



The Survival of the Fiscally Fit

For U.S. businesses, understanding the tax advantages available to you may mean the difference between mere survival (or worse) and thriving in this economy

By Jim Young, J.D.

Today's mantra is "Survival of the Fittest." U.S. companies are tightening their belts amid international competition, which is breathing down their necks. The current economic climate is forcing companies across the country to cut costs, cut production, and cut jobs. Once vibrant and growing, many are closing their doors for good, but many are surviving. In fact, some are even thriving. The reason? These forward-thinking companies are taking advantage of tax incentives which were created to help them survive.

Many small- and middle-market companies are not aware they qualify for tax breaks. In order to survive in the current economic climate, U.S. companies **must** educate themselves on the tax incentives available to them. Congress has a history of providing tax breaks to U.S. businesses for such activities as research & development, domestic production, hiring workers, and utilizing alternative fuels.

These various incentives have come and gone throughout the years, incentivizing a wide array of business activities; but for exporters, there really is only one, albeit a tremendously powerful, option. This tax strategy can increase your after-tax margin on exports by **ten percent**.

This incentive is called the Interest Charge - Domestic International Sales Corporation, more commonly known as the "IC-DISC." The IC-DISC traces its heritage as far back as 1971, but until 2003, it did little more than provide a tax deferral opportunity. This benefit was well appreciated by the *Fortune* 1000, but it packed little punch for the small and middle-market. In 2003, the tide turned.

Today, the IC-DISC regime allows U.S. companies to set up separate domestic entities which act as commission agents for the company's export sales. Once the IC-DISC is set up, the U.S. company can pay commissions to the IC-DISC. These commissions can be as high as 50% of net export income or 4% of gross export receipts, whichever is higher!

Why The IC-DISC is So Powerful

But why is it a good idea to pay a commission to the IC-DISC? The reasons are three: First, the commission is fully deductible. Second, the IC-DISC pays no federal income tax. Third, the IC-DISC is, at heart, a Subchapter C Corporation, meaning it distributes its income to its owners as a qualified dividend. The result is a permanent reduction in tax of twenty cents on every commission dollar (taking the difference between the top ordinary income rate and the qualified dividend rate)!

Often companies dismiss the IC-DISC as inapplicable to their business, but the IC-DISC is actually much broader than most people realize. It covers the sale of products that are manufactured in the United States, but that doesn't even mean the taxpayer must be the manufacturer.

In the same vein, if a manufacturer sells its product to another U.S. company, which in turn exports that product, then the original manufacturer can qualify just the same. Moreover, it is not only the export of tangible goods which qualifies; the provision of architectural and engineering services is incentivized by the IC-DISC as well. So if an engineering firm designs and builds a building in China, that engineering service would qualify for IC-DISC treatment.

Like Many of the More Powerful Tax-cutting Tools, It Must Be Handled With Care

On the surface, the rules governing the IC-DISC seem manageable; however, in order to maximize the benefit available to a company utilizing / implementing an IC-DISC, a firm that specializes in this complex structure needs to be engaged to manage the DISC structure on a monthly or quarterly basis.

It is important that CPA firms and their clients partner up with a reputable firm that has deep expertise in this field, as implementation of the IC-DISC, while offering extremely powerful benefits to companies, is littered with minefields and traps for the unwary that can cause businesses to miss out entirely on the benefits or claim much less than they actually deserve.

This is Not a Loophole!

There has been speculation that the benefits available through the IC-DISC may be short-lived. Many look for the Obama Administration to eliminate the ability to take IC-DISC dividends as qualified dividends. However, the White House seems to be singing a different tune, according to Dean Zerbe, who spent seven years as Tax Counsel on the Senate Finance Committee.

Zerbe notes that while there are many "loophole closers" present in the proposed budget released by the White House, the same budget "is loud in its silence on [the IC-DISC]." He goes on to explain: "The White House can read the tea leaves that a proposal to eliminate IC-DISC would be a political loser and would meet very real bipartisan opposition in the Senate."

Others point to the imminent change in the ordinary income and qualified dividend tax rates, and particularly the spread between the two, on which IC-DISC benefits depend. The current rates are set to expire on December 31, 2010. Once again, Zerbe points to the Obama budget proposal, which would set qualified dividends at twenty percent, while raising the top ordinary income rate to 39.6 percent. More recently, the White House has indicated the Bush tax cuts could be extended beyond 2010 before significant tax reform hits Congressional agendas. Says Zerbe, the "IC-DISC will remain in place for the foreseeable future."

That is good news for U.S. exporters, who face a struggling domestic economy and formidable international competition. But the clock is ticking. Unlike many incentives which may be captured on old returns, IC-DISC benefits are only available for transactions occurring **after** the IC-DISC is set up. Companies must be proactive in **all** areas of their business. Those that aren't may not survive.

Conclusion

It is particularly important that during these tough economic times accountants consult closely with their clients to identify those that may be eligible for the IC-DISC. This is an area in which providers of specialized tax services can help.

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