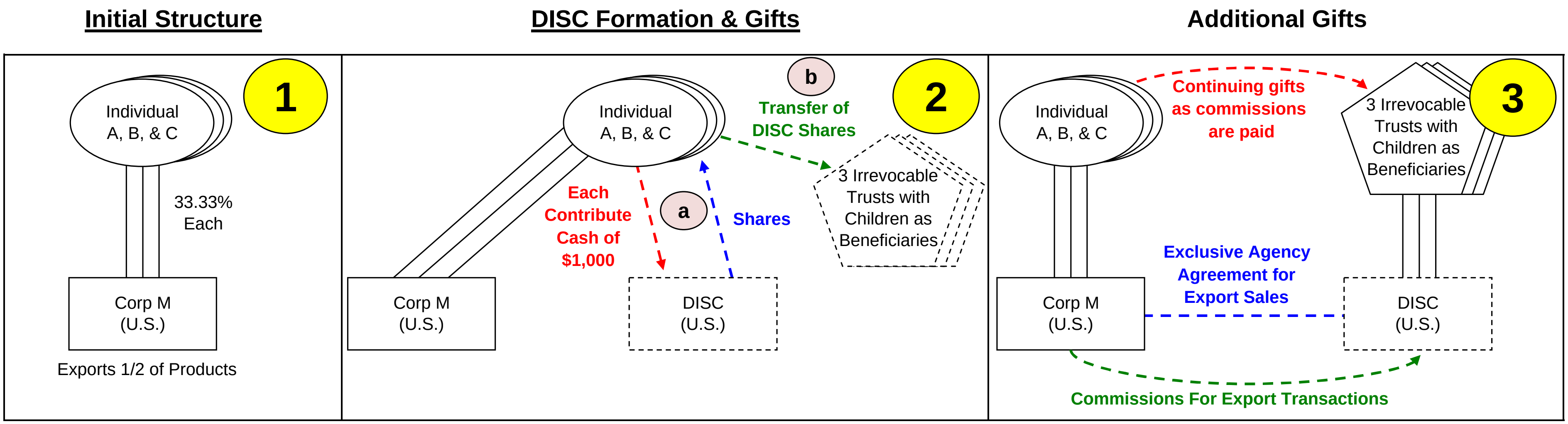
Revenue Ruling 81-54

DISC Commissions With Respect to Gifted DISC Shares Result in Continuing Gifts



Corporation M, a domestic manufacturing business, was organized in 1972. All of M's stock has been continuously owned in equal shares by individuals A, B, and C. M sells one-half of its products outside the United States. In January 1978, the three shareholders of M formed a DISC in order to maximize the profitability of export sales transactions by M. A, B, and C each transferred $1,000 in cash to the DISC in exchange for equal shares of the stock of the DISC. Immediately thereafter, A, B, and C made gifts of all of their DISC stock to three irrevocable trusts created for the benefit of their respective minor children. Each of the spouses of A, B, and C was designated as sole trustee of the trust for their respective children. The trustees of the three trusts were given full power to deal with the trust assets as if they owned those assets outright.

After the DISC stock was transferred to the trust, M and the DISC agreed in writing that the DISC would be the exclusive agent of M with respect to all export sales of M products. Under the terms of the agreement, the DISC is to be paid a commission for each export sales transaction. The amount of the commission on each sale is stated in the agreement to be the "maximum amount permitted under the intercompany pricing rules of section 994 of the Internal Revenue Code." The agreement requires that all commissions on sales of M products during a taxable year of the DISC be paid to the DISC within 30 days after the end of that taxable year. The agreement provides that it shall terminate immediately at the will of either party. Upon termination, a final payment of all outstanding obligations between M and the DISC is to be made. The taxable year of the DISC ends on December 31. The DISC performed no significant services.

In the present case, the three shareholders of M made gifts of the shares of the DISC stock when they transferred the shares to the trusts for their respective children. The value of the transferred DISC stock was equal to the value of the underlying assets of the DISC on the date of the stock transfers.
Transactions completed pursuant to the written agreement resulted in a continuing transfer of a portion of M's income to the trust beneficiaries via the DISC commission arrangement. M's retained right to unilaterally terminate the agreement with the DISC makes any transfer of commission that the DISC may receive from future transactions incomplete until the transactions take place. Upon completion of each transaction, the owners of M no longer retain any dominion and control over the payment of commissions to the DISC, because under the agreement, the DISC is entitled to a commission on each sale. Therefore, the donor's gifts occur as each transaction through the DISC is completed. The measure of the gift is the amount transferred to the DISC on each sale.