# Tax Update:
# What's In? What's Out? Planning for 2014

The tax season may have come and gone, but that doesn't mean owners of manufacturing and distribution companies should put tax planning on the back burner until next spring. Smart owners work closely with their CPAs to make tax planning a year-round initiative.

With this in mind, here's an update on some programs, incentives, deductions and credits that may impact your tax planning in 2014:

- **Repair regulations in effect.** New IRS regulations relative to tangible property went into effect on January 1, 2014. These new rules involve the capitalization of costs incurred in buying, maintaining and improving tangible property — both owned and leased — such as equipment, buildings, materials, and supplies.

  Virtually all manufacturers and distributors will be affected by these complex rules. To comply with the new regulations, you will likely need to file a Form 3115, Application for Change in Accounting Method. This may require a Section 481(a) adjustment over the next four years.

- **Deducting Capital Expenditures.** For property placed in service prior to December 31, 2013, the Section 179 expensing election limit was $500,000, with the phase-out beginning at $2 million. In addition, taxpayers were allowed bonus depreciation equal to 50 percent of qualifying property. These favorable tax provisions sunset this past December. The Section 179 deduction amount reverts back to $25,000, adjusted for inflation and bonus depreciation expired. However, The Senate Finance Committee's EXPIRE Act, which has not been voted on by the senate, would extend these favorable tax provisions two years, through 2015.

- **R&D tax credit bills considered by the U.S. House & Senate.** Numerous tax incentives, including the R&D tax credit, expired at the end of 2013. Commonly referred to as "Extenders", this group of provisions must regularly be renewed by Congress. In the recent past, Congress has let these provisions expire, only to retro-actively reinstate them. Along those lines, the House and Senate have taken different approaches to reinstating the R&D tax credit. Below, please find a summary of each bill:

| House Resolution 4438 | Senate Bill 2260 |
|---|---|
| • Retro-actively makes the R&D tax credit permanent | • Retro-actively reinstates the R&D tax credit for two years through 2015 |
| • Eliminates the traditional R&D tax credit, requiring taxpayers to 'look back' almost 30 years | • Eligible small business (<$50 million in sales) may use the R&D tax credit to offset AMT |
| • Increases the Alternative Simplified Credit (ASC) from 14% to 20% | • Allows "start-up" companies to use the R&D tax credit to offset up to $250,000 of payroll taxes |

The R&D tax credit is designed to promote innovation by offering a tax reduction for qualified expenses incurred in the development of new and improved processes, formulas, techniques and products. These expenses include wages, supply costs and 65 percent of contract labor costs.

The tax credit includes four distinct requirements that must be met. Qualifying isn't difficult, but applying for the credit, if it's renewed, will involve a fair amount of paperwork. Mueller Prost's Research Tax Credit Group has assisted clients in 44 states claim the R&D credit, and we would be happy to help identify any potential opportunities that may exist.

- **A LIFO conversion … maybe?** For manufacturers with significant amounts of raw materials, work-in-progress and finished goods on hand, a conversion to the last-in-first-out (LIFO) method of inventory accounting might be beneficial. In periods of rising costs, LIFO decreases the value of ending inventory when compared to the first-in-first-out (FIFO) method. Lower ending inventory value results in higher cost of goods sold, which in turn lowers taxable income.

  A simple way to estimate the value of converting to LIFO is to multiply inventory by anticipated inflation by the tax rate. For example, a taxpayer with $5 million of inventory in a 2 percent inflationary environment and paying a 40 percent tax rate would benefit by approximately $40,000.

- **Think IC-DISC.** If your company exports its products — either directly or indirectly — an Interest Charge-Domestic International Sales Corporation (or IC-DISC) may be worthwhile. An IC-DISC is a tax-exempt domestic corporation typically owned by the individual shareholders of the exporting company.

  The exporting company pays the IC-DISC a commission on its exports — either 50 percent of export net income or 4 percent of qualified export gross receipts — and deducts this amount from ordinary income. When the IC-DISC pays dividends, the shareholders pay only the dividend income tax rate on those funds, with the net effect of up to a 20 percent tax savings on IC-DISC income.

  Note the IC-DISC should be established as soon as possible because the tax benefits can only be claimed on export sales after the formation of the IC-DISC.

- **Consider cost segregation.** Buildings are depreciated under the straight-line method over 39 years. However, a building typically consists of equipment and fixtures that are depreciated under an accelerated method over three, five, seven or 15 years.

  A cost segregation study examines the building to determine which parts of it might qualify for accelerated depreciation. If your company recently moved into a new building, consider hiring a specialist to conduct a cost segregation study to maximize your depreciation opportunities.

Stay in touch with your Mueller Prost tax advisor to be sure you're taking advantage of tax planning opportunities throughout the year.

We hope you find this information valuable. As always, we are here to help. We love to talk taxes. Contact us to discuss strategies to minimize your tax burden. Please contact John Oeltjen or Michael Devereux, II at 314.862.2070 to discuss this or any other matter.

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