax year in such a way that the non-calendar year ended accounting periods are centered by the calendar year ended accounting period. The calendar year made up 82.1 percent of the number of returns for Tax Year 2001. (see "Introduction" in Section I)

### Tax Refund

[Page 1, Line 36]

See "Overpayment or Tax Due."

### Taxable Income

[Page 1, Line 30]

This line item from Form 1120 is called "Income Subject to Tax" in this report.

### Taxes Paid

[Page 1, Line 17]

Taxes paid included the amounts reported as an ordinary and necessary business deduction as well as identifiable amounts reported in the cost of goods sold schedules or capitalized under section 263A. Included among the deductible taxes were ordinary state and local taxes paid or accrued during the year; social security and payroll taxes; unemployment insurance taxes; excise taxes, import and tariff duties; and business, license and privilege taxes. Income and profit taxes paid to foreign

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countries or U.S. possessions were also deductible unless claimed as a credit against income tax. However, S corporations excluded any foreign taxes from the deduction for taxes paid, instead allocating them to their shareholders (who might either deduct them or take a foreign tax credit for them). Regulated investment companies also had to exclude those foreign taxes from the deduction for taxes when they elected under Code section 853 to allow their shareholders to claim a foreign tax credit (or a deduction) for the foreign taxes paid. See also, "Foreign Tax Credit."

Taxes not deductible generally included Federal income and excess profits taxes, gift taxes, taxes assessed against local benefits, taxes not imposed on the corporation, and certain other taxes, including state or local taxes that were paid or incurred in connection with an acquisition or disposition of property. Taxes related to the acquisition of property were to be treated as part of the cost of the property, while taxes related to the disposition of property were to be treated as a reduction in the amount realized from the disposition.

Some corporations included sales taxes and excise and related taxes, which were part of the sales price of their products, as receipts. When this occurred, an equal and offsetting amount was usually included in the cost of goods sold or as part of the separate deduction for taxes paid. When included in the cost of goods sold, these taxes were included in the statistics for taxes paid when they could be identified.

### Tentative Minimum Tax

[Form 4626, Line 13]

The tentative minimum tax was determined by applying a 20 percent rate of tax to the alternative minimum taxable income after the reduction for the alternative tax NOLD and the income exemption. The tentative minimum tax could be reduced by an AMT foreign tax credit and carryover of unused empowerment zone credit. The foreign tax credit was computed under the AMT system and could not become part of that credit allowed under the regular tax system. Up to 25 percent of the tentative minimum tax remaining after the AMT foreign tax credit could be reduced by the carryover of empowerment zone credit.

The amount by which the remaining tentative minimum tax exceeded the regular tax after reduction by the foreign tax credit (under the regular system) and the possessions tax credit was the alternative minimum tax.

### Total Assets and Total Liabilities

[Page 4, Schedule L, Lines 15(d) and 28(d)]

Total assets and total liabilities were those reported in the end-of-year balance sheet in the corporations' books of account. Total assets were net amounts after reduction by accumulated depreciation, accumulated amortization, accumulated depletion, and the reserve for bad debts. If these reserve accounts were reported as liabilities, they were treated as reductions from the asset accounts to which they related and total assets and liabilities were adjusted accordingly. When used in this report, the term total liabilities included both the claims of creditors and shareholders' equity (see also, "Net Worth"). In addition, total liabilities were net amounts after reduction by the cost of treasury stock. See also, "Balance Sheets" in this section.

### Total Deductions

As presented in this publication, total deductions comprised: (1) the cost of goods sold; (2) the ordinary and necessary business deductions from gross income; and (3) net loss from sales of noncapital assets. Components of total deductions were shown in the income statement segment of various tables throughout this report. See also, "Total Receipts."

### Total Income Tax After Credits

[Page 3, Schedule J, Line 11]

Income tax after credits in the statistics equals "Total Income Tax Before Credits" less the sum of the "Foreign Tax Credit," "U.S. Possessions Tax Credit," "Nonconventional Source Fuel Credit," "Qualified Electric Vehicle Credit," "General Business Credit," "Prior Year Minimum Tax Credit," and "Qualified Zone Academy Bond Credit". Each of these items is discussed under its own heading in this section.

### Total Income Tax Before Credits

Total income tax before credits was the sum of the following taxes:

- (1) Income Tax;
- (2) Personal Holding Company Tax;
- (3) Recapture Taxes;
- (4) Alternative Minimum Tax;
- (5) Excess Net Passive Income Tax;
- (6) Capital Gains Tax of regulated investment companies;
- (7) Tax on Net Income from Foreclosure Property;
- (8) Section 857(b)(5) Tax;

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- (9) Tax on Net Income from Prohibited Transactions;
- (10) Branch Tax of Foreign Corporations; and
- (11) Reciprocal Tax.

Other tax and interest amounts were included in or subtracted from the total income tax. Amounts included were tax and interest on a nonqualified withdrawal from a capital construction fund (section 7518), interest due on deferred gain (section 1260(b)), interest on deferred tax attributable to installment sales of certain timeshares and residential lots (section 453(l)(3)), certain nondealer installment obligations (section 453A(c)), interest due under the look-back method, and deferred tax due upon the termination of a section 1294 election for shareholders in qualified electing funds. Amounts subtracted were deferred tax on the corporations share of the undistributed earning of a qualified electing fund, and deferred LIFO recapture tax (section 1363(d)). These amounts were included in the statistics as adjustments to total income tax.

### Total Income Tax (S Corporations)

Total income tax for S corporations (Tables 14 and 15) was the sum of the following taxes, each discussed under its own heading:

- (1) Income Tax;
- (2) Income Tax Adjustments;
- (3) Excess Net Passive Income Tax;
- (4) Recapture Taxes; and
- (5) Adjustments to Total Tax.

### Total Receipts

Total receipts was the sum of the following items, each discussed under its own heading:

- (1) Business Receipts;
- (2) Interest;
- (3) Interest on Government Obligations: State and Local;
- (4) Rents;
- (5) Royalties;
- (6) Net Capital Gains (excluding long term gains from regulated investment companies);
- (7) Net Gain, Noncapital Assets;
- (8) Dividends Received from Domestic Corporations;
- (9) Dividends Received from Foreign Corporations (excluding certain taxable income from related foreign corporations only constructively received); and
- (10) Other Receipts.

Total receipts for S corporations was the sum of the following items, each discussed under its own heading:

- (1) Business Receipts;
- (2) Interest on Government Obligations: State and Local;
- (3) Net Gain, Noncapital Assets; and
- (4) Other Receipts.

S corporations reported receipts for Interest, Rents, Royalties, Net Capital Gains, and Dividends on the Form 1120S, Schedule K, Shareholders' Shares of Income, Credits, Deductions, etc. and are not included in these statistics. These statistics are presented in Bennett, Kelly, "S Corporation Returns, 2001," *Statistics of Income Bulletin*, Spring 2004, Volume 23, Number 4.

### Total Receipts Less Total Deductions

This item differed from net income (less deficit) for tax purposes in that it included nontaxable interest on state and local government obligations and excluded constructive taxable income from related foreign corporations.

### Total Special Deductions

[Page 1, line 29b]

See "Statutory Special Deductions."

### Trans-Alaska Pipeline Liability Fund Credit

This component of the general business credit refunds certain unused environmental tax payments under section 4612(e). See "General Business Credit" for limitations and carryover provisions. The components of the general business credit are shown in Table 21.

### U.S. Government Obligations

[Page 4, Schedule L, Line 4(d)]

See "Investments in Government Obligations."

### U.S. Possessions Tax Credit

[Page 3, Schedule J, Line 6b]

Before August 20, 1996, a U.S. corporation earning at least 80 percent of its gross income in Puerto Rico or a U.S. possession (and earning at least 75 percent of its gross income from the active conduct of trade or business within a U.S. possession) was eligible for a credit against U.S. income tax for some or all of the tax on income earned in the possessions. The credit was limited to either a flat percentage of the U.S. tax otherwise due on the income (40 percent in 1999) or a percentage of the corporations' wages paid in the possessions and depreciation on property located in the possessions. The Small Business Job Protection Act of 1996 repealed the credit for any corporation not already using it and instituted a phase-out of the

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credit for existing users. After 2005, the credit was to be completely repealed.

### **U.S. Tax Paid or Withheld at Source**

[Form 1120-F, Page 1, Line 6h]

Foreign corporations with income related to a U.S. business activity (i.e., effectively connected income) often had U.S. income tax withheld at the source for their taxes on portfolio or transportation income that was not effectively connected to their U.S. operations, as well as certain income that was effectively connected (e.g., gains from the disposition of U.S. real property reported on Form 8288-A or effectively connected income allocable to foreign partners reported on Form 8805). This withheld tax is shown separately for effectively connected income and non-effectively connected income in Tables 10 and 11.

U.S. taxes paid or withheld by resident foreign corporations on income that was effectively connected to a U.S. trade or business are included in the statistics for "Overpayment or Tax Due," but taxes withheld at the source on non-effectively connected income are not included in any statistics except the separate item in Tables 10 and 11.

### **Welfare-to-Work Credit [Form 8861]**

The Tax Relief Extension Act of 1999 extended the welfare-to-work credit for qualified individuals who began work for the employer before January 1, 2002. The welfare-to-work credit was claimed by taxpayers for wages paid to current and former welfare recipients hired by the corporation after December 31, 1997. The credit was equal to 35 percent of the first \$10,000 of the employee's first-year wages and 50 percent of the first \$10,000 of second-year wages. Eligible employees were persons or members of families who had received aid to families with dependent children or its equivalent for at least 18 of the past 24 months, or who had been cut off from such aid within the last 2 years. Wages qualifying for this credit could not also qualify for the work opportunity credit.

The welfare-to-work credit was claimed as one of the components of the general business credit. For a discussion of the income tax limitations and carryback and carryforward provisions of the credit, see "General Business Credit" in this section. The

components of the general business credit are shown separately in Table 21.

### **Work Opportunity Credit [Form 5884]**

The work opportunity credit was extended to include wages paid to qualified individuals who began work for the employer before January 1, 2002. This credit, the successor to the jobs credit, allowed in prior years, was allowed to taxpayers who hired individuals from certain targeted groups to work at least 120 hours during the year.

Targeted groups were:

- members of families receiving benefits under the Aid to Families with Dependent Children (AFDC) or its successor program, Temporary Assistance to Needy Families (TANF);
- certain disabled veterans in families receiving food stamps;
- newly released economically disadvantaged ex-felons;
- high-risk youth (18-24 year olds from disadvantaged areas);
- vocational rehabilitation referrals;
- qualified summer youth (16-17 year olds from disadvantaged areas);
- 18-24 year olds from families receiving food stamps; and
- recipients of supplemental security income (SSI) hired after September 30, 1997.

Only the first \$6,000 (\$3,000 for qualified summer youth) of qualified first-year wages paid or incurred during the tax year for each employee is taken into account. The credit was limited to 25 percent if the employee worked at least 120 hours but less than 400 hours, and 40 percent if the employee worked 400 hours or more during the year.

The work opportunity credit was claimed as one of the components of the general business credit. For a discussion of the income tax limitations and carryback and carryforward provisions of the credit, see "General Business Credit" in this section. The components of the general business credit are shown separately in Table 21.

### **Zero-Assets**

See "Balance Sheets."