

GLOBAL ACTION

A Newsletter of the **International Law Section** of the Cleveland Bar Association

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EDITOR'S NOTES

Mark J. Sundahl

In this issue of Global Action, our chairman, Bob Spira, shares the latest information about the upcoming International Law Section Seminar to be held at the Cleveland Metropolitan Bar Association offices (formerly the Cleveland Bar Association offices). This issue also features two articles, both of which address issues relevant to the exportation of goods. New opportunities for expanding export sales is one of the benefits of the weak dollar – and one of the few bright spots in an otherwise dark economic environment. The first piece, by Joseph Corsaro, explains how an interest charged domestic international sales company, or IC-DISC, can provide tax benefits to a client with foreign sales. The second piece, contributed by Bob Heintel, is a nutshell primer on export controls.

Please remember that submissions for future issues of Global Action are welcome and can be emailed directly to me for consideration. Submissions should be brief pieces (500-800 words) on a topic of interest to members of our section.

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A MESSAGE FROM THE CHAIR

Robert M. Spira

Please make your plans to attend the International Law Section Seminar on May 22nd at the Cleveland Metropolitan Bar Association offices. We are going to present a half-day program on topics of interest to lawyers practicing in the international arena. Topics will include: Doing Business in China, Legal Aspects of International Joint Ventures, and Commerce Department Assistance to U.S. Companies Seeking to Establish International Joint Ventures, as well as a follow-up to our 2007 Symposium on international business in Northeast Ohio.

Great topics! Great speakers! You will be receiving the details on the seminar soon if you do not have them already.

In addition to the seminar, the section has featured our "Global Forum" discussion groups throughout the year. Most recently, we had a very good session discussing international arbitration. The Forums are easy programs to put on. Very little preparation time is required. Please call me if you have a topic or topics that interest you.

As we move towards the end of the section's year, I want to be sure to recognize the leaders of our section: Tony Konkoly, Bob Heintel, Steve Petras, Dr. Mark Sundahl and Javier Pacheco, among others, have been the backbone of our section. Jon Yormick and Bruce Lowe have also made significant contributions. Also, I want to thank Reginald Russell for coordinating the participation of the CSU law students who have been attending our forums.

We are still one of the newest and smallest sections in CMBA. We need your support to be successful.

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TAX PLANNING FOR MANUFACTURERS WITH FOREIGN SALES

With an increasingly smaller world, merely understanding the tax consequences of domestic transactions is no longer good enough for your clients. This article recommends a tax planning strategy for manufacturers with foreign sales that maximizes tax efficiency in a new legal environment. Because of recent changes in the tax law, foreign sales income may be subject to higher tax rates in the future unless certain planning occurs.

In October 2004, the American Jobs Creation Act of 2004 ("AJCA") was passed which repealed the extraterritorial income exclusion ("ETI"). The ETI rules were designed to promote the export of U.S. manufactured products to foreign countries. These rules allowed a percentage of the income earned from the sale of qualified export property to be exempt from U.S. income tax. The AJCA reduced the benefit of ETI to 80% in 2005 and to 60% in 2006. As of 2007, the benefits of ETI no longer exist. In addition to the phase out of the ETI, the Jobs and Growth Tax Relief Reconciliation Act of 2003 reduced the dividend tax rate for individuals to 15% for dividends received from certain C corporations in tax years after December 31, 2002.

Notwithstanding the repeal of ETI, clients who export U.S.-manufactured products do not have to worry about a negative impact on the profitability of their foreign sales. By using an interest charged domestic international sales company ("IC-DISC"), your client may receive even greater tax benefits than under the ETI.

The IC-DISC was created by the Revenue Act of 1971 for eligible exports beginning on or after January 1, 1972. In 1984, the law changed, making it an "interest-charged" domestic international sales corporation because of requests from the European economic community.

The IC-DISC provides its owners the following benefits:

- Secures long term tax deferral; and
- Provides permanent income tax savings of roughly 20%

To be an IC-DISC, the corporation must be organized under the laws of any state or the District of Columbia. The shareholders select IC-DISC status by filing Form 4876, an Election to Be Treated as an Interest-Charge DISC, with the IRS. This election is considered to be in effect as long as the IC-DISC meets the following requirements: at least 95% of the IC-DISCs total receipts are "qualified export receipts"; and at least 95% of the adjusted basis of IC-DISCs are "qualified export assets"

An IC-DISC is also required to have only one class of stock, conform its tax year to that of the principle shareholder, and maintain separate books and records. In addition, an IC-DISC cannot be a member of any controlled group of which a foreign sales corporation is a member.

In general, 50% of the taxable profit of an IC-DISC attributable to foreign sales is sheltered from federal income taxation. This deferral usually takes the form of the operating company accruing a DISC commission deduction equal to the amount of the foreign taxable profits sheltered from current tax under the above-described formula, which results in a commission receivable on the books of the IC-DISC. This accrued commission is ultimately paid by the operating company to the IC-DISC and subsequently distributed to the IC-DISC shareholders. This distribution is treated as a C corporation dividend subject to the 15% federal income tax rate. It should also be noted that these benefits apply to architectural and engineering services on foreign construction projects and to the sale of certain computer software.

Example: Assume ABC Manufacturing Corporation has total sales of \$40,000,000. Of these sales, \$30,000,000 are domestic sales and \$10,000,000 are foreign sales. Further assume that the costs of goods sold and other expenses attributable to the foreign sales is \$6,000,000, thereby resulting in taxable profit of \$4,000,000 with respect to foreign sales. Under this scenario, there would be tax deferral (depending upon the timing of the actual distribution of foreign profits) and a permanent U.S. income tax savings in 2007 of \$400,000. This permanent savings could be even greater if foreign sales increase in future years.

To take advantage of this opportunity for 2008, one must act quickly. In general, you cannot take advantage of the IC-DISC rules until a new corporation is formed and various other technical requirements are satisfied. The foregoing discussion was hopefully somewhat straightforward; however, the actual design and implementation of an IC-DISC involves a variety of sophisticated tax rules and procedures. At Corsaro & Associates Co., LPA, we are skilled in designing and implementing IC-DISCs and would be pleased in assisting you in achieving these benefits for your clients.

Joseph G. Corsaro,
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PRACTICAL COMMENTS ABOUT U.S. EXPORT CONTROLS

Export control compliance is an area of U.S. regulatory compliance that can easily be overlooked by businesses. Unlike imports, which often have to physically pass through the control of U.S. customs, exports are less likely to come within the direct control of any U.S. regulatory agency while in transit. Also, export controls impact more than just the exportation of tangible goods. A business can easily engage in exporting activity that, unbeknownst to the business, violates U.S. laws or regulations. Fortunately, export controls affect a relatively small percentage of transactions. The purpose of this article is to highlight the regulatory issues most likely to affect exporting businesses.

The two key government agencies regulating exports are the Bureau of Industry and Security ("BIS"), within the Department of Commerce, and the Directorate of Defense Trade Controls ("DDTC"), within the State Department. Other

agencies, such as the Nuclear Regulatory Commission, also regulate exports, but the scope of their authority is so narrow that it is unlikely an affected business would be unaware of the applicable regulations.

BIS regulations contain restrictions and limitations on exports of particular products, technology and software. The exact restrictions depend upon the destination and end use of the products. The Commerce Control List ("CCL") of covered products is lengthy and varied. Although CCL items tend to be items that are high-tech, have very high-performance characteristics, or obviously could have some application in military or terrorist use, it is otherwise very difficult to generalize the items on the list.

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www.zimmerdesign.net

LINKS

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World Trade Center Cleveland:

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www.law.csuohio.edu

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Any exporting business should examine the CCL to get a feel for what it contains and then determine whether any of the business's products fall on the list. The CCL, and helpful information relating to the list, is available on the BIS website (www.bis.doc.gov).

DDTC regulations, the International Traffic in Arms Regulations ("ITAR"), govern weapons and military items and technology and therefore impact a small percentage of businesses. However, a business may make a single product or a few products specifically for a military application. Such a product very well may fall under ITAR. A business that sells any product designed for military use must be conversant with ITAR to ensure compliance.

U.S. country sanctions apply to nearly all products, and therefore any business involved in international trade should be aware of these restrictions. The U.S. imposes sanctions against only a small number of foreign countries, and anyone conversant with current events in U.S. foreign policy will already be aware of the most notable countries affected by sanction programs, such as Cuba, Iran and North Korea. It is therefore unlikely that a business will find itself inadvertently shipping in violation of U.S. sanctions. More likely, a business may believe that it can sell to customers who then ship into a sanctioned country, such as Cuba. Such attempts at "end runs" around sanction regulations are themselves violations. One can generally assume that a shipment which a business has reason to believe will ultimately end up in a sanctioned country will not be lawful no matter how the transaction is structured.

The lists of particular persons and entities subject to some type of export sanction or restriction are long and varied. These lists include domestic as well as foreign persons and entities. Any business selling a significant number of products for export, directly or indirectly, should be aware of these lists and should incorporate a system to check them with each order. No business can afford the publicity that would accompany a revelation that sales of its products are in some way helping to fund global terrorism.

Exporting businesses must also be aware of U.S. regulations prohibiting honoring foreign boycotts ("anti-boycott regulations"). However, because violations of anti-boycott regulations can often be avoided by the prospective customer's appropriate wording of its request, and any customer familiar with the anti-boycott regulations will use the appropriate wording, it is not common for a business to see an actual boycott request. It is more likely that a business will see something that on its face appears to be a boycott request, such as a requirement that no carrier of country X may transport the goods, when in fact this type of request is not considered a boycott request. However, any request from a customer that seems to impose restrictions relating to a particular country should be carefully reviewed in any case.

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UPCOMING EVENTS

The International Law Section Seminar will take place on May 22, 2008 at the Cleveland Metropolitan Bar Association offices located at 1301 East 9th Street on the second level (formerly the offices of the Cleveland Bar Association).

The International Law Section holds meetings on the second Monday of every month.

Please contact Alan Skerl, Assistant Director of Sections, at askerl@clevelandbar.org to be placed on the mailing list for updates or when seeking other information regarding section membership and activities.

This newsletter is intended to provide information to our members and related professionals and should not be considered as legal advice. Furthermore, the International Law Section of the Cleveland Bar Association is not responsible for the accuracy of the facts or the views expressed in any of the articles or case descriptions contained herein. Reproduction of this newsletter is prohibited without the express written permission of the International Law Section of the Cleveland Bar Association.