Allocation and Apportionment of Expenses

April 19th - 20th
U.S. International Tax Compliance & Reporting
Radisson Plaza – Warwick Hotel

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We cover in this Module:

- **Part 1** - How expense apportionment affects the foreign tax credit benefits.
- Providing key definitions for
  - class of income,
  - statutory groupings
  - residual groupings
We cover in this Module: continued

- **Part II** - Application and apportionment of
  - interest expense
  - research and experimental expenses
  - stewardship,
  - state taxes and charitable deductions

- **Part III** - Adopting a plan to apportion selling, general and administrative expenses
Part 1 - How expense apportionment affects the foreign tax credit benefits.
Example - How expense apportionment affects the foreign tax credit benefits.

- The allocation and apportionment of expenses affects the amount of foreign tax credit limitation since expenses are used in deriving taxable income.

The Limitation Equation

\[
\text{Foreign Source Taxable Income} \times \text{World-wide Taxable Income} \times \text{U.S. Tax Liability}
\]
How expense apportionment affects the foreign tax credit benefits.

<table>
<thead>
<tr>
<th>Source</th>
<th>Taxable Income</th>
<th>Tax Rate</th>
<th>Tax Liability</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreign Source Taxable Income</td>
<td>3,000</td>
<td>34%</td>
<td>1,020</td>
</tr>
<tr>
<td>U.S. Source Taxable Income</td>
<td>4,000</td>
<td>34%</td>
<td>1,360</td>
</tr>
<tr>
<td>Total</td>
<td>7,000</td>
<td></td>
<td>2,380</td>
</tr>
</tbody>
</table>

Foreign Source Taxable Income x 2,380 = 1,020
## Results

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. Tax Liability</td>
<td>2,380</td>
</tr>
<tr>
<td>Allowable FTC</td>
<td>-1,020</td>
</tr>
<tr>
<td>Unutilized FTC Carry Over</td>
<td>0</td>
</tr>
</tbody>
</table>
Re-allocate an expense item of 500 to Foreign Source Income

<table>
<thead>
<tr>
<th>Source Income</th>
<th>Tax Rate</th>
<th>Tax Liability</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreign Source Taxable Income</td>
<td>34%</td>
<td>850</td>
</tr>
<tr>
<td>U.S. Source Taxable Income</td>
<td>34%</td>
<td>1,530</td>
</tr>
<tr>
<td>Total</td>
<td>34%</td>
<td>2,380</td>
</tr>
</tbody>
</table>

Foreign Source Taxable Income \times 2,380 = 850
### Results Compared

<table>
<thead>
<tr>
<th>Allowable without expense allocation</th>
<th>1,020</th>
</tr>
</thead>
<tbody>
<tr>
<td>Allowable FTC</td>
<td>850</td>
</tr>
<tr>
<td>Carry Forward Unutilized FTC</td>
<td>170</td>
</tr>
</tbody>
</table>
FTC Interaction with Qualified Productions Activities Income

- A deduction is allowed for a taxpayers “qualified production activities income” which is currently 6% for 2009 and 9% thereafter. QPAI is actually DPGR less certain costs and expenses.

- There are three categories of costs and expenses; cost of goods sold allocable to DPGR, other expenses directly allocable and expenses not directly allocable.
Expense Allocation for QPAI

- Treasury Regulations allow three methods for allocating and apportioning expenses for purposes of §199.
  - The principal method
  - The §861 method
  - simplified deduction method
861 method = “preferred method”

- The Consistency Rule
  - If a taxpayer applies the allocation and apportionment rules of the IRC §861 regulations for one operative section, (i.e., to allocate expenses to FSI for the FTC) limitation the taxpayer must apply the same method of allocation and the same principles of apportionment to other operative sections such as calculating the QPAD
Exception to the Consistency Rule

- Net operating losses not apportioned to QPAI

- Charitable contributions are apportioned ratably between QPAI and non-QPAI

- Research & Experimental expenses are allocated and apportioned to QPAI without taking into account the exclusive apportionment applicable to the FTC limitation calculations
The QPAI Deduction and the FTC benefits

- Understand first…there are competing objectives with regard to expense allocations between the foreign tax credit ("FTC") limitation and the domestic production activity deduction ("DPAD")
  - The objective of the Foreign Tax Credit Limitation mechanism is to maximizes foreign source taxable income
  - The objective of the DPAD is to maximize the domestic production activities income deduction
Understand the Equations

➡️ **The Limitation Equation**

\[
\text{Foreign Source Taxable Income} \times \frac{\text{World-wide Taxable Income}}{\text{U.S. Tax Liability}} \times 35\%
\]

Stated another way…FSI x 35%

DPAD for 2008 = 6% of qualified production activity income ("QPAI") then you take that result and multiply by the tax rate (i.e. 35%)
Interest Allocations & Apportionment affects FTC benefits

- How is interest expense allocated
  - Fair Market Value of assets
  - Tax Book Value (Average assets)
  - Alternate Tax Book Value (Straight Line)
Consider

- How are U.S. assets depreciated?
- Is the consolidated U.S. tax balance sheet weighted unfairly to foreign assets because consolidating adjustments effectively eliminate: investments in U.S. subsidiaries, U.S. intercompany loans and U.S. intercompany accounts receivable?
- How are assets located outside the U.S. depreciated?
- Which assets have the higher TBV?
- Where does more of the interest get allocated?
Example – allocate $100 of Interest

<table>
<thead>
<tr>
<th>U.S. MACRS</th>
<th>Foreign Straight Line</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Average Assets</strong></td>
<td><strong>Average Assets</strong></td>
</tr>
<tr>
<td>$10,000,000</td>
<td>$10,000,000</td>
</tr>
<tr>
<td>($6,000,000)</td>
<td>($4,000,000)</td>
</tr>
<tr>
<td><strong>4,000,000</strong></td>
<td><strong>6,000,000</strong></td>
</tr>
</tbody>
</table>

40% 60%
Remember the Example?

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
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</thead>
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<tr>
<td>Allowable without expense allocation</td>
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<td>170</td>
</tr>
</tbody>
</table>

Unutilized FTC
Stewardship Expenses affects FTC benefits

- Stewardship and other oversight expenses reduce foreign source taxable income for the FTC limitation, but not QPAI
  - Allocated to a class of gross income consisting of dividends received or to be received from foreign companies
Research & Development

- **Specific Allocation of R&D Expenses**

  - Gross income method for the FTC limitation
    - 25% of the R&D is allocated to the country where the majority of the research was performed
  
  - Sales income method for the FTC limitation
    - 50% of the R&D is allocated to the country where the majority of the research was performed
  
  - For the DPAD, no specific allocation so 100% of the R&D is allocated to QPAI and non-QPAI
Research & Development Consistency

- Two Methods to allocate R&D to the FTC limitation: gross income method or the sales method
- Grouping using 3 digit SIC codes
- Specific Allocations:
  - Government regulations
  - For market development
Selling General & Administrative ("SG&A")

- Generally SG&A other than those previously discussed are allocated rather than apportioned.

👉 Remember

Allocation is fact based. Identify relevant drivers and allocate the expenses to the income of those drivers
Understanding key definitions for a class of income, statutory and residual groupings and gross income apportionment
Expense Apportionment

- Guidelines are provided in Treas. Reg. 1.861-8 for allocating and apportioning deductions. Specific expenses are enumerated along with the treatment for allocating and apportioning.

- Items that represent capital expenditures are not allocated and apportioned because they are included in the basis of another asset. This would represent items under UNICAP.
Where are the rules located?

- **Treasury Regulation 1.861-8**
  - Computation of taxable income from sources within and without the United States
Definition - Allocation

**Allocation** – expenses assigned based upon a factual relationship to certain classes of income (i.e. business income, rents, royalties, interest, and dividends).

- In other words, if an expense is incurred as a result of or incident to or in connection with an activity then, that expense is allocated to the income of that activity to which it is attributable (referred to as a class of income).

**Keys**…expense incurred (1) as a result of, (2) incident to or (3) in connection with
Example 1 – statutory and residual groupings

- Assume a domestic corporation manufactures in the United States and sells through its foreign branch. Assume the independent factory price ("IFP") method is used for dividing gross income between U.S. source manufacturing income and foreign source sales income.
Example 1 - results

- Expenses related to the foreign branch are definitely related to foreign source income (statutory grouping).

- Expense related to the manufacturing process are definitely related to US source gross income (referred to as a residual grouping) and are therefore excluded in determining FSI.
Terminology for Allocation & Apportionment

Residual Grouping

Statutory Grouping

US Co Mfg

Branch Sales

Income is determined by Statute or Code Section
Explanation

- **Statutory Grouping** - means the gross income from a specific source or activity which must first be determined in order to arrive at taxable income... under an operative section for example:

  - FSI
  - ECI
  - Subpart F
Definitions

- The previous example leads to another term that needs defined “Apportionment”
- If a deduction is definitely related to a class of gross income that includes income in a statutory grouping and the residual grouping....an “apportionment” is required.
Example 1 - expanded

- Assume domestic company incurs management expenses in connection with the manufacturing and sale of its goods.
  - Since the management expenses relate to all of the domestic company’s activities they are definitely related to a class of gross income that includes both U.S. and foreign source income.
  - Because the expenses fall partly in the statutory grouping and partly in the residual grouping they must be apportioned between the two groups.
Terminology for Allocation & Apportionment

Incurs Management Expenses

Management Expenses also relate to branch sales

US Co Mfg

Branch Sales

Management Expenses are “Apportioned” between Statutory and Residual groupings
Question

Incurs Management Expenses of 100

How much is “Apportioned” between each entity

US Co Mfg

Branch Sales
Question

Incurs Management Expenses of 100

US Co Mfg

Branch Sales

Apportionment by

- Units sold
- Gross receipts
- Gross income
- Cost of goods sold
- Assets used
- Space used
- Production hours
- Any other reasonable method
Debrief

- FTC benefits are affected by Expense Allocation & Apportionment

- Defined terms by example
  - Classes of income (i.e. business income, rents, royalties, interest, and dividends)

- Allocation & Apportionment to...
  - Statutory Groupings
  - Residual Groupings
Debrief - How is Allocation Accomplished?

- Allocation is accomplished by determining, with respect to each deduction, the class of gross income to which the deduction is definitely related and then allocating such deduction to such class of gross income.

- **Note**
  - A deduction shall be considered definitely related to a class of gross income if expense incurred
  - (1) as a result of, (2) incident to or (3) in connection with
Debrief - How is Apportionment Accomplished?

- Expenses have to be allocated and apportioned to statutory classes of income even if that particular class does not have any income.

- Consider the example of a U.S. company that owns several foreign subsidiaries that have not paid any dividends
  - The U.S. company has a statutory class of income: dividends from foreign subsidiaries
    - Interest, R&D, G&A, etc. would be allocated to this class of income
      - Allocations can create an overall foreign loss (“OFL”)
Debrief - How is Apportionment Accomplished?

- An apportionment must be done in a way that reflects to a reasonable extent the factual relationship between a deduction and the grouping of gross income *(Treas. Reg 1.861-8T(C)(1))*

- Acceptable Methods
  - Number of units sold
  - Gross receipts
  - Assets used
  - Space used or time spent
Part II of this Module

Application and apportionment of

- Interest expense
- Research expenses
- Stewardship expenses
- State tax
- Charitable contributions
Interest Expense

Interest expense relates to all of a taxpayer's activities and assets and therefore is apportioned based on the basis of assets rather than gross income. Note: Asset values determined under tax book value, fair market value or alternative tax book value.

Theoretically allocated to classes of gross income in proportion to assets that generate or can reasonably be expected to generate such income.

Generally use average of BOY and EOY assets, (monthly average may be required in case of significant acquisition or dispositions during the year).
Treas. Reg. §1.861-9T(j)

May elect to apportion interest of all CFCs under the “modified gross income” method as described in Reg. §1.861-9T(j)

- However, this election is not available to a CFC if a US shareholder and affiliates constitute a controlling shareholder and the CFC elects FMV method.
Interest Expense

- Example Asset Method
  - Assume interest expense of 200 for the year and average net assets is 4,000 which includes 800 of net assets used in activities that generate FSI
Interest Expense

- Step 1 – determine the apportionment amount for the **statutory grouping first** and then apportion balance to the residual grouping

  - **Result**
    - Statutory grouping \((800/4,000) \times 200 = 40\) of interest
    - Residual grouping 160 \((200-40)\)
A Formula to Allocate Interest Expense

\[
\text{Assets of affiliate group generating foreign source income} \times \frac{\text{U.S. interest expense}}{\text{Total average net assets of the affiliate group}} = \text{Interest expense apportioned to foreign source}
\]

The numerator includes investments in foreign subsidiaries, net E&P of foreign subsidiaries, loans to foreign subsidiaries, accounts receivable applicable to sales with foreign title passage, other assets of foreign branches and directly owned disregarded entities, etc.
TBV v. FMV Allocation
What’s the difference?

- The FMV may be advantages where US assets are fully depreciated or have a low tax basis and those assets possess a higher FMV. Taxpayer has highly appreciated domestic assets.

- This occurs where US assets have been subjected to accelerated depreciation and subject to a greater depreciation percentage than foreign assets. (note the ATBV may mitigate this problem)
FMV method

- The FMV election does not require the consent of the IRS. However, once the fair market value method has been elected, it may only be changed with the permission of the IRS.

- Retroactive Application? Yes
  - Ralston Purina v. Comr.
FMV Method

- Step 1. Determine aggregate value of all assets
- Step 2. Determine value all assets of taxpayer and percentage of assets related persons not including stock or indebtedness and intangibles in related persons
- Step 3. Subtract step 2 from step 1 and apportion the difference between the taxpayer and the related persons on net income before interest and taxes, excluding passive income.
- Step 4. Determine value of U.S. taxpayer’s stock in related persons
Alternative tax book value method

- Similar to TBV, but allows use of Alternate Deprecation method to determine TBV of U.S. assets, which is consistent with method used to determine TBV of foreign assets that are depreciated.

- Should result in higher tax basis in U.S. than the TBV method which uses accelerated depreciation in valuing US assets.

- This may be easier and less costly than FMV method
Debrief Summary

- Application of TBV, FMV or ATBV method

- May elect FMV on an amended return for open tax years.

- Once you elect a method you must stay on that method for five years.
Research and Experimental

Rules are covered under Treasury Regulation §1.861-17

Example

Where a taxpayer performs tests on a product in response to a requirement imposed by the U.S. Food and Drug Administration, and the test results cannot reasonably be expected to generate amounts of gross income (beyond de minimis amounts) outside the United States, the costs of testing shall be allocated solely to gross income from sources within the United States. The remainder of R&D costs are allocated and apportioned, at the taxpayers election, by the sales method or the gross income method.
Research and Experimental

- The regulations require taxpayers to segregate income into specified product categories and then match related R& E expenses with that income.
- This prevents R& E expenses incurred in one business line from reducing taxable income from a separate business line.
- For example, R& E performed for a taxpayer's chemical business should not reduce that taxpayer's income from a separate textile mill business.
Research and Experimental

Step 1

- Allocate to gross income in the Broad Product Categories (i.e. 3 digit SIC Code).
Research and Experimental

Step 2

- Identify Legally Mandated Research & Experimentation
  - R&E undertaken solely to meet legal requirements in a particular geographic area
    - This definitely related R&D is allocable ONLY to the group or groupings of gross income within that geographic area
Research and Experimental

☞ Step 3

- Identify whether 50% or more of the R&E efforts take place in a specific geographic area, i.e., the U.S., the UK, etc.?

☐ If the “Geographic Source Test” is met then, depending upon which allocation method is used, either 25% or 50% of the R&D is allocated to the geographical source
Research and Experimental

- What if exclusive apportionment does not exist
  - If 50% requirement is not met then there is no geographic apportionment. All R&D expenses are apportioned under the sales method or the gross income method.
  - This could happen if R&D activities are de-centralized and no particular geographic source accounts for more than 50% of the expenses
R&E: Exclusive Apportionment

- There are two methods to allocate and apportion the exclusively apportioned R&D amount to the statutory and residual groupings which a taxpayer can choose or elect
  - Sales Method (50%)
  - (Optional) Gross Income Method (25%)

Example: Sales Method

Assume taxpayer's total R & E expense of $1,000 for the products falling within SIC Code 363, $750 is incurred within the United States.
R&E: Exclusive Apportionment

- Under the sales method a taxpayer can exclusively apportion 50% of its R&E expenses within that product category (i.e., $500) to U.S.-source income (the residual grouping in this case), thereby reducing the amount of R&E apportioned to foreign-source income.

- The remaining $500 of R&E expenses would then be apportioned by a mathematical equation. For instance, sales in a particular SIC category divided by total sales.
Optional Gross Income Method

- Under the gross income method 25% of the exclusively apportioned R&E is apportioned exclusively to the applicable geographic source then, remainder of the R&E is allocated based upon gross income.
Optional Gross Income Method

- Two requirements accompany the sales method:
  - The amount allocated and apportioned under the statutory grouping must be at least 50% of the amount determined under the sales method.
  - The amount allocated and apportioned under the residual grouping must be at least 50% of the amount determined under the sales method.

- If either of the two preceding tests are failed then an adjustment is made to bring the allocated amount of R&D within the 50% amount determined using the sales method.
Comprehensive Example

- Alcan manufactures and distributes aluminum machines and incurred $60,000 of R&D in the U.S. Its products fall within the same SIC category. Alcan’s wholly owned subsidiary in Australia manufactures and sells the aluminum machines in Europe using the technology developed by Alcan.
Comprehensive Example

Alcan 500,000
Australia Company 300,000

Total World Wide Sales 800,000

Net Gross Income 160,000

Alcan’s US Gross Profit 140,000
Royalties - Australia 10,000
Interest income - US 10,000
Sales Method

Statutory Grouping
\[ 30,000 \times \frac{300,000}{800,000} = 11,250 \]

Residual Grouping
\[ 30,000 \times \frac{500,000}{800,000} = 18,750 \]

U.S. is apportioned 48,750
\[ 30,000 + 18,750 \]

½ of R&D allocated exclusively to the U.S. Remainder is apportioned
Optional Gross Income Method

Residual Grouping: $15,000

\[ 45,000 \times 150,000 / 160,000 = 57,188 \text{ – U.S. Residual Grouping} \]
\[ 45,000 \times 10,000 / 160,000 = 2,812 \text{ – FSI Statutory Grouping} \]

25% of R&D allocated exclusively to the U.S. Remainder is apportioned

Alcan Gross profit = $140,000
Australian royalties = $10,000
Interest Income = $10,000
Total Gross income = $160,000

Rule – must be at least 50% of what it would otherwise be under the sales method
Optional Gross Income Method

Residual Grouping 15,000
45,000 - 140,000 / 150,000 = 43,375 – U.S. Residual Grouping
45,000 - 10,000 / 150,000 = 5,625 – Statutory Grouping

Increase R&E allocated to statutory grouping to 50% of what it would be under the sales method 11,250 x 50% = 5,625
Choice of Sales Method or Gross Income Method

Taxpayers must generally follow a particular method for 5 years and after the 5 year period they can change to the other method and follow that method for 5 years [Treas. Reg. 1.861-17(e)]
R&E Allocations

- In general, regardless of whether a taxpayer applies the sales method or the gross income method, the allocation and apportionment of R&D within an affiliated group is determined as if all members were a single corporation [1.861-14T]
Stewardship

- Stewardship activities are overseeing activities and functions undertaken to supervise an investment in another entity.
  - The regulations view expenses relating to stewardship or overseeing functions as being incurred as a result of, or incident to, the payor corporation's ownership of stock in the related corporation.
    - Accordingly, the regulations treat such expenses as definitely related and allocable to dividends received or to be received from the related corporation.
The IRS has indicated that stewardship expenses include:

- the cost of duplicative review or performance of activities already undertaken by the subsidiary;
- the cost of periodic visitations and general review of the subsidiary's performance;
- the cost of complying with reporting requirements or other legal requirements that the subsidiary would not incur but for being part of the affiliated group; and
The IRS has indicated that stewardship expenses include:

- the cost of financing or refinancing the parent's ownership participation in the subsidiary.
- An example in the Treasury Regulations under Code Sec. 861 also indicates stewardship expenses include the costs of auditors from the parent's accounting department, and the costs of the parent's treasurer.
Charitable Contributions

- Under the 2005 final regulations, a charitable contribution deduction allowed under Sections 170, 873(b)(2), and 882(c)(1)(B) is treated as definitely related and allocable to all of the taxpayer's gross income.

  - The contribution is then apportioned between the statutory grouping (or among the statutory groupings) of gross income and the residual groupings of gross income on the basis of the relative amounts of U.S.-source gross income in each grouping.
State Income Taxes

- State income taxes are treated as definitely related and allocable to the gross income with respect to which taxes are imposed.

- If a corporation subjects foreign source income to taxation, that portion of state tax definitely related and allocable to FSI

- In general, state income taxes are allocable and apportioned based upon state taxable income
State Income Taxes

- State income tax is allocated and apportioned to foreign source income only if the sum of the entity's state taxable income exceeds its federal domestic source taxable income.
State Income Taxes

- **Treasury Regulation 1.861-8 Example 25**
  - Domestic Company operates in three states, A, B and C and also has a foreign branch in another country
  - Federal taxable income is as follows:
    - 150,000 = net FSI
    - 800,000 = net U.S. source income
  - FSI is taxable in all three states
## State Income Taxes Data for Example 25

<table>
<thead>
<tr>
<th>State</th>
<th>Taxable Income</th>
<th>Tax Rate</th>
<th>Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>State 1</td>
<td>550,000</td>
<td>10%</td>
<td>55,000</td>
</tr>
<tr>
<td>State 2</td>
<td>200,000</td>
<td>5%</td>
<td>10,000</td>
</tr>
<tr>
<td>State 3</td>
<td>200,000</td>
<td>2%</td>
<td>4,000</td>
</tr>
<tr>
<td>Total</td>
<td>950,000</td>
<td></td>
<td>69,000</td>
</tr>
</tbody>
</table>
State Income Taxes

- State taxes of 69,000 are related to and allocable to the gross income on which the taxes were imposed
  - No exemption for FSI
  - Taxable income > domestic federal income

- 800,000 of US-source and 150,000 of FSI
  - (950,000 - 800,000) = FSI
State Income Taxes Apportionment

- Foreign Source:
  
  69,000 \times \left( \frac{150,000}{950,000} \right) = 10,895 \text{ allocated to net FSI}

  69,000 \times \left( \frac{800,000}{950,000} \right) = 58,105 \text{ allocated to net U.S. source income}
Part III
Adopting a Plan for Expense Apportionment
Part I  Apportionment Plan Information

1. Type of controlled group:
   a. [ ] Parent-subsidiary group
   b. [ ] Brother-sister group
   c. [ ] Combined group
   d. [ ] Life insurance companies only

2. This corporation has been a member of this group:
   a. [ ] For the entire year.
   b. [ ] From __________, 20____, until__________, 20____

3. This corporation consents and represents to:
   a. [ ] Adopt an apportionment plan. All the other members of this group are adopting an apportionment plan effective for the current tax year which ends on __________, 20____, and for all succeeding tax years.
   b. [ ] Amend the current apportionment plan. All the other members of this group are currently amending a previously adopted plan, which was in effect for the tax year ending __________, 20____, and for all succeeding tax years.
   c. [ ] Terminate the current apportionment plan and not adopt a new plan. All the other members of this group are not adopting an apportionment plan.
   d. [ ] Terminate the current apportionment plan and adopt a new plan. All the other members of this group are adopting an apportionment plan effective for the current tax year which ends on __________, 20____, and for all succeeding tax years.
4. If you did not check a box on line 3 above, check the applicable box below concerning the status of the group’s apportionment plan (see instructions).
   a. [ ] No apportionment plan is in effect and none is being adopted.
   b. [ ] An apportionment plan is already in effect. It was adopted for the tax year ending __________, 20____, and for all succeeding tax years.

5. If all the members of this group are adopting a plan or amending the current plan for a tax year after the due date (including extensions) of the tax return for this corporation, is there at least one year remaining on the statute of limitations from the date this corporation filed its amended return for such tax year for assessing any resulting deficiency? See instructions.
   a. [ ] Yes,
      (i) [ ] The statute of limitations for this year will expire on __________, 20____.
      (ii) [ ] On __________, 20____, this corporation entered into an agreement with the Internal Revenue Service to extend the statute of limitations for purposes of assessment until __________, 20____.
   b. [ ] No. The members may not adopt or amend an apportionment plan.

   a. [ ] The corporation will determine its tax liability by applying the maximum tax rate under section 11 to the entire amount of its taxable income.
   b. [ ] The corporation and the other members of the group elect the FIFO method (rather than defaulting to the proportionate method) for allocating the group’s section 11(b)(1) additional tax.
Purpose of Schedule O

- A corporation that is a member of a controlled group must use Schedule O to report apportionment of taxable income, income tax and certain tax benefits between members of the controlled group.
  - If the corporation is adopting an apportionment plan for the current tax year.
  - If a corporation is amending or terminating and existing apportionment plan.
  - If a corporation has no apportionment plan and is not adopting a plan.
  - Corporation already has an apportionment plan in effect.
Who must file Schedule O?

- A corporation must file Schedule O with its income tax return, amended return, or claim for refund for each tax year that the corporation is a component member of a controlled group, even if no apportionment plan is in effect. 

- The common parent of that consolidate group must file as part of the consolidated income tax return. Only one Schedule O is required on behalf of the group. So subsidiary should file this form.
Disclaimers

- The informal comments and the information presented in these slides should not be construed as constituting tax advice applicable to any specific taxpayer because each taxpayer’s facts are different.

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