



Export Tax Incentives: IC DISC & Extra-territorial Income Exclusion

Presented to the Sarasota & Manatee Manufacturers' Association (SAMA)
October 18, 2006
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ogle international tax advisors can customize an international tax planning program tailored to your company's specific requirements. Our spectrum of international tax services can provide assistance in the areas of:

- ❖ **Foreign business investments** - structure investments in offshore businesses to minimize U.S. and host country taxation.
- ❖ **Offshore profits importing** - plan for the repatriation of foreign profits.
- ❖ **Foreign tax systems** - analyze host country deductions, exemptions, and incentives, including foreign tax credits.

ogle international tax advisors specializes in advising multi-national companies on international tax matters. Our clients include both public and privately held businesses. We also assist other regional CPA and Law firms who do not have expertise in international tax.

Our firm's staff includes both CPAs and attorneys. Our international tax services include: export tax incentives, structuring of foreign investments, repatriation strategies, transfer pricing, and mergers & acquisitions.

In the area of export tax incentives, we advise and assist privately-held exporting companies to take advantage of all available export tax incentives. The tax incentives include the Interest-Charge Domestic International Sales Corporation ("IC-DISC") and the Extraterritorial Income Exclusion ("EIE").

We have significant experience covering a broad range of industries and countries.



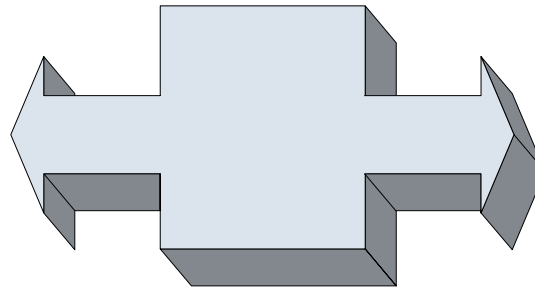
- ❖ US taxpayers (corporations, individuals, etc.) are taxed in the U.S. on their worldwide income.
- ❖ US taxpayers who directly conduct business in foreign countries are usually eligible for a foreign tax credit (FTC) to the extent that foreign income taxes were paid in the foreign country. The FTC mitigates double taxation of the same income.
- ❖ US taxpayers can generally defer US taxation on their foreign corporation's (subsidiary company) profits up until the time that such profits are repatriated to the U.S. in the form of dividends to the US taxpayer (US parent company).
- ❖ A foreign subsidiaries' profits are not deferred with respect to passive activities (subpart F).
- ❖ Upon repatriation of profits from the foreign corporation, double taxation is only avoided for "US C Corporate Shareholders" by allowing for an indirect FTC to flow up from its foreign subsidiary ("the foreign corporation").
- ❖ The profits of the foreign corporation are usually subject to current income taxes in its foreign jurisdiction.

Extra-territorial Income Exclusion

Approx. 5.25% Permanent U.S. Income Tax Savings on Qualified Export Profits. Effective for years 2000 – 2006 (Repealed)

Prior Years

 Amend Prior Returns



IC DISC

Approx. 10% Permanent U.S. Income Tax Savings on Qualified Export Profits. Effective for years 2003 – 2010 and potentially beyond

Current & Future Years

Create IC DISC Entity 

Extra-territorial Taxation - Overview

The Extra-territorial Income (EI) regime was signed into law on November 15, 2000. It is effective for the transactions beginning on or after October 1, 2000.

The EI regime is designed to promote exports by U.S. taxpayers. Taxpayers who export products are generally allowed an exclusion of a percentage of the income related to their exports.

Applies to U.S. C Corporations, Foreign Corporations, U.S. S Corporations, partnerships and individuals – much more expansive than the prior Foreign Sales Corporation (“FSC”) rules.

The EI rules allow taxpayers to amend previously filed returns to obtain any benefits available so long as the years involved are not closed under the statute of limitations (i.e., 3 years).

The benefits are usually an estimated **5.25% effective tax rate savings** on income associated with export sales.

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Benefit Calculation & General Requirements

- ❖ Benefit Calculation
- ❖ Qualifying Property
- ❖ Foreign economic process requirement
- ❖ No separate entity needed
- ❖ Applies both to public and privately held companies

The amount of the income exclusion under the EI regime is an amount, if excluded, would reduce the taxable income of a transaction involving “qualifying foreign trade property”

Benefits do require jumping through hoops

Calculating the EI Benefit

Qualifying foreign trade income is determined using one of the following three methods (taxpayer’s choice):

- ❖ 15% of foreign trade net income method
- ❖ 1.2% of foreign trading gross receipts from a transaction (but capped at 2X what is earned under the income method)
- ❖ 30% of the “foreign sales and leasing income” from the transaction

TAX TIP

Use 15% Method for >8% Profit Margins

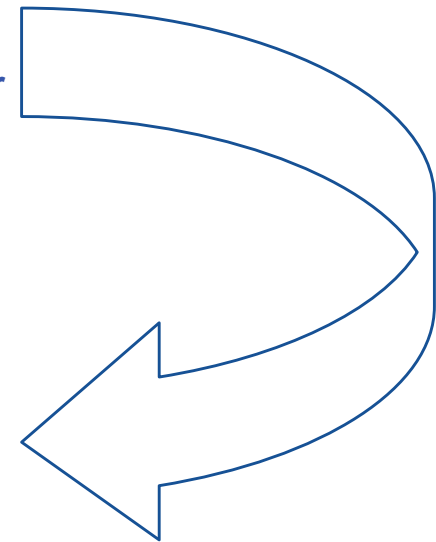
What is Qualifying Foreign Trade Property?

Qualifying foreign trade property is property that is:

- ❖ Held primarily for sale, lease or rent in the ordinary course of trade or business for direct use, consumption or disposition outside the U.S.,
- ❖ **Not more than 50% of the FMV attributable to article manufactured, produced, grown or extracted outside the U.S. or other value added outside of the U.S., and**
- ❖ Manufactured, produced, grown or extracted within or outside the U.S.,

The sale of QFTP results in Foreign Trading Gross Receipts

Note that this includes foreign parts put into a U.S. manufactured good.



What is Foreign Trading Gross Receipts?

Gross Receipts are Foreign Trading Gross Receipts only if certain economic processes take place outside the US. For exports over \$ 5 million annually (the “foreign economic process requirement”) – a 2 pronged test.

Both prongs must be met.

- 1. Foreign Sales Test** - This test requires that the taxpayer (or any person acting under a contract with the taxpayer) participates outside of the US in solicitation, negotiation or making of the contract relating to such transaction and incurs foreign direct costs attributable to the transaction.
- 2. Foreign Direct Costs Test** – This test requires at least 50% of all of the direct costs be foreign direct costs **OR** at least 85% of the total direct costs of 2 of the 5 categories be foreign direct costs.
 - ❖ Direct costs include the following:
 - ❖ Advertising and sales promotion
 - ❖ Processing customer orders and arranging for delivery
 - ❖ Transportation outside the US in connection with the delivery of the goods.
 - ❖ Determining and transmitting the invoice amount and receiving payments
 - ❖ Assumption of credit risk

ABC, Inc. EI Sample Calculation

TAX TIP

“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 EIE for previous tax years where qualified exports existed”

Jerry Ogle
Tampa Bay Business Journal
February 27, 2004

Income Statement

Total Company

Exports Only

Gross Receipts	20,000,000.	5,000,000.
COGS	<u>(12,000,000.)</u>	<u>(3,000,000.)</u>
Gross Margin	8,000,000.	2,000,000.
SGA Expenses	<u>(4,000,000.)</u>	<u>(1,000,000.)</u>
Taxable Income	4,000,000.	1,000,000.
Overall profit percentage	20.000%	20.000%

Methods of Calculating EI Exclusion

15% of Foreign Trade Income	150,000.	
1.2% of FTGR	60,000.	
Larger EI Exclusion of the two methods	150,000.	
Effective Tax Rate	35%	
2004 Federal Income Tax Savings	<u>52,500.</u>	100% benefit
2005 Federal Income Tax Savings	<u>42,000.</u>	80% benefit due to phase out legislation
2006 Federal Income Tax Savings	<u>31,500.</u>	60% benefit due to phase out legislation

IC DISC

The IC DISC regime was created by Congress in 1984 as a deferral benefit for exporters on the first \$10M of qualified exports.

Most taxpayers opted to utilize the more beneficial FSC regime that was repealed in 2000.

However, Congress changed the dividend tax rate to 15% in 2003 and made the IC DISC a very valuable export tax incentive to privately held businesses.

Applies to

- ❖ Manufacturers and Distributors
- ❖ Engineers and Architects who work on projects that are located abroad even if the work is performed in the US

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The IC DISC

General Requirements

- ❖ Must be a US Corporation
- ❖ 95% of FTGR must be from qualified export sales
- ❖ 95% of total assets must be qualified export assets on the close of each tax year
- ❖ One class of stock with at least \$2,500 of par or stated value
- ❖ Timely Election to be treated as IC DISC
- ❖ Cannot be part of a controlled group with a FSC member

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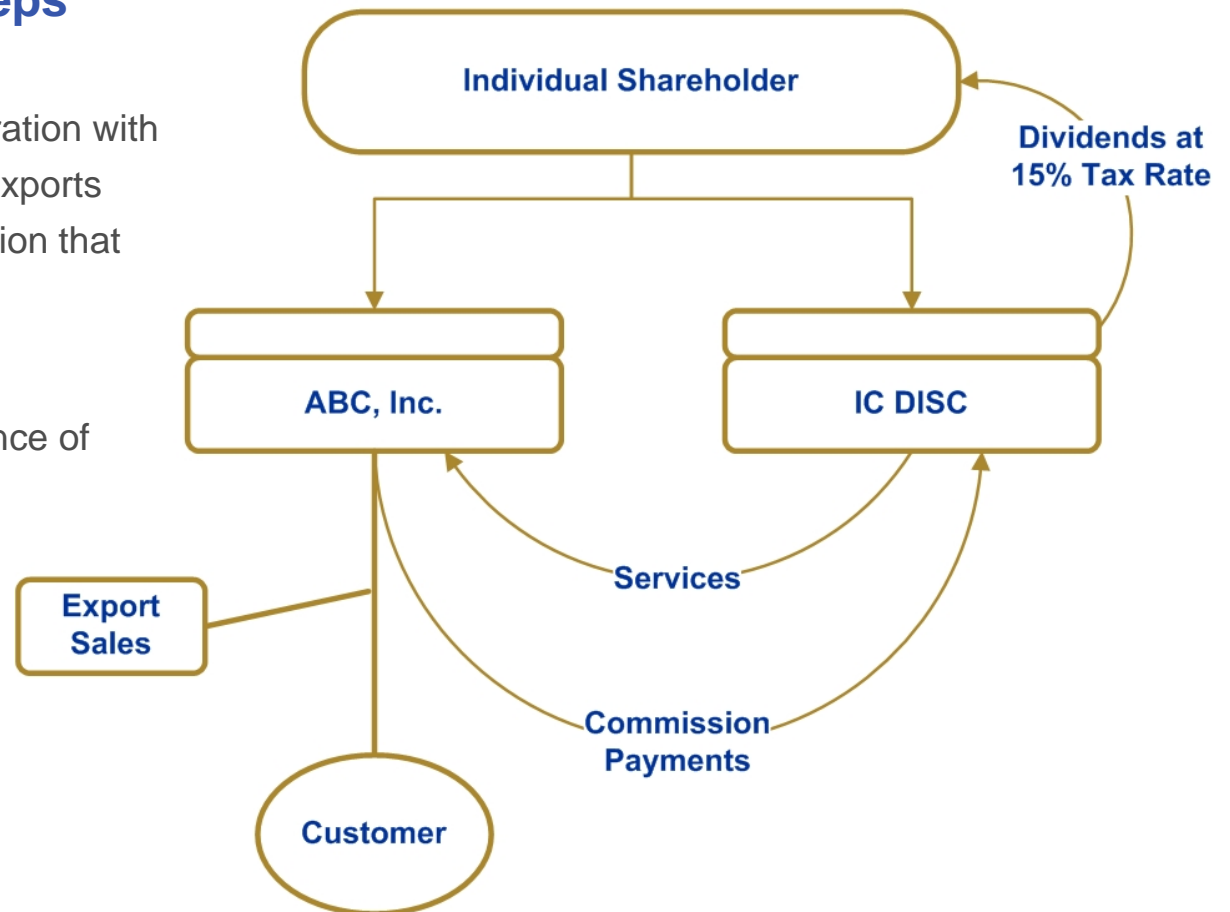
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IC DISC Chart

IC DISC General Setup Steps

ABC, Inc.'s owner (Florida S Corporation with a single shareholder that currently exports products) creates a Florida corporation that elects to be treated as an IC DISC.

IC DISC and ABC, Inc. enter into a commission agreement (The existence of the IC DISC is transparent to ABC's customers).



ABC, Inc. IC DISC Sample Calculation

Client Experience

“Mr. Ogle’s competency and professionalism has made the complicated tax rules we face more understandable and manageable.

Moreover, Ogle & Company advised us to establish an IC DISC export strategy that has helped us reduce the effective tax rate on our export profits by 10 percent.

This has improved our cash flows significantly and allowed us to invest into our international sales growth. We certainly view their services as value added.”

Mike Cundiff
Controller
American Torch Tip Company
www.americantorchtip.com

<u>Income Statement</u>	<u>Total Company</u>	<u>Exports Only</u>
Gross Receipts	20,000,000.	5,000,000.
COGS	(12,000,000.)	(3,000,000.)
Gross Margin	8,000,000.	2,000,000.
SGA Expenses	(4,000,000.)	(1,000,000.)
Taxable Income	4,000,000.	1,000,000.
Overall profit percentage	20.000%	20.000%

Methods of Calculating IC DISC Deduction

50% of Foreign Trade Income	500,000.
4% of FTGR	200,000.
Larger IC Deduction of the two methods	500,000.
Effective Tax Rate Without IC Disc	35%
Federal Income Tax Without IC DISC	175,000.
Effective Tax Rate With IC DISC	15%
Federal Income Tax With IC DISC	75,000.
Federal Income Tax Savings	100,000.

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- ❖ Anti-deferral Strategies, including Subpart F Planning
- ❖ Examining Optimum Legal Entity Structures
- ❖ Foreign Tax Credit Planning – Corporations vs. Individuals
- ❖ Transfer Pricing
- ❖ Mergers & Acquisitions and Corporate Transactions

International business is manageable and profitable with the right strategies in place.

ogle international tax advisors
can provide you with the cross
border solutions you seek!

Jerry E. Ogle , CPA is founder of the firm. He started his career with Deloitte & Touche, LLP. During his tenure at Deloitte, he worked as a tax advisor to various public & private companies. His clients included PepsiCo, Inc. and Interactive Cable Systems, Inc. (Joint Venture that included MCI Communications, Inc., Michael Milken, and Andersen News).

He left Deloitte as a Senior Tax Advisor to join his then client PepsiCo, Inc. He joined the Pepsi Team as a Manager of International Tax Planning. During his tenure at Pepsi, he was responsible for working with the financial and business planners to ensure global minimization objectives were met with respect to Pepsi's expanding and changing business environment. He led significant international planning projects in the UK, Belgium, France, Mexico, and China. He developed strong working relationships with Divisional Presidents and CFOs. He provided guidance to the Divisional Controller's group on the proper recording of tax expenses and cash flow impacts.

Since founding Ogle & Company in 2000, he has assisted clients domestically and abroad primarily with U.S. international tax planning. He represents members of the Fortune 500 as well mid-sized regional businesses. His clients include manufacturers, distributors, food processors, developers, resorts, restaurant chains, service providers, and high net worth individuals.

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Biography

Professional Affiliations:

- ❖ American Institute of Certified Public Accountants (AICPA) – Tax Section Member
- ❖ Member of the Business Advisory Council and serves as a Senior Florida Delegate for the National Republican Congressional Committee
- ❖ Member of the National Fisheries Institute
- ❖ Treasurer of Harvest United Methodist Church
- ❖ Guest Columnist with Tampa Bay Business Journal for International Tax Matters

Educational background:

- ❖ Master's Degree in Accounting – Concentration in Taxation Cum Laude, University of South Florida.
- ❖ Bachelor's Degree in Accounting - Minor in International Economics Summa Cum Laude, University of South Florida.
- ❖ Placed 2nd in Florida and in the top 100 in America on first sitting for the National CPA Exam.
- ❖ Biography published in the 17th and 18th annual edition of The National Dean's List for placing in the top 1/2 of 1% academically in our nation's universities.

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