2009 Instructions for Schedule M-3 (100/100W)

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

References in these instructions are to the Internal Revenue Code (IRC) as of **January 1, 2005,** and to the California Revenue and Taxation Code (R&TC).

What's New

Corporations with total assets of $10 million or more. For taxable years beginning on or after January 1, 2009, the Franchise Tax Board (FTB) requires any corporation or group of corporations filing a combined report with total assets of $10 million or more to complete and file Schedule M-3 (100/100W) - Net Income (Loss) Reconciliation for Corporations With Total Assets of $10 Million or More, instead of Schedule M-1, Reconciliation of Income (Loss) per Books With Income per Return. The requirement to file Schedule M-3 (100/100W) applies equally to a single corporation or a corporate group filing a combined report whether on a worldwide or water's-edge basis.

General Information

- In general, California law conforms to the Internal Revenue Code (IRC) as of January 1, 2005. However, there are continuing differences between California and federal law. When California conforms to federal tax law changes, we do not always adopt all of the changes made at the federal level. For more information, go to our website at **ftb.ca.gov** and search for **conformity**. Additional information can be found in FTB Pub. 1001, Supplemental Guidelines to California Adjustments, the instructions for California Schedule CA (540 or 540NR), and the Business Entity tax booklets.

  The instructions provided with California tax forms are a summary of California tax law and are only intended to aid taxpayers in preparing their state income tax returns. We include information that is most useful to the greatest number of taxpayers in the limited space available. It is not possible to include all requirements of the California Revenue and Taxation Code (R&TC) in the tax booklets. Taxpayers should not consider the tax booklets as authoritative law.
- In general, California law requires every unitary group of corporations to file a combined report to assign its combined income among the taxing jurisdictions in which members conduct business. For a discussion on the concepts of the unitary method of taxation and its application by California, see Cal. Code Regs., tit. 18 section 25106.5 and FTB Pub. 1061, Guidelines for Corporations Filing a Combined Report. The corporation can get this publication from our website at **ftb.ca.gov**.

A Purpose

Schedule M-3 (100/100W), Part I, asks certain questions about the corporation's financial information. It also reconciles financial statement net income (loss) in the consolidated financial statements of the corporation or group of corporations filing a combined report to the net income (loss) statement for the California tax return or combined report.

Schedule M-3 (100/100W), Part II and Part III, reconciles financial statement net income (loss) for the corporation or the combined reporting group to the taxable income on Form 100, Side 3, Schedule F, line 30, or Form 100W, Side 3, Schedule F, line 29.

B Who Must File

Any corporation subject to California franchise or income tax, including all members of a corporation or combined reporting group, that reports at least $10 million of combined assets on Form 100 or Form 100W, Side 4, Schedule L, at the end of its taxable year must complete and file Schedule M-3 (100/100W) in lieu of Form 100 or Form 100W, Schedule M-1. A corporation filing Form 100 or Form 100W but not required to file Schedule M-3 (100/100W) **may** file Schedule M-3 (100/100W) in place of Schedule M-1.
A corporation filing Schedule M-3 (100/100W) must check the box on Form 100 or Form 100W, Side 2, Question AA, indicating that Schedule M-3 (100/100W) is attached (whether required or voluntary). A corporation filing Schedule M-3 (100/100W) must not file Schedule M-1.

The FTB does not require a Schedule M-3 (100/100W) for tax-exempt corporations under R&TC Section 23701 that file Form 100 to include nonexempt income.

The $10 million asset-based filing requirement applies to any corporation or a combined reporting group, regardless of whether the California corporation taxpayer members elect to file a single return and aggregate their tax liabilities or file separate tax returns with each reporting only its own liability. That is, in testing whether a combined reporting group has year-end assets of $10 million or more, the Schedule M-3 (100/100W) requirement looks to the combined assets of the group, regardless of whether its taxpayer members file separately or in a single group return.

A corporation must use accrual accounting principles to test whether it or a combined reporting group meets the $10 million asset threshold. A corporation does not need to apply accrual accounting principles only if: (a) the corporation or all includible corporations in a combined reporting group prepare their tax returns using the cash method of accounting, and (b) the corporations didn't prepare accrual basis financial statements or whose results of operations are part of financial statements prepared on an accrual basis.

Example 1. Corporation C is subject to California tax. C owns 100 percent of F, a controlled foreign corporation. C and F are engaged in a unitary business with each other and file a worldwide combined report. For its 2009 taxable year, C prepares consolidated financial statements with F. The consolidated accrual basis financial statements for C and F report total assets at the end of the taxable year of $12 million after intercompany eliminations. On Form 100, Schedule L, C reports separate company total year-end assets of $7 million and F reports separate company total year-end assets of $5 million.

The worldwide combined reporting group (consisting of C and F) must complete and file Schedule M-3 (100/100W) for the 2009 taxable year because the combined year-end assets equal or exceed $10 million.

Example 2. Corporation A owns 75 percent of corporation B. B owns 100 percent of corporation C. For its 2009 taxable year, A prepares a consolidated worldwide financial statement for the ABC consolidated group. Each corporation is subject to California franchise tax. The ABC consolidated financial statement reports total year-end assets of $20 million, which is broken down as follows: A $12 million, B $6 million, and C $2 million. The ABC group is engaged in a unitary business and files a worldwide combined report.

The ABC unitary group must complete and file a California Schedule M-3 (100/100W) because the combined total year-end assets, after intercompany eliminations, equal or exceed $10 million.

Example 3. Same facts as in example 2 above, except that A is not engaged in a unitary business with the BC group. B and C are engaged in a unitary business and file a worldwide combined report.

For the 2009 taxable year, A must complete and file a California Schedule M-3 (100/100W) because it has year-end assets in excess of $10 million. The BC group is not required to file Schedule M-3 (100/100W) because the BC group's year-end total assets are less than $10 million. However, the BC group may voluntarily file Schedule M-3 (100/100W) in lieu of Schedule M-1.

Example 4. Corporation A files its California franchise or income tax return on a water's-edge basis. A is engaged in a unitary business with its wholly owned US domestic subsidiary B and wholly owned foreign subsidiary F. For its 2009 taxable year, A prepares consolidated financial statements with B and F that report total year-end assets of $12 million. A files a combined report with B. F is not an includible entity under R&TC Section 25110(a) and therefore is ineligible to file a combined report with A and B. The water's-edge combined report consisting of A and B shows combined assets on Form 100W, Schedule L of $8 million.

The AB water's-edge combined reporting

group need not file Schedule M-3 (100/100W) for the 2009 taxable year because the AB group has less than $10 million in assets at year end. However, the AB water's-edge combined reporting group may voluntarily file Schedule M-3 (100/100W) in-lieu of Schedule M-1.

Note: If A did not elect to file and determine its taxable income under the water's-edge method, A's combined reporting group on a worldwide basis (consisting of A, B, and F) would have to file Schedule M-3 (100/100W) for the 2009 taxable year because the combined assets of $12 million would have satisfied the $10 million filing requirement.

Example 5. U.S. Corporation X owns 100 percent of CFC1, a controlled foreign corporation, whose income and apportionment factors are partially included in X's water's-edge combined report. Following the provisions of R&TC Section 25110(a)(6), CFC1's inclusion ratio is 40 percent. For its 2009 taxable year, X prepares consolidated financial statements with CFC1. The consolidated accrual basis financial statements for X and CFC1 report total year-end assets of $12 million after intercompany eliminations. X reports separate year-end assets of $9 million and CFC1 reports year-end assets of $3 million.

X must complete and file a Schedule M–3 (100/100W) because the water's-edge combined year-end assets are at least $10 million. The water's edge combined report has $10.2 million of assets at year end, consisting of all the assets of X, or $9 million, plus $1.2 million, which is a prorated amount of CFC1's assets [CFC1's total assets of $3 million times its 40 percent inclusion ratio].

For more information and examples regarding filing requirements, see instructions for federal Schedule M-3 (Form 1120), Net Income (Loss) Reconciliation for Corporations With Total Assets of $10 Million or More.

C Form 100/100W Schedules and Schedule M- 3 Requirements

Schedule L
Total assets shown on Form 100 or Form 100W, Schedule L, line 14, column (d), must equal the total assets of the corporation (or, in the case of a combined reporting group, the total assets of all members of the combined reporting group) as of the last day of the taxable year, and must be the same total assets reported by the corporation (or by each member of the combined reporting group) in the financial statements, if any, used for Schedule M-3 (100/100W). If the corporation prepares financial statements, Schedule L must equal the sum of the financial statement total assets for each corporation included in the combined reporting group and included in the group's worldwide combined report net of eliminations for intercompany transactions between includible corporations. If the corporation does not prepare financial statements, Schedule L must be based on the corporation's books and records. The Form 100 or Form 100W, Schedule L may show tax-basis balance sheet amounts if the corporation is allowed to use books and records for Schedule M-3 (100/100W) and the corporation's books and records show only tax-basis amounts.

Schedule M-2
The amount shown on Form 100 or Form 100W, Schedule M-2, line 2 must equal the amount shown on Schedule M-3 (100/100W), Part I, line 11. Schedule M-2 must only show activity of corporations in the combined reporting group.

Schedule F
Report on Form 100 or Form 100W, Schedule F each item of income, gain, loss, expense, or deduction, after taking into account elimination entries for intercompany transactions and balances between includible corporations. Do not eliminate dividends between members of the same combined report. Report eliminated dividends on Schedule H (100), Dividend Income Deduction or Schedule H (100W), Dividend Income Deduction-Water's-Edge Filers.

D Entity Considerations for Schedule M-3 (100/100W)

For purposes of Schedule M-3 (100/100W), references to the classification of an entity (for example, as a corporation, a partnership, or a trust) are references to the treatment of the entity for federal and California franchise or income tax purposes.

An entity disregarded as separate from its owner for federal tax purposes (disregarded entity) is generally treated similarly for California franchise or income tax purposes. Do not report a disregarded entity separately on Schedule M-3 (100/100W). Instead, present all items of income, gain, loss, deduction, or credit of a disregarded entity as that of its owner.

E Combined Schedule M-3 (100/100W) Versus Combining Schedules M-3 (100/100W)

A combined reporting group must file a combined Schedule M-3 (100/100W) if it has total year-end assets of $10 million or more. A combined Schedule M-3 (100/100W), Parts I, II, and III must show the activity of the combined reporting group. In addition, each corporation in the combined report must complete Part II and Part III of a separate Schedule M-3 (100/100W) to show the activity of that includible corporation. Also, the group must complete Part II and Part III of a separate Schedule M-3 (100/100W) to show combined eliminations (i.e., entries that eliminate transactions between members of the unitary group along with advances to/from each other, and investments in and related equity accounts of those members).

For example, if the combined report group consists of four includible corporations (e.g., a parent and three subsidiaries), the group must complete six Schedule M-3 (100/100W)s as follows:

a) Parts I, II, and III completed on a combined basis to show the activity of the entire combined reporting group.
b) Parts II and III of a separate Schedule M-3 (100/100W) for each corporation in the combined report to show the activity of each includible corporation.
c) Parts II and III of a separate Schedule M-3 (100/100W) to eliminate intercompany transactions between includible corporations and to include limitations on deductions (e.g., charitable contribution limitations and capital loss limitations) and carryover amounts (e.g., charitable contribution carryovers and capital loss carryovers). For more information with respect to intercompany transactions between unitary members, see Cal. Code Regs., tit. 18, section 25106.5.

The corporation must check the appropriate box at the top of Schedule M-3 (100/100W), Part II and Part III, to indicate whether the Schedule M-3 (100/100W) is for:

- The combined reporting group
- An included corporation of the group
- The consolidated financial statement eliminations

An includible corporation must report on its Schedule M-3 (100/100W) each item of income or expense shown in the consolidated financial statements (or books and records) of the combined report group if the includible corporation retains the item in its books and records, rather than sharing or allocating all or a portion of the item applicable to another member(s) of the combined reporting group.

For more information regarding "key" corporations, see Cal. Code Regs., tit. 18, sections 25106.5 and 25106.5-11.

For example, a parent corporation of a combined reporting group prepares financial statements that include all members of the combined reporting group. The parent corporation records in its books and records the income tax expense shown in the consolidated financial statements of the group, rather than allocating the portion of the expense among the members of the group to which the expense relates. Accordingly, on its separate Schedule M-3 (100/100W), the parent corporation must include the income tax expense in the financial statements.

Do **not** include on a separate Schedule M-3 (100/100W) any adjustments at the combined reporting group level unrelated to any specific member of the combined reporting group (e.g., disallowance of net capital losses, contribution deduction carryovers, and limitation of contribution deductions). **Instead**, include those adjustments on the Schedule M-3 (100/100W) of the entire combined reporting group, and on Schedule M-3 (100/100W) for combined eliminations.

Do **not** file a blank Part II and Part III of Schedule M-3 (100/100W) for an includible corporation without any activity for a taxable year. Instead attach to the combined Schedule M-3 (100/100W) a statement with the name and California corporation number and/or FEIN of the inactive, includible corporation(s).

Enter numerical data on the relevant lines in all columns on Schedule M-3 (100/100W), Part II and Part III. Attach schedules to support each line item.

Specific Line Instructions

Follow the federal Schedule M-3 (1120), Net Income (Loss) Reconciliation For Corporations With Total Assets of $10 Million or More, and instructions to complete the California Schedule M-3 (100/100W). However, be aware of federal/state tax differences, as the amounts on Schedule M-3 (100/100W) must reflect the proper California tax treatment. That is, for each item where the federal and state laws differ, make sure to adjust such item to reflect the proper California tax treatment.

Below are the instructions for some of the more common line items where state law differs from the federal. The exceptions are provided for both a corporation or group of corporations filing on a worldwide basis (see Section A – Taxpayers Filing on a Worldwide Basis – Form 100) and water's-edge basis (see Section B – Taxpayers Filing on a Water's-Edge Basis – Form 100W).

Section A – Taxpayers Filing on a Worldwide Basis – Form 100

A corporation or a combined reporting group required to file Schedule M-3 (100/100W) must complete the entire schedule. The corporation must complete Part I by answering all applicable questions except that in the case of a combined reporting group, the "key" corporation (under whose name and California corporation number the group files a single tax return) must complete Part I only once, on the combined Schedule M-3 (100/100W). For more information regarding "key" corporations, see Cal. Code Regs., tit. 18, sections 25106.5 and 25106.5-11.

Part I – Financial Information and Net Income (Loss) Reconciliation

Line 1a - Line 1c. Questions Regarding the Type of Income Statement Prepared
Use the consolidated financial statements for the parent corporation of the combined reporting group (foreign or U.S.) that includes the corporation (or combined reporting group) required filing Schedule M-3 (100/100W).

Line 2a - Line 2c and Line 3a - Line 3c. Questions Regarding Income Statements and Voting Common Stock
In completing these lines, use the federal Schedule M-3 (1120) instructions.

Line 4. Worldwide Combined Net Income (Loss) per Income Statement
Include on Part I, line 4, the corporation's worldwide combined net income (loss) in the income statement (or books and records, if applicable). In completing Schedule M-3 (100/100W), the corporation must use financial statement amounts from the financial statement type checked "Yes" on Part I, line 1, or from its books and records if Part I, line 1c is checked "No." If Part I, line 1a, is checked "Yes," include on Part I, line 4, the net income amount included in the income statement presented to the SEC on the corporation's annual Form 10-K or with regard to SEC-registered foreign private issuers, Form 20-F. In any case, the income or loss to be included is the amount contained in the SEC filing for the security identified on Part I, line 3b, if applicable.

If a corporation prepares financial statements, the amount on line 4 must equal the financial statement net income (loss) for the income statement period ending with or within the taxable year shown on line 2a. If the corporation prepares financial statements and the income statement period differs from the corporation's taxable year, then the income statement period shown on line 2a applies for purposes of Part I, line 4 through line 8.

If the corporation does not prepare financial statements, check "No" on Part I, line 1c, and enter the net income (loss) in the books and records of the corporation (or the combined reporting group) on Part I, line 4.

Line 5a through line 10
Include all amounts required to adjust worldwide net income (loss) reported on Part I, line 4 (whether from financial statements or books and records), to net income (loss) of includible corporations that must be included on Part I, line 11.

Line 5 and Line 6. Net Income (Loss) of Non-includible Foreign and Domestic Entities
Exclude the portion of the financial statement net income or loss of each foreign or domestic entity in the consolidated financial statement group that is not included in the combined report. Generally, a corporation is excluded from the combined report if it:

- Lacks unity of ownership with the group (R&TC Section 25105)
- Is not engaged in a unitary business with the group (R&TC Section 25101)
- Is an insurance company constitutionally exempted from the California franchise or income tax (FTB Legal Ruling 385)

Attach a schedule with the name of each non-includible entity. Show its California corporation number and/or FEIN (if applicable) and net income (loss) in the financial statement (or books and records) included on line 4 but excluded on line 5 or line 6. Ignore the effect of consolidation or elimination entries on the scheduled net income (loss) of each non-includible entity. Also, the schedule must list separately net consolidation and elimination entries not includable on Part I, line 8, to insure that the separate financial accounting income (loss) of each non-includible entity remains separately stated.

On Part I, line 5 and line 6, do not exclude the financial statement net income (loss) of any non-includible entity accounted for in the financial statements under the equity method.

Part II and Part III – Reporting Requirements

Each corporation in the combined report completes Part II and Part III using California tax laws and must attach detailed schedules for all required line items in Part II and Part III of Schedule M-3 (100/100W). The number of Parts II should equal the number of Parts III filed by the corporation. Each corporation in the combined report completes Part II and Part III using California tax laws and must attach detailed schedules for all required line items in Part II and Part III of Schedule M-3 (100/100W).

On Part II and Part III, after the corporation name and California corporation number of the "key" corporation of the combined report group that files a single tax return, check the appropriate box to indicate whether the Schedule M-3 (100/100W) is for:

- Combined reporting group
- Parent corporation
- Combined eliminations
- Subsidiary corporation

For each line item in Part II and Part III, include in column (a) the applicable amount of the net income (loss) included on Part I, line 11, and include in column (d) the **applicable** amount of the taxable income on Form 100, Schedule F, line 30.

When to Complete Columns (a), (b), (c), and(d)
The corporation must complete all columns of Part II and Part III for all taxable years for which the corporation must file Schedule M-3 (100/100W). **For exampl**e, if a corporation must file Schedule M-3 (100/100W) as a member of a combined reporting group, and the corporation leaves the combined reporting group, the corporation must complete the entire Schedule M-3 (100/100W) for any succeeding taxable year that the corporation is required to complete Schedule M-3 (100/100W). If a corporation joins a different filing combined reporting group, then the corporation must complete its entire Schedule M-3 (100/100W) for any year that the combined reporting group is required to file Schedule M-3 (100/100W). Full completion of the Schedule M-3 is also required for those taxpayers who are not required to file Schedule M-3 (100/100W) but choose to voluntarily file Schedule M-3 (100/100W).

Columns (b) and (c)
Columns (b) and (c) of Parts II and III must be completed using California tax laws and must attach detailed schedules for all required line items.

For any item of income, gain, loss, expense, or deduction for which columns (a) and (d) differ, enter the temporary portion of this "book-tax" difference in column (b) and the permanent portion in column (c).

General Reporting Requirements

Include amounts related to a reportable transaction identified by the R&TC Section 18407 or described in Treas. Reg. Section 1.6011-4(b) (other than a transaction described in Treas. Regs. Section 1.6011-(4)(b)(6) relating to significant book-tax differences), in applicable columns (a), (b), (c), and (d) of Part II, line 12, items relating to reportable transactions, regardless of whether the amount would otherwise be included on Part II or Part III of Schedule M-3 (100/100W). Thus, if a corporation files federal Form 8886, Reportable Transaction Disclosure Statement, it must include the amounts related to that reportable transaction on Part II, line 12.

California listed transactions include all federal listed transactions. (R&TC Section 18407; FTB Chief Counsel Announcement 2003-1.)

Attach a copy of federal Form 8916-A, Supplemental Attachment to Schedule M-3 (100/100W), to support any amounts on Part II, line 13; Part II, line 17; or Part III, line 8.

Part II – Reconciliation of Net Income (Loss) per Income Statement of Includible Corporations With Taxable Income per Return

For any item included on Part II, line 1, line 3 through line 6, or line 8, attach a supporting schedule that provides the name of the entity for which the item is included, the type of entity (corporation, partnership, etc.), the entity's California corporation number and/or FEIN (if applicable), and the item amounts for columns (a) through (d).

For Part II line items not listed below, follow the federal Schedule M-3 (1120) instructions. However, all columns in Part II must reflect the proper California tax treatment.

Line 3. Subpart F, QEF, and Similar Income Inclusions

California does not conform to the federal subpart F provisions (IRC Section 951) or the treatment of certain passive foreign investment companies (IRC Sections 1291 through 1298). Under the unitary method, the business income from all unitary corporations is combined into a single worldwide combined report. The consolidated net income (loss) of all corporations included in the combined report is included in Part I, line 11. Accordingly, line 3 is not applicable for California franchise or income tax purposes.

The FTB will accept an alternative reporting method for this line. If the corporation or combined reporting group chooses to follow the federal Schedule M-3 (Form 1120) instructions, Part II, line 3, the corporation must include a state adjustment on Form 100, Side 1, line 16, to reverse the income amount included on Schedule M-3 (100/100W), Part II, line 3, column (d).

Line 4. IRC Section 78 Gross-Up

California does not conform to IRC Section 78, Gross-Up. Since line 4 is not applicable for California franchise or income tax purposes, column (d) should be zero.

The FTB will accept an alternative reporting method for this line. If the corporation or combined reporting group chooses to follow the federal Schedule M-3 (Form 1120) instructions, Part II, line 4, the corporation must include a state adjustment on Form 100, Side 1, line 16, to reverse the income amount included on Schedule M-3, Part II, line 4, column (d).

Line 5. Gross Foreign Distributions Previously Taxed

Include on line 5, column (a), any distributions received from corporations included in Part I, line 11, and were previously taxed for federal purposes. For example, include in column (a) amounts excluded from taxable income under IRC Sections 959 and 1293(c).

Do not exclude the previously taxed distribution amounts in column (b) or (c) as California does not conform to IRC Sections 959 and 1293(c). Under California law, actual distributions must be included in the combined report. Include the full distribution before any withholding tax on line 5, column (d).

Line 12. Items Relating to Reportable Transactions

Include on Part II, line 12 amounts related to any reportable transactions, as described in Treas. Regs. Section 1.6011-4 or identified under R&TC Section 18407 other than transactions described in Treas. Regs. Section 1.6011-4(b)(6) relating to significant book-tax differences, even if the differences reported elsewhere in Part II or Part III. Thus, if a corporation files federal Form 8886 for any reportable transaction described in Treas. Regs. Section 1.6011-4 or identified by the Franchise Tax Board and the transaction is not described in Treas. Regs. Section 1.6011-4(b)(6) relating to significant book-tax differences, the amounts related to that reportable transaction must be included on Part II, line 12. For additional information, see federal instructions for Schedule M-3 (1120), Part II, line 12.

Line 29. Reconciliation Totals

The amount included on Part II, line 29, columns (a) through (d) of the combined Schedule M-3 (100/100W), is the sum of what each member of the combined reporting group includes on its respective Schedule M-3 (100/100W) (including a Schedule M-3 (100/100W) for consolidation eliminations, if necessary).

The amount included on Part II, line 29, column (a), of the combined Schedule M-3 (100/100W) must equal the amount included on Part I, line 11, of the combined Schedule M-3 (100/100W), and the amount included on Part II, line 29, column (d), of the combined Schedule M-3 (100/100W) must equal the amount included on the combined Form 100, Schedule F, line 30.

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

Follow the federal Schedule M-3 (1120) instructions, for Part III line items not listed below. However, all columns in Part III must reflect the proper California tax treatment.

Line 1 through Line 7. Income Tax Expense

R&TC Section 24345 does not allow the deduction for taxes on, according to, or measured by income. Use columns (b) or (c) to adjust the deduction reported in columns (a).

The FTB will accept an alternative reporting method for these lines. If the corporation or combined reporting group chooses to follow the federal Schedule M-3 (Form 1120) instructions for Part III, lines 1 through 7, the corporation must report a state adjustment on Form 100, Side 1, line 2 and line 3, to reverse the federal deduction reported on column (d).

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 combined reporting group must complete line 1 through line 6 according to the allocation of tax expense among the members of the combined reporting 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 combined reporting group (income tax expense) is allocated among the members of the combined reporting 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 (100/100W). However, if the income tax expense is not shared or allocated among members of the combined reporting 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 (100/100W).

Line 22. Domestic Production Activities Deduction

California does not conform to IRC Section 199. Accordingly, line 22, column (d) is shaded.

Section B Taxpayers Filing on a Water's-Edge Basis – Form 100W

The instructions below apply to a corporation or group of corporations filing a combined report on a water's-edge basis using Form 100W, California Corporation Franchise or Income Tax Return – Water's-Edge Filers.

The water's-edge rules do not override the unitary business concept or the apportionment and allocation rules. For a discussion on the concepts of the unitary method of taxation and its application by California, see Cal. Code Regs., tit. 18 section 25106.5 and FTB Pub. 1061, Guidelines for Corporations Filing a Combined Report. For discussion on corporations making a Water's-Edge election and the entities included in a Water's-Edge combined report, see R&TC Sections 25110, 25111 and 25113.

Part I - Financial Information and Net Income (Loss) Reconciliation

Line 1a - Line 1c. Questions Regarding the Type of Income Statement Prepared
Use the consolidated financial statements for the parent corporation of the combined reporting group that includes the corporation (or combined reporting group) required filing Schedule M-3 (100/100W). See federal instructions to Schedule M-3 (1120), Part I, line 1.

Line 2a - Line 2c and Line 3a - Line 3c. Questions Regarding Income Statements and Voting Common Stock
In completing these lines, use the federal Schedule M-3 (1120) instructions.

Line 4. Worldwide Combined Net Income (Loss) per Income Statement
Report on Part I, line 4, the worldwide combined net income (loss) per the income statement (or books and records, if applicable) of the water's-edge combined reporting group. A corporation filing Form 100W must report its worldwide income on Part I, line 4. See federal instructions to Schedule M-3 (1120), Part I, line 4.

Line 5a through line 10.
Include all amounts required to adjust worldwide net income (loss) reported on Part I, line 4 (whether from financial statements or books and records), to net income (loss) of includible corporations that must be included on Part I, line 11.

Line 5. Net Income (Loss) of Non-includible Foreign Entities
Exclude the portion of the financial statement net income (line 5a) or loss (line 5b) of each foreign entity in the consolidated financial statement group that is not included in the combined report.

Generally, a foreign corporation is excluded from the combined report if it:

- Lacks unity of ownership with the group (R&TC Section 25105)
- Is not engaged in a unitary business with the group (R&TC Section 25101)
- Is an insurance company constitutionally exempted from the California franchise or income tax (FTB Legal Ruling 385)
- Is unitary with the group, but it is not an includible entity described in R&TC Section 25110(a)

Controlled Foreign Corporations (CFC) includible under R&TC Section 25110(a) – If a controlled foreign corporation is an includible in the combined report:

- Complete and file form FTB 2416, Schedule of Included Controlled Foreign Corporations (CFC)
- Report the includible net income (loss) of the CFC on Form 100W, Side 1, line 7a as computed on form FTB 2416
- Exclude the CFC's net income (line 5a) or loss (line 5b) included in Part I, line 4

For example, CFC has a net income of $100 and an inclusion ratio according to form FTB 2416 of 40 percent. The U.S. parent corporation included $100 of CFC's income in Part I, line 4. The U.S. parent reports the CFC's includible net income of $40 ($100 x 40%) on Form 100W, Side 1, line 7a. On line 5a, it removes the CFC's income of $100 because the CFC's includible income is being reported on Form 100W, Side 1, line 7a.

Attach a schedule with the name of each non-includible entity. Show its California corporation number and/or FEIN (if applicable) and net income (loss) in the financial statement (or books and records) included on line 4 but removed on this line 5. Ignore the effect of consolidation or elimination entries on the scheduled net income (loss) of each non-includible entity. On the schedule also show separately net consolidation and elimination entries not reportable on Part I, line 8, to insure that the separate financial accounting income (loss) of each non-includible entity remains separately stated.

For example, if line 5a includes the net income (after consolidation and elimination entries) of non-includible corporations, the schedule should show the income (loss) of each non-includible legal entity from its own financial accounting net income statement or books and records. It should also show all consolidation or elimination entries (for intercompany dividends, minority interests, etc.) not reportable on Part I, line 8, as a net amount on a line separate and apart from lines that report each non-includible entity's separate net income (loss).

On Part I, line 8, adjust for consolidation eliminations, minority interest, and intercompany dividends between each non-includible entity and each includible entity.

On Part I, line 5, do not exclude the financial statement net income (loss) of any non-includible entity accounted for in the financial statements under the equity method.

Line 6. Net Income (Loss) of Non-includible U.S. Entities
Exclude that portion of the financial statement net income (line 6a) or loss (line 6b) of each U.S. entity in the consolidated financial statement group that is not included in the combined report. Generally, a domestic corporation is excluded from the combined report if it:

- Lacks unity of ownership with the group (R&TC Section 25105)
- Is not engaged in a unitary business with the group (R&TC Section 25101)
- Is an insurance company constitutionally exempted from the California franchise or income tax (FTB Legal Ruling 385)

Attach a schedule with the name of each non-includible entity. Show its California corporation number and/or FEIN (if applicable) and net income (loss) in the financial statement (or books and records) included on line 4 but excluded on this line 6. Ignore the effect of consolidation or elimination entries on the scheduled net income (loss) of each non-includible entity. Also, show separately net consolidation and elimination entries not reportable on Part I, line 8, to insure that the separate financial accounting income (loss) of each non-includible entity remains separately stated.

For example, if Part I, line 6a, includes the net income (after consolidation and elimination entries) of non-includible corporations, the schedule should show the income (loss) of each non-includible legal entity from its own financial accounting net income statement or books and records. It should also show all consolidation or elimination entries (for intercompany dividends, minority interests, etc.) not reportable on Part I, line 8, as a net amount on a line separate and apart on the schedule from lines that report each non-includible entity's separate net income (loss).

On Part I, line 8, adjust for consolidation eliminations, minority interest, and intercompany dividends between each non-includible entity and each includible entity.

On Part I, line 6, do not exclude the financial statement net income (loss) of any non-includible entity accounted for in the financial statements under the equity method.

Part II - Reconciliation of Net Income (Loss) per Income Statement of Includible Corporations With Taxable Income per Return and

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

To complete these parts, see instructions under Specific Line Instructions, Section A, Taxpayers Filing on a Worldwide Basis – Form 100, Part II and Part III.