

# 1994



Department of the Treasury  
Internal Revenue Service

## Instructions for Form 1120-FSC U.S. Income Tax Return of a Foreign Sales Corporation

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

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

The time needed to complete and file this form and related schedule will vary depending on individual circumstances. The estimated average times are:

| Form              | Recordkeeping   | Learning about the law or the form | Preparing and sending the form to the IRS |
|-------------------|-----------------|------------------------------------|---|
| 1120-FSC          | 91 hr., 50 min. | 16 hr., 35 min.                    | 35 hr., 35 min.                           |
| Sch. P (1120-FSC) | 10 hr., 2 min.  | 1 hr., 29 min.                     | 1 hr., 43 min.                            |

If you have comments concerning the accuracy of these time estimates or suggestions for making this form and related schedule simpler, we would be happy to hear from you. You can write to both the **Internal Revenue Service**, Attention: Tax Forms Committee, PC:FP, Washington, DC 20224; and the **Office of Management and Budget**, Paperwork Reduction Project (1545-0935), Washington, DC 20503. **DO NOT** send the tax form to either of these offices. Instead, see **Where To File** on page 3.

### Changes To Note

- Some FSCs may be required to use a new method of depositing taxes due after 1994. Generally, the requirement applies to corporations whose total deposits of certain taxes during calendar year 1993 exceeded \$78 million. Other FSCs may use the new method voluntarily. For details, see **Depository Method of Tax Payment** on page 3.
- Final regulations under section 263A have been adopted. These regulations, which require the capitalization and inclusion in inventory of certain costs, generally are effective for tax years beginning after 1993. Changes in accounting methods may be necessary as a result of the issuance of the final regulations. These changes must be made under Rev. Proc. 94-49, 1994-30 I.R.B. 31.

The Revenue Reconciliation Act of 1993 (the Act) made changes to the tax law for FSCs. Some of the changes are highlighted below.

- The deductible portion of business meals and entertainment expenses has been reduced from 80% to 50%. See page 10.
- Generally, a publicly held FSC cannot deduct compensation paid to certain "covered employees" to the extent the compensation exceeds \$1 million. For details and exceptions, see the instructions for Schedule G, line 10.

### General Instructions

#### Purpose of Form

Form 1120-FSC is used to report income, gains, losses, deductions, and credits of a FSC. It is also used to figure the FSC's income tax liability or to claim a refund.

#### Definition of a FSC

Section 922(a) defines a FSC as a corporation that has met **all** of the following tests:

1. It must be a corporation created or organized under the laws of a qualifying foreign country or a U.S. possession.

A qualifying foreign country is a foreign country that meets the exchange of information requirements of section 927(e)(3)(A) or (B). The following income tax treaty jurisdictions have met the requirements of section 927(e)(3)(A) or (B): Australia, Austria, Barbados, Belgium, Bermuda, Canada, Costa Rica, Cyprus, Denmark, Dominica, Dominican Republic, Egypt, Finland, France, Germany, Grenada, Guyana, Honduras, Iceland, Ireland, Jamaica, Korea, Malta, Marshall Islands, Mexico, Morocco, the Netherlands, New Zealand, Norway, Pakistan, Philippines, St. Lucia, Sweden, and Trinidad and Tobago.

All U.S. possessions other than Puerto Rico are also certified as having met the requirements of section 927(e)(3)(A) or (B). A U.S. possession as defined in section 927(d)(5) includes Guam, American Samoa, the Commonwealth of the Northern Mariana Islands, and the Virgin Islands of the United States.

2. It must have no more than 25 shareholders at any time during the tax year.

3. It must not have preferred stock outstanding at any time during the tax year.

4. During the tax year, it must maintain an office in a qualifying foreign country or U.S. possession (defined above) and maintain a set of permanent books of account at that office. It must also maintain at a U.S. location the books and records required under section 6001 to sufficiently establish the amount of gross income, deductions, credits, or other matters required to be shown on its tax return.

5. At all times during the tax year, it must have at least one director who is not a resident of the United States.

6. It must not be a member, at any time during the tax year, of a controlled group of which a DISC is a member.

7. Its tax year must be the tax year of the principal shareholder who, at the beginning of the FSC's tax year, has the highest percentage of voting power. If two or more shareholders have the highest percentage of voting power, the FSC must elect the tax year of that shareholder. See section 441(h).

8. It must have made the FSC or small FSC (defined below) election by filing **Form 8279**, Election To Be Treated as a FSC or as a Small FSC, at the time and in the manner provided in section 927(f)(1). Also, it must have kept the election in effect for the tax year.

**Small FSC.**—Section 922(b) defines a small FSC as a corporation that (1) has elected small FSC status (by filing Form 8279 at the time and in the manner provided in section 927(f)(1)) and has kept it in effect for the tax year; and (2) is not a member, at any time during the tax year, of a controlled group that includes a FSC (unless that other FSC is also a small FSC).

A small FSC is exempt from the foreign management and foreign economic process requirements (see the instructions for **Foreign Management Requirements** and **Foreign Economic Process Requirements** on page 2) regarding its eligibility to treat a portion of its income as foreign trading gross receipts. Any foreign trading gross receipts of a small FSC for the tax year that exceed \$5 million are not to be considered in determining its exempt foreign trade income. The \$5 million limit is reduced if the small FSC has a short tax year and it may be reduced if the small FSC is a member of a controlled group that contains other small FSCs. See Regulations section 1.921-2(b) for more information.

#### Special Tax Treatment of a FSC

A FSC is not taxed on its **exempt foreign trade income**. Section 923 defines exempt foreign trade income as the gross income of a FSC from foreign trading gross receipts (see page 2). The percentage of foreign trade income that is exempt from taxation is figured differently for income determined under the administrative pricing rules (for details see the instructions for **Schedule P (Form 1120-FSC)**, Transfer Price or Commission) and income determined without regard to the administrative pricing rules. (These percentages are computed on Schedule E, page 4, Form 1120-FSC, and carried over to the computation of taxable income or (loss) on Schedule B, page 3, Form 1120-FSC.) See section 923(a)(4) for a special rule for foreign trade income allocable to a cooperative. See section 923(a)(5) for a special rule for military property.

#### Foreign Trading Gross Receipts

A FSC is treated as having foreign trading gross receipts (defined in section 924) only if it has met certain foreign management and foreign economic process requirements. (See the instructions on page 2 for definitions and rules of these requirements.)

Foreign trading gross receipts do **not** include:

- Certain excluded receipts (defined in section 924(f)).
- Investment income (defined in section 927(c)).
- Carrying charges (defined in section 927(d)(1)).

### Foreign Management Requirements

A FSC (other than a small FSC) is treated as having foreign trading gross receipts for the tax year only if the management of the FSC during the year takes place outside the United States. These management activities include:

- Meetings of the board of directors and meetings of the shareholders.
- Disbursing cash, dividends, legal and accounting fees, salaries of officers, and salaries or fees of directors from the principal bank account.
- Maintaining the principal bank account at all times during the tax year.

**Meetings of directors and meetings of the shareholders.**—All meetings of the board of directors of the FSC and all meetings of the shareholders of the FSC that take place during the tax year must take place outside the United States. Only meetings that are formally convened as meetings of the board of directors or as shareholder meetings are considered. If the participants in a meeting are not all physically present in the same location, the location of the meeting is determined by the location of the persons exercising a majority of the voting power (including proxies) participating in the meeting. In addition, all such meetings must comply with the local laws of the foreign country or U.S. possession in which the FSC was created or organized. The local laws determine whether a meeting must be held, when and where it must be held (if it is held at all), who must be present, quorum requirements, use of proxies, etc.

**Principal bank accounts.**—See **Definition of a FSC** beginning on page 1 for definitions of qualifying foreign country and U.S. possession. See Regulations section 1.924(c)-1(c) for more information regarding principal bank accounts.

### Foreign Economic Process Requirements

A FSC (other than a small FSC) has foreign trading gross receipts from any transaction only if certain economic processes for the transaction take place outside the United States. Section 924(d) and Regulations section 1.924(d)-1 set forth the rules for determining whether a sufficient amount of the economic processes of a transaction takes place outside the United States. Generally, a transaction will qualify if the FSC satisfies two requirements:

- Participation outside the United States in the sales portion of the transaction, and
- Satisfaction of either the 50% or the 85% foreign direct cost test.

The activities comprising these economic processes may be performed by the FSC or by any other person acting under contract with the FSC.

**Participation outside the United States in the sales portion of the transaction.—**  
**Page 2**

Generally, the requirement of section 924(d)(1)(A) is met for the gross receipts of a FSC derived from any transaction if the FSC has participated outside the United States in the following sales activities relating to the transaction: (1) solicitation (other than advertising), (2) negotiation, and (3) making a contract.

1. Solicitation (other than advertising) is any communication (including, but not limited to, telephone, telegraph, mail, or in person) by the FSC, to a specific, targeted customer or potential customer. The solicitation must specifically address the customer's attention to the product or service that is the subject of the transaction and it must take place during the 12-month period immediately before execution of a contract relating to the transaction. Activities that would otherwise constitute advertising (such as sending sales literature to a customer or potential customer) will be considered solicitation if the activities are not considered advertising under the foreign direct cost tests. An exception to this rule is provided for second mailings in Regulations section 1.924(e)-1(a)(1).

2. Negotiation is any communication by the FSC to a customer or potential customer aimed at an agreement on one or more of the terms of a transaction, including, but not limited to, price, credit terms, quantity, or time or manner of delivery. Negotiation does not include the mere receipt of a communication from a customer (such as an order) that includes terms of a sale.

3. Making a contract refers to performance by the FSC of any of the elements necessary to complete a sale, such as making or accepting an offer. Acceptance of an unsolicited bid or order is considered the making of a contract even if no solicitation or negotiation occurred with respect to the transaction. The written confirmation by the FSC to the customer of an oral or written agreement that confirms variable contract terms, such as price, credit terms, quantity, or time or manner of delivery, or specifies (directly or by reference) additional contract terms, will be considered the making of a contract. A written confirmation is any confirmation in writing, including a telegram, telex, or other similar written communication.

**Grouping transactions.**—Generally, the sales activities described above are to be applied on a transaction-by-transaction basis. However, a FSC may make an annual election to apply any of the sales activities on the basis of a group. To make the election, check the box in item 9a, **Additional Information**, on page 2 of Form 1120-FSC. See Regulations section 1.924(d)-1(c)(5) for details.

**Satisfaction of either the 50% or 85% foreign direct cost test.**—To qualify as foreign trading gross receipts, the foreign direct costs incurred by the FSC attributable to the transaction must equal or exceed 50% of the total direct costs incurred by the FSC attributable to the transaction. Direct costs are those costs attributable to the activities described in the five categories of section 924(e). Instead of satisfying the 50% foreign direct cost test, the FSC may incur foreign direct costs attributable to activities described in each of two of the section 924(e) categories. The costs must equal or exceed 85% of the total direct costs incurred by the FSC attributable to the activity described in

each of the two categories. If no direct costs are incurred by the FSC in a particular category, that category is not taken into account for purposes of determining whether the FSC has met either the 50% or 85% foreign direct cost test.

Direct costs are costs that are incident to and necessary for the performance of any activity described in section 924(e). Direct costs include the cost of materials consumed in the performance of the activity, and the cost of labor that can be identified or associated directly with the performance of the activity (but only to the extent of wages, salaries, fees for professional services, and other amounts paid for personal services actually rendered, such as bonuses or compensation paid for services on the basis of a percentage of profits). Direct costs also include the allowable depreciation deduction for equipment or facilities (or the rental cost for its use) that can be specifically identified or associated with the activity, as well as the contract price of an activity performed on behalf of the FSC by a contractor.

Total direct costs means all of the direct costs of any transaction attributable to activities described in any paragraph of section 924(e). For the 50% foreign direct cost test of section 924(d)(1)(B), total direct costs are based on the direct costs of all activities described in all paragraphs of section 924(e). For the 85% foreign direct cost test of section 924(d)(2), however, the total direct costs are determined separately for each paragraph of section 924(e).

Foreign direct costs means the portion of the total direct costs of any transaction attributable to activities performed outside the United States. For purposes of the 50% foreign direct cost test, foreign direct costs are based on the direct costs of all activities described in all paragraphs of section 924(e). For purposes of the 85% foreign direct cost test, however, foreign direct costs are determined separately for each paragraph of section 924(e).

For more details, see Regulations section 1.924(d)-1(d).

Check the applicable box(es) (in Item 9b, **Additional Information**, on page 2 of Form 1120-FSC) to indicate how the FSC met the foreign direct costs requirement.

**Grouping transactions.**—Generally, the foreign direct cost tests under Regulations section 1.924(d)-1(d) are applied on a transaction-by-transaction basis. However, the FSC may make an annual election (in Item 9d, **Additional Information**, on page 2 of Form 1120-FSC) to apply the foreign direct cost tests on a customer, contract, or product or product line grouping basis. Any grouping used must be supported by adequate documentation of performance of activities and costs of activities relating to the grouping used. See Regulations section 1.924(d)-1(e) for details.

**Exception for foreign military property.**—The economic process requirements do not apply to any activities performed in connection with foreign military sales except those activities described in section 924(e). See Regulations section 1.924(d)-1(f) for details.

## Section 925(c) Requirement

To use the administrative pricing rules to determine the FSC's (or small FSC's) profit on a transaction or group of transactions, the FSC must perform (or contract with another person to perform) all of the economic process activities relating to the transaction or group of transactions. All of the direct and indirect expenses relating to the performance of those activities must be reflected on the books of the FSC and on Form 1120-FSC. Under Temporary Regulations section 1.925(a)-1T(b)(2)(ii), an election may be made to include on the FSC's books all expenses, other than cost of goods sold, that are necessary to figure combined taxable income for the transaction or group of transactions. The expenses must be identified on Schedule G on the applicable line.

## Filing Form 1120-FSC

### Who Must File

Form 1120-FSC must be filed if the corporation elected, by filing Form 8279, to be treated as a FSC or small FSC, and the election is still in effect.

### When To File

In general, a corporation must file Form 1120-FSC by the 15th day of the 3rd month after the end of the tax year. If the due date falls on a Saturday, Sunday, or legal holiday, the FSC may file on the next business day.

**Extension.**—File **Form 7004**, Application for Automatic Extension of Time To File Corporation Income Tax Return, to request an automatic 6-month extension of time to file.

### Where To File

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

### Who Must Sign

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

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

The paid preparer must complete the required preparer information and—

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

### Accounting Methods

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

A member of a controlled group cannot use an accounting method that would distort any group member's income, including its own. For example, a FSC acts as a commission agent for property sales by a related corporation that uses the accrual method and pays the FSC its commission more than 2 months after the sale. In this case, the FSC should not use the cash method because that method would materially distort its income.

Generally, a FSC must use the accrual method of accounting if its average annual gross receipts exceed \$5 million. See section 448(c).

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

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

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

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

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

Dealers required to change their accounting method to comply with the new law are treated as having initiated the change in accounting method and as having received the consent of the IRS to the change. Generally, the net amount of the section 481(a) adjustment (reported on Schedule F, Part II, line 16) is taken into account ratably over 5 tax years, beginning with the first tax year ending on or after December 31, 1993. For details, including exceptions, see section 475, the related temporary regulations, and Rev. Rul. 94-7, 1994-3 I.R.B. 6.

### Change in Accounting Period

Generally, before changing an accounting period, the Commissioner's approval must be

obtained (Regulations section 1.442-1) by filing **Form 1128**, Application To Adopt, Change, or Retain a Tax Year. Also see Pub. 538.

**Note:** *In general, the tax year of a FSC must be the same as the tax year of that shareholder (or group of shareholders with the same 12-month tax year) who has the highest percentage of voting power. (See section 441(h)(1).)*

### Rounding Off to Whole Dollars

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

### Recordkeeping

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

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

### Depository Method of Tax Payment

A FSC must pay the tax due in full no later than the 15th day of the 3rd month after the end of the tax year. The method for payment of the tax due depends upon whether the FSC has an office or place of business in the United States.

1. FSCs that **do not** maintain an office or place of business in the United States must pay the tax due directly to the IRS (i.e., do not use the depository method of tax payment described in 2 below). The tax may be paid by check or money order, payable to the Internal Revenue Service. To help ensure proper crediting, write the FSC's employer identification number, "Form 1120-FSC," and the tax period to which the payment applies on the check or money order. Enclose the payment when Form 1120-FSC is filed with the Internal Revenue Service Center, Philadelphia, PA 19255.

2. FSCs that **do** maintain an office or place of business in the United States must pay the tax due using a qualified depository. Under this method, the FSC deposits its income tax payments (and estimated tax payments) with **Form 8109**, Federal Tax Deposit Coupon. Do not send deposits directly to an IRS office. Mail or deliver the completed Form 8109 with the payment to a qualified depository for Federal taxes or to the Federal Reserve bank (FRB) servicing the FSC's geographic area. Make checks or money orders payable to that depository or FRB.

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

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

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

**Caution:** *If the FSC owes tax and maintains an office or place of business in the United States when it files Form 1120-FSC, do not include the payment with the tax return. Instead, mail or deliver the payment with Form 8109 to a qualified depository or FRB.*

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

### Estimated Tax Payments

Generally, a FSC must make installment payments of estimated tax if it expects its estimated tax (income tax minus credits) to be \$500 or more. For a calendar or fiscal year corporation, the installments are due by the 15th day of the 4th, 6th, 9th, and 12th months of the tax year. If any date falls on a Saturday, Sunday, or legal holiday, the installment is due on the next regular business day. Use **Form 1120-W**, Estimated Tax for Corporations, as a worksheet to compute estimated tax. A FSC that maintains an office or place of business in the United States must use the deposit coupons (Forms 8109) to make deposits of estimated tax. For information on estimated tax payments, including penalties that apply if the FSC fails to make required payments, see the instructions for line 3 on page 6.

If the FSC overpaid estimated tax, it may be able to get a quick refund by filing **Form 4466**, Corporation Application for Quick Refund of Overpayment of Estimated Tax. The overpayment must be at least 10% of the expected income tax liability and at least \$500. To apply for a quick refund, file Form 4466 before the 16th day of the 3rd month after the end of the tax year, but before Form 1120-FSC is filed. Do not file Form 4466 before the end of the FSC's tax year.

### Interest and Penalties

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

**Late filing of return.**—A FSC that does not file its tax return by the due date, including extensions, may have to pay a penalty of 5% of the unpaid tax for each month or part of a month the return is late, up to a maximum of 25% of the unpaid tax. The minimum penalty for a return that is more than 60 days late is the smaller of the tax due or \$100. The

penalty will not be imposed if the FSC can show that the failure to file on time was due to reasonable cause. FSCs that file late must attach a statement explaining the reasonable cause.

**Late payment of tax.**—A FSC that does not pay the tax when due may have to pay a penalty of 1/2 of 1% of the unpaid tax for each month or part of a month the tax is not paid up to a maximum of the unpaid tax. This penalty may also apply to any additional tax not paid within 10 days of the date of the notice and demand for payment. The penalty will not be imposed if the FSC can show that the failure to pay on time was due to reasonable cause.

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

A FSC may also be subject to a penalty (under section 6686) of \$100 for each instance it fails to furnish the information required under section 6011(c), up to a maximum of \$25,000. This penalty will not apply if the FSC can show that the failure to furnish the required information was due to reasonable cause.

### Unresolved Tax Problems

The IRS has a Problem Resolution Program for taxpayers who have been unable to resolve their problems with the IRS. If the FSC has a tax problem it has been unable to resolve through normal channels, write to the FSC's local IRS district director or call the FSC's local IRS office and ask for Problem Resolution Assistance. Hearing-impaired persons who have access to TDD equipment may call 1-800-829-4059 to ask for help. The Problem Resolution office will ensure that your problem receives proper attention. Although the office cannot change the tax law or make technical decisions, it can help clear up problems that resulted from previous contacts.

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

#### Forms, Returns, and Schedules

The FSC may have to file the following forms:

**Form W-2**, Wage and Tax Statement, and

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

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

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

**Caution:** *The trust fund recovery penalty may apply if income, social security, and Medicare taxes that must be withheld are not withheld or are not paid to the IRS. The penalty is equal to the unpaid trust fund tax. The trust fund recovery penalty may be imposed on all persons who are determined by the IRS to be responsible for collecting, accounting for, and paying over these taxes, and who acted willfully in not doing so. See **Circular E**, Employer's Tax Guide (or **Circular A**, Agricultural Employer's Tax Guide) for more details, including the definition of responsible person.*

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

**Form 1042**, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons; and **Form 1042-S**, Foreign Person's U.S. Source Income Subject to Withholding. Use these forms to report and transmit withheld tax on payments or distributions made to nonresident alien individuals, foreign partnerships, or foreign corporations to the extent such payments or distributions constitute gross income from sources within the United States (see sections 861 through 865). For more information, see sections 1441 and 1442, and **Pub. 515**, Withholding of Tax on Nonresident Aliens and Foreign Corporations.

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

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

**Forms 1099-A, B, C, DIV, INT, MISC, OID, R, and S.** These information returns are for reporting abandonments, acquisitions through foreclosure, proceeds from broker and barter exchange transactions, discharges of indebtedness, certain dividends and distributions, interest payments, payments for certain fishing boat crew members, medical and dental health care payments, direct sales of consumer goods for resale, miscellaneous income payments, nonemployee compensation, original issue discount, distributions from profit-sharing plans, retirement plans, individual retirement arrangements, insurance contracts, etc., and proceeds from real estate transactions. Also use these returns to report amounts that were received as a nominee on behalf of another person.

For more information, see the instructions for Forms 1099, 1098, 5498, and W-2G, and **Pub. 937**, Employment Taxes.

**Note:** *Every FSC must file Form 1099-MISC if, in the course of its trade or business, it makes payments of rents, commissions, or other fixed or determinable income (see section 6041) totaling \$600 or more to any one person during the calendar year.*

**Form 5471**, Information Return of U.S. Persons With Respect to Certain Foreign Corporations. This form may have to be filed by certain officers, directors, or U.S. shareholders of a FSC.

Form 5471 does not have to be filed when the FSC is organized. However, this form may be required for subsequent changes in ownership (see section 6046 and the related regulations). Provided that a Form 1120-FSC is filed, a Form 5471 need not be filed to satisfy the requirements of section 6038 (see Temporary Regulations section 1.921-1T(b)(3) for more information). However, if the FSC is involved in other than FSC activities, Form 5471 and the applicable schedules may have to be filed.

**Form 5472**, Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business. Generally, a FSC that is engaged in a trade or business in the United States that had a reportable transaction with a foreign or domestic related party during the tax year must file Form 5472. Form 5472 must be filed by the due date of the FSC's income tax return (including extensions).

Attach Form 5472 to the tax return and file a copy of Form 5472 with the Internal Revenue Service Center, Philadelphia, PA 19255.

If the FSC's tax return is not filed when due, Form 5472 must nevertheless be timely filed at the service center where the tax return is due. When the tax return is filed, attach a copy of the previously filed Form 5472.

If a FSC does not file Form 5472 as described above, a \$10,000 penalty applies. The penalty also applies for failure to maintain records as required by Regulations section 1.6038A-3. For details, see Form 5472.

For purposes of who must file Form 5472, a FSC is considered to be **controlled** by a foreign person if it is owned, directly or indirectly, by a foreign person who owns at least:

- a. 25% of the total voting power of all classes of stock entitled to vote, or
- b. 25% of the total value of all classes of stock.

In addition, if a FSC is controlled (using the test just described) by another corporation, which in turn is controlled by a foreign person, it is treated as being controlled by that foreign person. In determining control for purposes of section 6038A, the constructive ownership rules of section 318(a) apply, except that 10% is substituted for 50% in applying section 318(a)(2)(C).

The following is a list of **transactions reportable** on Form 5472:

- a. Sales and purchases of stock in trade (inventory).
- b. Sales and purchases of tangible property other than stock in trade.
- c. Rents and royalties paid and received (other than intangible property rights).
- d. Sales, leases, licenses, purchases, and amounts paid and received as consideration for the use of intangible property such as copyrights, designs, formulas, inventions, models, patents, processes, trademarks, and other similar property rights.
- e. Consideration paid and received for technical, managerial, engineering, construction, scientific, or like services.
- f. Commissions paid and received.
- g. Amounts loaned and borrowed (other than open accounts resulting from sales and

purchases reported under the other items in this list) that arise and are collected in full in the ordinary course of business.

h. Interest paid and received.

i. Premiums paid and received for insurance and reinsurance.

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

**Schedule P (Form 1120-FSC)**, Transfer Price or Commission. Complete and attach a separate schedule for each transaction, group of transactions, or aggregate of transactions to which the administrative pricing rules of section 925 are applied.

**Form 8264**, Application for Registration of a Tax Shelter. This form is used by tax shelter organizers to register tax shelters with the IRS, for the purpose of receiving a tax shelter registration number.

**Form 8271**, Investor Reporting of Tax Shelter Registration Number. Taxpayers who have acquired an interest in a tax shelter, which is required to be registered, use this form to report the tax shelter's registration number. Form 8271 must be attached to any tax return (including an application for tentative refund (Form 1139) and an amended Form 1120-FSC) on which a deduction, credit, loss, or other tax benefit attributable to a tax shelter is taken or any income attributable to a tax shelter is reported.

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

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

**Form 8300**, Report of Cash Payments Over \$10,000 Received in a Trade or Business. Generally, this form is used to report the receipt of more than \$10,000 in cash or foreign currency in one transaction or in a series of related transactions. However, transactions that take place entirely outside the United States do not have to be reported.

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

**Form 8810**, Corporate Passive Activity Loss and Credit Limitations. Closely held FSCs (and FSCs that are personal service corporations) that are subject to the passive

activity limitations of section 469 must use this form to compute their allowable passive activity loss.

**Note:** *The credits allowed on Form 1120-FSC are not subject to the limits of section 469.*

**Form 8842**, Election To Use Different Annualization Periods for Corporate Estimated Tax. FSCs use Form 8842 for each year they want to elect one of the annualization periods in section 6655(e)(2)(C) for figuring estimated tax payments under the annualized income installment method.

## Attachments

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

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

## Filing Requirements—Foreign Personal Holding Companies and Personal Holding Companies

If the FSC is a foreign personal holding company (as defined in section 552), Regulations section 1.551-4 requires certain shareholders of the FSC to attach a statement to their returns (i.e., the shareholders' personal returns) containing the information required by section 551(c). Furthermore, section 6035 (and the related regulations) requires certain officers, directors, and shareholders of a foreign personal holding company to file **Schedule N** (Form 5471) and the appropriate schedules of Form 5471 (see the **Instructions for Form 5471** for additional information).

If the FSC is a personal holding company (as defined in section 542) but not a foreign personal holding company, it must file **Schedule PH (Form 1120)** with Form 1120-FSC. The FSC must report the personal holding company tax on line 6, Schedule J, Form 1120-FSC. See section 542 and Schedule PH (Form 1120) for details.

## Tax Treaty Benefits

A FSC may not claim any benefits under any income tax treaty between the United States and any foreign country.

## Specific Instructions

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

**Note:** *The 1994 Form 1120-FSC may also be used if (1) the FSC has a tax year of less than 12 months that begins and ends in 1995 and (2) the 1995 Form 1120-FSC is not yet available at the time the FSC is required to file its return. However, the FSC must show its 1995 tax year on the 1994 Form 1120-FSC and incorporate any tax law changes that are*

effective for tax years beginning after December 31, 1994.

**Name.**—Print or type the FSC's true name (as set forth in the charter or other legal document creating it).

**Address.**—Enter the U.S. address where the FSC maintains the records required under section 6001 (see section 922(a)(1)(D)(iii)). Include the suite, room, or other unit number after the street address.

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

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

**Employer identification number (EIN).**—

Show the correct EIN in item C on page 1 of Form 1120-FSC. If the FSC does not have an EIN, it should apply for one on **Form SS-4, Application for Employer Identification Number**. Form SS-4 can be obtained at most IRS or Social Security Administration (SSA) offices. If the FSC has not received its EIN by the time the return is due, write "Applied for" in the space for the EIN. See Pub. 583 for more information.

**Item A. Foreign Country or U.S. Possession of Incorporation.**—See **Definition of a FSC** on page 1 of the instructions.

**Item E. Total assets.**—Enter the FSC's total assets (as determined by the accounting method regularly used in keeping the FSC's books and records) at the end of the tax year of the FSC from page 6, Schedule L, column (d), line 15. If there are no assets at the end of the tax year, enter the assets as of the beginning of the tax year.

**Item F. Initial return, final return, change of address, or amended return.**—If this is the FSC's first return, check the "Initial return" box. If the corporation ceases to exist, file Form 1120-FSC and check the "Final return" box. If the FSC has changed its address since it last filed a return, check the box for "Change of address." If the FSC is amending its return, check the box for "Amended return."

**Item 1. Principal shareholder.**—Complete line **1a** through **1h** for the shareholder (individual, corporation, partnership, trust, or estate) that was the principal shareholder at the beginning of the FSC tax year. See item 7 under **Definition of a FSC** on page 1 for information on the principal shareholder.

**Item 2. Parent-subsidiary controlled group.**—If the FSC is a subsidiary in a parent-subsidiary controlled group and the principal shareholder is not the common parent of the group, complete lines **2a** through **2g** for the common parent. Enter the consolidated total assets on line **2d** for a group that files a consolidated return; otherwise, enter only the common parent's total assets.

**Note:** Check the "Yes" box in item 2 if the FSC is a subsidiary in a parent-subsidiary controlled group. This applies even if the FSC is a subsidiary member of one group and the parent corporation of another.

The term "parent-subsidiary controlled group" means one or more chains of corporations connected through stock ownership (sections 927(d)(4) and section

1563(a)(1)). Both of the following requirements must be met:

a. More than 50% of the total combined voting power of all classes of stock entitled to vote or more than 50% of the total value of all classes of stock of each corporation in the group (except the parent) must be owned by one or more of the other corporations in the group.

b. The common parent must own more than 50% of the total combined voting power of all classes of stock entitled to vote or more than 50% of the total value of all classes of stock of at least one of the other corporations in the group.

Stock owned directly by other members of the group is not counted when computing the voting power or value.

See sections 927(d)(4) and 1563(d)(1) for the definition of "stock" for purposes of determining stock ownership above.

## Tax and Payments

**Line 2h. Backup withholding.**—If the FSC had income tax withheld from any payments it received, because, for example, it failed to give the payer its correct EIN, include the amount withheld in the total for line 2h. This type of withholding is called backup withholding. Show the amount withheld in the blank space in the right-hand column between lines 1 and 2h, and write "backup withholding."

**Note:** Backup withholding does not include amounts reportable on line 2g for taxes paid or withheld at source.

**Line 3. Estimated tax penalty.**—A FSC that does not make estimated tax payments when due may be subject to an underpayment penalty for the period of underpayment. Generally, a FSC is subject to the penalty if its tax liability is \$500 or more, and it did not timely pay the smaller of (a) 100% of its tax liability for 1994, or (b) 100% of its prior year's tax. See section 6655 for details and exceptions, including special rules for large corporations.

**Form 2220, Underpayment of Estimated Tax by Corporations**, is used to determine whether the FSC owes the penalty and to figure the amount of the penalty. Generally, a FSC does not have to file this form since the IRS can figure the amount of any penalty and bill the FSC for it. However, complete and attach Form 2220 even if the FSC does not owe the penalty if either of the following apply:

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

If Form 2220 is attached, check the box on line 3, page 1, Form 1120-FSC, and enter the amount of any penalty on this line.

## Schedule A—Cost of Goods Sold Related to Foreign Trading Gross Receipts

Complete Schedule A only for the cost of goods sold deduction related to foreign trading gross receipts reported on lines 1 through 5 of Schedule B.

Complete column (a) to show the cost of goods sold for inventory acquired in

transactions using the administrative pricing rules. Complete column (b) to show the cost of goods sold for inventory acquired in transactions that did not use the administrative pricing rules. For details on administrative or nonadministrative pricing rules, see Schedule P (Form 1120-FSC).

If the FSC acts as another person's commission agent on a sale, do not enter any amount on Schedule A for the sale.

Small FSCs will have to make two separate computations for cost of goods sold if their foreign trading gross receipts exceed the limitation amount on line 6e of Schedule B. In this case, a deduction for cost of goods sold will be figured separately for the income on line 6h of Schedule B, and separately for the income on line 7 of Schedule F. Attach the computation for the cost of goods sold deduction entered on line 18 of Schedule F to Form 1120-FSC.

All FSCs must attach a separate computation for cost of goods sold and other costs attributable to income included on line 4 of Schedule F.

All FSCs should see the uniform capitalization rules of section 263A discussed in the instructions for Schedule G. See those instructions before completing Schedules A and F.

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

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

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

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

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

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

**Lines 9a through 9e. Inventory valuation methods.**—Inventories can be valued at:

- Cost;
- Cost or market value (whichever is lower); or
- Any other method approved by the IRS that conforms to the provisions of the applicable regulations cited below.

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

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

Inventory may be valued below cost when the merchandise is unsalable at normal prices or unusable in the normal way because the goods are subnormal because of damage, imperfections, shopwear, etc., within the meaning of Regulations section 1.471-2(c). The goods may be valued at the current bona fide selling price, minus direct cost of disposition (but not less than scrap value) if such a price can be established.

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

If the FSC changed or extended its inventory method to LIFO and had to write up opening inventory to cost in the year of election, report the effect of the write up as income (as appropriate on Schedule F, line 16), proportionately over a 3-year period that begins with the year of the LIFO election (section 472(d)).

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

### Additional Information

**Line 2.**—Show any tax-exempt interest received or accrued. Include any exempt-interest dividends received as a shareholder in a mutual fund or other regulated investment company.

**Line 4.**—See section 542 for definition of personal holding company and section 552 for the definition of foreign personal holding company. Also, see the **Filing Requirements—Foreign Personal Holding Companies and Personal Holding Companies** on page 5 for information and other details if the FSC meets the definition of either.

**Line 5.**—Check the box on line 5 if the FSC elects under section 172(b)(3) to forego the carryback period for an NOL. If the box is checked, do not attach the statement described in Temporary Regulations section 301.9100-12T(d).

**Line 6.**—Enter the amount of the NOL carryover to the tax year from prior years, regardless of whether any of the loss is used to offset income on this return. The amount to enter is the total of all NOLs generated in prior years but not used to offset income (either as a carryback or carryover) in a tax year prior to 1994. Do not reduce the amount by any NOL deduction reported on line 19a, Part II of Schedule B.

**Pub. 536**, Net Operating Losses, has a worksheet for figuring a FSC's NOL carryover.

**Lines 7c and 8b(2).**—See **Definition of a FSC** on page 1 of the instructions for definitions of qualifying foreign country and U.S. possession.

**Line 8.**—All FSCs (except small FSCs) must answer these questions. For more information, see **Foreign Management Requirements** on page 2 of the instructions.

**Line 9.**—All FSCs (except small FSCs) must answer line 9b. Indicate how they met the foreign direct costs requirement of section 924(d) for all transactions that generated foreign trading gross receipts reported on lines 1 through 5 of Schedule B. Also, answer line 9a and/or line 9d to make an election to use either of the annual grouping election(s) indicated. See the instructions for **Foreign Economic Process Requirements** on page 2 for details.

### Schedule B—Taxable Income or (Loss)

Use Schedule B to compute taxable income from all sources.

#### Part I

Use Part I to compute net income attributable to nonexempt foreign trade income. Income and expenses on lines 1 through 15 are reported in column (a) if the administrative pricing rules were used in the transaction that produced the income.

Report in column (b) all foreign trade income from all transactions in which the administrative pricing rules were not used. Attach a schedule showing the computation of the taxable amount. In Schedule B, Part II, include only the taxable portion on line 16.

**Lines 1 through 5.**—Enter foreign trading gross receipts identified on lines 1 through 5. See section 924(a) and **Foreign Trading Gross Receipts** beginning on page 1 of these instructions for receipts that are excluded and other details. Report commission income on line 1 or line 2 based on the sale, lease, or rental of property on which that commission arose.

**Line 5.**—If the 50% gross receipts test of section 924(a)(5) is **not** met, report the FSC's gross receipts that would have otherwise qualified under that section on line 16, Schedule F, instead of line 5, Schedule B.

**Lines 6b through 6h.**—See section 924(b)(2)(B) for the rules regarding the limitation on the amount of foreign trading gross receipts that a small FSC may take into account in determining its exempt foreign trade income.

**Line 6d.**—Temporary Regulations section 1.921-1T(b)(5) indicates that, in the case of a small FSC having a short tax year, the dollar limitation reported on line 6b or 6c is to be prorated on a daily basis. A small FSC having a short tax year must divide the number of days in its short tax year by the number of days that would have made up a full tax year and enter the resulting fraction on line 6d as a decimal less than 1.00000.

**Example:** For its 1994 calendar-year tax year, a small FSC has a short tax year of 100 days. The FSC enters 0.273973 (100/365) on line 6d.

**Line 6f.**—If commission income is reported in the total for line 6a of Schedule B, total receipts for purposes of line 6f are figured as follows:

- |   |          |
|---|----------|
| 1. Enter total of columns (a) and (b), line 6a, Schedule B . . . . .  | 1. _____ |
| 2. Enter total commission income reported on line 1 or line 2, Schedule B . . . . .   | 2. _____ |
| 3. Subtract line 2 from line 1 . . . . .  | 3. _____ |
| 4. For the commissions reported on line 2 above, enter total gross receipts for the sale, lease, or rental of property on which the commissions arose (section 927(b)(2)) . . . . . | 4. _____ |
| 5. Add lines 3 and 4. Enter here and on line 6f, Schedule B . . . . .   | 5. _____ |

**Line 6h.**—When making the line 6h allocation, allocate only the commission income from the gross receipts on line 4 above. If the small FSC's foreign trading gross receipts for the tax year (line 6f) exceed its allowable limitation (line 6e), the small FSC may select the gross receipts to which the limitation is allocated. In such a case, allocate the line 6g foreign trading gross receipts (which, in this case, is the line 6e limitation amount because it is smaller than the line 6f amount) between columns (a) and (b) of line 6h based on whether the administrative pricing rules were used for the gross receipts selected. See Regulations section 1.921-2(b)(4).

#### Part II

**Line 19a. Net operating loss deduction.**—A net operating loss (NOL) incurred by a FSC in one tax year may be used to reduce the FSC's taxable income in another year. Generally, a FSC may carry an NOL back to each of the 3 years preceding the year of the loss and then carry any remaining amount over to each of the 15 years following the year of the loss (but see **Exceptions to carryback rules** below). Enter on line 19a the total NOL carryovers from prior tax years, but do not enter more than the FSC's taxable income (after special deductions). An NOL deduction cannot be taken in a year in which the FSC has a negative taxable income. Attach a schedule showing the computation of the NOL deduction. Also complete line 6 in **Additional Information**.

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

**Carryback and carryover rules.**—Generally, an NOL first must be carried back to the third tax year preceding the year of the loss. To carry back the loss and obtain a quick refund of taxes, use **Form 1139**, Corporation Application for Tentative Refund. Form 1139 must be filed within 12 months after the close of the tax year of the loss. See section 6411 for details. Do not attach Form 1139 to the FSC's income tax return. Mail it in a separate envelope to the Internal Revenue Service Center, Philadelphia, PA 19255.

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

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

Special rules apply when an ownership change occurs (i.e., for any tax year ending after a post-1986 ownership change, the amount of the taxable income of a loss corporation that can be offset by pre-change

NOL carryovers is limited). See section 382 and the related regulations. Also see Temporary Regulations section 1.382-2T(a)(2)(ii), which requires that a loss corporation file an information statement with its income tax return for each tax year that it is a loss corporation and certain shifts in ownership occurred. Also see Regulations section 1.382-6(b) for details on how to make the closing-of-the-books election.

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

**Exceptions to carryback rules.**—A FSC may make an irrevocable election to forego the carryback period and instead carry the NOL over to each of the 15 years following the year of the loss. To make this election, check the box in question 5 in **Additional Information**. The return must be timely filed (including extensions).

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

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

**Line 19b. Dividends-received deduction.**—A FSC may be entitled to a deduction for dividends it receives from other corporations. See the instructions for the dividend worksheet below to figure the allowable dividends-received deduction. Attach the dividend worksheet to Form 1120-FSC.

**Schedule E—Percentages Used in Figuring Exempt Foreign Trade Income**

For purposes of the **Note** at the top of Schedule E, a C corporation is a corporation other than an S corporation. Shareholders

other than C corporations are individuals, partnerships, S corporations, trusts, and estates.

Use lines 2a through 2d to figure the exemption percentage for foreign trade income that was determined without regard to the administrative pricing rules (see section 923(a)(2)).

Use lines 3a through 3d to figure the exemption percentage for foreign trade income that was determined by using the administrative pricing rules (see section 923(a)(3)). See section 923(a)(4) for a special rule for foreign trade income allocable to a cooperative.

**Schedule F—Net Income from Nonexempt Foreign Trade Income and Taxable Nonforeign Trade Income**

**Part I**

Enter net income from nonexempt foreign trade income and related expenses in Part I.

**Line 2.**—Enter FSC income that resulted from the FSC's cooperation with an international boycott. See Form 5713 for reporting requirements for any FSC with operations in or related to a boycotting country. See section 927(e)(2).

**Line 3.**—Enter the amount, if any, paid for illegal payments, bribes, or kickbacks that the FSC paid directly or indirectly to government officials, employees, or agents. See section 927(e)(2).

**Line 5.**—See the instructions for Schedule A of Form 1120-FSC before completing this line.

**Part II**

Enter the taxable portion of gross income of the FSC that was **not** derived from foreign trading gross receipts. This type of income includes:

- Amounts specifically excluded from foreign trade income because of the small FSC limitation on line 6, Schedule B (line 7);
- Investment type income (lines 8 through 12);

- Income from property that is subsidized, deemed in short supply, or destined for use in the United States (lines 13 and 14);
- Amounts from transactions that did not meet the foreign economic process requirements (line 15); and,
- Other nonforeign trade income (line 16). For more details, see sections 924(f) and 927(a)(2) and (3).

**Line 9.**—Complete the dividend worksheet on this page to figure the total dividends to report on line 9. Attach a schedule similar to the worksheet below to Form 1120-FSC.

**Line 18.**—Enter the deductions allocated or apportioned to income on line 17. Attach to Form 1120-FSC a schedule listing each type of deduction. Show deductions related to cost of goods sold separately. See the instructions for Schedule A on page 6 before completing this line.

**Passive activity limitations.**—Section 469 generally limits the deduction of passive activity losses for closely held FSCs and FSCs that are personal service corporations. See section 469 and the instructions for Form 8810 for details.

**Instructions for Dividends and Dividends-Received Deduction Worksheet**

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

**Line 1, Column (a)**

Enter dividends (except those received on debt-financed stock acquired after July 18, 1984—see section 246A) that are received from less-than-20%-owned domestic corporations subject to income tax and that are subject to the 70% deduction under section 243(a)(1).

Also include on line 1 dividends (except those received on debt-financed stock acquired after July 18, 1984) from a regulated investment company (RIC). The amount of

| <b>Dividends and Dividends-Received Deduction Worksheet</b><br>(See instructions on this page.) |   |           |   |
|---|---|-----------|---|
|   | (a) Dividends received  | (b) %     | (c) Dividends-received deduction: (a) × (b) |
| 1   | Dividends from less-than-20%-owned domestic corporations that are subject to the 70% deduction (other than debt-financed stock)           | 70        |   |
| 2   | Dividends from 20%-or-more-owned domestic corporations that are subject to the 80% deduction (other than debt-financed stock)             | 80        |   |
| 3   | Dividends on debt-financed stock of domestic and foreign corporations (section 246A)  | See Inst. |   |
| 4   | Dividends on certain preferred stock of less-than-20%-owned public utilities  | 42        |   |
| 5   | Dividends on certain preferred stock of 20%-or-more-owned public utilities  | 48        |   |
| 6   | Dividends from less-than-20%-owned foreign corporations that are subject to the 70% deduction   | 70        |   |
| 7   | Dividends from 20%-or-more-owned foreign corporations that are subject to the 80% deduction   | 80        |   |
| 8   | <b>Total dividends-received deduction.</b> Add lines 1 through 7. See instructions for limitation. Enter here and on line 19b, Schedule B |           |   |
| 9   | Other dividends from foreign corporations not included on lines 3, 6, and 7   |           |   |
| 10  | Foreign dividend gross up (section 78)  |           |   |
| 11  | Other dividends   |           |   |
| 12  | <b>Total dividends.</b> Add lines 1 through 11. Enter here and on line 9, Schedule F  |           |   |

dividends eligible for the dividends-received deduction under section 243 is limited by section 854(b). The FSC should receive a notice from the RIC specifying the amount of dividends that qualify for the deduction.

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

**Line 2, Column (a)**

Enter dividends (except those received on debt-financed stock acquired after July 18, 1984) that are received from 20%-or-more-owned domestic corporations subject to income tax and that are subject to the 80% deduction under section 243(c).

**Line 3, Column (a)**

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

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

**Line 3, Columns (b) and (c)**

Dividends received on debt-financed stock acquired after July 18, 1984, are not entitled to the full 70% or 80% dividends-received deduction. The 70% or 80% deduction is reduced by a percentage that is related to the amount of debt incurred to acquire the stock. See section 246A. Also see section 245(a) before making this computation for an additional limitation that applies to dividends received from foreign corporations. Attach a schedule to Form 1120-FSC showing how the amount on line 3, column (c), was figured.

**Line 4, Column (a)**

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

**Line 5, Column (a)**

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

**Line 6, Column (a)**

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

**Line 7, Column (a)**

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

**Line 8, Column (c)**

**Limitation on dividends-received deduction.**—Generally, line 8 of column (c) may not exceed the amount from the worksheet below. However, in a year in which an NOL occurs, this limitation does not apply even if the loss is created by the dividends-received deduction. See sections 172(d) and 246(b).

1. Refigure line 18, Part II, Schedule B (page 3 of Form 1120-FSC) without any adjustment under section 1059 and without any capital loss carryback to the tax year under section 1212(a)(1). . . . . 1. \_\_\_\_\_
2. Multiply line 1 by 80%. . . . . 2. \_\_\_\_\_
3. Add lines 2, 5, and 7, column (c), and the part of the deduction on line 3, column (c), that is attributable to dividends from 20%-or-more-owned corporations . . . . . 3. \_\_\_\_\_
4. Enter the smaller of line 2 or 3. If line 3 is greater than line 2, stop here; enter the amount from line 4 on line 8, column (c), and do not complete lines 5–10 below . . . . . 4. \_\_\_\_\_
5. Enter the total amount of dividends from 20%-or-more-owned corporations that are included on lines 2, 3, 5, and 7, column (a) . . . . . 5. \_\_\_\_\_
6. Subtract line 5 from line 1. . . . . 6. \_\_\_\_\_
7. Multiply line 6 by 70%. . . . . 7. \_\_\_\_\_
8. Subtract line 3 above from line 8 of column (c) . . . . . 8. \_\_\_\_\_
9. Enter the smaller of line 7 or line 8 . . . . . 9. \_\_\_\_\_
10. **Dividends-received deduction after limitation (sec. 246(b)).** Add lines 4 and 9. Enter the result here and on line 8, column (c) . . . . . 10. \_\_\_\_\_

**Line 9, Column (a)**

Enter foreign dividends not reportable on lines 3, 6, and 7 that do not qualify for a dividends-received deduction.

**Line 10, Column (a)**

If the FSC claims the foreign tax credit, the tax that is deemed paid under sections 902 and 960 is treated as a dividend received from the foreign corporation. See sections 78 and 906(b)(4).

**Line 11, Column (a)**

Include the following:

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

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

  - If the FSC held the stock for 45 days or less (see section 246(c)(1)(A)), or
  - To the extent the FSC is under an obligation to make related payments for substantially similar or related property.

5. Any other taxable dividend income not properly reported above (including distributions under section 936(h)(4)).

If patronage dividends or per-unit retain allocations are included on line 11, column (a), identify the total of these amounts in a schedule attached to Form 1120-FSC.

**Schedule G—Deductions Allocated or Apportioned to Foreign Trade Income Other than Foreign Trade Income Reported on Schedule F**

**Limitations on deductions**

**Section 263A uniform capitalization rules.**—

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

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

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

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

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

**Transactions between related taxpayers.**—

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

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

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

**Line 1.**—Enter only foreign direct costs on lines 1a through 1e. See section 924(e) and Temporary Regulations sections 1.924(e)-1T(a) through (e) for definitions and rules on direct activity costs related to foreign trade income.

**Line 4. Depreciation.**—Besides depreciation, include on line 4 the part of the cost that the FSC elected to expense under section 179 for certain tangible property placed in service during tax year 1994 or carried over from 1993. See **Form 4562**, Depreciation and Amortization, and its instructions.

**Line 5. Salaries and wages.**—Enter the total salaries and wages paid or incurred for the tax year. Do not include salaries and wages deductible elsewhere on the return, such as amounts included in cost of goods sold, elective contributions to a section 401(k) cash or deferred arrangement, or amounts contributed under a salary reduction SEP agreement.

**Line 10. Compensation of officers.**—Enter any officers' deductible compensation on line 10. Do not include compensation deductible elsewhere on the return, such as amounts included in cost of goods sold, elective contributions to a section 401(k) cash or deferred arrangement, or amounts contributed under a salary reduction SEP agreement.

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

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

For this purpose, compensation does not include the following:

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

The deduction limit does not apply to:

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

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

For details, see section 162(m) and Notice 94-68, 1994-26 I.R.B. 12.

## Worksheet for Members of a Controlled Group (keep for your records)

**Note:** Each member of a controlled group (except a qualified personal service corporation) must compute the tax using the worksheet below.

|   |           |
|---|-----------|
| 1. Enter taxable income (Schedule B, line 20), . . . . .  | 1. _____  |
| 2. Enter line 1 or the FSC's share of the \$50,000 taxable income bracket, whichever is less . . . . .  | 2. _____  |
| 3. Subtract line 2 from line 1, . . . . .   | 3. _____  |
| 4. Enter line 3 or the FSC's share of the \$25,000 taxable income bracket, whichever is less . . . . .  | 4. _____  |
| 5. Subtract line 4 from line 3, . . . . .   | 5. _____  |
| 6. Enter line 5 or the FSC's share of the \$9,925,000 taxable income bracket, whichever is less . . . . .   | 6. _____  |
| 7. Subtract line 6 from line 5 . . . . .  | 7. _____  |
| 8. Multiply line 2 by 15% . . . . .   | 8. _____  |
| 9. Multiply line 4 by 25% . . . . .   | 9. _____  |
| 10. Multiply line 6 by 34% . . . . .  | 10. _____ |
| 11. Multiply line 7 by 35% . . . . .  | 11. _____ |
| 12. If the taxable income of the controlled group exceeds \$100,000, enter this member's share of the smaller of 5% of the taxable income in excess of \$100,000 or \$11,750 (See <b>Additional 5% tax</b> below.) . . . . .        | 12. _____ |
| 13. If the taxable income of the controlled group exceeds \$15 million, enter this member's share of the smaller of 3% of the taxable income in excess of \$15 million or \$100,000 (See <b>Additional 3% tax</b> below.) . . . . . | 13. _____ |
| 14. Add lines 8 through 13. Enter here and on Schedule J, line 3 . . . . .  | 14. _____ |

**Line 11. Bad debts.**—Enter the total debts that became worthless in whole or in part during the tax year.

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

**Line 14. Other deductions.**—**Note:** Do not deduct fines or penalties paid to a government for violating any law.

Attach a schedule, listing by type and amount all allowable deductions that are not deductible elsewhere on Form 1120-FSC. Enter the total on this line.

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

**Meals, travel, and entertainment.**—

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

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

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

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

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

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

**Schedule J—Tax Computation**

**Lines 1 and 2.**—A member of a controlled group, as defined in section 927(d)(4), must check the box on line 1 and complete lines 2a and 2b of Schedule J, Form 1120-FSC. Members of a controlled group are entitled to one \$50,000, one \$25,000, and one \$9,925,000 taxable income bracket amount (in that order) on line 2a.

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

**Equal apportionment plan.**—If no apportionment plan is adopted, members of a controlled group must divide the amount in each taxable income bracket equally among themselves. For example, controlled group AB consists of Corporation A and Corporation B. They do not elect an unequal apportionment plan. Therefore, Corporation A and Corporation B are each entitled to:

- \$25,000 (one-half of \$50,000) in the \$50,000 taxable income bracket on line 2a(1),
- \$12,500 (one-half of \$25,000) in the \$25,000 taxable income bracket on line 2a(2), and
- \$4,962,500 (one-half of \$9,925,000) in the \$9,925,000 taxable income bracket on line 2a(3).

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

**Additional 5% tax.**—Members of a controlled group are treated as one corporation for purposes of figuring the additional 5% tax that must be paid by corporations with taxable income in excess of \$100,000. If the additional tax applies, each member of the controlled group will pay that tax based on the part of the amount that is used in each taxable income bracket to reduce that member's tax. See section 1561(a). Each member of the group must enter its share of the additional 5% tax on line 2b(1) and attach to its tax return a schedule that shows the taxable income of the entire group as well as how its share of the additional 5% tax is figured.

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

**Line 3.**—A FSC that is not a member of a controlled group or a qualified personal service corporation must compute its tax on its taxable income as follows:

| Tax Rate Schedule                           |               |                 |                     |
|---|---------------|-----------------|---------------------|
| If taxable income (Schedule B, line 20) 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                   |

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

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

**Note:** If the FSC meets these tests, check the box on line 3, Schedule J, Form 1120-FSC.

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

**Line 4. Foreign tax credit.**—Generally, a FSC may not claim a foreign tax credit. It may, however, claim a foreign tax credit for any foreign taxes imposed on foreign source taxable nonforeign trade income (Schedule F, Part II) that is treated as effectively connected with a U.S. trade or business under section 921(d). See Temporary Regulations section 1.921-3T(d)(2) for more details.

**Line 6. Personal holding company tax.**—See the instructions on page 5, **Filing Requirements—Foreign Personal Holding Companies and Personal Holding Companies.**

**Line 7a. Alternative minimum tax.**—The FSC may owe the alternative minimum tax if it has any of the adjustments and tax preference items listed on **Form 4626, Alternative Minimum Tax—Corporations.** The FSC must file Form 4626 if its taxable income (loss) combined with these adjustments and

tax preference items is more than the smaller of:

- \$40,000, or
- The FSC's allowable exemption amount (from Form 4626).

For this purpose, taxable income does not include the NOL deduction. Get Form 4626 for details.

**Line 7b. Environmental tax.**—The FSC may be liable for the environmental tax if its modified alternative minimum taxable income exceeds \$2 million. See Form 4626 for details.

**Line 8. Total tax.—Interest on tax deferred under the installment method for certain nondealer installment obligations.**—An obligation arising from the disposition of property to which section 453A applies is outstanding at the close of the year, the FSC must include the interest due under section 453A(c) in the amount on line 8, Schedule J. Write on the dotted line to the left of line 8, Schedule J, "Section 453A(c) interest" and the amount. Attach a schedule showing the computation.

## Schedule L—Balance Sheets

**Line 5. Tax-exempt securities.**—Include on this line:

1. State and local government obligations, the interest on which is excludible from gross income under section 103(a), and
2. Stock in a mutual fund or other regulated investment company that distributed exempt-interest dividends during the tax year of the corporation.

## Schedule M-1

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

**Line 5c. Travel and entertainment.**—

Include on line 5c any of the following:

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

For more information, see Pub. 542.

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

# Codes for Principal Business Activity

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

Using the list below, enter on Form 1120-FSC, **Additional Information** on page 2, line 1a, the

code number for the specific industry group from which the largest percentage of total receipts is derived. Total receipts means the total of receipts on Schedule B, line 6a, and on Schedule F, lines 4 and 17.

On Form 1120-FSC, **Additional Information** on page 2, lines 1a, 1b, and 1c, state the principal business activity code no., the principal

business activity, and the principal product or service that account for the largest percentage of total receipts. For example, if the principal business activity is "Wholesale trade: Machinery, equipment, and supplies," the principal product or service may be "Engines and turbines." The principal business activity code no. is 5008.

|  |   |   |  |
|--|---|---|--|
| <p><b>Agriculture, Forestry, and Fishing</b><br/><i>Code</i><br/><b>0400</b> Agricultural production.<br/><b>0600</b> Agricultural services (except veterinarians), forestry, fishing, hunting, and trapping.</p>  | <p><i>Code</i><br/><b>Chemicals and allied products:</b><br/><b>2815</b> Industrial chemicals, plastics materials and synthetics.<br/><b>2830</b> Drugs.<br/><b>2840</b> Soap, cleaners, and toilet goods.<br/><b>2850</b> Paints and allied products.<br/><b>2898</b> Agricultural and other chemical products.</p>  | <p><b>Transportation and Public Utilities</b><br/><i>Code</i><br/><b>Transportation:</b><br/><b>4000</b> Railroad transportation.<br/><b>4100</b> Local and interurban passenger transit.<br/><b>4200</b> Trucking and warehousing.<br/><b>4400</b> Water transportation.<br/><b>4500</b> Transportation by air.<br/><b>4600</b> Pipe lines, except natural gas.<br/><b>4700</b> Miscellaneous transportation services.<br/><b>Communication:</b><br/><b>4825</b> Telephone, telegraph, and other communication services.<br/><b>4830</b> Radio and television broadcasting.<br/><b>Electric, gas, and sanitary services:</b><br/><b>4910</b> Electric services.<br/><b>4920</b> Gas production and distribution.<br/><b>4930</b> Combination utility services.<br/><b>4990</b> Water supply and other sanitary services.</p>   | <p><b>Finance, Insurance, and Real Estate</b><br/><i>Code</i><br/><b>Banking:</b><br/><b>6030</b> Mutual savings banks.<br/><b>6060</b> Bank holding companies.<br/><b>6090</b> Banks, except mutual savings banks and bank holding companies.<br/><b>Credit agencies other than banks:</b><br/><b>6120</b> Savings and loan associations.<br/><b>6140</b> Personal credit institutions.<br/><b>6150</b> Business credit institutions.<br/><b>6199</b> Other credit agencies.<br/><b>Security, commodity brokers and services:</b><br/><b>6210</b> Security brokers, dealers, and flotation companies.<br/><b>6299</b> Commodity contracts brokers and dealers; security and commodity exchanges; and allied services.</p>   |
| <p><b>Mining</b><br/><b>Metal mining:</b><br/><b>1010</b> Iron ores.<br/><b>1070</b> Copper, lead and zinc, gold and silver ores.<br/><b>1098</b> Other metal mining.<br/><b>1150</b> Coal mining.<br/><b>Oil and gas extraction:</b><br/><b>1330</b> Crude petroleum, natural gas, and natural gas liquids.<br/><b>1380</b> Oil and gas field services.<br/><b>Nonmetallic minerals, except fuels:</b><br/><b>1430</b> Dimension, crushed and broken stone; sand and gravel.<br/><b>1498</b> Other nonmetallic minerals, except fuels.</p>  | <p><b>Petroleum refining and related industries (including those integrated with extraction):</b><br/><b>2910</b> Petroleum refining (including integrated).<br/><b>2998</b> Other petroleum and coal products.<br/><b>Rubber and misc. plastics products:</b><br/><b>3050</b> Rubber products: plastics footwear, hose and belting.<br/><b>3070</b> Miscellaneous plastics products.<br/><b>Leather and leather products:</b><br/><b>3140</b> Footwear, except rubber.<br/><b>3198</b> Other leather and leather products.<br/><b>Stone, clay, and glass products:</b><br/><b>3225</b> Glass products.<br/><b>3240</b> Cement, hydraulic.<br/><b>3270</b> Concrete, gypsum, and plaster products.<br/><b>3298</b> Other nonmetallic mineral products.<br/><b>Primary metal industries:</b><br/><b>3370</b> Ferrous metal industries; misc. primary metal products.<br/><b>3380</b> Nonferrous metal industries.<br/><b>Fabricated metal products:</b><br/><b>3410</b> Metal cans and shipping containers.<br/><b>3428</b> Cutlery, hand tools, and hardware; screw machine products, bolts, and similar products.<br/><b>3430</b> Plumbing and heating, except electric and warm air.<br/><b>3440</b> Fabricated structural metal products.<br/><b>3460</b> Metal forgings and stampings.<br/><b>3470</b> Coating, engraving, and allied services.<br/><b>3480</b> Ordnance and accessories, except vehicles and guided missiles.<br/><b>3490</b> Misc. fabricated metal products.</p>   | <p><b>Wholesale Trade</b><br/><b>Durable:</b><br/><b>5008</b> Machinery, equipment, and supplies.<br/><b>5010</b> Motor vehicles and automotive equipment.<br/><b>5020</b> Furniture and home furnishings.<br/><b>5030</b> Lumber and construction materials.<br/><b>5040</b> Sporting, recreational, photographic, and hobby goods, toys and supplies.<br/><b>5050</b> Metals and minerals, except petroleum and scrap.<br/><b>5060</b> Electrical goods.<br/><b>5070</b> Hardware, plumbing and heating equipment and supplies.<br/><b>5098</b> Other durable goods.<br/><b>Nondurable:</b><br/><b>5110</b> Paper and paper products.<br/><b>5129</b> Drugs, drug proprietaries, and druggists' sundries.<br/><b>5130</b> Apparel, piece goods, and notions.<br/><b>5140</b> Groceries and related products.<br/><b>5150</b> Farm-product raw materials.<br/><b>5160</b> Chemicals and allied products.<br/><b>5170</b> Petroleum and petroleum products.<br/><b>5180</b> Alcoholic beverages.<br/><b>5190</b> Miscellaneous nondurable goods.</p>  | <p><b>Insurance:</b><br/><b>6355</b> Life Insurance.<br/><b>6356</b> Mutual insurance, except life or marine and certain fire or flood insurance companies.<br/><b>6359</b> Other insurance companies.<br/><b>6411</b> Insurance agents, brokers, and service.<br/><b>Real estate:</b><br/><b>6511</b> Real estate operators and lessors of buildings.<br/><b>6516</b> Lessors of mining, oil, and similar property.<br/><b>6518</b> Lessors of railroad property and other real property.<br/><b>6530</b> Condominium management and cooperative housing associations.<br/><b>6550</b> Subdividers and developers.<br/><b>6599</b> Other real estate.<br/><b>6749</b> Holding and investment companies except bank holding companies.</p>   |
| <p><b>Construction</b><br/><b>General building contractors and operative builders:</b><br/><b>1510</b> General building contractors.<br/><b>1531</b> Operative builders.<br/><b>1600</b> Heavy construction contractors.<br/><b>Special trade contractors:</b><br/><b>1711</b> Plumbing, heating, and air conditioning.<br/><b>1731</b> Electrical work.<br/><b>1798</b> Other special trade contractors.</p>  | <p><b>Machinery, except electrical:</b><br/><b>3520</b> Farm machinery.<br/><b>3530</b> Construction and related machinery.<br/><b>3540</b> Metalworking machinery.<br/><b>3550</b> Special industry machinery.<br/><b>3560</b> General industrial machinery.<br/><b>3570</b> Office, computing, and accounting machines.<br/><b>3598</b> Other machinery except electrical.<br/><b>Electrical and electronic equipment:</b><br/><b>3630</b> Household appliances.<br/><b>3665</b> Radio, television, and communication equipment.<br/><b>3670</b> Electronic components and accessories.<br/><b>3698</b> Other electrical equipment.<br/><b>3710</b> Motor vehicles and equipment<br/><b>Transportation equipment, except motor vehicles:</b><br/><b>3725</b> Aircraft, guided missiles and parts.<br/><b>3730</b> Ship and boat building and repairing.<br/><b>3798</b> Other transportation equipment, except motor vehicles.<br/><b>Instruments and related products:</b><br/><b>3815</b> Scientific instruments and measuring devices; watches and clocks.<br/><b>3845</b> Optical, medical, and ophthalmic goods.<br/><b>3860</b> Photographic equipment and supplies.<br/><b>3998</b> Other manufacturing products.</p>  | <p><b>Retail Trade</b><br/><b>Building materials, garden supplies, and mobile home dealers:</b><br/><b>5220</b> Building materials dealers.<br/><b>5251</b> Hardware stores.<br/><b>5265</b> Garden supplies and mobile home dealers.<br/><b>5300</b> General merchandise stores.<br/><b>Food stores:</b><br/><b>5410</b> Grocery stores.<br/><b>5490</b> Other food stores.<br/><b>Automotive dealers and service stations:</b><br/><b>5515</b> Motor vehicle dealers.<br/><b>5541</b> Gasoline service stations.<br/><b>5598</b> Other automotive dealers.<br/><b>5600</b> Apparel and accessory stores.<br/><b>5700</b> Furniture and home furnishings stores.<br/><b>5800</b> Eating and drinking places.<br/><b>Miscellaneous retail stores:</b><br/><b>5912</b> Drug stores and proprietary stores.<br/><b>5921</b> Liquor stores.<br/><b>5995</b> Other retail stores.</p>   | <p><b>Services</b><br/><b>7000</b> Hotels and other lodging places.<br/><b>7200</b> Personal services.<br/><b>Business services:</b><br/><b>7310</b> Advertising.<br/><b>7389</b> Business services, except advertising.<br/><b>Auto repair; miscellaneous repair services:</b><br/><b>7500</b> Auto repair and services.<br/><b>7600</b> Miscellaneous repair services.<br/><b>Amusement and recreation services:</b><br/><b>7812</b> Motion picture production, distribution, and services.<br/><b>7830</b> Motion picture theaters.<br/><b>7900</b> Amusement and recreation services, except motion pictures.<br/><b>Other services:</b><br/><b>8015</b> Offices of physicians, including osteopathic physicians.<br/><b>8021</b> Offices of dentists.<br/><b>8040</b> Offices of other health practitioners.<br/><b>8050</b> Nursing and personal care facilities.<br/><b>8060</b> Hospitals.<br/><b>8071</b> Medical laboratories.<br/><b>8099</b> Other medical services.<br/><b>8111</b> Legal services.<br/><b>8200</b> Educational services.<br/><b>8300</b> Social services.<br/><b>8600</b> Membership organizations.<br/><b>8911</b> Architectural and engineering services.<br/><b>8930</b> Accounting, auditing, and bookkeeping.<br/><b>8980</b> Miscellaneous services (including veterinarians).</p>   |
| <p><b>Manufacturing</b><br/><b>Food and kindred products:</b><br/><b>2010</b> Meat products.<br/><b>2020</b> Dairy products.<br/><b>2030</b> Preserved fruits and vegetables.<br/><b>2040</b> Grain mill products.<br/><b>2050</b> Bakery products.<br/><b>2060</b> Sugar and confectionary products.<br/><b>2081</b> Malt liquors and malt.<br/><b>2088</b> Alcoholic beverages, except malt liquors and malt.<br/><b>2089</b> Bottled soft drinks, and flavorings.<br/><b>2096</b> Other food and kindred products.<br/><b>2100</b> Tobacco manufacturers.<br/><b>Textile mill products:</b><br/><b>2228</b> Weaving mills and textile finishing.<br/><b>2250</b> Knitting mills.<br/><b>2298</b> Other textile mill products.<br/><b>Apparel and other textile products:</b><br/><b>2315</b> Men's and boys' clothing.<br/><b>2345</b> Women's and children's clothing.<br/><b>2388</b> Other apparel and accessories.<br/><b>2390</b> Miscellaneous fabricated textile products.<br/><b>Lumber and wood products:</b><br/><b>2415</b> Logging, sawmills, and planing mills.<br/><b>2430</b> Millwork, plywood, and related products.<br/><b>2498</b> Other wood products, including wood buildings and mobile homes.<br/><b>2500</b> Furniture and fixtures.<br/><b>Paper and allied products:</b><br/><b>2625</b> Pulp, paper, and board mills.<br/><b>2699</b> Other paper products.<br/><b>Printing and publishing:</b><br/><b>2710</b> Newspapers.<br/><b>2720</b> Periodicals.<br/><b>2735</b> Books, greeting cards, and miscellaneous publishing.<br/><b>2799</b> Commercial and other printing, and printing trade services.</p> | <p><b>Chemicals and allied products:</b><br/><b>2815</b> Industrial chemicals, plastics materials and synthetics.<br/><b>2830</b> Drugs.<br/><b>2840</b> Soap, cleaners, and toilet goods.<br/><b>2850</b> Paints and allied products.<br/><b>2898</b> Agricultural and other chemical products.<br/><b>Petroleum refining and related industries (including those integrated with extraction):</b><br/><b>2910</b> Petroleum refining (including integrated).<br/><b>2998</b> Other petroleum and coal products.<br/><b>Rubber and misc. plastics products:</b><br/><b>3050</b> Rubber products: plastics footwear, hose and belting.<br/><b>3070</b> Miscellaneous plastics products.<br/><b>Leather and leather products:</b><br/><b>3140</b> Footwear, except rubber.<br/><b>3198</b> Other leather and leather products.<br/><b>Stone, clay, and glass products:</b><br/><b>3225</b> Glass products.<br/><b>3240</b> Cement, hydraulic.<br/><b>3270</b> Concrete, gypsum, and plaster products.<br/><b>3298</b> Other nonmetallic mineral products.<br/><b>Primary metal industries:</b><br/><b>3370</b> Ferrous metal industries; 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