Hughes International Sales Corp. v. Commissioner, 100 T. C. 293 (1993)

A regulation requiring a DISC to use its related supplier's method of accounting for the 95% gross receipts test is invalid if it conflicts with the statute and legislative history.

Summary

Hughes International Sales Corp. (HISC), a wholly owned subsidiary of Hughes Aircraft Co. , was created to act as a commission agent for export sales. The IRS challenged HISC's status as a Domestic International Sales Corporation (DISC) for failing the 95% gross receipts test due to the inclusion of domestic sales commissions and the use of an accrual method of accounting, contrary to its related supplier's completed contract method. The Tax Court held that the regulation requiring HISC to use its supplier's accounting method was invalid because it conflicted with the statute and legislative history, which allowed the DISC to use its own accounting method. As a result, HISC qualified as a DISC for the years in question.

Facts

Hughes Aircraft Co. created HISC in 1973 to act as its export sales representative. HISC elected to be treated as a DISC and used the accrual method of accounting. Hughes paid HISC commissions on export sales, which were reported as income by HISC. However, during the taxable years ending March 31, 1982, and March 31, 1983, HISC inadvertently received and reported commissions on some domestic sales. Hughes used the completed contract method of accounting for some of its long-term contracts, while HISC continued to use the accrual method.

Procedural History

The IRS determined deficiencies in HISC's income tax for the taxable years ending March 31, 1982, and March 31, 1983, asserting that HISC did not qualify as a DISC because it failed to meet the 95% gross receipts test. HISC challenged this determination in the United States Tax Court. The court reviewed the validity of the regulation requiring HISC to use Hughes' method of accounting for the gross receipts test and ultimately ruled in favor of HISC, declaring the regulation invalid and affirming HISC's DISC status.

Issue(s)

1. Whether sec. 1. 993-6(e)(1), Income Tax Regs. , is valid in requiring a DISC to use its related supplier's method of accounting for the 95% gross receipts test.
2. Whether domestic sales commissions, erroneously included as qualified export receipts, should be included in the gross receipts test for DISC qualification.
3. Whether HISC can increase the amount of qualified export receipts it reported on its Federal income tax return.

© 2025 SCOTUSreports.com. All rights reserved.

Holding

1. No, because the regulation conflicts with the statute and legislative history, which allow the DISC to use its own method of accounting.
2. Yes, because the domestic sales commissions were paid and reported by HISC, they must be included in the gross receipts test.
3. No, because the issue is irrelevant to the case's outcome since HISC would qualify as a DISC regardless of the inclusion of additional qualified export receipts.

Court's Reasoning

The court found that the regulation requiring HISC to use Hughes' completed contract method of accounting for the gross receipts test was invalid because it conflicted with the statute and legislative history. The court emphasized that the DISC statute does not address the coordination of accounting methods between the DISC and its supplier. The legislative history explicitly stated that the DISC should use its own accounting method for the gross receipts test. The court rejected the IRS's argument that the regulation was necessary to prevent mismatching of income and deductions, noting that such issues should be addressed under normal accounting method sections. The court also found that domestic sales commissions, although inadvertently received, must be included in the gross receipts test because they were paid and reported by HISC.

Practical Implications

This decision clarifies that a DISC can use its own method of accounting for the gross receipts test, even if it differs from its related supplier's method. This ruling may encourage the use of DISCs by allowing more flexibility in accounting practices. It also highlights the importance of legislative history in interpreting regulations and statutes. Practitioners should carefully review the accounting methods used by DISCs and their suppliers to ensure compliance with the gross receipts test. This case may impact future IRS audits of DISCs, as the IRS will need to consider the DISC's accounting method separately from its supplier's method. Subsequent cases may further refine the application of this ruling to different types of DISCs and accounting scenarios.

© 2025 SCOTUSreports.com. All rights reserved.