2008 Instructions for Schedule M-3 (100S)

Net Income (Loss) Reconciliation for S 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, 2008, any corporation with total assets of $10 million or more must complete and file California Schedule M-3 (100S), Net Income (Loss) Reconciliation for S Corporations With Total Assets of $10 Million or More, instead of Form 100S, Schedule M-1, Reconciliation of Income (Loss) per Books With Income per Return. The requirement to file Schedule M-3 (100S) applies equally to a single S corporation or a corporate group filing a combined report.

General Information

In general, California law conforms to the Internal Revenue Code (IRC) as of January 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 regarding California and federal law, 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.

A Purpose

Schedule M-3 (100S), Part I, asks certain questions about the S corporation's financial statements and reconciles financial statement net income (loss) for the combined financial statement group to income (loss) per the income statement for the S corporation. Use federal Schedule M-3 (Form 1120S), Part I, amounts to complete California Schedule M-3 (100S), Part I.

Schedule M-3 (100S), Part II and Part III, reconcile financial statement net income (loss) to income (loss) per tax return. Adjustments consistent with California income and franchise tax law must be made to the book income and expenses to compute the California income (loss).

B Who Must File

S corporations must complete and file Schedule M-3 (100S), instead of Form 100S, Schedule M-1, if either of the following applies:

- Form 100S, Schedule L, line 14, total assets are $10 million or more at the end of the taxable year
- A federal Schedule M-3 (Form 1120S), Net Income (Loss) Reconciliation for S Corporations With Total Assets of $10 Million or More, is filed.

An S corporation not required to file Schedule M-3 (100S) may voluntarily file Schedule M-3 (100S) instead of Form 100S, Schedule M-1. If the S corporation voluntarily files Schedule M-3 (Form 1120S) for federal purposes, a Schedule M-3 (100S) **must** be filed for California purposes. An S corporation filing Schedule M-3 (100S) must check the box on Form 100S, Schedule Q, question R, indicating that Schedule M-3 (100S) is attached (whether required or voluntary.) For more information and examples regarding filing requirements, see federal Schedule M-3 (Form 1120S) instructions.

Specific Instructions

Column (a) through column (d)

To complete Schedule M-3 (100S), Part II and Part III, column (a) through column (d), the S corporation must apply the following rules:

- Completion of column (a) and column (d) is optional for the first taxable year in which the federal Schedule M-3 (Form 1120S) is required.
- Complete column (b) and column (c) for any taxable year for which the S corporation files the Schedule M-3.
- Complete column (a) through column (d) for all taxable years subsequent to the first taxable year the S corporation is required to file Schedule M-3 for federal purposes.
- If, an S corporation voluntarily files Schedule M-3 (100S) in lieu of Form 100S, Schedule M-1, then in those voluntary filing years the S corporation is not required to complete column (a) and column (d)
- Transfer the amounts reported on federal Schedule M-3 (Form 1120S), Part II and Part III, column (a) through column (d) to Schedule M-3 (100S), Part II and Part III, column (a) through column (d). See federal Schedule M-3 (Form 1120S) instructions for more information.

Attach a copy of federal Form 8916-A, Supplemental Attachment to Schedule M-3 (100S), to support any amounts on Part II, line 11, line 15; or Part III, line 26.

Column (e) California Adjustments

All adjustments entered on column (e) should be adjustments related to differences between California and federal tax laws for each specific line item. Therefore, do not include adjustments for amounts not apportioned or sourced to California.

Note: The differences between California and federal law identified in these instructions are not all-inclusive.

Column (f) Total Amounts Using California Law

Combine each line item of column (d) and column (e); enter the total on column (f). This is the total amount under California tax law. The totals on column (f) do not reflect amounts that are apportioned or sourced to California.

Specific Line Instructions

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

Complete Part I for any taxable year for which the S corporation files Schedule M-3 (100S). Follow the federal Schedule M-3 (Form 1120S) instructions "Specific Instructions for Part I" to complete line 1 through line 11. Use the same methodology and amounts reported on federal Schedule M-3 (Form 1120S), Part I to complete California Schedule M-3 (100S), Part I.

Part II – Reconciliation of Net Income (Loss) per Income Statement of the Corporation With Total Income (Loss) per Return

Income (Loss) Items

Use the amounts reported on federal Schedule M-3 (Form 1120S), Part II column (a) through column (d) to complete California Schedule M-3 (100S), Part II, column (a) through column (d). See Specific Instructions on how to complete Part II and Part III for more information.

Note: The differences between California and federal law identified in these instructions are not all-inclusive.

Line 2 – Gross foreign dividends not previously taxed

Enter an adjustment on line 2, column (e) for any gross foreign dividends entered on other lines.

Line 3a – Subpart F, QEF, and similar income inclusions

California does not conform to Subpart F or the federal passive foreign investment company rules. The corporation must include the amount reported on line 3a, column (d), as an adjustment on column (e).

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Line 3b – Income for California Purposes from Foreign Corporations
California does not conform to Subpart F or the federal passive foreign investment company rules. The corporation must enter income from foreign corporations on column (e) to the extent not entered on line 2.

Line 6 – U.S. Dividends

Line 11. Interest income
See FTB Pub. 1001 for examples of differences between federal and California law. Enter differences on column (e).

Line 7, Line 8, and Line 9 – Income (loss) from partnerships and other pass through entities
For each partnership or other pass through entity reported on line 7 through line 9, attach a supporting schedule that provides the entities name, FEIN (if applicable), the taxpayer's end of year profit-sharing percentage (if applicable), the taxpayer's end of year loss-sharing percentage (if applicable), and the amounts reported by the taxpayer in column a through column f, as applicable.

Line 15 – Cost of goods sold
California does not conform to IRC Section 198(h), relating to termination and expensing of environmental remediation costs after 12/31/2003. See R&TC Section 24369.4. Enter differences on column (e).

Line 17 – IRC Section 481(a) adjustments
Generally, an election to use a method of accounting for federal purposes is considered an election for California purposes. However, there are some exceptions. See R&TC Section 24721. Enter differences on column (e).

Line 19 – Income recognition from long-term contracts
California generally conforms to IRC Section 460. See R&TC Sections 24673 and 24673.2 for modifications to IRC Section 460. Enter differences on column (e).

Part III – Reconciliation of Net Income (Loss) per Income Statement of the Corporation With Total Income (Loss) per Return

Expense/ Deduction Items
Use the amounts reported on federal Schedule M-3 (Form 1120S), Part III column (a) through column (d) to complete California Schedule M-3 (100S), Part III, column (a) through column (d). See Specific Instructions on how to complete Part II and Part III for more information.

Note: The differences between California and federal law identified in these instructions are not all-inclusive.

Line 3 through Line 6 – Income tax expense
California does not allow a deduction for state or foreign taxes measured by income. Include on column (e) any deductions allowed for federal purposes on line 1 through line 4.

Line 11 – Pension and profit sharing
See R&TC Sections 24611 and 24612 for differences between federal and California law. Enter differences on column (e).

Line 13 – Deferred compensation
See R&TC Sections 24611 and 24612 for differences between federal and California law. Enter differences on column (e).

Line 22 – IRC Section 198 environmental remediation costs
California does not conform to IRC Section 198(h), relating to termination and expensing of environmental remediation costs after 12/31/2003. See R&TC Section 24369.4. Enter differences on column (e).

Line 24 – Depreciation

See FTB Pub. 1001 for examples of differences between federal and California law for depreciation. Enter differences on column (e) if the difference is not reportable elsewhere on Schedule M-3 (100S), for example, on Part II, line 7 through line 9 and line 15, column (e).

Line 29 – Other expense/deduction items with differences
See FTB Pub. 1001 for examples of differences between federal and California law for other expense/deduction items. Enter differences on column (e).

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