

# NUTS, BOLTS, DEALS & WHEELS

MANUFACTURING, DISTRIBUTION AND TRANSPORTATION NEWSLETTER

## From the Editor's Desk



A recent *National Association of Manufacturers/Industry Week* survey indicated that 80% of respondents are either “somewhat positive” or “very positive” on business forecasts, with 2012 sales levels expected to increase by 4.4%. Other recent data —the bellwether *Institute for Supply Management's* —*ISM Manufacturing Index* rose to 53.9 for December up from the previous month's 52.7 (the fastest rate in six months), reflecting gains in production, new orders and employment, offset by a slight decrease in order backlog. The index indicates any amount over 50 suggests “expansion” and less than 50 is “contraction” in the sector. The *Manufacturers Alliance for Productivity and Innovation* anticipates a 3% growth in production in 2012, led by higher output in the energy, high-tech, transportation and industrial equipment sectors.

While these forecasts are favorable to the economic growth of our clients and friends in the Manufacturing and Distribution sectors —we see increasing uncertainties and risks that merit a close watch:

- Instability of certain European economies and our trading partners and finding workable solutions within the EU,
- Ensuring continuity of critical supply chain from vendors,
- Development of a business environment that fosters growth,
- Managing health care costs, and
- Addressing an expected increase in material prices.

With the ongoing election year gridlock in the US, planning for the effects of emerging tax code changes and structuring future transactions is extremely difficult (to say the least) so stay tuned. We will be issuing “real time” guidance as the landscape evolves and agreements are enacted into law.

Since the “Global Economy” affects us all, we thought it timely to share some planning ideas with you on foreign export sales and strategies in establishing transfer pricing policy. With an ever increasing level of business activity with offshore entities, there are certainly risks and challenges to address; but, with a clear understanding of the incentives and documentation, your bottom line will certainly benefit. Finally, an often overlooked incentive (in the form of a Federal R&D tax credit) is also available to manufacturers, so take a quick look at your business activities and assess whether you qualify.

We wish you, your colleagues and families nothing less than a successful and rewarding 2012!

**Jim Hannan, Practice Leader, Manufacturing Distribution and Transportation Group**  
jhannan@withum.com • 973.898.9494

## FEATURE STORIES

01

MAXIMIZING THE RESEARCH AND DEVELOPMENT TAX CREDIT: TAX INCENTIVES FOR MANUFACTURERS FOUND IN DAILY OPERATIONS

03

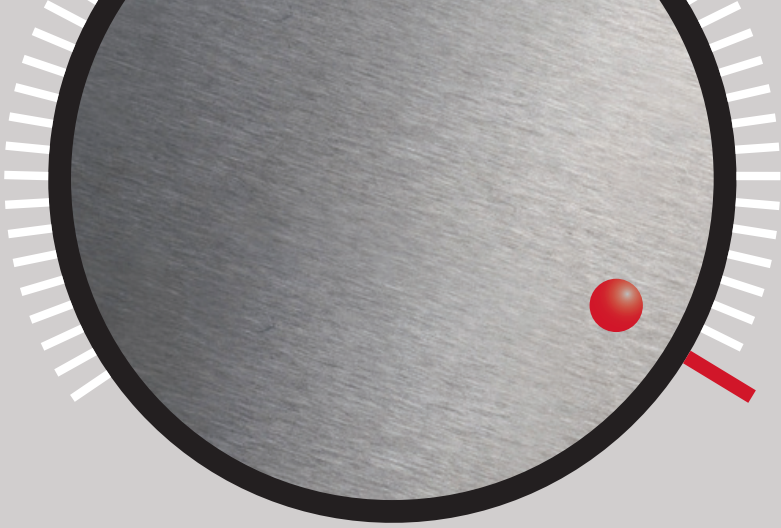
DOING BUSINESS IN THE GLOBAL ECONOMY

05

INCENTIVE AND OPPORTUNITY: IC-DISC (INTEREST-CHARGE DOMESTIC INTERNATIONAL SALES CORPORATION)

06

THE UPSIDE TO ACCOUNTING FOR UNCERTAINTY IN INCOME TAXES



by David J. Poillucci, CPA, MST, Senior Manager

# MAXIMIZING

## THE RESEARCH AND DEVELOPMENT TAX CREDIT

### TAX INCENTIVES FOR MANUFACTURERS FOUND IN DAILY OPERATIONS



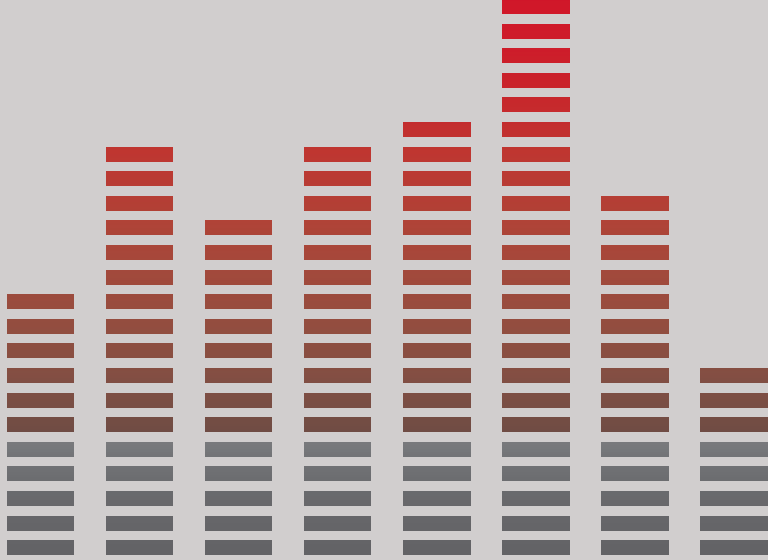
David J. Poillucci, CPA, MST  
Senior Manager

**Many manufacturing concerns are not aware that Federal and state research and development (“R&D”) tax credit programs are available as a reward for their everyday activities. That’s because manufacturing companies overlook routine operating activities as necessary in order to produce its product and stay competitive, rather than an extremely valuable incentive to spur economic development.**

Activities performed by today’s manufacturers entitle them to generous R&D tax incentives which are often ignored due to the stereotype that traditional R&D spending is limited to chemists dressed in white lab coats working in clean rooms.

However, in many cases, our manufacturing clients spend a considerable amount of time and effort to develop product designs that achieve optimized manufacturing process performance. Furthermore, many manufacturers, including “job shops,” conduct extensive activities to design and develop the manufacturing processes themselves to achieve specific project requirements and to stay competitive in the marketplace. All these activities require a high level of time and money expenditures in the engineering and production disciplines, which may meet the definition of “qualified research expenditures.” If you think you have to be a large public corporation developing products and inventions to qualify for R&D tax credits, think again. There are substantial R&D tax benefits out there for companies of all sizes. As an example, a company that incurs \$1 million of qualified expenditures typically can expect a \$65,000 credit against their Federal tax liability credit.

As many manufacturers tend to regard their efforts to make new, lighter, stronger, cheaper, more reliable products, or to design



**It is vital that your company take an in depth look at its operations in order to maximize its share of the more than \$5 billion in Federal R&D tax credits are offered annually.**

more precise, more economical and more versatile processes as “just doing my job” when, in fact, they have also been performing R&D qualifying activities. The following is a list of the common types of day-to-day activities performed by manufacturers that may be eligible for R&D tax incentives:

- Tooling, equipment fixture design and development
- Developing unique computer numerical control programs
- Designing innovative manufacturing equipment design
- Development of prototype three-dimensional solid modeling
- Designing and evaluating process alternatives
- Determining tooling requirements and optimal placement of equipment
- Evaluating and determining the most efficient flow of materials
- Designing, constructing, and testing product prototypes
- Developing processes that would meet increasing regulatory requirements
- Alternative material testing
- Achieving compliance with changing emissions laws and regulations
- Streamlining manufacturing processes through automation
- Developing & implementing new/improved safety enhancements
- Design, development or improvement of molds, dies, jigs, fixtures and new tooling machinery
- Production equipment development, implementation, and testing
- Stamping process improvement

Even if your company is claiming R&D tax credits, benefits may be overlooked if you do not analyze the expenditures beyond the “new product development” mentality. It is important to understand that R&D does not necessarily require a high degree of innovation and you can benefit from these tax incentives based on routine processes that are considered industry standards and accepted practices to keep up with technology and to maintain your competitiveness.

**THE FOLLOWING EXAMPLES ILLUSTRATE HOW DAILY MANUFACTURING OPERATIONS CAN QUALIFY FOR R&D TAX INCENTIVES.**

- *Can a custom panel fabricator design and manufacture its product without the use of engineers utilizing CAD software?* While the answer is “no,” the question was meant to be rhetorical. Engineering costs to design custom panels are clearly necessary to create this product which is why these types of expenses can be considered qualified R&D expenses.
- A company that routinely reprograms its CNC machines in order to stage its manufacturing process, based on a unique customer specification or a new product designs is incurring costs that may also be qualified expenses for claiming the R&D credit.

In summary, all manufacturing companies are incurring expenses at some level which may produce R&D tax incentives that can result in additional cash flow for your business. It is vital that your company take an in depth look at its operations in order to maximize its share of the more than \$5 billion in Federal R&D tax credits that are offered annually.

Additionally, many states offer similar tax benefits for companies that incur R&D costs. New Jersey, New York, and Pennsylvania all offer tax incentives for companies that perform R&D activities within their state.

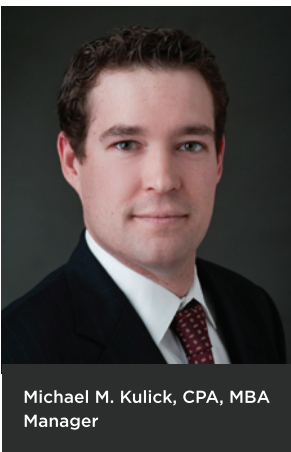
**David J. Poillucci, CPA, MST is a Senior Manager in WS+B’s Somerville office. Dave’s phone number is 908.526.6363 extension 3317 and email address is [dpoillucci@withum.com](mailto:dpoillucci@withum.com).**

# DOING BUSINESS IN THE GLOBAL ECONOMY

by Michael M. Kulick, CPA, MBA,  
Manager



3



Michael M. Kulick, CPA, MBA  
Manager

As we have all seen, the Global Economy is no longer a grandiose concept, but rather a force that affects us all. Years ago, who would have guessed that the troubles of the local Greek economy would diminish the value of our US 401(k) plans? Well, the Global Economy has changed the way we all operate and the roots of this expansion can be found in the political events, development of economic alliances (such as the European Union), free trade agreements and the geometric growth rate

of emerging Asian economies over the last 60+ years. These events were perceived to be stimuli for a rebuilding of regional economies, but to businesses and entrepreneurs, they provided new natural resource markets and an untapped pool of labor resources. The rise of the "BRIC" economies (Brazil, Russia, India and China) are a real time example of the expansion of the markets that the United States relies on in drawing up supply chains. However, the creation of more business opportunities worldwide also brings with it challenges of how to increase profitability and cash flow while maximizing tax benefits. This makes the adherence to local regulations, unique business practices, labor requirements, foreign accounting rules and federal, foreign, and provincial tax laws difficult to monitor. Some of the most significant issues faced by financial management arise from the alignment of an entity's business goals with financial and tax reporting requirements.

Companies that are planning on doing business abroad must first understand the local laws as well as the local customs in the region they wish to do business. This starts with hiring an attorney and accountant who are familiar with the region and

are able to assist in finding a suitable location or partner. Many regions require a local joint venture partner in order to startup a business operation in the foreign country. Depending on the type of business, assessing the qualifications of the local labor force and access to roads, airports or seaports is critical to getting goods manufactured and delivered to the ultimate consumer.

#### ACCOUNTING RULES - US GAAP VS FOREIGN PRACTICES

A US company's foreign subsidiary will typically have its books and records maintained in the local currency and adhere to the local generally accepted accounting rules. Depending upon the structure and ownership of the offshore company, the financial statements of the foreign subsidiary will be translated into US dollars and then US GAAP. However, as more countries conform to International Financial Reporting Standards ("IFRS") the challenges associated with translating financial statements will diminish in the future. The FASB and the International Accounting Standards Board are feverishly working on convergence and harmonization of rules to follow in future years. It's a complicated, time consuming and at times, an emotional process. We will certainly keep you abreast of developments as they surface.

#### MANAGING FOREIGN CURRENCY EXPOSURES

The effects of foreign currency fluctuations will have an impact on the US entity's operations. US entities doing business with foreign companies are subject to a number of financial and currency risks when conducting business in a foreign currency. The US entity may or may not choose to designate the transactions as hedges and may be able to utilize certain instruments to minimize the currency risk such as forward contracts, futures and/or puts/calls. The tax and accounting treatment of the underlying realized gain or loss requires a detailed analysis. Banks aren't the only institutions that have exposure in this Global Economy. If your company's offshore receivable is denominated in the U\$ and the local currency has dropped relative to the U\$ cash collections and a continued revenue stream are certainly challenges.



**Conducting business in the global economy provides significant opportunities for companies who proactively handle the “blocking and tackling” aspects of establishing a business overseas. Just be prepared to deal with local practices (which often conflict with US laws), managing foreign currency exposures and interpreting complexities in tax regulations —US, Foreign and Provincial/Local.**



**TRANSFER PRICING & TREATIES**

One significant area of concern when reporting on transactions with a foreign subsidiary is whether or not those transactions have been consummated in an “arm’s length” manner. Tax regulations and treaties require that these transactions be equivalent to what the entity sells/purchases with independent third parties. Transfer pricing issues can be proactively addressed with an independent pricing study or the negotiation and use of an Advance Pricing Agreement (“APA”). An APA essentially requires a calculation to equalize gross profit for the effects of pricing adjustments, economic ratios and, in some cases, foreign currency changes. These issues must also be evaluated and exposures, if any, will have an impact when preparing the entity’s tax returns. Under an APA, any adjustment, whether payment to or from the foreign entity, may be subject to a customs charge as the payment is considered a purchase from the foreign entity.

As indicated above, one of the most effective ways to mitigate some of the risk involved with doing business overseas is to negotiate an APA with authorities. The US tax code defines an APA as “...a binding contract between the IRS and a taxpayer by which the IRS agrees not to seek a transfer pricing adjustment

under Code Section 482 for a covered transaction if the taxpayer files its tax return for a covered year consistent with the agreed transfer pricing method.”

Essentially, the establishment of an APA takes out some of the uncertainty involved in transfer pricing because the taxpayer, the IRS, and in the case of a bi-lateral APA, the taxing entity of the foreign country have agreed upon an acceptable transfer pricing methodology in advance of the entity filing its tax returns. In addition, it ensures that the taxpayer will not be subject to double taxation by the IRS and the relevant foreign taxing authority.

A typical APA agreement has a five year term and can assist a company in budgeting (by defining a fixed cost for transfer pricing) as well as possibly increase earnings by eliminating the need to maintain a reserve for transfer pricing exposure. A company employing an APA also has the benefit of knowing they will not be subject to transfer pricing audits and related penalties during the period in which the agreement is in effect. Although there is an up-front cost associated with negotiating an APA agreement, it is worthwhile for most companies engaged in overseas transactions to explore the benefits of an APA as it allows a company to mitigate its transfer pricing risk exposure while permitting management to focus efforts on other important business opportunities.

**RESOURCES AVAILABLE**

WS+B has the expertise to advise any size company on the complexity and challenges of operating in the global economy. If you’re considering expansion into foreign markets and would like a “plain English” publication of doing business in another country, please contact me and I’ll make arrangements to send you the material. As a member firm of HLB International, we can introduce you to our resident experts in those countries as a sounding board for local rules and regulations.

**Michael M. Kulick, CPA, MBA is a Manager in WS+B’s Morristown office. Mike’s phone number is 973.898.9494 extension 4450 and email address is [mkulick@withum.com](mailto:mkulick@withum.com).**

# IC-DISC

by Michael A. Schreck, CPA, Partner

**“THE WHITE HOUSE AND CONGRESS AGREE THAT A KEY TO OUR NATION’S ECONOMIC RECOVERY IS STRENGTHENING OUR MANUFACTURING SECTOR AND ENCOURAGING EXPORTS. THE IC-DISC IS TAILOR-MADE TO ENCOURAGE EXACTLY SUCH ACTIVITY —PROVIDING A TREMENDOUS TAX INCENTIVE FOR SMALL AND MEDIUM BUSINESS OWNERS WHO MANUFACTURE AND EXPORT. THE DOOR IS OPEN FOR SIGNIFICANT TAX SAVINGS FOR THESE BUSINESSES – THEY JUST HAVE TO WALK THROUGH.”**

~ Dean Zerbe, National Managing Director of alliantgroup and former Tax Counsel to the Senate Finance Committee



Michael A. Schreck, CPA  
Partner

Do you have an export activity from your US domestic company and want suggestions and advice on how to save tax dollars? US Companies that export to overseas customers can take advantage of IC-DISC Companies. The following is an overview of how these companies operate.

If your company’s products are produced, grown or extracted from a US source, or provides services such as engineering or architectural for construction projects outside the US, then you should consider the IC-DISC .

### IC-DISC SET UP

The legal structure of the disc must be a domestic corporation incorporated under the laws of any state or the District of Columbia. They can only have one class of stock with par or stated value of outstanding stock of at least \$2,500 on each day of the taxable year. They must also make an election to be treated as an IC-DISC as executed by an authorized officer of the corporation.

In addition, you must draft articles of incorporation, draft and adopt by-laws, have a registered agent, and apply for a Federal ID number. Further requirements include executing a commission agreement, filing federal election form 4876-A, opening a bank account, and setting up internal processes to track qualified export sales.

### REQUIREMENTS

The IC-DISC must have 95% of “qualified export receipts,” and have the same tax year as the owner, either a corporation or individuals. They must also maintain their own books and records and cannot be a member of a controlled group with a foreign sales corporation. For sales to be included, they must be after the incorporation date of the IC-DISC. Qualified export receipts or property must come from sale or exchange of property outside of the US. Commission income is then earned on the sale or rental of this property, as well as the engineering or architectural services for the construction of projects outside of the US

### ANNUAL COMPLIANCE

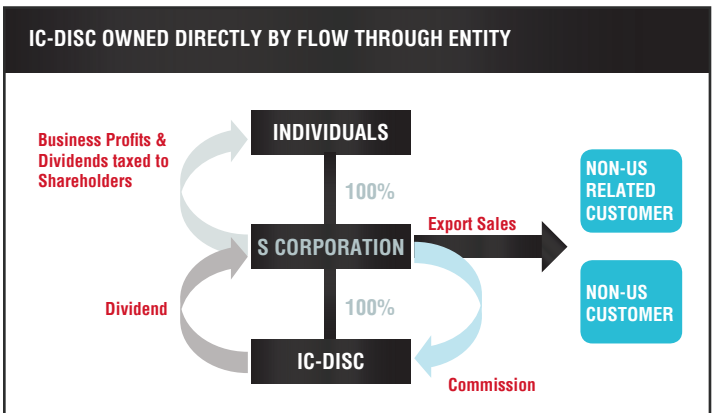
Annual compliance consists of holding board of directors meetings in the state of incorporation, record commissions received, maintain records of the transactions, and filing the Federal form 1120-IC-DISC tax returns along with the applicable State tax returns.

After all of the above administrative issues are adhered to, the company can now reap the tax benefits of the IC-DISC Company.

### TAX SAVINGS/BENEFITS

The IC-DISC can be complex, as many tax incentives are, but it will reward companies with export sales of US goods and or services overseas to non-US clients. This occurs by allowing the IC-DISC company to act as a commission agent for the companies export sales. These commissions are based on the income generated from the qualified export transactions.

Companies that use the IC-DISC are rewarded in the following manner: first the commission is fully deductible, and second, the IC-DISC pays no federal income tax, as it is allowed to distribute its income to the owners of the 20% IC-DISC as a qualified dividend. This results in a permanent reduction of one’s tax rate, as the qualified dividend is taxed at 15% versus the top federal ordinary rate of 35%.

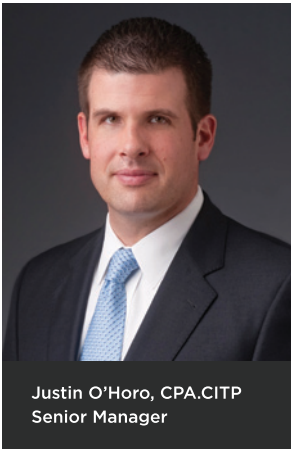


Michael A. Schreck, CPA is a Partner in WS+B’s Somerville office. Mike’s number is 908.526.6363 extension 3309 and email address is mschreck@withum.com.



THE **UPSIDE**  
 by Justin O'Horo, CPA.CITP, Senior Manager  
**TO ACCOUNTING FOR UNCERTAINTY IN INCOME TAXES**

One such opportunity is that AUIT creates a heightened awareness of corporate expenditures and results in an effective way to manage expenses. How so?



Justin O'Horo, CPA.CITP  
 Senior Manager

In 2006 the FASB issued guidance on the enigmatic topic *Accounting for Uncertainty in Income Taxes* ("AUIT") that we all refer to as "FIN 48" This standard requires a company to evaluate the likelihood of a tax assessment in the event that its returns come under audit by any governmental agency. A more granular analysis means that companies are required to look at their return on a line by line basis, assess the appropriateness of the deductions, compare the basis to existing case law or IRS guidance and conclude whether these positions will stand up under

audit. Further, companies are required to calculate the amount of the probable assessment and, if material: (1) accrue the amount (including interest and penalties) as a liability in their financial statements and (2) disclose the nature of this liability in their footnotes. To augment the implementation of this standard, the IRS has created a schedule that requires tax payers to report uncertain tax positions while filing income tax returns. In providing this GPS map and effectively sending the IRS a letter that says "Audit Me", tax payers aren't jumping at the opportunity.

If one accepts the premise that a minimal tax liability is appropriate and nobody wants to go through a tax exam, I also have to believe that the majority of Americans are honest and place a high importance on integrity in financial reporting. Nonetheless, there has been an outpouring of negative feedback about AUIT from the business community; however after significant debate, FIN 48 is here to stay. So let's try to look at compliance with this standard as an opportunity.

One such opportunity is that AUIT creates a heightened awareness of corporate expenditures and results in an effective way to manage expenses. How so? Typically an AUIT analysis focuses on those expenses that typically result in tax exam findings and assessments. Often these are meals and entertainment expenses or other largely discretionary expenditures that are sometimes made with the presumption of tax deductibility as a justification for incurring the expense. By reviewing these expenditures from the perspective that they may not be deductible and that they may, in fact, result in a liability, management may begin to challenge such costs. The result could

potentially lead to more effective management of discretionary expenses and, in turn, increased profitability.

Although not technically a tax paying entity, S-Corporations now need to more closely monitor state tax obligations arising from new business activities and activity in new geographic territories. Let's say you're a closely-held S-Corporation and over the past decade you've been fortunate to expand your customer base and your physical presence to 10 new states. States can have vastly different rules with respect to what constitutes doing business in their jurisdiction (commonly referred to as "nexus"), in addition, while many states will accept your "S-Status", some require a state level application for such status even though you have been accepted on a federal level (Example: New Jersey). Without affirmative state approval, you could be treated as a C-Corporation within that state and therefore will have a corporate level tax on your activities deemed to be performed in that state. Nexus is typically determined by having employees physically located in a state, having a physical presence (office) or providing services in the state. If you have "nexus" in those jurisdictions, a failure to file a return and/or an S-election could possibly result in a substantial tax assessment (income and sales/use taxes, interest and penalties) that could potentially be a corporate level liability. Further, this type of oversight could very well trigger a significant accrual and FIN 48 financial statement disclosure.

AUIT requires companies and their advisors to consider state nexus in evaluating S-Corporation status as a tax position and, in several cases, the result has been that companies have identified new jurisdictions in which they are required to register and file returns. This sounds like an extra burden, but isn't an ounce of prevention worth a pound of cure?

While these are only two examples, it is certainly evident that the seemingly onerous pronouncement that started as FIN 48 actually presents an opportunity for companies of varying sizes and legal structures. By enhancing familiarity with the issues AUIT addresses, we are all brought to a state of heightened awareness of potential tax and financial reporting issues that when addressed proactively are often easily dealt with. From the perspective of corporate management, this heightened awareness can translate to additional knowledge that facilitates more effective management of business operations.

Justin O'Horo, CPA.CITP is a Senior Manager in WS+B's Red Bank office. Justin's number is 732.842.3113 extension 2265 and email address is [johoro@withum.com](mailto:johoro@withum.com).



# WithumSmith+Brown, PC

Certified Public Accountants and Consultants

withum.com

465 South Street, Suite 200  
Morristown, NJ 07960-6497

## Return Service Requested

*Nuts, Bolts, Deals & Wheels* is published by WithumSmith+Brown, PC, Certified Public Accountants and Consultants, for clients and Friends of the Firm. The information contained in this publication is for informational purposes and should not be acted upon without professional advice. Please contact any one of our offices with your inquiries.



## CLIENT SPOTLIGHT

**“Benjamin Moore’s prime objective: first-class paint at all times. Better tomorrow than yesterday.” – Warren Buffet**

## BENJAMIN MOORE & CO.

In this edition’s client spotlight, we take a look at Benjamin Moore & Co., a high-performing, innovative manufacturer and retailer of quality coatings, as well as a provider of related goods and services for decoration and preservation.

For more than a century, Benjamin Moore & Co. has been dedicated to technological innovation, product leadership, and unrivaled color, and these values continue to inspire and direct all who work at the company today. Since 1883, they’ve created and sold products that preserve, protect, and beautify our homes, buildings, and structures. They excel at creating a portfolio of products that their customers desire and demand.

Acquired in 2000 by Berkshire Hathaway, Benjamin Moore joined a family of companies under the direction of Warren Buffett that embody success— sustainable brands that shine through the clutter of competition. They continue to be at the forefront of product innovation, with a commitment to

research and development unrivaled in the architectural coatings industry. At Benjamin Moore laboratories and manufacturing facilities, scientists and technicians work to exceed the already superior application, performance properties, and environmental safety of their products. Their commitment to color inspires an ongoing search for the perfect hues, the ones that lead their customers to claim “That’s the color I want.” Independent retailers—their distribution network—do more than sell their products. With Benjamin Moore’s help, retailers provide the service and tools that give customers confidence about their product choices, color selections, and ability to get the best results possible. Benjamin Moore embraces a company tradition of giving back. Across North America, the company is preserving historic structures, protecting the environment, and supporting programs that enrich our communities.

The company began in 1883, when Benjamin Moore and his brother Robert opened

Moore Brothers in Brooklyn, New York. True entrepreneurs, they started with \$2,000 and one product, “Moore’s® Prepared Calsom Finish,” which was sold exclusively through independent retailers. Moore Brothers built their company on Benjamin Moore’s belief in “the exercise of intelligent industry in the spirit of integrity,” and a dedication to manufacturing excellence and quality.

Today, Benjamin Moore & Co. continues to be a leader in the architectural coatings industry with products that set new standards of excellence. Headquartered in New Jersey, they manufacture at 7 plants, distribute from 18 facilities, and sell the finest paints, stains, and finishes through a network of more than 5,000 independent retailers across North America.



**Benjamin Moore®**