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## MEMORANDUM

Re: Schedule M-3 Released

From: Peter H. Winslow  
Samuel A. Mitchell

Date: July 9, 2004

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On July 7, 2004, Treasury and the IRS released the final draft Form 1120 Schedule M-3 Net Income (Loss) Reconciliation for Corporations With Assets of \$10 Million or More. The IRS also released Rev. Proc. 2004-45, which provides guidance for coordinating the Schedule M-3 with the significant book/tax difference disclosure requirement in Treas. Reg. § 1.6011-4. Schedule M-3 will be required for tax years ending on or after December 31, 2004. According to a Treasury question-and-answer news release, the final form of the Schedule M-3 was released early (and nominally marked “draft”) in order to assist corporations and practitioners in planning for compliance. No further changes are expected.

The revenue procedure clarifies that companies that properly comply with the disclosure requirements on the Schedule M-3 and file it with the original tax return for years ending on or after December 31, 2004, will be deemed to have complied with the reporting requirement under Treas. Reg. § 1.6011-4 for significant book/tax differences defined in Treas. Reg. § 1.6011-4(b)(6). It further provides that companies that are not required to file a Schedule M-3 can comply with the significant book/tax difference disclosure requirement by filling out the appropriate portions of the M-3, labeling it as an alternative disclosure under Rev. Proc. 2004-45, attaching it to the original filed return, and sending a copy to the Office of Tax Shelter Analysis. Companies can also use this alternative disclosure procedure for significant book/tax differences in a year that ends before December 31, 2004.

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Of particular interest to insurance companies, Treasury provided a separate news release providing answers to several frequently asked questions. One question is whether insurance companies in a consolidated group have to file the Schedule M-3. The answer depends on whether the holding company files on a Form 1120L or 1120PC, or a Form 1120. If the holding company files on a Form 1120L or 1120PC, no member of the group will be required to file the new M-3 regardless of whether any members of the group file a form 1120. If the holding company files a Form 1120, however, all members of the group must file the M-3 regardless of whether the members file on a Form 1120L or 1120PC. The members that file on an Form 1120L or 1120PC have the option of filling out the entire Schedule M-3 or aggregating book tax differences on line 30 of Part II of the Schedule and separately disclosing each individual difference on a supporting schedule. Additionally, Treasury announced in the news release that the schedule will be incorporated into Forms 1120L and 1120PC and other forms in the future.

Compliance with the Schedule M-3 requirements will be subject to a one-year transition period. In the first year of compliance, companies will not be required to fill in the line-by-line income statement and tax return amounts on Parts II and III of the Schedule for includible corporations. Rather, they will only have to give the amounts of the temporary and permanent differences for each line item on Parts II and III.

We will continue to monitor developments on this important compliance issue. Please call us if you have questions.