1985

Department of the Treasury
Internal Revenue Service

Instructions for Form 1120-FSC

U.S. Income Tax Return of a Foreign Sales Corporation

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

Paperwork Reduction Act Notice

We ask for this information to carry out the Internal Revenue laws of the United States. The information is used to ensure that taxpayers are complying with these laws and to allow us to figure and collect the right amount of tax. You are required to give us this information.

General Instructions

A. Purpose of Form

Form 1120-FSC is used to report a foreign sales corporation's (FSC) income, deductions, credits, and tax. If a refund is due, Form 1120-FSC may be used to claim it.

B. What Is a FSC

A FSC is a foreign corporation that has elected to be a FSC or small FSC and its election is still in effect. The FSC election is made by filing **Form 8279,** Election To Be Treated as a FSC or as a Small FSC.

To be a FSC (or small FSC) a corporation must meet all of the following tests:

1. It must be a corporation created or organized under the laws of a qualifying foreign country or a U.S. possession (other than Puerto Rico). The foreign country must meet the requirements of section 927(e)(3).

2. It may not have more than 25 shareholders.

3. It may not have preferred stock.

4. It must maintain an office in a qualifying foreign country or U.S. possession (other than Puerto Rico) and maintain a set of permanent books of account at that office. It must also maintain at a location in the U.S. such books and records as are sufficient under section 6001 to establish the amount of gross income, deductions, credits or other matters required to be shown on its tax return.

5. It must have at least one director who is not a resident of the U.S.

6. It may not be a member of a controlled group of which an interest charge DISC is a member.

7. Its tax year must conform to the tax year of the principal shareholder who at the beginning of the FSC's tax year has the highest percentage of voting power. If 2 or more shareholders have the highest percentage of voting power, the FSC must elect a tax year that conforms to that of any one of the shareholders. See section 441(h).

8. A FSC, other than a small FSC, must also meet certain foreign management and foreign economic process requirements. See general instructions F2 and F3 for details.

C. Filing Form 1120-FSC

1. Who Files.—You must file Form 1120-FSC if your corporation elected, by filing Form 8279, to be treated as a FSC or small FSC and the election is still in effect.

2. When To File.—File Form 1120-FSC by the 15th day of the 3rd month after the end of the tax year.

Extensions.—File **Form 7004**, Application for Automatic Extension of Time To File Corporation Income Tax Return, to request an automatic 6-month extension of time to file Form 1120-FSC.

Period covered.—File the 1985 return for calendar year 1985 and fiscal years that begin in 1985. If the return is for a fiscal year, fill in the tax year space at the top of the form.

Amended return.—To correct any error in a Form 1120-FSC already filed, file a revised Form 1120-FSC and write "Amended" across the top.

Change in tax year.—To change your tax year, file **Form 1128**, Application for Change in Accounting Period.

Final return.—If the corporation ceased to exist during the tax year, write "Final Return" at the top of the form.

3. Where To File.—File Form 1120-FSC with the Internal Revenue Service Center, Philadelphia, PA 19255.

4. Signature.—The return must be signed and dated by the president, vice president, treasurer, assistant treasurer, chief accounting officer, or any other corporate officer (such as tax officer) authorized to sign. A receiver, trustee, or assignee must sign and date any return required to be filed on behalf of a corporation.

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

Generally, anyone who is paid to prepare Form 1120-FSC must sign the return and fill in the other blanks in the Paid Preparer's Use Only area of the return.

The preparer required to sign the return MUST:

- Complete the required preparer information.
- 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-FSC to the taxpayer in addition to the copy filed with IRS.

Tax return preparers should be familiar with their responsibilities. See **Publication 1045,** Information and Order Blanks for Preparers of Federal Income Tax Returns, for more details.

D. Other Returns and Statements That May Be Required

1. Financial statements.—The balance sheets must agree with your books and records. Reconcile any differences.

2. Forms.—The FSC may also have to file other forms. A partial list includes:

Form 5471, Information Return with Respect to a Foreign Corporation.—Shareholders, directors, or officers of a FSC do not have to file Form 5471 when the FSC is organized. However, Form 5471 will be required with respect to subsequent changes in ownership as required under section 6046 and related regulations. Provided that a Form 1120-FSC is filed, a Form 5471 need not be filed to satisfy the requirements of section 6038. See temporary regulations section 1.921-1T(b), Question 3, for more information. However, if the FSC is involved in other than FSC activities, Form 5471 and applicable schedules may have to be filed.

Form 1096, Annual Summary and Transmittal of U.S. Information Returns.—Used to transmit certain information returns. **Note:** For transmitting Form 1099R information, use **Form W-3G**, Transmittal of Certain Information Returns.

Form 1098, Mortgage Interest Statement.—This form is used to report the receipt from any individual of $600 or more of mortgage interest in the course of the corporation's trade or business for any calendar year.

Forms 1099-DIV, INT, MISC, and R.—These are some of the information returns that must be filed to report certain payments, such as dividends and interest. For more information, see Form 1096 and its instructions, and **Publication 916**, Information Returns.

Form 4626, Computation of Minimum Tax-Corporations.—Attach to Form 1120-FSC if the corporation has either more than $10,000 in tax preference items (whether or not it has minimum tax) or minimum tax liability deferred from an earlier year.

Form 5713, International Boycott Report.—Used by persons having operations in or related to "boycotting" countries. In addition, persons who participate in or cooperate with an international boycott may have to complete Schedule A or Schedule B and Schedule C of Form 5713 to compute their loss of the following items: the foreign tax credit, the deferral of earnings of a controlled foreign corporation, IC-DISC benefits, and FSC benefits.

Form 8264, Application for Registration of a Tax Shelter.—Used by tax shelter organizers to register tax shelters with the IRS, for the purpose of receiving a tax shelter registration number.

Schedule PH (Form 1120).—Attach Schedule PH (Form 1120), Computation of U.S. Personal Holding Company Tax, to Form 1120-FSC if the FSC is a personal holding company described in section 542, but not a foreign personal holding company described in section 552.

Form 8271, Investor Reporting of Tax Shelter Registration Number.—Used by taxpayers who have acquired an interest in a tax shelter, which is required to be registered, to report the tax shelter's registration number. Form 8271 must be attached to any tax return (including an application for tentative refund (Form 1139 and an amended return)) on which a deduction, credit, loss, or other tax benefit attributable to a tax shelter is taken.

Form 8300, Report of Cash Payments Over $10,000 Received in a Trade or Business.—Generally, this form is used to report the receipt of more than $10,000 in cash or foreign currency in one transaction (or in a series of related transactions). However, transactions that take place entirely outside the U.S. do not have to be reported.

E. Paying the Tax

A FSC must pay the tax due when it files its tax return, but not later than the 15th day of the 3rd month after the end of the tax year. Mail all payments to the Internal Revenue Service Center, Philadelphia, PA 19255. On the payment (or attachment), write the FSC's name, address, and employer identification number; the tax year involved; and specify that the payment is for FSC income tax liability. (Do not use a Federal Tax Deposit Coupon (Form 8109)).

Estimated Tax.—A FSC must make estimated tax payments if it can expect its estimated tax (income tax minus credits) to be $40 or more.

Use **Form 1120-W (WORKSHEET)**, Corporation Estimated Tax, as a worksheet to compute estimated tax. Mail all payments to the Internal Revenue Service Center, Philadelphia, PA 19255. On the payment (or attachment), write the FSC's name, address, and employer identification number; the tax year involved; and specify that the payment is for FSC estimated income tax liability. (Do not use a Federal Tax Deposit Coupon (Form 8109)).

If the corporation overpaid estimated tax, it may be able to get a "quick refund" by filing **Form 4466**, Corporation Application for Quick Refund of Overpayment of Estimated Tax. The overpayment must be both: (1) at least 10% of expected income tax liability, and (2) at least $500. To apply, file Form 4466 within 2½ months after the end of the tax year and before Form 1120-FSC is filed.

F. Definitions, etc.

1. Small FSC.—A corporation must have filed Form 8279 and elected to be a small FSC. The small FSC cannot be a member of a controlled group which includes a FSC unless such FSC is also a small FSC.

A small FSC is treated as a FSC on the first $5,000,000 of its foreign trading gross receipts without meeting the foreign management and foreign economic process requirements. The $5,000,000 limit is reduced if the small FSC has a short tax year, or may be reduced if the small FSC is a member of a controlled group that contains other small FSCs. Any gross receipts in excess of the limitation are treated as non-foreign trading gross receipts.

See regulations section 1.921-2T(b) for more information.

Note: *Although a small FSC does not have to satisfy the foreign management requirements below, it has to meet the requirements of section 925(c) if it uses the administrative pricing rules.*

2. Foreign Management Requirements.—A FSC (other than a small FSC) is treated as having foreign trading gross receipts for the tax year only if the management of the FSC during the year takes place outside the United States. These management activities include:

a. Meeting of the board of directors and of shareholders.

b. Maintaining the principal bank account at all times during the tax year.

c. Disbursement of dividends, legal and accounting fees, salaries of officers, and salaries or fees of directors out of the principal bank account.

Meetings of directors and of shareholders.—All meetings of the board of directors of the FSC and all meetings of the shareholders of the FSC that take place during the tax year must take place outside the United States. Only meetings that are formally convened as meetings of the board of directors or as shareholders meetings are taken into account. If the participants in a meeting are not all physically present in the same location, the location of the meeting is determined by the location of the person exercising a majority of the voting power participating in the meeting. In addition, all such meetings must comply with the local laws of the foreign country or U.S. possession in which the FSC was created or organized. The local laws determine whether a meeting must be held, when and where it must be held, who must be present, quorum requirements, use of proxies, and so on.

Principal bank account.—The bank account that is regarded as the principal bank account of a FSC is the bank account from which disbursement of dividends, legal and accounting fees, salaries of officers, and salaries or fees of directors are made. The bank account regarded as the principal bank account must be maintained in a country which satisfies the exchange of information requirements of section 927(e)(3), or in any possession of the U.S. as defined in section 927(d)(5) and it generally must be so maintained for each day of the tax year. The principal bank account must be maintained in an institution that is engaged in the conduct of banking, financing, or similar business.

For more details, see regulations under section 1.924(c)-1T.

3. Economic Processes Requirements.—A FSC (other than a small FSC) has foreign trading gross receipts from any transaction only if economic processes for such transaction takes place outside the U.S. The regulations set forth the rules for determining whether a sufficient amount of the economic processes of a transaction take place outside the U.S. Generally, a transaction will qualify if the FSC satisfies two different requirements: Participation outside the U.S. in the sales portion of the transaction, and satisfaction of either the 50% or the 85% foreign direct cost test. The activities comprising these economic processes may be performed by the FSC or by any other person acting under contract with the FSC.

The FSC (or other person) may act upon standing instructions from another person in the performance of any activity, whether a sales activity or an activity relating to the disposition of export property.

Participation outside the U.S. in the sales portion of the transaction.—The requirement is met for the gross receipts of a FSC derived from any transaction if the FSC (or other person) has participated outside the United States in the following sales activities relating to such transaction:

a. Solicitation (other than advertising),

b. Negotiation, and

c. Making of the contract.

If any sales activity occurs with respect to a single contract for more than one transaction (or for items grouped separately for other purposes), that sales activity will apply to each transaction (or item), regardless of the fact that the transactions (or items) are grouped separately for other purposes (such as satisfying the foreign direct cost tests).

The FSC may elect on an annual basis to group transactions for purposes of satisfying the economic process requirements. Providing the necessary documentation and other rules of regulations section 1.924(d)-1T(e) are met, transactions may be grouped on the basis of product or product line, customer, contract, or product or product line within customer or contract groupings. For more details, see regulations section 1.924(d)-1T(e).

Solicitation (other than advertising) refers to any communication (by any method including, but not limited to, telephone, telegraph, mail, or in person) by the FSC (or other person), at any time during the 12-month period immediately preceding the execution of a contract relating to the transaction, to a specific, targeted customer or potential customer, that specifically addresses the customer's attention to the product or service covered by the transaction. Activities that would otherwise constitute advertising (such as sending sales literature to a customer or potential customer) will be considered solicitation (other than advertising) if the activities are not taken into account as advertising under the foreign direct costs tests.

Negotiation refers to any communication by the FSC (or other person) to a customer or potential customer of one or more of the terms of a transaction including, but not limited to, price, credit terms, quantity, or time or manner of delivery. Negotiation does not include the mere receipt of a communication from a customer (such as an order) that includes terms of a sale.

Making of a contract refers to performance by the FSC (or other person) of any of the elements necessary to complete a sale, such as making an offer or accepting an offer. Acceptance of an unsolicited bid or order is considered the "making of a contract" even if no solicitation or negotiation occurred with respect to the transaction.

The written confirmation by the FSC (or other person) to the customer of an oral or written agreement which confirms variable contract terms or specifies (directly or by cross-reference) additional contract terms will be considered the making of a contract. A written confirmation is any confirmation expressed in writing, including a telegram, telex, or other similar written communication.

Satisfaction of either the 50% or the 85% foreign direct cost test.—For the gross receipts of a transaction to qualify as foreign trading gross receipts, the foreign

direct costs incurred by the FSC attributable to the transaction must equal or exceed 50% of the total direct costs incurred by the FSC attributable to the transaction. Direct costs are those costs described in the five categories of section 924(e). Instead of satisfying the 50% foreign direct cost test described above, the FSC may incur foreign direct costs attributable to activities described in each of two of the section 924(e) categories that equal or exceed 85% of the total direct costs attributable to the activity described in that category. If no direct costs are incurred by the FSC in a particular category, that category is not taken into account for purposes of determining whether the FSC has met either the 50% or the 85% foreign direct cost test.

Direct costs are those costs that are incident to and necessary for the performance of any activity described in section 924(e). Direct costs include the cost of materials which are consumed in the performance of the activity, and the cost of labor which can be identified or associated directly with the performance of the activity (but only to the extent of wages, salaries, fees for professional services, and other amounts paid for personal services actually rendered, such as bonuses or compensation paid for services on the basis of a percentage of profits). Direct costs also include the cost of equipment or facilities (or the use thereof) that can be specifically identified or associated with the activity, as well as the contract price of an activity performed on behalf of the FSC by a contractor.

"Total direct costs" means all of the direct costs of any transaction attributable to any of the activities described in section 924(e). For the 50% foreign direct cost test, total direct costs are determined based on the direct costs of all activities described in all of the paragraphs of section 924(e). For the 85% foreign direct cost test, however, the total direct costs are determined separately for each paragraph of section 924(e).

"Foreign direct costs" means the portion of the total direct costs of any transaction that is attributable to activities performed outside of the U.S. For the 50% foreign direct cost test, foreign direct costs are determined based on the direct costs of all activities described in all of the paragraphs of section 924(e). For the 85% foreign direct cost test, however, foreign direct costs are determined separately for each paragraph of section 924(e).

For more details see regulations under section 1.924(d)-1T.

Exception for military property.—These requirements do not apply to any activities performed in connection with the sale of military property if the activities are required by law or regulation to be performed in the U.S., by or in conjunction with the U.S. Government.

G. Penalties

The corporation may have to pay the following penalties unless it can show that not filing or not paying was due to reasonable cause and not willful neglect. (These penalties are in addition to the interest charge on unpaid tax at a rate established under section 6621.)

A corporation that does not file its tax return when due (including any extension of time for filing) may be subject to a penalty of 5% a month or fraction of a month, up to a maximum of 25%, for each month the return is not filed. (The penalty is imposed on the net amount due.) The minimum penalty for failure to file a tax return within 60 days of the due date (including extensions) is the lesser of the underpayment of tax or $100.

A corporation that does not pay the tax when due may be subject to a penalty of ½% a month or fraction of a month, up to a maximum of 25%, for each month the tax is not paid. (The penalty is imposed on the net amount due.)

A corporation that does not pay the proper estimated tax when due may be subject to an underpayment penalty for the period of underpayment. To avoid the estimated tax penalty, the amount of estimated tax payments required to be made by a corporation is 90%. See section 6655(b)(1).

If the corporation underpaid estimated tax, attach **Form 2220**, Underpayment of Estimated Tax by Corporations, to show how the corporation figured the penalty or which exceptions the corporation believes it meets.

If there is a tax due on line 4, page 1, include the penalty in the total. If there is a refund due, subtract the penalty from the overpayment on line 5, page 1.

Penalty for Overstated Tax Deposits.—If deposits are overstated, the corporation may be subject to a penalty. See section 6656(b).

H. Cooperatives

Special rules may apply when cooperatives described in section 1381 are shareholders in a FSC. These special rules apply to the non-exempt portion of foreign trade income from the sale or other dispositions of agricultural or horticultural products by the FSC. The FSC may distribute its non-exempt foreign trade income to the cooperative and thereby not be taxed on this amount. The cooperative must include this amount in income for its tax year that includes the last day of the FSC's tax year, even though the FSC does not have to distribute the income until the due date of its income tax return.

I. Foreign Personal Holding Company

If the corporation is a foreign personal holding company as defined in section 552, certain officers, directors, and shareholders of the corporation must file Form 5471. See section 552 and Form 5471 for details. If the corporation is a personal holding company but not a foreign personal holding company, it must file Schedule PH (Form 1120) with Form 1120-FSC. See section 542 and Schedule PH (Form 1120) for details.

J. Tax Treaty Benefits

A FSC may not claim any benefits under any income tax treaty between the U.S. and any foreign country.

Specific Instructions

Accounting methods.—Compute taxable income by the accounting method regularly used to keep the FSC's books and records. The method used must clearly reflect taxable income. (See section 446.)

A member of a controlled group must avoid using an accounting method that would distort any group member's income, including its own. For example, a FSC acts as a commission agent for property sales by a related corporation that uses the accrual method and pays the FSC its commission more than 2 months after the sale. The FSC, then, should not use the cash method of accounting, because it materially distorts the income of the FSC.

Unless the law specifically permits otherwise, the FSC may change from the accounting method it used to report taxable income in earlier years (for income as a whole or for any material item) only after obtaining consent by filing **Form 3115**, Application for Change in Accounting Method.

Rounding Off.—You may show the money items on the return and accompanying schedules as whole-dollar amounts. To do so, drop any amount less than 50 cents, and increase any amount from 50 cents through 99 cents to the next higher dollar.

Attachments.—If you need more space, attach separate sheets to the back of Form 1120-FSC. Attach **Form 4136,** Computation of Credit for Federal Tax on Gasoline and Special Fuels, after page 6, Form 1120-FSC. Attach schedules in alphabetical order and other forms in numerical order after the Form 4136. Be sure to put the FSC's name and employer identification number (EIN) on each sheet.

To assist us in processing the return, we ask that you complete every applicable entry space on Form 1120-FSC. Please do not attach statements and write "See attached" in lieu of completing the entry space on Form 1120-FSC.

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Address.—The address used on the return should be the location of the books and records in the U.S. (as required by section 6001).

Employer Identification Number.—Enter the FSC's employer identification number (EIN). If the FSC does not have an EIN, it should apply for one on **Form SS-4**, Application for Employer Identification Number. You can get this form at most IRS or Social Security Administration offices. Send Form SS-4 to the Internal Revenue Service Center, Philadelphia, PA 19255. If you have not received the EIN by the time for filing Form 1120-FSC, write "Applied for" in the space for the EIN.

Item C. Country or U.S. Possession of Incorporation.—Enter the name of the foreign country or U.S. possession in which the FSC was incorporated. See sections 927(d)(5) and 927(e)(3).

Item G.—Enter the total assets of the FSC from line 14, column (d), Schedule L. If there are no assets at the end of the tax year, enter the assets as of the beginning of the tax year.

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Item N.—All FSCs (except small FSCs) must complete questions (1) and (2) under item N. For more information, see "Foreign Management Requirements" in General Instruction F2.

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Item S.—A FSC (other than a small FSC) must complete item S to show that it satisfied the foreign economic process requirements of section 924(d) for all transactions for which foreign trading gross receipts were reported on lines 1 through 5 of Schedule B. While these rules are generally applied on a transaction by

transaction basis, the FSC may make an annual election to group the transactions (regulations section 1.924(d)-1T(e)).

A FSC meets the foreign economic process tests for any transaction, if on an aggregate basis, the foreign direct costs attributable to the transaction are 50% or more of the total direct costs attributable to the transaction for the following activities: 1) advertising and sales promotion, 2) processing of customer orders and arranging for delivery, 3) transportation of property from the time of acquisition by the FSC (or in the case of a commission relationship, from the beginning of such relationship for such transaction) to delivery to the customer, 4) determination and transmittal of final invoice or statement of account and receipt of payment, and 5) assumption of credit risk. Alternatively, the FSC meets the foreign economic process test for any transaction if the foreign direct costs attributable to the activities described in at least two of the above categories is 85% or more of the total direct costs attributable to the activities described in those categories.

In item S indicate which test(s) apply to the transactions that gave rise to the gross receipts entered on lines 1 through 5, Schedule B. If only one test applies, check the appropriate box. If both tests apply, check both boxes.

In addition to completing item S the FSC must keep sufficient records to show it met the requirements for each transaction (or group of transactions). These records must be made available on examination of the FSC return.

Schedule A—Cost of Goods Sold and/or Operations Relating to Foreign Trading Gross Receipts

Complete Schedule A only for the cost of goods sold deduction related to foreign trading gross receipts reported on lines 1 through 5 of Schedule B.

If the FSC acts as another person's commission agent on a sale, do not enter any amount in Schedule A for the sale.

A small FSC will have to make two separate computations for cost of goods sold if its foreign trading gross receipts exceed the limitation amount on line 6e of Schedule B. In this case, a deduction for cost of goods sold will be figured separately for the income on line 6h of Schedule B, and separately for the income on line 3 of Schedule F. Attach the computation for line 3, Schedule F, to Form 1120-FSC.

Complete a separate computation for cost of goods sold and other expenses attributable to income reported on line 12 of Schedule B. Attach this schedule to Form 1120-FSC.

All FSCs are to complete a separate schedule for the computation of the cost of goods sold attributable to non-foreign trade income reported on Schedule F. Attach this schedule to Form 1120-FSC.

Complete lines 1 through 7, column (a) of Schedule A to show the cost of goods sold for inventory acquired in transactions using the administrative pricing rules. Complete lines 1 through 7, column (b), to show the cost of goods sold for inventory acquired in transactions in which the administrative pricing rules were not used. For details on administrative or non-administrative pricing rules, see separate **Schedule P (Form 1120-FSC)**, Computation of Transfer Price or Commission.

Line 8a. Valuation methods.—Inventories can be valued at: (a) cost, (b) cost or market value, whichever is lower, or (c) any other method approved by the Commissioner of Internal Revenue, that conforms to the applicable regulations cited below.

Taxpayers using erroneous valuation methods should file Form 3115 to change to a method permitted for Federal income tax purposes. For further details, see regulations section 1.446-1(e)(3) and Rev. Proc. 80-51, 1980-2 C.B. 818.

In line 8a, check the method(s) used for valuing inventories. Under lower of cost or market, market generally applies to normal market conditions when a current bid price prevails at the date the inventory is valued. When no regular open market exists or when quotations are nominal because of inactive market conditions, use fair market prices from the most reliable sales or purchase transactions that occurred near the date the inventory is valued. For more requirements, see regulations section 1.471-4.

Inventory may be valued below cost when the merchandise is unsalable at normal prices or unusable in the normal way because the goods are "subnormal" (that is, because of damage, imperfections, shop wear, etc.) within the meaning of regulations section 1.471-2(c). Such goods may be valued at a current bona fide selling price less direct cost of disposition (but not less than scrap value) if such a price can be established. See regulations section 1.471-2(c) for more requirements.

If this is the first year the "Last-in First-out" (LIFO) inventory method was either adopted or extended to inventory goods not previously valued under the LIFO method, provided in section 472, attach **Form 970**, Application To Use LIFO Inventory Method, or a statement with the information required by Form 970. Also check the LIFO box in line 8b. Enter the amount or percent of total closing inventories covered under section 472 in line 8c. Estimates are acceptable.

If the corporation changed or extended its inventory method to LIFO and had to "writeup" opening inventory to cost in the year of election, report the effect of this writeup as income (as appropriate in Schedule F, line 12) proportionately over a 3-year period that begins in the tax year the election was first made. See section 472(d).

Schedule B—Taxable Income

Schedule B provides for the computation of taxable income from all sources.

Part I

Part I provides for the computation of income attributable to foreign trade income. Income and expenses on lines 1 through 15 are reported in column (a) or (b) based on the method of pricing (administrative or non-administrative) used in the transaction that produced the income.

Report in column (b) all foreign trade income from all transactions in which the administrative pricing rules were not used. This income may or may not be effectively connected with a U.S. trade or business. Attach a schedule showing the computation of the taxable amount. (Only the taxable portion is included in line 16 of Schedule B.) Such income would be effectively connected and taxable more often for a small FSC as it normally has a place of business in the U.S.

Lines 1 through 5—Enter foreign trading gross receipts as defined in section 924(a).

Report commission income on lines 1 or 2 based on the sale, lease, or rental of property on which such commission arose.

Line 5—Gross receipts from the performance of managerial services for an unrelated FSC or DISC are foreign trading gross receipts if two conditions are met. These conditions are:

1. The managerial services must be performed with respect to activities that result in the sale, exchange, or other disposition of export property, the rental or lease by the lessee of export property outside the U.S., or that are related to and subsidiary to the activities described above; AND

2. At least 50% of the FSC's gross receipts for the tax year must be derived from the sale, exchange, or other disposition of export property, the lease or rental of export property outside the U.S., and services that are related or subsidiary to these activities. Gross receipts are defined in section 927(b).

For example, if receipts reported on lines 1, 2, and 3 of Schedule B are less than 50% of gross receipts for the year, managerial services would not qualify as foreign trading gross receipts for the year. In this case, these receipts would be reported on line 12 of Schedule F.

Lines 6b through 6h—Determination of limit on foreign trading gross receipts for the small FSC. See General Instruction F1 and section 924(b)(2) before completing this part.

Line 6f—If commission income is reported on lines 1 or 2 of Schedule B, total receipts for purposes of line 6f is figured as follows:

1. Enter total of columns (a) and (b), line 6a, Schedule B . . . . . _____
2. Enter total commission income reported on line 1 or 2, Schedule B _____
3. Line 1 less line 2 . . . . . _____
4. For the commissions reported on line 2 above, enter total gross receipts for the sale, lease, or rental of property on which the commissions arose. (Section 927(b)(2)) . . . . . _____
5. Add lines 3 and 4. Enter on line 6f, Schedule B . . . . . _____

Line 6h—When making the line 6h allocation, only allocate the commission income attributable to the gross receipts on line 4 above. If the foreign trading gross receipts of the FSC exceeds the line 6g, Schedule B, limitation, the FSC may select the gross receipts to which the limitation is allocated. See regulations section 1.921-2T(b) Q-5.

Line 7—Enter the deduction for cost of goods sold from line 7, Schedule A, page 2.

Line 10—Provides for exclusion of exempt foreign trade income based on exemption percentages on lines 9a and 9b.

Line 14—Enter deductions from Schedule G that are attributable to nonexempt foreign trade income.

Part II

Part II is a summary of taxable foreign trade income and taxable income from Schedule F (taxable non-foreign trade income).

Line 16—Combine the income on line 15, column (a) with any taxable amount in line

15, column (b). See instruction for Part I, column (b) above, regarding taxable income in column (b). Attach a schedule showing the computation of the taxable amount.

Line 19b—Special Deductions. A FSC may be entitled to a dividends-received deduction for dividends it receives from other corporations. Complete a dividend worksheet similar to that below to determine the total amount of dividends received by the FSC and to figure the dividends-received deduction. Attach your worksheet to Form 1120-FSC.

Schedule E—Percentages To Be Used in Figuring Exempt Trade Income, etc.

Schedule E is used to figure the exemption percentages that are used in figuring exempt foreign trade income (Schedule B, line 10) as well as deductions attributable to exempt foreign trade income (Schedule G, line 17).

Use lines 2a through 2d to figure the exemption percentage for foreign trade income that was determined without regard to the administrative pricing rules of section 923(a)(2).

Use lines 3a through 3d to figure the exemption percentage for foreign trade income that was determined by using the administrative pricing rules of section 923(a)(3).

Schedule F—Non-Foreign Trade Income

Schedule F—Enter the taxable portion of gross income of the FSC that is **not** derived from foreign trade gross receipts. This type of income includes amounts specifically excluded from foreign trade income by law (lines 1 through 3); passive type income (lines 4 through 8); income from property that is subsidized, deemed in short supply, or destined for use in the U.S. (lines 9 and 10); amounts from transactions that did not meet the foreign economic process tests (line 11); and other non-foreign trade income (line 12). For more details, see sections 924(f), 927(a)(2) and (3), and 927(e)(2).

Line 1—FSC income that resulted from cooperation with an international boycott is non-foreign trade income. See Form 5713 for reporting requirements for any FSC with operations in or related to a boycotting country and other details.

Line 2—Report as non-foreign trade income the amount of any illegal payments, bribes, or kickbacks that the FSC paid directly or indirectly to government officials, employees, or agents (section 927(e)(2)).

Line 5—See instructions for the dividend worksheet below to figure the dividend income to report on line 5. Attach the dividend worksheet you prepare to Form 1120-FSC.

Instructions for Dividend Worksheet

Column (a) Instructions

1. Enter dividends received from domestic corporations subject to income tax and the 85% deduction under section 243(a)(1) and certain dividends received from Federal Home Loan Banks (section 246(a)(2)). 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. Do not treat them as dividends.

Do not enter on line 1 any dividends received on "debt-financed" stock acquired after July 18, 1984.

2. Enter dividends that would have been eligible for the 85% deduction except that they are from "debt-financed" stock acquired after July 18, 1984. "Debt-financed" stock is stock that the corporation incurred a debt in acquiring.

3. 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.

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

6. Enter all other dividends received from foreign corporations that do not qualify for a dividends-received deduction.

7. If the FSC claims the foreign tax credit, the tax that is deemed paid under section 902(a) (relating to credit for a corporate stockholder in a foreign corporation) must be treated as a dividend received from the foreign corporation. (See section 906(b)(4).)

8. Include dividends (other than capital gain dividends and exempt interest dividends) received from regulated investment companies that do not qualify for the 85% deduction; dividends (other than capital gain dividends) received from a real estate investment trust that, for the tax year of the trust in which the dividends are paid, qualifies under sections 856-860; 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 (including distributions under section 934(e)(3) or 936(h)(4)).

Column (b), line 2 Instructions

The proper amount of deduction for dividends from "debt-financed" stock acquired after July 18, 1984, is only a portion of the 85% deduction. This portion is determined by multiplying 85% times the difference between 100% and the "average indebtedness percentage." For definitions, rules, and certain exceptions, please see section 246A.

Attach a schedule to the worksheet showing how you have computed the amount of allowable deduction for each share or block of shares that were "debt-financed."

Column (c) Instructions

Exclusion of certain dividends.—In general, no dividends-received deduction will be allowed on any share of stock (a) that is disposed of if the corporation held it 15 days or less (45 days or less for stock acquired after July 18, 1984), or (b) to the extent the corporation is under an obligation to make corresponding payments with respect to substantially identical stock or other securities.

Dividend Worksheet	(a) Dividends received	(b) Deduction %	(c) Special deductions (Multiply (a) by (b))
1. Domestic corporations subject to the 85% deduction		85	
2. Debt-financed stock of domestic corporations		See Inst.	
3. Certain preferred stock of public utilities		59.13	
4. Foreign corporations subject to the 85% deduction		85	
5. Total dividends-received deduction—Add lines 1 through 4, Column (c). Enter here and on line 19b, Schedule B			
6. Other dividends from foreign corporations			
7. Foreign dividend gross-up (section 78)			
8. Other dividends			
9. Total dividends—Add amounts on lines 1 through 8, Column (a). Enter here and on line 5, Schedule F			

5. Limitation on dividends-received deduction.—Line 5 may not be more than 85% of line 18, Schedule B. For this purpose compute line 18, Schedule B, without regard to any adjustment under section 1059 and any capital loss carryback to the tax year under section 1212(a)(1).

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

Line 14—Enter on line 14 the deductions allocated or apportioned to income on lines 1 through 12. Make a separate computation for any cost of goods sold deduction included in the line 14 amount. Attach the computation to Form 1120-FSC.

If a deduction is taken for business bad debts in the line 14 amount and the FSC uses the reserve method to figure the bad debt deduction, attach a schedule to Form 1120-FSC that provides for line 14 the information requested in the instructions for line 11 of Schedule G.

Schedule G—Deductions Relating to Foreign Trade Income

Schedule G is a summary listing of deductions or expenses relating to foreign trade income. Each line item or type of deduction is allocated in column (a) or column (b) based on the administrative or non-administrative pricing rules for the transactions to which the expense item(s) relate. The purpose of this allocation is to determine the amount of expenses that relate to exempt and non-exempt foreign trade income. Only expenses relating to non-exempt foreign trade income are deductible in figuring taxable income. See section 921(b).

Line 1. Only enter foreign direct costs in lines 1a through 1e. See section 924(e) and regulations section 1.924(e)-1T(a) through (e) for definitions and rules on direct activity costs relating to foreign trade income. If you take a deduction for bad debts on line 1e, and you use the reserve method to figure the deduction, attach a schedule as explained in the line 11 instruction below.

Line 11. Bad Debts.—The FSC may either deduct business bad debts when they become wholly or partially worthless, or it may make a reasonable addition to a reserve for bad debts.

If the FSC uses the reserve method, attach a schedule for 1985 that separately lists:

- Trade notes and accounts receivable outstanding at the end of the year;
- Sales on account;
- Amount added to reserve-current-year's provision;
- Amount added to reserve-recoveries;
- Amount charged against reserve; and
- Reserve for bad debts at end of year.

A FSC may choose either method on its first return in which it takes a bad debt deduction. It must use that method for the following years unless it receives consent to change by filing Form 3115. If the FSC is changing from the specific charge-off method (section 166(a)) to the reserve method (section 166(c)), see Revenue Procedure 82-19, 1982-1 C.B. 463.

Schedule J—Tax Computation

A corporation that is not a member of a controlled group (these members should see the instruction for lines 1 and 2 below) must compute the tax on its taxable income as follows:

If the amount on Line 20, page 3, Form 1120-FSC is:		Enter on Schedule J, Line 3:	
Over—	But not over—		Of the amount over—
0	$25,000	15%	0
$25,000	50,000	$3,750 + 18%	$25,000
50,000	75,000	8,250 + 30%	50,000
75,000	100,000	15,750 + 40%	75,000
100,000	-------	25,750 + 46%	100,000
Additional tax		see instructions below	

Additional Tax.—If the corporation has taxable income of more than $1,000,000, an additional tax is imposed on the corporation. The tax is the lesser of: 1) 5% of the taxable income over $1,000,000; or 2) $20,250.

Alternative Tax.—If the alternative tax does not apply, enter on line 3 of Schedule J, the amount computed above. If the alternative tax applies, see Schedule D (Form 1120).

Lines 1 and 2.—Members of a controlled group, as defined in section 927(d)(4), are entitled to only one $25,000 amount in each taxable income bracket.

When a controlled group adopts or later amends an apportionment plan, each member must attach to its tax return a copy of its consent to this plan. The copy (or an attached statement) must show the part of the $25,000 amount in each taxable income bracket apportioned to that member. There are other requirements as well. See regulations section 1.1561-3(b) for these requirements and for the time and manner of making the consent.

Equal Apportionment Plan.—If no apportionment plan is adopted, the members of the controlled group must divide the $25,000 amount in each taxable income bracket equally among themselves. For example, controlled group AB consists of corporation A and corporation B. They do not elect an unequal apportionment plan. Therefore, corporation A is entitled to $12,500 (one-half of $25,000) in each taxable income bracket. Corporation B is also entitled to $12,500 in each taxable income bracket.

Unequal Apportionment Plan.—Members of a controlled group may elect an unequal apportionment plan and divide the $25,000 amount in each taxable income bracket as they wish. There is no need for consistency among taxable income brackets. Any member of the controlled group may be entitled to all, some, or none of the $25,000 amount in a taxable income bracket. (But the total amount for all members of the controlled group cannot be more than $25,000 in any taxable income bracket.) Each member of a controlled group must figure the tax as follows:

Note: *If the alternative tax applies, corporations should do the following:*

(1) Complete lines 1 and 2 of Schedule J,

(2) On line 1 below, instead of entering amount from line 20, page 3, Form 1120-FSC, enter amount from line 14, Schedule D (Form 1120),

(3) Complete lines 2 through 16 below, and

(4) Enter the amount from line 16 below on line 15 of Schedule D (Form 1120) and complete balance of Schedule D (Form 1120).

1. Enter taxable income (line 20, page 3 Form 1120-FSC) . . . _____
2. Enter line 1 or the corporation's portion of the first $25,000 taxable income bracket, whichever is less . . . . . _____
3. Subtract line 2 from line 1 . . _____
4. Enter line 3 or the corporation's portion of the second $25,000 taxable income bracket, whichever is less . . . . . _____
5. Subtract line 4 from line 3 . . _____
6. Enter line 5 or the corporation's portion of the third $25,000 taxable income bracket, whichever is less . . . . . _____
7. Subtract line 6 from line 5 . . _____
8. Enter line 7 or the corporation's portion of the fourth $25,000 taxable income bracket, whichever is less . . . . . _____
9. Subtract line 8 from line 7 . . _____
10. 15% of line 2 . . . . . _____
11. 18% of line 4 . . . . . _____
12. 30% of line 6 . . . . . _____
13. 40% of line 8 . . . . . _____
14. 46% of line 9 . . . . . _____
15. Additional tax . . . . . _____
16. Total of lines 10 through 15. Enter this amount on line 3 of Schedule J _____

Additional Tax (line 15).—If the corporation is a member of a controlled group and the controlled group has taxable income of more than $1,000,000, an additional tax is imposed on the corporation. The tax is the lesser of: (1) 5% of the taxable income of the controlled group over $1,000,000; or (2) $20,250.

The corporation pays its additional tax based on its share of each taxable income bracket, and enters this amount on line 15. If the additional tax does not apply, enter zero on line 15.

Line 4. Foreign Tax Credit.—Generally, neither a FSC nor its shareholders may claim a foreign tax credit. The FSC may, however, claim a foreign tax credit for any foreign taxes imposed on foreign source, non-foreign trade income that is effectively connected with a U.S. trade or business. This income is subject to a separate limitation when computing the foreign tax credit.

A shareholder of a FSC may be entitled to a foreign tax credit on certain distributions from a FSC. These distributions are from foreign sourced foreign trade income that was determined without using administrative pricing. See regulations section 1.921-2T(l), Question 19.

Schedule P (Form 1120-FSC).—Complete and attach a separate Schedule P (Form 1120-FSC) for each transaction or group of transactions to which you apply the transfer pricing rules of section 925. See Schedule P (Form 1120-FSC) for details on completing the schedule.

Codes for Principal Business Activity

These industry titles and definitions are based, in general, on the Standard Industrial Classification System authorized by Regulatory and Statistical Analysis Division, Office of Information and Regulatory Affairs, Office of Management and Budget, to classify enterprises by type of activity in which they are engaged.

Using the list below, enter on page 1, under D, the code number for the specific industry group from which the largest percentage of "total receipts" is derived. "Total receipts" means the total of receipts on line 6a, Schedule B, line 12, Schedule B, and line 13, Schedule F.

On page 2, under O, state the principal business activity and principal product or service that accounts 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."

Agriculture, Forestry, and Fishing

Code

0400 Agricultural production.
0600 Agricultural services (except veterinarians), forestry, fishing, hunting, and trapping.

Mining

Metal mining:

1010 Iron ores.
1070 Copper, lead and zinc, gold and silver ores.
1098 Other metal mining.
1150 Coal mining.

Oil and gas extraction:

1330 Crude petroleum, natural gas, and natural gas liquids.
1380 Oil and gas field services.

Nonmetallic minerals, except fuels:

1430 Dimension, crushed and broken stone; sand and gravel.
1498 Other nonmetallic minerals, except fuels.

Construction

General building contractors and operative builders:

1510 General building contractors.
1531 Operative builders.

1600 Heavy construction contractors.

Special trade contractors:

1711 Plumbing, heating, and air conditioning.
1731 Electrical work.
1798 Other special trade contractors.

Manufacturing

Food and kindred products:

2010 Meat products.
2020 Dairy products.
2030 Preserved fruits and vegetables.
2040 Grain mill products.
2050 Bakery products.
2060 Sugar and confectionery products.
2081 Malt liquors and malt.
2088 Alcoholic beverages, except malt liquors and malt.
2089 Bottled soft drinks, and flavorings.
2096 Other food and kindred products.

2100 Tobacco manufacturers.

Textile mill products:

2228 Weaving mills and textile finishing.
2250 Knitting mills.
2298 Other textile mill products.

Apparel and other textile products:

2315 Men's and boys' clothing.
2345 Women's and children's clothing.
2388 Other apparel and accessories.
2390 Miscellaneous fabricated textile products.

Lumber and wood products:

2415 Logging, sawmills, and planing mills.
2430 Millwork, plywood, and related products.
2498 Other wood products, including wood buildings and mobile homes.

2500 Furniture and fixtures.

Paper and allied products:

2625 Pulp, paper, and board mills.
2699 Other paper products.

Printing and publishing:

2710 Newspapers.
2720 Periodicals.
2735 Books, greeting cards, and miscellaneous publishing.
2799 Commercial and other printing, and printing trade services.

Code

Chemicals and allied products:

2815 Industrial chemicals, plastics materials and synthetics.
2830 Drugs.
2840 Soap, cleaners, and toilet goods.
2850 Paints and allied products.
2898 Agricultural and other chemical products.

Petroleum refining and related industries (including those integrated with extraction):

2910 Petroleum refining (including integrated).
2998 Other petroleum and coal products.

Rubber and misc. plastics products:

3050 Rubber products: plastics footwear, hose and belting.
3070 Misc. plastics products.

Leather and leather products:

3140 Footwear, except rubber.
3198 Other leather and leather products.

Stone, clay, and glass products:

3225 Glass products.
3240 Cement, hydraulic.
3270 Concrete, gypsum, and plaster products.
3298 Other nonmetallic mineral products.

Primary metal industries:

3370 Ferrous metal industries; misc. primary metal products.
3380 Nonferrous metal industries.

Fabricated metal products:

3410 Metal cans and shipping containers.
3428 Cutlery, hand tools, and hardware; screw machine products, bolts, and similar products.
3430 Plumbing and heating, except electric and warm air.
3440 Fabricated structural metal products.
3460 Metal forgings and stampings.
3470 Coating, engraving, and allied services.
3480 Ordnance and accessories, except vehicles and guided missiles.
3490 Misc. fabricated metal products.

Machinery, except electrical:

3520 Farm machinery.
3530 Construction and related machinery.
3540 Metalworking machinery.
3550 Special industry machinery.
3560 General industrial machinery.
3570 Office, computing, and accounting machines.
3598 Other machinery except electrical.

Electrical and electronic equipment:

3630 Household appliances.
3665 Radio, television, and communication equipment.
3670 Electronic components and accessories.
3698 Other electrical equipment.

3710 Motor vehicles and equipment

Transportation equipment, except motor vehicles:

3725 Aircraft, guided missiles and parts.
3730 Ship and boat building and repairing
3798 Other transportation equipment, except motor vehicles.

Instruments and related products:

3815 Scientific instruments and measuring devices; watches and clocks.
3845 Optical, medical, and ophthalmic goods.
3860 Photographic equipment and supplies.

3998 Other manufacturing products.

Transportation and Public Utilities

Code

Transportation:

4000 Railroad transportation.
4100 Local and interurban passenger transit.
4200 Trucking and warehousing.
4400 Water transportation.
4500 Transportation by air.
4600 Pipe lines, except natural gas.
4700 Miscellaneous transportation services.

Communication:

4825 Telephone, telegraph, and other communication services.
4830 Radio and television broadcasting.

Electric, gas, and sanitary services:

4910 Electric services.
4920 Gas production and distribution.
4930 Combination utility services.
4990 Water supply and other sanitary 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 and supplies.
5098 Other durable goods.

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 Misc. nondurable goods.

Retail Trade

Building materials, garden supplies, and mobile home dealers:

5220 Building materials dealers.
5251 Hardware stores.
5265 Garden supplies and mobile home dealers.

5300 General merchandise stores.

Food 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.

5600 Apparel and accessory stores.

5700 Furniture and home furnishings stores.

5800 Eating and drinking places.

Misc. retail stores:

5912 Drug stores and proprietary stores.
5921 Liquor stores.
5995 Other retail stores.

Finance, Insurance, and Real Estate

Code

Banking:

6030 Mutual savings banks.
6060 Bank holding companies.
6090 Banks, except mutual savings banks and bank holding companies.

Credit agencies other than banks:

6120 Savings and loan associations.
6140 Personal credit institutions.
6150 Business credit institutions.
6199 Other credit agencies.

Security, commodity brokers and services:

6210 Security brokers, dealers, and flotation companies.
6299 Commodity contracts brokers and dealers; security and commodity exchanges; and allied services.

Insurance:

6355 Life Insurance
6356 Mutual insurance, except life or marine and certain fire or flood insurance companies.
6359 Other insurance companies.
6411 Insurance agents, brokers, and service.

Real estate:

6511 Real estate operators and lessors of buildings.
6516 Lessors of mining, oil, and similar property.
6518 Lessors of railroad property and other real property.
6530 Condominium management and cooperative housing associations.
6550 Subdividers and developers.
6599 Other real estate.

Holding and other investment companies, except bank holding companies:

6742 Regulated investment companies.
6743 Real estate investment trusts.
6744 Small business investment companies.
6749 Other holding and investment companies except bank holding companies.

Services

7000 Hotels and other lodging places.

7200 Personal services.

Business services:

7310 Advertising.
7389 Business services, except advertising.

Auto repair; miscellaneous repair services:

7500 Auto repair and services.
7600 Misc. repair services.

Amusement and recreation services:

7812 Motion picture production, distribution, and services.
7830 Motion picture theaters.
7900 Amusement and recreation services, except motion pictures.

Other services:

8015 Offices of physicians, including osteopathic physicians.
8021 Offices of dentists.
8040 Offices of other health practitioners.
8050 Nursing and personal care facilities.
8060 Hospitals.
8071 Medical laboratories.
8099 Other medical services.
8111 Legal services.
8200 Educational services.
8300 Social services.
8600 Membership organizations.
8911 Architectural and engineering services.
8930 Accounting, auditing, and bookkeeping.
8980 Miscellaneous services (including veterinarians).