Does the tax code penalize manufacturers?

By: Martin Daks

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According to President Joe Biden, the recently passed Inflation Reduction Act [IRA] will, among other accomplishments, "**finally** ask the largest corporations to pay their fair share [of taxes]." Some organizations, like the libertarian-leaning **Tax Foundation** and the **National Association of Manufacturers**, an advocacy group, say that manufacturers are already getting the shaft when it comes to taxes — and the IRA will only make it worse. Experts who spoke with NJBIZ, however, say the situation may be more nuanced.

One contentious provision of the **Inflation Reduction Act** is the Corporate Alternative Minimum Tax (CAMT). It imposes a 15% corporate alternative minimum tax on the "adjusted financial statement income" – basically the higher of publicly reported income or taxable income – of certain companies for taxable years beginning after Dec. 31, 2022. According to a **report** by the Congressional Joint Committee on Taxation, almost 50% of the additional revenue generated by the CAMT will come from one industry: manufacturing.

Not everyone's worried, though. "I'm a small manufacturer, and many manufacturers are also relatively small, and the CAMT doesn't kick in until your profits reach $1 billion a year, so for us it's a non-issue," said **Zago Manufacturing Co.** CEO Gail Friedberg. "If we reach the billion-dollar a year mark, I'll pay my 15% of income taxes."

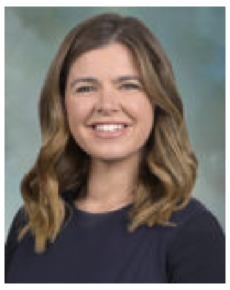
The current tax code provisions for accelerated depreciation offsets against income "work fine for me," she added. "In fact the Inflation Reduction Act will help small manufacturers like Zago."


Friedberg

On the other hand, she doesn't agree with tariffs on a wide range of imports from China that were imposed by President Donald Trump – and extended, for the most part by Biden – "since they make it more difficult for small businesses. At Zago, imports from China are minimal, but it still hurts. I can understand why the tariffs on steel and other products were imposed, but I don't think they'll accomplish much. I'm not seeing U.S.-based companies rushing out to build new steel plants here."

EisnerAmper Tax Partner Alexandra Colman also observed that the pluses and minuses are not so stark when it comes to taxes on manufacturing. "Some manufacturers feel targeted by the CAMT and other issues," she said. "But other industries also say they're being targeted. It can be a matter of perspective."

For example, under previous tax codes, research and development expenses could generally be completely written off against taxable income in the year in which they were incurred. But thanks to the 2017 Tax Cuts and Jobs Act (TCJA), as of Jan. 1, 2022, R&D expenditures must generally be amortized, or written off against income, over a statutory five-year period which, because of certain technicalities, effectively stretches the write-off over six years.


Colman

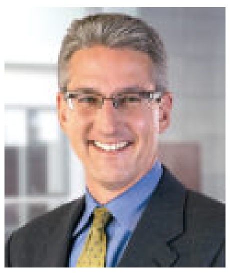
"I've got some life science companies with no revenue that feel they're getting burned since they're losing millions of dollars of potentially valuable NOL [net operating loss] carryforwards as a result of this rule," Colman said. "Some manufacturers that build components for bridges, for example – and incur significant R&D expenditures – are also losing out."

She noted, however, that the TCJA offered an olive branch by increasing first-year "bonus depreciation" – or the ability to write off certain capital expenses in the year incurred – to 100%. "The bad news is that qualifying property placed in service after Dec. 31, 2022, and before Jan. 1, 2024, will only get an 80% write off; and the percentage will continue to drop after that. Still, it's better than nothing."

But what about the IRA and its Corporate Alternative Minimum Tax provision? "The CAMT generally only applies to companies that average at least $1 billion of revenue a year over a three-year period," Colman said. "None of my manufacturing clients meet that threshold, but there may be some surprises as more guidance comes out."

Another CPA said the focus on the CAMT may obscure other concerns. "The Congressional Joint Committee on Taxation report, when it comes to the manufacturing industry, focuses on the tax effects of capitalized items that would generally have to be written off against income over time for financial statement purposes, as compared to a faster write off for tax purposes," said David Strong, a partner in the tax services group at **Crowe LLP**. "But the JCT report also notes that only about '150 taxpayers' will be affected, so the effects do appear to be limited to a fairly small subset of organizations."

In fact, other parts of the Inflation Reduction Act, which are aimed at stimulating wind- and solar-energy investments, may indirectly help manufacturers that produce those components, "since demand for their products may increase," he added.



Strong warned, though, that manufacturers are likely to suffer more from the planned phaseout – thanks to the 2017 Tax Cuts and Jobs Act – of "bonus depreciation" that has let them rapidly write off the costs of certain assets against income. "Accelerated depreciation has been a big help to manufacturers, since they tend to be capital intensive," he explained. "As the changes phase in, “Many of these targeted companies park their profits overseas in low-tax jurisdictions to avoid U.S. taxes, so I do not think the Corporate Alternative Minimum Tax will decimate manufacturing.”

He also had a bone to pick with a Tax Foundation claim that “While most business costs, such as utility bills or wages and salaries, are immediately deducted when they are incurred, business costs associated with physical capital are not immediately deducted. Instead, businesses must follow recovery periods set by lawmakers, indicating how many years over which deductions must be spread.”

Immediate expensing “would be mismatch of accounting principles, which generally call for matching income against expenses generated in the same period,” he explained. “Unlike supplies, which generally are used pretty quickly, capital assets like buildings or machinery and equipment generally have a longer useful life. In fact, accelerated depreciation rules, which have been around in one form or another for decades, may give companies the option of faster write offs.”

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