2019 Year-End Tax Planning for Manufacturing and Distribution Companies

WEALTH ADVISORY | OUTSOURCING | AUDIT, TAX, AND CONSULTING

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Presented by: Nate Richwine, CPA, JD

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About CLA

- A professional services firm with three distinct business lines
  - Wealth Advisory
  - Outsourcing
  - Audit, Tax, and Consulting
- More than 6,000 employees
- Offices coast to coast
- We serve nearly 7,000 privately held manufacturers and distributors

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Speaker Introductions

Nate Richwine, CPA, JD

Manager, Indianapolis, IN

Nathan is a manager in CLA's manufacturing industry group. He has more than seven years of experience in public accounting, providing tax compliance and advisory services to multi-state and multinational C corporations, S corporations, partnerships, and small-to-midsize family businesses and their owners across a variety of industries. He also has experience with tax provision preparation (ASC 740).

As a tax manager, Nathan is responsible for working closely with clients and overseeing CLA tax service teams with respect to tax return and provision preparation and tax planning and advisory services.

Speaker Introductions

Jamey Jagodzinski, CPA

Manager, Oak Brook, IL

Jamey is a manager in CLA's Manufacturing industry group. He has nine years of experience with a focus on tax serving a wide variety of businesses ranging from start-ups to multi-state, multi-national corporations. Industry experiences includes manufacturing and distribution, metal forming and machining, and food and beverage.

Learning Objectives

At the end of this session, you will be able to:

- Identify actions to take in the last 2 months of 2019 to optimize your tax position
- Determine year end strategies related to capital expenditures
- Recognize personal standard and itemized deduction strategies

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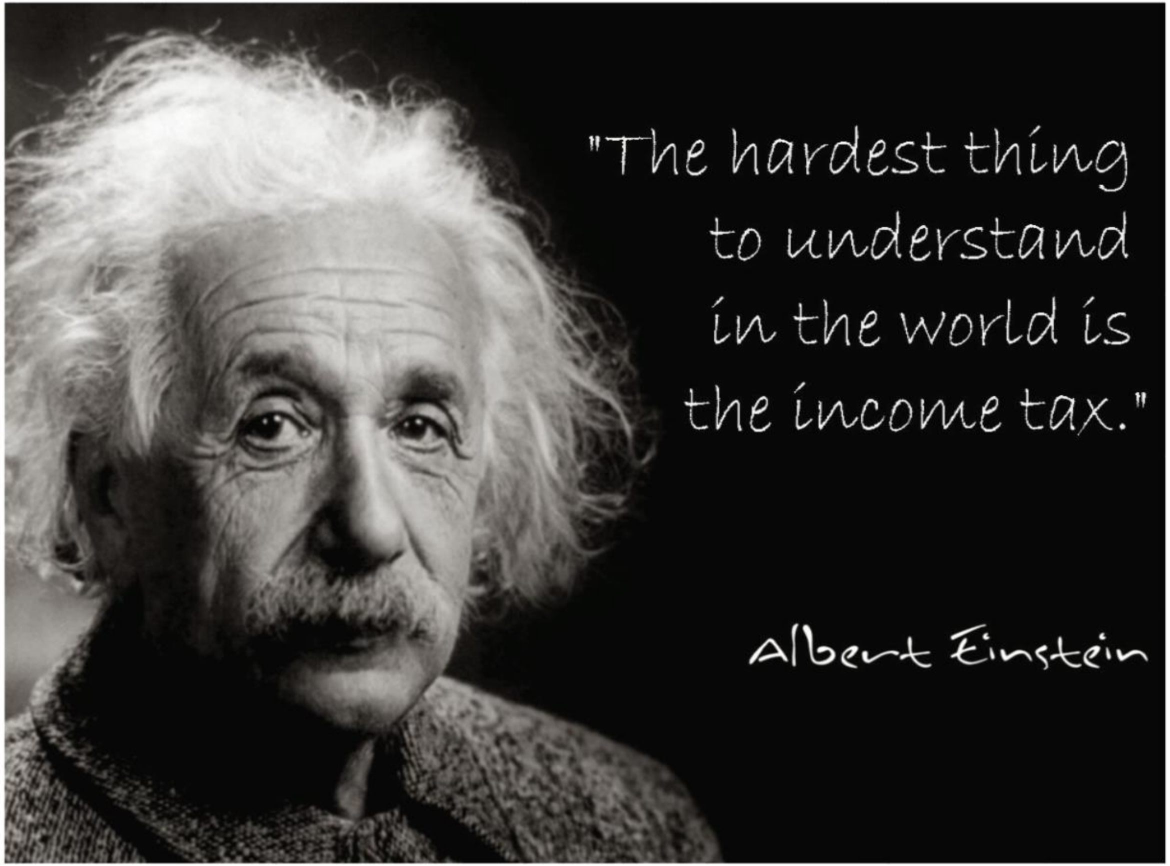
"The hardest thing
to understand
in the world is
the income tax."
Albert Einstein

History

- **9-27-17: Republican leadership issues Framework**
- **11-3-17: House Ways & Means Committee releases first draft of legislation: H.R. 1**
- **11-9-17: Senate mark-up**
- Conference committee reported 12-15-17
- **Reconciliation (budget allows $1.5 trillion increase in deficit for tax reform in 10-year period)**
- June 21, 2018 – South Dakota v. Wayfair, Inc. decision
- Proposed regulations issued on 2018 and 2019

Individual Planning Actions

- Charitable giving strategies
  - Bunching
  - Donor advised funds
  - Charitable trusts
  - Appreciated securities
- Review withholding/estimated payments
- Retirement plan contributions
- Review school funding strategies
- Review estate plan

Tax Cuts and Jobs Act (TCJA)

Key Aspect Comparison:
Business Provisions

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Individual Qualified Business Income (QBI Deduction)

- Taxpayers, other than C corps, can deduct up to 20% of QBI
- Limitation based on wages and qualified property
  - Does not apply to taxpayers under certain dollar threshold
- Taxpayers over the threshold determine a QBI component
- The Sec. 199A deduction is below AGI
  - Last item in arriving at taxable income
- Specified service businesses generally not eligible
  - Unless under threshold
- *Sunsets for tax years beginning after 12/31/2025*

Rental Real Estate Safe Harbor

- Must elect on return
- Spend 250 hours of service with respect to the enterprise
  - Narrowly construed
- Maintain separate books and records for each rental real estate enterprise
- Maintain contemporaneous records
  - No records = no safe harbor

Rental Real Estate Trade or Business

- Activity conducted with regularity and continuity
- Activity engaged in for profit
- Opportunity to re-structure triple net lease?

QBI Planning Opportunities

- Run estimated calculations
  - Consider aggregation of multiple trades or businesses
- Review owner compensation
- Review entity type (more to come)
  - Change to S-Corps for W-2 limitation?

Bonus Depreciation

- 100% Bonus Depreciation
  - Phase down beginning in 2023 (fully phased out after 2026)
  - Eligibility expanded to <u>used</u> property
  - State decoupling modifications

Capital Expenditure Planning

- Review cap-ex plan for coming years
  - Operations still #1 priority
- Consider a cost segregation study
  - For both existing buildings and newly purchased
  - Automatic accounting method change

Fixed Asset Depreciation Studies- Example

- 1,000,000 Asset placed in service on 1-1-2009 with a 39 year life
- Assume- 30% of the asset is allowed to be depreciated over 5 years rather than 39
- On 2019 tax return, taxpayer gets an additional deduction of 215,385
- 2019 tax savings of approximately $86,000
- Net Present Value Benefit of over $40,000

Accounting Methods

- **Methods of Accounting (Under TCJA)**
  - Cash method permitted for all businesses with average annual gross receipts < $25M
    - Aggregation of gross receipts from related businesses
  - Inventory accounted for as non-incidental supplies (i.e. hold at **cost** until sold) or by conforming to method reflected on financial statements
  - Exempt from Uniform Capitalization (§263A)
  - *Automatic Consent Accounting Method Change*

Example – Accrual to Cash Impact

ABC Manufacturing Corporation	
Assets	
Cash	31,000
Accounts Receivable, Net	**736,000**
Inventory – Raw Material	1,750,000
Inventory Work in Process – Labor and Overhead	**250,000**
Inventory – Materials and Supplies	100,000
Prepaid Expenses	**75,000**
Property, Plant, and Equipment, Net	450,000
Total Assets	**$3,392,000**
Liabilities and Equity	
Accounts Payable	**303,000**
Mortgage Payable	1,290,000
Accrued Payroll	**150,000**
Customer Deposits	300,000
Capital Stock	200,000
Retained Earnings	1,149,000
Total Liabilities and Equity	**$3,392,000**
*****$250,000 of costs capitalized to ending inventory under §263A**	

Example – Accrual to Cash Impact Cont.

481(a) Calculation	
Deduct Assets:	
Accounts Receivable, Net	(736,000)
Inventory Work in Process – Labor and Overhead	(250,000)
Prepaid Expenses	(75,000)
Addback Accrued Liabilities:	
Accounts Payable	303,000
Accrued Payroll	150,000
Deduct 263A Costs	
Previously Capitalized 263A Costs	(250,000)
Net 481(a) adjustment	**(858,000)**

Meals & Entertainment

- **Entertainment Expense: <u>Non-Deductible!</u>**
  - Transportation passes and parking fringes disallowed
  - Social, athletic and sporting clubs treated as entertainment
- **Employer-provided eating facility <u>limited to 50%</u>**
  - *Pre-TCJA: 100% Deductible*
  - Also repeals employer deduction for employer-provided on premises meals and employer eating facilities after 2025
- Meals consumed on work travel remain 50% deductible

Meals & Entertainment

- IRS Notice 2018-76: Meals are separate from entertainment when:
  - Ordinary and necessary, not lavish or extravagant;
  - Taxpayer or employee present at offering of food/beverage;
  - Provided to current or potential customer, client, consultant, or similar contact; and
  - If provided at an entertainment activity, food and beverages are purchased **separately** from the entertainment or the cost is stated **separately**

M&E Planning

- Start tracking separate buckets
- Request itemized receipts for certain events
- Educate employees

Research & Development Tax Credit

"Four-Part" Test/Qualified Research Activity (QRA)

- **Permitted Purpose**
  - Business Component: New or Improved
  - Product, Process, Computer Software, Technique, Formula or Invention
  - Held for sale, lease, license
  - Improve Functionality, Reliability, and/or Quality
- **Technological in Nature**
  - Physical Sciences (not social/business science)
- **Eliminate Uncertainty/Section 174 Expenses**
  - Buzzwords: Design, Prototype, Test
- **Process of Experimentation**
  - Iterative/Trial & Error

Qualified Research Expenses (QRE)

- **Qualified Wages**
  - Compensation for qualified services
  - Only includes wages for withholding purposes
  - Safe-Harbor 80% substantially all rule
- **Amounts Paid for Supplies**
  - Supplies have to be used and consumed in the qualified research
- **Contract Research Expenses**
  - 65% of payments paid to third-parties for qualified research
  - 75% of payments to certain research consortia

WORK OPPORTUNITY TAX CREDIT AMOUNT

TARGET GROUP	MAXIMUM TAX CREDIT
VETERANS	
Receives SNAP benefits	$2,400
VETERANS ENTITLED TO COMPENSATION FOR SERVICE CONNECTED DISABILITY	
Hired one year from leaving service	$4,800
Unemployed at least 6 months	$9,600
UNEMPLOYED VETERANS	
At least 4 weeks	$2,400
At least 6 months	$5,600
OTHER WOTC TARGET GROUPS	
Short Term TANF Recipient	$2,400
Long-Term TANF Recipient	$9,000 (over two years)
SNAP (Food Stamp) Recipient	$2,400
Designated Community Resident	$2,400
Vocational Rehabilitation Referral	$2,400
Ex-Felon	$2,400
SSI Recipient	$2,400
Qualified Long-term Unemployment Recipient	$2,400

Investments in Opportunity Zones

- TJCA created new opportunity to defer certain gains
  - Gains reinvested in qualified opportunity funds (QOF)
- Committee Report limits deferral to capital gains
  - Statutory language refers to "any property"
- Three tax incentives:
  - Defer income to future years
  - Reduce recognized gain through basis adjustment
  - Exclude gain on certain appreciation
- No limit on amount deferrable

OZ Gain Deferral & Basis Adjustment

- Must reinvest gain within 180 days from disposition
- Deferred gain included in income earlier of:
  - Date taxpayer sells or exchanges interest in QOF or 12/31/2026
- Amount of gain recognized is excess of:
  - Lesser of gain deferred or FMV of investment at end of period, over
  - Taxpayer's basis in the investment
- Basis – starts at $0
  - Basis increase of 10% of deferred gain if investment held 5 years
  - Additional 5% increase if investment held 7 years

OZ Permanent Gain Exclusion

- If investment held 10 years, basis = FMV when sold
- Definitions
- Key Dates
  - Deferral election expires 12/31/2026
  - Must invest by 2021 to receive 10% basis increase
  - Must invest by 2019 to receive additional 5% basis increase

Example – Permanent Exclusion

- **FACTS:**
  - Bob sells property to an unrelated party and realizes a gain of $100,000 in 2019.
  - Within 180 days of the disposition, Bob invests all of the $100,000 gain in a QOF and makes a temporary deferral election.
  - Bob finally sells his interest in the QOF in 2030 for $250,000, satisfying the 10-year holding period requirement.
- **RESULT:**
  - Bob recognizes no income in 2030 from the sale of the QOF interest.
  - As a result, Bob paid tax on only $85,000 (in 2026) of the total $250,000 gain he realized.

South Dakota v. Wayfair

- Supreme Court decision June 21, 2018
  - Overturned the physical presence requirement for sales and use tax collection obligation from Quill v. North Dakota (1992)
  - States now have possibility to enforce sales tax collection requirement (nexus) over remote sellers
- Planning
  - Review state sales tax filing profile
  - Update process for collecting exemption certificates

Choice of Entity

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Choice of Entity

- Considerations
  - Qualified for 20% pass-through deduction?
  - Timing of dividends?
    - Trigger double taxation with C-Corp
  - Reasonable Compensation
  - Deductibility of state income taxes
    - Very limited or eliminated at personal level (pass-through)
    - Deductible to C-Corp
  - Passive or active owners
    - Passive likely subject to 3.8% NIIT
  - Transition/Exit strategy
    - Stock v. Asset, potential gain exclusion for certain stock sales
  - Future changes to tax law

Choice of Entity

	C Corporation	Pass-through (Active)	Pass-through (Passive)
Taxable Income	$100.00	$100.00	$100.00
Entity Level Tax	($21.00)	($0.00)	($0.00)
Net Distribution	$79.00	$100.00	$100.00
20% Deduction		($20.00)	($20.00)
Individual tax	($18.80)	($29.60)	($33.40)
After-tax cash	$60.20	$70.40	$66.60
Effective tax rate	39.8%	29.6%	33.4%

Summary

- Opportunities!!!
  - Qualified business income deduction
  - Accelerated depreciation
  - Accounting method changes
  - Credits and incentives
  - Entity choice


Questions?

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Questions?

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