

Profitable Exports Can Mean Reduced Tax Rates— If You Have an IC-DISC

By Mark E. Christopher



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Interest Charge Domestic International Sales Corporations (IC-DISCs) were created by Congress many years ago via the Internal Revenue Code. Their purpose is to help domestic companies in global competition. Prior to 2003, IC-DISCs were rarely used, because of their administrative burden and complexity. In 2003, the maximum tax rate on qualified dividends changed to 15 percent (the maximum capital gains rate). This revived IC-DISCs' tax-benefit opportunity and lessened the administrative burden, culminating in a rare win-win in today's tax environment. The permanent tax savings can be up to 20 percent.

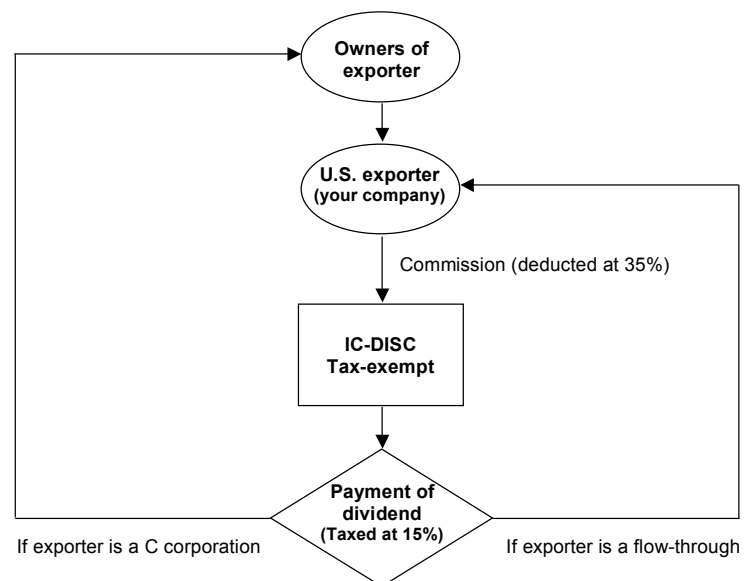
The Organizational Structure of the IC-DISC

An IC-DISC is a separate corporation that acts as a sales commission agent for a U.S. exporter. The IC-DISC itself is typically a paper company with a checking account and no employees; however, in certain circumstances an IC-DISC may function as an operating company with its own employees. Any type of entity or individual can own an IC-DISC. But if you want to maximize the tax benefits, ownership should be held by an individual or flow-through entity (LLC, LP, or S corporation).

Taxation of an IC-DISC

By statute, the IC-DISC is a tax-exempt entity. The exporter pays a commission to the IC-DISC and then deducts the commission from its income at a 35 percent rate (assuming you're in the highest tax bracket). The IC-DISC receives the commission and, as a tax-exempt entity, pays no tax on the commission. In most cases, the IC-DISC will then pay this cash back as a dividend to its shareholders. If the shareholders are other than a C corporation, they'll pay federal income tax on the dividends at the capital gains rate of 15 percent. The difference in the tax rates will result in a 20 percent tax savings on the commission.

As shown below, if the exporter is not a flow-through entity (LLC, LP, or S corporation), the exporter can take advantage of the tax benefits by having its owners own the IC-DISC directly as individuals. The IC-DISC may elect not to pay a dividend to its shareholders. In this case, an "interest charge" would apply to the deferred tax, and there would be other administrative complexities caused by holding the cash. This "interest charge" and complexity are the main reasons most exporters don't defer the tax.



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2nd Annual NORTHWEST INDUSTRIAL ENERGY EFFICIENCY SUMMIT

Presented by Washington State University Extension Energy Program
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January 20, 2010 • Oregon Convention Center • Portland, Oregon

Top-level executives from key industrial energy consuming companies, utilities and government agencies will be gathering for the second annual NW Industrial Energy Efficiency Summit at the Oregon Convention Center on Wednesday, January 20th. The summit will address the major issues and topics impacting energy efficiency within the region including the 6th Power Plan, U.S. carbon legislation, state-level sustainability and customer-driven efforts. The Summit includes facilitated work sessions designed to prioritize and develop commitment to actionable strategies, a key-not luncheon and a closing reception to provide networking opportunities for attendees.

This Northwest Food Manufacturing & Packaging Expo companion event is an annual executive-level forum to foster a collaborative, regional energy strategy to enhance the vitality of the industrial manufacturing sector in the Northwest. This one-day summit will bring together leading decision makers from industry, government, utilities,

associations and academia from Idaho, Montana, Oregon, and Washington.

Summit goals include:

- Reconfirming a regional commitment to industrial energy efficiency in the Northwest that was established at the 1st Summit held last February
- Establishing direction, priorities and commitment for strategic actions that will support achieving a significant increase in industrial energy efficiency
- Creating a working foundation for energy efficiency collaboration among industry, government, utilities and supporting organizations and other stakeholders

Summit attendees will include CEOs and executives of Northwest manufacturing companies, including representatives from the food processing, pulp and paper, electronics and chemical/refinery industries, industry association CEOs,

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IC-DISC - Continued from page 6

Other Benefits

An IC-DISC may be formed and include certain executives that are not shareholders of the exporter. This allows the exporter to provide some of the executive's compensation as dividends at the capital gains rate of 15 percent.

Example of Benefits

As you can see from the example table to the right, the use of an IC-DISC with these assumed sales and profit levels produces a permanent tax benefit of \$50,000.

| | No IC-DISC | Using Interest Charge DISC | |
|---|--------------|----------------------------|------------|
| | | Export Company | IC-DISC |
| Assumed Qualified Export Receipts | \$ 5,000,000 | \$ 5,000,000 | \$ - |
| Assumed Export Profit | \$ 500,000 | \$ 500,000 | \$ - |
| Calculated Extraterritorial Income Exclusion | - | - | - |
| Calculated DISC Commission* | - | (250,000) | 250,000 |
| Projected Taxable Income | \$ 500,000 | \$ 250,000 | \$ 250,000 |
| Assumed Federal Income Tax | \$ 175,000 | \$ 87,500 | \$ - |
| Cash Available for Dividend | N/A | N/A | \$ 250,000 |
| Projected Income Tax on Dividend (15%) | N/A | N/A | (37,500) |
| Remaining Cash After Tax | \$ 325,000 | \$ 162,500 | \$ 212,500 |
| Total Tax Paid | \$ 175,000 | \$ 87,500 | \$ 37,500 |
| | | | 87,500 |
| | | | \$ 125,000 |
| Net After-Tax Cash Advantage of IC-DISC Utilization | | | \$ 50,000 |

* Commission is statutorily set at the greater of either 50 percent of net income on export sales or 4 percent of gross export sales.