



PIASCIK & ASSOCIATES
CERTIFIED PUBLIC ACCOUNTANTS

Main / 804-527-1815

Toll Free / 866-527-1815

Fax / 804-527-1816

Innsbrook Corporate Center

4470 Cox Road, Suite 250

Glen Allen, Virginia 23060

The Last Remaining Export Incentive...

Author:

Ryan L. Losi, CPA

Executive Vice President, Piascik & Associates, P.C.

U.S. exporters, both domestic and foreign owned, take note! An old and in most cases forgotten export regime dating back to the 1970s has now reared its head again as an extremely beneficial tax savings strategy.

Exporters can now recoup or even exceed their tax savings on their product revenue -- and in some cases service revenue, as well -- by creating an interest charge-domestic international sales corporation ("IC-DISC"). This benefit is also available to companies whose products are exported by another party or "ultimately used" outside the U.S. by customers.

The IC-DISC is not a tax shelter. It once was a somewhat lackluster tax deferral vehicle, but it was revamped a few years ago under the Bush Administration by very favorable dividend tax rules prescribed under the Jobs and Growth Tax Relief Reconciliation Act of 2003.

In its new form, the IC-DISC provides at the least a permanent 20 percent tax savings for qualifying U.S. exporters -- and in some cases even eliminates U.S. tax entirely! It also has a number of sophisticated features that can be tailored to help export businesses meet their objectives and goals.

IC-DISC advantages and benefits:

Permanent tax savings on global sales

Permanent tax savings begins with the exporting company deducting the commission it pays to the IC-DISC from its ordinary income, which is taxed at 35 percent. Tax law sets the commission rate, which is based on export sales revenue, as the greater of either 50 percent of net export income or 4 percent of export sale revenue. Because the IC-DISC is tax exempt, tax is paid only on distributions to shareholders. Individual



and pass-thru company shareholders pay income tax on qualified dividends at the long term capital gains rate of 15 percent.

EXAMPLE 1: Example 1 illustrates how a 20 percent tax rate arbitrage creates a permanent tax benefit of \$100,000 on a commission of \$500,000 for pass thru companies such as sole proprietorships, single member LLCs, tax partnerships, S corporations, and LLCs electing to be taxed as partnerships.

Foreign trading gross receipts (Export Sales)		5,000,000	
Cost of goods sold		(3,000,000)	
Gross Margin		2,000,000	
Selling, general and administrative costs		(1,000,000)	
Export sales net income		1,000,000	
IC-DISC commission (greater of):			
50% of export net income	500,000		
4% of export gross receipts	200,000		
IC-DISC commission		500,000	
Federal tax savings (35%)		175,000	
IC-DISC dividend		500,000	
Federal tax cost (15%)		(75,000)	
IC-DISC net tax savings			100,000



EXAMPLE 2: Example 2 illustrates how a 29.75 percent tax rate arbitrage creates a permanent tax benefit of \$148,750 on a commission of \$500,000 for taxable companies such as C corporations and LLCs electing to be taxed as corporations. Unlike pass thru businesses, owners of C corporations incur two levels of taxation. One is at the corporate level and the second is at the shareholder level. This explains the heightened tax savings that C corporations receive over pass thru businesses when utilizing the IC-DISC.

Foreign trading gross receipts (Export Sales)		5,000,000	
Cost of goods sold		(3,000,000)	
Gross Margin		2,000,000	
Selling, general and administrative costs		(1,000,000)	
Export sales net income		1,000,000	
IC-DISC commission (greater of):			
50% of export net income	500,000		
4% of export gross receipts	200,000		
IC-DISC commission		500,000	
Fed Corporate Tax Savings (35%)		175,000	
Fed Shareholder Tax Savings (\$325K*15%)		48,750	
IC-DISC dividend		500,000	
Federal tax cost (15%)		(75,000)	
IC-DISC net tax savings			148,750



EXAMPLE 3: Example 3 illustrates how a 100 percent tax rate arbitrage creates a permanent tax benefit of \$223,750 on a commission of \$500,000 for taxable companies such as C corporations and LLCs electing to be taxed as corporations that are subsidiaries of foreign corporations located in a country having a favorable income tax treaty with the U.S. having been ratified after 1984 (e.g., Mexico, United Kingdom, Japan and more) and maintaining a 80 percent or greater ownership in the U.S. subsidiary. In this example, all U.S. tax is eliminated entirely!

Foreign trading gross receipts (Export Sales)	5,000,000	
Cost of goods sold	(3,000,000)	
Gross Margin	2,000,000	
Selling, general and administrative costs	(1,000,000)	
Export sales net income	1,000,000	
IC-DISC commission (greater of):		
50% of export net income	500,000	
4% of export gross receipts	200,000	
IC-DISC commission	500,000	
Fed Corporate Tax Savings (35%)	175,000	
Fed Shareholder Tax Savings (\$325K*30%)	48,750	
IC-DISC dividend		500,000
Federal tax cost (0%)		(0)
IC-DISC net tax savings		223,750

Increased liquidity for shareholders or the business

Shareholders who need to rebalance their investment risk profiles can, in most cases, use the IC-DISC to gain additional liquidity. By extracting cash in this tax-advantaged manner, they can deploy resources pursuant to their investment risk profiles. IC-DISC liquidity also provides a tool for combating lending and debt restrictions that inhibit diversification and risk management. Rather than being reined in by restrictions, such as salary and dividend limitations and debt covenants, shareholders have flexibility to take actions that serve the best interests of the business.



Ability to leverage cost of capital

An IC-DISC is more than a tax-savings vehicle. It can also be used as a deferral tool to leverage a company's cost of capital. IC-DISC earnings need not be distributed to shareholders; they can instead be used to perpetuate and grow the deductible dividend tax rate savings. Tax rate savings is perpetuated by lending accumulated IC-DISC earnings back to the exporting company in return for a note and interest. The exporting company can deduct the interest expense, and interest income is considered a dividend to the IC-DISC shareholders. Reinvesting IC-DISC earnings back into the exporting business results in additional tax rate savings and diminishes the group's cost of capital.

EXAMPLE 4: Example 4 reflects a reinvestment of IC-DISC earnings in the form of a loan (i.e., producer loan) back to the exporting company, which decreases the cost of capital to the group. However, please note at the current moment the qualified dividend tax rate remains at a historic low, thus many international tax practitioners would strongly recommend distributing the earnings in the form of a qualified dividend in order to capture/preserve the current low dividend tax rate on this income. Once the dividend is in the hands of the shareholder they can then determine how best to deploy the capital, after having now preserved the low tax rate.

Foreign trading gross receipts		5,000,000	
Cost of goods sold		(3,000,000)	
Gross Margin		2,000,000	
Selling, general and administrative costs		(1,000,000)	
Export sales net income		1,000,000	
IC-DISC commission (greater of):			
50% of export net income	500,000		
4% of export gross receipts	200,000		
IC-DISC commission		500,000	
Annual loan interest deduction (5%)		25,000	
Federal tax savings (35%)		8,750	
IC-DISC dividend		25,000	
Federal tax cost (15%)		(3,750)	
IC-DISC net tax savings			5,000
Net cost of capital (\$500,000 loan)			4.00%



Opportunities to create management incentives

Businesses can also use ownership in the IC-DISC to provide incentives. Exporting company management and other personnel can be named as shareholders — allowing them to benefit from additional cash flow created by increasing global sales.

Means to facilitate succession planning

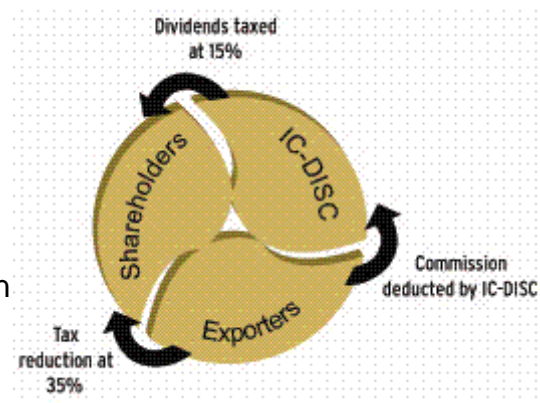
An IC-DISC offers a number of capabilities for executing a succession plan. Among these, ownership in the IC-DISC can be used as a means of generating cash, which can be distributed to shareholders in a tax-advantaged manner. IC-DISC shareholders participating in a buyout of current or previous shareholders can leverage these tax-advantaged IC-DISC earnings to pursue the buyout plan.

The IC-DISC structure

The IC-DISC is a “paper” entity utilized as a tax-savings vehicle. It does not require corporate substance or form, office space, employees or tangible assets. It simply serves as a conduit for export tax savings. An important feature of the IC-DISC is that shareholders can be corporations, individuals or a combination of these.

How an IC-DISC works:

- Owner-managed exporting company creates a tax-exempt IC-DISC
- Exporting company pays IC-DISC a commission
- Exporting company deducts commission from ordinary income taxed at 35 percent
- IC-DISC pays no tax on the commission
- Shareholders pay income tax on dividends at the capital gains rate of 15 percent
- Result is 20 or more percent tax savings on commission





Does your company Qualify?

In addition to other attributes, the IC-DISC has better staying power than its predecessors. U.S. trading partners decried the legitimacy of both the foreign sales corporation and the ETI exclusion. But the IC-DISC, which was added to the tax code in 1984, has never been challenged!

For U.S. exporters, the Interest Charge-Domestic International Sales Corporation (IC-DISC) is the **ONLY** remaining tax-saving opportunity. If you are unsure about whether or not an IC-DISC will work for you, ask yourself the following questions:

Do you have any transactions outside of the United States? Do you use overseas distribution? Does your product cross any borders?

If you answered yes to any of these questions, then an IC-DISC could be a valuable tax-savings vehicle for your business.

About the Author

Ryan L. Losi, CPA, is a partner and Executive Vice President of Piascik & Associates, P.C. (www.piascik.com), providing premier personalized financial services to a broad range of clients throughout the United States and abroad. Losi leads the firm's international tax practice, advising clients in numerous countries spanning four continents. Since 2007, Losi has served as a charter member and task force chair for the Virginia International Trade Alliance program, where his focus is to develop a marketing campaign to help attract international business to the Commonwealth. He also speaks regularly about 20 times a year and teaches international accounting at the Executive MBA program at Virginia Commonwealth University. In 2010, Losi was recognized among Virginia's "rising stars" in the CPA profession, with a Top 5 Under 35 Award by the Virginia Society of CPAs. Losi is a 1997 graduate of Virginia Commonwealth University. He can be contacted at Piascik & Associates by phone (877) 527-2046 or email rlosi@piascik.com.