SOLUTIONS FOR TAX PROFESSIONALS AND BUSINESSES
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IC-DISC: Permanent Tax Savings for Export Activities

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IC-DISC: Permanent Tax Savings for Export Activities

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Director

About KBKG



- Established in 1999 with offices across the US.
- Provide turn-key tax solutions to CPAs and businesses
  - R&D Tax Credits, Cost Segregation, Energy Tax Incentives, Repair vs. Capitalization Studies, IC-DISC Export Incentives
- Performed thousands of tax projects resulting in hundreds of millions of dollars in benefits for our clients.
- Our team is a diverse mix of tax specialists, attorneys, energy consultants and engineers from various disciplines. This combination of talent allows us to focus on our areas of service and maximize results for our clients.
- A preferred provider for thousands of CPAs across the country.

Alex Bagne, JD, MBA



- Practice Leader for KBKG’s Export Incentives & Tangible Property Regulations Service Lines
- 15 years tax and accounting experience, (10 years at Big 4)
- Extensive experience with International Tax
- Accounting Degree - Ohio State University
- Licensed Tax Attorney - Tulane School of Law
- MBA - University of Minnesota
- Member of American Society of Cost Segregation Professionals.

IC-DISC Overview



- An increasing number of closely held companies are using the IC-DISC (Interest Charge Domestic International Sales Corporation) provisions of the Internal Revenue Code intended to help U.S. companies compete internationally.

- Many, however, are still not utilizing the incentive or not capturing all of the available, intended and allowable benefits.

What is the IC-DISC?



- Sole surviving tax incentive created by Congress to facilitate export of U.S. made goods and services.

- Originally created to provide a deferral mechanism, in 2003 the IC-DISC began to provide a permanent tax savings for closely held flow through companies via the qualified dividend rate (15% from 2003-2012, currently 20%). Closely held "C" Corporations enjoyed permanent savings since 1984.

- At least 50% of Taxable Income, or 4% of Gross Receipts (limited to Taxable Income) from products made in the U.S. and used outside the U.S. are taxed at a 20%, rather than a 39.6%, rate (Affordable Care Act Dividend Tax also generally applies).

POLLING QUESTION #1

History of Export Incentives



- DISC (1971-1984), FSC (1984-1999), ETI Exclusion (2000-2006)
- Export incentives above put in place by Congress were all eventually repealed due to pressure from the United States' GATT, EU, and WTO trade partners.
- The IC-DISC has not been challenged by the WTO or EU to date.

What is the IC-DISC? (continued)



- Requires setup of a corporation which elects treatment as an IC-DISC and can be paid a deductible commission based on export sales or income. Dividends paid back to the parent are taxed at a 20% rate (plus 3.8% ACA tax, which generally applies). The entity files an 1120-IC DISC federal return.

- No change in business operations is needed.

- Typical structures on following slides.

“Original” Use Structure



Corp. or Ind. Owner(s)

Taxed at Ordinary Rates

US Operating Company

IC-DISC Commission Deduction

Loan (Interest-Charged) On Tax Normally Due

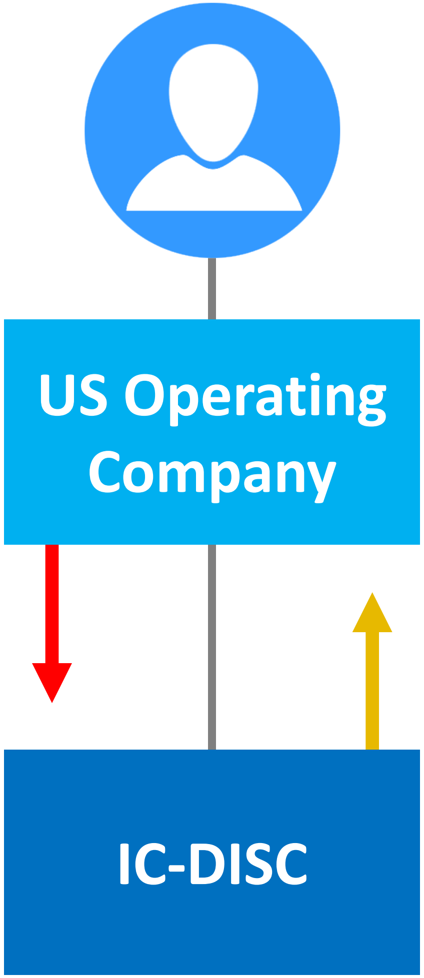
Generally, a Tax Exempt Entity

IC-DISC

Typical Structure for Flow Through



Corp. or Ind. Owner(s)



Taxed at Ordinary Rate, Top Rate 39.6%*

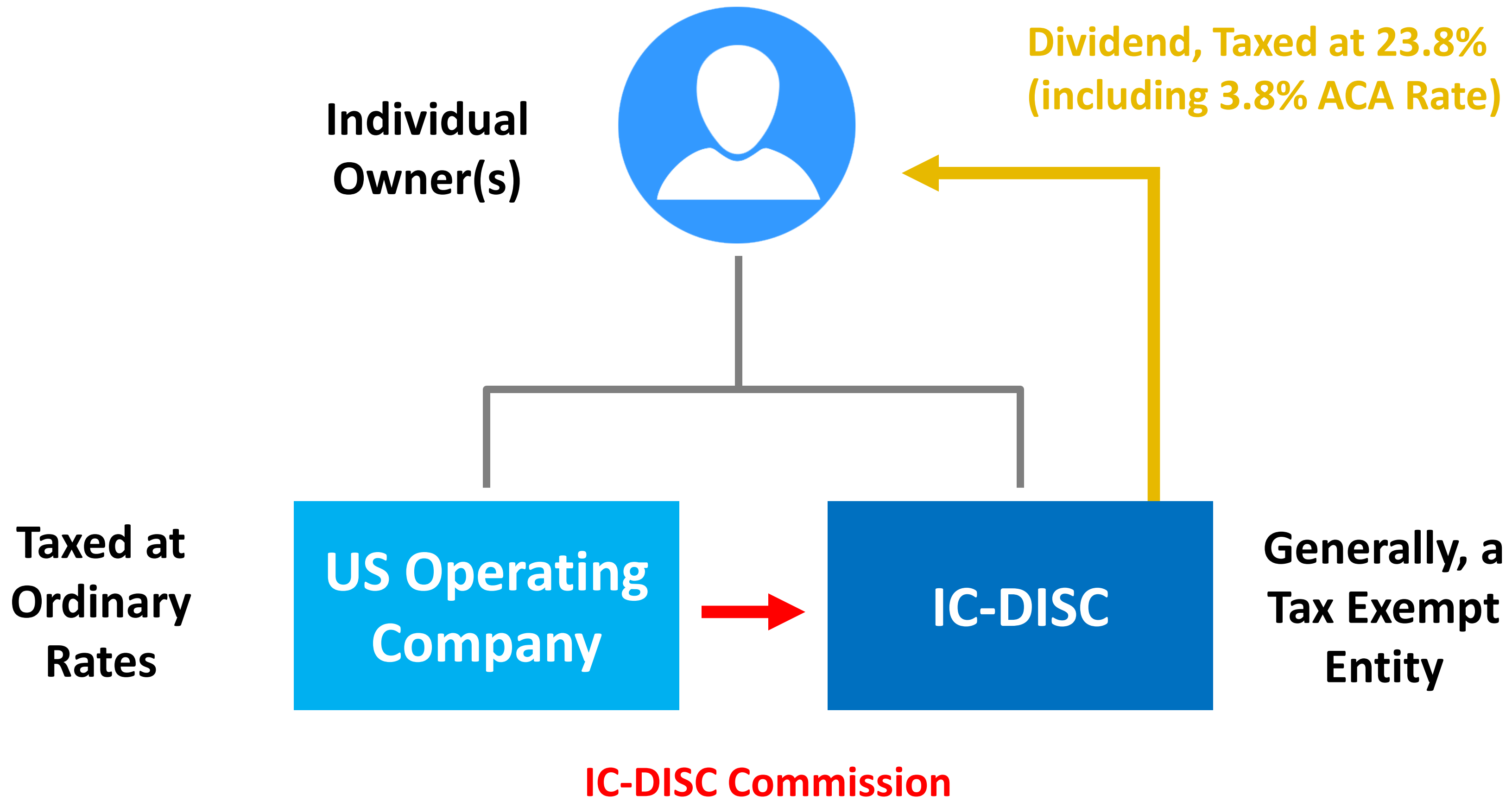
IC-DISC Commission Deduction

Dividend, Taxed at 23.8% (including 3.8% ACA Rate)

Generally, a Tax Exempt Entity

*3.8% ACA Rate may apply

Typical Structure for Closely Held C-Corp



Basic Benefits of an IC-DISC Calculation



Basic Benefit for Closely Held Flow Through:

	Without IC-DISC	With IC-DISC	Net Savings
Export Sales	5,000,000	5,000,000	
Net Margin	20%	20%	
Net Profit	1,000,000	1,000,000	
IC-DISC Commission(50%)		500,000	
Taxable Income	1,000,000	500,000	
Tax Rate	39.6%	39.6%	
a Partner Level Taxation	396,000	198,000	198,000
Dividend to Shareholder		500,000	
Tax Rate	20%	20%	
b Shareholder Level Taxation	-	100,000	(100,000)
c Total Taxation (c = a + b)	396,000	298,000	98,000

Note: 3.8% ACA Rate effect not shown

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Basic Benefits of an IC-DISC Calculation



Basic Benefit for Closely Held C-Corp:

		Without IC-DISC	With IC-DISC	Net Savings
	Export Sales	5,000,000	5,000,000	
	Net Margin	20%	20%	
	Net Profit	1,000,000	1,000,000	
	IC-DISC Commission(50%)		500,000	
	Taxable Income	1,000,000	500,000	
	Tax Rate	35%	35%	
a	Corporate Level Taxation	350,000	175,000	175,000
	Dividend to Shareholder	650,000	825,000	
	Tax Rate	20%	20%	
b	Shareholder Level Taxation	130,000	165,000	(35,000)
c	Total Taxation (c = a + b)	480,000	340,000	140,000

Note: 3.8% ACA Rate effect not shown

POLLING QUESTION #2

Legislative Backdrop and Outlook



- The IC-DISC was challenged in a proposed Tax Technical Corrections Act in 2008.
- A groundswell of support from a bipartisan Senate consortium, and IC-DISC benefactors lobbied successfully to have the DISC preserved as a worthwhile incentive for U.S. production and export of U.S. products.
- The qualified dividend rate, which was re-established at a top rate of 20% (formerly 15%) as part of the 2013 “fiscal cliff” negotiations, has created renewed interest in the IC-DISC.

What Products or Services Qualify for the IC-DISC?



- "Exported" Goods (direct *or indirectly* exported, includes Canada/Mexico!).
- U.S. Content (no more than 50% *of sales price* can be foreign content)
- U.S. Manufactured Goods (20% *of COGS* U.S. labor/burden safe harbor).
- Products must not be further manufactured within the U.S. by another party (further manufacture *outside* the U.S generally qualifies) after the sale.
- Certain services (Related and Subsidiary and Architectural and Engineering) and leases.

Frequently Missed Opportunities



- "Ultimate Use" Sales
- Sales to Related Party (and by Related Party in Some Cases)
- Detailed Transactional Calculations
- Distributor Sales
- Services

Misconceptions



- $10 Million Maximum Export Sales
- Taxpayer Must Manufacture Products
- Aggressive/Tax Shelter
- Business Operations Disrupted/Administrative Burden
- 4% of Export Sales or 50% of Export Profit is Maximum Commission
- Quarterly Commission Calculations Required
- IC-DISC Benefits for Foreign Owners Endorsed by Tax Code

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Benefits of a Detailed IC-DISC Analysis



- Identification of Additional Eligible Sales
- Allocation and Apportionment of Expenses
- Transactional Calculation with Marginal Costing
- Re-Determination of Prior Year Calculations

Benefits of a Detailed IC-DISC Analysis

Identification of Eligible Sales

- Typically, manufacturers, processors, distributors and growers with over $10M in sales are potential beneficiaries even if only a small percentage of their products are used outside the U.S.

- All manufacturing, growing, distribution, extraction, and architectural/engineering firms should be thoroughly examined, even if they do not think of themselves as manufacturers or exporters.

- Export Sales or Net Income at the company level is not necessarily a delimiter for closely held companies.

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Benefits of a Detailed IC-DISC Analysis



Identification of Eligible Sales – Overlooked Industries

- Software Companies
- Distributors/Brokers
- Food Growers
- Food Processors
- Equipment Leasing
- Recyclers
- Architectural/Engineering

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POLLING QUESTION #3

Benefits of a Detailed IC-DISC Analysis



Transactional Analysis

- Calculating IC-DISC benefits at a transactional, rather than aggregate, basis can add significant increases.

- Sophisticated calculation engines can maximize tax savings by dramatically increasing the IC-DISC benefit using the intended, allowable, complex methods in the regulations. These engines also generate the additional needed compliance.

- Until 2006, public companies routinely enjoyed significant increases in their export incentive calculations from detailed analyses using calculation engines. Now, such increased benefits are available to closely held companies through the IC-DISC.

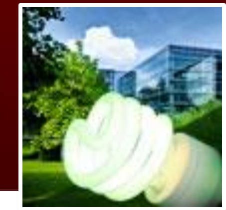
Benefits of a Detailed IC-DISC Analysis



Transactional Analysis – Loss Exclusion

- Loss transactions may be excluded, allowing benefit to be derived from the profitable transactions.

Benefits of a Detailed IC-DISC Analysis


Transactional Analysis – Marginal Costing

- In conjunction with transactional analysis, marginal costing is an element of the IC-DISC regulations which allows less profitable transactions to derive IC-DISC benefit largely *as if* they were as profitable as an average transaction.

- Marginal costing can be applied at transactional, product, product line, etc. levels. Highly sophisticated software is needed to optimize marginal costing benefits in conjunction with loss optimization.

Benefits of a Detailed IC-DISC Analysis



Transactional Analysis – Marginal Costing Example:

							IC-DISC Commission		
Product Group	Domestic or Export	Sales	COGS	MCCTI	Expenses	Net Income	4% of Sales Method	50% Net Income Method	Marginal Costing Method*
Pens	Export	100	80	20	12	8	4	4	7
Pens	Domestic	100	75	25	5	20			
Total		200	155	45	17	28			

Overall Profit Percentage: 14% (Net Income of $28 divided by Total Sales of $200)

*Marginal Costing Method Selected: MCCTI (Limited to Sales x OPP) x 50%
Equals: $20 (limited to $100 x 14%) x 50%
Equals: $20 (limited to $14) x 50%
Equals: $14 x 50% = $7
*Other Limitations and Documentation Requirements Apply

Benefits of a Detailed IC-DISC Analysis



Transactional Analysis – Product Hierarchy

Product	Product Line	Product Group	All Products
Erasable Pen	Pens	Writing Instruments	All Products
Standard Pen	Pens	Writing Instruments	All Products
Wood Pencil	Pencils	Writing Instruments	All Products
Mechanical Pencil	Pencils	Writing Instruments	All Products
Spiral Notebook	Notebooks	Stationary	All Products
Perforated Notebook	Notebooks	Stationary	All Products
Cardback Steno Pad	Steno Pads	Stationary	All Products
Plastic Back Steno Pad	Steno Pads	Stationary	All Products

- A product hierarchy exponentially increases the opportunities for marginal costing.
- Product hierarchies are usually easily constructed from existing data.

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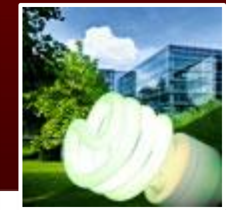
POLLING QUESTION #4

Benefits of a Detailed IC-DISC Analysis



Summary

- Care must be taken to ensure proper initial set up of the IC-DISC entity, required elections, preparation of shareholder agreements between the IC-DISC and the related supplier, etc. Basic maintenance of the entity, required estimates of the IC-DISC commission, and preparation of all compliance documents (e.g. the Form 1120 IC-DISC and Schedules P) are recurring activities.

- In conjunction with the proper guidance from specialists, the initial and the recurring administrative activities usually only cost companies a few hours per year. Needed data usually exists and is easily obtainable from Sales and Cost systems. Re-Determinations are allowed for prior years from the date of the DISC's inception.

QUESTIONS & ANSWERS



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See if you qualify:
KBKG.com/qualify

KBKG SERVICES

- R&D Tax Credits
- Green Tax Incentives
- Hiring Tax Credits
- Cost Segregation
- Fixed Asset Review
- IC-DISC
- Repair v. Capitalization
- Property Tax
- Sales & Use Tax