

2011

Instructions for Schedule D (Form 1120S)



Department of the Treasury
Internal Revenue Service

Capital Gains and Losses and Built-in Gains

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

General Instructions

What's New

Built-in gains. For tax years beginning in 2011, no tax is imposed on the net recognized built-in gain of an S corporation if the 5th year in the 10-year recognition period ended before the tax year. See *Part III. Built-in Gains Tax* and section 1374(d)(7)(B).

Future developments. The IRS has created a page on IRS.gov for information about Schedule D (Form 1120S) and its instructions at www.irs.gov/form1120s. Information about any future developments affecting Schedule D (such as legislation enacted after we released it) will be posted on that page.

Purpose of Schedule

Use Schedule D to report the following.

- Sales or exchanges of capital assets.
- Gains on distributions to shareholders of appreciated capital assets.
- Nonbusiness bad debts.
- Net recognized built-in gain. The built-in gains tax is figured in Part III of Schedule D.

Generally, report every sale or exchange of a capital asset (including like-kind exchanges) on this schedule even if there is no gain or loss.

Other Forms the Corporation May Have To File

Use Form 4797, Sales of Business Property, to report the following.

- The sale, exchange, or distribution of property used in a trade or business.
- The sale, exchange, or distribution of depreciable and amortizable property.
- The sale or other disposition of securities or commodities held in connection with a trading business, if the corporation made a mark-to-market election.
- The involuntary conversion (from other than casualty or theft) of property used in the corporation's trade or business and capital assets held in connection with a trade or business or a transaction entered into for profit.
- The disposition of noncapital assets other than inventory or property held primarily for sale to customers in the ordinary course of the corporation's trade or business.

Use Form 4684, Casualties and Thefts, to report involuntary conversions of property due to casualty or theft.

Use Form 6781, Gains and Losses From Section 1256 Contracts and Straddles, to report gains and losses from section 1256 contracts and straddles.

Use Form 8824, Like-Kind Exchanges, if the corporation made one or more "like-kind" exchanges. A like-kind exchange occurs when the corporation exchanges business or investment property for property of a like kind. For exchanges of capital assets, include the gain or (loss) from Form 8824, if any, on line 3 or line 9.

Capital Assets

Each item of property the corporation held (whether or not connected with its trade or business) is a capital asset except the following. See section 1221(a) for details.

- Stock in trade or other property included in inventory or held mainly for sale to customers. But see the *Tip* below.
- Accounts or notes receivable acquired in the ordinary course of the trade or business for services rendered or from the sale of stock in trade or other property included in inventory or held mainly for sale to customers.
- Depreciable or real property used in the trade or business, even if it is fully depreciated.
- Certain copyrights; literary, musical, or artistic compositions; letters or memoranda; or similar property. But see the *Tip* below.
- U.S. Government publications, including the Congressional Record, that the corporation received from the Government, other than by purchase at the normal sales price, or that the corporation got from another taxpayer who had received it in a similar way, if the corporation's basis is determined by reference to the previous owner's basis.
- Certain commodities derivative financial instruments held by a dealer.
- Certain hedging transactions entered into in the normal course of the trade or business.
- Supplies regularly used in the trade or business.



You can elect to treat as capital assets certain musical compositions or copyrights you sold or exchanged. See Pub. 550 for details.

Items for Special Treatment

Note. For more information, see Pub. 544, Sales and Other Dispositions of Assets.

Loss from a sale or exchange between the corporation and a related person.

Except for distributions in complete liquidation of a corporation, no loss is allowed from the sale or exchange of property between the corporation and certain related persons. See section 267.

Loss from a wash sale. The corporation cannot deduct a loss from a wash sale of stock or securities (including contracts or options to acquire or sell stock or securities) unless the corporation is a dealer in stock or securities and the loss was sustained in a transaction made in the ordinary course of the corporation's trade or business. A wash sale occurs if the corporation acquires (by purchase or exchange), or has a contract or option to acquire, substantially identical stock or securities within 30 days before or after the date of the sale or exchange. See section 1091.

Report a wash sale transaction on line 1 or 7. Enter the full amount of the (loss) in column (f). Directly below the line on which you reported the loss, enter "Wash Sale" in column (a), and enter as a positive amount in column (f) the amount of the loss not allowed.

Gain on distributions of appreciated property. Generally, gain (but not loss) is recognized on a nonliquidating distribution of appreciated property to the extent that the property's fair market value exceeds its adjusted basis. See section 311.

Gain or loss on distribution of property in complete liquidation. Generally, gain or loss is recognized on property distributed in a complete liquidation. Treat the property as if it had been sold at its fair market value. See section 336.

Gain or loss on certain short-term federal, state, and municipal obligations (other than tax-exempt obligations). These obligations are treated as capital assets in determining gain or loss. On any gain realized, a portion is treated as ordinary income and any remaining balance as a short-term capital gain. See section 1271(a)(3).

Gain from installment sales. If the corporation sold property at a gain and will receive a payment in a tax year after the year of sale, it generally must report the sale on the installment method unless it elects not to. However, the installment

method may not be used to report sales of stock or securities traded on an established securities market.

Use Form 6252, Installment Sale Income, to report the sale on the installment method. Also use Form 6252 to report any payment received during the tax year from a sale made in an earlier year that was reported on the installment method. To elect out of the installment method, report the full amount of the gain on Schedule D for the year of the sale on a return filed by the due date (including extensions). If the original return was filed on time without making the election, the corporation can make the election on an amended return filed no later than 6 months after the original due date (excluding extensions). Write "Filed pursuant to section 301.9100-2" at the top of the amended return.

Gain or loss on an option to buy or sell property. See sections 1032 and 1234 for the rules that apply to a purchaser or grantor of an option. See sections 1032 and 1234B for the rules that apply to securities futures contracts. Also, see Pub. 550, Investment Income and Expenses.

Gain or loss from a short sale of property. Report the gain or loss to the extent that the property used to close the short sale is considered a capital asset in the hands of the taxpayer.

Loss from securities that are capital assets that become worthless during the year. Except for securities held by a bank, treat the loss as a capital loss as of the last day of the tax year. See section 582 for the rules on the treatment of securities held by a bank.

Nonrecognition of gain on sale of stock to an employee stock ownership plan (ESOP) or an eligible cooperative. See section 1042 and Temporary Regulations section 1.1042-1T for rules under which the corporation can elect not to recognize gain from the sale of certain stock to an ESOP or an eligible cooperative.

Bonds and other debt instruments. See Pub. 550.

Nonbusiness bad debts. A nonbusiness bad debt must be treated as a short-term capital loss and can be deducted only in the year the debt becomes totally worthless. For each bad debt, enter the name of the debtor and "statement attached" in column (a) of line 1 and the amount of the bad debt as a loss in column (f). Attach a statement of facts to support each bad debt deduction.

Real estate subdivided for sale.

Certain lots or parcels that are part of a tract of real estate subdivided for sale may be treated as capital assets. See section 1237.

Sale of a partnership interest. A sale or other disposition of an interest in a partnership owning unrealized receivables or inventory items may result in ordinary gain or loss. See Pub. 541, Partnerships.

Special rules for traders in securities. Traders in securities are engaged in the business of buying and selling securities for their own account. To be engaged in a

business as a trader in securities, the corporation:

- Must seek to profit from daily market movements in the prices of securities and not from dividends, interest, or capital appreciation.
- Must be involved in a trading activity that is substantial.
- Must carry on the activity with continuity and regularity.

The following facts and circumstances should be considered in determining if a corporation's activity is a business.

- Typical holding periods for securities bought and sold.
- The frequency and dollar amount of the corporation's trades during the year.
- The extent to which the shareholders pursue the activity to produce income for a livelihood.
- The amount of time devoted to the activity.

Like an investor, a trader must report each sale of securities (taking into account commissions and any other costs of acquiring or disposing of the securities) on Schedule D or on an attached statement containing all the same information for each sale in a similar format. However, if a trader made the mark-to-market election (see the Instructions for Form 4797), each transaction is reported in Part II of Form 4797 instead of on Schedule D.

The limitation on investment interest expense that applies to investors does not apply to interest paid or incurred in a trading business. A trader reports interest expense and other expenses (excluding commissions and other costs of acquiring and disposing of securities) from a trading business on page 1 of Form 1120S.

A trader also may hold securities for investment. The rules for investors generally will apply to those securities. If they apply, allocate interest and other expenses between your trading business and investment securities. Report investment interest expense on line 12b of Schedule K and in box 12 of Schedule K-1 using code H.

Gain from certain constructive ownership transactions. Gain in excess of the gain the corporation would have recognized if it had held a financial asset directly during the term of a derivative contract must be treated as ordinary income. See section 1260.

Gain on the constructive sale of certain appreciated financial positions. Generally, if the corporation holds an appreciated financial position in stock or certain other interests, it may have to recognize gain (but not loss) if it enters into a constructive sale (such as a "short sale against the box"). See Pub. 550.

Rollover of gain from qualified stock. If the corporation sold qualified small business stock (defined below) it held for more than 6 months, it can postpone gain if it purchased other qualified small business stock during the 60-day period that began on the date of the sale. The corporation must recognize gain to the extent the sale proceeds exceed the cost of the replacement stock. Reduce the

basis of the replacement stock by any postponed gain.

If the corporation chooses to postpone gain, report the entire gain realized on the sale on line 1 or 7. Directly below the line on which the corporation reported the gain, enter in column (a) "Section 1045 Rollover" and enter the amount of the postponed gain as a (loss) in column (f).



The corporation also must separately state the amount of the gain rolled over on qualified stock under section 1045 on Form 1120S, Schedule K, line 10, because each shareholder must determine if he or she qualifies for the rollover at the shareholder level. Also, the corporation must separately state on that line (and not on Schedule D) any gain that could qualify for the section 1045 rollover at the shareholder level instead of the corporate level (because a shareholder was entitled to purchase replacement stock). If the corporation had a gain on qualified stock that could qualify for the exclusion under section 1202, report that gain on Schedule D, line 7 (and on Form 1120S, Schedule K, line 10).

To be qualified small business stock, the stock must meet all of the following tests.

- It must be stock in a C corporation.
- It must have been originally issued after August 10, 1993.
- As of the date the stock was issued, the corporation was a qualified small business. A qualified small business is a domestic C corporation with total gross assets of \$50 million or less (a) at all times after August 9, 1993, and before the stock was issued, and (b) immediately after the stock was issued. Gross assets include those of any predecessor of the corporation. All corporations that are members of the same parent-subsidiary controlled group are treated as one corporation.
- The corporation must have acquired the stock at its original issue (either directly or through an underwriter), either in exchange for money or other property or as pay for services (other than as an underwriter) to the corporation. In certain cases, the corporation may meet the test if it acquired the stock from another person who met this test (such as by gift or inheritance) or through a conversion or exchange of qualified small business stock held by the corporation.
- During substantially all the time the corporation held the stock:

1. The issuer was a C corporation,
2. At least 80% of the value of the issuer's assets were used in the active conduct of one or more qualified businesses (defined below), and
3. The issuing corporation was not a foreign corporation, DISC, former DISC, corporation that has made (or that has a subsidiary that has made) a section 936 election, regulated investment company, real estate investment trust, REMIC, FASIT, or cooperative.

Note. A specialized small business investment company (SSBIC) is treated as having met test (2) above.

A qualified business is any business other than the following.

- One involving services performed in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, or brokerage services.
- One whose principal asset is the reputation or skill of one or more employees.
- Any banking, insurance, financing, leasing, investing, or similar business.
- Any farming business (including the raising or harvesting of trees).
- Any business involving the production of products for which percentage depletion can be claimed.
- Any business of operating a hotel, motel, restaurant, or similar business.

Exclusion of gain from DC Zone assets.

If the corporation sold or exchanged a District of Columbia Enterprise Zone (DC Zone) asset held for more than 5 years, it can exclude any qualified capital gain. The sale or exchange of DC Zone capital assets reported on Schedule D include:

- Stock in a domestic corporation that was a DC Zone business.
- Interest in a partnership that was a DC Zone business.

Report the sale or exchange of property used in the corporation's DC Zone business on Form 4797.

Gains not qualified for exclusion.

The following gains do not qualify for the exclusion of gain from DC Zone assets.

- Gain attributable to unrecaptured section 1250 gain on the sale of an interest in a partnership that is a DC Zone business. See the instructions for line 8c of Schedule K for information on how to report unrecaptured section 1250 gain.
- Gain on the sale of an interest in a partnership attributable to real property or an intangible asset that is not an integral part of a DC Zone business.
- Gain from a related-party transaction. See *Sales and Exchanges Between Related Persons* in chapter 2 of Pub. 544.

See section 1400B for more details on DC Zone assets and special rules.

How to report. Report the entire gain realized from the sale or exchange as the corporation otherwise would without regard to the exclusion. On Schedule D, line 7, enter "DC Zone Asset" in column (a) and enter as a loss in column (f) the amount of the allowable exclusion.

Rollover of gain from empowerment zone assets.

If the corporation sold a qualified empowerment zone asset held for more than 1 year, it may be able to elect to postpone part or all of the gain. See section 1397B for details.

Exclusion of gain from qualified community assets.

If the corporation sold or exchanged a qualified community asset acquired after 2001 and before 2010, and held for more than 5 years, it may be able to exclude any qualified capital gain. The exclusion applies to an interest in, or property of, certain renewal community businesses.

Qualified community asset. A qualified community asset is any of the following.

- Qualified community stock.
- Qualified community partnership interest.
- Qualified community business property.

Qualified capital gain. Qualified capital gain is any gain recognized on the sale or exchange of a qualified community asset, but does not include any of the following.

- Gain treated as ordinary income under section 1245.
- Section 1250 gain figured as if section 1250 applied to all depreciation rather than the additional depreciation.
- Gain attributable to real property, or an intangible asset, that is not an integral part of a renewal community business.
- Gain from a related-party transaction. See *Sales and Exchanges Between Related Persons* in chapter 2 of Pub. 544.

See section 1400F for more details and special rules.

How to report. Report the entire gain realized from the sale or exchange as the corporation otherwise would without regard to the exclusion. On Schedule D, line 7, enter "Qualified Community Asset" in column (a) and enter as a loss in column (f) the amount of the allowable exclusion. If reporting the sale directly on Schedule D, line 7, use the line directly below the line on which the corporation is reporting the sale.

Collectibles (28%) rate gain or (loss).

Report any 28% gain or loss on line 8b of Schedule K (and each shareholder's share in box 8b of Schedule K-1). A collectibles gain or loss is any long-term gain or deductible long-term loss from the sale or exchange of a collectible that is a capital asset.

Collectibles include works of art, rugs, antiques, metals (such as gold, silver, and platinum bullion), gems, stamps, coins, alcoholic beverages, and certain other tangible property.

Also include gain (but not loss) from the sale or exchange of an interest in a partnership or trust held more than 1 year and attributable to unrealized appreciation of collectibles. See Regulations section 1.1(h)-1. Also, attach the statement required under Regulations section 1.1(h)-1(e).

Specific Instructions

Parts I and II

In Part I, report the sale, exchange, or distribution of capital assets held 1 year or less. In Part II, report the sale, exchange, or distribution of capital assets held more than 1 year. Use the trade dates for the dates of acquisition and sale of stocks and bonds traded on an exchange or over-the-counter market.

Column (b). Date Acquired

The acquisition date for an asset the corporation held on January 1, 2001, for which it made an election to recognize any gain on a deemed sale, is the date of the deemed sale and reacquisition.

Column (e). Cost or Other Basis

In general, the basis of property is its cost. See section 1012 and the related regulations. Special rules may apply to the receipt of certain distributions with respect to stock (section 301), liquidation of another corporation (334), transfer to another corporation (358), transfer from a shareholder or reorganization (362), bequest (1014), contribution or gift (1015), tax-free exchange (1031), involuntary conversion (1033), certain asset acquisitions (1060), or wash sale of stock (1091). Attach an explanation if the corporation uses a basis other than actual cost of the property. See Pub. 551, Basis of Assets, for more details.

Before making an entry in column (e), increase the cost or other basis by any expense of sale, such as broker's fees, commissions, state and local transfer taxes, and option premiums, unless the net sales price was reported in column (d).

If the corporation sold property in a bargain sale to a charitable organization, figure the adjusted basis for determining gain from the sale by dividing the amount realized by the fair market value and multiplying that result by the adjusted basis.

If the corporation elected to recognize gain on an asset held on January 1, 2001, its basis in the asset is its closing market price or fair market value, whichever applies, on the date of the deemed sale and reacquisition, whether the deemed sale resulted in a gain or unallowed loss.

See section 852(f) for the treatment of certain load charges incurred in acquiring stock in a mutual fund (or other regulated investment company) with a reinvestment right.

Column (f). Gain or (Loss)

Make a separate entry in this column for each transaction reported on line 1 or line 7 and any other line(s) that apply to the corporation. For lines 1 and 7, subtract the amount in column (e) from the amount in column (d). Enter negative amounts in parentheses.

Part III. Built-in Gains Tax

Section 1374 provides for a tax on built-in gains. The built-in gains tax may apply to the following S corporations.

1. An S corporation that was a C corporation before it elected to be an S corporation.
2. An S corporation that acquired an asset with a basis determined (in whole or in part) by reference to its basis (or the basis of any other property) in the hands of a C corporation (a **transferred-basis acquisition**). See section 1374(d)(8).

An S corporation may owe the tax if it has net recognized built-in gain during the applicable recognition period. The applicable recognition period is the 10-year period beginning:

- For an asset held when the S corporation was a C corporation, on the first day of the first tax year for which the corporation is an S corporation; or
- For an asset with a basis determined by reference to its basis (or the basis of

any other property) in the hands of a C corporation, on the date the asset was acquired by the S corporation.

A corporation described in both (1) and (2), above, must figure the built-in gains tax separately for the group of assets it held at the time its S election became effective and for each group of assets it acquired from a C corporation with basis determined (in whole or in part) by reference to the basis of the asset (or any other property) in the hands of the C corporation. For details, see Regulations section 1.1374-8.

For tax years beginning in 2011, no tax is imposed if the S corporation's 5th year of the applicable recognition period ended before the tax year.



For tax years beginning in 2011, no tax is imposed on the net recognized built-in gain of an S corporation if the 5th year of the applicable recognition period ended before the tax year. In figuring the amount to enter on line 14, exclude any recognized built-in gains and recognized built-in losses arising in the tax year if the 5th year of the applicable recognition period ended before the beginning of the tax year. This exclusion does not apply, however, for the following purposes.

- Determining the character of the deemed loss arising from the built-in gains tax, as described in Regulations section 1.1366-4(b);
- Figuring the carryover of net recognized built-in gain in excess of the taxable income limitation;
- Allocating your taxable income limitation (line 15) between separate groups of assets, as required by Regulations section 1.1374-8(d);
- Figuring your net unrealized built-in gain limitation (Schedule B, line 6) in any subsequent year; or
- Figuring your section 1374(b)(2) deduction (line 17) in any subsequent year.

For these purposes, treat net recognized built-in gain excluded from line 14 as if the full amount had been entered on line 14 in the current tax year.

Certain transactions involving the disposal of timber, coal, or domestic iron ore under section 631 are not subject to the built-in gains tax. See Rev. Rul. 2001-50, 2001-43 I.R.B. 343.

Line 14. Generally, enter the amount that would be the taxable income of the corporation for the tax year if only recognized built-in gains (including any carryover of gain under section 1374(d)(2)(B)) and recognized built-in losses were taken into account. However, **do not enter** any net recognized built-in gain if the 5th year in the applicable recognition period ended before the current tax year.

Generally, recognized built-in gain includes the following items.

1. Any gain recognized during the applicable recognition period on the sale or distribution (disposition) of any asset, except to the extent the corporation establishes that:

- The asset was not held by the corporation as of the beginning of the applicable recognition period, or
- The gain exceeds the excess of the fair market value of the asset as of the beginning of the applicable recognition period over the adjusted basis of the asset at that time; and

2. Any item of income that is properly taken into account during the applicable recognition period but is attributable to periods before the applicable recognition period.

Generally, recognized built-in loss includes the following items.

1. Any loss recognized during the applicable recognition period on the disposition of any asset to the extent the corporation establishes that:

- The asset was held by the corporation as of the beginning of the applicable recognition period, and
- The loss does not exceed the excess of the adjusted basis of the asset as of the beginning of the applicable recognition period, over the fair market value of the asset as of that time; and

2. Any amount that is allowed as a deduction during the applicable recognition period (determined without regard to any carryover) but is attributable to periods before the applicable recognition period.

For details, see section 1374(d) and Regulations section 1.1374-4.

The corporation must show on an attachment its total net recognized built-in gain and list separately any capital gain or loss and ordinary gain or loss.

Line 15. Figure taxable income by completing lines 1 through 28 of Form 1120. Follow the instructions for Form 1120. Enter the amount from line 28 of Form 1120 on line 15 of Schedule D. Attach to Schedule D the Form 1120 computation or other worksheet used to figure taxable income.

For corporations figuring the built-in gains tax for separate groups of assets, taxable income must be apportioned to each group of assets in proportion to the net recognized built-in gain for each group of assets. For details, see Regulations section 1.1374-8.

Note. Taxable income is figured as provided in section 1375(b)(1)(B) and is generally figured in the same manner as taxable income for line 9 of the Excess Net Passive Income Tax Worksheet for Line 22a in the Instructions for Form 1120S.

Line 16. If for any tax year the amount on line 14 exceeds the taxable income on line 15, the excess is treated as a recognized built-in gain in the succeeding tax year. This carryover provision applies only in the case of an S corporation that made its election to be an S corporation after March 30, 1988. See section 1374(d)(2)(B).

For corporations figuring the built-in gains tax for separate groups of assets,

do not use the amount from Schedule B, line 6. Instead, figure the amount of net unrealized built-in gain separately for each group of assets.

Line 17. Enter the section 1374(b)(2) deduction. Generally, this is any net operating loss carryforward or capital loss carryforward (to the extent of net capital gain included in recognized built-in gain for the tax year) either arising in tax years for which the corporation was a C corporation or acquired in a transferred-basis acquisition (defined earlier). The section 1374(b)(2) deduction must be figured and applied separately for each separate group of assets. See section 1374(b)(2) and Regulations section 1.1374-5.

Line 20. Enter the section 1374(b)(3) credit. Generally, this is any general business credit arising in tax years for which the corporation was a C corporation or acquired in a transferred-basis acquisition (defined earlier). The section 1374(b)(3) credit must be figured and applied separately for each separate group of assets. Section 1374(b)(3) business credit and minimum tax credit carryforwards from C corporation years are subject to the business credit limitation in section 38(c) and the AMT credit limitation in section 53(c), as modified by Regulations section 1.1374-6(b).

If corporations made the section 168(k)(4) election in prior years, they can elect to increase these limitations for pre-2006 unused research and minimum tax credits in lieu of claiming the special depreciation allowance for certain property acquired after March 31, 2008, and placed in service before January 1, 2013. For details, see Form 4562, Depreciation and Amortization; Form 3800, General Business Credit; Form 8827, Credit for Prior Year Minimum Tax - Corporations; and related instructions. Also, see Rev. Proc. 2009-33, 2009-29 I.R.B. 150; Rev. Proc. 2009-16, 2009-6 I.R.B. 449; and Rev. Proc. 2008-65, 2008-44 I.R.B. 1082.



An S corporation that made this election can use the credit carryforwards only against the built-in gains tax. The refundable credit provisions do not apply to S corporations.

Line 21. The built-in gains tax is treated as a loss sustained by the corporation during the same tax year. The character of the deemed loss is determined by allocating the loss proportionately among the net recognized built-in gains giving rise to the tax and attributing the character of each net recognized built-in gain to the allocable portion of the loss. Deduct the tax attributable to:

- Short-term capital gain as short-term capital loss on Schedule D, line 5.
- Long-term capital gain as long-term capital loss on Schedule D, line 12.
- Ordinary income as a deduction for taxes on Form 1120S, line 12.