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Fall 2013

YEAR END TAX PLANNING IDEAS FOR MANUFACTURERS & DISTRIBUTORS

As we approach year-end, it's again time to focus on last-minute moves you can make to save taxes -- both on your 2013 return and in future years.

Ideas for your business

Take advantage of tax breaks for purchasing equipment, software and certain real property. If you have plans to buy a business computer, office furniture, equipment, vehicle, or other tangible business property or to make certain improvements to real property, you might consider doing so before year-end to capitalize on the following generous, but temporary tax breaks.

Bigger Section 179 deduction. Your business may be able to take advantage of the temporarily increased Section 179 deduction. Under the Section 179 deduction privilege, an eligible business can often claim first-year depreciation write-offs for the entire cost of new and used equipment and software additions. (However, limits apply to the amount that can be deducted for most vehicles.) For tax years beginning in 2013, the maximum Section 179 deduction is $500,000. For tax years beginning in 2014, however, the maximum deduction is scheduled to drop to $25,000.

Section 179 deduction for real estate. Real property costs are generally ineligible for the Section 179 deduction privilege. However, an exception applies to tax years beginning in 2013. Under the exception, your business can immediately deduct up to $250,000 of qualified costs for restaurant buildings and improvements to interiors of retail and leased nonresidential buildings. The $250,000 Section 179 allowance for these real estate expenditures is part of the overall $500,000 allowance. This temporary real estate break will not be available for tax years beginning after 2013 unless Congress extends it.

Note: Watch out if your business is already expected to have a tax loss for the year (or be close) before considering any Section 179 deduction, as you cannot claim a Section 179 write-off that would create or increase an overall business tax loss. Please contact us if you think this might be an issue for your operation.

50% first-year bonus depreciation. Above and beyond the bumped-up Section 179 deduction, your business can also claim first-year bonus depreciation equal to 50% of the cost of most new (not used) equipment and software placed in service by December 31 of this year. For a new passenger auto or light truck that's used for business and is subject to the luxury auto depreciation limitations, the 50% bonus depreciation break increases the maximum first-year depreciation deduction by $8,000 for

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vehicles placed in service this year. The 50% bonus depreciation break will expire at year-end unless Congress extends it.

Note: First-year bonus depreciation deductions can create a Net Operating Loss (NOL) for your business's 2013 tax year. You can then carry back a 2013 NOL to 2011 and 2012 and collect a refund of taxes paid in those years, Please contact us for details on the interaction between asset additions and NOLs.

Evaluate inventory for damaged or obsolete items. Inventory is normally valued for tax purposes at cost or the lower of cost or market value. Regardless of which of these methods is used, the end-of-the-year inventory should be reviewed to detect obsolete or damaged items. The carrying cost of any such items may be written down to their probable selling price (net of selling expenses). [This rule does not apply to businesses that use the Last In, First Out (LIFO).]

To claim a deduction for a write-down of obsolete inventory, you are not required to scrap the item. However, in a period ending not later than 30 days after the inventory date, the item must actually be offered for sale at the price to which the inventory is reduced.

WINNING THE WAR ON WASTE

Old pallets, used hydraulic fluid, process wastewater … it all has to go somewhere. Dealing with waste often is a costly and frustrating issue for manufacturers, but it doesn't have to be. Simple steps can help you minimize the waste your plant produces and manage waste more efficiently, greening your operations while also saving money.

To create an effective waste management program:

Avoid creating waste in the first place. Examine your manufacturing processes to identify ways to minimize waste and even incorporate waste back into production. If you manufacture clothing, for example, have workers lay out patterns using the smallest amount of fabric possible to minimize scraps. Paper mills and plastic manufacturers, meanwhile, may be able to add scraps to raw materials and reuse them in production. In addition, hone your inspection process to minimize reject batches. You'll not only cut down on trash, but also wasted time and effort. Look for markets for "secondary" products.

Find new ways to reuse. One company's trash is another's treasure, so take the time to find new homes for your waste. If your waste includes valuable materials, such as metal, plastic wrap or cardboard, scrap processors will often pick them up for free or even pay you for them. Food manufacturers can also pass along their byproducts, such as wastewater and food scraps, to farms for irrigation and fertilizing.

Make your waste smaller. Even after reducing and recycling, you're likely to have some waste headed for the dumpster. Since waste haulers usually charge a flat rate per load, fill your trash bins as efficiently as possible. Many manufacturers have industrial-grade trash compactors on-site to break down high-volume, low-weight products, such as wood crates. Look for a compactor that takes up the same amount of space as a pallet and that workers can operate without supervision. Along with saving on trash pickups, compacting your waste means you'll use less landfill space.

IT'S 2013: DO YOU KNOW WHERE YOUR WORKFORCE OF TOMORROW IS?

By Bill Virgin

The Baby Boom generation – roughly defined as those born between 1946 and 1960 – has been disrupting just about everything in American life since its members first made their appearance.

From the suburban housing construction boom to accommodate growing families, to expanding school and college systems to educate all those additions to the population, to the huge marketplace for goods and services to be purchased by greater numbers of middle-class consumers, the pig-in-the-python demographic cohort has dominated, shaped and remade everything from politics to pop culture – sometimes to the exclusion and annoyance of preceding and succeeding generations.

Now the Baby Boomers are poised to launch one more massive disruption, this one to the American workplace.

How will they disrupt the workplace? By leaving it.

If you were born in 1946, then you are or are about to turn 67, an age by which many Americans have pulled the trigger on retirement.

The "typical" retirement age has been pushed up and down the scale in recent years by a series of factors. Some workers have taken earlier retirement because pension and savings plans allow them to do so. Others are working beyond the standard retirement age, either because they have to (the recession having clobbered the financial reserves they were banking on) or because they like to work and their health allows them to do so.

The larger point that shouldn't be obscured by these fluctuations is that millions of workers are already in the retirement-eligible zone, and millions more will be joining them.

That has a lot of companies worried. The nervousness is particularly acute among manufacturers and others that rely on skilled labor.

It's not just a person who cleans out a desk or locker and heads for the exit at retirement, it's also an accumulation of experience and expertise that leaves - knowledge that isn't recorded anywhere except in that worker's head. That knowledge gets passed down to the next generation of workers in that workplace like an oral tradition, an informal training system to pass on the insider tips on how to handle problems and get work done.

What's worrisome to employers is what happens when the older workers are no longer around to pass on that unwritten wisdom, and when there aren't enough skilled, enthusiastic and teachable younger workers to receive it.

It's not that no one saw this coming. Any manager who has spent even a few minutes with a demographic chart, or surveyed his or her own workforce for increasing amounts of grey hair, has seen the warning signals.

Some major companies have been sounding the alarm. Regional gas and electric utility Puget Sound Energy warned that 42 percent of its workforce was eligible to retire in the next five years; that was six years ago. More than two years ago Boeing warned that a third of its hourly workforce was already retirement eligible.

ThomasNet, an information-technology company that runs a service linking buyers and sellers within manufacturing, recently warned that "manufacturing's biological clock is silently ticking away," and the industry needs to do some serious succession planning now.

This wouldn't be a problem if manufacturing were shrinking and there were less demand for workers. In fact, manufacturing is growing and is being counted upon to sustain economic recovery.

Employers have a few options in dealing with the problem – greater automation to boost productivity and reduce labor inputs, for example, or outsourcing more work.

But those options only get you so far, and each comes with a host of complications.

That leaves the option of hiring replacement workers now and getting that transfer of knowledge going. Complications to that option? Of course. Aren't there always? For manufacturers, the challenges include finding good candidates and getting the word out that long-lasting, good-paying careers, not just jobs, are available in manufacturing.

Help is coming. In Washington and other states, the realization is growing that the community and technical college system holds the key to linking students who would be wasting time and money in a four-year degree program to manufacturers who could put them to work. Those schools are adding programs and rewriting courses of study to get students into the workforce faster with the skills they need.

Another attractive pool for candidates is the military, especially with the downsizing looming with all branches. The Center for Advanced Manufacturing Puget Sound, in which Shannon & Associates is an active member, runs the M2M (military to manufacturing) program to introduce military personnel to careers in the industry.

Manufacturers are also increasing the community outreach and public-awareness-building they do, to get high school students interested in manufacturing careers.

Such initiatives are not just a good idea, they're a necessity. Other business sectors face the same problem of finding smart, trainable and motivated workers and will be competing for them. Passivity won't cut it. If manufacturers assume that good candidates will migrate to manufacturing without any encouragement or enticement, what they'll wind up with is no next generation of workers for the present generation to hand the workplace to.

Bill Virgin is a veteran business journalist and the founder of the newsletters Washington Manufacturing Alert and Pacific Northwest Rail News. He is also a columnist for The News Tribune, Seattle Business Magazine and the energy newsletter Clearing Up.

NEW IRS REGULATIONS ON CAPITALIZING REPAIRS, MAINTENANCE AND IMPROVEMENTS TO BUSINESS PROPERTY

By David Volkert, Senior Accountant

In September of 2013, the IRS issued final regulations to provide guidance on when repairs and maintenance can be deducted and when they must be capitalized as a fixed asset. These regulations will significantly change how and when you're allowed to deduct your repair costs. The regulations are effective for tax years beginning on or after January 1, 2014, and can be applied to tax years beginning on or after January 1, 2012.

BACKGROUND

The reason these regulations have come up is that there's a fairly sizeable hole in the law in that there is very little guidance on when items can be expensed vs. capitalized. Instead, we have a series of court decisions which create case law that leaves lots of room for interpretation on both the IRS and the taxpayer side. The regulations seek to codify some of the existing case law in some areas and to create new law where the IRS believed the case law guidance was lax.

AN OVERVIEW

The regulations are long and complex. This summary cannot cover all the ins and outs of the regulation but should give you a general idea of what to expect.

More defined units of property. These regs introduce a more defined "unit of property" (shortened to UOP) when determining whether a disbursement should be expensed or capitalized. The smaller the UOP, the more likely it is that a cost related to the UOP should be capitalized. For example, repairs to an engine in a truck are more likely to be an expense if the UOP is the vehicle; however, if the UOP is the engine, the opposite would be true.

Previously, taxpayers would take the position that the UOP is always a large asset, rather than the components such as a building is a building, not a roof, structure, HVAC, etc. By taking the position that the building is the UOP, repairing the roof could be more easily be considered a repair as it would not extend the life of the UOP (the building). However, the new regs identify the roof itself as the UOP thus making the repair of the roof a new asset in of itself as it has extended the life of the UOP.

To capitalize or deduct. When paying to improve a UOP, the amount must be capitalized. These new regulations create considerable guidelines in determining what constitutes an improvement. Repairs and maintenance is then defined as anything that isn't required to be capitalized.

Additionally, UOP that costs less than $200 to purchase or produce can be expensed in the year it is acquired. There are further de minimis rules which may apply to you if you issue a financial statement, establish a written accounting policy, and the total amount expensed is below certain revenue and depreciation based threshold. Obviously, this second de minimis rule gets complicated.

Buildings get their own rules. Generally, buildings and their structural components are treated as one UOP; however, the new regulations list nine building "systems" that are separated from the structure itself. These systems are considered UOP by themselves so you must consider the effect on the system, rather than the building as a whole. Therefore, work performed on the HVAC system may be considered an improvement rather than a repair when only looking at the effect on the system itself.

Most everything else. A UOP is considered a component that can be placed into service without other components to function. So the engine in a truck is not a UOP as it cannot function without the rest of the truck. However, a conveyor belt which feeds items to a packaging machine is a separate UOP as it can still serve its function without the packaging machine in place.

Routine maintenance. There is a special safe harbor for routine maintenance performed on UOP that is not a building or structural component thereof. Under this safe harbor, routine maintenance is reoccurring activities that the business expects to perform to keep the UOP functioning properly. This would include activities like cleaning, testing, replacing worn out parts with new parts of the same type and inspections. The business must expect to perform these services more than once over the depreciation life of the property.

For example, a machine with a 7-year life property must have an annual maintenance which includes replacing various parts which wear out through ordinary use of the machine; additionally, there is an electric motor which is designed to last 10 years which has failed. The ordinary annual maintenance would fall under the routine maintenance safe harbor; however, the electric motor would need to be considered a capital expense as it is not expected to need to be replaced more than once over the life of the property.

BOTTOM LINE

At first glance, it may seem that there's not much for businesses to celebrate in these new regulations but:

Significant tax savings through cost segregation. Back to the roof example, both prior to and after these new regulations, a new roof on a building which would need to be capitalized and depreciated as real property. However, under the old regulations, there was no provision to allow the business to "dispose" of the original roof. The cost of the original roof is wrapped up in the cost of the building and will continue to be depreciated even though it no longer exists. With the new regulations, the roof is identified as a separate UOP from the building, therefore, the cost of the old roof can be written off when the new roof is placed into service.

To do this, you would need to have the roof separately identified and valued through a cost segregation study which we can help you with. A cost segregation study will break out the building UOP from the nine building systems UOP which will save you tax when you need to replace one of these systems.

The second de minimis exception may apply. As mentioned, there is a second de minimis exception for purchasing lower cost items which last longer than 12 months which some business may be able to implement. This would allow the business to establish an internal expensing policy to follow effectively decreasing the volume of items required to be capitalized, tracked and depreciated as fixed assets. However, the temporary regulations provide very specific rules in this area which some businesses may struggle to calculate on an annual basis, but we can help you decide if this planning opportunity works for your business.

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