1986

Department of the Treasury
Internal Revenue Service

Instructions for Form 1120-IC-DISC

Interest Charge Domestic International Sales Corporation Return

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

Paperwork Reduction Act Notice

We ask for this information to carry out the Internal Revenue laws of the United States. We need it to ensure that taxpayers are complying with these laws and to allow us to figure and collect the right amount of tax. You are required to give us this information.

Voluntary Contributions To Reduce the Public Debt

Quite often, inquiries are received about how voluntary contributions to reduce the public debt may be made. A domestic international sales corporation may contribute by enclosing a **separate** check payable to "Bureau of the Public Debt," with Form 1120-IC-DISC. These amounts are tax-deductible, subject to the rules and limitations for charitable contributions.

Tax Law Changes

The Tax Reform Act of 1986 (Act) made several changes which affect the way corporations electing IC-DISC status compute their taxable income. See page 9 for information on how the Act affects the IC-DISC for 1986 tax years and tax years beginning after 1986.

General Instructions

A. Purpose of Form

Form 1120-IC-DISC is an information return filed by interest charge domestic international sales corporations (IC-DISCs), former DISCs, and former IC-DISCs.

B. What Is an IC-DISC

An IC-DISC is a domestic corporation that has elected to be an IC-DISC and its election is still in effect. The IC-DISC election is made by filing **Form 4876A,** Election To Be Treated as an Interest Charge DISC.

Generally, an IC-DISC is not taxed on its income. Shareholders of an IC-DISC are taxed on its income when the income is actually or deemed distributed. In addition, section 995(f) imposes an interest charge on shareholders for their share of DISC-related deferred tax liability. See **Form 8404,** Computation of Interest Charge on DISC-Related Deferred Tax Liability, for details.

To be an IC-DISC, a corporation must be organized under the laws of a state or the District of Columbia and meet the following tests:

- Its tax year must conform to the tax year of the principal shareholder who at the beginning of the tax year has the highest percentage of voting power. If two or more shareholders have the highest percentage of voting power, the IC-DISC must elect a tax year that conforms to that of any one of the principal shareholders. (See section 441(h) for additional information.)
- Its election to be treated as an IC-DISC is in effect for the tax year.
- At least 95% of its gross receipts during the tax year are qualified export receipts.
- At the end of the tax year, the adjusted basis of its qualified export assets is at least 95% of the sum of the adjusted basis of all its assets.
- It has one class of stock, and its outstanding stock has a par value of at least $2,500 on each day of the tax year (or, for a new corporation, on the last day to elect IC-DISC status for the year and on each later day).
- On each day of the tax year, it has its own bank account and keeps separate books and records.
- It is not a member of any controlled group of which a foreign sales corporation (FSC) is a member.

See section 992 and related regulations for details and Instruction D for definitions.

Distribution to meet qualification requirements.—An IC-DISC that does not meet the gross receipts test or qualified export asset test during the tax year will still be considered to have met them if, after the tax year ends, the IC-DISC makes a pro rata property distribution to its shareholders and specifies at the time that this is a distribution to meet the qualification requirements.

If the IC-DISC did not meet the gross receipts test, the distribution equals the part of its taxable income attributable to gross receipts that are not qualified export gross receipts. If it did not meet the qualified export asset test, the distribution equals the fair market value of the assets that are not qualified export assets on the last day of the tax year. If the IC-DISC did not meet either test, the distribution equals the sum of both amounts. Regulations section 1.992-3 explains how to figure the distribution.

"Interest" on late distribution.—If the IC-DISC makes this distribution after the date Form 1120-IC-DISC is due, an interest charge must be paid to the Internal Revenue Service Center where you filed the form. The charge is 4½% of the distribution times the number of tax years that begin after the tax year to which the distribution relates until the date the IC-DISC made the distribution.

If you must pay this interest charge, send the payment to the service center within 30 days of making the distribution. On the payment write the IC-DISC's name, address, and employer identification number; the tax year involved; and a statement that the payment represents the interest charge under regulations section 1.992-3(c)(4).

Ineligible organizations.—The following organizations are not eligible for IC-DISC status. File the return indicated instead of Form 1120-IC-DISC:

- Tax-exempt organization (section 501): File the appropriate return in the Form 990 series.
- Personal holding companies (section 542): File Form 1120 with Schedule PH (Form 1120).
- Financial institution affected by section 581 or 593: File Form 1120.
- Life, mutual, or other insurance companies (subchapter L): File Form 1120L, 1120M, or 1120.
- Regulated investment company (section 851(a)): File Form 1120.
- An S corporation (section 1361(a)): File Form 1120S.

C. Filing Form 1120-IC-DISC

1. Who Files Form 1120-IC-DISC.— You must file Form 1120-IC-DISC if your corporation elected, by filing Form 4876A, to be treated as an IC-DISC.

If the corporation is a former DISC or former IC-DISC, you must file Form 1120-IC-DISC for it, in addition to any other return required. A former DISC is a corporation that was a DISC on or before December 31, 1984, but failed to qualify as a DISC sometime prior to December 31, 1984, or did not elect to be an IC-DISC after 1984; and at the beginning of the year, it had undistributed income that was previously taxed or accumulated DISC income. A former IC-DISC is a corporation that was an IC-DISC in an earlier year but did not qualify as an IC-DISC at the end of its 1986 tax year; and at the beginning of the year, it had undistributed income that was previously taxed or accumulated IC-DISC income. (See section 992 and related regulations.)

In regard to a former DISC or former IC-DISC, you need not complete page 1 and the Schedules for figuring taxable income, but you must complete Schedules J, L, and M of Form 1120-IC-DISC and Schedule K (Form 1120-IC-DISC). Write "Former DISC" or "Former IC-DISC" across the top of the return.

2. When To File.—File Form 1120-IC-DISC by the 15th day of the 9th month after the tax year ends. No extensions are allowed for time to file.

Period covered.—File the 1986 return for calendar year 1986 and fiscal years that begin in 1986. If the return is for a fiscal year, fill in the tax year space at the top of the form.

Amended return.—To correct any error in a Form 1120-IC-DISC already filed, file an amended Form 1120-IC-DISC and write "Amended" across the top.

Change in tax year.—To change your tax year, file **Form 1128**, Application for Change in Accounting Period.

Final return.—If the corporation ceased to exist during 1986, write "Final return" across the top of the form.

3. Where To File.—

If the main business, office, or agency is located in ▼	Use the following Internal Revenue Service Center address ▼
New Jersey, New York (New York City and counties of Nassau, Rockland, Suffolk, and Westchester)	Holtsville, NY 00501
New York (all other counties), Connecticut, Maine, Massachusetts, Minnesota, New Hampshire, Rhode Island, Vermont	Andover, MA 05501
Alabama, Florida, Georgia, Mississippi, South Carolina	Atlanta, GA 31101
Kentucky, Michigan, Ohio, West Virginia	Cincinnati, OH 45999
Kansas, Louisiana, New Mexico, Oklahoma, Texas	Austin, TX 73301
Alaska, Arizona, California (counties of Alpine, Amador, Butte, Calaveras, Colusa, Contra Costa, Del Norte, El Dorado, Glenn, Humboldt, Lake, Lassen, Marin, Mendocino, Modoc, Napa, Nevada, Placer, Plumas, Sacramento, San Joaquin, Shasta, Sierra, Siskiyou, Solano, Sonoma, Sutter, Tehama, Trinity, Yolo, and Yuba), Colorado, Idaho, Montana, Nebraska, Nevada, North Dakota, Oregon, South Dakota, Utah, Washington, Wyoming	Ogden, UT 84201
California (all other counties), Hawaii	Fresno, CA 93888
Illinois, Iowa, Missouri, Wisconsin	Kansas City, MO 64999
Arkansas, Indiana, North Carolina, Tennessee, Virginia	Memphis, TN 37501
Delaware, District of Columbia, Maryland, Pennsylvania	Philadelphia, PA 19255

If the IC-DISC is one of a group of IC-DISCs controlled by a common parent, file with the service center where the common parent files.

A group of corporations in several service center regions may file their separate returns with the service center for the principal office of the managing corporation that keeps all the books and records.

4. Signature.—The return must be signed and dated by the president, vice president, treasurer, assistant treasurer, chief accounting officer, or any other corporate officer (such as tax officer) authorized to sign. A receiver, trustee, or assignee must sign and date any return required to be filed on behalf of a corporation.

If your corporate officer filled in Form 1120-IC-DISC, the Paid Preparer's space under Signature of Officer should remain blank. If someone prepares Form 1120-IC-DISC and does not charge the corporation, that person should not sign the return. Certain others who prepare Form 1120-IC-DISC should not sign. For example, a regular, full-time employee of the corporation such as a clerk or secretary does not have to sign. (This list is not all-inclusive.)

Generally, anyone who is paid to prepare Form 1120-IC-DISC must sign the return and fill in the other blanks in the Paid Preparer's Use Only area of the return.

The preparer required to sign the return MUST:

- Complete the required preparer information.
- Sign it, by hand, in the space provided for the preparer's signature. (Signature stamps or labels are not acceptable.)
- Give a copy of Form 1120-IC-DISC to the taxpayer in addition to the copy filed with IRS.

Tax return preparers should be familiar with their responsibilities. See **Publication 1045,** Information and Order Blanks for Preparers of Federal Income Tax Returns, for more details.

5. Other Returns and Statements That May Be Required.—

a. Financial statements.

The balance sheets must agree with your books and records. Reconcile any differences.

b. Stock in foreign corporation.

If, on the last day of your tax year, you owned at least 5% in value of a foreign personal holding company's outstanding stock and the corporation was required to include in its gross income any undistributed foreign personal holding company income, attach a statement showing the foreign company's gross income, deductions, credits, taxable income, and undistributed foreign personal holding company income. See section 551(c).

If you controlled a foreign corporation or owned at least 10% of the shares in a controlled foreign corporation, you may have to file **Form 5471**, Information Return With Respect to a Foreign Corporation.

c. Forms 1042 and 1042S.

File **Form 1042**, U.S. Annual Return of Income Tax To Be Paid at Source (Under Chapter 3, IRC), and **Form 1042S**, Income Subject to Withholding under Chapter 3, Internal Revenue Code, to report tax withheld from amounts paid to nonresident aliens and foreign corporations (sections 1441 through 1443 and 1461). In addition, please inform your shareholders who are nonresident alien individuals or foreign corporations, trusts, or estates that if they have gains from disposing of stock in the IC-DISC, former DISC, or former IC-DISC, or distributions from accumulated IC-DISC income, including deemed distributions, they should treat these amounts as effectively connected with the conduct of a trade or business through a permanent establishment in the U.S.

D. Definitions

1. The following definitions are based on section 993.

a. Qualified export receipts, in general, are any of the following:

(1) Gross receipts from selling, exchanging, or otherwise disposing of export property.

(2) Gross receipts from renting export property that the lessee uses outside the U.S.

(3) Gross receipts from supporting services related to any qualified sale, exchange, rental, or other disposition of export property by the corporation.

(4) Gross receipts, if there is a gain, from selling, exchanging, or otherwise disposing of qualified export assets that are not export property.

(5) Dividends or amounts includible in gross income under section 951 regarding stock of a related foreign export corporation.

(6) Interest on any obligation that is a qualified export asset.

(7) Gross receipts for engineering or architectural services on construction projects outside the U.S.

(8) Gross receipts for managerial services performed for an unrelated IC-DISC.

For more information, see regulations section 1.993-1.

b. Qualified export assets are any of the following:

(1) Export property.

(2) Assets used mainly in performing the engineering or architectural services listed under qualified export receipts, item (7), or managerial services that further the production of qualified export receipts, items (1), (2), (3), and (7) above; or assets used mainly in assembling, servicing, handling, selling, leasing, packaging, transporting, or storing of export property.

(3) Accounts receivable produced by transactions listed under qualified export receipts, items (1)–(4), (7), or (8).

(4) Temporary investments, such as money and bank deposits, in an amount reasonable to meet the corporation's needs for working capital.

(5) Obligations related to a producer's loan.
(6) A related foreign export corporation's stock or securities that the IC-DISC holds.
(7) Certain obligations that are issued or insured by the U.S. Export-Import Bank or the Foreign Credit Insurance Association and that the IC-DISC acquires from the Bank, the Association, or the person who sold or bought the goods from which the obligations arose.
(8) Certain obligations, held by the IC-DISC, that were issued by a domestic corporation organized to finance export property sales under an agreement with the Export-Import Bank, by which the corporation makes export loans that the Bank guarantees.
(9) Other deposits in the U.S. used to acquire qualified export assets within the time provided by regulations section 1.993-2(j).

Regulations section 1.993-2 gives more information.

c. Export property must meet all the following terms. It is:

(1) Made, grown, or extracted in the U.S. by someone other than an IC-DISC.
(2) Neither excluded under section 993(c)(2) nor declared in short supply under section 993(c)(3).
(3) Held mainly for sale or rent in the ordinary course of trade or business, by or to an IC-DISC for direct use, consumption, or disposition outside the U.S.
(4) Not more than 50% of its fair market value is attributable to articles imported into the U.S.
(5) Neither sold nor leased by or to another IC-DISC that, immediately before or after the transaction, either belongs to the same controlled group (defined in section 993(a)(3)) as your IC-DISC or is related to your IC-DISC in a way that would result in losses being denied under section 267.

See regulations section 1.993-3 for details.

d. A producer's loan must meet all the following terms:

(1) Satisfy sections 993(d)(2) and (3) limiting loans the IC-DISC makes to any one borrower.
(2) Not raise the unpaid balance due the IC-DISC on all its producer's loans above the level of accumulated income it had at the start of the month in which it made the loan.
(3) Be indicated by written evidence of debt, such as a note, that has a stated maturity date no more than 5 years after the date of the loan.
(4) Be made to a person in the U.S. in the trade or business of making, growing, or extracting export property.
(5) Be designated as a producer's loan when made.

For more information, see regulations section 1.993-4.

e. A related foreign export corporation of any of the following kinds can pay dividends and interest to the IC-DISC without loss of IC-DISC status. The IC-DISC's investment must be related to exports from the U.S.

(1) A *foreign international sales corporation* is a related foreign export corporation if:

(i) The IC-DISC directly owns more than 50% of the total voting power of the foreign corporation's stock,
(ii) For the tax year that ends with your IC-DISC's tax year or ends within it, at least 95% of the foreign corporation's gross receipts consists of the qualified export receipts described in items (1)–(4) of definition **a** above and interest on the qualified export assets listed in items (3) and (4) of definition **b** above, and
(iii) The adjusted basis of the qualified export assets that are listed in items (1)-(4) of definition **b** above and that the foreign corporation held at the end of the tax year is at least 95% of the adjusted basis of all assets it held then.

(2) A *real property holding company* is a related foreign export corporation if:

(i) The IC-DISC directly owns more than 50% of the total voting power of the foreign corporation's stock, and
(ii) Applicable foreign law forbids the IC-DISC to hold title to real property; the foreign corporation's sole function is to hold the title; and only the IC-DISC uses the property, under lease or otherwise.

(3) An *associated foreign corporation* is a related foreign export corporation if:

(i) The IC-DISC or a controlled group of corporations to which the IC-DISC belongs owns less than 10% of the total voting power of the foreign corporation's stock (section 1563 defines a controlled group in this sense, and sections 1563(d) and (e) define ownership), and
(ii) The IC-DISC's ownership of the foreign corporation's stock or securities reasonably furthers transactions that lead to qualified export receipts for the IC-DISC.

See regulations section 1.993-5 for more information about related foreign export corporations.

f. Gross receipts are the IC-DISC's total receipts from (1) selling or renting property that the corporation holds for sale or rental in the course of its trade or business and (2) all other sources. For commissions on selling or renting property, include gross receipts from selling or renting the property on which the commissions arose. Regulations section 1.993-6 gives more information.

g. United States, as used in these instructions, includes Puerto Rico and U.S. possessions, as well as the 50 states and the District of Columbia.

2. Inter-company pricing rules (section 994).—If a related person described in section 482 sells export property to the IC-DISC, use inter-company pricing rules to figure taxable income for the IC-DISC and the seller. These rules generally do not permit the related person to price at a loss. Under inter-company pricing, the IC-DISC's taxable income from the sale (regardless of the price actually charged) is the greatest of:

(a) 4% of qualified export receipts on the IC-DISC's sale of the property plus 10% of the IC-DISC's export promotion expenses attributable to the receipts,
(b) 50% of the IC-DISC's and the seller's combined taxable income from qualified export receipts on the property, derived from the IC-DISC's sale of the property plus 10% of the IC-DISC's export promotion expenses attributable to the receipts, or
(c) taxable income based on the sale price actually charged, as long as it accurately reflects taxable income without evading taxes.

Schedule P (Form 1120-IC-DISC), Computation of Inter-company Transfer Price or Commission, explains inter-company pricing rules in more detail.

3. Export promotion expenses (section 994(c)).—These expenses are incurred to help distribute or sell export property for use or distribution outside the U.S. These expenses do not include income tax, but do include 50% of the cost of shipping the property on U.S.-owned and -operated aircraft or ships if the law and regulations do not require that it be shipped on them.

E. Penalties

The IC-DISC may have to pay the following penalties unless it can show that it had reasonable cause for not giving information or not filing a return:

- $100 for each instance of not giving information, up to $25,000 during the calendar year.
- $1,000 for not filing a return.

See section 6686 for other details.

Specific Instructions

File a Complete Return

In order to assist us in processing the return we ask that you complete every applicable entry space on Form 1120-IC-DISC. Please do not attach statements and write "See attached" in lieu of completing the entry space on Form 1120-IC-DISC.

Accounting methods.—Compute taxable income by the accounting method regularly used to keep the IC-DISC's books and records. The method used must clearly reflect taxable income. See section 446.

A member of a controlled group must avoid using an accounting method that would distort any group member's income, including its own. For example, an IC-DISC acts as a commission agent for property sales by a related corporation that uses the accrual method and pays the IC-DISC its commission more than 2 months after the sale. The IC-DISC, then, should not use the cash method of accounting, because it materially distorts the income of the IC-DISC.

Unless the law specifically permits otherwise, the IC-DISC may change from the accounting method it used to report taxable income in earlier years (for income as a whole or for any material item) only by first getting consent on **Form 3115**, Application for Change in Accounting Method.

Rounding Off.—You may show the money items on the return and accompanying schedules as whole-dollar amounts. To do so, drop any amount less than 50 cents, and increase any amount from 50 cents through 99 cents to the next higher dollar.

Attachments.—If you need more space, attach separate sheets to the back of Form 1120-IC-DISC. Attach **Form 4136**, Computation of Credit for Federal Tax on Gasoline and Special Fuels, after page 6, Form 1120-IC-DISC. Attach schedules in alphabetical order and other forms in numerical order after the Form 4136. Be sure to put the IC-DISC's name and employer identification number (EIN) on each sheet.

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Employer Identification Number.—Enter the IC-DISC's employer identification number (EIN). If the IC-DISC does not have an EIN, it should apply for one on **Form SS-4**, Application for Employer Identification Number. You can get this form at most IRS or Social Security Administration offices. Send Form SS-4 to the same Internal Revenue Service Center to which you send Form 1120-IC-DISC. If you have not received the EIN by the time for filing Form 1120-IC-DISC, write "Applied for" in the space for the EIN.

Question E.—Total assets.—Enter the total assets of the IC-DISC. If there are no assets at the end of the tax year, enter the assets as of the beginning of the tax year.

Question F.—For rules of stock attribution, see section 267(c). If the owner of the voting stock of the IC-DISC was an alien individual or a foreign corporation, partnership, trust, or estate, check the "Yes" box in the "Foreign Owner" column and enter the name of the owner's country, in parentheses, in the address column. "Owner's country" for individuals is their country of residence; for other foreign entities, it is the country in which organized or otherwise created, or in which administered.

Lines 1 through 8

An IC-DISC must figure its taxable income although it does not pay most taxes. Of the taxes imposed by sections 1 through 1564, an IC-DISC is subject only to the tax imposed by sections 1491 through 1494 on certain transfers to avoid tax. An IC-DISC is exempt from corporate income tax, minimum tax on tax preference items, and accumulated earnings tax.

An IC-DISC and its shareholders are not entitled to the possessions corporation tax credit (section 936). Also, an IC-DISC cannot claim the investment tax credit, the jobs credit, employee stock ownership plan credit, research credit, alcohol fuel credit, general business credit, and credit for fuel produced from a nonconventional source. In addition, these credits do not pass through to shareholders of an IC-DISC.

2. Cost of goods sold and/or operations.— See Instructions for Schedule A.

6a. Net operating loss deduction.—The "net operating loss deduction" is the amount of the net operating loss carryovers and carrybacks that can be deducted in the tax year. See section 172 for details.

6b. Dividends-received deduction.—See the instructions for Schedule C, line 6, Column (c) for details.

A deficit in earnings and profits is chargeable in the following order:

(1) First, to any other earnings and profits;

(2) Second, to any accumulated IC-DISC income; and

(3) Finally, to previously taxed income. Do not apply any deficit in earnings and profits against accumulated IC-DISC income that, as a result of the corporation's revoking its election to be treated as an IC-DISC (or other disqualification), is deemed distributed to the shareholders. (See section 995(b)(2)(A).)

7. Taxable income.—If you use either the gross receipts method or combined taxable income method to compute the IC-DISC's taxable income attributable to any transactions involving products or product lines, attach Schedule P (Form 1120-IC-DISC). Show in detail the IC-DISC's taxable income attributable to each such transaction or group of transactions.

8. Refund of U.S. tax on gasoline and special fuels.—Enter the credit from Form 4136. Also, if the IC-DISC is a producer of domestic crude oil and overpaid the windfall profit tax, include the overpayment from **Form 6249,** Computation of Overpaid Windfall Profit Tax, in the total on line 8. Also enter the overpayment separately in the margin beside line 8 and identify it as "Overpaid windfall profit tax." Attach Form 6249 to Form 1120-IC-DISC.

Schedule A.—Cost of Goods Sold and/or Operations

If you use inter-company pricing rules, reflect in Schedule A actual purchases from a related supplier. See General Instruction D2 and use the transfer price you compute in Part II of Schedule P (Form 1120-IC-DISC).

If the IC-DISC acts as another person's commission agent on a sale, do not enter any amount in Schedule A for the sale. See Schedule P (Form1120-IC-DISC).

Cost of operations.—If the entry on line 2, page 1, of Form 1120-IC-DISC is for the cost of operations, complete Schedule A even if inventories are not used.

Valuation methods.—Your inventories can be valued at: **1.** cost; **2.** cost or market value (whichever is lower); or **3.** any other method that is approved by the Commissioner of Internal Revenue and that conforms to the provisions of the applicable regulations cited below.

Taxpayers using erroneous valuation methods must change to a method permitted for Federal income tax purposes. Such changes should be made by filing Form 3115. For more information about the change, see regulations section 1.446-1(e)(3) and Rev. Proc. 84-74, 1984-2 C.B. 738.

In line 8a, check the method(s) used for valuing inventories. Under "lower of cost or market," market generally applies to normal market conditions when there is a current bid price prevailing at the date the inventory is valued. When no regular open market exists or when quotations are nominal because of inactive market conditions, use fair market prices from the most reliable sales or purchase transactions that occurred near the date the inventory is valued. For more requirements, see regulations section 1.471-4.

Inventory may be valued below cost when the merchandise is 1. unsalable at normal prices or 2. unusable in the normal way because the goods are "subnormal" (that is, because of damage, imperfections, shop wear, etc.) within the meaning of regulations section 1.471-2(c). Such goods may be valued at a current bona fide selling price minus direct cost of disposition (but not less than scrap value) if you can establish such a price. See regulations section 1.471-2(c) for more requirements.

In (iv) of 8a, indicate whether you used a method of inventory valuation other than those described in 8a (i) through (iii). Attach a statement describing the method used.

If this is the first year the "last-in first-out" (LIFO) inventory method was either adopted or extended to inventory goods not previously valued under the LIFO method, provided in section 472, attach **Form 970**, Application To Use LIFO Inventory Method, or a statement with the information required by Form 970. Also check the LIFO box in line 8b. In line 8c, enter the amount or percent of total closing inventories covered under section 472. Estimates are acceptable.

If the IC-DISC changed or extended its inventory method to LIFO and had to write up its opening inventory to cost in the year of election, report the effect of this writeup as income (line 3f, Schedule B) proportionately over a 3-year period that begins in the tax year the corporation made its election. (See section 472(d).)

Schedule B.—Gross Income

If an income item falls in two or more categories, report each part on the applicable line. For example, if interest income consists of qualified interest from a foreign international sales corporation and nonqualified interest from a domestic obligation, enter the qualified interest on an attached schedule for line 2g and the nonqualified interest on an attached schedule for line 3f.

For gain from selling qualified export assets, you will need to attach a separate schedule in addition to the forms required for lines 2h and 2i.

If you use the installment method of reporting, attach a schedule showing for the current and 3 preceding years: (a) gross sales, (b) cost of goods sold, (c) gross profit, (d) percentage of gross profit to gross sales, (e) amount collected, and (f) gross profit on the amount collected.

For tax years beginning after 1986, corporations that sell personal property on a revolving credit plan will not be permitted to account for such sales on the installment method. See sections 453 and 453A for more information.

Commissions: Special Rule.—If the IC-DISC received commissions on selling or renting property or furnishing services, list in column (b) the gross receipts from the sales, rentals, or services on which the commissions arose, and in column (c), list the commissions earned. In column (d) report receipts from non-commissioned sales or rentals of property or furnishing of services, as well as all other receipts.

For purposes of completing line 1a and line 1b, related purchasers are members of the same controlled group (as defined in section 993(a)(3)) as the IC-DISC. All other purchasers are unrelated.

A qualified export sale or lease must meet a use test and a destination test in order to qualify.

The **use requirement** applies at the time of sale or lease. If the property is used predominantly outside the U.S., and the sale or lease is not for ultimate use in the U.S., it is a qualified export sale or lease. Otherwise, if a reasonable person would believe that the property will be used in the U.S., the sale or lease is not a qualified export sale or lease.

For example, if property is sold to a foreign wholesaler, and it is known in trade circles that the wholesaler, to a substantial extent, supplies the U.S. retail market, the sale would not be a qualified export sale, and the receipts would not be qualified export receipts.

Destination test.—Regardless of where title or risk of loss shifts from the seller or lessor, the property must be delivered under one of the following conditions:

(a) Within the U.S. to a carrier or freight forwarder for ultimate delivery outside the U.S. to a buyer or lessee.

(b) Within the U.S. to a buyer or lessee who, within 1 year of the sale or lease, delivers it outside the U.S. or delivers it to another person for ultimate delivery outside the U.S.

(c) Within or outside the U.S. to an IC-DISC that is not a member of the same controlled group (as defined in section 993(a)(3)) as the IC-DISC that is making the sale or lease.

(d) Outside the U.S. by means of the seller's delivery vehicle (ship, plane, etc.).

(e) Outside the U.S. to a buyer or lessee at a storage or assembly site if the property was previously shipped from the U.S. by the IC-DISC.

(f) Outside the U.S. to a purchaser or lessee if the property was previously shipped by the seller or lessor from the U.S. and if the property is located outside the U.S. pursuant to a prior lease by the seller or lessor, and either (a) the prior lease terminated at the expiration of its term (or by the action of the prior lessee acting alone), (b) the sale occurred or the term of the subsequent lease began after the time at which the term of the prior lease would have expired, or (c) the lessee under the subsequent lease is not a related person (a member of the same controlled group as defined in section 993(a)(3) or a relationship that would result in a disallowance of losses under section 267 or section 707(b)) immediately before or after the lease with respect to the lessor and the prior lease was terminated by the action of the lessor (acting alone or together with the lessee).

Line-by-Line Instructions

Qualified export receipts to be entered in line 1 are received from the sale of property, such as inventory, that is produced in the U.S. for direct use, consumption, or disposition outside the U.S. These sales are qualified export sales.

1a. Enter the IC-DISC's qualified export receipts from export property sold to foreign, unrelated buyers for delivery outside the U.S. Do not include amounts entered on line 1b.

1b. Enter the IC-DISC's qualified export receipts from export property sold for delivery outside the U.S. to (i) a related foreign entity for resale to a foreign, unrelated buyer or (ii) an unrelated buyer when a related foreign entity acts as commission agent.

2a. Enter the gross amount received from leasing or subleasing export property to unrelated persons for use outside the U.S.

Receipts from leasing export property may qualify in some years and not in others, depending on where the lessee uses the property. Enter only receipts that qualify during the tax year. (Use Schedule E to deduct expenses such as repairs, interest, taxes, and depreciation.)

2b. A service connected to a sale or lease is related to it if the service is usually furnished with that type of sale or lease in the trade or business where it took place. A service is subsidiary if it is less important than the sale or lease.

2c. Include receipts from engineering or architectural services on foreign construction projects abroad or proposed for location abroad. These services include feasibility studies, design and engineering, and general supervision of construction, but do not include services connected with exploring for minerals.

2d. Include receipts for export management services provided to unrelated IC-DISCs.

2f. Include interest received on any loan that qualifies as a producer's loan.

2g. Enter interest on any qualified export asset other than interest on producer's loans.

For example, include interest on accounts receivable from sales in which the IC-DISC acted as a principal or agent and interest on certain obligations issued, guaranteed, or insured by the Export-Import Bank or the Foreign Credit Insurance Association.

2h. On Schedule D (Form 1120) report in detail every sale or exchange of a capital asset, even if there is no gain or loss.

In addition to Schedule D (Form 1120), attach a separate schedule computing gain from the sale of qualified export assets.

2i. Enter the net gain or loss from line 17, Part II, Form 4797.

In addition to Form 4797, attach a separate schedule computing gain from the sale of qualified export assets.

3b. Enter receipts from selling products subsidized under a U.S. program if they have been designated as excluded receipts.

3c. Enter receipts from selling or leasing property or services for use by any part of the U.S. Government if law or regulations require U.S. products or services to be used.

3d. Enter receipts from any IC-DISC that belongs to the same controlled group (defined in section 993(a)(3)).

3f. Include in an attached schedule any nonqualified gross receipts not reported on lines 3a through 3e. Do not offset an income item against a similar expense item.

Schedule C.—Dividends and Special Deductions

(Numbered to correspond to line numbers in Schedule C.)

Column (a)

1. Enter dividends received (except those received on debt-financed stock—see line 2 instruction below) from domestic corporations that are subject to the deduction under section 243(a)(1). Include taxable distributions from an IC-DISC, former DISC, or former IC-DISC that are eligible for this deduction.

For dividends from a regulated investment company, see section 854 for the amount subject to the section 243(a)(1) deduction.

So-called dividends or earnings from mutual savings banks, etc., are really interest. Report them in Schedule B, not in Schedule C.

2. Enter dividends on debt-financed stock (acquired after July 18, 1984) that are received from domestic corporations subject to income tax and that would otherwise be subject to the dividends-received deduction under section 243(a)(1). Also enter dividends on debt-financed stock of foreign corporations acquired after July 18, 1984. Generally, debt-financed stock is stock that the corporation acquired, and in doing so, incurred a debt (for example, it borrowed money to buy the stock).

See section 246A for more information.

3. Enter dividends received on the preferred stock of a public utility that is subject to income tax and is allowed the deduction provided in section 247 for dividends paid.

4. Enter dividends received from foreign corporations and certain FSCs that qualify for the deduction under section 245(a).

5. Enter dividends you can deduct that you received from wholly owned foreign subsidiaries.

7. Enter foreign dividends that are not reportable on lines 4 and 5. Exclude distributions of amounts constructively taxed under subpart F for your 1986 tax year or in earlier years.

8. Include income constructively received from controlled foreign corporations under subpart F. This amount should equal the total of amounts reported on Schedule J of Form(s) 5471.

9. Enter taxable distributions from an IC-DISC or former DISC or former IC-DISC that are not eligible for the dividends-received deduction. See sections 246(d), 995(b), and 996(a)(3).

10. Include: dividends, except capital gain dividends, from regulated investment companies that do not qualify for the section 243(a) deduction; dividends from tax-exempt organizations; dividends, except capital gain dividends, from a real estate investment trust that, for the trust's tax year in which the dividends are paid, qualifies under sections 856 through 860; dividends not eligible for a dividends-received deduction because of the holding period of the stock or an obligation to make corresponding payments for similar stock;

and other taxable dividend income not reported above.

Two situations in which the dividends-received deduction will not be allowed on any share of stock are:

(1) If the corporation held it 45 days or less (see section 246(c)(1)(A)), or

(2) To the extent the corporation is under an obligation to make related payments for substantially similar or related property.

12. Enter qualified dividends from the IC-DISC's investment in a related foreign export corporation (defined in General Instruction D1e). Include income constructively received from controlled foreign corporations under subpart F. Generally, the investment will be in stock or securities of the IC-DISC's foreign selling subsidiary that qualifies as a foreign international sales corporation.

No deduction is allowed for dividends received from another IC-DISC or former DISC or former IC-DISC if the dividend is paid from accumulated IC-DISC income or previously taxed income or if it is a deemed distribution under section 995(b)(1).

Columns (b) and (c)

1. The dividends-received deduction percentage for dividends received before January 1, 1987, is 85%. For dividends received after December 31, 1986, it is 80%. Multiply the dividends received in each period by the proper percentage to determine the correct dividends-received deduction.

2. The dividends-received deduction for dividends received on debt-financed stock is explained in section 246A. This section applies to dividends received from debt-financed stock of both domestic and foreign corporations acquired after July 18, 1984. The percentages to use for computing the dividends-received deduction for debt-financed stock under section 246A(a)(1) are 85% for dividends received before January 1, 1987, and 80% for dividends received after December 31, 1986.

3. Dividends on certain preferred stock of public utilities are entitled to a dividends-received deduction percentage of 59.13% if they are received before January 1, 1987. For dividends on certain preferred stock of public utilities received after December 31, 1986, but before July 1, 1987, the dividends-received deduction percentage is 55.652%. For these dividends received after June 30, 1987, the dividends-received deduction percentage is 47.059%.

Multiply the dividends received in each period by the proper percentage to determine the correct dividends-received deduction.

4. The dividends-received deduction percentage for dividends received from foreign corporations entitled to the dividends-received deduction under section 245(a) and section 245(c)(1) for certain FSCs is 85% for dividends received before January 1, 1987. The dividends-received deduction percentage for these dividends received after December 31, 1986, is 80%.

Multiply the dividends received in each period by the proper percentage to determine the correct dividends-received deduction.

6. Line 6 of Schedule C may not exceed 85% of line 5, page 1. For this purpose, figure line 5, page 1, without regard to any adjustment under section 1059, and without regard to any capital loss carryover to the tax year under section 1212(a)(1).

In a year when a net operating loss occurs, this 85% limit does not apply even if the dividends-received deduction creates the loss.

Schedule E.—Deductions

(Numbered to correspond to line numbers in Schedule E.)

1. Enter export promotion expenses on lines 1a through 1m. Export promotion expenses are an IC-DISC's ordinary and necessary expenses paid or incurred to obtain qualified export receipts. Do not include income taxes. Any part of an expense not incurred to obtain qualified export receipts should be entered in lines 2a through 2g.

1c. Attach **Form 4562**, Depreciation and Amortization, if you deduct depreciation. Enter on line 1c the depreciation not claimed on Schedule A or elsewhere on the return.

The rules for depreciation for property placed in service in 1987 have been changed. Also, the taxpayer may elect to apply the new rules to property placed in service after July 31, 1986. Effective for property placed in service after December 31, 1986, the amount the taxpayer may expense under section 179 has been raised from $5,000 to $10,000. See Form 4562-A for more information.

Also, see page 9 of these instructions.

The deduction for amortization of trademark and trade name expenses has been repealed for expenses paid or incurred after 1986.

1h. Enter half the freight expenses (except insurance) for shipping export property aboard U.S. flag ships and U.S.-owned and -operated aircraft, unless the law required you to use U.S. ships or aircraft.

1i. Attach a schedule showing the name, social security number, and amount of compensation paid to all officers.

An officer is a person, such as a regular officer or chairman of the board, who is elected or appointed to office or is designated as an officer in the corporation's charter or bylaws.

1j. Enter the cost of incidental repairs, such as labor and supplies, that do not add to the property's value or appreciably prolong its life.

1k. If the IC-DISC has any kind of funded deferred compensation plan, such as a pension or profit-sharing plan, file one of the forms described below.

There are penalties for failure to file these forms on time.

Form 5500.—Complete this form for each plan with 100 or more participants.

Form 5500-C or **5500-R.**—Complete the applicable form for each plan with fewer than 100 participants.

Form 5500EZ.—Complete this form for a one participant plan.

1l. Enter your contributions to employee benefit programs, such as insurance or health and welfare programs, that are not an incidental part of a plan included on line 1k. Also include contributions to a qualified group legal services plan. Section 120 gives certain rules that the IC-DISC must follow for its employees (including spouses and dependents) to be able to exclude from their income the IC-DISC's contributions to the legal services plan.

1m. Enter any other deduction not claimed above. Include amortization expense from Form 4562.

2a. You may treat bad debts in either of two ways: (i) as a deduction for specific debts that become worthless, in whole or in part, or (ii) as a deduction for a reasonable addition to a reserve for bad debts. (See section 166.)

For tax years beginning after 1986, only certain financial institutions will be able to use the reserve method of computing bad debts. See sections 166, 585, and 593 for more information.

2b. Enter taxes paid or accrued during the tax year. See section 164(d) for apportioning real property tax between seller and buyer.

2c. Do not include interest on debts incurred or continued to buy or carry obligations on which the interest is wholly exempt from income tax. (See section 265.)

Section 267 limits deductions for unpaid expenses and interest in transactions between related taxpayers. Section 461(g) limits a cash basis taxpayer's deduction for prepaid interest.

2d. Enter contributions or gifts paid within the tax year to or for the use of charitable and governmental organizations described in section 170(c).

The IC-DISC may claim up to 10% of modified adjusted taxable income as contributions. The limit is 10% of the amount on line 7, page 1, figured without the deduction for contributions, and before taking the dividends-received deduction (line 6b, page 1), premiums paid on bond repurchases (section 249), or payments made to the National Railroad Passenger Corporation (section 250); and before figuring carrybacks to the 1986 tax year for net operating loss (section 172) or capital loss (section 1212(a)(1)). Do not deduct charitable contributions above the 10% limit for the 1986 tax year.

A corporation on the accrual basis may elect to deduct contributions paid by the 15th day of the 3rd month after the tax year ends, if the board of directors authorized the contributions during the tax year. Attach both of the following to the return: a declaration, signed by an officer, stating that the board of directors adopted the resolution authorizing the contributions during the tax year, **and** a copy of the resolution.

If a contribution is made in property other than money, attach a schedule describing the kind contributed and what method was used to determine the fair market value.

Special rules for contributions of certain property.—To report contributed property, reduce its value by the ordinary income that would have resulted if the property were sold at its fair market value. For tax years beginning in 1986, contributions must also be reduced by 60.87% of the long-term capital gain that would have resulted from a sale at fair market value. These are contributions of: (1) tangible personal property to an organization for use in a way unrelated to the basis of its exemption, or (2) property (except stock for which market quotations are readily available—see section 170(e)(5)) to or for use by certain private foundations. (See section 170(e) and regulations section 1.170A-4.)

Section 170(e)(3) gives special rules about contributing inventory or other ordinary income property to certain organizations. Also see regulations section 1.170A-4A.

2e. Enter the freight expense not deducted on line 1h as an export promotion expense.

2g. Do not deduct any amount allocable to exempt income. Items directly attibutable to wholly exempt income must be allocated to that income, and items directly attributable to any class of taxable income must be allocated to that income. If an item is indirectly attributable to both taxable and exempt income, allocate a reasonable proportion to each.

Attach a statement showing (1) the amount of each class of exempt income and (2) the amount of expense items allocated to each class. Show apportioned amounts separately.

Schedule J.—Parts I Through V

(Numbered to correspond to line numbers in Schedule J.)

Part I.—Deemed Distributions Under Section 995(b)(1)

1. Enter gross interest derived during the tax year from producer's loans (section 995(b)(1)(A)).

2. Enter gain recognized on the sale or exchange of section 995(b)(1)(B) property.—Show the computation of the gain. Include only limited gain on qualified export assets that the IC-DISC acquired by transactions in which gain was not recognized. Report the same amount of the DISC's gain that the transferor did not recognize on the earlier transfer.

3. Enter gain recognized on the sale or exchange of property described in section 995(b)(1)(C). Show the computation of the gain. Do not include any gain included in the computation of line 2. Include only the amount of the IC-DISC's gain that the transferor did not recognize on the earlier transfer and that would have been treated as ordinary income if the property had been sold or exchanged rather than transferred to the IC-DISC. Do not include gain on sale or exchange of the IC-DISC's stock in trade or other property that either would be included in inventory if on hand at the end of the tax year or is held primarily for sale in the normal course of business.

4. Enter 50 percent of taxable income attributable to military property (section 995(b)(1)(D)). Show the computation of this income. To figure taxable income attributable to military property, use the gross income attributable to military property for the year and the deductions properly allocated to that income. Military property is defined in section 38 of the International Security Assistance and Arms Export Control Act of 1976 (22 USC 2778) and related regulations (22 CFR 121.01).

6. Enter the taxable income from line 7, page 1, of Form 1120-IC-DISC.

9. Line 9 provides for the computation of the one-seventeenth deemed distribution of section 995(b)(1)(F)(i). Line 9 only applies to shareholders of the IC-DISC that are C corporations. It does not apply to shareholders of the IC-DISC that are other than C corporations.

10. An IC-DISC is deemed to distribute any income that resulted from cooperating with an international boycott (section 995(b)(1)(F)(ii)). See **Form 5713**, International Boycott Report, to compute this deemed distribution and for reporting requirements about any IC-DISC with operations related to a boycotting country.

11. An IC-DISC is deemed to distribute the amount of any illegal payments, such as bribes or kickbacks, that it pays, directly or indirectly, to government officials, employees, or agents (section 995(b)(1)(F)(iii)).

14. Attach a computation showing the earnings and profits for the tax year.

Generally, the allowance for depreciation (and any amortization) is the amount that would be allowable if the IC-DISC had used the straight-line method of depreciation for each tax year. See section 312(k)(2) for exceptions.

17a. To figure the amount for line 17a, attach a computation showing: (1) the IC-DISC's foreign investment in producer's loans during the tax year; (2) accumulated earnings and profits (including earnings and profits for the 1986 tax year) less the amount on line 15, Part I; and (3) accumulated IC-DISC income. Enter the least of these amounts (but not less than zero) on line 17a.

17b. To figure the amount for line 17b, attach a computation showing: (1) the IC-DISC's foreign investment in producer's loans during the year; (2) accumulated earnings and profits (including earnings and profits for the 1986 tax year) less the amount on line 16, Part I; and (3) accumulated IC-DISC income. Enter the least of these amounts (but not less than zero) on line 17b.

For purposes of lines 17a and 17b, foreign investment in producer's loans is the least of:

(1) The net increase in foreign assets by members of the controlled group (defined in section 993(a)(3)) to which the IC-DISC belongs.

(2) The actual foreign investment by the group's domestic members.

(3) The IC-DISC's outstanding producer's loans to members of the controlled group.

"Net increase in foreign assets" and "actual foreign investment" are defined in sections 995(d)(2) and (3).

22 and 23. Allocate the line 22 amount to shareholders that are individuals, partnerships, S corporations, trusts, and estates. Allocate the line 23 amount to shareholders that are C corporations.

Part II.—Deemed Distribution Under Section 995(b)(1)(E)

Generally, any taxable income of the IC-DISC attributable to qualified export receipts that exceed $10 million will be deemed distributed.

1. If commission sales are not reported in Schedule B, page 2, enter on line 1, Part II, the total of line 1c, column (e), Schedule B, and line 2j, column (e), Schedule B.

If commission sales are reported in Schedule B, page 2, total qualified export receipts for purposes of line 1, Part II, is figured as follows:

1. Enter total of line 1c, column (e), Schedule B, and line 2j, column (e), Schedule B . . . . ________

2. Enter total commission income included in line 1 above . . . . ________

3. Line 1 less line 2 . . . . ________

4. For the commission income reported on line 2 above, enter the gross receipts on the sale, lease, or rental of the property on which such commission income arose (section 993(f)) . . . . ________

5. Add lines 3 and 4. Enter on line 1, Part II, Schedule J . . . . ________

3. If the IC-DISC is a member of a controlled group that includes more than one IC-DISC, the $10 million limit is allocated to each member of the group. If an allocation is made, a statement showing each member's portion of the $10 million limit must be attached to Form 1120-IC-DISC.

4 and 5. The $10 million limit (or the controlled group member's share) is prorated on a daily basis. Thus, for example, if for its 1986 tax year an IC-DISC has a short tax year of 73 days, the limit that would be entered on line 5 of Part II is $2 million (73/365 times $10 million).

7. Enter the taxable income attributable to line 6 qualified export receipts. The IC-DISC may select the qualified export receipts to which the line 5 limitation is allocated.

Part III.—Deemed Distributions Under Section 995(b)(2)

If the corporation is a former DISC or a former IC-DISC that revoked IC-DISC status for 1986, each shareholder is deemed to have received a distribution taxable as a dividend. The deemed distribution equals the shareholder's prorated share of the DISC's or IC-DISC's income accumulated during the years just before DISC or IC-DISC status ended. The shareholder will be deemed to receive the distribution in equal parts on the last day of the corporation's tax year for the shorter of the following periods after DISC or IC-DISC status ended:

- 10 tax years
- Twice the number of years the corporation was a DISC or IC-DISC.

Part IV.—Actual Distributions

4a. Include in line 4a any distributions of pre-1985 accumulated DISC income that is nontaxable. Also, in the space to the left of the line 4a amount, enter the dollar amount of the distribution and identify it as "nontaxable pre-1985 DISC income." Do not include distributions of pre-1985 DISC income that are made under section 995(b)(2) because of prior year revocations or disqualifications.

Part V.—Deferred DISC Income

In general, deferred DISC income is:

(1) Accumulated IC-DISC income (for periods after 1984) of the IC-DISC as of the close of the computation year, over

(2) The amount of distributions in excess of income for the tax year of the IC-DISC following the computation year.

Generally, the computation year is the IC-DISC's last tax year beginning in 1985.

For purposes of item (2) above, distributions in excess of income means, the excess (if any) of:

(1) Actual distributions to shareholders out of accumulated IC-DISC income, over

(2) Shareholders' pro rata share of the IC-DISC income (as defined in section 996(f)(1)) for the tax year following the computation year.

See section 995(f) and related regulations for more information on figuring deferred DISC income.

The amount on line 3, Part V, is allocated to each shareholder on line 2, Part III, of Schedule K (Form 1120-IC-DISC).

Schedule K.—Shareholder's Statement of IC-DISC Distributions

Attach a separate Copy A, Schedule K (Form 1120-IC-DISC), to Form 1120-IC-DISC for each shareholder who had an actual or deemed distribution or to whom you reported deferred DISC income during the IC-DISC's tax year.

Additional Information

Question P.—Check the "Yes" box if either (1) or (2) below applies to you; otherwise check the "No" box:

(1) At any time during the year you had an interest in or signature or other authority over a financial account in a foreign country (such as a bank account, securities account, or other financial account); AND

- The combined value of the accounts was more than $10,000 at any time during the year; AND
- The account was NOT with a U.S. military banking facility operated by a U.S. financial institution.

(2) The IC-DISC owns more than 50% of the stock in any corporation that would answer the question "Yes" based on item (1) above.

Get form **TD F 90-22.1,** Report of Foreign Bank and Financial Accounts, to see if you are considered to have an interest in or signature or other authority over a bank account, securities account, or other financial account in a foreign country.

If question P, is checked "Yes," file form TD F 90-22.1 by June 30, 1987, with the Department of the Treasury at the address shown on the form. **Form TD F 90-22.1 is not a tax return, so do not file it with the IRS.**

You can get form TD F 90-22.1 from many IRS offices.

Also, if question P is checked "Yes," write the name of the foreign country or countries. Attach a separate sheet if you need more space.

Question S.—File Form 5713 if the IC-DISC or any member of its controlled group (defined in section 993(a)) has operations in or related to a boycotting country (or with the government, a company, or a national of that country). An IC-DISC that cooperates with an international boycott is also deemed to distribute part of its income. See Form 5713 for more information.

Schedule L.—Balance Sheets

12. If the corporation was a qualified DISC as of December 31, 1984, the accumulated pre-1985 DISC income will generally be treated as previously taxed income (exempt from tax) when distributed to DISC shareholders after December 31, 1984. Exception: The exemption does not apply to distributions of accumulated pre-1985 DISC income of an IC- DISC or former DISC that was made taxable under section 995(b)(2) because of a prior revocation of the DISC election or disqualification of the DISC. For more details on these distributions, see regulations under section 1.921-1T(a)(6).

13. Accumulated IC-DISC income (for periods after 1984) is accounted for on line 13 of Schedule L. The balance of this account is used in figuring deferred DISC income in Part V of Schedule J.

Schedule N.—Export Gross Receipts of the IC-DISC and Related U.S. Persons

1. Product Code and Percentage.—Enter in 1a the code number and percentage of total receipts for the product or service that accounts for the largest portion of the IC-DISC's gross receipts. The product codes are located on page 11 of these instructions. On line 1b enter the same information for the IC-DISC's next largest product or service.

Example: An IC-DISC has export gross receipts of $10 million; selling agricultural chemicals accounts for $4.5 million (45%) of that amount, which is the IC-DISC's largest product or service. The IC-DISC should enter "287" (the product code for agricultural chemicals) and "45%" in 1a.

Selling industrial chemicals accounts for $2 million (20% of the $10 million total), and is the IC-DISC's second largest product or service. The IC-DISC should enter "281" (the product code for industrial chemicals) and "20%" in 1b.

2. Columns (a), (b), and (c)

Export Gross Receipts.—These are receipts from any of the following:

(a) selling, for direct use, consumption, or disposition outside the U.S., property (such as inventory) produced in the U.S.,
(b) renting this property to unrelated persons for use outside the U.S.,
(c) providing services involved in such a sale or rental,
(d) providing engineering or architectural services for construction projects located outside the U.S., and
(e) providing export management services.

For commission sales,"export gross receipts" include the total receipts on which the IC-DISC earned the commission.

For purposes of item 2, Schedule N only, no reduction is to be made for receipts attributable to military property. Therefore, an IC-DISC's "export gross receipts" for purposes of item 2 is the total of the amounts from page 2, Schedule B, columns (b) and (d), lines 1c, 2a, 2b, 2c, and 2d.

Related Persons.—The following are "related persons":

(a) an individual, partnership, trust, or estate that controls the IC-DISC,
(b) a corporation that controls the IC-DISC or is controlled by it, and
(c) a corporation controlled by the same person or persons who control the IC-DISC.

"Control" means direct or indirect ownership of more than 50% of the total voting power of all classes of stock entitled to vote. (See section 993(a)(3).)

U.S. Person.—A "U.S. person" is:

(a) a citizen or resident of the U.S.,
(b) a domestic corporation or partnership, or
(c) an estate or trust (other than a foreign estate or trust, which is one whose income is not includible in U.S. gross income because the income is from sources outside the U.S. and is not effectively connected with the conduct of a trade or business in the U.S.).

U.S.—U.S. includes the Commonwealth of Puerto Rico and possessions of the U.S. (See section 993(g).)

Export Gross Receipts for 1986

Column (a).—All IC-DISCs should complete column (a) in item 2. If two or more IC-DISCs are related persons, only the IC-DISC with the largest export gross receipts should complete columns (b) and (c). If an IC-DISC acts as a commission agent for a related person, attribute the total amount of the transaction to the IC-DISC.

Complete column (a) to report the IC-DISC's export gross receipts from all sources (including the U.S.) for the 1986 tax year.

Column (b).—Export gross receipts of related IC-DISCs.—Complete column (b) to report related IC-DISCs' export gross receipts from all sources (including the U.S.).

Column (c).—Export gross receipts of all other related U.S. persons.—Complete column (c) to report other related U.S. persons' export gross receipts from all sources except the U.S.

3. Related U.S. Persons.—Report the name, address, and identifying number of related U.S. persons in your controlled group.

If items 2(b) and 2(c) are completed, show first in item 3(b) the name, address, and identifying number of the IC-DISC that completed 2(b) and 2(c).

Separate Schedule P.—Computation of Inter-company Transfer Price or Commission

Complete and attach a separate Schedule P (Form 1120-IC-DISC) for each transaction or group of transactions to which you apply the inter-company pricing rules of section 994(a)(1) and (2). (Please see General Instruction D2.)

Tax Reform Act of 1986

The Tax Reform Act of 1986 made several changes that affect corporations. Some of the changes are effective starting with calendar year 1986 tax returns; some are effective starting with fiscal year 1986–1987 tax returns; and some are effective starting with calendar year 1987 tax returns.

Tax Changes Taking Effect Beginning in 1986

Long-Term Contracts

For long-term contracts entered into after February 28, 1986, all costs (including research and experimental costs attributable to the contract) must be allocated to the contract and taken into account using the method set forth in section 460. Expenses for unsuccessful bids and proposals and marketing, selling, and advertising are not considered attributable to long-term contracts. Production period interest expense attributable to long-term contracts is to be capitalized under the rules of new section 263A. For more rules, definitions, and exceptions, see section 460.

Deduction for Removing Barriers to the Handicapped Extended

The election to deduct expenses for the removal of architectural barriers to the handicapped and elderly was scheduled to expire on December 31, 1985. It has been permanently extended.

Asset Allocation Rules

New asset allocation rules apply in certain cases of asset acquisitions, and generally are effective for transfers made after May 6, 1986. In addition, there are reporting rules when these transfers take place. See new section 1060 for more information.

Increase in Penalty for Failure To File Information Returns

For returns due after December 31, 1986, the maximum penalty for failure to file information returns has been increased. A new penalty of $5 for supplying incorrect information has also been added. For more information, see sections 6652, 6676, 6678, and new sections 6721 through 6724.

The Following Provisions Begin in 1987 and Affect Fiscal 1986–1987 Tax Years

Reduction in Dividends-Received Deduction

The dividends-received deduction for dividends received from certain corporations has been reduced for dividends received after 1986. The new percentage is 80%; the previous percentage was 85%. See sections 243, 244, and 246A.

Foreign Intangible Drilling, Mining, and Development Costs

Foreign intangible drilling and development costs paid or incurred after 1986 must either be deducted ratably over a 10-year period or added to the corporation's basis for cost depletion purposes. See sections 263(i), 616, and 617 for more information.

Certain Costs Required To Be Capitalized or Included in Inventory Costs

New section 263A requires that certain costs incurred in the production of real and intangible property produced by the taxpayer be capitalized or included in inventory costs, rather than deducted. Generally, the changes affecting inventory are effective for tax years beginning after 1986 and the changes affecting capitalization are effective for tax years ending after 1986. Please see new section 263A.

Amortization of Trademark and Trade Name Expenditures

Generally, trademark and trade name expenditures made after 1986 will no longer be amortizable.

Depreciation

The rules for computing depreciation have been substantially changed for property placed in service after 1986. The new system provides specific methods for each class of assets. See **Form 4562-A,** Depreciation of Property Placed in Service After December 31, 1986, and section 168.

Also, corporations may make an election to use these new rules for property placed in service after July 31, 1986. Additionally, the section 179 deduction for property placed in service after 1986 is increased from $5,000 to $10,000.

Gain or Loss on Distributions in Complete Liquidation

Generally, corporations will recognize gain or loss on distributions of their property in complete liquidations as if they had sold the property at its fair market value. These new rules apply to liquidations completed after December 31, 1986. See sections 336 and 337.

Basis of Property and Inventory Costs for Property Imported by a Related Person

If property is imported into the U.S. by a related person after March 18, 1986, and the property has a customs value, the basis or inventory cost to the importer cannot exceed the customs value. For more information, see section 1059A.

Limitation on Net Operating Loss Carryovers

The amount of net operating loss carryover is limited when there has been a change in ownership or equity for net operating losses incurred after 1986. The limitation is described in section 382(b) and applies generally when a 5% shareholder or group of 5% shareholders increases its ownership in a corporation by more than 50 percentage points. For more information, see section 382.

The Following Provisions Begin in 1987 and Affect Tax Years Beginning After 1986

Meals, Travel, and Entertainment Expenses

Many of the rules on what are allowable expenses for meals, entertainment, travel, and certain other business expenses have been changed. See section 274.

Meals and entertainment.—The amount deductible for meals and entertainment expenses is generally limited to 80% of the amount otherwise allowable. In addition, meals must not be lavish or extravagant; a bona fide business discussion must precede or directly follow the meal; and your employee must be present at the meal. If the corporation claims a deduction for the unallowable meal expenses, it may have to pay a penalty.

Reporting of Tax-Exempt Interest.—For tax years beginning after 1986, any taxpayer required to file a tax return must report, as an item of information, on that return the amount of the tax-exempt interest received or accrued during the tax year.

Accrual Method of Accounting Required

Generally, corporations are prohibited from using the cash method of accounting for tax years after 1986. See new section 448.

For additional information on these changes and other provisions that affect tax years beginning after 1986, see **Publication 553,** Highlights of 1986 Tax Changes.

Codes for Principal Business Activity

These industry titles and definitions are based, in general, on the Standard Industrial Classification System authorized by Regulatory and Statistical Analysis Division, Office of Information and Regulatory Affairs, Office of Management and Budget, to classify establishments. However, certain activities such as manufacturing do not apply to an IC-DISC.

Using the list below, enter on page 1, under B, the code number for the specific industry group from which the largest percentage of "total receipts" is derived. "Total receipts" means all income (line 1, page 1). On page 5, under question I, state the principal business activity and principal product or service that account for the largest percentage of total receipts. For example, if the principal business activity is "Wholesale trade: Machinery, equipment, and supplies," the principal product or service may be "Engines and turbines."

TRANSPORTATION, COMMUNICATION, ELECTRIC, GAS, AND SANITARY SERVICES

Code

Transportation:

4400 Water transportation
4700 Other transportation services

Electric, gas, and sanitary services:

4910 Electric services
4920 Gas production and distribution
4930 Combination utility services

WHOLESALE TRADE

Durable

5008 Machinery, equipment, and supplies
5010 Motor vehicles and automotive equipment
5020 Furniture and home furnishings
5030 Lumber and construction materials
5040 Sporting, recreational, photographic, and hobby goods, toys, and supplies
5050 Metals and minerals, except petroleum and scrap
5060 Electrical goods
5070 Hardware, plumbing and heating equipment
5098 Other durable goods

Code

Nondurable

5110 Paper and paper products
5129 Drugs, drug proprietaries, and druggists' sundries
5130 Apparel, piece goods, and notions
5140 Groceries and related products
5150 Farm-product raw materials
5160 Chemicals and allied products
5170 Petroleum and petroleum products
5180 Alcoholic beverages
5190 Miscellaneous nondurable goods

RETAIL TRADE

Building materials, hardware, garden supply, and mobile home dealers:

5220 Building materials dealers
5251 Hardware stores
5265 Garden supplies and mobile home dealers

5300 General merchandise stores
5410 Grocery stores
5490 Other food stores

Automotive dealers and service stations:

5515 Motor vehicle dealers
5541 Gasoline service stations
5598 Other automotive dealers

Code

5600 Apparel and accessory stores
5700 Furniture and home furnishings stores
5800 Eating and drinking places

Miscellaneous retail stores:

5912 Drug stores and proprietary stores
5921 Liquor stores
5995 Other miscellaneous retail stores

FINANCE, INSURANCE, AND REAL ESTATE

Credit agencies other than banks:

6199 Other credit agencies

SERVICES

Business services:

7389 Export management services

Auto repair and services; miscellaneous repair services:

7500 Lease or rental of motor vehicles

Amusement and recreation services:

7812 Motion picture production, distribution, and services

Other services:

8911 Architectural and engineering services
8930 Accounting, auditing, and bookkeeping
8980 Miscellaneous services

Schedule N Product Code System

(These codes are to be used only with Schedule N, page 5, Form 1120-IC-DISC.)

Using the list below, enter in 1 of Schedule N the product code number and percent of export gross receipts as explained in the Specific Instructions.

This product code system is divided into two categories—(1) nonmanufactured product groups and services and (2) manufactured product groups.

NONMANUFACTURED PRODUCT GROUPS AND SERVICES

Code	
011	Grains and soybeans.
013	Cotton.
019	Crops, except cotton, grains and soybeans.
021	Livestock and livestock products.
070	Agricultural services.
090	Fishery products and services.
100	Metal mining, except iron ores, products and services.
101	Iron ores.
110	Coal mining (anthracite, bituminous and lignite) products and services.
130	Crude petroleum and natural gas products and services.
147	Chemical and fertilizer mineral products and services.
149	Other nonmetallic mineral products and services.
400	Transportation services (land, air and water).
490	Electric, gas, and sanitary services.
600	Finance, insurance, and real estate services.
730	Export management services.
780	Motion picture distribution.
850	Engineering and architectural services.
990	Miscellaneous nonmanufactured products and services.

MANUFACTURED PRODUCT GROUPS

Code	
	Ordnance and accessories:
191	Guns, howitzers, mortars, and related equipment.
192	Ammunition, except for small arms.
193	Tanks and tank components.
194	Sighting and fire control equipment.
195	Small arms.
196	Small arms ammunition.
199	Ordnance and accessories, not elsewhere classified.
	Food and kindred products:
201	Meat products.
202	Dairy products.
203	Canned and preserved fruits, vegetables and seafoods.
204	Grain mill products.
205	Bakery products.
206	Sugar.
207	Confectionery and related products.
208	Beverages.
209	Miscellaneous food preparations and kindred products.
	Tobacco manufactures:
211	Cigarettes.
212	Cigars.
213	Tobacco (chewing and smoking) and snuff.
214	Tobacco stemming and redrying.
	Textile mill products:
221	Broad woven fabric mills, cotton.
222	Broad woven fabric mills, man-made fiber and silk.
223	Broad woven fabric mills, wool (including dyeing and finishing).
224	Narrow fabrics and other smallwares mills: cotton, wool, silk, and man-made fiber.
225	Knitting mills.
226	Dyeing and finishing textiles, except wool fabrics and knit goods.
227	Floor covering mills.
228	Yarn and thread mills.
229	Miscellaneous textile goods.
	Apparel and other finished products made from fabrics and similar materials:
231	Men's, youths', and boys' suits, coats, and overcoats.
232	Men's, youths', and boys' furnishings, work clothing, and allied garments.
233	Women's, misses', and juniors' outerwear.
234	Women's, misses', children's, and infants' undergarments.
235	Hats, caps, and millinery.
236	Girls', children's, and infants' outerwear.
237	Fur goods.
238	Miscellaneous apparel and accessories.
239	Miscellaneous fabricated textile products.
	Lumber and wood products, except furniture:
241	Logging camps and logging contractors.
242	Sawmills and planing mills.
243	Millwork, veneer, plywood, and prefabricated structural wood products.
244	Wooden containers.
249	Miscellaneous wood products.
	Furniture and fixtures:
251	Household furniture.
252	Office furniture.
253	Public building and related furniture.
254	Partitions, shelving, lockers, and office and store fixtures.
259	Miscellaneous furniture and fixtures.
	Paper and allied products:
261	Pulp mills.
262	Paper mills, except building paper mills.
263	Paperboard mills.
264	Converted paper and paperboard products, except containers and boxes.
265	Paperboard containers and boxes.
266	Building paper and building board mills.
	Printing, publishing, and allied products:
271	Newspapers: publishing, publishing and printing.
272	Periodicals: publishing, publishing and printing.
273	Books.
274	Miscellaneous publishing.
275	Commercial printing.
276	Manifold business forms.
277	Greeting card publishing.
278	Blankbooks, looseleaf binders, and bookbinding and related work.
279	Service industries for the printing trade.
	Chemicals and allied products:
281	Industrial inorganic and organic chemicals.
282	Plastics materials and synthetic resins, synthetic rubber, synthetic and other man-made fibers, except glass.
283	Drugs.
284	Soap, detergents, and cleaning preparations, perfumes, cosmetics, and other toilet preparations.
285	Paints, varnishes, lacquers, enamels, and allied products.
286	Gum and wood chemicals.
287	Agricultural chemicals.
289	Miscellaneous chemical products.
	Petroleum refining and related products:
291	Petroleum refining.
295	Paving and roofing materials.
299	Miscellaneous products of petroleum and coal.
	Rubber and miscellaneous plastics products:
301	Tires and inner tubes.
302	Rubber footwear.
303	Reclaimed rubber.
306	Fabricated rubber products, not elsewhere classified.
307	Miscellaneous plastics products.
	Leather and leather products:
311	Leather tanning and finishing.
312	Industrial leather belting and packing.
313	Boot and shoe cut stock and findings.
314	Footwear, except rubber.
315	Leather gloves and mittens.
316	Luggage.
317	Handbags and other personal leather goods.
319	Leather goods, not elsewhere classified.
	Stone, clay, glass, and concrete products:
321	Flat glass.
322	Glass and glassware, pressed or blown.
323	Glass products, made or purchased glass.
324	Cement, hydraulic.
325	Structural clay products.
326	Pottery and related products.
327	Concrete, gypsum, and plaster products.
328	Cut stone and stone products.
329	Abrasive, asbestos, and miscellaneous nonmetallic mineral products.
	Primary metal products:
331	Blast furnaces, steel works, and rolling and finishing mills.
332	Iron and steel foundries.
333	Primary smelting and refining of nonferrous metals.
334	Secondary smelting and refining of nonferrous metals.
335	Rolling, drawing, and extruding of nonferrous metals.
336	Nonferrous foundries.
339	Miscellaneous primary metal products.
	Fabricated metal products, except ordnance, machinery, and transportation equipment:
341	Metal cans.
342	Cutlery, hand tools, and general hardware.
343	Heating apparatus (except electric) and plumbing fixtures.
344	Fabricated structural metal products.
345	Screw machine products, and bolts, nuts, screws, rivets and washers.
346	Metal stampings.
347	Coating, engraving, and allied services.
348	Miscellaneous fabricated wire products.
349	Miscellaneous fabricated metal products.
	Machinery except electrical:
351	Engines and turbines.
352	Farm machinery and equipment.
353	Construction, mining, and materials handling machinery and equipment.
354	Metalworking machinery and equipment.
355	Special industry machinery, except metalworking machinery.
356	General industrial machinery and equipment.
357	Office, computing, and accounting machines.
358	Service industry machines.
359	Miscellaneous machinery, except electrical.
	Electrical machinery, equipment, and supplies:
361	Electric transmission and distribution equipment.
362	Electrical industrial apparatus.
363	Household appliances.
364	Electric lighting and wiring equipment.
365	Radio and television receiving sets, except communication types.
366	Communication equipment.
367	Electronic components and accessories.
369	Miscellaneous electrical machinery, equipment, and supplies.
	Transportation equipment:
371	Motor vehicles and motor vehicle equipment.
372	Aircraft and parts.
373	Ship and boat building and repairing.
374	Railroad equipment.
375	Motorcycles, bicycles, and parts.
379	Miscellaneous transportation equipment.
	Professional, scientific, and controlling instruments; photographic and optical goods; watches and clocks:
381	Engineering, laboratory, and scientific and research instruments and associated equipment.
382	Instruments for measuring, controlling, and indicating physical characteristics.
383	Optical instruments and lenses.
384	Surgical, medical, and dental instruments and supplies.
385	Ophthalmic goods.
386	Photographic equipment and supplies.
387	Watches and clocks.
	Miscellaneous manufactured products:
391	Jewelry, silverware, and plated ware.
393	Musical instruments.
394	Toys, amusement, sporting and athletic goods.
395	Pens, pencils, and other office and artists' materials.
396	Costume jewelry, costume novelties, buttons, and miscellaneous notions, except precious metal.
399	Miscellaneous manufactured products.