HOW TAX REFORM WILL IMPACT MANUFACTURING

Summary

On December 22, just a few weeks following the passage of the Senate's Tax Cuts and Jobs Act, the conference version of the bill was signed into law, marking the largest change to U.S. tax policy in decades.

With most of the provisions set to go into effect in the new year, it's important that the manufacturing industry review the changes that occurred during the conference process to understand the impact to their companies.

What Changes are Coming for Manufacturing Organizations?

To help organizations navigate the key provisions affecting manufacturers, we've summarized top considerations and implications below.

Provision	**Summary of Changes**	**Implications for M&D**
Reduce the Corporate Tax Rate	Reduces the top corporate tax rate from 35 to 21%. **Effective date:** Taxable years after Dec. 31, 2017	**Industry View:** Positive ***What's at stake***: This is a huge win for manufacturers. The effective actual tax rate for manufacturers has historically averaged 22%.
Repeal the Corporate Alternative Minimum Tax (AMT)	Conforming to the repeal of the corporate AMT, the bill also repeals the election to accelerate AMT credits in lieu of bonus depreciation. **Effective Date:** Taxable years after Dec. 31, 2017	**Industry View:** Positive ***What's at stake:*** Keeping the corporate AMT would have made it difficult for businesses to reduce their effective corporate tax rate lower than 21%.
Pass-Through Tax Treatment / Section 199A	Lowers the top rate for "pass-through" business income (i.e. income from businesses such as partnerships, S corporations, and sole proprietorships claimed on individual tax returns) from 39.6% to 20%. **Effective date**: Taxable years after	**Industry view:** Positive ***What's at stake:*** Because many manufacturers are structured as pass-throughs, this should end up as a net positive for the industry. It's important to keep in mind, however, that the 20% rate only applies to about 20% of their pass-through

	Dec. 31, 2017	business income. Still, other tax breaks will still apply.
Limitations on Interest Deductibility	Revises Section 163(j) and expands its applicability to every business, including partnerships. Generally, caps deduction of interest expense to the sum of 1) business interest income; 2) 30% of adjusted taxable income (computed without regard to deductions allowable for depreciation, amortization, or depletion; and 3) the taxpayer's floorplan financing interest for the tax year. Disallowed interest is carried forward indefinitely. Contains a small business exception. **Effective date:** Taxable years after December 31, 2017.	**Industry View**: Mixed ***What's at stake***: This is a base broadener that would limit the interest deduction to 30% of EBITDA for four years, then 30% of EBIT thereafter. The interest expense ceiling could be problematic to manufacturers that rely heavily on debt financing. But, the exclusion of floor plan financing interest from the 30% cap is a win for auto manufacturers.
Repeal of Domestic Production Activities Deduction (DPAD or Section 199)	DPAD was a tax incentive for businesses that manufactured property at least partially within the United States. **Effective date:** Taxable years after December 31, 2017.	**Industry View**: Negative ***What's at stake***: Manufacturers that previously claimed the section 199 deduction will no longer be able to reduce their tax rate by the benefit; however, this impact will likely be offset by the significant reduction in overall tax rates.
Research Tax Credit	The Research Tax Credit's net value was effectively increased by 22%--from 65% to 79% of incremental qualified spending—because of the corporate rate's reduction to 21% and the required Sec. 280C(c)(3) election or addback of R&E deduction. **Effective date:** Taxable years after	**Industry View**: Positive ***What's at stake***: In addition to the credit benefit increasing by 22%, the elimination of AMT means more taxpayers may benefit from the credit.

	December 31, 2017.	
R&E Tax Deduction	Companies will be required to write-off research expenses over a longer time period. **Effective date:** Taxable years after December 31, 2021.	**Industry View:** Negative ***What's at stake***: Taxpayers will not be permitted to immediately expense costs in the year incurred and instead must write off costs associated with R&D over a longer time period. Under current law, taxpayers have the choice of taking an immediate deduction or capitalizing the amounts and amortizing over five years; going forward, the new bill makes capitalization/amortization mandatory.
Eliminate Ability to Carryback Net Operating Losses	Generally, companies may not use an NOL to offset income in any prior year and may offset only 80% of taxable income (after NOL) in carryforward year. **Effective date:** The elimination of carrybacks is effective in taxable years after December 31, 2017. The current 100% allowance is phased down by 20% per year beginning in 2023.	**Industry View**: Negative ***What's at stake***: Costs incurred in one year will not be able to offset 100% of taxable income in the next year. In situations where manufacturers' earnings are volatile, the restrictions on the carryback and use of NOLs could present a significant cash flow obstacle.
Immediate Expensing of Certain Capital Expenditures	Companies will be able to fully expense certain capital expenditures, including acquisitions of used property, in 2018. **Effective date:** Applies until 2022 for purchases made after Sept. 28, 2017. The percentage of allowable expensing will be phased out at a rate of 20% per year from 2023 (80%) to	**Industry View:** Positive ***What's at stake:*** This is likely to encourage more capital spending, potentially driving up sales for hardware manufacturers of products eligible for expensing.

	2026 (20%).	
Like-Kind Exchanges (Section 1031)	Like-kind exchanges will be limited to exchanges of real property that is not primarily held for sale. **Effective date:** Taxable years after December 31, 2017. However, there is an exception if the property was disposed of by the taxpayer on or before December 31, 2017.	**Industry View**: Negative ***What's at stake***: This imposes greater limitations on the types of property manufacturers could consider as part of a like-kind exchange.
Offer a Deduction for Foreign-Derived Intangible Income	Effectively taxes such income at a reduced 13.125% tax rate. Deduction only available to C corporations that are not RICs or REITs. **Effective date**: The effective tax rate on FDII will be 13.125% in tax years beginning after 2017 and before 2026 and 16.406% after 2025.	**Industry View**: Positive ***What's at stake***: Some commentators have described this as being similar to a "patent box," which is featured in the tax framework of some European countries to encourage the formation of intellectual property within those respective countries, and provides a preferential tax rate on certain income.
Participation Exemption System	The participation exemption system generally provides a 100% dividends received deduction for the foreign source portion of dividends received by U.S. shareholders that are C corporations (other than a RIC or REIT) from certain foreign subsidiaries. **Effective date**: Applicable to distributions made after Dec. 31, 2017	**Industry View**: Positive ***What's at stake***: Most businesses would agree that a territorial tax system could lead to significant tax savings. Nevertheless, accompanying international tax provisions may mute some of the enthusiasm.

Base Erosion Anti-Abuse Tax (BEAT)	Introduces a new base erosion minimum tax that applies to certain multinational groups that make certain types of cross-border payments to related foreign persons. **Effective date:** Taxable years after Dec. 31, 2017	**Industry View:** Mixed ***What's at stake:*** The BEAT lowers the threshold at which a manufacturer can be taxed. However, this is a more favorable alternative than the originally proposed excise tax.
Tax Existing Overseas Profits	**I**mposes a one-time tax rate of 15.5% on cash assets and 8% on non-cash assets held offshore, regardless of whether or not the amounts are actually distributed. **Effective date**: Taxable years after Dec. 31, 2017	**Industry View**: Positive ***What's at stake***: This measure is designed to raise tax revenue from income that has not previously been subject to U.S. tax. But it's also meant to entice companies to invest some of their foreign profits stateside.

TACKLING TAX REFORM: 5 INTIAL STEPS MANUFACTURERS CAN TAKE NOW

Here are five steps manufacturing companies should take now to tackle tax reform:

1. **Assess impact.** Tax professionals will likely need to review the bill text manually, measure their organization's specific circumstances against it to assess the impact of each provision, as well as the holistic effect on their bottom line.
2. **Assemble a team.** While the heaviest burden may fall on accountants, companies and their finance teams will have an important role to play to gather all the necessary data.
3. **Dig into the data.** Assessing the impact of tax reform requires a substantial amount of data. Organizations need to move from modeling the impact of tax reform to focus on data collection and computations as soon as possible. If you have an international presence, bear in mind that some of the information needed could date back to 1987.
4. **Establish priorities.** When considering what to undertake in the limited time before year's end, focus on the areas that could have the greatest impact on your organization.
5. **Initiate tax reform conversations with your tax advisor.** Tax reform of this magnitude is the biggest change we've seen in a generation, and will require intense focus to understand not only how the changes apply at a federal level, but also to navigate the ripple effect this is likely to have on state taxation as well.