

under the law of the country in which such property is situated.

(2) *Activities of the foreign corporation.* For purposes of subparagraph (1)(ii) of this paragraph, a foreign corporation which holds title to real property situated outside the United States may also perform activities with respect to such property (such as management, maintenance, and payment of taxes) which are ancillary to its function of holding title to such property.

(3) *Exclusive use by the DISC.* Real property held by the foreign corporation must be used exclusively by the DISC whether under a lease or any other arrangement. Real property is not so used by the DISC if the DISC subleases such property to any other person. If, however, during a taxable year of the DISC—

(i) 90 percent or more of the qualified export receipts of the DISC for such year are derived from transactions with respect to which it is a commission agent for a related supplier (as defined in § 1.994-1(a)(3)(ii)), and

(ii) The DISC subleases such property to such related supplier

then such property will be considered as used exclusively by the DISC during such year if such related supplier does not sublease such property.

(d) *Associated foreign corporation—(1) In general.* A foreign corporation is an associated foreign corporation with respect to a taxable year of the DISC if—

(i) On each day during such taxable year of the DISC on which the foreign corporation has stock issued and outstanding, the DISC, or one or more members of the same controlled group of corporations (as defined in subparagraph (2) of this paragraph) as the DISC, owns (within the meaning of section 1563 (d) and (e)) stock of the foreign corporation possessing less than 10 percent of the total combined voting power of all classes of stock of the foreign corporation entitled to vote, as determined under the principles of § 1.957-1(b), or owns no stock of such corporation, and

(ii) The ownership of stock, or of securities (as defined in § 1.993-2(g)), of the foreign corporation by the DISC or by one or more members of such controlled group of corporations reasonably furthers a transaction or trans-

actions giving rise to qualified export receipts for the DISC.

(2) *Controlled group of corporations.* For purposes of this paragraph, the term “controlled group of corporations” has the same meaning assigned to the term in section 1563(a) and not section 993(a)(3) and § 1.993-1(k). Thus, for purposes of this paragraph, the test of control is 80 percent control and, since the rules of section 1563(b) apply, only domestic members are considered to be members of the controlled group.

(3) *Furtherance of qualified export receipts.* Ownership of stock or securities of a foreign corporation will be considered as reasonably furthering a transaction or transactions giving rise to qualified export receipts for a DISC if—

(i) The ownership is necessary to obtain or maintain the foreign corporation as a customer of the DISC or of a related supplier, as defined in § 1.994-1(a)(3)(ii) of the DISC or to aid the sales distribution system of the DISC or of such related supplier, and

(ii) The amount of the investment in the foreign corporation bears a reasonable relationship to the amount of the DISC’s annual net profit from transactions in its trade or business which it may reasonably expect to derive on account of such ownership.

In determining whether the amount of the investment is reasonable, there shall be taken into account any stock or securities of the foreign corporation owned by any other foreign corporation which, if it were a domestic corporation, would be a member of the same controlled group of corporations as the DISC.

[T.D. 7514, 42 FR 55467, Oct. 17, 1977; 42 FR 60910, Nov. 30, 1977]

§ 1.993-6 Definition of gross receipts.

(a) *General rule.* Under section 993(f), for purposes of sections 991 through 996, the gross receipts of a person for a taxable year are—

(1) The total amounts received or accrued by the person from the sale or lease of property held primarily for sale or lease in the ordinary course of a trade or business, and

(2) Gross income recognized from all other sources, such as, for example, from—

(i) The furnishing of services (whether or not related to the sale or lease of property described in subparagraph (1) of this paragraph),

(ii) Dividends and interest,

(iii) The sale at a gain of any property not described in subparagraph (1) of this paragraph, and

(iv) Commission transactions as and to the extent described in paragraph (e) of this section.

(b) *Nongross receipts items.* For purposes of paragraph (a) of this section, gross receipts do not include amounts received or accrued by a person from—

(1) The proceeds of a loan or of the repayment of a loan, or

(2) A receipt of property in a transaction to which section 118 (relating to contribution to capital) or 1032 (relating to exchange of stock for property) applies.

(c) *Nonreduction of total amounts.* For purposes of paragraph (a) of this section, the total amounts received or accrued by a person are not reduced by returns and allowances, costs of goods sold, expenses, losses, a deduction for dividends received under section 243, or any other deductible amounts.

(d) *Method of accounting.* For purposes of paragraph (a) of this section, the total amounts received or accrued by a person shall be determined under the method of accounting used in computing its taxable income. If, for example, a DISC receives advance or installment payments for the sale or lease of property described in paragraph (a)(1) of this section, for the furnishing of services, or which represent recognized gain from the sale of property not described in paragraph (a)(1) of this section, any amount of such advance payments is considered to be gross receipts of the DISC for the taxable year for which such amount is included in the gross income of the DISC.

(e) *Commission transactions.* (1) In the case of transactions which give rise to a commission on the sale or lease of property or the furnishing of services by a principal, the amount recognized by the commission agent as gross income from all such transactions shall be the gross receipts derived by the principal from the sale or lease of the property, or the gross income derived by the principal from the furnishing of

services, with respect to which the commissions are derived. In the case of a commission agent for a related supplier (as defined in §1.994-1(a)(3)(ii)), the gross receipts or gross income of such agent shall be determined as if it used the same method of accounting as its related supplier. In the case of a commission agent for a principal other than a related supplier, the gross receipts or gross income of such principal shall be determined as if such principal used the same method of accounting as its agent.

(2) If the commission arrangement provides that the commission agent will receive a commission only with respect to sales or leases of export property, or the furnishing of services, which result in qualified export receipts, the commission agent will not take into account the gross receipts or gross income, as the case may be, derived by the principal from any transaction for which the commission agent would not be entitled to a commission under the commission arrangement.

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

Example. During 1973, M, a related supplier (as defined in §1.994-1(a)(3)(ii)) of N, is engaged in the manufacture of machines in the United States. N, a calendar year taxpayer, is engaged in the sale and lease of such machines in foreign countries. N furnishes services which are related and subsidiary to its sale and lease of such machines. N also acts as a commission agent in foreign countries for Z, an unrelated supplier, with respect to Z's sale of products. N receives dividends on stock owned by it in a related foreign export corporation (as defined in §1.993-5), interest on producer's loans made to M, and proceeds from sales of business assets located outside the United States resulting in a recognized gains and losses. N's gross receipts for 1973 are \$3,550, computed on the basis of the additional facts assumed in the table below:

(1) N's sales receipts for machines manufactured by M (without reduction for cost of goods sold and selling expenses)	\$1,500
(2) N's lease receipts for machines manufactured by M (without reduction for depreciation and leasing expenses)	500
(3) N's gross income from services for machines manufactured by M (without reduction for service expenses)	400
(4) Z's sale receipts for products manufactured by Z (without reduction for Z's cost of goods sold, commissions on sales, and commission sales expenses)	550
(5) Dividends received by N	150

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(6) Interest received by N on producer's loans	200
(7) Proceeds received by N representing recognized gain (but not losses) from sales of business assets located outside the United States	250
(8) N's gross receipts	3,550

[T.D. 7514, 42 FR 55468, Oct. 17, 1977]

§ 1.993-7 Definition of United States.

Under section 993(g), the term "United States" includes the States, the District of Columbia, the Commonwealth of Puerto Rico, and possessions of the United States. For the requirement that a DISC must be incorporated and existing under the laws of a State or the District of Columbia, see §1.992-1(a)(1).

[T.D. 7514, 42 FR 55468, Oct. 17, 1977]

§ 1.994-1 Inter-company pricing rules for DISC's.

(a) *In general*—(1) *Scope*. In the case of a transaction described in paragraph (b) of this section, section 994 permits a person related to a DISC to determine the allowable transfer price charged the DISC (or commission paid the DISC) by its choice of three methods described in paragraph (c)(2), (3), and (4) of this section: The "4 percent" gross receipts method, the "50-50" combined taxable income method, and the section 482 method. Under the first two methods, the DISC is entitled to 10 percent of its export promotion expenses as additional taxable income. When the gross receipts method or combined taxable income method is applied to a transaction, the Commissioner may not make distributions, apportionments, or allocations as provided by section 482 and the regulations thereunder. For rules as to certain "incomplete transactions" and for computing combined taxable income, see paragraph (c)(5) and (6) of this section. Grouping of transactions for purposes of applying the method chosen is provided by paragraph (c)(7) of this section. The rules in paragraph (c) of this section are directly applicable only in the case of sales or exchanges of export property to a DISC for resale, and are applicable by analogy to leases, commissions, and services as provided in paragraph (d) of this section. For rules limiting the application of the gross receipts method and combined taxable

income method so that the supplier related to the DISC will not incur a loss on transactions, see paragraph (e)(1) of this section. Paragraph (e)(2) of this section provides for the applicability of section 482 to resales by the DISC to related persons. Paragraph (e)(3) of this section provides for the time by which a reasonable estimate of the transfer price (including commissions and other payments) should be paid. The subsequent determination and further adjustments to transfer prices are set forth in paragraph (e)(4) of this section. Export promotion expenses are defined in paragraph (f) of this section. Paragraph (g) of this section has several examples illustrating the provisions of this section. Section 1.994-2 prescribes the marginal costing rules authorized by section 994(b)(2).

(2) *Performance of substantial economic functions*. The application of section 994(a)(1) or (2) does not depend on the extent to which the DISC performs substantial economic functions (except with respect to export promotion expenses). See paragraph (1) of §1.993-1.

(3) *Related party and related supplier*. For the purposes of this section—

(i) The term "related party" means a person which is owned or controlled directly or indirectly by the same interests as the DISC within the meaning of section 482 and §1.482-1(a).

(ii) The term "related supplier" means a related party which singly engages in a transaction directly with the DISC which is subject to the rules of section 994 and this section. However, a DISC may have different related suppliers with respect to different transactions. If, for example, X owns all the stock of Y, a corporation, and of Z, a DISC, and sells a product to Y which is resold to Z, only Y is the related supplier of Z, and, thus, only the resale from Y to Z is subject to section 994 and this section. If, however, X sells directly to Z and Y also sells directly to Z, then, as to the transactions involving direct sales to Z, each of X and Y is a related supplier of Z.

(b) *Transactions to which section 994 applies*. Section 994(a)(3) may be applied, as described in paragraph (a) of this section, to any transaction between a related supplier and a DISC. Section 994(a)(1) or (2) may be applied,