# How misinterpretations can mean higher taxes for closely held companies

SBN Staff | 4:00 am | September 29, 2013

Companies that have looked into using the IC-DISC (Interest-Charge Domestic International Sales Corporation) provisions of the tax code, intended to help U.S. companies compete internationally, might remember that the incentive essentially reduces the top federal tax rate on income from certain qualified goods and services from 39.6 to 20 percent.

"Partly because it is thought of as a manufacturing and export incentive, many companies have dismissed the IC-DISC. Many more have misinterpreted the rules, which actually do not require manufacturing or exporting," says Amit Mathur, CPA, partner at Quantitax IC-DISC Services.

Pete Chudyk, head of the tax consulting practice at Maloney + Novotny LLC, says "We have helped many companies realize that the definition of 'qualified export' sales for IC-DISC purposes is explicitly based on use outside of the U.S., and does not literally require the exporting of goods."

*Smart Business* spoke with Mathur and top accounting firms about five IC-DISC myths that lead to business owners missing or underutilizing the valuable government incentive.

**Myth 1: Products must be exported.**

Perhaps the most widely held IC-DISC misinterpretation is that a company must export a product and sell to a foreign customer to qualify for benefits.

While the product generally must be ultimately used outside of the U.S. — without being further manufactured by another party inside the U.S. — there is no requirement that the product be exported, or that the customer be foreign. In some cases, the product may even return to the U.S. For example, an Ohio auto parts maker that sells to General Motors Co. can claim benefits if the parts are incorporated into a car GM builds in Mexico. A special component rule allows these parts to qualify after being incorporated into another product abroad that returns to the U.S.

Mike Trabert, a partner at Skoda Minotti, says "Any closely held manufacturer or distributor should examine where the ultimate use of their products occurs. While they may not consider themselves 'exporters,' significant and easy to implement tax benefits may be available."

**Myth 2: The taxpayer must manufacture the product.**

Closely held distributors and brokers, as well as the final manufacturers, of any U.S.-made product are eligible for IC-DISC benefits for any given qualified sale or lease. Unlike the Domestic Production Activities Deduction often enjoyed in tandem with the IC-DISC — both benefits can be claimed — manufacture by the taxpayer is not required.

**Myth 3: Business operations will be disrupted.**

A popular misconception is that using an IC-DISC will require a new entity to sell qualified exported goods in order to obtain the tax savings. This fear of having to alter contracts, logistics, payments, etc., is totally unfounded. There is actually no effect on cash flow or any other business operations from using an IC-DISC. Other than receiving a commission from the related operating company and immediately paying a dividend back to the company, or its owners, the IC-DISC typically does not perform any activities whatsoever.

**Myth 4: IC-DISC benefits are limited to $10 million of qualified sales.**

No limitation exists on the amount of qualified export sales that can generate IC-DISC benefits. Originally, the IC-DISC provided a deferral benefit, and the amount that could be deferred was related to only $10 million of qualified export sales.

**Myth 5: IC-DISC commission is 4 percent of export sales or 50 percent of export income.**

IC-DISC savings result from allowable commission paid to an IC-DISC, generating an expense at ordinary rates (39.6 percent) with the same amount typically being paid from the IC-DISC to its shareholders as a dividend, taxed at dividend rates (top rate 20 percent). Many believe this commission amount is limited to 4 percent of export sales or 50 percent of export taxable income. In reality, each qualified export transaction can use either of these basic methods, or a host of other methods explicitly encouraged in the regulations that can be more beneficial. Some methods even allow loss transactions to generate a commission. •

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