

Interest Charged Domestic International Sales Corporation (IC-DISC)

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The Interest Charged Domestic International Sales Corporation (IC-DISC) is one of the few remaining tax benefits to U.S. companies that export offshore. The IC-DISC provides multiple benefits including ease to create, exemption from U.S. taxation, and the dividends distributed from the IC-DISC meet the criteria for the qualified dividend tax rate.

Background

The IC-DISC provisions have been in place since 1984. Over the years, many of the benefits provided to U.S. exporters have been criticized by the major trading partners of the U.S. This led to the repeal of a majority of the tax rules for U.S. exporters. However, the IC-DISC has not yet been abolished as its benefits are geared toward small businesses in compliance with the General Agreement on Tariffs and Trade (GATT).

Requirements

In order to take advantage of the benefits, an IC-DISC provides certain requirements must be met. First, the IC-DISC must be a U.S. corporation that is organized under the laws of a State or the District of Columbia. Second, the IC-DISC can only have a single class of stock and the stock must have a minimum par or stated value of \$2,500 on each day of the taxable year. If it is a new corporation, the \$2,500 value is only required on the last day to elect IC-DISC status for the year and on each later day. Lastly, the corporation must elect to be treated as an IC-DISC by filing Form 4876-A.

Qualifications

To be considered an IC-DISC, the corporation must pass both the qualified export receipts and qualified export asset tests. The qualified export receipts tests requires that 95% of the gross receipts of the IC-DISC be qualified export receipts. Qualified export receipts include receipts from sales of export tangible export property outside the U.S., lease or rent of tangible export property outside the U.S., services which are related and subsidiary to export sales, and engineering or architectural services for construction projects located or proposed for location outside the U.S. The qualified export assets test requires that at the end of the tax year, the adjusted basis of its qualified export assets is at least 95% of the sum of the adjusted basis of all its assets.

Election

The corporation files Form 4876-A to elect to be treated as an IC-DISC. There is a time period under which the corporation must file Form 4876-A for the election to be effective in the current tax year. If the corporation is a newly-formed corporation, the election must be filed within 90-days after the beginning of the corporation's first taxable year. For an existing corporation, the election must be filed during the 90-day period preceding the first day of the corporation's taxable year. If the election is not made within the applicable time period, the election will not take effect until the next tax year. The taxable year-end of the IC-DISC must be that of the majority shareholder.

Structure

Under a C corporation structure, the U.S. manufacturing entity pays a commission to the IC-DISC for exporting its product. The U.S. manufacturing entity receives the benefit of a deduction for the commission paid to the IC-DISC and the IC-DISC is not taxed on the commission income until it is distributed to the owners of the IC-DISC as a dividend. The dividend that is distributed from the IC-DISC is taxed at the qualified dividend rate of 15% to the individual owners. It should be noted that the IC-DISC and the U.S. manufacturing entity can have the same ownership.

Commission

Since the commission is being paid between the IC-DISC and its related supplier, the transfer pricing rules come into effect. There are three methods under which the commission can be calculated. The first method is 4% of gross receipts, the second method is 50% of combined taxable income, and the third method is under the rules of Internal Revenue Code

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Section 482. The method that is chosen is required on a transaction by transaction basis. However, the rules can be applied to each transaction separately. Neither the gross receipts method nor the combined taxable income method can be applied in a way that causes a loss to a related supplier in any tax year.

Tax Filings

Even though the IC-DISC generally is not taxed on the commission income there is still a requirement to file an annual tax return with the Internal Revenue Service. The IC-DISC files Form 1120-IC-DISC to report the activity of the current tax year. Form 1120-IC-DISC is due 9 ½ months after the end of the tax year and no extensions are available.

The tax-exempt aspect of the IC-DISC is specific to the federal tax level. Based on the state under which the IC-DISC is incorporated there could be a filing requirement with the applicable state taxing authority. Therefore, it is best to incorporate the IC-DISC in a state that does not have a corporate income tax such as Delaware or Nevada. If the IC-DISC is incorporated in a state without a corporate income tax, there is not a filing requirement or tax at the state level. However, if the IC-DISC is incorporated in a state that has a corporate income tax, the filing requirements for that applicable state will need to be determined.

Future of the IC-DISC

Currently, the qualified dividend rate is set to lapse after December 31, 2010. The benefits of the dividend distribution to the IC-DISC owners at that time would not be available as the dividend would be taxed at the ordinary income tax rate. However, until December 31, 2010, the IC-DISC provides tax benefits to those corporations meeting the qualifications.



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