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COVID-19 crisis

How amending previous years' tax returns can possibly free up cash

For many manufacturers, 2020 has been a year like no other due to the novel coronavirus (COVID-19) pandemic, and cash flow is a major issue. The Coronavirus Aid, Relief, and Economic Security (CARES) Act *retroactively* modifies certain business-related sections of the Tax Cuts and Jobs Act (TCJA) that can help provide quick liquidity. To take full advantage of these CARES Act provisions, however, you may need to file one or more amended tax returns.

More favorable loss deduction rules

A net operating loss (NOL) generally occurs when a company's deductible expenses exceed its income. Under the TCJA, for NOLs that arise in tax years starting after December 31, 2017, the maximum amount of taxable income that can be offset with NOL deductions is generally reduced from 100% to 80%. Also, under the TCJA, NOLs incurred in tax years ending after December 31, 2017, generally can't be carried back to an earlier tax year but can be carried forward indefinitely (as opposed to the 20-year limit under pre-TCJA law).

Under the CARES Act, for NOLs arising in 2018, 2019 or 2020, businesses can now carry back the NOLs to the prior five tax years. In addition, for tax years beginning before 2021, businesses are generally allowed an NOL deduction equal to 100% of taxable income.

This means that businesses can potentially carry back an NOL as far as 2013 (if generated in 2018). Carrying back an NOL is particularly beneficial if you were previously in a higher tax bracket. Filing an amended return to secure a tax refund will help improve your cash flow.

Noncorporate taxpayers may benefit from another loss-related change made by the CARES Act. The TCJA had set a new limit applicable to deductions for current-year business losses incurred by noncorporate taxpayers, known as the "excess business loss" limitation. The CARES Act retroactively turns off the limitation for 2018, 2019 and 2020.

Got QIP? It may save you tax now and in the future

Another tax-relief provision of the CARES Act that may help manufacturers' cash flow involves real estate qualified improvement property (QIP).

Under the TCJA, QIP is defined as an improvement to an interior portion of a nonresidential building that's placed in service after the date the building was first placed in service. When drafting the TCJA, members of Congress intended to designate QIP as 15-year property, making it eligible for 100% bonus depreciation. Due to a drafting error, however, the 15-year-property designation for QIP never made it into the actual statutory language of the TCJA, and QIP was classified as 39-year property.

Effective for property placed in service after 2017, the CARES Act corrects this drafting error. As a result, to immediately improve cash flow, if you had QIP in 2018 (or in 2019 and have already filed your 2019 return), you can file an amended return to 1) switch from a 39-year recovery period to a 15-year recovery period, or 2) claim 100% bonus depreciation on QIP. Alternatively, you can file Form 3115 (Application for Change in Accounting Method) to claim an adjustment.

If you were subject to the limitation in 2018 (or 2019, if you've filed a return already), you can file an amended return to remove the limitation. That will either 1) further reduce your tax liability, which will produce a refund, or 2) create an NOL, which can now be carried back.

Liberalized business interest expense limitation

Generally, under the TCJA, interest paid or accrued by a business is deductible only up to 30% of adjusted taxable income (ATI). Taxpayers with average annual gross receipts of $25 million or less for the three previous tax years are generally exempt from the interest deduction limitation. So, many smaller manufacturers are already exempt from this rule.

But if this rule applies to your business, for 2019 and 2020, the CARES Act generally increases the business interest expense limitation from 30% to 50% of ATI. It also allows businesses to use 2019 ATI in calculating their 2020 limitation.

This means that some manufacturers should be able to deduct more interest expense in 2019 and 2020. If an NOL is generated (or increased) in either of those years because of the bigger interest expense deduction, that NOL may be carried back to earlier years — and it won't be subject to the 80% limitation.

Get cash

If your cash flow is tight, the CARES Act may help. Contact your tax professional to learn more and possibly get started on filing amended federal returns. ■

SECURE Act: New tax incentives for employers to offer retirement benefits

The Setting Every Community Up for Retirement Enhancement (SECURE) Act authorizes a new, cost-effective type of retirement plan: the pooled employer plan (PEP), beginning in 2021. This is a new type of multiple employer plan (MEP).

MEPs have been available for many years, but they suffer from some serious drawbacks that make them impractical for many businesses, especially smaller ones. By creating the PEP, the SECURE Act largely eliminates these obstacles, extending the benefits of MEPs to more businesses.

What are the upsides?

MEPs are 401(k) or other retirement plans maintained by two or more employers. Participating employers may sponsor the plans themselves, or a trade association, professional employer organization (PEO) or other third party can sponsor them. (*Note:* Don't confuse MEPs with the "multiemployer plans" maintained by some unionized companies.)

The benefits of MEPs include:

Reduced costs. They allow employers to take advantage of group purchasing power and other economies of scale to achieve significant savings. Participants may also enjoy access to the MEP's expertise and advanced technology.

Time savings. MEPs can assume time-consuming administrative burdens, freeing up participants to focus on operating their businesses.

Lower liability. Participants can shift some (but not all) of their fiduciary obligations to the MEP.

So-called "closed" MEPs offer the greatest benefits, because they're treated as a single employer plan for purposes of annual reporting, annual audits and other administrative functions.

What are the potential pitfalls?

Under current law, there are obstacles that make it difficult for many businesses to enjoy these benefits to their fullest extent. First, to be treated as a single employer plan, a MEP must be closed. A closed MEP is one in which participating employers have a commonality of interest. That means they're in the same industry or geographical area, or join a MEP sponsored by an eligible organization, such as a trade association or PEO.

"Open" MEPs are another option. But each participating employer in an open MEP is treated as maintaining a separate plan, with its own filing, audit and other administrative obligations.

Another deterrent to joining a MEP is the one-bad-apple rule. Under that rule, the tax-advantaged status of an open or closed MEP may be lost if even one participating employer fails to meet the qualification requirements. The U.S. Departments of Treasury and Labor issued proposed regulations last year that would alleviate the impact of the one-bad-apple rule on some, but not all, MEPs.

CARES Act expands financial options for impacted employees

Congress has made it easier for some 401(k) plan participants to tap into their retirement savings to ease financial strains caused by the novel coronavirus (COVID-19) pandemic. Specifically, the Coronavirus Aid, Relief, and Economic Security (CARES) Act generally allows participants who're adversely affected by the pandemic to take out up to $100,000 from their 401(k) and certain other retirement plans in 2020 without any immediate federal income tax consequences.

Eligible employees can recontribute the amounts any time up to three years later with no federal income tax consequences. They'll be taxed on any distributions that aren't recontributed within the three-year window. But they won't owe the 10% early withdrawal penalty if they're under age 59½.

To allow these withdrawals, you will have to amend your plan, and additional rules and limits apply to this relief. If your 401(k) plan allows plan loans, the CARES Act also temporarily liberalizes the rules for those. Contact your tax and benefits advisors for details.

What makes a PEP special?

Under the SECURE Act, a properly structured PEP is treated as a single plan for filing, audit and other compliance purposes, regardless of whether it satisfies the commonality of interest requirement. This allows unrelated businesses of any size to take advantage of the benefits of a MEP. PEPs also avoid the one-bad-apple rule if their plan documents include certain provisions for addressing a participating employer's compliance failure.

The SECURE Act also expands access to MEPs by allowing financial services companies, insurance companies, third-party administrators and other organizations to sponsor PEPs, provided they meet certain requirements. To qualify as a pooled plan provider (PPP), a sponsoring entity must register with the IRS and the Department of Labor, acknowledge in writing that it's the PEP's named fiduciary and plan administrator, and ensure proper bonding of individuals who handle plan assets.

Beyond PEPs

The SECURE Act includes other provisions to encourage employers to offer retirement benefits to their workers. For example, it increases the maximum tax credit for retirement plan start-up expenses incurred by small businesses from $500 to $5,000. In addition, it provides a $500 tax credit for employers that add an automatic-enrollment feature to eligible plans and extends the due date for establishing a new 401(k) plan. Contact your CPA to discuss expanding the tax-favored retirement benefits your company offers its employees. ■

Highlights of the USMCA for manufacturers

One of the biggest issues manufacturers have faced in recent years is trade uncertainty. And with the continuing novel coronavirus (COVID-19) pandemic, trade stability is even more sought after. The United States-Mexico-Canada Agreement (USMCA) relieves some uncertainty by updating the North American Free Trade Agreement (NAFTA).

Like NAFTA, the USMCA is designed to facilitate the free flow of trade across the three countries' borders. The agreement will take effect as soon as each country has taken certain steps to implement it. Here are some key changes that will soon affect manufacturers.

Labor rules

One criticism of NAFTA was that it caused the loss of U.S. jobs because many manufacturers shifted production to Mexico, where labor is far cheaper. To help level the playing field, the USMCA includes provisions designed to protect Mexican workers and make it easier for them to unionize.

The agreement also sets wages for certain workers in the automobile industry. For example, it requires that 40% to 45% of North American automobile content be made by workers earning at least $16 per hour.

Rules of origin

Like NAFTA, the USMCA requires products to originate in one of the signatory countries in order to enjoy zero tariffs. Products that contain materials from non-USMCA countries may still be deemed to originate in North America if they're sufficiently "transformed" within the region, but the agreement makes some significant changes.

For automotive manufacturers, the agreement requires:

1. At least 75% of the content (parts) in automobiles and light trucks to be produced in North America rather than imported from other parts of the world, and

2. At least 70% of a vehicle's steel and aluminum to originate (be melted and poured) in North America.

The USMCA also strengthens procedures for verifying the origin of a product's content and streamlines enforcement of the rules.

De minimis rules

To promote cross-border exports, particularly by small and midsized businesses, the USMCA requires Mexico and Canada to increase their *de minimis* shipment value thresholds. These are the thresholds for goods that may enter a country free of customs, duties and sales taxes.

Canada has agreed to increase its *de minimis* thresholds from $20 to $40 (Canadian) for tax-free shipments and from $20 to $150 (Canadian) for duty-free shipments. Mexico will continue to allow tax-free shipments up to $50 and increase its duty-free threshold from $50 to $117. The *de minimis* threshold for the U.S. continues to be $800.

More rules

The USMCA also covers the following trade issues:

Digital commerce. In addition to extending trade protections to digital products, the USMCA facilitates e-commerce by promoting the free flow of data across borders. Specifically, the agreement ensures nondiscriminatory treatment of digital products, prohibits cross-border data flow restrictions, prohibits countries from requiring companies to store data within their borders, bans customs duties or other charges for electronically transmitted products, and promotes cooperation on cybersecurity.

Intellectual property (IP). The USMCA helps protect innovators — particularly in the technology sector — by modernizing, strengthening and standardizing patent, trademark, copyright, and other IP protections throughout North America. It also improves enforcement of IP rights to deter theft, misappropriation and counterfeiting.

Environmental protections. The agreement contains several provisions designed to improve environmental protections, strengthen enforcement and level the compliance playing field. According to the U.S. Trade Representative, these provisions, among other things, seek to protect marine wildlife from pollution and overfishing, improve air quality, support sustainable forest management and ensure appropriate procedures for environmental impact assessments.

Assess the impact

Though many manufacturers have been overwhelmed by COVID-19 concerns, now is a good time to familiarize yourself with the USMCA's provisions and evaluate its potential effects on your business. Many of these provisions will be phased in by 2023. The agreement is complex and wide-ranging. Please contact your CPA to discuss what the new trade deal means for you. ■

Is it time to update your company's drug use policy?

Given the safety risks involved with many manufacturing jobs, it's a good idea for manufacturers to adopt a drug and alcohol policy and enforce it consistently. However, the evolving legal environment — particularly the trend in many states toward legalization of marijuana — greatly complicates the process.

Alcohol vs. marijuana

When marijuana was illegal everywhere, determining how to respond to a positive drug test was a simpler matter. Many manufacturers adopted a zero-tolerance policy and routine drug testing for positions where impairment could cause safety issues.

But today, medical marijuana is legal in more than half of U.S. states, and a significant number of states have also legalized its recreational use. The reason the situation is complicated stems from differences between marijuana and alcohol.

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Tests that measure blood alcohol level provide a clear measure of impairment. But the correlation between levels of THC (marijuana's main active ingredient) and impairment is less well understood. Plus, unlike alcohol, some level of THC may stay

in a person's system for days or even weeks, so employees may test positive even if they're "sober."

Drug policy updates

What should you do in this changing environment? First, it's important to review your company's drug-use policies. Some companies have stopped testing for marijuana for fear that it will discourage qualified workers from applying for jobs. However, most companies will screen for marijuana or alcohol use if there's reason to believe an employee is under the influence at work. Others test only for safety-sensitive jobs.

Also monitor legal developments to ensure that your policy balances safety and legal obligations, if any, to accommodate medical marijuana use. Some experts believe that employers should focus on neurocognitive or functional testing, which measures fitness for work, rather than testing THC levels.

Need help?

The legal landscape in this area is in a state of flux. Consult your legal advisors to ensure that your policy achieves your company's safety objectives without exposing it to excessive liability. ■

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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.

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