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Campaign Promise of Tomorrow Here Today

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With the 2016 presidential election season fast approaching, candidates on both sides of the political aisle will be touting proposals on incentives for U.S. manufacturers and exporters such as farmers, software distributors and engineering service providers.

However, there currently exists an often overlooked income tax incentive in the Internal Revenue Code for exporting U.S. products and services: the interest charge domestic international sales corporation, or IC-DISC.

An IC-DISC is a corporation that may earn tax-deferred commissions from a related supplier. For participating in the export activities of a supplier, an IC-DISC may be paid a commission equal to the greater of: 4 percent of the supplier's gross export receipts or 50 percent of the supplier's net income from the sale of export property. These commissions are only subject to income tax when the IC-DISC pays its shareholders a dividend. The dividend payments can be subject to tax at a maximum rate of 23.8 percent. Furthermore, in exchange for a minimal interest charge, up to \$10 million each year may be retained by the IC-DISC and not distributed to the shareholders.

The related supplier may deduct these commissions from its taxable income. Thus, the IC-DISC structure provides an opportunity for individual U.S. shareholders to reduce their U.S. federal income tax from 43.4 percent to 23.8 percent on income from the sale of property that is produced in the United States and exported overseas. Likewise a similar significant tax savings benefit may also be available for an individual foreign shareholder. In addition, a foreign shareholder may benefit from a bilateral income tax treaty to reduce the U.S. withholding tax on U.S. source dividends.

IC-DISC Requirements

The IC-DISC must be formed as a separate corporation from the related supplier. In order to maximize the benefit, an IC-DISC will generally be formed as either a brother-sister corporation to a related supplier or as a subsidiary to a related supplier that is treated for

U.S. federal income tax purposes as a pass-through entity, such as a partnership or S corporation. The IC-DISC must be a domestic corporation that meets the following requirements: at least 95 percent of its gross receipts are from certain activities related to the sale of so-called "export property," at least 95 percent of its assets are export property and related assets and certain other administrative requirements are met, which include having only one class of stock outstanding and at least \$2,500 of contributed capital for the entire tax year.

For IC-DISC qualification purposes, export property only includes property that is manufactured or produced in the United States by a person other than an IC-DISC, held primarily for sale in the ordinary course of a trade or business for use outside of the United States, and which is less than 50 percent attributable to components that were imported into the United States. Thus, the IC-DISC tax benefit would only apply if the goods themselves are manufactured in the United States and from mostly U.S. products. Furthermore, many different types of businesses aside from traditional manufacturing, such as farming, software development, product distribution, and even engineering services, can qualify.

Filing Requirements

In order to make the IC-DISC election, a corporation should file Form 4876-A, Election to Be Treated as an Interest Charge DISC, within 90 days of the beginning of the tax year in which the election will take effect. An IC-DISC must file an annual Form 1120-IC-DISC. Extensions are not allowed for filing this return, but the due date is generally the same as the extended deadline for filing of the Form 1120.

The benefit of the IC-DISC can be especially useful for companies based in Florida. Unlike other states, there is no adjustment made to an IC-DISC's federal taxable income to calculate Florida corporate income tax. In other words, an IC-DISC can also be exempt from Florida corporate income tax. In addition, the commissions paid by the related supplier to the IC-DISC are still deductible for Florida corporate income tax purposes.

The IC-DISC can be a powerful tool to be used by manufacturers or other U.S. distributors to reduce their U.S. and Florida taxable income. Therefore, not every business must wait until after next year's election to start more efficient tax planning today.

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