Oregon Farmers with Export Business should consider IC-DISCs (and quick) for Tax Savings

If you, or your client, are an Oregon farmer who sells crops outside the United States, then you should immediately consider establishing an Interest Charge Domestic International Sales Corporation ("IC-DISC").

An IC-DISC structure bestows substantial federal tax benefits to farmers who either directly or indirectly sell crops to foreign buyers. When an IC-DISC is in place, generally 50% of the farmer's taxable income generated by export sales may be taxed at the federal qualified dividend rate rather than at the ordinary income rate.

In addition to federal tax benefits associated with IC-DISCs, Oregon farmers can now receive state tax benefits as well. Last October, Governor Kitzhaber signed into law HB 3601, which permits IC-DISC corporations to qualify for an exemption from the Oregon minimum tax. Additionally, IC-DISC commissions will be taxed at a lower rate than the rate usually applied to corporations.

But these new Oregon benefits only apply to IC-DISCs formed on or before January 1, 2014. Thus, to take advantage of both federal and state tax benefits associated with IC-DISCs, Oregon farmers should act now.

What is an IC-DISC?

An IC-DISC is a tax rate structure designed to encourage investment in exports and to help U.S. businesses compete with foreign producers and manufacturers. The sole purpose of an IC-DISC is tax benefits; it does not perform other functions, and it is not required to satisfy many of the usual corporate tax requirements. An IC-DISC, for example, need not have an office or employees. Rather, an IC-DISC is simply a corporation that has elected and been approved for a special tax status with the Internal Revenue Service (IRS).

Who can benefit from an IC-DISC?

The IC-DISC is a valuable tool for anyone who exports goods that have been manufactured, produced, grown, extracted, or engineered in the United States. Although not all individuals or companies will qualify, the IC-DISC benefit is more encompassing than it is narrow.

Some farmers have found IC-DISCs particularly useful. In Georgia, for example, farmers export a significant amount of their cotton and pecan crops. So they set up IC-DISC corporations to reduce the total amount of federal income tax owed on these sales.

About 40% of Oregon's agricultural products are exported to foreign countries. Thus, Oregon farmers, both organic and non-organic, could also see significant benefits if they establish IC-DISC corporations. And even small to medium size farmers could see substantial tax savings.

How does it work?

First, the farmer creates a corporation under state law. Then the corporation files an election with the IRS to be treated as an IC-DISC. Upon approval, that corporation has a special federal tax status.

Next, the farmer sells his or her crops to a foreign buyer in the same manner as the farmer has always sold crops prior to establishing an IC-DISC. In some cases, the farmer does not have to directly sell the corps to a foreign buyer so long as the farmer can document that the crops end up abroad.

Then the farmer pays a commission for the income generated by this sale to the IC-DISC. Essentially, the farmer treats the IC-DISC as if it brokered the sale. The commission paid to the IC-DISC is the greater of 50% of export net income or 4% of export gross receipts.

Finally, the IC-DISC distributes the commission as a dividend back to the farmer, who is the IC-DISC's shareholder

As for the tax savings, the farmer can deduct the commissions paid to the IC-DISC. And, at the core of the tax savings, the commissions are not taxed until they are distributed to the IC-DISC shareholder, i.e. the farmer. When they are distributed, they are taxed at the federal dividend rate rather than the much higher ordinary income rate.

In short, the farmer sells the crops exactly as the farmer has sold crops in the past. But when a farmer sets up and pays commissions to an IC-DISC, the farmer reduces the federal income tax rate paid on about half of the profits from a foreign sale of crops.

An example of an IC-DISC in action

Allen H. Olson, an agricultural lawyer based in Albany, Georgia with extensive experience setting up IC-DISCs for Georgia farmers, has set forth the following example of an IC-DISC in an article written for his firm newsletter:

"If a farmer in the 35% [ordinary income tax] bracket has a $200,000 profit on export sales, the farmer will pay roughly $70,000 in tax if the entire amount is treated as ordinary income. However, by using an IC-DISC corporation, $100,000 of the profit will be taxed at 15% and $100,000 at 35% for a total tax of $50,000, thus saving the farmer $20,000.00 [in federal income taxes]."

What are the Oregon tax benefits?

An IC-DISC formed on or before January 1, 2014 is exempt from the Oregon minimum tax. And commissions received by IC-DISCs are taxed at 2.5 percent rather than the usual rates applied to corporations.

I am interested in setting up an IC-DISC . . . now what?

The IRS outlines specific qualification and organization requirements for IC-DISCs. So any farmer interested in setting up an IC-DISC should immediately consult with an attorney or accountant.

To receive the Oregon state tax benefits the IC-DISC must be in place on or before January 1, 2014. Additionally, an IC-DISC has no retroactive benefits. It must be set up and a commission agreement in place before the crops are shipped or the contract filled.

In sum, time is of the essence for any Oregon farmer with export business who wants to receive federal and state tax benefits by establishing an IC-DISC corporation.