UHY LLP
Certified Public Accountants

MANUFACTURING INSIDER

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TAX REFORM UPDATE

PRESIDENT TRUMP'S TAX PROPOSAL

On April 26, 2017, the White House distributed a memo describing President Trump's goals for tax reform. The memo lists the following four points under business reform:

- Reduced business tax rate
- Territorial tax system
- One-time tax on repatriation of trillions of dollars held overseas
- Elimination of tax breaks for special interests

Potential effects on corporate tax

Under President Trump's plan, the maximum tax rate for corporations would be reduced to 15 percent. The plan also aims to eliminate the corporate alternative minimum tax.

Potential effects on international tax

President Trump's plan replaces the current worldwide tax system with a territorial tax system. Under the territorial system, income is taxed in the country where it is earned without subsequently being taxed in the US.

Potential effects on pass-through entity income

Income recognized from pass-through entities and sole proprietorships would be taxed at a maximum rate of 15 percent. Treasury Secretary Mnuchin indicated measures may need to be taken to prevent employees from lowering their taxes and manipulating the tax system.

THE HOUSE OF REPRESENTATIVES TAX PROPOSAL

In June, 2017, the House Ways and Means Committee released a blueprint with the committee's goals for tax reform. The blueprint seeks to lower business taxes, repeal the alternative minimum tax, and to implement a destination-basis tax system for imports and exports.

Potential effects on corporate tax

The blueprint reduces the corporate tax rate to a flat 20 percent, and repeals the corporate alternative minimum tax.

Potential effects on international tax

The blueprint calls for a destination-basis tax system for imports and exports. Under a destination-basis approach, tax jurisdiction is determined based on the location of consumption. Similar to President Trump's

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plan, the blueprint advocates for a tax system exempting overseas profits from additional US taxation. The blueprint further advocates for border tax adjustments. However, it was announced on July 27, 2017, that the border adjustment tax will not be included in the tax reform bill. The border adjustment tax would have eliminated US tax on products and services exported while imposing a 20 percent US tax on products and services imported.

Potential effects on pass-through entities

The blueprint limits the tax on income recognized from pass-through entities and small businesses to a maximum rate of 25 percent.

Other house considerations

The blueprint allows businesses to take a full write-off for investments in tangible and intangible assets, with the exception of land.

Additionally, there are proposals for the following:

- Limitations regarding interest expense deductibility
- Preservation of the LIFO method of valuing inventory
- Permanent research and development credit

SEPTEMBER FRAMEWORK

On Sept. 27, 2017, a group of congressional leaders and White House officials, known as the Big Six, released the Unified Framework for Fixing Our Broken Tax Code. This framework for tax legislation is what Republicans hope to pass this year.

Potential effects on corporate tax

The September framework reduces the corporate tax rate to 20 percent and eliminates the corporate alternative minimum tax.

Potential effects on international tax

The September framework calls for the transformation of our existing offshoring model to an American model. The framework treats accumulated foreign earnings as repatriated with payment of tax spread over several years. Foreign profits of US multinational corporations will be taxed on a global basis, at a reduced rate.

Potential effects on pass-through entity income

The September Framework reduces tax on income recognized from pass-through entities and small businesses to a maximum rate of 25 percent. The committees will need to define wages and business profits in order to prevent tax avoidance by re-characterizing wages to business income.

Other house considerations

The September framework allows businesses to claim 100 percent expensing for depreciable assets, other than structures, for at least five years. This provision applies to capital expenditures made after Sept. 27, 2017.

Additional proposals include:

- Limitation of interest expense deductibility
- Elimination of the domestic production deduction under IRC Section 199
- Preservation of the research and development credit

What you can do now to prepare for tax reform

In order to prepare for potential tax rate cuts, you should take advantage of traditionally permanent items like the domestic production activities deduction and the research and development credit.

The following are several considerations to accelerate deductions into the current, higher tax year.

- Review depreciation to identify misclassified assets
- Deduct repair and maintenance costs
- Deduct software development costs
- Review inventory valuation methods, including the amounts currently capitalized to inventory
- Deduct Section 174 (research and experimental) expenses for prototypes
- Deduct IBNR for self-insured medical expenses
- Deduct twelve months of prepaid expenses
- Deduct rebates, services, and property taxes using the recurring item exception

Additionally, several changes should be considered to defer income into future, lower tax years.

- Defer advanced payments up to one year
- Defer recognition of disputed income
- Defer income recognition using the non-accrual experience method
- Defer recognition of advanced invoiced cash discounts (for example: prompt-pay discounts)

A change in accounting method may be necessary to take advantage of these deductions or income deferrals.

CONCLUSION

Whether tax reform will be accomplished in 2017, and to what extent, remains to be seen. However, you can act now to be prepared for potential changes.

By Colleen Dunn, Staff Accountant (St. Louis, MO)

> "The September framework reduces the corporate tax rate to 20 percent and eliminates the corporate alternative minimum tax."

CURRENT STATE OF THE MANUFACTURING INDUSTRY

According to a new Standard & Poor's report, there are two key indicators that will tell you what kind of shape the manufacturing industry is in. The first is the Institute for Supply Management's Purchasing Manager's Index and the second is the Federal Reserve's Capacity Utilization Index for motor vehicles and parts. A reading above 50 percent for the ISM index indicates that manufacturing is expanding in the US, and below 50 means that it is contracting. History shows that each time since 1983 that the index fell below 43 percent "speculative grade" automotive companies began to panic. Similarly any time the Fed's utilization rate dropped below 72 percent during that period, it caused stress to automotive companies. Let's take a look at where we stand as of August 2017:

ISM Purchasing Managers Index: 58.8%

Fed.Capacity Utilization Rate: 76.1%

MANUFACTURING INDUSTRY INSIGHT

UHY LLP recognizes that manufacturing companies require their auditors, tax specialists and business advisors to add value to financial reporting activities. That is why we combine the strength of business and financial expertise with a hands-on, "shop floor" approach to solving complex business decisions in these key segments:

- Aerospace & Defense
- Distribution
- Automotive Suppliers
- Industrial Manufacturing
- Consumer Products

Our professionals are leaders in the industry and take the steps necessary to ensure our client's future success by identifying and addressing new trends, accounting requirements and regulations.

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