



Tax & Business Alert

FEBRUARY 2018

TAKE A LOOK AT THE DOMESTIC PRODUCTION ACTIVITIES DEDUCTION

The domestic production activities deduction (DPAD) provides a tax break for certain “domestic production activities.” Unfortunately, many businesses tend to overlook this valuable tax break because they believe it’s applicable only to certain industries. In fact, the deduction remains available to a wide range of businesses for the 2017 tax year.

SIGNIFICANT BENEFITS

Calculating the DPAD is complex. Generally, the deduction is equal to the lesser of 9% (6% for “oil-related” activities) of a company’s income from qualified production activities or its taxable income. In addition, the deduction can’t exceed 50% of W-2 wages for the year that are attributable to domestic production.

To determine its qualified income, a business needs to start with its gross receipts from qualified domestic



production activities and subtract the cost of goods sold and certain other costs allocable to those activities.

INDUSTRY SPECIFICS

Over the last couple of years, the IRS has issued guidance related to the application of the DPAD to several specific industries. These include:

Contract manufacturing. Which party to a contract manufacturing arrangement is entitled to claim the DPAD? Under current rules, the answer depends on which party enjoys the benefits and bears the burdens of ownership. That, in turn, depends on several factors, including which party:

- Retains legal title to manufactured property during production,
- Controls the property and the process,
- Bears the risk of loss or damage,
- Receives profits from the property’s sale, and
- Pays property taxes.

To eliminate the uncertainty associated with this analysis, proposed regulations would establish a bright-line test under which the party that actually performs the activity would be entitled to claim the deduction.

Construction. Qualified production activities include those associated with the construction or substantial renovation of U.S. real property, including those “typically performed by a general contractor,” such

TREATMENT OF W-2 WAGES UNDER DPAD

The IRS has provided guidance on the W-2 wage limitation to taxpayers with a short taxable year as it applies to the domestic production activities deduction. Wages are calculated on a calendar-year basis, and there had been some uncertainty over the treatment of wages paid during a short tax year that didn't include a calendar year end. Temporary regulations provide that wages paid to employees during such a short tax year are included for the purposes of the W-2 wage limitation.

The temporary regulations also clarify the treatment of wages when a business is acquired or disposed of during the year. If employees receive wages from two different taxpayers, those wages are allocated between the taxpayers based on the employees' respective periods of employment with each taxpayer.

as management and oversight of the construction process. Proposed regulations would clarify that a contractor whose activities are limited to approving and authorizing invoices and payments is ineligible for the DPAD.

Testing and packaging. Under current rules, qualified production activities may include testing of component parts, packaging, repackaging, labeling and "minor assembly." Proposed regulations would exclude

these activities if the taxpayer isn't otherwise involved in manufacturing, producing, growing or extracting the property in question.

ASSISTANCE AVAILABLE

If your business has claimed the DPAD before, or if you think you may be able to for the 2017 tax year, please contact us. We can assist you with both the calculations involved and compliance with IRS rules. ■

MAKING 2017 RETIREMENT PLAN CONTRIBUTIONS IN 2018

The clock is ticking down to the tax filing deadline. The good news is that you still may be able to save on your impending 2017 tax bill by making contributions to certain retirement plans.

For example, if you qualify, you can make a deductible contribution to a traditional IRA right up until the April 17, 2018, filing date and still benefit from the resulting tax savings on your 2017 return. You also have until April 17 to make a contribution to a Roth IRA.

And if you happen to be a small business owner, you can set up and contribute to a Simplified Employee Pension (SEP) plan up until the due date for your company's tax return, including extensions.



DEADLINES AND LIMITS

Let's look at some specifics. For IRA and Roth IRA contributions, the maximum regular contribution is \$5,500. Plus, if you were at least age 50 on December 31, 2017, you are eligible for an additional \$1,000 "catch-up" contribution.

There are also age limits. You must have been under age 70½ on December 31, 2017, to contribute to a traditional IRA. Contributions to a Roth can be made regardless of age, if you meet the other requirements.

For a SEP, the maximum contribution is \$54,000, and must be made by the April 17th date, or by the extended due date (up to Monday, October 15, 2018) if you file a valid extension. (There's no SEP catch-up amount.)

PHASEOUT RANGES

If not covered by an employer's retirement plan, your contributions to a traditional IRA are not affected by your modified adjusted gross income (MAGI). Otherwise, when you (or a spouse, if married) are active in an employer's plan, available contributions begin to phase out within certain MAGI ranges.

For married couples filing jointly, the MAGI range is \$99,000 to \$119,000. For singles or heads of

household, it's \$62,000 to \$72,000. For those married but filing separately, the MAGI range is \$0 to \$10,000, if you lived with your spouse at any time during the year. A phaseout occurs between AGI of \$186,000 and \$196,000 if a spouse participates in an employer-sponsored plan.

Contributions to Roth IRAs phase out at mostly different ranges. For married couples filing jointly, the MAGI range is \$186,000 to \$196,000. For singles or heads of household, it's \$118,000 to \$133,000. But for those married but filing separately, the

phaseout range is the same: \$0 to \$10,000, if you lived with your spouse at any time during the year.

ESSENTIAL SECURITY

Saving for retirement is essential for financial security. What's more, the federal government provides tax incentives for doing so. Best of all, as mentioned, you still have time to contribute to an IRA, Roth IRA or SEP plan for the 2017 tax year. Please contact our firm for further details and a personalized approach to determining how to best contribute to your retirement plan or plans. ■

DO YOU KNOW THE TAX IMPACT OF YOUR COLLECTIBLES?

They say one person's trash is another person's treasure. This may hold true when it comes to collectibles — those various *objets d'art* for which many people will pay good money. But if you're considering selling or donating some of your precious items, be sure to consider the tax impact on your 2017 return.

SALES

The IRS views most collectibles, other than those held for sale by dealers, as capital assets. As a result, any gain on the sale of a collectible that you've had for more than one year generally is treated as a long-term capital gain.

But while long-term capital gains on many types of assets are taxed at either 15% or 20% for the 2017 tax year, capital gains on collectibles are taxed at 28%. (As with other short-term capital gains, the tax rate when you sell a collectible that you've had for one year or less typically will be your ordinary-income tax rate.)

Determining the gain on a sale requires first determining your "basis" — generally, your cost to acquire the collectible. If you purchased it, your basis is the amount you paid for the item, including any brokers' fees.

If you inherited the collectible, your basis is its fair market value at the time you inherited it. The fair market value can be determined in several ways, such as by an appraisal or through an analysis of the prices obtained in sales of similar items at about the same time.

DONATIONS

If you want to donate a collectible, your tax deduction will likely depend both on its value and on the way

in which the item will be used by the qualified charitable organization receiving it.

For you to deduct the fair market value of the collectible, the donation must meet what's known as the "related use" test. That is, the charity's use of the donated item must be related to its mission. This probably would be the case if, for instance, you donated a collection of political memorabilia to a history museum that then puts it on display.



Conversely, if you donated the collection to a hospital, and it sold the collection, the donation likely wouldn't meet the related-use test. Instead, your deduction typically would be limited to your basis.

PROPER HANDLING

There are a number of other rules that may come into play when selling or donating collectibles. Our firm can help you handle the transaction properly on your 2017 return. ■

WHEN AN ELDERLY PARENT MIGHT QUALIFY AS YOUR DEPENDENT

It's not uncommon for adult children to help support their aging parents. If you're in this position, you might qualify for an adult-dependent exemption to deduct up to \$4,050 for each person claimed on your 2017 return.

BASIC QUALIFICATIONS

For you to qualify for the adult-dependent exemption, in most cases your parent must have less gross income for the tax year than the exemption amount. (Exceptions may apply if your parent is permanently and totally disabled.) Social Security is generally excluded, but payments from dividends, interest and retirement plans are included.



In addition, you must have contributed more than 50% of your parent's financial support. If you shared caregiving duties with one or more siblings and your combined support exceeded 50%, the exemption can be claimed even though no one individually provided more than 50%. However, only one of you can claim the exemption in this situation.

IMPORTANT FACTORS

Although Social Security payments can usually be excluded from the adult dependent's income, they can still affect your ability to qualify. Why? If your parent is using Social Security money to pay for medicine or other expenses, you may find that you aren't meeting the 50% test.

Also, if your parent lives with you, the amount of support you claim under the 50% test can include the fair market rental value of part of your residence. If the parent lives elsewhere — in his or her own residence or in an assisted-living facility or nursing home — any amount of financial support you contribute to that housing expense counts toward the 50% test.

EASING THE BURDEN

An adult-dependent exemption is just one tax break that you may be able to employ on your 2017 tax return to ease the burden of caring for an elderly parent. Contact us for more information on qualifying for this break or others. ■