Gibbons International, Inc. v. Commissioner, 89 T. C. 1156 (1987)

Commissions receivable from a related supplier must be paid within 60 days after the close of the DISC's taxable year to qualify as export assets.

Summary

Gibbons International, a wholly owned subsidiary of J. T. Gibbons, Inc. , was set up as a Domestic International Sales Corporation (DISC) to allocate a portion of Gibbons' export income for tax benefits. The court held that Gibbons International did not qualify as a DISC because the commissions receivable from its parent, J. T. Gibbons, were not paid within 60 days after the close of Gibbons International's taxable year as required by the regulations. The court rejected the argument that an ongoing obligation to purchase receivables constituted payment, emphasizing the strict timing requirements for DISC qualification.

Facts

Gibbons International was established in 1974 as a DISC to allocate a portion of J. T. Gibbons' export income. It operated as a commission agent, with commissions calculated at 4% of J. T. Gibbons' export sales. The commissions were accrued but not paid during the taxable years in question (1978-1981). Gibbons International's books reflected these commissions as receivables, but no actual payment was made within the required 60-day period after the close of each taxable year. In 1981, an accounting entry was made to offset some receivables against dividends payable, but this was deemed untimely for prior years' receivables.

Procedural History

The Commissioner issued statutory notices of deficiency for the taxable years 1978-1981 to Gibbons International and 1977-1980 to J. T. Gibbons, disallowing DISC status and reallocating income. Gibbons International and J. T. Gibbons filed petitions with the U. S. Tax Court, which consolidated the cases. The Tax Court held that Gibbons International did not qualify as a DISC due to the failure to timely pay commissions receivable.

Issue(s)

1. Whether commissions receivable from a related supplier must be paid within 60 days after the close of the DISC's taxable year to qualify as export assets.
2. Whether an ongoing obligation to purchase receivables constitutes payment of commissions receivable under the DISC regulations.
3. Whether accounting entries offsetting receivables against dividends payable can qualify as payment of commissions receivable for prior years.

Holding

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1. Yes, because the regulations explicitly require payment within 60 days after the close of the taxable year for commissions receivable to qualify as export assets.
2. No, because an ongoing obligation to purchase receivables does not constitute payment under the regulations, which require actual payment.
3. No, because the offsetting accounting entries were made after the 60-day period for the years in which the receivables arose, and thus did not qualify as payment for those years.

Court’s Reasoning

The court applied the regulations under section 1. 994-1(e)(3), which require that commissions receivable from a related supplier be paid within 60 days after the close of the DISC’s taxable year. The court emphasized that the purpose of these rules is to prevent the artificial accumulation of receivables to meet the qualified export assets test. Gibbons International’s argument that an ongoing obligation to purchase receivables constituted payment was rejected because the regulations require actual payment. The court also rejected the argument that accounting entries offsetting receivables against dividends payable could qualify as payment for prior years’ receivables, as these entries were made after the 60-day period. The court noted that the validity of the regulations had been upheld in prior cases, and that the strict timing requirements were essential to the integrity of the DISC provisions.

Practical Implications

This decision underscores the importance of strict compliance with the timing requirements for DISC qualification. Attorneys advising clients on DISC arrangements must ensure that commissions receivable from related suppliers are paid within the 60-day window to avoid disqualification. The case highlights the need for careful accounting and documentation to demonstrate compliance. Businesses using DISCs must be aware that attempts to use ongoing obligations or delayed accounting entries to meet the qualified export assets test will be scrutinized and likely rejected. Subsequent cases have continued to apply these principles, reinforcing the need for timely payment of commissions receivable in DISC arrangements.

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