

May 15, 1972, such corporation can, pursuant to this subdivision, change its annual accounting period and adopt a taxable year beginning on the first day of any month in 1972 after May. A change to a new annual accounting period made pursuant to this subdivision is effective only if the corporation which makes such change qualifies as a DISC for such new period. A corporation may change its annual accounting period and adopt a new taxable year pursuant to this subdivision without regard to the provisions of §1.1502-76 (relating to the taxable year of members of a group). A copy of the statement described in (b) of this subdivision shall be attached to the return of a corporation for the new taxable year to which such corporation changes pursuant to this subdivision. A corporation which changes its annual accounting period pursuant to this subparagraph will not be permitted under section 442 to change its annual accounting period at any time before 1982, except with the consent of the Commissioner as provided in §1.442-1(b)(1) or pursuant to subparagraph (4) of this paragraph.

(4) *Transition rule for change of taxable year of certain DISC's.* In the case of a DISC all of the shares of which are held by a single shareholder or by members of a group who file a consolidated return, such DISC may (without the consent of the Commissioner) change its annual accounting period and adopt a taxable year beginning in 1972 which is the same as the taxable year of such shareholder or the members of such group. A change to a new annual accounting period may be made by a DISC pursuant to this subparagraph even if such DISC has changed its annual accounting period pursuant to subparagraph (3)(ii) of this paragraph.

(5) *Transition rule for beginning of first taxable year of certain corporations.* If a corporation organized before January 1, 1972, neither acquires assets (other than cash or other property acquired as consideration for the issuance of stock) nor begins doing business prior to January 1, 1972, the first taxable year of such corporation is deemed to begin at the time such corporation acquires any asset (other than cash or other property acquired as consideration for the

issuance of stock) or begins doing business, whichever is earlier: *Provided*, That such corporation is a DISC for such first taxable year. For purposes of §1.6012-2(a), such corporation is treated as not coming into existence until the beginning of such first taxable year.

(c) *Effective date.* The provisions of this section and the regulations under sections 992 through 997 apply with respect to taxable years ending after December 31, 1971, except that a corporation may not be a DISC for any taxable year beginning before January 1, 1972.

(d) *Related statutes.* For rules relating to the transfer, during a taxable year beginning before January 1, 1976, to a DISC of assets of an export trade corporation (as defined in section 971), where a parent owns all the outstanding stock of both such DISC and such export trade corporation, see section 505(b) of the Revenue Act of 1971 (85 Stat. 551). For rules regarding limitations on the qualification of a corporation as an export trade corporation for any taxable year beginning after October 31, 1971, see section 971(a)(3).

[T.D. 7323, 39 FR 34402, Sept. 25, 1974, as amended by T.D. 7854, 47 FR 51738, Nov. 17, 1982]

#### § 1.992-1 Requirements of a DISC.

(a) *"DISC" defined.* The term "DISC" refers to a domestic international sales corporation. The term "DISC" means a corporation which, for a taxable year—

(1) Is duly incorporated and existing under the laws of any State or the District of Columbia,

(2) Satisfies the gross receipts test described in paragraph (b) of this section,

(3) Satisfies the assets test described in paragraph (c) of this section,

(4) Satisfies the capitalization requirement described in paragraph (d) of this section,

(5) Satisfies the requirement that an election to be treated as a DISC be in effect for such year, as described in paragraph (e) of this section,

(6) [Reserved]

(7) Maintains separate books and records, and

(8) Is not an ineligible corporation described in paragraph (f) of this section.

A corporation which satisfies the requirements described in subparagraphs (1) through (8) of this paragraph for a taxable year is treated as a separate corporation for Federal tax purposes and qualifies as a DISC, even though such corporation would not be treated (if it were not a DISC) as a corporate entity for Federal income tax purposes. An association cannot qualify as a DISC even if such association is taxable as a corporation pursuant to section 7701(a)(3). In addition, a corporation created or organized in, or under the law of, a possession of the United States cannot qualify as a DISC. The rules contained in this paragraph constitute a relaxation of the general rules of corporate substance otherwise applicable under the Code. The separate incorporation of a DISC is required under section 992(a)(1) to make it possible to keep a better record of the income which is subject to the special treatment provided by sections 991 through 996, but this does not necessitate in all other respects the separate relationships which otherwise would be required between a parent corporation and its subsidiary. However, this relaxation of the general rules of corporate substance does not apply with respect to other corporations in other contexts. In the case of a transaction between a DISC and a person related to such DISC for purposes of section 482, see § 1.993-1(l) for rules for determining whether income is income of a DISC to which the intercompany pricing rules authorized by section 994 apply.

(b) *Gross receipts test.* In order for a corporation described in paragraph (a)(1) of this section to be a DISC for a taxable year, 95 percent or more of its gross receipts (as defined in § 1.993-6) for such year must consist of qualified export receipts (as defined in § 1.993-1). Gross receipts for a taxable year are determined in accordance with the method of accounting adopted by the corporation pursuant to § 1.991-1(b)(2). However, for rules regarding gross receipts in the case of a commission sale by such corporation, see § 1.993-6.

(c) *Assets test—(1) In general.* In order for a corporation described in paragraph (a)(1) of this section to be a DISC for a taxable year, the adjusted basis (determined under section 1011) of its

qualified export assets at the close of such year must equal or exceed 95 percent of the sum of the adjusted bases (determined under section 1011) of all assets of such corporation at the close of such year.

(2) *Assets acquired to meet assets test.* For purposes of determining whether the requirements of subparagraph (1) of this paragraph are satisfied by a corporation at the end of a taxable year, an asset which is a qualified export asset is treated as not being an asset of such corporation at such time if such asset is held for a total of 60 days or less and is acquired directly or indirectly through borrowing, unless the acquisition of such asset is established to the satisfaction of the Commissioner or his delegate to have been for bona fide purposes. Such acquisition is deemed to have been for bona fide purposes if, for example, it is made in the usual course of the corporation's trade or business.

(d) *Capitalization requirement—(1) In general.* To qualify as a DISC for a taxable year, a corporation must have, on each day of that taxable year, only one class of stock. The par value (or, in the case of stock without par value, the stated value) of the corporation's outstanding stock must be on each day of the taxable year at least \$2,500. In the case of a corporation which elects to be treated as a DISC for its first taxable year, the requirements of this paragraph (d)(1) are satisfied if the corporation has no more than one class of stock at any time during the year and if the par value (or, in the case of stock without par value, the stated value) of the corporation's outstanding stock is at least \$2,500 on the last day of the period within which the election must be made and on each succeeding day of the year. For purposes of this paragraph (d)(1), the stated value of shares is the aggregate amount of the consideration paid for such shares which is not allotted to paid in surplus, or other surplus. The law of the State of incorporation of the DISC determines what consideration may be used to capitalize the DISC. A corporation will not be a qualified DISC unless at least \$2,500 of valid consideration was used for this purpose. If a corporation has a realized or unrealized loss during a taxable year

which results in the impairment of all or part of the capital required under this paragraph (d)(1), that impairment does not result in disqualification under this paragraph (d)(1), provided that the corporation does not take any legal or formal action under State law to reduce capital for that year below the amount required under this paragraph (d)(1).

(2) *Treatment of debt payable to shareholders*—(i) *In general.* Purported debt of a DISC payable to any person, whether or not such person is a shareholder or a member of a controlled group (as defined in §1.993-1(k)) of which such DISC is a member, is treated as debt for all purposes of the Code, provided that such purported debt—

(a) Would qualify as debt for purposes of the Code if the DISC were a corporation which did not qualify as a DISC,

(b) Qualifies under subdivision (ii) of this subparagraph, or

(c) Are trade accounts payable described in subdivision (iii) of this subparagraph.

Such debt is not treated as stock, and interest payable by the DISC on such debt is treated as interest by both the DISC and the holder of such debt. Payment of the principal of such debt by a DISC does not constitute the payment of a dividend by such DISC. The provisions of this subparagraph apply for a taxable year of a DISC, even though debt described in this subparagraph would be treated as stock of the corporation if such corporation did not qualify as a DISC for such year.

(ii) *Safe harbor rule.* Purported debt of a DISC will in no event be treated as other than debt for purposes of subdivision (i) of this subparagraph if—

(a) It is a written obligation to pay a sum certain on or before a fixed maturity date,

(b) Interest is payable on such purported debt at an arm's length interest rate (as determined under §1.482-2(a)(2)), expressed as a fixed dollar amount or a fixed percentage of principal,

(c) Such purported debt is not convertible into stock or into other purported debt unless such other purported debt qualifies under this subparagraph as debt of the DISC,

(d) Such purported debt does not confer voting rights upon its holder, except in the event of default thereon, and

(e) Interest and principal are paid in accordance with the terms of such purported debt or with any modification of such terms consistent with (a) through (d) of this subdivision.

The determination of whether purported debt of a DISC constitutes debt described in this subdivision is made without regard to the proportion of debt of the DISC held by any of its shareholders, to the ratio of the outstanding debt of the DISC to its equity, or to the amount of outstanding debt of such DISC. The provisions of (e) of this subdivision do not prevent the modification of the terms of debt of a DISC where, for example, a DISC becomes unable to make timely payments of principal required under such terms, provided that such modification is consistent with (a) through (d) of this subdivision.

(iii) *Trade accounts payable.* Trade accounts payable of a DISC which arise in the normal course of its trade or business (such as in consideration for inventory or supplies) constitute debt of the DISC (whether or not such accounts payable are debt described in subdivision (i) (a) or (b) of this subparagraph), provided that such accounts are payable within 15 months after they arise. If such accounts are payable more than 15 months after they arise, they are debt of such DISC only if they are debt described in subdivision (i) (a) or (b) of this subparagraph.

(iv) *Relation of subparagraph to other corporations.* The provisions of this subparagraph generally constitute a relaxation of the ordinary rules used in determining whether purported debt of a corporation is debt or equity. This relaxation is in recognition of the principle that a corporation may qualify as a DISC even though it has relatively little capital. This relaxation does not apply with respect to purported debt of other corporations in other contexts. The provisions of subdivisions (i), (ii), and (iii) of this subparagraph apply only for taxable years for which a corporation qualifies (or is treated) as a DISC.

(3) *Classes of stock.* [Reserved]

(e) *Election in effect.* In order for a corporation to be a DISC for a taxable year, an election to be treated as a DISC must be made by such corporation pursuant to § 1.992-2 and must be in effect for such taxable year. A corporation does not become or remain a DISC solely by making such an election. A corporation is a DISC for a taxable year only if such an election is in effect for that year and the corporation also satisfies the requirements of paragraphs (a) through (d) of this section. See § 1.992-2 for rules regarding the time and manner of making such an election.

(f) *Ineligible corporations.* The following corporations shall not be eligible to be treated as a DISC—

(1) A corporation exempt from tax by reason of 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)),

(6) A China Trade Act corporation receiving the special deduction provided in section 941(a), or

(7) An electing small business corporation (as defined in section 1371(b)).

(g) *Status as DISC after having filed return as a DISC.* Under section 992(a)(2), notwithstanding the failure of a corporation to meet the requirements of paragraph (a) of this section for a taxable year, such corporation will be treated as a DISC for purposes of the Code for such taxable year (and, thus, will not be able to claim that it is not eligible to be a DISC) if—

(1) Such corporation files a return as a DISC for such taxable year,

(2) Such corporation does not notify the district director, more than 30 days before the expiration of the period of limitation (including extensions thereof) on assessment for underpayment of tax for such taxable year (as determined under section 6501 and the regulations thereunder), that it is not a DISC for such taxable year, and

(3) The Internal Revenue Service has not issued, within such period of limitation (including extensions thereof) on assessment for underpayment of tax

for such taxable year, a notice of deficiency based on a determination that such corporation is not a DISC for such taxable year.

A corporation is treated as a DISC, for all purposes, pursuant to the provisions of this paragraph for any taxable year for which it meets the requirements of this paragraph, even if such corporation is an ineligible corporation described in paragraph (f) of this section for such taxable year. Thus, for example, a corporation which is treated as a DISC for a taxable year pursuant to this paragraph is treated as a DISC for that taxable year for purposes of § 1.992-2(e)(3) (relating to the termination of a DISC election if a corporation is not a DISC for each of any 5 consecutive taxable years). If a corporation is treated as a DISC for a taxable year pursuant to this paragraph, persons who held stock of such corporation at any time during such taxable year are treated, with respect to such stock, as holders of stock in a DISC for the period or periods during which they held such stock within such taxable year.

(h) *Definition of "former DISC".* Under section 992(a)(3), the term "former DISC" refers to a corporation which is not a DISC for a taxable year but which was (or was treated as) a DISC for a prior taxable year. However, a corporation is not a former DISC for a taxable year unless such corporation has, at the beginning of such taxable year, undistributed previously taxed income (as defined in § 1.996-3(c) or accumulated DISC income (as defined in § 1.996-3(b)). A corporation which is a former DISC for a taxable year is a former DISC for all purposes of the Code.

(Secs. 385 and 7805 of the Internal Revenue Code of 1954 (83 Stat. 613 and 68A Stat. 917; 26 U.S.C. 385 and 7805))

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**§ 1.992-2 Election to be treated as a DISC.**

(a) *Manner and time of election—(1) Manner—(i) In general.* A corporation