SMART TALK
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President's Column

Consult Your Nearest Tax Advisor

By SMART President Bill Schapiro

For many years, American exporters have been afforded tax benefits through DISCS (Domestic International Sales Corporations); FSC'S (Foreign Sales Corporations) AND most recently E.I.E (Extraterritorial Income Exclusions). A few weeks ago a member asked me why SMART isn't educating the membership about these laws.

The simple answer is that tax advice is the province of each company's tax attorneys and accountants, not of a trade association that has no expertise in this area.

What SMART can do, however, is lobby government for tax relief when there is an issue about whether or not what we do could be covered by a particular tax benefit. In addition, once a member's advisors have apprised a company of tax laws that can benefit our members, this information can be the subject of a SMARTLine communication by a member willing to share or the subject of a SMARTTalk article such as this. In fact, the member's inquiry to me about these laws is what generated my idea to write about them for this column.

I really believe a good tax attorney is essential to our member companies, especially if a member is engaged in export. On more than one occasion I have informed industry members about these export tax laws and neither they, nor their tax advisors were the least bit aware of them. As we all know, much of what we do in this always fascinating industry is "outside the box" so to speak, and it sometimes takes a very skilled attorney or accountant to interpret the law so that it works in our favor.

Below, my tax attorney, Harry Shapiro, who is head of the tax department of Saul Ewing LLP in Baltimore, MD, nimbly tackles our age old question of whether what many of us do fits under the definition of "manufacturing and/or producing." Please understand this memo is one attorney's perspective and each member should consult his or her advisors to see if this analysis fits their circumstances.

EXPORT TAX BENEFITS MAY STILL BE AVAILABLE

By Harry D. Shapiro, Saul Ewing LLP, Baltimore, Maryland

Although Congress has been forced by the World Trade Organization to abandon DISCs[1], FSCs[2] and EIE[3] tax benefits as unlawful subsidies, for 2005 and 2006 exporters can still take advantage of EIE and going forward an Interest Charge- DISC ("IC-DISC") can provide tax benefits, albeit somewhat limited.

The EIE tax benefit is available based on transitional rules that provide 80% and 60% of the full tax benefits for tax years 2005 and 2006, respectively. If our members can qualify, amended tax returns can be filed for the years 2005 and 2006 within three years after those income tax returns were originally filed on a timely basis, including extensions. For example, if a member has a calendar tax year and filed its corporation tax return on March 15, 2006 for the 2005 tax year, an amended return can be filed by March 15, 2009 and the EIE benefits can be claimed.

[1] Domestic International Sales Corporations

[2] Foreign Sales Corporations

[3] Extraterritorial Income Exclusion

The most difficult hurdle to claim the EIE benefits is that although the "qualifying foreign trade property" can be manufactured or produced both within and outside the U.S., not more than 50% of the fair market value of the article can be manufactured or produced outside the U.S. including the direct costs for labor performed outside the U.S. This may sound more daunting than it is.

For example, a dealer purchases bales of textiles from Goodwill and other charities because these charities cannot sell the individual articles. Prior to making the bales, the individual articles may be worth between 3 and 5 cents per pound. After the bales are assembled, the value has increased to 8 to 13 cents or more. The relevant law says that one is to determine the fair market value by looking at its appraised value under the 1930 Tariff Act, but there is no provision governing these transactions because the articles that were once imported into the U.S. have been worn, donated and are not salable to customers at the thrift stores. This is why they have been baled and sold by the pound. In many instances, even greater value is created in the U.S. when graders sort the articles that are then baled again. One could reasonably argue that these efforts taking place in the U.S. have added value that exceeds 50% of the articles' value that existed prior to these activities.

Another existing export benefit is the IC-DISC. It is easy to form, a corporation organized in any state, and as long as its income is from the sale, whether direct or from commissions, the income is not taxable to the owners until the IC-DISC pays a dividend. However, the owners must pay to the IRS each taxable year interest equal to the deferred tax liability calculated on the IC-DISC taxable income not distributed to the owners' times the base T-bill rate set by the Secretary of the Treasury. It is the one year average T-bill rate as of September 30 ending with the close of the tax year.

However, there is, as is the case of the EIE, a similar "export property" hurdle. Unlike the EIE, the article must be manufactured or produced in the U.S. and it cannot include more than 50% foreign value.

One can argue, as suggested above with regard to the EIE, that the article has been used in the U.S., worn and given away. The article at this point has no or very little foreign value and it can be viewed as "export property" eligible for the IC-DISC benefit. The IRS published Revenue Ruling 73-279 in January of 1973 that confirmed "qualified export assets" can include the purchase and sale of scrap steel, shears and bales. The only requirement is that the IC-DISC cannot assemble the bales, etc. In fact, the IC-DISC usually is paid a commission for the sale of the article by an affiliate. The commission is simply booked to the IC-DISC that is in reality a group of papers kept in a desk drawer.

You should discuss this with your tax advisor to determine if this makes sense for your business.