

International Tax Tips and Traps

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International Tax Tips & Traps

- Agenda
 - Tip> Domestic International Sales Corporation (IC-DISC) opportunity
 - Trap> Subpart F income recognition
 - Tip or Trap?>International tax changes

Domestic International Sales Corporation (IC-DISC)



Export Incentive History

- 1971 – Domestic International Sales Corp. (DISC). *Allowed exporters to accumulate profits inside the DISC without paying taxes until distributed.*
- 1984 – DISC regime challenged as an illegal export subsidy
- 1984 – Foreign Sales Corp. (FSC) *Allowed partial tax exemption if exporters formed a foreign corporation – DISC changed to IC-DISC*

Export Incentive History

- 1999 – WTO ruled the FSC constituted an illegal export subsidy
- 2000 – FSC Repealed. Extraterritorial Income (ETI) enacted. *Allowed all exporters a benefit by excluding a portion of profits from export income*
- 2001 – WTO ruled ETI constituted an illegal export subsidy



Export Incentive History

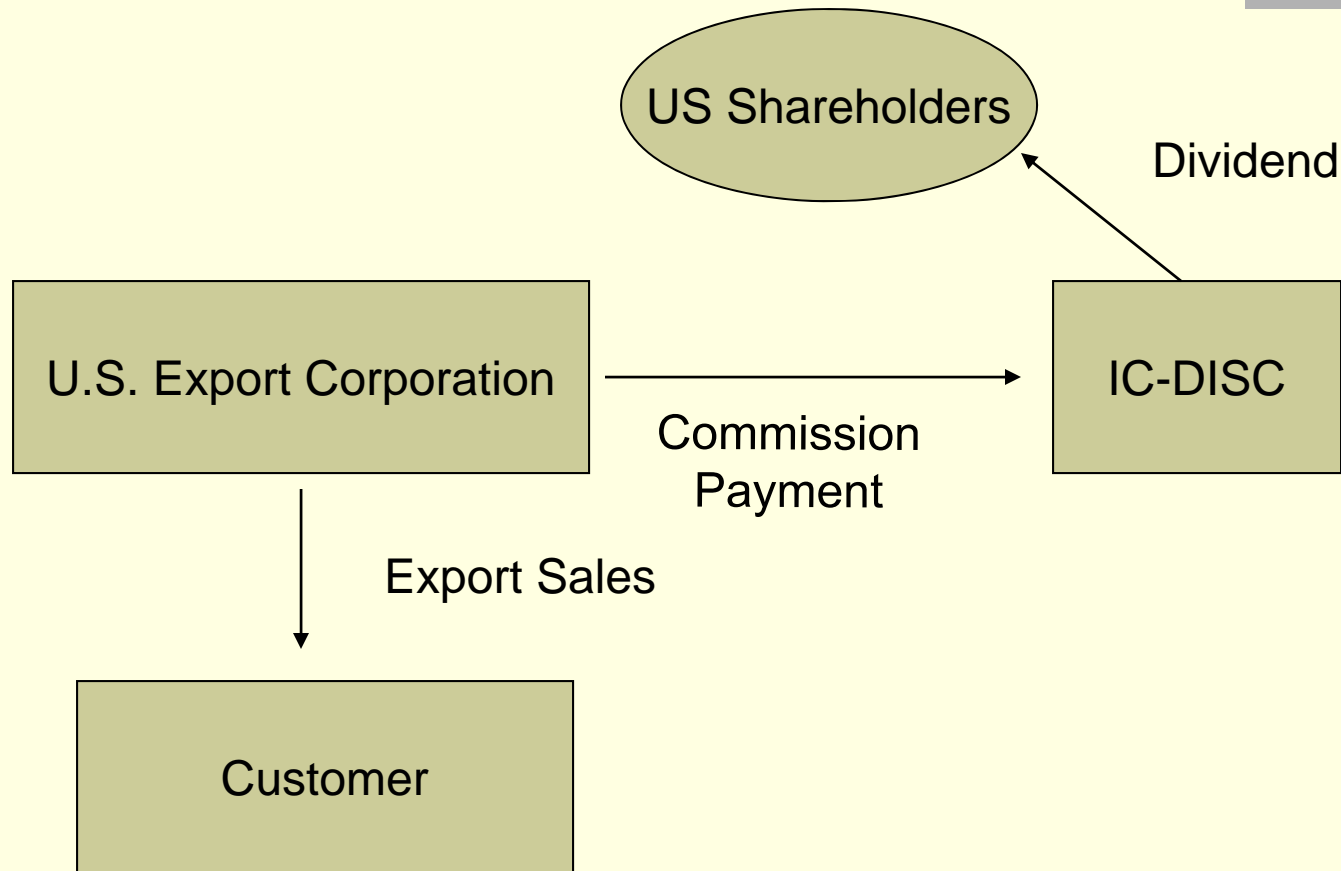
- 2004 – ETI repealed
- Today: IC-DISC remains unchallenged and available
 - Does it still have value?



What is an IC-DISC?

- U.S. Corporation
- Single Class of Stock
- Required capitalization = \$2,500 Warning!
- File Timely Election > Form 4876-A
- Pass 2 tests: qualified export receipts and qualified export assets both must = 95%
- Interest charge paid on deferred income
- Deemed distribution when export gross receipts > \$10 million

How does an IC-DISC function?





How is the commission calculated?

- The IC-DISC commission is the greater of:
 - 4% of qualified export receipts, or
 - 50% of combined taxable export income
- Commission cannot exceed the combined taxable export income
- Combined Taxable Income
 - Calculated with fully loaded expense allocation
 - Can use general or specific allocation



Commission Base

- Qualified Export Receipts
 - Receipts from sale, lease, or rental of export property.
 - Services related or incidental to sale/lease of export property.
 - Engineering or architectural services for construction projects located outside the U.S. (excludes oil exploration).



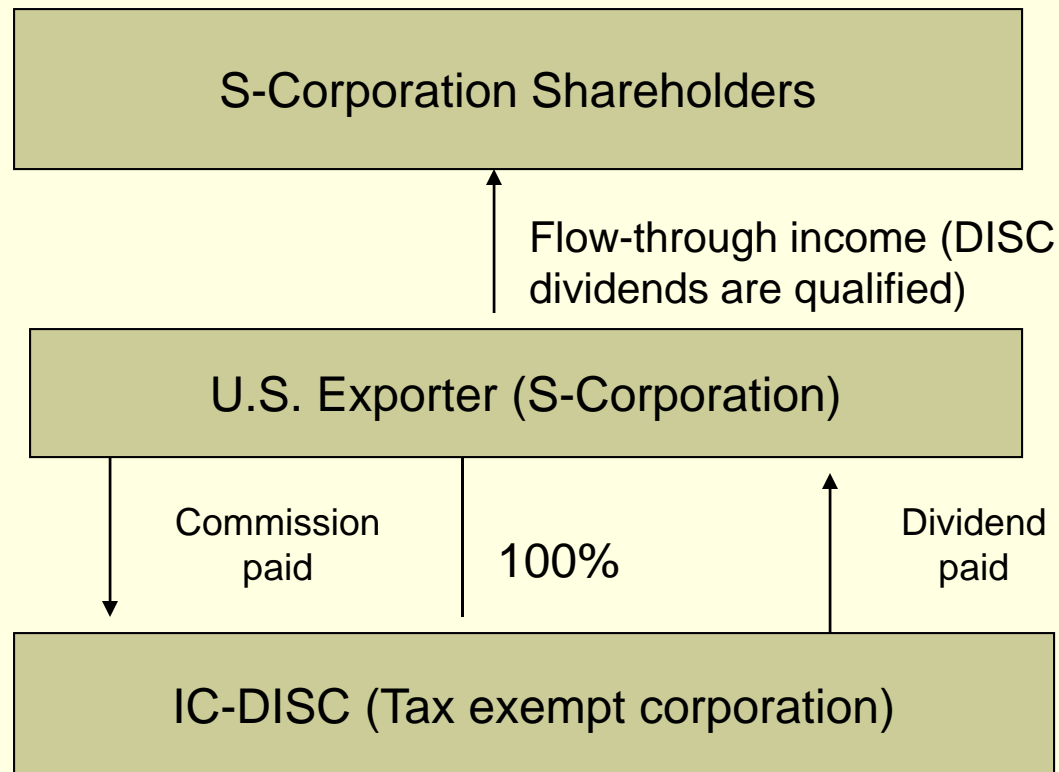
Commission Base

- Qualified Export Property – 3 requirements
 - Non-depletable property manufactured, produced or grown by a person other than the IC-DISC; *and*
 - Held primarily for sale, lease or rental for direct use, consumption or disposition outside the U.S.; *and*
 - Destination Test and 365 day Test
 - Export property value has maximum 50% foreign content

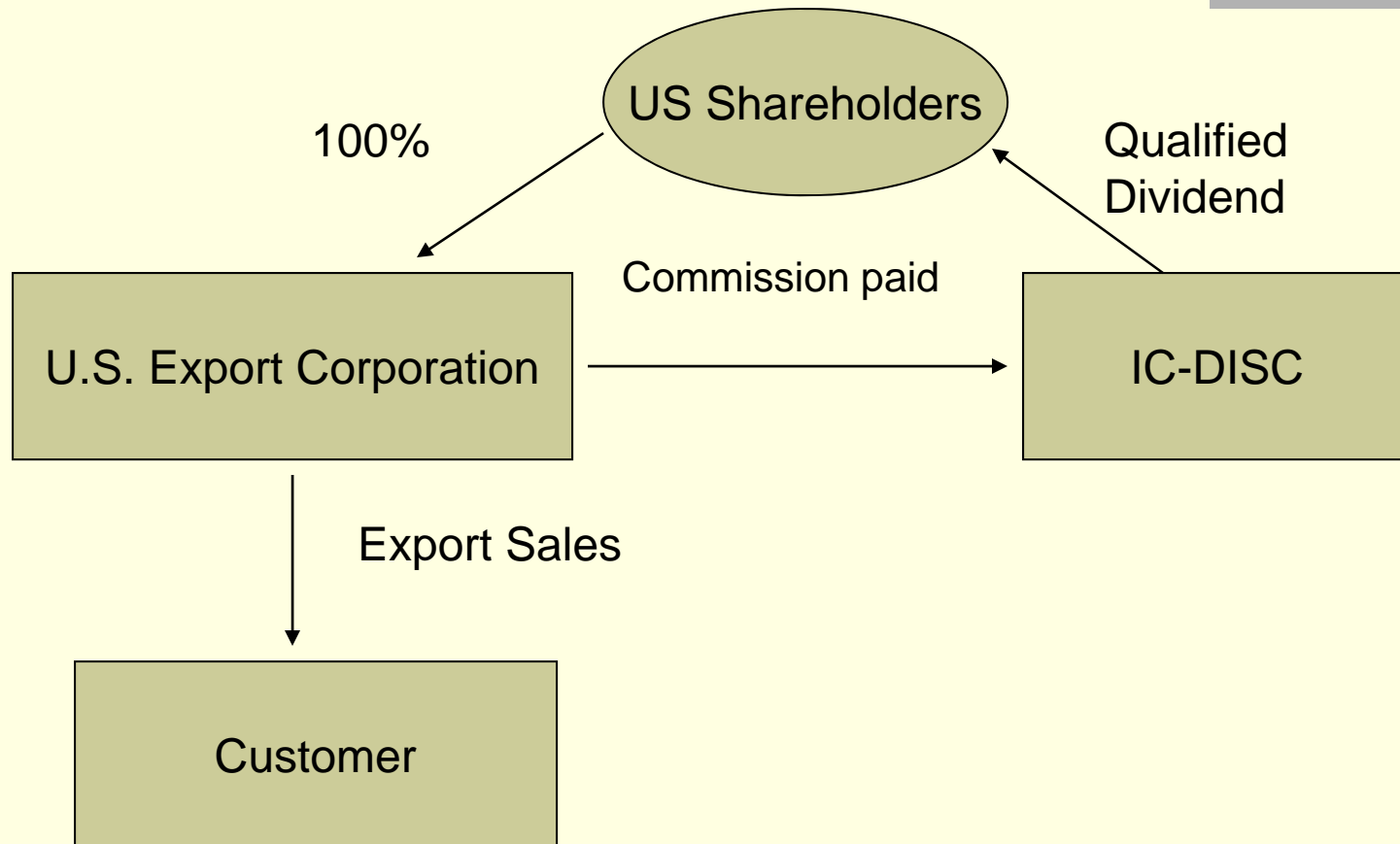
How is the IC-DISC taxed?

- Generally, IC-DISC is not taxed on its income.
- The shareholders of the IC-DISC are taxed on deemed or distributed dividends.
- The related exporter gets a deduction for the IC-DISC commission paid or accrued.
- An interest charge may apply to the shareholders if the IC-DISC has accumulated income in consecutive years.

IC-DISC owned by S-Corporation



IC-DISC owned by shareholders (same for C or S entities)



IC-DISC benefit to S Shareholders

	No IC-DISC	IC-DISC
Export Profits	\$1,000,000	\$1,000,000
Commission (50% profits)	N/A	500,000
Income taxed @ 35%	1,000,000	500,000
Income taxed @ 15%	N/A	500,000
Total Tax	\$ 350,000	\$ 250,000

IC-DISC benefit to C Corporation

	NO IC-DISC	IC-DISC
Export Profits	\$1,000,000	\$1,000,000
Commission	N/A	500,000
Corp taxable income	1,000,000	500,000
Corp tax @ 35%	350,000	175,000
SH Distribution	650,000	825,000
SH tax @ 15%	97,500	123,750
Total Tax	\$ 447,500	\$ 298,750

IC-DISC benefits summarized

- S Corporations
 - Effectively converts ordinary income into qualified dividend income
 - Savings depends on rate differential between ordinary income and dividend income
- C Corporations
 - Deferral of taxable income up to \$10 million
 - Rate differential between corporations and individuals



IC-DISC Implementation

- Analyze export sales (including Canada)
- Incorporate IC-DISC before export sales begin
- Minimum capital account balance \$2,500
- Adopt commission agreement
- Prepare and file Form 4876-A to elect IC-DISC status for corporation>no retroactive application
- Recordkeeping requirements>ensure revenue and asset tests are met
- IC-DISC return due 15th day of 9th month after end of tax year:1120 IC-DISC, Sch P, Sch K

Subpart F Income Recognition

Subpart F in a nutshell

- Income earned by a Controlled Foreign Corporation deemed to be currently taxable income to the US owner
 - Insurance Income
 - Foreign base company sales or services
 - A portion of international boycott income
 - Illegal bribes or kickbacks paid by CFC
 - Income derived by certain disfavored countries

Subpart F Traps

- Earnings of CFC invested in U.S. property may be deemed a dividend to U.S. shareholders
 - TRAP: U.S. loan agreement guaranteed by U.S. and affiliates. Who is included in “affiliates” per loan agreement?
- IRC 954(c)(6) provided that certain income (dividends, interest, rents, royalties) between CFC’s were not subject to Subpart F taxation from 1/1/06 – 12/31/09. “Look-through Rule”
 - TRAP: Until extended, above income required to be included as taxable income in quarterly financial statement effective income tax rates.



International Tax Changes



China

- 1/8/09 China released national transfer pricing rules – retroactive 1/1/08.
- 7/6/09 adopted cross-border related-party transactions guide requiring transfer pricing documentation
 - Beijing, Kunshan, Ningbo, Shandong, Shenzhen, Tianjin and Zhongshan issued local notices
- NOTE: documentation is due ***annually***



China

- 2/20/10 – Circular 19 provides new guidelines to calculate Enterprise Income Tax (EIT)
 - Impacts foreign companies conducting business in China: construction, design, consulting, management and other services
 - Sets forth rules for determining net profit if entity does not keep books based on Chinese accounting requirements



France

- 3/31/10 – French Supreme Court ruled on the Zimmer Ltd case.
 - Ruled that a French permanent establishment is not created solely through use of a commissionaire.
 - Review any current commissionaire agreements and contracts to ensure no language exists that provides the commissionaire has the authority to bind the U.S. principal to the 3rd party.



U.S. Foreign Reporting

- Section 513(c) of the Hiring Incentives to Restore Employment Act provides the 3 yr IRS limitation to assess tax does not begin until all required forms are filed – including Form 5471 and 8865.
- 6 yr IRS limitation for income omitted >\$5,000 attributable to foreign financial assets reporting under new Section 6038D

Questions?

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