Subpart 3-9 of Part 3 of Subchapter A of Title 20 of the Codes, Rules and Regulations of the State of New York is repealed and a new Subpart 3-10, Domestic International Sales Corporation (DISC), is added to read as follows:

SUBPART 3-10

DOMESTIC INTERNATIONAL SALES CORPORATION (DISC)

Section 3-10.1. General. [Tax Law, §§ 208(1) and (9)(i), 209(6)]

(a) For purposes of article 9-A, a corporation will be treated as a Domestic International Sales Corporation (hereinafter called a "DISC") if it meets the requirements of IRC section 992(a). At the time it files an election to be treated as a DISC pursuant to IRC section 992(b)(1), the corporation must also file a copy of such election with the Department, in the manner prescribed by the Department.

(b) For purposes of article 9-A, a DISC is either a "tax exempt DISC" or a "taxable DISC." For any taxable year during which a corporation does not meet the requirements for treatment as a DISC, it will be treated in the same manner as any other taxpayer subject to tax under article 9-A.

(c) The term "former DISC" refers, with respect to any taxable year, to a corporation that is not a DISC during such year but was (or was treated as) a DISC for a prior taxable year. However, a corporation will not be considered a former DISC for a taxable year unless such corporation has, at the beginning of such taxable year, undistributed previously taxed income or accumulated DISC income.

Section 3-10.2. Taxable DISC. [Tax Law, §§ 209(6), 211(1)]

A taxable DISC is a DISC that does not meet the requirements for tax exemption as described in section 3-10.3 of this Subpart. A taxable DISC is subject to tax measured by the capital base or the fixed dollar minimum tax, whichever is greater. A taxable DISC is not subject to tax measured by the business income base. A taxable DISC must file its report on or before the 15th day of the ninth month following the close of its taxable year, and must identify itself as a DISC on such report.

Section 3-10.3. Tax exempt DISC. [Tax Law, §§ 208(9)(i), 211(1)]

(a) A tax exempt DISC is a DISC that during a taxable year:

(1) receives more than five percent of its gross receipts from the sale of inventory or other property that it purchased from its stockholders; or

(2) receives more than five percent of its gross rentals from the rental of property that it purchased or leased from its stockholders; or

(3) receives more than five percent of its total receipts other than from sales or rentals from its stockholders.

(b) A tax exempt DISC has no filing requirement under article 9-A, although its corporate stockholders may have a filing requirement (see section 3-10.4 of this Subpart).

Section 3-10.4. Corporate stockholders of tax exempt DISC. [Tax Law, § 208(9)(i)]

(a) A taxpayer that is subject to tax under article 9-A and is a stockholder of a tax exempt DISC must do the following on its report required to be filed under article 9-A:

(1) adjust its receipts, expenses, assets and liabilities to include its attributable share of the DISC's receipts, expenses, assets and liabilities;

(2) eliminate any deemed or actual distributions received from the DISC to the extent already included in entire net income; and

(3) eliminate intercorporate transactions between the stockholder and the tax exempt DISC.

(b) A taxpayer required to file a report pursuant to this section must also file the affiliated entity information schedule.

Section 3-10.5. Corporate stockholder's treatment of distribution and capital of a DISC. [Tax Law, § 208(8-A)]

(a) Since a DISC is not subject to tax on its earnings and profits, no deduction is allowed for the dividends distributed to a corporation owning stock of a DISC.

(b) Deemed distributions from a DISC or a former DISC that are taxable as dividends pursuant to IRC section 995(b) must be treated as business income.

(c) Actual distributions from a DISC or a former DISC must be treated as business income, unless such distributions meet the requirements of subdivision (d) of this section.

(d) Actual distributions from a DISC or a former DISC will be treated as investment income if:

(1) such distributions are treated as being made out of "other earnings and profits" for Federal income tax purposes, under IRC section 996; and

(2) the stock of the DISC meets the definition of investment capital as set forth in section 3-4.1 of this Part.

(e) Any gain or loss recognized for Federal income tax purposes on the disposition of stock in a DISC or a former DISC must be treated as business income, whether or not the stock of the DISC meets the definition of investment capital as set forth in section 3-4.1 of this Part.

(f) The corporate stockholder's distributive share of the DISC's investments in the stocks, bonds or other securities or indebtedness from a DISC must be treated as business capital.

Section 3-10.6. Combined reports. [Tax Law, § 210-C]

(a)(1) If both the capital stock requirement, pursuant to section 6-2.2 of this Title, and the unitary business requirement, pursuant to section 6-2.3 of this Title, are met with respect to a taxpayer that is a stockholder of a taxable DISC and such DISC, the taxpayer is required to make a combined report with the taxable DISC.

(2) If the capital stock requirement, pursuant to section 6-2.2 of this Title, is met, but the unitary business requirement, pursuant to section 6-2.3 of this Title, is not met, with respect to a taxpayer that is a stockholder of a taxable DISC and such DISC, the taxable DISC will be included in a combined report with the taxpayer only if the taxpayer is part of a combined group that has made the commonly owned group election, pursuant to section 6-2.7 of this Title.

(See Subpart 6-2 of this Title—Combined reports).

(b) In filing a combined report pursuant to subdivision (a) of this section, intercorporate dividends from a taxable DISC or a taxable former DISC are treated as business income and shall not be eliminated.

Section 3-10.7. Rules for treatment of earnings and profits

(a) For purposes of article 9-A, the earnings and profits of a DISC or of a former DISC are deemed to be divided into the following three categories:

(1) accumulated DISC income, which includes the earnings and profits of the corporation that have been deferred from taxation, as defined in section 1.996-3(b) of the Federal income tax regulations (26 CFR 1.996-3[b]);

(2) previously taxed income, which includes the earnings and profits of the DISC that have been previously taxed by reason of having been deemed distributed, as defined in section 1.996-3(c) of the Federal income tax regulations (26 CFR 1.996-3[c]); and

(3) other earnings and profits, which includes the earnings and profits of the DISC that were derived by the corporation in taxable years when it was not qualified as a DISC, as defined in section 1.996-3(d) of the Federal income tax regulations (26 CFR 1.996-3[d]).

(b) Any actual distribution to a stockholder that is made out of the earnings and profits of a DISC or a former DISC shall be treated as made in the following order:

(1) first, out of previously taxed income, as described in paragraph (2) of subdivision (a) of this section;

(2) second, out of accumulated DISC income, as described in paragraph (1) of subdivision (a) of this section; and

(3) third, out of other earnings and profits, as described in paragraph (3) of subdivision (a) of this section.

(c) If for any taxable year a DISC, or a former DISC, incurs a deficit in earnings and profits, such deficit shall be charged in the following order:

(1) first, to other earnings and profits, as described in paragraph (3) of subdivision (a) of this section;

(2) second, to accumulated DISC income, as described in paragraph (1) of subdivision (a) of this section; and

(3) third, to previously taxed income, as described in paragraph (2) of subdivision (a) of this section.