EXPORT GUIDE

IC-DISCs

Tax Savings for Exporters: IC-DISCs

What is an IC-DISC?

The Interest Charge-Domestic International Sales Corporation (IC-DISC) is a tax saving vehicle for U.S. exporters. Eligible U.S. companies can recoup or exceed their tax savings on exported product (and in some cases services) revenue by creating an IC-DISC. IC-DISC dates back to the 1970's and is the last remaining tax incentive for exporters.

The IC-DISC tax benefit is tied to the differential between qualified dividend rates and the ordinary income tax rates. U.S. exporters that operate their business as a sole proprietorship or as a pass-through entity (i.e., limited liability company (LLC), S corporation, or limited partnership [LP]) are often eligible to take advantage of these tax savings. Companies operating as a C corporation can use the IC-DISC to eliminate double taxation on a significant portion of their export income.

Qualified exporters can receive a permanent tax savings of 20 percent or more on Federal income tax fromexport profits by utilizing an IC-DISC. The IC-DISC has enabled many exporting companies to achieve significant tax savings.

An IC-DISC is not a tax shelter, but instead began as a tax deferral vehicle. It was revamped under the Jobs and Growth Tax Relief Reconciliation Act of 2003 as a permanent tax savings vehicle, and was renewed again and made permanent under the Obama administration in 2013 as a job creation strategy during the economic downturn.

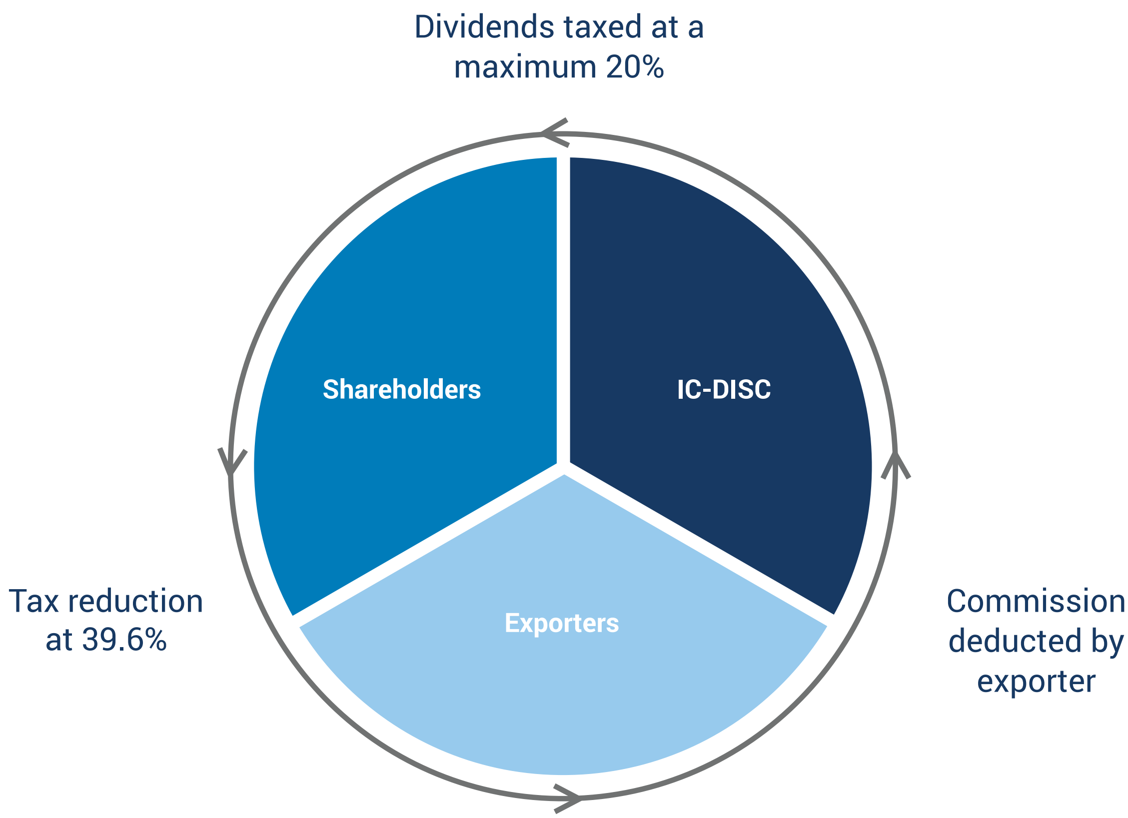
(Source: "IC DISC: Offering Continued Tax Savings for Exporters," David M. Chase, Wall, Einhorn & Chernitzer P.C.)

IC-DISCs in Virginia

The Virginia General Assembly recently enacted legislation that will conform state income tax treatment of IC-DISCs to follow federal income tax treatment. Until S.B. 515, H.B. 280 was approved on March 5, 2014 by the Virginia General Assembly, Virginia did not provide IC-DISCs with tax exemptions at the state level. For taxable years beginning on or after January 1, 2014, IC-DISCs in Virginia are exempt from the Virginia corporateincome tax.

(Source: "More States Conform to Beneficial Federal Tax Treatment ..." Baker Donelson Bearman Caldwell & Berkowitz PC)

How does an IC-DISC function?



An IC-DISC is a "paper" entity that is used as a tax savings vehicle. IC-DISCs do not require corporate substance, employees, or assets — instead it serves as a conduit for export tax savings.

How an IC-DISC works:

An eligible U.S. exporting company forms a special U.S. corporation that elects to be an IC-DISC. The election is made on Form 4876-A. Elections must be made within 90 days after the formation of the corporation.

- The exporting company pays the IC-DISC a commission
- The exporting company deducts commission from ordinary income taxed at up to 39.6 percent
- The IC-DISC pays no tax on the commission as long as qualification standards are met (see "Who is Eligible?"); export receipts in excess of US $10 million are not eligible for deferral of tax
- Shareholders of an IC-DISC are generally not taxed until the earnings are distributed as dividends; shareholders must pay annual interest on the tax deferred, which is currently around .20 percent

The result of forming an IC-DISC can be a **20 percent or more tax savings** on commission.

(Source: "IC DISC: Offering Continued Tax Savings for Exporters," David M. Chase, Wall, Einhorn & Chernitzer P.C.)

Who is eligible to establish an IC-DISC?

U.S. exporters who operate their business via a sole proprietorship, pass-through entity (LLC, S corporation, LP, etc.), or C corporation may be eligible to form an IC-DISC. To take advantage of the tax savings an IC-DISC provides from which a commission is computed, it must meet the following qualifications:

- 95% or more of an IC-DISC's gross receipts must be qualified export receipts
- 95% of an IC-DISC's assets must be qualified export assets
- The IC-DISC must have capital of at least $2,500 and only one class of stock on each taxable year
- The IC-DISC must make a valid election to be treated as an IC-DISC

Qualified Export Receipts can include sales and leases of export property, export-related services (including engineering, design, architectural, and managerial services), and interest from loans and export accounts receivable.

Qualified Export Assets can include export property, receivables, producer loans, and working capital. Qualified export property must be manufactured or produced in the United States and cannot have more than 50% foreign content.

(Source: "IC DISC: Offering Continued Tax Savings for Exporters," David M. Chase, Wall, Einhorn & Chernitzer P.C.)

Next Steps: How to Set up an IC-DISC

If you are unsure if your company is eligible to set up an IC-DISC to take advantage of tax savings, ask the following questions:

- Do you have any transactions outside of the United States?
- Do you use overseas distribution?
- Does your product cross any borders?
- Are you generating operating income?

If the answer to any of these questions is yes, an IC-DISC may be a valuable tax savings option for your business.

It is important to talk to a qualified accountant with experience in setting up IC-DISCs to fully understand the benefits and costs of creating an IC-DISC. For help finding an experienced accountant, contact your local VEDP Trade Manager.

Virginia Economic Development Partnership - International Trade offers a number of export-related services to Virginia businesses, including trade missions and market research by our Global Network of in-country consultants. These services are available to all Virginia exporters.

For more information, please visit our website, ExportVirginia.org.

Additional Resources

Ryan Losi, CPA
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"IC-DISC: The Big Tax-Break for Exporters"
Forbes.com

IRS Form 4876-A (sample)
IRS.gov

Last Revised: March 2022