

## TAMPA BAY Business Journal

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# Time is ticking for U.S. exporters to capitalize on income tax breaks

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The Extraterritorial Income Exclusion is a U.S. tax policy that currently provides U.S. exporters with an approximate 5.25 percent permanent income tax savings on qualified export profits. The EIE is applicable to export sales since Oct. 1, 2000.

Many small and medium-sized businesses and their advisers are unaware that export tax benefits exist. The benefits are available to sole proprietors, partnerships, S-corporations and C-corporations.

The tax law permits businesses that qualified for the EIE in prior years to file amended returns and receive a refund. However, income tax returns generally can only be amended for the past three years.

Consequently, time is ticking for U.S. exporters to claim the EIE for previous tax years where qualified exports existed.

### General EIE requirements

The tax rules limit the EIE benefits to sales of "qualifying foreign trade property."

Qualifying foreign trade property is:

- Export property that is held for sale, lease or rental in the ordinary course of business for direct use, disposition or consumption outside the United States; and
- Export property that has no more than 50 percent of the value of the final product attributable to foreign labor costs and foreign components
- Engineering and architectural services for construction projects located (or proposed for location) abroad.

Distributors or manufacturers may qualify for the benefit on their export sales. Moreover, distributors and manufacturers may claim the EIE benefit on the same export product.

However, the distributor will be required to share copies of its bill of lading with the manufacturer in order for both companies to receive the benefit. In addition, the distributor generally must not further process or change the manufacturer's product before exporting it for both companies to qualify for the benefit.

### Foreign economic process requirements

In addition to satisfying the qualified foreign trade property requirements, foreign economic processes are required to take place for companies that export more than \$5 million annually. However, even if companies export more than \$5 million annually and do not meet the foreign

economic process requirements, the company can still claim the EIE on up to \$5 million of export sales.

The foreign economic process requirements are met through a sales test and a foreign direct cost test. Companies can satisfy the sales test if they or their agent participate abroad in the solicitation, negotiation or contracting of the export sale.

The foreign direct cost test focuses on the following five expense categories for export sales:

- Advertising and promotions
- Processing orders and arranging for delivery
- Transporting property outside the United States
- Determining and transmitting the final invoice or statement of account and receiving payment
- Assuming credit risk

The regulations provide two ways to meet the foreign direct cost test. The aggregate foreign direct costs that the company incurs from all five of the above categories must be at least 50 percent of the transaction's total direct costs. Alternatively, the foreign direct costs from any two categories must be at least 85 percent of the transaction's total direct costs.

#### Expected repeal of the EIE for 2004

Congress is expected to repeal the EIE in early 2004 for tax years 2004 and beyond. It is unclear if the repeal will eliminate the EIE entirely in 2004 or if a phasing out of the benefit will occur over several years.

The repeal is a result of the United States receiving an adverse ruling from the [World Trade Organization](#) labeling the EIE an illegal subsidy. The [European Union](#) brought the charge to the WTO against the United States. If the United States does not repeal the EIE by March 2004, the EU will likely impose sanctions on imports from the United States.

Congress is considering many international tax law changes to compensate for U.S. multinationals losing tax benefits under the EIE regime. Companies should monitor the expected new international tax laws in order to minimize their global income tax rates.

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