



***Manufacturing & Distribution Industry Webinar:***  
**Accounting and Tax Update**

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# Agenda

1. Accounting update – upcoming standards and market impacts
2. Tax update – upcoming tax law changes and tax planning opportunities
3. State and local tax update – sales and use tax issues



# Polling Question

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# A&A Update

1. New lease standard impact
2. Current expected credit losses (CECL)
3. Other upcoming standards
4. Market impacts

# Leases – ASC 842

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- Effective for years ending December 31, 2022
- Essentially all leases will be recorded on the balance sheet as a right-of-use asset and lease liability
- Impact on debt covenants
- What leases apply?
- How to apply to related party leasing arrangements
- What you should be doing now



# Financial Instruments – Credit Losses (ASC 326)

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- Effective for years ending December 31, 2023

## Current GAAP – Probable Loss Model

- Allowance for doubtful accounts recorded when it becomes probable that a loss has been incurred
- Not forward looking

## New GAAP – Current Expected Credit Losses Model

- Allowance recorded at inception of the underlying asset
- Company must estimate expected credit losses
- Evaluate based on shared risk characteristics based on pooled basis
  - Geographic
  - Industry
  - Credit rating

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# Other Standards – Now & Upcoming

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- Goodwill
  - ASU 2017-04, effective for years ending December 31, 2022
  - Simplifies the impairment test for goodwill
- Reference Rate Reform
  - FASB ASC 848
  - Provides optional expedients for contract modifications undertaken because of reference rate reform
- Others



# Market Impacts

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- Inflationary environment, potential downturn/recession looming
  - LIFO accounting change
  - Losses on long-term revenue contracts
  - Renegotiated leases and supply agreements
  - What to do with excess cash
- Excessive freight/transportation costs
  - Typically a period cost and should not be included in inventory cost
  - Potential for lower of cost or NRV issues down the road

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# Polling Question

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# Tax Update

1. Revisiting available tax credits
2. R&D tax credit – update
3. LIFO planning opportunity
4. Other tax updates

# Revisiting Available Federal Tax Credits

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- Employee Retention Credit (ERC)
- Work Opportunity Tax Credit (WOTC)



# Revisiting Available Federal Tax Credits

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## Employee Retention Tax Credit

- Gross receipts test
  - 2020: 50% reduction
  - 2021: Q1-Q3 20% reduction
    - Lookback test
- Shutdown/government orders test – **facts and circumstances**
- Credit potential
  - \$5,000 per employee for 2020
  - \$21,000 per employee for 2021 (maximum \$7,000 per employee / each eligible quarter)



# Revisiting Available Federal Tax Credits

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## Work opportunity tax credit

- Targeted groups:
  - 1) Qualified IV-A recipient;
  - 2) Qualified Veteran;
  - 3) Qualified Ex-Felon;
  - 4) Designated Community Resident;
  - 5) Vocational Rehabilitation Referral;
  - 6) Summer Youth Employee;
  - 7) Supplemental Nutrition Assistance Program (SNAP "food stamps") recipient;
  - 8) Supplemental Security Income (SSI) recipient;
  - 9) Long-term Family Assistance recipient; and
  - 10) Qualified Long-term Unemployment recipient



# Revisiting Available Federal Tax Credits

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## Work opportunity tax credit

- Process
  - IRS form completion
  - Submission to state labor agency
- \*\* Timing of above steps is critical and must be completed during hiring process \*\**
  - Track employees' hours
  - Tax reporting on business tax return
- Credit potential
  - \$2,400 - \$9,600 per eligible employee



# R&D Tax Credit Update

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- Revisiting the credit
- Important tax changes



# R&D Tax Credit Update

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## Qualifying Activities

- Permitted purpose
- Technological in nature
- Elimination of uncertainty
- Process of experimentation

## Qualifying Expenses

- Salaries and wages
- Supplies
- Contractor costs

## Tax Impact – Current Law

- ~5-10% of qualifying expenses generate federal tax credit
- State tax credits potentially available
- Costs deductible\*

*\* See update to deductibility in subsequent slides*





# R&D Tax Credit Update

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Tax Cuts and Jobs Act created a change – effective 1/1/2022

- All costs paid or incurred in connection with software development are now considered R&D expenditures.
- **All R&D expenditures are capitalized and amortized over five years (fifteen years for foreign research).**



# R&D Tax Credit Update

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- Potential “fixes”
  - Tax extender package
  - Delay until 2026
  - Cancel outright
- Need to be mindful in the event none of the above come to fruition



# LIFO – Tax Planning Opportunity

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- LIFO: Last in, first out – Combat impact of inflation on financials/tax return
- This inventory valuation method assumes that the most recent products (produced or purchased at inflated costs) are sold first (before products produced or purchased at lower costs). The price paid for the more recent products is used in the cost of goods sold calculation, producing substantial tax savings.



# LIFO – Tax Planning Opportunity

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- Tax and Accounting Benefits
  - Tax Savings
    - The most significant advantage of adopting LIFO is the cash flow generated through income tax savings.
    - When inflation increases the value of inventory items sold, LIFO allows those higher costs to be reported on the current year's tax return, thereby increasing the COGS amount and reducing taxable income.
  - Matching principle
    - Match current costs with current revenue

*\*\*GAAP Note: Financial statements must also adopt this method\*\**

*\*\*Tax Note: Accounting Method change with the IRS\*\**



# Superfund Excise Tax

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- **What is it?** – An additional tax due on certain chemicals primarily found in hazardous waste sites. The government is taxing certain chemicals at the earliest point in the process. Tax due upon first sale or use after import or manufacture in the United States. Tax may be passed along to customers as an additional expense.
- **When does it begin?** – Effective July 1, 2022.
- **Who is impacted?** – Companies who are a manufacturer, producer, or importer of listed taxable chemicals or an importer of specified taxable substances.



# Depreciation Changes

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- Bonus Depreciation – Current Law
  - 100% expensing of eligible property
- Changes on the horizon - **After December 31, 2022**, the deduction for first-year bonus depreciation changes according to the following schedule:
  - 80% for property placed in service between January 1, 2023 and December 31, 2023.
  - 60% for property placed in service between January 1, 2024 and December 31, 2024.
  - 40% for property placed in service between January 1, 2025 and December 31, 2025.
  - 20% for property placed in service between January 1, 2026 and December 31, 2026



# Polling Question

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# Sales Tax Considerations For Manufacturers and Distributors

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# Things To Consider – Manufacturers

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- How does your home state define manufacturing?
  - When does the manufacturing process begin?
  - When does the manufacturing process end?
  - What is considered an exempt purchase for manufacturing?
    - Raw materials
    - Equipment
    - Parts – maybe (some states, like NJ, have specific rules related to parts purchased to maintain/repair manufacturing equipment)

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# General Considerations

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- Purchases
  - What are you buying?
  - How will you use it?
    - Directly in manufacturing? General use or convenience?
  - Purchase for use or resale? (Distributors)
- Who are you selling to?
  - Retailers (Resellers)
  - Direct to consumers
- What do I need to provide my vendor/ what do you need from your customer?
  - VALID EXEMPTION CERTIFICATES



# Exemption Certificate Considerations – Manufacturers

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- Most common exemption for manufacturers:
- Purchases – exempt use
  - Manufacturing – many states do not have a specific definition of what constitutes manufacturing
  - Research and Development (R&D)
  - Direct use requirement
- Sales to customer – Sale for resale
  - Has the right exemption certificate been received from your customer?

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# Exemption Certificate Considerations – Distributors

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Most common exemption for Distributors:

- Purchases for Resale
  - Has the right exemption certificate been provided to your vendor?
- Sales for Resale
  - Has the right exemption certificate been received from your customer?
- Factors to consider regarding exemption certificates
  - State Specific
  - Uniform Sales and Use Tax Exemption Certificate
  - Streamlined Sales Tax Agreement Certificate of Exemption



# Common Issues with Exemption Certificates

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Most Common Problems We See with exemption certificates:

- Not fully completed, including, the name, address, **sales tax number** and signature of the taxpayer;
- Not on the correct form for the particular exemption;
- Exemption that was not available when the purchase was made; and
- Exemption does not apply to the item being purchased (remember the direct use requirement)

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# Nexus Considerations

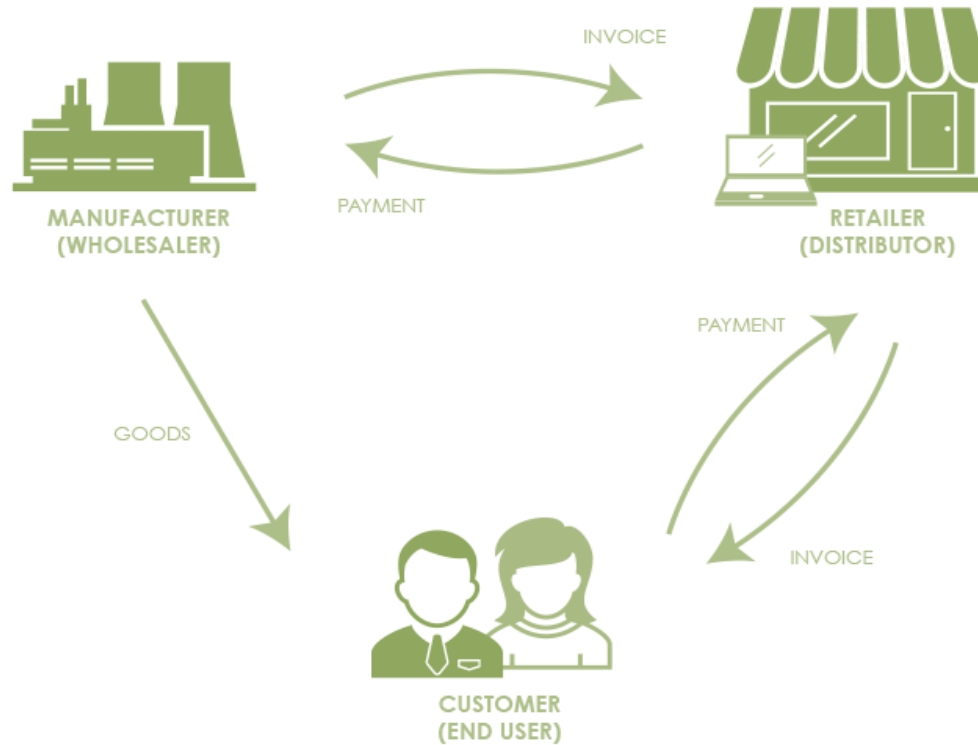
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- Economic Nexus resulting from Wayfair Decision
- Have you considered the impact of Wayfair?
- Common Traps
  - Exemption Certificates
  - Drop Shipments



# Drop Shipping and Sales Tax in the Wake of Wayfair

## THE DROP SHIPMENT MODEL



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# Polling Question

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# Questions?

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# Contact the Presenter

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**Steven P. Feimster**  
**Director, Audit & Accounting and Manufacturing & Distribution Industry**  
**Group Co-Leader**  
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Steve has a wide range of experience providing traditional audit and accounting services to a variety of businesses, including manufacturers, not-for-profits, distributors, and professional services organizations. Steve has also provided business advisory services such as accounting department assessments and due diligence services for his clients.

Steve serves on Kreischer Miller's Manufacturing Industry Group and Not-for-Profit Industry Group, and he is a member of the ESOP specialty area. As an ESOP specialist, Steve has presented at a number of industry events, including those sponsored by the ESOP Association and the National Center for Employee Ownership. He is also an instructor for several of Kreischer Miller's in-house professional training seminars and has delivered presentations on various accounting issues, focusing on ESOPs, inventory, and industry updates for manufacturing and not-for-profit clients.



# Contact the Presenter

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**Brian D. Kitchen**  
**Director, Tax Strategies**  
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Brian has a wide range of experience providing domestic and international tax planning and compliance services to a variety of middle market companies and entrepreneurial businesses in a number of industries, including manufacturing, distribution, media, real estate, financial, and professional services. He has also assisted companies with business transactions, including mergers, acquisitions and transition planning. He has significant experience in federal, state, and local tax audits, settlements, and appeals.

As a member of Kreischer Miller's Manufacturing Industry Group, Brian assists in the development and instruction of in-house professional training and external presentations on topics relating to the manufacturing industry. As an advisor to his clients, Brian uses his experience within the manufacturing industry to ensure all tax incentives are being considered. Some of these incentives include federal and state research and development tax credits, utility sales tax exemptions and, for those domestic manufacturing clients with significant exports, the Interest Charge Domestic International Sales Corporation (IC-DISC).



# Contact the Presenter

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**Thomas M. Frascella**  
**Director, State and Local Tax**  
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Tom has a wide range of experience providing state and local tax strategies & services in the areas of income/franchise, sales and use, realty transfer, and unclaimed property taxes to a variety of businesses, including multi-state and multi-national businesses in the light and heavy manufacturing, distribution, life sciences, not-for-profit and professional services industries. He helps businesses address their multi-state tax needs.

As an experienced multi-state tax professional, Tom has developed a solid understanding of the issues and concerns of growing middle market companies and large publicly-traded enterprises and has been proactive in anticipating their issues and developing solutions to minimize administrative burdens and tax exposures.

He has also assisted clients with navigating the complex state and local tax issues associated with significant entity life events, such as acquisitions, dispositions, or liquidations. His experience working with clients during restructurings has allowed Tom to gain an appreciation of the operational issues associated with these events to address issues in a direct manner and to make adjustments to achieve the anticipated operational and tax efficient project goals. Tom is widely recognized for his expertise in Pennsylvania and Philadelphia tax matters.



# Contact the Presenter

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**Reed Brown**  
**Manager, State and Local Tax**  
**[reedbrown@kmco.com](mailto:reedbrown@kmco.com)**

Reed is a Manager in Kreischer Miller's State and Local Tax group. As an experienced multi-state tax professional, Reed has developed a solid understanding of state and local tax concerns and he assists businesses in anticipating issues and developing solutions to minimize administrative burdens and exposures. He has a wide range of experience providing services in the areas of multi-state income/franchise tax and sales and use tax, as well as audit defense, tax planning, and state tax controversies in the manufacturing, construction, distribution, and professional services industries.

Reed is actively involved with Kreischer Miller's Construction Industry Group, and he is a frequent writer and speaker on state and local tax topics that impact construction contractors. He is also an instructor for the firm's internal training program for team members.



# About Kreischer Miller

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Kreischer Miller is an accounting, tax, and business advisory firm that has been serving clients in the Greater Philadelphia region since 1975. We've built our firm to respond to the unique needs of growth-oriented private companies, helping you smoothly transition through growth phases, business cycles, and ownership changes. The companies we work with need to be able to quickly adapt and respond to changing market opportunities and challenges. That's why our focus is on being responsive, decisive, and forward-thinking. We're up to the challenge—always looking at the road ahead, not in the rear-view mirror. **Learn more at [www.kmco.com](http://www.kmco.com).**

