



presents

IC-DISC: Mastering Intricacies of the Federal Tax Incentive for Exporters

Overcoming Compliance Challenges to Maximize Tax Benefits

A Live 110-Minute Teleconference/Webinar with Interactive Q&A

Today's panel features:

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Wednesday, March 10, 2010

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IC-DISC: Mastering Intricacies of the Federal Tax Incentive for Exporters Webinar

March 10, 2010

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Today's Program

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IC-DISCs

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**Background And
Statutory Requirements
Of IC-DISCs**

Jim Foster, Paradigm Partners

IC-DISC Background

- **1972: Congress created DISC (domestic international sales corporation)**
 - First significant export tax incentive legislation
 - Government attempting to place U.S. exporters on an equal tax footing with other nations
 - DISC created to defer tax without paying interest on a portion of a company's foreign sales
- **1984: DISC eliminated; IC-DISC and FSC (foreign sales corporation) created**
 - DISC came under attack by trading partners subject to GATT (General Agreement on Tariffs and Trade) and was repealed in 1984.
 - Congress changed the structure of the regime and created IC-DISC.
 - Created FSC to exempt a percentage of an FSC's income from U.S. tax

IC-DISC Background (Cont.)

- **1998: WTO ruled against FSC**
 - The World Trade Organization (WTO) rules the FSC to be an illegal subsidy.
- **2000: Congress eliminated FSC and created EIE (extraterritorial income exclusion)**
 - New legislation to exclude a portion of extraterritorial income from taxation
- **2003: Dividend rate decreased to 15%**
 - Change in dividend rate by the Jobs & Growth Tax Relief Reconciliation Act of 2003 provides a new benefit to IC-DISC shareholders.

IC-DISC Background (Cont.)

- **2004: EIE repealed**
 - WTO ruled the EIE was also an illegal export subsidy.
 - American Jobs Creation Act of 2004 repealed the EIE for transactions after 2004, subject to transition rule.
 - EIE was completely phased out by the end of calendar 2006.
- **Today: IC-DISC is the only remaining export incentive available**

Statutory Requirements - Formation

- The IC-DISC must be a U.S. corporation
 - Typically incorporated in Delaware or Nevada
 - The date of formation is when the benefit starts running.
- Can only have one class of stock with at least \$2,500 of par or stated value
 - This applies to *each* day of the year.
 - Practical tip: Put \$3,000 in the bank account to ensure that no bank fees or other miscellaneous items take the value below \$2,500.

Statutory Requirements – Formation (Cont)

- Corporation must file a Form 4876-A to elect to be treated as an IC-DISC
 - Must be done within 90 days of incorporation, if it is a new entity
 - Must be done within the 90 days *preceding* the beginning of the corporation's taxable year, if it is an existing corporation
 - Practical tip: Do this after forming the bank account, so that the par value requirement exists from the beginning of the election.

Statutory Requirements – Miscellaneous

- Qualified export receipts test
 - 95% or more of the gross receipts of the IC-DISC must be qualified export receipts.
 - Qualified export receipts include gross receipts from sales of export property, rents for the use of export property outside the U.S., services related and subsidiary to such export sales, and engineering or architectural services for construction projects.
 - If paying the IC-DISC commissions, you look to the gross receipts upon which the commissions were calculated.

Statutory Requirements – Miscellaneous (Cont.)

- Qualified export receipts test – Example 1

Joe Smith wholly-owns ABC Company, an S corporation that manufactures alphabet blocks. Due to a shortage in Europe, ABC Company's foreign sales increase dramatically and Joe Smith forms a wholly-owned IC-DISC. The only activity of the IC-DISC is receiving commissions calculated off of qualified export receipts. Since 100% of the IC-DISC's gross receipts constitute qualified export receipts, the qualified export receipts test is met.

Statutory Requirements – Miscellaneous (Cont.)

- Qualified export receipts test – Example 2

Joe Smith wholly-owns ABC Company, an S corporation that manufactures children's gadgets that are sold in Japan. The sales contracts also include a small sales portion for maintenance service of the gadgets. Because the maintenance service is subsidiary and incidental to the sale of the gadgets, the gross receipts from that portion also meet the qualified export receipts test.

Statutory Requirements – Miscellaneous (Cont.)

- Qualified export assets test
 - 95% or more of the assets of the IC-DISC must be qualified export assets.
 - Qualified export assets include export property, accounts receivable, temporary investments and loans to producers.

Statutory Requirements – Miscellaneous (Cont.)

- Qualified export assets test – Example

Joe Smith wholly-owns ABC Company, an S corporation that manufactures alphabet blocks. Joe Smith forms an IC-DISC with a \$3,000 initial capital contribution. During the year, a \$10,000 commission is paid to and distributed from the IC-DISC. Because the \$3,000 cash remaining constitutes working capital to meet the needs of potential creditors, the \$3,000 is a temporary investment, and 100% of the IC-DISC's assets constitute qualified export assets. Therefore, the qualified export assets test is met.

Statutory Requirements – Export Property

Three-part test

1. MPGE requirement
2. Content requirement
3. Destination test

Statutory Requirements – Export Property (Cont.)

MPGE requirement

- Goods must be manufactured, produced, grown or extracted within the U.S.
 - U.S. includes Puerto Rico and U.S. possessions.
- Manufacturing includes:
 - “Substantial transformations” such as making paper from wood pulp or the canning of fish
 - Operations that are substantial in nature and are generally considered manufacturing
 - Manufacturing ‘safe harbor’ provision
 - When conversion costs (direct labor and factory burden, including packaging or assembly) account for 20% of the COGS or inventory costs

Statutory Requirements – Export Property (Cont.)

MPGE requirement – Practical tips and considerations

- The substantial transformation provision allows recyclers to usually qualify under this requirement.
- If there are two or more domestic manufacturers involved in making a product, only the last domestic manufacturer can qualify.
- When dealing with goods manufactured both in and outside the U.S., you need to look at the order of things.
- There is no requirement that the client be the manufacturer.
 - Distributors can utilize the IC-DISC, but they need to be able to prove this requirement.

Statutory Requirements – Export Property (Cont.)

MPGE requirement – Example 1

Cab Company manufactures the cabs to be mounted on cranes and then sells it to Crane Inc, which incorporates the cab into the crane they are manufacturing. Afterward, Crane Inc. sells the crane abroad. In this instance, Cab Company is not able to utilize the IC-DISC because they were not the last domestic manufacturer.

Statutory Requirements – Export Property (Cont.)

MPGE requirement – Example 2

ABC Company manufactures widget components at its facility in Juárez, Mexico for a cost of \$10 each. After the widget components are made, they are sent to ABC's facility in El Paso, Texas, where eight components are assembled and packaged as 1 widget. After packaging, the widgets are shipped to Brazil.

If the assembly and packaging costs are \$20 or more, then ABC Company will be able to utilize the IC-DISC, because the assembly and packaging costs were 20% or more.

Statutory Requirements – Export Property (Cont.)

MPGE requirement – Example 3

Widgets Express Company (WEC) is a distributor that buys widgets from several U.S. companies and then sells them in England. WEC will *only* be able to utilize the IC-DISC if it can prove the widgets were actually manufactured in the U.S. Buying the widgets from a U.S. company does not prove the goods were manufactured here.

Statutory Requirements – Export Property (Cont.)

Content requirement

- No more than 50% of the fair market value of the export property can be attributable to articles imported into the U.S.
- Fair market value is the *sales price*, not the cost.
- To determine the value of the foreign materials, you look at the dutiable value assigned to them when they were imported
- If you have interchangeable components that are a mixture of domestic and foreign sourced, then you have to treat the goods as having used foreign sourced materials until all foreign sourced materials are accounted for.

Statutory Requirements – Export Property (Cont.)

Content requirement – Example 1

Bucket Company manufactures steel buckets in Texas and ships them to Australia, where they are used to gather opals, and to Oklahoma, where they are used to gather salt. Bucket Company buys 300 bars of raw steel from a company in Pittsburgh for \$10 a bar (cheap steel) and 200 bars from a company in Hong Kong for \$10 a bar each year. The steel is indistinguishable once it arrives in Texas.

Each bucket utilizes 1/2 of a bar (\$5 of steel) and \$2 of labor. The final sales price of the bucket is \$20. The content requirement is met because the foreign materials comprise less than 50% (25% in this case) of the final sales price.

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Statutory Requirements – Export Property (Cont.)

Content requirement – Example 2

Bucket Company manufactures steel buckets in Texas and ships them to Australia, where they are used to gather opals, and to Oklahoma, where they are used to gather salt. Bucket Company buys 300 bars of raw steel from a company in Pittsburgh for \$10 a bar (cheap steel) and 200 bars from a company in Hong Kong for \$10 a bar each year. The steel is indistinguishable once it arrives in Texas.

Each bucket utilizes 1/2 of a bar (\$5 of steel) and \$2 of labor. The final sales price of the bucket is \$8, making the material cost 62.5% of the final sales price. In this instance, the first 400 buckets will be deemed to utilize the Chinese steel and the content requirement will not be met. Now that all of the Chinese steel has been accounted for, the remaining 600 buckets will be deemed to utilize the domestic steel and the content requirement *will* be met.

Statutory Requirements – Export Property (Cont.)

Destination test

- The property must be sold or leased for direct use, consumption or disposition outside the U.S.
- It is perfectly okay to sell to a freight forwarder or a distributor, as long as the goods are shipped for the foreign end use within one year.
 - It is possible in this instance for both the manufacturer and the distributor to take advantage of the IC-DISC.
- Canada and Mexico as the destinations are perfectly fine.
- Note: International waters qualify as outside the U.S.

Statutory Requirements – Export Property (Cont.)

Destination test – Example 1

LongArm, Inc. sells cranes to Exxon Mobil, which uses the cranes in Africa. The destination test for LongArm's IC-DISC is met as long, as Exxon provides documentation of that the cranes were shipped for use in Africa.

There is no requirement that you sell to a foreign entity – only that the goods be use outside the U.S.

Statutory Requirements – Export Property (Cont.)

Destination test – Example 2

LongArm, Inc. sells cranes to The Lifting Company, a distributor based in New York. The Lifting Company in turn sells the cranes to its customers in India. The destination test for LongArm's IC-DISC will be met as long as two things occur:

1. The Lifting Company ships the cranes within one year of LongArm's sale, and
2. The Lifting Company provides documentation of the date of shipment and the country of destination.

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Implementing Various Ownership Structures For The IC-DISC

Robert J. Misesy, Jr., Reinhart Boerner

Jim Foster, Paradigm Partners



Overview Of Presentation

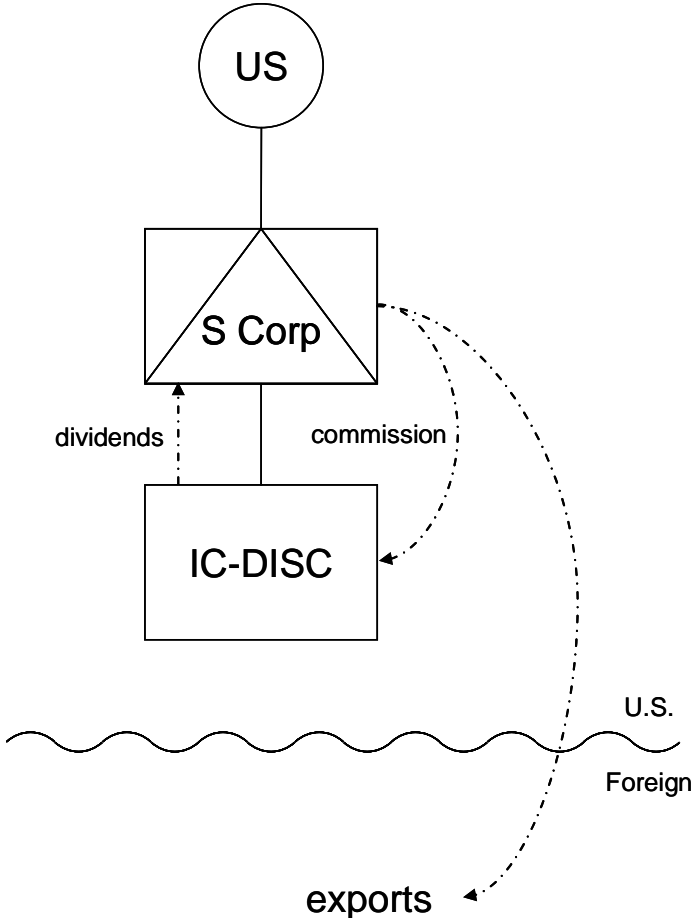
- Flow-through entities: Partnership, LLC, S corporation
- Privately-owned C corporation
- Estate planning
- Executive compensation
- Publicly-traded C corporation
- Treaty benefits for foreign owners
- Sourcing benefits



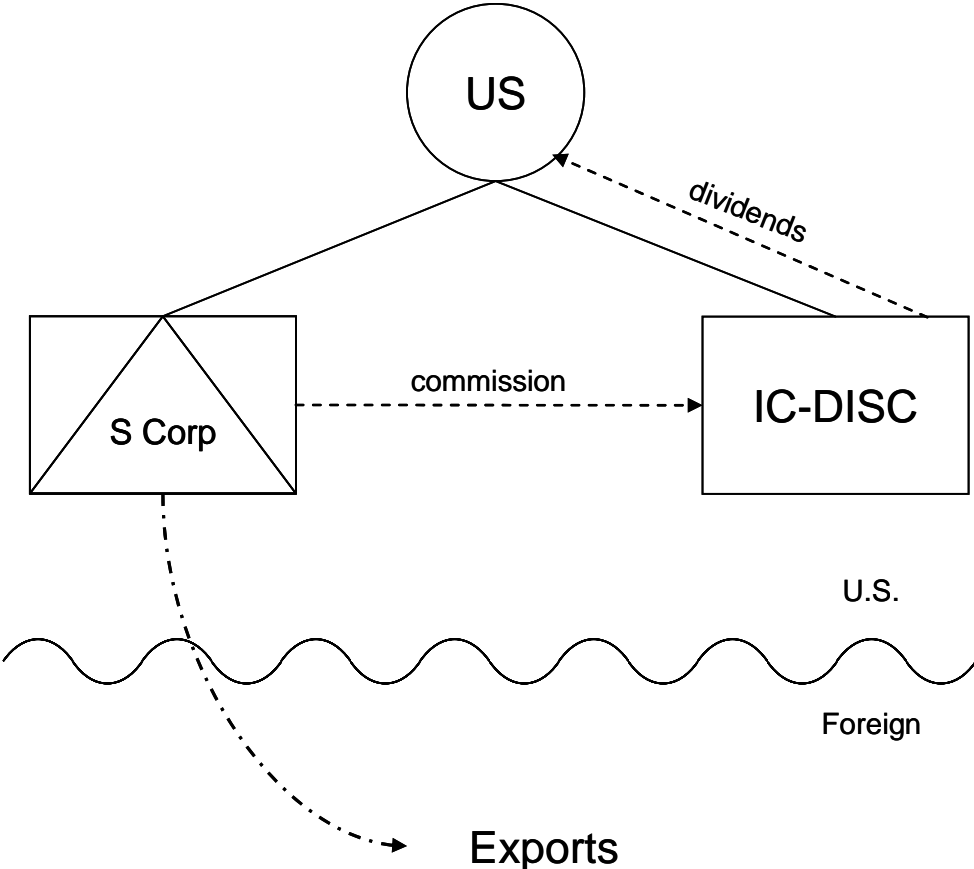
S Corporations, LLCs And Partnerships

- Commission creates a deduction.
- Dividends pass through the entity to the shareholders, who incur tax at a 15% rate.

IC-DISC Subsidiary



Brother/Sister IC-DISC

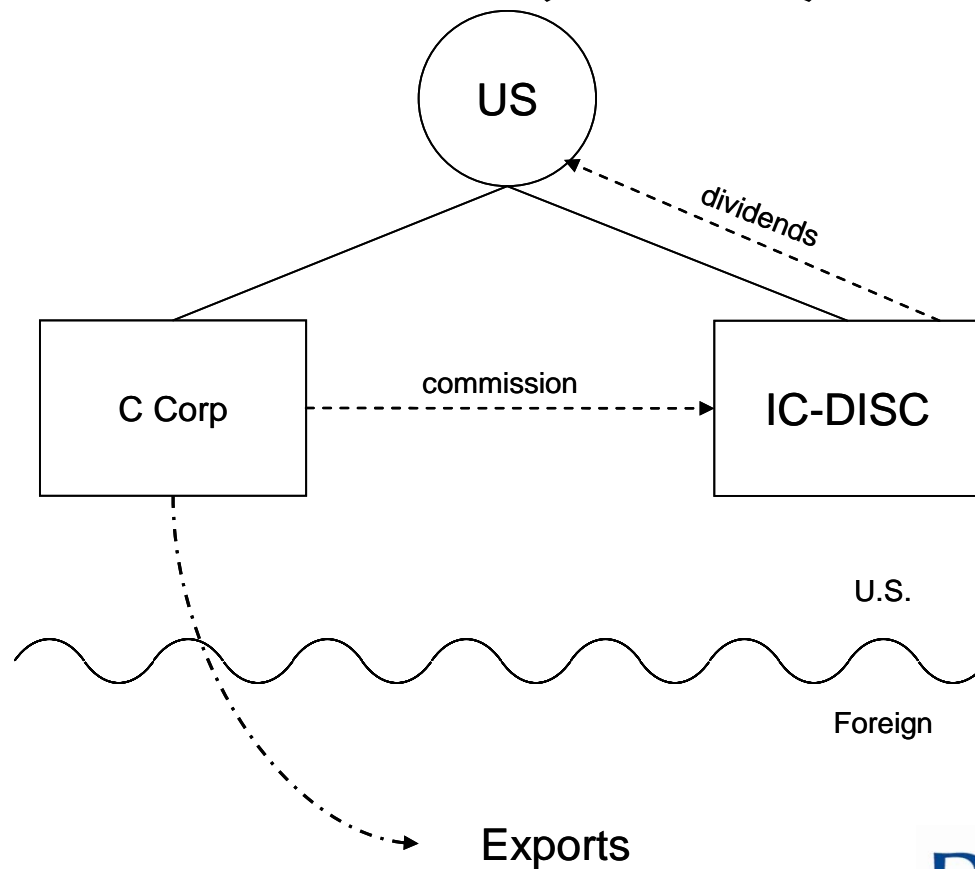




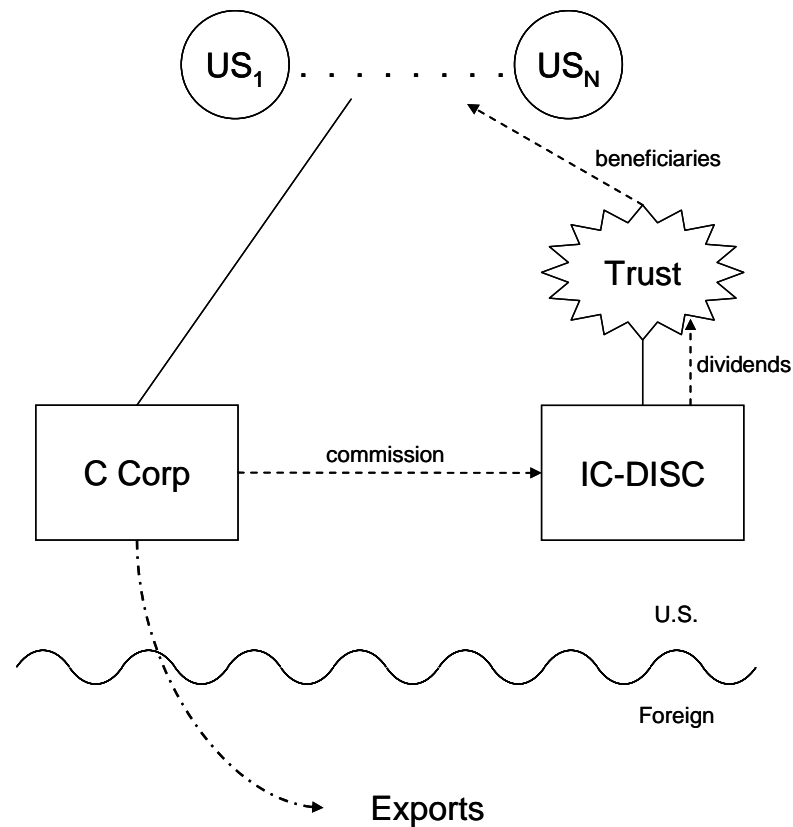
Privately-Held C Corporation

- Dividends subject to corporate tax at approximately 35%.
- Recommended that IC-DISC be owned directly by the shareholders of the C corporation, so they can avoid double-taxation and receive dividends at a 15% rate.

Privately-Held C Corporation (Cont.)



C Corporation With Many Shareholders And A Trust

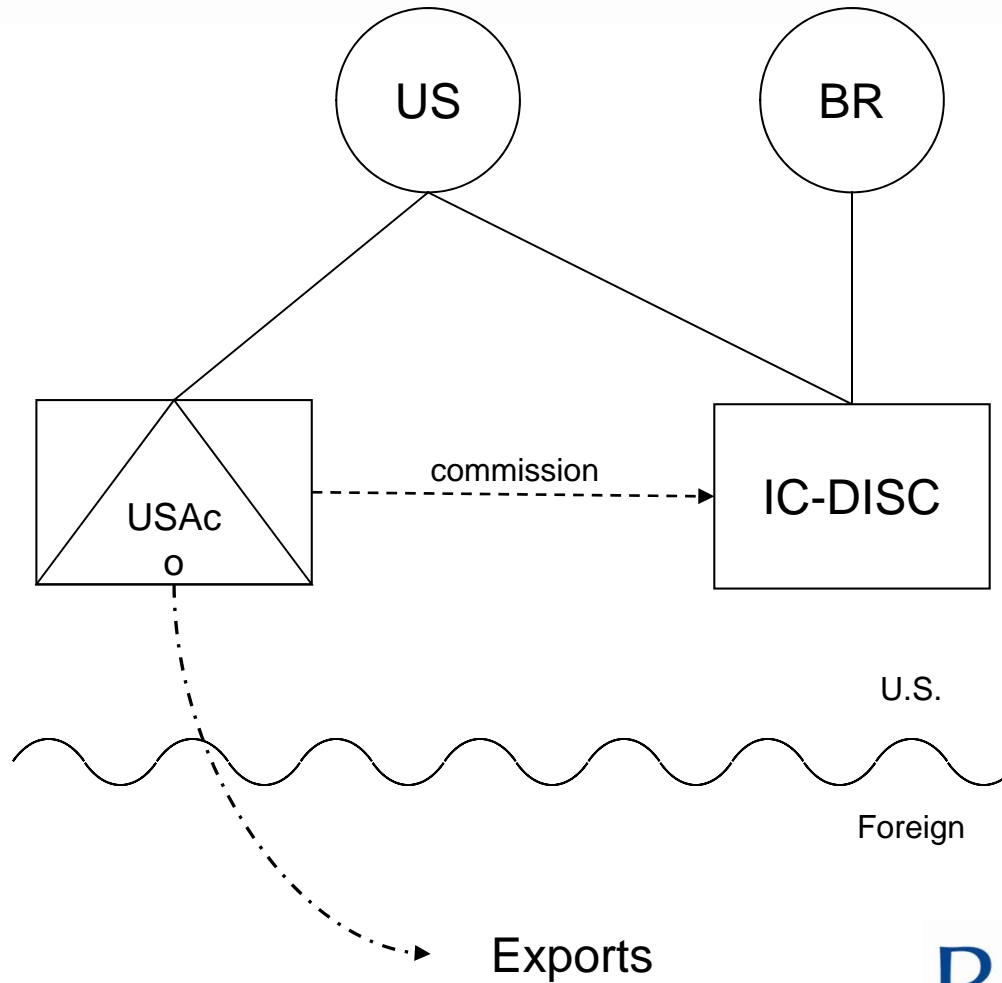




Estate Planning

- Ownership of IC-DISC stock in different proportions than exporting company stock can remove IC-DISC dividends from estate. Rev. Rul. 81-54 may result in gift tax exposure.

BR Is A Daughter Of US

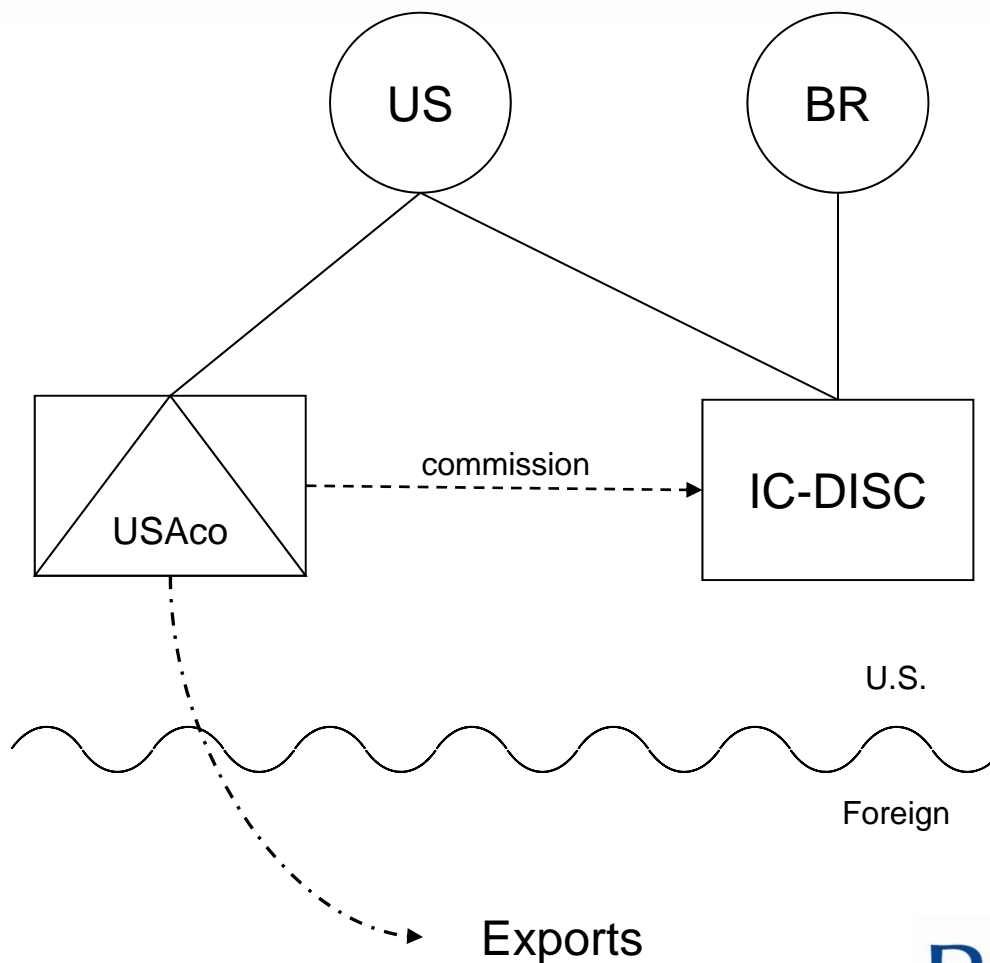




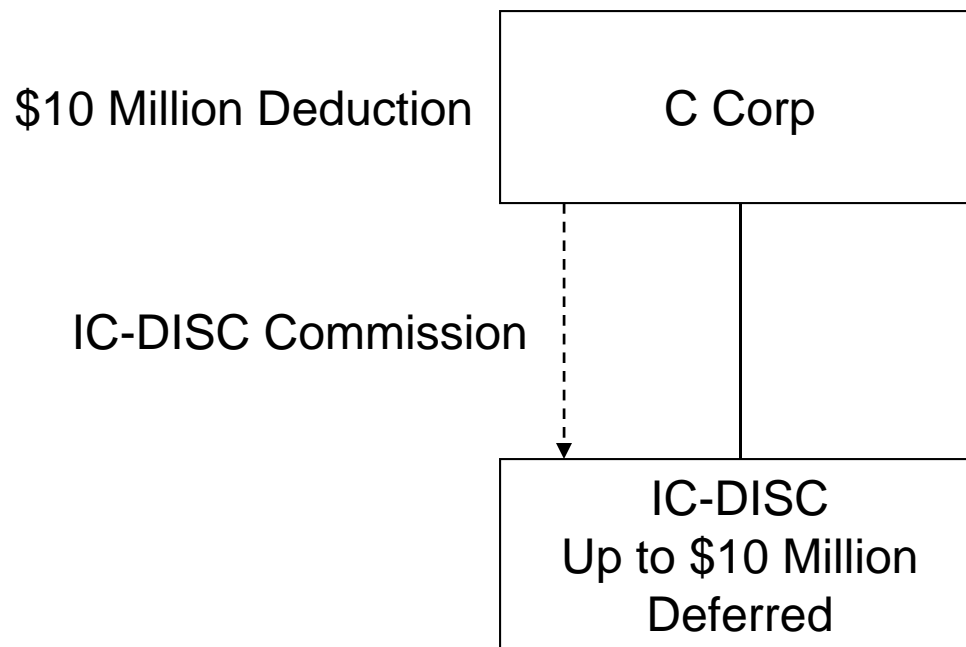
Executive Compensation

- IC-DISC dividends can be paid to designated employees who own IC-DISC stock but do not have to be the same shareholders of the exporter.

BR Is A Key Employee



Publicly-Traded C Corporation - Deferral



Publicly-Traded C Corporation

- IC-DISC may defer from taxation 16/17 of best \$10 million of gross receipts. The balance is deemed distributed to its shareholders.
- Large exporters that generate substantial export receivables can sell the receivables to the IC-DISC at a discount. The discount income qualifies as qualified export receipts.



Publicly-Traded C Corporation (Cont.)

- Deferred income becomes a low-cost, pre-tax source of funds for export working capital and financing international sales.
- As much as \$10 million may be generated from discount income and 16/17 deferred from tax, *i.e.* \$1 of discount income = \$1 of gross receipts.



Publicly-Traded C Corporation (Cont.)

Example 1

Assume:

An IC-DISC owned by a C corporation receives commissions for export sales and earns discount income from factoring export receivables of \$8 million. It earns a 25% or \$.5 million commission on the best \$2 million of sales. The IC-DISC retains income attributable to the best \$10 million of gross receipts. The balance of gross receipts over \$10 million is deemed distributed to the IC-DISC's shareholders as a dividend. Use of the IC-DISC results in a \$2.8 million tax savings as follows:

Publicly-Traded C Corporation (Cont.)

Example 1 (Cont.)

Discount income	\$8.00 million
Commission on best \$2 million of sales	.50 million
Total IC-DISC income before deemed distribution	\$8.50 million
Less 1/17 deemed distribution	<u>.50 million</u>
Total income to be retained	\$8.00 million
Tax Savings @ 35%	<u>\$2.80 million</u>

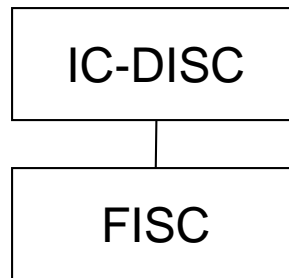
Publicly-Traded C Corporation (Cont.)

Example 1 (Cont.)

Interest charge imposed on IC-DISC shareholder
on tax savings (based upon One Year Treasury Bill rate)

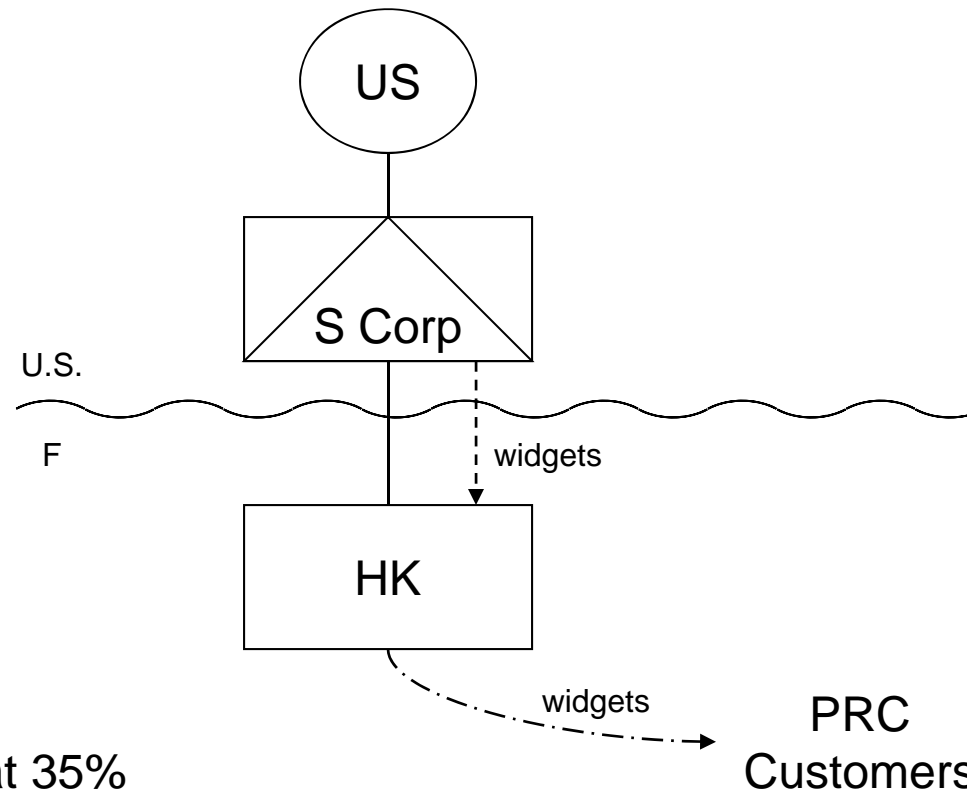
Assume tax savings	\$2.80 million
Interest rate on one-year Treasury bill in September , when return filed	<u>3.5%</u>
Interest charge payable when IC-DISC shareholder's return due	\$98,000

Foreign International Sales Corporation (FISC)



- FISC: Owned more than 50% by IC-DISC
- FISC dividends: Qualified IC-DISC export receipts (count toward best \$10 million of gross receipts)
- Qualifying activities for a FISC are generally the same as those for an IC-DISC.
- 95% qualified export assets and gross receipts tests
- No safe harbor pricing
- Recommended when qualifying activities subject to low tax and otherwise would be Subpart F income

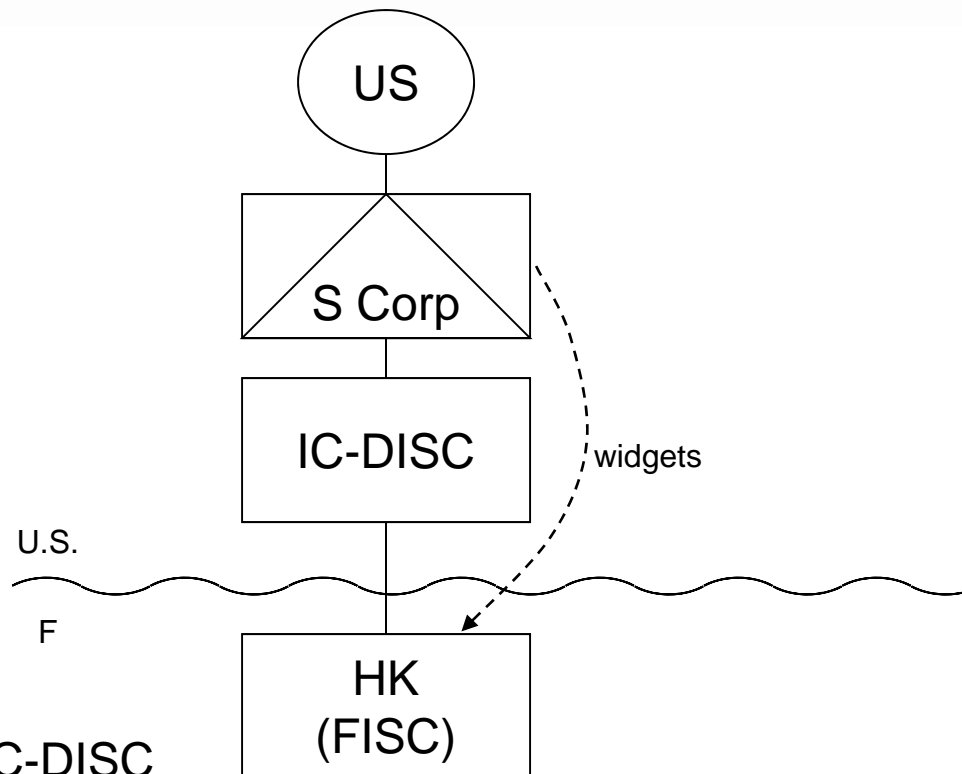
The Subpart F Problem



Hong Kong tax at 16%

Subpart F tax in U.S. at 35%

The FISC Solution



Hong Kong tax at 16%

Subpart F income of the IC-DISC
(no tax)

IC-DISC dividends taxed at 15%

PRC
Customers



Treaty Benefits For Foreign Owners

(Ownership of a DISC by a treaty country corporation)

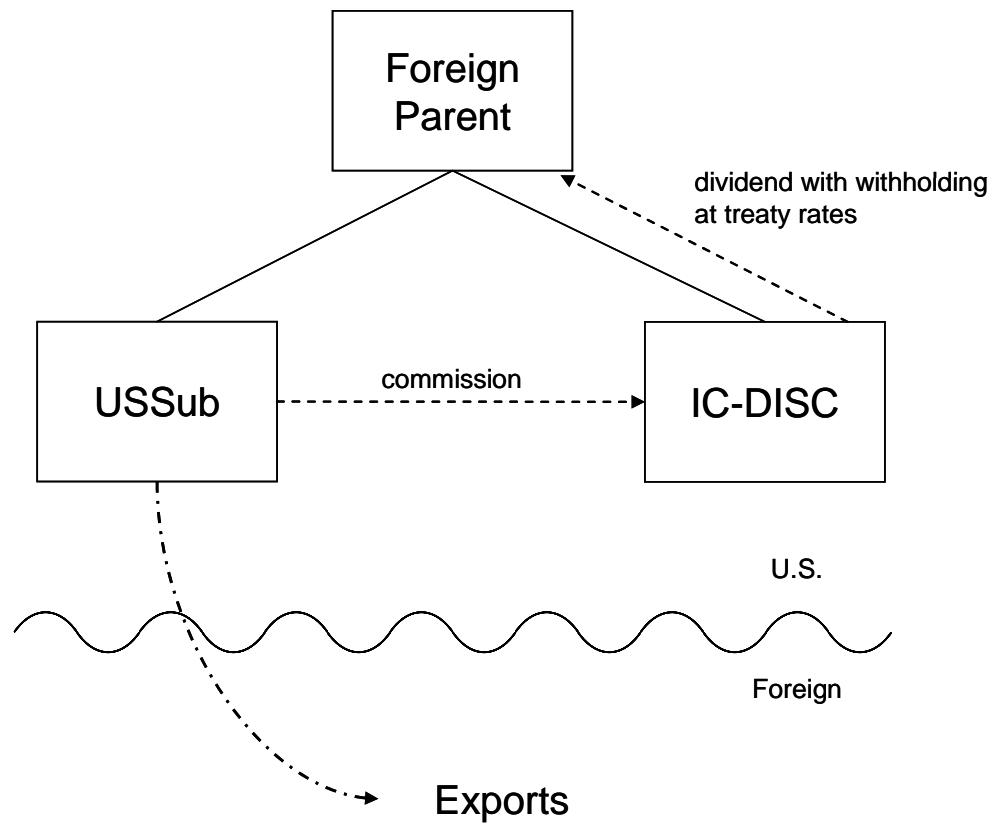
- Sect. 996(g) classifies IC-DISC dividends as effectively connected income to the conduct of a U.S. trade or business, resulting in a foreign corporation shareholder of an IC-DISC being subject to tax on the IC-DISC's dividends at up to 35% tax.
- Sect. 996(g) is in conflict with most treaties which prevent taxation of a treaty country corporation in the absence of an actual permanent establishment, *i.e.* the mere existence of a U.S. subsidiary is not sufficient for U.S. taxation of dividends to parent as effectively connected income to the conduct of a U.S. trade or business.



Treaty Benefits For Foreign Owners (Cont.)

- Under the later-in-time theory, treaties executed after June 1984 therefore may prevent 996(g) from applying.
- IC-DISC dividends may thus be subject to zero tax or be taxed at treaty rate on dividends.

Treaty Benefits For Foreign Owners (Cont.)





Sourcing Benefits

- Sect. 861(a)(1)(D) treats IC-DISC dividends attributable to qualified export receipts as foreign-source income to U.S. shareholders.
- IC-DISC dividends are presently in a separate basket (Sect. 904(d)).
- Who is paying the foreign taxes?
- Planning opportunities?

Structuring And Implementation

- Determine the structure that maximizes tax savings
 - Incorporate the IC-DISC before the export sales begin and make a \$3,000 capital contribution
 - Analyze export assets and gross export receipts, which can include sales to distributors
 - Analyze the manufacturing, destination and content requirements for export property
 - Draft the commission agreement between the IC-DISC and the exporter
 - Prepare and file the Form 4876-A that elects IC-DISC status for the corporation
 - Prepare a manual that contains guidelines for the client's operating procedures and includes a checklist/calendar to determine when the client should complete various activities, such as when the client should determine that the IC-DISC has satisfied the gross receipts test and the export assets test

Generally

- It only makes sense for a Roth IRA to own the IC-DISC, because it provides the least tax liability.
 - A traditional IRA only defers the tax until the funds are withdrawn.
- Historically, there has been a \$100,000 income cap for Roth IRAs, which essentially eliminated their use with the IC-DISC.
 - There has been a change for 2010 that eliminates this restriction.

Conversion From Traditional To Roth IRA

IRS Publication 590 (2009) on Individual Retirement Arrangements (IRAs)

- Beginning in 2010, the modified AGI and filing status requirement for converting a traditional IRA to a Roth IRA are eliminated.
- Traditional Roth IRA conversions require you to pay income tax on the full amount of any tax-deferred assets that you convert in the year of conversion.
- Under new rule for conversions completed in 2010, you can either complete the recognition (taxes paid) in 2010 or spread the tax liability (i.e. pay taxes) for the conversion equally over 2011 and 2012.

Practical tip: It is perfectly legitimate to convert a portion of the traditional IRA funds to a Roth IRA. You could convert the amount needed for the IC-DISC capitalization (\$2,500 minimum, \$3,000 recommended).

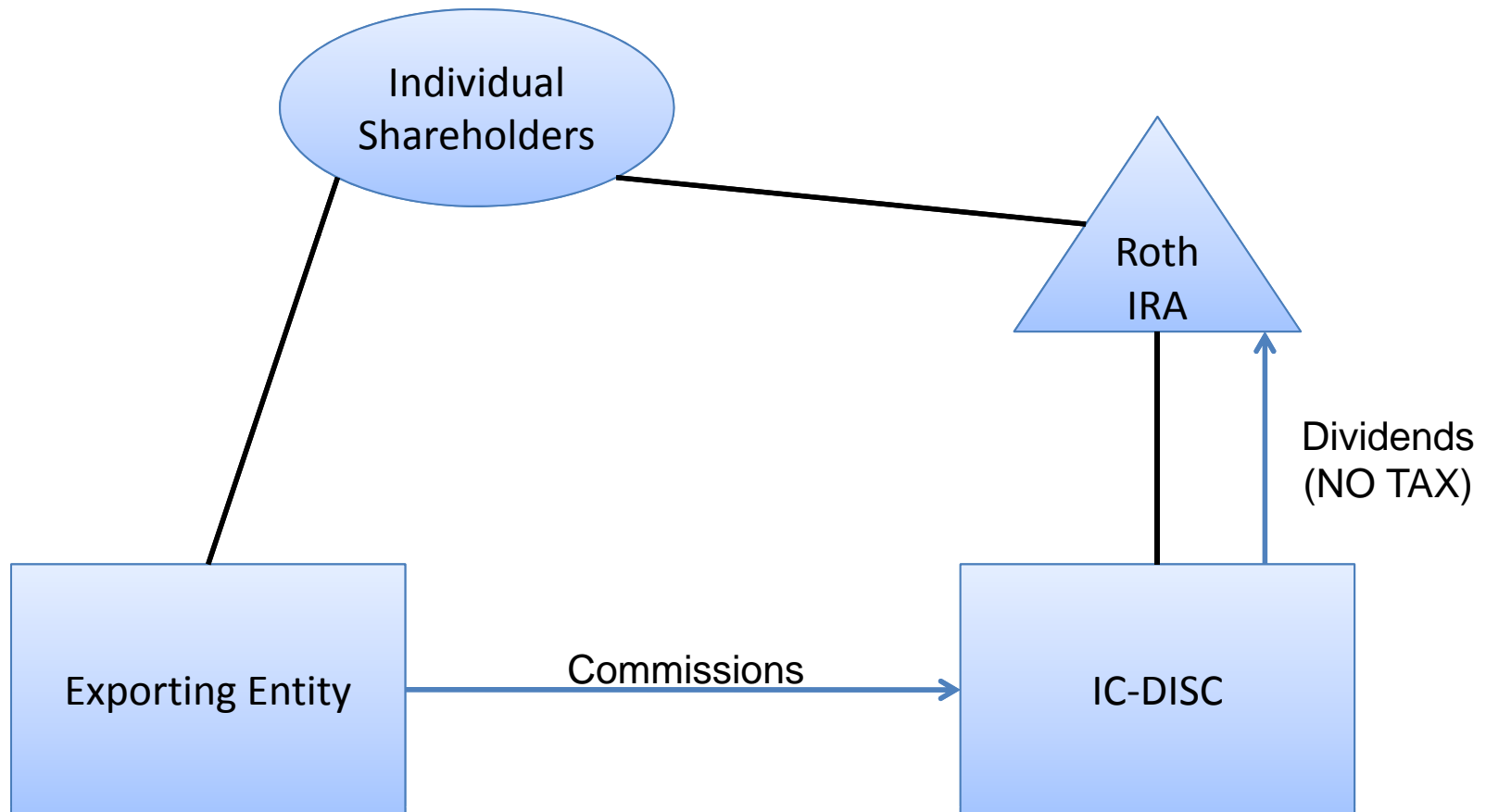
Pros

- IC-DISC dividends build up the value of the Roth IRA tax-free.
- No payment on income tax when you withdraw from your savings in the retirement account.
- Fewer withdrawal restrictions for the Roth vs. traditional IRA.

Cons

One big one: It is not likely that the no-income limitation for traditional-to-Roth IRA conversions will survive for very long. Consequently, Roth IRA ownership of an IC-DISC is for a limited time only.

Structure



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Compliance And Reporting By IC-DISCs

Tom Miller, BKD LLP

DISC Requirements

- Domestic corporation (C corporation)
- Single class of stock = At least \$2,500 par value on each day of the taxable year
- File timely elections (Form 4876-A within 90 days from beginning of tax year)
- Same tax year as shareholders
 - Must conform to shareholder with highest percentage of voting power
- Maintain separate books and records

DISC Requirements (Cont.)

- 95% qualified gross receipts test (§993(a))
 - General rule: Gross receipts from the sale, exchange or other disposition of property
 - Remedy: Distribution in an amount equal to the portion of taxable income attributable to gross receipts that are not qualified export receipts
- 95% qualified export asset test (§993(b))
 - Accrued commission: Which arise by reason of transactions
 - Working capital: Temporary investments reasonably necessary
 - Remedy: Distribution in an amount equal to the FMV of assets that are not qualified assets on the last day of the tax year

Commission Payment

- Commission payment
 - An amount (or reasonable estimate) equal to at least 50% of the final determination must be paid on, or before, 60 days after year-end. Reg. §1.994-1(e)(3).
 - Any additional commission determined must be paid within 90 days after the date it was established. §1.994-1(e)(5)(i).

Export Property For DISC (1.993-3)

- Manufactured, produced, grown or extracted in the U.S. by a person other than a DISC
 - “Substantial transformation” test
 - “Facts and circumstances” test
 - “20% conversion costs” test
- Held primarily for sale, lease or rental for direct use, consumption or disposition outside the U.S.
 - Destination test

Export Property For DISC (1.993-3), Cont.

- 50% of fair market value of the export property can be attributable to foreign content
- Consider qualified export property sold to U.S. distributors

Steps To Calculation

- Three common methods
 - Transaction-by-transaction analysis (TXT)
 - Grouping of transactions analysis
 - Marginal costing analysis

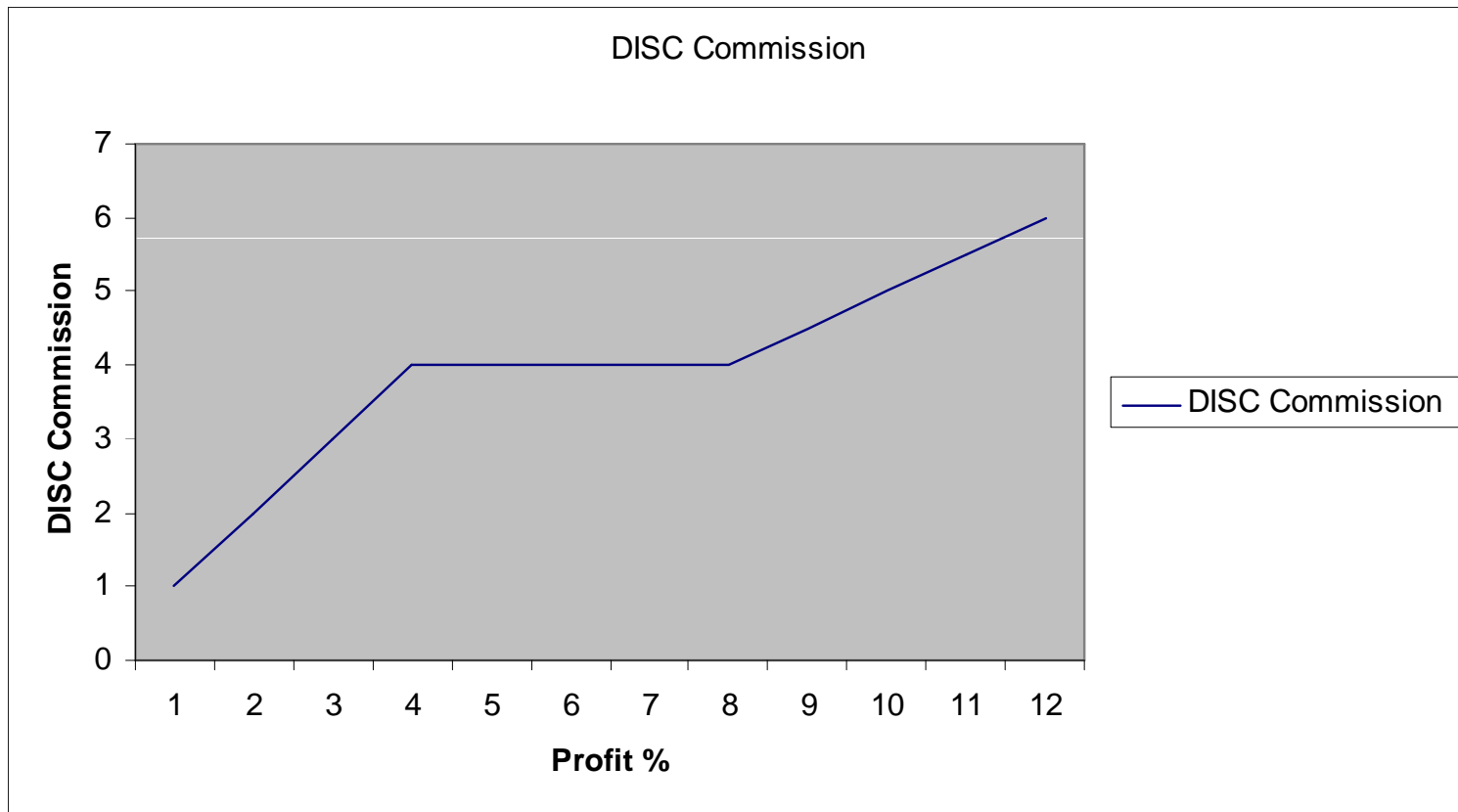
Steps:

- Identify qualifying sales
- Allocate and apportion expenses
- Apply various pricing methods

Inter-Company Pricing Rules

- DISC commission equals greater of:
 - 50% of combined taxable income (CTI) or
 - 4% of qualified export receipts, limited to 100% of (CTI)
- Plus:
- 10% of export promotion expenses

Commission Vs. Profitability



Example

- S corp. with \$300 of foreign sales, \$600 total sales
- Six examples
 - Base example
 - Example 1: Export sales and COGS
 - Example 2: Expense allocation
 - Example 3: Other income
 - Example 4: Three transactions (TxT)
 - Example 5: Marginal costing

Base Example

Assume that the only information available is the company's tax return and the amount of export sales in total.

	Domestic	Export	Total
Sales	300	300	600
COGS	150	150	300
Gross Margin	150	150	300
SG&A Expenses			
Salaries	50	50	100
Commissions	25	25	50
Administrative	10	10	20
Total SG&A	85	85	170
Taxable Income (CTI)	65	65	130
50% of CTI		32.50	
4% of Sales		12.00	
Greater of 50% or 4% Method		32.50	

Example 1

Additional information is now available regarding cost of sales. \$160 to domestic sales and \$140 to export sales.

	Domestic	Export	Total
Sales	300	300	600
COGS	160	140	300
Gross Margin	140	160	300
SG&A Expenses			
Salaries	50	50	100
Commissions	25	25	50
Administrative	10	10	20
Total SG&A	85	85	170
Taxable Income (CTI)	55	75	130
50% of CTI		37.50	
4% of Sales		12.00	
Greater of 50% or 4% Method		37.50	

Example 2

Upon inquiry, you learn that most of the commissions (80%) are incurred for domestic sales. Only 20% of the commissions are paid on export sales.

	Domestic	Export	Total
Sales	300	300	600
COGS	160	140	300
Gross Margin	140	160	300
SG&A Expenses			
Salaries	50	50	100
Commissions	40	10	50
Administrative	10	10	20
Total SG&A	100	70	170
Taxable Income (CTI)	40	90	130
50% of CTI		45.00	
4% of Sales		12.00	
Greater of 50% or 4% Method		45.00	

Example 3

You notice that the company has a significant amount of other income. Upon further inquiry, you learn that the company sold a division at a gain. Management spent 25% of its time and \$10 of expenses on it.

Sales	300	300		600
Other Income			100	100
COGS	160	140		300
Gross Margin	140	160	100	400
SG&A Expenses				
Salaries	38	38	25	100
Commissions	40	10		50
Administrative	5	5	10	20
Total SG&A	83	53	35	170
Taxable Income (CTI)	58	108	65	230
50% of CTI		53.75		
4% of Sales		12.00		
Greater of 50% or 4% Method		53.75		

Example 4

Finally, you learn that the company had three export sales and you obtain the amount of sales and the cost of goods sold for each.

	Transaction 1	Transaction 2	Transaction 3	Total Export
Sales	75	100	125	300
COGS	70	35	35	140
Gross Margin	5	65	90	160
SG&A Expenses				
Salaries	13	13	13	38
Commissions	5	5		10
Administrative	2	2	2	5
Total SG&A	19	19	15	53
Taxable Income (CTI)	(14)	46	76	108
50% of CTI	(7.08)	22.92	37.75	
4% of Sales	3.00	4.00	5.00	
Greater of 50% or 4% Method	0.00	22.92	37.75	60.67

Estimated Tax Benefit

Estimated DISC Federal Tax Benefit										
For use with Pass-through Entities										
Assumes no state tax benefit or expense										
assumes federal tax rate of 35% and capital gains tax rate of 15%										
Assumes no enhancements from expense allocation, transaction by transaction analysis, grouping or loss elimination										
	Profitability									
Export Sales	0	2%	4%	6%	8%	10%	20%	30%	40%	50%
250,000	0	1,000	2,000	2,000	2,000	2,500	5,000	7,500	10,000	12,500
500,000	0	2,000	4,000	4,000	4,000	5,000	10,000	15,000	20,000	25,000
750,000	0	3,000	6,000	6,000	6,000	7,500	15,000	22,500	30,000	37,500
1,000,000	0	4,000	8,000	8,000	8,000	10,000	20,000	30,000	40,000	50,000
1,250,000	0	5,000	10,000	10,000	10,000	12,500	25,000	37,500	50,000	62,500
1,500,000	0	6,000	12,000	12,000	12,000	15,000	30,000	45,000	60,000	75,000
1,750,000	0	7,000	14,000	14,000	14,000	17,500	35,000	52,500	70,000	87,500
2,000,000	0	8,000	16,000	16,000	16,000	20,000	40,000	60,000	80,000	100,000
2,250,000	0	9,000	18,000	18,000	18,000	22,500	45,000	67,500	90,000	112,500
2,500,000	0	10,000	20,000	20,000	20,000	25,000	50,000	75,000	100,000	125,000
2,750,000	0	11,000	22,000	22,000	22,000	27,500	55,000	82,500	110,000	137,500
3,000,000	0	12,000	24,000	24,000	24,000	30,000	60,000	90,000	120,000	150,000

Estimated Tax Benefit (Cont.)

Estimated DISC Federal Tax Benefit

With a C Corporation

Assumes no state tax benefit or expense

Assumes federal tax rate of 35% and no incremental capital gains tax

Assumes no enhancements from expense allocation, transaction by transaction analysis, grouping or loss elimination

Export Sales	Profitability									
	0	2%	4%	6%	8%	10%	20%	30%	40%	50%
250,000	0	1,750	3,500	3,500	3,500	4,375	8,750	13,125	17,500	21,875
500,000	0	3,500	7,000	7,000	7,000	8,750	17,500	26,250	35,000	43,750
750,000	0	5,250	10,500	10,500	10,500	13,125	26,250	39,375	52,500	65,625
1,000,000	0	7,000	14,000	14,000	14,000	17,500	35,000	52,500	70,000	87,500
1,250,000	0	8,750	17,500	17,500	17,500	21,875	43,750	65,625	87,500	109,375
1,500,000	0	10,500	21,000	21,000	21,000	26,250	52,500	78,750	105,000	131,250
1,750,000	0	12,250	24,500	24,500	24,500	30,625	61,250	91,875	122,500	153,125
2,000,000	0	14,000	28,000	28,000	28,000	35,000	70,000	105,000	140,000	175,000
2,250,000	0	15,750	31,500	31,500	31,500	39,375	78,750	118,125	157,500	196,875
2,500,000	0	17,500	35,000	35,000	35,000	43,750	87,500	131,250	175,000	218,750
2,750,000	0	19,250	38,500	38,500	38,500	48,125	96,250	144,375	192,500	240,625
3,000,000	0	21,000	42,000	42,000	42,000	52,500	105,000	157,500	210,000	262,500

Form 1120-IC-DISC

- Due Sept. 15 for current-year DISC
 - Schedule J reports deemed and actual distributions.
- Schedule K reports distributions (taxable income) for each shareholder.
- Schedule P reports DISC pricing or commission.
 - Separate schedule prepared for each transaction or group of transactions.

Taxable Income To Shareholder

- Actual distributions
 - Distributions from accumulated earnings including current-year earnings
- Deemed distribution of taxable income on export gross receipts >\$10 million

State Tax Implications

- Some states impose corporate level tax on IC-DISCs
 - Corporations may be subject to tax as separate companies
 - Pass-through entities face double-taxation
 - Tax to the IC-DISC
 - Tax to shareholder

Related Supplier/Shareholder

-
- Accrual of commission expense
 - For example, commission expense paid in 2010 for tax year 2009 can be deducted on 2009 tax return.
- Dividend income
 - Dividend is recorded on a cash basis.

Strafford

**Round Table:
Enforcement, Audit
Issues**

Jim Foster, Paradigm Partners

Robert J. Misey, Reinhart Boerner

Tom Miller, BKD LLP

Audits Of 95%-Of-Assets Test

- Temporary investments
- Working capital

Audits Of Proof-Of-Destination Test

- Bill of lading, certificate
- Carbon copy
- What is reasonable?

Discussions With IRS IC-DISC Technical Advisor

- IRS aware of taxpayer-friendly legislation
- IC-DISC election
- Chances of audit

More IRS Audit Experiences

- Limited resources within the IRS on DISCs
- Magnitude of the commission and tax benefit are generally accepted by IRS agents
- Focus has been on abusive transactions, not run-of-the-mill calculations
 - For example, Roth IRA-owned DISCS
- Some audit experience on technical requirements