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How to Earn More from Your Exports

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If your client currently exports goods produced within the U.S., you could potentially save them more.

This is possible by taking advantage of the relatively unknown and underutilized tax incentive called the IC-DISC benefit. Using this, a company can save more of what is earned from exporting products.

The DISC benefit has been in existence since 1971 and originally promoted the deferral of export income. Since then, the "IC", or Interest Charge, was added to limit the deferral of income for an indefinite period of time. Now, the IC-DISC entity typically serves as a "commission agent" to a "related supplier," or company that is exporting property to provide a tax break on export income.

There are numerous ways to utilize the entity, depending on the type of company; thus, consulting with a specialist for these details is encouraged.

Where is the benefit derived?

Here's the best part – an IC-DISC is a separate entity recognized as federally tax free. The general mechanics consist of a portion of the related supplier's export income being paid to the IC-DISC, which is then distributed back to its owner as dividend. As such, the ordinary income tax rate does not apply to this portion of export income and the capital gains rate is applicable instead. The arbitrage depends on the supplier's specific tax bracket, but is typically 19.6 percent for S-corps., and even more for C-corps.

Right, but this sounds too good to be true.

An understandable response, but actually the benefit is real. If you would like to add 991-997 of the Internal Revenue Code to your weekend reading list, you will find that these sections are exclusively devoted to the

IC-DISC benefit and corresponding regulations. In fact, the very first section is the best: it states that an IC-DISC entity is tax free at the federal level.

What are you and your client responsible for?

At the outset, the IC-DISC entity must be incorporated and capitalized, like any other corporation, by your client. Then, the benefit can start rolling. Since you are a tax expert, you know that incorporation and maintenance of an IC-DISC can be very complicated. The IC-DISC has regulations that the entity in general must meet, but also entails an extensive qualitative process for products being exported. Additionally, the calculation of the commission brings its own set of intricacies and nuances that require intimate knowledge of other code sections, including 861 and 61. Thus, it is best to rely on a specialized provider.

Who qualifies?

In general, products must be manufactured, grown, harvested or developed within the U.S. for ultimate use outside of the U.S. and its territories. Furthermore, the product must meet a content test which examines the amount of foreign sourced material used in the production. Several industries outside of general manufacturers and distributors can also take advantage of this benefit, including wine-making, agriculture, cosmetics and software. Additionally, services provided by architecture and engineering firms for overseas projects qualify.

Next steps?

The IC-DISC benefit is, unfortunately, not retroactive. Therefore, it is important to act now. The sooner the IC-DISC entity is formed, the sooner you can save your client valuable tax dollars to invest back in their business, hire additional employees or just keep more of what they've earned.

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