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Example 1. P Corporation forms S Corporation as a wholly-owned subsidiary. S qualifies as a DISC for its taxable year. S has no employees on its payroll. S is granted a franchise with respect to specified exports of P. P will sell such exports to S for resale by S. Such exports are of a type which produce qualified export receipts as defined in paragraph (b) of this section. P's sales force will solicit orders in the name of S using S's order forms. S places orders with P only when S itself has received orders. No inventory is maintained by S. P makes shipments directly to customers of S. Employees of P will act for S and billings and collections will be handled by P in the name of S. Under these facts, the income derived by S for such taxable year from the purchase and resale of the specified export is treated for Federal income tax purposes as the income of S, and the amount of income allocable to S will be determined under section 994 of the Code.

Example 2. P Corporation forms S Corporation as a wholly-owned subsidiary. S qualifies as a DISC for its taxable year. S has no employees on its payroll. S is granted a sales franchise with respect to specified exports of P and will receive commissions with respect to such exports. Such exports are of a type which will produce gross receipts for S which are qualified export receipts as defined in paragraph (b) of this section. P's sales force will solicit orders in the name of P. Billings and collections are handled directly by P. Under these facts, the commissions paid to S for such taxable year with respect to the specified exports shall be treated for Federal income tax purposes as the income of S, and the amount of income allocable to S is determined under section 994 of the Code.

[T.D. 7514, 42 FR 55454, Oct. 17, 1977; 42 FR 60910, Nov. 30, 1977, as amended by T.D. 7854, 47 FR 51739, Nov. 17, 1982]

§ 1.993–2 Definition of qualified export assets.

(a) *In general.* For a corporation to qualify as a DISC, at the close of its taxable year it must have qualified export assets with adjusted bases equal to at least 95 percent of the sum of the adjusted bases of all its assets. An asset which is a qualified export asset under more than one paragraph of this section shall be taken into account only once in determining the sum of the adjusted bases of all qualified export assets. Under section 993(b), the qualified export assets held by a corporation are—

(1) Export property as defined in §1.993–3 (see paragraph (b) of this section),

(2) Business assets described in paragraph (c) of this section,

(3) Trade receivables described in paragraph (d) of this section,

(4) Temporary investments to the extent described in paragraph (e) of this section,

(5) Producer's loans as defined in §1.993–4 (see paragraph (f) of this section),

(6) Stock or securities (described in paragraph (g) of this section) of related foreign export corporations as defined in §1.993–5,

(7) Export-Import Bank and other obligations described in paragraph (h) of this section,

(8) Financing obligations described in paragraph (i) of this section, and

(9) Funds awaiting investment described in paragraph (j) of this section.

(b) *Export property.* In general, export property is certain property held for sale or lease which meets the requirements of §1.993–3.

(c) *Business assets.* For purposes of this section, business assets are assets used by a DISC (other than as a lessor) primarily in connection with—

(1) The sale, lease, storage, handling, transportation, packaging, assembly, or servicing of export property, or

(2) The performance of engineering or architectural services (described in §1.993–1(h)) or managerial services (described in §1.993–1(i)) in furtherance of the production of qualified export receipts.

Assets used primarily in the manufacture, production, growth, or extraction (within the meaning of §1.993–3(c)) of property are not business assets.

(d) *Trade receivables*—(1) *In general.* For purposes of this section, trade receivables are accounts receivable and evidences of indebtedness which arise by reason of transactions of such corporation or of another corporation which is a DISC and which is a member of a controlled group which includes such corporation described in subparagraph (A), (B), (C), (D), (G), or (H), of section 993(a)(1) and which are due the DISC (or, if it acts as an agent, due its principal) and held by the DISC.

(2) *Trade receivables representing commissions.* If a DISC acts as commission agent for a principal in a transaction described in §1.993–1 (b), (c), (d), (e), (h),

or (i) which results in qualified export receipts for the DISC, and if an account receivable or evidence of indebtedness held by the DISC and representing the commission payable to the DISC as a result of the transaction arises (and, in the case of an evidence of indebtedness, designated on its face as representing such commission), such account receivable or evidence of indebtedness shall be treated as a trade receiveable. If, however, the principal is a related supplier (as defined in §1.994–1(a)(3)) with respect to the DISC, such account receivable or evidence of indebtedness will not be treated as a trade receivable unless it is payable and paid in a time and manner which satisfy the requirements of §1.994–1(e)(3) or (5) (relating to initial payment of transfer price or commission and procedure for adjustments to transfer price or commission, respectively), as the case may be. However, see subparagraph (3) of this paragraph for rules regarding certain accounts receivable representing commissions payable to a DISC by its related supplier.

(3) *Indebtedness arising under §1.994–1(e).* An indebtedness arising under §1.994–1(e)(3)(iii) (relating to initial payment of transfer price or commission) in favor of a DISC is not a qualified export asset. An indebtedness arising under §1.994–1(e)(5)(i) (relating to procedure for adjustments to transfer price or commission) in favor of a DISC is a trade receivable if it is paid in the time and manner described in §1.994–1(e)(5)(i) and (ii) and if it otherwise satisfies the requirements of subparagraph (2) of this paragraph. If such an indebtedness is not paid in the time and manner described in §1.994–1(e)(5)(i) and (ii), it is not a qualified export asset.

(e) *Temporary investments*—(1) *In general.* For purposes of this section, temporary investments are money, bank deposits (not including time deposits of more than 1 year), and other similar temporary investments to the extent maintained by a DISC as reasonably necessary to meet its requirements for working capital. For purposes of this paragraph, a temporary investment is an obligation, including an evidence of indebtedness as defined in paragraph (d)(1) of this section, which is a demand obligation or has a period remaining to maturity of not more than 1 year at the date it is acquired by the DISC. A temporary investment does not include trade receivables.

(2) *Determination of amount of working capital maintained.* For purposes of this paragraph—

(i) The working capital of a DISC is the excess of its current assets over current liabilities.

(ii) Current assets are cash and other assets (other than trade receivables) which may reasonably be expected to be converted into cash or sold or consumed during the current normal operating cycle of the DISC's trade or business.

(iii) Current liabilities are obligations (or portions of obligations) due within the current normal operating cycle of the trade or business of the DISC whose satisfaction when due is reasonably expected to require the use of current assets.

(iv) Generally accepted financial accounting treatments will be accepted, and

(v) Current assets (other than temporary investments) are taken into account before temporary investments, and trade receivables are never taken into account, in determining whether such temporary investments are maintained by the DISC as reasonably necessary to meet his current liabilities and its requirements for working capital.

(3) *Determination of amount of working capital reasonably required.* For purposes of this paragraph, a determination of the amount of money, bank deposits, and other similar temporary investments reasonably necessary to meet the requirements of the DISC for working capital will depend upon the nature and volume of the activities of the DISC existing at the end of the DISC's taxable year for which such determination is made, such as, for example—

(i) In the case of a DISC which purchases and sells inventory, the amount of working capital reasonably required is limited to an amount reasonably necessary to meet the ordinary operating expenses during the current normal operating cycle of the trade or business of the DISC, an amount reasonably needed to meet specific and definite plans for expansion and any

amounts necessary for reasonably anticipated extraordinary business expenses.

(ii) In the case of a DISC which actively conducts a trade or business (including the employment of a sales force) and receives commissions in respect of goods to which such DISC does not have title, the amount of working capital required will depend upon the nature and volume of the activities of the DISC which produce such income as they exist on the applicable determination date. In determining the amount of working capital which is reasonably required for the production of such income, the anticipated future needs of the business will be taken into account to the extent that such needs relate to the year of the DISC following the applicable determination date. Anticipated future needs relating to a later period will not be taken into account unless it is clearly established that such needs are reasonably related to the production of such income as of the applicable determination date.

(iii) In the case of a DISC which does not actively conduct a trade or business, and which receives commissions solely by reason of section 994(a)(1), (a)(2), or (b) with respect to goods to which such DISC does not have title, no working capital would be required beyond a de minimis amount unless it appears from the facts and circumstances that additional working capital will be required.

(iv) In the case of a DISC deriving income from the leasing of property, the amount of working capital required will be determined on the basis of the facts and circumstances in such case.

(4) *Relationship of working capital to other qualified export assets.* If a temporary investment is a qualified export asset under any provision of this section (other than this paragraph), this paragraph shall not affect its status as a qualified export asset. However, any such temporary investment is taken into account before other temporary investments in determining whether such other temporary investments are maintained by a DISC as reasonably necessary to meet its requirements for working capital. Current assets (other than temporary investments) are taken into account before temporary investments, and trade receivables are never taken into account, in determining whether such temporary investments are maintained by the DISC as reasonably necessary requirements for working capital. An obligation issued or incurred by a member of a controlled group (as defined in §1.993–1(k)) of which the DISC is a member is not a qualified export asset under this paragraph. For rules regarding working capital as of the end of each month of a taxable year for purposes of the 70-percent reasonableness standard with respect to certain deficiency distributions, see paragraph (j)(3) of this section.

(f) *Producer's loans.* For purposes of this section, a producer's loan is an evidence of indebtedness arising in connection with producer's loans which are made by a DISC and which meet the requirements of §1.993–4. If a producer's loan is a qualified export asset, interest accrued with respect to the producer's loan will also be treated as a qualified export asset provided that payment is made in the form of money, property (valued at its fair market value on its date of transfer and including accounts receivable for sales by or through a DISC), a written obligation which qualifies as a debt under the safe harbor rule of §1.992–1(d)(2)(ii), or an accounting entry offsetting the account receivable against an existing debt owed by the person in whose favor the account receivable was established to the person with whom it engaged in the transaction and that payment is made no later than 60 days following the close of the taxable year of accrual of the interest. This paragraph (f) is effective for taxable years beginning after January 10, 1985 except that the taxpayer may at its option apply the provisions of this paragraph to taxable years ending after December 31, 1971.

(g) *Stock or securities of related foreign corporations.* For purposes of this section, the term ''stock or securities'', with respect to a related foreign export corporation (as defined in §1.993–5), has the same meaning as such term has as used in section 351 (relating to transfers to controlled corporations), except that the term ''securities'' does not include obligations which are repaid, in whole or in part, at any time during

the taxable year of the DISC following the taxable year of the DISC during which such obligations were acquired by the DISC or were issued, unless the DISC demonstrates to the satisfaction of the district director that the repayment was for bona fide business purposes and not for the purpose of avoidance of Federal income taxes.

(h) *Export-Import Bank obligations.* For purposes of this section, the term ''Export-Import Bank obligations'' means obligations issued, guaranteed, insured, or reinsured (in whole or in part) by the Export-Import Bank of the United States or by the Foreign Credit Insurance Association, but only if such obligations are acquired by the DISC—

(1) From the Export-Import Bank of the United States,

(2) From the Foreign Credit Insurance Association, or

(3) From the person selling or purchasing the goods or services by reason of which such obligations arose, or from any corporation which is a member of the same controlled group (as defined in §1.993–1(k)) as such person.

For purposes of this paragraph, obligations issued by a person described in subparagraphs (1), (2), and (3) of this paragraph are treated as acquired from such person by the DISC if acquired from any person not more than 90 days after the date of original issue (as defined in §1.1232–3(b)(3)). Examples of specific types of Export-Import Bank obligations include debentures issued by such bank and certificates of loan participation.

(i) *Financing obligations.* For purposes of this section, financing obligations are obligations (held by a DISC) of a domestic corporation organized solely for the purpose of financing sales of export property pursuant to an agreement with the Export-Import Bank of the United States under which such corporation makes export loans guaranteed by such Bank.

(j) *Funds awaiting investment*—(1) *In general.* For purposes of this section, subject to the limitation descibed in subparagraph (2) of this paragraph, if, at the close of a DISC's taxable year, the sum of the DISC's money, bank deposits, and other similar temporary investments is determined under paragraph (e) of this section to exceed an amount reasonably necessary to meet the DISC's requirements for working capital, the amount of the DISC's bank deposits in the United States to the extent of the amount of this excess are funds awaiting investment at the close of such taxable year.

(2) *Limitation.* Bank deposits described in subparagraph (1) of this paragraph are funds awaiting investment only if, by the last day of each of the sixth, seventh, and eighth months after the close of such taxable year, the sum of the adjusted bases of the qualified export assets of the DISC (other than such bank deposits) equals or exceeds 95 percent of the sum of the adjusted bases of all assets of the DISC (including such bank deposits) it held on the last day of such taxable year. For purposes of this subparagraph, the adjusted bases of assets of a DISC are determined as of the end of each of the months referred to in this subparagraph. Funds awaiting investment as described in this paragraph need not be traceable to any of the qualified export assets held by the DISC at the end of any of the months referred to in this subparagraph.

(3) *Coordination with certain deficiency distribution provisions.* Under section 992(c)(3) and §1.992–3(d) a deficiency distribution made on or before the 15th day of the ninth month after the end of a corporation's taxable year is deemed to be for reasonable cause if certain requirements are met, including the requirement (described in section 992(c)(3)(B) and §1.992–3(d)(2)) that the sum of the adjusted bases of the qualified export assets held by the corporation on the last day of each month of such year equals or exceeds 70 percent of the sum of the adjusted bases of all assets held by the corporation on each such last day. If, on any such last day, the sum or a DISC's money, bank deposits, and other similar temporary investments is determined under paragraph (e) of this section to exceed an amount reasonably necessary to meet the DISC's requirements for working capital, the amount of the DISC's bank deposits to the extent of the amount of this excess are funds awaiting investment on such last day, if either—

(i) The requirements of subparagraph (2) of this paragraph are satisfied with

respect to the taxable year of the DISC which includes such month or

(ii) At the close of such taxable year the sum of the DISC's money, bank deposits, and other similar temporary investments is determined under paragraph (e) of this section not to exceed an amount reasonably necessary to meet the DISC's requirements for working capital.

(Secs. 995(e)(7), (8) and (10), 995(g) and 7805 of the Internal Revenue Code of 1954 (90 Stat. 1655, 26 U.S.C. 995 (e)(7), (8) and (10); 90 Stat. 1659, 26 U.S.C. 995(g); and 68A Stat 917, 26 U.S.C. 7805))

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§ 1.993–3 Definition of export property.

(a) *General rule.* Under section 993(c), except as otherwise provided with respect to excluded property in paragraph (f) of this section and with respect to certain short supply property in paragraph (i) of this section, export property is property in the hands of any person (whether or not a DISC)—

(1) Manufactured, produced, grown, or extracted in the United States by any person or persons other than a DISC (see paragraph (c) of this section),

(2) Held primarily for sale or lease in the ordinary course of a trade or business to any person for direct use, consumption, or disposition outside the United States (see paragraph (d) of this section),

(3) Not more than 50 percent of the fair market value of which is attributable to articles imported into the United States (see paragraph (e) of this section), and

(4) Which is not sold or leased by a DISC, or with a DISC as commission agent, to another DISC which is a member of the same controlled group (as defined in §1.993–1(k)) as the DISC.

(b) *Services.* For purposes of this section, services (including the written communication of services in any form) are not export property. Whether an item is property or services shall be determined on the basis of the facts and circumstances attending the development and disposition of the item. Thus, for example, the preparation of a map of a particular construction site would constitute services and not export property, but standard maps prepared for sale to customers generally would not constitute services and would be export property if the requirements of this section were otherwise met.

(c) *Manufacture, production, growth, or extraction of property*—(1) *By a person other than a DISC.* Export property may be manufactured, produced, grown, or extracted in the United States by any person, provided that such person does not qualify (and is not treated) as a DISC. Property held by a DISC which was manufactured, produced, grown, or extracted by it at a time when it did not qualify (and was not treated) as a DISC is not export property of the DISC. Property which sustains further manufacture or production outside the United States prior to sale or lease by a person but after manufacture or production in the United States will not be considered as manufactured, produced, grown, or extracted in the United States by such person.

(2) *Manufactured or produced*—(i) *In general.* For purposes of this section, property which is sold or leased by a person is considered to be manufactured or produced by such person if such property is manufactured or produced (within the meaning of either subdivision (ii), (iii), or (iv) of this subparagraph) by such person or by another person pursuant to a contract with such person. Except as provided in subdivision (iv) of this subparagraph, manufacture or production of property does not include assembly or packaging operations with respect to property.

(ii) *Substantial transformation.* Property is manufactured or produced by a person if such property is substantially transformed by such person. Examples of substantial transformation of property would include the conversion of woodpulp to paper, steel rods to screws and bolts, and the canning of fish.

(iii) *Operations generally considered to constitute manufacturing.* Property is manufactured or produced by a person if the operations performed by such person in connection with such property are substantial in nature and are generally considered to constitute the manufacture or production of property.