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Dust Off Your DISC

By Robert Verzi, International Tax Partner

Few people know of the tax rule that could be saving your manufacturing or distribution company millions of dollars each year. Despite it being the oldest tax benefit available for exporters, many companies are missing out. "What is this tax benefit," you ask? It is the use of Domestic International Sales Corporations, or DISC.

The use of a DISC has the potential to reduce your company's tax rate on exports between 50 and 100 percent, meaning huge savings for you and your shareholders. How? A DISC avoids C-corporation tax on export profits and is a tax-exempt entity. Any dividend paid to a shareholder is taxed at up to 23.8 percent, compared to the typical rate of 35 to 43.4 percent.

WHAT IS A DISC? A DISC is a tax-exempt entity that has few or no business activities, yet receives tax benefits that allow companies in certain industries to re-categorize some of their ordinary income into qualified dividend income within the DISC on qualifying export property.

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Overall, the benefits of using a DISC exist around the percent of tax paid by shareholders on their dividends. For example, a company with a net export profit of $1 million can save $100,000 in federal income tax per year, just by setting up a DISC. Moreover, state income taxes can be saved by using the DISC structure. The savings is unlimited, and the more your business exports, the more the potential savings.

HOW IT WORKS A DISC acts as a separate, legal, tax-exempt entity from its parent company that doesn't pay tax on commission income. Therefore, using a DISC, a U.S. company pays "commission" to the DISC based on its profits from the sale of qualifying export products. This commission is deductible by the parent company. In return, the DISC pays a dividend to its shareholders. That dividend is treated as a qualifying dividend under the law and is taxed at up to 23.8 percent, under current law.

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There are, however, certain requirements that must be met before a company can qualify to use a DISC. These include being either a U.S. manufacturer or distributor that exports U.S. manufacturing goods, or an architectural and engineering firm that oversees non-U.S. construction projects.

Qualifying export property:

✔ EXPORT PROPERTY MUST BE ✔

Manufactured, produced, grown or extracted in the U.S., but not by the DISC	Used, consumed or disposed of outside the U.S.	No more than 50 percent of the value related to imported components

✘ CANNOT FALL INTO ANY OF THESE CATEGORIES ✘

Property, leased or rented to related person	Income from intangibles	Certain oil, gas, coal and uranium products
Unprocessed softwood timber	Export controlled products	Products in short supply

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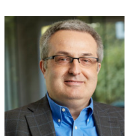

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