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# WHAT YOU NEED TO KNOW

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Interest Charge  
Domestic Interest  
Sales Corporation  
(IC-DISC)



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# WHAT YOU NEED TO KNOW: INTEREST CHARGE-DOMESTIC INTEREST SALES CORPORATION

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The Interest Charge Domestic Interest Sales Corporation (IC-DISC) is a tool manufacturers, producers, resellers, and exporters of goods can use to minimize their tax burden. If a company classifies as an IC-DISC, up to 50% of its export income can be reduced by more than 50% through converting the income into a qualified dividend.

Unfortunately, thousands of small to medium businesses in the US fail to take advantage of this incentive even though it has low initial costs and the potential for very large tax savings. This incentive was passed in 1971 to help strengthen U.S. exporters and foster economic growth. Given Congress's push to recover our economy, the IC-DISC encourages strengthening the manufacturing sector through increased exports from small to medium-sized businesses. Many different types of companies can be classified as an IC-DISC including S corporations, C corporations, LLC's, individuals, partnerships, trusts or a combination of those listed.



## FAST FACTS

- A company that wishes to classify as an IC-DISC must have at least 95% of its respective receipts qualify as export receipts
- The federal tax rate on qualified dividends can be reduced by almost 16% for companies that qualify
- The amount of returns filed by IC-DISC's has increased rapidly over the past decade
- IC-DISC's are simply a "paper" company designed to minimize overall taxes

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## HOW IT WORKS

Shareholders form a separate ID-DISC company. A commission is paid to the IC-DISC from the operating export company based on how profitable the company's export sales are. Then the exporting company deducts this paid commission from its income. No federal income tax is imposed on this commission by the IC-DISC, a tax-exempt entity. Once the income is re-classified as a qualified dividend, shareholders pay federal income tax at a rate of only 23.8% which is significantly lower than the 39.6% tax rate on ordinary income. This transformation can save the entity up to 40% on its tax bill on the export portion of its income.

## REQUIREMENTS

An IC-DISC must have at least 95% of its respective receipts qualify as export receipts. These specified qualified receipts have to be defined under Sec. 993(a) of the Internal Revenue Code. The company must also make a timely election and have only one class of stock with a minimal par value.

To qualify as an IC-DISC, a company must also meet the qualified export assets test. This test requires 95% of the corporation's adjusted basis of total assets to be qualified export assets. A qualified asset can be export property, investments for a company's working capital requirements, stock in a foreign export company, and assets used in the connection with qualified export receipts. For a complete listing on what meets requirements for a qualified export, Section 993(b) of the Internal Revenue Code has further detail.

## FYI

Be sure to talk with Reilly, Penner & Benton LLP to learn what the most current rules, regulations and changes may apply to you when working with Interest Charge- Domestic Sales Corporations.

## BENEFITS

Since the tax rate for qualified dividends was reduced as a result of the Jobs and Growth Tax Relief Reconciliation Act of 2003, the IC-DISC has great advantages for U.S. exporters. Along with big tax savings on exported goods, IC-DISC's also increase liquidity for the business and its shareholders, and increase the ability to leverage cost of capital. The formation of the IC-DISC also does not affect the general business operations of the company nor its customers and suppliers.

## OTHER CONSIDERATIONS

An IC-DISC cannot be used if the exporting company in question is in a tax loss situation during the year. Individual states can allow this tax advantage but are not required to do so. States such as Massachusetts, Maine, and California do not allow the benefit. The commission that is paid to maintain the IC-DISC status also must be paid when required. Along with paying commissions, the company must also meet maintenance requirements. For more information on these requirements and on IC-Disc's in general, contact our tax team.