



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

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by section 6103.

The time needed to complete and file the following forms will vary depending on individual circumstances. The estimated average times are:

Form	Recordkeeping	Learning about the law or the form	Preparing the form	Copying, assembling, and sending the form to the IRS
1120-IC-DISC	94 hr., 56 min.	19 hr., 54 min.	30 hr., 43 min.	2 hr., 25 min.
Schedule K	4 hr., 4 min.	18 min.	22 min.	-----
Schedule P	12 hr., 40 min.	1 hr., 29 min.	1 hr., 46 min.	-----

If you have comments concerning the accuracy of these time estimates or suggestions for making these forms simpler, we would be happy to hear from you. You can write to the Tax Forms Committee, Western Area Distribution Center, Rancho Cordova, CA 95743-0001. **Do not** send these tax forms to this office. Instead, see **Where To File** on page 3.

Contents	Page	Contents	Page
Changes To Note	1	Schedule J—Deemed and Actual Distributions and Deferred DISC Income	12
Photographs of Missing Children	1	Schedule K—Shareholder's Statement of IC-DISC Distributions	13
Unresolved Tax Issues	1	Schedule L—Balance Sheets per Books	13
How To Make a Contribution To Reduce the Public Debt	2	Schedule N—Export Gross Receipts of the IC-DISC and Related U.S. Persons	13
How To Get Forms and Publications	2	Schedule O—Other Information	14
<b>General Instructions</b>	2	Schedule P (Form 1120-IC-DISC)—Intercompany Transfer Price or Commission	14
Purpose of Form	2	Codes for Principal Business Activity	15
Who Must File	2	Product Code System for Schedule N	16
When To File	2		
Who Must Sign	3		
Where To File	3		
Other Forms, Returns, and Statements That May Be Required	3		
Accounting Methods	4		
Accounting Periods	5		
Rounding Off to Whole Dollars	5		
Definitions	5		
Penalties	6		
<b>Specific Instructions</b>	6		
Taxable Income	6		
Schedule A—Cost of Goods Sold	7		
Schedule B—Gross Income	8		
Schedule C—Dividends and Special Deductions	8		
Schedule E—Deductions	10		

### Changes To Note

- The FSC Repeal and Extraterritorial Income Exclusion Act of 2000 allows a new extraterritorial income exclusion for transactions after September 30, 2000. The exclusion is based on a corporation's qualifying foreign trade income. For more details and to figure the amount of the exclusion, see new **Form 8873**, Extraterritorial Income Exclusion.
- *Special rule for IC-DISCs.* The extraterritorial income exclusion may **not** be claimed by any taxpayer for any taxable year if, at any time during the tax year, the taxpayer is a member of a controlled group of corporations (as

defined in section 927(d)(4), as in effect before its repeal) of which the IC-DISC is a member.

- The IC-DISC may need to mail its return to a different service center this year because the IRS has changed the filing location for several areas. See **Where To File** on page 3.
- Generally, if the IC-DISC's average annual gross receipts for the 3 prior tax years are \$1 million or less, it may be eligible to adopt or change to the cash method of accounting. If the IC-DISC makes this change, it will not be required to account for inventories. Instead, the IC-DISC may treat inventory in the same manner as costs of materials and supplies that are not incidental. For details, see the instructions for **Cost of Goods Sold** on page 7.
- Corporations that file Form 1120-IC-DISC and, at any time during the tax year, had assets in or operated a business in a foreign country may have to **attach new Schedule N (Form 1120)**, Foreign Operations of U.S. Corporations, to their tax returns. See Schedule N (Form 1120) for details.

### Photographs of Missing Children

The Internal Revenue Service is a proud partner with the National Center for Missing and Exploited Children. Photographs of missing children selected by the Center may appear in instructions on pages that would otherwise be blank. You can help bring these children home by looking at the photographs and calling **1-800-THE-LOST** (1-800-843-5678) if you recognize a child.

### Unresolved Tax Issues

If the corporation has attempted to deal with an IRS problem unsuccessfully, it should contact the Taxpayer Advocate. The Taxpayer Advocate independently represents the corporation's interests and concerns within the IRS by protecting its rights and resolving problems that have not been fixed through normal channels.

While Taxpayer Advocates cannot change the tax law or make a technical tax decision, they can clear up problems that resulted from previous contacts and ensure that the corporation's case is given a complete and impartial review.

The corporation's assigned personal advocate will listen to its point of view and will work with the corporation to address its concerns. The corporation can expect the advocate to provide:

- A "fresh look" at a new or on-going problem.

- Timely acknowledgement.
- The name and phone number of the individual assigned to its case.
- Updates on progress.
- Timeframes for action.
- Speedy resolution.
- Courteous service.

When contacting the Taxpayer Advocate, the corporation should provide the following information:

- The corporation's name, address, and employer identification number.
- The name and telephone number of an authorized contact person and the hours he or she can be reached.
- The type of tax return and year(s) involved.
- A detailed description of the problem.
- Previous attempts to solve the problem and the office that had been contacted.
- A description of the hardship the corporation is facing (if applicable).

The corporation may contact a Taxpayer Advocate by calling toll-free number, **1-877-777-4778**. Persons who have access to TTY/TDD equipment may call 1-800-829-4059 and ask for the Taxpayer Advocate assistance. If the corporation prefers, it may call, write, or fax the Taxpayer Advocate office in its area. See **Pub. 1546**, The Taxpayer Advocate Service of the IRS, for a list of addresses and fax numbers.

## How To Make a Contribution To Reduce the Public Debt

To help reduce the public debt, send a check made payable to the "Bureau of the Public Debt" to Bureau of the Public Debt, Department G, P.O. Box 2188, Parkersburg, WV 26106-2188. Or, enclose a check with Form 1120-IC-DISC. Contributions to reduce the public debt are deductible subject to the rules and limitations for charitable contributions.

## How To Get Forms and Publications

**Personal computer.** You can access the IRS Web Site 24 hours a day, 7 days a week at [www.irs.gov](http://www.irs.gov) to:

- Download forms, instructions, and publications.
- See answers to frequently asked tax questions.
- Search publications on-line by topic or keyword.
- Send us comments or request help by e-mail.
- Sign up to receive local and national tax news by e-mail.

You can also reach us using file transfer protocol at [ftp.irs.gov](ftp://ftp.irs.gov).

**CD-ROM.** Order **Pub. 1796**, Federal Tax Products on CD-ROM, and get:

- Current year forms, instructions, and publications.
- Prior year forms, instructions, and publications.
- Popular tax forms that may be filled in electronically, printed out for submission, and saved for recordkeeping.
- The Internal Revenue Bulletin.

Buy the CD-ROM on the Internet at [www.irs.gov/cdorders](http://www.irs.gov/cdorders) from the National Technical Information Service (NTIS) for \$21 (no handling fee), or call **1-877-CDFORMS** (1-877-233-6767) toll free to buy the CD-ROM for \$21 (plus a \$5 handling fee).

**By phone and in person.** You can order forms and publications 24 hours a day, 7 days a week, by calling **1-800-TAX-FORM** (1-800-829-3676). You can also get most forms and publications at your local IRS office.

## General Instructions

### 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.

### 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 4876-A**, 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**, 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:

- 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).
- It maintains separate books and records for the tax year.
- It is not a member of any controlled group of which a foreign sales corporation (FSC) is a member.
- 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 its regulations for more information.
- Its election to be treated as an IC-DISC is in effect for the tax year.

See **Definitions** on page 5 and section 992 and related regulations for details.

### 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 a distribution after Form 1120-IC-DISC is due, interest must be paid to the United States Treasury. The interest 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 the IC-DISC must pay this interest, send the payment to the Internal Revenue Service Center where you filed Form 1120-IC-DISC within 30 days of making the distribution. On the payment, write the IC-DISC's name, address, and employer identification number; the tax year; and a statement that the payment represents the interest charge under Regulations section 1.992-3(c)(4).

### Who Must File

The corporation must file Form 1120-IC-DISC if it elected, by filing Form 4876-A, to be treated as an IC-DISC and its election is in effect for the tax year.

If the corporation is a former DISC or former IC-DISC, it must file Form 1120-IC-DISC 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 after 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 it had 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 1999 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 lines 1 through 8 on 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.

### 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. If the due date falls on a Saturday, Sunday, or a legal holiday, file on the next business day.

**Private delivery services.** You can use certain private delivery services designated by the IRS to meet the "timely mailing as timely filing/paying" rule for tax returns and payments. The most recent list of designated private delivery services was published by the IRS in August 1999. This list includes only the following:

- Airborne Express (Airborne): Overnight Air Express Service, Next Afternoon Service, Second Day Service.
- DHL Worldwide Express (DHL): DHL "Same Day" Service, DHL USA Overnight.
- Federal Express (FedEx): FedEx Priority Overnight, FedEx Standard Overnight, FedEx 2Day.
- United Parcel Service (UPS): UPS Next Day Air, UPS Next Day Air Saver, UPS 2nd Day Air, UPS 2nd Day Air A.M.  
The private delivery service can tell you how to get written proof of the mailing date.

## Who Must Sign

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.

Receivers, trustees, or assignees must also sign and date any return filed on behalf of a corporation.

If a corporate officer completed Form 1120-IC-DISC, the Paid Preparer's space should remain blank. Anyone who prepares Form 1120-IC-DISC but does not charge the corporation should not sign the return. Generally, anyone who is paid to prepare Form 1120-IC-DISC must sign it and fill in the Paid Preparer's Use Only area.

The **paid preparer** must complete the required preparer information and—

- Sign the return, by hand, in the space provided for the preparer's signature (signature stamps or labels are not acceptable).
- Give a copy of the return to the taxpayer.

## Where To File

File your return at the applicable IRS address listed below.

If the corporation's principal business, office, or agency is located in	Use the following Internal Revenue Service Center address
Florida, Georgia	Atlanta, GA 39901
Kansas, New Mexico, Oklahoma	Austin, TX 73301
Delaware, District of Columbia, Indiana, Kentucky, Maryland, Michigan, New Jersey, North Carolina, Ohio, Pennsylvania, South Carolina, West Virginia, Wisconsin	Cincinnati, OH 45999
New York (New York City and counties of Nassau, Rockland, Suffolk, and Westchester)	Holtsville, NY 00501
New York (all other counties), Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, Vermont	Andover, MA 05501
Illinois	Kansas City, MO 64999
Alabama, Tennessee	Memphis, TN 37501

Alaska, Arizona, Arkansas, 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, Hawaii, Idaho, Iowa, Louisiana, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, North Dakota, Oregon, South Dakota, Texas, Utah, Washington, Wyoming

Ogden, UT 84201

California (all other counties) Fresno, CA 93888  
Virginia 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 located in several service center regions will often keep all the books and records at the principal office of the managing corporation. In this case, the income tax returns of the corporations may be filed with the service center for the region in which the principal office is located.

## Other Forms, Returns, and Statements That May Be Required

### Forms

The IC-DISC may have to file some of the following forms. See the form for more information.

### Employment Tax Returns

**Form 940** or **Form 940-EZ**, Employer's Annual Federal Unemployment (FUTA) Tax Return. The corporation may be liable for FUTA tax and may have to file Form 940 or 940-EZ if either of the following applies:

1. It paid wages of \$1,500 or more in any calendar quarter in 1999 or 2000 or
2. It had at least one employee who worked for the corporation for some part of a day in any 20 or more different weeks in 1999 or 20 more different weeks in 2000.

**Form 941**, Employer's Quarterly Federal Tax Return or **Form 943**, Employer's Annual Tax Return for Agricultural Employees. Employers must file these forms to report income tax withheld, and employer and employee social security and Medicare taxes. Also, see **Trust fund recovery penalty** on page 6.

**Form 945**, Annual Return of Withheld Federal Income Tax. File Form 945 to report income tax withholding from nonpayroll distributions or payments such as the following income:

- Pensions, annuities, IRAs, military retirement, gambling winnings and
  - Indian gaming profits and backup withholding.
- See **Trust fund recovery penalty** on page 6.

### Information Returns

**Form W-2**, Wage and Tax Statement, and **Form W-3**, Transmittal of Wage and Tax Statements. Use these forms to report withheld income, wages, tips, other compensation,

social security, and Medicare taxes for an employee.

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

**Form 1098**, Mortgage Interest Statement. Use this form to report the receipt from any individual of \$600 or more of mortgage interest (including points) in the course of the corporation's trade or business and reimbursements of overpaid interest.

**Forms 1099**. Use these information returns to report the following:

- **Form 1099-A**. Acquisitions and abandonments of secured property.
- **Form 1099-B**. Proceeds from broker and barter exchange transactions.
- **Form 1099-C**. Cancellation of a debt.
- **Form 1099-DIV**. Certain dividends and distributions.
- **Form 1099-INT**. Interest income.
- **Form 1099-LTC**. Certain payments made under a long-term care insurance contract and certain accelerated death benefits.
- **Form 1099-MISC**. Miscellaneous income (e.g., payments to certain fishing boat crew members; payments to providers of health and medical services; rent or royalty payments; nonemployee compensation, etc.).

**Note:** Every IC-DISC must file Form 1099-MISC if it makes payments or rents, commissions, or other fixed or determinable income (see section 6041) totaling \$600 or more to any one person in the course of its trade or business during the calendar year.

- **Form 1099-MSA**. Distributions from a medical savings account (MSA) or Medicare+Choice MSA.
- **Form 1099-OID**. Original issue discount.
- **Form 1099-R**. Distributions from pensions, annuities, retirement or profit-sharing plans, individual retirement arrangements (IRAs) (including SEPs, SIMPLEs, Roth IRAs, Ed IRAs, Roth conversions, and IRA recharacterizations), or insurance contracts.

Also use these returns to report amounts received as a nominee for another person. **Form 5498**, IRA Contribution Information. Use this form to report contributions (including rollover contributions) to any IRA, including a SEP, SIMPLE, Roth IRA and Ed IRA, Roth Conversions, IRA recharacterizations, and the fair market value of the account.

**Form 5498-MSA**, MSA or Medicare+Choice MSA Information. Use to form to report contributions to a medical savings account (MSA) and the fair market value of an MSA or Medicare+Choice MSA.

For more information, see the Instructions for Forms 1099, 1098, 5498 and W-2G.

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

### International Forms

**Form 926**, Return by a U.S. Transferor of Property to a Foreign Corporation. Use Form 926 to report information required under section 6038B.

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

**Form 1042-S**, Foreign Person's U.S. Source Income Subject to Withholding. Use these forms to report and send withheld tax on payments or distributions made to nonresident alien individuals, foreign partnerships, or foreign corporations.

Also see **Pub. 515**, Withholding of Tax on Nonresident Aliens and Foreign Corporations, and sections 1441 and 1442.

Please inform shareholders who are nonresident alien individuals or foreign corporations, trusts, or estates that if they have gains from disposal 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 United States and derived from sources within the United States.

**Form 4876-A**, Election To Be Treated as an Interest Charge DISC.

**Form 5471**, Information Return of U.S. Persons With Respect to Certain Foreign Corporations. This form is required if the corporation controls a foreign corporation; acquires, disposes of, or owns 10% or more in value or vote of the outstanding stock of a foreign corporation; or had control of a foreign corporation for an uninterrupted period of at least 30 days during the annual accounting period of the foreign corporation. (See Question 4 of Schedule N (Form 1120)).

**Form 5713**, International Boycott Report. Corporations that have operations in, or related to, certain "boycotting" countries file Form 5713.

**Form 8404**, Interest Charge on DISC-Related Deferred Tax Liability. Shareholders use this form to figure and report their interest on DISC-related deferred tax liability.

**Form 8621**, Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund. Use this form to make certain elections by shareholders in a passive foreign investment company and to figure certain deferred taxes.

**Form 8865**, Return of U.S. Persons With Respect To Certain Foreign Partnerships. A domestic corporation may have to file Form 8865 if it:

1. Controlled a foreign partnership (i.e., owned more than a 50% direct or indirect interest in the partnership).
2. Owned at least a 10% direct or indirect interest in a foreign partnership while U.S. persons controlled that partnership.
3. Had an acquisition, disposition, or change in proportional interest in a foreign partnership that:
  - Increased its direct interest to at least 10% or reduced its direct interest of at least 10% to less than 10%.
  - Changed its direct interest by at least a 10% interest.
4. Contributed property to a foreign partnership in exchange for a partnership interest if:
  - Immediately after the contribution, the corporation owned, directly or indirectly, at least a 10% interest in the foreign partnership or
  - The fair market value of the property the corporation contributed to the foreign partnership in exchange for a partnership

interest, when added to other contributions of property made to the foreign partnership during the preceding 12-month period, exceeds \$100,000.

Also, the domestic corporation may have to file Form 8865 to report certain dispositions by a foreign partnership of property it previously contributed to that partnership if it was a partner at the time of the disposition.

For more details, including penalties for failing to file Form 8865, see Form 8865 and its separate instructions.

#### Other Forms

**Form 720**, Quarterly Federal Excise Tax Return. Use this form to report and pay the luxury tax on passenger vehicles, environmental taxes, communications and air transportation taxes, fuel taxes, manufacturers' taxes, ship passenger taxes, and certain other excise taxes.

**Form 966**, Corporate Dissolution or Liquidation. Use this form to report the adoption of a resolution or plan to dissolve the corporation or liquidate any of its stock.

**Form 5452**, Corporate Report of Nondividend Distributions. Use this form to report nondividend distributions.

**Form 8264**, Application for Registration of a Tax Shelter. Tax shelter organizers use this form to receive a tax shelter registration number from the IRS.

**Form 8271**, Investor Reporting of Tax Shelter Registration Number. Taxpayers, who have acquired an interest in a tax shelter that is required to be registered, use this form 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 taken or any income attributable to a tax shelter is reported.

**Form 8275**, Disclosure Statement, and **Form 8275-R**, Regulation Disclosure Statement. Disclose items or positions taken on a tax return that are not otherwise adequately disclosed on a tax return or that are contrary to Treasury regulations (to avoid parts of the accuracy-related penalty or certain preparer penalties).

**Form 8594**, Asset Acquisition Statement. Use this form to report the purchase or sale of a group of assets that constitute a trade or business if goodwill or going concern value attach to the assets.

**Form 8697**, Interest Computation Under the Look-Back Method for Completed Long-Term Contracts. This form is used to figure the interest due or to be refunded under the look-back method of section 460(b)(2). The look-back method applies to certain long-term contracts accounted for under the percentage of completion or the percentage of completion-capitalized cost method.

**Form 8849**, Claim for Refund of Excise Taxes. Corporations use this form to claim a refund of certain excise taxes.

**Form 8866**, Interest Computation Under the Look-Back Method for Property Depreciated Under the Income Forecast Method. Figure the interest due or to be refunded under the look-back method of section 167(g)(2) for property placed in service after September 13, 1995, that is depreciated under the income forecast method.

## Statements

**Stock ownership in foreign corporations.** Attach the statement required by section 551(c) if:

- The corporation owned 5% or more in value of the outstanding stock of a foreign personal holding company and
- The corporation was required to include in its gross income any undistributed foreign personal holding company income from a foreign personal holding company.

**Transfers to a corporation controlled by the transferor.** If a person receives stock of a corporation in exchange for property and no gain or loss is recognized under section 351, the person (transferor) and the transferee must each attach to their tax returns the information required by Regulations section 1.351-3.

## Assembling the Return

After page 6, Form 1120-IC-DISC, assemble any schedules and other forms in the tax return in the following order.

1. Schedule N (Form 1120).
2. Form 4136.
3. Additional schedules in alphabetical order.
4. Additional forms in numerical order.

Complete every applicable entry space on Form 1120-IC-DISC. Do not write "See attached" instead of completing the entry spaces. If more space is needed on the forms or schedules, attach separate sheets using the same size and format as the printed forms. If there are supporting statements and attachments, arrange them in the same order as the schedules or forms they support and attach them last. Show the totals on the printed forms. Also, be sure to enter the IC-DISC's name and EIN on each supporting statement or attachment.

## Accounting Methods

An accounting method is a set of rules used to determine when and how income and expenses are reported.

Figure taxable income using the accounting method regularly used in keeping the IC-DISC's books and records. Generally, permissible methods include:

- Cash,
- Accrual, or
- Any other method authorized by the Internal Revenue Code.

In all cases, the method used must clearly reflect taxable income. If inventories are required, the accrual method must be used for sales and purchases of merchandise. See **Cost of Goods Sold** on page 7.

Generally, an IC-DISC (other than a qualified personal service corporation) must use the accrual method of accounting if its average annual gross receipts exceed \$5 million. See section 448(c). For exceptions, see section 447.

Under the accrual method, an amount is includable in income when:

- All the events have occurred that fix the right to receive the income, which is the earliest of the date: (a) the required performance takes place, (b) payment is due, or (c) payment is received and
- The amount can be determined with reasonable accuracy.

See Regulations section 1.451-1(a) for details.

Generally, an accrual basis taxpayer can deduct accrued expenses in the tax year when:

- All events that determine the liability have occurred,
- The amount of the liability can be figured with reasonable accuracy, and
- Economic performance takes place with respect to the expense.

There are exceptions to the economic performance rule for certain items, including recurring expenses. See section 461(h) and the related regulations for the rules for determining when economic performance takes place.

Long-term contracts (except for certain real property construction contracts) must generally be accounted for using the percentage of completion method described in section 460. See section 460 for general rules on long-term contracts.

A member of a controlled group cannot use 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. In this case, the IC-DISC should not use the cash method of accounting because it materially distorts the income of the IC-DISC.

**Change in accounting method.** Generally, the IC-DISC must get IRS consent to change the method of accounting used to report taxable income (for income as a whole or for any material item). To do so, it must file **Form 3115**, Application for Change in Accounting Method. For more information, see **Pub. 538**, Accounting Periods and Methods.

## Accounting Periods

An IC-DISC must figure its taxable income on the basis of a tax year. The tax year is the annual accounting period the IC-DISC uses to keep its records and report its income and expenses. Generally, IC-DISCs can use a calendar year or a fiscal year.

For more information about accounting periods, see Temporary Regulations sections 1.441-1T, 1.441-2T, and Pub. 538.

**Note:** *The tax year of an IC-DISC must be the same as the tax year of the principal shareholder which, at the beginning of the IC-DISC 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 have a tax year that conforms to any 1 tax year of the principal shareholders. See section 441(h)(1).*

**Calendar year.** If the calendar year is adopted as the annual accounting period, the corporation must maintain its books and records and report its income and expenses for the period from January 1 through December 31 of each year.

**Fiscal year.** A fiscal year is 12 consecutive months ending on the last day of any month except December. A 52–53-week year is a fiscal year that varies from 52 to 53 weeks.

**Adoption of tax year.** A corporation adopts a tax year when it files its first income tax return. It must adopt a tax year by the due date (not including extensions) of its first income tax return.

**Change in tax year.** Generally, a corporation must get the consent of the IRS before

changing its tax year by filing **Form 1128**, Application To Adopt, Change, or Retain a Tax Year. However, under certain conditions, an IC-DISC may change its tax year without getting the consent. See Regulations section 1.442-1 and Pub. 538.

## Rounding Off to Whole Dollars

The IC-DISC may show the money items on the return and accompanying schedules as whole dollars. To do so, drop amounts less than 50 cents and increase amounts from 50 cents through 99 cents to the next higher dollar.

## Recordkeeping

Keep the IC-DISC's records for as long as they may be needed for the administration of any provision of the Internal Revenue Code. Usually, records that support an item of income, deduction, or credit on the return must be kept for 3 years from the date the return is due or filed, whichever is later. Keep records that verify the IC-DISC's basis in property for as long as they are needed to figure the basis of the original or replacement property.

The IC-DISC should keep copies of all filed returns. They help in preparing future returns and amended returns.

## Definitions

The following definitions are based on sections 993, 994, and 994(c).

**Note:** *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.*

### Section 993

**Qualified export receipts** 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 United States.
3. Gross receipts from supporting services related to any qualified sale, exchange, rental, or other disposition of export property by the IC-DISC.
4. Gross receipts from selling, exchanging, or otherwise disposing of qualified export assets that are not export property, but **only** if there is a recognized gain.
5. Dividends or amounts includible in gross income regarding stock of a related foreign export corporation and under section 951 (relating to amounts included in the gross income of U.S. shareholders of controlled foreign corporations).
6. Interest on any obligation that is a qualified export asset.
7. Gross receipts for engineering or architectural services on construction projects outside the United States.
8. Gross receipts for performance of managerial services in furtherance of the production of other qualified export receipts of an IC-DISC.

For more information, see Regulations section 1.993-1.

**Qualified export assets** are any of the following:

1. Export property (see below).

2. Assets used mainly in performing the engineering or architectural services (listed under qualified export receipts, item 7 above) 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 above.

4. Temporary investments, such as money and bank deposits, in an amount reasonable to meet the IC-DISC'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 United States used to acquire qualified export assets within the time provided by Regulations section 1.993-2(j).

See Regulations section 1.993-2 for more information.

**Export property** must be:

1. Made, grown, or extracted in the United States 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 United States.
4. Property not more than 50% of the fair market value of which is attributable to articles imported into the United States.
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.

**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 United States 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.

**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 United States.

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

1. The IC-DISC directly owns more than 50% of the total voting power of the foreign corporation's stock;
2. 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 **Qualified export receipts** and interest on the qualified export assets listed in items 3 and 4 of **Qualified export assets**; and
3. The adjusted basis of the qualified export assets in items 1-4 of **Qualified export assets** 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.

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

1. The IC-DISC directly owns more than 50% of the total voting power of the foreign corporation's stock and
2. 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.

**An associated foreign corporation** is a related foreign export corporation if:

1. 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
2. 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.

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

## Section 994, Intercompany Pricing Rules

If a related person described in section 482 sells export property to the IC-DISC, use the intercompany 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 intercompany pricing, the IC-DISC's taxable income from the sale (regardless of the price actually charged) may not exceed the greatest of:

1. 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,
2. 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

3. 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)**, Intercompany Transfer Price or Commission, explains the intercompany pricing rules in more detail.

## Section 994(c), Export Promotion Expenses

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

## Penalties

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

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

If the return is filed late and the failure to file timely is due to reasonable cause, please explain. See section 6686 for other details.

**Trust fund recovery penalty.** This penalty may apply if certain excise, income, social security, and Medicare taxes that must be collected or withheld are not collected or withheld, or these taxes are not paid. These taxes are generally reported on Forms 720, 941, 943, or 945. The trust fund recovery penalty may be imposed on all persons who are determined by the IRS to have been responsible for collecting, accounting for, and paying over these taxes, and who acted willfully in not doing so. The penalty is equal to the unpaid trust fund tax. See the Instructions for Form 720, **Pub. 15 (Circular E)**, Employer's Tax Guide, or **Pub. 51 (Circular A)**, Agricultural Employer's Tax Guide, for details, including the definition of responsible persons.

## Specific Instructions

### General Information

#### Period Covered

File the 2000 return for calendar year 2000 and fiscal years that begin in 2000 and end in 2001. For a fiscal year, fill in the tax year space at the top of the form.

**Note:** *The 2000 Form 1120-IC-DISC may also be used if:*

- *The corporation has a tax year of less than 12 months that begins and ends in 2001 and*
- *The 2001 Form 1120-IC-DISC is not available at the time the corporation is required to file its return.*

*The corporation must show its 2001 tax year on the 2000 Form 1120-IC-DISC and take into account any tax law changes that are effective*

*for tax years beginning after December 31, 2000.*

### Address

Include the suite, room, or other unit number after the street address. If the Post Office does not deliver mail to the street address and the IC-DISC has a P.O. box, show the box number instead.

**Note:** *If a change in address occurs after the return is filed, use Form 8822, Change of Address, to notify the IRS of the new address.*

### Item C—Employer Identification Number (EIN)

Show the correct EIN in item C on page 1 of Form 1120-IC-DISC. If the corporation does not have an EIN, it should apply for one on **Form SS-4**, Application for Employer Identification Number. If the IC-DISC has not received its EIN by the time the return is due, write "Applied for" in the space for the EIN. See **Pub. 583**, Starting a Business and Keeping Records, for details.

### Item E—Total Assets

Enter the IC-DISC's total assets (as determined by the accounting method regularly used in keeping the IC-DISC's books and records) at the end of the tax year. If there are no assets at the end of the tax year, enter the assets as of the beginning of the tax year.

### Item F—Initial Return, Final Return, Change in Address, or Amended Return

- If this is the IC-DISC's initial return or final return, check the applicable box in item F at the top of the form.
- If the IC-DISC has changed its address since it last filed a return, check the box for "Change in address."
- To correct an error in a Form 1120-IC-DISC already filed, file an amended Form 1120-IC-DISC and check the "Amended return" box. If the amended return changes the income or distributions of income to shareholders, an amended Schedule K (Form 1120-IC-DISC) must be filed with the amended Form 1120-IC-DISC and given to each shareholder. Write "AMENDED" across the top of the corrected Schedule K you give to each shareholder.

### Question G(1)

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.

### Taxable Income

An IC-DISC must figure its taxable income although it does not pay most taxes. An IC-DISC is exempt from the corporate income tax, alternative minimum tax, and accumulated earnings tax.

An IC-DISC and its shareholders are not entitled to the possessions corporation tax credit (section 936). An IC-DISC cannot claim the general business credit or the credit for fuel produced from a nonconventional source. In

addition, these credits cannot be passed through to shareholders of the corporation.

#### Line 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 **Pub. 536**, Net Operating Losses, 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.
3. Third, 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).

#### Line 6b—Dividends-Received Deduction

See the instructions under **Schedule C, Line 9, Column (c)** on page 9 for details.

#### Line 7—Taxable Income

If the IC-DISC uses 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.

#### Line 8—Refundable Credit for Federal Tax Paid on Fuels

Enter the credit from Form 4136.

## Schedule A

### Cost of Goods Sold

Generally, inventories are required at the beginning and end of each tax year if the production, purchase, or sale of merchandise is an income-producing factor. See Regulations section 1.471-1.

However, if a IC-DISC's average annual gross receipts for the 3 prior tax years are \$1 million or less and the IC-DISC is an eligible taxpayer that adopts or changes to the cash method of accounting, it will be not required to account for inventories. If the IC-DISC is not required to account for inventories and does not want to do so, it must treat inventory in the same manner as costs of materials and supplies that are not incidental. Under this rule, inventory costs for raw materials purchased for use in producing finished goods and merchandise purchased for resale are deductible in the year the finished goods or merchandise are sold (or, if later, the year the IC-DISC paid for the raw materials or merchandise). Enter amounts paid for all raw materials and merchandise during the tax year on line 2. The amount the IC-DISC can deduct for the tax year is figured on line 8.

If the IC-DISC wants to change to the cash method of accounting, it must file Form 3115. It may also have to make an adjustment to prevent amounts of income or expense from

being duplicated or omitted. This is called a section 481(a) adjustment, which is taken into account over a period not to exceed 4 years. For example, if the IC-DISC accrued sales in 1999 for which it received payment in 2000, it must report those sales in both years as a result of changing its accounting method and will make a section 481(a) adjustment to prevent duplication of income. See Rev. Proc. 99-49, 1999-52 I.R.B. 725, to figure the amount of this adjustment for the tax year. Include any positive section 481(a) adjustment in Schedule B, line 2j. If the section adjustment is negative, report it in Schedule E, line 2g.

For eligibility requirements and further details on changing to the cash method of accounting, see Pub. 553.

All filers not using the cash method of accounting should see **Section 263A uniform capitalization rules** on page 10 before completing Schedule A.

If the IC-DISC uses intercompany pricing rules, reflect in Schedule A actual purchases from a related supplier. See **Section 994, Intercompany Pricing Rules** on page 6 and use the transfer price figured in Part II of Schedule P.

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).

#### Line 1

##### Inventory at Beginning of Year

If the IC-DISC is changing its method of accounting from accrual to cash for the current tax year and it does not want to account for inventories, it must refigure last year's closing inventory using the cash method and enter the result on line 1. If there is a difference between the closing inventory and the refigured amount, attach an explanation and take it into account when figuring the IC-DISC's section 481(a) adjustment.

#### Line 4

##### Additional Section 263A Costs

An entry is required on this line only for IC-DISCs that have elected a simplified method of accounting.

For IC-DISCs that have elected the **simplified production method**, additional section 263A costs are generally those costs, other than interest, that were not capitalized under the IC-DISC's method of accounting immediately prior to the effective date of section 263A but are now required to be capitalized under section 263A. For details, see Regulations section 1.263A-2(b).

For IC-DISCs that have elected the **simplified resale method**, additional section 263A costs are generally those costs incurred with respect to the following categories.

- Off-site storage or warehousing.
- Purchasing; handling, such as processing, assembling, repackaging, and transporting.
- General and administrative costs (mixed service costs).

For details, see Regulations section 1.263A-3(d).

Enter on line 4 the balance of section 263A costs paid or incurred during the tax year not includable on lines 2, 3, and 5.

#### Line 5

##### Other Costs

Enter on line 5 any costs paid or incurred during the tax year not entered on lines 2 through 4.

#### Line 7

##### Inventory at End of Year

See Regulations section 1.263A-1 through 1.263A-3 for details on figuring the amount of additional section 263A costs to be included in ending inventory.

If the IC-DISC is using the cash method of accounting and it does not want to account for inventories, enter on line 7 the portion of its raw materials and merchandise purchased for resale that are included on line 6 and were not sold during the year.

#### Lines 9a Through 9f

##### Inventory Valuation Methods

Inventories can be valued at:

- Cost;
- Cost or market value (whichever is lower); or
- Any other method approved by the IRS that conforms to the requirements of the applicable regulations cited below.

However, the IC-DISC is required to use cost if it is using the cash method of accounting.

Producers whose average annual gross receipts are \$1 million or less that use the cash method of accounting and choose not to account for inventories may currently deduct expenditures for direct labor and all indirect costs that would otherwise be included in inventory costs.

The average cost (rolling average) method of valuing inventories generally does not conform to the requirements of the regulations. See Rev. Rul. 71-234, 1971-1 C.B. 148.

IC-DISCs that use erroneous valuation methods must change to a method permitted for Federal income tax purposes. To make this change, use Form 3115.

On line 9a, check the method(s) used for valuing inventories. Under lower of cost or market, the term "market" (for normal goods) means the current bid price prevailing on the inventory valuation date for the particular merchandise in the volume usually purchased by the taxpayer. For a manufacturer, market applies to the basic elements of cost—raw materials, labor, and burden. If section 263A applies to the taxpayer, the basic elements of cost must reflect the current bid price of all direct costs and all indirect costs properly allocable to goods on hand at the inventory date.

Inventory may be valued below cost when the merchandise is unsalable at normal prices or unusable in the normal way because the goods are subnormal due to damage, imperfections, shopwear, etc., within the meaning of Regulations section 1.471-2(c). The goods may be valued at the current bona fide selling price, minus direct cost of disposition (but not less than scrap value) if such a price can be established.

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 on line 9c. On line 9d, enter the amount or the 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 the opening inventory to cost in the year of election, report the effect of the write-up as other income, proportionately over a 3-year period that begins with the year of the LIFO election (section 472(d)).

For more information on inventory valuation methods, see **Pub. 538**, Accounting Periods and Methods.

## 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, attach a separate schedule in addition to the forms required for lines 2h and 2i.

Accrual basis taxpayers need not accrue certain amounts to be received from the performance of services which, on the basis of their experience, will not be collected (section 448(d)(5)). This provision does not apply to any amount if interest is required to be paid on such amount or if there is any penalty for failure to pay timely such amount. IC-DISCs that fall under this provision should attach a schedule showing: (a) total gross receipts, (b) amount not accrued as a result of the application of section 448(d)(5), and (c) the net amount accrued. The net amount should be entered on the applicable line of Schedule B. For more information and guidelines on this non-accrual experience method, see Temporary Regulations section 1.448-2T.

### 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 United States, and the sale or lease is not for ultimate use in the United States, it is a qualified export sale or lease. Otherwise, if a reasonable person would believe that the property will be used in the United States, 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.

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 to meet the **destination test**:

1. Within the United States to a carrier or freight forwarder for ultimate delivery outside the United States to a buyer or lessee.
2. Within the United States to a buyer or lessee who, within 1 year of the sale or lease, delivers it outside the United States or delivers it to another person for ultimate delivery outside the United States.
3. Within or outside the United States 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.
4. Outside the United States by means of the seller's delivery vehicle (ship, plane, etc.).
5. Outside the United States to a buyer or lessee at a storage or assembly site if the property was previously shipped from the United States by the IC-DISC.
6. Outside the United States to a purchaser or lessee if the property was previously shipped by the seller or lessor from the United States and if the property is located outside the United States 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

**Line 1.** Qualified export receipts in line 1 are received from the sale of property, such as inventory, that is produced in the United States for direct use, consumption, or disposition outside the United States. These sales are qualified export sales.

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

**Line 1b.** Enter the IC-DISC's qualified export receipts from export property sold for delivery outside the United States to a related foreign entity for resale to a foreign, unrelated buyer, or an unrelated buyer when a related foreign entity acts as commission agent.

**Line 2a.** Enter the gross amount received from leasing or subleasing export property to unrelated persons for use outside the United States.

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.)

**Line 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.

**Line 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 mineral exploration.

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

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

**Line 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.

**Line 2h.** On **Schedule D (Form 1120)**, Capital Gains and Losses, 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.

**Line 2i.** Enter the net gain or loss from line 18, Part II, **Form 4797**, Sales of Business Property.

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

**Line 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 as a result of the repeal of the installment method of reporting income if the IC-DISC reported income under the installment method for prior tax years.

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

**Line 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.

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

**Line 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

For purposes of the 20% ownership test on lines 1 through 7, the percentage of stock owned by the corporation is based on voting power and value of the stock. Preferred stock described in section 1504(a)(4) is not taken into account.

**Line 1, Column (a)**

Enter dividends (except those received on debt-financed stock acquired after July 18, 1984—see section 246A) that:

- Are received from less-than-20%-owned domestic corporations subject to income tax and
- Qualify for the 70% deduction under section 243(a)(1).

Also include on line 1:

- Taxable distributions from an IC-DISC or former DISC that are designated as being eligible for the 70% deduction and certain dividends of Federal Home Loan Banks. See section 246(a)(2).
- Dividends received (except those received on debt-financed stock acquired after July 18, 1984) from a regulated investment company (RIC). The amount of dividends eligible for the dividends-received deduction under section 243 is limited by section 854(b). The corporation should receive a notice from the RIC specifying the amount of dividends that qualify for the deduction.

Report so-called dividends or earnings received from mutual savings banks, etc., as interest. Do not treat them as dividends.

**Line 2, Column (a)**

Enter on line 2:

- dividends (except those received on debt-financed stock acquired after July 18, 1984) that are received from 20%-or-more-owned domestic corporations subject to income tax and that are eligible for the 80% deduction under section 243(c) and
- Taxable distributions from an IC-DISC or former DISC that are considered eligible for the 80% deduction.

**Line 3, Column (a)**

Enter dividends that are:

- Received on debt-financed stock acquired after July 18, 1984, from domestic and foreign corporations subject to income tax and that would otherwise be subject to the dividends-received deduction under section 243(a)(1), 243(c), or 245(a). Generally, debt-financed stock is stock that the corporation acquired by incurring a debt (e.g., it borrowed money to buy the stock).
- Received from a RIC on debt-financed stock. The amount of dividends eligible for the dividends-received deduction is limited by section 854(b). The corporation should receive a notice from the RIC specifying the amount of dividends that qualify for the deduction.

**Line 3, Columns (b) and (c)**

Dividends received on debt-financed stock acquired after July 18, 1984, are not entitled to the full 70% or 80% dividends-received deduction. The 70% or 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 that applies to dividends received from foreign corporations. Attach a

schedule showing how the amount on line 3, column (c), was figured.

**Line 4, Column (a)**

Enter dividends received on the preferred stock of a less-than-20%-owned public utility that is subject to income tax and is allowed the deduction provided in section 247 for dividends paid.

**Line 5, Column (a)**

Enter dividends received on preferred stock of a 20%-or-more-owned public utility that is subject to income tax and is allowed the deduction under section 247 for dividends paid.

**Line 6, Column (a)**

Enter the U.S.-source portion of dividends that:

- Are received from less-than-20%-owned foreign corporations and
- Qualify for the 70% deduction under section 245(a). To qualify for the 70% deduction, the corporation must own at least 10% of the stock of the foreign corporation by vote and value. Also include dividends received from a less-than-20%-owned FSC that are:
  - Attributable to income treated as effectively connected with the conduct of a trade or business within the United States (excluding foreign trade income) and
  - Qualify for the 70% deduction under section 245(c)(1)(B).

**Line 7, Column (a)**

Enter the U.S.-source portion of dividends that are received from 20%-or-more-owned foreign corporations and that qualify for the 80% deduction under section 245(a). Also include dividends received from a 20%-or-more-owned FSC that:

- Are attributable to income treated as effectively connected with the conduct of a trade or business within the United States (excluding foreign trade income) and
- Qualify for the 80% deduction under section 245(c)(1)(B).

**Line 8, Column (a)**

Enter dividends received from wholly owned foreign subsidiaries that are eligible for the 100% deduction under section 245(b).

In general, the deduction under section 245(b) applies to dividends paid out of the earnings and profits of a foreign corporation for a tax year during which:

- All of its outstanding stock is owned (directly or indirectly) by the domestic corporation receiving the dividends and
- All of its gross income from all sources is effectively connected with the conduct of a trade or business within the United States.

**Line 9, Column (c)—Limitation on Dividends-Received Deduction**

Generally, line 9, column (c), may not exceed the amount from the worksheet below. However, in a year in which an NOL occurs, this limitation does not apply even if the loss is created by the dividends-received deduction. See sections 172(d) and 246(b).

**Line 9, Column (c) Worksheet**

1. Refigure line 5, page 1, Form 1120-IC-DISC, without any adjustment under section 1059 and without any capital loss carryback to the tax year under section 1212(a)(1) .....
2. Multiply line 1 by 80% (.80) .....
3. Add lines 2, 5, 7, and 8, column (c), and the part of the deduction on line 3, column (c), attributable to dividends received from 20%-or-more-owned corporations.....
4. Enter the smaller of line 2 or line 3. If line 3 is larger than line 2, do not complete the rest of this worksheet. Instead, enter the amount from line 4 in the margin next to line 9 of Schedule C and on line 6b, page 1, Form 1120-IC-DISC.....
5. Enter the amount of dividends received from 20%-or-more-owned corporations included on lines 2, 3, 5, 7, and 8 of column (a) ..
6. Subtract line 5 from line 1.....
7. Multiply line 6 by 70% (.70) .....
8. Subtract line 3 above from column (c) of line 9 .....
9. Enter the smaller of line 7 or line 8.....
10. Dividends-received deduction after limitation. Add lines 4 and 9. (If this is less than line 9 of Schedule C, enter the smaller amount on line 6b, page 1, Form 1120-IC-DISC, and in the margin next to line 9 of Schedule C.) .....

**Line 13, Column (a)—Other Dividends**

Include the following:

1. Dividends (other than capital gain and exempt-interest dividends) that are received from regulated investment companies and that are not subject to the 70% deduction.
2. Dividends from tax-exempt organizations.
3. Dividends (other than capital gain dividends) received from a real estate investment trust that, for the tax year of the trust in which the dividends are paid, qualifies under section 856 through 860.
4. Dividends not eligible for a dividends-received deduction because of the holding period of the stock or an obligation to make corresponding payments with respect to similar stock.

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

- If the IC-DISC held it less than 46 days during the 90-day period beginning 45 days before the stock became ex-dividend with respect to the dividend (see section 246(c)(1)(A) or
- To the extent the IC-DISC is under an obligation to make related payments for substantially similar or related property.
- 5. Any other taxable dividend income not properly reported above (including distributions under section 936(h)(4)).

## Line 15, Column (a)

Qualified dividends are dividends that qualify as qualified export receipts. They include all dividends includible in gross income that are attributable to stock of related foreign export corporations and amounts includible in income under section 951 (relating to amounts included in the gross income of U.S. shareholders of controlled foreign corporations). See item 6 under **Qualified export receipts** on page 5 and **A related foreign export corporation** on page 6 for more details.

## Schedule E

### Deductions

#### Limitations on Deductions

##### Section 263A uniform capitalization rules.

The uniform capitalization rules of section 263A require corporations to capitalize, or include in inventory costs, certain costs incurred in connection with:

- The production of real property and tangible personal property held in inventory or held for sale in the ordinary course of business.
- Real property or personal property (tangible and intangible) acquired for resale.
- The production of real property and tangible personal property produced by a corporation for use in its trade or business or in an activity engaged in for profit.

**Tangible personal property** produced by a corporation includes a film, sound recording, video tape, book, or similar property.

IC-DISCs subject to the section 263A uniform capitalization rules are required to capitalize:

1. Direct costs and
2. An allocable part of most indirect costs (including taxes) that (a) benefit the assets produced or acquired for resale or (b) are incurred by reason of the performance of production or resale activities.

For inventory, some of the **indirect costs** that must be capitalized are:

- Administration expenses.
- Taxes.
- Depreciation.
- Insurance.
- Compensation paid to officers attributable to services.
- Rework labor.
- Contributions to pension, stock bonus, and certain profit-sharing, annuity, or deferred compensation plans.

Regulations section 1.263A-1(e)(3) specifies other indirect costs that relate to production or resale activities that must be capitalized and those that may be currently deducted.

**Interest expense** paid or incurred during the production period of designated property must be capitalized and is governed by special rules. For more details, see Regulations sections 1.263A-8 through 1.263A-15.

The costs required to be capitalized under section 263A are not deductible until the property (to which the costs relate) is sold, used, or otherwise disposed of by the corporation.

**Exceptions.** Section 263A does not apply to:

- Personal property acquired for resale if the taxpayer's average annual gross receipts for the 3 prior tax years are \$10 million or less.

- Timber.
- Most property produced under a long-term contract.
- Certain property produced in a farming business.
- Research and experimental costs under section 174.
- Intangible drilling costs for oil, gas, and geothermal property.
- Mining exploration and development costs.
- Inventory of a cash method IC-DISC that does not account for inventories. See **Pub. 553**, Highlights of 2000 Tax Changes, for details.

For more details on the uniform capitalization rules, see Regulations sections 1.263A-1 through 1.263A-3.

##### 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 sections 163(e)(3), 163(j), and 267 for limitations on deductions for unpaid expenses and interest.

**Golden parachute payments.** A portion of the payments made by a corporation to key personnel that exceeds their usual compensation may not be deductible. This occurs when the corporation has an agreement (golden parachute) with these key employees to pay them these excessive amounts if control of the corporation changes. See section 280G.

**Business startup expenses.** These must be capitalized unless an election is made to amortize them over a period of 60 months. See section 195 and Regulations section 1.195-1.

#### Line 1—Export Promotion Expenses

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. Enter on lines 2a through 2g any part of an expense not incurred to obtain qualified export receipts.

##### Line 1c—Depreciation

Attach **Form 4562**, Depreciation and Amortization, if you claim a deduction for depreciation or amortization, make the section 179 election to expense certain tangible property, or provide information on the business use of an automobile or other listed property. Enter on line 1c the depreciation and section 179 expense not claimed on Schedule A or elsewhere on the return.

Enter any amortization expense on line 1m. See Form 4562 and its instructions for details.

##### Line 1h—Freight

Enter 50% of the freight expenses (except insurance) for shipping export property aboard U.S. flagships and U.S.-owned and U.S.-operated aircraft, unless you are required to use U.S. ships or aircraft by law or regulations.

##### Line 1i—Compensation of Officers

Attach a schedule showing the name, social security number, and amount of compensation paid to all officers. Do not include compensation deductible elsewhere on the return, such as amounts included in cost of goods sold, elective contributions to a section 401(k) cash or deferred arrangement, or

amounts contributed under a salary reduction SEP agreement or a SIMPLE IRA plan.

Include only the deductible part of officers' compensation on line 1i. (See **Disallowance of deduction for employee compensation in excess of \$1 million** below.)

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.

##### Disallowance of deduction for employee compensation in excess of \$1 million.

Publicly held corporations may not deduct compensation to a "covered employee" to the extent that the compensation exceeds \$1 million. Generally, a covered employee is:

- The chief executive officer of the corporation (or an individual acting in that capacity) as of the end of the tax year or
- An employee whose total compensation must be reported to shareholders under the Securities Exchange Act of 1934 because the employee is among the four highest compensated officers for that tax year (other than the chief executive officer).

For this purpose, compensation does not include the following:

- Income from certain employee trusts, annuity plans, or pensions and
- Any benefit paid to an employee that is excluded from the employee's income.

The deduction limit does not apply to:

- Commissions based on individual performance;
- Qualified performance-based compensation; and
- Income payable under a written, binding contract in effect on February 17, 1993.

The \$1 million limit is reduced by amounts disallowed as excess golden parachute payments under section 280G.

For details, see section 162(m) and Regulations section 1.162-27.

#### Line 1j—Repairs and Maintenance

Enter the cost of incidental repairs and maintenance not claimed elsewhere on the return, such as labor and supplies, that do not add to the property's value or appreciably prolong its life. New buildings, machinery, or permanent improvements that increase the value of the property are not deductible. They must be depreciated or amortized.

#### Line 1k—Pension, Profit-sharing, etc., Plans

Enter the deduction for contributions to qualified pension, profit-sharing, or other funded deferred compensation plans. Employers who maintain such a plan generally must file one of the forms listed below, even if the plan is not a qualified plan under the Internal Revenue Code. The filing requirement applies even if the corporation does not claim a deduction for the current tax year. There are penalties for failure to file these forms on time and for overstating the pension plan deduction. See sections 6652(e) and 6662(f).

**Form 5500**, Annual Return/Report of Employee Benefit Plan. File this form for a plan that is not a one-participant plan (see below).

**Form 5500-EZ**, Annual Return of One-Participant (Owners and their Spouses) Retirement Plan. File this form for a plan that only covers the owner (or the owner and his or her spouse) but only if the owner (or the

owner and his or her spouse) owns the entire business.

### Line 11—Employee Benefit Programs

Enter contributions to employee benefit programs not claimed elsewhere on the return (e.g., insurance, health and welfare programs, etc.) that are not an incidental part of a pension, profit-sharing, etc., plan included on line 1k.

### Line 1m—Other

Enter any other allowable deduction not claimed elsewhere on the return. Include amortization expense from Part VI, Form 4562.

**Note:** Do not deduct penalties imposed on the IC-DISC.

### Line 2a—Bad Debts

The IC-DISC must use the specific chargeoff method of accounting for bad debts and deduct business bad debts when they become wholly or partially worthless.

### Line 2b—Taxes and Licenses

Enter taxes paid or accrued during the tax year.

Do not include state or local sales taxes 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.

### Line 2c—Interest

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.

Certain interest paid or accrued by the corporation (directly or indirectly) to a related person may be limited if no tax is imposed on that interest. See section 163(j) for more detailed information.

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.

### Line 2d—Charitable Contributions

Enter contributions or gifts paid within the tax year to or for the use of charitable and governmental organizations described in section 170(c) and any unused charitable contributions carried over from prior years.

The IC-DISC may not claim more than 10% of modified adjusted taxable income as contributions. The limit is 10% of the amount on line 7, page 1, figured without regard to the deduction for contributions, and before taking the dividends-received deduction (line 6b, page 1), or premiums paid on bond repurchases (section 249); and before figuring carrybacks to the tax year for a net operating loss (section 172) or a capital loss (section 1212(a)(1)).

Charitable contributions over the 10% limitation may not be deducted for the tax year but may be carried over to the next 5 tax years.

IC-DISCs reporting taxable income on the accrual basis may elect to treat as paid during the tax year any contributions paid by the 15th day of the 3rd month after the end of the tax year if the contributions were authorized by the board of directors during the tax year. Attach

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.

**Substantiation requirements.** Generally, no deduction is allowed for any contribution of \$250 or more unless the IC-DISC gets a written acknowledgment from the donee organization that shows the amount of cash contributed, describes any property contributed, and gives an estimate of the value of any goods or services provided in return for the contribution. The acknowledgment must be obtained by the due date (including extensions) of the IC-DISC's return, or, if earlier, the date the return is filed. Do not attach the acknowledgment to the tax return, but keep it with the IC-DISC's records.

The IC-DISC or former DISC must complete and attach **Form 8283**, Noncash Charitable Contributions to their returns for contributions of property (other than money) if the total claimed deduction for all property contributed was more than \$5000.

For more information on substantiation and recordkeeping requirements, see the regulations under section 170 and **Pub. 526**, Charitable Contributions.

**Contributions to organizations conducting lobbying activities.** Contributions made to an organization that conducts lobbying activities are not deductible if:

- The lobbying activities relate to matters of direct financial interest to the donor's trade or business and
  - The principal purpose of the contribution was to avoid Federal income tax by obtaining a deduction for activities that would have been nondeductible under the lobbying expense rules if conducted directly by the donor.
- Reduced deduction for contributions of certain property.** For a charitable contribution of property, the IC-DISC must reduce the contribution by the sum of:
- The ordinary income and short-term capital gain that would have resulted if the property were sold at its fair market value (FMV) and
  - For certain contributions, the long-term capital gain that would have resulted if the property were sold at its FMV.

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

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

### Line 2e—Freight

Enter freight expense not deducted on line 1h as export promotion expense.

### Line 2g—Other

**Note:** Do not deduct fines or penalties paid to a government for violating any law.

Enter any other allowable deduction not claimed on line 1 or lines 2a through 2f.

Generally, a deduction may not be taken for any amount that is allocable to a class of exempt income. See section 265(b) for exceptions.

**Travel, meals, and entertainment.** Subject to the limitations and restrictions discussed below, a corporation can deduct ordinary and necessary travel, meals, and entertainment expenses paid or incurred in its trade or business. Special rules apply to deductions for gifts, skybox rentals, luxury water travel, convention expenses, and entertainment tickets. See section 274 and Pub. 463 for more details.

**Travel.** The IC-DISC cannot deduct travel expenses of any individual accompanying a corporate officer or employee, including a spouse or dependent of that officer or employee, unless:

- That individual is an employee of the IC-DISC and
- His or her travel is for a bona fide business purpose and would otherwise be deductible by that individual.

**Meals and entertainment.** Generally, the IC-DISC can deduct only 50% of the amount otherwise allowable for meals and entertainment expenses. In addition (subject to exceptions under section 274(k)(2)):

- Meals must not be lavish or extravagant;
- A bona fide business discussion must occur during, immediately before, or immediately after the meal; and
- An employee of the IC-DISC must be present at the meal.

**Membership dues.** The IC-DISC may deduct amounts paid or incurred for membership dues in civic or public service organizations, professional organizations (such as bar and medical associations), business leagues, trade associations, chambers of commerce, boards of trade, and real estate boards. However, no deduction is allowed if a principal purpose of the organization is to entertain, or provide entertainment facilities for, members or their guests. In addition, corporations may not deduct membership dues in any club organized for business, pleasure, recreation, or other social purpose. This includes country clubs, golf and athletic clubs, airline and hotel clubs, and clubs operated to provide meals under conditions favorable to business discussion.

**Entertainment facilities.** The corporation cannot deduct an expense paid or incurred for a facility (such as a yacht or hunting lodge) used for an activity usually considered entertainment, amusement, or recreation.

**Note:** The IC-DISC may be able to deduct otherwise nondeductible meals, travel, and entertainment expenses if the amounts are treated as compensation and reported on Form W-2 for an employee or on Form 1099-MISC for an independent contractor.

**Deduction for clean-fuel vehicles and certain refueling property.** Section 179A allows a deduction for part of the cost of qualified clean-fuel vehicle property and qualified clean-fuel vehicle refueling property placed in service during the tax year. For details, see **Pub. 535**, Business Expenses.

**Lobbying expenses.** Generally, lobbying expenses are not deductible. These expenses include amounts paid or incurred in connection with influencing Federal or state legislation (but

not local legislation) or amounts paid or incurred in connection with any communication with certain Federal executive branch officials in an attempt to influence the official actions or positions of the officials. See Regulations section 1.162-29 for the definition of "influencing legislation." However, if certain in-house expenditures do not exceed \$2,000, they are deductible. Dues and other similar amounts paid to certain tax-exempt organizations may not be deductible. See section 162(e). For information on contributions to charitable organizations that conduct lobbying activities, see the instructions for line 2d. For more information on lobbying expenses, see section 162(e).

## Schedule J Deemed and Actual Distributions and Deferred DISC Income for the Tax Year

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

#### Line 2—Recognized Gain on Section 995(b)(1)(B) Property

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.

#### Line 3—Recognized Gain on Section 995(b)(1)(C) Property

Enter gain recognized on the sale or exchange of property described in section 995(b)(1)(C). Show the computation of the gain on a separate schedule. 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 IC-DISC 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.

#### Line 4—Income Attributable to Military Property

Enter 50% 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.

#### Line 9—Deemed Distributions to C Corporations

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.

#### Line 10—International Boycott Income

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 to figure this deemed distribution and for reporting requirements for any IC-DISC with operations related to a boycotting country.

#### Line 11—Illegal Bribes, etc.

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)).

#### Line 14—Earnings and Profits

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

See section 312 for rules on figuring earnings and profits for the purpose of the section 995(b)(1) limitation.

#### Line 17—Foreign Investment Attributable to Producer Loans

**Line 17a—For shareholders other than C corporations.** 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 2000 tax year) minus the amount on line 15, Part I; and (3) accumulated IC-DISC income. Enter the smallest of these amounts (but not less than zero) on line 17a.

**Line 17b—For C corporation shareholders.** To figure the amount for line 17b, 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 2000 tax year) minus the amount on line 16, Part I; and (3) accumulated IC-DISC income. Enter the smallest 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 smallest 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; or (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.

**Lines 20 and 21.** The percentages on lines 20 and 21 must add up to 100%.

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

### Part II—Section 995(b)(1)(E) Taxable Income

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

#### Line 1—Export Receipts

If there were no commission sales, leases, rentals, or services for the tax year, enter on

line 1, Part II, the total of lines 1c and 2k, column (e), Schedule B.

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, are figured as follows (section 993(f)):

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

#### Line 3—Controlled Group Allocation

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.

#### Lines 4 and 5—Proration of \$10 Million Limit

The \$10 million limit (or the controlled group member's share) is prorated on a daily basis. Thus, for example, if, for its 2000 calendar tax year, an IC-DISC has a short tax year of 73 days, and it is not a member of a controlled group, the limit that would be entered on line 5 of Part II is \$1,994,535 (73/366 times \$10 million).

#### Line 7—Taxable Income

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 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 that 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 that permit the greatest amount of taxable income to be allocated to the IC-DISC under the intercompany 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 2000 tax return, the allocation of the \$10 million limitation and the computation of the line 7 deemed distribution may be changed by filing an amended Form 1120-IC-DISC only under the conditions specified in Proposed 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 2000, each shareholder is deemed to have received a distribution taxable as a dividend on the last day of the 2000 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

#### Line 1—Distributions to Meet Section 992(c)(2)(B)

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.

#### Line 4a—Previously Taxed Income

Report on line 4a all actual distributions of previously taxed income. Also, include any distributions of pre-1985 accumulated DISC income that are nontaxable. 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 Under Section 995(f)(3)

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.

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

- Actual distributions to shareholders out of accumulated IC-DISC income over
- The amount of IC-DISC income (as defined in section 996(f)(1)) for the tax year following the computation year.

For purposes of items 1 and 2 above, see section 995(f) and Proposed Regulations section 1.995(f)-1 for a definition of computation year, examples, and other details on figuring deferred DISC income.

The amount on line 3, Part V, is allocated to each shareholder on line 10, Part III, of Schedule K (Form 1120-IC-DISC).

Shareholders of an IC-DISC must file Form 8404, Interest Charge on DISC-Related Deferred Tax Liability, if the IC-DISC reports

deferred DISC income on line 10, Part III of Schedule K.

## 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 received an actual or deemed distribution during the tax year or to whom the corporation reported deferred DISC income for the tax year.

## Schedule L

### Balance Sheets per Books

The balance sheet should agree with the IC-DISC's books and records. Include certificates of deposits as cash on line 1.

#### Line 12—Accumulated Pre-1985 DISC Income

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 Temporary Regulations section 1.921-1T(a)(7).*

#### Line 13—Accumulated IC-DISC Income

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

### Line 1

#### Product Code and Percentage

Enter in line 1a the code number and percentage of total export gross receipts (defined below), for the product or service that accounts for the largest portion of the IC-DISC's export gross receipts. The product codes are on page 16 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 inorganic and organic chemicals) and "20%" in line 1b.

### Line 2

#### Definitions

**Export gross receipts** are receipts from any of the following:

- Providing engineering or architectural services for construction projects located outside the United States.
- Selling for direct use, consumption, or disposition outside the United States, property (such as inventory) produced in the United States.
- Renting this property to unrelated persons for use outside the United States.
- Providing services involved in such a sale or rental.
- 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 line 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 line 2 is the total of the amounts from page 2, Schedule B, columns (b) and (d) of lines 1c, 2a, 2b, 2c, and 2d.

**Related persons** are—

- An individual, partnership, estate, or trust that controls the IC-DISC.
- A corporation that controls the IC-DISC or is controlled by it.
- 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** is—

- A citizen or resident of the United States, which includes the Commonwealth of Puerto Rico and possessions of the United States.
- A domestic corporation or partnership.
- An estate or trust (other than a foreign estate or trust as defined in section 7701(a)(31)).

#### Export Gross Receipts for 2000

**Column (a).** All IC-DISCs should complete column (a) in line 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 United States) for the 2000 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 United States).

**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 United States.

**Line 3****Related U.S. Persons**

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

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

---

**Schedule O  
Other Information**

**Question 6—Boycott of Israel.** If question 6a, 6b, or 6c is checked "Yes," the IC-DISC must file Form 5713 and is also deemed to distribute part of its income. See Form 5713 for more information.

**Question 7—Tax-exempt interest.** Show any tax-exempt interest received or accrued. Include any exempt-interest dividends received

as a shareholder in a mutual fund or other regulated investment company.

---

**Schedule P  
(Form 1120-IC-DISC)****Intercompany 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 intercompany pricing rules of section 994(a)(1) and (2).

## Form 1120-IC-DISC Codes for Principal Business Activity

This list of principal business activities and their associated codes is designed to classify an enterprise by the type of activity in which it is engaged to facilitate the administration of the Internal Revenue Code. For tax years beginning after 1997, these principal business activity codes are based on the North American Industry Classification System. 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 gross receipts is derived. Total receipts means all income (line 1, page 1).

On page 6, Schedule O, line 1, enter the principal business activity and principal product or service that account for the largest percentage of total receipts. For example, if the principal activity is "Wholesale Trade: Machinery, Equipment, & Supplies Wholesalers," the principal product or service may be "Engines and Turbines."

<b>Wholesale Trade</b> <i>Code</i>	<i>Code</i> <b>Wholesale Trade, Nondurable Goods</b>	<b>Information</b> <i>Code</i>	<b>Rental and Leasing</b> <i>Code</i>
<b>Wholesale Trade, Durable Goods</b>		<b>Publishing Industries</b>	<b>Rental and Leasing Services</b>
421100 Motor Vehicle & Motor Vehicle Part & Supplies Wholesalers	422100 Paper & Paper Product Wholesalers	511110 Newspaper Publishers	532100 Automotive Equipment Rental & Leasing
421200 Furniture & Home Furnishing Wholesalers	422210 Drugs & Druggists' Sundries Wholesalers	511120 Periodical Publishers	532400 Commercial & Industrial Machinery & Equipment Rental & Leasing
421300 Lumber & Other Construction Materials Wholesalers	422300 Apparel, Piece Goods, & Notions Wholesalers	511130 Book Publishers	<b>Lessors of Other Nonfinancial Assets</b>
421400 Professional & Commercial Equipment & Supplies Wholesalers	422400 Grocery & Related Product Wholesalers	511140 Database & Directory Publishers	533110 Lessors of Nonfinancial Intangible Assets (except Copyrighted Works)
421500 Metal & Mineral (except Petroleum) Wholesalers	422500 Farm Product Raw Material Wholesalers	511190 Other Publishers	
421600 Electrical Goods Wholesalers	422600 Chemical & Allied Products Wholesalers	511210 Software publishers	
421700 Hardware, & Plumbing & Heating Equipment, & Supplies Wholesalers	422700 Petroleum & Petroleum Products Wholesalers	<b>Motion Picture and Sound Recording Industries</b>	
421800 Machinery, Equipment, & Supplies Wholesalers	422800 Beer, Wine, & Distilled Alcoholic Beverage Wholesalers	512100 Motion Picture & Video Industries (except video rental)	<b>Professional, Scientific and Technical Services</b>
421910 Sporting & Recreational Goods & Supplies Wholesalers	422910 Farm Supplies Wholesalers	512200 Sound Recording Industries	<b>Architectural, Engineering, and Related Services</b>
421920 Toy & Hobby Goods & Supplies Wholesalers	422920 Book, Periodical, & Newspaper Wholesalers	<b>Broadcasting and Telecommunications</b>	541310 Architectural Services
421930 Recyclable Material Wholesalers	422930 Flower, Nursery Stock, & Florists' Supplies Wholesalers	513100 Radio & Television Broadcasting	541330 Engineering Services
421940 Jewelry, Watch, Precious Stone, & Precious Metal Wholesalers	422940 Tobacco & Tobacco Product Wholesalers	513200 Cable Networks & Program Distribution	
421990 Other Miscellaneous Durable Goods Wholesalers	422950 Paint, Varnish, & Supplies Wholesalers	513300 Telecommunications (including paging, cellular, satellite, & other telecommunications)	
	422990 Other Miscellaneous Nondurable Goods Wholesalers	<b>Information Services and Data Processing Services</b>	
		514100 Information Services (including news syndicates, libraries, & on-line information services)	
		514210 Data Processing Services	

## Schedule P (Form 1120-IC-DISC) Codes for Principal Business Activity

(These codes are used only with Schedule P (Form 1120-IC-DISC)).

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. Certain activities such as manufacturing do not apply to an IC-DISC.

Using the list below, enter on each Schedule P, the code for the specific industry group and the product or product line for which the Schedule P is completed.

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

