



# Instructions for Form 1120-IC-DISC

## Interest Charge Domestic International Sales Corporation Return

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

Contents	Page
What's New . . . . .	1
Photographs of Missing Children . . . . .	1
Unresolved Tax Issues . . . . .	1
How To Make a Contribution To Reduce Debt Held by the Public . . . . .	1
How To Get Forms and Publications . . . . .	2
<b>General Instructions</b> . . . . .	2
Purpose of Form . . . . .	2
Who Must File . . . . .	2
When To File . . . . .	2
Where To File . . . . .	2
Who Must Sign . . . . .	3
Other Forms That May Be Required . . . . .	3
Assembling the Return . . . . .	3
Accounting Methods . . . . .	3
Accounting Periods . . . . .	3
Rounding Off to Whole Dollars . . . . .	4
Recordkeeping . . . . .	4
Definitions . . . . .	4
Penalties . . . . .	5
<b>Specific Instructions</b> . . . . .	5
Taxable Income . . . . .	5
Schedule A—Cost of Goods Sold . . . . .	6
Schedule B—Gross Income . . . . .	6
Schedule C—Dividends and Dividends-Received Deduction . . . . .	7
Schedule E—Deductions . . . . .	8
Schedule J—Deemed and Actual Distributions and Deferred DISC Income for the Tax Year . . . . .	11
Schedule K—Shareholder's Statement of IC-DISC Distributions . . . . .	12
Schedule L—Balance Sheets per Books . . . . .	12
Schedule N—Export Gross Receipts of the IC-DISC and Related U.S. Persons . . . . .	12
Schedule O—Other Information . . . . .	13
Schedule P—Intercompany Transfer Price or Commission . . . . .	13
Codes for Principal Business Activity . . . . .	14
Schedule N Product Code System . . . . .	15

## What's New

- An IC-DISC can elect to deduct a limited amount of business start-up and organizational costs paid or incurred after October 22, 2004. See page 9.
- For charitable contributions of certain property made after June 3, 2004, an IC-DISC must file Form 8283 and obtain a qualified appraisal if claiming a deduction of more than \$5,000. See page 10.
- For charitable contributions of patents and certain other intellectual property made after June 3, 2004, an IC-DISC will receive a reduced deduction but can deduct certain qualified donee income. See page 10.
- Special rules apply to charitable contributions after 2004 of used motor vehicles, boats, or airplanes with a claimed value of more than \$500. See section 170(f)(12).
- Charitable contributions made in January 2005 for the relief of victims in areas affected by the Indian Ocean tsunami may be treated as if made on December 31, 2004.
- The deduction for certain travel, meals, and entertainment expenses incurred after October 22, 2004, is limited to the amount treated as compensation to officers, directors, and more-than-10% shareholders. See section 274(e)(2).

## 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 acknowledgment.
- 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 be prepared to provide the following information:

- The corporation's name, address, and employer identification number (EIN).
- 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 was contacted.
- A description of the hardship the corporation is facing and verifying documentation (if applicable).

The corporation may contact a Taxpayer Advocate by calling 1-877-777-4778 (toll free). Persons who have access to TTY/TDD equipment may call 1-800-829-4059 and ask for 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 Debt Held by the Public

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

## How To Get Forms and Publications

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

- Order IRS products online.
- Download forms, instructions, and publications.
- See answers to frequently asked tax questions.
- Search publications online by topic or keyword.
- Send us comments or request help by email.
- Sign up to receive local and national tax news by email.

**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.
- Frequently requested tax forms that can 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 \$22 (no handling fee) or call 1-877-CDFORMS (1-877-233-6767) toll free to buy the CD-ROM for \$22 (plus a \$5 handling fee).

**By phone and in person.** You can order forms and publications 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 of 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.
- 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 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 4 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 current tax 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 for the current tax year; and at the beginning of the current tax 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 its tax year ends. No extensions are allowed. If the due date falls on a Saturday, Sunday, or a legal holiday, the corporation may file on the next business day.

**Private delivery services.** Corporations 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. These private delivery services include only the following:

- DHL Express (DHL): DHL Same Day Service, DHL Next Day 10:30 am, DHL Next Day 12:00 pm, DHL Next Day 3:00 pm, and DHL 2nd Day Service.
- Federal Express (FedEx): FedEx Priority Overnight, FedEx Standard Overnight, FedEx 2Day, FedEx International Priority, and FedEx International First.

---

## Where To File

File the IC-DISC's 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:
The United States (including Alaska and Hawaii)	Cincinnati, OH 45999-0012
A foreign country or U.S. possession	Philadelphia, PA 19255-0012

A group of corporations with members located in more than one service center area will often keep all the books and records at the principal office of the managing corporation. In this case, the tax returns of the corporations may be filed with the service center for the area in which the principal office of the managing corporation is located.

• United Parcel Service (UPS): UPS Next Day Air, UPS Next Day Air Saver, UPS 2nd Day Air, UPS 2nd Day Air A.M., UPS Worldwide Express Plus, and UPS Worldwide Express.

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.

If a return is filed on behalf of a corporation by a receiver, trustee or assignee, the fiduciary must sign the return, instead of the corporate officer. Returns and forms signed by a receiver or trustee in bankruptcy on behalf of a corporation must be accompanied by a copy of the order or instructions of the court authorizing signing of the return or form.

If an employee of the corporation completes 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 complete that section. 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 in the space provided for the preparer's signature.
- Give a copy of the return to the taxpayer.

**Note.** A paid preparer may sign original returns, amended returns, or requests for filing extensions by rubber stamp, mechanical device, or computer software program.

## Other Forms That May Be Required

For a list of additional forms the IC-DISC may need to file, see *Other Forms That May Be Required* in the Instructions for the Forms 1120 and 1120-A.

## Schedules

An IC-DISC may have to attach Schedule N (Form 1120), Foreign Operations of U.S. Corporations, to its Form 1120-IC-DISC. See Schedule N (Form 1120) for details.

## Statements

### Shareholders who are foreign persons.

The corporation should 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.

**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

To ensure that the corporation's tax return is correctly processed, attach all schedules and other forms after page 6, Form 1120-IC-DISC, and 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 enter "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 corporation'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 method of accounting regularly used in keeping the IC-DISC's books and records. In all cases, the method used must clearly show taxable income.

Generally, permissible methods include:

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

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 that method materially distorts its income.

**Accrual method.** Generally, an IC-DISC must use the accrual method of accounting if its average annual gross receipts exceed \$5 million. See section 448(c).

If inventories are required, the accrual method generally must be used for sales and purchases of merchandise. However, qualifying taxpayers and eligible businesses of qualifying small business taxpayers are excepted from using the accrual method for eligible trades or businesses and may account for inventoriable items as materials and supplies that are not incidental. For details, see *Cost of Goods Sold* on page 6.

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

1. 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
2. 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.

### **Nonaccrual experience method.**

Accrual method corporations are not required to accrue certain amounts to be received from the performance of certain services that, on the basis of their experience, will not be collected, if the corporation's average annual gross receipts for the 3 prior tax years does not exceed \$5 million.

This provision does not apply to any amount if interest is required to be paid on the amount or if there is any penalty for failure to timely pay the amount. For more information, see section 448(d)(5) and Temporary Regulations section 1.448-2T. For reporting requirements, see the instructions for Schedule B on page 6.

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

**Section 481(a) adjustment.** The IC-DISC may have to make an adjustment under section 481(a) to prevent amounts of income or expense from being duplicated or omitted. This section 481(a) adjustment period is generally 1 year for a net negative adjustment and 4 years for a net positive adjustment. However, an IC-DISC can elect to use a 1-year adjustment period if the net section 481(a) adjustment for the change is less than \$25,000. The IC-DISC must complete the appropriate lines of Form 3115 to make the election.

Include any net positive section 481(a) adjustment on page 2, Schedule B, line 2j or 3f (depending on whether the inventory, when sold, will generate qualified export receipts). If the net section 481(a) adjustment is negative, report it on page 3, Schedule E, line 2g.

## Accounting Periods

An IC-DISC must figure its taxable income on the basis of a tax year. A tax year is the annual accounting period an 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.

**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 the tax year of any such shareholder. See section 441(h).

**Calendar year.** If the IC-DISC is required to use the calendar year as its annual accounting period, the IC-DISC 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.

## Rounding Off to Whole Dollars

The IC-DISC may round off cents to whole dollars on its return and schedules. If the IC-DISC does round to whole dollars, it must round all amounts. To round, drop amounts under 50 cents and increase amounts from 50 to 99 cents to the next dollar (for example, \$1.39 becomes \$1 and \$2.50 becomes \$3).

If two or more amounts must be added to figure the amount to enter on a line, include cents when adding the amounts and round off only the total.

## 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 and amended returns.

## Definitions

The following definitions are based on sections 993 and 994.

**Note.** "United States," as used in the following 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 leasing or renting export property that the lessee uses outside the United States.
3. Gross receipts from supporting services related to any qualified sale, exchange, lease, 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 under section 951) with respect to stock of a related foreign export corporation (defined below).
6. Interest on any obligation that is a qualified export asset.

7. Gross receipts for engineering or architectural services for construction projects outside the United States.

8. Gross receipts for the 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 primarily in connection with the sale, lease, rental, storage, handling, transportation, packaging, assembly, or servicing of export property, or the performance of engineering or architectural services described in item 7 of *Qualified export receipts* above or managerial services in furtherance of the production of qualified export receipts described in items 1, 2, 3, and 7 above.
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. Stock or securities of a related foreign export corporation (defined below).
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 such Bank or Association or from the person who sold or bought the goods or services 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 under which the domestic corporation makes export loans that the Export-Import Bank guarantees.
9. Amounts (other than reasonable working capital) on deposit 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 a person 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, lease, or rent in the ordinary course of a 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 the requirements of sections 993(d)(2) and (3).
2. Not raise the unpaid balance due the IC-DISC on all of 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 evidenced by a note (or other written evidence of indebtedness) with a stated maturity date no more than 5 years after the date of the loan.
4. Be made to a person engaged in a U.S. 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** includes the following:

1. A **foreign international sales corporation** is a related foreign export corporation if:
  - The IC-DISC directly owns more than 50% of the total voting power of the foreign corporation's stock;
  - For the tax year that ends with or within the IC-DISC's tax year, 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* above and interest on the qualified export assets listed in items 3 and 4 of *Qualified export assets* above; and
  - 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.
2. A **real property holding company** is a related foreign export corporation if:
  - The IC-DISC directly owns more than 50% of the total voting power of the foreign corporation's stock and
  - Its exclusive function is to hold title to real property located outside the United States for the exclusive use (under lease or otherwise) of the IC-DISC and applicable foreign law forbids the IC-DISC to hold title to the property.
3. An **associated foreign corporation** is a related foreign export corporation if:
  - 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
  - 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, leasing, or renting property that the corporation holds for sale, lease, or rent in the ordinary course of its trade or business and gross income from all other sources. For commissions on selling, leasing, or renting property, include gross

receipts from selling, leasing, 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 are expenses 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 in those cases where U.S. law or regulations do not require that the export property be shipped on such aircraft or ships.

## Deficits in Earnings and Profits

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).

## 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, 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 or Pub. 15 (Circular E), Employer's Tax Guide, for details, including the definition of responsible persons.

## Specific Instructions

### Period Covered

File the 2004 return for calendar year 2004 and fiscal years that begin in 2004 and end in 2005. For a fiscal year return, fill in the tax year space at the top of the form.

**Note.** The 2004 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 2005 and
- The 2005 Form 1120-IC-DISC is not available at the time the corporation is required to file its return.

The corporation must show its 2005 tax year on the 2004 Form 1120-IC-DISC and take into account any tax law changes that are effective for tax years beginning after December 31, 2004.

### 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 corporation has a P.O. box, show the box number instead.

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

Enter the corporation's EIN. If the corporation does not have an EIN, it must apply for one. An EIN may be applied for:

- Online—Click on the EIN link at [www.irs.gov/businesses/small](http://www.irs.gov/businesses/small). The EIN is issued immediately once the application information is validated.
- By telephone at 1-800-829-4933 from 7:00 a.m. to 10:00 p.m. in the corporation's local time zone.
- By mailing or faxing Form SS-4, Application for Employer Identification Number.

If the corporation has not received its EIN by the time the return is due, enter "Applied for" in the space for the EIN. For more details, see Pub. 583, Starting a Business and Keeping Records.

### 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 -0-.

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

- If this is the IC-DISC's initial 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 "Address change."

**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.

- If the IC-DISC changed its name since it last filed a return, check the box for "Name change." Generally, an IC-DISC also must have amended its articles of incorporation and filed the amendment with the state in which it was incorporated.
- To correct an error on 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 carryover and carryback that can be deducted in the tax year. See section 172 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 purchase or sale of merchandise is an income-producing factor. See Regulations section 1.471-1.

However, if the IC-DISC is a qualifying taxpayer or a qualifying small business taxpayer, it may adopt or change its accounting method to account for inventoriable items in the same manner as materials and supplies that are not incidental.

A **qualifying taxpayer** is a taxpayer that, for each prior tax year ending after December 16, 1998, has average annual gross receipts of \$1 million or less for the 3-tax-year period ending with that prior tax year.

A **qualifying small business taxpayer** is a taxpayer (a) that, for each prior tax year ending on or after December 31, 2000, has average annual gross receipts of \$10 million or less for the 3-tax-year period ending with that prior tax year and (b) whose principal business activity is not an ineligible activity.

Under this accounting method, inventory costs for merchandise purchased for resale are deductible in the year the merchandise is sold (but not before the year the IC-DISC paid for the merchandise, if it is also using the cash method). For additional guidance on this method of accounting for inventoriable items, see Pub. 538.

Enter amounts paid for merchandise during the tax year on line 2. The amount the IC-DISC can deduct for the tax year is figured on line 8.

All filers not using the cash method of accounting should see *Section 263A uniform capitalization rules* on page 8 before completing Schedule A.

If the IC-DISC uses intercompany pricing rules (for purchases from a related supplier), use the transfer price figured in Part II of Schedule P (Form 1120-IC-DISC).

If the IC-DISC acts as another person's commission agent on a sale, do not enter any amount in Schedule A for the sale. See Schedule P (Form 1120-IC-DISC).

### Line 1. Inventory at Beginning of Year

If the IC-DISC is changing its method of accounting for the current tax year, it must refigure last year's closing inventory using the new method of accounting and enter the result on line 1. If there is a difference between last year's closing inventory and the refigured amount, attach an explanation and take it into account when figuring the IC-DISC's section 481(a) adjustment (explained on page 3).

### 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 includible 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 sections 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 accounts for inventoriable items in the same manner as materials and supplies that are not incidental, enter on line 7 the portion of its merchandise purchased for resale that is included on line 6 and was 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, if the IC-DISC is using the cash method of accounting, it is required to use cost.

IC-DISCs that account for inventoriable items in the same manner as materials and supplies that are not incidental 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. Use Form 3115 to make this change.

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. 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 (on page 2, Schedule B, line 2j or 3f), 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.

## 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 nonqualifying interest from a domestic obligation, enter the qualified interest on an attached schedule for line 2g and the nonqualifying 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.

### Nonaccrual experience method.

Corporations that qualify to use the nonaccrual experience method (described on page 3), should attach a schedule showing total gross receipts, the amount not accrued as a result of the application of section 448(d)(5), and the net amount accrued. Enter the amount on the applicable line of Schedule B.

### Commissions: Special Rule

**Note.** "United States," as used in the following instructions, includes Puerto Rico and U.S. possessions, as well as the 50 states and the District of Columbia.

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 seller or lessor.
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 seller or lessor.
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 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.

In some cases, an IC-DISC may have to enter a section 481(a) adjustment on line 2j. See *Change in accounting method* on page 3.

**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 nonqualifying gross receipts not reported on lines 3a through 3e. Do not

offset an income item against a similar expense item.

## Schedule C

### Dividends and Dividends-Received Deduction

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 to Form 1120-IC-DISC 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.

**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).

**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)**

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), that is 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 total amount of dividends received from 20%-or-more-owned corporations that are 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)**

Include the following:

1. Dividends (other than capital gain distributions reported on Schedule D (Form 1120) and exempt-interest dividends) that are received from RICs and that are not subject to the 70% deduction.
2. Dividends from tax-exempt organizations.
3. Dividends (other than capital gain distributions) received from a real estate investment trust that, for the tax year of the trust in which the dividends are paid, qualifies under sections 856 through 860.
4. Dividends not eligible for a dividends-received deduction, which include the following:
  - a. Dividends received on any share of stock held for less than 46 days during the 91-day period beginning 45 days before the ex-dividend date. When counting the number of days the corporation held the stock, you cannot count certain days during which the corporation's risk of loss was diminished. See section 246(c)(4) and Regulations section 1.246-5 for more details.
  - b. Dividends attributable to periods totaling more than 366 days that the IC-DISC received on any share of preferred stock held for less than 91 days during the 181-day period that began 90 days before the ex-dividend date. When counting the number of days the IC-DISC held the stock, you cannot count certain days during which the IC-DISC's risk of loss was diminished. See section 246(c)(4) and Regulations section 1.246-5 for more details. Preferred dividends attributable to periods totaling less than 367 days are subject to the 46-day holding period rule above.
  - c. Dividends on any share of stock to the extent the IC-DISC is under an obligation (including a short sale) to make related payments with respect to positions in 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 (or amounts) includible in gross income (under section 951) that are attributable to stock of related foreign export corporations. See item 6 under *Qualified export receipts* and *A related foreign export corporation* on page 4 for more details.

**Schedule E**

**Deductions**

**Limitations on Deductions**

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

- Personal property (tangible and certain intangible property) 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, videotape, 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 expenses 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 deductible.

**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 IC-DISC's average annual gross receipts for the 3 prior tax years were \$10 million or less.
- Inventoriable items accounted for in the same manner as materials and supplies that are not incidental. See *Cost of Goods Sold* on page 6 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 interest and expenses.

**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 excess amounts if control of the corporation changes. See section 280G.

**Business start-up and organizational costs.** Business start-up and organizational costs must be capitalized unless an election is made to deduct or amortize them. For costs paid or incurred before October 23, 2004, the IC-DISC must capitalize them unless it elects to amortize these costs over a period of 60 months or more. For costs paid or incurred after October 22, 2004, the following rules apply separately to each category of costs.

- The IC-DISC can elect to deduct up to \$5,000 of such costs for the year the IC-DISC begins business operations.
- The \$5,000 deduction is reduced (but not below zero) by the amount the total costs exceed \$50,000. If the total costs are \$55,000 or more, the deduction is reduced to zero.
- If the election is made, any costs that are not deductible must be amortized ratably over a 180-month period beginning with the month the IC-DISC begins business operations.

For more details on the election for business start-up costs, see section 195 and attach the statement required by Regulations section 1.195-1(b). For more details on the election for organizational costs, see section 248 and attach the statement required by Regulations section 1.248-1(c). Report the deductible amount of these costs and any amortization on line 2g of Schedule E. For amortization that begins during the 2004 tax year, complete and attach Form 4562.

### 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

Include on line 1c depreciation and the part of the cost of certain property that the corporation elected to expense under section 179. See Form 4562 and its instructions.

### 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 in those cases where

you are not 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.

The IC-DISC determines who is an officer under the laws of the state where it is incorporated.

### 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 value of the property 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 IC-DISC 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 1l. 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 Export Promotion Expenses

Enter any other allowable export promotion expenses not claimed elsewhere on the return.

**Note.** Do not deduct fines or 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 may only 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, but do not include the following:

- Taxes not imposed on the corporation.
- Taxes, including state or local sales taxes, that are paid or incurred in connection with an acquisition or disposition of property (these taxes must be treated as 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).
- Taxes assessed against local benefits that increase the value of the property assessed (such as for paving, etc.).
- Taxes deducted elsewhere on the return, such as those reflected in cost of goods sold.

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

### Line 2c. Interest

Do not deduct the following interest:

- Interest on indebtedness incurred or continued to purchase or carry obligations if the interest is wholly exempt from income tax. For exceptions, see section 265(b).
- For cash basis taxpayers, prepaid interest allocable to years following the current tax year (e.g., a cash basis calendar year taxpayer who in 2004 prepaid interest allocable to any period after 2004 can deduct only the amount allocable to 2004).
- Interest on debt allocable to the production of designated property by a corporation for its own use. The corporation must capitalize this interest. Also capitalize any interest on debt allocable to an asset used to produce the property. See section 263A(f) and Regulations sections 1.263A-8 through 1.263A-15 for definitions and more information.

Special rules apply to:

- Interest on which no tax is imposed (see section 163(j)).
- Forgone interest on certain below-market-rate loans (see section 7872).
- Original issue discount on certain high-yield discount obligations. (See section 163(e) to figure the disqualified portion.)
- Interest which is allocable to unborrowed policy cash values of life insurance, endowment, or annuity contracts issued after June 8, 1997. See section 264(f). Attach a statement showing the computation of the deduction.

### 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.

IC-DISCs reporting taxable income on the accrual method 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 a declaration to the return stating that the resolution authorizing the contributions was adopted by the board of directors during the tax year. The declaration must include the date the resolution was adopted.

**Limitation on deduction.** The total amount claimed may not be more than 10% of taxable income (line 7, page 1) computed without regard to the following:

- Any deduction for contributions,

- The dividends-received deduction on line 6b, page 1,
- The deduction allowed under section 249,
- Any net operating loss (NOL) carryback to the tax year under section 172, and
- Any capital loss carryback to the tax year under section 1212(a)(1).

**Carryover.** 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.

**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, either gives a description and a good faith estimate of the value of any goods or services provided in return for the contribution or states that no goods or services were 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. These rules apply in addition to the filing requirements for Form 8283, Noncash Charitable Contributions, described below.

For more information on charitable contributions, including substantiation and recordkeeping requirements, see section 170 and the related regulations and Pub. 526, Charitable Contributions.

**Contributions of property other than cash.** If an IC-DISC contributes property other than cash and claims over a \$500 deduction for the property, it must attach a schedule to the return describing the kind of property contributed and the method used to determine its fair market value (FMV). The IC-DISC generally must complete and attach Form 8283 to its return for contributions of property (other than money) if the total claimed deduction for all property contributed was more than \$5,000.

If the IC-DISC made a "qualified conservation contribution" under section 170(h), also include the FMV of the underlying property before and after the donation, as well as the type of legal interest contributed, and describe the conservation purpose benefited by the donation. If a contribution carryover is included, show the amount and how it was determined.

**Contributions after June 3, 2004.** For contributions of certain property made after June 3, 2004, an IC-DISC must file Form 8283 and get a qualified appraisal if claiming a deduction of more than \$5,000. Do not attach the appraisal to the tax return unless claiming a deduction of more than \$500,000, or, for art, a deduction of \$20,000 or more. See Form 8283.

**Contributions of used vehicles.** Special rules apply to contributions after 2004 of used motor vehicles, boats, or airplanes with a claimed value of more than \$500. See section 170(f)(12).

**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 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,
- Contributions of any property to or for the use of certain private foundations except for stock for which market quotations are readily available (section 170(e)(5)), and
- Any patent or certain other intellectual property contributed after June 3, 2004. See section 170(e)(1)(B). However, the IC-DISC can deduct certain qualified donee income from this property. See section 170(m).

**Larger deduction.** A larger deduction is allowed for certain contributions of:

- Inventory and other property to certain organizations for use in the care of the ill, needy, or infants (see section 170(e)(3) and Regulations section 1.170A-4A),
- Scientific equipment used for research to institutions of higher learning, or to certain scientific research organizations (see section 170(e)(4)), and
- Computer technology and equipment for educational purposes (see section 170(e)(6)).

#### Line 2e. Freight

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

#### Line 2g. Other Expenses

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.

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

Special rules apply to the following expenses:

**Travel, meals, and entertainment.** Subject to the limitations and restrictions discussed below, an IC-DISC can deduct ordinary and necessary travel, meals, and entertainment expenses paid or incurred in its trade or business. Also, 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 the 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 paid or incurred in its trade or business. 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, business leagues, trade associations, chambers of commerce, and boards of trade. 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, IC-DISCs 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 IC-DISC 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.

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

However, if the recipient is an officer, director, or beneficial owner (directly or indirectly) of more than 10% of any class of stock, the deduction for otherwise nondeductible meals, travel, and entertainment expenses incurred after October 22, 2004, is limited to the amount treated as compensation. See section 274(e)(2).

**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."

Dues and other similar amounts paid to certain tax-exempt organizations may not be deductible. See section 162(e)(3). If certain in-house lobbying expenditures do not exceed \$2,000, they are deductible. For information on contributions to charitable organizations that conduct lobbying activities, see section 170(f)(9).

For more information on other deductions that may apply to corporations, see Pub. 535.

## 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, other than property which in the hands of the IC-DISC was a qualified export asset, previously transferred to the IC-DISC in a transaction in which the transferor realized gain but did not recognize the gain in whole or in 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 the 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 2004 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 2004 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 2004 calendar tax year, an IC-DISC has a short tax year of 183 days, and it is not a member of a controlled group, the limit that would be entered on line 5 of Part II is \$5,000,000 (183/366 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 2004 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 2004, each shareholder is deemed to have received a distribution taxable as a dividend on the last day of the 2004 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 Qualification Requirements under Section 992(c)

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 (see the instructions for Schedule L, line 12, below). Enter on the dotted line to the left of the line 4a amount, the dollar amount of the distribution that is nontaxable pre-1985 DISC income and identify it as such. 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 995(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 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 15 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 includes 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 2004

**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 2004 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**

Enter on line 3 the name, address, and identifying number of related U.S. persons in your controlled group.

**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.

or group of transactions to which you apply the intercompany pricing rules of section 994(a)(1) and (2).

**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.

**Schedule P****Intercompany Transfer Price or Commission**

Complete and attach a separate Schedule P (Form 1120-IC-DISC) for each transaction

**Privacy Act and 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. Section 6109 requires return preparers to provide their identifying numbers on the return.

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.	20 hr.	30 hr., 48 min.	2 hr., 24 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 Internal Revenue Service, Tax Products Coordinating Committee, SE:W:CAR:MP:T:T:SP, 1111 Constitution Ave. NW, IR-6406, Washington, D.C. 20224. Do not send these tax forms to this office. Instead, see *Where To File* on page 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. 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, item 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 Durable Goods: Machinery, Equipment, & Supplies," the principal product or service may be "Engines and Turbines."

<p><b>Wholesale Trade</b></p> <p><b>Merchandise Wholesalers, Durable Goods</b></p> <p>423100 Motor Vehicle &amp; Motor Vehicle Parts &amp; Supplies</p> <p>423200 Furniture &amp; Home Furnishings</p> <p>423300 Lumber &amp; Other Construction Materials</p> <p>423400 Professional &amp; Commercial Equipment &amp; Supplies</p> <p>423500 Metal &amp; Mineral (except Petroleum)</p> <p>423600 Electrical &amp; Electronic Goods</p> <p>423700 Hardware, &amp; Plumbing &amp; Heating Equipment, &amp; Supplies</p> <p>423800 Machinery, Equipment, &amp; Supplies</p> <p>423910 Sporting &amp; Recreational Goods &amp; Supplies</p> <p>423920 Toy &amp; Hobby Goods &amp; Supplies</p> <p>423930 Recyclable Materials</p> <p>423940 Jewelry, Watch, Precious Stone, &amp; Precious Metals</p> <p>423990 Other Miscellaneous Durable Goods</p> <p><b>Merchandise Wholesalers, Nondurable Goods</b></p> <p>424100 Paper &amp; Paper Products</p> <p>424210 Drugs &amp; Druggists' Sundries</p> <p>424300 Apparel, Piece Goods, &amp; Notions</p> <p>424400 Grocery &amp; Related Products</p>	<p>424500 Farm Product Raw Materials</p> <p>424600 Chemical &amp; Allied Products</p> <p>424700 Petroleum &amp; Petroleum Products</p> <p>424800 Beer, Wine, &amp; Distilled Alcoholic Beverage</p> <p>424910 Farm Supplies</p> <p>424920 Book, Periodical, &amp; Newspapers</p> <p>424930 Flower, Nursery Stock, &amp; Florists' Supplies</p> <p>424940 Tobacco &amp; Tobacco Products</p> <p>424950 Paint, Varnish, &amp; Supplies</p> <p>424990 Other Miscellaneous Nondurable Goods</p> <p><b>Information Publishing Industries (except Internet)</b></p> <p>511110 Newspaper Publishers</p> <p>511120 Periodical Publishers</p> <p>511130 Book Publishers</p> <p>511140 Directory &amp; Mailing List Publishers</p> <p>511190 Other Publishers</p> <p>511210 Software Publishers</p> <p><b>Motion Picture and Sound Recording Industries</b></p> <p>512100 Motion Picture &amp; Video Industries (except video rental)</p> <p>512200 Sound Recording Industries</p>	<p><b>Broadcasting (except Internet)</b></p> <p>515100 Radio &amp; Television Broadcasting</p> <p>515210 Cable &amp; Other Subscription Programming</p> <p><b>Internet Publishing and Broadcasting</b></p> <p>516110 Internet Publishing &amp; Broadcasting</p> <p><b>Telecommunications</b></p> <p>517000 Telecommunications (including paging, cellular, satellite, cable &amp; other program distribution, resellers, &amp; other telecommunications)</p> <p><b>Internet Service Providers, Web Search Portals, and Data Processing Services</b></p> <p>518111 Internet Services Providers</p> <p>518112 Web Search Portals</p> <p>518112 Data Processing, Hosting, &amp; Related Services</p> <p><b>Other Information Services</b></p> <p>519100 Other Information Services (including news syndicates, libraries)</p>	<p><b>Rental and Leasing</b></p> <p><b>Rental and Leasing Services</b></p> <p>532100 Automotive Equipment Rental &amp; Leasing</p> <p>532210 Consumer Electronics &amp; Appliances Rental</p> <p>532220 Formal Wear &amp; Costume Rental</p> <p>532230 Video Tape &amp; Disc Rental</p> <p>532290 Other Consumer Goods Rental</p> <p>532310 General Rental Centers</p> <p>532400 Commercial &amp; Industrial Machinery &amp; Equipment Rental &amp; Leasing</p> <p><b>Professional Services</b></p> <p><b>Architectural, Engineering, and Related Services</b></p> <p>541310 Architectural Services</p> <p>541320 Landscape Architecture Services</p> <p>541330 Engineering Services</p> <p>541340 Drafting Services</p> <p>541350 Building Inspection Services</p> <p>541360 Geophysical Surveying &amp; Mapping Services</p> <p>541370 Surveying &amp; Mapping (except Geophysical) Services</p> <p>541380 Testing Laboratories</p> <p><b>Other Professional Services</b></p> <p>541600 Management Services</p>
---	--	--	---

## 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.

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

