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be treated as a DISC and such election terminates in either manner described in subparagraph (2) or (3) of this paragraph, such corporation is eligible to reelect to be treated as a DISC at any time by following the procedures described in paragraphs (a) through (c) of this section. If a corporation terminates its election and subsequently reelects to be treated as a DISC, the corporation and its shareholders continue to be subject to sections 995 and 996 with respect to the period during which its first election was in effect. Thus, for example, distributions upon disqualification includible in the gross incomes of shareholders of a corporation pursuant to section 995(b)(2) continue to be so includible for taxable years for which a second election of such corporation is in effect without regard to the second election.

[T.D. 7323, 39 FR 34405, Sept. 25, 1974, as amended by T.D. 7420, 41 FR 20655, May 20, 1976]

§ 1.992–3 Deficiency distributions to meet qualification requirements.

(a) *In general.* A corporation which meets the requirements described in §1.992–1 for treatment as a DISC for a taxable year, other than the 95 percent of gross receipts test described in §1.992–1(b) or the 95-percent assets test described in §1.992–1(c), or both tests, may nevertheless qualify as a DISC for such year by making deficiency distributions (attributable to its gross receipts other than qualified export receipts and its assets other than qualified export assets) if all of the following requirements are satisfied:

(1) The corporation distributes the amount determined under paragraph (b) of this section as a deficiency distribution. The amount of a deficiency distribution is determined without regard to the amount by which the corporation fails to meet either test.

(2) The reasonable cause requirements prescribed in paragraph (c)(1) of this section are satisfied with respect to both the corporation's failure to meet either test and its failure to make a deficiency distribution prior to the time the distribution is made.

(3) The corporation makes such deficiency distribution pro rata to all its shareholders.

(4) The corporation designates the distribution, at the time of the distribution, as a deficiency distribution, pursuant to section 992(c), to meet the qualification requirements to be a DISC. Such designation shall be in the form of a communication sent at the time of such distribution to each shareholder and to the service center with which the corporation has filed or will file its return for the taxable year to which the distribution relates. A corporation may not retroactively designate a prior distribution as a deficiency distribution to meet qualification requirements. Subject to the limitation described in paragraph (c)(3) of this section, a corporation may make a deficiency distribution with respect to a taxable year at any time after the close of such taxable year or, in the case of a deficiency distribution made on or before September 29, 1975, at any time during or after such taxable year.

See sections 246(d), 904(f), 995, and 996 for rules regarding the treatment of a deficiency distribution to meet qualification requirements by the shareholders and the corporation.

(b) *Amount of deficiency distribution*—(1) *In general.* In order to meet the requirements of paragraph (a) of this section, the amount of a deficiency distribution must be, if the corporation fails to meet—

(i) The 95 percent of gross receipts test, the amount determined in subparagraph (2) of this paragraph,

(ii) The 95-percent assets test, the amount determined in subparagraph (3) of this paragraph, and

(iii) Both such tests, except as provided in subparagraph (4) of this paragraph, the sum of the amounts determined in subparagraphs (2) and (3) of this paragraph.

(2) *Computation of deficiency distribution to meet 95 percent of gross receipts test*—(i) *In general.* If a corporation fails to meet the 95 percent of gross receipts test described in §1.992–1(b) for its taxable year, the amount of the deficiency distribution required by this subparagraph is an amount equal to the sum of its taxable income (if any) from each transaction giving rise to gross receipts (as defined in §1.993–6) which are

not qualified export receipts (as defined in §1.993–1). A corporation's taxable income from a transaction shall be the amount of such gross receipts from such transaction reduced only by (*a*) its cost of goods sold attributable to such gross receipts, and by (*b*) its expenses, losses, and other deductions properly apportioned or allocated thereto in a manner consistent with the rules set forth in §1.861–8. For purposes of this subdivision, however, any expenses, losses, or other deductions which cannot definitely be allocated to some item or class of gross income in such manner shall not reduce such gross receipts. If the corporation is a commission agent for a principal in a transaction, the corporation's taxable income is the amount of the commission from such transaction reduced only by the amounts described in (*b*) of this subdivision.

(ii) *Example.* The provisions of this subparagraph may be illustrated by the following example:

Example. (*a*) X and Y are calendar year taxpayers. X, a domestic manufacturing company, owns all the stock of Y, which seeks to qualify as a DISC for 1973. During 1973, X manufactures a machine which is eligible to be export property as defined in §1.993–3. Y is made a commission agent with respect to exporting such machine. Thereafter, during 1973 Y is considered to receive gross receipts of $100,000, as determined under section 993(f), attributable to X's sale of the machine in a manner which causes the gross receipts to be excluded receipts pursuant to section 993(a)(2) and, therefore, not qualified export receipts. Y's total gross receipts for 1973 are $1 million of which $900,000 (*i.e.*, 90 percent) are qualified export receipts. Therefore, Y does not satisfy the 95 percent of gross receipts test for 1973 because less than 95 percent of its gross receipts are qualified export receipts. Y has $9,000 of expenses properly apportioned or allocated to its gross income from such sale and $1,000 of other expenses which cannot definitely be allocated to some item or class of gross income, determined in a manner consistent with the rules set forth in §1.861–8. In order to satisfy the 95 percent of gross receipts test for 1973, if the commission due from X to Y were $15,000, Y must make a deficiency distribution of $6,000 computed as follows:

Y's commission (gross income) from the transaction	$15,000
Less: Y's expenses apportioned or allocated to its gross income from the transaction	9,000
Required deficiency distribution by reason of $100,000 of gross receipts which are not qualified export receipts	6,000

(*b*) If the commission due from X to Y were $9,400, resulting in a net loss of $600 to Y ($9,400 to $10,000), Y must make a deficiency distribution of $400 computed as follows:

Y's commissions (gross income) from the transaction	$9,400
Less: Y's expenses apportioned or allocated to its gross income from the transaction	9,000
Required deficiency distribution by reason of $100,000 of gross receipts which are not qualified export receipts	400

(*c*) If the commission due from X to Y were $8,500, Y would not be required to make a deficiency distribution since, under this subparagraph, there would be no taxable income attributable to gross receipts from the sale.

(3) *Computation of deficiency distribution to meet 95 percent assets test*—(i) *In general.* If a corporation fails to meet the 95 percent assets test described in §1.992–1(c) for its taxable year, the amount of the deficiency distribution required by this subparagraph is an amount equal to the fair market value as of the last day of such taxable year of the assets which are not qualified export assets held by such corporation on such last day.

(ii) *Asset held for more than 1 year.* In the case of a corporation which holds continuously an asset which is not a qualified export asset at the close of more than 1 taxable year, it must distribute an amount equal to its fair market value (or, if greater, the amount determined under subparagraph (4) of this paragraph) only once if, at the close of the first such taxable year, such corporation reasonably believed that such asset was a qualified export asset. This subdivision shall not apply for any taxable year beginning after the date the corporation knows (or a reasonable man would have known) that an asset is not a qualified export asset and in order to qualify for each such year, the corporation must distribute the fair market value of such asset for each such year.

(4) *Computation in the case of a failure to meet both tests as a result of a single transaction.* If a corporation fails to meet both the 95 percent of gross receipts test and the 95 percent assets test for a taxable year, and if the corporation holds at the end of such year

assets (other than cash or qualified export assets) which were received as proceeds of a sale or exchange during such year which resulted in gross receipts other than qualified export receipts, then the amount of the deficiency distribution required by this paragraph with respect to such sale or exchange and assets held is the larger of the amount required by subparagraph (2) of this paragraph with respect to the sale or exchange or the amount required by subparagraph (3) of this paragraph with respect to such assets held. Thus, for example, if a corporation sells property which is not a qualified export asset for $100, receives $85 in cash and a note for $15, and derives $25 of taxable income from the sale as determined under subparagraph (2) of this paragraph, it must distribute $25. If the provisions of this subparagraph are applied with respect to assets of a DISC (other than qualified export assets), such provisions do not apply to any property received as proceeds from a sale or exchange of such assets.

(c) *Reasonable cause for failure*—(1) *In general.* If for a taxable year, a corporation has failed to meet the 95 percent of gross receipts test, the 95 percent assets test, or both tests, such corporation may satisfy any such test for such year by means of a deficiency distribution in the amount determined under paragraph (b) of this section only if the reasonable cause requirements of this subparagraph are satisfied. Such reasonable cause requirements are satisfied if—

(i) There is reasonable cause (as determined in accordance with subparagraph (2) of this paragraph) for such corporation's failure to satisfy such test and to make such distribution prior to the date on which it was made, the time limit in subparagraph (3) of this paragraph for making the distribution is satisfied, and interest (if required) is paid in the amount and in the manner prescribed by subparagraph (4) of this paragraph, or

(ii) The time and ''70-percent'' requirements of the reasonable cause test of paragraph (d) of this section are satisfied.

(2) *Determination of reasonable cause.* In general, whether a corporation's failure to meet the 95 percent of gross receipts test, the 95 percent assets test, or both tests for a taxable year and its failure to make a pro rata distribution prior to the date on which it was made will be considered for reasonable cause where the action or inaction which resulted in such failure occurred in good faith, such as failure to meet the 95 percent assets test resulting from blocked currency or expropriation, or failure to meet either test because of reasonable uncertainty as to what constitutes a qualified export receipt or a qualified export asset. For further examples, if a corporation's reasonable determination of the percentage of its total gross receipts that are qualified export receipts is subsequently redetermined to be less than 95 percent as a result of a price adjustment by the Internal Revenue Service under section 482, or if the corporation has a casualty loss for which it receives an unanticipated insurance recovery which causes its qualified export receipts to be less than 95 percent of its total gross receipts, then the failure to satisfy the 95 percent of gross receipts test is considered to be due to reasonable cause.

(3) *Time limit for deficiency distribution.* Except as otherwise provided in this subparagraph, the time limit prescribed by this subparagraph for making a deficiency distribution is satisfied if the amount of the distribution required by paragraph (b) of this section is made within 90 days from the date of the first written notification to the corporation by the Internal Revenue Service that it had not satisfied the 95 percent of gross receipts test or the 95 percent assets test or both tests, for a taxable year. Upon a showing by the corporation that an extension of the 90-day time limit is reasonable and necessary, the Commissioner may grant such extension of such time limit. In any case in which a corporation contests the decision of the Internal Revenue Service that such corporation has not met the 95 percent of gross receipts test, the 95 percent assets test, or both tests, an extension of the 90-day time limit will be allowed until 30 days after the final determination of such contest. The date of the final determination of such contest shall, for

purposes of section 992(c), be established in the manner specified in subdivisions (i) through (iv) of this subparagraph:

(i) The date of final determination by a decision of the United States Tax Court is the date upon which such decision becomes final, as prescribed in section 7481.

(ii) The date of final determination in a case which is contested in a court (and upon which there is a judgment) other than the Tax Court is the date upon which the judgment becomes final and will be determined on the basis of the facts and circumstances of each particular case. For example, ordinarily a judgment of a United States district court becomes final upon the expiration of the time allowed for taking an appeal, if no such appeal is duly taken within such time; and a judgment of the United States Court of Claims becomes final upon the expiration of the time allowed for filing a petition for certiorari if no such petition is duly filed within such time.

(iii) The date of a final determination by a closing agreement, made under section 7121, is the date such agreement is approved by the Commissioner.

(iv) A final determination under section 992(c) may be made by an agreement signed by the district director or director of the service center with which the corporation files its annual return or by such other official to which authority to sign has been delegated, and by or on behalf of the taxpayer. The agreement shall set forth the total amount of the deficiency distribution to be paid to the shareholders of the DISC for the taxable year or years. An agreement under this subdivision shall be sent to the taxpayer at his last known address by either registered or certified mail. For further guidance regarding the definition of last known address, see §301.6212–2 of this chapter. If registered mail is used for such purpose, the date of registration is considered the date of final determination; if certified mail is used for such purpose, the date of postmark on the sender's receipt for such mail is considered the date of final determination. If the corporation makes a deficiency distribution before such registration or postmark date but on or after the date the district director or director of the service center or other official has signed the agreement, the date of signature by the district director or director of the service center or other official is considered the date of final determination. If the corporation makes a deficiency distribution before the district director or director of the service center or other official signs the agreement, the date of final determination is considered to be the date of the making of the deficiency distribution. During any extension of time the interest charge provided in subparagraph (4) of this paragraph will continue to accrue at the rate provided for in such subparagraph.

(4) *Payment of interest for delayed distribution*—(i) *In general.* If a corporation makes a deficiency distribution after the 15th day of the ninth month after the close of the taxable year with respect to which such distribution is made, such distribution will not be deemed to satisfy the 95 percent of gross receipts test or the 95 percent assets test for such year unless such corporation pays to the Internal Revenue Service a charge determined by multiplying (a) an amount equal to 4½ percent of such distribution by (*b*) the number of its taxable years which begin (*1*) after the taxable year with respect to which the distribution is made and (*2*) before such distribution is made. Such charge must be paid, within the 30-day period beginning with the day on which such distribution is made, to the service center with which the corporation files its annual information return for its taxable year in which the distribution is made. For purposes of the Internal Revenue Code, such charge is considered interest.

(ii) *Example.* The provisions of subdivision (i) of this subparagraph may be illustrated by the following example:

Example. X corporation, which uses the calendar year as its taxable year, meets the 95 percent assets test but fails to meet the 95 percent of gross receipts test for 1972 and does not by September 15, 1973, make the deficiency distribution required by reason of its failure to meet such test. Assume that reasonable cause exists for the corporation's failure to meet the 95 percent of gross receipts test and failure to make the required

deficiency distribution. If X makes the required deficiency distribution, in the amount of $10,000, on April 1, 1976, X must pay on or before April 30, 1976, to the service center with which it files its annual information return a charge of $1,800, computed as follows:

Deficiency distribution made by X	$10,000
Multiplied by 4½ percent	.045
Intermediate product	450
Multiplied by: Number of X's taxable years beginning after 1972 and before April 1, 1976	4
Charge to be paid service center because of late deficiency distribution (which is considered interest)	1,800

(d) *Certain distributions deemed for reasonable cause.* If a corporation makes a distribution in the amount required by paragraph (b) of this section with respect to a taxable year on or before the 15th day of the ninth month after the close of such year, it will be deemed to have acted with reasonable cause with respect to its failure to satisfy the 95 percent of gross receipts test, the 95 percent assets test, or both tests, for such year and its failure to make such distribution prior to the date on which the distribution was made if—

(1) At least 70 percent of the gross receipts of such corporation for such taxable year consist of qualified export receipts, and

(2) The sum of the adjusted bases of the qualified export assets held by such corporation on the last day of each month of the taxable year equals or exceeds 70 percent of the sum of the adjusted bases of all assets held by the corporation on each such day.

[T.D. 7323, 39 FR 34407, Sept. 25, 1974; 39 FR 36009, Oct. 7, 1974, as amended by T.D. 7420, 41 FR 20655, May 20, 1976; T.D. 7854, 47 FR 51739, Nov. 17, 1982; T.D. 8939, 66 FR 2819, Jan. 12, 2001]

§ 1.992–4 Coordination with personal holding company provisions in case of certain produced film rents.

(a) *In general.* Section 992(d)(2) provides that a personal holding company is not eligible to be treated as a DISC. Section 543(a)(5)(B) provides that, for purposes of section 543, the term ''produced film rents'' means payments received with respect to an interest in a film for the use of, or the right to use, such film, but only to the extent that such interest was acquired before substantial completion of production of such film. Under section 992(e), if such produced film rents are included in the ordinary gross income (as defined in section 543(b)(1)) of a qualified subsidiary for a taxable year of such subsidiary, and such interest was acquired by such subsidiary from its parent, such interest is deemed (for purposes of the application of sections 541, 543(b)(1), and 992(d)(2), and §1.992–1(f) for such taxable year) to have been acquired by such subsidiary at the time such interest was acquired by such parent. Thus, for example, if a parent acquires an interest in a film before it is substantially completed, then substantially completes such film prior to transferring an interest in such motion picture to a qualified subsidiary, the qualified subsidiary is considered as having acquired such interest prior to substantial completion of such motion picture for purposes of determining whether payments from the rental of such motion picture will be classified as produced film rents of such subsidiary. The provisions of section 992(e) and this section are not applicable in determining whether payments received with respect to an interest in a film are included in the ordinary gross income of a parent or a qualified subsidiary. Thus, even though a qualified subsidiary is treated pursuant to this section as having acquired an interest in a film at the time such interest was acquired by such subsidiary's parent, payments received by such parent with respect to such interest prior to the transfer of such interest to such subsidiary are includible in the ordinary gross income of such parent and not includible in the ordinary gross income of such subsidiary.

(b) *Definitions*—(1) *Qualified subsidiary.* For purposes of this section, a corporation is a qualified subsidiary for a taxable year if—

(i) Such corporation was established for the purpose of becoming a DISC,

(ii) Such corporation would qualify (or be treated) as a DISC for such taxable year if it is not a personal holding company, and

(iii) On every day of such taxable year on which shares of such corporation are outstanding, at least 80 percent of such shares are held directly by a second corporation.