

## **Memo of Major Changes for 2007 Form 1120S, U.S. Income Tax Return for an S Corporation**

The majority of changes to this form were made in response to Rev. Proc. 2007-62 (which permits certain corporations an additional method of relief for making late elections) and in response to changes made to IRC code section 904(d) by section 404 of the American Jobs Creation Act of 2004 (PL 108-357).

We have made Item C (instead of Item H) the checkbox used to indicate that Schedule M-3 is attached. All subsequent entries in the opening section have been relettered.

Rev. Proc. 2007-62 permits, in certain situations, relief from a late election by attaching a properly completed Form 2553 to Form 1120S. This applies to tax years ending on or after December 31, 2007. We added text under the form's title to state that Form 2553 can be attached. Also, in relettered Item G, we have changed the question to ask if it is the corporation's first return, and added a "Yes" checkbox and a "No" checkbox. If the S Corp. checks "Yes", we added text to tell the S Corp. to attach Form 2553 to the return (if Form 2553 has not been previously filed).

In relettered Item H, we require S corporations to check all applicable checkboxes. The first four checkboxes on relettered Item H correspond to checkboxes (2) through (5) of Item F of the 2006 Form 1120S. On relettered Item H, checkbox (5) will read "S election termination or revocation." We are adding this at the request of LMSB and the service centers because the lack of notification of terminated S elections, and reversion to C status, is causing erroneous refunds and unnecessary expenditure of staff time.

Since previous Item H is now relettered Item C, previous Item H has been deleted.

Previous Item G is now Item I.

Since TETR will not apply for 2007, we have deleted line 23d, and line 23e has been renamed line 23d. All subsequent line references have been renumbered.

We have removed question 4 from Schedule B based on the advice of an S Corporation LMSB technical advisor. The advice pertains to imminent issuance of a new regulation stating that an S corporation cannot be a member of a controlled group. Subsequent questions in Schedule B have been renumbered. We deleted the "Note" at the end of Schedule B, as this item is no longer new.

On page 3, under 14, Foreign Transactions, we changed codes d through f and i through k to read as follows:

- d Passive category
- e General category
- f Other (attach statement)

- i Passive category
- j General category
- k Other (attach statement)

These changes rename and reorder the categories of foreign gross income sources at the shareholder level and deductions allocated and apportioned at the shareholder level to foreign source income. This reflects changes made to section 904(d) by the American Jobs Creation Act of 2004, PL 108-357, sec 404. Please note that as a result of these changes, statements will now be attached to line 14(f) and line 14(k) (rather than line 14(e) and line 14(j)).

Throughout the form, all year references have been updated.

## Major Changes for Instructions for Form 1120S

**Minor changes.** Throughout the instructions we made minor changes such as updating the tax year, certain other dates, and line references. We also made various editorial changes to conform to changes made to similar text in the Instructions for Form 1120.

### Page 1

**What's New.** We updated these items to reflect current changes which include the following.

Revenue Procedure 2007-62 (see IRB 2007-41 dated October 9, 2007) makes it possible to get relief from a late S corporation election by filing Form 2553 with Form 1120S for the first tax year for which the election was intended.

The Small Business and Work Opportunity Tax Act of 2007 made changes to the tax laws regarding S Corps. Section 8231 of the Act states that for tax years beginning after May 25, 2007, gains from sales or exchanges of stock or securities will not be treated as an item of passive investment income for S corporations.

### Page 2

**Who Must File.** We revised this text to reflect changes made by Rev. Proc. 2007-62.

### Page 3

**Electronic Filing.** We deleted the bulleted items stating that amended returns and returns with a name change could not be filed electronically to reflect current guidance at [www.irs.gov/efile](http://www.irs.gov/efile).

**Where To File.** We revised the mailing addresses to add "Department of the Treasury" to all 2 line addresses to reflect the new 3 line minimum USPS requirement. We also made changes so that returns from corporations voluntarily attaching Schedule M-3 will be filed with Ogden. Ogden is the only center set up to process Schedule M-3.

### Page 6

**Other Forms and Statements That May Be Required.** Under "Reportable transaction disclosure statement" we added item #6 to the list to reflect new reporting requirements for "transactions of interest" as discussed in the circulated draft Instructions for Form 8886. Under "Reportable transactions by material advisors" we revised text to reflect new Regulations under section 301.6111-3 and the requirement to file new Form 8918, Material Advisor Disclosure Statement.

*Under "Penalties" we revised text to reflect change to the Instructions for Form 8886.*

### Page 11

**Extraterritorial Income Exclusion.** We revised text to reflect the transition rules covering exceptions to the December 31, 2006, expiration of this Code section 942 exclusion.

**Name and Address.** We adopted an employee suggestion to clarify that the address on the return should be the corporation's principal place of business or the address of the principal office.

**Item C. Schedule M-3 Information.** This item was moved to reflect changes to Form 1120S. It was previously item H. Items D and F were previously items C and E.

**Item H. Final Return, Name Change, Address Change, Amended Return, or S Election Termination or Revocation.** This item was moved to reflect changes to Form 1120S. It was previously item F. We removed "initial return" since those instructions are now part of line G on Form 1120S. We added "S election termination or revocation" to reflect the new box on Form 1120S.

#### Page 12

**Line 5. Other Income (Loss).** We added another example to the bulleted list (see page 13) to cover proceeds from certain corporate-owned life insurance contracts issued after August 17, 2006, to reflect Code section 101(j).

#### Page 13

**Limitations on Deductions.** We added an item at the end of the bulleted list under "Exceptions" to reflect the exception for Code section 179B capital costs incurred to comply with EPA sulfur regulations per Code section 263A(c)(3).

#### Page 14

**Reducing certain expenses for which credits are allowable.** We deleted the reference to Form 5884-A, Credits for Employers Affected by Hurricane Katrina, Rita, or Wilma. These credits expired before 2007 per Code section 1400P(f).

**Line 11. Rents.** We revised the inclusion amount table to reflect Revenue Procedure 2007-30 which raised the vehicle fair market value amount to \$15,500 for lease terms beginning after 12/31/06 but before 01/01/08. We also removed information for years before 2004 since we also refer readers to Publication 463, Travel, Entertainment, Gift, and Car Expenses.

#### Page 18

**Line 23d.** This was previously line 23e. We renumbered it because we deleted the previous 23d which covered the credit for federal telephone excise tax paid which only applied to 2006 returns.

#### Page 19

**Schedule B. Other Information.** Question 4 from the 2006 Form 1120S was deleted so we have renumbered subsequent items. Under "Question 4" (former Question 5), we added a reference to Form 8918, and deleted the reference to Form 8264 and related material. Under "Question 7" (former question 8), we added a sentence to state that "Estimates based on retained earnings at the end of the tax year are acceptable." We

b.f.

Lines 9a through 9f We revised text to more clearly reflect Reg. section 1.471-2(c) at the request of counsel

have received complaints from preparers that sometimes the actual amount is just not available so an LMSB S corp technical advisor suggested this text.

#### Page 21

**Item C.** This item was added to tell corporations that e-file to enter "e-file" in the space for "IRS Center where corporation filed return." We also deleted text for former items D and E in Part I which dealt with former tax shelter registration requirements.

#### Page 25

**Noncash contributions (50%)(code C).** We added text to address the requirement to use Form 8283, Noncash Charitable Contributions, when the claimed deduction exceeds \$5,000. *We also added a reference to the Code for more details on deductions of food inventory due to the possible but unlikely expiration of this provision for fiscal year filers on the advice of the Senior Technical Advisor.*  
**Qualified conservation contributions.** We added a reference to Notice 2007-50 for additional guidance.

#### Page 26

**Reforestation expense deduction (code N).** We added text to state that the increased deduction for qualified timber property located in the Gulf Opportunity Zones (GO Zones) does not apply to expenditures paid or incurred after December 31, 2007, per Code section 1400N(i)(5)(A)(ii)(I).

#### Page 27

**Domestic production activities deduction (code O).** This entire section which covers codes O, P, and Q was rewritten to reflect guidance provided by Revenue Procedure 2007-34.

**Other deductions (code R).** The bullet discussing film and television production expenses was revised to reflect guidance provided by and to include a reference to Temporary Regulations sections 1.181-1T through 1.181-6T.

#### Page 28

**Other credits (code P).** We removed the qualified electric vehicle credit from the list because it expired at the end on 2006 per Code section 30(e). We also deleted the reference to Form 5884-A, Credits for Employers Affected by Hurricane Katrina, Rita, or Wilma, since these credits expired before 2007 per Code section 1400P(f).

#### Page 29

**Lines 14d-14f. Foreign Gross Income Sourced at Corporate Level.** We revised the instructions for lines 14d, 14e, and 14f to reflect changes made to Form 1120S, Schedules K and K-1, and Form 1116, Foreign Tax Credit, and its instructions.

**Page 30**

**Lines 14i-14k. Deductions Allocated and Apportioned at Corporate Level to Foreign Source Income.** We revised these instructions to reflect changes made to Form 1120S, Schedules K and K-1, and Form 1116, Foreign Tax Credit, and its instructions.

**Page 33**

**Recapture of other credits (code H).** We added the alternative motor vehicle credit (see Code section 30B(h)(8)) and the alternative fuel vehicle refueling property credit (see Code section 30C(e)(5)) to the list to reflect changes made to the Form 1040 instructions.

**Page 34**

**Other information (code T).** We deleted the first bullet concerning the disclosure requirements under Code section 6111 and the list keeping requirements under Regulations section 301.6112-1 to reflect new Regulations under section 301.6111-3.

**Pages 38 – 40**

**Principal Business Activity Codes.** We made changes to certain Principal Business Activity Codes and the text accompanying the codes at the request of the IRS Statistics of Income (SOI) Division.

**Memo of Major Changes to Schedule K-1 (Form 1120S), Shareholder's Share of  
Income, Deductions, Credits, etc.**

The revised 1.6011-4 regulations have been published. The regulations state that investors will no longer be required to file Forms 8271 that are due on or after August 3, 2007. Therefore, we have revised Schedule K-1 (Form 1120S) to delete item D (Tax Shelter Registration Number) and item E (Check if Form 8271 is attached). We relettered the subsequent items to correspond with this change. We moved "Part II" so it comes directly after Item C. We increased the size of the "For IRS Use Only" box.

To conform to changes made to Schedule A (Form 1040), we updated the line references for codes used in box 12. Box 12, Code J, now instructs taxpayers to enter the portfolio (2% floor) amount that is part of Schedule A, line 23. Box 12, Code K, now instructs taxpayers to enter the portfolio (other) amount that is part of Schedule A, line 28.

To conform to changes on Form 8903, Domestic Production Activities Deduction, we updated the line reference for Box 12, Code Q. Box 12, Code Q now instructs taxpayers to enter employer's Form W-2 wages on Form 8903, line 15.

On page 2, under 14, Foreign transactions, we changed codes D through F and I through K to read as follows:

- D Passive category
- E General category
- F Other
- I Passive category
- J General category
- K Other

These changes rename and reorder the categories of foreign gross income sources at the shareholder level and deductions allocated and apportioned at the shareholder level to foreign source income. This conforms to the changes we plan to make to Schedule K on Form 1120S and reflects changes made to section 904(d) by the American Jobs Creation Act of 2004, PL 108-357, sec 404.

All year references have been updated appropriately.

**Memo of Major Changes to the Instructions for Schedule K-1 (Form 1120S),  
Shareholder's Instructions for Schedule K-1 (Form 1120S)**

Whenever appropriate, we updated line references to forms to conform to the 2007 version of the forms.

All year references have been updated appropriately.

**Page 5**

We deleted the specific instructions for Part I of Schedule K-1 (Form 1120S) because the previous items D and E which we discussed were removed from the Schedule K-1 after it was circulated per changes to Regulations section 1.6011-4 effective August 3, 2007. The subsequent items in Part II of Schedule K-1 were re-lettered.

**Page 11**

**Code H. Work opportunity credit.** We removed the references to Form 3800 because this credit is no longer reported on Form 3800 per section 8214 of the Small Business and Work Opportunity Tax Act of 2007.

**Code N. Credit for employer social security and Medicare taxes.** We removed the references to Form 3800 because this credit is no longer reported on Form 3800 per section 8214 of the Small Business and Work Opportunity Tax Act of 2007.

**Code P. Other credits.** We removed the qualified electric vehicle credit from the list because it expired at the end of 2006 per Code section 30(e). We also deleted the reference to Form 5884-A, Credits for Employers Affected by Hurricane Katrina, Rita, or Wilma, since these credits expired before 2007 per Code section 1400P(f).

**Page 13**

**Code H. Recapture of other credits.** We added the alternative motor vehicle credit (see Code section 30B(h)(8)) and the alternative fuel vehicle refueling property credit (see Code section 30C(e)(5)) to the list to reflect changes made to the Form 1040 instructions.

**Page 14**

**Code T. Other information.** We deleted the first bullet point concerning the disclosure requirements under Code section 6111 and the list keeping requirements under Regulations section 301.6112-1 to reflect new Regulations under section 301.6111-3.



**Memo of Major Changes to 2007 Schedule M-3 (Form 1120S), Net Income (Loss)  
for S Corporations With Total Assets of \$10 Million or More**

***Changes on Page 1***

The text of 1a now states "Did the corporation prepare a certified audited non-tax-basis income statement for the period ending with or within this tax year? (See instructions if multiple non-tax-basis income statements are prepared.)"

In the text for 1b, we replaced "an" with "a non-tax-basis".

On line 3b, we deleted the "3".

We changed line 7a to read "Net income (loss) of other disregarded entities (except qualified subchapter S subsidiaries) (attach schedule)".

We changed line 7b to read "Net income (loss) of other qualified subchapter S subsidiaries (QSubs) (attach schedule)". We deleted the parenthesis in the box for line 7b.

We deleted the words "Privacy Act and" from the Paperwork Reduction Act Notice at the bottom of the page.

***Changes on Page 2***

From columns (a) and (d), we deleted the parentheses and the word "optional".

On line 11, Interest income, we inserted: "(attach Form 8916-A)".

On line 15, Cost of goods sold, we inserted parentheses in columns (a) and (d) since this item is a negative amount that reduces income.

***Changes on Page 3***

From columns (a) and (d), we deleted the parentheses and the word "optional".

On line 26, Interest expense, we inserted "(attach Form 8916-A)".

On the schedule, all year references have been updated.

## **Major Changes to the 2007 Instructions for Schedule M-3 (Form 1120S)**

We made minor editorial changes throughout the instructions. We deleted the word “federal” wherever used in the term “U.S. federal income tax return” since it is redundant when used with “U.S.” The years used in the examples were updated as appropriate. Other minor editorial changes were made to conform to the TFP style guide.

All technical changes described below were made at the request of the LMSB M-3 Team.

### **Page 1**

**What’s New.** We inserted new text concerning changes made to the Instructions for Schedule M-3.

- Non-tax-basis and tax-basis financial statements defined for Schedule M-3 filers.
- Changes to Part I, line 7a and 7b.
- Form 8916-A expanded to include Interest Income and Interest Expense.
- Reportable entity partner discussion.
- Clarification of entries in Part III.

### **Purpose of Schedule**

We revised text to clarify the purpose of Schedule M-3.

### **Who Must File**

We removed text that provided non-specific guidance to 52-53-week tax year filers.

### **Other Issues Affecting Schedule M-3 Filing Requirements**

We inserted a note referencing the instructions for Part 1, line 1, referring to non-tax-basis income statements used in preparing Schedule M-3.

### **Page 2**

## **Schedule L**

We inserted a new first paragraph concerning non-tax-basis income statements. We also inserted "non-tax-basis" before "financial statements" wherever applicable. We inserted a new third paragraph concerning differences in ending of year and beginning of year total assets. The fourth paragraph (which is an expansion of the second paragraph that appeared under *Schedule L* in the 2006 version of these instructions) concerns measuring total assets at the end of the year.

## **Entity Considerations for Schedule M-3**

We added text to reflect changes to Schedule M-3, Part I, line 7a and 7b. We added a heading to the discussion of qualified subchapter S subsidiaries (QSubs).

## **Reportable Entity Partner Reporting Responsibilities**

We made the list in the second paragraph a numbered list. We updated dates where applicable. We inserted a new paragraph concerning reportable entity partner retention of copies of reports.

## **Page 3**

### **Non-Tax-Basis Financial Statement and Tax-Basis Financial Statements.**

We inserted "non-tax-basis" before "financial statements," where applicable. We inserted a new header and text concerning non-tax-basis and tax-basis financial statements as applied to Schedule M-3 including the header and text for "Order of priority in accounting standards."

### **Line 4. Worldwide consolidated Net Income (Loss) per Income Statement**

Where applicable, we revised the third, fourth, and fifth paragraphs by inserting "non-tax-basis" before "financial statements."

## **Page 4**

### **Line 5. Net Income (Loss) of Nonincludible Foreign Entities**

We made several minor editorial changes for clarity.

### **Line 6. Net Income (Loss) of Nonincludible U.S. Entities**

We made several minor editorial changes for clarity.

**Lines 7a and 7b. Net Income (Loss) of Other Disregarded Entities (Except Qualified Subchapter S Subsidiaries) and Net Income (Loss) of Other Qualified Subchapter S Subsidiaries (QSubs)**

We made multiple revisions to the text for this line in order to address disregarded entities and qualified subchapter S subsidiaries. We made these changes to conform to changes made to these lines on Schedule M-3.

**Page 5**

**Line 8. Adjustment to Eliminations of Transaction Between Includible Entities and Nonincludible Entities**

We made several editorial changes for clarity.

**Page 8**

**Separately stated and adequately disclosed**

We deleted the references to Rev. Proc. 2004-45 and 2005-75, and inserted a reference to Rev. Proc. 2006-48. This conforms to the references used in the Instructions for Schedule M-3 (Form 1120).

**Page 11**

**Line 11. Interest Income**

We inserted text stating that Form 8916-A, Part II must now be completed and attached. This was done to clarify what is reported on this line.

**Page 12**

**Line 15. Cost of Goods Sold**

We further clarified the text regarding completing and attaching Form 8916-A. We inserted a "Note" to stress that the entries in columns (a) and (d) are negative amounts.

**Page 14**

**Line 23. Total Income (Loss) Items.**

We inserted a new header and a "Note" for this item to stress that cost of goods sold amounts (columns (a) and (d) of line 15) should be subtracted from the totals on line 23.

**Part III. Reconciliation of Net Income (Loss) per Income Statement of the Corporation With Total Income (Loss) per Return—Expense/Deduction Items**

We inserted a “Note” concerning when certain amounts on Part III must be reported as positive amounts.

**Page 16**

**Line 26. Interest Expense**

We inserted text stating that Form 8916-A, Part III must now be completed. This text was added to clarify what is reported on this line.

**Line 29. Other Expense/Deduction Items With Differences**

In the section entitled “Reserves and contingent liabilities, we added a new first paragraph.