



# Consumer products year-end tax planning: Incentives, opportunities and compliance requirements

December 12, 2013

# Housekeeping

- If you experience audio issues during the call, please press \*0 for operator assistance
- To view the slides in full-screen, press F5 on your keyboard; press Escape to return to the webcast menu
- To answer polling questions, click on the radio button to the left of the desired answer; the button will fill in, indicating you have responded to the question
- To ask a question during the meeting, launch the Q&A Manager located on the toolbar at the top of your screen
- To download a copy of today's presentation, click on the Handouts icon located on the toolbar at the top of your screen
  - The presentation and link to the event recording will be sent to all participants following the event
- Today's presentation will be recorded

# Housekeeping

## CPE Credit Eligibility

- Log in to the webcast with your first and last name and e-mail address
  - For attendees participating in a group, designate one proctor to log in as an individual on behalf of the group, then complete and submit the group sign-in form within 24 hours of the event's conclusion. The form can be downloaded by clicking the Handouts icon on the toolbar at the top of your screen.
- Participants/proctors must remain on the webcast for a minimum of 50 minutes to receive credit
- Participants—and proctors on behalf of a group—must answer polling questions (75% participation required)
  - To answer a polling question, click on the radio button to the left of the answer you'd like to choose. You do not need to have the correct answer but must participate to receive credit. Once each poll closes, participants will no longer be able to respond to that question.
- 1.0 CPE credit will be issued to eligible participants within 60 days
- NASBA will not issue credit if all criteria is not met, without exceptions

# McGladrey consumer products focus



## **Carol Lapidus**

*Assurance Partner  
National Consumer Products  
Industry Leader*  
212. 372.1272  
carol.lapidus@mcgladrey.com

- McGladrey serves over 4,600 consumer products companies from across the country
- Specialty practices include food and beverage, retail and apparel
- To sign up for our monthly retail industry commentary or learn more about our industry focus, visit our website at <http://mcgladrey.com/Industries/Consumer-Products>
- For more information on tax services, visit [http://mcgladrey.com/content/mcgladrey/en\\_US/what-we-do/services/tax.html](http://mcgladrey.com/content/mcgladrey/en_US/what-we-do/services/tax.html)

# Today's presenters



**Dustin Petersen**

Partner  
Tax Services



**Kari Peterson**

Manager  
Washington National Tax



**Jeremy Rubischko**

Director  
Tax Services



**Steve Pashley**

Manager  
Washington National Tax

# Quarterly update

Topic	Minutes
Introduction and overview	5
Overview on the final (and proposed) tangible property regulations	20
New perspective on domestic manufacturing deduction	20
Excise tax	10
Q&A	5

# **Overview on the final (and proposed) tangible property regulations**

# Agenda

Topic	Minutes
Overview on the final (and proposed) tangible property regulations	10
Practical application of the final and proposed regulations	10



# Overview

- Final and proposed regulations issued in Sept. 2013 (sections 162, 168 and 263(a))
  - Generally effective for tax years (or amounts paid or incurred in tax years) beginning on or after Jan. 1, 2014
  - Govern treatment of:
    - Materials and supplies
    - De minimis amounts
    - Costs of acquiring tangible property
    - Costs of repairing versus improving tangible property
    - Dispositions of tangible property (and components thereof)
- Procedural guidance expected this month
  - Two automatic consent method change revenue procedures

# Materials and supplies

- Definitions
  - Components acquired to maintain, repair or improve a unit of property (UOP)
    - Includes rotatable and temporary spare parts (rotables) and standby emergency spare parts
  - Fuel, lubricants, water, etc. reasonably expected to be consumed in  $\leq 12$  months
  - UOP with economic useful life of  $\leq 12$  months
  - UOP with acquisition or production cost of  $\leq \$200$
- Timing of recognizing amounts paid or incurred for materials and supplies
  - Incidental – in the year paid or incurred
  - Non-incidentally – in the year first used or consumed in operations
  - Special rules for rotatables
- If de minimis safe harbor elected, must be applied to all eligible materials and supplies, except as otherwise provided

# De minimis safe harbors

- Taxpayers with an Applicable Financial Statement (AFS)
  - Follow written book capitalization policy up to \$5,000 per item or invoice, as applicable, if policy in effect and followed in AFS since beginning of tax year
- Taxpayers without an AFS
  - Follow accounting procedures up to \$500 per item or invoice, as applicable, if accounting procedures in effect and followed in books and records since beginning of tax year
- Annual election
- Anti-abuse rule

# Costs to acquire or produce tangible property

- Capitalize amounts paid to:
  - Acquire or produce tangible property
  - Defend or perfect title to tangible property
  - Facilitate acquisition of tangible property
    - Special rules for real property investigatory costs
    - Simplifying convention for employee costs and overhead
    - Eleven inherently facilitative costs
      - May generally be allocated between property not acquired and property acquired
      - Special rule for contingency fees
- Acquisition costs of property included in de minimis safe harbor election are not capitalizable acquisition costs

# Improvement standards

- Applied on UOP basis
  - General rule – functional interdependence standard
  - Special rules for buildings, leased property, plant property (industrial processes), and network assets
- General framework
  - Betterment
  - Restoration
  - Adaptation to new or different use
- Small taxpayer safe harbor
- Routine maintenance safe harbor
- Election to capitalize repair and maintenance costs

# Dispositions and general asset accounts (proposed regulations)

- May be applied to taxable years beginning on or after Jan. 1, 2012, and before applicability date of final regulations
  - Certain elections may be made for years in which the timely filed tax return has already been filed
- Building (including structural components) is the asset
  - No general asset account (GAA) election necessary to forego disposition loss
- Dispositions generally only include structural components if make annual partial disposition election
  - Required for specified transactions (sale or section 165, 168(i)(7), 1031 or 1033 transaction)
- Annual GAA election
  - Narrow definition of qualifying disposition
- Special rule for IRS adjustments to repairs

# Why is this important to your business?

- All business likely will be affected by the tangible property regulations
- Taxpayers need to have policies in place as of Jan. 1, 2014 to take advantage of certain provisions
- Many taxpayers will need to file method changes for 2014 and may want to consider early adoption of some provisions
- Changes might have financial statement implications
- Companies may need/want to make changes to fixed asset accounting systems

# **Practical application of the final and proposed regulations**



# Practical application of the final and proposed regulations

- Repairs and maintenance
  - May have previously treated improvements as repairs/maintenance (exposure)
  - May have previously treated repairs/maintenance as improvements (opportunity)
- Retail stores
  - Refreshes completed or expected
  - Understanding the impact of these rules related to this
- Favorable dispositions rules
  - Upgrades or major repairs have been capitalized
  - Opportunity may be available to take a current year deduction for the remaining basis of old asset(s) on books

# Practical application of the final and proposed regulations (cont.)

- Materials and supplies
  - Opportunity to increase deductions if make favorable changes to books and records
- Fixed assets
  - Opportunity to adopt or make elections that eliminate need to track dispositions of assets
  - Great time to consider implementing new fixed asset systems to track assets and “clean up the fixed assets”

# **New perspective on domestic manufacturing deduction**

# DPAD opportunities for retail

- Domestic production activities deduction (DPAD)
  - Section 199 deduction
- Tax-only deduction of 9 percent for qualified production activities income
  - Permanent tax-only deduction
  - Reduces tax rate by up to 3 percent

# Calculating the deduction

- 9 percent deduction on the lesser of:
  - Production activities income
    - Gross receipts, less cost of goods sold (COGS) and direct expenses, less allocable expenses
  - Taxable income
  - 50 percent of Form W-2 wages associated with production activities
- Production activities must be preformed in the United States
- Conversion costs to be deemed production account for 20 percent or more of the COGS for the produced item

# Qualifying activities for retailers

- Food and beverage preparation at retail establishments does not qualify
- Exception applies if production is done in a location other than a retail establishment
- Exception example of a coffee retailer and manufacturer

# Qualifying activities for retailers (cont.)

- Bakery production preformed off-site and sold in retail locations
- Butchering or meat production
  - Off-site seasoning/preparation for ready to cook
  - Off-site pre-cooking
- Deli
  - Off-site sandwiches, pizza, salads, meat/cheese, vegetable trays

# Qualifying activities for retail (cont.)

- Dairy
  - Off-site pasteurization and microfiltration of raw milk
  - Off-site production of cheese, butter, yogurt and other milk-based products
- Pharmacy
  - Filling pill bottles does not qualify
  - Compounding or mixing drugs qualifies
    - Allergies, avoid ingredients, dosage size



# Qualifying activities for retail (cont.)

- Eyewear
  - Grinding, frame fitting, tinting, assembly, quality control
- Film processing
  - Processing of 35mm film
  - Printing of photos, invitations, magnets, calendars, etc.

# Contract manufacturing and private label goods

- The party in the contract that has the benefits and burdens of ownership receives the manufacturing deduction
- Factors to consider
  - Legal title
  - Risk of loss or damage (insurance purchased)
  - Control over the production process
  - How the parties treat the transaction

# IRS exam and appeals experience

- Preparation of vegetable trays
- Ripening of bananas
- Contract manufacturing
- Items that do not meet the 20 percent value-add safe harbor
- Allocation of indirect expenses
  - Allocate indirect expenses to high-volume but low-margin sales, creating more DPAD income

# Federal excise tax

# Contents

- Manufacturers Excise Tax – General Concepts
- Firearms and Ammunition
- Sport Fishing & Archery Equipment
- Ozone Depleting Chemicals

# Manufacturers Excise Tax

- In general
  - Tax applies to manufacturers, producers and importers
    - Firearms and certain sporting goods
    - Heavy Trucks and Trailers
    - ODC's
    - Fuels
    - Tires
    - Distilled Spirits
    - Tobacco
    - Medical Devices
  - Rates and basis for tax vary by industry and product
    - Selling Price
    - Unit of measure (e.g., gallons, per unit produced, weight)

# Manufacturers Excise Tax

- Definition of Sales Price
  - The “arm’s length” price of a taxable article **and** any charge incident to placing the article in condition ready for use.
  - The sales price **does not include** the **excise tax** assessed and the following charges **if separately stated**:
    - State taxes
    - Delivery/Transportation charges from taxpayer to purchaser
    - Insurance
    - Installation charges (with some exceptions)
    - “Buyers Option” Warranty charges

# Manufacturers Excise Tax

- Exemptions
  - Further Manufacture
    - Exempt for tax provided sale is made directly by the manufacturer to another manufacturer or single intermediate dealer.
      - The article sold must become a physical part of the item being manufactured.
      - Articles consumed in testing other articles (other than gasoline as a fuel).
    - Tax applies on the first retail sale or use ***upon completion*** of further manufacturing



# Manufacturers Excise Tax

- Exemptions

- Exports - § 4221(a)(2)

- Exempt from tax if the article is sold by the manufacturer for export or for resale by the purchaser to a second purchaser for export.

- An article may not be sold tax free under the provisions of this section by a manufacturer to a purchaser for resale to a second purchaser which does not intend to export the article itself but plans to resell it to a third purchaser for export.

# Exemptions – Recordkeeping Requirements

- For such sales to be tax exempt, the manufacturer, purchaser (and second purchaser, if applicable) must register with the IRS by filing Form 637
- Manufacturer must indicate to purchaser that such articles are being sold tax-free and that purchaser is obtaining the articles tax-free for an exempt purpose under an exemption certificate or its equivalent

# Exemptions – Recordkeeping Requirements

- If sold to purchaser who resells the article to a second purchaser who performs further manufacture or exports the article:
  - Purchaser must provide proof to the manufacturer that the article has been exported or resold for use in further manufacture
  - Proof must be received within 6 months of the date of sale by the manufacturer or shipping date, if earlier
  - Manufacturer may, at time of sale, in good faith, accept certification from purchaser that article will be used in accordance with exempt purpose

# Firearms and Ammunition

- Tax imposed upon the sale by a manufacturer, producer or importer
  - 10% of sales price
    - Pistols
    - Revolvers
  - 11% of sales price
    - Firearms (other than pistols and revolvers)
    - Shells and cartridges

# Firearms and Ammunition

- Spare Parts and Accessories
  - **Not** subject to tax when sold separately or together with a complete firearm.
  - **Non-taxable** spare parts - Parts sold with firearms that duplicate component parts (e.g. extra barrels, sights).
  - **Non-taxable** accessories - Items not designed to be attached to a firearm during use or are not, in the ordinary course of trade, provided with the firearm at the time of the sale by the manufacturer or importer (e.g. cleaning equipment, tools, gun cases)
  - **Taxable** component part - Items that would ordinarily be attached to a firearm during use and packaged with the firearm at the time of sale by the manufacturer or importer (e.g. magazine, choke, trigger mechanism, grips).

# Sport Fishing and Archery Equipment

## ■ Sport Fishing Equipment

- 10% tax imposed on the sale of any article of sport fishing equipment by the manufacturer, producer or importer
  - Limitation on fishing poles and rods
    - Shall not exceed \$10
  - Parts and accessories are treated as being included with the original article
- Electric outboard motors and tackle boxes
  - Subject to 3% tax

# Sport Fishing and Archery Equipment

- Archery Equipment
  - Bow
    - 11% tax imposed on the sale by the manufacturer, producer or importer of any bow which has a peak draw weight of 30 pounds or more
  - Archery equipment
    - 11% tax imposed on any accessory suitable for inclusion in or attachment on a bow and any quiver, broadhead or point suitable for use with an arrow
  - Arrows
    - Tax imposed of \$0.48 per shaft on the first sale by the manufacturer, producer or importer of an shaft (whether separately or incorporated as part of a finished or unfinished product) of a type used to manufacture any arrow which after its assembly -
      - Measures more than 18 inches
      - Or is suitable used for a bow as described in § 4161(1)(A)

# Ozone Depleting Chemicals

- Ozone Depleting Chemicals (ODCs)
  - chemicals including Chlorofluorocarbons (CFCs) and Halons used as
    - refrigerants, cleaners, solvents, sterilants and propellants and in the manufacture of insulation, fast food cartons and electronics.
  - No longer produced in the United States
  - Excise tax in effect since 1/1/1990



# Ozone Depleting Chemicals

- Types of Excise Tax on ODCs
  - Tax on the sale or use of ODCs by the manufacturer, producer or importer of the ODC.
  - The sale or use in the United States by the importer of any “imported taxable products” as defined by IRC § 4681(b)(2)
    - Imported taxable product - any product entered in the US for consumption, use or warehousing and is listed in the Imported Products table set forth in Treasury Reg § 52.4682-3(f), if any ODC was used as material in manufacture or production of such product.
  - Floor stock tax - ODCs in inventory January 1 each year.

# Ozone Depleting Chemicals

## ■ Calculation of the Tax

- Sale or Use by manufacturer or importer
  - Amount of tax is equal to
    - Base rate \* Ozone depletion factor \* amount (in lbs)
      - Base rate - \$5.35/pound plus \$0.45 for each year since 1995
- Imported taxable products
  - Tax calculated using the Harmonized Tariff Schedule (HTS)
    - Number of items \* ODC weight per item per the HTS \* Base Tax amount \* Ozone depletion factor
- Floor Stock Tax
  - Tax equal to
    - The tentative tax for the new year less the amount of taxes that were previously imposed on the ODCs.

# Ozone Depleting Chemicals

- 3 methods to determine weight for purposes of ODC excise tax
  - Exact Method
    - Actual weight of the ODC used
  - Table Method
    - Listed weight on the imported products table
  - Value Method
    - 1% of the entry value reported to U.S. Customs
      - Used when exact weight cannot be determined and product is not listed on imported products table

# Ozone Depleting Chemicals

## ■ Exemptions

- Exports
  - Tax does not apply to sale by manufacturer or producer that are for export
    - There are limits to the amount that can be exempt, § 4682(d)(3)(B) describes the limits
- Metered-dose inhalers
  - Tax does not apply to the use or qualified sale of any substance as a propellant in metered-dose inhalers.
    - Qualified Sale – sale by manufacture, producer, importer or resale to a second purchaser of a substance for use by the purchaser as a propellant in metered-dose inhalers.

# Ozone Depleting Chemicals

- Exemptions (con't)
  - Recycled ODCs (§ 4682(d)(1))
    - ODCs diverted or recovered in the United States as part of recycling process and not as part of the original manufacturing or production process.
  - Further Manufacture (§ 4682(d)(2))
    - Tax does not apply to ODCs that are entirely consumed in the manufacture or production of any other chemical
  - Used as Feedstock
    - No tax on an ODC's for use or used as feedstock provided they are entirely consumed in the manufacture of another chemical.
      - Use of an ODC in a mixture does not qualify for the purpose of the exemption

# Addressing your questions



**Dustin Petersen**

Partner  
Tax Services



**Kari Peterson**

Manager  
Washington National Tax



**Jeremy  
Rubischko**

Director  
Tax Services



**Steve Pashley**

Manager  
Tax Services

- **It is now time for our Q&A session.**
- **Click the “Ask a Question” button, type your question in the open area and click “Ask Question” to submit.**

# Thank you for attending!

## Reminder to obtain CPE credit

- Individuals: No further action is required
- Proctors on behalf of a group:
  - The group proctor should be the same individual who logged in to the web and teleconference lines
  - Submit the group sign-in form within 3 days (available by clicking on the Presentation Assets section on the left side of your screen)
- 1.0 CPE credit hours will be issued to eligible participants within 60 days
- NASBA will not issue credit if all criteria is not met, without exceptions

## Follow-up materials

- The presentation slides and a link to the call recording will be sent to all participants within a few days of the webinar

**McGladrey LLP is registered with the National Association of State Boards of Accountancy (NASBA) as a sponsor of continuing professional education on the National Registry of CPE Sponsors. State boards of accountancy have final authority on the acceptance of individual courses for CPE credit. Complaints regarding registered sponsors may be addressed to the National Registry of CPE Sponsors, 150 Fourth Avenue North, Suite 700, Nashville, TN, 37219-2417. Website: [www.nasba.org](http://www.nasba.org).**



This document contains general information, may be based on authorities that are subject to change, and is not a substitute for professional advice or services. This document does not constitute assurance, tax, consulting, business, financial, investment, legal or other professional advice, and you should consult a qualified professional advisor before taking any action based on the information herein. McGladrey LLP, its affiliates and related entities are not responsible for any loss resulting from or relating to reliance on this document by any person.

McGladrey LLP is an Iowa limited liability partnership and the U.S. member firm of RSM International, a global network of independent accounting, tax and consulting firms. The member firms of RSM International collaborate to provide services to global clients, but are separate and distinct legal entities that cannot obligate each other. Each member firm is responsible only for its own acts and omissions, and not those of any other party.

McGladrey®, the McGladrey logo, the McGladrey Classic logo, *The power of being understood®*, *Power comes from being understood®*, and *Experience the power of being understood®* are registered trademarks of McGladrey LLP.

**McGladrey LLP**

800.274.3978  
[www.mcgladrey.com](http://www.mcgladrey.com)



Assurance ■ Tax ■ Consulting