IC-DISC
Export Tax Incentive

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Export Tax Incentives:
IC-DISC

Presented by

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What is an IC-DISC?

- Interest-charge Domestic International Sales Corporation
- Export of U.S.-produced products and certain services
- Brief History
  - DISC (1972 – 1984) Replaced with IC-DISC
  - FSC (1985-2000) Repealed
  - ETI (2000 -2005) Repealed
  - IC-DISC (since 1984 – alive and well!!)
- Initially only provided for a limited deferral of tax
- 2004 JGTRRA Act established 15% QDI rate
- Widely misunderstood and tragically underutilized
- Now offers <u>unlimited permanent tax savings</u>

The 15% QDI Tax Rate

- Scheduled to expire 12/31/12
- No way of knowing for sure what will happen
- Inertia is not the answer
- Make the most of the current opportunity

Mechanics

- New entity is formed
- C-corporation, any state, $2,500 capitalization
- Ownership: (“Related Supplier” = the U.S. Exporting Company)
  - S-corp or LLC Related Supplier: owned by that entity
  - Closely held C-corp Related Supplier: owned by individuals or a new LLC
- New entity makes an “IC-DISC” Election
- Related Supplier deducts the DISC Commission (@35%)
- DISC Shareholders have Qualified Dividend Income (@15%)
- Permanent tax savings on the rate play (20%)
- Additional C-corp tax savings
- Who this works for: closely held OR flow-through

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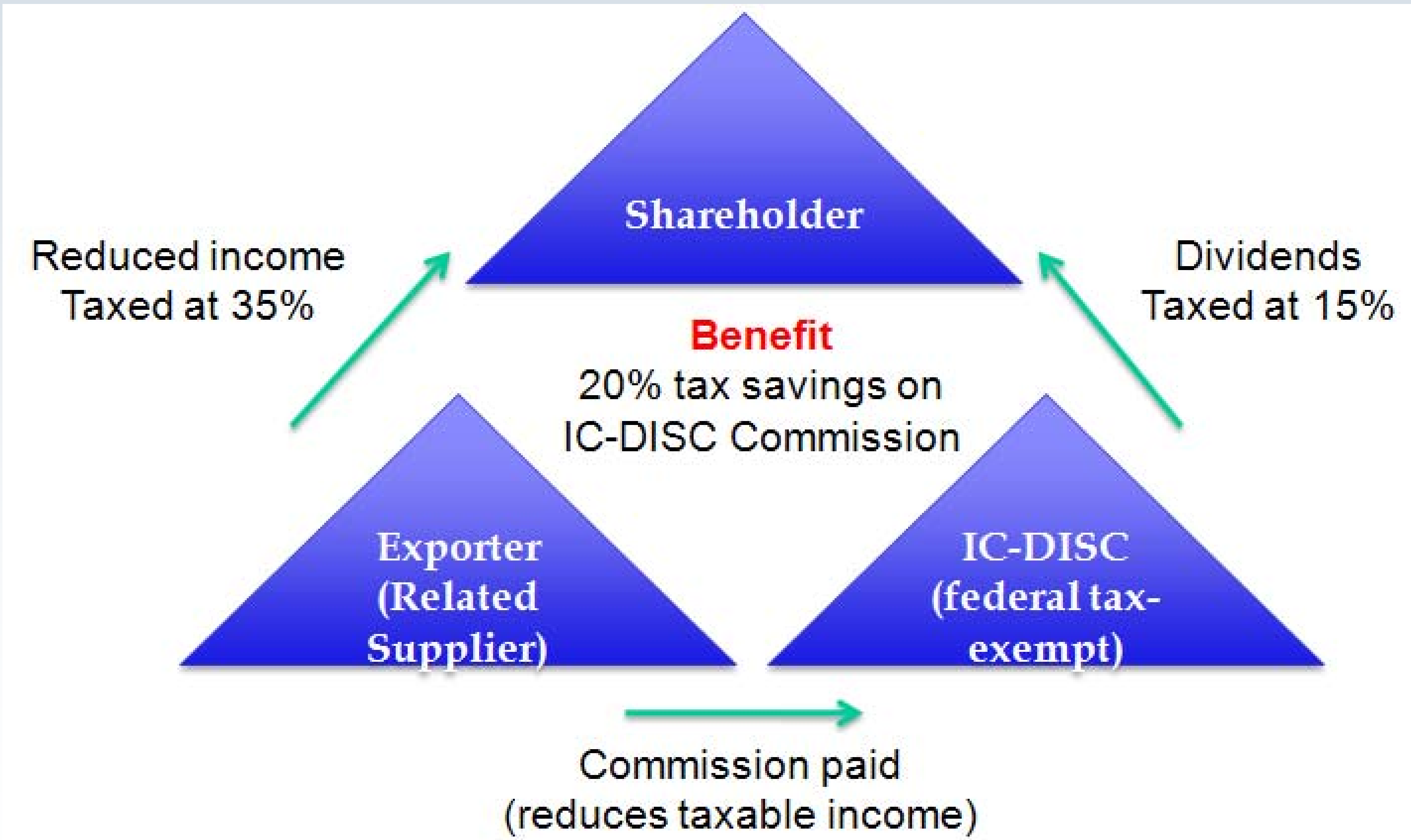
Structure Illustration

- Basic income/deduction flow:



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Impact on Clients' Business

- Basically NO impact
- Transparent to customers
- Tax reporting logistics:
  - Form 1120-IC-DISC
  - S-corp or LLC Related Supplier:
    - ◊ Ordinary deduction & QDI
    - ◊ Both flow to their owners on one Sch K-1
  - C-corp Related Supplier:
    - ◊ Ordinary deduction (Form 1120)
    - ◊ DISC s/h receives Sch K reporting QDI

◊ Cash Payments
  - S-corp or LLC Related Supplier: Journal Entries
  - C-corp Related Supplier: Actual Cash Payments
  - Cash can be immediately loaned back (or APIC)

◊ Minimal effort needed from client personnel

Qualified Export Property "QEP"

- QEP is Manufactured, Produced, Grown or Extracted in the U.S. (or U.S. Possessions)
- Components can qualify
- QEP may be "used" equipment, or even scrap
- Related and Subsidiary Services
- Architectural and Engineering Services
- Leases of U.S. manufactured property
- Both original manufacturers and resellers can claim a benefit

Foreign Content Test

- "Less than 50% imported material"
- Important: 50% of Selling Price, not COGS
- Example:
  - Product is sold overseas for $100
  - Manufacturer's COGS is $75
  - Cost of imported materials can not exceed $50
  - NOT 50% of $75 ($37.50)
- Common misconception that it won't pass
  - Often does

Destination Test

- Must be for direct use, consumption, or disposition outside the United States
- F.O.B. Point does not matter
  - Freight-forwarding = OK
- Shipments to U.S. Distributors can qualify
  - Products must leave the U.S. within one year from original sale
  - Evidence substantiating the export is required
    - ◊ Documentation from distributor (or other proof)

◊ No re-import into the U.S. – except qualified components

  - Test: Selling price of exported components is less than 20% of final product's FMV

Achieving Tax Benefits

- Determine Export Taxable Income
  - Client identifies qualifying export sales, and COGS
  - Expenses are allocated
- Apply “Statutory Pricing Methods”
  - 4% of Qualified Export Gross Receipts (4% GR)
  - 50% of the Taxable Income attributable to qualified exports
  - Marginal Costing is also available

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Simple Example

- High-Level “Overall” Approach

	Export	Domestic	Total
Sales	4,000,000	6,000,000	10,000,000
COGS	3,100,000	4,900,000	8,000,000
Gross Margin	900,000	1,100,000	2,000,000
SG&A	387,500	612,500	1,000,000
Net Income	512,500	487,500	1,000,000
Profit %	12.8%	8.1%	10.0%
4% GR	160,000		
50% CTI	256,250	$ 51,250	Tax Savings

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Maximizing Tax Benefits

- Transaction-by-Transaction Analysis (“TxT”)
  - Client provides invoice data download
  - Detailed allocations of cost/expenses are made
  - Taxable income by invoice line item is calculated
  - Most beneficial pricing method applied to each

TxT Example

- Transaction-by-Transaction Example

	Export Trans 1	Export Trans 2	Total Export		
Sales	2,000,000	2,000,000	4,000,000		
COGS	1,350,000	1,750,000	3,100,000		
Gross Margin	650,000	250,000	900,000		
SG&A	168,750	218,750	387,500		
Net Income	481,250	31,250	512,500		
Profit %	24.1%	1.6%	12.8%		
4% GR	80,000	80,000	160,000		
50% CTI	240,625	15,625	256,250	$ 51,250	Tax Savings
			320,625	$ 64,125	Tax Savings
				25%	increase

TxT Savings Examples

- $54mil manufacturer of equipment controls
  - $20mil in qualifed exports
  - Overall Company Loss & Overall Loss on Exports
  - $1.1mil DISC Commission using TxT (saving $220k)
- $102mil producer of Pork Rinds
  - $21mil in qualified exports
  - Worked with client to accurately allocate costs
  - Simple Approach = $827,000 DISC Commission
  - TxT Approach = $2.7mil. Total tax savings: $540,000

Maximizing Tax Benefits

- Transaction-by-Transaction Analysis (“TxT”)
- Product Grouping
  - Work with clients to develop a Product Hierarchy
  - Provides different profit %’s
  - Work around limitations
  - Utilize Marginal Costing
- These options can double or triple the DISC benefit!

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VantagePoint Software

- Performs highly complex calculations not possible in a spreadsheet
- Integrates 861-8 allocation and apportionment
  - Maximizes IC-DISC Export Tax Savings
    - ◊ Marginal costing
    - ◊ Grouping for pricing and OPP
    - ◊ Special no-loss rules
  - Domestic Production Activities Deduction (DPAD)
    - ◊ Item-by-Item documentation
    - ◊ Maximizes QPAI limitation
  - Foreign Tax Credit Limitation

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Next Steps

- IC-DISC BENEFITS ARE PROSPECTIVE ONLY!
- Formation of IC-DISC
  - Complete turn-key package
  - Incorporation, legal documents, election, agreements
  - Typical fee: $5,000
- Annual Services
  - ◊ Commission Maximization calculations (TxT approach)
  - ◊ 1120-IC-DISC preparation
  - ◊ DISC Financial Statements & Journal Entries
  - ◊ Fees vary on complexity/scope (typically $10-$20k)
- Important revenue-increasing opportunity: clients/prospects with an existing DISC
  - ◊ Rarely are their annual calculations being fully maximized
  - ◊ Opportunity to go back and redetermine commissions

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Questions?

- Thank you for your time, please contact me with any additional questions:

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