

**U.S. Corporation Short-Form Income Tax Return**

**2005**

For calendar year 2005 or tax year beginning \_\_\_\_\_, 2005, ending \_\_\_\_\_, 20\_\_\_\_\_  
▶ See separate instructions to make sure the corporation qualifies to file Form 1120-A.

**A** Check this box if the corporation is a personal service corporation (see instructions).

Use IRS label. Otherwise, print or type.

Name \_\_\_\_\_  
Number, street, and room or suite no. If a P.O. box, see instructions. \_\_\_\_\_  
City or town, state, and ZIP code \_\_\_\_\_

**B** Employer identification number \_\_\_\_\_  
**C** Date incorporated \_\_\_\_\_  
**D** Total assets (see instructions) \_\_\_\_\_

**E** Check if: (1)  Initial return (2)  Final return (3)  Name change (4)  Address change \$ \_\_\_\_\_  
**F** Check accounting method: (1)  Cash (2)  Accrual (3)  Other (specify) ▶ \_\_\_\_\_

<b>Income</b>	<b>1a</b> Gross receipts or sales		<b>b</b> Less returns and allowances		<b>c</b> Balance ▶	<b>1c</b>	
	<b>2</b> Cost of goods sold (see instructions)					<b>2</b>	
	<b>3</b> Gross profit. Subtract line 2 from line 1c					<b>3</b>	
	<b>4</b> Domestic corporation dividends subject to the 70% deduction.					<b>4</b>	
	<b>5</b> Interest					<b>5</b>	
	<b>6</b> Gross rents					<b>6</b>	
	<b>7</b> Gross royalties					<b>7</b>	
	<b>8</b> Capital gain net income (attach Schedule D (Form 1120))					<b>8</b>	
	<b>9</b> Net gain or (loss) from Form 4797, Part II, line 17 (attach Form 4797)					<b>9</b>	
	<b>10</b> Other income (see instructions—attach schedule)					<b>10</b>	
	<b>11 Total income.</b> Add lines 3 through 10					<b>11</b>	
<b>Deductions</b> <small>(See instructions for limitations on deductions.)</small>	<b>12</b> Compensation of officers (see instructions)					<b>12</b>	
	<b>13</b> Salaries and wages (less employment credits)					<b>13</b>	
	<b>14</b> Repairs and maintenance					<b>14</b>	
	<b>15</b> Bad debts					<b>15</b>	
	<b>16</b> Rents					<b>16</b>	
	<b>17</b> Taxes and licenses					<b>17</b>	
	<b>18</b> Interest					<b>18</b>	
	<b>19</b> Charitable contributions (see instructions for 10% limitation)					<b>19</b>	
	<b>20a</b> Depreciation (attach Form 4562)		<b>20a</b>			<b>20c</b>	
	<b>b</b> Less depreciation claimed elsewhere on return		<b>20b</b>			<b>20c</b>	
	<b>21</b> Domestic production activities deduction (attach Form 8903)					<b>21</b>	
<b>22</b> Other deductions (attach schedule)					<b>22</b>		
<b>23 Total deductions.</b> Add lines 12 through 22					<b>23</b>		
<b>24</b> Taxable income before net operating loss deduction and special deductions. Subtract line 23 from line 11					<b>24</b>		
<b>25 Less:</b> <b>a</b> Net operating loss deduction (see instructions)		<b>25a</b>			<b>25c</b>		
<b>b</b> Special deductions (see instructions)		<b>25b</b>			<b>25c</b>		
<b>26 Taxable income.</b> Subtract line 25c from line 24					<b>26</b>		
<b>27 Total tax</b> (page 2, Part I, line 5)					<b>27</b>		
<b>Tax and Payments</b>	<b>28 Payments:</b>						
	<b>a</b> 2004 overpayment credited to 2005	<b>28a</b>					
	<b>b</b> 2005 estimated tax payments	<b>28b</b>					
	<b>c</b> Less 2005 refund applied for on Form 4466	<b>28c</b>	(	)	<b>Bal</b> ▶	<b>28d</b>	
	<b>e</b> Tax deposited with Form 7004					<b>28e</b>	
	<b>f</b> Credits: (1) Form 2439 (2) Form 4136					<b>28f</b>	
	<b>g Total payments.</b> Add lines 28d through 28f					<b>28g</b>	
	<b>29</b> Estimated tax penalty (see instructions). Check if Form 2220 is attached. <input type="checkbox"/>					<b>29</b>	
	<b>30 Tax due.</b> If line 28g is smaller than the total of lines 27 and 29, enter amount owed					<b>30</b>	
	<b>31 Overpayment.</b> If line 28g is larger than the total of lines 27 and 29, enter amount overpaid					<b>31</b>	
<b>32</b> Enter amount of line 31 you want: <b>Credited to 2006 estimated tax</b> ▶ <b>Refunded</b> ▶					<b>32</b>		

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

**Sign Here**

Signature of officer \_\_\_\_\_ Date \_\_\_\_\_ Title \_\_\_\_\_

May the IRS discuss this return with the preparer shown below (see instructions)?  Yes  No

**Paid Preparer's Use Only**

Preparer's signature \_\_\_\_\_ Date \_\_\_\_\_ Check if self-employed  Preparer's SSN or PTIN \_\_\_\_\_  
Firm's name (or yours if self-employed), address, and ZIP code \_\_\_\_\_ EIN \_\_\_\_\_  
Phone no. ( ) \_\_\_\_\_

**Part I Tax Computation** (see instructions)

1	Income tax. If the corporation is a qualified personal service corporation (see instructions), check here. <input type="checkbox"/>	<b>1</b>		
2	General business credit. Check box(es) and indicate which forms are attached: <input type="checkbox"/> Form 3800 <input type="checkbox"/> Form(s) (specify) ▶ .....	<b>2</b>		
3	Subtract line 2 from line 1	<b>3</b>		
4	Other taxes. Check if from: <input type="checkbox"/> Form 4255 <input type="checkbox"/> Form 8611 <input type="checkbox"/> Form 8697 <input type="checkbox"/> Form 8866 <input type="checkbox"/> Form 8902 <input type="checkbox"/> Other (attach schedule)	<b>4</b>		
5	<b>Total tax.</b> Add lines 3 and 4. Enter here and on page 1, line 27	<b>5</b>		

**Part II Other Information** (see instructions)

<p>1 See instructions and enter the:</p> <p><b>a</b> Business activity code no. ▶ .....</p> <p><b>b</b> Business activity ▶ .....</p> <p><b>c</b> Product or service ▶ .....</p> <p>2 At the end of the tax year, did any individual, partnership, estate, or trust own, directly or indirectly, 50% or more of the corporation's voting stock? (For rules of attribution, see section 267(c).) <input type="checkbox"/> Yes <input type="checkbox"/> No If "Yes," attach a schedule showing name and identifying number.</p> <p>3 Enter the amount of tax-exempt interest received or accrued during the tax year. ▶ \$</p> <p>4 Enter total amount of cash distributions and the book value of property distributions (other than cash) made during the tax year. ▶ \$</p>	<p><b>5a</b> If an amount is entered on page 1, line 2, enter from worksheet in instructions:</p> <p><b>(1)</b> Purchases</p> <p><b>(2)</b> Additional 263A costs (attach schedule)</p> <p><b>(3)</b> Other costs (attach schedule)</p> <table border="1" style="width: 100%; border-collapse: collapse;"> <tr><td style="width: 80%;"></td><td style="width: 10%;"></td><td style="width: 10%;"></td></tr> <tr><td></td><td></td><td></td></tr> <tr><td></td><td></td><td></td></tr> <tr><td></td><td></td><td></td></tr> </table> <p><b>b</b> If property is produced or acquired for resale, do the rules of section 263A apply to the corporation? <input type="checkbox"/> Yes <input type="checkbox"/> No</p> <p>6 At any time during the calendar year, did the corporation have an interest in or a signature or other authority over a financial account (such as a bank account, securities account, or other financial account) in a foreign country? <input type="checkbox"/> Yes <input type="checkbox"/> No If "Yes," the corporation may have to file Form TD F 90-22.1. If "Yes," enter the name of the foreign country ▶ .....</p> <p>7 Are the corporation's total receipts (line 1a plus lines 4 through 10 on page 1) for the tax year <b>and</b> its total assets at the end of the tax year less than \$250,000? <input type="checkbox"/> Yes <input type="checkbox"/> No If "Yes," the corporation is <b>not</b> required to complete Parts III and IV below.</p>												

**Part III Balance Sheets per Books**

		(a) Beginning of tax year	(b) End of tax year
<b>Assets</b>	1 Cash		
	2a Trade notes and accounts receivable		
	<b>b</b> Less allowance for bad debts	( )	( )
	3 Inventories		
	4 U.S. government obligations		
	5 Tax-exempt securities (see instructions)		
	6 Other current assets (attach schedule)		
	7 Loans to shareholders		
	8 Mortgage and real estate loans		
	9a Depreciable, depletable, and intangible assets		
	<b>b</b> Less accumulated depreciation, depletion, and amortization	( )	( )
	10 Land (net of any amortization)		
11 Other assets (attach schedule)			
12 <b>Total assets</b>			
<b>Liabilities and Shareholders' Equity</b>	13 Accounts payable		
	14 Other current liabilities (attach schedule)		
	15 Loans from shareholders		
	16 Mortgages, notes, bonds payable		
	17 Other liabilities (attach schedule)		
	18 Capital stock (preferred and common stock)		
	19 Additional paid-in capital		
	20 Retained earnings		
	21 Adjustments to shareholders' equity (attach schedule)		
	22 Less cost of treasury stock	( )	( )
	23 <b>Total liabilities and shareholders' equity</b>		

**Part IV Reconciliation of Income (Loss) per Books With Income per Return**

1 Net income (loss) per books			
2 Federal income tax per books			
3 Excess of capital losses over capital gains			
4 Income subject to tax not recorded on books this year (itemize):			
5 Expenses recorded on books this year not deducted on this return (itemize):			
6 Income recorded on books this year not included on this return (itemize):			
7 Deductions on this return not charged against book income this year (itemize):			
8 Income (page 1, line 24). Enter the sum of lines 1 through 5 less the sum of lines 6 and 7			



# Instructions for Forms 1120 and 1120-A

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

Contents	Page
Photographs of Missing Children . . . . .	1
Unresolved Tax Issues . . . . .	1
Direct Deposit of Refund . . . . .	1
How To Make a Contribution To Reduce Debt Held by the Public . . . . .	1
How To Get Forms and Publications . . . . .	1
IRS E-Services . . . . .	2
<b>General Instructions</b> . . . . .	2
Purpose of Form . . . . .	2
Who Must File . . . . .	2
Electronic Filing . . . . .	3
When To File . . . . .	3
Where To File . . . . .	3
Who Must Sign . . . . .	3
Paid Preparer Authorization . . . . .	3
Assembling the Return . . . . .	4
Depository Methods of Tax Payment . . . . .	4
Estimated Tax Payments . . . . .	4
Interest and Penalties . . . . .	4
Accounting Methods . . . . .	5
Accounting Period . . . . .	5
Rounding Off to Whole Dollars . . . . .	5
Recordkeeping . . . . .	5
Other Forms and Statements That May Be Required . . . . .	5
<b>Specific Instructions</b> . . . . .	6
Subchapter T Cooperative . . . . .	6
Period Covered . . . . .	6
Name and Address . . . . .	6
Identifying Information . . . . .	6
Employer Identification Number (EIN) . . . . .	6
Total Assets . . . . .	6
Initial Return, Final Return, Name Change, Address Change . . . . .	6
Income . . . . .	6
Deductions . . . . .	8
Tax and Payments . . . . .	12
Schedule A . . . . .	12
Cost of Goods Sold Worksheet . . . . .	13
Schedule C . . . . .	14
Worksheet for Schedule C . . . . .	15
Schedule J . . . . .	15
Worksheet for Members of a Controlled Group . . . . .	16
Schedule K . . . . .	18
Schedule L . . . . .	19
Schedule M-1 . . . . .	19
Principal Business Activity Codes . . . . .	20
Index . . . . .	23

## What's New

- The corporation may be able to deduct a portion of the income from certain qualified domestic production activities. See section 199 and Form 8903, Domestic Production Activities Deduction. Report the deduction

on line 25, Form 1120 (line 21, Form 1120-A).

- A corporation can elect to deduct qualified cash contributions made after August 27, 2005, and before January 1, 2006, for relief efforts related to Hurricane Katrina without regard to the 10% taxable income limit. See page 10.
- A corporation with a food inventory from a trade or business may deduct charitable contributions of "apparently wholesome food" that were made after August 27, 2005, and before January 1, 2006. See section 170(e)(3)(C).
- A corporation is allowed a deduction for qualified book contributions made after August 27, 2005, and before January 1, 2006, to certain public schools. See section 170(e)(3)(D).



*At the time these instructions went to print, Congress was considering legislation that would provide additional tax relief for corporations affected by Hurricanes Katrina, Rita, and Wilma. For more details, and to find out if this legislation was enacted, see Pub. 4492.*

## Photographs of Missing Children

The Internal Revenue Service is a proud partner with the National Center for Missing and Exploited Children. Photographs of missing children selected by the Center may appear in instructions on pages that would otherwise be blank. You can help bring these children home by looking at the photographs and calling 1-800-THE-LOST (1-800-843-5678) if you recognize a child.

## Unresolved Tax Issues

If the corporation has attempted to deal with an IRS problem unsuccessfully, it should contact the Taxpayer Advocate. The Taxpayer Advocate independently represents the corporation's interests and concerns within the IRS by protecting its rights and resolving problems that have not been fixed through normal channels.

While Taxpayer Advocates cannot change the tax law or make a technical tax decision, they can clear up problems that resulted from previous contacts and ensure that the corporation's case is given a complete and impartial review.

The corporation's assigned personal advocate will listen to its point of view and will work with the corporation to address its concerns. The corporation can expect the advocate to provide:

- A "fresh look" at a new or ongoing problem,
- Timely acknowledgment,

- The name and phone number of the individual assigned to its case,
- Updates on progress,
- Timeframes for action,
- Speedy resolution, and
- Courteous service.

When contacting the Taxpayer Advocate, the corporation should be prepared to provide the following information.

- The corporation's name, address, and employer identification number.
- The name and telephone number of an authorized contact person and the hours he or she can be reached.
- The type of tax return and year(s) involved.
- A detailed description of the problem.
- Previous attempts to solve the problem and the office that was contacted.
- A description of the hardship the corporation is facing and supporting documentation (if applicable).

The corporation can contact a Taxpayer Advocate as follows.

- Call the Taxpayer Advocate's toll-free number: 1-877-777-4778.
- Call, write, or fax the Taxpayer Advocate office in its area (see Pub. 1546 for addresses and phone numbers).
- TTY/TDD help is available by calling 1-800-829-4059.
- Visit the website at [www.irs.gov/advocate](http://www.irs.gov/advocate).

## Direct Deposit of Refund

To request a direct deposit of the corporation's income tax refund into an account at a U.S. bank or other financial institution, attach Form 8050, Direct Deposit of Corporate Tax Refund (see page 12).

## How To Make a Contribution To Reduce Debt Held by the Public

To help reduce debt held by the public, make a check payable to "Bureau of the Public Debt." Send it to Bureau of the Public Debt, Department G, P.O. Box 2188, Parkersburg, WV 26106-2188. Or, enclose a check with the income tax return. Contributions to reduce debt held by the public are deductible subject to the rules and limitations for charitable contributions.

## How To Get Forms and Publications

**Internet.** You can access the IRS website 24 hours a day, 7 days a week, at [www.irs.gov](http://www.irs.gov) to:

- Download forms, instructions, and publications;

- Order IRS products online;
- Research your tax questions online;
- Search publications online by topic or keyword; and
- Sign up to receive local and national tax news by email.

**CD-ROM.** You can order Pub. 1796, IRS Tax Products CD-ROM, and obtain:

- A CD that is released twice so you have the latest products. The first release ships in late December and the final release ships in late February;
- Current year forms, instructions, and publications;
- Prior year forms, instructions, and publications;
- Tax Map: an electronic research tool and finding aid;
- Tax law frequently asked questions (FAQs);
- Tax Topics from the IRS telephone response system;
- Fill-in, print and save features for most tax forms;
- Internal Revenue Bulletins; and
- Toll-free and email technical support.

Buy the CD-ROM from the National Technical Information Service (NTIS) at [www.irs.gov/cdorders](http://www.irs.gov/cdorders) for \$25 (no handling fee) or call 1-877-CDFORMS (1-877-233-6767) toll free to buy the CD-ROM for \$25 (plus a \$5 handling fee).

**By phone and in person.** You can order forms and publications by calling 1-800-TAX-FORM (1-800-829-3676). You can also get most forms and publications at your local IRS office.

## IRS E-Services Make Taxes Easier

Now more than ever before, businesses can enjoy the benefits of filing and paying their federal taxes electronically. Whether you rely on a tax professional or handle your own taxes, the IRS offers you convenient programs to make taxes easier.

- You can *e-file* your Form 1120 and 7004; Form 940 and 941 employment tax returns; Form 1099 and other information returns. Visit [www.irs.gov/efile](http://www.irs.gov/efile) for details.
- You can pay taxes online or by phone using the free Electronic Federal Tax Payment System (EFTPS). Visit [www.eftps.gov](http://www.eftps.gov) or call 1-800-555-4477 for details.

Use these electronic options to make filing and paying taxes easier.

## General Instructions

### Purpose of Form

Use Form 1120, U.S. Corporation Income Tax Return, or Form 1120-A, U.S. Corporation Short-Form Income Tax Return, to report the income, gains, losses, deductions, credits, and to figure the income tax liability of a corporation.

### Who Must File

Unless exempt under section 501, all domestic corporations (including corporations in bankruptcy) must file an income tax return whether or not they have taxable income. Domestic corporations must

file Form 1120 or, if they qualify, Form 1120-A, unless they are required to file a special return. See *Special Returns for Certain Organizations* below.

**Limited liability companies.** If an entity with more than one owner was formed as a limited liability company (LLC) under state law, it generally is treated as a partnership for federal income tax purposes and files Form 1065, U.S. Return of Partnership Income. Generally, a single-member LLC is disregarded as an entity separate from its owner and reports its income and deductions on its owner's federal income tax return. The LLC can file a Form 1120 or Form 1120-A only if it has filed Form 8832, Entity Classification Election, to elect to be treated as an association taxable as a corporation. For more information about LLCs, see Pub. 3402, Tax Issues for Limited Liability Companies.

**Corporations engaged in farming.** Any corporation that engages in farming should use Form 1120 or, if they qualify, Form 1120-A, to report the income (loss) from such activities. Enter the income and deductions of the corporation according to the instructions for lines 1 through 10 and 12 through 29.

**Ownership interest in a Financial Asset Securitization Investment Trust (FASIT).** Special rules apply to a FASIT in existence on October 22, 2004, to the extent that regular interests issued by the FASIT before October 22, 2004, continue to remain outstanding in accordance with their original terms.

If a corporation holds an ownership interest in a FASIT to which these special rules apply, it must report all items of income, gain, deductions, losses, and credits on the corporation's income tax return (except as provided in section 860H). Show a breakdown of the items on an attached schedule. For more information, see sections 860H and 860L.

### Who May File Form 1120-A

A corporation may file Form 1120-A if it met all of the following requirements during the tax year.

1. Its gross receipts (line 1a on page 1) are under \$500,000.
2. Its total income (line 11 on page 1) is under \$500,000.
3. Its total assets (Item D on page 1) are under \$500,000.
4. Its only dividend income is from domestic corporations and those dividends (a) qualify for the 70% dividends-received deduction and (b) are not from debt-financed securities. Subchapter T cooperatives can include patronage dividends on Form 1120-A.
5. It does not owe alternative minimum tax.
6. It does not have any of the "write-in" additions to tax listed in the instructions for Schedule J, line 3 or line 11.
7. It has no nonrefundable tax credits other than the general business credit.
8. It is not:
  - a. A member of a controlled group,
  - b. A personal holding company,
  - c. Filing a consolidated return,
  - d. Electing to forego the entire carryback period for any NOL, or

e. Required to file one of the returns listed under *Special Returns for Certain Organizations*.

9. It does not have:

- a. Any ownership in a foreign corporation or foreign partnership,
- b. Foreign shareholders that directly or indirectly own 25% or more of its stock, or
- c. Any ownership in, or transactions with, a foreign trust.

## Special Returns for Certain Organizations

Instead of filing Form 1120 or Form 1120-A, certain organizations, as shown below, have to file special returns.

If the organization is a:	File Form
Farmers' cooperative (sec. 1381)	990-C
Exempt organization with unrelated trade or business income	990-T
Religious or apostolic organization exempt under section 501(d)	1065
Entity formed as a limited liability company under state law and treated as a partnership for federal income tax purposes	1065
Entity that elects to be treated as a real estate mortgage investment conduit (REMIC) under section 860D	1066
Interest charge domestic international sales corporation (section 992)	1120-IC-DISC
Foreign corporation (other than life and property and casualty insurance company filing Form 1120-L or Form 1120-PC)	1120-F
Foreign sales corporation (section 922)	1120-FSC
Condominium management, residential real estate management, or timeshare association that elects to be treated as a homeowners association under section 528	1120-H
Life insurance company (section 801)	1120-L
Fund set up to pay for nuclear decommissioning costs (section 468A)	1120-ND



Property and casualty insurance company (section 831)	<b>1120-PC</b>
Political organization (section 527)	<b>1120-POL</b>
Real estate investment trust (section 856)	<b>1120-REIT</b>
Regulated investment company (section 851)	<b>1120-RIC</b>
S corporation (section 1361)	<b>1120S</b>
Settlement fund (section 468B)	<b>1120-SF</b>

## Electronic Filing (Form 1120 Only)

Corporations can generally file Form 1120 and related forms, schedules, and attachments electronically. However, the option to file electronically does not apply to certain returns, including:

- Amended returns,
- Bankruptcy returns,
- Returns with a name change,
- Returns with precomputed penalty and interest,
- Returns with reasonable cause for failing to file timely,
- Returns with reasonable cause for failing to pay timely, and
- Returns with request for overpayment to be applied to another account.

Certain corporations with total assets of \$50 million or more that file at least 250 returns a year are required to electronically file Form 1120. See Temporary Regulations section 301.6011-5T. However, these corporations can request a waiver of the electronic filing requirements. See Notice 2005-88, 2005-48 I.R.B. 1060.

Visit [www.irs.gov/efile](http://www.irs.gov/efile) for details.

## When To File

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

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

## Private Delivery Services

Corporations can use certain private delivery services designated by the IRS to meet the "timely mailing as timely filing/paying" rule for tax returns and payments. These private delivery services include only the following.

- DHL Express (DHL): DHL Same Day Service, DHL Next Day 10:30 am, DHL Next Day 12:00 pm, DHL Next Day 3:00 pm, and DHL 2nd Day Service.

- Federal Express (FedEx): FedEx Priority Overnight, FedEx Standard Overnight, FedEx 2Day, FedEx International Priority, and FedEx International First.
- United Parcel Service (UPS): UPS Next Day Air, UPS Next Day Air Saver, UPS 2nd Day Air, UPS 2nd Day Air A.M., UPS Worldwide Express Plus, and UPS Worldwide Express.

The private delivery service can tell you how to get written proof of the mailing date.



*Private delivery services cannot deliver items to P.O. boxes. You must use the U.S. Postal Service to mail any item to an IRS P.O. box address.*

## Extension of Time To File

File Form 7004, Application for Automatic 6-Month Extension of Time To File Certain Business Income Tax, Information, and Other Returns, to request a 6-month extension of time to file. Generally file Form 7004 by the regular due date of the return.

## 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.

If a return is filed on behalf of a corporation by a receiver, trustee, or assignee, the fiduciary must sign the return,

instead of the corporate officer. Returns and forms signed by a receiver or trustee in bankruptcy on behalf of a corporation must be accompanied by a copy of the order or instructions of the court authorizing signing of the return or form.

If an employee of the corporation completes Form 1120 or Form 1120-A, the paid preparer's space should remain blank. Anyone who prepares Form 1120 or Form 1120-A but does not charge the corporation should not complete that section. 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 in the space provided for the preparer's signature.
- Give a copy of the return to the taxpayer.

**Note.** A paid preparer may sign original or amended returns by rubber stamp, mechanical device, or computer software program.

## Paid Preparer Authorization

If the corporation wants to allow the IRS to discuss its 2005 tax return with the paid preparer who signed it, check the "Yes" box in the signature area of the return. This authorization applies only to the individual whose signature appears in the "Paid Preparer's Use Only" section of the return. It

## Where To File

File the corporation's return at the applicable IRS address listed below.

If the corporation's principal business, office, or agency is located in:	And the total assets at the end of the tax year (Form 1120, page 1, item D) are:	Use the following Internal Revenue Service Center address:
Connecticut, Delaware, District of Columbia, Illinois, Indiana, Kentucky, Maine, Maryland, Massachusetts, Michigan, New Hampshire, New Jersey, New York, North Carolina, Ohio, Pennsylvania, Rhode Island, South Carolina, Vermont, Virginia, West Virginia, Wisconsin	Less than \$10 million	Cincinnati, OH 45999-0012
	\$10 million or more	Ogden, UT 84201-0012
Alabama, Alaska, Arizona, Arkansas, California, Colorado, Florida, Georgia, Hawaii, Idaho, Iowa, Kansas, Louisiana, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, New Mexico, North Dakota, Oklahoma, Oregon, South Dakota, Tennessee, Texas, Utah, Washington, Wyoming	Any amount	Ogden, UT 84201-0012
A foreign country or U.S. possession (or the corporation is claiming the possessions corporation tax credit under sections 30A and 936)	Any amount	Philadelphia, PA 19255-0012

A group of corporations with members located in more than one service center area will often keep all the books and records at the principal office of the managing corporation. In this case, the tax returns of the corporations may be filed with the service center for the area in which the principal office of the managing corporation is located.

does not apply to the firm, if any, shown in that section.

If the "Yes" box is checked, the corporation is authorizing the IRS to call the paid preparer to answer any questions that may arise during the processing of its return. The corporation is also authorizing the paid preparer to:

- Give the IRS any information that is missing from the return,
- Call the IRS for information about the processing of the return or the status of any related refund or payment(s), and
- Respond to certain IRS notices about math errors, offsets, and return preparation.

The corporation is not authorizing the paid preparer to receive any refund check, bind the corporation to anything (including any additional tax liability), or otherwise represent the corporation before the IRS.

The authorization will automatically end no later than the due date (excluding extensions) for filing the corporation's 2006 tax return. If the corporation wants to expand the paid preparer's authorization or revoke the authorization before it ends, see Pub. 947, Practice Before the IRS and Power of Attorney.

## Assembling the Return

To ensure that the corporation's tax return is correctly processed, attach all schedules and other forms after page 4, Form 1120 (or page 2, Form 1120-A), and in the following order.

1. Schedule N (Form 1120).
2. Form 8050.
3. Form 4136.
4. Form 4626.
5. Form 851.
6. Additional schedules in alphabetical order.
7. Additional forms in numerical order.

Complete every applicable entry space on Form 1120 or Form 1120-A. Do not enter "See Attached" instead of completing the entry spaces. If more space is needed on the forms or schedules, attach separate sheets using the same size and format as the printed forms. If there are supporting statements and attachments, arrange them in the same order as the schedules or forms they support and attach them last. Show the totals on the printed forms. Enter the corporation's name and EIN on each supporting statement or attachment.

## Depository Methods of Tax Payment

The corporation must pay any tax due in full no later than the 15th day of the 3rd month after the end of the tax year. The two methods of depositing taxes are discussed below.

### Electronic Deposit Requirement

The corporation must make electronic deposits of all depository taxes (such as employment tax, excise tax, and corporate income tax) using the Electronic Federal Tax Payment System (EFTPS) in 2006 if:

- The total deposits of such taxes in 2004 were more than \$200,000 or
- The corporation was required to use EFTPS in 2005.

If the corporation is required to use EFTPS and fails to do so, it may be subject to a 10% penalty. If the corporation is not required to use EFTPS, it can participate voluntarily. To enroll in or get more information about EFTPS, call 1-800-555-4477. To enroll online, visit [www.eftps.gov](http://www.eftps.gov).

**Depositing on time.** For EFTPS deposits to be made timely, the corporation must initiate the transaction at least 1 business day before the date the deposit is due.

### Deposits With Form 8109

If the corporation does not use EFTPS, deposit corporation income tax payments (and estimated tax payments) with Form 8109, Federal Tax Deposit Coupon. If you do not have a preprinted Form 8109, use Form 8109-B to make deposits. You can get this form by calling 1-800-829-4933 or visiting an IRS taxpayer assistance center. Have your EIN ready when you call or visit.

Do not send deposits directly to an IRS office; otherwise, the corporation may have to pay a penalty. Mail or deliver the completed Form 8109 with the payment to an authorized depository (a commercial bank or other financial institution authorized to accept federal tax deposits). Make checks or money orders payable to the depository.

If the corporation prefers, it can mail the coupon and payment to: Financial Agent, Federal Tax Deposit Processing, P.O. Box 970030, St. Louis, MO 63197. Make the check or money order payable to "Financial Agent."

To help ensure proper crediting, enter the corporation's EIN, the tax period to which the deposit applies, and "Form 1120" on the check or money order. Darken the "1120" box under "Type of Tax" and the appropriate "Quarter" box under "Tax Period" on the coupon. Records of these deposits will be sent to the IRS. For more information, see "Marking the Proper Tax Period" in the instructions for Form 8109.

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



*If the corporation owes tax when it files Form 1120 or Form 1120-A, do not include the payment with the tax return. Instead, mail or deliver the payment with Form 8109 to an authorized depository, or use EFTPS, if applicable.*

### Estimated Tax Payments

Generally, the following rules apply to the corporation's payments of estimated tax.

- The corporation must make installment payments of estimated tax if it expects its total tax for the year (less applicable credits) to be \$500 or more.
- 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.
- If the corporation does not use EFTPS, use the deposit coupons (Forms 8109) to make deposits of estimated tax.

- If the corporation overpaid estimated tax, it may be able to get a quick refund by filing Form 4466, Corporation Application for Quick Refund of Overpayment of Estimated Tax.

See the instructions for lines 32b and 32c, Form 1120 (lines 28b and 28c, Form 1120-A).

**Estimated tax penalty.** A corporation that does not make estimated tax payments when due may be subject to an underpayment penalty for the period of underpayment. Generally, a corporation is subject to the penalty if its tax liability is \$500 or more and it did not timely pay the smaller of:

- Its tax liability for 2005 or
- Its prior year's tax.

See section 6655 for details and exceptions, including special rules for large corporations.

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

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

Also, see the instructions for line 33, Form 1120 (line 29, Form 1120-A).

## Interest and Penalties

**Interest.** Interest is charged on taxes paid late even if an extension of time to file is granted. Interest is also charged on penalties imposed for failure to file, negligence, fraud, substantial valuation misstatements, substantial understatements of tax, and reportable transaction understatements from the due date (including extensions) to the date of payment. The interest charge is figured at a rate determined under section 6621.

**Late filing of return.** A corporation that does not file its tax return by the due date, including extensions, may be penalized 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 over 60 days late is the smaller of the tax due or \$100. The penalty will not be imposed if the corporation can show that the failure to file on time was due to reasonable cause. Corporations that file late should attach a statement explaining the reasonable cause.

**Late payment of tax.** A corporation that does not pay the tax when due generally may be penalized 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 25% of the unpaid tax. The penalty will not be imposed if the corporation can show that the failure to pay on time was due to reasonable cause.

**Trust fund recovery penalty.** This penalty may apply if certain excise, income, social security, and Medicare taxes that must be

collected or withheld are not collected or withheld, or these taxes are not paid. These taxes are generally reported on:

- Form 720, Quarterly Federal Excise Tax Return;
- Form 941, Employer's Quarterly Federal Tax Return;
- Form 943, Employer's Annual Federal Tax Return for Agricultural Employees; or
- Form 945, Annual Return of Withheld Federal Income Tax.

The trust fund recovery penalty may be imposed on all persons who are determined by the IRS to have been responsible for collecting, accounting for, and paying over these taxes, and who acted willfully in not doing so. The penalty is equal to the unpaid trust fund tax. See the Instructions for Form 720, Pub. 15 (Circular E), Employer's Tax Guide, or Pub. 51 (Circular A), Agricultural Employer's Tax Guide, for details, including the definition of responsible persons.

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

## Accounting Methods

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

Generally, the following rules apply.

- A corporation (other than a qualified personal service corporation) must use the accrual method of accounting if its average annual gross receipts exceed \$5 million.
- Unless it is a qualifying taxpayer or a qualifying small business taxpayer, a corporation must use the accrual method for sales and purchases of inventory items. See page 12.
- A corporation engaged in farming must use the accrual method. For exceptions, see section 447.
- Special rules apply to long-term contracts. See section 460.
- Dealers in securities must use the mark-to-market accounting method. Dealers in commodities and traders in securities and commodities can elect to use the mark-to-market accounting method. See section 475.

**Change in accounting method.** To change its method of accounting used to report taxable income (for income as a whole or for the treatment of any material item), the corporation must file Form 3115, Application for Change in Accounting Method.

See Form 3115 and Pub. 538, Accounting Periods and Methods, for more information on accounting methods.

## Accounting Period

A corporation must figure its taxable income on the basis of a tax year. A tax year is the annual accounting period a corporation uses to keep its records and report its income and expenses. Generally, corporations can use a calendar year or a fiscal year. Personal service corporations, however, must use a

calendar year unless they meet one of the exceptions discussed on page 6.

**Change of tax year.** Generally, a corporation, including a personal service corporation, must get the consent of the IRS before changing its tax year by filing Form 1128, Application To Adopt, Change, or Retain a Tax Year. However, under certain conditions, a corporation can change its tax year without getting consent.

See Form 1128 and Pub. 538 for more information on accounting periods and tax years.

## Rounding Off to Whole Dollars

The corporation can round off cents to whole dollars on its return and schedules. If the corporation does round to whole dollars, it must round all amounts. To round, drop amounts under 50 cents and increase amounts from 50 to 99 cents to the next dollar. For example, \$1.39 becomes \$1 and \$2.50 becomes \$3.

If two or more amounts must be added to figure the amount to enter on a line, include cents when adding the amounts and round off only the total.

## Recordkeeping

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

The corporation should keep copies of all filed returns. They help in preparing future and amended returns.

## Other Forms and Statements That May Be Required

**Amended return.** Use Form 1120X, Amended U.S. Corporation Income Tax Return, to correct a previously filed Form 1120 or Form 1120-A.

**Reportable transaction disclosure statement.** Disclose information for each reportable transaction in which the corporation participated. Form 8886, Reportable Transaction Disclosure Statement, must be filed for each tax year that the federal income tax liability of the corporation is affected by its participation in the transaction. The corporation may have to pay a penalty if it is required to file Form 8886 and does not do so. The following are reportable transactions.

1. Any listed transaction, which is a transaction that is the same as or substantially similar to tax avoidance transactions identified by the IRS.
2. Any transaction offered under conditions of confidentiality for which the corporation paid an advisor a fee of at least \$250,000.

3. Certain transactions for which the corporation has contractual protection against disallowance of the tax benefits.

4. Certain transactions resulting in a loss of at least \$10 million in any single year or \$20 million in any combination of years.

5. Certain transactions resulting in a book-tax difference of more than \$10 million on a gross basis.

6. Certain transactions resulting in a tax credit of more than \$250,000, if the corporation held the asset generating the credit for 45 days or less.

**Penalties.** The corporation may have to pay a penalty if it is required to disclose a reportable transaction under section 6011 and fails to properly complete and file Form 8886. The penalty is \$50,000 (\$200,000 if the reportable transaction is a listed transaction) for each failure to file Form 8886 with its corporate return or for failure to provide a copy of Form 8886 to the Office of Tax Shelter Analysis (OTSA). Other penalties, such as an accuracy-related penalty under section 6662A, may also apply. See the Instructions for Form 8886 for details.

**Reportable transactions by material advisors.** Until further guidance is issued, material advisors who provide material aid, assistance, or advice with respect to any reportable transaction, must use Form 8264, Application for Registration of a Tax Shelter, to disclose reportable transactions in accordance with interim guidance provided in Notice 2004-80, 2004-50 I.R.B. 963; Notice 2005-17, 2005-8 I.R.B. 606; and Notice 2005-22, 2005-12 I.R.B. 756.

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

**Dual consolidated losses.** If a domestic corporation incurs a dual consolidated loss (as defined in Regulations section 1.1503-2(c)(5)), the corporation (or consolidated group) may need to attach an elective relief agreement and/or an annual certification as provided in Temporary Regulations section 1.1503-2T(g)(2).

**Election to reduce basis under section 362(e)(2)(C).** The transferor and transferee in certain section 351 transactions can make a joint election under section 362(e)(2)(C) to limit the transferor's basis in the stock received instead of the transferee's basis in the transferred property. The transferor and transferee may make the election by attaching the statement as provided in Notice 2005-70, 2005-41 I.R.B. 694, to their tax returns filed by the due date (including extensions) for the tax year in which the transaction occurred. Once made, the election is irrevocable. See section 362(e)(2)(C) and Notice 2005-70.

**Other forms and statements.** See Pub. 542 for a list of other forms and statements a corporation may need to file in addition to the forms and statements discussed throughout these instructions.



# Specific Instructions

## Subchapter T Cooperative

To ensure that Form 1120 or Form 1120-A is timely and properly processed, a corporation that is a cooperative should write "SUBCHAPTER T COOPERATIVE" at the top of page 1 of the form.

## Period Covered

File the 2005 return for calendar year 2005 and fiscal years that begin in 2005 and end in 2006. For a fiscal or short tax year return, fill in the tax year space at the top of the form.

The 2005 Form 1120 can also be used if:

- The corporation has a tax year of less than 12 months that begins and ends in 2006, and
- The 2006 Form 1120 is not available at the time the corporation is required to file its return.

The corporation must show its 2006 tax year on the 2005 Form 1120 and take into account any tax law changes that are effective for tax years beginning after December 31, 2005.

## Name and Address

Print or type the corporation's true name (as set forth in the charter or other legal document creating it), address, and EIN on the appropriate lines. 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 corporation has a P.O. box, show the box number instead.

If the corporation receives its mail in care of a third party (such as an accountant or an attorney), enter on the street address line "C/O" followed by the third party's name and street address or P.O. box.

If the corporation received a Form 1120 tax package, use the preprinted label. Cross out any errors and print the correct information on the label.

## Item A. Identifying Information

### Consolidated Return (Form 1120 Only)

Corporations filing a consolidated return must attach Form 851, Affiliations Schedule, and other supporting statements to the return. Also, for the first year a subsidiary corporation is being included in a consolidated return, attach Form 1122, Authorization and Consent of Subsidiary Corporation To Be Included in a Consolidated Income Tax Return, to the parent's consolidated return. Attach a separate Form 1122 for each subsidiary being included in the consolidated return.

File supporting statements for each corporation included in the consolidated return. Do not use Form 1120 as a supporting statement. On the supporting statement, use columns to show the following, both before and after adjustments.

1. Items of gross income and deductions.
2. A computation of taxable income.
3. Balance sheets as of the beginning and end of the tax year.
4. A reconciliation of income per books with income per return.
5. A reconciliation of retained earnings.



*Adjustments must be made to eliminate all intercompany transactions and balances.*

Enter the totals for the consolidated group on Form 1120. Attach consolidated balance sheets and a reconciliation of consolidated retained earnings.



*The corporation does not have to complete (3), (4), and (5) above, if its total receipts (line 1a plus lines 4 through 10 on page 1 of the return) and its total assets at the end of the tax year are less than \$250,000.*

For more information on consolidated returns, see the regulations under section 1502.

### Personal Holding Company (Form 1120 Only)

A personal holding company must attach to Form 1120 a Schedule PH (Form 1120), U.S. Personal Holding Company (PHC) Tax. See the instructions for Schedule PH (Form 1120) for details.

### Personal Service Corporation

A personal service corporation must use a calendar tax year unless:

- It elects to use a 52-53-week tax year that ends with reference to the calendar year or tax year elected under section 444;
- It can establish a business purpose for a different tax year and obtains the approval of the IRS (see Form 1128 and Pub. 538); or
- It elects under section 444 to have a tax year other than a calendar year. To make the election, use Form 8716, Election To Have a Tax Year Other Than a Required Tax Year.

If a corporation makes the section 444 election, its deduction for certain amounts paid to employee-owners may be limited. See Schedule H (Form 1120), Section 280H Limitations for a Personal Service Corporation (PSC), to figure the maximum deduction.

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

For more information regarding a personal service corporation, see Pub. 542.

### Schedule M-3 (Form 1120 Only)

A corporation with total assets (consolidated for all corporations included within the tax consolidation group) of \$10 million or more on the last day of the tax year must complete Schedule M-3, Net Income (Loss) Reconciliation for Corporations With Total Assets of \$10 Million or More, instead of Schedule M-1. A corporation filing Form

1120 that is not required to file Schedule M-3 may voluntarily file Schedule M-3 instead of Schedule M-1. See the separate Instructions for Schedule M-3.

## Item B. Employer Identification Number (EIN)

Enter the corporation's EIN. If the corporation does not have an EIN, it must apply for one. An EIN can be applied for:

- Online—Click on the EIN link at [www.irs.gov/businesses/small](http://www.irs.gov/businesses/small). The EIN is issued immediately once the application information is validated.
- By telephone at 1-800-829-4933 from 8:00 a.m. to 8:00 p.m. in the corporation's local time zone.
- By mailing or faxing Form SS-4, Application for Employer Identification Number.

If the corporation has not received its EIN by the time the return is due, enter "Applied for" in the space for the EIN. For more details, see Pub. 583.

**Note.** The online application process is not yet available for corporations with addresses in foreign countries or Puerto Rico.

## Item D. Total Assets

Enter the corporation's total assets (as determined by the accounting method regularly used in keeping the corporation's books and records) at the end of the tax year. If there are no assets at the end of the tax year, enter -0-.

If the corporation is required to complete Schedule L, enter total assets from Schedule L, line 15, column (d) on page 1, item D. If filing a consolidated return, report total consolidated assets for all corporations joining in the return.

## Item E. Initial Return, Final Return, Name Change, or Address Change

- If this is the corporation's first return, check the "Initial return" box.
- If this is the corporation's final return and it will no longer exist, check the "Final return" box.
- If the corporation changed its name since it last filed a return, check the box for "Name change." Generally, a corporation also must have amended its articles of incorporation and filed the amendment with the state in which it was incorporated.
- If the corporation has changed its address since it last filed a return (including a change to an "in care of" address), check the box for "Address change."

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

## Income

Except as otherwise provided in the Internal Revenue Code, gross income includes all income from whatever source derived.

**Extraterritorial income.** Gross income generally does not include extraterritorial income that is qualifying foreign trade income. The extraterritorial income exclusion is reduced by 20% for



transactions in 2005 (40% for transactions in 2006), unless made under a binding contract with an unrelated person in effect on September 17, 2003, and at all times thereafter. Use Form 8873, Extraterritorial Income Exclusion, to figure the exclusion. Include the exclusion in the total for "Other deductions" on line 26, Form 1120 (line 22, Form 1120-A).

### Income from qualifying shipping

**activities.** Gross income does not include income from qualifying shipping activities if the corporation makes an election under section 1354 to be taxed on its notional shipping income (as defined in section 1353) at the highest corporate tax rate (35%). If the election is made, the corporation generally may not claim any loss, deduction, or credit with respect to qualifying shipping activities. A corporation making this election also may elect to defer gain on the disposition of a qualifying vessel.

Use Form 8902, Alternative Tax on Qualifying Shipping Activities, to figure the tax. Include the alternative tax on Schedule J, line 10.

## Line 1. Gross Receipts or Sales

Enter gross receipts or sales from all business operations except those that must be reported on lines 4 through 10. In general, advance payments are reported in the year of receipt. To report income from long-term contracts, see section 460. For special rules for reporting certain advance payments for goods and long-term contracts, see Regulations section 1.451-5. For permissible methods for reporting advance payments for services by an accrual method corporation, see Rev. Proc. 2004-34, 2004-22 I.R.B. 991.

**Installment sales.** Generally, the installment method cannot be used for dealer dispositions of property. A "dealer disposition" is any disposition of: (a) personal property by a person who regularly sells or otherwise disposes of personal property of the same type on the installment plan or (b) real property held for sale to customers in the ordinary course of the taxpayer's trade or business.

These restrictions on using the installment method do not apply to dispositions of property used or produced in a farming business or sales of timeshares and residential lots for which the corporation elects to pay interest under section 453(l)(3).

For sales of timeshares and residential lots reported under the installment method, the corporation's income tax is increased by the interest payable under section 453(l)(3). Report this addition to the tax on line 10, Schedule J, Form 1120 (Part I, line 4, Form 1120-A).

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

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

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

**Nonaccrual experience method.** Accrual method corporations are not required to accrue certain amounts to be received from the performance of services that, on the basis of their experience, will not be collected, if:

- The services are in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting or
- The corporation's average annual gross receipts for the 3 prior tax years does not exceed \$5 million.

This provision does not apply to any amount if interest is required to be paid on the amount or if there is any penalty for failure to timely pay the amount. For more information, see section 448(d)(5) and Temporary Regulations section 1.448-2T.

Corporations that qualify to use the nonaccrual experience method should attach a schedule showing total gross receipts, the amount not accrued as a result of the application of section 448(d)(5), and the net amount accrued. Enter the net amount on line 1a.

## Line 2. Cost of Goods Sold

Enter the cost of goods sold on line 2, page 1. Before making this entry, a Form 1120 filer must complete Schedule A on page 2 of Form 1120. See the Schedule A instructions on page 12. Form 1120-A filers can use the worksheet on page 13 to figure the amount to enter on line 2.

## Line 4. Dividends

**Form 1120 filers.** See the instructions for Schedule C on page 14. Then, complete Schedule C and enter on line 4 the amount from Schedule C, line 19.

**Form 1120-A filers.** Enter the total dividends received (that are not from debt-financed stock) from domestic corporations that qualify for the 70% dividends-received deduction.

## Line 5. Interest

Enter taxable interest on U.S. obligations and on loans, notes, mortgages, bonds, bank deposits, corporate bonds, tax refunds, etc. Do not offset interest expense against interest income. Special rules apply to interest income from certain below-market-rate loans. See section 7872 for details.

**Note.** Report tax-exempt interest income on Schedule K, item 9 (Part II, item 3, Form 1120-A). Also, if required, include the same amount on Schedule M-1, line 7; Form 1120-A, Part IV, line 6; or Schedule M-3 (Form 1120), Part II, line 13.

## Line 6. Gross Rents

Enter the gross amount received for the rental of property. Deduct expenses such as repairs, interest, taxes, and depreciation on the proper lines for deductions. A rental activity held by a closely held corporation or a personal service corporation may be

subject to the passive activity loss rules. See *Passive activity limitations* on page 8.

## Line 10. Other Income

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

1. Recoveries of bad debts deducted in prior years under the specific charge-off method.

2. The amount included in income from Form 6478, Credit for Alcohol Used as Fuel.

3. The amount included in income from Form 8864, Biodiesel and Renewable Diesel Fuels Credit.

4. Refunds of taxes deducted in prior years to the extent they reduced income subject to tax in the year deducted (see section 111). Do not offset current year taxes against tax refunds.

5. Any recapture amount under section 179A for certain clean-fuel vehicle property (or clean-fuel vehicle refueling property) that ceases to qualify. See Regulations section 1.179A-1 for details.

6. Ordinary income from trade or business activities of a partnership (from Schedule K-1 (Form 1065 or 1065-B)). Do not offset ordinary losses against ordinary income. Instead, include the losses on line 26, Form 1120 (line 22, Form 1120-A). Show the partnership's name, address, and EIN on a separate statement attached to this return. If the amount entered is from more than one partnership, identify the amount from each partnership.

7. Any LIFO recapture amount under section 1363(d). The corporation may have to include a LIFO recapture amount in income if it:

a. Used the LIFO inventory method for its last tax year before the first tax year for which it elected to become an S corporation or

b. Transferred LIFO inventory assets to an S corporation in a nonrecognition transaction in which those assets were transferred basis property.

The LIFO recapture amount is the amount by which the C corporation's inventory under the FIFO method exceeds the inventory amount under the LIFO method at the close of the corporation's last tax year as a C corporation (or for the year of the transfer, if (b) above applies). For more information, see Regulations section 1.1363-2 and Rev. Proc. 94-61, 1994-2 C.B. 775. Also see the instructions for Schedule J, line 11.

8. Any net positive section 481(a) adjustment. The corporation may have to make an adjustment under section 481(a) to prevent amounts of income or expense from being duplicated or omitted. The section 481(a) adjustment period is generally 1 year for a net negative adjustment and 4 years for a net positive adjustment. However, a corporation can elect to use a 1-year adjustment period if the net section 481(a) adjustment for the change is less than \$25,000. The corporation must complete the appropriate lines of Form 3115 to make the election. If the net section 481(a) adjustment

is negative, report it on line 26, Form 1120 (line 22, Form 1120-A).

## Deductions

### Limitations on Deductions

**Section 263A uniform capitalization rules.** The uniform capitalization rules of section 263A generally require corporations to capitalize, or include in inventory, certain costs incurred in connection with:

- The production of real property and tangible personal property held in inventory or held for sale in the ordinary course of business.
- Real property or personal property (tangible and intangible) acquired for resale.
- The production of real property and tangible personal property by a corporation for use in its trade or business or in an activity engaged in for profit.

Tangible personal property produced by a corporation includes a film, sound recording, videotape, book, or similar property.

Corporations subject to the section 263A uniform capitalization rules are required to capitalize:

1. Direct costs and
2. An allocable part of most indirect costs (including taxes) that (a) benefit the assets produced or acquired for resale or (b) are incurred because of the performance of production or resale activities.

For inventory, some of the indirect expenses that must be capitalized are:

- Administration 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.

Regulations section 1.263A-1(e)(3) specifies other indirect costs that relate to production or resale activities that must be capitalized and those that may be currently deductible.

**Interest expense** paid or incurred during the production period of designated property must be capitalized and is governed by special rules. For more details, see Regulations sections 1.263A-8 through 1.263A-15.

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

**Exceptions.** Section 263A does not apply to the following.

- Personal property acquired for resale if the corporation's average annual gross receipts for the 3 prior tax years were \$10 million or less.
- Timber.
- Most property produced under a long-term contract.
- Certain property produced in a farming business.
- Research and experimental costs under section 174.

- Geological and geophysical costs amortized under section 167(h).
- Intangible drilling costs for oil, gas, and geothermal property.
- Mining exploration and development costs.
- Inventoriable items accounted for in the same manner as materials and supplies that are not incidental. See *Cost of Goods Sold* on page 12.

For more details on the uniform capitalization rules, see Regulations sections 1.263A-1 through 1.263A-3. See Regulations section 1.263A-4 for rules for property produced in a farming business.

**Transactions between related taxpayers.** Generally, an accrual basis taxpayer can only deduct business expenses and interest owed to a related party in the year the payment is included in the income of the related party. See sections 163(e)(3), 163(j), and 267 for limitations on deductions for unpaid interest and expenses.

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

**Golden parachute payments.** A portion of the payments made by a corporation to key personnel that exceeds their usual compensation may not be deductible. This occurs when the corporation has an agreement (golden parachute) with these key employees to pay them these excess amounts if control of the corporation changes. See section 280G and Regulations section 1.280G-1.

**Business start-up and organizational costs.** Business start-up and organizational costs must be capitalized unless an election is made to deduct or amortize them. The corporation can elect to amortize costs paid or incurred before October 23, 2004, over a period of 60 months or more. For costs paid or incurred after October 22, 2004, the following rules apply separately to each category of costs.

- The corporation can elect to deduct up to \$5,000 of such costs for the year the corporation begins business operations.
- The \$5,000 deduction is reduced (but not below zero) by the amount the total costs exceed \$50,000. If the total costs are \$55,000 or more, the deduction is reduced to zero.
- If the election is made, any costs that are not deducted must be amortized ratably over a 180-month period.

In all cases, the amortization period begins the month the corporation begins business operations. For more details on the election for business start-up and organizational costs, see Pub. 535.

Attach any statement required by Regulations sections 1.195-1(b) or 1.248-1(c). Report the deductible amount of these costs and any amortization on line 26 (line 22 of Form 1120-A). For amortization that begins during the 2005 tax year, complete and attach Form 4562.

**Passive activity limitations.** Limitations on passive activity losses and credits under

section 469 apply to personal service corporations and closely held corporations.

Generally, the two kinds of passive activities are:

- Trade or business activities in which the corporation did not materially participate for the tax year; and
- Rental activities, regardless of its participation.

For exceptions, see Form 8810, Corporate Passive Activity Loss and Credit Limitations.

Corporations subject to the passive activity limitations must complete Form 8810 to compute their allowable passive activity loss and credit. Before completing Form 8810, see Temporary Regulations section 1.163-8T, which provides rules for allocating interest expense among activities. If a passive activity is also subject to the earnings stripping rules of section 163(j), the at-risk rules of section 465, or the tax-exempt use loss rules of section 470, those rules apply before the passive loss rules.

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

**Closely held corporations.** A corporation is a closely held corporation if:

- At any time during the last half of the tax year more than 50% in value of its outstanding stock is directly or indirectly owned by or for not more than five individuals, and
- The corporation is not a personal service corporation.

Certain organizations are treated as individuals for purposes of this test. See section 542(a)(2). For rules for determining stock ownership, see section 544 (as modified by section 465(a)(3)).

**Reducing certain expenses for which credits are allowable.** For each credit listed below, the corporation must reduce the otherwise allowable deductions for expenses used to figure the credit.

- Employment credits. See the instructions for line 13 on page 9.
- Research credit.
- Orphan drug credit.
- Disabled access credit.
- Enhanced oil recovery credit.
- Employer credit for social security and Medicare taxes paid on certain employee tips.
- Credit for small employer pension plan startup costs.
- Credit for employer-provided childcare facilities and services.
- Low sulfur diesel fuel production credit.

If the corporation has any of these credits, figure each current year credit before figuring the deduction for expenses on which the credit is based. See the instructions for the applicable form used to figure the credit.

**Limitations on deductions related to property leased to tax-exempt entities.** If a corporation leases property to a governmental or other tax-exempt entity, the corporation can not claim deductions related to the property to the extent that they exceed the corporation's income from the lease payments (tax-exempt use loss). Amounts disallowed may be carried over to the next tax year and treated as a deduction with respect to the property for that tax year.



See section 470 for more details and exceptions.

## Line 12. Compensation of Officers

Enter deductible officers' compensation on line 12. Form 1120 filers must complete Schedule E if their total receipts (line 1a, plus lines 4 through 10) are \$500,000 or more. 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 or a SIMPLE IRA plan.

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

If a consolidated return is filed, each member of an affiliated group must furnish this information.

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

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

For this purpose, compensation does not include the following.

- Income from certain employee trusts, annuity plans, or pensions.
- 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 disallowed as excess parachute payments under section 280G.

For details, see section 162(m) and Regulations section 1.162-27.

## Line 13. Salaries and Wages

Enter the total salaries and wages paid for the tax year, reduced by the amount claimed on:

- Form 5884, Work Opportunity Credit, line 2;
- Form 5884-A, Hurricane Katrina Employee Retention Credit, line 2;
- Form 8844, Empowerment Zone and Renewal Community Employment Credit, line 2;
- Form 8845, Indian Employment Credit, line 4; and
- Form 8861, Welfare-to-Work Credit, line 2.

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 or a SIMPLE IRA plan.



*If the corporation provided taxable fringe benefits to its employees, such as personal use of a car, do not deduct as wages the amount allocated for depreciation and other expenses claimed on lines 20 and 26, Form 1120 (lines 20 and 22, Form 1120-A).*

## Line 14. Repairs and Maintenance

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

## Line 15. Bad Debts

Enter the total debts that became worthless in whole or in part during the tax year. A small bank or thrift institution using the reserve method of section 585 should attach a schedule showing how it figured the current year's provision. A cash basis taxpayer cannot claim a bad debt deduction unless the amount was previously included in income.

## Line 16. Rents

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

The lease term began:	And the vehicle's FMV on the first day of the lease exceeded:
After 12/31/04 but before 1/1/06 . .	\$15,200
After 12/31/03 but before 1/1/05 . .	\$17,500
After 12/31/02 but before 1/1/04 . .	\$18,000
After 12/31/98 but before 1/1/03 . .	\$15,500

If the lease term began before January 1, 1999, see Pub. 463, Travel, Entertainment, Gift, and Car Expenses, to find out if the corporation has an inclusion amount. The inclusion amount for lease terms beginning in 2006 will be published in the Internal Revenue Bulletin in early 2006.

See Pub. 463 for instructions on figuring the inclusion amount.

## Line 17. Taxes and Licenses

Enter taxes paid or accrued during the tax year, but do not include the following.

- Federal income taxes.

- Foreign or U.S. possession income taxes if a tax credit is claimed (however, see the Instructions for Form 5735 for special rules for possession income taxes).
- Taxes not imposed on the corporation.
- Taxes, including state or local sales taxes, that are paid or incurred in connection with an acquisition or disposition of property (these taxes must be treated as a part of the cost of the acquired property or, in the case of a disposition, as a reduction in the amount realized on the disposition).
- Taxes assessed against local benefits that increase the value of the property assessed (such as for paving, etc.).
- Taxes deducted elsewhere on the return, such as those reflected in cost of goods sold.

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

## Line 18. Interest

**Note.** Do not offset interest income against interest expense.

The corporation must make an interest allocation if the proceeds of a loan were used for more than one purpose (for example, to purchase a portfolio investment and to acquire an interest in a passive activity). See Temporary Regulations section 1.163-8T for the interest allocation rules.

Mutual savings banks, building and loan associations, and cooperative banks can deduct the amounts paid or credited to the accounts of depositors as dividends, interest, or earnings. See section 591.

Do not deduct the following interest.

- Interest on indebtedness incurred or continued to purchase or carry obligations if the interest is wholly exempt from income tax. For exceptions, see section 265(b).
- For cash basis taxpayers, prepaid interest allocable to years following the current tax year. For example, a cash basis calendar year taxpayer who in 2005 prepaid interest allocable to any period after 2005 can deduct only the amount allocable to 2005.
- Interest and carrying charges on straddles. Generally, these amounts must be capitalized. See section 263(g).
- Interest on debt allocable to the production of designated property by a corporation for its own use or for sale. The corporation must capitalize this interest. Also capitalize any interest on debt allocable to an asset used to produce the property. See section 263A(f) and Regulations sections 1.263A-8 through 1.263A-15 for definitions and more information.
- Interest paid or incurred on any portion of an underpayment of tax that is attributable to an understatement arising from an undisclosed listed transaction or an undisclosed reportable avoidance transaction (other than a listed transaction) entered into in tax years beginning after October 22, 2004.

**Special rules** apply to:

- Interest on which no tax is imposed (see section 163(j)).
- Foregone interest on certain below-market-rate loans (see section 7872).
- Original issue discount on certain high-yield discount obligations. (See section 163(e) to figure the disqualified portion.)



- Interest which is allocable to unborrowed policy cash values of life insurance, endowment, or annuity contracts issued after June 8, 1997. See section 264(f). Attach a statement showing the computation of the deduction.

## Line 19. Charitable Contributions

Enter contributions or gifts actually paid within the tax year to or for the use of charitable and governmental organizations described in section 170(c) and any unused contributions carried over from prior years. Special rules and limits apply to contributions to organizations conducting lobbying activities. See section 170(f)(9).

Corporations reporting taxable income on the accrual method can elect to treat as paid during the tax year any contributions paid by the 15th day of the 3rd month after the end of the tax year if the contributions were authorized by the board of directors during the tax year. Attach a declaration to the return stating that the resolution authorizing the contributions was adopted by the board of directors during the tax year. The declaration must include the date the resolution was adopted.

**Limitation on deduction.** The total amount claimed cannot be more than 10% of taxable income (line 30, Form 1120, or line 26, Form 1120-A) computed without regard to the following.

- Any deduction for contributions.
- The special deductions on line 29b, Form 1120 (line 25b, Form 1120-A).
- The deduction allowed under section 249.
- The domestic production activities deduction.
- Any net operating loss (NOL) carryback to the tax year under section 172.
- Any capital loss carryback to the tax year under section 1212(a)(1).

**Temporary suspension of 10% limitation.** A corporation may elect to deduct qualified cash contributions without regard to the general 10% limit if the contributions were made after August 27, 2005, and before January 1, 2006, to a qualified charitable organization (other than certain private foundations described in section 509(a)(3)), for Hurricane Katrina relief efforts. The total amount claimed cannot be more than taxable income as computed above substituting "100%" for "10%." Excess qualified contributions are carried over to the next 5 years. Attach a statement substantiating that the contributions are for Hurricane Katrina relief efforts and indicating the amount of qualified contributions for which the election is made. See Pub. 4492.

**Carryover.** Charitable contributions over the 10% limitation cannot be deducted for the tax year but can be carried over to the next 5 tax years.

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

To figure the amount of any remaining NOL carryover to later years, taxable income must be modified (see section 172(b)). To the extent that contributions are

used to reduce taxable income for this purpose and increase an NOL carryover, a contributions carryover is not allowed. See section 170(d)(2)(B).

**Substantiation requirements.** Generally, no deduction is allowed for any contribution of \$250 or more unless the corporation gets a written acknowledgment from the donee organization that shows the amount of cash contributed, describes any property contributed, and, either gives a description and a good faith estimate of the value of any goods or services provided in return for the contribution or states that no goods or services were provided in return for the contribution. The acknowledgment must be obtained by the due date (including extensions) of the corporation's return, or, if earlier, the date the return is filed. Do not attach the acknowledgment to the tax return, but keep it with the corporation's records. These rules apply in addition to the filing requirements for Form 8283, Noncash Charitable Contributions.

**Contributions of property other than cash.** If a corporation (other than a closely held or personal service corporation) contributes property other than cash and claims over a \$500 deduction for the property, it must attach a schedule to the return describing the kind of property contributed and the method used to determine its fair market value (FMV). Closely held corporations and personal service corporations must complete Form 8283 and attach it to their returns. All other corporations generally must complete and attach Form 8283 to their returns for contributions of property (other than money) if the total claimed deduction for all property contributed was more than \$5,000. Special rules apply to the contribution of certain property. See the Instructions for Form 8283.

**Larger deduction.** A larger deduction is allowed for certain contribution of:

- Inventory and other property to certain organizations for use in the care of the ill, needy, or infants (section 170(e)(3)), including contributions after August 27, 2005, and before January 1, 2006, of "apparently wholesome food" (section 170(e)(3)(C)) and qualified book contributions (section 170(e)(3)(D)).
- Scientific equipment used for research to institutions of higher learning or to certain scientific research organizations (other than by personal holding companies and service organizations (section 170(e)(4)); and
- Computer technology and equipment for educational purposes (section 170(e)(6)).

For more information on charitable contributions, including substantiation and recordkeeping requirements, see section 170 and the related regulations and Pub. 526, Charitable Contributions. For special rules that apply to corporations, see Pub. 542.

## Line 20. Depreciation

Include on line 20 depreciation and the cost of certain property that the corporation elected to expense under section 179. See Form 4562 and its instructions.

## Line 21. Depletion (Form 1120 Only)

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

Attach Form T (Timber), Forest Activities Schedule, if a deduction for depletion of timber is taken.

Foreign intangible drilling costs and foreign exploration and development costs must either be added to the corporation's basis for cost depletion purposes or be deducted ratably over a 10-year period. See sections 263(i), 616, and 617 for details.

See Pub. 535 for more information on depletion.

## Line 23. Pension, Profit-Sharing, etc., Plans (Form 1120 Only)

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

**Form 5500,** Annual Return/Report of Employee Benefit Plan. File this form for a plan that is not a one-participant plan (see below).

**Form 5500-EZ,** Annual Return of One-Participant (Owners and Their Spouses) Retirement Plan. File this form for a plan that only covers the owner (or the owner and his or her spouse) but only if the owner (or the owner and his or her spouse) owns the entire business.

## Line 24. Employee Benefit Programs (Form 1120 Only)

Enter contributions to employee benefit programs not claimed elsewhere on the return (for example, insurance, health and welfare programs, etc.) that are not an incidental part of a pension, profit-sharing, etc., plan included on line 23.

## Line 26, Form 1120 (Line 22, Form 1120-A). Other Deductions

Attach a schedule, listing by type and amount, all allowable deductions that are not deductible elsewhere on Form 1120 or Form 1120-A. Form 1120-A filers should include amounts described in the instructions above for lines 21, 23, and 24 of Form 1120. Enter the total of other deductions on line 26, Form 1120 (line 22, Form 1120-A).

See *Special rules* on page 11 for limits on certain other deductions. Also, see Pub. 535 for details on other deductions that may apply to corporations.

Examples of other deductions include the following.

- Amortization. See Form 4562.

• Certain costs of qualified film or television productions. See section 181.

• Certain business start-up and organizational costs the corporation elects to deduct. See page 8.

• Reforestation costs. The corporation can elect to deduct up to \$10,000 of qualifying reforestation expenses for each qualified timber property. The corporation can elect to amortize over 84 months any amount not deducted. See Pub. 535.

• Insurance premiums.

• Legal and professional fees.

• Supplies used and consumed in the business.

• Utilities.

• Ordinary losses from trade or business activities of a partnership (from Schedule K-1 (Form 1065 or 1065-B)). Do not offset ordinary income against ordinary losses. Instead, include the income on line 10.

Show the partnership's name, address, and EIN on a separate statement attached to this return. If the amount is from more than one partnership, identify the amount from each partnership.

• Any extraterritorial income exclusion (from Form 8873, line 54).

• Deduction for clean-fuel vehicle and certain refueling property placed in service before January 1, 2006. See Pub. 535.

• Any negative net section 481(a) adjustment. See the instructions for line 10.

• Deduction for certain energy efficient commercial building property placed in service after December 31, 2005. See section 179D.

• Dividends paid in cash on stock held by an employee stock ownership plan. However, a deduction can only be taken for the dividends above if, according to the plan, the dividends are:

1. Paid in cash directly to the plan participants or beneficiaries;

2. Paid to the plan, which distributes them in cash to the plan participants or their beneficiaries no later than 90 days after the end of the plan year in which the dividends are paid;

3. At the election of such participants or their beneficiaries (a) payable as provided under 1 or 2 above or (b) paid to the plan and reinvested in qualifying employer securities; or

4. Used to make payments on a loan described in section 404(a)(9).

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

Do not deduct the following.

• Fines or penalties paid to a government for violating any law.

• Any amount that is allocable to a class of exempt income. See section 265(b) for exceptions.

**Special rules** apply to the following expenses.

#### **Travel, meals, and entertainment.**

Subject to limitations and restrictions discussed below, a corporation can deduct ordinary and necessary travel, meals, and entertainment expenses paid or incurred in its trade or business. Also, special rules apply to deductions for gifts, skybox rentals, luxury water travel, convention expenses, and entertainment tickets. See section 274 and Pub. 463 for details.

**Travel.** The corporation cannot deduct travel expenses of any individual accompanying a corporate officer or employee, including a spouse or dependent of the officer or employee, unless:

• That individual is an employee of the corporation, and

• His or her travel is for a bona fide business purpose and would otherwise be deductible by that individual.

**Meals and entertainment.** Generally, the corporation can deduct only 50% of the amount otherwise allowable for meals and entertainment expenses paid or incurred in its trade or business. In addition (subject to exceptions under section 274(k)(2)):

• Meals must not be lavish or extravagant;

• A bona fide business discussion must occur during, immediately before, or immediately after the meal; and

• An employee of the corporation must be present at the meal.

See section 274(n)(3) for a special rule that applies to expenses for meals consumed by individuals subject to the hours of service limits of the Department of Transportation.

**Membership dues.** The corporation can deduct amounts paid or incurred for membership dues in civic or public service organizations, professional organizations (such as bar and medical associations), business leagues, trade associations, chambers of commerce, boards of trade, and real estate boards. However, no deduction is allowed if a principal purpose of the organization is to entertain, or provide entertainment facilities for, members or their guests. In addition, corporations cannot deduct membership dues in any club organized for business, pleasure, recreation, or other social purpose. This includes country clubs, golf and athletic clubs, airline and hotel clubs, and clubs operated to provide meals under conditions favorable to business discussion.

**Entertainment facilities.** The corporation cannot deduct an expense paid or incurred for a facility (such as a yacht or hunting lodge) used for an activity usually considered entertainment, amusement, or recreation.

**Amounts treated as compensation.** Generally, the corporation may be able to deduct otherwise nondeductible entertainment, amusement, or recreation expenses if the amounts are treated as compensation to the recipient and reported on Form W-2 for an employee or on Form 1099-MISC for an independent contractor.

However, if the recipient is an officer, director, or beneficial owner (directly or indirectly) of more than 10% of any class of stock, the deductible expense is limited. See section 274(e)(2) and Notice 2005-45, 2005-24 I.R.B. 1228.

**Lobbying expenses.** Generally, lobbying expenses are not deductible. These expenses include:

• Amounts paid or incurred in connection with influencing federal or state legislation (but not local legislation) or

• Amounts paid or incurred in connection with any communication with certain federal executive branch officials in an attempt to influence the official actions or positions of the officials. See Regulations section

1.162-29 for the definition of "influencing legislation."

Dues and other similar amounts paid to certain tax-exempt organizations may not be deductible. See section 162(e)(3). If certain in-house lobbying expenditures do not exceed \$2,000, they are deductible.

## **Line 28, Form 1120 (Line 24, Form 1120-A). Taxable Income Before NOL Deduction and Special Deductions**

**At-risk rules.** Generally, special at-risk rules under section 465 apply to closely held corporations (see *Passive activity limitations* on page 8) engaged in any activity as a trade or business or for the production of income. These corporations may have to adjust the amount on line 28, Form 1120, or line 24, Form 1120-A. (See below.)

The at-risk rules do not apply to:

• Holding real property placed in service by the taxpayer before 1987;

• Equipment leasing under sections 465(c)(4), (5), and (6); or

• Any qualifying business of a qualified corporation under section 465(c)(7).

However, the at-risk rules do apply to the holding of mineral property.

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

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

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

## **Line 29a, Form 1120 (Line 25a, Form 1120-A). Net Operating Loss Deduction**

A corporation can use the NOL incurred in one tax year to reduce its taxable income in another tax year. Enter on line 29a (line 25a, Form 1120-A), the total NOL carryovers from other tax years, but do not enter more than the corporation's taxable income (after special deductions). Attach a schedule showing the computation of the NOL deduction. Form 1120 filers must also complete item 12 on Schedule K.

The following special rules apply.

• A personal service corporation may not carry back an NOL to or from any tax year to which an election under section 444 to have a tax year other than a required tax year applies.

• A corporate equity reduction interest loss may not be carried back to a tax year



preceding the year of the equity reduction transaction (see section 172(b)(1)(E)).

- If an ownership change occurs, the amount of the taxable income of a loss corporation that may be offset by the pre-change NOL carryovers may be limited (see section 382 and the related regulations). A loss corporation must file an information statement with its income tax return for each tax year that certain ownership shifts occur (see Temporary Regulations section 1.382-2T(a)(2)(ii) for details). See Regulations section 1.382-6(b) for details on how to make the closing-of-the-books election.

- If a corporation acquires control of another corporation (or acquires its assets in a reorganization), the amount of pre-acquisition losses that may offset recognized built-in gain may be limited (see section 384).

- If a corporation elects the alternative tax on qualifying shipping activities under section 1354, no deduction is allowed for an NOL attributable to the qualifying shipping activities to the extent that the loss is carried forward from a tax year preceding the first tax year for which the alternative tax election was made. See section 1358(b)(2).

- Certain electric utility companies can elect a 5-year carryback period for a portion of NOLs arising in 2003, 2004, and 2005. The election may be made during any tax year ending after December 31, 2005, and before January 1, 2009. See section 172(b)(1)(I). Also see the Instructions for Form 1139, Corporation Application for Tentative Refund, for limitations and special rules.

For more details on the NOL deduction, see section 172, Form 1139, and Pub. 542.

## Line 29b, Form 1120 (Line 25b, Form 1120-A). Special Deductions

**Form 1120 filers.** See the instructions for Schedule C on page 14.

**Form 1120-A filers.** Generally, enter 70% of line 4, page 1, on line 25b. However, this deduction cannot be more than 70% of line 24, page 1. Compute line 24 without regard to any adjustment under section 1059 and without regard to any capital loss carryback to the tax year under section 1212(a)(1).

In a year in which an NOL occurs, this 70% limitation does not apply even if the loss is created by the dividends-received deduction. See sections 172(d) and 246(b).

## Tax and Payments

### Line 30, Form 1120 (Line 26, Form 1120-A). Taxable Income

**Minimum taxable income.** The corporation's taxable income cannot be less than the largest of the following amounts.

- The amount of nondeductible CFC dividends under section 965. This amount is equal to the difference between columns (a) and (c) of Form 1120, Schedule C, line 12.

- The inversion gain of the corporation for the tax year, if the corporation is an expatriated entity or a partner in an expatriated entity. For details, see section 7874.

- The sum of the corporation's excess inclusions from Schedules Q (1066), line 2c,

and the corporation's taxable income determined solely with respect to its ownership and high-yield interests in FASITs. For details, see sections 860E(a) and 860J.

**Net operating loss (NOL).** If line 30 (figured without regard to the items listed above under minimum taxable income), is zero or less, the corporation may have an NOL that can be carried back or forward as a deduction to other tax years. Generally, a corporation first carries back an NOL 2 tax years. However, the corporation can elect to waive the carryback period and instead carry the NOL forward to future tax years. To make the election, see the instructions for Schedule K, item 11 on page 18.

See Form 1139 for details, including other elections that may be available, which must be made no later than 6 months after the due date (excluding extensions) of the corporation's tax return.

**Capital construction fund.** To take a deduction for amounts contributed to a capital construction fund (CCF), reduce the amount that would otherwise be entered on line 30 (line 26, Form 1120-A) by the amount of the deduction. On the dotted line next to the entry space, enter "CCF" and the amount of the deduction. For more information, see section 7518.

### Line 32b, Form 1120 (Line 28b, Form 1120-A). Estimated Tax Payments

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

**Beneficiaries of trusts.** If the corporation is the beneficiary of a trust, and the trust makes a section 643(g) election to credit its estimated tax payments to its beneficiaries, include the corporation's share of the payment in the total for line 32b, Form 1120 (line 28b, Form 1120-A). Enter "T" and the amount on the dotted line next to the entry space.

**Special estimated tax payments for certain life insurance companies.** If the corporation is required to make or apply special estimated tax payments (SETP) under section 847 in addition to its regular estimated tax payments, enter on line 32b (line 28b, Form 1120-A), the corporation's total estimated tax payments. In the margin near line 32b, enter "Form 8816" and the amount. Attach a schedule showing your computation of estimated tax payments. See sections 847(2) and 847(8) and Form 8816, Special Loss Discount Account and Special Estimated Tax Payments for Insurance Companies, for more information.

### Line 32c, Form 1120 (Line 28c, Form 1120-A). Overpaid estimated tax

If the corporation overpaid estimated tax, it may be able to get a quick refund by filing Form 4466. The overpayment must be at least 10% of the corporation's expected income tax liability and at least \$500. File Form 4466 after the end of the corporation's tax year, and no later than the 15th day of the third month after the end of the tax year. Form 4466 must be filed before the corporation files its tax return.

### Line 32f, Form 1120 (Line 28f, Form 1120-A)

**Credit from Form 2439.** Enter the credit from Form 2439, Notice to Shareholder of Undistributed Long-Term Capital Gains, for the corporation's share of the tax paid by a regulated investment company (RIC) or a real estate investment trust (REIT) on undistributed long-term capital gains included in the corporation's income. Attach Form 2439 to Form 1120 or Form 1120-A.

**Credit for federal tax on fuels.** Enter any credit from Form 4136, Credit for Federal Tax Paid on Fuels. Attach Form 4136 to Form 1120 or Form 1120-A.

**Credit for tax on ozone-depleting chemicals.** Include on line 32f (line 28f, Form 1120-A) any credit the corporation is claiming under section 4682(g)(2) for tax on ozone-depleting chemicals. Enter "ODC" next to the entry space.

### Line 32g, Form 1120 (Line 28g, Form 1120-A). Total Payments

On Form 1120, add the amounts on lines 32d through 32f and enter the total on line 32g. On Form 1120-A, add the amounts on lines 28d through 28f and enter the total on line 28g.

**Backup withholding.** If the corporation had federal 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 32g, Form 1120 (line 28g, Form 1120-A). On Form 1120, enter the amount withheld and the words "Backup Withholding" in the blank space above line 32g. On Form 1120-A, show the amount withheld on the dotted line to the left of line 28g, and enter "Backup Withholding."

### Line 33, Form 1120 (Line 29, Form 1120-A). Estimated Tax Penalty

If Form 2220 is attached, check the box on line 33, Form 1120 (line 29, Form 1120-A), and enter the amount of any penalty on this line.

### Line 36, Form 1120 (Line 32, Form 1120-A). Direct Deposit of Refund

If the corporation wants its refund directly deposited into its checking or savings account at any U.S. bank or other financial institution instead of having a check sent to the corporation, complete Form 8050 and attach it to the corporation's tax return.

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## Schedule A, Form 1120 (Worksheet, Form 1120-A)

### Cost of Goods Sold

Generally, inventories are required at the beginning and end of each tax year if the production, purchase, or sale of merchandise is an income-producing factor. See Regulations section 1.471-1.

However, if the corporation is a qualifying taxpayer or a qualifying small business

Instructions for Forms 1120 and 1120-A



taxpayer, it can adopt or change its accounting method to account for inventoriable items in the same manner as materials and supplies that are not incidental (unless its business is a tax shelter (as defined in section 448(d)(3))).

A qualifying taxpayer is a taxpayer that, for each prior tax year ending after December 16, 1998, has average annual gross receipts of \$1 million or less for the 3-tax-year period ending with that prior tax year.

A qualifying small business taxpayer is a taxpayer (a) that, for each prior tax year ending on or after December 31, 2000, has average annual gross receipts of \$10 million or less for the 3-tax-year period ending with that prior tax year and (b) whose principal business activity is not an ineligible activity.

Under this accounting method, inventory costs for raw materials purchased for use in producing finished goods and merchandise purchased for resale are deductible in the year the finished goods or merchandise are sold (but not before the year the corporation paid for the raw materials or merchandise, if it is also using the cash method). For additional guidance on this method of accounting for inventoriable items, see Pub. 538 and the Instructions for Form 3115.

Enter amounts paid for all raw materials and merchandise during the tax year on line 2. The amount the corporation can deduct for the tax year is figured on line 8.

All firms not using the cash method of accounting should see *Section 263A uniform capitalization rules* on page 8 before completing Schedule A or the worksheet. The instructions for lines 1 through 7 that follow apply to Schedule A (Form 1120) and the worksheet for Form 1120-A below.

### Line 1. Inventory at Beginning of Year

If the corporation is changing its method of accounting for the current tax year, it must refigure last year's closing inventory using its new method of accounting and enter the result on line 1. If there is a difference between last year's closing inventory and the refigured amount, attach an explanation and take it into account when figuring the corporation's section 481(a) adjustment.

### Line 4. Additional Section 263A Costs

An entry is required on this line only for corporations that have elected a simplified method of accounting.

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

For corporations that have elected the simplified resale method, additional section 263A costs are generally those costs incurred with respect to the following categories.

- Off-site storage or warehousing.
- Purchasing.

- Handling, such as processing, assembling, repackaging, and transporting.
- General and administrative costs (mixed service costs).

For details, see Regulations section 1.263A-3(d).

Enter on line 4 the balance of section 263A costs paid or incurred during the tax year not includible 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 sections 1.263A-1 through 1.263A-3 for details on figuring the amount of additional section 263A costs to be included in ending inventory. If the corporation accounts for inventoriable items in the same manner as materials and supplies that are not incidental, enter on line 7 the portion of its raw materials and merchandise purchased for resale that is included on line 6 and was not sold during the year.

### Lines 9a Through 9f. 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 requirements of the applicable regulations cited below.

However, if the corporation is using the cash method of accounting, it is required to use cost.

Corporations that account for inventoriable items in the same manner as materials and supplies that are not incidental can currently deduct expenditures for direct labor and all indirect costs that would otherwise be included in inventory costs.

The average cost (rolling average) method of valuing inventories generally does not conform to the requirements of the regulations. See Rev. Rul. 71-234, 1971-1 C.B. 148.

Corporations that use erroneous valuation methods must change to a method

permitted for federal income tax purposes. Use Form 3115 to make this change.

On line 9a, check the method(s) used for valuing inventories. Under lower of cost or market, the term "market" (for normal goods) means the current bid price prevailing on the inventory valuation date for the particular merchandise in the volume usually purchased by the taxpayer. For a manufacturer, market applies to the basic elements of cost—raw materials, labor, and burden. If section 263A applies to the taxpayer, the basic elements of cost must reflect the current bid price of all direct costs and all indirect costs properly allocable to goods on hand at the inventory date.

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 due to 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 9c. On line 9d, enter the amount or the percent of total closing inventories covered under section 472. Estimates are acceptable.

If the corporation changed or extended its inventory method to LIFO and had to write up the opening inventory to cost in the year of election, report the effect of the write-up as other income (line 10, page 1), proportionately over a 3-year period that begins with the year of the LIFO election (section 472(d)).

**Note.** Corporations using the LIFO method that make an S corporation election or transfer LIFO inventory to an S corporation in a nonrecognition transaction may be subject to an additional tax attributable to the LIFO recapture amount. See the instructions for line 11, Schedule J, on page 18, and line 10, *Other Income*, on page 7.

### Cost of Goods Sold Worksheet (Form 1120-A) (keep for your records)

1. Inventory at beginning of year. Enter here and in Part III, line 3, column (a), Form 1120-A . . . . .	1. _____
2. Purchases. Enter here and in Part II, line 5a(1), Form 1120-A . . . . .	2. _____
3. Cost of labor. Enter here and include in total in Part II, line 5a(3), Form 1120-A . . . . .	3. _____
4. Additional section 263A costs. Enter here and in Part II, line 5a(2), Form 1120-A (see instruction for line 4) . . . . .	4. _____
5. Other costs. Enter here and include in Part II, line 5a(3), Form 1120-A . . . . .	5. _____
6. <b>Total.</b> Add lines 1 through 5 . . . . .	6. _____
7. Inventory at end of year. Enter here and in Part III, line 3, column (b), Form 1120-A . . . . .	7. _____
8. <b>Cost of goods sold.</b> Subtract line 7 from line 6. Enter the result here and on page 1, line 2, Form 1120-A . . . . .	8. _____

For more information on inventory valuation methods, see Pub. 538.

## Schedule C (Form 1120 Only)

For purposes of the 20% ownership test on lines 1 through 7, the percentage of stock owned by the corporation is based on voting power and value of the stock. Preferred stock described in section 1504(a)(4) is not taken into account. Corporations filing a consolidated return should see Regulations sections 1.1502-13, 1.1502-26, and 1.1502-27 before completing Schedule C.

Corporations filing a consolidated return must not report as dividends on Schedule C any amounts received from corporations within the tax consolidation group. Such dividends are eliminated in consolidation rather than offset by the dividends-received deduction.

### 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
- Qualified for the 70% deduction under section 243(a)(1).

Also include on line 1 the following.

- Taxable distributions from an IC-DISC or former DISC that are designated as eligible for the 70% deduction and certain dividends of Federal Home Loan Banks. See section 246(a)(2).
- Dividends (except those received on debt-financed stock acquired after July 18, 1984) from a regulated investment company (RIC). The amount of dividends eligible for the dividends-received deduction under section 243 is limited by section 854(b). The corporation should receive a notice from the RIC specifying the amount of dividends that qualify for the deduction.

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

### Line 2, Column (a)

Enter on line 2:

- 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), and
- Taxable distributions from an IC-DISC or former DISC that are considered eligible for the 80% deduction.

### Line 3, Column (a)

Enter the following.

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

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

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

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

### Line 4, Column (a)

Enter dividends received on 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
- Qualify for the 70% deduction under section 245(a). To qualify for the 70% deduction, the corporation must own at least 10% of the stock of the foreign corporation by vote and value.

Also include dividends received from a less-than-20%-owned FSC that:

- Are attributable to income treated as effectively connected with the conduct of a trade or business within the United States (excluding foreign trade income), and
- Qualify for the 70% deduction under section 245(c)(1)(B).

### Line 7, Column (a)

Enter the U.S.-source portion of dividends that:

- Are received from 20%-or-more-owned foreign corporations, and
- Qualify for the 80% deduction under section 245(a).

Also include dividends received from a 20%-or-more-owned FSC that:

- Are attributable to income treated as effectively connected with the conduct of a trade or business within the United States (excluding foreign trade income), and
- Qualify for the 80% deduction under section 245(c)(1)(B).

### Line 8, Column (a)

Enter dividends received from wholly owned foreign subsidiaries that are eligible for the 100% deduction under section 245(b).

In general, the deduction under section 245(b) applies to dividends paid out of the

earnings and profits of a foreign corporation for a tax year during which:

- All of its outstanding stock is directly or indirectly owned by the domestic corporation receiving the dividends, and
- All of its gross income from all sources is effectively connected with the conduct of a trade or business within the United States.

### Line 9, Column (c)

Generally, line 9, column (c), cannot 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).

### Line 10, Columns (a) and (c)

Small business investment companies operating under the Small Business Investment Act of 1958 (see 15 U.S.C. 661 and following) must enter dividends that are received from domestic corporations subject to income tax even though a deduction is allowed for the entire amount of those dividends. To claim the 100% deduction on line 10, column (c), the company must file with its return a statement that it was a federal licensee under the Small Business Investment Act of 1958 at the time it received the dividends.

### Line 11, Columns (a) and (c)

Enter dividends from FSCs that are attributable to foreign trade income and that are eligible for the 100% deduction provided in section 245(c)(1)(A).

Also, enter dividends that qualify under section 243(b) for the 100% dividends-received deduction described in section 243(a)(3). Corporations taking this deduction are subject to the provisions of section 1561.

The 100% deduction does not apply to affiliated group members that are joining in the filing of a consolidated return.

### Line 12, Column (a)

Enter qualifying dividends from line 11 of Form 8895, One-Time Dividends Received Deduction for Certain Cash Dividends from Controlled Foreign Corporations.

### Line 13, Column (a)

Enter foreign dividends not reportable on lines 3, 6, 7, 8, 11 or 12 of column (a). Include on line 13 the corporation's share of the ordinary earnings of a qualified electing fund from line 1c of Form 8621, Return by a Shareholder of a Passive Foreign Investment Company or Qualifying Electing Fund. Exclude distributions of amounts constructively taxed in the current year or in prior years under subpart F (sections 951 through 964).

### Line 14, Column (a)

Include income constructively received from CFCs under subpart F. This amount should equal the total subpart F income reported on Schedule I, Form 5471, Information Return of U.S. Persons With Respect to Certain Foreign Corporations.

### Line 15, Column (a)

Include gross-up for taxes deemed paid under sections 902 and 960.

**Line 16, Column (a)**

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

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

- Is paid out of the corporation's accumulated IC-DISC income or previously taxed income, or
- Is a deemed distribution under section 995(b)(1).

**Line 17, Column (a)**

Include the following.

1. Dividends (other than capital gain distributions reported on Schedule D (Form 1120) and exempt-interest dividends) that are received from RICs and that are not subject to the 70% deduction.

2. Dividends from tax-exempt organizations.

3. Dividends (other than capital gain distributions) received from a REIT 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, which include the following.

a. Dividends received on any share of stock held for less than 46 days during the 91-day period beginning 45 days before the ex-dividend date. When counting the number of days the corporation held the stock, you cannot count certain days during which the corporation's risk of loss was diminished. See section 246(c)(4) and Regulations section 1.246-5 for more details.

b. Dividends attributable to periods totaling more than 366 days that the corporation received on any share of preferred stock held for less than 91 days during the 181-day period that began 90 days before the ex-dividend date. When counting the number of days the corporation held the stock, you cannot count certain days during which the corporation's risk of loss was diminished. See section 246(c)(4)

and Regulations section 1.246-5 for more details. Preferred dividends attributable to periods totaling less than 367 days are subject to the 46-day holding period rule above.

c. Dividends on any share of stock to the extent the corporation is under an obligation (including a short sale) to make related payments with respect to positions in 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 17, identify the total of these amounts in a schedule attached to Form 1120.

**Line 18, Column (c)**

Section 247 allows public utilities a deduction of 40% of the smaller of (a) dividends paid on their preferred stock during the tax year, or (b) taxable income computed without regard to this deduction. In a year in which an NOL occurs, compute the deduction without regard to section 247(a)(1)(B). See section 172(d).

**Schedule J, Form 1120 (Part I, Form 1120-A)**



If the corporation is making a section 965 election, see the instructions for Parts III and IV of Form 8895 before completing Schedule J.

**Lines 1 and 2 (Form 1120 Only)**

**Members of a controlled group.** A member of a controlled group must check the box on line 1 and complete lines 2a and 2b of Schedule J, Form 1120. The term "controlled group" means any parent-subsidiary group, brother-sister group, or combined group. See the definitions below.

**Parent-subsidiary group.** A parent-subsidiary group is one or more chains of corporations connected through

stock ownership with a common parent corporation if:

- Stock possessing at least 80% of the total combined voting power of all classes of stock entitled to vote or at least 80% of the total value of shares of all classes of stock of each of the corporations, except the common parent corporation, is directly or indirectly owned by one or more of the other corporations; and
- The common parent corporation directly or indirectly owns stock possessing at least 80% of the total combined voting power of all classes of stock entitled to vote or at least 80% of the total value of shares of all classes of stock of at least one of the other corporations, excluding, in computing such voting power or value, stock owned directly by such other corporations.

**Brother-sister group.** A brother-sister group is two or more corporations if 5 or fewer persons who are individuals, estates, or trusts directly or indirectly own stock possessing:

1. At least 80% of the total combined voting power of all classes of stock entitled to vote or at least 80% of the total value of shares of all classes of the stock of each corporation, and
2. 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 shares of all classes of stock of each corporation, taking into account the stock ownership of each such person only to the extent such stock ownership is identical with respect to each such corporation.

The definition of brother-sister group does not include (1) above, for purposes of the taxable income brackets, alternative minimum tax exemption amounts, and accumulated earnings credit.

**Combined group.** A combined group is three or more corporations each of which is a member of a parent-subsidiary group or a brother-sister group, and one of which is:

- A common parent corporation included in a group of corporations in a parent-subsidiary group, and also
- Included in a group of corporations in a brother-sister group.

For more details on controlled groups, see section 1563.

**Line 2a.** 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.

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

**Worksheet for Schedule C, line 9 (keep for your records)**

1. Refigure line 28, page 1, Form 1120, without any domestic production activities deduction, any adjustment under section 1059, and without any capital loss carryback to the tax year under section 1212(a)(1) . . .	1. _____
2. Complete lines 10 and 11, column (c), and enter the total here . . . . .	2. _____
3. Subtract line 2 from line 1 . . . . .	3. _____
4. Multiply line 3 by 80% . . . . .	4. _____
5. Add lines 2, 5, 7, and 8, column (c), and the part of the deduction on line 3, column (c), that is attributable to dividends from 20%-or-more-owned corporations . . . . .	5. _____
6. Enter the smaller of line 4 or 5. If line 5 is greater than line 4, stop here; enter the amount from line 6 on line 9, column (c), and do not complete the rest of this worksheet . . . . .	6. _____
7. Enter the total amount of dividends from 20%-or-more-owned corporations that are included on lines 2, 3, 5, 7, and 8, column (a) . . .	7. _____
8. Subtract line 7 from line 3 . . . . .	8. _____
9. Multiply line 8 by 70% . . . . .	9. _____
10. Subtract line 5 above from line 9, column (c) . . . . .	10. _____
11. Enter the smaller of line 9 or line 10 . . . . .	11. _____
12. <b>Dividends-received deduction after limitation</b> (sec. 246(b)). Add lines 6 and 11. Enter the result here and on line 9, column (c) . . . . .	12. _____



than the total amount in each taxable income bracket.

**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 apportionment plan. Therefore, each corporation is entitled to:

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

**Line 2b.** Members of a controlled group are treated as one group to figure the applicability of the additional 5% tax and the additional 3% tax. If an additional tax applies, each member will pay that tax based on the part of the amount used in each taxable income bracket to reduce that member's tax. See section 1561(a). If an additional tax applies, attach a schedule showing the taxable income of the entire group and how the corporation figured its share of the additional tax.

**Line 2b(1).** Enter the corporation's share of the additional 5% tax on line 2b(1).

**Line 2b(2).** Enter the corporation's share of the additional 3% tax on line 2b(2).

### Line 3, Form 1120 (Line 1, Form 1120-A)

Members of a controlled group should use the worksheet below to figure the tax for the group. In addition, members of a controlled group must attach to Form 1120 a statement showing the computation of the tax entered on line 3.

Most corporations not filing a consolidated return figure their tax by using the Tax Rate Schedule below. Qualified

personal service corporations should see the instructions below.

### Tax Rate Schedule

If taxable income (line 30, Form 1120, or line 26, Form 1120-A) on page 1 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 corporation.** A qualified personal service corporation is taxed at a flat rate of 35% on taxable income. If the corporation is a qualified personal service corporation, check the box on line 3, Schedule J, Form 1120 (line 1, Part I, Form 1120-A) even if the corporation has no tax liability.

A corporation is a qualified personal service corporation if it meets both of the following tests.

1. Substantially all of the corporation's activities involve the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting.
2. At least 95% of the corporation's stock, by value, is directly or indirectly owned by
  - a. Employees performing the services,
  - b. Retired employees who had performed the services listed above,
  - c. Any estate of an employee or retiree described above, or

d. Any person who acquired the stock of the corporation 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).


**Mutual savings bank conducting life insurance business.** The tax under section 594 consists of the sum of (a) a partial tax computed on Form 1120 on the taxable income of the bank determined without regard to income or deductions allocable to the life insurance department, and (b) a partial tax on the taxable income computed on Form 1120-L of the life insurance department. Enter the combined tax on line 3 of Schedule J, Form 1120. Attach Form 1120-L as a schedule (and identify it as such) or a statement showing the computation of the taxable income of the life insurance department.

**Deferred tax under section 1291.** If the corporation was a shareholder in a passive foreign investment company (PFIC) and received an excess distribution or disposed of its investment in the PFIC during the year, it must include the increase in taxes due under section 1291(c)(2) in the total for line 3, Schedule J, Form 1120. On the dotted line next to line 3, enter "Section 1291" and the amount.

Do not include on line 3 any interest due under section 1291(c)(3). Instead, show the amount of interest owed in the bottom margin of page 1, Form 1120, and enter "Section 1291 interest." For details, see Form 8621.

**Additional tax under section 197(f).** A corporation that elects to pay tax on the gain from the sale of an intangible under the related person exception to the anti-churning rules should include any additional tax due under section 197(f)(9)(B) in the total for line 3. On the dotted line next to line 3, enter "Section 197" and the amount.

### Line 4 (Form 1120 Only)

 A corporation that is not a small corporation exempt from the AMT (see below) may be required to file Form 4626 if it claims certain credits, even though it does not owe any AMT. See Form 4626 for details.

Unless the corporation is treated as a small corporation exempt from the AMT, it may owe the AMT if it has any of the adjustments and tax preference items listed on Form 4626. The corporation must file Form 4626 if its taxable income (or loss) before the NOL deduction, combined with these adjustments and tax preference items is more than the smaller of \$40,000 or the corporation's allowable exemption amount (from Form 4626). For this purpose, taxable income does not include the NOL deduction. See Form 4626 for details.

**Exemption for small corporations.** A corporation is treated as a small corporation exempt from the AMT for its tax year beginning in 2005 if that year is the corporation's first tax year in existence (regardless of its gross receipts) or:

1. It was treated as a small corporation exempt from the AMT for all prior tax years beginning after 1997 and

## Tax Computation 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 this worksheet.

- |   |           |
|---|-----------|
| 1. Enter taxable income (Form 1120, page 1, line 30) . . . . .  | 1. _____  |
| 2. Enter line 1 or the corporation'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 corporation'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 corporation'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 the instructions for Schedule J, line 2b). . . . .        | 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 the instructions for Schedule J, line 2b). . . . . | 13. _____ |
| 14. <b>Total.</b> Add lines 8 through 13. Enter here and on line 3, Schedule J, Form 1120 . . . . .   | 14. _____ |

2. Its average annual gross receipts for the 3-tax-year period (or portion thereof during which the corporation was in existence) ending before its tax year beginning in 2005 did not exceed \$7.5 million (\$5 million if the corporation had only 1 prior tax year).

### Line 6a (Form 1120 Only)

To find out when a corporation can take the credit for payment of income tax to a foreign country or U.S. possession, see Form 1118.

### Line 6b (Form 1120 Only)

The Small Business Job Protection Act of 1996 repealed the possessions credit. However, existing credit claimants may qualify for a credit under the transitional rules. See Form 5735, Possessions Corporation Tax Credit (Under Sections 936 and 30A).

### Line 6c (Form 1120 Only)

If the corporation can take either of the following credits, check the appropriate box(es) and include the amount of the credits in the total for line 6c.

**Nonconventional source fuel credit (calendar year filers only).** For tax years ending on December 31, 2005, use Form 8907, Nonconventional Source Fuel Credit, to figure the credit for the sale of qualified fuels produced from a nonconventional source. Include the amount from line 23 in the total for line 6c, Form 1120.

**Note.** For tax years ending after December 31, 2005, the nonconventional source fuel credit is a general business credit included on Form 3800.

**Qualified electric vehicle (QEV) credit.** Use Form 8834, Qualified Electric Vehicle Credit, if the corporation can claim a credit for the purchase of a new qualified electric vehicle. Vehicles that qualify for this credit are not eligible for the deduction for clean-fuel vehicles under section 179A.

### Line 6d, Form 1120 (Line 2, Form 1120-A)

Enter on line 6d (line 2 of Form 1120-A) the corporation's total general business credit.

If the corporation is filing Form 8844, Empowerment Zone and Renewal Community Employment Credit; Form 6478, Credit for Alcohol Used as Fuel; or Form 8835 (see list below) with a credit from Section B; check the "Form(s)" box, enter the form number in the space provided, and include the allowable credit on line 6d (line 2 of Form 1120-A).

If the corporation is required to file Form 3800, General Business Credit, check the "Form 3800" box and include the allowable credit on line 6d (line 2 of Form 1120-A). See the instructions for Form 3800.

If the corporation is not required to file Form 3800, check the "Form(s)" box, enter the form number in the space provided, and include on line 6d (line 2 of Form 1120-A) the allowable credit from the applicable form listed below.

- Investment Credit (Form 3468).
- Work Opportunity Credit (Form 5884).
- Welfare-to-Work Credit (Form 8861).
- Credit for Increasing Research Activities (Form 6765).

- Low-Income Housing Credit (Form 8586).
- Enhanced Oil Recovery Credit (Form 8830).
- Disabled Access Credit (Form 8826).
- Renewable Electricity Production Credit (Form 8835).
- Indian Employment Credit (Form 8845).
- Credit for Employer Social Security and Medicare Taxes Paid on Certain Employee Tips (Form 8846).
- Orphan Drug Credit (Form 8820).
- New Markets Credit (Form 8874).
- Credit for Small Employer Pension Plan Startup Costs (Form 8881).
- Credit for Employer-Provided Childcare Facilities and Services (Form 8882).
- Qualified Railroad Track Maintenance Credit (Form 8900).
- Biodiesel and Renewable Diesel Fuels Credit (Form 8864).
- Low Sulfur Diesel Fuel Production Credit (Form 8896).
- Credit for Contributions to Selected Community Development Corporations (Form 8847).

### Line 6e (Form 1120 Only)

To figure the minimum tax credit and any carryforward of that credit, use Form 8827, Credit for Prior Year Minimum Tax—Corporations. Also see Form 8827 if any of the corporation's 2004 nonconventional source fuel credit or qualified electric vehicle credit was disallowed solely because of the tentative minimum tax limitation. See section 53(d).

### Line 6f (Form 1120 Only)

Enter the amount of any credit from Form 8860, Qualified Zone Academy Bond Credit or from Form 8912, Clean Renewable Energy Bond Credit. Check the applicable box(es) and include the amount of the credit in the total for line 6f.

### Line 9 (Form 1120 Only)

A corporation is taxed as a personal holding company under section 542 if:

- At least 60% of its adjusted ordinary gross income for the tax year is personal holding company income, and
- At any time during the last half of the tax year more than 50% in value of its outstanding stock is directly or indirectly owned by five or fewer individuals.

See Schedule PH (Form 1120) for definitions and details on how to figure the tax.

### Line 10, Form 1120 (Line 4, Form 1120-A)

Include any of the following taxes and interest in the total on line 10 (Form 1120-A, Part I, line 4). Check the appropriate box(es) for the form, if any, used to compute the total.

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

**Recapture of low-income housing credit.** If the corporation disposed of property (or there was a reduction in the qualified basis of the property) for which it took the low-income housing credit, it may owe a tax.

See Form 8611, Recapture of Low-Income Housing Credit.

**Interest due under the look-back methods.** If the corporation used the look-back method for certain long-term contracts, see Form 8697, Interest Computation Under the Look-Back Method for Completed Long-Term Contracts, for information on figuring the interest the corporation may have to include.

The corporation may also have to include interest due under the look-back method for property depreciated under the income forecast method. See Form 8866, Interest Computation Under the Look-Back Method for Property Depreciated Under the Income Forecast Method.

**Alternative tax on qualifying shipping activities.** Enter any alternative tax on qualifying shipping activities from Form 8902. Check the box for Form 8902.

**Other.** Additional taxes and interest amounts can be included in the total entered on line 10 (Form 1120-A, Part I, line 4). Check the box for "Other" if the corporation includes any additional taxes and interest such as the items discussed below. See *How to report* below for details on reporting these amounts on an attached schedule.

- Recapture of qualified electric vehicle (QEV) credit. The corporation must recapture part of the QEV credit it claimed in a prior year if, within 3 years of the date the vehicle was placed in service, it ceases to qualify for the credit. See Regulations section 1.30-1 for details on how to figure the recapture.
- Recapture of Indian employment credit. Generally, if an employer terminates the employment of a qualified employee less than 1 year after the date of initial employment, any Indian employment credit allowed for a prior tax year because of wages paid or incurred to that employee must be recaptured. For details, see Form 8845 and section 45A.
- Recapture of new markets credit (see Form 8874).
- Recapture of employer-provided childcare facilities and services credit (see Form 8882).
- Tax and interest on a nonqualified withdrawal from a capital construction fund (section 7518).
- Interest on deferred tax attributable to (a) installment sales of certain timeshares and residential lots (section 453(l)(3)) and (b) certain nondealer installment obligations (section 453A(c)).
- Interest due on deferred gain (section 1260(b)).

**How to report.** If the corporation checked the "Other" box, attach a schedule showing the computation of each item included in the total for line 10 (Form 1120-A, Part I, line 4) and identify the applicable Code section and the type of tax or interest.

### Line 11 (Form 1120 Only)

Include any deferred tax on the termination of a section 1294 election applicable to shareholders in a qualified electing fund in the amount entered on line 11. See Form 8621, Part V, and *How to report*, below.

**Subtract** the following amounts from the total for line 11.



- Deferred tax on the corporation's share of undistributed earnings of a qualified electing fund (see Form 8621, Part II).
- Deferred LIFO recapture tax (section 1363(d)). This tax is the part of the LIFO recapture tax that will be deferred and paid with Form 1120S in the future. To figure the deferred tax, first figure the total LIFO recapture tax. Follow the steps below to figure the total LIFO recapture tax and the deferred amount. Also see the instructions regarding LIFO recapture amount under *Line 10. Other Income*.

**Step 1.** Figure the tax on the corporation's income including the LIFO recapture amount. (Complete Schedule J through line 10, but do not enter a total on line 11 yet.)

**Step 2.** Using a separate worksheet, complete Schedule J again, but do not include the LIFO recapture amount in the corporation's taxable income.

**Step 3.** Compare the tax in Step 2 to the tax in Step 1. (The difference between the two is the LIFO recapture tax.)

**Step 4.** Multiply the amount figured in Step 3 by 75%. (The result is the deferred LIFO recapture tax.)

**How to report.** Attach a schedule showing the computation of each item included in, or subtracted from, the total for line 11. On the dotted line next to line 11, specify (a) the applicable Code section, (b) the type of tax, and (c) enter the amount of tax. For example, if the corporation is deferring a \$100 LIFO recapture tax, subtract this amount from the total on line 11, then enter "Section 1363-Deferred Tax-\$100" on the dotted line next to line 11.

## Schedule K, Form 1120 (Part II, Form 1120-A)

The following instructions apply to Form 1120, page 3, Schedule K, or Form 1120-A, page 2, Part II. Complete all items that apply to the corporation.

### Question 4 (Form 1120 Only)

- Check the "Yes" box for question 4 if:
- The corporation is a subsidiary in an affiliated group (defined below), but is not filing a consolidated return for the tax year with that group, or
  - The corporation is a subsidiary in a parent-subsidiary controlled group (defined on page 15).

Any corporation that meets either of the requirements above should check the "Yes" box. This applies even if the corporation is a subsidiary member of one group and the parent corporation of another.

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

**Affiliated group.** An affiliated group is one or more chains of includible corporations (section 1504(a)) connected through stock ownership with a common parent corporation. The common parent must be an includible corporation and the following requirements must be met.

1. The common parent must own directly stock that represents at least 80% of

the total voting power and at least 80% of the total value of the stock of at least one of the other includible corporations.

2. Stock that represents at least 80% of the total voting power and at least 80% of the total value of the stock of each of the other corporations (except for the common parent) must be owned directly by one or more of the other includible corporations.

For this purpose, the term "stock" generally does not include any stock that (a) is nonvoting, (b) is nonconvertible, (c) is limited and preferred as to dividends and does not participate significantly in corporate growth, and (d) has redemption and liquidation rights that do not exceed the issue price of the stock (except for a reasonable redemption or liquidation premium). See section 1504(a)(4). See section 1563(d)(1) for the definition of stock for purposes of determining stock ownership above.

### Question 6 (Form 1120-A Only)

**Foreign financial accounts.** Check the "Yes" box for question 6 if either 1 or 2 below applies to the corporation. Otherwise, check the "No" box.

1. At any time during the 2005 calendar year, the corporation had an interest in or signature or other authority over a bank, securities, or other financial account in a foreign country (see Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts); and

- a. The combined value of the accounts was more than \$10,000 at any time during the calendar year and
- b. The account was not with a U.S. military banking facility operated by a U.S. financial institution.

2. The corporation owns more than 50% of the stock in any corporation that would answer "Yes" to item 1 above.

If the "Yes" box is checked:

- Enter the name of the foreign country or countries. Attach a separate sheet if more space is needed.
- File Form TD F 90-22.1 by June 30, 2006, with the Department of the Treasury at the address shown on the form. Because Form TD F 90-22.1 is not a tax form, do not file it with Form 1120-A. You can order Form TD F 90-22.1 by calling 1-800-TAX-FORM (1-800-829-3676) or you can download it from the IRS website at [www.irs.gov](http://www.irs.gov).

### Question 7 (Form 1120 Only)

Check the "Yes" box if one foreign person owned at least 25% of (a) the total voting power of all classes of stock of the corporation entitled to vote, or (b) the total value of all classes of stock of the corporation.

The constructive ownership rules of section 318 apply in determining if a corporation is foreign owned. See section 6038A(c)(5) and the related regulations.

Enter on line 7a the percentage owned by the foreign person specified in question 7. On line 7b, enter the name of the owner's country.

**Note.** If there is more than one 25%-or-more foreign owner, complete lines 7a and 7b for the foreign person with the highest percentage of ownership.

**Foreign person.** The term "foreign person" means:

- A foreign citizen or nonresident alien,
- An individual who is a citizen of a U.S. possession (but who is not a U.S. citizen or resident),
- A foreign partnership,
- A foreign corporation,
- Any foreign estate or trust within the meaning of section 7701(a)(31), or
- A foreign government (or one of its agencies or instrumentalities) to the extent that it is engaged in the conduct of a commercial activity as described in section 892.

**Owner's country.** For individuals, the term "owner's country" means the country of residence. For all others, it is the country where incorporated, organized, created, or administered.

**Requirement to file Form 5472.** If the corporation checked "Yes," it may have to file 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 25% foreign-owned corporation that had a reportable transaction with a foreign or domestic related party during the tax year must file Form 5472. See Form 5472 for filing instructions and penalties for failure to file.

### Item 9, Form 1120 (Item 3, Form 1120-A)

Show any tax-exempt interest received or accrued. Including any exempt-interest dividends received as a shareholder in a mutual fund or other RIC. Also, if required, include the same amount on Schedule M-1, line 7; Form 1120-A, Part IV, line 6; or Schedule M-3, Part II, line 13.

### Item 11 (Form 1120 Only)

If the corporation has an NOL for its 2005 tax year, it can elect to waive the entire carryback period for the NOL and instead carry the NOL forward to future tax years. To do so, check the box on line 11 and file the tax return by its due date, including extensions (do not attach the statement described in Temporary Regulations section 301.9100-12T). Once made, the election is irrevocable. See Pub. 542 and Form 1139 for more details.

Corporations filing a consolidated return must also attach the statement required by Temporary Regulations section 1.1502-21T(b)(3).

### Item 12 (Form 1120 Only)

Enter the amount of the NOL carryover to the tax year from prior years, even if some 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) to a tax year prior to 2005. Do not reduce the amount by any NOL deduction reported on line 29a.

## Schedule L, Form 1120 (Part III, Form 1120-A)

The balance sheet should agree with the corporation's books and records.



Corporations with total receipts (line 1a plus lines 4 through 10 on page 1) and total assets at the end of the tax year less than \$250,000 are not required to complete Schedules L, M-1, and M-2 (Parts III and IV, Form 1120-A) if the "Yes" box on Schedule K, question 13 (Part II, question 7, Form 1120-A), is checked. If the corporation is required to complete Schedule L, include total assets reported on Schedule L, line 15, column (d), on page 1, item D.

If filing a consolidated return, report total consolidated assets, liabilities, and shareholder's equity for all corporations joining in the return. See *Consolidated Return* on page 6 of these instructions.

Corporations with total assets (consolidated for all corporations included within the tax consolidation group) of \$10 million or more on the last day of the tax year must complete Schedule M-3 (Form 1120) instead of Schedule M-1. See the separate instructions for Schedule M-3 (Form 1120) for provisions also affecting Schedule L.

### Line 1

Include certificates of deposit as cash on this line.

### Line 5

Include on this line:

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

### Line 26, Form 1120 (Line 21, Form 1120-A)

Some examples of adjustments to report on this line include:

- Unrealized gains and losses on securities held "available for sale."
- Foreign currency translation adjustments.
- The excess of additional pension liability over unrecognized prior service cost.
- Guarantees of employee stock (ESOP) debt.
- Compensation related to employee stock award plans.

If the total adjustment to be entered on line 26 (line 21, Form 1120-A) is a negative amount, enter the amount in parentheses.

### Schedule M-1, Form 1120 (Part IV, Form 1120-A)

Corporations with total receipts (line 1a plus lines 4 through 10 on page 1) and total assets at the end of the tax year less than \$250,000 are not required to complete Schedules L, M-1, and M-2 (Parts III and IV, Form 1120-A) if the "Yes" box on Schedule K, question 13 (Part II, question 7, Form 1120-A), is checked.

Corporations with total assets (consolidated for all corporations included within the tax consolidation group) of \$10 million or more on the last day of the tax year must complete Schedule M-3 instead of Schedule M-1. A corporation filing Form 1120 that is not required to file Schedule M-3 may voluntarily file Schedule M-3

instead of Schedule M-1. See the separate instructions for Schedule M-3.

### Line 5c, Form 1120 (Line 5, Form 1120-A)

Include any of the following.

- Meal and entertainment expenses not deductible under section 274(n).
- Expenses for the use of an entertainment facility.
- The part of business gifts over \$25.
- Expenses of an individual over \$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% limit under section 274(n)).
- The cost of skyboxes over the face value of nonluxury box seat tickets.
- The part of luxury water travel expenses not deductible under section 274(m).
- Expenses for travel as a form of education.
- Other nondeductible travel and entertainment expenses.

For more information, see Pub. 542.

### Line 7, Form 1120 (Line 6, Form 1120-A)

Report any tax exempt interest received or accrued, including any exempt-interest dividends received as a shareholder in a mutual fund or other RIC. Also report this same amount on Schedule K, item 9 (item 3, Form 1120-A).

**Privacy Act and Paperwork Reduction Act Notice.** We ask for the information on these forms 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. Section 6109 requires return preparers to provide their identifying numbers on the return.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by section 6103.

The time needed to complete and file the following forms will vary depending on individual circumstances. The estimated average times are:

Form	Recordkeeping	Learning about the law or the form	Preparing the form	Copying, assembling, and sending the form to the IRS
1120	70 hr., 47 min.	42 hr., 1 min.	72 hr., 56 min.	8 hr., 2 min.
1120-A	43 hr., 30 min.	24 hr., 13 min.	42 hr., 33 min.	4 hr., 49 min.
Sch. D (1120)	6 hr., 56 min.	3 hr., 55 min.	6 hr., 3 min.	32 min.
Sch. H (1120)	5 hr., 58 min.	35 min.	43 min.	-----
Sch. M-3	76 hr., 3 min.	3 hr., 40 min.	5 hr., 4 min.	-----
Sch. N (1120)	3 hr., 49 min.	1 hr., 30 min.	4 hr., 25 min.	48 min.
Sch. PH (1120)	15 hr., 18 min.	6 hr., 12 min.	8 hr., 35 min.	32 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form and related schedules simpler, we would be happy to hear from you. You can write to Internal Revenue Service, Tax Products Coordinating Committee, SE:W:CAR:MP:T:T:SP, 1111 Constitution Ave. NW, IR-6406, Washington, DC 20224. Do not send the tax form to this address. Instead, see *Where To File* on page 3.

# Forms 1120 and 1120-A

## Principal Business Activity Codes

This list of principal business activities and their associated codes is designed to classify an enterprise by the type of activity in which it is engaged to facilitate the administration of the Internal Revenue Code. These principal business activity codes are based on the North American Industry Classification System.

Using the list of activities and codes below, determine from which activity the company derives the largest percentage of its "total receipts." Total receipts is defined as the sum of gross receipts or sales (page 1, line 1a) plus all other income (page 1, lines 4 through 10). If the company purchases raw materials and supplies them to a subcontractor to produce the finished product, but retains title to the product, the company is considered a manufacturer and must use one of the manufacturing codes (311110-339900).

Once the principal business activity is determined, entries must be made on Form 1120, Schedule K, lines 2a, 2b, and 2c, or on Form 1120-A, Part II, lines 1a, 1b, and 1c. For the business activity code number, enter the six digit code selected from the list below. On the next line (Form 1120, Schedule K, line 2b, or Form 1120-A, Part II, line 1b), enter a brief description of the company's business activity. Finally, enter a description of the principal product or service of the company on Form 1120, Schedule K, line 2c, or Form 1120-A, Part II, line 1c.

Code	Code	Code	Code
<b>Agriculture, Forestry, Fishing and Hunting</b> <b>Crop Production</b> 111100 Oilseed & Grain Farming 111210 Vegetable & Melon Farming (including potatoes & yams) 111300 Fruit & Tree Nut Farming 111400 Greenhouse, Nursery, & Floriculture Production 111900 Other Crop Farming (including tobacco, cotton, sugarcane, hay, peanut, sugar beet & all other crop farming) <b>Animal Production</b> 112111 Beef Cattle Ranching & Farming 112112 Cattle Feedlots 112120 Dairy Cattle & Milk Production 112210 Hog & Pig Farming 112300 Poultry & Egg Production 112400 Sheep & Goat Farming 112510 Animal Aquaculture (including shellfish & finfish farms & hatcheries) 112900 Other Animal Production <b>Forestry and Logging</b> 113110 Timber Tract Operations 113210 Forest Nurseries & Gathering of Forest Products 113310 Logging <b>Fishing, Hunting and Trapping</b> 114110 Fishing 114210 Hunting & Trapping <b>Support Activities for Agriculture and Forestry</b> 115110 Support Activities for Crop Production (including cotton ginning, soil preparation, planting, & cultivating) 115210 Support Activities for Animal Production 115310 Support Activities For Forestry	<b>Heavy and Civil Engineering Construction</b> 237100 Utility System Construction 237210 Land Subdivision 237310 Highway, Street, & Bridge Construction 237990 Other Heavy & Civil Engineering Construction <b>Specialty Trade Contractors</b> 238100 Foundation, Structure, & Building Exterior Contractors (including framing carpentry, masonry, glass, roofing, & siding) 238210 Electrical Contractors 238220 Plumbing, Heating, & Air-Conditioning Contractors 238290 Other Building Equipment Contractors 238300 Building Finishing Contractors (including drywall, insulation, painting, wallcovering, flooring, tile, & finish carpentry) 238900 Other Specialty Trade Contractors (including site preparation)	<b>Wood Product Manufacturing</b> 321110 Sawmills & Wood Preservation 321210 Veneer, Plywood, & Engineered Wood Product Mfg 321900 Other Wood Product Mfg <b>Paper Manufacturing</b> 322100 Pulp, Paper, & Paperboard Mills 322200 Converted Paper Product Mfg <b>Printing and Related Support Activities</b> 323100 Printing & Related Support Activities <b>Petroleum and Coal Products Manufacturing</b> 324110 Petroleum Refineries (including integrated) 324120 Asphalt Paving, Roofing, & Saturated Materials Mfg 324190 Other Petroleum & Coal Products Mfg <b>Chemical Manufacturing</b> 325100 Basic Chemical Mfg 325200 Resin, Synthetic Rubber, & Artificial & Synthetic Fibers & Filaments Mfg 325300 Pesticide, Fertilizer, & Other Agricultural Chemical Mfg 325410 Pharmaceutical & Medicine Mfg 325500 Paint, Coating, & Adhesive Mfg 325600 Soap, Cleaning Compound, & Toilet Preparation Mfg 325900 Other Chemical Product & Preparation Mfg <b>Plastics and Rubber Products Manufacturing</b> 326100 Plastics Product Mfg 326200 Rubber Product Mfg <b>Nonmetallic Mineral Product Manufacturing</b> 327100 Clay Product & Refractory Mfg 327210 Glass & Glass Product Mfg 327300 Cement & Concrete Product Mfg 327400 Lime & Gypsum Product Mfg 327900 Other Nonmetallic Mineral Product Mfg <b>Primary Metal Manufacturing</b> 331110 Iron & Steel Mills & Ferroalloy Mfg 331200 Steel Product Mfg from Purchased Steel 331310 Alumina & Aluminum Production & Processing 331400 Nonferrous Metal (except Aluminum) Production & Processing 331500 Foundries <b>Fabricated Metal Product Manufacturing</b> 332110 Forging & Stamping 332210 Cutlery & Handtool Mfg 332300 Architectural & Structural Metals Mfg 332400 Boiler, Tank, & Shipping Container Mfg 332510 Hardware Mfg 332610 Spring & Wire Product Mfg 332700 Machine Shops; Turned Product; & Screw, Nut, & Bolt Mfg	332810 Coating, Engraving, Heat Treating, & Allied Activities 332900 Other Fabricated Metal Product Mfg <b>Machinery Manufacturing</b> 333100 Agriculture, Construction, & Mining Machinery Mfg 333200 Industrial Machinery Mfg 333310 Commercial & Service Industry Machinery Mfg 333410 Ventilation, Heating, Air-Conditioning, & Commercial Refrigeration Equipment Mfg 333510 Metalworking Machinery Mfg 333610 Engine, Turbine & Power Transmission Equipment Mfg 333900 Other General Purpose Machinery Mfg <b>Computer and Electronic Product Manufacturing</b> 334110 Computer & Peripheral Equipment Mfg 334200 Communications Equipment Mfg 334310 Audio & Video Equipment Mfg 334410 Semiconductor & Other Electronic Component Mfg 334500 Navigational, Measuring, Electromedical, & Control Instruments Mfg 334610 Manufacturing & Reproducing Magnetic & Optical Media <b>Electrical Equipment, Appliance, and Component Manufacturing</b> 335100 Electric Lighting Equipment Mfg 335200 Household Appliance Mfg 335310 Electrical Equipment Mfg 335900 Other Electrical Equipment & Component Mfg <b>Transportation Equipment Manufacturing</b> 336100 Motor Vehicle Mfg 336210 Motor Vehicle Body & Trailer Mfg 336300 Motor Vehicle Parts Mfg 336410 Aerospace Product & Parts Mfg 336510 Railroad Rolling Stock Mfg 336610 Ship & Boat Building 336990 Other Transportation Equipment Mfg <b>Furniture and Related Product Manufacturing</b> 337000 Furniture & Related Product Manufacturing <b>Miscellaneous Manufacturing</b> 339110 Medical Equipment & Supplies Mfg 339900 Other Miscellaneous Manufacturing
<b>Mining</b> 211110 Oil & Gas Extraction 212110 Coal Mining 212200 Metal Ore Mining 212310 Stone Mining & Quarrying 212320 Sand, Gravel, Clay, & Ceramic & Refractory Minerals Mining & Quarrying 212390 Other Nonmetallic Mineral Mining & Quarrying 213110 Support Activities for Mining	<b>Manufacturing</b> <b>Food Manufacturing</b> 311110 Animal Food Mfg 311200 Grain & Oilseed Milling 311300 Sugar & Confectionery Product Mfg 311400 Fruit & Vegetable Preserving & Specialty Food Mfg 311500 Dairy Product Mfg 311610 Animal Slaughtering and Processing 311710 Seafood Product Preparation & Packaging 311800 Bakeries & Tortilla Mfg 311900 Other Food Mfg (including coffee, tea, flavorings & seasonings) <b>Beverage and Tobacco Product Manufacturing</b> 312110 Soft Drink & Ice Mfg 312120 Breweries 312130 Wineries 312140 Distilleries 312200 Tobacco Manufacturing <b>Textile Mills and Textile Product Mills</b> 313000 Textile Mills 314000 Textile Product Mills <b>Apparel Manufacturing</b> 315100 Apparel Knitting Mills 315210 Cut & Sew Apparel Contractors 315220 Men's & Boys' Cut & Sew Apparel Mfg 315230 Women's & Girls' Cut & Sew Apparel Mfg 315290 Other Cut & Sew Apparel Mfg 315990 Apparel Accessories & Other Apparel Mfg <b>Leather and Allied Product Manufacturing</b> 316110 Leather & Hide Tanning & Finishing 316210 Footwear Mfg (including rubber & plastics) 316990 Other Leather & Allied Product Mfg	<b>Wholesale Trade</b> <b>Merchant Wholesalers, Durable Goods</b> 423100 Motor Vehicle & Motor Vehicle Parts & Supplies 423200 Furniture & Home Furnishings 423300 Lumber & Other Construction Materials 423400 Professional & Commercial Equipment & Supplies	

**Forms 1120 and 1120-A (continued)**

<p><i>Code</i></p> <p>423500 Metal &amp; Mineral (except Petroleum)</p> <p>423600 Electrical &amp; Electronic Goods</p> <p>423700 Hardware, &amp; Plumbing &amp; Heating Equipment &amp; Supplies</p> <p>423800 Machinery, Equipment, &amp; Supplies</p> <p>423910 Sporting &amp; Recreational Goods &amp; Supplies</p> <p>423920 Toy &amp; Hobby Goods &amp; Supplies</p> <p>423930 Recyclable Materials</p> <p>423940 Jewelry, Watch, Precious Stone, &amp; Precious Metals</p> <p>423990 Other Miscellaneous Durable Goods</p> <p><b>Merchant Wholesalers, Nondurable Goods</b></p> <p>424100 Paper &amp; Paper Products</p> <p>424210 Drugs &amp; Druggists' Sundries</p> <p>424300 Apparel, Piece Goods, &amp; Notions</p> <p>424400 Grocery &amp; Related Products</p> <p>424500 Farm Product Raw Materials</p> <p>424600 Chemical &amp; Allied Products</p> <p>424700 Petroleum &amp; Petroleum Products</p> <p>424800 Beer, Wine, &amp; Distilled Alcoholic Beverages</p> <p>424910 Farm Supplies</p> <p>424920 Book, Periodical, &amp; Newspapers</p> <p>424930 Flower, Nursery Stock, &amp; Florists' Supplies</p> <p>424940 Tobacco &amp; Tobacco Products</p> <p>424950 Paint, Varnish, &amp; Supplies</p> <p>424990 Other Miscellaneous Nondurable Goods</p> <p><b>Wholesale Electronic Markets and Agents and Brokers</b></p> <p>425110 Business to Business Electronic Markets</p> <p>425120 Wholesale Trade Agents &amp; Brokers</p>	<p><i>Code</i></p> <p>445100 Convenience Stores</p> <p>445210 Meat Markets</p> <p>445220 Fish &amp; Seafood Markets</p> <p>445230 Fruit &amp; Vegetable Markets</p> <p>445291 Baked Goods Stores</p> <p>445292 Confectionery &amp; Nut Stores</p> <p>445299 All Other Specialty Food Stores</p> <p>445310 Beer, Wine, &amp; Liquor Stores</p> <p><b>Health and Personal Care Stores</b></p> <p>446110 Pharmacies &amp; Drug Stores</p> <p>446120 Cosmetics, Beauty Supplies, &amp; Perfume Stores</p> <p>446130 Optical Goods Stores</p> <p>446190 Other Health &amp; Personal Care Stores</p> <p><b>Gasoline Stations</b></p> <p>447100 Gasoline Stations (including convenience stores with gas)</p> <p><b>Clothing and Clothing Accessories Stores</b></p> <p>448110 Men's Clothing Stores</p> <p>448120 Women's Clothing Stores</p> <p>448130 Children's &amp; Infants' Clothing Stores</p> <p>448140 Family Clothing Stores</p> <p>448150 Clothing Accessories Stores</p> <p>448190 Other Clothing Stores</p> <p>448210 Shoe Stores</p> <p>448310 Jewelry Stores</p> <p>448320 Luggage &amp; Leather Goods Stores</p> <p><b>Sporting Goods, Hobby, Book, and Music Stores</b></p> <p>451110 Sporting Goods Stores</p> <p>451120 Hobby, Toy, &amp; Game Stores</p> <p>451130 Sewing, Needlework, &amp; Piece Goods Stores</p> <p>451140 Musical Instrument &amp; Supplies Stores</p> <p>451211 Book Stores</p> <p>451212 News Dealers &amp; Newsstands</p> <p>451220 Prerecorded Tape, Compact Disc, &amp; Record Stores</p> <p><b>General Merchandise Stores</b></p> <p>452110 Department Stores</p> <p>452900 Other General Merchandise Stores</p> <p><b>Miscellaneous Store Retailers</b></p> <p>453110 Florists</p> <p>453210 Office Supplies &amp; Stationery Stores</p> <p>453220 Gift, Novelty, &amp; Souvenir Stores</p> <p>453310 Used Merchandise Stores</p> <p>453910 Pet &amp; Pet Supplies Stores</p> <p>453920 Art Dealers</p> <p>453930 Manufactured (Mobile) Home Dealers</p> <p>453990 All Other Miscellaneous Store Retailers (including tobacco, candle, &amp; trophy shops)</p> <p><b>Nonstore Retailers</b></p> <p>454110 Electronic Shopping &amp; Mail-Order Houses</p> <p>454210 Vending Machine Operators</p> <p>454311 Heating Oil Dealers</p> <p>454312 Liquefied Petroleum Gas (Bottled Gas) Dealers</p> <p>454319 Other Fuel Dealers</p> <p>454390 Other Direct Selling Establishments (including door-to-door retailing, frozen food plan providers, party plan merchandisers, &amp; coffee-break service providers)</p>	<p><i>Code</i></p> <p><b>Truck Transportation</b></p> <p>484110 General Freight Trucking, Local</p> <p>484120 General Freight Trucking, Long-distance</p> <p>484200 Specialized Freight Trucking</p> <p><b>Transit and Ground Passenger Transportation</b></p> <p>485110 Urban Transit Systems</p> <p>485210 Interurban &amp; Rural Bus Transportation</p> <p>485310 Taxi Service</p> <p>485320 Limousine Service</p> <p>485410 School &amp; Employee Bus Transportation</p> <p>485510 Charter Bus Industry</p> <p>485990 Other Transit &amp; Ground Passenger Transportation</p> <p><b>Pipeline Transportation</b></p> <p>486000 Pipeline Transportation</p> <p><b>Scenic &amp; Sightseeing Transportation</b></p> <p>487000 Scenic &amp; Sightseeing Transportation</p> <p><b>Support Activities for Transportation</b></p> <p>488100 Support Activities for Air Transportation</p> <p>488210 Support Activities for Rail Transportation</p> <p>488300 Support Activities for Water Transportation</p> <p>488410 Motor Vehicle Towing</p> <p>488490 Other Support Activities for Road Transportation</p> <p>488510 Freight Transportation Arrangement</p> <p>488990 Other Support Activities for Transportation</p> <p><b>Couriers and Messengers</b></p> <p>492110 Couriers</p> <p>492210 Local Messengers &amp; Local Delivery</p> <p><b>Warehousing and Storage</b></p> <p>493100 Warehousing &amp; Storage (except lessors of miniwarehouses &amp; self-storage units)</p>	<p><i>Code</i></p> <p>518210 Data Processing, Hosting, &amp; Related Services</p> <p><b>Other Information Services</b></p> <p>519100 Other Information Services (including news syndicates &amp; libraries)</p> <p><b>Finance and Insurance</b></p> <p><b>Depository Credit Intermediation</b></p> <p>522110 Commercial Banking</p> <p>522120 Savings Institutions</p> <p>522130 Credit Unions</p> <p>522190 Other Depository Credit Intermediation</p> <p><b>Nondepository Credit Intermediation</b></p> <p>522210 Credit Card Issuing</p> <p>522220 Sales Financing</p> <p>522291 Consumer Lending</p> <p>522292 Real Estate Credit (including mortgage bankers &amp; originators)</p> <p>522293 International Trade Financing</p> <p>522294 Secondary Market Financing</p> <p>522298 All Other Nondepository Credit Intermediation</p> <p><b>Activities Related to Credit Intermediation</b></p> <p>522300 Activities Related to Credit Intermediation (including loan brokers, check clearing, &amp; money transmitting)</p> <p><b>Securities, Commodity Contracts, and Other Financial Investments and Related Activities</b></p> <p>523110 Investment Banking &amp; Securities Dealing</p> <p>523120 Securities Brokerage</p> <p>523130 Commodity Contracts Dealing</p> <p>523140 Commodity Contracts Brokerage</p> <p>523210 Securities &amp; Commodity Exchanges</p> <p>523900 Other Financial Investment Activities (including portfolio management &amp; investment advice)</p> <p><b>Insurance Carriers and Related Activities</b></p> <p>524140 Direct Life, Health, &amp; Medical Insurance &amp; Reinsurance Carriers</p> <p>524150 Direct Insurance &amp; Reinsurance (except Life, Health &amp; Medical) Carriers</p> <p>524210 Insurance Agencies &amp; Brokerages</p> <p>524290 Other Insurance Related Activities (including third-party administration of insurance and pension funds)</p> <p><b>Funds, Trusts, and Other Financial Vehicles</b></p> <p>525100 Insurance &amp; Employee Benefit Funds</p> <p>525910 Open-End Investment Funds (Form 1120-RIC)</p> <p>525920 Trusts, Estates, &amp; Agency Accounts</p> <p>525930 Real Estate Investment Trusts (Form 1120-REIT)</p> <p>525990 Other Financial Vehicles (including closed-end investment funds)</p> <p>"Offices of Bank Holding Companies" and "Offices of Other Holding Companies" are located under <b>Management of Companies (Holding Companies)</b> on page 22.</p>
<p><b>Retail Trade</b></p> <p><b>Motor Vehicle and Parts Dealers</b></p> <p>441110 New Car Dealers</p> <p>441120 Used Car Dealers</p> <p>441210 Recreational Vehicle Dealers</p> <p>441221 Motorcycle Dealers</p> <p>441222 Boat Dealers</p> <p>441229 All Other Motor Vehicle Dealers</p> <p>441300 Automotive Parts, Accessories, &amp; Tire Stores</p> <p><b>Furniture and Home Furnishings Stores</b></p> <p>442110 Furniture Stores</p> <p>442210 Floor Covering Stores</p> <p>442291 Window Treatment Stores</p> <p>442299 All Other Home Furnishings Stores</p> <p><b>Electronics and Appliance Stores</b></p> <p>443111 Household Appliance Stores</p> <p>443112 Radio, Television, &amp; Other Electronics Stores</p> <p>443120 Computer &amp; Software Stores</p> <p>443130 Camera &amp; Photographic Supplies Stores</p> <p><b>Building Material and Garden Equipment and Supplies Dealers</b></p> <p>444110 Home Centers</p> <p>444120 Paint &amp; Wallpaper Stores</p> <p>444130 Hardware Stores</p> <p>444190 Other Building Material Dealers</p> <p>444200 Lawn &amp; Garden Equipment &amp; Supplies Stores</p> <p><b>Food and Beverage Stores</b></p> <p>445110 Supermarkets and Other Grocery (except Convenience) Stores</p>	<p><b>Transportation and Warehousing</b></p> <p><b>Air, Rail, and Water Transportation</b></p> <p>481000 Air Transportation</p> <p>482110 Rail Transportation</p> <p>483000 Water Transportation</p>	<p><b>Information</b></p> <p><b>Publishing Industries (except Internet)</b></p> <p>511110 Newspaper Publishers</p> <p>511120 Periodical Publishers</p> <p>511130 Book Publishers</p> <p>511140 Directory &amp; Mailing List Publishers</p> <p>511190 Other Publishers</p> <p>511210 Software Publishers</p> <p><b>Motion Picture and Sound Recording Industries</b></p> <p>512100 Motion Picture &amp; Video Industries (except video rental)</p> <p>512200 Sound Recording Industries</p> <p><b>Broadcasting (except Internet)</b></p> <p>515100 Radio &amp; Television Broadcasting</p> <p>515210 Cable &amp; Other Subscription Programming</p> <p><b>Internet Publishing and Broadcasting</b></p> <p>516110 Internet Publishing &amp; Broadcasting</p> <p><b>Telecommunications</b></p> <p>517000 Telecommunications (including paging, cellular, satellite, cable &amp; other program distribution, resellers, &amp; other telecommunications)</p> <p><b>Internet Service Providers, Web Search Portals, and Data Processing Services</b></p> <p>518111 Internet Service Providers</p> <p>518112 Web Search Portals</p>	<p><b>Real Estate and Rental and Leasing</b></p> <p><b>Real Estate</b></p> <p>531110 Lessors of Residential Buildings &amp; Dwellings</p> <p>531114 Cooperative Housing</p>



**Forms 1120 and 1120-A (continued)**

<p><i>Code</i></p> <p>531120 Lessors of Nonresidential Buildings (except Miniwarehouses)</p> <p>531130 Lessors of Miniwarehouses &amp; Self-Storage Units</p> <p>531190 Lessors of Other Real Estate Property</p> <p>531210 Offices of Real Estate Agents &amp; Brokers</p> <p>531310 Real Estate Property Managers</p> <p>531320 Offices of Real Estate Appraisers</p> <p>531390 Other Activities Related to Real Estate</p> <p><b>Rental and Leasing Services</b></p> <p>532100 Automotive Equipment Rental &amp; Leasing</p> <p>532210 Consumer Electronics &amp; Appliances Rental</p> <p>532220 Formal Wear &amp; Costume Rental</p> <p>532230 Video Tape &amp; Disc Rental</p> <p>532290 Other Consumer Goods Rental</p> <p>532310 General Rental Centers</p> <p>532400 Commercial &amp; Industrial Machinery &amp; Equipment Rental &amp; Leasing</p> <p><b>Lessors of Nonfinancial Intangible Assets (except copyrighted works)</b></p> <p>533110 Lessors of Nonfinancial Intangible Assets (except copyrighted works)</p>	<p><i>Code</i></p> <p>541910 Marketing Research &amp; Public Opinion Polling</p> <p>541920 Photographic Services</p> <p>541930 Translation &amp; Interpretation Services</p> <p>541940 Veterinary Services</p> <p>541990 All Other Professional, Scientific, &amp; Technical Services</p> <p><b>Management of Companies (Holding Companies)</b></p> <p>551111 Offices of Bank Holding Companies</p> <p>551112 Offices of Other Holding Companies</p> <p><b>Administrative and Support and Waste Management and Remediation Services</b></p> <p><b>Administrative and Support Services</b></p> <p>561110 Office Administrative Services</p> <p>561210 Facilities Support Services</p> <p>561300 Employment Services</p> <p>561410 Document Preparation Services</p> <p>561420 Telephone Call Centers</p> <p>561430 Business Service Centers (including private mail centers &amp; copy shops)</p> <p>561440 Collection Agencies</p> <p>561450 Credit Bureaus</p> <p>561490 Other Business Support Services (including repossession services, court reporting, &amp; stenotype services)</p> <p>561500 Travel Arrangement &amp; Reservation Services</p> <p>561600 Investigation &amp; Security Services</p> <p>561710 Exterminating &amp; Pest Control Services</p> <p>561720 Janitorial Services</p> <p>561730 Landscaping Services</p> <p>561740 Carpet &amp; Upholstery Cleaning Services</p> <p>561790 Other Services to Buildings &amp; Dwellings</p> <p>561900 Other Support Services (including packaging &amp; labeling services, &amp; convention &amp; trade show organizers)</p> <p><b>Waste Management and Remediation Services</b></p> <p>562000 Waste Management &amp; Remediation Services</p>	<p><i>Code</i></p> <p>621340 Offices of Physical, Occupational &amp; Speech Therapists, &amp; Audiologists</p> <p>621391 Offices of Podiatrists</p> <p>621399 Offices of All Other Miscellaneous Health Practitioners</p> <p><b>Outpatient Care Centers</b></p> <p>621410 Family Planning Centers</p> <p>621420 Outpatient Mental Health &amp; Substance Abuse Centers</p> <p>621491 HMO Medical Centers</p> <p>621492 Kidney Dialysis Centers</p> <p>621493 Freestanding Ambulatory Surgical &amp; Emergency Centers</p> <p>621498 All Other Outpatient Care Centers</p> <p><b>Medical and Diagnostic Laboratories</b></p> <p>621510 Medical &amp; Diagnostic Laboratories</p> <p><b>Home Health Care Services</b></p> <p>621610 Home Health Care Services</p> <p><b>Other Ambulatory Health Care Services</b></p> <p>621900 Other Ambulatory Health Care Services (including ambulance services &amp; blood &amp; organ banks)</p> <p><b>Hospitals</b></p> <p>622000 Hospitals</p> <p><b>Nursing and Residential Care Facilities</b></p> <p>623000 Nursing &amp; Residential Care Facilities</p> <p><b>Social Assistance</b></p> <p>624100 Individual &amp; Family Services</p> <p>624200 Community Food &amp; Housing, &amp; Emergency &amp; Other Relief Services</p> <p>624310 Vocational Rehabilitation Services</p> <p>624410 Child Day Care Services</p>	<p><i>Code</i></p> <p>721120 Casino Hotels</p> <p>721191 Bed &amp; Breakfast Inns</p> <p>721199 All Other Traveler Accommodation</p> <p>721210 RV (Recreational Vehicle) Parks &amp; Recreational Camps</p> <p>721310 Rooming &amp; Boarding Houses</p> <p><b>Food Services and Drinking Places</b></p> <p>722110 Full-Service Restaurants</p> <p>722210 Limited-Service Eating Places</p> <p>722300 Special Food Services (including food service contractors &amp; caterers)</p> <p>722410 Drinking Places (Alcoholic Beverages)</p> <p><b>Other Services</b></p> <p><b>Repair and Maintenance</b></p> <p>811110 Automotive Mechanical &amp; Electrical Repair &amp; Maintenance</p> <p>811120 Automotive Body, Paint, Interior, &amp; Glass Repair</p> <p>811190 Other Automotive Repair &amp; Maintenance (including oil change &amp; lubrication shops &amp; car washes)</p> <p>811210 Electronic &amp; Precision Equipment Repair &amp; Maintenance</p> <p>811310 Commercial &amp; Industrial Machinery &amp; Equipment (except Automotive &amp; Electronic) Repair &amp; Maintenance</p> <p>811410 Home &amp; Garden Equipment &amp; Appliance Repair &amp; Maintenance</p> <p>811420 Reupholstery &amp; Furniture Repair</p> <p>811430 Footwear &amp; Leather Goods Repair</p> <p>811490 Other Personal &amp; Household Goods Repair &amp; Maintenance</p> <p><b>Personal and Laundry Services</b></p> <p>812111 Barber Shops</p> <p>812112 Beauty Salons</p> <p>812113 Nail Salons</p> <p>812190 Other Personal Care Services (including diet &amp; weight reducing centers)</p> <p>812210 Funeral Homes &amp; Funeral Services</p> <p>812220 Cemeteries &amp; Crematories</p> <p>812310 Coin-Operated Laundries &amp; Drycleaners</p> <p>812320 Drycleaning &amp; Laundry Services (except Coin-Operated)</p> <p>812330 Linen &amp; Uniform Supply</p> <p>812910 Pet Care (except Veterinary) Services</p> <p>812920 Photofinishing</p> <p>812930 Parking Lots &amp; Garages</p> <p>812990 All Other Personal Services</p> <p><b>Religious, Grantmaking, Civic, Professional, and Similar Organizations</b></p> <p>813000 Religious, Grantmaking, Civic, Professional, &amp; Similar Organizations (including condominium and homeowners associations)</p>
<p><b>Professional, Scientific, and Technical Services</b></p> <p><b>Legal Services</b></p> <p>541110 Offices of Lawyers</p> <p>541190 Other Legal Services</p> <p><b>Accounting, Tax Preparation, Bookkeeping, and Payroll Services</b></p> <p>541211 Offices of Certified Public Accountants</p> <p>541213 Tax Preparation Services</p> <p>541214 Payroll Services</p> <p>541219 Other Accounting Services</p> <p><b>Architectural, Engineering, and Related Services</b></p> <p>541310 Architectural Services</p> <p>541320 Landscape Architecture Services</p> <p>541330 Engineering Services</p> <p>541340 Drafting Services</p> <p>541350 Building Inspection Services</p> <p>541360 Geophysical Surveying &amp; Mapping Services</p> <p>541370 Surveying &amp; Mapping (except Geophysical) Services</p> <p>541380 Testing Laboratories</p> <p><b>Specialized Design Services</b></p> <p>541400 Specialized Design Services (including interior, industrial, graphic, &amp; fashion design)</p> <p><b>Computer Systems Design and Related Services</b></p> <p>541511 Custom Computer Programming Services</p> <p>541512 Computer Systems Design Services</p> <p>541513 Computer Facilities Management Services</p> <p>541519 Other Computer Related Services</p> <p><b>Other Professional, Scientific, and Technical Services</b></p> <p>541600 Management, Scientific, &amp; Technical Consulting Services</p> <p>541700 Scientific Research &amp; Development Services</p> <p>541800 Advertising &amp; Related Services</p>	<p><b>Educational Services</b></p> <p>611000 Educational Services (including schools, colleges, &amp; universities)</p> <p><b>Health Care and Social Assistance</b></p> <p><b>Offices of Physicians and Dentists</b></p> <p>621111 Offices of Physicians (except mental health specialists)</p> <p>621112 Offices of Physicians, Mental Health Specialists</p> <p>621210 Offices of Dentists</p> <p><b>Offices of Other Health Practitioners</b></p> <p>621310 Offices of Chiropractors</p> <p>621320 Offices of Optometrists</p> <p>621330 Offices of Mental Health Practitioners (except Physicians)</p>	<p><b>Arts, Entertainment, and Recreation</b></p> <p><b>Performing Arts, Spectator Sports, and Related Industries</b></p> <p>711100 Performing Arts Companies</p> <p>711210 Spectator Sports (including sports clubs &amp; racetracks)</p> <p>711300 Promoters of Performing Arts, Sports, &amp; Similar Events</p> <p>711410 Agents &amp; Managers for Artists, Athletes, Entertainers, &amp; Other Public Figures</p> <p>711510 Independent Artists, Writers, &amp; Performers</p> <p><b>Museums, Historical Sites, and Similar Institutions</b></p> <p>712100 Museums, Historical Sites, &amp; Similar Institutions</p> <p><b>Amusement, Gambling, and Recreation Industries</b></p> <p>713100 Amusement Parks &amp; Arcades</p> <p>713200 Gambling Industries</p> <p>713900 Other Amusement &amp; Recreation Industries (including golf courses, skiing facilities, marinas, fitness centers, &amp; bowling centers)</p> <p><b>Accommodation and Food Services</b></p> <p><b>Accommodation</b></p> <p>721110 Hotels (except Casino Hotels) &amp; Motels</p>	<p><b>Religious, Grantmaking, Civic, Professional, and Similar Organizations</b></p> <p>813000 Religious, Grantmaking, Civic, Professional, &amp; Similar Organizations (including condominium and homeowners associations)</p>

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**Index**

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<b>A</b>	Dividends-received deduction ..... 14-15	Inventory: Section 263A uniform capitalization rules ..... 8, 13 Valuation methods ..... 13	<b>Q</b>
Accounting methods ..... 5	Dues, membership and other ..... 11		Qualified personal service corporation ..... 16
Accounting period (Tax Year) ..... 5			
Address change ..... 6	<b>E</b>	<b>L</b>	<b>R</b>
Affiliated group ..... 18	Electronic Federal Tax Payment System (EFTPS) ..... 4	LIFO recapture: Tax on ..... 18 Where to report ..... 7 Limitations on deductions ..... 8	Recapture taxes ..... 17 Reconciliation of income ..... 19 Recordkeeping ..... 5 Related party transactions ..... 8 Rents (expense) ..... 9 Rents (income) ..... 7 Repairs and maintenance ..... 9
Amended return ..... 5	Electronic filing ..... 3	Lobbying expenses, nondeductibility ..... 11	
Amortization ..... 8	Employee benefit programs ..... 10		
Apportionment plan ..... 15	Employer identification number (EIN) ..... 6	<b>M</b>	<b>S</b>
Assembling the return ..... 4	Estimated tax: Penalty ..... 4, 12	Minimum tax: Alternative ..... 16 Prior year, credit for ..... 17	Salaries and wages ..... 9
At-risk rules ..... 11	Estimated tax payments ..... 4	Mutual savings banks conducting life insurance business ..... 16	Schedule: A ..... 12 C ..... 14 K ..... 18 L ..... 18 M-1 ..... 19
	Extension of time to file ..... 3		Schedule M-3 ..... 6
<b>B</b>	Extraterritorial income ..... 6, 11	<b>N</b>	Section 263A costs ..... 8, 13
Backup withholding ..... 12		Name change ..... 6	Shareholders' equity adjustments ..... 19
Bad debts ..... 9	<b>F</b>	Net operating loss ..... 11, 18	Signature ..... 3
Balance sheets ..... 18	Farming, corporations engaged in ..... 2	Nonaccrual experience method ..... 7	Special returns for certain organizations ..... 2
Business startup expenses ..... 8	Final return ..... 6		
	Financial asset securitization investment trust (FASIT) ..... 2	<b>O</b>	<b>T</b>
<b>C</b>	Foreign financial accounts ..... 18	Other deductions ..... 10	Tax issues, unresolved ..... 1
Capital construction fund: Deduction for contributions ..... 12 Tax on nonqualified withdrawal ..... 17	Foreign person (defined) ..... 18	Other income ..... 7	Tax rate schedule ..... 16
Closely held corporations ..... 8	Foreign tax credit ..... 17	Other taxes ..... 17	Tax-exempt securities ..... 19
Compensation of officers ..... 9	Form 1120-A requirements ..... 2	Overpaid estimated tax ..... 12	Taxes and licenses ..... 9
Consolidated return ..... 6, 18	Forms and publications, how to get ..... 1		Travel, meals, and entertainment ..... 11
Contributions to reduce debt held by the public ..... 1		<b>P</b>	
Contributions, charitable ..... 10	<b>G</b>	Partnership income (loss) ..... 7, 11	
Controlled group: Brother-Sister ..... 15 Combined group ..... 15 Member of ..... 15 Parent-Subsidiary ..... 15	General business credit ..... 17	Passive activity limitations ..... 8	<b>W</b>
Controlled group members, tax computation ..... 16	Golden parachute payments ..... 8	Penalties ..... 4, 12	When to file ..... 3
Cooperative, subchapter T ..... 6	Gross receipts ..... 7	Pension, profit-sharing, etc. plans ..... 10	Where to file ..... 3
Cost of goods sold ..... 7, 12		Personal holding company ..... 6	Who must file ..... 2
Credits against tax ..... 17	<b>I</b>	Personal holding company tax ..... 17	Who must sign ..... 3
	Income ..... 6	Personal service corporation ..... 6	Worksheets: Cost of goods sold ..... 13 Schedule C ..... 15
<b>D</b>	Installment sales ..... 7	Possessions tax credit ..... 17	
Deductions ..... 8	Interest due: Late payment of tax ..... 4 Look-back method ..... 17	Preparer, tax return ..... 3	
Depletion ..... 10	Interest expense (relating to section 263A) ..... 8	Private delivery services ..... 3	
Depository methods of tax payment ..... 4	Interest expense ..... 9		
Depreciation ..... 10	Interest income: Tax-exempt ..... 18, 19 Taxable ..... 7		
Direct deposit of refund ..... 1, 12			
Disclosure statement ..... 5			
Dividend income ..... 7			