5x5 series: Insights and actions

IC-DISC Issues and Considerations

Interest Charge Domestic International Sales Corporations (IC-DISCs) have been in the Internal Revenue Code for decades and may provide significant permanent tax benefits to exporters of US-manufactured products. In a passthrough context, an IC-DISC currently provides a potential opportunity to reduce the individual federal income tax rate on a portion of the income from qualified export receipts by as much as 17% (from 40.8% to 23.8%, taking into account the 3.8% net investment income tax but omitting the impact of section 199A). In a C-corp context, the DISC commission paid by the C corp to an individual-owned IC-DISC is deducted by the C corp and escapes corporate-level taxation.

5 insights you should know

Shareholders establish a C corp and elect IC-DISC treatment by filing Form 4876-A. The IC-DISC must be in place before benefits can begin to accrue.

In our experience, the tax benefit on as little as $10 million in qualified sales or $1 million in qualified income will typically exceed the annual compliance costs of maintaining an IC-DISC.

With over a dozen ways to calculate the IC-DISC commission under the applicable Code and regulation provisions, the choice of calculation can significantly impact the allowable commission. For example, in our experience, calculating a commission on a transaction-by-transaction (TxT) basis can result in an increase compared to the default methods.

Unlike under the Foreign Derived Intangible Income (FDII) provisions, export sales made through a US intermediary may still qualify for IC-DISC benefits if the goods are used outside the US within one year of the initial transaction.

For C corps, an IC-DISC commission and a FDII deduction may both be generated on the same qualifying revenue stream. The IC-DISC commission is typically deducted from Deduction Eligible Income (DEI) and Foreign Derived Deduction Eligible Income (FDDEI) in arriving at the section 250 deduction for FDII.

5 actions to take now

1. Companies should identify potentially qualifying gross receipts, model potential benefits, and consider whether to structure and set up an IC-DISC. Set-ups may occur at any point during the year if the facts warrant, and typically take about a week to complete.
2. Companies with existing IC-DISC structures should review current methodologies to identify qualifying revenues and costs to ensure inclusion of indirect exports and sales through foreign related parties.
3. Review IC-DISC commission calculations: Could a commission be increased by changing to a TxT approach and/or by developing product/product line groupings to enhance the benefit under the marginal costing rules? Deloitte's services, leveraging our proprietary calculation engine, can help with this analysis.
4. Companies with existing IC-DISC structures should review processes to ensure compliance with IC-DISC qualification requirements (e.g., 95% qualified assets test, 95% qualified receipts test, separate books and records, single class of stock, etc.) annually to preserve the commission deduction and mitigate the tax exposure of the DISC as a C corp.
5. Analyze expense allocation and apportionment (A&A) methodologies: Consider completing a detailed review of expense A&A methodologies and verify consistency with other calculations, including FTC calculations. Analyze R&E A&A methodology to ensure conformity with complex guidance in Treas. Reg. § 1.861-17.

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