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For The Tax-Savvy Exporter: The IC-DISC Appears To Be Staying With Us

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U.S. companies are finding it harder and harder to compete with companies around the globe. Many firms face an uphill climb as they are being out-produced, out-performed, and out-maneuvered by their foreign counterparts. For the savvy exporter, one solution that appears to be helping is something called the Interest Charge–Domestic International Sales Corporation (IC-DISC).

Congress has a history of providing tax breaks to U.S. companies that export U.S.-made products, and even certain services. These incentives have come and gone throughout the years, but the IC-DISC remains, and it is powerful enough to increase after-tax margin on exports by ten percent.

There has been speculation that the benefits available through the IC-DISC may be short-lived. Many have thought that the Obama administration would eliminate the ability to take IC-DISC dividends as qualified dividends. The White House, however, appears to have other ideas. Dean Zerbe, National Managing Director of alliantgroup, a national tax consulting firm, spent seven years as Tax Counsel on the Senate Finance Committee. He says, "While there are many 'loophole closers' present in the proposed budget released by the White House, the same budget is loud in its silence on the IC-DISC." He goes on to explain: "The White House can read the tea leaves that a proposal to eliminate IC-DISC would be a political loser and would meet very real bipartisan opposition in the Senate."

Others point to the imminent change in the ordinary income and qualified dividend tax rates, and particularly the spread between the two, on which IC-DISC benefits depend. The current rates are set to expire on December 31, 2010. Once again, Zerbe points to the Obama budget proposal, which would set qualified dividends at twenty percent, while raising the top ordinary income rate to 39.6 percent. Says Zerbe, the "IC-DISC will remain in place for the foreseeable future."

This is excellent news for U.S. exporters, who face a struggling domestic economy and formidable international competition. But the clock is ticking. Unlike many incentives which may be captured on old returns, IC-DISC benefits are only available for transactions occurring after the IC-DISC is set up. "Companies must be proactive in all areas of their business," says Jim Young, alliantgroup's Export Practice Leader.

Young adds, "U.S. companies must educate themselves on the tax incentives available to them. For exporters, the IC-DISC is the only viable option left, but it is a tremendously powerful one."

IC-DISC History and How it Works

The IC-DISC traces its heritage as far back as 1971, but until 2003, it did little more than provide a tax deferral opportunity. This benefit was well appreciated by the *Fortune* 1000, but it packed little punch for the small and middle-market. In 2003, the tide turned. Today, the IC-DISC 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!

There are three reasons why it is a good idea to pay a commission to the IC-DISC.

1. The commission is fully deductible.
2. The IC-DISC pays no federal income tax.
3. The IC-DISC is, at heart, a Subchapter C Corporation, meaning it distributes its income to its owners as a qualified dividend.

The result is a permanent reduction in tax of twenty cents on every commission dollar (taking the difference between the top ordinary income rate and the qualified dividend rate).

Jim Young and his team at alliantgroup work with companies across the United States to increase profitability through this government-sponsored tax incentive. "Often," he says, "companies dismiss the IC-DISC as inapplicable, but many times they are wrong. 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," Young continues, "if a manufacturer sells its product to another U.S. company, which in turn exports that product, the manufacturer can qualify just the same. Moreover, it is not only the export of tangible goods which qualifies; the provision of architectural and engineering services is incentivized by the IC-DISC as well. So if an engineering firm designs and builds a building in China, that engineering service would qualify for the IC-DISC."

Don't Try This At Home

On the surface, the rules governing the IC-DISC seem straightforward. In order to maximize the benefit, however, a firm that specializes in this complex structure needs to be engaged to manage the DISC structure on a monthly or quarterly basis.

alliantgroup's CEO, Dhaval Jadav, tells of "one client who was claiming a \$120,000 tax benefit via the IC-DISC structure that they self-implemented. When alliantgroup was brought in to review the company's IC-DISC structure, we discovered that they should have been claiming \$1.2 million in tax benefits as opposed to the \$120,000 benefit they were claiming via self-implementation and self-calculation! Here is a situation where the company and its CPA firm thought they understood the rules and that they were maximizing the benefit of the IC-DISC structure. Unfortunately, nothing could have been further from the truth."

Jim Young points out that alliantgroup sees situations like this on a weekly basis. "It is important," he says, "that CPA firms and their clients partner with a reputable firm that has deep expertise in this field, as implementation of the IC-DISC, while offering extremely powerful benefits to companies, is littered with minefields and traps for the unwary that can cause businesses to entirely miss out on the benefits or claim much less than they actually deserve."

It is particularly important, Young points out, that accountants consult closely with their clients to identify those that may be eligible for the IC-DISC. This is an area in which providers of specialized tax services can help.

For more information on the benefits of an IC-DISC, please contact alliantgroup's Jim Young at 713.212.1495 or jim.young@alliantgroup.com.