

Regulatory and Tax Update

IC-DISC Opportunities – Farmer Cooperatives

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OVERVIEW

- I. Objectives
- II. Patronage Dividend Requirements
- III. Structuring Considerations
- IV. Implementation
- V. Takeaways/Challenges

I. Objectives

1. IC-DISC provides permanent federal tax savings on export sales of up to nearly 16 percentage points.¹
 - Federated Cooperative System – Marketing Function
 - Federated System Export Income + Local Export Income = Potential Tax Savings

¹ Introduction of reduced tax rate for qualified dividends in 2003 and extended in 2012 has revived the IC-DISC. While U.S. trading partners decried the original DISC and foreign sales corporation, the IC-DISC added to the code in 1984 has not been challenged.

I. Objectives (Cont.)

2. Typical IC-DISC structure involves internal computations and support but does not affect how the exporter deals with customers and suppliers. ²
3. The IC-DISC does not have to generate customer invoices, lease office space, employ personnel or invest in fixed assets.

² Requires formation of corporation with minimal capital, commission agreement between IC-DISC and exporter, and submission of initial tax election and subsequent annual tax returns.

II. Patronage Dividend Requirements

1. Cash dividends to patrons (both Federated and local); equities do not translate to tax savings on export income.
 - Coops with export income need available cash intended for patron distributions to shelter/shift distributed cash from ordinary income to qualified dividend income

II. Patronage Dividend Requirements (cont.)

- Required of IC-DISC: Cannot hold cash (i.e. non-qualified export asset) beyond 60 days of IC-DISC tax year end (exempt entity!)

2. Direct Ownership.

- Only individuals and pass-through farm entities realize rate differential benefits;
- cooperatives/corporations not eligible for qualified dividend rate

III. Structuring Considerations

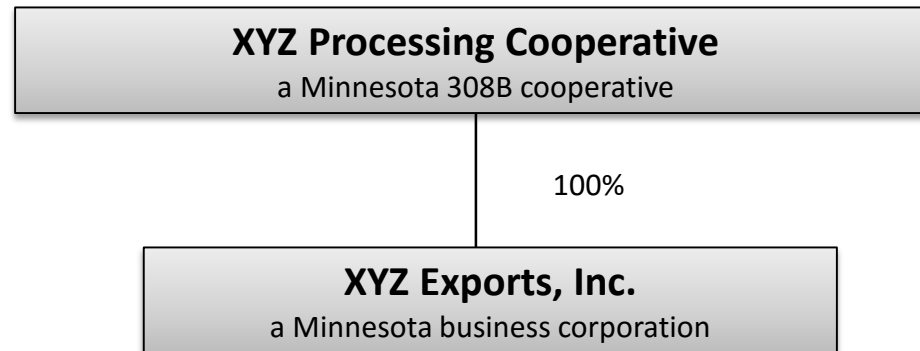
1. Requirements – A cooperative is not a pass-through entity; creating structuring challenges for a cooperative that wishes to take advantage of tax savings on export income.
2. Commingling Rules create challenges for Federated System and characterization and distribution of export income to Locals.

III. Structuring Considerations (cont.)

XYZ PROCESSING COOPERATIVE CORPORATE STRUCTURE

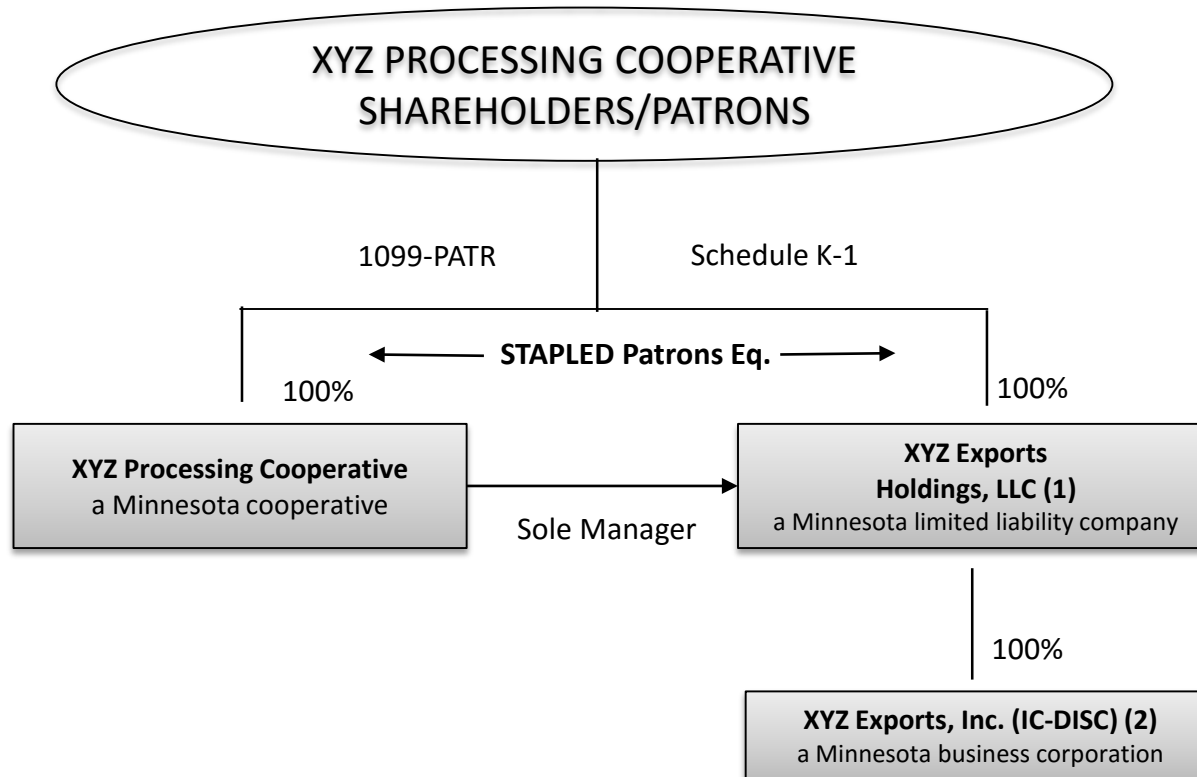
As of November 4, 2016

IC-DISC Cooperative Opportunities



XYZ PROCESSING COOPERATIVE CORPORATE STRUCTURE

Effective November 4, 2016



Footnotes:

- (1) The IC-DISC is a wholly-owned subsidiary of the LLC. The LLC income is limited to dividends paid and received from the IC-DISC; the amount and character of the dividend income received by the LLC will be paid and reported to patrons on Schedule K-1 from the LLC.
- (2) The IC-DISC's income is exempt from federal and state income tax and is limited to patronage-sourced commission income received under a commission agreement between the Exporter (XYZ Coop) and the IC-DISC.

IV. Implementation

1. The exporter company creates a domestic corporation to become the IC-DISC.
2. The shareholders of the domestic corporation (all shareholders) must consent to the election of IC-DISC status.
 - Export Holdings, LLC solves consent requirement

IV. Implementation (cont.)

3. The exporter company pays the IC-DISC a commission based on profitability of the export sales; the size of the commission is determined under specific statutory rules.
4. The exporter company deducts the commissions owed to the IC-DISC from its ordinary income (shifting taxable income to IC-DISC); DISC declares and pays qualified dividend to shareholder(s).

V. Takeaways/Challenges

1. Direct Ownership Requirement – Solved.
2. Commingling Rules – can be solved; lower risk.
 - Rev. Rul. 77-484 requires coop to set up systems to segregate fungible export property, such as grain, from non-export property
 - This is a FSC special segregation rule vs. a DISC rule (but DISC still subject to Rev. Rul. 77-484 (segregation))

V. Takeaways/Challenges (cont.)

- It appears that IRS position in 77-484 is not a strong one in the DISC area; it appears that the IRS has been unwilling to litigate on the basis of Rev. Rul. 77-484; IRS Field Service Advisory memo from 1995
 - Set up of segregation systems still needed
3. Aggregate 16% savings on Cooperative System Export Income.