Login Register

accountingTODAY

The Latest (0/5)

Voices 10 winning IC-DISC tax strategies

By Robert Feinschreiber, Margaret Kent
Published June 08 2017, 3:11pm EDT

More in International taxes, Tax breaks

Print Email Reprints Share

U.S. exporters have been claiming the DISC or IC-DISC tax break for more than 45 years. Despite these facts, some enterprises fail to take advantage of the federal government's tax giveaways for Interest Charge Domestic International Sales Corporations. Here are 10 winning IC-DISC strategies an exporter can use:

1. Decision time: Take a broad view of your enterprise's goals

Your enterprise has two choices, to save taxes over the long run or claim immediate benefits. An enterprise seeking long-term tax benefits might claim the export IC-DISC's deferral benefits. But the enterprise might seek immediate IC-DISC tax savings each year, taking advantage of more favorable tax rates. Such an enterprise can take each year's IC-DISC benefits now as a flow-through strategy. Each exporter has a choice of these two IC-DISC benefit options. The exporter should plan for these options in advance.

2. Demonstrating your enterprise's export activities

The tax rules require the enterprise to be involved in U.S. exports, hopefully to provide a boost to American exports. These export rules do not require the enterprise to be involved in foreign operations. An enterprise can qualify for the IC-DISC export tax break if it sells its manufactured products anywhere in the United States to another U.S. company. Inland enterprises can qualify for the export tax break if they can demonstrate to the IRS that its products actually go overseas.

3. Meeting your IC-DISC's annual requirements

The IC-DISC imposes two requirements on American exporters: a gross receipts test and an export assets test. It's easy for a flow-through IC-DISC to meet the assets test, as few assets remain at the end of the year. The assets test becomes harder to meet each year for an IC-DISC seeking to obtain a long-term tax deferral. Many IC-DISCs apply export revenues to meet the gross receipts test.

4. Structuring for the IC-DISC's estate planning

An IC-DISC need not necessarily have the same shareholders as its parent company. Gift tax rules typically apply to determine the validity of the parent-IC DISC shareholder relationship. The IRS will typically look to the functional analysis of the parent and IC-DISC shareholders. Functional analysis is a transfer pricing section 482 concept.

5. Pricing IC-DISC's parent company transactions

An IC-DISC typically has three intercompany pricing options for an eligible transaction: (1) 4 percent of gross receipts when the IC-DISC and its related party sell their products to an independent third party, (2) half of the total net income shared between the IC-DISC and its related supplier when they sell their products to an independent third party, or (3) the arm's length income the IC-DISC determines using a section 482 transfer pricing basis. The pricing rules include a 'no loss" rule, limiting the IC-DISC to the entire amount of its income, with the related supplier receiving no income. The pricing rules do not require the IC-DISC or its related supplier to use a constant pricing approach by product or tax year, so planning options abound.

6. Grouping transactions compared with the transaction-by-transaction approach

In some situations, an IC-DISC might find it advantageous to group eligible transactions together. Yet in other situations, an IC-DISC might find it advantageous to determine its profits on a transaction-by-transaction basis. Consider two examples, each comprising two transactions, where the gross receipts from each transaction are $100.

• The company in the first situation earns combined IC-DISC and related supplier profits of $2 from one transaction and $6 from another transaction. Under the transaction –by-transaction method, the IC-DISC would receive profits of $2 under the no loss rule and $4 under the 4 percent rule, or $6 in total. The grouping rule would give the IC-DISC $8 compared with $200 in gross receipts, a clear benefit from grouping.

• The company in the second situation earns combined IC-DISC and related supplier profits of $6 from one transaction and $10 from another transaction. Under the transaction-by-transaction method, the IC-DISC would receive profits of $4 under the 4 percent rule and the IC-DISC would receive $5 under the 50/50 profit split rule, or $9 in total. The grouping rule would give the IC-DISC a total of $8, half of the total $6 and $10 amounts. Here the IC-DISC would have a detriment from grouping its transactions.

7. Doubling export profits through a DISC's subsidiary, the FISC

The U.S government is intent on encouraging exports by having the IC-DISC become directly involved in international operations through an offshore entity. The IC-DISC might be able to double its IC-DISC benefits by having a Foreign International Sales Corporation, a FISC. The U.S. exporter can defer this FISC income or, alternatively, flow this FISC income to the IC-DISC.

8. Avoiding the $10 million IC-DISC limitation

When the U.S. government initially converted DISCs to IC-DISCs during the '80s, the exporter initially received no additional tax benefits beyond the $10 million limitation. President Bush changed this limitation some time ago, enabling IC-DISC shareholders to benefit from this tax incentive beyond the $10 million amount.

9. Industries that benefit from the IC-DISC program

White Paper **Adopting a suite approach to apps**

Making the Business Case for Midmarket Companies

PARTNER INSIGHTS
SPONSOR CONTENT FROM:

ORACLE + NETSUITE

Accounting
June 1

The U.S. government designed the IC-DISC program to benefit a wide variety of diverse U.S. industries, including aircraft manufacturers, grain traders, medical equipment manufacturers, miners, farmers and a whole host of industries. The Trump administration has demonstrated the government's renewed interest in reversing America's trade imbalance. One of the beneficiaries of this American trade issue might very well be that the U.S. legislators will emphasize on the IC-DISC program. We suggest the U.S. government vastly increase the $10 million limitation amount.

10. Keeping your paperwork straight

The IC-DISC program strongly suggests that the IC-DISC itself enter into legal agreements with other related and unrelated entities. IC-DISCs rarely create export sales on their own. Instead, the IC-DISC needs operating agreements such as a franchise agreement. Be extremely cautious about hand-me-down agreements. Having an IC-DISC that has the same IC-DISC operating rules for an aircraft manufacturer and the grain trader, for example, might not achieve the applicable results for either business.

Robert Feinschreiber

Robert Feinschreiber is an experienced tax practitioner, attorney and counselor at Feinschreiber & Associates in Key Biscayne, Florida, who co-founded the Transfer Pricing Consortium.

More from this Author

UN seeks a broader transfer pricing role

Margaret Kent

Margaret Kent of Feinschreiber & Associates and the Transfer Pricing Consortium has been an attorney for over 20 years, focusing on law and international taxation.

More from this Author