



ECONOMIC CONSULTING SERVICES, LLC

For more than thirty years, ECS has been a leading authority on various tax, trade, and customs issues. Clients include multinational corporations, U.S. and non U.S. small- and medium-sized businesses, and both U.S. and foreign tax authorities. Services include the provision of financial and economic analysis and expert-witness services in connection with actual or potential litigation.

MAXIMIZING YOUR TAX BENEFITS

ECS has developed a line of customized services to assist clients in maximizing the benefits under the Interest Charge – Domestic International Sales Corporation (IC-DISC) while minimizing the time and resources necessary to achieve these results. ECS' services enable proactive firms to minimize their tax burden.

EXPERTISE AND EXPERIENCE AT ECS

ECS employs a group of highly trained economists and accountants with expertise in economics, accounting, finance, and international trade. ECS augments this expertise with a proficiency in developing and analyzing large transactional databases, a prerequisite for maximizing a company's tax benefits from an IC-DISC.

ECS has provided FSC/ETI calculations and documentation services for a number of Fortune 500 companies utilizing its proprietary analytical programs and documentation procedures. ECS' FSC/ETI calculations have withstood the scrutiny of IRS audits and its documentation services have proved to be an invaluable resource to clients. ECS routinely prepares transactional databases in its antidumping practice area and has participated with its clients in over one hundred on-site verifications conducted by officials of the U.S. and foreign authorities.

WHAT IS AN IC-DISC?

With the repeal of the extraterritorial income exclusion in October 2004, the Interest Charge – Domestic International Sales Corporation (IC-DISC) (*IRS Sec-*

tion 992, 993, 994, and 995) might be the only available option to qualifying U.S. exporters to obtain export-related tax benefits. The IC-DISC is a tax deferral vehicle, particularly beneficial for small- and mid-sized, owner-managed exporting businesses.

Combined with the favorable dividend tax rules enacted under the Jobs and Growth Tax Relief Reconciliation Act of 2003, the IC-DISC now provides a permanent 20 percent tax savings for qualifying U.S. exporters. It can also be tailored into various sophisticated forms to help companies meet business and capital objectives.

In addition, the IC-DISC has better staying power than FSC/ETI. The IC-DISC has been a part of the IRS code since 1984 and has never been challenged by GATT, the WTO, and U.S. trading partners. It is an important vehicle to consider by forward-looking companies.

WHAT ARE THE IC-DISC BENEFITS?

Deferral of IC-DISC Income from Current Income Taxation

The portion of the IC-DISC income attributable to the "best" \$10,000,000 of export sales may be deferred from current taxation. A relatively modest interest charge on the tax of the IC-DISC's earnings would be assessed annually by the IRS. The interest rate is the 1-year Treasury rate, which recently has been in the range of 1 to 2 percent.

Increased Cash Paid As Dividends to Shareholders

The entire amount of IC-DISC income may be paid as a dividend at the end of the taxable year. Depending upon the ownership structure of the IC-DISC, this dividend payment could be subject to only a 15-percent individual dividend tax rate as provided in the Jobs and Growth Tax Relief Reconciliation Act of 2003 rather than the corporate tax rate of 35 percent.

Reduced U.S. Taxable Income Base

By setting up an IC-DISC, the exporting company can decrease its taxable base at the corporate level by the amount of the commission paid to the IC-DISC.

HOW DOES AN IC-DISC WORK?

Step 1: The exporting company creates a tax-exempt IC-DISC. The IC-DISC is a “paper” entity that does not require office space, employees or tangible assets. In this example, the IC-DISC is set up under the ownership of the individual shareholders of the exporting company.

Step 2: The exporting company pays the IC-DISC a commission. The IC-DISC commission may be determined as the greater of: 1) 50 percent of export net income or 2) 4 percent of export gross receipts. The commission may be increased even more if it is reasonably established based on a Section 482 transfer price study.

Step 3: The exporting company deducts the commission amount paid to the IC-DISC from its ordinary income taxed at 35 percent. The commission income for the IC-DISC is deferred from current taxation.

Step 4: When the IC-DISC pays dividend to its shareholders, the shareholders pay dividend income tax, currently at a rate of 15 percent.

Step 5: The net effect of this is a 20 percent tax savings on the IC-DISC commission. These steps are illustrated below:

Without IC DISC

Foreign Trading Gross Receipts	10,000,000
Cost of Goods Sold	6,000,000
<u>Selling, General and Administrative</u>	<u>3,000,000</u>
Export Net Income	1,000,000
Tax Rate	35%
Tax Paid	350,000

With IC DISC

	<u>Combined</u>	<u>Exporter</u>	<u>IC-DISC</u>
Foreign Trading Gross Receipts	10,000,000		
Cost of Goods Sold	6,000,000		
Selling, General and Administrative	<u>3,000,000</u>		
Export Net Income	1,000,000	1,000,000	
IC-Disc (Greater of):			
1) 50% of Export Net Income		500,000	
2) 4% of Export Gross Receipts		400,000	
IC-DISC Commission:		500,000	
IC-DISC Commission Deduction		<u>500,000</u>	500,000
Tax Base After IC-DISC Commission		500,000	500,000
Tax Rate		35%	15%
Tax Paid	250,000	175,000	75,000
IC-DISC Net Tax Savings: 350,000 - 250,000 = 100,000			

ECS CUSTOMIZED SERVICES

ECS provides customized services to meet the needs of each individual client. Services provided range from an initial benefit assessment to a full-scale IC-DISC outsourcing service.*

Sophisticated Pricing Assessment and Feasibility Study

ECS offers a basic assessment of the potential benefits of using an IC-DISC with sophisticated pricing strategies (T-by-T, marginal costing, product grouping, etc.) with readily available data. ECS provides a feasibility study of sophisticated pricing strategy given the company’s available data and circumstances.

Data Analysis and Documentation

Companies with data collection systems already in place might benefit from using ECS’ proprietary analytical IC-DISC computer program package to maximize tax savings. ECS can analyze the company’s self-prepared data and identify the grouping and intercompany pricing rules that will maximize tax savings. ECS can provide all necessary documentation to support these calculations in the event of an audit and to meet the IRS filing requirements.

Full-Scale IC-DISC Outsourcing Service

For companies wishing to outsource the preparation of IC-DISC calculations and supporting documentation, ECS can work with the company’s accounting and information systems personnel and legal counsel to develop each requisite piece of information including the final transactional database. Once the transactional database and supporting schedules have been prepared, ECS will perform the same steps outlined above for the data analysis and documentation. With renewed emphasis on internal controls and documentation under Sec. 404 of Sarbanes-Oxley, companies may benefit from ECS’ full-scale outsourcing service that documents all the necessary procedures, schedules, and final reconciliations required by the IRS for IC-DISC tax benefits.

Section 482 Intercompany Transfer Price Study

For companies wishing to take a more comprehensive approach in determining the IC-DISC commission, rather than simply following the safe harbor intercompany pricing rules, ECS can prepare a full Section 482 transfer price study. ECS’ economists have a long and successful history of work in this area. ECS is the developer and principal sponsor of the Transfer Pricing Network, www.transferpricing.com, an internet web site dedicated to providing information about the issues, latest news and ideas in transfer pricing in the U.S. and worldwide.

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