The Operation and Effect of the Domestic International Sales Corporation Legislation

1979 Annual Report

Department of the Treasury
April 1981

THE SECRETARY OF THE TREASURY
WASHINGTON 20220

27 APR 1981

Dear Mr. Speaker:

Section 506 of Public Law 92-178, the Revenue Act of 1971, provides that "the Secretary of the Treasury shall, commencing for the calendar year 1972, submit an annual report to the Congress within 15-1/2 months following the close of each calendar year setting forth an analysis of the operation and effect of the provisions of" Title V of that Act, which authorizes the creation of domestic international sales corporations.

Pursuant to that section, I hereby submit the eighth annual report entitled "The Operation and Effect of the Domestic International Sales Corporation Legislation."

I am sending a similar letter to the President of the Senate.

Sincerely,

Donald T. Regan

Donald T. Regan

The Honorable
Thomas P. O'Neill
Speaker of the House of Representatives
Washington, D.C. 20515

Enclosure

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Chapter 1 - Introduction and Summary

This report is the eighth in an annual series on the operation and effect of the domestic international sales corporation (DISC) legislation. A DISC is a special corporation that allows the deferral of income tax on a portion of export profits. The report covers the seventh full year of DISC operations, referred to as DISC year 1979. It presents statistical estimates derived from a sample of tax returns, Form 1120-DISC, filed for accounting periods ending between July 1, 1978 and June 30, 1979. 1/

The scope of DISC activity measured both by export receipts and net income continued to expand in DISC year 1979. The number of active DISCs increased from 6,665 to 7,208, reversing the decline in the previous year. DISC manufactured exports as a share of total U.S. manufactured exports rose from 60.7 percent in DISC year 1978 to 65.7 percent in DISC year 1979. 2/

Chapter 2 discusses the 1971 DISC legislation and the modifications to the original legislation in the Tax Reduction Act of 1975 and the Tax Reform Act of 1976.

1/ Because the majority of DISCs have tax years ending in December 1978 or January 1979, roughly 82.7 percent of the exports reported in DISC year 1979 occurred in calendar year 1978. Consequently, activities in 1978 are major determinants of the results reported for DISC year 1979.

2/ Statistics on DISC exports of nonmanufactured products, specifically agricultural products, exceed actual U.S. exports from all sources by a substantial margin because of sales between unrelated DISC. That is to say, one DISC may sell to another DISC--as long as the property sold is ultimately for direct use, consumption, or sale outside the United States, its sale is a qualified export receipt. Therefore, comparisons between DISC exports and total U.S. exports of agricultural products do not lead to any meaningful comparisons. Inter-DISC sales may also add some error to the statistics on manufactured exports, but the error is not believed to be large.

Chapter 3 discusses the impact of the DISC legislation on U.S. exports. Previous DISC reports have presented a specific, although qualified, estimate of the impact of the DISC legislation on U.S. exports by comparing the growth of DISC and non-DISC exports. A similar estimate will not be made in the current report because the limitations of the earlier methodology have become more apparent. The shortcomings of the methodology were alluded to in last year's report and are explained in Appendix B of this report.

Instead of a single estimate of the extent to which DISC increased exports in DISC year 1979 over what they would otherwise have been, Chapter 3 offers a range of between $4.5 billion and $7.0 billion. This range is based on a consideration of the conditions of demand and supply in various product categories. DISC tax savings increase the profitability of exports, and therefore stimulate an additional supply of exports. The extent to which export supply is stimulated depends on the responsiveness of supply to the change in the profitability of capital used for export production.

U.S. exports are classified into four basic categories with differing supply and demand behavior. In most cases the supply of output to foreign markets is extremely responsive since it represents the diversion of output from domestic consumption, which can be instantaneous. If the return from diverting output is positive, the destination of the product will change until the return from selling in either market is identical. In the case of many goods, total output is also highly responsive to increased profitability because they are produced with standard technologies. Labor and capital can therefore be readily adapted to expanding production. The responsiveness of demand varies among product categories depending on the differentation of products in world trade. Some products, including agricultural goods, are highly standardized, and foreign demand is therefore highly elastic. In other cases there may be somewhat more differentation because of the necessity to tailor goods to particular markets. While it is reasonable to assume these systematic differences in supply and demand elasticities, it is difficult to be precise about the exact elasticity values in each category. It is, therefore, necessary in some cases to use a range of demand or supply elasticities, which results in the $4.5 to $7.0 billion range indicated.

The $4.5 to $7.0 billion range for the effect of DISC on exports does not take into account the second round effect through flexible exchange rates. The change in tax on export profits causes a shift in the U.S. supply of exports, which results in more exports. The increase in exports will lead to an appreciation of the dollar which will stimulate an increase in U.S. imports. In the long run, there will be somewhat more exports and also an increase in imports.

Furthermore, the increase in exports draws capital into industries producing exports. This may simply be a shift from elsewhere in the corporate sector, e.g., from import competing industries; it may be new savings stimulated by the cut in taxes; or it may be capital attracted from the noncorporate sector or from abroad. The lower taxation of exporting firms reduces their overall cost of capital.

As shown in Chapter 4, the revenue cost of DISC in DISC year 1979 was $994 million, assuming no behavorial change due to DISC. This amounted to a 36 percent increase over DISC year 1978, somewhat less than had been projected in previous reports. There had been a 35 percent decline in revenue costs from DISC year 1976 to DISC year 1977 because of the incremental and other provisions of the Tax Reform Act of 1976. 3/ There was a further, but small, decline in DISC year 1978 as all DISCs became subject to the incremental provision compared to somewhat more than 70 percent in the previous year. The large increase in DISC year 1979 in part reflects the 23 percent increase in DISC income. It is also due to the increase in the DISC deferral rate since the base years used to apply the incremental rules did not change between 1978 and 1979. In making the no behavorial change revenue estimates, no account is taken of the fact that, in the absence of DISC, total exports and profit margins might be different and total corporate profits might therefore be different without DISC.

Summary income and balance sheet statistics derived from DISC returns are presented in Chapter 5. The consolidated profit margin earned on DISC exports of manufactured goods increased from 13.1 percent in DISC year 1978 to 14.1 percent in DISC year 1979. 4/ Tax deferred income was 18.3 percent of the consolidated income from manufactured exports by DISCs. Net income reported by all DISCs was $6.4 billion. Transportation equipment, non-electrical machinery, and chemicals -- in that order -- accounted for the largest dollar amounts of DISC income.

3/ The Act, which is discussed more fully in Chapter 2, restricted DISC benefits to increased, rather than total, export sales.

4/ As noted in footnote 2, statistics for DISC exports of nonmanufactured products, specifically agricultural products, are overstated relative to actual exports because of inter-DISC sales. Thus, the ratio between DISC net income and gross receipts for agricultural products does not represent the true rate of return on DISC exports of these products.

Chapter 2 - History and Provisions of DISC Statute
Provisions of the Original DISC Legislation

Title V of the Revenue Act of 1971 provided for the creation of Domestic International Sales Corporations (DISCs). Its objective was to stimulate an increase in exports by lowering the effective rate of taxation of export income. The legislation provided a tax deferral for part of the export income channeled through a DISC. A DISC is exempt from federal income tax, but its shareholders are taxable on dividends distributed or deemed distributed by a DISC. Until 1976, the shareholders of a DISC were generally deemed to receive an annual dividend equal to one half of the DISC's taxable income, even if the DISC distributed less. This deemed distribution was fully taxable to the shareholders. Federal income tax could be deferred on the remaining half of the DISC's taxable income, until the income was actually distributed to the DISC shareholders, a shareholder disposed of the DISC stock, the DISC was liquidated, the corporation ceased to qualify as a DISC, or the DISC election was terminated or revoked by the shareholder(s).

To qualify for tax exemption, a DISC must have been incorporated under the laws of any state or the District of Columbia, have only one class of stock, have issued outstanding capital stock with a par or stated value of at least $2,500, have elected to be treated as a DISC, and have satisfied the "gross receipts" and "gross assets" tests.

The gross receipts test required that at least 95 percent of the corporation's gross receipts consist of "qualified export receipts." In general, qualified export receipts were to be derived from the sale or lease for use outside the United States of "export property," or from the furnishing of services related and subsidiary to the sale or lease of export property. Also included were dividends on stock of a "related foreign export corporation" and interest on any obligation which was a "qualified export asset." "Export property" was defined as property manufactured, produced, grown or extracted in the United States. Exports subsidized by the U.S. Government or exports intended for use in the United States did not qualify as export property. A DISC could not engage in producing, growing, or manufacturing export property.

The gross assets test required that at least 95 percent of the corporation's assets be qualified export assets. In general, qualified export assets were inventories of export property, necessary operational equipment and supplies, trade receivables from export sales (including commissions receivable), producer's loans, working capital, investments in related foreign export corporations, obligations issued, guaranteed, or insured by the Export-Import Bank or the Foreign Credit Insurance Association, and obligations of domestic corporations organized solely to finance export sales under guaranty agreements with the Export-Import Bank.

The law also provided that even if a DISC failed to meet either the gross receipts or gross assets test, it could continue to qualify as a DISC by making a pro-rata distribution to its shareholders equal to the portion of the income attributable to the ineligible receipts or equal to the fair market value of the unqualified assets, depending on the nature of the disqualification. However, if a DISC were disqualified, or otherwise terminated its status as a DISC, the deferred tax became payable over a period of time equal to the number of years the DISC had been in existence, up to a maximum of 10 years.

A DISC usually acquires export property from its parent corporation or an affiliated corporation ("related supplier") and then sells the property abroad; however, it can act simply as a commission agent. In many cases, a DISC is a "paper" corporation without any employees or real operations. The method used for allocating income between a DISC and its related suppliers therefore is an important part of the DISC statute. The allocation is achieved through special intercompany pricing rules which permit the DISC to realize taxable income in an amount which does not exceed the greater of:

(a) 4 percent of the qualified export receipts attributable to the sale of export property plus 10 percent of related "export promotion expenses", defined as ordinary and necessary expenses incurred to obtain qualified export receipts (referred to as the 4 percent method);

(b) 50 percent of the combined taxable income of the DISC and its related supplier attributable to qualified export receipts plus 10 percent of related "export promotion expenses" (referred to as the 50-50 method); or

(c) taxable income based upon the price actually charged the DISC by its related supplier if that price is justifiable on an arm's-length basis (referred to as the arm's-length method).

Neither the 4 percent method nor the 50-50 method can be applied in such a way as to cause a loss to the related supplier while the DISC is earning a net profit. These special rules allow exporters to allocate more income to a DISC, and thus to defer a larger portion of their total tax burden, than they would be able to under the normal arm's-length rule.

Statutory Amendments

The Tax Reduction Act of 1975 denied DISC benefits to profits arising from exports of products in short domestic supply, as determined by the Commerce Department under the Export Administration Act of 1969 or by Executive Order of the President. The Act also removed DISC benefits from exports of natural resource products, such as oil, gas, and minerals, subject to a depletion allowance. The Tax Reform Act of 1976, however, restored DISC benefits to these natural resource products for sales made pursuant to fixed contracts entered into before March 19, 1975, and consummated prior to March 19, 1980. It also excluded renewable resources, such as timber, from the natural resource products ineligible for DISC benefits.

The incremental provision in the Tax Reform Act of 1976 reduced DISC benefits for eligible export products by about 40 percent for taxable years beginning after December 31, 1975. 1/ Under these provisions, applicable to accounting periods beginning after December 31, 1975, DISC benefits (deferral of tax on one half of profits) are limited to income attributable to export gross receipts in excess of 67 percent of average export gross receipts in a 4-year base period.

1/ The amount of the reduction is estimated by comparing the ratios, for periods before and after the 1976 Act was effective, of DISCs' tax-deferred income to net income. Statistics in the 1977 and 1978 Reports indicate that this ratio was .49 in the last full year before the Act came into effect, and .29 in the first full year to which the Act applied (the last part of DISC year 1977 and the first part of DISC year 1978). The ratio of tax-deferred income to net income increased to 32.4 percent in DISC year 1979 because the base period remained unchanged. The ratio will increase further in 1980 and 1981, as the number of years between the end of the base period and the current taxable year rises from two to four.

For taxable years beginning in 1976 through 1979, the base period years are 1972 through 1975. Starting with taxable years beginning in 1980, the base period will be advanced each year. For example, the base period will be 1973 through 1976 for taxable years beginning in 1980, and 1974 through 1977 for taxable years beginning in 1981. 2/ DISCs with incomes of $100,000 or less are exempted from the incremental rule. This exemption is phased out over the $100,000 to $150,000 income range.

In applying the incremental rule, a DISC's export gross receipts are treated as equal to zero for those base period years in which the DISC did not exist. In order to prevent a controlling shareholder from gaining an advantage by shifting exports from one DISC to another, the sales of all DISCs that are part of a controlled group are combined in calculating base-period exports. Appropriate allowance is made for base-period sales of products no longer fully eligible for DISC benefits, such as natural resource products.

The 1976 Act made additional amendments to the DISC legislation. The most important of these was to reduce the DISC deferral on sales of military goods to one half the amount which would otherwise be allowed. The 1976 Act also lengthened the period for recapture of the deferred tax, in the event of disqualification or termination of DISC status, to twice the number of years of the DISC's existence, up to a maximum period of 10 years.

2/ For an analysis of the effect of the incremental provision on the incentive to expand exports, see the 1976 Report, pages 15-16 and 53-58. These pages demonstrate that, for the same increase in tax revenue, an across-the-board reduction in the DISC deferral rate might have had a slightly more favorable impact on the incentive to expand exports than the more complicated 1976 provision does.

Chapter 3 - The Effect of DISC on the Level and Structure of U.S. Trade

In a departure from previous reports, this report offers a range of estimates of the impact of-DISC on exports based on assumed responses to increased supplies made possible by-DISC. Previous reports compared the growth in DISC and non-DISC exports and presented a specific estimate of the impact of DISC on exports. This DISC/non-DISC comparison is not used in this year's report because of limitations explained in Appendix B.

Any attempt to estimate the precise impact of DISC on exports is complicated by the many factors which contributed to the $100 billion growth in exports between 1971 and 1978. These include:

1. The substantial domestic and worldwide inflation during the period. For example, the $100 billion increase in the value of U.S. exports from 1971 to 1978 represents an increase in the real (deflated) volume of exports of 62 percent combined with a 104 percent increase in prices.

2. The rapid expansion of overall world trade. While U.S. exports increased substantially, the U.S. share of free world exports declined from 19.7 percent in 1971 to 17.0 percent in 1978. 1/ In part this was due to the rapid growth of productive capacity in almost all major countries. The ratio of exports to GNP also increased in many countries: from 4.1 percent in 1971 to 6.6 percent in 1978 in the U.S., from 18.0 percent to 22.3 percent in Germany, and from 16.1 percent to 23.2 percent in the United Kingdom. 2/

1/ All aggregate trade data are taken from the quarterly publication by the U.S. Department of Commerce, International Economic Indicators.

2/ The conspicuous exception is Japan in which exports as a percentage of GNP were basically unchanged from 1971 to 1978. This indicates the importance of the expansion in overall productive capacity in explaining Japanese export performance. The difference between the falling U.S. share of world trade and the simultaneous increase in U.S. exports as a percentage of domestic GNP is an example of the difficulty in evaluating U.S. export performance.

3. The devaluation of the dollar relative to major foreign currencies. The value of the dollar fell by 14.5 percent on a trade weighted basis from December 1971 to December 1978, making U.S. exports more attractive to foreign purchasers. The devaluation of the dollar since 1971 did not simply compensate for higher inflation in the U.S. compared to our trading partners over the period. In fact, between March 1973 and December 1978, the real effective value of the dollar, i.e., adjusted for inflation in each country, declined somewhat more than the nominal value. 3/

DISC increases the profitability of exporting and therefore stimulates an increase in export supply by U.S. producers. Labor and capital are drawn into the export sector. The extent to which a reduction in costs or an increase in price induces the expanded production of exports is indicated by the price elasticity of supply. The stimulating effect of DISC on exports therefore depends on supply and demand responses, combined with the shift in export supply brought about by DISC.

The impact of DISC on exports is estimated by first classifying the specific products listed in Table 3-1 into four categories with differing supply and demand behavior. The responsiveness of export supply is generally assumed to be very high. One reason is that output can easily be diverted from domestic consumption, which for most goods is much larger than export demand. If the return from diverting output is positive, the destination of sales will change until the return from selling in either market is identical. Furthermore, many goods are produced with standard, widely diffused technologies so that labor and capital can easily be shifted from other uses in order to expand output. Demand is also highly responsive where standardized commodities are sold in many markets, as in the case of farm products. The responsiveness of demand is somewhat lower in cases in which products are more differentiated, or have to be adapted to particular markets.

3/ See World Financial Markets, published monthly by Morgan Guaranty Trust. March 1973 is the base for their real exchange rate calculations.

The four categories into which products are classified are:

1. Nonmanufactured products (mainly agricultural commodities). These are products whose demand is very highly responsive to price changes because identical products are supplied and demanded by many countries. For example, grains are sold in standard grades in many markets. The elasticity of supply is not as high as in manufacturing, however, because of the constraints imposed by the available agricultural land or mineral resources. Furthermore, a significant share of U.S. output is already exported so that a large percentage increase in exports requires a significant increase in domestic production.

2. Basic manufacturing industries not requiring advanced technology. These products include textiles, rubber, fabricated metal products, and transportation equipment other than aircraft. Since these products use relatively standard technologies, capital and labor can easily be adapted to expanded production. Supply is therefore very elastic. Furthermore, the elasticity of demand is also high because products tend to be relatively standardized in most world markets.

3. High technology manufactured products. Examples include chemicals, aircraft, electrical machinery and equipment, and office machinery. It is assumed that demand is somewhat less elastic than category 2. The high technological level reduces the number of countries that may be alternative sources of supply. Products are also more likely to be differentiated, which would also reduce the elasticity of demand.

4. Resource-related manufacturing products. These include paper, lumber, and nonferrous metals. Production of these products is constrained by the availability of some natural resource in the U.S. Products tend to be standardized. This category is therefore close in character to nonmanufactured products in having very elastic demand, but lower supply elasticities than other manufactured products.

The particular products in each category are listed in Appendix C. Appendix C also gives the elasticities of demand and supply assumed in each category.

Figure 1 illustrates the analysis of the change in exports that would occur if DISC were eliminated. The example depicted is for an export such as an agricultural good with a very high demand elasticity. DD and SS are the current demand and supply schedules respectively. The current level of exports is OX and the price is XA. The elimination of DISC decreases export supply, i.e., shifts the supply of export schedule upwards to S'S' because it reduces the after-tax profit from producing any level of exports. If a price of XA were required, with DISC, to induce producers to produce OX of exports, then without DISC, a price of XB would be needed. But since that price cannot be obtained with the demand represented by DD, OX of exports will not be supplied.

The magnitude of BA, the vertical shift in the supply schedule, depends on the DISC tax saving per dollar of capital devoted to producing exports. Exporters would be willing to continue to supply OX if they could earn the same after-tax profit per unit of such capital. The DISC tax saving per unit of capital is approximated by the reduction in tax on the pre-tax return per unit of capital used. This reduction depends on the percentage of profits that can be deferred and the marginal corporate tax rate (48 percent for DISC year 1979).

As a result of the shift in supply resulting from the elimination of DISC, exports fall to OY. More generally, the magnitude of the changes in the quantity of exports depends on the slopes of the demand and supply schedules in each category.

The analysis of the reduction in the value of exports if DISC were eliminated is summarized in Table 3-2. The overall reduction in the value of exports is in the range of $4.5 to $7.0 billion. The relatively modest reduction of exports of nonmanufactured products reflects the small DISC-induced shift in supply. Exports of both basic and high technology manufactured products decline substantially. Although demand in high technology products is assumed to be somewhat less price sensitive than basic manufactured products, the decline in exports is substantial because the DISC induced shift in supply is large.

Figure 1

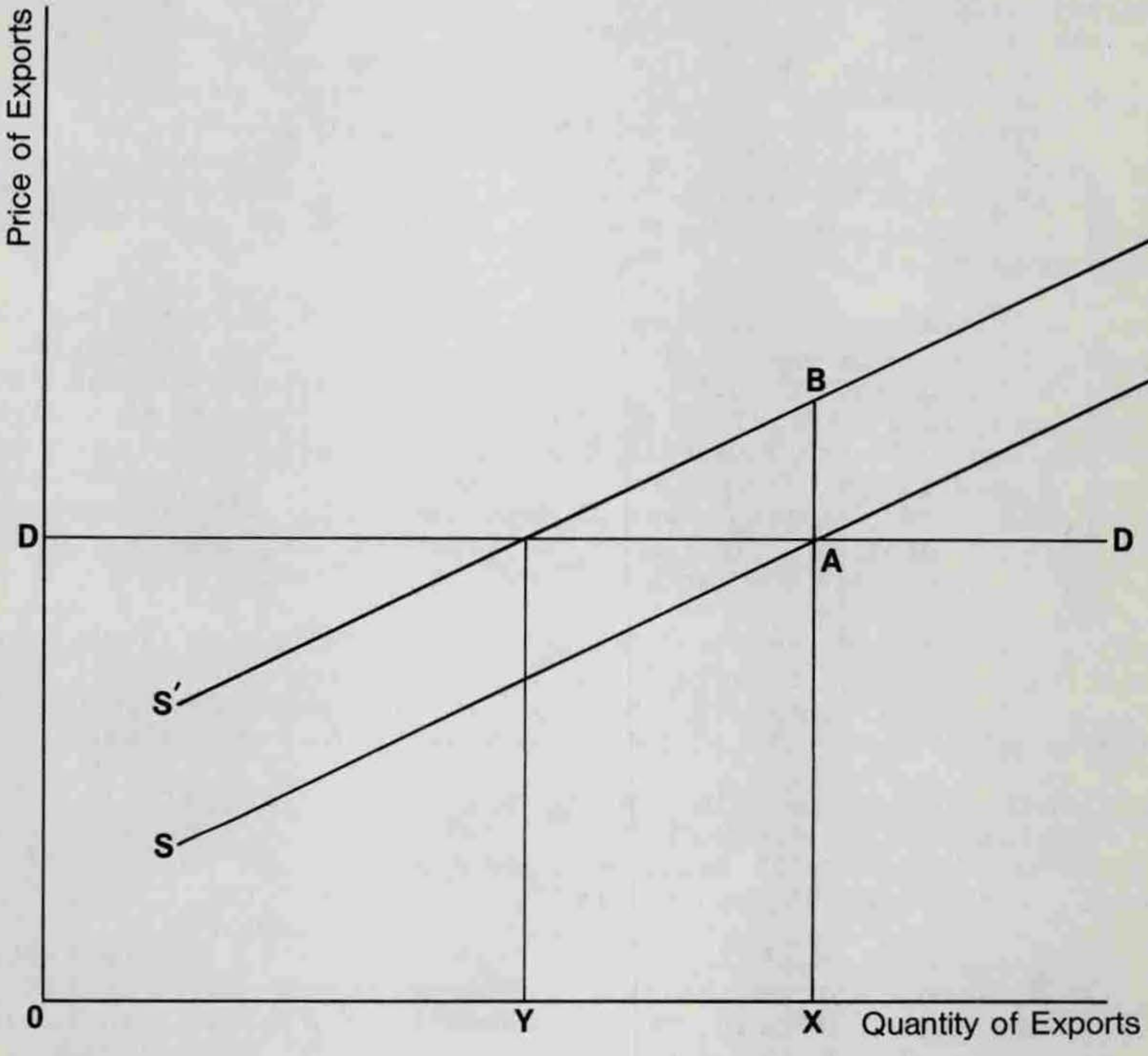

Table 3-1

Gross Receipts, Net Income and Tax Deferred Income by Major Product Class 1/ - DISC year 1979
(Dollar Amounts in Millions)

Major Product Class	Number of Returns	Gross Receipts	Net Income	Tax-deferred Income	Deferred Tax as a Percent of Gross Receipts 3/
Total	7,208	99,604	6,402.1	2,071.3	1.0
Nonmanufactured products	934	26,038	478.9	170.6	0.3
Agricultural products	299	24,616	341.6	119.4	0.2
Grains	100	22,516	278.9	97.3	0.2
Other agricultural products	192	2,100	62.7	22.3	0.5
Mineral products	114	333	10.7	3.7	0.5
Other	521	1,089	126.6	47.5	2.1
Manufactured products 2/	6,274	73,566	5,923.1	1,900.7	1.2
Ordnance and accessories	46	247	28.7	6.3	1.2
Food and kindred products	270	2,592	183.9	65.1	1.2
Meat products	73	633	34.0	12.2	0.9
Canned fruits, vegetables, seafood	64	514	48.9	20.2	1.9
Grain mill products	42	647	46.8	15.0	1.1
Tobacco manufactures	10	715	71.0	26.0	1.7
Textile mill products	243	991	57.4	18.4	0.9
Apparel, etc.	137	245	11.0	4.5	0.9
Lumber, etc., except furniture	190	1,947	71.5	22.5	0.6
Saw and planing mill products, logging	34	998	22.2	6.0	0.3
Millwork, veneer, etc.	54	198	10.2	3.4	0.8
Furniture and fixtures	39	28	3.3	1.5	2.6
Paper and allied products	162	1,525	102.3	25.2	0.8
Printing, publishing, etc.	84	285	29.2	9.9	1.7
Chemicals and allied products	507	9,491	910.2	288.4	1.5
Inorganic, organic chemicals	78	4,339	476.1	152.0	1.7
Plastics materials, etc., including fibers	81	2,019	181.5	60.7	1.4
Drugs	44	506	87.2	25.5	2.4
Agricultural	74	1,262	51.6	13.1	0.5
Rubber and miscellaneous plastic products	141	640	41.9	13.8	1.0
Leather and leather products	110	1,358	13.4	5.1	0.2

Table 3-1 Continued

Major Product Class	Number of Returns	Gross Receipts	Net Income	Tax-deferred Income	Deferred Tax as a Percent of Gross Receipts 3/
Stone, clay, glass and concrete products	71	665	62.7	21.7	1.6
Primary metal industries	175	1,366	76.4	22.6	0.8
Iron and steel industries	16	118	9.2	2.8	1.1
Fabricated metal products	605	2,774	223.9	78.9	1.4
Structural metal products	93	363	33.3	11.9	1.6
Cutlery, etc.	90	164	14.5	5.9	1.7
Heating and plumbing	59	99	5.3	2.0	1.0
Machinery, except electrical	1,225	15,688	1,327.1	424.3	1.3
Engines and turbines	34	3,062	260.3	77.6	1.2
Farm machinery and equipment	62	921	40.5	14.5	0.8
Construction, mining, etc.	183	5,116	392.8	124.3	1.2
Metal working	88	380	34.3	10.7	1.4
Special industry	363	1,890	166.0	56.2	1.4
Office, etc.	72	1,989	233.6	83.2	2.0
Electrical Machinery and Equipment	1,006	8,885	801.4	278.9	1.5
Transmission and distribution equipment	27	1,023	125.8	38.4	1.8
Household appliances	35	898	64.8	21.4	1.1
Communications equipment	104	821	81.1	27.6	1.6
Electronic components, etc.	407	3,482	309.6	109.9	1.5
Transportation equipment	441	18,716	1,345.4	386.9	1.0
Motor vehicles and equipment	221	11,102	671.0	207.31	0.9
Aircraft and parts	164	7,396	657.4	174.5	1.1
Prof. and scientific instruments, etc.	371	3,851	460.9	157.0	2.0
Research instruments	72	760	73.1	26.0	1.6
Physical measuring instruments	131	725	73.2	26.6	1.8
Surgical, medical, dental, etc.	117	536	52.7	19.9	1.8
Photographic equipment	25	1,718	253.4	81.6	2.3
All other manufactures	441	1,555	118.1	43.9	1.4

Office of the Secretary of the Treasury
Office of Tax Analysis

1/ Classification is based on the product or product class accounting for the largest portion of gross receipts.

2/ Statistics on DISC sales of agricultural products exceed U.S. exports from all sources by a substantial margin because of inter-DISC sales. Therefore, the ratio of net income to gross receipts understates the profit margin on exports of these products.

3/ Tax deferred income X 0.48/Gross receipts.

Table 3-2

Estimated Reduction in Exports
if DISC Were Eliminated - DISC Year 1979

Product Category	DISC Saving Per Dollar of Sales (in cents)	Percent Reduction in Value of Exports (range)	Decrease in Dollar value of Exports (billions)
1. Nonmanufactured Products	.3	.9 - 1.5	.2 - .4
2. Basic Manufactures	1.0	7.7 - 10.0	2.2 - 2.9
3. High Technology Manufactures	1.5	4.9 - 9.0	1.8 - 3.3
4. Resource Related Manufactures	.9	4.3 - 4.7	.3 - .4
TOTAL	1.0	4.5 - 7.0	4.5 - 7.0

Office of the Secretary of the Treasury
Office of Tax Analysis

As noted earlier, the \$4.5 to \$7.0 billion increase in exports because of DISC is the direct effect before any induced change in the exchange rate. The initial increase in the dollar value of exports when DISC was enacted resulted in an appreciation of the dollar, increasing imports. 4/

In addition to its impact on the level and composition of U.S. exports, DISC has other related effects which should be noted. One is the consequence of the increase in the value of the dollar following the DISC-induced expansion of exports. The higher value of the dollar decreases the real cost of imports to all consumers of imported goods and services. In other words, they benefit because they obtain the same amount of imports at a lower price in dollars. 5/

The principal effect of DISC is that the expansion in export opportunities draws capital into the export sector. This capital may come from several sources. It may be attracted from elsewhere in the corporate sector producing import competing-goods, for example, or it may be attracted from the noncorporate sector. The new capital may also derive from new saving stimulated by the lower taxes on exports, or from foreign capital also attracted by the higher after tax returns.

4/ There is some possibility that DISC exports displace non-DISC exports, but this effect is not likely to be significant. The circumstances in which exporters cannot use a DISC are very specific, as noted in Chapter 2. A DISC would not be used if the firm is making an overall loss. Mineral products benefiting from a percentage depletion allowance are excluded, as are those not intended for use outside the U.S. The latter would include goods exported for assembly and then reimported. DISC and non-DISC exports are therefore unlikely to be very close substitutes.

5/ The reduction in the price of imports may be more or less than the initial reduction in export prices. The appreciation of the dollar would be larger than the drop in export prices if, for example, the demand for products receiving the largest DISC incentive was more price sensitive than exports in general.

Chapter 4 - Effect of DISC on Tax Revenues

The revenue cost of DISC in DISC year 1979 was $994.2 million. The revenue cost is estimated by applying the then applicable corporate tax rate of 48 percent to the portion of DISC income on which tax is deferred. 1/ The tax-deferred income of a DISC is equal to its taxable income less its deemed distributions. Under the original DISC legislation, the principal deemed distribution was 50 percent of adjusted taxable income. 2/ Thus, the ratio of deemed distributions to DISC taxable income was 51 percent in DISC year 1976.

For accounting periods beginning after December 31, 1975, DISCs are subject to the incremental provision introduced by the Tax Reform Act of 1976. For these periods, DISC shareholders are deemed to receive, in place of 50 percent of DISC adjusted taxable income, all adjusted taxable income attributable to base period exports (defined as 67 percent of the average of the export gross receipts of the DISC during calendar years 1972 through 1975), plus 50 percent of the excess of total adjusted taxable income over the amount attributable to base period exports. 3/ As a result of the incremental provision, as well as other kinds of deemed distributions provided by the Tax Reform Act of 1976, the ratio of deemed distributions to DISC taxable income was nearly 70 percent for DISC year 1977 and 71 percent for DISC year 1978. 4/ The deemed distribution rate decreased to 67.6 percent in DISC year 1979 because the base period remained unchanged from 1978.

1/ The 48 percent tax rate is appropriate for DISC year 1979 because the lower 46 percent rate only applies to taxable years beginning after December 31, 1978.

2/ Other deemed distributions were interest derived from producer's loans made by a DISC, certain kinds of capital gains recognized by a DISC, and the amount of foreign investment attributable to producer's loans for the taxable year.

3/ This base period applies to taxable years beginning in 1976 through 1979. Starting with taxable years beginning in 1980, the base period is advanced each year.

4/ Additional deemed distributions which apply to accounting periods beginning after December 31, 1975, are 50 percent of taxable income attributable to sales of military property, income attributable to international boycott activity, and the amount of illegal bribes.

The foregoing revenue estimates assume that the labor and capital producing DISC exports would have the same level of income in the absence of DISC, with the only change being that the full corporate rate would apply to profits. This might be true, for example, if exports and pre-tax profit margins did not change or if the capital flowing into exports would have earned the same income elsewhere, but fully taxable at the regular corporate rate. In reality, economic responses may make the true revenue cost different from the $994.2 million estimate. In the absence of DISC, before-tax margins may increase to give exporters the same after tax return. In fact, this was assumed in the elasticity estimates in Chapter 3. In that case, the revenue estimate would be understated. On the other hand, there may be responses which reduce the revenue cost of DISC. By reducing the tax on the corporate sector, DISC will increase saving and attract capital from the noncorporate sector. The increased capital stock may also lead to higher levels of output, employment, and tax revenue. In the absence of DISC, exporters might have found other ways within existing law to "shelter" export profits. These and other behavorial changes may have an impact on the revenue cost of DISC, but the magnitude of the offset cannot be estimated without more precise information on the adjustments taking place.

The $994 million estimated revenue cost for DISC year 1979 is based on the assumption that DISC income would be taxable to the parent at the then effective rate of 48 percent in the year in which earned. The estimate understates the revenue cost of DISC in those cases where the existence of a DISC enables taxation of the deemed distribution to be postponed until the next year. Such cases occur where the end of the DISC's fiscal year is one or two months later than the end of the parent corporation's fiscal year.

Table 4-1 presents the estimated revenue costs of DISC for calendar and fiscal years 1972 through 1978, as well as projected revenue costs for 1978 through 1986. 5/ Adjusting DISC income in DISC year 1979 to a calendar year basis requires apportioning the income reported on all DISC returns filed for tax years which overlap calendar year 1978. This results in an estimate of DISC

5/ The $994 million estimate refers to DISC year 1979, and is therefore to be distinguished from the calendar and fiscal year estimates in Table 4-1.

Table 4-1

Revenue Cost Estimates and Projections,
Actual Tax Rates and DISC Provisions 1/
(Millions of Dollars)

Year (1)	Calendar Year Tax Liability: Cost Under Original Act (2)	Cost Reductions 2/: Incremental Provision (3)	Cost Reductions 2/: Other (4)	Cost Under Present Law 3/ (5)	Fiscal Year Receipts Foregone (Present Law) 4/ (6)
1972	$ 350			$ 350	$ 100
1973	730			730	460
1974	1,120			1,120	850
1975	1,160		$ 10	1,150	1,130
1976	1,160	$ 390	40	730	1,020
1977	1,200	450	50	700	720
1978	1,430	440	50	940	820
1979	1,690	420	60	1,210	1,060
1980	2,050	510	70	1,470	1,340
1981	2,250	590	80	1,580	1,600
1982	2,430	650	100	1,680	1,630
1983	2,610	740	100	1,770	1,730
1984	2,820	870	120	1,830	1,810
1985	3,040	1,020	130	1,890	1,870
1986	3,280	1,190	130	1,960	1,930

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1/ The 1972 through 1978 figures are estimated from DISC returns. All other figures are projections. All figures are based on the assumption that in the absence of DISC, the earnings would be subject to tax at the corporate tax rate, which is 48 percent for 1972-78 and 46 percent for 1979 and subsequent years.

2/ Net reduction in revenue costs as a result of changes provided for in the Tax Reduction Act of 1975 and the Tax Reform Act of 1976 (see Chapter 2 for details).

3/ Column (2) minus the sum of columns (3) and (4).

4/ Calculated on the basis of normal relationships between calendar year corporate tax liabilities and fiscal year receipts. Fiscal years through 1976 end on June 30 of the corresponding calendar year, thereafter on September 30. The transition quarter in 1976 is not shown separately. The receipts estimate for that quarter is $110 million. The jump in receipts in fiscal 1981 followed by the small increase in FY 1982 reflects the speed up in estimated payments by large corporations as a result of the Omnibus Reconciliation Act of 1980.

revenue cost for calendar year 1978 of $940 million. As shown in column 3, the incremental provision reduced the revenue cost of the original DISC program by 31 percent in calendar year 1978. Tax savings provided by the other amendments to the original DISC program (i.e., reduced benefits for military exports and the exclusion of certain natural resource products from DISC benefits) reduced the revenue cost of the original legislation by an additional 3.5 percent in calendar year 1978.

Distribution of DISC Benefits

For corporate owners for which asset size is available, 62.7 percent of the tax-deferred income of the DISCs in DISC year 1979 accrued to the 6.7 percent of the DISCs with parent companies having assets of at least $500 million (see Table 4-2). The 138 DISCs with gross receipts of $100 million or more accounted for 55.2 percent of all tax-deferred DISC income (see Table 4-3). The 93 DISCs with net incomes of $10 million or more accounted for 53.4 percent of all tax-deferred income (see Table 4-4). Ten DISC parents accounted for 24.5 percent of all tax-deferred income and 26.7 percent of all net income. 6/

Data on the distribution of tax-deferred income to DISCs owned directly or indirectly by foreign corporations are available only for DISC year 1975. They show that $85 million of DISC dividends -- 4 percent of the total -- were distributed to U.S. corporations with foreign owners; $2 million of DISC dividends -- 0.1 percent of the total -- were distributed directly to foreign corporations.

6/ The fact that the distribution of tax-deferred income was less concentrated than the distribution of DISC net income reflects the exemption of small DISCs from the incremental provision of the 1976 Tax Reform Act.

Table 4-2

Gross Receipts, Net Income and Tax-deferred Income by Asset Size of Corporate Majority Shareholder - DISC Year 1979
(Dollar Amounts in Millions)

Asset Size of Corporate Majority Shareholder	Returns		Gross Receipts		Net Income		Tax-deferred Income	
	Number	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
All Returns	7,208	100.0	99,604	100.0	6,402.1	100.0	2,071.3	100.0
No Majority Shareholder or Assets not Available	2,230	30.9	8,921	9.0	360.5	5.6	140.7	6.8
Returns with Majority Corporate Shareholder	4,978	69.1	90,623	91.0	6,041.5	94.4	1,930.6	93.2
			Returns with Majority Corporate Shareholder					
Total	4,978	100.0	90,623	100.0	6,041.5	100.0	1,930.6	100.0
$1 under $100,000	64	1.3	53	0.1	2.7	*	1.1	0.1
$100,000 under $1,000,000	635	12.8	636	0.7	38.0	0.6	17.0	0.9
$1,000,000 under $5,000,000	1,495	30.0	2,364	2.6	169.6	2.8	70.3	3.6
$5,000,000 under $10,000,000	606	12.2	2,286	2.5	118.2	2.0	48.7	2.5
$10,000,000 under $50,000,000	1,100	22.1	14,877	16.4	544.5	9.0	197.0	10.2
$50,000,000 under $100,000,000	269	5.4	3,577	3.9	245.4	4.1	84.2	4.4
$100,000,000 under $250,000,000	291	5.8	5,207	5.7	429.4	7.1	136.5	7.1
$250,000,000 under $500,000,000	185	3.7	8,764	9.7	503.0	8.3	164.8	8.5
$500,000,000 under $1,000,000,000	122	2.5	9,421	10.4	668.6	11.1	204.9	10.6
$1,000,000,000 or more	211	4.2	43,439	47.9	3,321.8	55.0	1,006.1	52.1

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* Less than 0.5 percent

Table 4-3

Gross Receipts, Net Income and Tax-deferred Income by Size of Gross Receipts of the DISC - DISC year 1979
(Dollar Amounts in Millions)

Sizes of Gross Receipts	Returns		Gross Receipts		Net Income		Tax-deferred Income	
	Number	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
			All Returns					
Total	7,208	100.0	99,604	100.0	6,402.1	100.0	2,071.3	100.0
Zero Receipts	544	7.5	--	--	25.9	0.4	7.5	0.4
$1 under $50,000	376	5.2	9	*	1.7	*	1.1	0.1
$50,000 under $250,000	866	12.0	126	0.1	13.0	0.2	6.9	0.3
$250,000 under $1,000,000	1,700	23.6	983	1.0	98.0	1.5	48.7	2.4
$1,000,000 under $10,000,000	2,740	38.0	9,400	9.4	726.2	11.3	274.6	13.3
$10,000,000 under $100,000,000	844	11.7	24,619	24.7	1,805.7	28.2	590.9	28.5
$100,000,000 under $250,000,000	90	1.2	14,459	14.5	1,016.1	15.9	322.1	15.6
$250,000,000 or more	48	0.7	50,007	50.2	2,715.4	42.4	819.5	39.6

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* Less than 0.5 percent

Table 4-4

Gross Receipts, Net Income and Tax-deferred Income by Size of Net Income - DISC year 1979
(Dollar Amounts in Millions)

Size of Net Income	Returns		Gross Receipts		Net Income		Tax-deferred Income	
	Number	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Net Income
All returns	7,208	100.0	99,604	100.0	6,402.1	100.0	2,071.3	32.3
Less: Deficit returns	748	10.4	565	0.6	-26.9	-0.4	--	--
Returns with zero net income	102	1.4	964	1.0	--	--	--	--
Returns with net income	6,358	88.2	98,074	98.5	6,428.9	100.4	2,071.3	32.3
$1 under $100,000	3,241	45.0	3,162	3.2	120.2	1.9	57.3	47.7
$100,000 under $200,000	972	13.5	2,456	2.5	139.3	2.2	59.4	42.6
$200,000 under $1,000,000	1,383	19.2	12,313	12.4	641.1	10.0	224.2	35.0
$1,000,000 under $5,000,000	576	8.0	19,194	19.3	1,254.9	19.6	407.2	32.4
$5,000,000 under $10,000,000	96	1.3	8,366	8.4	682.9	10.7	217.8	31.9
$10,000,000 under $25,000,000	54	0.7	13,718	13.8	826.8	12.9	265.3	32.1
$25,000,000 under $50,000,000	20	0.3	8,551	8.6	672.2	10.5	206.6	30.7
$50,000,000 or more	16	0.2	30,316	30.4	2,091.6	32.7	633.5	30.3

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DISC Elections

A total of 13,796 elections was made through February 1981 (see Table 4-5). This represents an increase of 1,604, or 13 percent, over February 1980. The continued increase in DISC elections supports the assumption that the use of DISC will increase over time. However, the data on DISC elections are not adjusted for DISCs that are inactive or that have been liquidated or have withdrawn their elections. 7/

7/ For example, for accounting periods ending between July 1, 1978 and June 30, 1979, 7,208 DISC returns were filed even though 10,144 DISC elections had been made as of February 28, 1978. These two figures are chosen for comparison since a DISC election must be made, at the latest, within 90 days after the beginning of the DISC's taxable year, and the largest number of returns are for periods beginning in December 1977 and January 1978. The difference between these two figures reflects primarily the number of inactive DISCs, including newly created DISCs which have not yet begun operations. The number of DISC returns filed during DISC year 1979 increased by 543, or 8.1 percent, which is slightly faster than the growth in elections. This apparent decline in the percentage of inactive DISCs is consistent with the growth in profit margins and the decline in the percent of DISC returns with a deficit in DISC year 1979.

Table 4-5

DISC Elections

End of Period	Cumulative Total
1972 - March	1,136
June	2,412
September	3,049
December	3,439
1973 - March	3,842
June	4,164
September	4,466
December	4,825
1974 - March	5,184
June	5,570
September	6,569
December	6,738
1975 - March	7,293
June	7,653
September	7,956
December	8,258
1976 - March	8,522
June	8,805
September	9,070
December	9,331
1977 - February	9,447
June	9,718
September	9,827
December	10,024
1978 - February	10,144
June	10,341
September	10,552
December	10,780
1979 - February	10,978
June	11,285
September	11,667
December	11,924
1980 - February	12,192
June	12,645
September	13,061
December	13,489
1981 - February	13,796

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Chapter 5 - General Statistical Information

This Report covers the sixth full year of DISC operations. The tabulations are based on a sample of 2,039 tax returns, Form 1120-DISC, filed by active DISCs for taxable periods ending between July 1, 1978, and June 30, 1979. This period is defined as DISC year 1979, although most of the activity it covers occurred in calendar year 1978. 1/ Table 5-1 presents the total number of DISC returns filed for DISC years 1975-78, as well as statistics on DISC receipts, net income, and assets for each of these years.

DISC Income

In DISC year 1979, net income attributable to DISC manufactured exports amounted to $5.9 billion. This figure is 120 percent greater than the amount reported in the second DISC year, 1974, and is 23 percent greater than net income reported in DISC year 1978. Because the 23 percent increase in net income slightly exceeded the 22 percent increase in DISC gross sales of manufactures, DISCs' average profit margin for all manufactured product classes rose from 8.0 to 8.1 percent of sales between DISC years 1978 and 1979. Table 5-2 presents statistics on DISC receipts, net income, and tax-deferred income by accounting period in DISC year 1979. The weighted average of tax-deferred income as a percentage of net income was 32.4 percent.

Table 5-3 presents data on the pricing methods used by DISCs. It shows that about 34.7 percent of DISC sales were reported as being subject to the 50-50 pricing method, 32.8 percent to the 4 percent method, and 4.7 percent to the arm's-length pricing method. The remaining 27.8 percent of DISC sales were subject to some combination of these three methods or were shown on returns in which the pricing method could not be determined. This information can be used to estimate the combined profit margins of DISCs and their related suppliers. The average value of this combined margin for all manufactured exports sold through DISCs was 14.1 percent of gross sales in DISC year 1979. 2/

1/ DISC year 1979 is equivalent to statistical year 1978 as used by the Internal Revenue Service. See Appendix A for definitions and a description of the sampling procedure.

2/ For an explanation of the derivation of the combined profit margins, see pages 35-36 of the 1976 Report.

Table 5-1

Historical Statistics, DISC Years 1976-1979
(Dollar Amounts in Millions)

	1976	1977	1978	1980
Number of Returns, Total	6,431	6,911	6,665	7,208
Full Year	5,844	6,421	6,316	6,768
Part Year	833	490	349	440
Gross Receipts, Total	$73,220	$82,681	$85,887	99,603
Nonmanufactured Products	20,469 1/	23,997 1/	25,521 1/	26,038 1/
Manufactured Products	52,751	58,684	60,366	73,566
Export Receipts, Total	73,220	82,681	85,887	99,604
Canada	n.a.	11,382	n.a.	14,360
Latin American Republics	n.a.	8,334	n.a.	11,691
Europe	n.a.	26,261	n.a.	30,395
Japan	n.a.	7,287	n.a.	8,927
U.S. Destinations	n.a.	4,691	n.a.	4,701
All Other and Unallocated	n.a.	24,726	n.a.	29,530
Net Income	4,764	5,062	5,211	6,402
Nonmanufactured Products	442	421	411	480
Manufactured Products	4,322	4,651	4,800	5,923
Tax-deferred Income	2,352	1,572	1,519	2,071
Nonmanufactured Products	219	145	139	171
Manufactured Products	2,133	1,427	1,380	1,901
Total Assets, End of Year	11,832	14,678	15,955	19,725
Trade Receivables	7,491	8,840	10,162	12,416
Other Assets	4,341	5,838	5,793	7,309
Accumulated Income, End of Year	6,946	8,527	9,560	11,383

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1/ Statistics on DISC sales of nonmanufactured products, specifically agricultural products, exceed U.S. exports from all sources by a substantial margin because of inter-DISC sales. Therefore, gross receipts of nonmanufactured products overstate exports of these products.

n.a. -- not available

Table 5-2

Gross Receipts, Net Income and Tax-deferred Income by Accounting Period - DISC Year 1979
(Dollar Amounts in Millions)

Accounting Period Ending	Number of Returns	Gross Receipts	Net Income	Tax-deferred Income	Tax-deferred Income as a Percent of Net Income
All Returns	7,208	99,604	6,402.1	2,071.3	32.4
Full Year Returns, All Periods	6,768	98,420	6,333.5	2,402.9	32.3
July 1979	457	2,346	178.4	61.0	34.2
August 1979	271	948	72.9	24.9	34.2
September 1979	499	3,011	143.0	50.2	35.1
October 1979	420	4,262	321.8	104.8	32.6
November 1979	312	2,204	156.3	49.6	31.7
December 1979	1,527	28,072	1,998.5	636.9	31.9
January 1980	1,153	25,131	2,259.5	694.8	30.8
February 1980	273	5,180	336.9	114.0	33.8
March 1980	484	6,154	187.5	63.7	34.0
April 1980	365	3,009	211.0	77.1	36.5
May 1980	331	9,228	186.6	67.7	36.3
June 1980	676	9,056	280.0	98.4	35.1
Part Year Returns, All Periods	440	1,184	68.6	28.4	41.4

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Table 5-3

Gross Receipts, Net Income and Tax Deferred Income by Pricing Method - DISC Year 1979
(Dollar Amounts in Millions)

Pricing Method	Number of Returns	Gross Receipts	Net Income: Amount	Net Income: Percent of Gross Receipts	Tax-deferred Income
		All products			
All returns	7,208	99,604	6,402.1	6.4	2,071.3
Returns reporting pricing method	5,812	93,036	6,162.4	6.6	1,981.6
50-50 method	2,874	34,546	3,849.1	11.1	1,145.3
4 percent method	1,561	32,717	787.1	2.4	263.1
Arm's-length method	991	4,734	319.6	6.8	111.5
50-50 and 4 percent	375	19,246	1,512.7	7.9	445.1
All other combinations	11	1,843	53.9	2.9	16.4
Pricing method not determinable	1,396	6,518	239.6	3.7	89.7
		Nonmanufactured products			
All returns	934	26,038	478.9	1.8	170.6
Returns reporting pricing method	568	22,849	440.1	1.9	155.4
50-50 method	193	1,270	101.4	0.8	36.7
4 percent method	163	18,502	259.9	1.4	89.0
Arm's-length method	182	1,069	32.8	3.1	12.4
All combinations	30	2,008	46.1	2.3	17.4
Pricing method not determinable	366	3,188	41.9	1.3	15.2
		Manufactured products			
All returns	6,274	73,566	5,923.1	8.1	1,900.7
Returns reporting pricing method	5244	70,237	5,722.4	8.1	1,826.2
50-50 method	2,681	33,276	3,387.7	10.2	1,108.7
4 percent method	1,398	14,215	527.2	3.7	174.2
Arm's-length method	809	3,665	286.9	7.8	99.1
All combinations	356	19,080	1,520.6	8.0	444.2
Pricing method not determinable	1,030	3,329	200.8	6.0	74.4

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Balance Sheet Statistics

Table 5-4 presents year-end balance sheet statistics. Total assets of DISCs amounted to $19.7 billion, 2.3 percent higher than the previous year's figure. Of these assets, 63 percent consisted of trade receivables (accounts and notes receivable). The second largest asset item was producer's loans, which were 20 percent higher than in DISC year 1978. The category "other assets" increased by 42 percent between DISC year 1978 and 1979, after falling 23 percent the previous year. The next fastest growing category was Export-Import Bank obligations which grew 30 percent.

On the liabilities and capital side in the lower part of Table 5-4, the largest item was accumulated DISC income, amounting to $16.3 billion, 83 percent of the value of liabilities and stockholders' equity. The amount of accumulated DISC income was approximately equal to the difference between total reported DISC earnings of $30.9 billion through DISC year 1979, and total reported actual DISC distributions of $13.4 billion. 3/ Total actual DISC distributions through DISC year 1979 were $5.8 billion less than the amount deemed to have been distributed--and taxed--to shareholders. Retention of tax-paid earnings by DISCs presumably reflects the financial incentives involved, notably the favorable tax treatment of interest earned on qualified export receivables and other investments.

Income Statement Statistics 4/

Table 5-5 presents combined income statement statistics for all DISCs. While almost all of the qualified receipts of $34.4 billion consisted of receipts from the sale of export property, about $1 billion constituted receipts from other sources. The largest item in this latter category was interest income, amounting to almost $700 million.

3/ The difference between accumulated DISC income and total earnings less actual distributions is due to statistical and reporting errors.

4/ Note that, for income statement purposes, receipts include only the commissions in the case of goods sold on a commission basis.

Table 5-4

Balance Sheet Statistics - DISC year 1979
(Millions of Dollars)

	All Products
Total assets	19,725
Qualified assets, total	10,624
Working capital	460
Export-Import Bank obligations	1,200
Trade receivables	12,416
Export property	901
Producer's loans	3,031
Other	1,616
Nonqualified assets	101
Total liabilities and capital	19,725
Liabilities, total	3,201
Accounts payable	1,857
Other current liabilities	853
Mortages, notes, bonds payable in one year or more	177
Other liabilities	314
Capital accounts, total	16,524
Capital stock and paid-in surplus	186
Previously taxed income	4,954
Tax-deferred income	11,383

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Table 5-5

Income Statement Statistics

	Number of Returns	Amount (Millions)
Total receipts 1/	6,863	34,445
Qualified export receipts, total	6,853	34,325
Qualified receipts from property sales	6,497	33,300
Other qualified receipts	3,418	1,025
Leasing of export property	72	52
Services related to qualified exports	229	118
Engineering and architectural services	118	135
Qualified dividends	41	17
Interest on producer's loans	1,353	211
Other interest	2,189	470
Other qualified receipts	n.a.	23
Nonqualified receipts, total 2/	977	132
Total deductions	6,221	28,005
Cost of sales and operations	3,567	26,325
Export promotion expenses	3,568	1,016
Other expenses	5,577	714
Total receipts less total deductions	7,208	6,389
Net income	7,106	6,402
Tax deferred and taxable income	6,330	6,427
Total deemed distributions	6,315	4,360
Attributable to base period export gross receipts	1,309	1,895
All other deemed distributions	n.a.	2,465
Actual distributions	3,644	3,174

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1/ For income statement purposes receipts include only the commission earned on commission sales.

2/ Net of adjustments to income.

n.a. -- Not available.

As would be expected, the largest deduction was the $26.3 billion for cost of goods sold and cost of operations. The only other significant deduction was for export promotion expenses, amounting to just over $1 billion or one percent of the value of total DISC exports.

Audit Results

Substantial adjustments in DISC income were proposed in calendar year 1980 as a result of audit examinations. In total, DISC income was reduced by $312.7 million and the income of parents was increased by the same amount. Tax liabilities increased by about $70 million. Most of the proposed adjustments were for the years from 1974 to 1977. More than 70 percent of the reduction of DISC income was due to intercompany pricing adjustments. Apparently these were largely the result of the failure of parents and their DISCs to have explicit written agreements on their exact pricing rules. The only other significant reason for proposed adjustments to DISC income was the disallowance of DISC status because the corporation did not meet the 95 percent export assets test in section 993 of the Internal Revenue Code.

Appendix A -- Definitions and Sampling Procedure

Definitions

Unless otherwise indicated, the following definitions apply throughout this Report.

1. DISC gross receipts. Gross receipts of a DISC include the full value of goods and services sold on a commission basis. This item is reported on Schedule N, Part I, Section A, Column 2 of Form 1120-DISC. 1/

2. DISC net income. Net income of a DISC is gross receipts less costs and less deductions. It is reported on line 10 of page 1, Form 1120-DISC. Net income may be positive or negative. Of 7,208 DISC returns filed for DISC year 1979, only 748 showed net losses (i.e., negative net income).

3. DISC taxable income. Taxable income of a DISC is net income less net operating loss deduction and dividends-received deduction. It is reported on line 12 of page 1, Form 1120-DISC.

4. Tax-deferred income. The tax-deferred income of a DISC is the part of its taxable income which may be retained tax deferred by the DISC. It equals its taxable income less deemed distributions. For taxable years beginning before January 1, 1976, deemed distributions were the sum of (1) interest on producer's loans, (2) certain capital gains, (3) one half of the excess of taxable income over the sum of (1) and (2), and (4) foreign investment attributable to producer's loans for the taxable year. The Tax Reform Act of 1976 added several new types of deemed distributions and modified (3) above to conform. For taxable years beginning after December 31, 1975, deemed distributions were the sum of (1) adjusted taxable income attributable to base period export gross receipts; (2) interest on producer's loans; (3) certain capital gains; (4) one half of taxable income attributable to military sales; (5) one half of the excess of taxable income over the sum of (1), (2), (3), and (4); (6) income attributable to international boycott activity; (7) the amount of illegal bribes; and (8) foreign investment attributable to producer's loans for the taxable year. Total deemed distributions are reported on Schedule J, Part 1, line 17 of Form 1120-DISC.

1/ All references to Form 1120-DISC are to the 1978 form, which appears in Appendix D.

5. DISC year 1979. This is defined to cover accounting periods ended July 1, 1978, through June 30, 1979. DISC year 1979 corresponds to SOI year 1978 in the Internal Revenue Service publications on the Statistics of Income.

Sampling Procedure

The statistical estimates presented in this Report are based on a stratified random sample of DISC returns. All DISCs with net income of $51 million or more or with parent corporations having assets of $250 million or more were included in the sample (sampling rate of 100 percent). DISCs with less than $200,000 of net income and with parent corporations having assets of less than $50 million received prior to January 1980 were sampled at a 10 percent rate and those received after December 1979 were sampled at a 20 percent rate. The remaining DISCs were sampled at a 40 percent rate. DISCs owned by individuals or partnerships were sampled only according to the amount of their net income. A full description of the sampling procedure, together with additional information from DISC returns for the SOI year 1978, will appear in the forthcoming publication, Statistics of Income, Supplemental Report, Domestic International Sales Corporations.

Table A-1

Summary of Sampling Results

	Number of Returns	Gross Receipts ($ Millions)	Net Income ($ Millions)
All returns	7,208	99,604	6,402.1
Returns sampled at 100%	934	83,663	5,591.9
Returns sampled at less than 100%	6,274	15,941	810.2
Addendum			
Unweighted amounts for returns sampled at less than 100%	1,105	4,345	252.9

Office of the Secretary of the Treasury
Office of Tax Analysis

APPENDIX B

Review of the Limitations of the Methodology Used in Previous Reports to Estimate the DISC Effect on Exports

The methodology used in previous reports was described in detail in the 1975 DISC report. The estimated DISC effect was based on a comparison of the growth in non-DISC and DISC exports. The comparison required a complex sequence of statistical calculations. First, the growth rate of DISC exports over the most recent two years was computed from DISCs in operation for all of the current year which also reported exports for all of the previous year. Total current year DISC exports and the estimated growth rate in DISC exports were used to compute an "estimate" of total DISC exports in the previous year. Current year DISC exports were subtracted from current year aggregate exports to obtain non-DISC exports in the current year. Similarly, the "estimated" level of DISC exports in the previous year was subtracted from aggregate exports in the previous year to obtain non-DISC exports in the previous year. The growth in non-DISC exports was then calculated from these two successive levels of non-DISC exports.

Over the years, the following difficulties with the methodology became apparent:

1. The uncertain validity of non-DISC exports as a control group. Because of DISC's benefits, exporters would only fail to use a DISC under very special circumstances. One is where the firm has overall losses. Similarly, a firm which has overall profits may choose to put profitable exports through a DISC but leave any unprofitable exports outside. The export product may also fail the DISC requirement that it be "for direct use, consumption or disposition outside the United States." Electronic components which are exported for assembly and then reimported would be an example. It is very unclear whether goods exported under these very special circumstances should be expected to grow at the same rate as goods using DISC would have in the absence of DISC.

2. The failure to give recognition to the role of new DISCs. The incremental DISC effects were based on the growth of exports by DISCs which were in operation for all of the current year and also reported exports for all of the previous year. Some DISCs were therefore ignored in the first year of their existence, and all new exporters starting DISCs could be ignored for up to the first two years of their existence. The methodology also ignored DISCs which left the export business. The statistical problem is the familiar one of estimating rates of growth using a series of linked samples. The estimate may drift substantially from the true growth rate because of entry and exit.

3. The use of trade data originating from completely different data systems to compare the growth in DISC and non-DISC exports. DISC exports come from tax returns and are based on accounting entries. Aggregate exports are compiled by the Commerce Department from customs reports and are based on physical shipments. A serious effort was made to correct for timing differences. However, the hazards of using trade data from different sources are well known. For example, there are major discrepancies in the exports reported by one country and the imports reported by the receiving country

4. The sensitivity of the estimates to errors in the trade data. The methodology tended to accentuate the effect of data errors. Consider, for example, an error overstating the growth in DISC exports. Because non-DISC exports are derived by subtracting DISC exports from total exports, this error would lead to an understatement in the growth of non-DISC exports. The estimated difference in the growth of DISC and non-DISC exports would therefore have two errors in the same direction, because of the overstatement in DISC and the understatement in non-DISC. This problem was recognized and adjustments were made in certain cases, but substantial errors may still remain.

5. The erratic pattern of the estimates based on the methodology. The final overall DISC effect in recent years was the net result of large positive and negative effects in various individual products. The pattern did not seem to be the result of product classification errors. They may have been due to random fluctuations, but this suggests that the overall estimate was still highly unreliable.

APPENDIX C: Information Used to Estimate DISC Effect

Table C-1

Elasticities of Export Demand and Supply
Assumed in Each Major Category

Product Category	Supply Elasticity	Demand Elasticity (absolute value)
1. Nonmanufactured Products	1.5-2.5	Infinite
2. Basic Manufactures	20	6-8
3. High Technology Manufactures	20	3-5
4. Resource Related Manufactures	4	8-10

Office of the Secretary of the Treasury
Office of Tax Analysis

Table C-2

Specific Products in Each Major Category

1. All Nonmanufactured Products

2. Basic Manufactured Products

Textile mill products
Apparel
Furniture and fixtures
Printing and publishing
Rubber and miscellaneous plastic products
Leather and leather products
Stone, clay, and glass products
Iron and steel industries
Fabricated metal products
Transportation equipment except aircraft
Nonelectrical machinery other than office
Machinery, engines and turbines, and special industry machinery
Miscellaneous manufactures

3. High Technology Manufactures

Chemicals and allied products
Electrical machinery and equipment
Aircraft and parts
Professional and scientific instruments
Ordnance
Office machinery
Special industry machinery

4. Resource Related Manufactures

Food and kindred products
Tobacco manufactures
Paper and allied products
Lumber
Primary nonferrous metals
Petroleum and related products

Form **1120-DISC**
Department of the Treasury
Internal Revenue Service

Domestic International Sales Corporation Return

(PLEASE TYPE OR PRINT)

1978

For calendar year 1978 or other taxable year beginning , 1978, ending , 19

A Date of DISC election	Name	C Employer identification number
	Number and street	D Date incorporated
B Business code number (See page 8 of instructions)	City or town, State, and ZIP code	E Enter total assets from line 3, column (B), Schedule L (see instruction L) $

F Did any corporation, individual, partnership, trust or estate at the end of your taxable year own, directly or indirectly, 50% or more of your voting stock? . . . . . Yes ☐ No ☐

If "Yes," enter below the owner's name, address, identifying number, percentage of voting stock owned and, if a corporation, total assets. (See General Instruction Q)

Name	Identifying number	Address	Percentage of voting stock owned	Total assets (Corporations only)	Foreign owner Yes	Foreign owner No

G Indicate by placing an "X" in the appropriate box(es) the inter-company pricing rule or rules which were applied to 25% or more of total receipts (line 4, page 1).
☐ 50–50 combined taxable income method, ☐ 4% gross receipts method, ☐ Section 482 method ("arm's length pricing")

All Computations Must Reflect Inter-Company Pricing Rules Under Section 994 If Used (See Schedule P (Form 1120–DISC))

Gross Income

1 Qualified export receipts from the sale of export property (line 1(c) column E, Schedule B) . . . . .
2 Other qualified export receipts: (line 2(j) column E, Schedule B) . . . . .
3 Nonqualified gross receipts: (line 3(g) column E, Schedule B) . . . . .
4 Total of lines 1, 2, and 3 . . . . .
5 Subtract: Cost of goods sold (line 7, Schedule A) and/or operations (attach schedule) . . . . .
6 Total income . . . . .

Deductions

7 Export promotion expenses: (line 1(o), Schedule E) . . . . .
8 Other expenses not deducted above: (line 2(h), Schedule E) . . . . .
9 Total deductions (add lines 7 and 8) . . . . .

Computation of Taxable Income

10 Taxable income before net operating loss deduction and dividends-received deduction (subtract line 9 from line 6) .
11 Subtract: (a) Net operating loss deduction (see instructions—attach schedule) . . .
(b) Dividends-received deduction (line 2, Schedule I) . . . . .
12 Taxable income (subtract line 11 from line 10) . . . . .
13 Refund of U.S. tax on special fuel, nonhighway gas, and lubricating oil (attach Form 4136) . . . . .

Please Sign Here

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Signature of officer Date Title

Paid Preparer's Information	Preparer's signature	Preparer's social security no.	Check if self-employed ☐
	Firm's name (or yours, if self-employed), address and ZIP code	E.I. No.	
		Date	

Schedule A Cost of Goods Sold (See instructions for Schedule A)
Reflect ACTUAL purchases from a related supplier at the transfer price determined under the inter-company pricing rules of section 994, if used. See Schedule P (Form 1120-DISC).

1 Inventory at the beginning of the year	
2 Purchases	
3 Salaries and wages	
4 Other costs (attach schedule)	
5 Total	
6 Less: Inventory at the end of the year	
7 Cost of goods sold—Enter here and on line 5, page 1	

8 (a) Check valuation method(s) used for total closing inventory:
☐ Cost
☐ Lower of cost or market
☐ Other (attach explanation)

(b) Check if this is the first year LIFO inventory method was adopted and used ☐
If checked, attach Form 970.

(c) If the LIFO inventory method was used for this taxable year, enter percentage (or amounts) of closing inventory computed under LIFO

(d) Was there any substantial change in determining quantities, cost, or valuations between opening and closing inventory? ☐ Yes ☐ No
If "Yes," attach explanation.

Schedule B Gross Income (See instructions for Schedule B)

A. Type of receipt	Commission sales		D. Other receipts	E. Total (add columns C and D)
	B. Gross receipts	C. Commission		
1 Qualified export receipts from the sale of export property:				
(a) To unrelated purchasers:				
(i) Direct foreign sales				
(ii) Foreign sales through a related foreign entity				
(iii) To persons in the U.S. (other than an unrelated DISC)				
(iv) To an unrelated DISC				
(b) To related purchasers:				
(i) Direct foreign sales				
(ii) To persons in the U.S.				
(c) Total—Enter amount in column E on line 1, page 1				
2 Other qualified export receipts:				
(a) Leasing or renting of export property				
(b) Services related and subsidiary to a qualified export sale or lease				
(c) Engineering and architectural services				
(d) Export management services				
(e) Qualified dividends (line 10, Schedule C)				
(f) Interest on producer's loans				
(g) Other interest (attach schedule)				
(h) Capital gain net income (Attach Schedule D (Form 1120))				
(i) Ordinary gain or (loss) from Part II, Form 4797 (attach Form 4797, see instructions)				
(j) Total—Enter amount in column E on line 2, page 1				
3 Nonqualified gross receipts:				
(a) Ultimate use in U.S.				
(b) Exports subsidized by the U.S. Government (see instructions)				
(c) Certain direct or indirect sales or leases for use by the U.S. Government				
(d) Sales to other DISCs in the same controlled group				
(e) Nonqualified dividends (line 11, Schedule C)				
(f) Other (see instructions—attach schedule)				
(g) Total—Enter amount in column E on line 3, page 1				
4 Total—Enter amount in column E on line 4, page 1				

Schedule C Dividends (See instructions for Schedule C)

1 Domestic corporations subject to the 85% deduction	
2 Certain preferred stock of public utilities	
3 Foreign corporations subject to the 85% deduction	
4 Dividends from wholly-owned foreign subsidiaries subject to the 100% deduction (section 245(b))	
5 Other dividends from foreign corporations	
6 Includable income from controlled foreign corporations under subpart F (attach Forms 3646)	
7 Taxable dividends from a DISC or former DISC not included in line 1 (section 246(d))	
8 Other dividends	
9 Total (add lines 1 through 8)	
10 Subtract: Qualified dividends—Enter the qualified dividends here and on line 2(e), column D, Schedule B	
11 Nonqualified dividends—Enter here and on line 3(e), column D, Schedule B	

Schedule E Deductions (See instructions for Schedule E)

1 Export promotion expenses:	
(a) Market studies	
(b) Advertising	
(c) Depreciation (attach Form 4562)	
(d) Salaries and wages	
(e) Rents	
(f) Sales commissions	
(g) Warehousing	
(h) Freight (excluding insurance—see instructions)	
(i) Compensation of officers	
(j) Repairs (see instructions)	
(k) Amortization (attach schedule)	
(l) Pension, profit-sharing, etc. plans (see instructions) (enter number of plans ► ....)	
(m) Employee benefit programs	
(n) Other (list):	
(o) Total (add lines 1(a) through 1(n))—Enter here and on line 7, page 1	
2 Other expenses not deducted above:	
(a) Bad debts (Schedule F if reserve method is used)	
(b) Taxes	
(c) Interest	
(d) Contributions (not over 5% of line 12, page 1 adjusted per instructions—attach schedule)	
(e) Freight	
(f) Freight insurance	
(g) Other (attach schedule)	
(h) Total (add lines 2(a) through 2(g))—Enter here and on line 8, page 1	

Schedule F Bad Debts—Reserve Method

1. Year	2. Trade notes and accounts receivable outstanding at the end of the year	3. Sales on account	Amount added to the reserve		6. Amount charged against the reserve	7. Reserve for bad debts at the end of the year
			4. Current year's provision	5. Recoveries		
1973						
1974						
1975						
1976						
1977						
1978						

Schedule I Dividends-received Deduction (See instructions for Schedule I)

1 (a) 85% of line 1, Schedule C	
(b) 60.208% of line 2, Schedule C	
(c) 85% of line 3, Schedule C	
(d) 100% of line 4, Schedule C	
2 Total—See instructions for limitation. Enter here and on line 11(b), page 1	

Schedule J Deemed and Actual Distributions to Shareholders for the Taxable Year (See instructions for Schedule J)

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

1 Gross interest derived during the year from producer's loans (section 995(b)(1)(A))	
2 Gain recognized on the sale or exchange of property (section 995(b)(1)(B)) (see instructions—attach schedule)	
3 Gain recognized on the sale or exchange of property (section 995(b)(1)(C)) (see instructions—attach schedule)	
4 50% of taxable income attributable to military property (section 995(b)(1)(D)) (see instructions—attach schedule)	
5 Total of lines 1, 2, 3, and 4	
6 Taxable income (line 12, page 1)	
7 Adjusted taxable income (subtract line 5 from line 6) (enter here and on line 1, Part II)	
8 Taxable income attributable to base period export gross receipts (section 995(b)(1)(E)) (from line 22, Part II)	
9 Subtract line 8 from line 7 (enter zero if less than zero)	
10 50% of line 9 (section 995(b)(1)(F)(i))	
11 International boycott income (section 995(b)(1)(F)(ii)) (see instructions)	
12 Amount of illegal bribes and other payments (section 995(b)(1)(F)(iii)) (see instructions)	
13 Total of lines 5, 8, 10, 11, and 12	
14 Earnings and profits for year (see instructions—attach schedule)	
15 Enter the smaller of line 13 or line 14 (but not less than zero)	
16 Foreign investment attributable to producer's loans (section 995(b)(1)(G)) (see instructions—attach schedule)	
17 Total deemed distributions under section 995(b)(1) (add lines 15 and 16)	

PART II.—Computation of Taxable Income Attributable to Base Period Export Gross Receipts

1 Adjusted taxable income (from line 7, Part I)	
2 Enter the larger of (a) 365 divided by the number of days in your taxable year or (b) 1 (one)	
3 Annualized adjusted taxable income (line 1 times line 2)	
4 Annualized adjusted taxable income of all other DISCs in your controlled group (see instructions for exceptions)	
5 Line 3 plus line 4 (if $100,000 or less see instructions)	

6 Taxable years beginning in 1972, 1973, 1974, and 1975 (use a separate line for each full or part year, starting with the earliest):

A. Beginning of year (month, day, year)	B. End of year (month, day, year)	C. Qualified export receipts as described in Sections 993(a)(1)(A), (B), (C), (G), and (H) (see instructions for certain exclusions)	D. 50 percent of qualified export receipts in column C attributable to military property
(a)			
(b)			
(c)			
(d)			
(e)			
(f) Totals (add lines (a) through (e))			

(g) Base period export gross receipts (subtract Column 6D, line (f) from Column 6C, line (f))	
7 Enter the smaller of (a) 1,461 divided by the number of days in your base period or (b) 1 (one)	
8 Line 6(g) times line 7	
9 Adjustment factor	.1675
10 Adjusted base period export gross receipts (line 8 times line 9)	
11 Additions to adjusted base period export gross receipts:	
(a) Adjusted base period export gross receipts of all other DISCs in your controlled group	
(b) Other additions (attach schedule—see instructions)	
(c) Total additions (line 11(a) plus line 11(b))	
12 Line 10 plus line 11(c)	
13 (a) Qualified export receipts as described in sections 993(a)(1)(A), (B), (C), (G), and (H). (Add the amounts from Schedule B, Columns B and D, lines 1(c), 2(a), 2(b), 2(c), and 2(d))	
(b) 50 percent of qualified export receipts on line 13(a) attributable to military property	
(c) Export gross receipts (subtract line 13(b) from line 13(a))	
14 Annualized export gross receipts (line 2 times line 13(c))	
15 Annualized export gross receipts of all other DISCs in your controlled group	
16 Line 14 plus line 15	
17 Enter the smaller of (a) line 12 divided by line 16 or (b) 1 (one)	
18 Line 5 times line 17	
19 Small DISC phaseout:	
(a) Enter the greater of (a) $150,000 less line 5 (but not more than $50,000) or (b) zero	
(b) Line 19(a) times 2 (two)	
20 Subtract line 19(b) from line 18 (enter zero if less than zero)	
21 Line 1 divided by line 5	
22 Taxable income attributable to base period export gross receipts (line 20 times line 21) (enter here and on line 8, Part I)	

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

1 Annual installment of distribution attributable to revocation of election in a prior year	
2 Annual installment of distribution attributable to a failure to qualify as a DISC in a prior year	
3 Total deemed distributions under section 995(b)(2) (add line 1 and line 2)	

PART IV.—Actual Distributions

1 Distributions to meet qualification requirements under section 992(c) (attach computation)		
2 Other actual distributions		
3 Total of line 1 and line 2		
4 Amount on line 3 treated as distributed out of:		
(a) Previously taxed income		
(b) Accumulated DISC income (including DISC income of the current year)		
(c) Other earnings and profits		
(d) Other		

Schedule K Shareholder's Statement of DISC Distribution
(Attach a separate Copy A, Schedule K (Form 1120-DISC) for each shareholder receiving a deemed or actual distribution. Give Copy B to the shareholder. See instructions on the back of Copy C.)

Additional Information Required

	Yes	No
H Did you claim a deduction for expenses connected with:		
(1) Entertainment facility (boat, resort, ranch, etc.)?		
(2) Living accommodations (except employees on business)?		
(3) Employees' families at conventions or meetings?		
If "Yes," were any of these conventions or meetings outside the United States or its possessions?		
(4) Employee or family vacations not reported on Form W-2?		
I Enter total amount claimed on Form 1120-DISC for entertainment, entertainment facilities, gifts, travel, and conventions of the type for which substantiation is required under section 274(d) of the Internal Revenue Code. (See instruction S.) ▶ $		
J Refer to page 8 of the instructions and state the principal:		
Business activity ▶		
Product or service ▶		
K Were you a U.S. shareholder of any controlled foreign corporation?		
(See sections 951 and 957.) If "Yes," attach Form 3646 (and Form 2952 where appropriate) for each corporation.		
L Did you file all required Forms 1087, 1096, and 1099?		
M (1) Did 95% or more of your gross receipts for the taxable year consist of qualified export receipts (as defined in section 993(a))?		
(2) Did the adjusted basis of your qualified export assets (as defined in section 993(b)) at the close of the taxable year equal or exceed 95% of the sum of the adjusted basis of all your assets at the close of the taxable year?		
(3) If the answer to (1) or (2) is "No," did you make a pro rata distribution of property as defined in section 992(c)?		
N (1) Did you have more than one class of stock at any time during the taxable year?		
(2) Was the par or stated value of your stock at least $2,500 on each day (for a new corporation, on the last day for making an election and for each succeeding day) of the taxable year?		
O Are you a member of a controlled group that includes other DISCs?		
If "Yes," (1) Report in Part II, Section B of Schedule N the names, addresses, and employer identification numbers of the DISCs. (2) State the name and employer identification number of the DISC in your controlled group completing Columns 3 and 4 of Part I, Sections A and B of Schedule N. See specific instruction B, Schedule N (Form 1120-DISC).		
Name ▶		
Employer identification number ▶		
P Did you have your own bank account?		
Q Did you maintain separate books and records?		
R Did you, at any time during the taxable year, have an interest in or signature or other authority over a bank, securities, or other financial account in a foreign country?		
If "Yes," see instruction R.		
S Were you the grantor of, or transferor to, a foreign trust during any taxable year, which foreign trust was in being during the current taxable year, whether or not you have any beneficial interest in such trust?		
If "Yes," you may be required to file Forms 3520, 3520-A, or 926.		

Schedule L Balance Sheets

		(A) Beginning of the taxable year	(B) End of the taxable year
Assets	1 Qualified assets:		
	(a) Working capital (cash and necessary temporary investments)		
	(b) Funds awaiting investment (cash in U.S. banks in excess of working capital needs to acquire other qualified export assets)		
	(c) Export-Import Bank obligations		
	(d) Trade receivables (accounts and notes receivable)		
	(i) Subtract allowance for bad debts	( )	( )
	(e) Export property (net) (including inventory and qualified property held for lease)		
	(f) Producer's loans		
	(g) Investment in related foreign export corporations		
	(h) Depreciable assets		
	(i) Subtract accumulated depreciation	( )	( )
	(i) Other (attach schedule)		
	2 Nonqualified assets (net) (list):		
	3 Total assets		
Liabilities and Stockholders' Equity	4 Accounts payable		
	5 Other current liabilities (attach schedule)		
	6 Mortgages, notes, bonds payable in 1 year or more		
	7 Other liabilities (attach schedule)		
	8 Capital stock		
	9 Paid-in or capital surplus		
	10 Other earnings and profits		
	11 Previously taxed income (sec. 996(f)(2))		
	12 Accumulated DISC income		
	13 Less cost of treasury stock	( )	( )
	14 Total liabilities and stockholders' equity		

Schedule M-1 Reconciliation of Income per Books With Income per Return

1 Net income per books		6 Income recorded on books this year not included in this return (itemize)	
2 Excess of capital losses over capital gains			
3 Taxable income not recorded on books this year (itemize)		7 Deductions in this return not charged against book income this year (itemize)	
4 Expenses recorded on books this year not deducted in this return (itemize)			
		8 Total of lines 6 and 7	
5 Total of lines 1 through 4		9 Income (line 10, page 1) (line 5 less line 8)	

Schedule M-2 Analysis of Other Earnings and Profits (Line 10 above)

1 Balance at the beginning of the year		5 Distributions to qualify under sec. 992(c)	
2 Increases (itemize)		6 Other decreases (itemize)	
3 Total of lines 1 and 2		7 Total of lines 4, 5, and 6	
4 Deficit in earnings and profits		8 Balance at end of year (line 3 less line 7)	

Schedule M-3 Analysis of Previously Taxed Income (Line 11 above)

1 Balance at the beginning of the year		5 Deficit in earnings and profits	
2 Deemed distributions under section 995(b)		6 Distributions to qualify under sec. 992(c)	
3 Other increases (itemize)		7 Other decreases (itemize)	
		8 Total of lines 5, 6, and 7	
4 Total of lines 1, 2, and 3		9 Balance at end of year (line 4 less line 8)	

Schedule M-4 Analysis of Accumulated DISC Income (Line 12 above)

1 Balance at the beginning of the year		6 Distributions to qualify under sec. 992(c)	
2 Increases (itemize)		7 Distributions upon disqualification (sec. 995(b)(2))	
		8 Other decreases (itemize)	
3 Total of lines 1 and 2			
4 Deficit in earnings and profits		9 Total of lines 4 through 8	
5 Redemptions under section 996(d)		10 Balance at end of year (line 3 less line 9)	

Schedule N Export Gross Receipts of the DISC and Related U.S. Persons (Attach separate Schedule N (Form 1120–DISC))

Schedule P Computation of Inter-company Transfer Price or Commission (Attach separate Schedule P (Form 1120–DISC))

1978 Department of the Treasury Internal Revenue Service

Instructions for Form 1120-DISC

Domestic International Sales Corporation Return

(References are to the Internal Revenue Code)

Sec. 992. Requirements of a DISC

(a). General rule.—A DISC is a corporation that is incorporated under the laws of any State or the District of Columbia and satisfies the following conditions for the taxable year:

(1) 95% or more of its gross receipts (as defined in section 993(f)) consists of qualified export receipts (as defined in section 993(a));

(2) the adjusted basis of its qualified export assets (as defined in section 993(b)) at the end of the taxable year equals or exceeds 95% of the sum of the adjusted basis of all its assets at the end of the taxable year;

(3) it does not have more than one class of stock and the par or stated value of its outstanding stock is at least $2,500 on each day (for a new corporation, on the last day for making an election and for each succeeding day) of the taxable year;

(4) it has made an election to be treated as a DISC and the election is in effect for the taxable year;

(5) it has its own bank account on each day of the taxable year (for exceptions see section 1.992–1(i) of the regulations) and maintains separate books and records; and

(6) it is not an ineligible corporation.

(b). Election.—An election by an existing corporation to be treated as a DISC for a taxable year must be made at any time during the 90-day period immediately preceding the beginning of the taxable year and by a new corporation within 90 days after the beginning of the first taxable year.

In general, the election will be valid only if all persons who are shareholders in the corporation on the first day of the first taxable year for which the election is effective consent to the election. (See Form 4876, Election to be Treated as a DISC.)

An election may be terminated by a revocation of the election for any taxable year after the first taxable year for which the election is effective if made at any time during the first 90 days of the taxable year (or for the taxable year following the taxable year in which made, if made after the close of such 90 days).

The election will be terminated by the continued failure of the corporation to be a DISC for each of any 5 consecutive taxable years for which an election is effective.

(c). Distributions to meet qualification requirements.—A corporation that for a taxable year does not satisfy the gross receipts or qualified export assets conditions will be deemed to satisfy the conditions for the taxable year if it makes a pro rata distribution of property after the close of the taxable year to its shareholders (designated at the time of the distribution as a distribution to meet qualification requirements) with respect to their stock in an amount which is equal to (1) the portion of its taxable income attributable to its gross receipts that are not qualified export receipts if it fails the gross receipts condition, (2) the fair market value of those assets that are not qualified export assets on the last day of the taxable year if the qualified export assets condition is not met, and (3) the sum of (1) and (2) if neither condition is met.

See section 992(c)(2) for reasonable cause for failure to make distributions to meet qualification requirements and section 992(c)(3) for distributions made within 8½ months after the close of the taxable year.

For computation of deficiency distributions to meet qualification requirements, see section 1.992–3 of the regulations.

A DISC that makes a deficiency distribution after the 15th day of the ninth month following the close of its taxable year must pay an "interest" charge for the amount to qualify as a deficiency distribution. The "interest" charge is 4½% per each taxable year of the DISC beginning after the taxable year to which the deficiency distribution relates until the date of the distribution times the amount of the deficiency distribution.

The DISC must pay this "interest" charge within 30 days of the distribution to the Internal Revenue Service Center where it filed its Form 1120–DISC. When submitting payment, the DISC should give its name, address, employer identification number, the taxable year to which the distribution relates, and state that the amount submitted is the "interest" charge imposed by regulation section 1.992–3(c)(4).

(d). Ineligible corporations.—The following corporations are not eligible for DISC treatment:

(1) a corporation exempt from tax under section 501,

(2) a personal holding company as defined in section 542,

(3) a financial institution to which section 581 or 593 applies,

(4) an insurance company subject to the tax imposed by subchapter L,

(5) a regulated investment company as defined in section 851(a), or

(6) an electing small business corporation as defined in section 1371(b).

(e). Restrictions on DISCs and DISC corporate stockholders.—For any taxable year in which a corporation is a DISC or in which at any time it owns, directly or indirectly, stock in a DISC or former DISC, such corporation is not allowed to take the Western Hemisphere Trade Corporation deduction (section 922), and is not entitled to the benefits of section 936.

Sec. 993. Definitions

(a). Qualified export receipts.—Except as provided by regulations under section 993(a)(2), qualified export receipts of a corporation are:

(1) gross receipts from the sale, exchange, or other disposition of export property;

(2) gross receipts from the lease or rental of export property that is used by the lessee of the property outside the U.S.;

(3) gross receipts for services that are related and subsidiary to any qualified sale, exchange, lease, rental, or other disposition of export property by the corporation;

(4) gain from the sale, exchange, or other disposition of qualified export assets (other than export property);

(5) dividends (or amounts includible in gross income under section 951) with respect to stock of a related foreign export corporation;

(6) interest on any obligation that is a qualified export asset;

(7) gross receipts for engineering or architectural services for construction projects located (or proposed for location) outside the U.S.; and

(8) gross receipts for the performance of managerial services in furtherance of the production of other qualified export receipts of a DISC.

(b). Qualified export assets.—Qualified export assets of a corporation are:

(1) export property;

(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 as described in section 993(a)(1)(G) or managerial services in the furtherance of the production of qualified export receipts as described in section 993(a)(1)(A), (B), (C), and (G);

(3) accounts receivable and evidences of indebtedness that arise by reason of transactions described in section 993(a)(1)(A), (B), (C), (D), (G), or (H);

(4) money, bank deposits, and other similar temporary investments that are reasonably necessary to meet the working capital requirements of the corporation;

(5) obligations arising in connection with a producer's loan;

(6) stock or securities of a related foreign export corporation;

(7) certain obligations issued, guaranteed, or insured, in whole or in part, by the Export-Import Bank of the U.S. or the Foreign Credit Insurance Association in those cases where the obligations are acquired from the bank or association or from the seller or purchaser of the goods or services from which the obligations arose;

(8) certain obligations issued by a domestic corporation organized solely for the purpose of financing sales of export property pursuant to an agreement with the Export-Import Bank of the U.S. under which the corporation makes export loans guaranteed by the bank; and

(9) amounts (other than reasonable working capital) on deposit in the U.S. that are utilized during the period provided by regulations to acquire other qualified export assets.

(c). Export property.—Export property is property (except property excluded under section 993(c)(2) and property in short supply):

(1) manufactured, produced, grown, or extracted in the U.S. by a person other than a DISC;

(2) held primarily for sale, lease, or rental in the ordinary course of trade or business, by, or to, a DISC, for direct use, consumption, or disposition outside the U.S.;

(3) whose fair market value is not more than 50% attributable to articles imported into the U.S.; and

(4) not sold or leased (i) by a DISC, or with a DISC as commission agent, to another DISC that is a member of the same controlled group (as defined in section 993(a)(3)) as the DISC or (ii) by any person to a Western Hemisphere trade corporation (as defined in section 921) that is 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 a transaction with respect to the seller, lessor, or commission agent.

(d). Producer's loans.—An obligation subject to the rules provided in section 993(d)(2) and (3) will be treated as arising out of a producer's loan if:

(1) the loan, when added to the unpaid balance of all other producer's loans made by the DISC, does not exceed the accumulated DISC income at the beginning of the month in which the loan was made;

(2) the obligation is evidenced by a note (or other evidence of indebtedness) with a stated maturity date not more than 5 years from the date of the loan;

(3) the loan is made to a person engaged in the U.S. in the manufacturing, production, growing, or extraction of export property; and

(4) it is designated as a producer's loan at the time of the loan.

(e). Related foreign export corporation.—A DISC may acquire and receive income in the form of dividends and interest from the following investments that are related to exports from the U.S.

Foreign international sales corporation (FISC).—A foreign corporation is a related foreign export corporation if:

(1) stock possessing more than 50% of the total combined voting power of all classes of stock entitled to vote is owned directly by the DISC;

(2) 95% or more of the foreign corporation's gross receipts for its taxable year ending with or within the taxable year of the DISC consists of qualified export receipts described in section 993(a)(1)(A) through (D) and interest on any obligation described in section 993(b)(3) and (4); and

(3) the adjusted basis of the qualified export assets held by the foreign corporation at the close of the taxable year equals or exceeds 95% of the sum of the adjusted basis of all assets held by it at the close of the taxable year.

Real property holding company.—A foreign corporation is a related foreign export corporation if:

(1) stock possessing more than 50% of the total combined voting power of all classes of stock entitled to vote is owned directly by the DISC, and

(2) its exclusive function is to hold title to real property for the exclusive use (under a lease or otherwise) of the DISC because of a requirement of applicable foreign law that the DISC cannot hold title.

Associated foreign corporation.—A foreign corporation is a related foreign export corporation if:

(1) less than 10% of the total combined voting power of all classes of the foreign corporation's stock entitled to vote is owned (within the meaning of section 1563(d) and (e)) by the DISC or by a controlled group of corporations (within the meaning of section 1563) of which the DISC is a member, and

(2) the ownership of stock and securities in the foreign corporation by the DISC is determined to be reasonably in furtherance of a transaction or transactions giving rise to qualified export receipts of the DISC.

(f). Gross receipts.—The term gross receipts means the total receipts from the sale, lease, or rental of property held primarily for sale, lease, or rental in the ordinary course of a trade or business and gross income from all other sources.

In the case of commissions on the sale, lease, or rental of property, the amount taken into account will be the gross receipts on the sale, lease, or rental of the property on which the commissions arose.

(g). United States.—U.S. includes the Commonwealth of Puerto Rico and the possessions of the U.S.

Sec. 994. Inter-Company Pricing Rules

In the case of a sale of export property to a DISC by a person described in section 482, the taxable income of the DISC and the other person may be based upon a transfer price which would allow the DISC to derive taxable income attributable to the sale (regardless of the sales price actually charged) in an amount which does not exceed the greatest of:

(1) 4% of the qualified export receipts on the sale of the property by the DISC plus 10% of the export promotion expenses of the DISC attributable to the receipts,

(2) 50% of the combined taxable income of the DISC and the person which is attributable to the qualified export receipts on the property derived as the result of a sale by the DISC plus 10% of the export promotion expenses of the DISC attributable to the receipts, or

(3) taxable income based upon the sale price actually charged (subject to the rules provided in section 482).

Note: Generally, inter-company pricing rules (1) and (2) above will not permit the related person to price at a loss. See Schedule P (Form 1120–DISC).

Export promotion expenses are those expenses incurred to advance the distribution or sale of export property for use, consumption, or distribution outside the U.S. but do not include income tax. They include freight expenses to the extent of 50% of the cost of shipping export property aboard airplanes owned and operated by U.S. persons or ships documented under the laws of the U.S. in those cases where law or regulations do not require that the property be shipped aboard such airplanes or ships.

General Instructions

A. Corporations required to file Form 1120–DISC.—Form 1120–DISC must be filed by a domestic corporation that has elected to be treated as a DISC and has satisfied the requirements under section 992 for treatment as a DISC for the taxable year.

A "former DISC" (as defined in section 992(a)(3)), in addition to filing any other return required, must file Form 1120–DISC, and clearly mark that it is filing as a former DISC. The former DISC need not complete those items pertaining to the computation of taxable income, but must complete Schedules J, K, L, and M (Form 1120–DISC).

B. Where to file.—

If the principal business, office, or agency is located in	Use the following Internal Revenue Service Center address
New Jersey, New York City and counties of Nassau, Rockland, Suffolk, and Westchester	Holtsville, NY 00501

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New York (all other counties), Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, Vermont	Andover, MA	05501
Alabama, Florida, Georgia, Mississippi, South Carolina	Atlanta, GA	31101
Michigan, Ohio	Cincinnati, OH	45999
Arkansas, Kansas, Louisiana, New Mexico, Oklahoma, Texas	Austin, TX	73301
Alaska, Arizona, Colorado, Idaho, Minnesota, Montana, Nebraska, Nevada, North Dakota, Oregon, South Dakota, Utah, Washington, Wyoming	Ogden, UT	84201
Illinois, Iowa, Missouri, Wisconsin	Kansas City, MO	64999
California, Hawaii	Fresno, CA	93888
Indiana, Kentucky, North Carolina, Tennessee, Virginia, West Virginia	Memphis, TN	37501
Delaware, District of Columbia, Maryland, Pennsylvania	Philadelphia, PA	19255

The separate income tax returns of a group of Corporations located in several Service Center regions may be filed with the Service Center for the area in which the principal office of the managing corporation that keeps all the books and records is located.

C. When to file.—Form 1120–DISC must be filed on or before the 15th day of the 9th month following the close of the taxable year.

No extension of time to file will be granted.

D. Period to be covered by the 1978 return.—The 1978 return is to be filed for calendar year 1978 and fiscal years beginning in 1978 and ending in 1979. If the return is for a fiscal year, fill in the taxable year space on the form.

Final return.—If the corporation ceases to exist, write "FINAL RETURN" at the top of the form.

E. Change in accounting period.—To change an accounting period, see section 1.442–1 of the regulations and Form 1128, Application for Change in Accounting Period.

F. Accounting methods.—A DISC may, generally, choose any method of accounting permissible under section 446(c) and the regulations thereunder. However, if a DISC is a member of a controlled group (as defined in section 993(a)(3)), the DISC may not choose a method of accounting that, when applied to transactions between the DISC and other members of the controlled group, will result in a material distortion of the income of the DISC or any other member of the controlled group. A material distortion would occur, for example, if a DISC chooses to use the cash method of accounting where the DISC acts as a commission agent in a substantial volume of sales of property by a related corporation that uses the accrual method of accounting and customarily pays commissions to the DISC more than 2 months after the sales.

Unless the law specifically permits, you may not change the method of accounting used to report income in prior years (for income as a whole or for any material item) without first obtaining consent on Form 3115, Application for Change in Accounting Method.

Rounding off to whole-dollar amounts.—Money items may be shown as whole-dollar amounts by dropping any amount less than 50 cents and increasing any amount from 50 cents through 99 cents to the next higher dollar.

G. Stock ownership in foreign corporations.—If you owned 5% or more in value of the outstanding stock of a foreign personal holding company, attach the statement required by section 551(c).

If you control a foreign corporation or were a 10% or more shareholder of a controlled foreign corporation, you may be required to file Forms 2952 and 3646.

H. Financial statements.—The balance sheets must agree with your books and records. Any differences must be reconciled.

I. Attachments.—If more space is needed on forms or schedules, attach separate sheets. Attach schedules in alphabetical order and forms in numerical order to the back of Form 1120–DISC. Be sure to put the taxpayer's name and employer identification number on these separate sheets.

J. Amended return.—Correct any error in a previously filed return by filing an amended Form 1120–DISC.

K. Signature.—The return must be signed and dated by the president, vice president, treasurer, assistant treasurer, chief accounting officer, or by any other corporate officer (such as tax officer) authorized to sign.

A receiver, trustee, or assignee must sign any return that he is required to file on behalf of a corporation.

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

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

When more than one person prepares Form 1120–DISC, the preparer with primary responsibility for the overall accuracy of the return must sign as the preparer.

If the preparer is self-employed (i.e., is not employed by any person or business entity to prepare the return), he or she should check the "SE" box.

If you have questions about whether a preparer is required to sign Form 1120–DISC, please contact an IRS office.

The person required to sign the return MUST:

—Sign it, by hand, in the space provided for the preparer's signature (signature stamps or labels are not acceptable);

—Give a copy of Form 1120–DISC to the taxpayer in addition to the copy filed with IRS.

Publication 1054 is a guide listing some of the preparer's responsibilities and penalties for which he or she may be liable. The publication also contains the regulation citations which govern their work. Tax return preparers should be familiar with their responsibilities. This publication is available at IRS offices.

L. Total assets.—If there are no assets at the end of the taxable year, enter the total assets at the beginning of the taxable year.

M. Penalty for failure to file returns and provide information.—A penalty is imposed by section 6686 (in addition to the penalty imposed by section 7203) on any person required to supply information or file a return who fails to supply information or file a return at the time prescribed or who files a return that does not show the information required.

Unless it is shown that the failure is due to reasonable cause, the penalty is (1) $100 for each failure to supply information (the total amount imposed for all failures during any calendar year will not exceed $25,000) or (2) $1,000 for each failure to file a return.

N. Taxation of a DISC.—A DISC is not subject to any tax imposed by sections 1 through 1564 except for the tax imposed by sections 1491 through 1494 on certain transfers to avoid tax.

A DISC is not subject to the corporate income tax, the minimum tax on tax preferences, or the accumulated earnings tax.

A DISC is subject to the provisions of sections 1441 through 1461 relating to withholding of tax on nonresident aliens and foreign corporations.

O. Investment credit and work incentive (WIN) credit.—The investment credit and the work incentive (WIN) credit do not apply to a DISC and they do not pass through to any shareholder in a DISC.

P. Nonresident alien individuals and foreign corporations, trusts, and estates.—Treat all gains on the disposition of stock in a DISC or former DISC and all distributions out of accumulated DISC income, including deemed distributions, as effectively connected with the conduct of a trade or business conducted through a permanent establishment within the U.S.

Q. Stock ownership.—For rules of stock attribution, see section 267(c). If the owner of the voting stock of the DISC was an alien individual or a foreign entity (corporation, partnership, trust, or estate), so indicate by placing an X in 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.

R. Foreign financial accounts and foreign trusts.—If at any time during the taxable year, you had an interest in or signature or other authority over a bank account, securities account, or other financial account in a foreign country, check the Yes box for question R. However, you should check the No box if the combined assets in the account(s) were $1,000 or less during the entire year, or were with a U.S. military banking facility operated by a U.S. financial institution.

If you own more than 50 percent of the stock in any corporation that owns one or more foreign bank accounts, you must check the Yes box for question R. Get Forms 90–22.1 to see if you are considered to have an interest in, or signature or other authority over a bank, security, or other financial account in a foreign country.

If you checked Yes for question R, file Form 90–22.1. You can get this form from many IRS offices. File the completed form by June 30, 1979, with the Department of the Treasury, P.O. Box 28309, Central Station, Washington, DC 20005. Do not file it with the IRS, it is not a tax return.

If you were a grantor of, or transferor to a foreign trust, which was in being during the tax year, check the Yes box for question S.

S. Travel and entertainment (section 274(d).—(See Form 1120–DISC question I, page 5.) The amount required to be entered is the total amount expended during the year for entertainment, entertainment facilities, gifts, travel, and conventions for which substantiation would be required under section 274(d).

Expenditures paid or incurred in years prior to taxable years beginning in 1978 but not deducted in those years are not required to be included in the total (i.e., expenditures reflected in beginning inventories, capitalized expenditures subject to depreciation, etc.). However, expenditures paid or incurred in tax years beginning in 1978 that are included in the cost of inventory, merchandise purchased for resale, or capitalized in asset accounts, etc., should be reported in the total as if they were fully deducted on the return even though all or a portion of such expenditures are included in ending inventory, asset accounts, etc.

Do not include amounts treated as compensation and reported on Forms W–2.

See regulations section 1.274–5 for definitions and rules governing the types of expenses for which substantiation is required and therefore reportable in question I.

See Form 1120–FY (1978–79) for rules regarding the deduction of travel and entertainment expenses for fiscal year DISCs.

Specific Instructions

(Numbered to correspond with the line numbers on page 1 of the return.)

5. Cost of goods sold.—Enter the amount shown on line 7, Schedule A.

Cost of operations (where inventories are not an income-determining factor).—If the amount entered on line 5 includes an amount applicable to cost of operations, attach a schedule showing (1) salaries and wages and (2) other costs in detail.

Computation of Taxable Income

11(a). Net operating loss deduction.—The "net operating loss deduction" is the sum of the net operating loss carryovers and carrybacks to the taxable year. (Section 172(a).)

A net operating loss may be carried back to each of the 3 years preceding the year of each loss and carried over to each of the 7 years following the year of such loss; or, an election may be made whereby a net operating loss may be carried over to each of the 7 years following the year of such loss. After applying the net operating loss to the initial year, the portion of the loss that may be carried to each of the remaining taxable years is the excess, if any, of the loss over the sum of the taxable income for each of the prior taxable years to which the loss may be carried. (Section 172(b).)

The term "net operating loss" means the excess of allowable deductions over gross income, computed with the following modifications under section 172(d):

(1) No net operating loss deduction is allowed.

(2) The dividends-received deduction in line 1 of Schedule I is computed without regard to the 85% limitation provided in section 246(b). See section 1.172–2 of the regulations.

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

(1) first, to other earnings and profits, to the extent thereof;

(2) second, to accumulated DISC income, to the extent thereof; and

(3) finally, to previously taxed income,

except that a deficit in earnings and profits will not be applied against accumulated DISC income which has been determined is to be deemed distributed to the shareholders (pursuant to section 995(b)(2)(A)) as a result of a revocation of election or other disqualification.

In determining the taxable income that must be subtracted from a net operating loss to determine the portion of the loss that will still be available to carry to a subsequent year, the net operating loss deduction is determined without regard to the net operating loss for the loss year or any taxable year thereafter, and, under certain circumstances, without regard to any portion of a net operating loss attributable to a foreign expropriation loss.

12. Taxable income.—If either the gross receipts method or combined taxable income method is chosen for computing the taxable income of the DISC attributable to a transaction or group of transactions consisting of products or product lines, attach a Schedule P (Form 1120–DISC) showing, in detail, the computation of the DISC's taxable income attributable to each such transaction or group of transactions.

Schedule A.—Cost of goods sold

If inter-company pricing rules are used, reflect in Schedule A actual purchases from a related supplier at the transfer price determined under the inter-company pricing rules of section 994. See Schedule P (Form 1120–DISC).

Where the DISC acts as a commission agent on a sale for any person, do not enter any amount in Schedule A for such sale. See Schedule P (Form 1120–DISC).

The method of valuing inventories may not be changed without permission. Application for permission to change must be made on Form 3115. Check method(s) used for valuing closing inventories on line 8(a).

If this is the first year the "Last-in First-out" (LIFO) inventory method provided in section 472 was adopted and used, attach Form 970 or a statement with the information required by Form 970 to Form 1120–DISC and check the LIFO box in line 8(b). Enter the amount or percent (estimates may be used) of total closing inventories covered under section 472 in line 8(c).

Schedule B.—Gross Income

(Numbered to correspond with the line numbers in Schedule B.)

Enter gross income in lines 1 through 3 categorized as either (1) qualified export receipts from the sale of export property, (2) other qualified export receipts, or (3) nonqualified gross receipts. If an income item consists of two or more categories, report each on the applicable line. For example, if interest income consists of qualified interest from a foreign international sales corporation and nonqualified interest from a domestic obligation, enter the qualified interest on an attached schedule for line 2(g) and the nonqualified interest on an attached schedule for line 3(f).

Special rule when the DISC acts as a commission agent.—For commissions on the sale, lease, or rental of property, or the furnishing of services, list in column B the gross receipts on the sale, lease, or rental of property, or the furnishing of services on which the commissions arose and in column C the commissions earned. Receipts from non-commission sales, leases, rentals, or the furnishing of services and all other receipts should be reported on the appropriate lines in column D. Column E is the sum of commissions reported in Column C and receipts from

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non-commission sales, leases, or rentals and all other receipts reported in column D.

See instructions for lines 2(h) and 2(i) for details regarding the reporting of gains from sale of qualified export assets.

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

1. Qualified export receipts from the sale of export property.—These are receipts from the sale of property, such as inventory, produced in the U.S. for direct use, consumption, or disposition outside the U.S.

For a sale to meet the export requirement, it must meet (1) a destination test and (2) a requirement that the sale not be for ultimate use in the U.S.

The destination test will be considered satisfied if the property is delivered (regardless of the F.O.B. point or the place at which title passes or risk of loss shifts from the seller or lessor):

(a) Within the U.S. to a carrier or freight forwarder for ultimate delivery outside the U.S. to a purchaser or lessee (or to a subsequent purchaser or sublessee);

(b) Within the U.S. to a purchaser or lessee, if the property is ultimately delivered outside the U.S. (including delivery to a carrier or freight forwarder for delivery outside the U.S.) by the purchaser or lessee (or a subsequent purchaser or sublessee) within one year after the sale or lease;

(c) Within or outside the U.S. to a purchaser or lessee that, at the time of the sale or lease, is a DISC and is not a member of the same controlled group (as defined in section 993(a)(3)) as the seller or lessor;

(d) From the U.S. to the purchaser or lessee (or a subsequent purchaser or sublessee) at a point outside the U.S. by means of the seller's or lessor's own ship, aircraft, or other delivery vehicle;

(e) Outside the U.S. to a purchaser or lessee from a warehouse, a storage facility, or assembly site located outside the U.S., if the property was previously shipped by the seller or lessor from the U.S.; or

(f) Outside the U.S. to a purchaser or lessee if the property was previously shipped by the seller or lessor from the U.S. and if the property is located outside the U.S. pursuant to a prior lease by the seller or lessor, and either (a) the prior lease terminated at the expiration of its term (or by the action of the prior lessee acting alone), (b) the sale occurred or the term of the subsequent lease began after the time at which the term of the prior lease would have expired, or (3) 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).

The second part of the export requirement for sales is that the sale must not be for ultimate use in the U.S. This test is applied at the time of the sale. If the property is to be used predominantly outside the U.S., the sale is not for ultimate use in the U.S.

Property sold to an unrelated person is considered sold for ultimate use in the U.S. if it is sold pursuant to an agreement or understanding that it will be used in the U.S. or if a reasonable person would have believed that it will be used in the U.S.

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.

Special rules apply in the case of certain exported components incorporated into products imported into the U.S.

In general, related purchasers are purchasing corporations that are members of the same controlled group (as defined in section 993(a)(3)) as the DISC. Unrelated purchasers are all other purchasers.

1(a).—Enter the DISC's qualified export receipts (other than those entered on line 1(b)) from sales of export property to foreign unrelated purchasers for delivery outside the U.S.

1(b).—Enter the DISC's qualified export receipts from sales of export property for delivery outside the U.S. to (i) a related foreign entity for resale (directly or indirectly) to a foreign unrelated purchaser, or (ii) an unrelated purchaser where a related foreign entity acts as commission agent. A related foreign entity is a foreign corporation that is a member of the same controlled group (as defined in section 993(a)(3)) as the DISC.

2(a). Leasing of export property.—Enter the gross amount received from the leasing (including subleasing) of export property to unrelated persons for use outside the U.S.

Whether the leased property satisfies the usage test is to be determined on a year-by-year basis.

The receipts from a lease of export property may qualify in some years and not in other years depending upon the place where the lessee uses the property in the years involved.

Deduct expenses such as repairs, interest, taxes, and depreciation on the proper lines for such deductions.

2(b). Services related and subsidiary to a qualified export sale or lease.—A service is related to a sale or lease if it is of a kind customarily and usually furnished with that type of transaction in a trade or business in which the transaction arose and if the agreement to furnish the services is connected with the sale or lease. A service is subsidiary if it is of less importance and value as compared to the sale or lease.

2(c). Engineering and architectural services.—Receipts from engineering or architectural services on foreign construction projects which are either located abroad or proposed for location abroad are qualified receipts. They include feasibility studies, design and engineering, and general supervision of construction but do not include services connected with exploration for minerals.

2(d). Export management services.—Include receipts for export management services provided to unrelated DISCs.

2(f). Interest on producer's loans.—A producer's loan must be evidenced by a note or other evidence of indebtedness, be designated as a producer's loan, have a stated maturity not to exceed 5 years, and be attributable to the borrower's assets used in exporting and research and development.

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

Include, for example, interest on accounts receivable arising out of sales in which the 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.

2(h). Capital gain net income.—Every sale or exchange of a capital asset must be reported in detail on a separate Schedule D (Form 1120) even though no gain or loss is indicated.

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

2(i). Ordinary gain or (loss).—Enter the total ordinary gain or loss from line 11, Part II, Form 4797.

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

3(b). Exports subsidized by the U.S. Government.—Enter receipts from the sale of products subsidized under a program of the U.S. Government, or any instrumentality thereof, that have been designated as excluded receipts.

3(c). Certain direct or indirect sales or leases for use by the U.S. Government.—Enter receipts from direct or indirect sales or leases of property or services for use by the U.S. Government, or any instrumentality thereof, where the use of U.S. products or services is required by statute or regulations.

3(d). Sales to another DISC in the same controlled group.—Enter receipts from a DISC that is a member of the same controlled group of corporations.

See section 993(a)(3) for the definition of controlled group.

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

Schedule C.—Dividends

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

1. Enter dividends received from domestic corporations subject to income tax and the 85% deduction under section 243(a)(1).

Include on this line taxable distributions received from a DISC or former DISC that are designated as being eligible for the 85% dividends-received deduction.

For dividends received from a regulated investment company, see section 854 for the amount subject to the 85% deduction.

So-called dividends or earnings received from mutual savings banks, etc., are really interest and should not be treated as dividends.

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

3. Enter dividends received from foreign corporations that qualify for the 85% deduction provided in section 245(a).

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

5. Enter foreign dividends (including minimum distributions under subpart F) that are not reportable on lines 3 and 4. Exclude distributions of amounts constructively taxed in the current year or in prior years under subpart F.

6. Include income constructively received from controlled foreign corporations under subpart F. This amount should equal the total of amounts reported in Schedule A, line 5 of Form(s) 3646.

7. Enter taxable distributions from a DISC or former DISC that are designated as not being eligible for the 85% dividends-received deduction. (See sections 246(d), 995(b), and 996(a)(3).)

8. Include dividends (other than capital gain dividends) received from regulated investment companies that are not subject to the 85% deduction; dividends from tax-exempt organizations; dividends (other than capital gain dividends) received from a real estate investment trust which, for the taxable year of the trust in which the dividends are paid, qualifies under sections 856 through 858; dividends not eligible for a dividends-received deduction because of the holding period of the stock or an obligation to make corresponding payments with respect to similar stock; and any other taxable dividend income not properly reported above.

10. Enter dividends (and income constructively received from controlled foreign corporations under subpart F) from a qualified foreign investment of a DISC in a related foreign export corporation which constitute qualified dividends. Generally, the investment will be in stock or securities of a foreign selling subsidiary of the DISC which qualifies as a foreign international sales corporation (FISC).

Schedule E.—Deductions

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

Enter export promotion expenses in line 1. Export promotion expenses are a DISC's ordinary and necessary expenses paid or incurred to obtain qualified export receipts (but do not include income taxes). Any expense (or any part of an expense) not incurred to obtain qualified export receipts should be entered in line 2.

1(c). Depreciation.—Attach Form 4562 if you claim a deduction for depreciation. Enter on this line the depreciation not claimed in Schedule A and elsewhere on the return.

1(h). Freight.—Enter one-half of the freight expenses (not including insurance) for shipping export property aboard U.S. flag vessels and U.S. owned and operated aircraft (unless required by law).

1(i). Compensation of officers.—Attach a schedule showing the name, social security number, amount of compensation, and expense account allowance for your 6 highest paid officers.

To determine the highest paid officers, add all allowances, including expense account allowances, to each officer's compensation. Expense account allowance means (1) amounts, other than compensation, received as advances or reimbursements and (2) amounts paid by or for the corporation for expenses incurred by or on behalf of an officer. The expense account allowance does not have to be shown for any officer for whom the combined compensation and expense account allowance is less than $30,000.

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

1(j). Repairs.—Enter the cost of incidental repairs, such as labor and supplies, that do not add to the value or appreciably prolong the life of the property. Include on this line the total amount of repairs figured under the Class Life Asset Depreciation Range (CLADR) System.

1(k). Amortization.—If a deduction for amortization is claimed, attach a schedule showing: (1) a description of the expenditures being amortized; (2) date acquired, completed, or expended; (3) amount being amortized; (4) amortization deducted in prior years; (5) amortization period (number of months); (6) amortization for this year; and (7) the total amount of amortization less the amount claimed in Schedule A and elsewhere on the return.

1(l). Pension, profit-sharing, etc. plans.—The number of plans to be entered refers to all plans for which all assets have not been distributed. Also include any plans in which assets were distributed in the current year. The number of plans must be indicated whether or not a deduction is claimed. Complete Form 5500 for each plan and file each as a separate return. Complete Form 5500–C in lieu of Form 5500 if there were fewer than 100 participants at the beginning of the plan year. See instructions for above forms for computation of the amount of allowable deduction. File these forms on or before the last day of the 7th month following the close of the plan year.

Caution: *ERISA imposes penalties for failure to furnish complete information and failure to file statements, returns and reports.*

1(m). Employee benefit programs.—Enter the amount of your contributions to employee benefit programs (e.g. insurance, health and welfare programs) that are not an incidental part of a pension, profit-sharing, etc., plan included on line 1(l). Also include contributions to a qualified group legal services plan. Section 120 imposes certain rules on an employer which will permit employees (including spouses and dependents) to exclude from income employer contributions to a qualified group legal services plan.

2(a). Bad debts.—Bad debts may be treated in either of two ways—(i) as a deduction for debts that become worthless in whole or in part, or (ii) as a deduction for a reasonable addition to a reserve for bad debts. (Section 166.)

Application to change the method of computing bad debts must be made on Form 3115.

2(b). Taxes.—Enter taxes paid or accrued during the taxable year.

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

2(c). Interest.—Do not include interest on indebtedness incurred or continued to purchase or carry obligations on which the interest is wholly exempt from income tax. (Section 265.)

See section 267 for the limitation on deductions for unpaid expenses and interest in transactions between related taxpayers.

See section 461(g) for limitation on deduction for prepaid interest by a cash basis taxpayer.

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

The total amount claimed may not exceed 5% of taxable income (line 12 of page 1) computed without regard to (1) any deduction for contributions, (2) the dividends-received deduction on line 11(b) of page 1, (3) deductions allowed under sections 249 and 250, (4) any net operating loss carryback to the taxable year under section 172, and (5) any capital loss carryback to the taxable year under section 1212(a)(1).

Charitable contributions in excess of the 5% limitation may not be deducted for the taxable year but may be carried over to the next 5 taxable years.

A contribution carryover is not allowed to the extent that it increases a net operating loss carryover. See section 170(d)(2)(B).

Corporations on the accrual basis may elect to deduct contributions paid on or before the 15th day of the 3d month following the close of the taxable year if the contributions are authorized by the board of directors during the taxable year. A declaration, signed by an officer, stating that the resolution authorizing the contributions was adopted by the board of directors during the taxable year, and a copy of the resolution, must both be attached to the return.

Attach a schedule showing the name of each organization and the amount paid. If a contribution is made in property other than money, describe the kind of property contributed and the method used in determining its fair market value. If a contribution carryover is included, show the amount and how it was determined.

Special rule for contributions of certain property.—If a charitable contribution of property is made, the contribution must be reduced by the sum of

(1) the ordinary income and

(2) for certain contributions, 62½% (60.870% for gifts made after December 31, 1978) of the long-term capital gain,

that would have resulted if the property were sold at its fair market value. The reduction for 62½% (60.870% for gifts made after December 31, 1978) of the long-term capital gain applies to (1) contributions of tangible personal property for use by an exempt organization for a purpose or function unrelated to the basis for its exemption, and (2) contributions of any property to or for the use of certain private foundations. (Section 170(e).) However, a charitable contribution of inventory and property described in section 1221(1) and (2), to an exempt organization described in section 501(c)(3) for use in the care of the ill, needy, or children may be deducted to the extent of basis plus one-half of appreciation of such property, but in no event may the deduction exceed twice the basis for such property. (Section 170(e).)

Bargain sale to a charitable organization.—If a charitable contribution deduction for property sold to a charitable organization is claimed, the adjusted basis for determining gain from the sale is an amount which is in the same ratio to the adjusted basis as the amount realized is to the fair market value of the property.

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

2(g). Other.—No deduction is allowable for any amount allocable to a class of exempt income. Items directly attributable to wholly exempt income must be allocated to such income, and items directly attributable to any class of taxable income must be allocated to such taxable income.

If an item is indirectly attributable both to taxable income and exempt income, a reasonable proportion of the item, determined in the light of all the facts and circumstances in each case, must be allocated to each.

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

Schedule I.—Dividends-received deduction

1. In general, no dividends-received deduction will be allowed on any share of stock (a) that is disposed of before the corporation has held it 15 days or less or (b) to the extent the corporation is under an obligation to make corresponding payments with respect to substantially identical stock or securities.

No deduction is allowed under section 243 for a dividend from a DISC or former DISC (as defined in section 992(a)) to the extent it is paid out of accumulated DISC income or previously taxed income or is a deemed distribution pursuant to section 995(b)(1).

2. Limitation on dividends-received deduction.—Line 2 may not exceed 85% of line 10, page 1.

For this purpose, line 10 is to be computed without regard to any capital loss carryback to the taxable year under section 1212(a)(1).

In a year in which a net operating loss occurs, sections 172(d) and 246(b) provide that this 85% limitation does not apply even if the loss is created by the dividends-received deduction.

3. Fiscal year DISCs that have received dividends on certain preferred stock of public utilities must use Form 1120–FY (1978–79) to compute their dividends-received deduction.

Schedule J.—Deemed and Actual Distributions to Shareholders for the Taxable Year

Part I.—Deemed distributions under section 995(b)(1) (Numbered to correspond with the line numbers in Part I of Schedule J.)

2. Attach a computation showing the gain recognized by the DISC during the taxable year on the sale or exchange of property, other than property which in the hands of the DISC is a qualified export asset, previously transferred to it in a transaction in which gain was not recognized in whole or in part, but only to the extent that the transferor's gain on the previous transfer was not recognized.

3. Attach a computation showing the gain (other than the gain entered on line 2) recognized by the DISC during the taxable year on the sale or exchange of property (other than property which in the hands of the DISC is stock in trade or other property described in section 1221(1)) previously transferred to it in a transaction in which gain was not recognized in whole or in part, but only to the extent that the transferor's gain on the previous transfer was not recognized and would have been treated as ordinary income if the property had been sold or exchanged rather than transferred to the DISC.

4. For purposes of computing the portion of taxable income attributable to military property use the gross income for the year attributable to military property and the deductions which are properly apportioned or allocated to such income. See section 38 of the International Security Assistance and Arms Export Control Act of 1976 (22 USC 2778) and regulations thereunder (22 CFR 121.01) for definition of "military property."

11. Under section 995(b)(1)(F)(ii), a DISC is deemed to distribute the entire amount of its income attributable to participation in or cooperation with an international boycott. See Form 5713 for computation of this deemed distribution and reporting requirements of any DISC with operations in or related to a "boycotting" country.

12. Under section 995(b)(1)(F)(iii), a DISC is deemed to distribute the amount of any illegal bribe, kickback or other payment paid by or on behalf of the DISC, directly or indirectly, to an official, employee or agent of any government.

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

For purposes of computing the earnings and profits for taxable years beginning after June 30, 1972, the allowance for depreciation (and amortization, if any) is the amount which would be allowable for such year if the straight line method of depreciation had been used for each taxable year beginning after June 30, 1972. See section 312(k)(2) for exception.

16. Attach a computation showing the amount of (1) foreign investment attributable to producer's loans (as defined in section 995(d)) of the DISC for the taxable year; (2) all accumulated earnings and profits including earnings and profits for the taxable year less the amount on line 15, Part I; and (3) accumulated DISC income. Enter the smaller of these 3 amounts (but not less than zero) on line 16.

Foreign investment attributable to producer's loans will be the smallest of these 3:

(1) the net increase in foreign assets by members of the controlled group (as defined in section 993(a)(3)) that includes the DISC,

(2) the actual foreign investment by domestic members of the group, or

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

For the definitions of "net increase in foreign assets" and "actual foreign investment," see sections 995(d)(2) and 995(d)(3).

Part II.—Computation of Taxable Income Attributable to Base Period Export Gross Receipts

(Numbered to correspond with the line numbers in Part II of Schedule J.)

4. Include the annualized taxable income but no taxable losses incurred by any DISC which is a member of your controlled group (as defined in section 993(a)(3)) for the latest taxable year ending with or within your taxable year.

5. If this amount is $100,000 or less, omit lines 6 through 21 and enter zero on line 22 and on line 8, Part I.

6. Column C.—Generally, if export property does not qualify in the current year under 993(c)(2) as giving rise to export gross receipts, then the gross receipts from such property should be excluded in computing the export gross receipts for the base period.

However, if, by virtue of section 603(b)(2) of the Tax Reduction Act of 1975, export property qualifies in the current year as giving rise to export gross receipts, then the DISC must increase its export gross receipts for the base period. See section 1101(g)(5) of of the Tax Reform Act of 1976 for computation to be used.

Note: *Enter gross receipts, not just commissions, in the case of transactions made on a commission basis.*

11b. Additions must be made to base period export gross receipts in certain cases where there has been a separation in ownership of the stock in the DISC from ownership in the underlying trade or business which produced the export gross receipts during the base period, and in cases where any 5% or more shareholder owned 5% or more of the stock of another DISC in any base period year. (See sections 995(e)(9) and 995(e)(10).)

15. Include on this line the annualized export gross receipts of all DISCs which are members of your controlled group (as defined in section 993(a)(3)) for their latest taxable year ending with or within your taxable year.

Part III.—Deemed distribution under section 995(b)(2)

A shareholder of a corporation that revoked its election to be treated as a DISC or failed to qualify as a DISC for a taxable year will be deemed to have received a distribution taxable as a dividend equal to his pro rata share of the DISC income of the corporation accumulated during the immediately preceding consecutive taxable years for which the corporation was a DISC. The distributions will be deemed to be received in equal installments on the last day of each of the 10 taxable years of the corporation following the year of the termination or disqualification (but in no case over more than twice the number of immediately preceding consecutive taxable years during which the corporation was a DISC).

Schedule K.—Shareholder's Statement of DISC Distribution

Attach a separate Copy A, Schedule K (Form 1120–DISC) to Form 1120–DISC for each shareholder who had an actual or deemed distribution during the DISC's taxable year.

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

Complete and attach Schedule N (Form 1120–DISC) to Form 1120–DISC.

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

Attach a separate Schedule P (Form 1120–DISC) for each transaction or group of transactions to which the inter-company pricing rules of section 994 (a)(1) and (2) are applied.

Codes for Principal Business Activity

These industry titles and definitions are based, in general, on the Enterprise Standard Industrial Classification system developed by the Office of Management and Budget, Executive Office of the President, to classify enterprises by type of activity in which they are engaged. The system follows closely the Standard Industrial Classification used to classify establishments. However, certain activities such as manufacturing, do not apply to a DISC.

Using the list below, enter on page 1, under B, the code number for the specific industry group from which the largest percentage of "total receipts" is derived. "Total receipts" means all income (line 4, page 1). On page 5, question J, state the principal business activity and principal product or service that account for the largest percentage of total receipts. For example, if the principal business activity is "Wholesale trade: Machinery, equipment, and supplies," the principal product or service may be "Engines and turbines."

TRANSPORTATION, COMMUNICATION, ELECTRIC, GAS, AND SANITARY SERVICES

Code

Transportation:
4400 Water transportation
4700 Other transportation services

Electric, gas, and sanitary services:
4910 Electric services
4920 Gas production and distribution
4930 Combination utility services

WHOLESALE TRADE

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

Code

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

RETAIL TRADE

Building materials, hardware, garden supply, and mobile home dealers:
5220 Building materials dealers
5251 Hardware stores
5265 Garden supplies and mobile home dealers
5300 General merchandise stores
5410 Grocery stores
5490 Other food stores

Automotive dealers and service stations:
5515 Motor vehicle dealers
5541 Gasoline service stations
5598 Other automotive dealers

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

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

FINANCE, INSURANCE, AND REAL ESTATE

Credit agencies other than banks:
6199 Other credit agencies

SERVICES

Business services:
7389 Export management services

Auto repair and services; miscellaneous repair services:
7500 Lease or rental of motor vehicles

Amusement and recreation services:
7812 Motion picture production, distribution, and services

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

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SCHEDULE N
(Form 1120–DISC)
Department of the Treasury
Internal Revenue Service

Export Gross Receipts of the DISC and Related U.S. Persons

▶ See separate instructions.
▶ Attach this schedule to Form 1120–DISC.

1978

Name as shown on Form 1120–DISC

Employer identification number

Export gross receipts of the DISC by product code (See specific instruction A)

Product code number	Percent of export gross receipts

Part I

Section A.—Export Gross Receipts in the Current Year by Country (See specific instruction B)

1 Country of ultimate destination (Use one line for each country)	2 Export gross receipts of the DISC	Export gross receipts of related U.S. persons	
		3 Related DISCs	4 All other related U.S. persons
United States (including Puerto Rico and U.S. possessions) .			
Totals . . . . ▶			

Section B.—Export Gross Receipts in Preceding Years (See specific instruction B for adjustments due to changes to the definition of qualified export gross receipts)

1 Taxable year of the DISC (Use a separate line for each taxable year of the DISC, starting with the first preceding year. Include all taxable years beginning on or after January 1, 1972)		2 Export gross receipts of the DISC	Export gross receipts of related U.S. persons	
(a) Beginning of year (month, day, year)	(b) End of year (month, day, year)		3 Related DISCs	4 All other related U.S. persons

Part II

Section A.—Related U.S. Persons, Except DISCs, in Your Controlled Group (Attach additional copies of this schedule if necessary)

Name	Address	Identifying number

Section B.—DISCs in Your Controlled Group

Name	Address	Emp. ident. no.

1978 Department of the Treasury
Internal Revenue Service

Instructions for Schedule N (Form 1120-DISC)
Export Gross Receipts of the DISC and Related U.S. Persons

(References are to the Internal Revenue Code)

General Instructions

1. Purpose of Schedule N (Form 1120-DISC).—This schedule must be completed and attached to Form 1120-DISC to report:

(a) export gross receipts of the DISC by product code;

(b) export gross receipts of the DISC and related U.S. persons in the current year by country;

(c) export gross receipts of the DISC and related U.S. persons in preceding years; and

(d) the name, address, and identifying number of related U.S. persons.

If the lines on this schedule are not sufficient, attach additional copies of Schedule N.

2. Export Gross Receipts.—These are receipts from:

(a) the sale for direct use, consumption, or disposition outside the U.S. of property (such as inventory) produced in the U.S.;

(b) the lease or rental of such property to unrelated persons for use outside the U.S.;

(c) services related and subsidiary to a sale described in (a), or a lease or rental described in (b);

(d) engineering or architectural services for construction projects outside the U.S.; and

(e) export management services.

In the case of commission sales, "export gross receipts" include the total receipts on which the commission was earned. (See section 995(e)(4).)

Note: For purposes of Schedule N only, no reduction is to be made for receipts attributable to military property. Therefore, a DISC's "export gross receipts" for purposes of Schedule N should be taken from line 13(a), Part II, Schedule J (Form 1120-DISC 1978) for the current taxable year; from line 13(a), Part II, Schedule J (Form 1120-DISC 1977) for taxable years beginning in 1977; from line 13(a), Part II, Schedule J (Form 1120-DISC 1976) for taxable years beginning in 1976; and from column C, lines 6(a) through 6(e), Part II, Schedule J (Form 1120-DISC 1978) for taxable years beginning in 1972 through 1975.

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

4. Geographic Source of Export Gross Receipts.—The geographic source of export gross receipts from the sale of property is the country of ultimate destination of the property, or the country in which the property is consumed or further processed to the best of the DISC's knowledge. However, all receipts from sales by a DISC to a second DISC have the U.S. as their geographic source for purposes of Schedule N, regardless of the disposition of the property by the second DISC. For non-DISC related U.S. persons, all receipts from sales to or through a related or unrelated DISC, and from sales of property ultimately destined for the U.S., are to be excluded from "export gross receipts" and therefore not reported on Schedule N.

The geographic source of export gross receipts from the lease or rental of property is the country in which the property is located.

The geographic source of gross receipts from the provision of services is the country in which the purchaser is located.

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

(a) an individual, partnership, trust, or estate which controls the DISC;

(b) a corporation which controls, or is controlled by the DISC; and

(c) a corporation which is controlled by the same person or persons who control the DISC.

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

6. U.S. Person.—A "U.S. person" is:

(a) a citizen or resident of the U.S.;

(b) a domestic corporation or partnership; or

(c) any estate or trust (other than a foreign estate or trust, within the meaning of section 7701(a)(31)).

Specific Instructions

A. Export Gross Receipts of the DISC by Product Code.—Product code numbers and percentages of export gross receipts are reported in the information block in the upper righthand corner of page 1, Schedule N. Using the product code system on page 2 of these instructions, enter the code number for the major product or service (as measured by export gross receipts) sold or provided by the DISC in the first column of the first line of the information block. Enter the percentage of total export gross receipts accounted for by this product or service in the second column of the first line. Enter the same information on the second line for the next largest product or service (as measured by export gross receipts) sold or provided by the DISC.

Example: A DISC has export gross receipts of $10 million. The sale of agricultural chemicals accounts for $4.5 million (45%) of that amount, the largest product or service sold or provided by the DISC. The number "287" (the product code for agricultural chemicals) should be entered in the first column, and 45% in the second column of the first line. The sale of industrial chemicals accounts for $2 million (20% of $10 million), the second largest product or service sold or provided by the DISC. The number "281" (the product code for industrial chemicals) should be entered in the first column and 20% in the second column of the second line.

B. Part I.—If two or more DISCs are related persons, only the DISC with the largest export gross receipts should complete columns 3 and 4 in Sections A and B. All DISCs should complete columns 1 and 2 in both Sections.

Period for which Information is to be Furnished for Related U.S. Persons.—Furnish the information required in columns 3 and 4 for the related DISCs' and other related U.S. persons' annual accounting periods ending with or within the DISC's taxable year.

Section A—Export Gross Receipts in the Current Year by Country.—The receipts from any transaction should be reported only in one column. If a DISC acts as a commission agent for a related person, the total amount of the transaction should be attributed to the DISC.

(1) Column 2—Export gross receipts of the DISC.—Complete column 2 to report the geographic source of the DISC's export gross receipts from all souces (including the U.S.) for the taxable year.

(2) Column 3—Export gross receipts of related DISC's.—Complete column 3 to report the geographic source of all related DISCs' export gross receipts from all sources (including the U.S.).

(3) Column 4—Export gross receipts of all other related U.S. persons.—Complete column 4 to report the geographic source of all other related U.S. persons' export gross receipts from all sources except the U.S.

Section B—Export Gross Receipts in Preceding Years.—Complete Part I, Section B to report the export gross receipts of the DISC, all related DISCs and all other related U.S. persons for each taxable year of the DISC beginning on or after January 1, 1972.

If any of the prior year DISC export gross receipts were adjusted to exclude gross receipts from property which does not currently qualify as export property under section 993(c)(2), attach a schedule showing the amount of the adjustment for each year for each DISC in the related group. Include the adjustments for each year in the export gross receipts of the "all other related U.S. persons" (column 4) as if the export had not originally been made through the DISC.

C. Part II.—Report the name, address, and identifying number of related U.S. persons in your controlled group on Schedule N, page 2.

Product Code System

(These codes are to be used only with Schedule N (Form 1120–DISC)).

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

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

NONMANUFACTURED PRODUCT GROUPS AND SERVICES

Code

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

MANUFACTURED PRODUCT GROUPS

Ordnance and accessories:

191 Guns, howitzers, mortars, and related equipment.
192 Ammunition, except for small arms.
193 Tanks and tank components.
194 Sighting and fire control equipment.
195 Small arms.
196 Small arms ammunition.
199 Ordnance and accessories, not elsewhere classified.

Food and kindred products:

201 Meat products.
202 Dairy products.
203 Canned and preserved fruits, vegetables and seafoods.
204 Grain mill products.
205 Bakery products.
206 Sugar.
207 Confectionery and related products.
208 Beverages.
209 Miscellaneous food preparations and kindred products.

Tobacco manufactures:

211 Cigarettes.
212 Cigars.
213 Tobacco (chewing and smoking) and snuff.
214 Tobacco stemming and redrying.

Textile mill products:

221 Broad woven fabric mills, cotton.
222 Broad woven fabric mills, manmade fiber and silk.
223 Broad woven fabric mills, wool (including dyeing and finishing).
224 Narrow fabrics and other smallwares mills: cotton, wool, silk, and manmade fiber.
225 Knitting mills.
226 Dyeing and finishing textiles, except wool fabrics and knit goods.
227 Floor covering mills.
228 Yarn and thread mills.
229 Miscellaneous textile goods.

Apparel and other finished products made from fabrics and similar materials:

231 Men's, youths', and boys' suits, coats, and overcoats.
232 Men's, youths', and boys' furnishings, work clothing, and allied garments.
233 Women's, misses', and juniors' outerwear.
234 Women's, misses', children's, and infants' undergarments.
235 Hats, caps, and millinery.
236 Girls', children's, and infants' outerwear.
237 Fur goods.
238 Miscellaneous apparel and accessories.
239 Miscellaneous fabricated textile products.

Lumber and wood products, except furniture:

241 Logging camps and logging contractors.
242 Sawmills and planing mills.

Code

243 Millwork, veneer, plywood, and prefabricated structural wood products.
244 Wooden containers.
249 Miscellaneous wood products.

Furniture and fixtures:

251 Household furniture.
252 Office furniture.
253 Public building and related furniture.
254 Partitions, shelving, lockers, and office and store fixtures.
259 Miscellaneous furniture and fixtures.

Paper and allied products:

261 Pulp mills.
262 Paper mills, except building paper mills.
263 Paperboard mills.
264 Converted paper and paperboard products, except containers and boxes.
265 Paperboard containers and boxes.
266 Building paper and building board mills.

Printing, publishing, and allied products:

271 Newspapers: publishing, publishing and printing.
272 Periodicals: publishing, publishing and printing.
273 Books.
274 Miscellaneous publishing.
275 Commercial printing.
276 Manifold business forms.
277 Greeting card publishing.
278 Blankbooks, looseleaf binders, and bookbinding and related work.
279 Service industries for the printing trade.

Chemicals and allied products:

281 Industrial inorganic and organic chemicals.
282 Plastics materials and synthetic resins, synthetic rubber, synthetic and other manmade fibers, except glass.
283 Drugs.
284 Soap, detergents, and cleaning preparations, perfumes, cosmetics, and other toilet preparations.
285 Paints, varnishes, lacquers, enamels, and allied products.
286 Gum and wood chemicals.
287 Agricultural chemicals.
289 Miscellaneous chemical products.

Petroleum refining and related products:

291 Petroleum refining.
295 Paving and roofing materials.
299 Miscellaneous products of petroleum and coal.

Rubber and miscellaneous plastics products:

301 Tires and inner tubes.
302 Rubber footwear.
303 Reclaimed rubber.
306 Fabricated rubber products, not elsewhere classified.
307 Miscellaneous plastics products.

Leather and leather products:

311 Leather tanning and finishing.
312 Industrial leather belting and packing.
313 Boot and shoe cut stock and findings.
314 Footwear, except rubber.
315 Leather gloves and mittens.
316 Luggage.
317 Handbags and other personal leather goods.
319 Leather goods, not elsewhere classified.

Stone, clay, glass, and concrete products:

321 Flat glass.
322 Glass and glassware, pressed or blown.
323 Glass products, made or purchased glass.
324 Cement, hydraulic.
325 Structural clay products.
326 Pottery and related products.
327 Concrete, gypsum, and plaster products.
328 Cut stone and stone products.
329 Abrasive, asbestos, and miscellaneous nonmetallic mineral products.

Primary metal products:

331 Blast furnaces, steel works, and rolling and finishing mills.

Code

332 Iron and steel foundries.
333 Primary smelting and refining of nonferrous metals.
334 Secondary smelting and refining of nonferrous metals.
335 Rolling, drawing, and extruding of nonferrous metals.
336 Nonferrous foundries.
339 Miscellaneous primary metal products.

Fabricated metal products, except ordnance, machinery, and transportation equipment:

341 Metal cans.
342 Cutlery, hand tools, and general hardware.
343 Heating apparatus (except electric) and plumbing fixtures.
344 Fabricated structural metal products.
345 Screw machine products, and bolts, nuts, screws, rivets and washers.
346 Metal stampings.
347 Coating, engraving, and allied services.
348 Miscellaneous fabricated wire products.
349 Miscellaneous fabricated metal products.

Machinery except electrical:

351 Engines and turbines.
352 Farm machinery and equipment.
353 Construction, mining, and materials handling machinery and equipment.
354 Metalworking machinery and equipment.
355 Special industry machinery, except metalworking machinery.
356 General industrial machinery and equipment.
357 Office, computing, and accounting machines.
358 Service industry machines.
359 Miscellaneous machinery, except electrical.

Electrical machinery, equipment, and supplies:

361 Electric transmission and distribution equipment.
362 Electrical industrial apparatus.
363 Household appliances.
364 Electric lighting and wiring equipment.
365 Radio and television receiving sets, except communication types.
366 Communication equipment.
367 Electronic components and accessories.
369 Miscellaneous electrical machinery, equipment, and supplies.

Transportation equipment:

371 Motor vehicles and motor vehicle equipment.
372 Aircraft and parts.
373 Ship and boat building and repairing.
374 Railroad equipment.
375 Motorcycles, bicycles, and parts.
379 Miscellaneous transportation equipment.

Professional, scientific, and controlling instruments; photographic and optical goods; watches and clocks:

381 Engineering, laboratory, and scientific and research instruments and associated equipment.
382 Instruments for measuring, controlling, and indicating physical characteristics.
383 Optical instruments and lenses.
384 Surgical, medical, and dental instruments and supplies.
385 Ophthalmic goods.
386 Photographic equipment and supplies.
387 Watches and clocks.

Miscellaneous manufactured products:

391 Jewelry, silverware, and plated ware.
393 Musical instruments.
394 Toys, amusement, sporting and athletic goods.
395 Pens, pencils, and other office and artists' materials.
396 Costume jewelry, costume novelties, buttons, and miscellaneous notions, except precious metal.
399 Miscellaneous manufactured products.

Department of the Treasury
Washington, D.C. 20220

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