

You Qualify for a Tax Incentive — Did You Know You're an Exporter?

By Jim Young, J.D., Director of Export Incentives at alliantgroup, LP
(reprinted from *Management & Tax Concepts*, a newsletter of Trien Rosenberg, CPAs)

The current economic climate is forcing companies across the country to cut costs, cut production, and cut jobs. But, some are thriving because these companies are taking advantage of tax incentives created to keep them strong ... and to keep them from leaving the United States.

Tax incentives have come and gone throughout the years, incentivizing a wide array of business activities; but for exporters (keep reading — you may actually be an exporter and didn't know it); there is only one, powerful, option. This tax strategy can increase your after-tax margin on exports by ten percent.

This incentive is called the Interest Charge — Domestic International Sales Corporation, known as the "IC-DISC." The IC-DISC traces its heritage as far back as 1971 when it did little more than provide a tax deferral opportunity. This benefit was well appreciated by the *Fortune 1000*, but it did little for small and middle-market companies. That changed in 2003.

Today, the IC-DISC regime allows U.S. companies to set up separate domestic entities which act as commission agents for the company's export sales. Once the IC-DISC is set up, the U.S. company can pay commissions to the IC-DISC. These commissions can be as high as 50% of net export income or 4% of gross export receipts, whichever is higher!

Why the IC-DISC is So Powerful

But why is it a good idea to pay a commission to the IC-DISC? The reasons are three: First, the commission is fully deductible. Second, the IC-DISC pays no federal income tax. Third, the IC-DISC is, at heart, a Subchapter C Corporation, meaning it dis-

tributes its income to its owners as a qualified dividend. The result is a permanent reduction in tax of twenty cents on every-commission dollar (the difference between the top federal corporate tax rate and the individual qualified dividend rate)!

Often companies dismiss the IC-DISC as inapplicable to their business, but the IC-DISC is actually much broader than most people realize. It covers the sale of products that are manufactured in the United States, but that doesn't mean the taxpayer must be the manufacturer. In the same vein, if a manufacturer sells its product to another U.S. company, which in turn exports that product, or simply uses the product outside the U.S., then the original manufacturer can qualify just the same.

Consider the case of a U.S. company engaged in the sale and installation of large scale lighting systems. Upon a cursory review of the IC-DISC requirements, this company did not believe they qualified. In fact, because they actually sold the systems for use outside the United States, the sales qualified for DISC treatment even though they did no manufacturing. Additionally, this company generated significant receipts from the installation and maintenance of these systems, which count as related and subsidiary services. These activities ultimately provided over \$100,000 in annual tax savings.

As With the More Powerful Tax-cutting Tools, It Must Be Handled With Care

On the surface, the rules governing the IC-DISC seem manageable. However, in order to maximize the benefit available to a company utilizing / implementing an IC-DISC, a firm that specializes in this complex struc-

ture needs to be engaged to manage the DISC structure on a monthly or quarterly basis.

It is important that taxpayers partner with a firm that has deep expertise in this field. Implementation of the IC-DISC, while offering extremely powerful benefits, is littered with minefields and traps for the unwary that can cause businesses to miss out entirely on the benefits or claim less than they deserve.

Conclusion

During these tough economic times, it is important that taxpayers consult with their tax advisors to identify their eligibility for the IC-DISC. This is an area in which providers of specialized tax services can provide invaluable assistance, allowing companies to take full advantage of the tax incentives that are meant for them.

Jim Young, J.D.

Director, Houston Office

Jim Young currently leads the Export Incentives group at alliantgroup, assisting CPA firms and their clients in understanding and taking advantage of the federal tax incentives available to businesses that export.

