

Internal Revenue Code Section 995

Taxation of DISC income to shareholders.

(a) General rule. A shareholder of a DISC or former DISC shall be subject to taxation on the earnings and profits of a DISC as provided in this chapter, but subject to the modifications of this subpart.

(b) Deemed distributions.

(1) Distributions in qualified years. A shareholder of a DISC shall be treated as having received a distribution taxable as a dividend with respect to his stock in an amount which is equal to his pro rata share of the sum (or, if smaller, the earnings and profits for the taxable year) of—

(A) the gross interest derived during the taxable year from producer's loans,

(B) 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,

(C) the gain (other than the gain described in subparagraph (B)) 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(a)(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,

(D) 50 percent of the taxable income of the DISC for the taxable year attributable to military property,

(E) the taxable income of the DISC attributable to qualified export receipts of the DISC for the taxable year which exceed \$10,000,000,

(F) the sum of—

- (i) in the case of a shareholder which is a C corporation, one-seventeenth of the excess of taxable income of the DISC for the taxable year, before the reduction for any distributions during the year, over the sum of the amounts deemed distributed for the taxable year under subparagraphs (A), (B), (C), (D), and (E),

(ii) an amount equal to 16/17 of the excess referred to in clause (i), multiplied by the international boycott factor determined under section 999, and

(iii) any illegal bribe, kickback, or other payment (within the meaning of section 162(c)) paid by or on behalf of the DISC directly or indirectly to an official, employee, or agent in fact of a government, and

(G) the amount of foreign investment attributable to producer's loans (as defined in subsection (d)) of a DISC for the taxable year.

Distributions described in this paragraph shall be deemed to be received on the last day of the taxable year of the DISC in which the income was derived. In the case of a distribution described in subparagraph (G), earnings and profits for the taxable year shall include accumulated earnings and profits.

(2) Distributions upon disqualification.

(A) A shareholder of a corporation which revoked its election to be treated as a DISC or failed to satisfy the conditions of section 992(a)(1) for a taxable year shall be deemed to have received (at the time specified in subparagraph (B)) a distribution taxable as a dividend equal to his pro rata share of the DISC income of such corporation accumulated during the immediately preceding consecutive taxable years for which the corporation was a DISC.

(B) Distributions described in subparagraph (A) shall 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 described in subparagraph (A) (but in no case over more than twice the number of immediately preceding consecutive taxable years during which the corporation was a DISC).

(3) Taxable income attributable to military property.

(A) In general. For purposes of paragraph (1)(D), taxable income of a DISC for the taxable year attributable to military property shall be determined by only taking into account—

(i) the gross income of the DISC for the taxable year which is attributable to military property, and

(ii) the deductions which are properly apportioned or allocated to such income.

(B) Military property. For purposes of subparagraph (A), the term "military property" means any property which is an arm, ammunition, or implement of war designated in the munitions list published pursuant to section 38 of the Arms Export Control Act (22 U.S.C. 2778).

(4) Aggregation of qualified export receipts.

(A) In general. For purposes of applying paragraph (1)(E), all DISC's which are members of the same controlled group shall be treated as a single corporation.

(B) Allocation. The dollar amount under paragraph (1)(E) shall be allocated among the DISC's which are members of the same controlled group in a manner provided in regulations prescribed by the Secretary.

(c) Gain on disposition of stock in a DISC.

(1) In general. If—

(A) a shareholder disposes of stock in a DISC or former DISC any gain recognized on such disposition shall be included in gross income as a dividend to the extent provided in paragraph (2), or

(B) stock of a DISC or former DISC is disposed of in a transaction in which the separate corporate existence of the DISC or former DISC is terminated other than by a mere change in place of organization, however effected, any gain realized on the disposition of such stock in the transaction shall be recognized notwithstanding any other provision of this title to the extent provided in paragraph (2) and to the extent so recognized shall be included in gross income as a dividend.

(2) Amount included. The amounts described in paragraph (1) shall be included in gross income as a dividend to the extent of the accumulated DISC income of the DISC or former DISC which is attributable to the stock disposed of and which was accumulated in taxable years of such corporation during the period or periods the stock disposed of was held by the shareholder which disposed of such stock.

(d) Foreign investment attributable to DISC earnings. For the purposes of this part –

(1) In general. The amount of foreign investment attributable to producer's loans of a DISC for a taxable year shall be the smallest of—

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

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

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

(2) Net increase in foreign assets. The term "net increase in foreign assets" of a controlled group means the excess of—

(A) the amount incurred by such group to acquire assets (described in section 1231(b)) located outside the United States over,

(B) the sum of—

(i) the depreciation with respect to assets of such group located outside the United States;

(ii) the outstanding amount of stock or debt obligations of such group issued after December 31, 1971, to persons other than the United States persons or any member of such group;

(iii) one-half the earnings and profits of foreign members of such group and foreign branches of domestic members of such group;

(iv) one-half the royalties and fees paid by foreign members of such group to domestic members of such group; and

(v) the uncommitted transitional funds of the group as determined under paragraph (4).

For purposes of this paragraph, assets which are qualified export assets of a DISC (or would be qualified export assets if owned by a DISC) shall not be taken into account. Amounts described in this paragraph (other than in subparagraphs (B)(ii) and (v)) shall be taken into account only to the extent they are attributable to taxable years beginning after December 31, 1971.

(3) Actual foreign investment. The term "actual foreign investment" by domestic members of a controlled group means the sum of—

(A) contributions to capital of foreign members of the group by domestic members of the group after December 31, 1971,

(B) the outstanding amount of stock or debt obligations of foreign members of such group (other than normal trade indebtedness) issued after December 31, 1971, to domestic members of such group,

(C) amounts transferred by domestic members of the group after December 31, 1971, to foreign branches of such members, and

(D) one-half the earnings and profits of foreign members of such group and foreign branches of domestic members of such group for taxable years beginning after December 31, 1971.

As used in this subsection, the term "domestic member" means a domestic corporation which is a member of a controlled group (as defined in section 993(a)(3)), and the term "foreign member" means a foreign corporation which is a member of such a controlled group.

(4) Uncommitted transitional funds. The uncommitted transitional funds of the group shall be an amount equal to the sum of—

(A) the excess of—

(i) the amount of stock or debt obligations of domestic members of such group outstanding on December 31, 1971, and issued on or after January 1, 1968, to persons other than United States persons or any members of such group, but only to the extent the taxpayer establishes that such amount constitutes a long-term borrowing for purposes of the foreign direct investment program, over

(ii) the net amount of actual foreign investment by domestic members of such group during the period that such stock or debt obligations have been outstanding; and

(B) the amount of liquid assets to the extent not included in subparagraph (A) held by foreign members of such group and foreign branches of domestic members of such group on October 31, 1971, in excess of their reasonable working capital needs on such date.

For purposes of this paragraph, the term "liquid assets" means money, bank deposits (not including time deposits), and indebtedness of 2 years or less to maturity on the date of acquisition and the actual foreign investment shall be determined under paragraph (3) without regard to the date in subparagraph (A) of such paragraph and without regard to subparagraph (D) of such paragraph.

(5) Special rule. Under regulations prescribed by the Secretary the determinations under this subsection shall be made on a cumulative basis with proper adjustments for amounts previously taken into account.

(e) Certain transfers of DISC assets. If—

(1) a corporation owns, directly or indirectly, all of the stock of a subsidiary and a DISC,

(2) the subsidiary has been engaged in the active conduct of a trade or business (within the meaning of section 355(b)) throughout the 5-year period ending on the date of the transfer and continues to be so engaged thereafter, and

(3) during the taxable year of the subsidiary in which its stock is transferred and its preceding taxable year, such trade or business gives rise to qualified export receipts of the subsidiary and the DISC,

then, under such terms and conditions as the Secretary by regulations shall prescribe, transfers of assets, stock, or both, will be deemed to be a reorganization within the meaning of section 368, a transaction to which section 355 applies, an exchange of stock to which section 351 applies, or a combination thereof. The preceding sentence shall apply only to the extent that the transfer or transfers involved are for the purpose of preventing the separation of the ownership of the stock in the DISC from the ownership of the trade or business which (during the base period) produced the export gross receipts of the DISC.

(f) Interest on DISC-related deferred tax liability.

(1) In general. A shareholder of a DISC shall pay for each taxable year interest in an amount equal to the product of—

(A) the shareholder's DISC-related deferred tax liability for such year, and

(B) the base period T-bill rate.

(2) Shareholder's DISC-related deferred tax liability. For purposes of this subsection—

(A) In general. The term "shareholder's DISC-related deferred tax liability" means, with respect to any taxable year of a shareholder of a DISC, the excess of—

(i) the amount which would be the tax liability of the shareholder for the taxable year if the deferred DISC income of such shareholder for such taxable year were included in gross income as ordinary income, over

(ii) the actual amount of the tax liability of such shareholder for such taxable year.

Determinations under the preceding sentence shall be made without regard to carrybacks to such taxable year.

(B) Adjustments for losses, credits, and other items. The Secretary shall prescribe regulations which provide such adjustments—

(i) to the accounts of the DISC, and

(ii) to the amount of any carryover or carryback of the shareholder,

as may be necessary or appropriate in the case of net operating losses, credits, and carryovers, and carrybacks of losses and credits.

(C) Tax liability. The term "tax liability" means the amount of the tax imposed by this chapter for the taxable year reduced by credits allowable against such tax (other than credits allowable under sections 31, 32, and 34).

(3) Deferred DISC income. For purposes of this subsection—

(A) In general. The term "deferred DISC income" means, with respect to any taxable year of a shareholder, the excess of—

(i) the shareholder's pro rata share of accumulated DISC income (for periods after 1984) of the DISC as of the close of the computation year, over

(ii) the amount of the distributions-in-excess-of-income for the taxable year of the DISC following the computation year.

(B) Computation year. For purposes of applying subparagraph (A) with respect to any taxable year of a shareholder, the computation year is the taxable year of the DISC which ends with (or within) the taxable year of the shareholder which precedes the taxable year of the shareholder for which the amount of deferred DISC income is being determined.

(C) Distributions-in-excess-of-income. For purposes of subparagraph (A), the term "distributions-in-excess-of-income" means, with respect to any taxable year of a DISC, the excess (if any) of—

(i) the amount of actual distributions to the shareholder out of accumulated DISC income, over

(ii) the shareholder's pro rata share of the DISC income for such taxable year.

(4) Base period T-bill rate. For purposes of this subsection, the term "base period T-bill rate" means the annual rate of interest determined by the Secretary to be equivalent to the average of the 1-year constant maturity Treasury yields, as published by the Board of Governors of the Federal Reserve System, for the 1-year period ending on September 30 of the calendar year ending with (or of the most recent calendar year ending before) the close of the taxable year of the shareholder.

(5) Short years. The Secretary shall prescribe such regulations as may be necessary for the application of this subsection to short years of the DISC, the shareholder, or both.

(6) Payment and assessment and collection of interest. The interest accrued during any taxable year which a shareholder is required to pay under paragraph (1) shall be treated, for purposes of this title, as interest payable under section 6601 and shall be paid by the shareholder at the time the tax imposed by this chapter for such taxable year is required to be paid.

(7) DISC includes former DISC. For purposes of this subsection, the term "DISC" includes a former DISC.

(g) Treatment of tax-exempt shareholders. If any organization described in subsection (a)(2) or (b)(2) of section 511 (or any other person otherwise subject to tax under section 511) is a shareholder in a DISC—

(1) any amount deemed distributed to such shareholder under subsection (b),

(2) any actual distribution to such shareholder which under section 996 is treated as out of accumulated DISC income, and

(3) any gain which is treated as a dividend under subsection (c),

shall be treated as derived from the conduct of an unrelated trade or business (and the modifications of section 512(b) shall not apply). The rules of the preceding sentence shall apply also for purposes of determining any such shareholder's DISC-related deferred tax liability under subsection (f).