

# S CORPORATION ASSOCIATION

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October 24, 2006

The Honorable Bill Thomas  
Chairman  
House Ways and Means Committee  
1102 Longworth House Office Building  
Washington, DC 20515

The Honorable Charles Grassley  
Chairman  
Senate Finance Committee  
219 Dirksen Senate Office Building  
Washington, DC 20510

RE: Comments to Tax Technical Corrections Act of 2006 (H.R. 6264 and S. 4026)

Dear Chairmen Thomas and Grassley:

On behalf of the members of the S Corporation Association and the 3.2 million S corporations nationwide, we appreciate your introduction of H.R. 6264 and S 4026, the Tax Technical Corrections Act of 2006. Enactment of this measure will resolve numerous ambiguities in the Tax Code, improving compliance while providing certainty.

Per the Committee's request for comments, I would like to raise serious concerns regarding Section 7 of the Act which, if enacted, would significantly increase taxes on small and closely-held U.S. *manufacturing* exporters.

Since the 1970s, the EU has successfully challenged a number of U.S. tax provisions -- DISC, FSC, and ETI -- designed to mitigate the harm caused by their use of border-adjustable taxes and to assist U.S. exporters competing in the global marketplace. In each of these cases, the U.S. has been forced to comply with the EU challenge by eliminating the pro-export provision.

The IC-DISC (Interest Charge Domestic International Sales Corporation) was created in 1984 to allow the deferral of tax on IC-DISC income until it is repatriated as a dividend. The IC-DISC is different from DISC in that IC-DISC shareholders must pay interest on any deferred taxes. Because it requires shareholders to pay interest on any deferred tax liability, the EU has never challenged its legality under GATT or WTO.

Under the IC-DISC, a U.S. exporter pays the IC-DISC an annual "commission" equal to a percentage of its export income. This income accumulates untaxed within the IC-DISC. When the IC-DISC income is repatriated, it is distributed to the IC-DISC

shareholders in the form of a dividend. Since the repeal of FSC/ETI and the reduction in the dividend tax rate to 15 percent, the IC-DISC has become a very popular tool for small and closely held manufacturers seeking to increase their exports.

Section 7 of the Tax Technical Corrections Act of 2006 would increase the tax on IC-DISC dividends by making these payments ineligible for the lower 15-percent tax rate for dividends. This change would apply to dividends paid after September 29, 2006. Our objections to this provision are two-fold.

First, we believe this provision does not qualify as a technical correction. It is substantive, controversial, and would significantly impact revenues. The question of whether IC-DISC dividends should be taxed at 15 or 35 percent is a policy matter for Congress to determine through the normal legislative process, not as part of a bill reserved for technical and non-controversial adjustments to the tax code.

Second, Congress should oppose raising taxes on domestic exporters. While U.S. exports are on the rise, particularly from smaller manufacturers, it is critical that this growth continue for the United States to continue making progress toward addressing our current trade imbalance. Following the repeal of the most recent RSC/ETI regime, the IC-DISC provisions are the sole remaining tax provisions targeted directly at U.S. exporters. Given the current size of the U.S. trade deficit, it makes little sense for Congress to act unilaterally to harm small and closely-held manufacturers and other exporters.

Based on these concerns, we urge you to support America's small and closely-held exporters and remove this provision from the Tax Technical Corrections Act.

Thank you for your consideration of our comments and we would be pleased to discuss this matter further with you as you work to complete this bill.

With best regards,

Tom McMahon  
Vice President/Operations  
Barker Company (Iowa)