

1987



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.

Changes You Should Note Tax Reform Act of 1986 (Act)

The Act made many changes to the Internal Revenue Code that affect the IC-DISC and its shareholders. Many of these changes are contained in the instructions. For information on other changes, see **Publication 921**, Explanation of the Tax Reform Act of 1986 for Business.

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) and the regulations thereunder 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 only one class of stock, and its outstanding stock has a par or stated 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, interest 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, 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 organizations (section 501): File the appropriate return in the Form 990 series.
- Personal holding companies (section 542): File Form 1120 and Schedule PH (Form 1120).
- Financial institutions affected by section 581 or 593: File Form 1120.
- Insurance companies (subchapter L): File Form 1120L or 1120-PC.
- Regulated investment companies (section 851(a)): File Form 1120-RIC.
- Real estate investment trusts (section 856): File Form 1120-REIT.
- S corporations (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.)

A former DISC or former IC-DISC need not complete page 1 and the Schedules for figuring taxable income, but 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 1987 return for calendar year 1987 and fiscal years that begin in 1987. 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 39901
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 for Tax Practitioners, 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

The IC-DISC may have to file any of the following:

Forms W-2 and W-3. Wage and Tax Statement; and Transmittal of Income and Tax Statements.

Form W-2P. Statement for Recipients of Annuities, Pensions, Retired Pay, or IRA Payments.

Form 966. Corporate Dissolution or Liquidation.

Form 1096. Annual Summary and Transmittal of U.S. Information Returns.

Form 1098. Mortgage Interest Statement. This form is used to report the receipt from any individual of \$600 or more of mortgage interest in the course of the corporation's trade or business for any calendar year.

Forms 1099-A, B, DIV, INT, MISC, OID, PATR, and R. Information returns for reporting abandonments, acquisitions through foreclosure, proceeds from brokers, barter exchange, and real estate transactions, certain dividends and distributions, interest payments, payments for certain fishing boat crew members, medical and dental health care payments, direct sales of consumer goods for resale, miscellaneous income payments, nonemployee compensation, original issue discount, patronage dividends, and total distributions from profit-sharing plans, retirement plans, and individual retirement arrangements. Also use these returns to report amounts that were received as a nominee on behalf of another person.

For more information, see **Publication 916**, Information Returns.

Note: Every corporation must file information returns if, in the course of its trade or business, it makes payments or rents, commissions, or other fixed or determinable income (see section 6041) totaling \$600 or more to any one person during the calendar year.

Form 5452. Corporate Report of Nontaxable Dividends.

Form 5498. Individual Retirement Arrangement Information. It is to be used to provide IRS with contribution information on individual retirement arrangements, simplified employee pensions, and deductible voluntary employee contributions.

Form 5713. International Boycott Report, for persons having operations in or related to "boycotting" countries. In addition, persons who participate in or cooperate with an international boycott may have to complete Schedule A or Schedule B and Schedule C of Form 5713 to compute their loss of the following items: the foreign tax credit, the deferral of earnings of a controlled foreign corporation, IC-DISC benefits, and FSC benefits.

Form 8264. Application for Registration of a Tax Shelter. It is used by tax shelter organizers to register tax shelters with the IRS, for the purpose of receiving a tax shelter registration number.

Form 8271. Investor Reporting of Tax Shelter Registration Number. It is used by taxpayers who have acquired an interest in a tax shelter, which is required to be registered, to report the tax shelter's registration number.

Form 8271 must be attached to any tax return (including an application for tentative refund (Form 1139) and an amended Form 1120-IC-DISC) on which a deduction, credit, loss, or other tax benefit attributable to a tax shelter is reported.

Form 8281. Information return for Publicly Offered Original Issue Discount Instruments. This form is generally required to be filed by issuers of public offerings of debt instruments within 30 days of the issuance of the debt instrument.

Form 8300. Report of Cash Payments Over \$10,000 Received in a Trade or Business. Generally, this form is used to report the receipt of more than \$10,000 in cash or foreign currency in one transaction (or a series of related transactions).

Forms 1042 and 1042S.—File **Form 1042**, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons,

and **Form 1042S**, Foreign Person's U.S. Source Income Subject to Withholding, 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 must treat these amounts as effectively connected with the conduct of a trade or business conducted through a permanent establishment in the U.S., and derived from sources within 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) Property not more than 50% of the fair market value of which 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 IC-DISC 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 Schedule Q (Form 1120-IC-DISC), Borrower's Certificate of Compliance with the Rules for Producer's Loans, and 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 **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 the 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) may not exceed 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, provided that under section 482 the price actually charged clearly reflects the taxable income of the IC-DISC and the related person.

Schedule P (Form 1120-IC-DISC). Computation of Inter-company Transfer Price or Commission, explains the 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 export property on U.S.-owned and -operated aircraft or ships if U.S. law or 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 required 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

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, 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 and **Publication 536**, Net Operating Losses, 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 earnings and profits other than accumulated IC-DISC income or previously taxed income;

- (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 (Form 1120-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 valued using the LIFO method. 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 the 3-year period that begins in the tax year the corporation made its LIFO election. (See section 472(d).)

Section 263A Uniform Capitalization Rules.—The uniform capitalization rules of section 263A are discussed in general in the instructions for Limitations on Deductions in the Schedule E instructions. See those instructions before completing Schedule A.

Corporations subject to section 263A will be required to make adjustments to the cost of goods sold computation on Schedule A. To the extent section 263A costs were not included in inventory in prior years, corporations must revalue their beginning inventory. Corporations may elect one of the simplified methods of accounting for section 263A costs provided in Temporary Regulations section 1.263A-1T for purposes of both revaluing their inventory and accounting for costs in subsequent years. See the instruction for line 4a below. Absent the election of a simplified method, the corporation is required to allocate additional costs to be included in inventory under section 263A with the same degree of specificity as was required of inventoriable costs under prior law.

Line 1.—For tax years beginning after 1986, beginning inventory must be revalued as if section 263A rules had been in effect for all prior tax years. Enter the revalued beginning inventory on line 1. An adjustment to income is required under section 481(a). This adjustment should be included in income on line 2j (or 3f if applicable) of Schedule B, Form 1120-IC-DISC, and separately identified on an attached schedule. The section 481 adjustment is taken into account over a period not to exceed 4 years. In addition, since the application of section 263A is considered to be a change in accounting method, the corporation is required to complete Form 3115 to show its computation of the section 481(a) adjustment. Attach Form 3115 to Form 1120-IC-DISC. Be sure to use the 1987 revision of Form 3115. See section 803(d)

of the Tax Reform Act of 1986 and regulations under section 263A for more information on revaluing beginning inventory.

Line 4a.—An entry is required on this line only for corporations electing a simplified method of accounting. For corporations electing the simplified production method, additional section 263A costs are generally those costs, other than interest, that were not capitalized or included in inventory costs under the corporation's method of accounting immediately prior to the effective date in Temporary Regulations section 1.263A-1T that are now required to be capitalized under section 263A. For corporations electing the simplified resale method, additional sections 263A costs are generally those costs incurred with respect to the following categories: off-site storage or warehousing; purchasing; handling; processing, assembly and repackaging; and general and administrative costs (mixed service costs). Enter on line 4a the balance of section 263A costs paid or incurred during the tax year not included on lines 2 and 3. See Temporary Regulations section 1.263A-1T for more information.

Line 4b.—Enter on line 4b any other inventoriable costs paid or incurred during the tax year not entered on lines 2 through 4a.

Line 6.—See section 263A and Temporary Regulations section 1.263A-1T for details on figuring the amount of additional section 263A costs to be capitalized and added to ending inventory.

Schedule B.—Gross Income

If an income item falls into 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 are not permitted to account for such sales on the installment method.

Also, use of the installment method is limited by the proportionate disallowance rules of new section 453C for sale to customers of personal property. See section 453C and section 811(c)(7) of the Tax Reform Act of 1986 for details.

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 noncommissioned

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 test** applies at the time of the 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 18, Part II, Form 4797.

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

2j. Enter any other qualified export receipts for the tax year not reported on lines 2a through 2i. Such receipts include the IC-DISC's allocable portion of an adjustment to income required under section 481(a) because of a change in accounting method. For example, section 481(a) income must be reported if the IC-DISC has to revalue its beginning inventory as a result of the

uniform capitalization rules of new section 263A. See the instruction for line 1 of Schedule A for details.

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 (as 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 only if such distributions are eligible for this deduction. See line 9 instruction below for distributions not 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 on Schedule B, not on 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), and dividends received from certain FSCs that qualify for the deduction under section 245(c).

5. Enter dividends you can deduct that you received from wholly owned foreign subsidiaries. See section 245(b).

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. Enter amount required to be included in gross income from controlled foreign corporations under subpart F (sections 951-964). This amount should equal the

total of amounts reported on Schedule J of Form 5471. If a controlled foreign corporation is a related foreign export corporation, enter subpart F inclusions on line 12 of Schedule C.

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).

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).

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 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.

Columns (b) and (c)

1. The dividends-received deduction percentage for dividends received after December 31, 1986, is 80%.

2. The dividends-received deduction for dividends received on debt-financed stock is explained in section 246A. This section applies to dividends received on debt-financed portfolio stock acquired after July 18, 1984.

Dividends received on debt-financed stock are not entitled to the full 80% dividends-received deduction. The 80% deduction is reduced by a percentage that is related to the amount of debt incurred to acquire the stock. See section 246A. Also see section 245(a) before making this computation for an additional limitation which applies to dividends received from foreign corporations. A schedule showing how the amount on line 2, column (c) was figured must be attached to Form 1120-IC-DISC.

3. 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 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(s) for line 4 is: (1) 80% for dividends from foreign corporations for which the deduction is allowed under section 245(a), and (2) 85% for dividends from certain FSCs for which the deduction is allowed under section 245(c)(1)(B).

Note: *The 85% will be reduced to 80% if pending technical corrections legislation is enacted.*

6. Line 6 of Schedule C may not exceed 80% of line 5, page 1. For this purpose, figure line 5, page 1, without any net operating loss deduction under section 172 and without any dividends-received deductions, without regard to any adjustment under section 1059, and to any capital loss carryover to the tax year under section 1212(a)(1).

In a year when a net operating loss occurs, this 80% 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.)

Limitations on deductions

a. Section 263A Uniform Capitalization Rules.—Many items that were deductible under prior law must now be capitalized or included in inventory under the new uniform capitalization rules of section 263A. The new rules require corporations to capitalize or include in inventory certain costs incurred in connection with the production of real and personal tangible property held in inventory or held for sale in the ordinary course of business. Tangible personal property produced by a taxpayer includes a film, sound recording, video, tape, book, or similar property. The rules also apply to personal property (tangible and intangible) acquired for resale. Taxpayers subject to the rules are required to capitalize not only direct costs but an allocable portion of most indirect costs (including taxes) that benefit the assets produced or acquired for resale. Interest expense paid or incurred in the course of production must be capitalized and is governed by special rules. The uniform capitalization rules also apply to the production of property constructed by a taxpayer for use in its trade or business or in an activity engaged in for profit.

Section 263A does not apply to personal property acquired for resale if the taxpayer's annual average gross receipts are \$10,000,000 or less. It does not apply to timber or to property produced under a long-term contract. The rules do not apply to property which is produced for use by the taxpayer if substantial construction occurred before March 1, 1986.

The uniform capitalization rules are generally effective for costs and interest paid or incurred after 1986. With respect to inventory, the uniform capitalization rules apply to tax years beginning after 1986. Transitional rules are contained in section 803 of the Tax Reform Act of 1986.

In the case of inventory, some of the indirect costs which may not have been

capitalized before 1987, which must now be capitalized, are administration expenses, taxes, insurance costs, compensation paid to officers attributable to services, rework labor, and contributions to pension, stock bonus, and certain profit-sharing, annuity, or deferred compensation plans.

Current deductions may be claimed for research and experimental costs under section 174. Intangible drilling costs for oil and gas and geothermal property, and mining and exploration and development costs are still separately reported to shareholders for purpose of determinations under sections 59(e) and 613A(c)(13). Temporary Regulations section 1.263A-1T specifies other indirect costs that may be currently deducted and those that must be capitalized with respect to production or resale activities. For more information, see the instructions for Schedule A on pages 4 and 5 and Temporary Regulations section 1.263A-1T.

b. Meals and Entertainment Expense.—For tax years beginning after 1986, the amount deductible for business meals and entertainment expense is generally limited to 80% of the amount otherwise allowable. For more information on the 80% limitation and other limitations, see section 274.

c. Transactions between related taxpayers.—Generally, an accrual basis taxpayer may only deduct business expenses and interest owed to a related party in the year the payment is included in the income of the related party. See section 267 for limitations on deductions for unpaid expenses and interest.

Line-by-Line Instructions

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 on lines 2a through 2g.

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

Besides depreciation, include in line 1c the part of the cost that the corporation elected to expense for certain recovery property placed in service during the 1987 tax year. Generally, for property placed in service after December 31, 1986, the amount the IC-DISC may expense under section 179 has been raised from \$5,000 to \$10,000. See the instructions for Form 4562 for other limitations.

1h. Enter half the freight expenses (except insurance) for shipping export property aboard U.S. flagships and U.S.-owned and -operated aircraft, unless by law or regulations you are required 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.

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

2a. You may take a deduction for specific debts that become worthless, in whole or in part. (See section 166.)

For tax years beginning before 1987, an IC-DISC could treat bad debts in either of two ways: (1) as a deduction for specific debts that become worthless, in whole or in part, or (2) as a deduction for a reasonable addition to a reserve for bad debts. For tax years beginning after 1986, the IC-DISC can only use the specific charge off method for figuring its bad-debt deduction. See section 166.

When changing to the specific charge off method, the following rules apply:

- The change is treated as a change in the IC-DISC's accounting method that is initiated by the IC-DISC;
- The change shall be considered as approved by the Commissioner; and
- The net amount of adjustments required by section 481 because of the change in accounting method must be reported as income as explained below.

The amount of the adjustment referred to in item **c** above is the balance of the bad-debt reserve at the close of the IC-DISC's 1986 tax year (column (g), Schedule F, page 3, Form 1120-IC-DISC). The adjustment is reported as income ratably in each of the first 4 tax years beginning after 1986. Report each year's ratable portion of the income on line 2j, Schedule B, Form 1120-IC-DISC if the amount reported related to a class of receivables that are qualified export asset; otherwise report the amount on line 3f of Schedule B. For more information, see section 805(d)(2) of the Tax Reform Act of 1986.

2b. Enter taxes paid or accrued during the tax year.

Do not include state or local sales taxes that are paid or incurred in connection with an acquisition or disposition of property. Such taxes must be treated as a part of the cost of the acquired property or, in the case of a disposition, as a reduction in the amount realized on the disposition.

See section 164(d) for apportionment of taxes on real property between seller and purchaser.

2c. Do not deduct 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 1987 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 1987 tax year. The amount of contributions made in the 1987 tax year in excess of the 10% limitation, however, may be carried over in order of time to the next 5 succeeding tax years until deducted against the 10% limitation of one of the 5 succeeding tax years.

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.—For a charitable contribution of property, the corporation must reduce the contribution by the sum of:

1. The ordinary income, short-term capital gain that would have resulted if the property were sold at its fair market value; and
2. For contributions made in tax years beginning after 1986, all of the long-term capital gain that would have resulted if the property were sold at its fair market value.

The reduction for the long-term capital gain applies to:

1. Contributions of tangible personal property for use by an exempt organization for a purpose or function unrelated to the basis for its exemption; and

2. Contributions of any property (except stock for which market quotations are readily available—see section 170(e)(5)) to or for the use of certain private foundations. (See section 170(e) and Regulations section 1.170A-4.)

For special rules for contributions of inventory and other property to certain organizations, see section 170(e)(3) and 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 attributable 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 during the tax year on the sale or exchange of property which in the hands of the IC-DISC was not a qualified export asset and which was previously transferred to the IC-DISC in a transaction in which the transferor realized gain but did not recognize the gain in whole or part. See section 995(b)(1)(B). Show the computation of the gain on a separate schedule. Include no more of the IC-DISC's gain than the amount of gain 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. See Regulations section 1.995-6. 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 for 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.

See section 312(n) for certain adjustments to earnings and profits that are required to be made to more accurately reflect economic income and loss (including adjustments for construction period carrying charges, organizational expenditures, LIFO inventories, installment sales, and the completed contract accounting method).

Line 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 1987 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.

Line 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 1987 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).

See Regulations section 1.995-5 for additional information on computing foreign investment attributable to producer's loans.

20 and 21. The percentages on lines 20 and 21 must add up to 100 percent.

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 there were no commission sales, leases, rentals or services for tax year, enter on line 1, Part II, the total of lines 1c and 2k, column (e), Schedule B.

2. If there were commission sales, leases, rentals or services for the tax year, the total qualified export receipts to be entered on line 1, Part II, is figured as follows (section 993(f)):

1. Enter total of lines 1c and 2k, column (b), Schedule B _____
2. Enter total of lines 1c and 2k, column (d), Schedule B _____
3. Add lines 1 and 2. Enter on line 1, Part II, Schedule J _____

3. If the IC-DISC is a member of a controlled group (as defined in section 993(a)(3)) that includes more than one IC-DISC, only one \$10 million limit is allowed to the group. If an allocation is required, a statement showing each member's portion of the \$10 million limit must be attached to Form 1120-IC-DISC. See proposed Regulations section 1.995-8(f) for details.

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 1987 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).

Note: Use 366 days instead of 365 days as the denominator if the IC-DISC's tax year includes February 29, 1988, and it is filing for a 12 month tax year.

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.

See Proposed Regulations section 1.995-8 for details on determining the IC-DISC's taxable income attributable to qualified export receipts in excess of the \$10 million amount. Special rules are provided in Proposed Regulations section 1.995-8 for allocating the taxable income attributable to any related and subsidiary services, and for the ratable allocation of the taxable income attributable to the first transaction selected by the IC-DISC which exceeds the \$10 million amount. Deductions must be allocated and apportioned according to the rules of Regulations section 1.861-8. The selection of the excess receipts by the IC-DISC is intended to permit the IC-DISC to allocate the \$10 million limitation to the qualified export receipts of those transactions occurring during the tax year which permit the greatest amount of taxable income to be allocated to the IC-DISC under the inter-company pricing rules of section 994.

To avoid double counting of the deemed distribution, if an amount of taxable income

for the tax year attributable to excess qualified export receipts is also deemed distributed under either line 1, 2, 3, or 4 of Part I, such amount of taxable income is only includable on that line of Part I, and must be subtracted from the amount otherwise reportable on line 7 of Part II and carried to line 5 of Part I. See Proposed Regulations section 1.995-8(d).

After filing the IC-DISC's 1987 tax return, the allocation of the \$10 million limitation and the computation of the line 7, Part II deemed distribution may be changed by filing an amended Form 1120-IC-DISC return only under the conditions specified in Regulations section 1.995-8(b)(1).

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 or lost IC-DISC status for failure to satisfy one or more of the conditions specified in section 992(a)(1) for 1987, each shareholder is deemed to have received a distribution taxable as a dividend on the last day of the 1987 tax year. 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 each of the 10 tax years of the corporation following the year of the termination or disqualification of the IC-DISC (but in no case over more than twice the number of years the corporation was a DISC or IC-DISC).

Part IV.—Actual Distributions

1. If the corporation is required to pay interest under section 992(c)(2)(B) on the amount of a distribution to meet the qualification requirements of section 992(c), report this interest on line 2c, Schedule E. Also include the amount on line 1, Part IV of Schedule J and show the computation of the interest on an attached schedule.

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) The amount of IC-DISC income (as defined in section 996(f)(1)) for the tax year following the computation year.

See section 995(f) and Proposed Regulation section 1.995(f)-1 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).

Separate 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.

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 12 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 line 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 line 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 as defined in section 7701(a)(31)).

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

Export Gross Receipts for 1987

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 1987 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).

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,” enter 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.

Question T.—Report any tax-exempt interest received or accrued in the space provided. Include any exempt-interest dividends received as a shareholder in a mutual fund or other regulated investment company.

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 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.

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.)

Codes for Principal Business Activity

These codes for the Principal Business Activity are designed to classify enterprises by the type of activity in which they are engaged to facilitate the administration of the Internal Revenue Code. Though similar in format and structure to the Standard Industrial Classification Codes (SIC), they should not be used for SIC codes. Also, 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."

<p>TRANSPORTATION, COMMUNICATION, ELECTRIC, GAS, AND SANITARY SERVICES</p>		<p><i>Code</i></p>	<p><i>Code</i></p>
<p><i>Code</i></p>	<p>Nondurable</p>	<p>5600 Apparel and accessory stores</p>	<p>5700 Furniture and home furnishings stores</p>
<p>Transportation:</p>	<p>5110 Paper and paper products</p>	<p>5800 Eating and drinking places</p>	
<p>4400 Water transportation</p>	<p>5129 Drugs, drug proprietaries, and druggists' sundries</p>	<p>Miscellaneous retail stores:</p>	
<p>4700 Other transportation services</p>	<p>5130 Apparel, piece goods, and notions</p>	<p>5912 Drugstores and proprietary stores</p>	
<p>Electric, gas, and sanitary services:</p>	<p>5140 Groceries and related products</p>	<p>5921 Liquor stores</p>	
<p>4910 Electric services</p>	<p>5150 Farm-product raw materials</p>	<p>5995 Other miscellaneous retail stores</p>	
<p>4920 Gas production and distribution</p>	<p>5160 Chemicals and allied products</p>	<p>FINANCE, INSURANCE, AND REAL ESTATE</p>	
<p>4930 Combination utility services</p>	<p>5170 Petroleum and petroleum products</p>	<p>Credit agencies other than banks:</p>	
	<p>5180 Alcoholic beverages</p>	<p>6199 Other credit agencies</p>	
	<p>5190 Miscellaneous nondurable goods</p>	<p>SERVICES</p>	
<p>WHOLESALE TRADE</p>	<p>RETAIL TRADE</p>	<p>Business services:</p>	
<p>Durable</p>	<p>Building materials, hardware, garden supply, and mobile home dealers:</p>	<p>7389 Export management services</p>	
<p>5008 Machinery, equipment, and supplies</p>	<p>5220 Building materials dealers</p>	<p>Auto repair and services; miscellaneous repair services:</p>	
<p>5010 Motor vehicles and automotive equipment</p>	<p>5251 Hardware stores</p>	<p>7500 Lease or rental of motor vehicles</p>	
<p>5020 Furniture and home furnishings</p>	<p>5265 Garden supplies and mobile home dealers</p>	<p>Amusement and recreation services:</p>	
<p>5030 Lumber and construction materials</p>	<p>5300 General merchandise stores</p>	<p>7812 Motion picture production, distribution, and services</p>	
<p>5040 Sporting, recreational, photographic, and hobby goods, toys, and supplies</p>	<p>5410 Grocery stores</p>	<p>Other services:</p>	
<p>5050 Metals and minerals, except petroleum and scrap</p>	<p>5490 Other food stores</p>	<p>8911 Architectural and engineering services</p>	
<p>5060 Electrical goods</p>	<p>Automotive dealers and service stations:</p>	<p>8930 Accounting, auditing, and bookkeeping</p>	
<p>5070 Hardware, plumbing and heating equipment</p>	<p>5515 Motor vehicle dealers</p>	<p>8980 Miscellaneous services</p>	
<p>5098 Other durable goods</p>	<p>5541 Gasoline service stations</p>		
	<p>5598 Other automotive dealers</p>		

