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HOW TAX REFORM WILL IMPACT MANUFACTURING

What Changes are Coming for Manufacturing Organizations?

With most of the provisions set to go into effect in 2018, it's important that the manufacturing industry review the changes that occurred with the tax reform to understand the impact to their companies. We've summarized top considerations and implications below.

Reduction of the Corporate Tax Rate

Reduces the top corporate tax rate from 35 to 21%.

This is a huge win for manufacturers. The effective actual tax rate for manufacturers has historically averaged 22%.

Repeal the Corporate Alternative Minimum Tax (AMT)

Keeping the corporate AMT would have made it difficult for businesses to reduce their effective corporate tax rate lower than 21%, the bill also repeals the election to accelerate AMT credits in lieu of bonus depreciation.

Pass-Through Tax Treatment / Section 199A

Pass-through entities may qualify for a 20% deduction on qualified business income under the new tax bill. This deduction is subject to certain W-2 wage limitations. Qualified business income is basically all domestic business income other than investment income, investment interest income, short term capital gains, long term capital gains, etc……

Limitations on Interest Deductibility

Revises Section 163(j) and expands its applicability to every business. Generally, caps deduction of interest expense to the sum of 1) business interest income; 2) 30% of adjusted taxable income (computed without regard to deductions allowable for depreciation, amortization, or depletion; and 3) the taxpayer's floorplan financing interest for the tax year. Disallowed interest is carried forward indefinitely. Contains a small business exception.

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Repeal of Domestic Production Activities Deduction (DPAD or Section 199)

DPAD was a tax incentive for businesses that manufactured property at least partially within the United States.

Manufacturers that previously claimed the section 199 deduction will no longer be able to reduce their tax rate by the benefit; however, this impact will likely be offset by the significant reduction in overall tax rates.

Research Tax Credit

The Research Tax Credit's net value was effectively increased by 22%--from 65% to 79% of incremental qualified spending—because of the corporate rate's reduction to 21% and the required Sec. 280C(c)(3) election or addback of R&E deduction.

In addition to the credit benefit increasing by 22%, the elimination of AMT means more taxpayers may benefit from the credit.

R&D Tax Deduction

Companies will be required to write-off research expenses over a longer time period.

Taxpayers will not be permitted to immediately expense costs in the year incurred and instead must write off costs associated with R&D over a longer time period. Under current law, taxpayers have the choice of taking an immediate deduction or capitalizing the amounts and amortizing over five years; going forward, the new bill makes capitalization/amortization mandatory.

Eliminate Ability to Carryback Net Operating Losses

Generally, companies may not use an NOL to offset income in any prior year and may offset only 80% of taxable income (after NOL) in carryforward year.

Costs incurred in one year will not be able to offset 100% of taxable income in the next year. In situations where manufacturers' earnings are volatile, the restrictions on the carryback and use of NOLs could present a significant cash flow obstacle. The elimination of carrybacks is effective in taxable years beginning after December 31, 2017. The current 100% allowance is phased down by 20% per year beginning in 2023.

Immediate Expensing of Certain Capital Expenditures

Companies will be able to fully expense certain capital expenditures, including acquisitions of used property, in 2018.

This is to encourage more capital spending, potentially driving up sales for hardware manufacturers of products eligible for expensing. Applies until 2022 for purchases made after Sept. 28, 2017. The percentage of allowable expensing will be phased out at a rate of 20% per year from 2023 (80%) to 2026 (20%).

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Like-Kind Exchanges (Section 1031)

Like-kind exchanges will be limited to exchanges of real property that is not primarily held for sale.

This imposes greater limitations on the types of property manufacturers could consider as part of a like-kind exchange. This is effective for taxable years after December 31, 2017. However, there is an exception if the property was disposed of by the taxpayer on or before December 31, 2017.

Participation Exemption System

The participation exemption system generally provides a 100% dividends received deduction for the foreign source portion of dividends received by U.S. shareholders that are C corporations (other than a RIC or REIT) from certain foreign subsidiaries.

Most businesses would agree that a territorial tax system could lead to significant tax savings. Nevertheless, accompanying international tax provisions may mute some of the enthusiasm. Applicable to distributions made after Dec. 31, 2017

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TACKLING TAX REFORM: 5 INTIAL STEPS MANUFACTURERS CAN TAKE NOW

Here are five steps manufacturing companies should take now to tackle tax reform:

1. **Initiate tax reform conversations with your tax advisor.** Tax reform of this magnitude is the biggest change we've seen in a generation, and will require intense focus to understand not only how the changes apply at a federal level, but also to navigate the ripple effect this is likely to have on state taxation as well.
2. **Assess impact.** Tax professionals will likely need to review the bill text manually, measure their organization's specific circumstances against it to assess the impact of each provision, as well as the holistic effect on their bottom line.
3. **Assemble a team.** While the heaviest burden may fall on accountants, companies and their finance teams will have an important role to play to gather all the necessary data.
4. **Dig into the data.** Assessing the impact of tax reform MAY require a substantial amount of data. Organizations need to move from modeling the impact of tax reform to focus on data collection and computations as soon as possible. If you have an international presence, bear in mind that some of the information needed could date back to 1987.
5. **Establish priorities.** When considering what to undertake in the limited time before year's end, focus on the areas that could have the greatest impact on your organization.