MANUFACTURER

Winter 2020

On the road

Let's review the tax implications of providing company cars

How "Made in America" can work for you

Why the segmented income statement is a powerful management tool

Is it time to revisit the R&D credit?

Tariffs: Six strategies for protecting your company

THE HOFFMAN GROUP
Certified Public Accountants & Consultants

Phone: 443.320.4101 www.hoffmancpas.com Fax: 1.410.630.5001

10055 Red Run Boulevard, Suite 130 Owings Mills, MD 21117

On the road

Let's review the tax implications of providing company cars

A company car can be a valuable perk for business owners, salespeople and other employees. And now may be an ideal time to invest in business vehicles. The Tax Cuts and Jobs Act of 2017 (TCJA) more than tripled the luxury auto threshold, from $15,800 to an inflation-adjusted $50,000. For 2019, the dollar cap on depreciation deductions doesn't kick in until a vehicle's cost exceeds $50,400.

Methods of valuing personal use

If you provide company cars as a fringe benefit, you must include the fair market value (FMV) of employees' personal use of these vehicles in their wages for income and payroll tax purposes. (You can still deduct your full cost as a business expense.)

According to the IRS, the FMV of personal use is "the amount the employee would have to pay a third party to lease the same or similar vehicle on the same or comparable terms in the geographic area where the employee uses the vehicle." It also provides three alternative valuation methods that can simplify the process:

1. Cents-per-mile method. Under this method, you multiply a standard mileage rate (58 cents for 2019) by the total number of miles an employee drives an eligible vehicle for personal use. The standard rate includes the value of fuel you provide for miles driven in the United States, Canada and Mexico. If you don't provide fuel, you may reduce the rate by up to 5.5 cents. Special rules apply for fuel provided outside the United States, Canada and Mexico.

You can use this method if 1) you reasonably expect the vehicle to be regularly used in your trade or business, or 2) the vehicle meets certain minimum mileage requirements. A vehicle is used regularly in your business if at least 50% of its mileage is business-related or if it's used daily to drive at least three employees to and from work as part of a company-sponsored commuting pool.

2. Commuting method. This method allows you to value personal use of a vehicle at $1.50 per one-way commute (from home to work or from work to home). It's available only if you have a written policy that limits personal use to commuting or minimal personal activities (such as running an errand on the way home from work), and you don't use the method for "control" employees. Control employees include certain owners, directors and highly compensated employees. Other rules and restrictions apply; ask your tax professional for details.

3. Annual lease value method. Under this method, the vehicle's FMV is converted into an annual lease value (using an IRS table). That amount is then multiplied by the percentage of total miles driven that were for personal purposes to estimate the value of the employee's personal use.

A fleet-average-value rule allows employers with a fleet of 20 or more automobiles to take the average FMV for all automobiles in the fleet and apply the resulting annual lease value to each eligible vehicle.

Effects of the TCJA

The simple cents-per-mile and fleet-average-value methods aren't available for vehicles whose FMV exceeds certain thresholds. For example, in 2017, the cents-per-mile method's maximum FMV was $15,900 for passenger cars and $17,800 for trucks and vans. That same year, the fleet-average-value method's limit was $21,100 for passenger cars and $23,300 for trucks and vans.

To align these thresholds with the TCJA's new luxury auto threshold, the IRS recently proposed regulations that will increase the threshold to an inflation-adjusted $50,000 across the board. This change will allow many more employers to use the cents-per-mile and fleet-average-value methods.

Review your options

If you provide company cars for employees, work with your tax advisors to determine the optimal method for computing the value of personal use for income inclusion purposes. In light of recent rule changes, consider whether your company would benefit from switching to a different valuation method. ■

How "Made in America" can work for you

"Made in the USA" is a hot marketing trend that can help manufacturers differentiate products in the marketplace. If manufacturers can obtain goods domestically faster and at lower costs than foreign suppliers can offer, it seems like a win. But, when "homegrown" products are more expensive than foreign-sourced products, purchasers may balk at the higher price tag.

For manufacturers that have used overseas suppliers, deciding when and whether to return to U.S. factories and suppliers can be a tough decision. Here's what you should know before jumping on the Made-in-America bandwagon.

Learn the rules

To claim a product is "Made in the USA," you must comply with strict regulations enacted by the Federal Trade Commission (FTC). Under the rules, final assembly must take place on U.S. soil and the majority of total manufacturing costs must be spent on U.S. parts and processing. Complex labeling standards may also apply if an American flag or map is used on packaging to imply the country of origin.

A company can make a qualified claim when a product is made in several countries, however. For example, it may specify the percentage of a product's domestic content or label a product as "Assembled in the USA" instead.

Compliance with these rules is essential. False claims are likely to attract an FTC investigation, which could lead to enforcement actions and negative publicity. Violators also may need to modify packaging to comply with the FTC regulations, which can be another costly expenditure.

Promote the benefits

Deciding to have your product "Made in the USA" will undoubtedly benefit domestic manufacturing. Prepare by investing staff, inventory and equipment to meet increasing demand for domestic-made products.

Remind your customers about the benefits of using domestic manufacturers. This includes less expensive

and reliable shipping. For example, the United States offers lower labor, natural gas and electricity costs than some other developed countries in Europe and Asia, including Germany, Austria and Japan. Tariffs and high shipping costs can also make overseas production cost-prohibitive. And volatile foreign political environments may prevent products from shipping on time, leading to production delays.

People feel patriotic when they support the U.S. economy and create jobs for American workers. They also want to know that factory workers aren't subjected to unsafe conditions, low wages or other forms of exploitation that the U.S. Department of Labor and domestic labor unions protect against.

Avoid business risks

Intellectual property theft and devaluation of the U.S. dollar are just some of the risks companies face when they outsource production to other countries. Additionally, important instructions — such as product specifications or shipping terms — may be lost in translation when communicating with foreign suppliers.

News stories about contaminated plastic and pet food products from China have led to recalls, illnesses and even deaths. Products made under the scrutiny of the U.S. Food and Drug Administration and Departments of Commerce and Agriculture are typically held to higher quality standards than many foreign-made products. Safer materials and products give manufacturers peace of mind that they're not exposing end-users to unsafe products — and themselves to liability claims.

The U.S. Environmental Protection Agency also requires manufacturers to adhere to strict environmental standards that limit emissions and pollutants. Other countries, including China and India, are making huge carbon footprints today that will harm the environment for many years.

Whether you sell to businesses or consumers, consider implementing a marketing campaign that positions your products as American-made. This may include new advertising programs and repackaging with the "Made in the USA" label.

Preparing for a comeback

As 2020 looms, manufacturers and distributors should consider how to best incorporate "Made in the USA" and its ability to attract business. Customer demand for U.S.-manufactured products has been holding steady even in the face of tariff uncertainty. (See "Tariffs: Six strategies for protecting your company" on page 7.) Make sure your business is positioned accordingly. ■

Why the segmented income statement is a powerful management tool

A companywide income statement may be sufficient for lenders or other outsiders to evaluate your company's financial performance. But from management's perspective, a "segmented" income statement can provide valuable insight into key performance drivers and possible improvement strategies.

How does it differ from a traditional income statement?

A conventional income statement starts with revenue and then subtracts costs to arrive at a net profit or loss. A segmented income statement provides additional detail, breaking down revenues and expenses by business unit, such

as product line, location, department, salesperson or territory. This breakdown helps management identify underperforming segments and develop strategies for boosting profits.

Creating a segmented income statement can be challenging, because you must assign costs to various segments. In addition to direct costs attributable to a segment, such as materials and direct labor, you'll need to allocate a portion of the company's *indirect* costs, such as rent, insurance, utilities and executive salaries, to each segment.

Indirect costs are allocated based on the extent that a segment benefits from or drives those costs. For example, you might allocate indirect costs based on segments' relative sales dollars, units sold, direct labor hours or floor space occupied. Different methods may produce substantially different results, so carefully select a method that fairly reflects each segment's net income.

Are your segments contributing to overall profits?

By uncovering business units that are underperforming, segmented income statements can help remedy the situation. Depending on the reasons for a segment's poor performance, potential strategies might include:

- Increasing prices,
- Reducing costs,
- Addressing quality or design issues, or
- Shutting down a segment.

Just because a segment is operating at a loss doesn't necessarily mean that closing it will benefit the company. In some cases, terminating an underperforming segment can cause the company's overall net income to go *down*. How's that possible? Because a seemingly unprofitable segment may still contribute to the company's net income.

Most indirect expenses allocated to a segment, as well as some direct expenses, are fixed. That is, your company will continue to incur them even if you eliminate the segment. So, even if a segment is operating at a loss, you're likely better off retaining it (at least in the short term) if it contributes to companywide net income.

To determine whether a segment is making a contribution, calculate its contribution margin, which is simply revenue less variable costs. Variable costs are those that increase or decrease with the level of production output and, therefore, will drop to zero if a segment is shut down.

If a segment has a positive contribution margin, it's contributing revenue to the company's fixed costs and profit and is probably worth keeping. So, it's a good idea to report contribution margin on your segmented income statement.

Get professional help

A segmented income statement, if properly designed, can help enhance profitability. However, determining an appropriate method for allocating costs among segments requires significant professional judgment. Consult your CPA for assistance. ■

Is it time to revisit the R&D credit?

The federal tax credit for increasing research and development activities — popularly known as the R&D credit — can be a valuable break for manufacturers. Eligible companies can reduce their tax liability by as much as 7.9 cents (or more if state research credits are available) for each dollar of qualified research expenditures on wages, supplies, consulting fees and contract research. Unfortunately, many manufacturers lose out because they underestimate their R&D expenditures or believe their taxable income is too low to make it worthwhile.

Not just for scientific research

Many people associate R&D with biotech and pharmaceutical companies, but the credit is available to many types of businesses. Generally, qualifying research must:

1. Be related to development or improvement of a product, process, software program or other "business component,"
2. Attempt to eliminate uncertainty over whether, and how, the business component can be developed or improved,
3. Involve a "process of experimentation," using techniques such as modeling, simulation or trial and error, and
4. Be technological in nature, meaning it relies on engineering, computer science or "hard sciences," such as biology or chemistry.

Qualified research expenditures don't need to lead to innovations that are new to your industry, but the changes must be new to *your company*. For manufacturers, this may include:

- Developing new products,
- Redesigning products to make them cheaper, cleaner or more durable,
- Redesigning processes to make them more efficient, safer or less wasteful,
- Experimenting with new packaging materials or techniques that reduce costs, avoid waste or minimize environmental impact,
- Developing or improving robotics or other automated technology,
- Optimizing tooling or equipment placement, and
- Developing software or other methods for improving quality control.

These are just a few examples, but they give you an idea of the broad range of eligible activities.

Expanded benefits for start-ups and small businesses

There's another reason to revisit the R&D credit: Legislation enacted in 2015 expanded the credit's

availability by allowing start-ups to offset R&D credits against up to $250,000 in payroll taxes. Start-ups are generally businesses in operation for less than five years with less than $5 million in gross receipts.

The legislation also allows small businesses (those with average gross receipts of no more than $50 million) to use the credit to reduce their alternative minimum tax (AMT) liability. Note that 2017's Tax Cuts and Jobs Act eliminated corporate AMT, but owners of pass-through entities may still benefit from the change.

Worth another look

If your company hasn't been claiming R&D credits, it's time to revisit the potential benefits. If available, the credit can boost your cash flow by reducing your tax liability. And you may be able to claim credits you missed over the last few years by filing amended returns. ■

Tariffs: Six strategies for protecting your company

Tariffs on imported materials, such as steel and aluminum, are increasing costs for many manufacturers. Here are six ways to help evaluate and manage the effects on your business.

1. Scrutinize your supply chain. Determine whether, and how, tariffs affect you. Analyze your supply chain to identify the countries from which materials and components originate. This isn't always immediately apparent, especially if you buy materials from distributors or service centers.

2. Identify alternative sources. If your materials costs are subject to tariffs, consider alternative sources that aren't affected by tariffs. Don't switch unless these sources can supply you with materials of comparable quality in the quantities you need on a timely basis.

3. Buy in advance. Stock up on materials before tariffs take effect, if possible.

4. Increase prices. Some manufacturers are taking a wait-and-see approach, absorbing increased costs in the hope that the "trade wars" will cool off soon. Others are increasing their prices and passing these costs on to their customers. As you review your options, research what your competitors are doing and communicate with your customers before imposing price increases.

5. Reduce costs. Examine cost-cutting strategies. Examples include implementing just-in-time inventory or lean manufacturing techniques, redesigning products or packaging, or reducing overhead and administrative costs.

6. Use contract manufacturing. You may be able to avoid or reduce tariffs by partnering with contract manufacturers in other countries to avoid importing affected raw materials or components.

Avoid knee-jerk reactions

These are just a few of the potential strategies for minimizing the effects of tariffs. Whatever you decide to do, avoid hasty reactions and carefully evaluate the potential risks and benefits of each option. ■

This publication is distributed with the understanding that the author, publisher and distributor are not rendering legal, accounting or other professional advice or opinions on specific facts or matters, and, accordingly, assume no liability whatsoever in connection with its use. ©2019

10055 Red Run Boulevard
Suite 130
Owings Mills, MD 21117

We Know Manufacturing

With increasing regulations, technological changes and heightened competition, manufacturing companies are faced with a myriad of challenges in getting their products to clients in a fast and cost-effective manner. Staying abreast of the constantly changing rules in the industry makes it difficult to remain profitable. The Hoffman Group is experienced in helping manufacturers develop profit enhancing solutions to improve the bottom line and anticipate marketplace changes. We become a part of your management team to help develop and implement strategic decisions.

TAX & ASSURANCE

- Tax Compliance & Preparation
- Audit, Review & Compile Financial Statements
- Sales & Use Tax
- International Tax
- Cost Segregation Studies
- Mergers & Acquisitions
- Research & Development Credits
- Minimize Multistate Tax Burden

CONSULTING

- Strategic Planning
- Forecasting & Budgeting
- Inventory Costing
- Operational Assessments
- E-Business Strategy
- Business Plans
- Financing Assistance
- Internal Control Assessments
- Performance Measurement

hoffmancpas.com 443.320.4101 info@hoffmancpas.com