State of Louisiana
Department of Revenue

Revenue Ruling
No. 02-010
August 26, 2002

Corporation Income Tax and Individual Income Tax

Conformity With the Federal Extraterritorial Income Provisions

Issue: Is the federal exclusion for extraterritorial income recognized for Louisiana corporation and individual income tax purposes?

Discussion: Federal income tax incentives that promote export trade have existed since the early 1970s. These incentives were created to encourage U.S. exports and discourage U.S. corporations from moving their foreign sales operations to low tax countries.

The first such incentive was the domestic foreign sales corporation (DISC). Under the DISC provisions, a company was allowed to follow a more favorable income tax regime that allowed a certain portion of the DISC's income to be nontaxable or tax deferred. The DISC structure allowed a fixed percentage of the DISC's income to be treated as if earned by the parent corporation and thus was taxable, but the remaining income was treated as offshore income and therefore free from tax unless distributed to its U.S. parent as a dividend. The DISC was determined to be a violation of international trade principles under the General Agreement on Tariffs and Trade.

Congress then created the foreign sales corporation (FSC) as a replacement for the DISC. A FSC is a foreign corporation with a U.S. parent set up to handle the export activities of the parent. The FSC must have a genuine foreign presence and its income must be attributable to substantial commercial activity outside the U.S. Only the foreign trade income of a FSC is subject to the favorable FSC taxing rules**.** A FSC generally is not subject to federal income tax on its exempt foreign trade income, which is generally 15/23rds, or about sixty-five percent of its total foreign trade income. However, the FSC does pay federal income tax on its non-exempt foreign income. The exempt foreign trade income of a FSC is treated as foreign-source income that is not effectively connected with the conduct of a trade or business within the United States. In addition, the U.S. parent corporation of a FSC generally is not subject to U.S. income tax on dividends distributed from the FSC out of certain earnings because the parent is allowed a dividend received deduction for the dividends it receives from the FSC equal to 100% of the dividend income.

In November 2000, the United States Congress enacted Public Law 106-519, the FSC Repeal and Extraterritorial Income Exclusion Act of 2000 (the Act), in response to the World Trade Organization Appellate Body ruling that the FSC regime constitutes an illegal export subsidy. The Act disallowed the creation of new foreign sales corporations and created an exclusion for extraterritorial income. Extraterritorial income (ETI) is the gross income of the taxpayer that is attributable to foreign trading gross receipts. Under Section 114 of the Internal Revenue Code, extraterritorial income is not included in the federal gross income of corporate or individual taxpayers to the extent that it is qualifying foreign trade income. The ETI provisions also disallow any deduction that is allocated to ETI that is excluded from federal gross income. Unlike the DISC and FSC provisions, the ETI provisions do not require the formation of a special entity to which sales are made. Also unlike the FSC provisions, the ETI provisions apply to corporations and individuals in the same manner.

For Louisiana corporation income tax purposes, the starting point for determining Louisiana taxable income is federal gross income. Federal items of income and deduction are included in determining Louisiana income unless there is a specific modification. There are specific modifications that address the DISC and the FSC in La. Rev. Stat. Ann. § 47:287.734. Both the DISC and the FSC were regarded as federal tax incentives that need not be recognized for Louisiana corporation income tax purposes. The DISC and FSC are taxed for Louisiana purposes as if they were any other corporation. In addition, the parent corporation of the DISC or FSC must modify its federal gross income to add back any income not included in its gross income because of the existence of the DISC or FSC. No similar statutory modification has been enacted with respect to the exclusion of extraterritorial income and related deductions, and the DISC and FSC provisions are very specific and cannot be extended to apply to extraterritorial income.

Unlike the DISC and the FSC, the extraterritorial income exclusion and disallowance of related deductions is also applicable to individual taxpayers. The starting point for determining Louisiana tax table income is federal adjusted gross income. Any additions or subtractions from federal adjusted gross income used in determining Louisiana tax table income are specifically set forth in La. Rev. Stat. Ann. § 47:293. Because there are no modifications to adjusted gross income for extraterritorial income and related deductions in R.S. 47:293, the exclusion is followed for Louisiana individual income tax purposes.

Conclusion:

For corporate income taxpayers, extraterritorial income will be excluded from gross income for Louisiana income tax purposes to the extent it is properly excluded from federal gross income. For individual taxpayers, extraterritorial income will be excluded from Louisiana tax table income to the extent it is properly excluded from federal adjusted gross income. For both corporate and individual income taxpayers, deductions allocated to ETI that are disallowed for federal purposes are also disallowed for Louisiana income tax purposes. This revenue ruling does not alter the application of the FSC and DISC modifications.

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