

For Decades The IC-DISC Has Been Saving Companies Money – Why Aren't You Using It?

Presented By: Paul Ferreira, CPA
President
Export Tax Management, Inc.



What is an IC-DISC?

The Interest Charge-Domestic International Sales Corporation (IC-DISC) is a statutory provision in the Internal Revenue Code (IRC) that was originally enacted in 1971¹ and modified in 1984.²

- Provides a federal income tax incentive for US manufacturers and distributors of US products to keep jobs in the United States and sell their products for use outside of the United States
- The incentive is realized by allowing some or all of the taxable income relative to export sales to be taxed as a qualified dividend (23.8%) as opposed to ordinary income (39.6%)
 - Also allows for deferral of income in limited circumstances

¹ H.R. 10947 – The Revenue Act of 1971

² P.L. 98-369 – Deficit Reduction Act of 1984

What is an IC-DISC? (Continued)

- The IC-DISC is a statutory provision of the IRC and is not an aggressive tax strategy or abusive tax shelter
 - The current form and substance of the IC-DISC represents the full intent of Congress as enacted
 - Treas. Reg. §1.992-1(a) –“The rules contained in this paragraph constitute a relaxation of the general rules of corporate substance otherwise applicable under the Code. The separate incorporation of a DISC is required under section 992(a)(1) to make it possible to keep a better record of the income which is subject to the special treatment provided by sections 991 through 996...”
- 95% of the assets as well as the sales must be “qualified”

When Does It Apply To Manufacturers?

EXPORT TAX

- **Products that are manufactured, produced, grown or extracted within the United States and sold for use outside of the United States (or leased) will qualify for the benefits of the IC-DISC**
 - **Manufactured – equipment, machinery, high-tech**
 - **Produced – food products, films, software, architectural designs**
 - **Grown – agricultural & horticultural products, processed timber**
 - **Extracted – seafood, scrap metal**
 - **Primary products form oil, gas, coal or uranium do not qualify**

When Does It Apply To Manufacturers? (Continued)

- Indirect sales by a US manufacturer will qualify for the benefits of the IC-DISC
 - e.g. – US Manufacturer builds industrial machine in New Jersey and sells to a distributor in Pennsylvania. Distributor in Pennsylvania sells machine to customer in Canada within one year.
 - Both the manufacturer in New Jersey and distributor in Pennsylvania can utilize an IC-DISC

When Does It Apply To Manufacturers? (Continued)



- **Products must contain at least 50% US content to qualify for the IC-DISC**
 - **No more than 50% of the total fair market value can be attributable to components imported into the United States**



Benefits of The IC-DISC – Converting Ordinary Income to Qualified Dividend Rates

- Ordinary income derived from the normal course of your enterprise is taxable at maximum marginal rate of 39.6% for federal income tax purposes
- Qualified dividend income is taxable at a maximum marginal rate of 23.8%
- Possible deferral of income
 - Regulatory guidelines are very strict, but deferral can be an effective strategy in the right circumstances
- Estate planning opportunities



How To Set Up The IC-DISC

- **The IC-DISC is a separate legal entity (corporation) that is incorporated within any state in the United States**
 - **Single class of common stock with minimum capitalization requirement (\$2,500)**
 - **Must have separate checking account and books & records**
- **Once incorporated, the newly formed corporation elects non-taxable IC-DISC status with the Internal Revenue Service (IRS)**
 - **This election must be filed with the IRS within 90 days of incorporation**
- **IC-DISC benefits are realized on a go-forward basis only**
 - **Benefits are realized as of effective date of incorporation of the IC-DISC**

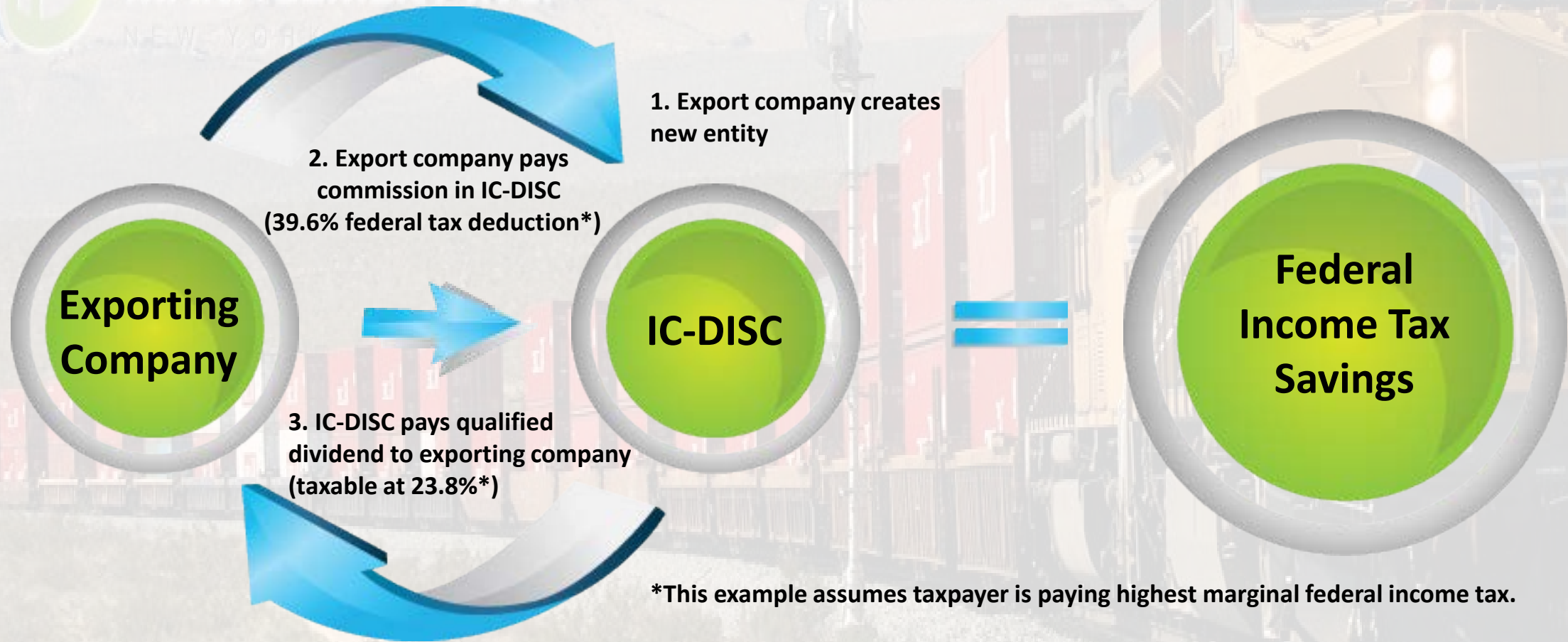
How To Set Up The IC-DISC (Continued)

- The exporting company pays a commission to the IC-DISC
 - Deductible as an expense to the exporter at 39.6%
 - Commission amount is determined by the Treasury Regulations
 - Basically 4% of gross receipts from export sales, or
 - 50% of taxable income of export sales
 - Marginal costing
 - ❖ Added benefit when export sales are sold at a lower margin than domestic sales
 - Savings are significantly increased by calculating commission for each transaction
 - Reasonable estimate of the IC-DISC commission must be paid within 60 days after IC-DISC year-end

How To Set Up The IC-DISC (Continued)

- **IC-DISC then immediately pays a qualified dividend to the owners of the IC-DISC**
 - **Generally, the owner of the IC-DISC is the same as the exporting company**
 - **S Corporations, LLC's and partnerships can own the IC-DISC**
 - **C Corporations require a brother-sister ownership structure**
 - **Dividend paid to the IC-DISC is taxable as a qualified dividend at a rate of 23.8%**
 - **15.8% reduction**
 - ❖ **e.g. \$1,000,000 commission paid to the IC-DISC will result in an anticipated federal income tax savings of \$158,000.**
 - **Cash is returned to the operating company immediately**
 - **IC-DISC files annual tax return with the IRS**
 - **Form 1120-IC-DISC**
 - **IC-DISC dividend must be paid before filing of Form 1120-IC-DISC**

The IC-DISC Process



*This example assumes taxpayer is paying highest marginal federal income tax.

The IC-DISC Process (Continued)

- The IC-DISC is completely non-invasive to your normal daily operations
 - Export property does not need to be physically segregated from non-export property
 - Customers, vendors, employees do not need to have any involvement in the IC-DISC
 - The IC-DISC merely collects the commission and pays a qualified dividend
 - ❖ *Still, it's not too good to be true. It's true and every exporter should strongly consider an IC-DISC!*

Contact Export Tax Management, Inc.

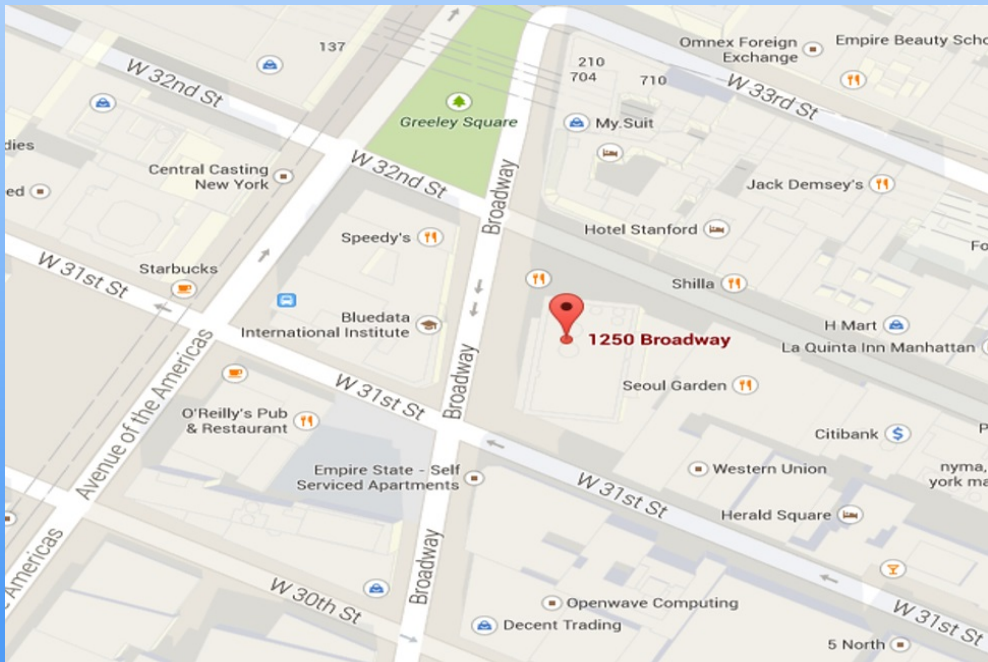
You can reach us at either the Boston or New York locations:

New York

1250 Broadway, 36th Floor, New York, NY 10001

Office: 646-475-8057

Fax: 646-607-5153



Boston

800 Boylston Street, 16th Floor, Boston, MA 02199

Office: 857-453-6577

Fax: 617-507-8460

