Instructions for Schedule D (Form 1120S)

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
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 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 of the last day of the 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 applicable under section 1042.
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 unrecovered 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 unrecovered 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.

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 “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), 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. 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.
Corporation as of the beginning of the applicable recognition period. A corporation described in both (1) and (2), above, must figure the built-in gains tax separately for each group of assets it held at the time it was a C corporation or acquired by the S corporation. For details, see Regulations section 1.1374-8.

For tax years beginning in 2011, no tax is imposed if the C corporation’s 5th year of the applicable recognition period occurred 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 applicable recognition period 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 Regulations section 1.1374-8. Generally, recognized built-in losses arising in tax years for which the corporation was a C corporation or acquired in a transferred-basis acquisition (defined earlier) are not subject to Regulations section 1.1374-8(d); and are not subject to the AMT 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 2006 unused 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, 2009-5 I.R.B. 449; and Rev. Proc. 2006-65, 2006-44 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.

The built-in gains tax is treated provided in section 1375(b)(1)(B) and is generally figured in the same manner as taxable income for line 7 of the Excess Net Passive Income Tax Worksheet for Form 1120. 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 7 of the Excess Net Passive Income Tax Worksheet for Line 22a in the Instructions for Form 1120S.

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, 1998. 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 recognized 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 the 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).

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