

PERSPECTIVE



CHANGES EVERYTHING.

Year-End Tax Planning | Tax Policy Update

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Year-End Tax Planning

Tax Policy

MAPP 2022 Finance Forum

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Wipfli and our Manufacturing Expertise

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- Focus on **Manufacturing, Retail & Distribution** as our largest industry segment
- Serving clients for **over 90 years**
- 3,400+ employees worldwide offers our clients **global expertise** with local consultants

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Today's Agenda

01 Tax Policy & Legislation

History of recent and upcoming tax legislation impacting the manufacturing sector

02 Tax Topics

Relevant tax topics for manufacturers, along with a summary of what's important to processors

03 Top 10 List – Tax Topics

Ten things every manufacturer should evaluate



**Tax Policy
& Legislation**

Update from Hill

- Election Outcomes for Legislative Branch
 - U.S. Senate: Democrats retain control – margin TBD by Georgia
 - U.S. House: Republicans projected to win control of the House
- What it means for tax policy
 - Most likely gridlock for the next two years, except for must-pass legislation
 - Tax Cuts and Jobs Act (TCJA) sunsets are unlikely to change unless part of year-end tax extenders package

Timeline of Scheduled TCJA Changes over the Next Decade

TIMELINE

-
- After the end of 2021 Businesses will be required to deduct research and experimentation costs over five years, rather than immediately
 - After the end of 2021 The deduction for business net interest expense will be limited to 30% of EBIT, rather than 30% of EBITDA
 - After the end of 2022 Full expensing for short-life business investments will begin phasing out
 - After the end of 2025 The reduction of individual income tax rates will expire
 - After the end of 2025 The increase in the standard deduction, elimination of the personal exemption, and doubling of the child tax credit will expire
 - After the end of 2025 Limits on the state and local tax deduction and the mortgage interest deduction will expire
 - After the end of 2025 The reduction of the alternative minimum tax will expire
 - After the end of 2025 The newly created pass-through deduction (§199A) will expire
 - After the end of 2025 Three international-related provisions (GILTI, FDII, and BEAT) will become more restrictive
 - After the end of 2025 The reduction of the estate tax will expire

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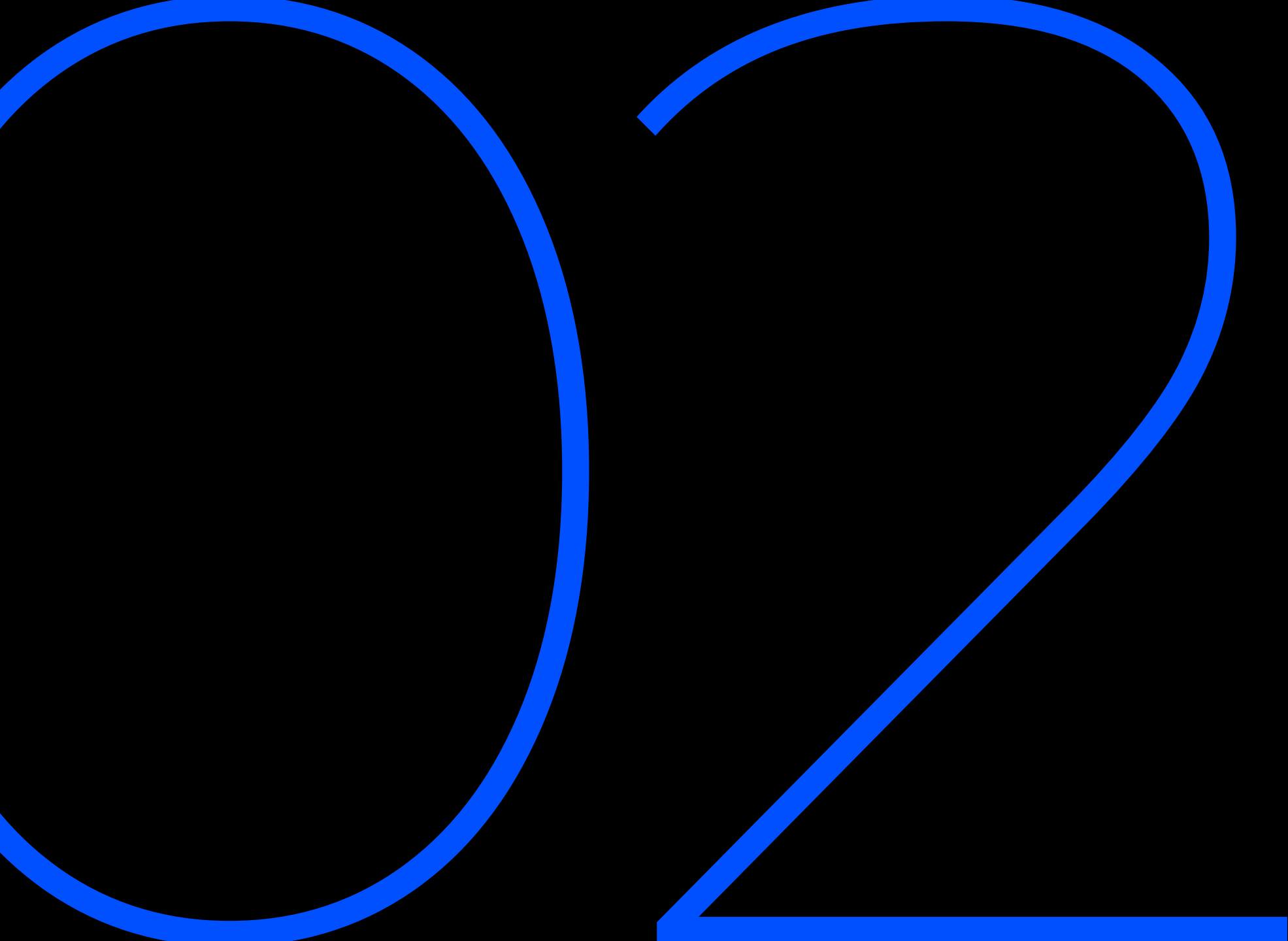
Lame Duck Legislation: Tax Extenders

- Likely included
 - Section 174 – Research Expenditures
 - How long?
 - Expanded Child Tax Credit
- Possibly included
 - 100% bonus depreciation
 - 163(j) Interest Expense Limitation – EBIT vs. EBITDA
- Unlikely included
 - TCJA provisions scheduled to sunset after 2025

Recent Tax Legislation

- Infrastructure Investment and Jobs Act
 - ▶ Surprisingly, no income tax increases (excise taxes are another story)

- Inflation Reduction Act
 - ▶ CAMT – 15% Corporate Alternative Minimum Tax
 - ▶ R&D tax credit expansion
 - ▶ Excess business losses deduction extended two years – 12/31/2028
 - ▶ Expansion of energy efficient buildings deduction



**Tax
Topics**

Tax Credits & Incentives for Manufacturers

R&D Tax Credit

- ▶ Development or improvement of business components (products and processes)
- ▶ Proprietary and custom development qualifies

Accounting Methods

- ▶ Cash Basis | UNICAP | Inventory
- ▶ Last-In-First-Out (LIFO)

State and Local Tax

- ▶ Sales tax exemptions
- ▶ Entity Level Tax elections (SALT CAP workaround)

Hiring & Payroll Incentives

- ▶ Work Opportunity Tax Credits (WOTC)
- ▶ Employee Retention Credit (ERC)

Plant & Equipment

- ▶ Cost segregation study
- ▶ Energy Efficient Building Deduction

Other Planning

- ▶ Bonus depreciation
- ▶ IC-DISC



Research &

Development (R&D) Tax Credit

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Qualified Research Activities

- New or improved business component
 - ▶ Includes: Product, Process, Technique, Formula, Invention, or Computer Software
 - DFM, part-specific processes, new molds, automation and EOAT
- Technological in nature
- Uncertainty at outset
- Process of experimentation
 - ▶ Formal or informal, evaluation of alternatives, systematic trial and error

R&D Credits

- Federal credit – 14% or 20%
- Federal benefit – typically between 4% and 9%
- Approximately 35 states have an R&D tax credit program
- Wages, supplies, contract labor
- \$ for \$ reduction of tax due

R&D Expenditures

- Manufacturers able to deduct research expenditures as they are paid or incurred since 1954
- TCJA modified IRC 174 to require amortization in 2022 and thereafter
- Tax extenders to be taken up during lame duck
- Caution: Unless Congress acts, 2022 research expenditures will be 1/5 (or 1/15) of what they would be if Congress acts

R&D Updates

- 174 Research Expenditures amortization
 - IRC 174 expenditures vs. IRC 41 tax credit
 - Change in accounting method
 - Software development expenditures codified as IRC 174 Expenditures
- Chief Counsel Memorandum
 - All amended returns claiming R&D credits
 - Requirements




Accounting

Methods

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Accounting Methods

- Automatic Accounting Method Changes (Form 3115)
- Tax Cuts & Jobs Act Opportunities
 - ▶ Cash Basis
 - ▶ UNICAP | Inventory
 - ▶ Requirements
 - Average Annual Gross Receipts - \$27 million
- Increasing Cost of Raw Materials
 - ▶ LIFO Method of Accounting



Hiring & Payroll

Incentives

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Work Opportunity Tax Credit (WOTC)

- WOTC recently extended through December 31, 2025
- Up to \$9,600 Federal tax credit for each eligible to hire
- Percentage of eligible employee wages (120 hours minimum)
- Onboarding process – state paperwork within 28 days of hire
- Eligible Groups
 - ▶ Disabled veteran
 - ▶ Unemployed disabled veteran
 - ▶ Unemployed veteran
 - ▶ SNAP (food stamp) recipients
 - ▶ Short-term Temporary Assistance for Needy Families (TANF)
 - ▶ Qualified long-term unemployment recipients
 - ▶ Designated community residents
 - ▶ Vocational rehabilitation referrals
 - ▶ Ex-felons
 - ▶ Supplemental Security Income (SSI)
 - ▶ Summer youth employee

Employee Retention Credit (ERC)

Summary

- Timeline
 - ▶ CARES Act (March 2020)
 - ▶ Consolidated Appropriations Act (December 2020)
 - ▶ American Rescue Plan of 2021
- Eligible wages (and healthcare) from March 13, 2020 through September 30, 2021
- Refundable Credits of up to 7,000 per employee, per quarter
- Can claim ERC with 100% PPP loan forgiveness
- Substantial Opportunity – rules changed mid-stream

Employee Retention Credit

Who Can Qualify:

- Fully or partially suspended due to covid-related government orders
- Decline in quarterly gross receipts, compared to same quarter in 2019:
 - ▶ Q2 to Q4 2020 50% decline in gross receipts when compared to 2019
 - ▶ Q1 to Q3 2021 20% decline in gross receipts when compared to 2019
 - ▶ Q1 2021 20% decline in gross receipts Q4 2020 vs Q4 2019
- Maximum number of full-time employees
 - ▶ 100 for 2020
 - ▶ 500 for 2021

Employee Retention Credit

Amount of the Credit:

- 2020: 50% of first \$10,000 per employee
 - ▶ \$5,000 per employee for the year
- 2021: 70% of first \$10,000 per employee per quarter
 - ▶ \$21,000 per employee for the year if all three quarters qualify

Employee Retention Credit

Additional commentary:

- ERC misunderstood due to law changes – you may qualify!
- Big quarter in 2019 can cause 20% revenue decline
- Can method of accounting change help qualify?
- ESOPs, NOLs – ERC is not an income tax credit
- Can also qualify if you paid employees (including healthcare) while not working
- Huge potential impact. That intern you paid \$1,000 to cut the grass last summer, could net you \$700.

Employee Retention Credit

AICPA Fact or Fiction

My business did not have a significant revenue decline in a calendar quarter compared to 2019 (50% or more for 2020 or 20% or more for 2021), but I can still qualify for an ERC.

FACT. However, as noted above, there must have been a full or partial suspension of operations BECAUSE OF A GOVERNMENT ORDER that limited commerce, travel or group meetings due to COVID-19. A partial suspension is based on the facts and circumstances of what government orders are in place for the location. The orders would need to have a more than a nominal impact on the business to qualify for the ERC.

Employee Retention Credit

AICPA Fact or Fiction

All safety recommendations or guidelines a government agency issues should be considered government orders to suspend operation requirements.

FICTION. Government orders are defined as orders, proclamations and decrees from federal, state or local governments that have jurisdiction over the business operations. No federal order during 2020 or 2021 would qualify businesses for the ERC, so it is important to review the state and local orders.

Employee Retention Credit

AICPA Fact or Fiction

My business experienced supply chain disruption, which means it qualifies for the ERC.

FICTION. Experiencing supply chain issues stemming from the pandemic does not guarantee ERC eligibility. The supply chain issues must result from a government order that affects its supplier, and **ALL** these requirements must be met:

- ▶ Supplier cannot make deliveries of critical goods due to a government order.
- ▶ Business can't purchase those critical goods from another supplier.
- ▶ Business must experience a more than nominal effect as a result.

Employee Retention Credit

AICPA Fact or Fiction

My business was in a location where there was a stay-at-home order, and I adjusted operations based on this. This automatically means I can claim the ERC.

FICTION. The IRS clearly states that voluntary reductions of hours or closing based on service demand do not create a full or partial suspension of its operations due to a government order.

Employee Retention Credit

AICPA Fact or Fiction

There were so many claims for the ERC that the IRS is unlikely to audit my business' return.

FICTION. While there is no guarantee that the IRS will examine your business' ERC claim, they are aware of the potential for abuse related to this credit and scrutiny of COVID-19 relief funds are high in general.

If my business must pay back the ERC, the penalties will be large.

FACT. The amount of the penalty (and interest) on the unpaid payroll taxes could be substantial, especially if the IRS imposes fraud and negligence penalties upon examination.



State and

Local Tax (SALT)

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Sales Tax Exemption Opportunities – Varies by State

- Refunds and go forward benefits
- Manufacturing Process and Equipment Exemption
 - ▶ Movement between processes in same plant
 - Forklifts
 - Overhead costs
 - Carts
- Electricity and Natural Gas used in Manufacturing
 - ▶ Utility study

State Entity Level Tax Election – Varies by State

- State income and real estate tax deductions capped at \$10,000
- Entity level tax: SALT CAP workaround
- Entity-level election allows pass-through entities to be taxed at the entity level and bypass the SALT deduction limits
- Tax paid at entity level and deducted on corporate return
- Better net result for flow-through entity owner



Plant &

Equipment

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Manufacturing Plant & Equipment

- Bonus depreciation – phase-down begins in 2023
- Repairs & maintenance analysis
- Qualified improvement property
 - Clean rooms
 - Office remodels
- Self-constructed equipment

Manufacturing Plant & Equipment

- Cost Segregation Study
 - ▶ Acceleration of depreciation deductions
 - ▶ Bonus depreciation and the automatic method change opportunity makes this extremely impactful
- Energy Efficient Building Deduction (179D)
 - ▶ Lighting, HVAC or Building Envelope
 - ▶ As much as \$5.00 per square foot
- Self-Constructed Assets
 - ▶ Process Research & Development
 - ▶ Design & Development of equipment & processes – IRC 174(a)



Other

Planning

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Other Tax Planning

- Pass-through entities
 - ▶ Basis, At-risk, Active vs. passive, excess loss limitations
- Export Incentives
 - ▶ IC-DISC
- IRS Budget Increasing
 - ▶ Many more audits
 - ▶ Time to review your methods of accounting!



Top 10 List
Tax Benefits for Plastic Processors

Top Ten Credits & Incentives for Plastics Processors

1. R&D Tax Credits
2. Accounting methods (cash basis, UNICAP)
3. LIFO
4. Work Opportunity Tax Credit (WOTC)
5. Employee Retention Credit (ERC)
6. Sales Tax Exemptions
7. Entity Level Tax
8. Cost Segregation
9. Energy Efficient Building Deduction (Section 179D)
10. IC-DISC

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