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The Proposed 2017 Federal Budget and Its Impact on Manufacturers

MANUFACTURING, TAX
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Earlier this month, President Obama released his final federal budget proposal for fiscal year 2017. The proposal has implications to a broad scope of taxpayers, including manufacturers and their owners, as the budget would raise an estimated $2.8 trillion (net) over a 10-year period. The impact of the budget proposal to manufacturers varies, with both favorable and unfavorable changes.

INTERNAL REVENUE CODE SECTION 179

Smaller manufacturers would see some relief in both capital investment expensing and cumbersome tax accounting requirements. The President has proposed that the Internal Revenue Code Section 179 expensing deduction be increased to $1.0 million annually (up from $500,000 currently) to encourage increased investment activity and job creation. The phase-out threshold of $2 million would remain in place.

The President has proposed establishing a uniform threshold of $25 million in average revenues for allowing exceptions from typically required accounting methods, including the accrual basis of accounting and conformity with IRC Section 263A (UNICAP) rules. This threshold would allow small manufacturers to utilize the cash basis method of accounting for tax purposes and avoid the often burdensome requirement of calculating the annual UNICAP adjustment to ending tax inventory.

THE LAST-IN, FIRST-OUT (LIFO) METHOD

The repeal of the last-in, first-out (LIFO) method of accounting for inventories continues to be a hot item. Taxpayers using LIFO may defer taxes in periods of rising inventory costs. The repeal of LIFO would bring U.S. GAAP into conformity with International Financial Reporting Standards, which do not permit the use of the LIFO method. This change in inventory accounting method would result in significant income pickup for those taxpayers currently using the LIFO method. Accordingly, the budget proposal would permit this cumulative adjustment to be recognized ratably over a ten-year period.

THE LOWER-OF-COST-OF-MARKET (LCM) METHOD

The budget proposal also includes the repeal of another inventory method commonly used by taxpayers: the lower-of-cost-of-market (LCM) method of accounting for inventories. Taxpayers using the LCM method may currently write-down the values of their inventory to current market values (if less than cost), resulting in a partial tax deduction prior to the sale of the inventory. Under the budget proposal, taxpayers would be required to change their method of accounting for inventories to something other than the LCM method. Any cumulative adjustment would be recognized into income ratably over a four-year period.

THE NET INVESTMENT INCOME TAX (NIIT)

One significant item applicable to taxpayers in all industries is the proposed change to the application of the net investment income tax (NIIT). Currently, the NIIT is assessed on passive-type income, including interest, dividends, gains and income from passive ownership in pass-through entities. The budget proposal would amend the definition of "net investment income" to include all gross income from any trade or business that is not otherwise subject to self-employment taxes. Essentially, high-income taxpayers who own pass-through entities (with either passive or active participation) would pay their share of Medicare taxes through self-employment tax, NIIT, or payroll. Additionally, it appears that gains from any trade or businesses would also be subject to the NIIT.

The budget ultimately enacted by Congress will likely look much different than the one proposed by the President. However, as our country continues to struggle with increasing Federal debt levels, the push for revenue-raisers is in full force.

Contact us with questions about how the proposed 2017 budget may impact your organization and visit the Our Thoughts On blog for more articles pertaining to the manufacturing industry.

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