1994

Department of the Treasury
Internal Revenue Service

Instructions for Schedule PH (Form 1120)

U.S. Personal Holding Company (PHC) Tax

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

General Instructions

Purpose of Schedule

This schedule is used to figure personal holding company (PHC) tax.

Who Must File

A corporation that is a PHC must attach this schedule to its income tax return.

To find out if a corporation is a PHC, complete Part I of Schedule PH and lines 1 through 5 of the worksheet below. Then, complete Part II of Schedule PH and line 6 of the worksheet. Generally, if line 6 of the worksheet is 60% or more and the stock ownership requirement (decribed in **2** below) is met, the corporation must file Schedule PH and pay the PHC tax. See **Exceptions** below.

A corporation is a PHC if **both** of the following apply:

1. At least 60% of the corporation's adjusted ordinary gross income for the tax year is PHC income. See section 543(b)(2) for the definition of adjusted ordinary gross income, and section 543(a) for the definition of PHC income.

2. At any time during the last half of the tax year, more than 50% in value of the corporation's outstanding stock is owned, directly or indirectly, by five or fewer individuals. For purposes of this requirement, the following organizations are considered individuals: a qualified pension, profit-sharing, or stock bonus plan described in section 401(a); a trust that provides for the payment of supplemental unemployment compensation under certain conditions (section 501(c)(17)); a private foundation (section 509(a)); or a part of a trust permanently set aside or used exclusively for the purpose described in section 642(c). See section 542(a)(2) for details.

Exceptions. The term "personal holding company" does not include the following corporations, even if the two requirements above are met:

- Tax-exempt corporations.
- Banks.
- Domestic building and loan associations.
- Life insurance companies.
- Surety companies.
- Foreign personal holding companies (as defined in section 552).
- Certain lending or finance companies.
- Foreign corporations that do not have income under section 543(a)(7), if, during the last half of the tax year, all of the corporation's stock is owned by nonresident alien individuals.
- Certain small business investment companies operating under the Small Business Investment Act of 1958.
- Corporations under the jurisdiction of the court in a Title 11 or similar case.
- Passive foreign investment companies.

See section 542(c) for more information.

Worksheet For Figuring Ordinary Gross Income, Adjusted Ordinary Gross Income, and the 60% PHC Income Test
(See **Worksheet Instructions** on page 2.) (keep for your records)

1. Gross income. Non-life-insurance companies, see section 543(c)			1	
2. Less: Gains from the sale or disposition of capital assets and section 1231(b) property			2	( )
3. Ordinary gross income. Combine lines 1 and 2. (Foreign corporations, see instructions.)			3	
4. Adjustments				
a Adjustments described in section 543(b)(2)(A)	a			
b Adjustments described in section 543(b)(2)(B)	b			
c Interest income excluded under section 543(b)(2)(C)	c			
d Adjustments described in section 543(b)(2)(D)	d			
e Total adjustments. Add lines 4a through 4d			4e	
5. Adjusted ordinary gross income. Subtract line 4e from line 3			5	
6. Complete Part II of Schedule PH. Divide the amount on line 25, Part II, by the amount on line 5 above. Enter the result as a percentage			6	%

If line 6 is **less than 60%,** the corporation is not a PHC. Do not file Schedule PH.
If line 6 is **60% or more** and the stock ownership requirements of section 542(a) are met, the corporation is a PHC. Complete Part III, line 26, and Part IV. File Schedule PH with the corporation's income tax return.

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At-risk and passive activities.—A corporation that has an activity subject to the at-risk or passive activity rules (or both) may have deductions and losses suspended under those provisions. Deductions and losses used in any of the computations for PHC tax should not include suspended at-risk and passive activity deductions and losses. Any prior year deductions and losses allowed under the at-risk and passive activity rules are treated as current year deductions and losses in the year they are allowed.

Foreign corporations must file a return.—If a foreign corporation that is a PHC does not file Schedule PH as required, it will be charged a penalty. The penalty is 10% of the corporation's Federal income taxes (including the PHC tax) and is in addition to any other penalties charged the corporation. See section 6683.

Worksheet Instructions

Lines 1 through 3.—Ordinary gross income is gross income as defined in section 61 and the related regulations, computed without gains from the sale or disposition of capital assets and without gains from the sale or other disposition of property described in section 1231(b). Foreign corporations (if not exempt under section 542(c)(7)) should only include gross income subject to U.S. tax.

Line 3.—If all of a foreign corporation's stock is owned during the last half of the tax year by nonresident alien individuals (directly or indirectly), ordinary gross income is reduced by all items of income that would otherwise constitute PHC income, except for amounts received under personal service contracts and from their sale (Part II, line 23).

Line 4a.—Enter the total of the following deductions allocable to gross income from rents (not to exceed the gross income from rents): depreciation and amortization of property (other than tangible personal property not customarily retained by any one lessee for more than 3 years), property taxes, interest, and rent. See section 543(b)(3) for the definition of the term "rents."

Line 4b.—Enter the total of the following deductions allocable to gross income from mineral, oil, and gas royalties (including production payments and overriding royalties) and gross income from working interests in an oil or gas well: depreciation, amortization, depletion, property and severance taxes, interest, and rent. The total deductions allocable to royalties may not exceed the gross income from the royalties, and the total deductions allocable to working interests may not exceed the gross income from the working interests.

Line 4c.—Include the following interest on this line: (1) interest received on a direct obligation of the United States held for sale to customers in the ordinary course of trade or business by a regular dealer who is making a primary market in the obligations and (2) interest on a condemnation award, a judgment, or a tax refund.

Line 4d.—Enter the total of the following deductions allocable to gross income from compensation for the use of, or the right to use, any tangible personal property manufactured or produced by the corporation, if during the tax year the corporation is engaged in substantial manufacturing or production of tangible personal property of the same type: depreciation and amortization of property (other than tangible personal property that is not customarily retained by any one lessee for more than 3 years), property taxes, interest, and rent. The total deductions allocable to the compensation may not exceed the gross income from the compensation.

Specific Instructions

Part I

Additions

Line 1—Taxable income before net operating loss deduction and special deductions.—Enter the amount shown on Form 1120, line 28, page 1. If the income on line 28 was figured using section 443(b) (placing the income on an annual basis), refigure it without using that section.

A foreign corporation must figure line 1 by including only income derived from U.S. sources or effectively connected with a U.S. trade or business, reduced by deductions allowable in determining taxable income before the net operating loss deduction and special deductions.

If all of a foreign corporation's stock is owned during the last half of the tax year by nonresident alien individuals (directly or indirectly), taxable income for section 545(a) is only income received under a contract for personal services as described in section 543(a)(7), reduced by deductions attributable to that income, and adjusted as provided in section 545(b) with respect to that income.

Line 3—Expenses and depreciation.—If the corporation earned rent or other compensation for the use of, or right to use, property and that rent or compensation was less than the total allowable expenses and depreciation, complete Part V and enter the excess on line 3.

This adjustment must be made unless the corporation can establish that all three of the following apply:

1. The rent or other compensation the corporation received was the highest obtainable. If none was received, it must be shown that none was obtainable.

2. The property was held in the course of a business carried on for profit.

3. There was a reasonable expectation that the property's operation would result in a profit, or that the property was necessary to conduct the business.

Do not complete Part V if the corporation meets the three requirements above. Instead, attach a statement reporting the deductions with the complete facts, circumstances, and arguments to support them. The statement must include the information required by Regulations section 1.545-2(h)(2).

Deductions

Line 5—Federal and foreign income, war profits, and excess profits taxes.—Attach a schedule showing the kind of tax, the tax year, and the amount. Under section 545(b)(1), the corporation can deduct Federal income taxes accrued during the tax year, but not the accumulated earnings tax under section 531 or the PHC tax under section 541.

The foreign tax credit is not allowed against PHC tax. A deduction is allowed, however, for income, war profits, and excess profits taxes accrued (or considered paid under section 902(a) or 960(a)(1)) during the tax year to foreign countries and U.S. possessions. A corporation is allowed this deduction even if a credit for the taxes was claimed when figuring the corporation's income tax.

Line 6—Contributions.—Compute the deduction using the limitations under sections 170(b)(1)(A), (B), and (D) but without sections 170(b)(2) and (d)(1). When computing the limitations under section 170(b)(1), use taxable income computed with the adjustments (other than the 10% limitation) provided in sections 170(b)(2) and (d)(1) and without any expenses and depreciation disallowed under section 545(b)(6).

Line 7—Net operating loss.— Section 545(b)(4) provides that instead of the net operating loss deduction provided in section 172, a deduction is allowed for the net operating loss (as defined in section 172(c)) for the preceding tax year figured without the deductions provided in Part VIII (except section 248) of subchapter B.

Line 8—Net capital gain.—Net capital gain for a foreign corporation is determined by taking into account only gains and losses that are effectively connected with the conduct of a trade or business within the United States that are not exempt from tax under treaty.

Line 10.—Include in the total for line 10 any deduction for amounts used or irrevocably set aside to pay or retire qualified indebtedness under section 545(c) (as in effect before November 5, 1990, i.e., before the date of enactment of the Revenue Reconciliation Act of 1990). See Regulations section 1.545-3. Write the amount and "Section 545(c)" on the dotted line next to line 10.

Line 12—Dividends paid after the end of the tax year.—The corporation may elect to treat dividends (other than deficiency dividends) paid after the end of the year and before the 16th day of the third month following the end of the tax year, as paid during the tax year. Enter these dividends on line 12 but not in Part VI.

Line 13—Undistributed personal holding company income of certain foreign corporations.—If 10% or less in value of the outstanding stock of a foreign corporation is owned (see section 958(a)) during the last half of the tax year by U.S. persons, undistributed PHC income is determined by multiplying the undistributed PHC income (determined without this instruction) by a percentage in value of the corporation's outstanding stock. This percentage is figured by using the greatest percentage in value of its outstanding stock owned by the U.S. persons on any one day during the period.

Part II

Personal Holding Company Income

Note: *Use the worksheet on page 1 to figure ordinary gross income and adjusted ordinary gross income.*

Line 15b—Amounts excluded under section 543(a)(1)(A), 543(a)(1)(B), 543(a)(1)(D), or 543(b)(2)(C).— Include the following interest on this line:

- Interest constituting rent.
- Interest on amounts set aside in a reserve fund under section 511 or 607 of the Merchant Marine Act of 1936.
- Interest received by a broker or dealer (within the meaning of section 3(a)(4) or (5) of the Securities Exchange Act of 1934) in connection with **(a)** any securities or money market instruments held as property described in section 1221(1), **(b)** margin accounts, or **(c)** any financing for a customer secured by securities or money market instruments.
- Interest included on line 4c of the worksheet.

Lines 18a through 18c—Adjusted income from rents.—If both of the following tests are met, rents are not considered PHC income and these lines should not be completed:

1. The amount computed for line 18c is at least 50% of adjusted ordinary gross income (line 5 of the worksheet).

2. The sum of Part VI, line 3, and Part I, line 12, is at least equal to the amount, if any, that PHC income (computed without regard to lines 18c and 22 and by including as PHC income, copyright royalties and the adjusted income from mineral, oil, and gas royalties) exceeds 10% of ordinary gross income (line 3 of the worksheet).

If either of these tests are not met, enter rents (as defined in section 543(b)(3)) on line 18a. Enter the amount from line 4a of the worksheet on line 18b and complete line 18c.

Lines 19a through 19c—Adjusted income from mineral, oil, and gas royalties.—If all three of the following tests are met, mineral, oil, and gas royalties are not PHC income and these lines should not be completed:

1. The amount computed on line 19c is at least 50% of adjusted ordinary gross income (line 5 of the worksheet).

2. PHC income (computed without regard to line 19c, and by including as PHC income, copyright royalties and the adjusted income from rents) is not more than 10% of ordinary gross income (line 3 of the worksheet).

3. The deductions allowable under section 162 (other than compensation for personal services rendered by a shareholder and deductions specifically allowable under other sections) are 15% or more of adjusted ordinary gross income.

If any of these tests are not met, enter mineral, oil, and gas royalties (including production payments and overriding royalties) on line 19a. Enter the amount included on line 4b of the worksheet on line 19b and complete line 19c.

Line 20—Copyright royalties. (Note: *For royalties received in connection with the licensing of computer software, see page 4.***)—**If all three of the following tests are met, copyright royalties are not PHC income and should not be included on line 20:

1. The amount computed for line 20 (not including royalties received for the use of, or right to use, copyrights or interests in copyrights on works created in whole or in part by any shareholder) is at least 50% of ordinary gross income (line 3 of the worksheet).

2. PHC income is not more than 10% of ordinary gross income (line 3 of the worksheet). For this purpose, PHC income is computed:

a. Without regard to copyright royalties (other than royalties received for the use of, or right to use, copyrights or interests in copyrights on works created in whole or in part by any shareholder owning more than 10% of the corporation's stock),

b. Without regard to dividends from any corporation which meets Test **1** above and Test **3** below, and in which the corporation owns at least 50% of all stock (by vote and value), and

c. By including as PHC income the adjusted income from rents and the adjusted income from mineral, oil, and gas royalties.

3. The sum of the deductions allocable to the royalties allowable under section 162 (other than deductions for compensation for personal services rendered by shareholders, deductions for royalties paid or accrued, and deductions specifically allowable under sections other than section 162) is at least 25% of the amount by which ordinary gross income (line 3 of the worksheet) exceeds the sum of the royalties paid or accrued and the depreciation allowable with respect to copyright royalties.

Royalties received in connection with the licensing of computer software.—Royalties received in connection with the licensing of computer software are not considered PHC income if all four of the following tests are met:

1. The corporation is engaged in the active business of developing, manufacturing, or producing computer software.

2. The royalties are at least 50% of ordinary gross income (line 3 of the worksheet).

3. The sum of the deductions allowable under sections 162, 174, and 195 that are allocable to the computer software business is at least 25% of ordinary gross income (or the average of the deductions for the 5 tax years ending with the current tax year is at least 25% of the average ordinary gross income for that period).

4. The sum of Part VI, line 3, and Part I, line 12, is at least equal to the amount, if any, by which PHC income (as modified in accordance with section 543(d)(5)(B)) exceeds 10% of ordinary gross income.

See section 543(d) for more information.

Line 21—Produced film rents.— Produced film rents are not considered PHC income if the rents constitute at least 50% of ordinary gross income (line 3 of the worksheet). See section 543(a)(5) for the definition of produced film rents.

Line 22—Compensation received for the use of corporation property by a 25% or more shareholder.— This line applies only to a corporation with other PHC income in excess of 10% of ordinary gross income (line 3 of the worksheet). For purposes of this limitation, other PHC income is modified in accordance with section 543(a)(6)(C). Enter on line 22 amounts received as compensation for the use of or right to use tangible property of the corporation by or for an individual who at any time during the tax year owned, directly or indirectly, at least 25% in value of the corporation's outstanding stock.

Line 23—Amounts received under personal service contracts and from their sale.—Enter amounts received under a contract under which the corporation is to furnish personal services if some person other than the corporation has the right to designate the individual who is to perform the services (or if the individual who is to perform the services is designated in the contract). Also include amounts received from the sale or other disposition of such a contract. This line applies only if the individual who has performed, is to perform, or may be designated to perform such services, owned at some time during the tax year 25% or more in value of the corporation's outstanding stock.

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