

Instructions for Schedule M-3 (Form 1120)

(Rev. November 2022)

(For use with the December 2019 revision of Schedule M-3 (Form 1120))

**Net Income (Loss) Reconciliation for Corporations
With Total Assets of \$10 Million or More**

Volume 3 of 3



Department of the Treasury
Internal Revenue Service

Instructions for Form 1120 Schedule M-3 (Rev. 11-2022) Catalog Number 54645N
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Note. The entries in columns (a) and (d) of Schedule M-3, line 17, are negative amounts.

Do not report on line 17 or on Form 8916-A amounts such as:

- Amounts reportable on Part II, line 12;
- Any gain or loss from inventory hedging transactions reportable on Part II, line 15;
- Amounts reportable on Part II, line 18;
- Amounts reportable on Part II, line 21;
- Mark-to-market income or (loss) associated with the inventories of dealers in securities under section 475, reportable on Part II, line 16;
- Section 481(a) adjustments related to cost of goods sold or inventory valuation, reportable on Part II, line 19;
- Fines and penalties reportable on Part III, line 12;

- Judgments, damages, awards, and similar costs, reportable on Part III, line 13; and
- Amounts included on Part III, line 34.

Note. Any corporation that files Form 1120 (or Form 1120-C) that (a) is required to file Schedule M-3 (Form 1120) and has less than \$50 million in total assets at the end of the tax year, or (b) is not required to file Schedule M-3 and voluntarily files Schedule M-3, is not required to file Form 8916-A, but may voluntarily do so.

Example 18. Corporation C is a calendar year taxpayer that placed in service 10 depreciable fixed assets in a prior tax year. C is required to file and entirely complete Schedule M-3 for its current tax year. C's total depreciation expense for its current tax year for five of the assets is \$50,000 for financial accounting purposes and \$70,000 for U.S. income tax purposes. C's total annual depreciation expense for its

current tax year for the other five assets is \$40,000 for financial accounting purposes and \$30,000 for U.S. income tax purposes. In addition, C incurs \$200 of meals expenses that C deducts in computing net income for financial accounting purposes. All \$200 of the meals expenses are subject to the 50% limitation under section 274(n). In its financial statements, C treats the \$50,000 depreciation and \$100 of the meals as other costs in computing cost of goods sold. C must include on Form 8916-A and on Schedule M-3, Part II, line 17, column (a), the \$50,000 of depreciation and \$100 of meals. C must also include a temporary difference of \$20,000 in column (b), a permanent difference of (\$50) in column (c), and \$70,050 in column (d) (\$70,000 depreciation and \$50 meals expenses). In addition, C must report on Part III, line 31, for its current tax year income statement, depreciation expense of \$40,000 in column (a), a temporary difference of (\$10,000) in column (b), and \$30,000 in

column (d); and on Part III, line 11, meals expenses of \$100 in column (a), a permanent difference of (\$50) in column (c), and \$50 in column (d). All other cost of goods sold items would be added to the amounts included on Part II, line 17, detailed in this example and reported on Form 8916-A and on Part II, line 17, in the appropriate columns.

Line 18. Sale Versus Lease (for Sellers and/or Lessors)

Note. Also see the instructions for purchasers and lessees in Part III, line 34.

Asset transfer transactions with periodic payments characterized for financial accounting purposes as either a sale or a lease may, under some circumstances, be characterized as the opposite for tax purposes. If the transaction is treated as a lease, the seller/lessor reports the periodic payments as gross rental income and also reports depreciation expense. If the

transaction is treated as a sale, the seller/lessor computes gain from the sale of assets and reports the periodic payments as payments of principal and interest income.

On Part II, line 18, column (a), report the gross profit or gross rental income for financial accounting purposes for all sale or lease transactions that must be given the opposite characterization for U.S. income tax purposes. On Part II, line 18, column (d), report the gross profit or gross rental income for federal income tax purposes. Interest income amounts for such transactions must be reported on Part II, line 13, in column (a) or (d), as applicable. Depreciation expense for such transactions must be reported on Part III, line 31, in column (a) or (d), as applicable. Use columns (b) and (c) of Part II, lines 13 and 18, and Part III, line 31, as applicable to report the differences between columns (a) and (d).

Example 19. Corporation M sells and leases property to customers. M is a calendar year taxpayer that files and entirely completes Schedule M-3. For financial accounting purposes, M accounts for each transaction as a sale. For U.S. income tax purposes, each of M's transactions must be treated as a lease. In its financial statements, M treats the difference in the financial accounting and the U.S. income tax treatment of these transactions as temporary. During its current tax year, M reports in its financial statements \$1,000 of sales and \$700 of cost of goods sold with respect to its current year lease transactions. M receives periodic payments of \$500 in its current year with respect to these current year transactions and similar transactions from prior years and treats \$400 as principal and \$100 as interest income. For financial accounting purposes, M reports gross profit of \$300 (\$1,000 - \$700) and interest income of \$100 from these transactions. For U.S. income tax purposes, M

reports \$500 of gross rental income (the periodic payments) and (based on other facts) \$200 of depreciation deduction on the property. On its current year Schedule M-3, M must report on Part II, line 13, \$100 in column (a), (\$100) in column (b), and zero in column (d). In addition, M must report on Part II, line 18, \$300 of gross profit in column (a), \$200 in column (b), and \$500 of gross rental income in column (d). Lastly, M must report on Part III, line 31, \$200 in columns (b) and (d).

Line 19. Section 481(a) Adjustments

With the exception of a section 481(a) adjustment that is required to be reported on Part II, line 12, for reportable transactions, any difference between an income or expense item attributable to an authorized (or unauthorized) change in method of accounting made for U.S. income tax purposes that results in a section 481(a) adjustment must be reported on Part II, line

19, regardless of whether a separate line for that income or expense item exists in Part II or Part III.

Example 20. Corporation N is a calendar year taxpayer that files and entirely completes Schedule M-3 for its current tax year. N was depreciating certain fixed assets over an erroneous recovery period and, effective for its current tax year, N receives IRS consent to change its method of accounting for the depreciable fixed assets and begins using the proper recovery period. The change in method of accounting results in a positive section 481(a) adjustment of \$100,000 that is required to be spread over 4 tax years, beginning with the current tax year. In its financial statements, N treats the section 481(a) adjustment as a temporary difference. N must report on Part II, line 19, \$25,000 in columns (b) and (d) for its current tax year and each of the subsequent 3 tax years (unless N is otherwise required to

recognize the remainder of the section 481(a) adjustment earlier). N must not report the section 481(a) adjustment on Part III, line 31.

Line 20. Unearned/Deferred Revenue

Report on line 20, column (a), amounts of revenues included in Part I, line 11, that were deferred from a prior financial accounting year. Report on line 20, column (d), amounts of revenues recognizable for U.S. income tax purposes in the current tax year that are recognized for financial accounting purposes in a different year. Also, report on line 20, column (d), any amount of revenues reported on line 20, column (a), that are recognizable for U.S. income tax purposes in the current tax year. Use columns (b) and (c) of line 20, as applicable, to report the differences between columns (a) and (d).

Line 20 must not be used to report income recognized from long-term contracts. Instead, use line 21.

Line 21. Income Recognition From Long-Term Contracts

A deduction for income attributable to domestic production activities is available for specified agricultural or horticultural cooperatives (specified cooperatives). See section 199A(g). Also, see the Instructions for Form 8903.

Line 22. Original Issue Discount and Other Imputed Interest

Report on line 22 any amounts of original issue discount (OID) and other imputed interest. The term "original issue discount and other imputed interest" includes, but is not limited to:

1. The excess of a debt instrument's stated redemption price at maturity

over its issue price, as determined under section 1273;

2. Amounts that are imputed interest on a deferred sales contract under section 483;
3. Amounts treated as interest or OID under the stripped bond rules under section 1286; and
4. Amounts treated as OID under the below-market interest rate rules under section 7872.

**Line 23a. Income Statement
Gain/Loss on Sale, Exchange,
Abandonment, Worthlessness, or
Other Disposition of Assets Other
Than Inventory and Pass-Through
Entities**

Report on line 23a, column (a), all gains and losses on the disposition of assets except for (1) gains and losses on the disposition of inventory, and (2) gains and losses allocated to the corporation from a pass-through entity

(for example, on Schedule K-1) that are included in the net income (loss) of includible corporations reported on Part I, line 11. Reverse the amount reported in column (a) in column (b) or (c), as applicable. The corresponding gains and losses for U.S. income tax purposes are reported on Part II, lines 23b through 23g, as applicable.

Line 23b. Gross Capital Gains From Schedule D, Excluding Amounts From Pass-Through Entities

Report on line 23b gross capital gains reported on Schedule D (Form 1120), Capital Gains and Losses, excluding capital gains from pass-through entities, which must be reported on Part II, line 9, 10, or 11, as applicable.

Line 23c. Gross Capital Losses From Schedule D, Excluding Amounts From Pass-Through Entities, Abandonment Losses, and Worthless Stock Losses

Report on line 23c gross capital losses reported on Schedule D (Form 1120), excluding capital losses from (a) pass-through entities, which must be reported on Part II, line 9, 10, or 11, as applicable; (b) abandonment losses, which must be reported on Part II, line 23e; and (c) worthless stock losses, which must be reported on Part II, line 23f. Do not report on line 23c capital losses carried over from a prior tax year and utilized in the current tax year. See the instructions for Part II, line 24, regarding the reporting requirements for capital loss carryovers utilized in the current tax year.

Line 23d. Net Gain/Loss Reported on Form 4797, Line 17, Excluding Amounts From Pass-Through Entities, Abandonment Losses, and Worthless Stock Losses

Report on line 23d the net gain or loss reported on line 17 of Form 4797, Sales of Business Property, excluding amounts from (a) pass-through entities, which must be reported on Part II, line 9, 10, or 11, as applicable; (b) abandonment losses, which must be reported on Part II, line 23e; and (c) worthless stock losses, which must be reported on Part II, line 23f.

Note. Traders in securities or commodities that have made a valid election under section 475(f) to use the mark-to-market method to account for securities or commodities, see the instructions for Part II, line 16, earlier.

Line 23e. Abandonment Losses

Report on line 23e any abandonment losses, regardless of whether the loss is characterized as an ordinary loss or a capital loss.

Line 23f. Worthless Stock Losses

Report on line 23f any worthless stock loss, regardless of whether the loss is characterized as an ordinary loss or a capital loss. Attach a statement that separately states and adequately discloses each event that gives rise to a worthless stock loss and the amount of each loss.

Line 23g. Other Gain/Loss on Disposition of Assets Other Than Inventory

Report on line 23g any gains or losses from the sale or exchange of property other than inventory that are not reported on lines 23b through 23f.

Line 24. Capital Loss Limitation and Carryforward Used

Report as a positive amount on line 24, column (b) or (c), as applicable, and (d) the excess of the net capital losses over the net capital gains reported on Schedule D (Form 1120) by the corporation. For a U.S. consolidated tax group, the Schedule M-3 adjustment for the amount of the consolidated net capital loss that is disallowed should not be made on the separate consolidating Schedules M-3 of the includible corporations, but on the separate Schedule M-3 for consolidated eliminations (or on Form 8916 in the case of a mixed group) as described under *Completing Schedule M-3 and Certain Allocations, Limitations, and Carryovers*, earlier.

If the corporation utilizes a capital loss carryforward on Schedule D in the current tax year, report the carryforward utilized as a negative amount on Part II, line 24, column

(b) or (c), as applicable, and column (d). For a U.S. consolidated tax group, the Schedule M-3 adjustment for the amount of the consolidated capital loss carryforward should not be made on the separate consolidating Schedules M-3 of the includible corporations, but on the separate Schedule M-3 for consolidation eliminations (or on Form 8916 in the case of a mixed group) as described under *Completing Schedule M-3 and Certain Allocations, Limitations, and Carryovers*, earlier.

Line 25. Other Income (Loss) Items With Differences

Separately state and adequately disclose on Part II, line 25, all items of income (loss) with differences that are not otherwise listed on Part II, lines 1 through 24. Attach a statement that itemizes the type of income (loss) and the amount of each item and provides a description that states the income (loss) name for book purposes for the amount

recorded in column (a) and describes the adjustment being recorded in column (b) or (c). The entire description completes the tax description for the amount included in column (d) for each item separately stated on this line.

The attached statement should have five columns. The first column has the description for the next four columns. The second column is column (a) income (loss) per income statement, the third column is column (b) temporary difference, the fourth column is column (c) permanent difference, and the fifth column is column (d) income (loss) per tax return. Every item listed on the attached statement for line 25 must always have columns (a) + (b) + (c) = (d). Each item with amounts in columns (a), (b), (c), and (d) will be totaled and included as one line on Part II, line 25.

If any "comprehensive income," as defined by Statement of Financial Accounting Standards

(SFAS) No. 130, is reported on this line, describe the item(s) in detail. Examples of sufficiently detailed descriptions include “foreign currency translation adjustments—comprehensive income” and “gains and losses on available-for-sale securities—comprehensive income.”

Whether an item of income (loss) is reported on line 25, or is reported on Part II, line 28, is determined separately by each member of the U.S. consolidated tax group and not at the U.S. consolidated tax group level.

Line 26. Total Income (Loss) Items

Combine lines 1 through 25 and enter the total on line 26.

Note. Line 17, Cost of goods sold, columns (a) and (d), if applicable, are negative amounts which will affect the totals entered on line 26.

Line 27. Total Expense/ Deduction Items

Report on Part II, line 27, columns (a) through (d), as applicable, the negative of the amounts reported on Part III, line 39, columns (a) through (d), as applicable.

Report positive amounts as negative and negative amounts as positive. For example, if Part III, line 39, column (a), reflects an amount of \$1 million, then report on Part II, line 27, column (a), (\$1 million). Similarly, if Part III, line 39, column (b), reflects an amount of (\$50,000), then report on Part II, line 27, column (b), \$50,000.

Line 28. Other Items With No Differences

If there is no difference between the financial accounting amount and the taxable amount of an entire item of income, gain, loss, expense, or deduction and the item is not described or included in Part II, lines 1 through 25, or Part

III, lines 1 through 38, report the entire amount of the item in columns (a) and (d) of line 28. If a portion of an item of income, loss, expense, or deduction has a difference and a portion of the item does not have a difference, do not report any portion of the item on line 28. Instead, report the entire amount of the item (that is, both the portion with a difference and the portion without a difference) on the applicable line of Part II, lines 1 through 25, or Part III, lines 1 through 38. See *Example 11*, earlier.

Line 29a. 1120 Subgroup Reconciliation Totals

For filers other than a mixed group, combine lines 26 through 28 and skip lines 29b and 29c. On the sub-consolidated Schedule M-3 for a mixed group, combine lines 26 through 28 and skip lines 29b and 29c. For the consolidated Schedule M-3 of a mixed group, complete only lines 29a through 29c and line 30 of Part II. No Part III is required to be

completed for the consolidated Schedule M-3 of a mixed group.

Line 29b. PC Insurance Subgroup Reconciliation Totals

Line 29b is only used by mixed groups. See Schedule M-3 Consolidation for Mixed Groups (1120/L/PC), earlier.

Line 29c. Life Insurance Subgroup Reconciliation Totals

Line 29c is only used by mixed groups. See Schedule M-3 Consolidation for Mixed Groups (1120/L/PC), earlier.

Line 30. Reconciliation Totals

Mixed groups, see Schedule M-3 Consolidation for Mixed Groups (1120/L/PC), earlier.

Part III. Reconciliation of Net Income (Loss) per Income Statement of Includible Corporations With Taxable Income per Return—Expense/Deduction Items

Note. Expense amounts that reduce financial accounting income must be reported on Part III, column (a), as positive amounts.

Deduction amounts that reduce taxable income must be reported on Part III, column (d), as positive amounts. Amounts reported on Part II, line 27, must be the negative of the amounts reported on Part III, line 39.

Lines 1 Through 6. Income Tax Expense

If the corporation does not distinguish between current and deferred income tax expense in its financial statements (or its books and records, if applicable), report

income tax expense as current income tax expense using lines 1, 3, and 5, as applicable.

A U.S. consolidated tax group must complete lines 1 through 6 in accordance with the allocation of tax expense among the members of the U.S. consolidated tax group in the financial statements (or its books and records, if applicable). If the current and deferred U.S., state, and foreign income tax expense for the U.S. consolidated tax group (income tax expense) is allocated among the members of the U.S. consolidated tax group in the group's financial statements (or its books and records, if applicable), then each member must report its allocated income tax expense on Part III, lines 1 through 6, of that member's separate Schedule M-3. However, if the income tax expense is not shared or allocated among members of the U.S. consolidated tax group but is retained in the parent corporation's financial statements (or books and records, if applicable), then

amounts are reported only on Part III, lines 1 through 6, of the parent's separate Schedule M-3.

Line 7. Foreign Withholding Taxes

Report on line 7, column (a), the amount of foreign withholding taxes included in financial accounting net income on Part I, line 11. If the corporation is deducting foreign tax, use column (b) or (c), as applicable, to correct for any difference between foreign withholding tax included in financial accounting net income and the amount of foreign withholding taxes being deducted on the return. If the corporation is crediting foreign withholding taxes against the U.S. income tax liability, use column (b) or (c), as applicable, to negate the amount reported in column (a).

Line 8. Interest Expense

Report on Part III, line 8, column (a), the total amount of interest expense included on Part I, line 11, and report on Part III, line 8,

column (d), the total amount of interest deduction included on Form 1120, page 1, line 28, that is not required to be reported elsewhere on Schedule M-3. In column (b) or (c), as applicable, include any adjustments for any amounts treated for U.S. income tax purposes as interest deduction that are treated as some other form of expense for financial accounting purposes, or vice versa. For example, adjustments to interest expense/ deduction resulting from adjustments made in accordance with the instructions for Part III, line 34, Purchase versus lease (for purchasers and/or lessees), should be made in columns (b) and (c), as applicable, on this line 8.

Complete Part III of Form 8916-A. Enter the amounts from Form 8916-A, Part III, line 5, columns (a) through (d), on Schedule M-3, Part III, line 8, columns (a) through (d), as applicable. Attach Form 8916-A.

Do not report on Form 8916-A and this line 8 amounts reported in accordance with the instructions for Part II, lines 9, 10, 11, and 12.

Note. Any corporation that files Form 1120 (or Form 1120-C) that (a) is required to file Schedule M-3 (Form 1120) and has less than \$50 million in total assets at the end of the tax year, or (b) is not required to file Schedule M-3 and voluntarily files Schedule M-3, is not required to file Form 8916-A, but may voluntarily do so.

Line 9. Stock Option Expense

Report on line 9, column (a), amounts expensed on Part I, line 11, net income per the income statement, that are attributable to all stock options. Report on line 9, column (d), deduction amounts attributable to all stock options.

Line 10. Other Equity-Based Compensation

Report on line 10 any amounts for equity-based compensation or consideration that are reflected as expense for financial accounting purposes (column (a)) or deducted in the U.S. income tax return (column (d)) other than amounts reportable elsewhere on Schedule M-3, Parts II and III (for example, on Part III, line 9, for stock options expense). Examples of amounts reportable on line 10 include payments attributable to employee stock purchase plans (ESPPs), phantom stock options, phantom stock units, stock warrants, stock appreciation rights, qualified equity grants, and restricted stock, regardless of whether such payments are made to employees or nonemployees, or as payment for property or compensation for services.

Line 11. Meals and Entertainment

Report on line 11, column (a), any amounts paid or accrued by the corporation during the tax year for meals, beverages, and entertainment that are accounted for in financial accounting income, regardless of the classification, nomenclature, or terminology used for such amounts, and regardless of how or where such amounts are classified in the corporation's financial income statement or the income and expense accounts maintained in the corporation's books and records. Report only amounts not otherwise reportable elsewhere on Schedule M-3, Parts II and III (for example, Part II, line 17).

Line 12. Fines and Penalties

Report on line 12 any fines or similar penalties paid to a government or other authority for the violation of any law for which fines or penalties are assessed. All fines and penalties expensed in financial accounting

income (paid or accrued) must be included on this line 12, column (a), regardless of the government or other authority that imposed the fines or penalties; regardless of whether the fines and penalties are civil or criminal; regardless of the classification, nomenclature, or terminology used for the fines or penalties by the imposing authority in its actions or documents; and regardless of how or where the fines or penalties are classified in the corporation's financial income statement or the income and expense accounts maintained in the corporation's books and records. Also report on line 12, column (a), the reversal of any overaccrual of any amount described in this paragraph.

See section 162(f) for additional guidance.

Report on line 12, column (d), any such amounts as described in the preceding paragraph that are includible in taxable income, regardless of the financial accounting

period in which such amounts were or are included in financial accounting net income.

Complete columns (b) and (c) as appropriate.

Do not report on line 12 amounts required to be reported in accordance with the instructions for Part III, line 13.

Do not report on line 12 amounts recovered from insurers or any other indemnitors for any fines and penalties described above.

Line 13. Judgments, Damages, Awards, and Similar Costs

Report on line 13, column (a), the amount of any estimated or actual judgments, damages, awards, settlements, and similar costs, however named or classified, included in financial accounting income, regardless of whether the amount deducted was attributable to an estimate of future anticipated payments or actual payments. Also report on line 13, column (a), the

reversal of any overaccrual of any amount described in this paragraph.

Report on line 13, column (d), any such amounts as are described in the preceding paragraph that are includible in taxable income, regardless of the financial accounting period in which such amounts were or are included in financial accounting net income.

Complete columns (b) and (c) as appropriate.

Do not report on line 13 amounts required to be reported in accordance with the instructions for Part III, line 12.

Do not report on line 13 amounts recovered from insurers or any other indemnitors for any judgments, damages, awards, or similar costs described above.

Line 14. Parachute Payments

Report on line 14, column (a), the total expense included in financial accounting net income on Part I, line 11, that is subject to

section 280G. Report in column (b) or (c), as applicable, the amount of nondeductible parachute payments pursuant to section 280G, and report in column (d) the deductible amount of compensation after any excess parachute payment limitations under section 280G. If a payment is subject to limitation under both sections 162(m) and 280G, report the total payment on this line 14.

Line 15. Compensation With Section 162(m) Limitation

Report on line 15, column (a), the total amount of current compensation expense for the corporate officers to whom section 162(m) applies. Report in column (b) or (c), as applicable, the nondeductible amount of current compensation in excess of \$1 million (\$500,000 if the corporation receives or has received financial assistance under the Treasury Troubled Asset Relief Program (TARP)). Report the deductible compensation in column (d). If a payment is subject to

limitation under both sections 162(m) and 280G, report the total payment on Part III, line 14, Parachute payments. See Regulations section 1.162-27(g) for the interaction between sections 162(m) and 280G.

Line 16. Pension and Profit-Sharing

Report on line 16 any amounts attributable to the corporation's pension plans, profit-sharing plans, and any other retirement plans.

Line 17. Other Post-Retirement Benefits

Report on line 17 any amounts attributable to other post-retirement benefits not otherwise includible on Part III, line 16 (for example, retiree health and life insurance coverage, dental coverage, etc.).

Line 18. Deferred Compensation

Report on line 18, column (a), any compensation expense included in the net income (loss) amount reported in Part I, line

11, that is not deductible for U.S. income tax purposes in the current tax year and that was not reported elsewhere on Schedule M-3, in column (a). Report on line 18, column (d), any compensation deductible in the current tax year that was not included in the net income (loss) amount reported in Part I, line 11, for the current tax year and that is not reportable elsewhere on Schedule M-3. For example, report originations and reversals of deferred compensation subject to section 409A on line 18.

Line 20. Charitable Contribution of Intangible Property

Report on line 20 any charitable contribution of intangible property, for example, contributions of:

- Intellectual property, patents (including any amounts of additional contributions allowable by virtue of income earned by

donees subsequent to the year of donation), copyrights, and trademarks;

- Securities (including stocks and their derivatives, stock options, and bonds);
- Conservation easements (including scenic easements or air rights);
- Railroad rights of way;
- Mineral rights; and
- Other intangible property.

Line 21. Charitable Contribution Limitation/ Carryforward

Report as a negative amount on line 21, columns (b), (c), and (d), as applicable, the excess of charitable contributions made during the tax year over the amount of the charitable contribution limitation amount.

If the corporation utilizes a contribution carryforward in the current tax year, report

the carryforward utilized as a positive amount in columns (b), (c), and (d), as applicable.

When a consolidated income tax return is being filed, Schedule M-3 adjustments for the amount of charitable contributions in excess of the limitation, or for charitable contribution carryforward utilized, should not be made on the separate consolidating Schedules M-3 of the includible corporations, but on the separate consolidating Schedule M-3 for consolidation eliminations (or on Form 8916 in the case of a mixed group). See *Completing Schedule M-3 and Certain Allocations, Limitations, and Carryovers*, earlier.

Line 22. Domestic Production Activities Deduction

A deduction for income attributable to domestic production activities is available for specified agricultural or horticultural cooperatives (specified cooperatives). See

section 199A(g). Also, see the Instructions for Form 8903.

Report on line 22, column (d), the cooperative's section 199A(g) deduction that is reported on Form 1120-C. Complete columns (b) and (c) as appropriate. Do not report any portion of the cooperative's section 199A(g) deduction on any other line of Schedule M-3.

Line 23. Current Year Acquisition or Reorganization Investment Banking Fees

Report on line 23 any investment banking fees paid or incurred in connection with a taxable or tax-free acquisition of property (for example, stock or assets) or a tax-free reorganization. Report on this line any investment banking fees incurred at any stage of the acquisition or reorganization process including, for example, fees paid or incurred to evaluate whether to investigate an

acquisition, fees to conduct an actual investigation, and fees to consummate the acquisition. Also include on this line investment banking fees incurred in connection with the liquidation of a subsidiary, a spin-off of a subsidiary, or an initial public stock offering.

Line 24. Current Year Acquisition or Reorganization Legal and Accounting Fees

Report on line 24 any legal and accounting fees paid or incurred in connection with a taxable or tax-free acquisition of property (for example, stock or assets) or tax-free reorganization. Report on this line any legal and accounting fees incurred at any stage of the acquisition or reorganization process including, for example, fees paid or incurred to evaluate whether to investigate an acquisition, fees to conduct an actual investigation, and fees to consummate the acquisition. Also include on this line legal and

accounting fees incurred in connection with the liquidation of a subsidiary, a spin-off of a subsidiary, or an initial public stock offering.

Line 25. Current Year Acquisition/Reorganization Other Costs

Report on line 25 any other fees paid or incurred in connection with a taxable or tax-free acquisition of property (for example, stock or assets) or a tax-free reorganization not otherwise reportable on Schedule M-3 (for example, Part III, line 23 or 24). Report on this line any fees paid or incurred at any stage of the acquisition or reorganization process including, for example, fees paid or incurred to evaluate whether to investigate an acquisition, fees to conduct an actual investigation, and fees to consummate the acquisition.

Also include on this line other acquisition/reorganization costs incurred in

connection with the liquidation of a subsidiary, a spin-off of a subsidiary, or an initial public stock offering.

Line 26. Amortization/ Impairment of Goodwill

Report on line 26 amortization of goodwill or amounts attributable to the impairment of goodwill.

Line 27. Amortization of Acquisition, Reorganization, and Start-Up Costs

Report on line 27 amortization of acquisition, reorganization, and start-up costs. For purposes of columns (b), (c), and (d), include amounts amortizable under section 167, 195, or 248.

Line 28. Other Amortization or Impairment Write-Offs

Report on line 28 any amortization or impairment write-offs not otherwise includible on Schedule M-3.

Line 29. Reserved

When using this line to figure amounts on other tax forms or worksheets, this line should be considered to be zero.

Line 31. Depreciation

Report on line 31 any depreciation expense that is not required to be reported elsewhere on Schedule M-3 (for example, on Part II, line 9, 10, 11, or 17).

Line 32. Bad Debt Expense

Report on line 32, column (a), any amounts attributable to an allowance for uncollectible accounts receivable or actual write-offs of accounts receivable included on Part I, line 11. Report in column (d) the amount of bad debt expense deductible for federal income tax purposes under section 166.

Line 33. Corporate Owned Life Insurance Premiums

Report on line 33 all amounts of insurance premiums attributable to any life insurance policy if the corporation is directly or indirectly a beneficiary under the policy or if the policy has a cash value. Report in column (d) the amount of the premiums that are deductible for federal income tax purposes.

Line 34. Purchase Versus Lease (for Purchasers and/or Lessees)

Note. Also see the instructions for sellers and/or lessors in the instructions for Part II, line 18.

Asset transfer transactions with periodic payments characterized for financial accounting purposes as either a purchase or a lease may, under some circumstances, be characterized as the opposite for tax purposes.

If a transaction is treated as a lease, the purchaser/lessee reports the periodic payments as gross rental expense. If the transaction is treated as a purchase, the purchaser/lessee reports the periodic payments as payments of principal and interest and also reports depreciation expense or deduction with respect to the purchased asset.

Report in column (a) gross rent expense for a transaction treated as a lease for financial accounting purposes but as a sale for U.S. income tax purposes. Report in column (d) gross rental deductions for a transaction treated as a lease for U.S. income tax purposes but as a purchase for financial accounting purposes. Report interest expense for such transactions on Part III, line 8, column (a) or (d), as applicable. Report depreciation expense or deductions for such transactions on Part III, line 31, column or (d), as applicable. Use columns and (c) of Part

III, lines 8, 31, and 34, as applicable, to report the differences between columns (a) and (d) for such recharacterized transactions.

Example 21. U.S. corporation X acquired property in a transaction that, for financial accounting purposes, X treats as a lease. X is a calendar year taxpayer that files and entirely completes Schedule M-3 for its current tax year. Because of its terms, the transaction is treated for U.S. income tax purposes as a purchase and X must treat the periodic payments it makes partially as payment of principal and partially as payment of interest. In its financial statements, X treats the difference between the financial accounting and U.S. income tax treatment of this transaction as a temporary difference. For its current tax year, X reports in its financial statements \$1,000 of gross rental expense that, for U.S. income tax purposes, is recharacterized as a \$700 payment of principal and a \$300 payment of interest,

accompanied by a depreciation deduction of \$1,200 (based on other facts). On its Schedule M-3, X must report the following on Part III, line 34: column (a) \$1,000, its financial accounting gross rental expense; column (b), (\$1,000); and column (d), zero. On Part III, line 8, X reports zero in column (a) and \$300 in columns (b) and (d) for the interest deduction. On Part III, line 31, X reports zero in column (a) and \$1,200 in columns (b) and (d) for the depreciation deduction.

Line 35. Research and Development Costs

Report in column (a) the amount of research and development expenditures reported as a deduction in your financial statements (or its books and records, if applicable), on Part I, line 11. Report in column (d) the amount of amortization deductions of specified research or experimental expenditures and research or experimental expenditures included on Form

4562, Part VI, line 44, and in total deductions on Form 1120, page 1, line 27. In column (c), as applicable, include any adjustments for any amounts treated for U.S. income tax purposes as research or experimental expenditures that are treated as some other form of expense for financial accounting purposes, or vice versa. Report any difference in timing recognition in column (b). For example, if the taxpayer's financial accounting method does not specify otherwise, column (b) adjustments include adjustments for timing differences between financial and tax accounting for (1) deferral and amortization of research expenditures that began in your 2022 tax year, (2) a section 59(e) election that began before your 2022 tax year, (3) reduction of section 174 expenditures under section 280C or section 482, (4) costs attributable to obtaining a patent, and (5) research in social sciences.

For tax years beginning after December 31, 2021, for U.S. income tax purposes, research

and experimental expenditures paid or incurred by a taxpayer in connection with the taxpayer's trade or business must be amortized. The expenditures must be amortized ratably over the 5-year period (15-year period for specified expenditures attributable to foreign research), beginning with the midpoint of the tax year in which the expenses are paid or incurred. See section 174. If properly adopted or elected under section 174(b) and section 174(f) prior to amendment by P.L. 115-97 and section 59(e), any amortization otherwise allowable related to such costs is reported in column (b).

Example 22. Corporation X is a calendar year taxpayer that files and entirely completes Schedule M-3 for its current tax year. During its current tax year, X incurred \$100,000 of research and development costs that X recognized as an expense in its financial statements. In compliance with

section 174, X amortizes research and experimental expenditures for U.S. income tax purposes. Accordingly, X must report \$100,000 in column (a), (\$90,000) in column (b), and \$10,000 $((\$100,000/5 \text{ years}) \times 1/2)$ in column (d).

Example 23. Corporation X is a calendar year taxpayer that files and entirely completes Schedule M-3 for its current tax year. During its current tax year, X incurred \$10,000 of research and development costs related to social sciences that it recognized as an expense in its financial statements. X amortizes research and experimental expenditures for U.S. income tax purposes. Because such costs are not allowable costs under section 174, X must report \$10,000 in column (a), permanent difference (\$10,000) in column (c), and \$0 in column (d). If such costs are otherwise deductible for U.S. income tax purposes, X must report this item

of expense on Part III, line 38, Other expense/deduction items with differences.

Example 24. Corporation X is a calendar year taxpayer that files and entirely completes Schedule M-3 for its current tax year. During its current tax year, X paid \$75,000 to acquire or in-license intangible assets under a collaborative arrangement with another company that X recognized as a research and development expense in its financial statements. X amortizes research and experimental expenditures for U.S. income tax purposes. Because payments made to acquire rights to a product or technology are excluded costs from the definition of research and experimental expenditures, X must report \$75,000 in column (a), (\$75,000) in column (c), and \$0 in column (d). X must report any amortization otherwise allowable related to the payments on Part III, line 28, Other amortization or impairment write-offs.

Line 36. Section 118 Exclusion

Report on line 36 any inducements received in the current year and treated as contributions to the capital of a corporation by a nonshareholder.

Report in column (a) any income amount as a negative number and any expense amount as a positive number.

Under the general rule, any contribution in aid of construction or any contribution by a governmental entity to the capital of a corporation is not eligible for exclusion from income under section 118. The following nonshareholder contributions to capital are not eligible for exclusion under section 118.

- Any contribution in aid of construction or any other contribution as a customer or potential customer.
- Any contribution by any civic group.

- Any contribution by any governmental entity, except any contribution made after December 22, 2017, and made pursuant to a master development plan that was approved prior to December 22, 2017, by a governmental entity.

Corporations must identify on an accompanying statement referencing line 36 the fair market value of land or other property (including cash) provided to the corporation by any nonshareholder, including a governmental unit, as an inducement, or for any other purpose. Include inducements for the corporation to locate its business in a particular state, municipality, community, or locality for the purpose of enabling the corporation to expand its existing operating facilities, including corporate headquarters, distribution center(s), or factory(ies) (“inducements”).

On the accompanying statement, also identify any inducements that include refundable or

transferable tax credits, including transferable credits that were sold.

The statement must separately state, adequately disclose, and identify all of the dollar amounts summarized by this line. An accompanying statement is required even if there are no dollar amounts reported on line 36.

Contributions in aid of construction for regulated water and sewerage disposal utility companies. Under a special rule, any amount of money or property received after December 31, 2020, as a contribution in aid of construction or a contribution to the capital of a regulated public utility which provides water or sewerage disposal services is eligible for exclusion from income under section 118. Include amounts treated as contribution in aid of construction under this provision on line 36. For more information, see section 118.

Line 37. Section 162(r)—FDIC Premiums Paid by Certain Large Financial Institutions

Report on line 37, column (a), the total amount paid or accrued as FDIC premiums included on Part I, line 11. Report on line 37, column (c), any disallowed amounts, subject to the applicable percentage, of any FDIC premiums paid or included by the large financial institution. For this purpose, the large financial institution includes members of its expanded affiliated group, as defined in section 162(r)(6) (B). The disallowance does not apply if the institution's (including members of its expanded affiliated group's) total consolidated assets (determined as of the close of the tax year) do not exceed \$10 billion.

The applicable percentage is the excess of the corporation's total consolidated assets over \$10 billion, divided by \$40 billion. For taxpayers with total consolidated assets of

\$50 billion or more, the applicable percentage is 100%. See section 162(r).

Example 25. Corporation X has total consolidated assets of \$20 billion. Under section 162(r), no deduction is allowed for 25% $((\$20,000,000,000 - \$10,000,000,000) / \$40,000,000,000)$ of FDIC premiums.

Line 38. Other Expense/ Deduction Items With Differences

Separately state and adequately disclose on Part III, line 38, all items of expense/deduction that are not otherwise listed on Part III, lines 1 through 37.

Attach a statement that describes and itemizes the type of expense/ deduction and the amount of each item, and provides a description that states the expense/deduction name for book purposes for the amount recorded in column (a) and describes the adjustment being recorded in column (b) or (c). The entire description completes the tax

description for the amount included in column (d) for each item separately stated on this line.

The statement attached to the Schedule M-3 for line 38 must separately state and adequately disclose the nature and amount of the expense related to each reserve and/or contingent liability. The appropriate level of disclosure depends upon each taxpayer's operational activity and the nature of its accounting records. For example, if a corporation's net income amount reported in the income statement includes anticipated expenses for a discontinued operation as a single amount, and its general ledger or other books, records, and workpapers provide details for the anticipated expenses under more explanatory and defined categories such as employee termination costs, lease cancellation costs, loss on sale of equipment, etc., a supporting statement that lists those categories of expenses and their details will

satisfy the requirement to separately state and adequately disclose. In order to separately state and adequately disclose the employee termination costs, it is not required that an anticipated termination cost amount be listed for each employee, or that each asset (or category of asset) be listed along with the anticipated loss on disposition.

The attached statement should have five columns. The first column has the description for the next four columns. The second column is column (a) expense per income statement, the third column is column (b) temporary difference, the fourth column is column (c) permanent difference, and the fifth column is column (d) deduction per tax return. Every item listed on the attached statement for line 38 must always have columns (a) + (b) + (c) = (d). Each item with amounts in columns (a), (b), (c), and (d) will be totaled and included as one line on Part III, line 38.

Comprehensive income. If any “comprehensive income,” as defined by SFAS No. 130, is reported on this line, describe the item(s) in detail as, for example, “Foreign currency translation adjustments—comprehensive income” and “Gains and losses on available-for-sale securities—comprehensive income.”

Reserves and contingent liabilities. Report on line 38 amounts related to the change in each reserve or contingent liability that is not required to be reported elsewhere on Schedule M-3. For example, (1) amounts relating to changes in reserves for litigation must be reported on Part III, line 13, Judgments, damages, awards, and similar costs; and (2) amounts relating to changes in reserves for uncollectible accounts receivable must be reported on Part III, line 32, Bad debt expense. See *Example 9*, earlier.

Report on line 38 the amortization of various items of prepaid expense, such as prepaid

subscriptions and license fees, prepaid insurance, etc.

Report on line 38, column (a), expenses included in net income reported on Part I, line 11, that are related to reserves and contingent liabilities. Report on line 38, column (d), amounts related to liabilities for reserves and contingent liabilities that are deductible in the current tax year for U.S. income tax purposes. Examples of reserves that are allowed for book purposes, but not for tax purposes, include warranty reserves, restructuring reserves, reserves for discontinued operations, and reserves for acquisitions and dispositions. Only report on line 38 items that are not required to be reported elsewhere on Schedule M-3, Parts II and III.

Example 26. Corporation Q is a calendar year taxpayer that files and entirely completes Schedule M-3 for its current tax year. On July 1 of each year, Q has a fixed

liability for its annual insurance premiums on its home office building that provides a 12-month coverage period beginning July 1 through June 30. In addition, Q historically prepays 12 months of advertising expenses on July 1. On July 1, Q prepays its insurance premium of \$500,000 and advertising expenses of \$800,000. For statutory accounting purposes, Q capitalizes and amortizes the prepaid insurance and advertising over 12 months. For U.S. income tax purposes, Q deducts the insurance premium when paid and amortizes the advertising over the 12-month period. In its annual statement, Q treats the difference attributable to the annual statement treatment and U.S. income tax treatment of the prepaid insurance as a temporary difference. As there is no difference between the book and tax treatment of advertising expense, it should be included on Part II, line 28, Other items with no differences.

Q also has a legal reserve where \$300,000 was expensed for financial accounting purposes and a (\$100,000) temporary difference was calculated to arrive at the income tax deduction of \$200,000. The statement attached to Q's return for Part III, line 38, must be separately stated and adequately disclosed as follows.

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Line 38—Example 26

Statement Concerning Other Expense/Deduction Items With Differences

Description	Column (a) Expense per Income Statement	Column (b) Temporary Difference	Column (c) Permanent Difference	Column (d) Deduction per Tax Return
Prepaid insurance premium expensed not capitalized	\$250,000	\$250,000	-0-	\$500,000
Legal expense reserve	<u>\$300,000</u>	<u>(\$100,000)</u>	<u>-0-</u>	<u>\$200,000</u>
Total line 38	<u>\$550,000</u>	<u>\$150,000</u>	<u>-0-</u>	<u>\$700,000</u>

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Line 39. Total Expense/ Deduction Items

Report on Part II, line 27, columns (a) through (d), as applicable, the negative of the amounts reported on Part III, line 39, columns (a) through (d), as applicable.

Report positive amounts as negative and negative amounts as positive. For example, if Part III, line 39, column (a), reflects an amount of \$1 million, then report on Part II, line 27, column (a), (\$1 million). Similarly, if Part III, line 39, column (b), reflects an amount of (\$50,000), then report on Part II, line 27, column (b), \$50,000.

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