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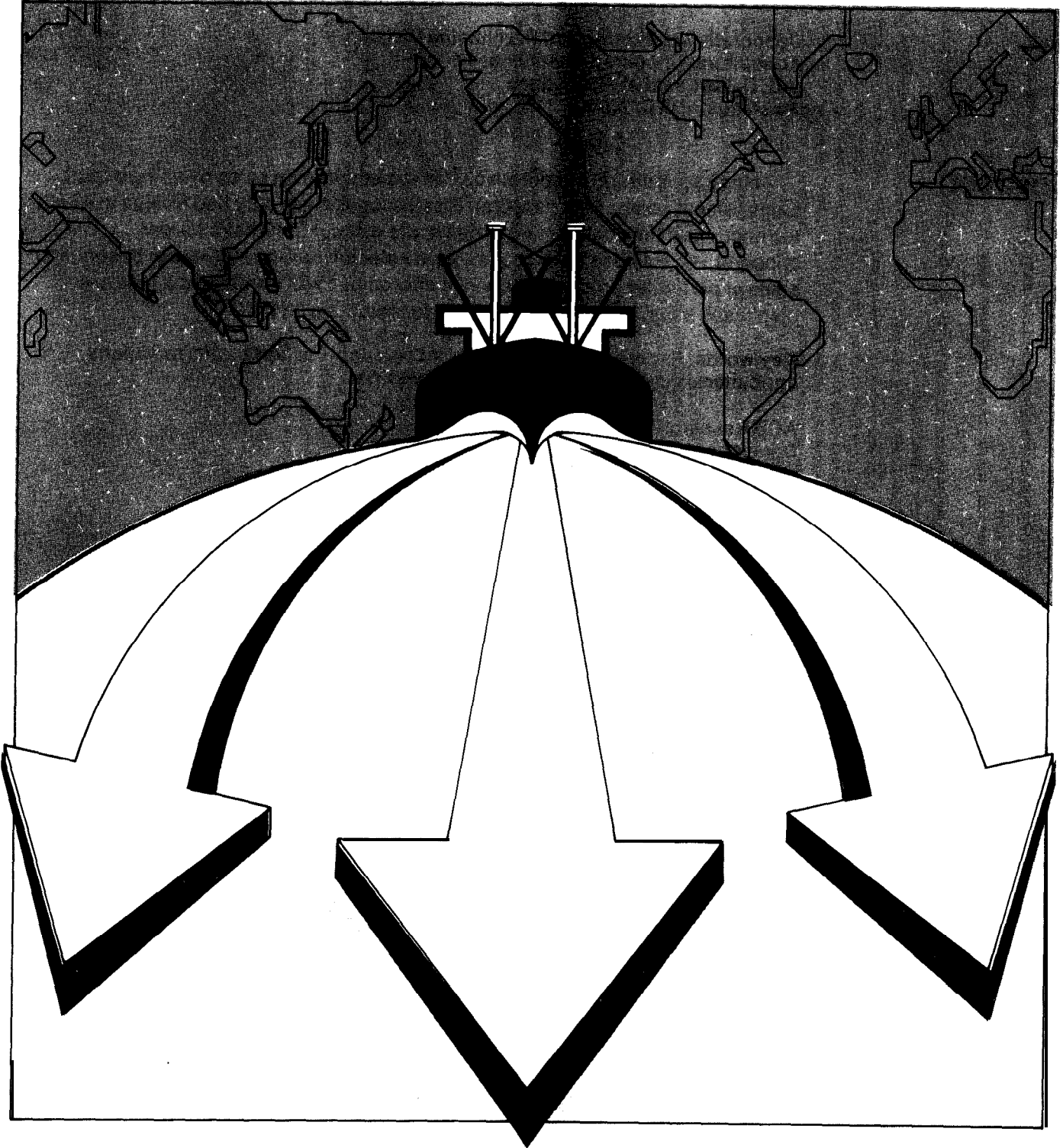


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Using Export Companies to Expand Cooperatives' Foreign Sales



**Using Export Companies
to Expand Cooperatives' Foreign Sales**

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Abstract

Many agricultural cooperatives can expand foreign sales by using export management companies (**EMC's**). Small cooperatives may find foreign markets too costly and time consuming to penetrate without EMC help. Larger cooperatives may use **EMC's** for sales in selected foreign markets or to enhance sales of particular products. Services offered by **EMC's** and typical fees are discussed along with some guidelines for selecting an EMC.

Key words: Export, export management company, export trading company, agricultural cooperatives, export performance.

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Contents

| | |
|----|---|
| iv | Highlights |
| 1 | Types of Companies and Definitions |
| 2 | Description of Companies |
| 3 | Typical Services Provided by Exporting Companies |
| 4 | Products Handled |
| 5 | Market Coverage |
| 6 | Fees, Margins, and Costs |
| 7 | Ownership and Financial Structure |
| 7 | Advantages of an EMC or ETC |
| 8 | Disadvantages of an EMC or ETC |
| 9 | References |
| 10 | Appendix A: Export Trading Company Act of 1982 |
| 12 | Appendix B: Tax Reform Act of 1984: Foreign Sales Corporations |
| 15 | Appendix C: Quick Reference chart for FSC's |

Highlights

Export management companies (**EMC's**) can help cooperatives expand exports. Historically, EMC's have assisted export operations of domestic companies in two major ways. First, as a commission house the EMC finds the foreign buyer, negotiates the sales terms, prepares export documentation, and arranges ocean freight. Financing and risk of collections, however, remain with the seller. Second, the EMC does all of the above, plus accepts collection and financing risk. To the supplier, the sale is like a domestic sale. Today, the second method is used almost exclusively.

EMC's exist under many names. Export trading company (**ETC**) is most common. Regardless of name, most companies provide services characteristic of either type of company.

Some specialized types of companies exist. These include Title II (antitrust exemptions for groups of exporters) and Title III (banks with equity ownership) export trading companies. Foreign sales corporations (**FSC's**) are foreign-based companies handling U.S. exports that receive beneficial Federal income tax rates on export earnings. Most domestic international sales corporations (DISC's) were replaced with **FSC's**, but some small ones still exist. DISC's also generate Federal income tax benefits for U.S. exporters. **Webb-Pomerene** associations provide limited antitrust exemptions for groups of U.S. exporters. Only a handful of these associations remain active. EMC's or **ETC's** may establish **FSC's**, DISC's or Webb-Pomerene associations.

EMC's or **ETC's** can be broadly classified into three groups. One group primarily handles processed food products such as those on grocery store shelves, or ready for use by institutional buyers. This group has the largest number of companies. A second group specializes in fresh fruit and vegetables. This is the smallest group of companies. A third group handles primarily bulk agricultural commodities such as grains, oilseeds, and products. This group has the largest dollar value of exports and is dominated by large multinational companies.

This study focuses on the first two groups of companies. The third group is characterized by large economies of scale in trading operations, and exports in a much different manner from the first two groups.

Most export companies are small, with revenues under \$10 million and fewer than 20 employees. Despite few employees, most companies provide a wide range of export services. Their major contribution to the export process is long experience in international trade, and many contacts with potential foreign buyers. A typical export company has been in business 15 to 20 years, and has principal traders with more than 20 years' experience. It is common for a small export company to have contacts with 100 or more foreign buyers, and purchase products from 20 to 80 sources. Larger companies may sell to more than 200 buyers.

While export companies may be located anywhere, most are concentrated at port cities. Fresh fruit and vegetables exporters are concentrated near production areas to facilitate grower contact and inspect produce.

Export companies seldom conduct formal market development. They rely on experience and extensive contacts with foreign buyers to test new products.

Products requiring long-term development or much training or consulting on how to handle, process, or use will be avoided by many export companies.

Export companies claim they will trade with any country. As a practical matter, most companies conduct most trade in a few regions. This regional focus usually arises from how exporters establish markets. Export companies with regional marketing rights to a major branded product emphasize complementary products in those same markets. Buyers encourage this by asking exporters handling the branded product to supply it with other products. This also saves on transaction and transportation costs.

Exporters continually search for new products to export. They are most interested in high-quality, nationally advertised products. Buyers with access to U.S. food service magazines often request that exporters supply advertised products.

Most exporters prefer exclusive rights to export a product. Exclusive rights may free the exporter from the cut-throat price competition that may otherwise occur. Pricing freedoms thus gained may be marginal, however, because other exporters may procure the product from domestic wholesalers and export to the same market. If a product requires much market development, the exporter may require exclusive rights to protect against the high costs of developing sales. Marketing agreements of 1 to 3 years are common.

Exporters usually acquire goods from the supplier much like a domestic sale. The exporter takes title to the goods, prepares documentation, and ships to the foreign buyer. The exporter assumes risk of collections and may provide **short-term** financing. Typical margins for this service range from 4 to 7 percent of product value. Unprocessed fruit and vegetable exporters usually have margins of 1.5 to 4 percent. Large sales of processed products may also have margins between 1.5 to 4 percent. Products requiring additional services or requiring long-term market development may require significantly higher fees.

Exporters not assuming risk of collections nor providing interim financing usually charge lower fees. Fees for established products with moderate sales volume range from 2 to 4 percent. Large sales with minimal services typically carry fees near 1 percent.

There are several advantages to using export companies. Perhaps the most significant is faster foreign market penetration with a lower initial investment and less risk. Small suppliers may not be able to effectively export without using these companies. Other advantages include lower costs to some markets, quicker payment for goods exported, distribution to more markets, and nearby expert advice if export problems develop.

Likewise, there are several disadvantages to using export companies. The supplier has less control over handling, distribution, and pricing of its exports. Large suppliers may find it less costly to conduct their own export operations. Some exporters serve only a few markets, and a supplier exporting to many markets may need several export companies. Also, many export companies are not well equipped to do market development of new or specialized products. Finally, low margins on food products may make some exporters give preference to other products. Even within the food group, more highly processed products usually carry larger margins, and may receive more attention from export companies.

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Export companies come in all sizes, types, and configurations. In addition, most companies calling themselves by a particular name often perform services typical of companies referring to themselves by other names. In short, the company name may not always indicate services performed.

TYPES OF COMPANIES AND DEFINITIONS

Historically, the two most common types of export companies are export management companies (EMC's) and export trading companies (ETC's). The latter is the most important in exporting food and agricultural products.

Other organizations arising out of trade-related legislation are aimed at facilitating exports or providing export incentives. These include domestic international sales corporations (DISC's), foreign sales corporations (FSC's), ETC's organized under the Export Trading Company Act of 1982, and Webb-Pomerene Associations. Export trading and export management companies may also be organized as or be a member of one of these types of companies. Highlights of these types of organizations follow.

The terminology describing an EMC or an ETC is changing. Today, many more companies call themselves ETC's even though they still function occasionally as a commission agent. Even though a company may call itself one name or the other, it usually provides services typical of either type.

Export Management Companies (EMC's)

Traditionally, the export management company, as the name implies, managed exports for other companies and did not take title to goods or trade for their own account. The EMC acted as the export department for another company, taking over most of the technical export responsibilities.¹ The EMC found buyers in foreign markets, negotiated the sale including delivery and payment terms, prepared export documentation, handled document transmittal, collected from the buyer, and remitted funds to the supplier. The EMC usually was paid

¹U.S. Department of Commerce, U.S. *Export Management Companies*, Washington, DC, 1981, p. 189. Some publications refer to export management companies as a type of export representative. For two definitions, see National Association of Export Companies, Inc. (NAEC), *A Profile of the Export Trading Company Industry*, New York, NY., 1981, p. 3. and Hav Associates. *A Study to Determine the Feasibility of the Export Trading Company Concept*, unpublished report to the U.S. Department of Commerce, March 1977.

commission but may also have received a salary, a retainer plus commission, or other compensation negotiated in advance with the supplier. Payment risk and title, however, usually remained with the supplier, the EMC being only an intermediary.

In exporting food products, EMC commission arrangements are declining and account for only a small percentage of sales. Both suppliers and exporters now prefer that the EMC take title to goods and accept the accompanying risks.

Export Trading Companies (ETC's)

Export trading companies are characterized as principals in export of goods and services. They purchase product from suppliers, often on similar terms as for domestic sales, export the product, and then collect from buyers. They conduct all export-related activities plus assume title and payment risk. Compensation for their services comes from the difference between buying and selling prices the ETC is able to negotiate. ETC's are sometimes referred to as export distributors.*

The Export Trading Company Act of 1982 established rules under which U.S. companies can join to export goods and services. The Act differs from prior legislation, the Webb-Pomerene Act, in that it allows banking interests to have equity investments in trading companies (Title II). In addition, the Act provides limited antitrust protection by giving qualified ETC's prior clearance to engage in specified export trade activities (Title III). Any exporter may apply for antitrust certification. The legislation defines export trading companies in broad terms, so ETC's under the Act may not resemble the types of ETC's described above. Requirements to set up regulations governing Title II and Title III ETC's are reviewed in appendix A.

Foreign Sales Corporations (FSC's) and Domestic International Sales Corporations (DISC's)

As part of the Deficit Reduction Act of 1984, Congress made significant changes to the DISC. DISC's were essentially paper corporations allowing exporters to postpone a portion of their Federal income tax on exports. Changing from DISC's to FSC's was primarily in response to complaints from several foreign countries that DISC rules created an illegal export

²U.S. Department of Commerce, 1981, p. 189.

subsidy under terms of the General Agreement on Tariffs and Trade. In most cases, DISC's are replaced with FSC's.

An FSC is a new legal entity providing tax incentives to exporters. Under the legislation, a portion of foreign trade income of an FSC is exempt from U.S. income tax. To obtain the exemption, an FSC must meet certain requirements. Unlike a DISC, the FSC must be a foreign corporation and meet certain economic activities tests. FSC provisions and regulations are reviewed in appendices B and C.

Other Export Associations

Webb-Pomerene associations allow U.S. suppliers to join to fix prices and allocate market shares when exporting. Only a few associations have existed and most have been inactive over long periods of time. These associations may apply for certification under the Export Trading Company Act. Although Webb-Pomerene associations may still be formed, the number of associations will probably decline.

Terminology Used in this Report

This report focuses on EMC's and ETC's as two generalized forms of export trading companies. Today they are essentially the same. The term EMC is sometimes used to refer to companies exporting under commission arrangements with title and acting as principals in the export transaction. The term "exporter" or "export company" is used to refer to both types of companies. Export companies organized under the Export Trading Company Act with banks as equity participants or with antitrust certification, will be referred to as Title II and Title III ETC's, respectively.

Export management and export trading companies handle a wide variety of products and services. The description that follows focuses on those that export agricultural and food products. References to "all exporters" means those handling all products, including nonagricultural as well as agricultural and food products.

ETC's Are Most Common

The ETC is by far the most important type of exporting arrangement for agricultural and food exports. With agriculture and food commodities, including many nonfood consumer goods typically found in supermarkets, almost all transactions are conducted on a buy/sell basis. Few commission sales still occur. In most cases, both the export company and supplier prefer a buy/sell relationship.

Taking title provides the exporter complete control over shipment, documentation, and collections. Suppliers prefer this arrangement, which resembles a domestic sale, because it

allows them overseas distribution of their products without the costs and risks of exporting.

Even if approached by a supplier to work on a commission basis, most export companies are reluctant to do so, as they feel suppliers may eventually "quit" the export company to supply directly markets developed by that exporter.

To be sure, most export companies will, if requested, provide management services for commission, but report they are seldom asked to do so.

DESCRIPTION OF COMPANIES

Location

While exporting companies are spread throughout the United States, most are in port cities. For agricultural and food products, there is some concentration of companies in New York, New Orleans, Los Angeles, and San Francisco. In general, export company offices may be located anywhere. An important exception is that a California location is preferred for fresh fruit and vegetable exporters to Pacific rim countries. Office location should not affect performance as long as the location permits efficient international communications. International travel is easier from large cities and remote location may reduce direct contact with foreign buyers. Travel by employees of the exporting company in a remote location would also be more difficult, but for the two to five trips per year typical for each trader, the inconvenience and extra cost are small.

Age

Most exporting companies have considerable trade experience. Spiewak and Maritz reported 36 percent of all exporters had been in business 20 or more years and 62 percent had been in business 10 or more years.³

Principal owners and traders usually have many years of experience in international trade. Most companies in business 10 or fewer years have principal owners with many more years of international trade experience.

Despite the longevity of many traders, there is significant entry and exit by companies in the industry. Because of the low cost of entry, there will always be new small exporting companies. Many companies are closely tied to one or a few principal traders and may go out of business or be absorbed by other companies when a principal trader leaves. However, there is some evidence of a trend toward larger exporting companies.

³Spiewak and Maritz, p. 6.

Revenues

Most exporters are small. In 1983, two-thirds of exporters had annual revenues of less than \$5 million.⁴ Only 2 percent had revenues exceeding \$50 million. Exporters handling agricultural commodities and food products usually have larger gross revenues than export companies handling manufactured products, but they also have smaller margins. Even so, many successful and well established export companies specializing in agricultural and food exports have annual gross revenues of less than \$10 million.

Employees

In line with their small revenues, most export companies have few employees. A minimum size for effective operations seems to be two or three traders and associated clerical assistance. Some companies may have a few more but only the largest companies would have 20 or more employees.

Foreign Offices and Contacts

Export companies rely on extensive foreign contacts, but few maintain foreign offices. In fact, the reason these companies exist is they are specialists in identifying opportunities for trade in foreign markets. They have contacts in many countries and have extensive experience in identifying products that will sell in foreign markets. For products that appear promising, exporting companies usually know or can find importers or distributors willing to test market the product in their countries.

Developing Foreign Markets

Few export companies conduct formal foreign market research and development. Most rely on their own and their agent's extensive knowledge of specific markets to identify opportunities and position products. Significant market development efforts are dependent of the foreign distributor or importer, which often limits market development to products that can quickly generate large sales. New products requiring large amounts of training or consulting on how to handle, process, or use are unlikely to receive serious consideration. Larger export companies are more likely to undertake market development efforts, but even their efforts may be limited for some products.

Only a few larger export companies have overseas employees or offices. Having foreign employees, however, does not necessarily mean an exporter will dedicate much time to longrun market development programs. The low export margins for agricultural and food products usually do not allow such expenditures regardless of whether the foreign

contact is an employee or an independent agent.

Some companies may provide foreign warehousing and distribution services, but this has little bearing on whether the exporter would be willing to undertake longrun market development.

Number of Suppliers and Customers

Exporting companies typically obtain export products from many suppliers, and supply product to many foreign customers. It is common for a small food exporting company to purchase products from 20 to 80 sources and to sell to a hundred or more buyers. Large exporters may deal with 100 to 200 suppliers and an equal number of buyers.

Usually a large percentage of product traded by either large or small exporters is accounted for by a few suppliers and a few buyers. A typical small exporting company may have 5 to 20 suppliers and an equal number of buyers that account for a two-thirds or larger share of the business. Spiewak and Maritz reported 63 percent of all exporters had 60 percent or more of their business represented by the top 5 suppliers.' It is typical for an export company to have several major branded products it distributes to markets in one or more regions. Orders for less than a full shipping container load of branded products are filled out with a variety of other products. Some of these may be products the exporter normally ships, or it may be products the importer has requested.

TYPICAL SERVICES PROVIDED BY EXPORTING COMPANIES

Table 1 indicates services offered by all export companies. Locating and training foreign distributors, agents, and buyers is the most frequent service offered. Other frequently offered services include setting or recommending prices, conducting market research, foreign language assistance, credit analysis, participation in trade shows, and arranging for servicing products overseas.

Companies exporting food and agricultural products offer similar services, but some less frequently than indicated in table 1. For example, 91 percent of all export companies reported "always" or "sometimes" offering foreign language assistance. Agricultural products, however, are purchased from the U.S. supplier much like a domestic sale, with the export company handling documentation, shipping, and collection arrangements. The U.S. supplier has little need for foreign language assistance.

For similar reasons, exporters seldom provide credit

⁴Spiewak and Maritz, p. 7.

⁵Spiewak and Maritz, p. 13.

Table 1 -Frequency of services provided by all export companies

| Service | Always | Some-times | Never |
|--|----------------|------------|-------|
| | <i>Percent</i> | | |
| Locating distributors, agents, buyers | 62 | 14 | 4 |
| Setting or recommending prices | 62 | 31 | 5 |
| Market research' | 50 | 42 | 6 |
| Providing insurance | 46 | 32 | 20 |
| Acting as own freight forwarder or shipper | 46 | 39 | 32 |
| Advertising assistance | 37 | 42 | 20 |
| Assisting in developing packaging and labels | 27 | 51 | 20 |
| Modifying products | 10 | 55 | 33 |
| Foreign language assistance' | 56 | 35 | 6 |
| Credit analysis' | 55 | 33 | 10 |
| Participating in trade shows' | 39 | 50 | 9 |
| Training of distributors and/or agents' | 6 | 37 | 13 |
| Arranging for servicing products overseas' | 36 | 47 | 14 |
| Arranging licensing for foreign manufacturing' | 9 | 9 | 41 |
| Arranging warehousing' | 17 | 52 | 29 |
| Warehousing in own U.S. facilities' | 19 | 34 | 45 |
| Warehousing in own facilities abroad' | 10 | 21 | 66 |

Source: Spiewak and Maritz, p. 16.

¹ Companies exporting agricultural and food products provide these services less frequently than indicated here.

information to suppliers, although they routinely conduct credit analysis for in-house use. Exporters will, however, supply credit information to suppliers they represent on a commission basis.

Participation in trade shows is usually a minor activity for exporters of agricultural and food products. Most participate in occasional shows, often at the request of a supplier or foreign importer.

Agricultural and food products seldom require training of foreign distributors or agents because importers are usually familiar with these products before ordering. If requested by importers, export companies will provide product literature obtained from the supplier. Agricultural and food products usually do not require servicing of products overseas.

Most export companies handle export documentation in-house, but still retain services of freight forwarders for special documents such as consular invoices, and for document transmittal. Some exporters can prepare documents in less

time than it takes to transmit the information to a forwarder.

Companies exporting food and agricultural products seldom perform the last four licensing and warehousing functions in table 1. There are few requests to license foreign processing of food products. Most exporting companies indicate they are willing to assist in licensing requests but are seldom asked.

Foreign warehousing services are seldom provided by exporters, except for a few larger traders. Likewise, few exporting companies own or operate domestic warehouse facilities. Many companies will, however, arrange for U.S. port warehousing if desired by the supplier. In the food industry, it is more common for suppliers to deliver products to dockside and provide temporary warehousing if necessary. With container shipments, dockside warehousing should seldom be needed.

PRODUCTS HANDLED

Export companies usually specialize in a few, related products, although, as mentioned, they may deal in a large number of different products by request of customers and suppliers. In the food and agriculture sector, exporting companies have specialized in three major areas. These are processed food products; fresh fruits and vegetables, including nuts; and bulk grains, oilseeds, and related products.

Processed Food Products

Processed food product companies are the largest group. Their expertise lies in exporting products in consumer-ready packages for retail sale and in institutional food service products. Headquarters location may be less important for this group than for the other two.

This group of companies has a strong preference for well-established regionally or nationally branded consumer products. Foreign buyers with access to American trade and food industry magazines often see products advertised that they believe will sell in the markets they serve and often request these products by brand. Brand name requests are often used to assure product quality.

Because of strong brand preference by foreign buyers, there is intense competition by export companies to obtain trading rights to these products. Successful exporters in the processed food products group usually have obtained representation rights to one or more nationally advertised products. The exporting companies may represent the product worldwide, although it is more common to represent it in selected regions. Although desired, the export company may not have exclusive rights even in the markets it serves.

Exports companies having exclusive rights to a nationally branded product are more willing to incur expenses and take time needed to conduct market development in foreign

markets. If a significant expenditure of time and money is expected, an export company may require a long agreement or, occasionally, a retainer. Extended marketing agreements are usually for 1 to 3 years, with the shorter periods being more common. Terms of an agreement can be quite flexible and are subject to negotiation with each supplier, and perhaps in each region or market. Marketing agreements are usually contained in letters of understanding. Formal written contracts are seldom prepared, except where large market development expenditures are likely to be incurred by the exporter.

Fresh Fruits, Vegetables, and Nuts

Companies that export fresh agricultural products tend to be located near production areas. The largest concentration in the United States is in California, and within California in the San Francisco Bay area.

While still important, brand identification is less a factor for fresh than for processed products. Products are often purchased based on U.S. Department of Agriculture grades specified in the sales contract. Branded products, however, are sometimes requested by buyers to help ensure quality.

Companies that export fresh products make significant efforts to ensure consistent product quality to buyers. Larger companies often employ field inspectors to examine product at packing houses. Buyers may request product from particular packers that have reputations for high quality. Of course, price must be competitive.

Bulk Grains, Oilseeds, and Related Products

While fewest in number, these companies are largest in volume of sales. This sector is dominated by large multinational export companies. Economics of scale preclude small companies from having anything but a peripheral role in exports of grains and oilseeds.

Other Commodities

Two commodities that do not fit neatly into the above classifications are cotton and rice. Several exporting companies specialize in cotton exporting. While U.S. cotton is usually exported as a bulk, unprocessed agricultural product, marketing requirements for quality usually make selling methods more like processed food products than bulk grains and oilseeds.

Several regional cotton marketing cooperatives make export sales of cotton through **Amcot**, a joint marketing agency. This joint arrangement provides centralized representation by **Amcot** personnel in foreign markets, while each individual cooperative continues individual merchandising by its home sales staff.

Rice may be marketed as a processed food product or as a bulk grain. When marketed like a processed food product, rice is usually packaged in bags, and often shipped in containers. Many export sales are prepackaged for retail consumer or institutional use. Ocean shipping is often via scheduled ocean liners. Sales contracts specify specific qualities, and are usually in smaller lots than bulk grains. Because trading methods are the same, some exporting companies handling processed foods also handle rice exports. These companies are usually the larger exporters.

When rice is marketed as a bulk grain, it may be bulk loaded into ships but is usually bagged. Sales quantities are usually large. Ocean shipping is typically via charter ships. Exporters of bulk grains and **oilseed** often market bulk rice as well.

Support by the Supplier

Regardless of product exported, companies that buy and sell for their own account and those that sell on commission stress the need for support from suppliers. Even though the trading company may take title and bear the risk of delivery and collections, it is important that a supplier cooperate with respect to product quality, continuity of supply, and label content. The supplier needs to be willing to modify product or packaging or shipping schedules, or other items to adapt to foreign market preferences. This requires the supplier be committed to exporting for the long term.

MARKET COVERAGE

Regardless of size or location, most export companies are willing to trade with any country. As a practical matter, however, many companies, especially smaller ones, conduct most trade in a few regions. There are several reasons. First, export companies having regional marketing rights to a major branded product will emphasize marketing of complimentary products in those same markets. This occurs naturally because many buyers request an exporting company handling the branded product to supply it with other food and consumer products. Economics of scale in transportation and document preparation also encourage sales of different products to the same market.

A second major reasons companies today operate in only a few markets is because under current economic conditions, some regions are only limited importers. Europe, for example, is a limited market for many U.S. food products. Much of Latin America lacks sufficient foreign exchange for imports. Certain Middle Eastern and Pacific Rim countries are the most important importers of processed food products from the United States. Many export companies are active in these markets.

While export companies in general are willing to trade with any country, they might not market a particular product in a

particular country. For most exporters, the nature of the product to be exported is the most important criterion in deciding to promote a product. If the product is a high-quality, nationally advertised product the company believes will sell, the exporter may undertake to introduce it not only in the markets it currently exports to, but in other markets as well. The “right” product may very well be the entry vehicle for the exporter into new markets.

It is difficult for the exporter to find high-quality products with sufficient sales potential to establish new markets. Even if discovered, the exporter will likely face intense competition from other companies that are seeking market rights to the same product.

Not all export companies are equally skilled or have as many contacts as others. A U.S. processor or producer seeking an exporting company should determine which exporter or combination of exporters can best represent it in markets where it believes its product will sell.

Most, but not all, exporters prefer exclusive rights to a product in as many markets as they can effectively serve.⁶ Exclusive marketing rights may free the exporter from cut-throat price competition that may otherwise occur. Pricing freedoms thus gained may be marginal, however, because other exporters can likely procure the product from wholesalers and brokers and sell in the same market.

Exclusive rights agreements are usually longer term agreements and may pose some risks for both exporter and supplier. If the product is not successful, the exporter may not be able to drop the line and handle competitors’ products. Likewise, if the exporter with exclusive rights does not effectively promote the product, the supplier may not be able to select another exporter. In summary, granting exclusive marketing rights has potential to improve profit levels, but risks are involved for both.

FEES, MARGINS, AND COSTS

Nearly all export companies handling food and agricultural products trade for their own account. The exporter procures product from the supplier at domestic wholesale prices or a lower negotiated price; for example, domestic wholesale price less domestic sales overhead. Terms are usually either free on board (f.o.b.) manufacturing plant, in which case the exporter will arrange to have a container shipped to the plant for loading, or f.o.b. or free along side (f.a.s.) port, in which case the supplier pays freight to port.

⁶Exclusive marketing rights means a supplier sells to only one exporter for a particular market. Likewise, the exporter does not sell competing products in that market.

Export companies trading food and agricultural products on their own account typically work with small margins compared with companies exporting nonagricultural products.⁷ Most of these companies try to obtain margins of 4 to 7 percent. Unprocessed fruit and vegetable exporters usually have lower margins, typically 1.5 to 4 percent. Large-volume sales may also obtain lower margins.

Exporters trading for their own account usually accept risk of delivery and collections. Product damaged or lost in transit is usually covered by insurance. Political and commercial risks are also usually assumed by the exporter, although in some cases these can be insured. Exporters usually assume risks for losses based on documentation, and customs problems. Some exporters also assume the risk of labeling and assuring that products meet quality and safety standards in the importing country.*

Risk of product quality may or may not be assumed by the exporter. Claims against product arriving in poor quality will likely be made against the transportation company, the exporter, or both depending on the circumstances of the situation. Exporters, however, will usually look to suppliers for satisfaction of claims against product quality.

Fresh fruit and vegetable exporters often obtain U.S. Department of Agriculture inspection certificates for their products. Claims against product arriving in poor quality may be defended based on the USDA certificate. If not successful, an exporter will still look to the supplier for redress of any losses suffered because of product quality.

Interim financing—financing between the time the exporter must pay the supplier and the time the exporter can collect from the buyer—is usually assumed by the exporter. If interim financing needs are especially large, exporters may discount receivables at commercial banks.

In certain circumstances, export companies still work on a commission basis. This was more common in the past and several suppliers with longstanding export management company arrangements retain those relationships.

Export companies acting as commission agents negotiate

⁷Margins as referred to in the next few paragraphs equal selling price to foreign buyer less the sum of procurement price paid to supplier, transportation costs, and ocean freight insurance costs. Other exporter costs such as documentation, communications, salaries, short-term interim financing costs, and office overhead are paid out of margins.

*Assuming risk of labeling and antiboycott restrictions is an important service provided by trading companies doing business in some Middle Eastern countries. Trading companies with extensive experience in these areas will usually assume risk of product labeling. If they are buying and selling on their own account, they then assume risk of complying with antiboycott legislation.

appropriate fees with supplying companies. Fees can vary widely depending on services rendered and risks accepted. Most fees for established products with moderate sales volume range from 2 to 4 percent of sales value. If sales or transactions are large and services needed are minimal, fees are typically near 1 percent. Fees are usually negotiated and remain in force over an agreed time period. In some cases, however, fees are negotiated for individual sales.

If significant additional services are needed or if the exporter is to accept payment or credit risk, then fees can be much higher. In these cases, fees of 5 to 7 percent of sales value are common.

Even these higher fees will purchase only a limited amount of market development services. If a product appears promising for successful sales in foreign markets, an export company may be willing to accept a moderate fee level in exchange for a longer term commitment by the supplier. Usually, however, only larger export companies are willing to risk much market development work in exchange for long-term marketing agreements.

OWNERSHIP AND FINANCIAL STRUCTURE

Most exporting companies are small and closely held, independent corporations. The principal owners often are also the principal traders. These companies usually have salaried clerical employees. Few companies own or operate foreign businesses or have foreign employees. Most have extensive contacts with foreign businesses but these relationships seldom contain formal ties of ownership or decisionmaking authority.

Larger companies usually have a more complex structure. Almost all are closely held corporations. Owners are often "CEO's," "vice presidents," or "managers." Despite these titles, these people are usually traders also, although they do not involve themselves in details of every transaction as do owners of smaller companies. Nevertheless, they still interact personally with suppliers and buyers. In addition to owners, traders on staff may be salaried, paid on commission, or a combination of each. Clerical employees are salaried.

Larger companies have more formalized relationships in foreign countries. Some own or operate warehouses to handle foreign inland distribution while others have foreign offices. The primary function of foreign employees is to supervise sales and service in that region, and to provide sales leads. A secondary function, but one that is critical in some situations, is to provide market and credit intelligence. Companies with foreign employees often rely on them as part of their risk management.

With the exception of salaries, overhead costs are usually small, consisting primarily of office rent, supplies, communications, and travel. Of these, travel and communications are usually the largest.

ADVANTAGES OF AN EMC OR ETC

Many small- to medium-sized cooperatives should consider using export management or trading companies to promote foreign sales. Often these companies can provide better services than in-house staff. Even larger cooperatives may find their services useful in some situations.

When deciding on an export company, some major differences should be noted between export management or an export trading company. For companies exporting food and agricultural products, the preference is usually an export trading company.

Lower Initial Investment

Most suppliers utilize export companies as an opportunity to expand markets without incurring development costs and risks. In most cases, companies can make domestic sales to an ETC without learning marketing skills or taking risks in foreign markets. As foreign sales of their products begin to increase, many companies reevaluate the trading company relationship to determine if an in-house exporting effort would be profitable.

Initial investment costs may be required also to modify products for foreign markets. An experienced trader should be able to identify needed changes early in the export effort.

Distribution to More Markets

For suppliers new to international trade, export companies can provide faster access to more foreign markets than the supplier. The strength of export companies is their extensive contacts with foreign distributors, many of whom are willing to try new products in their markets. Also, except for the smallest and very specialized companies, exporters can place products in several markets within a short period. A new product can penetrate a market rapidly.

Less Risk

Export companies usually have long experience in the markets they serve and they are aware of business customs and import regulations. This experience avoids expensive marketing mistakes made by many companies new to exporting. Some foreign countries have unusually difficult import regulations. Exporting companies that take title to the goods they export accept this risk, which they can usually do with less expense than the supplier.

U.S. export regulations sometimes increase risk for exporters. The antiboycott legislation for exports to Arabic countries poses significant risks for U.S. companies not familiar with the regulations. Also, export licensing regulations for sensitive products to certain centrally planned countries are less complex than antiboycott regulations but are being changed.

Lower Exporting Costs for Some Markets

Economies of scale in exporting are significant for some commodities and some functions. Consolidating shipments to reduce shipping costs as well as selling costs is a major reason export companies continue to exist. For small or infrequent exports, an export company is usually less expensive than if the supplier tried to do its own exporting. Exporters' costs for some markets are already relatively low.

Exporting Specialists on Call

Although exporting companies typically buy product from suppliers as if the sale were a domestic transaction, suppliers occasionally receive questions or product inquiries from foreign importers. Export companies usually will assist the supplier responding to these inquiries. Also, export companies will assist in modifying or preparing the supplier's product to be more attractive in foreign markets.

Avoiding Expensive Traders

For export markets with limited growth potential, an experienced international trader will not necessarily be able to expand sales. A projection of significant long-term sales should be made before hiring such a person.

Money Received Sooner

Selling through an export company makes the transaction much like a domestic transaction, thus avoiding international delays in receiving payment. Collecting from foreign buyers can be a lengthy process. Usual float time (the time between shipping the goods and receiving payment) for letter of credit is about 5 to 10 days. Float times for sight draft, cash against documents, or other terms are usually 30 to 60 days. Transactions that encounter difficulties may take significantly longer to collect. Export trading companies usually provide this interim financing, covering their cost out of the difference between their buying and selling prices.

DISADVANTAGES OF AN EMC OR ETC

Handling and Distribution

Products requiring specialized handling and care or extensive training for foreign buyers may not receive adequate service

from some export companies. Exporters vary in their ability to handle new or nontraditional products. A supplier with unusual needs should contact several exporters to determine which may best provide special services. In some cases, a supplier may find it easier to train its own product specialists to make foreign sales than train export company personnel in product use and special handling requirements.

Pricing and Merchandising Technique

Proper pricing and merchandising are important to establish the reputation of a brand as a premium quality product. Improper merchandising technique may diminish brand identity, resulting in lower margins to exporters. Selling direct from supplier to foreign distributor enhances the ability to control merchandising techniques and prices. Most export companies will work closely with the supplier in establishing pricing policy.

Limited Market Development

Most export companies work on slim margins and are usually reluctant to conduct long-term market development work without additional compensation. Additional compensation usually is sought in exclusive long-term marketing agreements. Even so, most exporting companies rely on foreign distributors to test the market. Suppliers would have little control of test marketing procedures and feedback may be distorted by passing through one or more traders.

Higher Costs with Large Quantities

Suppliers with large shipments to particular markets can save money having their own export department. Often, however, although sales are large enough in one market to justify an in-house department, exports to many other markets may be small and best suited for handling through an outside company. Competition forces exporting companies to adjust their fees to the size of a sale, or to the quantity of annual sales.

Less Motivated to Promote Low Margin Products

As any well-managed company would, export companies focus attention on those sales that they expect to carry the highest profit margin. Food products tend to be lower margin products than other manufactured products. Within the food group, more highly processed products tend to carry larger margins, and hence may receive more attention from export companies.

Limited Geographic Coverage

Although most export companies have skills to export to any country, in fact many only provide services in specific regions. Their ability to successfully export a supplier's product may

vary significantly. The success of an export company is often dependent on the distributors it serves in foreign markets. To enter new markets, an export company may not necessarily be more successful than the supplier itself, particularly if the export company has not been active in that market.

FSC Legislation

Selling through a U.S.-based export company may preclude the supplier from directly taking tax advantages of a foreign sales corporation (FSC). If the exporter handles the supplier's product through an FSC, then the supplier may not also assign the same sale through its own FSC. Both supplier and exporter may operate FSC's, but any one sale may be reported only under one FSC. It is anticipated that export companies will establish FSC's, and tax benefits that accrue may be partially passed on to suppliers in the form of higher prices.

Limited Service by Some Companies

Most export companies offer exporting services in a rather limited spectrum, both with respect to the functions they perform, and the products and markets they actively serve. A few of the larger companies offer more services, for which they usually must obtain a greater margin on sales.

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Appendix A: Export Trading Company Act of 1982

The Export Trading Company Act of 1982 allows U.S. businesses to join for the purpose of exporting. This Act differs from past legislation in that it allows banking and service entities to have an equity interest in export trading companies. In addition, the Act provides limited antitrust immunity for approved export activities. The intent of these provisions is to increase U.S. exports by making U.S. products more competitive in world markets. The Act is further designed to encourage small- and medium-sized firms in particular to begin exporting or to enhance existing export activities.

The Export Trading Company Act does not supersede the Webb-Pomerene Act. Exporters may still register as Webb-Pomerene associations, although that legislation does not provide prior clearance to exempt activities from antitrust laws and does not allow for the export of services. Webb-Pomerene associations may invest in ETCs and may apply for certification under ETC regulations.

Prior to the passage of the Act, restrictive banking regulations and uncertainties in antitrust laws inhibited the development of joint exporting organizations by combinations of producers, manufacturers, banks, and export service companies. The Act provides some relief from these impediments by allowing banks to invest in ETCs, by providing limited antitrust protection in the performance of specified trade activities and by providing for the export of services.

Permitted Activities

An ETC is allowed to perform any or all services related to exporting, including market research, promotion, export financing, warehousing, shipping, insurance, documentation, distribution, currency transactions, and market intelligence. An ETC can take title to the goods it exports or act as a commission agent, and can provide services to nonmembers on a fee basis.

It may be necessary to engage in certain other trade activities to gain access to certain markets. Accordingly, ETC's are also allowed to engage in importing and other trade activities such as barter or countertrade arrangements. It should be noted, however, that the Federal Reserve Board requires that Title II ETC's (ETC's with bank equity) conduct countertrade activities only "where necessary or useful in the conduct of an export trading company's primary business of exporting, so that the revenues generated by the nonexporting activities should not exceed the export trading company's export revenues."⁹

⁹U.S. Department of Commerce, ETC Guidebook, 1984.

Bank Participation

Title II of the Act, the Bank Export Services Act, relieves restrictions on banking practices by allowing equity investments in ETC's by bank holding companies, banker's banks, and Edge Act Corporations.¹⁰

These types of banking institutions, subject to the approval of the Federal Reserve Board, may own as much as 100 percent of the stock in an ETC, as long as the total investment in all ETC's by a particular bank is limited to 5 percent of the bank's capital and surplus. Loans to ETC's are limited to 10 percent of the bank's capital and surplus.

Title II also makes provisions for export financing by directing the Eximbank to develop loan guarantee programs for ETC's and other exporters. It is intended that small- and medium-sized businesses, minority businesses, and agricultural concerns be the primary beneficiaries of those loan guarantees.

Export trading companies formed under Title II with banks as investors must be organized principally to export with at least 50 percent of their business being derived from export activities.

Antitrust Certification

Title III of the Export Trading Company Act is known as Export Trade Certificates of Review and provides limited antitrust protection through a review procedure that gives qualified ETCs or any other exporter prior clearance to engage in specified trade activities. An ETC is certified by the Department of Commerce, with concurrence of the Justice Department if it can establish that it:

1. Will not substantially lessen competition or restrain trade in the U.S. or restrain the export trade of a U.S. competitor.
2. Will not unreasonably enhance, stabilize, or depress prices in the U.S.
3. Will not constitute an unfair method of competition.
4. Will not result in the sale or resale in the U.S. of the exported goods or services.

¹⁰"Bank holding companies own at least 25 percent of any bank and are registered with the Federal Reserve Board (FRB) under the Bank Holding Company Act. Banker's banks are individual banks whose only clients are other banks. Small banks form them to offer services they could not offer independently. Allowing banker's banks to participate in ETC's should encourage regional and small bank investment in joint ventures. Edge Act Corporations are chartered, supervised, and examined by the FRB to engage in foreign or international banking or financial operations.

Once the certificate is issued, the ETC will generally be exempt from civil and criminal liability under Federal and State antitrust laws. However, private parties may sue for actual damages on the ground that the conduct failed to comply with the four eligibility standards listed above. Prior to the ETC Act, private parties could sue for treble damages in such cases. If the holder of the certificate prevails in such a suit, he may recover the costs of defending against the suit, including reasonable attorney's fees.

There is no minimum export requirement for **nonbank ETC's**, but only export activities are eligible for certification under Title III, even if exporting is a small part of a company's total business.

Only export conduct and conduct related to provision of export trade facilitation services is eligible for certification under Title III. This includes technology licensing, but not overseas investment.

Certification Procedure

Any "person" can apply for an export trade certificate of review. "Person" is defined in Title II as:

1. Any individual who is a resident of the U.S.;
2. A partnership formed under the laws of any State or the U.S.;
3. State or local government entity;
4. A corporation (profit or nonprofit) formed under the laws of any State or the U.S.;
5. Any association or combination, by contract or other arrangement, between or among such persons;
6. Foreign persons can apply as members of a U.S. trading entity.

The U.S. Department of Commerce's Office of Export Trading Company Affairs offers free preapplication counseling to exporters applying for an export trade certificate of review.

Once an application has been submitted, the Department has 5 days to review the application for completeness before it is deemed submitted. Once it is deemed submitted, Commerce has 90 days to issue or decline to issue a certificate. Commerce can extend the **90-day** limit only with the applicant's consent.

Application for a certificate of review involves the disclosure to the Government of business plans, and other financial and commercial information that could be deemed confidential. However, steps have been taken to protect the confidentiality

of information related to application. Any information officially submitted in connection with an application for a certificate of review is exempt from disclosure under the Freedom of Information Act. In addition, the applicant is allowed to draft his own summary for the required publication in the Federal Register.

Appendix B: Tax Reform Act of 1984; Foreign Sales Corporations

The Tax Reform Act of 1984 amended the Internal Revenue Code to provide for the establishment of Foreign Sales Corporations (FSC). This legislation was drafted in response to objections made by U.S. trading partners in the General Agreement on Tariffs and Trade (GATT) that DISC's constituted illegal tax subsidies for exports. The FSC incentive requires the exporter to be incorporated and have economic activity outside U.S. customs territory, thereby not violating GATT antisubsidy rules. Transactions by the FSC must satisfy certain managerial and economic tests. The legislation provides alternatives for smaller exporters in the form of "small FSCs" and "interest-charge DISC's"

The Act exempts a portion of export income of a qualified foreign sales corporation from Federal income tax. In addition, a domestic corporation is allowed 100 percent dividends-received deduction for dividends distributed from the FSC out of earnings attributable to certain foreign trade income. This eliminates corporate level tax for a portion of the income from exports.

FSC rules replacing DISCs became effective January 1, 1985, and included transition rules allowing deferred tax on income of a DISC meeting qualification requirements as of December 31, 1984, to be forever forgiven when actually distributed.

Qualification as an FSC

To qualify for preferential tax treatment, a corporation must meet the statutory definition of an FSC and satisfy the tests for foreign management and economic processes.

Foreign Presence Test

A corporation must file an election to become an FSC with the Internal Revenue Service and satisfy each of the following "foreign presence" requirements:

1. An FSC must be a corporation chartered under laws in a jurisdiction outside U.S. customs territory. This includes any U.S. possession except Puerto Rico (i.e., Guam, the Virgin Islands, American Samoa, and the Northern Mariana Islands), countries with an exchange of information agreement with the U.S. that meets standards of the Caribbean Basin legislation (section 274(h)(6)(C)), and approved foreign countries with which the U.S. has an agreement for the exchange of tax information. Approved countries include: Australia, Austria, Barbados, Belgium, Canada, Denmark, Egypt, Finland, France, West Germany, Iceland, Ireland, Jamaica, South Korea, Malta, Morocco, Netherlands, New Zealand, Norway, Pakistan, Philippines, South Africa, Sweden, and Trinidad and Tobago.

2. An FSC may not have more than 25 shareholders at anytime during the taxable year. Directors holding shares required to be owned by a resident of the country under whose laws the FSC is organized are not counted as shareholders for this requirement.

3. An FSC may not have any preferred stock outstanding during the taxable year. The FSC is allowed to create more than one class of common stock so long as none of the rights of a class of stock has the effect of avoidance of Federal income tax.

4. An FSC must maintain a "permanent" office location in an approved country outside the U.S.

5. The foreign office must maintain a permanent set of books that must include invoices, quarterly income statements, and a year-end balance sheet of the FSC. The FSC must maintain similar records in the U.S.

6. At least one member of the FSC's board of directors must be a resident of the country under whose laws the FSC is organized, but this person may be a U.S. citizen.

7. The FSC may not be a member of a controlled group of corporations that includes a DISC.

Foreign Management Requirement

There are three requirements to satisfy the stipulation that the management of an FSC during the taxable year take place outside the United States:

1. All meetings of the FSC's board of directors and shareholders must be held outside the U.S.

2. The principal bank account of the FSC must be maintained outside the U.S. during the taxable year.

3. Payment of dividends, legal and accounting fees, and salaries of officers and members of the board of directors must be disbursed out of bank accounts of the FSC maintained outside the U.S.

Management activities need not be performed in the country where the FSC is organized, unless required by local law. They need only be performed outside the U.S.

Foreign Economic Processes Requirements

An FSC, except for a small FSC, must meet two requirements related to foreign economic processes to qualify an export transaction for a tax exemption:

1. The FSC must participate outside the U.S. in the solicitation (other than advertising), negotiation, or making of a contract

relating the particular export transaction. Any one of these could be performed by a foreign agent. The Senate Finance Committee Report defines the above three terms as: Solicitation-communication either by telephone, telegraph, mail or in person by the FSC to a specific, targeted, potential customer regarding a transaction. **Negotiation**—communication by the FSC to a customer or potential customer of the terms of sale, such as the price, credit, delivery, or other specification. Making of **contract**—performance of any of the elements necessary to complete a sale such as making an offer or accepting the offer, making written confirmation of oral agreement, or specifying additional contract terms. The location of solicitation, negotiation, or making of the contract is determined by the place where the activity is initiated by the FSC or its agent.”

2. Specific percentages of certain transaction costs incurred by the FSC or its agent with respect to the particular export transaction must be “foreign direct costs,” which are costs incurred by the FSC for activities it or its agent performs outside the U.S.

This second test can be satisfied if the foreign direct costs incurred by the FSC account for at least 50 percent of the total direct costs of all, or 85 percent of the direct costs of any two of the following categories of activities:

1. Advertising and sales promotion;
2. Processing of customer orders and arranging for delivery of export property;
3. Transportation of the export property to the customer;
4. Determination and transmittal of a **final** invoice or statement of account and receipt of payment;
5. Assumption of credit risk.

Foreign Trade Income and Foreign Trading Gross Receipts

The statutory definition of foreign trade income, as set forth in FSC regulations, is gross income of the FSC that is attributable to foreign trading gross receipts. The cost of goods sold is subtracted from foreign trading gross receipts to arrive at foreign trade income. This includes profits earned by the FSC from exports and commissions earned by the FSC from products and services exported by others.

Foreign Trading Gross Receipts

Foreign trading gross receipts are earnings generated by the FSC from:

“Senate Committee on Finance, “Explanation of S. 2062,” U.S. Senate, Washington, DC, 1984.

1. Sale or exchange of export property.
2. Lease or rental of export property for use by the **leasee** outside the U.S.
3. Services which are related and subsidiary to any sale, exchange, lease, rental or other disposition of export property.
4. Engineering or architectural services for construction projects located outside the U.S.
5. Managerial services for an unrelated FSC or DISC.

To qualify as export property, the product must meet all three criteria as follows:

1. Property manufactured, produced, grown, or extracted in the U.S. by a person other than an FSC;
2. Is held primarily for sale, lease, or rental by or to an FSC for direct use, consumption, or disposition outside the U.S., and;
3. Does not have more than 50 percent import component.

Some types of exports do not qualify as foreign trading gross receipts. These include:

1. Income from export of property or services for use in the U.S., or use by the U.S. or one of its instrumentalities and is required by law.
2. Income from a transaction made by a subsidy from the U.S.
3. Receipts from another FSC that is a member of the same group of controlled corporations.
4. Half of the gross receipts attributable to disposition of military property and related services.
5. Investment income including dividends, interest, royalties, annuities, rents (except rental of export property outside U.S.), gain from sale of stock, securities, futures transactions, and gain from disposition of interest in an estate or trust; and carrying charges.

Determining Exempt and Nonexempt Foreign Trade Income

The FSC’s foreign trade income is separated into exempt and nonexempt portions according to two administrative pricing rules or to an **arm’s-length** pricing rule. The FSC may select the most desirable of the two administrative pricing rules to determine exempt foreign trade income. These are:

1. One and eighty-three hundredths percent of foreign trading gross receipts, except that the amount cannot exceed 46

percent of the amount allowed if the combined taxable income method was used.

2. Twenty-three percent of the combined taxable income of the FSC and the related supplier.

To be able to use the administrative pricing rules, however, the FSC or a person under contract to the FSC must perform all of the five activities listed for the “direct cost test” and the three activities listed for the “sales activity test” for the foreign economic process requirement (see above). Unlike the foreign economic process test, however, these activities may be performed inside as well as outside the U.S.

With administrative pricing rules, 15/23 of foreign trade income is exempt from U.S. income tax if the FSC has corporate shareholders, otherwise 16/23 is exempt.

Foreign trade income may also be based on **arm’s-length** pricing subject to Internal Revenue Code section 482. Using this method, 30 percent of foreign trade income is exempt from U.S. income tax if the FSC has corporate shareholders, otherwise 32 percent if exempt.

An FSC is restricted in the use of foreign tax credits and deduction for foreign taxes paid on exempt foreign trade income. Thus, only foreign countries with low tax rates are desirable locations for the FSC.

The domestic corporation is entitled to 100 percent dividend received deduction for dividends paid by an FSC from foreign trade income. Some restrictions apply here to earnings from the use of the **arm’s-length** pricing method.

Cooperative Provisions

The FSC legislation includes provisions for special treatment of cooperatives exporting members’ products. The provisions allow the combined taxable income of the cooperative and the FSC to be computed without taking into account patronage dividends, per-unit retain allocations, and certain deductions for nonpatronage distributions under section 1382. Thus the cooperative does not have to distribute income attributable to exempt foreign income in order to benefit from the corporate level tax exemption on that income. This rule applies only to the cooperative shareholder of the FSC and not to members and patrons who may also be cooperatives.

The rules also provide that foreign trade income, other than exempt foreign trade income will be treated as exempt income to FSC, if it is distributed currently to the cooperative shareholder. If not distributed currently, that income will be taxed at the FSC level. Distributions from the FSC to the cooperative shareholder that are attributable to foreign trade income treated as exempt foreign trade income will not be included in the taxable income of the cooperative. Thus,

nonexempt foreign trade income will be taxed at the member level and treated as a single level of tax as provided for under Subchapter T.

These rules are available to agricultural cooperatives only if the income of the cooperative eligible for the FSC incentive is based on **arm’s-length** transactions between the cooperative and its members or patrons.

Small FSC

Recognizing that small exporters may have difficulty complying with the foreign presence and economic activity requirements, the bill provides two options to eligible small businesses, the small FSC and the interest-charge DISC.

A small FSC must **file** an election to become a small FSC and must satisfy foreign presence requirements (i.e., incorporation outside U.S. customs territory), but is not required to meet the foreign management and economic processes tests. However, in determining exempt foreign trade income, gross trading receipts in excess of \$5 million for the taxable year are not taken into account. A small FSC exceeding the \$5 million limit may choose the gross receipts to which the limitation is allocated. That is, a small FSC may choose to allocate the most profitable sales to satisfy the limitation.

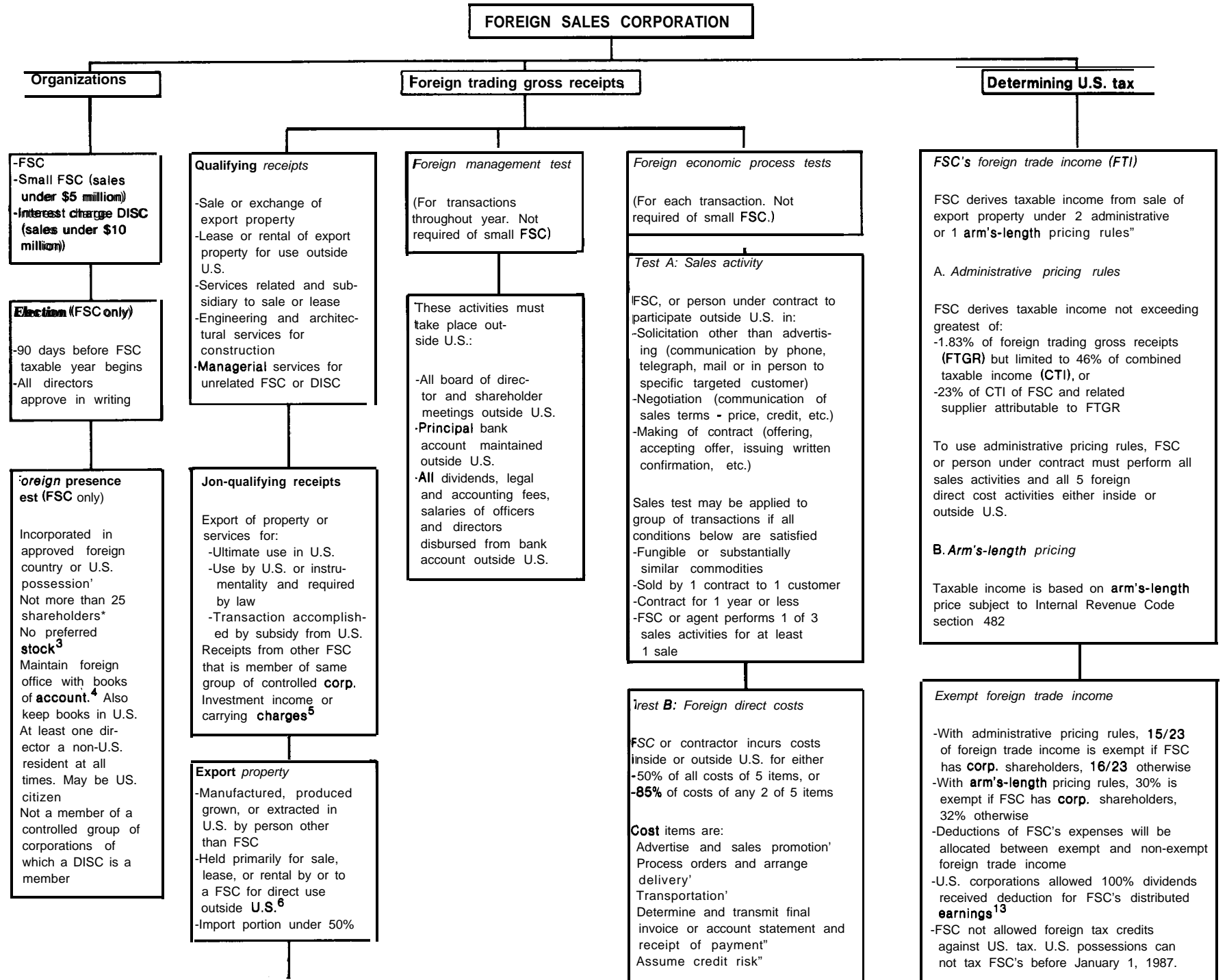
The administrative pricing rules for regular FSC’s also apply to small FSC’s.

Interest-Charge DISC

Another alternative is the interest-charge DISC. In this case, exporters continue using a DISC or may start a new DISC to receive tax benefits on up to \$10 million in export sales, but must pay an interest charge on accumulated tax deferrals occurring after the effective date of the legislation. The interest charge is at Treasury bill rates and is deductible by DISC shareholders as a business expense.

The incremental rule relating to base period exports is eliminated for interest-charge DISCs and the deferral for export income of up to \$10 million will be 94 percent for corporate shareholders. The deferral for individual shareholders is unclear at this time, but will be at least 94 percent.

Qualified export income in excess of \$10 million is deemed distributed. Thus, the DISC is not disqualified, but the excess receipts are not eligible for deferral. In addition, DISC’s and DISC shareholders may not be or be a part of an FSC.



Non-export property

- Leased** by FSC for use by member of controlled group of corporations of which FSC is a member
- Intangible** property: patents, inventions, models, designs, formulas, some copyrights, goodwill, trademarks, brands, etc.
- Oil** or gas and primary products
- Prohibited exports under Sec. 3 of export Administration Act 1979
- Property designated by President as being in short supply

Cooperative principles

FSC with qualifying cooperative shareholder may retain profits (allocated to that cooperative's products) as entirely exempt at the FSC level.¹⁴ Upon repatriation of profits, the otherwise exempt portion of FSC profit may be retained without taxation by the cooperative and used as working capital. Remaining profit is allocated to members by patronage.

i-The FSC must be incorporated under laws of a jurisdiction outside U.S. customs territory. This includes U.S. possessions except Puerto Rico, countries that meet standards of Caribbean Basin legislation (Section 274(h)(6)(C)), or countries with an income tax information exchange treaty approved by Treasury. Approved countries include Australia, Austria, Barbados, Belgium, Canada, Denmark, Egypt, Finland, France, West Germany, Iceland, Ireland, Jamaica, South Korea, Malta, Morocco, Netherlands, New Zealand, Norway, Pakistan, Philippines, South Africa, Sweden and Trinidad and Tobago. U.S. possessions, which may not tax foreign trade income of an FSC prior to January 1, 1967, include Guam, American Samoa, Commonwealth of Northern Mariana Islands, and Virgin Islands.

P-Directors holding shares required to be owned by a resident of the country under whose laws the FSC is organized are not counted as shareholders for this purpose.

3-Multiple classes of common stock are allowed provided it does not enable a taxpayer to avoid federal income tax.

&Permanent books of account shall include as a minimum all invoices, quarterly income statement, and year-end balance sheet.

B-Investment income" means dividends, interest, royalties, annuities, rents (except export property), gains from sale or exchange of stock or securities, gains from futures transactions (except bonafied hedging transactions), gains from sale or other disposition of interest in estate or trust. Carrying charges" means the same as normally used in domestic commerce or as may be defined by Treasury regulations as any amount in excess of the price for an immediate cash sale and any other unstated interest." Section 927(d)(l)(B).

6-Rule applies regardless of purchaser's nationality, fob point, place of title passage, or whether property is for use by purchase or for resale.

T-Advertising means an appeal related to specific product or product line and directed at part or all potential customers. Sales promotion is an appeal made in person to potential export customers for sale of specific product or product line at a trade show or annual customer meeting. This may include the cost of the trade show or meeting but excluding salaries or commissions of direct sales persons.

s-Processing customer orders means notifying related supplier of the order and of requirements for delivery. Arranging for delivery means taking needed steps to ship as required by order including clerks salaries, telephone, telegraph, and documentation costs but excluding packaging, crating, and similar pre-transportation costs and shipping costs. Delivery may occur inside or outside U.S.

e-Transportation includes transport costs during period the FSC owns the export property. FSC has no transport cost if customer pays transport directly. Amount of direct costs treated as foreign direct costs is determined by the ratio of mileage outside U.S. to total mileage. For fungible commodities, total direct costs include only those transportation costs incurred after goods have been identified to a contract.

lo-Determination and transmittal means assembly of final invoice or statement of account and forwarding document to customer. Final invoice is the invoice upon which payment is made or receipt for payment issued. Statement of account means a summary statement to customer giving status of transaction occurring within an accounting period net exceeding one taxable year. Cost of office supplies and equipment, clerical salaries, mail, etc., directly attributable to assembly and transmittal of invoice or statement constitute direct costs for this activity. Engineering or cost accounting functions involved in establishing price are not included. Receipt of payment means crediting FSC's bank account with proceeds of the transaction. Payments received in the U.S. may be transferred immediately to bank account of FSC outside U.S. Direct costs include expenses of FSC in maintaining bank account.

ii-FSC is considered to bear economic risk of non-payment if it contractually bears such risk and if either 1, a debt becomes uncollectible or 2, an addition is made to the bad debt reserve of the FSC in at least 1 year within a 3-year period.

In-These rules apply to sale of export property. Treasury may prescribe regulations defining taxable foreign trade income arising from commissions, rentals, and other types of FSC income.

13-The 100% dividends-received exemption is not allowed for non-exempt foreign trade income under arm's-length pricing and for any other income other than foreign trade income, investment income, and carrying charges.

14-Computation of combined taxable income under FSC administrative pricing rule does not take into account patronage dividends, per-unit retain allocations, or certain nonpatronage distributions.

**U.S. Department of Agriculture
Agricultural Cooperative Service**

Agricultural Cooperative Service (ACS) provides research, management, and educational assistance to cooperatives to strengthen the economic position of farmers and other rural residents. It works directly with cooperative leaders and Federal and State agencies to improve organization, leadership, and operation of cooperatives and to give guidance to further development.

The agency (1) helps farmers and other rural residents develop cooperatives to obtain supplies and services at lower cost and to get better prices for products they sell; (2) advises rural residents on developing existing resources through cooperative action to enhance rural living; (3) helps cooperatives improve services and operating efficiency; (4) informs members, directors, employees, and the public on how cooperatives work and benefit their members and their communities; and (5) encourages international cooperative programs.

ACS publishes research and educational materials and issues *Farmer Cooperatives* magazine. All programs and activities are conducted on a nondiscriminatory basis, without regard to race, creed, color, sex, or national origin.