

Exporters, Are You Leaving Money on the Table? The IC-DISC Tax Incentive- - interest-charge domestic international sales corporation



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No one is interested in paying more than is necessary in federal taxes, but for some closely held companies in the business of exporting U.S.-made goods, this may be the case if they fail to take advantage of a special export tax incentive known as an *interest-charge domestic international sales corporation*, or *IC-DISC*.

What is an IC-DISC?

It is a U.S. corporation designed to be taxed at favorable rates if certain requirements are met. The IC-DISC tax incentive is aimed at stimulating growth in U.S. manufacturing and increasing U.S. exports to foreign countries. Individual business owners can take advantage of this incentive by forming a new "IC-DISC" company, held either directly or indirectly through an entity like an S corporation or partnership, and by meeting certain requirements that are discussed below.

How Does An IC-DISC Provide Tax Benefits?

In a simple example of the IC-DISC structure, the business owner's exporting company continues to operate as usual, exporting goods abroad, except that it now also pays a commission to the IC-DISC on such export sales. The commission is generally limited to the greater of either four percent of the exporting company's gross receipts from qualified exports, or 50 percent of the exporting company's net income from qualified exports. This commission payment is deductible to the exporting entity and is not taxable to the IC-DISC on receipt. The tax on commission profits is deferred until the IC-DISC distributes the commission payments to its owner as a dividend. This dividend is taxed to the owner at the dividend rate, not the ordinary tax rate that otherwise would have applied had the company not used the IC-DISC export incentive, so this rate difference may help taxpayers save on taxes.

For example, assume that the exporting company's ordinary income passes through to its owners so that it is taxed at the maximum federal rate of 39.6 percent plus the additional Medicare tax rate of 0.9 percent on high-income earners. Assume that dividends to the IC-DISC's owners are taxed at the maximum rate of 23.8 percent. Based on the simple example above, this difference in tax rates could save the IC-DISC owner up to 16.7 percent in federal taxes on a portion of its net export income.

What Are Some Issues To Consider Before Taking Advantage of the IC-DISC Tax Incentive?

The costs and benefits of an IC-DISC should be weighed and analyzed carefully before undertaking a plan to use such a structure. IC-DISC benefits are usually limited to those businesses with production or manufacturing operations in the U.S. deriving a significant amount of income from exporting overseas. To qualify for favorable tax treatment, at least 95 percent of the IC-DISC's gross receipts and assets must be related to the export of property whose value is at least 50 percent attributable to U.S. produced content. There are exceptions to this rule that permit businesses not engaged in traditional exporting to use an IC-DISC. Qualifying "export receipts" include, in some cases, profits derived from the lease or rental of U.S. produced content overseas, interest payments related to some producer's loans, and income from overseas engineering and architectural services. Even if a company currently meets the exporting threshold requirements for an IC-DISC, it is prudent to analyze whether the IC-DISC is sustainable in the long term if U.S. exports decline or become more costly because of overseas competition, currency fluctuation, or political turmoil.

Additional technical prerequisites to favorable tax treatment include the fact that the IC-DISC must regularly distribute its earnings or face interest charges for failure to make timely distributions. It also must maintain its own bank account, and minimum capitalization of \$2,500 of authorized and issued shares. An IC-DISC need not have substantial operations or provide services, have employees, or maintain a physical office location. It can obtain tax benefits with minimal activity, but it must keep separate accounting records, and file U.S. tax returns.

Taxpayers should analyze how the IC-DISC structure may interact with their other tax savings structures that are already in place. Those already taking advantage of certain treaty benefits or deductions, including the deduction for qualified production asset income, should determine how the IC-DISC structure may impact

their current tax-savings strategies.

Let Us Help You Determine Whether an IC-DISC Is Right For You

If you are interested in determining whether an IC-DISC could reduce your overall federal tax obligation, please contact us. We can help you evaluate whether you are a good candidate for an IC-DISC, form the IC-DISC entity, and draft any accompanying documents, including commission sales agreements.

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