



# Instructions for Form 1120-PC

## U.S. Property and Casualty Insurance Company

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

Contents	Page
Photographs of Missing Children . . . . .	1
Unresolved Tax Issues . . . . .	1
How To Get Forms and Publications . . . . .	2
IRS E-Services . . . . .	2
General Instructions . . . . .	2
Purpose of Form . . . . .	2
Who Must File . . . . .	2
When To File . . . . .	2
Where To File . . . . .	2
Who Must Sign . . . . .	3
Paid Preparer Authorization . . . . .	3
Other Forms That May Be Required . . . . .	3
Consolidated return . . . . .	3
Statements . . . . .	4
Assembling the Return . . . . .	4
Accounting Methods . . . . .	4
Accounting Periods . . . . .	4
Rounding Off to Whole Dollars . . . . .	4
Recordkeeping . . . . .	5
Depository Methods of Tax Payment . . . . .	5
Estimated Tax Payments . . . . .	5
Interest and Penalties . . . . .	5
Specific Instructions . . . . .	6
Period Covered . . . . .	6
Address . . . . .	6
Employer Identification Number . . . . .	6
Item A . . . . .	6
Item E . . . . .	6
Taxable Income . . . . .	6
Tax Computation and Payments . . . . .	6-9
Schedule A . . . . .	9-15
Schedule B, Part I . . . . .	15
Schedule B, Part II . . . . .	15
Schedule C . . . . .	15-17
Schedule E . . . . .	17
Schedule F . . . . .	18
Schedule G . . . . .	18
Schedule H . . . . .	19
Schedule I . . . . .	19
Schedule L . . . . .	20
Schedule M-1 . . . . .	20
Index . . . . .	21

## What's New

- For tax years beginning after December 31, 2003, an insurance company, other than a life insurance company, is generally exempt from

income taxes if (1) the gross receipts for the taxable year are \$600,000 or less, and over half of the gross receipts consist of premiums; or (2) if a specified mutual insurance company, the gross receipts for the taxable year are \$150,000 or less, and over 35 percent of the gross receipts consist of premiums. For additional information, including exceptions and transition rules, see section 501(c)(15)(A).

- Charitable contributions made in January 2005 for the relief of victims in areas affected by the Indian Ocean tsunami may be treated as if made on December 31, 2004.
- Corporations can file new Form 8895, Section 965(f) Election for Corporations that are U.S. Shareholders of a Controlled Foreign Corporation, to elect the 85% dividends-received deduction on repatriated dividends received under section 965. Changes are made to Form 1120-PC, Schedule C, lines 10 and 24.
- For tax years beginning after October 22, 2004, corporations can elect to be taxed on income from qualifying shipping activities using an alternative tax method. See page 10.
- Corporations can elect to deduct a limited amount of business start-up and organizational costs paid or incurred after October 22, 2004. See page 11.
- Corporations cannot deduct certain interest paid or incurred in tax years beginning after October 22, 2004, on an underpayment of tax from certain undisclosed transactions. See page 12.
- For charitable contributions of certain property made after June 3, 2004, a corporation must file Form 8283 and obtain a qualified appraisal if claiming a deduction of more than \$5,000. See page 13.
- For charitable contributions of patents and certain other intellectual property made after June 3, 2004, corporations will receive a reduced deduction but can deduct certain qualified donee income. See page 13.
- Special rules apply to charitable contributions after 2004 of used motor vehicles, boats, or airplanes with a claimed value of more than \$500. See section 170(f)(12).
- The deduction for certain travel, meals, and entertainment expenses incurred

after October 22, 2004, is limited to the amount treated as compensation to officers, directors, and more-than-10% shareholders. See section 274(e)(2).

- If the corporation is an expatriated entity or a partner in an expatriated entity, the corporation's taxable income cannot be less than its inversion gain for the tax year. See section 7874.

## 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.
- 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 (EIN).
- 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 verifying documentation (if applicable).

The corporation can contact a Taxpayer Advocate by calling 1-877-777-4778 (toll free). Persons who have access to TTY/TDD equipment can call 1-800-829-4059 and ask for the Taxpayer Advocate assistance. If the corporation prefers, it can call, write, or fax the Taxpayer Advocate in its area. See Pub. 1546, The Taxpayer Advocate Service of the IRS, for a list of addresses and fax numbers.

## How To Get Forms and Publications

### Personal computer

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

- Order IRS products online.
- Download forms, instructions, and publications.
- See answers to frequently asked tax questions.
- Search publications online by topic or keyword.
- Send us comments or request help by email.
- Sign up to receive local and national tax news by email.

You can also reach us using file transfer protocol at [ftp.irs.gov](ftp://ftp.irs.gov).

### CD-ROM

Order Pub. 1796, Federal Tax Products on CD-ROM, and get:

- Current year forms, instructions, and publications.
- Prior year forms, instructions, and publications.
- Frequently requested tax forms that can be filled in electronically, printed out for submission, and saved for recordkeeping.
- The Internal Revenue Bulletin.

Buy the CD-ROM on the Internet at [www.irs.gov/cdorders](http://www.irs.gov/cdorders) from the National Technical Information Service (NTIS) for \$22 (no handling fee) or call 1-877-CDFORMS (1-877-233-6767) toll free to buy the CD-ROM for \$22 (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 940 and 941 employment tax returns, Form 1099, and other information returns. Visit [www.irs.gov/efile](http://www.irs.gov/efile) for more information.
- 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 more information.

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

## General Instructions

### Purpose of Form

Use Form 1120-PC, U.S. Property and Casualty Insurance Company Income Tax Return, to report the income, gains, losses, deductions, credits, and to figure the income tax liability of insurance companies, other than life insurance companies.

### Who Must File

Every domestic nonlife insurance company and every foreign corporation that would qualify as a nonlife insurance company subject to taxation under section 831, if it were a U.S. corporation, must file Form 1120-PC. This includes organizations described in section 501(m)(1) that provide commercial-type insurance and organizations described in section 833.

**Exceptions.** A nonlife insurance company that is:

- Exempt under section 501(c)(15) should file Form 990, Return of Organization Exempt from Income Tax.
- Subject to taxation under section 831, and disposes of its insurance business

and reserves, or otherwise ceases to be taxed under section 831, but continues its corporate existence while winding up and liquidating its affairs, should file Form 1120, U.S. Corporation Income Tax Return.

**Life insurance companies.** Life insurance companies should file Form 1120-L, U.S. Life Insurance Company Income Tax Return.

### 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 may 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.*

## 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:	Use the following Internal Revenue Service Center address:
The United States	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)	Philadelphia, PA 19255-0012

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

## 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-PC, the paid preparer's space should remain blank. Anyone who prepares Form 1120-PC 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 returns, amended returns, or requests for filing extensions by rubber stamp, mechanical device, or computer software program.

## Paid Preparer Authorization

If the corporation wants to allow the IRS to discuss its 2004 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 corporation's return. It 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 that the corporation has shared with the preparer

about math errors, offsets, and return preparation. The notices will not be sent to the preparer.

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. If the corporation wants to expand the paid preparer's authorization, see Pub. 947, Practice Before the IRS and Power of Attorney.

The authorization cannot be revoked. However, the authorization will automatically end no later than the due date (excluding extensions) for filing the corporation's 2005 tax return.

## Other Forms That May Be Required

The corporation may have to file some of the forms listed below. See the form for more information.

For a list of additional forms the corporation may need to file, see *Other Forms That May Be Required* in the Instructions for Forms 1120 and 1120-A.

- **Form W-2**, Wage and Tax Statement. Use this form to report wages, tips, and other compensation, and withheld income, social security, and Medicare taxes for employees.
- **Form 720**, Quarterly Federal Excise Tax Return. Use this form to report and pay environmental taxes, communications and air transportation taxes, fuel taxes, manufacturers taxes, ship passenger taxes, and certain other excise taxes.
- **Form 851**, Affiliations Schedule. The parent corporation of an affiliated group of corporations must attach this form to its consolidated return. If this is the first year one or more subsidiaries are being included in a consolidated return, also see Form 1122, Authorization and Consent of Subsidiary Corporation To Be Included in a Consolidated Income Tax Return, on page 3.
- **Form 941**, Employer's Quarterly Federal Tax Return. Employers must file this form to report income tax withheld and employer and employee social security and Medicare taxes. Also, see *Trust fund recovery penalty* on page 5.
- **Form 945**, Annual Return of Withheld Federal Income Tax. File Form 945 to report income tax withheld from nonpayroll distributions or payments, including pensions, annuities, IRAs, gambling winnings, and backup withholding. Also, see *Trust fund recovery penalty* on page 5.
- **Form 1099-MISC**, Miscellaneous Income. Use this form to report payments: to providers of health and medical services, of rent or royalties, nonemployee compensation, etc.

**Note.** Every corporation must file Form 1099-MISC if it makes payments of rents,

commissions, or other fixed or determinable income (see section 6041) totaling \$600 or more to any one person in the course of its trade or business during the calendar year.

- **Form 1122**, Authorization and Consent of Subsidiary Corporation To Be Included in a Consolidated Income Tax Return. File this form if this is the first year a consolidated return is being filed.
- **Form 5471**, Information Return of U.S. Persons With Respect to Certain Foreign Corporations. This form is filed by a domestic nonlife insurance company that controls a foreign corporation; acquires, disposes of, or owns 10% or more in value or vote of the outstanding stock of a foreign corporation; or had control of a foreign corporation for an uninterrupted period of at least 30 days during the annual accounting period of the foreign corporation. See Question 4 of Schedule N (Form 1120).
- **Form 5472**, Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business. This form is filed by a domestic nonlife insurance company that is 25% or more foreign-owned. See Question 6 on page 19.
- **Form 8302**, Electronic Deposit of Tax Refund of \$1 Million or More. This form must be filed to request an electronic deposit of a tax refund of \$1 million or more.
- **Form 8621**, Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund. A domestic nonlife insurance company uses this form to make certain elections by shareholders in a passive foreign investment company and to figure certain deferred taxes.
- **Form 8816**, Special Loss Discount Account and Special Estimated Tax Payments for Insurance Companies. This form must be filed by any insurance company that elects to take an additional deduction under section 847.
- **Form 8895**, Section 965(f) Election for Corporations that are U.S. Shareholders of a Controlled Foreign Corporation. Use this form to elect the dividends-received deduction on repatriated dividends received under section 965.

## Consolidated Return

If an affiliated group of corporations includes one or more domestic life insurance companies taxed under section 801, the common parent may elect to treat those companies as includible corporations. The life insurance companies must have been members of the group for the 5 tax years immediately preceding the tax year for which the election is made. See section 1504(c)(2) and Regulations section 1.1502-47(d)(12).

File supporting statements for each corporation included in the consolidated



return. Do not use Form 1120-PC 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.

Enter the totals for the consolidated group on Form 1120-PC. Attach consolidated balance sheets and a reconciliation of consolidated retained earnings. For more information on consolidated returns, see the regulations under section 1502.

**Note.** If a nonlife insurance company is a member of an affiliated group, file Form 1120-PC as an attachment to the consolidated return in lieu of filing supporting statements. Across the top of page 1 of Form 1120-PC, write "Supporting Statement to Consolidated Return."

## Statements

**NAIC annual statement.** Regulations section 1.6012-2(c) requires that the NAIC annual statement be filed with Form 1120-PC. A penalty for the late filing of a return may be imposed for not including the annual statement when the return is filed.

**Stock ownership in foreign personal holding companies (FPHC).** Attach the statement required by section 551(c) if:

1. The corporation owned 5% or more in value of the outstanding stock of a FPHC and
2. The corporation was required to include in its gross income any undistributed FPHC income from a FPHC.

**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.

## Assembling the Return

To ensure that the corporation's tax return is correctly processed, attach all schedules and other forms after page 8, Form 1120-PC, and in the following order:

1. Schedule N (Form 1120).
2. Form 8302.
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-PC. 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. Also be sure to put the corporation's name and EIN on each supporting statement or attachment.

## Accounting Methods

An accounting method is a set of rules used to determine when and how income and expenses are reported. Figure taxable income using the method of accounting regularly used in keeping the corporation's books and records. Generally, permissible methods include:

- Cash,
- Accrual, or
- Any other method authorized by the Internal Revenue Code.

The gross amounts of underwriting and investment income should be computed on the basis of the underwriting and investment exhibit of the NAIC annual statement to the extent not inconsistent with the Internal Revenue Code and its Regulations. In all cases, the method used must clearly show taxable income.

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

Under the accrual method, an amount is includible in income when:

1. All the events have occurred that fix the right to receive the income, which is the earliest of the date (a) the required performance takes place, (b) payment is due, or (c) payment is received and
2. The amount can be determined with reasonable accuracy.

See Regulations section 1.451-1(a) for details.

Generally, an accrual basis taxpayer can deduct accrued expenses in the tax year when:

- All events that determine the liability have occurred,
- The amount of the liability can be figured with reasonable accuracy, and
- Economic performance takes place with respect to the expense.

There are exceptions to the economic performance rule for certain items, including recurring expenses. See section 461(h) and the related regulations for the

rules for determining when economic performance takes place.

## 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. For more information, see Form 3115 and Pub. 538, Accounting Periods and Methods.

### Safe harbor method of accounting for premium acquisition expenses.

Insurance companies subject to tax under section 831 are provided with a safe harbor method of accounting for premium acquisition expenses. Form 3115 must be filed in order to change to the safe harbor method. For more information, see the Instructions for Form 3115 and item 67 in the *List of Automatic Accounting Method Changes*.

**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.

Include any net positive section 481(a) adjustment on Schedule A, line 13. If the net section 481(a) adjustment is negative, report it on Schedule A, line 31.

## Accounting Periods

An insurance company must figure its taxable income on the basis of a tax year. A tax year is the annual accounting period an insurance company uses to keep its records and report its income and expenses.

As a general rule under section 843, the tax year for every insurance company is the calendar year. However, if an insurance company joins in the filing of a consolidated return, it may adopt the tax year of the common parent corporation even if that year is not a calendar year.

## 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.

## Depository Methods of Tax Payment

The corporation must pay the tax due in full no later than the 15th day of the 3rd month after the end of the tax year. The two methods of depositing corporate income 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 2005 if:

- The total deposits of such taxes in 2003 were more than \$200,000 or
- The corporation was required to use EFTPS in 2004.

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 or 1-800-945-8400. 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. Be sure to have your EIN ready when you call.

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 that 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-PC" on the check or money order. Be sure to 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-PC, 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.

For more information on estimated tax payments, including penalties that apply if the corporation fails to make required payments, see the instructions for line 15 on page 9.

### Overpaid 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. 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 income tax return.



*Foreign insurance companies, see Notice 90-13, 1990-1 C.B. 321, before computing estimated tax.*

## 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, and substantial understatements of tax from the due date (including extensions) to the date of payment. The interest charge is figured at a rate determined under section 6621.

**Penalty for 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.

**Penalty for late payment of tax.** A corporation that does not pay the tax when due generally may have to pay a penalty of 1/2 of 1% of the unpaid tax for each month or part of a month the tax is not paid, up to a maximum of 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; or Form 945, Annual Return of Withheld Federal Income Tax (see *Other Forms That May Be Required* on page 3). The trust fund recovery penalty may be imposed on all persons 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 or Pub. 15 (Circular E), 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, and fraud. See sections 6662 and 6663.

## Specific Instructions

### Period Covered

Generally, file the 2004 return for calendar year 2004. However, if an insurance company joins in the filing of a consolidated return, it may adopt the tax year of the common parent corporation even if that year is not a calendar year. For a fiscal year return, fill in the tax year space at the top of the form.

### Address

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.

### 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 7:00 a.m. to 10:00 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 A. Section 953 Elections

Check the applicable box if the corporation is a foreign corporation and elects under:

1. Section 953(c)(3)(C) to treat its related person insurance income as effectively connected with the conduct of a trade or business in the United States or
2. Section 953(d) to be treated as a domestic corporation.

Generally, a foreign corporation making either election must file its return with the Internal Revenue Service Center, Philadelphia, PA 19255. See Notice 87-50, 1987-2 C.B. 357, and Rev. Proc. 2003-47, 2003-28 I.R.B. 55, for the procedural rules, election statement formats, and filing addresses for making the respective elections under section 953(c)(3)(C) or section 953(d).

**Note.** Once either election is made, it will apply to the tax year for which made and all subsequent tax years unless revoked with the consent of the IRS. Also, any loss of a foreign corporation electing to be treated as a domestic insurance company under section 953(d) will be treated as a dual-consolidated loss and may not be used to reduce the taxable income of any other member of the affiliated group for this tax year or any other tax year.

**Note.** If a section 953(d) election is made, include the additional tax required to be paid, on line 13, page 1. On the dotted line to the left of line 13, page 1, write "Section 953(d)" and the amount. Attach a schedule showing the computation. See section 953(d) for more details.

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

Indicate a final return, name change, address change, or amended return by checking the appropriate box.

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

### Taxable Income

**Line 1, Taxable income, and line 2, Taxable investment income.** If the corporation is a small company as defined in section 831(b)(2) and elects under section 831(b)(2)(A)(ii) to be taxed on taxable investment income, complete Schedule B (ignore Schedule A) and enter the amount from Schedule B, line 21, on line 2, page 1. All other corporations should complete Schedule A (ignore Schedule B) and enter on line 1, page 1, the amount from Schedule A, line 37.

**Note.** If Schedule C, line 10 was completed, see *Minimum taxable income* on page 15.

### Tax Computation and Payments

#### Line 3

**Members of a controlled group.** A member of a controlled group must check the box on line 3 and complete lines 3a and 3b of the Form 1120-PC. 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 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.

For tax years beginning after October 22, 2004, the definition of brother-sister group does not include (1) above, but only 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 3a.** 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 3a.



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

**Line 3b.** 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 3b(1).** Enter the corporation's share of the additional 5% tax on line 3b(1).

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

**Line 4**

Most corporations figure their tax by using the *Tax Rate Schedule*, on this page. Exceptions apply to members of a controlled group. See the *Tax Computation Worksheet for Members of a Controlled Group*, on this page. Members of a controlled group must attach a statement showing the computation of the tax entered on line 4.

**Tax Rate Schedule**

If the amount on line 1 or line 2, Form 1120-PC, 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

**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 total increase in taxes due under section 1291(c)(2) in the amount entered on line 4. On the dotted line next to line 4, enter "Section 1291" and the amount.

Do not include on line 4 any interest due under section 1291(c)(3). Instead, show the amount of interest owed in the bottom margin of page 1 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 4. On the dotted line next to line 4, enter "Section 197" and the amount. For more information, see Pub. 535, Business Expenses.

**Line 5. Enter amount of tax that a reciprocal must include.** A mutual insurance company that is an interinsurer or reciprocal underwriter may elect, under section 835, to limit the deduction for amounts paid or incurred to a qualifying attorney-in-fact to the amount of the deductions of the attorney-in-fact allocable to the income received by the attorney-in-fact from the reciprocal. If this election is made, any increase in taxable income of a reciprocal as a result of this limitation is taxed at the highest rate of tax specified in section 11(b).

Make no entry on line 5 if the mutual insurance company's taxable income before including the section 835(b) amount is \$100,000 or more. Otherwise, this tax is 35% of the section 835(b) amount. If an entry is made on line 5, attach a statement showing how the tax was computed.

Reciprocal underwriters making the section 835(a) election are allowed a credit on line 14h for the amount of tax paid by the attorney-in-fact that is related to the income received by the attorney-in-fact from the reciprocal in the tax year.

See section 835 and the related regulations for special rules and information regarding the statements required to be attached to the return.

**Tax Computation Worksheet for Members of a Controlled Group**  
(keep for your records)

**Note.** Each member of a controlled group must compute its tax using this worksheet.

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

## Line 6. Alternative minimum tax (AMT).



A corporation that is not a small corporation exempt from the AMT (see page 8) 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 corporation.** A corporation is treated as a small corporation exempt from the AMT for its tax year beginning in 2004 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
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 2004 did not exceed \$7.5 million (\$5 million if the corporation had only 1 prior tax year).

**Line 8a. Foreign tax credit.** 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, Foreign Tax Credit—Corporations.

### Line 8b. Other Credits

Include any other credits on line 8b. On the dotted line to the left of the entry space, write the amount of the credit and identify it.

**Possessions tax credit.** 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 Tax Credit (under Sections 936 and 30A).

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

**Qualified electric vehicle (QEV) credit.** Include on line 8b any credit from Form 8834, Qualified Electric Vehicle Credit.

Vehicles that qualify for this credit are not eligible for the deduction for clean-fuel vehicles under section 179A.

### Line 8c. General Business Credit

Enter on line 8c the corporation's total general business credit.

If the corporation is filing Form 8844, Empowerment Zone and Renewal Community Employment Credit, or Form 8884, New York Liberty Zone Business Employee Credit, 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 8c.

If the corporation is required to file Form 3800, General Business Credit, check the "Form 3800" box and include the allowable credit on line 8c.

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 8c the allowable credit from the applicable form listed below.

- Investment Credit (Form 3468).
- Work Opportunity Credit (Form 5884).
- Credit for Alcohol Used as Fuel (Form 6478).
- Credit for Increasing Research Activities (Form 6765).
- Low-Income Housing Credit (Form 8586).
- Disabled Access Credit (Form 8826).
- Enhanced Oil Recovery Credit (Form 8830).
- Renewable Electricity and Refined Coal Production Credit (Form 8835).
- Indian Employment Credit (Form 8845).
- Credit for Contributions to Selected Community Development Corporations (Form 8847).
- Welfare-to-Work Credit (Form 8861).
- Biodiesel Fuels Credit (Form 8864).
- 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).
- Low Sulfur Diesel Fuel Production Credit (Form 8896).

**Line 8d. Credit for prior year minimum tax.** 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 2003 nonconventional source fuel credit or qualified electric vehicle credit was disallowed solely because of the tentative minimum tax limitation. See section 53(d).

**Line 8e. Qualified zone academy bond credit.** Enter the amount of any credit from Form 8860, Qualified Zone Academy Bond Credit.

**Line 10. Foreign corporations.** A foreign corporation carrying on an insurance business in the United States is taxed as a domestic insurance company

on its income effectively connected with the conduct of a trade or business in the United States (see sections 864(c) and 897 for definition).

Generally, any other U.S.-source income received by the foreign corporation is taxed at 30% (or at a lower treaty rate) under section 881. If the corporation has this income, attach a schedule showing the kind and amount of income, the tax rate, and the amount of tax. Enter the tax on line 9. However, see *Reduction of section 881 tax*, below.

**Note.** Interest received from certain portfolio debt investments that were issued after July 18, 1984, is not subject to the tax. See section 881(c) for details.

See section 842 for more information.

**Minimum effectively connected net investment income.** See section 842(b) and Notice 89-96, 1989-2 C.B. 417, for the general rules for computing this amount. Also, see Rev. Proc. 2004-55, 2004-34 I.R.B. 343, for the domestic asset/liability percentages and domestic investment yields needed to compute this amount.

Any additional income required by section 842(b) must be included in taxable income (e.g., Schedule A, line 13).

### Reduction of section 881 tax.

Additional taxes resulting from the net investment income adjustment may offset a corporation's section 881 tax on U.S.-source income. The tax reduction is determined by multiplying the section 881 tax by the ratio of the amount of income adjustment to income subject to the section 881 tax, computed without the exclusion for interest on state and local bonds or income exempted from taxation by treaty. See section 842(c)(2). Attach a statement showing how the reduction under section 881 was figured. Enter the net tax imposed by section 881 on line 10.

**Line 11. Personal holding company tax.** A corporation (other than a corporation described in section 542(c)) is taxed as a personal holding company (PHC) under section 542 if:

- At least 60% of its adjusted ordinary gross income for the tax year is PHC 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), U.S. Personal Holding Company Tax, for definitions and details on how to figure the tax.

A foreign PHC (defined in section 552) must file Form 5471.

### Line 12. Other Taxes

Include any of the following taxes and interest in the total on line 12. 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, for details.

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

**Other.** Additional taxes and interest amounts can be included in the total entered on line 12. 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 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).
- Interest on deferred tax attributable to certain nondealer installment obligations (section 453A(c)).
- Interest due on deferred gain (section 1260(b)).
- For tax years beginning after October 22, 2004, tax on notional shipping income. See *Income from qualifying shipping activities* on page 10.

**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 12 and identify the applicable Code section and the type of tax or interest.

### Line 13. Total Tax

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 13. See Form 8621, Part V, and *How to report* below.

Subtract any deferred tax on the corporation's share of undistributed earnings of a qualified electing fund (see Form 8621, Part II).

**How to report.** Attach a schedule showing the computation of each item included in, or subtracted from, the total for line 13. On the dotted line next to line 13, specify (a) the applicable Code section, (b) the type of tax, and (c) the amount of tax.

**Line 14b. Prior year(s) special estimated tax payments to be applied.** The amount entered on line 14b must agree with the amount(s) from Form 8816, Part III, line 11. See Form 8816 and section 847 for additional information.

**Line 14c. Estimated tax payments.** Enter any estimated tax payments the corporation made for the tax year. Do not include any amount being applied on line 14d.

**Line 14d. Special estimated tax payments.** If the deduction under section 847 is claimed on Schedule A, line 27, special estimated tax payments must be made in an amount equal to the tax benefit of the deduction. These payments must be made on or before the due date (without regard to extensions) of this tax return. See Form 8816 and section 847(2) for additional information.

**Tax benefit rule.** Section 847(8) requires that if a corporation carries back net operating losses or capital losses that arise in years after a year in which a section 847 deduction was claimed, then the corporation must recompute the tax benefit attributable to the previously claimed section 847 deduction taking into account the loss carrybacks. Tax benefits also include those derived from filing a consolidated return with another insurance company (without regard to section 1503(c)).

Therefore, if the recomputation changes the amount of the section 847 tax benefit, then the taxpayer must provide a computation schedule and attach it to Form 8816.

**Line 14h. Credit by reciprocal for tax paid by attorney-in-fact under section 835(d).** Enter the amount of tax paid by an attorney-in-fact as a result of income received by the attorney-in-fact from the reciprocal during the tax year. For more information, see section 835, the related regulations, and the instructions for line 5 on page 7.

**Line 14i. Other credits and payments.** Enter the amount of any other credits the corporation may take and/or payments made. Write to the left of the entry space, an explanation of the entry.

**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 14i. Write the amount withheld and the words "Backup Withholding" on the dotted line to the left of the entry space for line 14i.

**Line 14j. Total payments.** Add the amounts on lines 14f through 14i and enter the total on line 14j.

**Line 15. 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 2004 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.)

If Form 2220 is attached, check the box on line 15 and enter the amount of any penalty on that line.

**Line 18. Electronic deposit of tax refund of \$1 million or more.** If the corporation is due a refund of \$1 million or more and wants it electronically 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 8302 and attach it to the corporation's tax return.

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## Schedule A—Taxable Income

**Gross income.** Under section 832, gross amounts of underwriting and investment income should be computed on the basis of the underwriting and investment exhibit of the NAIC annual statement to the extent not inconsistent with the Internal Revenue Code and its Regulations.

**Extraterritorial income.** Gross income generally does not include extraterritorial income that is qualifying foreign trade income. However, the extraterritorial income exclusion is reduced by 20% for transactions after 2004, 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 31.

**Income from qualifying shipping activities.** For tax years beginning after October 22, 2004, the corporation's gross income does not include income from qualifying shipping activities (as defined in section 1356) 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 under section 1359.

Report the section 1352(1) tax on page 1, line 4, and report the section 1352(2) tax on page 1, line 12. For page 1, line 12, check the "Other" box and attach a schedule that shows the computation of the section 1352(2) amount.

**Note.** In computing the amounts for lines 2, 3, and 4, take all interest, dividends, or rents received during the year, add interest, dividends, or rents due and accrued at the end of the tax year, and deduct interest, dividends, or rents due and accrued at the end of the preceding tax year. For rules regarding the accrual of dividends, see Regulations section 1.301-1(b).

**Line 3a, column (a). Gross interest.** Enter the gross amount of interest income, including all tax-exempt interest.

**Line 3b, column (a).** Section 103(a) excludes interest on state or local bonds from gross income.

This exclusion does not apply to any:

1. Private activity bond which is not a qualified bond as defined by section 141;
2. Arbitrage bond as defined by section 148; or
3. Bonds not meeting the requirements of section 149 (regarding the registration of tax-exempt bonds).

**Lines 3a and 3b, column (b). Amortization of premium.** Enter on line 3a, column (b), the total amortization of bond premium, including amortization on tax-exempt bonds. Enter on line 3b, column (b), the amortization of bond premium on tax-exempt bonds only.

**Note.** Insurance companies electing to amortize discount for tax purposes must reduce the amortization of premium by any amortization of discount.

**Line 4. Gross rents.** Enter gross rents, computed as indicated under the instructions for *Gross income* above.

Deduct expenses, such as repairs, interest, taxes, and depreciation, on the proper lines for deductions.

**Line 6. Capital gain net income.** Every sale or exchange of a capital asset must be reported in detail on Schedule D (Form 1120), Capital Gains and Losses, even if there is no gain or loss.

Generally, losses from sales or exchanges of capital assets are only allowed to the extent of gains. However, corporations taxed under section 831 may claim losses from capital assets sold or exchanged to get funds to meet abnormal insurance losses and to pay dividends and similar distributions to policyholders. Do not include those types of losses here, but instead, report them on Schedule G.

The net capital loss for these corporations is the amount by which losses for the year from sales or exchanges of capital assets exceed the gains from these sales or exchanges plus the smaller of:

1. Taxable income (computed without gains or losses from sales or exchanges of capital assets); or
2. Losses from the sale or exchange of capital assets sold or exchanged to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders.

Subject to the limitations in section 1212(a), a net capital loss can be carried back 3 years and forward 5 years as a short-term capital loss.

**Line 8. Certain mutual fire or flood insurance company premiums.** A mutual fire or flood insurance company whose principal business is the issuance of policies (1) for which the premium deposits are the same (regardless of the length of the term the policies are written for) and (2) under which the unabsorbed portion of such premium deposits not required for losses, expenses, or establishment of reserves is returned or credited to the policyholder on cancellation or expiration of the policy, must include in income an amount equal to 2% of the premiums earned on insurance contracts during the tax year with respect to such policies after deduction of premium deposits returned or credited during the same tax year. See section 832(b)(1)(D).

**Line 9. Income on account of special income and deduction accounts.** Corporations which write the kinds of insurance below must maintain the following special accounts. A corporation which writes:

1. Mortgage guaranty insurance, must maintain a mortgage guaranty account;
2. Lease guaranty insurance, must maintain a lease guaranty account; and

3. Insurance on obligations the interest on which is excludable from gross income under section 103, must maintain an account with respect to insurance on state and local obligations.

Amounts required to be subtracted from these accounts under sections 832(e)(5) and 832(e)(6) must be reported as income on line 9. See section 832(e) for more information.

**Line 10. Income from protection against loss account.** Although section 1024 of P.L. 99-514 repealed section 824 relating to the protection against loss (PAL) account, PAL account balances are includible in income as though section 824 were still in effect. Attach a schedule showing the computation.

**Line 11. Mutual interinsurers or reciprocal underwriters—decrease in subscriber accounts.** Enter the decrease for the tax year in savings credited to subscriber accounts of a mutual insurance company that is an interinsurer or reciprocal underwriter.

**Line 12. Income from a special loss discount account.** Enter the amount from Form 8816, Part II, line 6.

**Line 13. Other Income.** Enter any other taxable income not reported on lines 1 through 12. 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 13. Examples of other income to report on line 13 are:

1. The amount of credit for alcohol used as fuel (determined without regard to the limitation based on tax) entered on Form 6478, Credit for Alcohol Used as Fuel.
2. 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.
3. The amount of any deduction previously taken under section 179A that is subject to recapture. The corporation must recapture the benefit of any allowable deduction for clean-fuel vehicle property (or clean-fuel vehicle refueling property) if the property later ceases to qualify. See Regulations section 1.179A-1 for details.
4. Ordinary income from trade or business activities of a partnership (from Schedule K-1 (Form 1065 or Form 1065-B)). Do not offset ordinary losses against ordinary income. Instead, include the losses on line 31. 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.

## Deductions

### Limitations on Deductions

**Section 263A uniform capitalization rules.** The uniform capitalization rules of section 263A require corporations to capitalize certain costs.

For details on the uniform capitalization rules, see Regulations sections 1.263A-1 through 1.263A-3.

#### 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 certain deductions. 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. For costs paid or incurred before October 23, 2004, the corporation must capitalize them unless it elects to amortize these costs 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 deductible must be amortized ratably over a 180-month period beginning with the month the corporation begins business operations.

For more details on the election for business start-up costs, see section 195 and attach the statement required by Regulations section 1.195-1(b). For more details on the election for organizational costs, see section 248 and attach the statement required by Regulations

section 1.248-1(c). Report the deductible amount of these costs and any amortization on line 31, Schedule A. For amortization that begins during the 2004 tax year, complete and attach Form 4562.

**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 by the amount of the current year credit.

- Work opportunity credit.
- Research credit.
- Disabled access credit.
- Enhanced oil recovery credit.
- Empowerment zone and renewal community employment credit.
- Indian employment credit.
- Welfare-to-work credit.
- Credit for small employer pension plan startup costs.
- Credit for employer-provided childcare facilities and services.
- New York Liberty Zone business employee credit.
- 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.

#### Line 15. Compensation of officers.

Enter deductible officers' compensation on line 15. Do not include compensation deductible elsewhere on the return, such as 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 line 15. (See *Disallowance of deduction for employee compensation in excess of \$1 million*, below.) Attach a schedule for all officers using the following columns:

1. Name of officer.
2. Social security number.
3. Percentage of time devoted to business.
4. Amount of compensation.

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 16. 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 8844, Empowerment Zone and Renewal Community Employment Credit, line 2,
- Form 8845, Indian Employment Credit, line 4,
- Form 8861, Welfare-to-Work Credit, line 2, and
- Form 8884, New York Liberty Zone Business Employee Credit, line 2.

Do not include salaries and wages deductible elsewhere on the return, such as 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 the personal use of a car, do not deduct as wages the amount allocated for depreciation and other expenses that are claimed elsewhere on the return (e.g., Schedule A, line 22 or line 31).*

**Line 18. 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 the 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 12/31/03 and before 1/1/05 . . .	\$17,500
After 12/31/02 and 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 2005 will be published in the Internal Revenue Bulletin in early 2005.

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

**Line 19. 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.

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

**Line 20a. 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.

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).
- 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 section 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 20b. Less tax-exempt interest expense.** Enter interest paid or accrued during the tax year 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).

**Line 21. 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.

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 may not be more than 10% of taxable income (line 37, Schedule A) computed without regard to the following.

- Any deduction for contributions.
- The deduction for dividends received.
- 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).

**Carryover.** Charitable contributions over the 10% limitation may not be

deducted for the tax year but may be carried over to the next 5 tax years.

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

For more information on charitable contributions, including substantiation and recordkeeping requirements, see section 170 and the related regulations and Pub. 526, Charitable Contributions.

**Contributions of property other than cash.** If a corporation (other than a closely held or personal service corporation) contributes property other than cash and 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.

If the corporation made a "qualified conservation contribution" under section 170(h), also include the FMV of the underlying property before and after the donation, as well as the type of legal interest contributed, and describe the conservation purpose benefited by the donation. If a contribution carryover is

included, show the amount and how it was determined.

**Contributions after June 3, 2004.**

For contributions of certain property made after June 3, 2004, a corporation must file Form 8283 and get a qualified appraisal if claiming a deduction of more than \$5,000. Do not attach the appraisal to the tax return unless claiming a deduction of more than \$500,000 or, for art, a deduction of \$20,000 or more. See Form 8283.

**Contributions of used vehicles.**

Special rules apply to contributions after 2004 of used motor vehicles, boats, or airplanes with a claimed value of more than \$500. See section 170(f)(12).

**Reduced deduction for contributions of certain property.** For a charitable contribution of property, the corporation must reduce the contribution by the sum of:

- The ordinary income and short-term capital gain that would have resulted if the property were sold at its FMV and
- For certain contributions, the long-term capital gain that would have resulted if the property were sold at its FMV.

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

- Contributions of tangible personal property for use by an exempt organization for a purpose or function unrelated to the basis for its exemption,
- Contributions of any property to or for the use of certain private foundations except for stock for which market quotations are readily available (section 170(e)(5)), and
- Any patent or certain other intellectual property contributed after June 3, 2004. See section 170(e)(1)(B). However, the corporation can deduct certain qualified donee income from this property. See section 170(m).

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

- Inventory and other property to certain organizations for use in the care of the ill, needy, or infants (see section 170(e)(3) and Regulations section 1.170A-4A);
- 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) (see section 170(e)(4)); and
- Computer technology and equipment for educational purposes. See section 170(e)(6).

**Line 22. Depreciation.** Include on line 22 depreciation and the part of the cost that the corporation elected to expense under section 179 of certain property. See Form 4562 and its instructions.

**Line 23. Depletion.** See sections 613 and 613A for percentage depletion rates applicable to natural deposits. Also, see

section 291 for the limitation on the depletion deduction for iron ore and coal (including lignite).

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 24. Pension, profit-sharing, etc., plans.** 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 25. Employee benefit programs.** 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 24.

**Line 27. Additional deduction.** Enter on line 27, the total from Form 8816, Part II, line 5.

Any insurance company taking the additional deduction must:

- Make special estimated tax payments equal to the tax benefit from the deduction and
- Establish and maintain a Special Loss Discount Account. See section 847 and Form 8816 for more information.

**Line 29. Dividends to policyholders.** Enter the total dividends and similar distributions paid or declared to policyholders, as policyholders, except in the case of a mutual fire insurance company exclusively issuing perpetual policies. Whether dividends have been paid or declared should be determined

according to the method of accounting employed by the insurance company.

**Dividends and similar distributions** include amounts returned or credited to policyholders on cancellation or expiration of policies issued by a mutual fire or flood insurance company:

1. Where the premium deposits for the policy are the same (regardless of the length of the policy) and
2. The unabsorbed portion of the premium deposits not required for losses, expenses, or establishment of reserves is returned or credited to the policyholder on cancellation or expiration of the policy.

In the case of a qualified group self-insurers fund, the fund's deduction for policyholder dividends is allowed no earlier than the date the state regulatory authority determines the amount of the policyholder dividend that may be paid. See section 6076 of the Technical and Miscellaneous Revenue Act of 1988 ("Act of 1988").

**Line 30. Mutual interinsurers or reciprocal underwriters—increase in subscriber accounts.** A mutual insurance company that is an interinsurer or reciprocal underwriter may deduct the increase in savings credited to subscriber accounts for the tax year.

Savings credited to subscriber accounts means the surplus credited to the individual accounts of subscribers before the 16th day of the 3rd month following the close of the tax year. This is true only if the corporation would be required to pay this amount promptly to a subscriber if the subscriber ended the contract when the corporation's tax year ends. The corporation must notify the subscriber as required by Regulations section 1.823-6(c)(2)(v). The subscriber must treat any savings credited to the subscriber's account as a dividend paid or declared.

**Line 31. Other deductions.** Attach a schedule, listing by type and amount, all allowable deductions under sections 832(c)(1) and (10) (net of the annual statement change in undiscounted unpaid loss adjustment expenses) that are not deductible on lines 15 through 30. Examples of amounts to include are:

- Certain business start-up and organizational costs that the corporation elects to deduct. See page 11.
- 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 13. 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.

- Extraterritorial income exclusion (from Form 8873, line 52a or 52b).
- Deduction for clean-fuel vehicle and certain refueling property (see Pub. 535).
- Dividends paid in cash on stock held by an employee stock ownership plan.

However, a deduction may only be taken if, according to the plan, the dividends are:

- a. Paid in cash directly to the plan participants or beneficiaries;
- b. 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;
- c. At the election of the participants or their beneficiaries; (i) payable as provided under a or b above or (ii) paid to the plan and reinvested in qualifying employer securities; or
- d. 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 fines or penalties paid to a government for violating any law.*

#### **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 more 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 may not 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 use of a facility (such as a yacht or hunting lodge) for an activity usually considered entertainment, amusement, or recreation.

**Amounts treated as compensation.** Generally, the corporation may be able to deduct otherwise nondeductible meals, travel, and entertainment 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 deduction for otherwise nondeductible meals, travel, and entertainment expenses incurred after October 22, 2004, is limited to the amount treated as compensation. See section 274(e)(2).

**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. For information on contributions to charitable organizations that conduct lobbying activities, see section 170(f)(9). For more information on lobbying expenses, see section 162(e).

For more information on other deductions that may apply to corporations, see Pub. 535.

**Line 32. Total deductions.** Insurance companies that issue specified insurance contracts (as defined in section 848(e)(1)) are generally required to amortize policy acquisition expenses on a straight-line basis over a period of 120 months beginning with the 1st month in the 2nd half of the tax year (section 848(a)). Reduce total deductions on line 32 by the amount required to be capitalized under section 848. Attach a schedule showing all computations. See section 848 and its regulations for special rules, definitions, and exceptions. Also see Schedule G, Form 1120-L, and its instructions for more information.

**Line 34b. Deduction on account of the special income and deduction accounts.** Enter the total of the amounts required to be added under sections 832(e)(4) and (6). However, no deduction is permitted unless tax and loss bonds are purchased in an amount equal to the tax benefit of the deduction. See section 832(e).

**Note.** The deduction on account of the special income and deduction accounts is limited to taxable income for the tax year (computed without regard to this deduction or to any carryback of a net operating loss).

**Line 36b. Net operating loss deduction.** A corporation can use the net operating loss (NOL) incurred in one tax year to reduce its taxable income in another tax year.

Enter on line 36b the total NOL carryovers from other tax years, but do not enter more than the corporation's taxable income (after the dividends-received deduction). Attach a schedule showing the computation of the NOL deduction. Also complete item 12 on Schedule I.

The following special rules apply.

- 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).

An NOL cannot be carried to or from any tax year for which the insurance company is not subject to tax under section 831(a), or to any tax year if, between the tax year from which the loss is being carried and such tax year, there is an intervening tax year for which the insurance company was not subject to tax imposed by section 831(a).

For details on the NOL deduction, see Pub. 542, section 172, section 844, and Form 1139, Corporation Application for Tentative Refund.

**Line 37. Taxable income.** If line 37 (figured without regard to the rules discussed under *Minimum taxable income*, below) is zero or less, the corporation may have an NOL that may 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 may 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 I, item 11, on page 19.

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.

**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 line 10(b) and line 24(b) of Form 1120-PC, Schedule C.
- 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.

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## Schedule B, Part I— Taxable Investment Income of Electing Small Companies

**Note.** (1) Once an election under section 831(b) is made to be taxed only on investment income, it can only be revoked with the consent of the Secretary, and (2) a corporation making this election must include on line 8, gross investment income, any amount subtracted from a protection against loss account.

### Income

**Line 1a, column (a). Gross interest.** Enter the gross amount of interest income including all tax-exempt interest income.

**Line 1b, column (a). Interest exempt under section 103.** Enter the amount of interest on state and local bonds that is exempt from taxation under section 103. See the instructions for Schedule A, line 3b, column (a), for more information.

**Lines 1a and 1b, column (b). Amortization of premium.** Enter on line 1a, column (b), the total amortization of premium on tax-exempt bonds.

Enter on line 1b, column (b), the amortization of bond premium on tax-exempt bonds.

**Note.** Insurance companies electing to amortize discount for tax purposes must reduce the amortization of premium by any amortization of discount.

**Line 3. Gross rents.** Enter the gross rents received or accrued during the tax year. Deduct rental expenses such as repairs, interest, taxes, and depreciation on the proper lines in the *Deductions* section.

**Line 5. Gross income from a trade or business, other than an insurance business, and from Form 4797.** Enter the gross income from a trade or business, other than an insurance business, carried on by the insurance company or by a partnership of which the insurance company is a partner. Include section 1245 and section 1250 gains (as modified by section 291), and other gains from Form 4797, Sales of Business Property, on investment assets only.

**Line 6. Income from leases described in sections 834(b)(1)(B) and 834(b)(1)(C).** Enter gross income from entering into, changing, or ending any lease, mortgage, or other instrument or agreement from which the company earns interest, rents, or royalties.

**Line 8. Gross investment income.** If gross investment income includes an amount subtracted from the protection against loss account, write on the dotted line next to line 8, "PAL" and the amount.

### Deductions

**Note.** See section 834(d)(1) regarding the limitation of expenses on real estate owned and occupied in part or in whole by a mutual insurance company.

**Line 9. Real estate taxes.** Enter taxes paid or accrued on real estate owned by the corporation and deductible under section 164.

**Line 10. Other real estate expenses.** Enter all ordinary and necessary real estate expenses, such as fire insurance, heat, light, and labor. Also enter the cost of incidental repairs, such as labor and supplies, that do not add to the property's value or appreciably prolong its life. Do not include any amount paid for new buildings or for permanent improvements or betterments made to increase the value of any property or any amount

spent on foreclosed property before the property is held for rent.

**Line 11. Depreciation.** Enter depreciation on assets only to the extent that the assets are used to produce gross investment income reported on lines 1 through 7 of Schedule B. For more information, see the instructions for line 22, Schedule A.

**Line 12. Depletion.** Enter any allowable depletion on royalty income reported on line 4, Schedule B. See the instructions for line 23, Schedule A, for more information.

**Line 13. Trade or business deductions.** Enter the total deductions related to any trade or business income included in gross investment income under section 834(b)(2). Do not include deductions for any insurance business. Do not include losses from sales or exchanges of capital assets or property used in the business, or from the compulsory or involuntary conversion of property used in the trade or business.

**Line 14. Interest.** See the instructions for lines 20a and 20b, Schedule A.

**Line 17. Investment expenses.** Enter expenses that are properly chargeable as investment expenses. If general expenses are allocated to investment expenses, the total deduction cannot be more than the amount on Schedule B, Part II, line 39. Attach a schedule showing the kind and amount of general expenses. Minor items may be grouped together.

See section 267 for the limitation on deductions for unpaid expenses and interest in transactions between related taxpayers.

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## Schedule B, Part II— Invested Assets Book Values

Use Schedule B, Part II, to compute the limitation on investment expenses under section 834(c)(2) when any general expenses are in part assigned to, or included in, the investment expenses deducted on Schedule B, Part I, line 17.

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## Schedule C—Dividends and Special Deductions

### Definitions

The acquisition date for investments acquired by direct purchase is the trade date rather than the settlement date. For investments not acquired by direct purchase (such as those acquired through transfers among affiliates, tax-free reorganizations, or the liquidation of a subsidiary, etc.), the actual acquisition date should be used

regardless of the holding period determined under section 1223.

A special rule applies in determining the acquisition date of dividends received from affiliates. This rule provides that the portion of any 100% dividend which is related to prorated amounts be treated as received with respect to stock acquired on the later of:

(a) the date the payor acquired the stock or obligation to which the prorated amounts are attributable or

(b) the first day on which the payor and payee were members of the same affiliated group as defined in section 243(b).

Also, if the taxpayer is a member of an affiliated group filing a consolidated return, its determination of dividends received is made as if the group were not filing a consolidated return.

**Prorated amounts** means tax-exempt interest and dividends for which a deduction is allowable under section 243, 244, or 245 (other than 100% dividends).

**100% dividend** means any dividend if the percentage used for purposes of determining the deduction allowable under section 243, 244, or 245(b) is 100%. A special rule applies to certain dividends received by a foreign corporation.

### Lines 1 through 25

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.

**Lines 1 through 9, column (a).** Enter in column (a) of the appropriate line those dividends that are subject to the provisions of section 832(b)(5)(B). This will include:

1. All dividends (other than 100% dividends) received on stock acquired after August 7, 1986, and
2. 100% dividends received on stock acquired after August 7, 1986, to the extent that such dividends are attributable to prorated amounts (see definition above).

In the case of an insurance company that files a consolidated return, the determination with respect to any dividend paid by a member to another

member of the affiliated group is made as if no consolidated return was filed. See section 832(g).

**Line 1.** 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
- Qualify for the 70% deduction under section 243(a)(1).

Also, include on line 1:

- 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.** 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.** Enter dividends that are:

- 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).
- 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 4.** 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.** 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.** 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 foreign corporation by vote and value.

Also include dividends received from a less-than-20%-owned foreign sales corporation (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.** 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 provided in section 245(c)(1)(B).

**Line 8.** 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.

Also, include on line 8 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).

**Line 9.** Enter only those 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 10.** Enter qualifying dividends from Form 8895.

**Line 11, column (b).** Enter foreign dividends not reportable on lines 3, 6, 7, 8, column (b), and 10. Include on line 11 the corporation's share of the ordinary earnings of a qualified electing fund from line 1c, Form 8621. Exclude distributions of amounts constructively taxed in the current year or in prior years under subpart F (sections 951 through 964).

**Line 12, column (b).** Include income constructively received from controlled foreign corporations under subpart F. This amount should equal the total subpart F income reported on Schedule I of Form 5471.

**Line 13, column (b).** Include gross-up for taxes deemed paid under sections 902 and 960.

**Line 14, column (b).** 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)).

**Line 18.** 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 showing how the amount on line 18 was figured.

**Line 25, column (b).** Generally, line 25, column (b), 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).

## Schedule E—Premiums Earned

### Definitions

**Undiscounted unearned premiums** means the unearned premiums shown in the annual statement filed for the year ending with or in the tax year.

**Applicable interest rate** means the annual rate determined under section 846(c)(2) for the calendar year the premiums are received.

**Applicable statutory premium recognition pattern** means the statutory premium recognition pattern in effect for the calendar year the premiums are received, and is based on the statutory premium recognition pattern which applies to premiums received by the corporation in that calendar year. For purposes of the preceding sentence, premiums received during any calendar year will be treated as received in the middle of such year.

**Line 1.** Enter gross premiums written on insurance contracts during the tax year, less return premiums and premiums paid for reinsurance. See Regulations section 1.832-4.

**Lines 2a and 4a.** Include on lines 2a and 4a:

1. All life insurance reserves, as defined in section 816(b) (but determined under section 807) and
2. All unearned premiums of a Blue Cross or Blue Shield organization to which section 833 applies.

**Lines 2b and 4b.** Include on lines 2b and 4b, 90% of unearned premiums for insurance against default in the payment of principal or interest on securities described in section 165(g)(2)(C) (relating to worthless securities) with maturities of more than 5 years.

**Lines 2c and 4c.** The amount of discounted unearned premiums at the end of any tax year must be the present value of those premiums (as of such time and separately with respect to premiums

### Worksheet for Schedule C, line 25 (keep for your records)

1. Refigure the amount from Schedule A, line 35 or Schedule B, line 19, whichever applies, without any adjustment under section 1059 and without any capital loss carryback to the tax year under section 1212(a)(1) . . . . .	_____
2. Enter the sum of the amounts from line 23, column (b) (without regard to wholly owned foreign subsidiary dividends) and line 9, column (b) . . . . .	_____
3. Subtract line 2 from line 1 . . . . .	_____
4. Multiply line 3 by 80% . . . . .	_____
5. Add lines 17, 20, 22, and 23 (without regard to FSC dividends), column (b), and the portion of the deduction on line 18, column (b), that is attributable to dividends received from 20%-or-more-owned corporations . . . . .	_____
6. Enter the smaller of line 4 or line 5. If line 5 is greater than line 4, stop here; enter the amount from line 6 on line 25, column (b). Do not complete the rest of this worksheet . . . . .	_____
7. Enter the total amount of dividends received from 20%-or-more-owned corporations that are included on lines 2, 3, 5, 7, and 8 (without regard to FSC dividends), column (b) . . . . .	_____
8. Subtract line 7 from line 3 . . . . .	_____
9. Multiply line 8 by 70% . . . . .	_____
10. Subtract line 5 from line 25, column (b) (without regard to FSC dividends) . . . . .	_____
11. Enter the smaller of line 9 or line 10 . . . . .	_____
12. <b>Dividends-received deduction after limitation (section 246(b)).</b> Add lines 6 and 11. Enter the result here and on line 25, column (b) . . . . .	_____



received in each calendar year) determined by using:

1. The amount of the undiscounted unearned premiums at such time;
2. The applicable interest rate; and
3. The applicable statutory premium recognition pattern.

**Lines 2d and 4d.** Include on lines 2d and 4d, 80% of the total of all unearned premiums not reported on lines 2a through 2c, or 4a through 4c, respectively.

A reciprocal or interinsurer required under state law to reflect unearned premiums on its annual statement net of premium acquisition expenses should increase its unearned premiums by the amount of such acquisition expenses prior to making the computation on lines 2d and 4d. See section 832(b)(7)(E).

**Line 6.** Transitional adjustments apply to companies which become taxable under section 831(a). See section 832(b)(7)(D) for more information.

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## Schedule F—Losses Incurred

**Line 1. Losses paid.** Enter the total losses paid on insurance contracts during the tax year less salvage and reinsurance recovered during the tax year.

**Lines 2a and 4a. Unpaid losses on life insurance contracts.** Unpaid losses must be adjusted for recoveries of reinsurance. The amounts of expected recoveries should be estimated based on the facts in each case and the corporation's experience with similar cases. See Regulations section 1.832-4(b).

**Lines 2b and 4b. Discounted unpaid losses outstanding.** Enter all discounted unpaid losses as defined in section 846.

Section 846 provides that the amount of discounted unpaid losses must be computed separately by each line of business (multiple peril lines must be treated as a single line of business) and by each accident year and must be equal to the present value of those losses determined by using the:

1. Amount of the undiscounted unpaid losses,
2. Applicable interest rate, and
3. Applicable loss payment pattern.

Special rules apply with respect to:

- Unpaid losses related to disability insurance (other than credit disability insurance),
- Noncancelable accident and health insurance,
- Cancelable accident and health insurance, and
- International and reinsurance lines of business.

With regard to the special rules for discounting unpaid losses on accident and health insurance (other than disability income insurance), unpaid losses are assumed to be paid in the middle of the year following the accident year.

Generally, the amount of undiscounted unpaid losses means the unpaid losses and unpaid loss adjustment expenses shown in the annual statement. However, see Regulations section 1.846-1(a)(1) referring to Regulations section 1.832-4(b) relating to the determination of unpaid losses.

Under section 832(b)(5)(A), unpaid losses must be adjusted to take into account estimated recoveries due to salvage and reinsurance for those losses. If the amounts shown in the annual statement were determined on a discounted basis and if the extent to which these losses were discounted can be determined on the basis of information disclosed on or with the annual statement, the amount of the undiscounted unpaid losses must be recomputed to eliminate any reduction caused by such discounting. In no event can the amount of discounted unpaid losses with respect to any line of business for an accident year exceed the total amount of unpaid losses with respect to any line of business for an accident year as reported on the annual statement. Also see Regulations section 1.832-4(d) regarding increasing unpaid losses shown on the annual statement by salvage recoverable. Also see Rev. Proc. 92-77, 1992-2 C.B. 454.

The applicable interest rate for each calendar year and the applicable loss payment pattern for each accident year for each line of business are determined by the IRS. The applicable interest rate and loss payment patterns for 2004 are published in Rev. Proc. 2004-69, 2004-49 I.R.B. 906. The applicable interest rates and loss payment pattern for 2002 and 2003 are published in Rev. Proc. 2003-17, 2003-6 I.R.B. 427, and Rev. Proc. 2004-9, 2004-2 I.R.B. 275, respectively.

Corporations having sufficient historical experience to determine a loss payment pattern may, under certain circumstances, elect under section 846(e) to use their own historical experience (instead of the loss payment patterns determined by the IRS). If this election is made, the loss payment patterns will be based on the most recent calendar year for which an annual statement was filed before the beginning of the accident year. The election will not apply to any international or reinsurance line of business. If the corporation makes this election, check the "Yes" column for question 7 in Schedule I, Other Information. For more information, see section 846(e), Regulations section

1.846-2, and Rev. Proc. 92-76, 1992-2 C.B. 453.

**Note.** There is a special application of the "fresh start" provision for an insurance company that is not subject to tax under section 831(a) for its first tax year beginning after December 31, 1986, because (1) it is described in section 501(c) or (2)—it is subject to tax under section 831(b) on its investment income.

If the insurance company later becomes subject to tax under section 831(a), the rules relating to the fresh start under the discounting provisions are applied by treating the last tax year before the year in which the insurance company becomes subject to tax under section 831(a) as the insurance company's last tax year beginning before 1987. See section 1010(e) of the Technical and Miscellaneous Revenue Act of 1988 and Notice 88-100, 1988-2 C.B. 439.

**Lines 6 and 7. Estimated salvage and reinsurance recoverable.** Enter on lines 6 and 7 the amount of estimated salvage and reinsurance recoverable. The amount of estimated salvage recoverable must be determined on a discounted basis. The estimated salvage discount factors for 2003 are published in Rev. Proc. 2004-10, 2004-2 I.R.B. 288. The 2004 estimated salvage and reinsurance rates are published in Rev. Proc. 2004-70, 2004-49 I.R.B. 918. Also see Regulations section 1.832-4.

**Line 9. Tax-exempt interest subject to section 832(b)(5)(B).** Enter the amount of tax-exempt interest received or accrued during the tax year on investments made after August 7, 1986. For information regarding the determination of the acquisition date of an investment, see the instructions for Schedule C.

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## Schedule G—Other Capital Losses

Capital assets are considered sold or exchanged to provide funds to meet abnormal insurance losses and to pay dividends and make similar distributions to policyholders to the extent that the gross receipts from their sale or exchange are not more than the amount by which the sum of dividends and similar distributions paid to policyholders, losses paid, and expenses paid for the tax year is more than the total on line 9, Schedule G.

Total gross receipts from sales of capital assets (line 12, column (c)) must not be more than line 10. If necessary, the corporation may report part of the gross receipts from a particular sale of a capital asset on this schedule and the rest on Schedule D (Form 1120). Otherwise, do not include on Schedule D (Form

1120) any sales reported on this schedule.

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## Schedule H—Special Deduction and Ending Adjusted Surplus for Section 833 Organizations

**Line 5. Beginning adjusted surplus.** If the corporation was a section 833 organization in 2003, it should enter the amount from Schedule H, line 10, of its 2003 Form 1120-PC.

Generally, the adjusted surplus as of the beginning of any tax year is an amount equal to the adjusted surplus as of the beginning of the preceding tax year:

1. Increased by the amount of any adjusted taxable income for the preceding tax year or
2. Decreased by the amount of any adjusted net operating loss for the preceding tax year.

If 2004 is the first tax year the taxpayer qualifies as a section 833 organization, see section 833(c)(3)(C) to determine the adjusted surplus as of the beginning of the 2004 tax year.

For purposes of the computation of the adjusted surplus, the terms “adjusted taxable income” and “adjusted net operating loss” mean the taxable income or the net operating loss, respectively, determined with the following modifications:

1. Without regard to the deduction determined under section 833(b)(1);
2. Without regard to any carryover or carryback to that tax year; and
3. By increasing gross income by an amount equal to the net exempt income for the tax year.

**Line 6. Special deduction.** The deduction for any tax year is limited to taxable income for that tax year determined without regard to this deduction.

**Note.** Under section 833(b)(4), any determination under section 833(b) must be made by only taking into account items from the health-related business of the corporation.

**Line 8a. Adjusted tax-exempt income.** Reduce the total tax-exempt interest received or accrued during the tax year by any amount (not otherwise deductible) which would have been allowable as a deduction for the tax year if such interest were not tax-exempt. Enter the result on line 8a.

**Line 8b. Adjusted dividends-received deduction.** Reduce the total amount allowed as a deduction under sections 243, 244, and 245 by the amount of any decrease in deductions allowable for the

tax year because of section 832(b)(5)(B) when the decrease is caused by the deductions under sections 243, 244, and 245. Enter the result on line 8b.

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## Schedule I—Other Information

The following instructions apply to page 7, Form 1120-PC. Be sure to complete all of the items that apply to the corporation.

### Question 4

Check the “Yes” box 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 6).

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).

### Question 6

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 6a the percentage owned by the foreign person specified in question 6. On line 6b, enter the name of the owner’s country.

**Note.** If there is more than one 25%-or-more foreign owner, complete lines 6a and 6b 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).
- 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. 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 10

Show any tax-exempt interest received or accrued. Include any exempt-interest dividends received as a shareholder in a mutual fund or other RIC.

### Item 11

If the corporation has an NOL for its 2004 tax year, it can elect under section 172(b)(3) 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, section 172, 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)(i) or (ii).

### Item 12

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 2004. Do not reduce the amount by any NOL deduction reported on Schedule A, line 36b.

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## Schedule L—Balance Sheets per Books

**Note.** All insurance companies required to file Form 1120-PC must complete Schedule L.

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

In the case of a consolidated return, report total consolidated assets, liabilities, and shareholder's equity for all corporations joining in the return. See the discussion of consolidated returns on page 3 of these instructions.

**Line 1. Cash.** Include certificates of deposit as cash on this line.

**Line 5. Tax-exempt securities.** 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 18. Insurance liabilities.** Include on this line:

- Undiscounted unpaid losses.
- Loss adjustment expenses.
- Unearned premiums.

See section 846 for more information.

**Line 27. Adjustments to shareholders' equity.** 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 27 is a negative amount, enter the amount in parentheses.

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## Schedule M-1—Reconciliation of Income (Loss) per Books With Income per Return

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

Include on line 5c any of the following.

- Meals 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 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 7a. Tax-exempt interest.** 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 I, item 10.

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**Privacy Act and Paperwork Reduction Act Notice.** We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax. Section 6109 requires return preparers to provide their identifying number 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 this form will vary depending on individual circumstances. The estimated average times are:

**Recordkeeping** . . . . . 97 hr., 48 min.

**Learning about the law or the form** . . . . . 37 hr., 40 min.

**Preparing the form** . . . . . 68 hr., 50 min.

**Copying, assembling, and sending the form to the IRS** . . . . . 8 hr., 2 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. You can write to the 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 office. Instead, see *Where To File* on page 2.



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**Index**

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<b>A</b>	<b>E</b>	<b>N</b>	Special estimated tax payments:
Accounting methods:	Electronic deposit of tax refund of \$1 million or more ..... 9	NAIC annual statement ..... 4	Prior year(s) special estimated tax payments to be applied ..... 9
Change in accounting method ..... 4	Electronic Federal Tax Payment System (EFTPS):	Name Change ..... 6	Tax benefit rule ..... 9
Accounting periods ..... 4	Depositing on time ..... 5	Net operating loss ..... 14	Stock ownership in foreign corporations ..... 4
Address Change ..... 6	Employer identification number ..... 6	<b>O</b>	
Adjustments to shareholders' equity ..... 20	Estimated tax payments ..... 5, 9	Other deductions ..... 13	
Affiliated group ..... 19	Estimated tax penalty ..... 9	Overpaid estimated tax ..... 5	
Amended Return ..... 6	Extension of time to file ..... 3	Owner's country ..... 19	
Assembling the return ..... 4			
<b>B</b>	<b>F</b>	<b>P</b>	<b>T</b>
Backup withholding ..... 9	Final Return ..... 6	Paid preparer authorization ..... 3	Tax and payments ..... 6
Business startup expenses ..... 11	Foreign corporations ..... 8	Penalties:	Tax computation worksheet for members of a controlled group ..... 7
<b>C</b>	Foreign person ..... 19	Estimated tax penalty ..... 9	Tax rate schedule ..... 7
Charitable contributions ..... 12	Foreign tax credit ..... 8	Late filing of return ..... 5	Tax-exempt securities ..... 20
Consolidated return ..... 3	Forms and publications, how to get ..... 2	Late payment of tax ..... 5	Transactions between related taxpayers ..... 11
Controlled group:	<b>G</b>	Other penalties ..... 5	Transfers to a corporation controlled by the transferor ..... 4
Brother-sister ..... 6	General business credit ..... 8	Trust fund recovery penalty ..... 5	Travel, meals, and entertainment ..... 14
Combined group ..... 6	Golden parachute payments ..... 11	Pension, profit-sharing, etc. plans ..... 13	
Member of ..... 6		Period covered ..... 6	
Parent-subsidiary ..... 6		Personal holding company tax ..... 8	
<b>D</b>	<b>I</b>	<b>R</b>	<b>U</b>
Deductions ..... 11	Insurance liabilities ..... 20	Recordkeeping ..... 5	Unresolved tax issues ..... 1
Definitions:	Interest:	<b>S</b>	<b>W</b>
100% dividend ..... 16	Late payment of tax ..... 5	Schedule:	When to file:
Acquisition date ..... 15	<b>L</b>	A ..... 9	Extension ..... 2
Applicable interest rate ..... 17	Limitation on dividends-received deduction ..... 17	B, Part I ..... 15	Where to file ..... 2
Applicable statutory premium recognition pattern ..... 17	Limitations on deductions ..... 11	B, Part II ..... 15	Who must file:
Prorated amounts ..... 16	Lobbying expenses ..... 14	C ..... 15	Exceptions ..... 2
Undiscounted unearned premiums ..... 17		E ..... 17	Life insurance companies ..... 2
Depository method of tax payment:	<b>M</b>	F ..... 18	Who must sign ..... 3
Deposits With Form 8109 ..... 5	Minimum tax:	G ..... 18	Worksheets:
Electronic deposit requirement:	Alternative ..... 8	H ..... 19	Members of a controlled group, tax computation ..... 7
Depositing on time ..... 5	Prior year, credit for ..... 8	I ..... 19	Schedule C ..... 17