TAX OPPORTUNITIES AND CHALLENGES FOR MANUFACTURERS

Navigating a complicated tax landscape

Thursday, January 19, 2017
Our manufacturing focus

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2017 OUTLOOK
Why tax planning is urgent today

• Major tax law changes are in the horizon
  • Focused on reduction in tax rates
  • Potential for limits on incentives
  • Impact on federal, international and state taxes

• Opportunity
  • 2016 filing
  • 2017 planning
FEDERAL TAX

2017 planning tips for manufacturers
Giving manufacturers a competitive edge

• Reduce corporate tax rates and promote fair rules for global income inclusion
• Create a more reasonable regulatory environment
• Encourage innovation by incentivizing research leveraging technology and employing top talent
• Reform trade, energy and environmental policies and improve infrastructure
• Invest in education and reform health care
### Proposed business tax reform

| Proposal |
|------------------|------------------|
| **Donald Trump** | • Comprehensive tax reform  
 • Lower the rates for all types of businesses  
 • Encourage investment in capital (tangible and intangible)  
 • End inversions  
 • Tax foreign earnings as earned – eliminate deferral |
| **House Republicans** | • Comprehensive tax reform proposal  
 • Lower the rates for all types of businesses  
 • Encourage investment in capital (tangible and intangible)  
 • Discourage debt  
 • Restructure taxation of foreign earnings  
 • Level the trade playing field |
The current PATH for 2016: Credits

• Research and Development (R&D) Credit
  • Permanent provision
  • Special rules for small business
    • Alternative Minimum Tax
    • FICA Payroll Tax

• Work Opportunity Tax Credit (WOTC)
  • Extended provision through 2019
  • Reduces employers tax liability
    • Up to $9,600 per newly-hired eligible employee
The current PATH for 2016: Reducing taxable income

• S Corporations
  • Stock basis adjustment for charitable contributions of property
  • Exemption from corporate tax on built in gains assets

• Capital expenditures
  • Small business expensing under Section 179
  • 15-year recovery for certain property
  • bonus depreciation
Tax accounting methods

• Timing of recognizing income and expenses for tax purposes
• Comparison to book/GAAP treatment
• Changing tax rates provide for a permanent savings – “tax rate arbitrage”
  • Deduct item for tax in 2016 at 35 percent rate
  • Reverse item in 2017 at 15 percent rate
  • 20 percent permanent cash tax savings
Benefits of method changes

- Streamlined filing procedures
- No need to amend open returns
- Favorable recognition periods
- IRS audit protection
Income deferral strategies

• Overall cash or accrual
• Advanced payments, deposits and deferred revenue
• Long-term contracts
• Installment sales
• Like-kind exchanges
Expense acceleration strategies

- Prepaid expenses
- Self-insured medical
- Accrued rebates
- Software development costs
- Fixed assets and depreciation
- Other opportunity
  - Meals and entertainment
STATE TAX

Important changes with state taxing regimes
Nexus

• Nexus defined
  • The level of activity a business has to have with a state before that state can impose a tax liability and filing responsibility on the business

• Moving target
  • Recent statutory and judicial developments
  • Changes in business structure and operations
Nexus opportunities

• Opportunities to consider
  • P.L. 86-272
  • Right to apportion
  • Throwback or throwout reduction
  • Attribute maximization through nexus-related structuring
  • Combined group management
Apportionment rules for manufacturers

• Enactment of special apportionment rules for manufacturers:
  • Keeping UDITPA apportionment rules when rules applicable to other entities are changed; OR
  • Providing a sales factor heavy apportionment rule for manufacturers to incentivize in-state manufacturing

• Examples

<table>
<thead>
<tr>
<th></th>
<th>Connecticut</th>
<th>Massachusetts</th>
<th>Oklahoma</th>
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</thead>
<tbody>
<tr>
<td>Louisiana</td>
<td></td>
<td>Mississippi</td>
<td>Rhode Island</td>
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<tr>
<td>Maryland</td>
<td></td>
<td>New Mexico</td>
<td>Virginia</td>
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Credits and incentives opportunities

• Transaction-driven
  • Acquiring a new business operation

• Company-driven
  • Create new business operations
  • Expand, realign or relocate existing facilities
  • Maintain existing facilities

• Typical Investments
  • Construction, purchase or lease of new or expanded facilities
  • Purchase of new machinery or equipment
  • Infrastructure improvements
  • Hiring or retention of employees (new or existing)
  • Training of employees (new or existing)
Tax reform possibilities

• State conformity with Internal Revenue Code
  • Decoupling provisions
    • Bonus depreciation
    • Section179
  • Expansion of the sales and use tax base
    • Extend application to various services, digital goods and software as a service
    • Remove existing exemptions
  • Adopt gross receipts or hybrid tax system
    • Broaden the tax base, lower the tax rate
    • Ohio CAT, Texas Margin Tax, Washington B&O
• Property tax
INTERNATIONAL TAX

Important considerations for the multinational manufacturer
2016 developments: BEPS and CbCR

Base Erosion and Profit Shifting (BEPS)

• Multilateral instrument finalized
  • Scrutiny on treaty abuse
  • Commissionaire structures targeted
  • May alter treaties by mid-2017 (definition of permanent establishment)

• Country by country reporting (CbCR)
  • U.S. rules generally coming into effect in 2017
  • Foreign rules may apply in 2016
2016 developments: 987 regulations finalized

- Will impact most multinationals with disregarded/flow through entities in their structures
- Complex and cumbersome computations and tracking
- Effective dates vary depending on prior methods used
- Relevant one time elections become important
## Possible 2017 tax reform: International tax

<table>
<thead>
<tr>
<th>Worldwide taxation (current U.S. system)</th>
<th>Territorial system</th>
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<tbody>
<tr>
<td>Tax all worldwide income of domestically headquartered companies <strong>when the money is repatriated to the United States (deferral)</strong></td>
<td>Tax only the income earned within a country’s borders. Income earned abroad is not taxed.</td>
</tr>
<tr>
<td>Allow credits for taxes paid in foreign countries when the earnings are repatriated to the United States</td>
<td>Exempts dividends received from foreign subsidiaries</td>
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### Possible reform: Overall system

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<th>Proposal</th>
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| **Donald Trump**               | • Retain worldwide system  
|                                | • Eliminate deferral of tax on foreign earnings  
|                                | • Credit for foreign taxes paid                                         |
| **House Republicans**          | • Territorial system  
|                                | • Border adjustment for exports and imports, i.e., impose tax on imports and rebate tax on exports |
## Possible reform: Current accumulated foreign earnings

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<th>Proposal</th>
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<tbody>
<tr>
<td><strong>Donald Trump</strong></td>
<td>• 10 percent tax</td>
</tr>
</tbody>
</table>
| **House Republicans** | • 8.75 percent tax on cash  
• 3.5 percent tax on remainder  
• Paid over eight years |
Questions for globally-active manufacturers

- Do you have aggressive treaty positions or rely on commissionaire structures?
- What’s your overall global tax strategy and how does this align with the general direction that the US tax system is headed?
- How will the one-time deferred earnings tax impact you?
  - Do you have low-taxed earnings that this could “free up” to bring back?
  - Is there a reason to consider bringing highly-taxed earnings back before the new regime?