Durbin Paper Stock Co. v. Commissioner, 80 T. C. 252 (1983)

IRS regulations requiring 'paid-in' capital and a separate bank account for DISC qualification were held invalid as they exceeded statutory authority and contradicted Congressional intent.

Summary

In Durbin Paper Stock Co. v. Commissioner, the U. S. Tax Court ruled that the IRS's regulations requiring Domestic International Sales Corporations (DISCs) to have 'paid-in' capital and maintain a separate bank account were invalid. The court found these regulations exceeded the statutory authority under Section 992 of the Internal Revenue Code and contradicted Congress's intent to relax corporate substance rules for DISCs. Durbin Paper Stock Co. 's subsidiary, Durbin International, Inc. , was thus deemed a valid DISC despite not meeting these regulatory requirements, as it met the statutory criteria of having outstanding stock with a par value of at least $2,500.

Facts

Durbin Paper Stock Co. , a Florida corporation, formed a subsidiary, Durbin International, Inc. , which sought DISC status for the fiscal years ending July 31, 1974, and 1975. Durbin International issued 3,000 shares of $1 par value common stock to Durbin Paper Stock Co. , recording a subscription receivable of $3,000 without any actual payment. It did not maintain a separate bank account until September 27, 1974. The IRS denied DISC status, asserting non-compliance with regulations requiring 'paid-in' capital and a separate bank account.

Procedural History

The IRS issued a notice of deficiency to Durbin Paper Stock Co. for the fiscal years ending July 31, 1973, 1974, and 1975, asserting that Durbin International did not qualify as a DISC due to non-compliance with the 'paid-in' capital and separate bank account requirements under the IRS regulations. Durbin Paper Stock Co. petitioned the U. S. Tax Court, challenging the validity of these regulations.

Issue(s)

1. Whether the IRS regulation requiring 'paid-in' capital for DISC qualification under Section 1. 992-1(d)(1) is valid.
2. Whether the IRS regulation requiring a separate bank account for DISC qualification under Section 1. 992-1(a)(6) is valid.

Holding

1. No, because the 'paid-in' capital requirement in the regulation conflicts with the clear statutory language of Section 992(a)(1)(C) and the Congressional intent to

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relax corporate substance rules for DISCs.
2. No, because the separate bank account requirement in the regulation has no statutory basis and contradicts the purpose of DISCs as stated by Congress.

Court's Reasoning

The court analyzed the statutory language of Section 992(a)(1)(C), which only requires outstanding stock with a par or stated value of at least $2,500, not 'paid-in' capital. The court cited Congressional intent to relax corporate substance rules for DISCs, as evidenced by legislative history. Florida corporate law, under which Durbin International was incorporated, allowed stock issuance based on valid indebtedness, which the court found sufficient to meet the statutory requirement. The court rejected the IRS's argument that the regulations merely clarified the statute, holding that the regulations added unwarranted requirements that contradicted the statute and its purpose. The court also invalidated the separate bank account requirement, noting its lack of statutory support and inconsistency with the purpose of DISCs.

Practical Implications

This decision impacts how DISCs are formed and maintained by invalidating IRS regulations that added burdensome requirements not found in the statute. Legal practitioners should focus on the statutory criteria for DISC qualification, particularly the requirement for outstanding stock with a par or stated value, without needing actual payment or a separate bank account. Businesses can structure their DISCs with more flexibility, using valid indebtedness for stock issuance. This ruling may encourage more companies to utilize DISCs for tax deferral on export profits, potentially increasing U. S. exports. Subsequent cases have applied this ruling to challenge other IRS regulations that exceed statutory authority.

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