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Return on Investments

Capital Equipment Purchases: The Time Value of Money

Don Sears | Sep 05, 2018

For those manufacturers looking to maximize their tax savings in this calendar year, tax advisers say there is opportunity to reinvest now in areas such as equipment purchases—and there are other potential savings to be had in R&D projects and used equipment purchases.

Learn More About The Section 179 Deduction

Call *MSC's Machinery Team* for questions or help planning your upcoming equipment purchases at 800-331-1110

Is now a good time to buy that new 5-axis CNC machine or other major manufacturing equipment you've been eager to get into production?

"The answer to that question is always: Don't let the tax answer sway you one way or the other," says CPA ***Brian Kitchen***, a director of tax strategies who specializes in the manufacturing industry for Kreischer Miller. "It should always be a business decision first. But if there is an opportunity to reinvest in the company with a new piece of equipment that may be faltering or may need to be repaired—or maybe it's been repaired dozens of times already—the thought of acquiring a new piece of equipment by cash or financing qualifies for a tax incentive."

How the TCJA Is Impacting Tax Reform in Manufacturing

Under the 2017 U.S. Tax Cuts and Jobs Act, or "TCJA," companies ***can now expense*** the full cost of equipment at 100 percent for federal taxable income—whereas in the past, equipment expenses could only be deducted at 50 percent in the first year and were depreciated over the course of five to seven years, explains Kitchen. Through 2023, companies can continue to expense the full cost of capital equipment at 100 percent rates. For example, if a manufacturer spends $500,000 on new machines and software and simulation technology, that manufacturer can deduct that total amount in the year it is acquired.

"That could be significant tax savings, as indirectly, the government is effectively subsidizing that asset

acquisition via not having to pay taxes on those dollars," says Kitchen. It means more money in the hands of manufacturers to invest for growth—rather than cost.

Is this a good thing for manufacturers? With the tax reform act, corporate rates have been slashed from 35 to 21 percent and are expected to generate tax savings of as much as $261.5 billion for the manufacturing industry, per the ***Penn Wharton Budget Model***. John Livingstone, a tax principal for industrial products at PwC, thinks it's advantageous for the manufacturing sector. In his PwC blog post, "***Manufacturers and Tax Reform: Seize the Opportunities***," Livingstone writes:

"With more cash on hand, manufacturers have the opportunity to modernize their plants and processes. They can buy state-of-the-art equipment, boost IT infrastructure and expand digitization of manufacturing facilities and supply chains. They also can rethink how they want to allocate capital and grow the business."

Manufacturing Sentiment: It Remains Positive

It appears that manufacturers of all sizes share in the overall positivity in the manufacturing industry. From wages to capital expenses to hiring, the National Association of Manufacturers reports record optimistic sentiment of 95 percent in its second-quarter report from 2018—which is the sixth consecutive quarter of positivity.

"In the latest ***Manufacturers' Outlook Survey*** from NAM, it is clear that businesses continue to experience highly elevated levels of activity as a result of pro-growth policies like tax reform, with optimism once again breaking records—95.1 percent of respondents were either somewhat or very positive about their own company's outlook, the highest rate since the 20-year-old survey was introduced in the fourth quarter of 1997."

Sales, hiring, rising wages and investments are all seeing major bumps in optimism—many that are at the highest levels ever recorded by NAM.

So what are the biggest concerns for manufacturers lately? Unsurprisingly, it's the "inability to attract and retain a quality workforce," according to the NAM survey report. The second-highest concern is the cost of raw materials.

Despite the skills gap concerns, manufacturers are planning on hiring. Almost 7 out of 10 (66 percent) are expecting hiring to increase in the next year—with 27 percent planning employment growth of 5 percent or more.

Under the Radar: Used Manufacturing Equipment Gets a Boost

It used to be that the bonus depreciation tax benefit rewarded only those companies that bought new equipment—but many manufacturers also buy or lease used manufacturing equipment. Buyers of used machining gear also have something to celebrate.

"New tax laws allow bonus depreciation on used property, removing the restriction that required you to be the original purchaser," ***writes*** Kerry Defler, a lead tax partner in manufacturing and distribution for Aprio. But there is a timetable. "This additional expensing is currently set to reduce by 20 percent each

year starting in 2023 and expire completely after 2026," notes Defler.

Want the inside scoop on tax reform? Read "Better MRO Asks Experts to Weigh In on Tax Reform Opportunities for Manufacturers.

Don't Forget About the Value of R&D Tax Credits

Another under the radar area for a bit of potential tax relief comes in the form of research and development credits, explains Kitchen. R&D, as it's commonly referred to, has not disappeared, nor has its tax credit diminished for manufacturers.

"If a company is buying equipment but that equipment is being used for a new focus area—such as new product development—they are likely using research and development efforts to make that happen," says Kitchen. "That new piece of equipment could be vital to that process. And so a good amount of the costs associated with product development could be eligible for that research and development tax credit."

In a machining context, perhaps a machine shop decides to prove its ability to manufacture aerospace or medical parts—and invests in new equipment. There is a fair amount of trial and error and quality testing to bring parts to specification—and also to an output level that proves profitable.

"It isn't only a deduction for the equipment, but it's also a credit on top of the deduction," says Kitchen. "The credit lowers your tax liability."

As an example, Kitchen says that he has seen companies that spend around $100,000 in R&D typically yield a 5 to 10 percent tax credit—with 10 percent being the highest end. And it's not just equipment that is potentially eligible: It's also the labor involved in the R&D project that can be part of the qualifying expenses, according to Kitchen.

"If it's a machine shop, they're likely going to have a fair amount of scrap in the R&D process," says Kitchen. "Typically, companies are not getting their new products or parts right the first time. Maybe the fifth time. There is a lot of trial and error, and so this R&D credit in manufacturing can be profound."

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> Brian Kitchen
> Director, Tax Strategies for Manufacturing, Kreischer Miller

The Time Value of Money

Do these immediate "accelerated" tax savings benefit manufacturers, or does the former way of depreciating costs over time have its own set of benefits that companies can continue to use?

"It does depend, but I always look at it and ask this: If you can save a tax dollar today and perhaps reinvest in the company and generate more revenue, that's usually a win," says Kitchen. "But it varies from taxpayer to taxpayer."

To help determine the best financial equipment investment strategy that is aligned with your company's goals, Kitchen advises that your tax adviser run time value of money calculations with you to find out what makes the most sense for your business in the timing you need. It really will depend

on your situation.

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