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John F. Martin, CPA/PFS, CFP®
Joseph A. Hardick, CPA, CCIFP

Tax Planning for Manufacturers

John F. Martin, CPA/PFS, CFP®

Tax Partner

jmartin@dmcpas.com

Joseph A. Hardick, CPA, CCIFP

Tax Partner

jhardick@dmcpas.com

Dannible & McKee's Annual Manufacturing Conference

DoubleTree by Hilton, East Syracuse, New York

October 18, 2016

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Circular 230

Any tax advice contained herein was not intended or written to be used, and cannot be used, for the purpose of avoiding penalties that may be imposed under the Internal Revenue Code or applicable state or local tax law provisions.

Disclaimer

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Why Year-End Tax Planning is Important for Manufacturers

- Proper planning prior to year end allows manufacturers time to implement the opportunities and strategies that may defer, reduce or eliminate taxable income prior to year end.
- To provide manufacturers assistance in planning for and managing important tax issues.
- Avoidance of any unexpected tax issues arising during the preparation of tax returns.

Year-End Tax Planning – Projecting Book Income

- Comprehensive review of year-to date financial statements.
- Book adjustments are made as required.
- Projections of net book income for the remainder of the year need to be developed with client.

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Year-End Tax Planning – Projecting Book Income Example

ABC Manufacturing Corporation
Year-End Tax Planning Summary

	December 31, 2016	
	As Is	**Planning**
Net Book Income /(Loss) at October 31, 2016	**$ 2,000,000**	**$ 2,000,000**
Year-End Book Adjustments		
Projected November 2016 Net Book Income / (Loss)	100,000	100,000
Projected December 2016 Net Book Income / (Loss)	(75,000)	(75,000)
IC-DISC Commission	-	(250,000)
Projected 2016 Net Book Income / (Loss)	**$ 2,025,000**	**$ 1,775,000**

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Net Export Income Calculation (IC-DISC)

Qualified Export Receipts	$ 5,000,000
Cost of Goods Sold	(4,000,000)
Gross Margin	1,000,000
Selling, General and Administrative Expenses	(500,000)
Net Export Income	$ 500,000

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Commission Calculation

4% of Qualified Export Receipts **[1]**	$	200,000
50% of Net Export Income **[2]**		250,000
Greater of **[1]** or **[2]** - Commission to IC-DISC		250,000
Tax Rate		35.0%
Value of IC-DISC Commission Deduction		87,500
Less: Projected Tax on IC-DISC Dividend to Shareholder (23.8%)		(59,500)
Permanent Tax Savings	$	28,000

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Year-End Tax Planning – Tax Adjustments Example

ABC Manufacturing Corporation
Year-End Tax Planning Summary

	December 31, 2016	
	As Is	**Planning**
Tax Adjustments		
Meals and Entertainment - IRC Section 274(n)	$ 22,000	$ 22,000
Fines and Penalties - IRC Section 162(f)	3,000	3,000
Officers' Life Insurance - IRC Section 264(a)	30,000	30,000
Work Opportunity Credit - IRC Section 51	-	61,325
Book/Tax Depreciation Difference	475,000	475,000
First Year MACRS Depreciation	(286,264)	(129,737)
Bonus Depreciation (50%) - IRC Section 168(k)		(900,000)
Fixed Asset Expensing Election - IRC Section 179	-	(350,000)
Domestic Production Activity Deduction - IRC Section 199	-	(100,592)
Tax Adjustments	**$ 243,736**	**$ (889,004)**

Year-End Tax Planning – Tax Adjustments

- Meals and Entertainment – IRC Section 274(n): For tax purposes, 50 percent of certain meals and entertainment expenses are not deductible pursuant to Internal Revenue Code Section 274(n). It is important to note that certain meals and entertainment expenses would be 100 percent deductible for income tax purposes. These expenses include recreational expenses incurred for the benefit of the employees (office parties, Christmas parties, etc.) and meals provided for the convenience of the employer (such as working lunches or overtime meals provided to employees).
- Fines and Penalties – IRC Section 162(f): Pursuant to Internal Revenue Code Section 162(f), no deduction shall be allowed for any fine or penalty paid to the Federal government or any state or local government for the violation of any law.
- Officers' Life Insurance – IRC Section 264(a): Pursuant to Internal Revenue Code Section 264(a), the premiums paid on officers' life insurance are not deductible by the Company; however, the increase in cash surrender value of such policies is not taxable.

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Year-End Tax Planning - Opportunities for Manufacturers

- Interest Charge Domestic International Sales Corporation (IC-DISC).
- Employment Tax Credits - Work Opportunity Tax Credit (WOTC).
- Section 179 Expensing Election and Bonus Depreciation.
- The Domestic Production Activity Deduction (DPAD).
- Research and Development (R&D) Tax Credits.

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WOTC

Name	Hire Date	Term Date	Payroll 1/1/16-12/31/16	Date Applied must not be 28 days after start date	120-399 hrs	over 400 hrs	Qualified Wages	Applicable Percentage	Calculated Credit	Type of Targeted Employee per Form 8850
2nd year										
Employee	7/14/2015		$45,000.00	7/24/2015		1,550.00	10,000	50%	5,000	LT Temp Asst for Needy Family
Current Year								**25% or 40%**		
Employee	8/25/2016	11/13/2016	$12,000.00	8/25/2016	380.00		6,000	25%	1,500	ST Temp Asst for Needy Family
Employee	8/4/2016	10/12/2016	$7,000.00	8/4/2016	220.00		6,000	25%	1,500	SNAP (Food Stamps)
Employee	7/7/2016	8/26/2016	$3,500.00	7/7/2016	175.00		3,500	25%	875	SNAP (Food Stamps)
Employee	6/30/2016	9/8/2016	$10,000.00	6/23/2016	345.00		6,000	25%	1,500	SNAP (Food Stamps)
Employee	9/28/2016		$7,500.00	9/28/2016	270.00		6,000	25%	1,500	SNAP (Food Stamps)
Employee	9/8/2016	1/11/2017	$10,000.00	9/8/2016	395.00		6,000	25%	1,500	SNAP (Food Stamps)
Employee	5/5/2016	8/25/2016	$5,000.00	5/5/2016	320.00		3,000	25%	750	Summer Youth Employee
Employee	9/26/2016		$13,500.00	9/26/2016		2,100.00	6,000	40%	2,400	SNAP (Food Stamps)
Employee	8/24/2016	1/14/2017	$13,000.00	8/24/2016		500.00	6,000	40%	2,400	SNAP (Food Stamps)
Employee	7/14/2016		$24,500.00	7/14/2016		805.00	6,000	40%	2,400	SNAP (Food Stamps)
Employee	3/23/2016	10/26/2016	$30,000.00	3/23/2016		1,350.00	6,000	40%	2,400	SNAP (Food Stamps)
Employee	1/26/2016		$52,000.00	1/16/2016		1,650.00	6,000	40%	2,400	Veteran - unemployed 4 weeks
Employee	8/31/2016		$13,000.00	8/31/2016		485.00	6,000	40%	2,400	SNAP (Food Stamps)
Employee	2/16/2016	10/16/2016	$20,000.00	2/27/2016		800.00	6,000	40%	2,400	SNAP (Food Stamps)
Employee	4/27/2016		$18,000.00	4/27/2016		1,250.00	6,000	40%	2,400	SNAP (Food Stamps)
Employee	5/27/2016		$23,500.00	5/27/2016		850.00	6,000	40%	2,400	SNAP (Food Stamps)
Employee	7/7/2016		$25,000.00	7/7/2016		800.00	12,000	40%	4,800	Veteran - serv dbl & hired within 1 yr
Employee	1/20/2016		$55,000.00	1/13/2016		1,990.00	14,000	40%	5,600	Veteran - unemployed 6 mo
Employee	1/5/2016	7/27/2016	$15,000.00	1/19/2016		600.00	14,000	40%	5,600	Veteran - unemployed 6 mo
Employee	7/7/2016		$25,000.00	7/7/2016		820.00	24,000	40%	9,600	Veteran - serv dbl & unempl 6 mo
						Total Credits			61,325	

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WOTC (con't.)

Form 5884 Reconciliation

		Wages		Credit
Qualifed 1st Year Wages (25%)	$	36,500	$	9,125
Qualifed 1st Year Wages (40%)		118,000		47,200
Qualifed 2nd Year Wages (50%)		10,000		5,000
Total	$	164,500	$	61,325

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2016 Capital Expenditures

Asset	Depreciable Life		Cost
Computer Software	3 Years	$	50,000
Computer / Network Equipment	5 Years		100,000
Manufacturing Equipment	7 Years		1,700,000
Qualified Leasehold Improvements	15 Years		300,000
Total 2016 Capital Expenditures		$	2,150,000

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2016 Section 179 Election

Asset	Cost	Section 179
Computer Software	$ 50,000	$ -
Computer / Network Equipment	100,000	-
Manufacturing Equipment	1,700,000	100,000
* Qualified Leasehold Improvements	300,000	250,000
	$ 2,150,000	$ 350,000

* Includes A/C and heating units starting in 2016

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2016 Bonus Depreciation

Asset	Cost	Section 179	Bonus Depreciation	MACRS	MACRS w/o Section 179 and Bonus Depreciation
Computer Software	$50,000	$0	$25,000	$4,167	$8,334
Computer / Network Equipment	100,000	-	50,000	10,000	20,000
Manufacturing Equipment	1,700,000	100,000	800,000	114,320	242,930
*Qualified Leasehold Improvements	300,000	250,000	25,000	1,250	15,000
	$2,150,000	$350,000	$900,000	$129,737	$286,264

Total First Year Depreciation w/179 and 50% Bonus	**$1,379,737**
Total First Year Depreciation w/o 179 and 50% Bonus	**$286,264**
Additional First Year Depreciation Deductions	**$1,093,473**

* Includes A/C and heating units starting in 2016

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Section B – Alternative Simplified Credit

Line 24	Wages for Qualified Services	$ 875,000
Line 25	Cost of Supplies	150,000
Line 26	Rental or Lease Costs of Computers	-
Line 27	Enter the Applicable Percentage of Contract Research Expenses	250,000
Line 28	Total Qualified Research Expenses. Add Lines 24 through 27	1,275,000
Line 29	Enter Your Total Qualified Research Expenses for the Prior Three Years	3,670,000
	2014 1,250,000 **PYTR**	
	2013 1,270,000 **PYTR**	
	2012 1,150,000 **PYTR**	
Line 30	Divide Line 29 by 6	611,667
Line 31	Subtract Line 30 from Line 28	663,333
Line 32	Multiply Line 31 by 14%	92,867
Line 34	Multiply Line 32 by 65% for the Reduced Credit under IRC Section 280C	$ 60,363

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Year-End Tax Planning – Taxable Income Summary

ABC Manufacturing Corporation
Year-End Tax Planning Summary

	December 31, 2016	
	As Is	**Planning**
Projected 2016 Net Book Income / (Loss)	**$ 2,025,000**	**$ 1,775,000**
Tax Adjustments		
Meals and Entertainment - IRC Section 274(n)	22,000	22,000
Fines and Penalties - IRC Section 162(f)	3,000	3,000
Officers' Life Insurance - IRC Section 264(a)	30,000	30,000
Work Opportunity Credit - IRC Section 51	-	61,325
Book/Tax Depreciation Difference	475,000	475,000
First Year MACRS Depreciation	(286,264)	(129,737)
Bonus Depreciation (50%) - IRC Section 168(k)		(900,000)
Fixed Asset Expensing Election - IRC Section 179	-	(350,000)
Domestic Production Activity Deduction - IRC Section 199	-	(100,592)
Taxable Income	**$ 2,268,736**	**$ 885,996**

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Year-End Tax Planning – Illustration of Tax Savings

ABC Manufacturing Corporation
Year-End Tax Planning Summary

	December 31, 2016	
	As Is	**Planning**
Net Book Income /(Loss) at October 31, 2016	**$ 2,000,000**	**$ 2,000,000**
<u>Year-End Book Adjustments</u>		
Projected November 2016 Net Book Income / (Loss)	100,000	100,000
Projected December 2016 Net Book Income / (Loss)	(75,000)	(75,000)
IC-DISC Commission	-	(250,000)
Projected 2016 Net Book Income / (Loss)	2,025,000	1,775,000
<u>Tax Adjustments</u>		
Meals and Entertainment - IRC Section 274(n)	22,000	22,000
Fines and Penalties - IRC Section 162(f)	3,000	3,000
Officers' Life Insurance - IRC Section 264(a)	30,000	30,000
Work Opportunity Credit - IRC Section 51	-	61,325
Book/Tax Depreciation Difference	475,000	475,000
First Year MACRS Depreciation	(286,264)	(129,737)
Bonus Depreciation (50%) - IRC Section 168(k)		(900,000)
Fixed Asset Expensing Election - IRC Section 179	-	(350,000)
Domestic Production Activity Deduction - IRC Section 199	-	(100,592)
Taxable Income	**$ 2,268,736**	**$ 885,996**

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Year-End Tax Planning – Illustration of Tax Savings (con't.)

Computation of Income Tax

Income Tax	**$ 771,370**	**$ 301,239**
Less: Fuel Tax Credit (For Off-Highway Use)	**$0**	**($2,000)**
Less: R&D Tax Credit	**-**	**(100,592)**
Less: Work Opportunity Tax Credit	**-**	**(61,325)**
Total Tax	**$ 771,370**	**$ 137,321**

Summary of Total Income Tax Savings

Deferral of Income Tax with Election of Section 179 and 50% Depreciation	**$ 371,781**
Tax Savings with IC-DISC*	**85,000**
Tax Savings with DPAD	**34,201**
Tax Savings with Fuel Tax Credit	**2,000**
Tax Savings with R&D Tax Credit	**100,592**
Tax Savings with WOTC	**40,475**
Total Income Tax Savings	**$ 634,049**

* Net tax savings on IC-DISC must be adjusted for tax on dividend income to shareholders

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Additional Changes for 2016

- Accelerated filing deadlines take effect for Forms W-2, W-3, and Form 1099-MISC for the 2016 tax year – The filing deadlines for these reporting forms have been moved up and are now due to the IRS by January 31, 2017 rather than the last day of February .
- Increased penalties for late information return filings – along with the accelerated filing dates for certain reporting forms, beginning in 2017 the related penalties are now subject to inflationary adjustments.

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Additional Changes for 2016 (con't.)

- Changes to C corporation, partnership and other tax return due dates:

  a. Beginning with the 2016 tax returns, the due date for C Corporation calendar-year and fiscal year tax returns, other than C corporations with a fiscal year ending on June 30th, has been moved back one month to the 15th day of the fourth month following the corporation's year-end.

  b. Partnership tax returns are now due on the 15th day of the third month following the partnership's year-end.

  c. The filing deadline for FinCEN Form 114, report of Foreign Bank and Financial Accounts (FBAR), was moved up from June 30th to April 15th. FBAR filers can also request a six month extension.

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New York State Tax Changes

1. Corporate tax changes effective January 1, 2015 – See TSB-M-15(1)C.

   A. New Bases for Corporate Tax.

      - All corporations will compare the taxes on business income, business capital and the fixed dollar minimum tax, and pay the largest one.
      - The alternative minimum tax and the tax on subsidiary capital have been repealed.

   B. Starting point – Federal taxable income. No add-back of foreign taxes paid. NO exemption for income from subsidiary capital. No 50 percent dividend deduction. Most other modifications are continued.

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New York State Tax Changes (con't.)

- Business income – Use business allocation percentage (receipts only). Start with entire net income minus investment income and exempt income.

C. Market-based sourcing.

- Single sales factor using market-based sourcing. The rules do not change for sales of tangible property (sourced to the location of the customer) and data/information delivered on-line (location of customer's access). Services, however, will now be sourced to the location where the services are delivered, not where the services were performed. If the delivery or access point is unknown, the customer's billing address/zip code can be used.

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Overview of the rules:

Market-Based Sourcing

Type of Income	Old Rule	New Rule
Sales of TPP	"Ship to" address	Customer's location
Services	Where are the services performed	Hierarchy: 1. Location where services delivered 2. Customer's billing address 3. Zip code 4. Last year's apportionment schedule

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2. Rates – Entire Net Income (ENI) Base/Business Income Base

Type of Income	Tax Year 2015	Tax Year 2016	Tax Year 2017	Tax Year 2018 and Thereafter
Qualified New York Manufacturers [1]	0.000%	0.000%	0.000%	0.000%
Qualified Emerging Technology Companies (QETCs)	5.700%	5.500%	5.500%	4.875%
Small Business (under 100 employees) [2]	6.500%	6.500%	6.500%	6.500%
Remaining Taxpayers	7.100%	6.500%	6.500%	6.500%

[1] Includes eligible qualified New York manufacturers. Either all of $1 million of manufacturing property in New York. Over 50 percent of receipts from manufacturing. Limited to property "principally used by the taxpayer in the production of goods by manufacturing, processing, assembly, refining, mining, extracting, farming, agriculture, horticulture, viticulture or commercial fishing." *See* TSB-M-15(3)C and TSB-M-15(3.1)C.

[2] For the 2015 tax year, current law graduated rates apply to small businesses.

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- The fixed dollar minimum amounts were reduced for most C corporations and are unchanged for S corporations.

Type of Business	Tax Year 2015	Tax Year 2016	Tax Year 2017	Tax Year 2018	Tax Year 2019	Tax Year 2020	Tax Year 2021 and Thereafter
Qualified New York Manufacturers & QETCs	0.015%	0.106%	0.085%	0.056%	0.038%	0.019%	0.000%
Remaining Taxpayers	0.150%	0.125%	0.100%	0.075%	0.050%	0.025%	0.000%

- For tax years beginning on or after January 1, 2015, the tax is capped at $350,000 for qualified New York manufacturers and QETCs, and $5 million for all other taxpayers.

- Small business taxpayers are exempt from the capital base tax in their first two years.

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3. Net Operating Losses

- Will now be computed without reference to Federal net operating losses. Losses incurred after 2014 can be carried back three years (not before 2015) and forward 20 years.
- The net operating loss carryforward will equal the current year's loss times the business allocation percentage for that year.
- Beginning in 2015, a taxpayer will not be able to deduct any losses incurred in prior years or when the taxpayer was not a New York taxpayer. Instead, there will be a new prior net operating loss conversion subtraction (PNOLCS).

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- A company's net operating loss will be computed on the last day of 2014 and multiplied by the base year (usually 2014) apportionment and divided by 6.5 percent (or 5.7 percent for manufacturers) to equal the total PNOLCS for the future. Taxpayers can claim one-tenth a year for up to the next 20 years (with a carryover if unused) or use one-half in 2016 (with no carryover if unused).
- Note that the PNOLCS cannot reduce the tax on business income lower than either of the tax on business capital or the fixed dollar minimum.

New York State
Tax Benefits for Manufacturers

- Economic Nexus – Under previous law, a corporation does not have nexus if it only has sales into New York since nexus requires a physical presence, employees, or assets in New York.
- The law adopts a "bright line" economic standard of taxation for corporations deriving at least $1 million of receipts from activities in New York beginning January 1, 2015.

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New York State
Tax Benefits for Manufacturers

- For example, if an out-of-state company with no physical presence in New York has sales to New York customers in excess of $1 million, they will be subject to New York tax.
- Public Law 86-272 still applies and should provide a safe-harbor, but only for tax on income from sales of tangible personal property.
- Public Law 86-272 cannot protect against tax on capital or the fixed dollar minimum tax.

New York State
Tax Benefits for Manufacturers

Attention

- The zero tax rate only applies to corporate taxes (C-corporation); therefore, all other forms of entity S-corporations, LLCs, partnerships and sole proprietors, which are taxed at the individual level, do not benefit from the zero tax rate.

New York State
Tax Benefits for Manufacturers

Real Property Tax Credit for Manufacturers

- Effective for tax years beginning on or after January 1, 2014, qualified New York manufacturers can claim a credit equal to 20 percent of the real property taxes paid during the taxable year for real property owned by such manufacturer in New York and principally used in manufacturing.

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New York State
Tax Benefits for Manufacturers

- Credit is also allowed for property taxes paid on real property leased from an unrelated third-party if the taxes are paid pursuant to explicit requirements in written lease and remitted directly to the taxing authority.

Other Credits Still Available

Investment Tax Credit (Form CT-46)

- Manufacturers who acquire certain property that is located in New York State and is principally used by the taxpayer in manufacturing or research and development may qualify for the New York State Investment Tax Credit. This credit is equal to a certain percentage (see below) of the cost basis of tangible property, including buildings and structural components of buildings that is depreciable under Internal Revenue Code Section 167 or 168, has a useful life of 4 years or more and was not expensed under Internal Revenue Code Section 179(a).

Other Credits Still Available

- For C corporations, the respective percentage is 5 percent of the cost basis of the qualifying property used in manufacturing and 9 percent of the cost basis of qualifying property used in research and development. For S corporations, partnerships and LLCs, the percentage is 4 percent of the cost basis of qualifying property used in manufacturing and 7 percent of the cost basis of qualifying property used in research and development.

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Other Credits Still Available

- For Article 9-A taxpayers, the Investment Tax Credit is nonrefundable and cannot reduce the taxpayer's tax liability to less than the greater of the tax on minimum income (MTI) or the fixed dollar minimum tax. For Article 22 taxpayers, the Investment Tax Credit is also nonrefundable and can reduce the taxpayer's tax to zero. Any credits generated in a tax year, but not used due to the limitations can be carried forward for 15 tax years for C corporations and 10 tax years for other entities. However, there is a provision whereby "new businesses," defined as any business in operation for 5 years or less, can elect to have any excess credit refunded instead of carried forward.

Other Credits Still Available

- The acquisition costs of an entire building can qualify for the ITC if at least 50 percent of the usable space is used in a qualifying activity. TSB-A-10(9)C. Equipment qualifies if it is used in a qualifying activity more than 50 percent of its operating time. However, loan originations, without the sale of the resulting securities are not a qualifying activity. *Astoria Financial Corporation*, _NYS2d_(3d Dept't., June 11, 2009).

Other Credits Still Available

<u>Employment Incentive Credit (Form CT-46)</u>

- For manufacturers who took advantage of the Investment Tax Credit, there is available an Employment Incentive Credit. The Employment Incentive Credit is allowed for 2 years following any claim for the Investment Tax Credit. In order to qualify for the credit, the taxpayer's average number of employees in New York State must be at least 101 percent of the employees in New York State during the employment base year (the year prior to the year when the Investment Tax Credit was claimed).

Other Credits Still Available

- The amount of the Employment Incentive Credit is a percentage of the original investment credit base and will vary depending on the level employment ranging from 1.5 percent to 2.5 percent depending on the percentage increase of average employees over the base year.

Other Credits Still Available

- For Article 9-A taxpayers , the Employment Incentive Credit is nonrefundable and cannot reduce the taxpayer's tax liability to less than the greater of the tax on minimum income (MTI) or the fixed dollar minimum tax. For Article 22 taxpayers, the Employment Incentive Credit is also nonrefundable and can be reduce the taxpayer's tax to zero. Any credits generated in a tax year but not used due to the limitations can be carried forward for 15 tax years for C corporations and 10 tax years for other entities. However, there is a provision whereby "new businesses," defined as any business in operation for 5 years or less, can elect to have any excess credit refunded instead of carried forward.

Other Credits Still Available

Hire a Veteran Credit

- Beginning with tax years starting on or after January 1, 2015, but before January 1, 2016, manufacturers may be able to claim a nonrefundable tax credit for the hiring and employing of qualified veterans. This credit can be used to offset both Article 9-A and Article 22 taxes.

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Other Credits Still Available

- In order to claim this credit, the taxpayer must hire a qualified veteran who begins his or her employment on or after January 1, 2014 but before January 1, 2017, <u>and</u> employ said qualified veteran in New York State for one year or more for at least 35 hours each week. In addition, the employer must have the qualified veteran complete Form DTF-75, Employee Affidavit for the Hire a Veteran Credit on or before he or she begins employment.

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Other Credits Still Available

- The amount of the credit allowed depends on whether the qualified veteran is also a disabled veteran. If the qualified veteran is not a disabled veteran, the amount of the credit is equal to 10 percent of the total wages paid to the veteran during his or her first full year of employment, but not more than $5,000. If the qualified veteran is a disabled veteran, the amount of the credit is equal to 15 percent of the total wages paid to the veteran during his or her first full year of employment, but not more than $15,000

Other Credits Still Available

- The credit is nonrefundable, however, any amount of the credit not used in the current tax year may be carried forward to the following 3 years. For Article 9-A taxpayers, the credit cannot reduce the tax below the fixed dollar minimum tax. For Article 22 taxpayers, the amount of the credit may reduce the tax to zero.

Other Credits Still Available

- It is important to note that a taxpayer who discharges or terminates an employee and hires as a replacement a qualified veteran solely for the purpose of qualifying for this credit is not eligible to claim the credit for <u>any</u> qualified veteran.

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Questions

John F. Martin, CPA/PFS, CFP®
Tax Partner

Email: jmartin@dmcpas.com

Web: www.dmcpas.com

Address:
Financial Plaza
221 South Warren Street
5th Floor
Syracuse, NY 13202

Phone: (315) 472-9127

Scan to add John Martin to your contacts.

DANNIBLE & MCKEE, LLP
Certified Public Accountants and Consultants

Joseph A. Hardick, CPA, CCIFP
Tax Partner

Email: jhardick@dmcpas.com

Web: www.dmcpas.com and
www.dmconsulting.com

Address:
Financial Plaza
221 South Warren Street
5th Floor
Syracuse, NY 13202

Phone: (315) 472-9127

Scan to add Joseph Hardick to your contacts.

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Appendix A

Interest Charge Domestic International Sales Corporation

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Basics of IC-DISC

- IC-DISC starts as Domestic C-Corp.
- Its purpose is to assist the exporter with their export sales and the DISC is entitled to commission equal to the <u>greater</u> of:
  - 50 percent of the export profits; or
  - 4 percent of the export sales (limited to profits).
- Exporter deducts commission at up to 35 percent Federal tax (C-Corp) or 39.6 percent for pass-through entities (S-Corp and LLCs).

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Basics of IC-DISC

- DISC <u>pays no Federal income tax</u> on commission income.
- Shareholders of IC-DISC are not taxed until dividends are distributed.
  - Individual shareholders are taxed at the qualified dividend rate of 20 percent.
- IC-DISC history goes back to 1971, but in 1986 FSC became much more popular, as it was a permanent tax benefit, and the DISC was conceived as deferral only.

Basics of IC-DISC

- *Deferral*: Commissions of up to $10 million of export sales every year can accumulate in the IC-DISC and do not need to be paid out as dividends – thus originally the IC-DISC was meant as a deferral benefit, but since 2004 the 15 percent dividend rate is more advantageous and even still is today at 20 percent.

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Calculation Example – Tax Benefits for a C-Corporation

Net Export Income Calculation

Qualified Export Receipts	$	5,000,000
Cost of Goods Sold		(4,000,000)
Gross Margin		1,000,000
Selling, General and Administrative Expenses		(500,000)
Net Export Income	$	500,000

Commission Calculation

4% of Qualified Export Receipts **[1]**	$	200,000
50% of Net Export Income **[2]**		250,000
Greater of **[1]** or **[2]** - Commission to IC-DISC		250,000
Tax Rate		35.0%
Value of IC-DISC Commission Deduction		87,500
Less: Tax on IC-DISC Dividend to Shareholder (23.8%)		(59,500)
Permanent Tax Savings	$	28,000

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Who May Be a Good Candidate

- Manufacturers, distributors, assembler, agriculture producer, software maker, extractor, engineering/architectural services provider.
  - Benefit where exports are at least $2 million at decent profits (10 percent or better) = $200,000 minimum export profit = minimum $15,000 tax savings.
    - Exporters often do not realize how much they export, since much of it (or even all of it) may be indirect through others.
    - Ultimate destination determines export classification.

Qualified Export Property Leading to Qualified Export Receipts

- Manufactured, produced, grown, extracted in U.S. by person other than IC-DISC.
- Held for sale, lease, or rental for direct consumption/disposition outside the U.S. (including indirect sales).
- Services related and subsidiary to qualified sale, rental, etc.
- Architectural and engineering services for construction projects outside U.S.

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What Qualifies as Export Property

- Export Property
  - Made, grown, extracted, etc. in the U.S. by person other than DISC.
  - Held for sale, lease, or rent for use, consumption, disposition outside U.S.
  - No more than 50 percent of FMV of product sold attributable to articles imported in the U.S.
  - Not sold or leased to another IC-DISC in the same controlled group.

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What Qualifies as Export Property

- Not Export Property:
  - Patents, trademarks, models, inventions, designs, processes, copyrights, or goodwill.
  - Prohibited products per 1979 Export Administration Act.
  - Unprocessed timber which is softwood.
  - Depletable property like oil, gas, coal, or uranium.
  - Presidentially decreed property in short supply.

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IC-DISC Benefits – Entity Types

- Exporter Flow-Through (S-Corp, Partnership, or LLC).
  - Assuming owners are taxed at 39.6 percent, the IC-DISC can turn ordinary income into dividend income at 20 percent = 19.6 percent savings.
  - IC-DISC owned by individual SHs or Flow-Through entity.
  - Consider next generation ownership.

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IC-DISC Benefits – Entity Types

- Exporter Private C-Corp.
  - C-Corp taxed at 35 percent maximum. Thus, IC-DISC saves 35 percent corporate tax-div 20 percent = 15 percent savings.
  - IC-DISC should be owned by individuals – no benefit if owned by exporter C-Corp (since no beneficial 20 percent rate).

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Non-Tax Reasons for IC-DISC

- Why use an IC-DISC (in addition to the obvious tax benefits)?
- Sale of a company or other succession.
- Executive bonus plan.
  - Could use deferral or just straight out rate differential for particular person or group of executives as bonus plan.
- Estate planning.
  - Consider gift tax implications under Revenue Ruling 81-54.

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IC-DISC Commission Details

1. Identify qualified export receipts – don’t forget indirect sales.
2. Track COGS for each export receipt (if possible).
3. Track SG&A:
   - Direct export expenses – allocable to exports 100 percent.
   - Indirect export expenses – apportioned based on appropriate methods.
4. Identify and eliminate loss transactions.
5. Perform full costing and marginal costing calculations.

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IC-DISC Implementation Timeline

- No benefits prior to IC-DISC incorporation.
  - File SS-4 and incorporate.
- File Form 4876-A within 90 days of incorporation.
  - Decide on owners:
    - With C-Corp exporter, usually C-Corp owners.
    - With S-Corp/LLC/other exporter, usually the pass-through entity owners.

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IC-DISC Implementation Timeline

- Prepare IC-DISC documents, by-laws, articles of incorporation, minutes, stock certificates, export sales agreement.
- Set-up general ledger for IC-DISC and bank account.

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The Federal Work Opportunity Tax Credit (WOTC)

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Employment Tax Credits

The Work Opportunity Tax Credit (WOTC) is a Federal tax credit available to employers for hiring individuals from certain target groups who have consistently faced significant barriers to employment. Each year, employers claim over $1 billion in tax credits under the WOTC program. WOTC joins other workforce programs that incentivize workplace diversity and facilitate access to good jobs for American workers.

The PATH Act extended the WOTC through tax years ending on or before December 31, 2019. Prior to the passing of the PATH Act, the WOTC was set to expire for tax years beginning on or after January 1, 2015.

Employment Tax Credits

- Employers Make the Hiring Decision - WOTC reduces an employer's cost of doing business and requires little paperwork, while helping those in need to find and retain good jobs.
- The U.S. Economy Benefits - The success and growth of this income tax credit for private sector business is beneficial for all who participate, while increasing America's economic growth and productivity.

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Employment Tax Credits
Who is Eligible?

Veteran

To be considered a veteran eligible for WOTC, an individual must meet these two standards:

1. Have served on active duty (not including training) in the U.S. Armed Forces for more than 180 days or have been discharged or released from active duty for a service-connected disability; and

2. Cannot have a period of active duty (not including training) of more than 90 days that ended during the 60-day period ending on the hiring date.

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Employment Tax Credits
Who is Eligible?

- To be eligible for WOTC, a veteran must also be one of the following:
  - A member of a family that received Supplemental Nutrition Assistance Program benefits (food stamps) for at least 3-months during the 15-month period ending on the hiring date; or
  - Entitled to compensation for a service-connected disability and was:
    - Hired within 1 year of discharge or release from active duty;
    - Unemployed for at least 6 months in the year ending on the hiring date; or

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Employment Tax Credits
Who is Eligible?

- Unemployed for:
  - At least 4 weeks (but less than 6 months) in the year ending on the hiring date; or
  - At least 6 months in the year ending on the hiring date.

Employment Tax Credits

Long-Term or Short-Term Temporary Assistance for Needy Families Recipient.

- Short-term Temporary Assistance for Needy Families (TANF) Recipient – An individual who is a member of a family that:
  - Received TANF benefits for any 9 months during the 18-month period ending on the hiring date.

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Employment Tax Credits

Long-term TANF Recipient – An individual who is a member of a family that meets one of the following:

- Received TANF benefits for at least 18 consecutive months ending on the hiring date;
- Stopped being eligible for TANF payments during the past 2 years because a Federal or state law limited the maximum time those payments could be made, and the individual is hired not more than 2 years after such eligibility ended; or
- Received TANF benefits for any 18 months after August 5, 1997, and has a hiring date that is not more than 2 years after the end of the earliest 18-month period after August 5,1997.

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Employment Tax Credits

Supplemental Nutrition Assistance Program Recipient (Food Stamps)

- A Supplemental Nutrition Assistance Program (SNAP) recipient age 18-39 years who is a member of a family that received SNAP benefits (food stamps) for:
  - The 6-month period ending on the hiring date; or
  - At least 3 of the 5 months ending on the hiring date, in the case of a family member who ceased to be eligible for such assistance under Section 6(o) of the Food Stamp Act of 1977.

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Employment Tax Credits

Designated Community Resident

An 18-39 year old who lives within one of the Federally-designated Rural Renewal Counties or Empowerment Zones.

Vocational Rehabilitation Referral

An individual with a disability who completed or is completing rehabilitative services from a state certified agency, an Employment Network under the Ticket to Work program, or the U.S. Department of Veteran Affairs.

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Employment Tax Credits

Ex-Felon

An individual who:

- Has been convicted of a felony; and
- Who is hired within 1 year after the conviction or release date from prison.

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Employment Tax Credits

Supplemental Security Income Recipient

An individual who received Supplemental Security Income (SSI) benefits for any month that ended during the 60-day period ending on the hire date.

Summer Youth Employee

A 16 or 17 year-old youth who:

- Works for the employer between May 1st and September 15th; and
- Lives within one of the federally-designated Empowerment Zones.

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Employment Tax Credits

Some employees do not qualify the employer for the WOTC. They include:

- Relatives and dependents of the employer, including sons, daughters, stepchildren, spouses, fathers, mothers, brothers, sisters, step-brothers or sisters, nephews, nieces, uncles, aunts, cousins, or in-laws.
- Former employees, regardless of how long it has been since he/she last worked for the employer.
- Majority owners of the business.

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Employment Tax Credits

HOW TO CALCULATE THE TAX CREDIT

The amount of the tax credit that employers can claim depends on the target group of the individual employment. There is also a maximum tax credit that can be earned for each target group.

Employees must work at least 120 hours in the first year of employment for the employer to qualify to claim the tax credit with the Internal Revenue Service (IRS). The tax credit is generally calculated as follows; however, please refer to the chart on the following page for full details.

Employment Tax Credits

After Working at Least 120 Hours

The employer may claim a tax credit equal to 25 percent of the new hire's first year of qualified wages. The maximum tax credit on first year wages is between $750 and $6,000, depending on the eligible target group.

After Working at Least 400 Hours

The employer may claim a tax credit equal to 40 percent of the new hire's first year of wages. The maximum tax credit on first year wages is between $1,200 and $9,600, depending on the eligible target group.

Employment Tax Credits

For the Long-term Temporary Assistance for Needy Families (TANF) Recipient target group, the credit is also available to employers in the second year of employment. The employer may claim a tax credit equal to 50 percent of second year wages, up to the maximum tax credit of $5,000.

Employment Tax Credits

Maximum Tax Credit Amounts

Veteran Target Group	Worked at least 120 hours but less than 400 hours	Worked at least 400 hours
Receives SNAP (food stamps) benefits	**Up to $1,500** (25% of $6,000 of first-year wages)	**Up to $2,400** (40% of $6,000 of first-year wages)
Entitled to compensation for service-connected disability:		
Hired 1 year after leaving service	**Up to $3,000** (25% of $12,000 of first-year wages)	**Up to $4,800** (40% of $12,000 of first-year wages)
Unemployed at least 6 months	**Up to $6,000** (25% of $24,000 of first-year wages)	**Up to $9,600** (40% of $24,000 of first-year wages)
Unemployed:		
At least 4 weeks	**Up to $1,500** (25% of $6,000 of first-year wages)	**Up to $ 2,400** (40% of $6,000 of first-year wages)
At least 6 months	**Up to $ 3,500** (25% of $14,000 of first-year wages)	**Up to $5,600** (40% of $14,000 of first-year wages)

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Employment Tax Credits

Maximum Tax Credit Amounts

Other WOTC Target Groups	Worked at least 120 hours but less than 400 hours	Worked at least 400 hours
Short-Term TANF Recipient	**Up to $1,500** (25% of $6,000 for first-year wages)	**Up to $2,400** (40% of $6,000 of first-year wages)
Long-Term TANF Recipent	N/A	**Up to $9,000** (over 2 years) (40% of $10,000 of first-year wages and 50% of $10,000 of second -year wages)
SNAP (food stamp) Recipient	**Up to $1,500** (25% of $6,000 for first-year wages)	**Up to $2,400** (40% of $6,000 of first-year wages)
Designated Community Resident	**Up to $1,500** (25% of $6,000 for first-year wages)	**Up to $2,400** (40% of $6,000 of first-year wages)
Vocational Rehabiliation Referral	**Up to $1,500** (25% of $6,000 for first-year wages)	**Up to $2,400** (40% of $6,000 of first-year wages)
Ex-Felon	**Up to $1,500** (25% of $6,000 for first-year wages)	**Up to $2,400** (40% of $6,000 of first-year wages)
SSI Recipient	**Up to $1,500** (25% of $6,000 for first-year wages)	**Up to $2,400** (40% of $6,000 of first-year wages)
Summer Youth Employee	**Up to $750** (25% of $3,000 for first-year wages)	**Up to $1,200** (40% of $3,000 of first-year wages)

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Employment Tax Credits

Maximum Tax Credit Amounts

Please note that the maximum tax credit amounts listed above are applicable to private-sector businesses only.

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Employment Tax Credits

How Do I Apply?

The application process involves five simple steps with little paperwork. Please note that prior to claiming the tax credit with the IRS, an employer must request and receive certification from its State Workforce Agency (SWA), stating that the new hire is a member of at least one of the WOTC target groups.

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Employment Tax Credits

Since the required forms change periodically, please ensure that you submit the current approved versions of the forms. For the most up-to-date copies of forms used to apply for certification from the SWA and claim the credit with IRS, please refer to the:

- WOTC website at: http://www.doleta.gov/business/incentives/opptax/forms.cfm
- IRS website at: https://www.doleta.gov/business/incentives/opptax/

Employment Tax Credits

Complete IRS Form 8850

Employers must fill out IRS Form 8850, Pre-Screening Notice and Certification Request for the Work Opportunity Credit, to pre-screen employees, and make a written request to their SWA to certify the new hire as a member of a WOTC target group.

- Page one of IRS Form 8850 – The job applicant gives information to the employer on or before the day a job offer is made. This information is entered on the form.

Employment Tax Credits

- Page two of IRS Form 8850 – Based on the applicant's information, the employer determines whether or not he or she believes the applicant is a member of one of the WOTC target groups. If so, the employer completes page two of the form.

Both the job applicant (or a parent/guardian if the applicant is a minor) and the employer, or an authorized employer representative, must sign and date IRS Form 8850 before submitting the form to the SWA.

Employment Tax Credits

Complete ETA Form 9061

Next, the employer completes a U.S. Department of Labor WOTC form:

- Employers will typically complete ETA Form 9061, the Individual Characteristics Form.
- Some states will also accept ETA Form 9062, Conditional Certification. This form would be used if a conditional certification is provided to the job applicant by a participating agency, such as a SWA, a Vocational Rehabilitation agency, an American Job Center (also referred to locally as a One-Stop Career Center), or an Employment Network for the Ticket to Work program.

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Employment Tax Credits

If completing ETA Form 9061, employers are encouraged to provide copies of documentation of eligibility for a WOTC target group, if available. Examples of documentation are provided in the instructions to ETA Form 9061.

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Employment Tax Credits

Submit Completed IRS and ETA Forms to Your State Workforce Agency

IRS Form 8850 must be submitted within 28 calendar days after the employee's start date for it to be considered "timely" filed. WOTC applications that are not submitted within 28 calendar days will be denied by the SWA.

To expedite the certification process, submit the following forms and documentation together, as a complete application, to your SWA no later than the 28th day after the job applicant begins work:

- IRS Form 8850.
- ETA Form 9061 (or ETA Form 9062, if applicable).
- Documentation of target group eligibility as described in the instructions to ETA Form 9061, if available.

Employment Tax Credits

States accept applications through various methods (i.e., via mail, fax, or e-mail). Many states have automated systems and accept electronic submissions. If you are not sure how your state accepts applications, contact the WOTC Coordinator in your state. A directory of state WOTC Coordinators is available at:

http://www.doleta.gov/business/incentives/opptax/State_Contacts.cfm

Employment Tax Credits

Receive Final Determination

The SWA will issue a final determination for each WOTC application. In some cases before that determination is made, assistance may be requested from the employer to obtain additional information or documentation. The final determination will indicate whether the new employee is certified as meeting the eligibility for one of the WOTC target groups. In those instances where the SWA is not able to verify that the new employee meets the eligibility, the SWA will issue a denial with an explanation. When a certification is received, then the employer can claim the tax credit with the IRS.

Employment Tax Credits

File for the Credit with the IRS

After receiving a certification from the SWA, employers may file for the tax credit with the IRS. Generally, an employer elects to take the credit by filing IRS Form 5884, Work Opportunity Credit. However, a tax-exempt organization that hires an employee in the WOTC veteran target group should use IRS Form 5884-C, Work Opportunity Credit for Qualified Tax-Exempt Organizations Hiring Qualified Veterans.

Employers also must meet requirements for the Minimum Employment Period, which is the number of hours required to be worked by the employee – at least 120 hours in the first year of employment – before they can file and qualify for the tax credit.

Section 179 Expensing Election and Bonus Depreciation

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Section 179 Expensing Election

- Pursuant to IRC Section 179, manufacturers are allowed to expense the cost of qualifying fixed asset purchases up to a statutory limit (the "dollar limitation") provided certain requirements are met.

- The ***Protecting Americans from Tax Hikes Act of 2015*** ("PATH") permanently extended the dollar limitation back to its previous level of $500,000 for up to $2 million of qualified additions for 2015 (the "investment limitation"). In addition, the annual limits of $500,000 and $2 million will be indexed for inflation going forward.

- Qualifying additions exceeding the $2 million investment limitation reduce the eligible Section 179 deduction dollar-for-dollar (i.e. the deduction is completely phased-out for qualifying investments that exceed $2.5 million).

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Section 179 Expensing Election

- In addition, Section 179(f) provides for a first year deduction for “qualified leasehold improvement property” which is non-structural interior costs of property that is placed in service more than 3 years after the date the building was first placed in service.
- Interior office expansion, build-outs, and renovations qualify if they are not structural in nature, do not enlarge the building and meet the 3 year test above.

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Section 179 Expensing Election

- A similar deduction is available for "qualified retail improvement costs" which also applies to non-structural interior costs of property that is placed in service more than 3 years after the date the building was first placed in service.
- The renovated space must be open to the general public and used in a retail business of selling tangible personal property to the general public.

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Section 179 Expensing Election

Tax Tip

- It is advisable to maximize the first year Section 179 deduction on longer-lived assets first and then apply any remainder to shorter-lived assets.

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Section 179 Expensing Election

Section 179 – Example #1

2016 Capital Expenditures

Asset	Depreciable Life	Cost
Computer Software	3 Years	$50,000
Computer / Network Equipment	5 Years	100,000
Manufacturing Equipment	7 Years	1,700,000
Qualified Leasehold Improvements	15 Years	300,000
		$2,150,000

As shown, ABC's qualifying additions exceeds the investment limitation of $2 million; therefore, the dollar limitation is reduced dollar-for-dollar resulting in a maximum allowable Section 179 deduction of $350,000.

2016 Section 179 Election

Asset	Cost	Section 179
Computer Software	$ 50,000	$ -
Computer / Network Equipment	100,000	-
Manufacturing Equipment	1,700,000	100,000
Qualified Leasehold Improvements	300,000	250,000
	$ 2,150,000	$ 350,000

In allocating the Section 179 deduction of $350,000, it is more advantageous to utilize the deduction against the longer-lived assets first; therefore, $250,000 is allocated to the QRIs and the balance against the manufacturing equipment.

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Section 179 Expensing Election

- Aside from the dollar limitation and the investment limitation, there is a taxable income limitation that must be met.
- For C-Corporations, this means that the Section 179 deduction cannot reduce taxable income below $0 in a given tax year (without regard to NOL carrybacks or carryforwards).
- Similar rules for S-Corporations, partnerships, LLCs, and LLPs also exist with one important distinction which is often overlooked.

Section 179 Expensing Election

Tax Tip

- For S-Corporations, taxable income for purposes of the Section 179 limitation is computed without regard to compensation paid to an S-Corporation's shareholder employees (Regulation Section 1.179-3).
- In similar fashion, taxable income for partnerships, LLCs and LLPs is computed without regard to guaranteed payments paid to partners or members (Reg. Sec. 1.179-2).

Section 179 Expensing Election

- Any excess Section 179 expense that exceeds the taxable income limitation can be carried forward indefinitely and utilized to the extent of the taxable income limitation.
- Members of a related group of corporations connected through common stock ownership (a “controlled group of corporations”) are treated as one taxpayer for purposes of the Section 179 deduction and, therefore, are allowed one $500,000 deduction.

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Section 179 Expensing Election

- As illustrated in the preceding examples, only certain types of property qualify for Section 179 expensing, including tangible personal property, off-the-shelf software, qualified leasehold improvements, and qualified retail improvement costs.
- Real property, including buildings and structural components do not qualify; however, cost segregation may reclassify building costs to a different category.

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Bonus Depreciation

- In addition to the Section 179 expensing election, the *2015 PATH Act* also extended the Section 168(k) "bonus depreciation" rules through the tax year ending on or before December 31, 2019.

- Manufacturers may write-off the first 50 percent of qualifying additions placed in service in 2015, 2016 and 2017, <u>without limitation</u>. As part of the *2015 PATH Act,* in 2018 the applicable write-off percentage decreases to 40 percent of qualifying additions, and in 2019 the applicable write-off percentage further decreases to 30 percent for qualifying additions before being completely eliminated for tax years beginning January 1, 2020 and later.

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Bonus Depreciation

- However, unlike the Section 179 deduction, the property must be new in that the original use of the asset must commence with the taxpayer and cannot be used property.
- Qualifying property must have a class life of 20 years or less and can include capitalized reconditioning costs.
- Similar to the Section 179 deduction, bonus depreciation is also allowable for Alternative Minimum Tax (AMT).

Bonus Depreciation

Tax Tip

- Section 179 election is generally preferred over 50 percent bonus depreciation since it produces a greater tax deduction in the year of acquisition assuming limitations are met.
- However, the 50 percent bonus depreciation deduction does <u>not</u> have a taxable income limitation which means it can be used to create a tax loss in a given year, regardless of the form of entity.

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Bonus Depreciation

Tax Tip (con't.)

- One drawback of the 50 percent bonus depreciation deduction is that most states (including New York) have "decoupled" from this Federal tax law and manufacturers utilizing this deduction will be required to make certain adjustments at the state level in computing their state tax liabilities; this includes shareholders in S-Corporations, partners in partnerships, and members of LLCs or LLPs.

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Bonus Depreciation

Example #2

- Consider the same facts as Example #1, after considering bonus depreciation and regular first year depreciation (MACRS), ABC Company, Inc.'s total first year depreciation is, as follows:

Asset	Cost	Section 179	Bonus Depreciation	MACRS	MACRS w/o Section 179 and Bonus Depreciation
Computer Software	$ 50,000	$ -	$ 25,000	$ 4,167	$ 8,334
Computer / Network Equipment	100,000	-	50,000	10,000	20,000
Manufacturing Equipment	1,700,000	100,000	800,000	114,320	242,930
Qualified Leasehold Improvements	300,000	250,000	25,000	1,250	15,000
	$ 2,150,000	$ 350,000	$ 900,000	$ 129,737	$ 286,264

Total First Year Depreciation w/179 and 50% Bonus	**$ 1,379,737**
Total First Year Depreciation w/o 179 and 50% Bonus	**$ 286,264**
Additional First Year Depreciation Deductions	**$ 1,093,473**

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The Qualified Production Activity Deduction for Manufacturing/Production Activities

- **Overview of Section 199**
  - The Code permits a deduction against a certain class of net income – qualified production activity income (“QPAI”)
  - The deduction equals 9 percent of the lesser of QPAI or, in the case of a C corporation, modified taxable income or, in the case of an individual, modified adjusted gross income

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The Qualified Production Activity Deduction for Manufacturing/Production Activities

- The deduction was phased-in over five years, as follows:

Year	Deduction
2005 – 2006	3%
2007 – 2009	6%
2010 and thereafter	9%

- There is a "cap" on the deduction equal to 50 percent of W-2 wages paid by the taxpayer during the calendar year that ends in such taxable year.

The Qualified Production Activity Deduction for Manufacturing/Production Activities

- The domestic production activities deduction is allowed for AMT.
- Available to C corporations, S corporations, partnerships, sole proprietorships, estates and trusts.

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The Qualified Production Activity Deduction for Manufacturing/Production Activities

- **The Calculation of the Qualified Production Activity Deduction.**
  - The first calculation is qualified production activity income.
    - QPAI is defined as the excess of the taxpayer's domestic production gross receipts (DPGR) over the sum of:
      - The cost of goods sold;
      - Other deductions, expenses and losses directly allocable to such receipts; and
      - A ratable portion of deductions, expenses and losses not directly allocable to such receipts or another class of income.

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The Qualified Production Activity Deduction for Manufacturing/Production Activities

- In general, Section 199 defines DPGR as gross receipts of the taxpayer derived from the following sources:
  - Any lease, rental, license, sale, exchange, or other disposition of:
    - Qualifying production property (tangible personal property, any computer software, and certain sound recordings) which was manufactured, produced, grown, or extracted by the taxpayer in whole or significant part within the United States;

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The Qualified Production Activity Deduction for Manufacturing/Production Activities

- Any qualifying film produced by the taxpayer; and
- Electricity, natural gas, or potable water produced by the taxpayer in the United States.

- Construction performed in the United States.
- Engineering or architectural services performed in the United States for construction projects in the United States.

Federal Research & Development (R&D) Credit

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Federal R&D Credit

- Introduced by the Economic Recovery Tax Act (P.L. 97-34) in 1981 under Section 41 of the Internal Revenue Code.
- Since its enactment it had remained a "temporary credit."
- Congress had extended the credit for temporary, short-term periods an unprecedented 16 times since its original enactment.
- Under the ***Protecting Americans From Tax Hikes Act of 2015 ("PATH")***, the credit was made permanent.
- The PATH Act also includes a provision whereby certain eligible small businesses (defined as those with average gross receipts of under $50 million for the previous three tax years), can use the Federal R&D credit to not only offset regular tax but also the alternative minimum tax. Prior to the PATH Act, the Federal R&D credit could not be used to offset any alternative minimum tax.

Federal R&D Credit
Qualified Research Expenses

Qualified Research Expenses (QREs) are defined by Section 41(b) of the Internal Revenue and include the following:

- Wages paid or incurred to an employee for “qualified services” performed by the employee.
- Any amount paid or incurred for supplies used in the conduct of qualified research.
- Any amount paid or incurred for the right to use computers in the conduct of qualified research.
- 65 Percent of any “contract research expenses” paid or incurred to any person (other than an employee) for the conduct of qualified research.

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Federal R&D Credit
Qualified Research

In order for an activity to constitute "qualified research" it must meet four criteria:

1. The Section 174 Test: The activity must qualify as research pursuant to Internal Revenue Code Section 174 which requires that an activity be research in the "experimental or laboratory sense aimed at the development of a new product."
2. The Business Component Test: The information sought must be intended to be useful in the development of a new or improved business component of the taxpayer.
3. The Technical Discovery Test: The research has to be undertaken for the purpose of discovering information that is technological in nature.
4. Process of Experimentation: To constitute qualified research, substantially all of the activities must be part of a process of experimentation that relates to a qualified purpose.

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