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Report From Counsel

Insights and Developments in the Law **Summer 2013**

Tax Breaks for Exporters—IC-DISC Update 2013

By George W. Skogstrom, Jr.

On January 2, 2013, President Obama signed the American Taxpayer Relief Act of 2012 providing for, among other things, permanence for the Interest Charge-Domestic International Sales Corporation (IC-DISC) in 2013 and beyond. IC-DISC is a highly effective tax planning strategy for companies delivering products (and certain engineering and architectural services) outside the U.S. allowing you to significantly reduce federal income taxes relating to export sales.

IC-DISCs have been around since 1971. Their purpose is to stimulate the export of goods rather than jobs. Although export subsidies have faced many a criticism over the years, they are here to stay. The current administration is working hard to curb the mass exodus of jobs from the U.S. and recognizes the IC-DISC as the predominant vehicle to allow U.S. companies to remain competitive in foreign markets.

IC-DISCs are relatively easy to set up and operate and have numerous benefits. An IC-DISC is a domestic corporation (i.e., formed in the U.S.) that must be approved by the IRS to be treated as an IC-DISC for federal income tax purposes. It must maintain its own bank account, keep separate accounting records and file its own tax return (it is a tax exempt entity), however, it need not have an office, employees or tangible assets. It is not required to actually perform any services.

Due to its status, the IC-DISC pays no income tax and reduces the exporter's tax liability by effectively converting a portion of net export income, taxable at ordinary income rates, into qualified dividends generally taxed at a much lower rate. The savings can be very significant.

This article is not intended to be an exhaustive discussion of the requirements or benefits of an IC-DISC so consultation with your accountant and attorney is recommended before embarking on the IC-DISC path. Generally speaking, to be an IC-DISC the entity need only be incorporated domestically, accepted by the IRS, have a single class of stock and meet annual

Continued on page three.

The Repeal of DOMA and the Impact on Massachusetts Employers

By Brianne M. Dobush, Esq.

On June 26, 2013, the U.S. Supreme Court held that section 3 of the federal Defense of Marriage Act ("DOMA"), which defines marriage and spouse as excluding same-sex partners, was unconstitutional due to principles of state sovereignty, equal protection and due process (*U.S. v. Windsor*). This historic decision will have the greatest impact in states that currently recognize same-sex marriages, such as Massachusetts, and will have little impact in states where same-sex marriage is not recognized.

Massachusetts employers will see the following changes from the *Windsor* decision:

- Reporting of same-sex married couples as married for federal tax purposes
- Use of pretax money for health-insurance premiums for same-sex spouses
- Employee benefit plans extending benefits to a same-sex spouse
- Use of Health Care Spending Accounts and Flexible Spending Accounts for same-sex spouses
- FMLA leave to care for same-sex spouses
- Extension of COBRA coverage to same-sex spouses

Prior to the repeal of DOMA, same-sex married couples were recognized as married for purposes of Massachusetts law but not federal law. Due to this conflicting status, Massachusetts employers faced difficulty and addi-

Continued on page four.

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Take the Time to Update Your Will

By some accounts, 70% of adults do not have a will. If you have at least gone to the trouble of making a will, consider yourself ahead of the curve and pat yourself on the back. Then come back to earth and understand that your work is not completely done. A will is not a static instrument. To serve its purposes, it must keep current with life changes, including an individual's financial circumstances, and with some external factors, such as tax laws. With the help of a professional, you should periodically review your will, staying alert to new or different circumstances that might call for updates.

Marriage, Divorce, and Remarriage

Obviously, a marriage usually brings a new beneficiary into the picture, and a divorce may remove one. Some of the changes in a will prompted by a change in marital status may not be so apparent. For example, when a widow or widower remarries, the will may need to be updated to show how children from the previous marriage and the new spouse are to be provided for.

Additions and Subtractions

A new child is a new beneficiary, but a will can and should cover more than just the distribution of property to heirs. Parents can name a guardian, and even an alternate guardian, to care for their children in the event that something happens to both parents. Absent such a provision in a will, a court will appoint a guardian.

The death of an executor, guardian, beneficiary, or trustee creates a gap in how the will is supposed to operate. Fill in the gaps by making necessary changes, such as naming a new individual or, in the case of a deceased beneficiary, simply removing him or her from the will.

Changing Fortunes

If you enjoy an unexpected windfall, you may still want the larger pie divided up as before. But it is likely that some changes in your will are called for. If the increase in the potential estate is large enough, it might trigger the need for planning to avoid or minimize estate taxes. A reversal of fortune could also suggest some changes. For example, you may have to revise downward that fixed sum you were planning to leave to a favorite charity.

Moving Out of State

You will not have to start from scratch if you move to another state, because all of the states recognize a will that was properly created in another state. Nonetheless, legal advice should be sought in the new state because changes in the law from state to state could require some tinkering with the will. There may be more than tinkering involved if you move to or from a community property state.

Changes in Tax Laws

The government's intentions can change even if your intentions have not. Some of the changes benefit individuals with wills, but you can take full advantage of them only if you are aware of them. The big item here is changes to the federal estate tax exemption, which is the amount an estate can reach before it is subject to a (hefty) estate tax. In recent years the exemption has headed up, but there are no guarantees about what Congress will do with the exemption going forward.

Continued on page three.

Internet Sales Tax Law: Will It Pass?

By J. Keith Phifer, Esq.

Last month the U.S. Senate overwhelmingly, and with strong bipartisan support, passed the Marketplace Fairness Act of 2013 by a vote of 69-27. ***The Act would allow individual states to collect sales and use tax on internet sales to customers in the state.*** Currently, the U.S. Supreme Court's decision in *Quill Corp. vs. North Dakota* 504 U.S. 298 (1992) remains the law of the land and prevents a state from compelling a seller to collect that state's sales tax if the seller does not maintain a physical presence in the state (e.g. an office, retail location, call center, etc). Therefore, currently, there is no way for states to collect sales tax from large internet retailers, which may not have physical locations in a state, but sell and ship products to residents of that state. The Act would change that.

Supporters of the bill argue that the Act would put online retailers on equal footing with brick and mortar retailers, who complain that customers often come to their locations to browse products and ask questions, then go home and buy the same products on the internet to avoid the sales tax. Opponents argue that compliance with tax collection in all of the various jurisdictions would place an undue burden on small businesses. Further, they argue that the Act creates a precedent for businesses to be subject to audits and tax enforcement in jurisdictions where they have no legislative representation.

Despite the overwhelming passage in the Senate, the Act is now getting increased scrutiny in the House Judiciary Committee. Media reports have suggested that the Act, in its current form, is unlikely to pass the House. However, the House is currently considering alternatives to the Act and we will keep our clients informed as to what the ultimate resolution will be. It is an issue that will have wide ramifications for businesses as well as consumers.

IC-DISC

Continued from page one.

qualified export receipts and qualified export assets tests (these tests require that at least 95% of an IC-DISC's gross receipts and assets must be related to export of property whose value is at least 50% attributable to U.S.-produced content).

The way an IC-DISC works is relatively simple. You, the exporter, pay a tax-deductible commission to the IC-DISC which is equal to the greater of 4% of your company's gross receipts or 50% of your net income from qualified exports. Your income is reduced by the deduction. The commissions are not taxable to the IC-DISC and when the IC-DISC distributes the money, it is treated as a dividend.

While there are some limits on who can receive the dividend (i.e., only individuals), by using pass through or disregarded entities, you can generally achieve the result you want.

In addition to the significant savings this structure can generate, there are also several ancillary benefits that are very important:

- Because the shareholders of the IC-DISC need not be the same as the exporter, you can use the structure as part of your estate plan to direct money to your heirs (and keeping it out of your own estate) or to incentivize employees involved in the export business;
- You can have the IC-DISC perform services promoting your company's exports (advertising, market studies, sales commissions, warehousing, other selling expenses, freight, cost of packaging and cost of designing and labeling) and then have the export-related expenses, plus 10%, reimbursed by the exporter;
- You can purchase exporter's receivables at a discount (factoring), thereby increasing the IC-DISC's income, reducing your income, and increasing the tax benefit;
- You can defer tax on commissions related to $10 Million of export sales per year that are left in the IC-DISC by making modest, annual interest rates to the IRS (currently at very low rates);
- You can make producer's loans and accounts receivable loans (with undivided interest) that are used to fund low-cost export working capital, international buyer financing and R&D.
- Any interest earned on the IC-DISC's investments is treated as dividend income to the shareholders.

One last point on IC-DISCs—just because your product is not *directly exported*, don't lose hope! A company that manufactures a good that is *incorporated in a product that is exported* may be able to take advantage of the IC-DISC structure. This is probably the biggest missed opportunity for businesses when it comes to IC-DISC. IC-DISC benefits are available when you make a component part in an exported product.

There are additional tax incentives available by way of Foreign International Sales Corporations (FISCs). FISCs are located in jurisdictions outside the U.S. and typically engage in buying and on-selling inventory to foreign customers to generate export revenue and then adding the IC-DISC commissions from these sales. A discussion of FISCs is beyond the scope of this article.

If you are interested in discussing the benefits of an IC-DISC, call Schlossberg, LLC and we can help.

Update Your Will

Continued from page two.

You Change Your Mind

If you decide you want to change beneficiaries, a guardian, an executor, or anything else in a will, you can do so. For example, you want to make sure that the beneficiaries in your will are the same as the beneficiaries you have named in your insurance policies and retirement accounts. Otherwise, the beneficiaries actually named in those documents, not the beneficiaries under the will, will get the money from the policies and accounts. Bear in mind that no amount of talking about your new intentions will make them happen. The changes must be indicated in a properly executed will.

You should keep the finished (at least until the next update) product in a safe place. When "they" say "keep this with your important papers," think of your will. Your family should know where to find the executed will. An unsigned copy of your will in its latest form is a good starting point for the next periodic review.

Letter of Instruction

Even the best-drafted will is not likely to cover everything needed for a smooth disposition of your estate. To supplement the will, consider executing a letter of instruction. It generally is not legally binding, but it can go a long way to expedite the process and

Continued on page four.

DOMA

Continued from page one.

tional administrative burdens to separately address workplace benefits for same-sex married couples. With the repeal of DOMA, Massachusetts employers will no longer need to establish policies that for federal purposes distinguish between married couples of the same-sex and those of the opposite sex, making benefits policies more consistent and reducing paperwork. However, there will initially be a number of plan document changes, benefit election form changes, and operational changes for these employers.

With respect to federal income tax withholdings, prior to the repeal of DOMA, Massachusetts employers were required to treat employees who were in a same-sex marriage as married for purposes of state income tax withholding, but treat them as single under federal law. This problem is now eliminated with the *Windsor* decision. Employees affected by the repeal of DOMA may need to file a new W-4 to reflect their updated filing status as married. Furthermore, the tax treatment of health-insurance premiums for married same-sex couples will change, allowing the spouse's premium to be paid with pretax earnings. Employers will likely need to make adjustments to their payroll tax withholding to accommodate this change.

Previously, same-sex spouses were not extended the same protections afforded to opposite-sex spouses with respect to benefit plans governed by the Employee Retirement Income Security Act (ERISA), a federal law. Now, employers that offer benefit and retirement plans with spousal benefits, including 401(k) plans, Health Care Spending Accounts and Flexible Spending Accounts, will need to offer these benefits to a same-sex spouse. Likewise, an employee with a same-sex spouse will now be entitled to FMLA leave to care for their spouse and to COBRA coverage for their same-sex spouse. Employers should also note that, under the Health Insurance Portability and Accountability Act ("HIPAA"), marriage is a qualifying "change in status" event that allows an employee to immediately add a new spouse on a health plan. The ability of a same-sex spouse's benefits to be paid pre-tax may now motivate some employees to request spouses to be added. However, it is currently unclear whether federal recognition of same-sex marriages due to the *Windsor* decision will qualify as a triggering event under HIPAA, allowing the employee to immediately add the spouse instead of waiting for the enrollment period.

Employers should review their plan documents and policies to determine where changes need to be made. For example, employers may need to revise the definition of "spouse" in plan documents, reprogram tax-reporting systems, and update enrollment forms, distribution-election forms, tax notices, beneficiary designation forms, and summary plan descriptions. If you need advice on how the repeal of DOMA affects your business specifically, please contact us for further information and guidance on what steps your business needs to take in order to comply with the Supreme Court's decision.

Update Your Will

Continued from page three.

provide information not to be found in the will.

Some items appropriate for a letter of instruction include a list of bank, brokerage, and mutual fund accounts; directions on where to find important documents or personal property; user names, PIN numbers, and passwords necessary for access to electronic records; and contact information for legal and financial advisors. Be sure to list any life insurance policies, as beneficiaries will collect on those policies outside of the will. Any advance plans for the funeral and burial also should be mentioned in the letter of instruction.

Taxes on Gambling Winnings

Hitting the jackpot while gambling may feel a lot more like manna from heaven than remuneration for a good day's work, but as far as the government is concerned, those winnings might as well be wages as the results of wagering.

In short, the proceeds are ordinary income on which the winner owes income tax. By "gambling," the federal income tax code means coming out ahead in a wide range of betting settings, such as casinos, racetracks, and lotteries. Not only that, but income tax will be imposed where someone wins a prize instead of cash, in which case the provider of the prize will put a fair market value on the item won and report that to the IRS.

As a method of ensuring compliance, gaming establishments are required to report to the IRS, on Form W-2G, certain winnings, such as $1,200 or more from a slot machine or $5,000 or more won in a poker tournament. Also, in many instances, 25% of winnings over $5,000 will be withheld and sent to the IRS, not unlike the treatment of wages from employment.

Gamblers who are not in the trade or business of gambling need to report any of their winnings as "other income" on their Form 1040s. In some cases, especially where people have won large sums of money in lotteries, they may decide to sell the rights to future payouts from the lottery so as to reap most of the benefits from their good fortune immediately rather than having to wait a period of years for annual payouts. Depending on the individual, this may be a prudent choice to make, but it probably should not be driven by income tax ramifications. The money received from such a sale of the right to future payments is taxed as ordinary income, notwithstanding arguments made by some in that position that such a sale should receive capital gain treatment under the tax laws.