

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 gain 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
(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 .....	<u>3,550</u>

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#### § 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).

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#### § 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—