MANUFACTURER

Summer 2021

American Rescue Plan Act

Employee retention credit extended through 2021

Are you ready for Industry 4.0?

Operating in multiple states may have state tax implications

Remote auditing: Is it here to stay?

American Rescue Plan Act

Employee retention credit extended through 2021

The employee retention credit (ERC) keeps getting better. Established by last year's CARES Act, the credit is designed as an incentive for businesses to keep employees on the payroll despite the financial impact of the COVID-19 pandemic. Originally, the ERC allowed businesses to claim up to $5,000 per employee for wages paid in 2020. But recent legislation extended the credit through the end of 2021 and increased the maximum credit to $7,000 per quarter or $28,000 per employee for 2021.

CARES Act creation

The CARES Act provided eligible employers with a fully refundable tax credit against the employer's share of Social Security payroll taxes equal to 50% of up to $10,000 per employee in qualified wages paid from March 13, 2020, through December 31, 2020. Employers were eligible for the ERC if either:

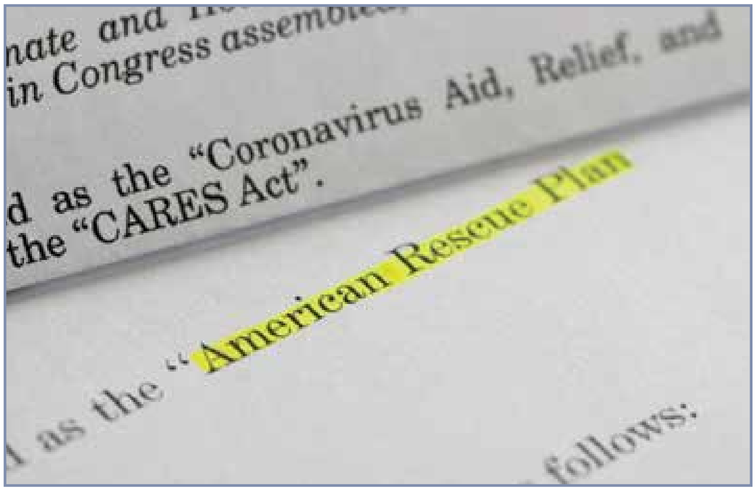
- Their operations were fully or partially suspended (see "What's a partial shutdown?" on page 3) under a COVID-19-related governmental order, or
- They suffered a significant decline in gross receipts, defined as gross receipts in a 2020 calendar quarter that were less than 50% of gross receipts in the same calendar quarter of 2019.

For businesses with more than 100 employees, qualified wages were limited to wages paid to employees who weren't working. Smaller businesses, however, could claim the credit for all employees, regardless of whether they continued to work.

CAA extension

The Consolidated Appropriations Act (CAA), passed last December, extended the ERC to wages paid in the first two quarters of 2021 and increased the available credit from 50% of up to $10,000 in qualified wages for the *year* to 70% of up to $10,000 in qualified wages per *quarter*. The law expanded eligibility for the credit by defining a significant decline as gross receipts in a 2021 calendar quarter that are less than 80% of gross receipts in the same calendar quarter of 2019. Employers that didn't exist in 2019 may use the corresponding quarter in 2020 to measure their decline in gross receipts in 2021, and certain employers may use the immediately preceding calendar quarter.

The CAA also increased the small business cutoff from 100 to 500 employees. In other words, all businesses with 500 or fewer employees may claim



What's a partial shutdown?

Employers are eligible for the employee retention credit (ERC) in a calendar quarter if their operations are "fully or partially suspended" during that quarter as a result of a COVID-19-related governmental order. *Fully* suspended seems straightforward enough, but how do you know whether your operations are *partially* suspended?

In early guidance, the IRS defined partial suspension to mean that "more than a nominal portion" of an employer's business operations are suspended. But what does "nominal" mean? IRS Notice 2021-20 provides an answer.

According to the notice, a portion of an employer's business operations is "more than nominal," for purposes of the ERC, if either:

- Gross receipts from that portion are at least 10% of total gross receipts, or
- Employee service hours in that portion are at least 10% of total employee service hours.

Both measurements are based on the corresponding 2019 calendar quarter. Although the notice is limited to the 2020 tax year, the IRS will likely apply the same definition of "partially suspended" for 2021.

the credit for wages paid to eligible employees, regardless of whether they continue working.

ARPA updates

In March 2021, the American Rescue Plan Act (ARPA) extended the ERC to qualified wages paid through the end of 2021. Although the credit is now applied against the employer's share of Medicare rather than Social Security taxes, any excess credit, as before, is fully refundable. So, an employer eligible for the ERC in all four quarters of 2021 can potentially receive credits totaling $28,000 per employee for 2021 (70% × $10,000 × 4).

The ARPA also expanded eligibility for the credit in the third and fourth calendar quarters of 2021 to two types of employers:

1. "Recovery startup businesses." These are employers that 1) opened their doors after February 15, 2020, 2) have annual gross receipts of $1 million or less, and 3) aren't otherwise eligible for the ERC. These employers may claim the credit for the last two quarters of 2021, up to a maximum credit of $50,000 per quarter in the aggregate.

2. "Severely financially distressed employers." This includes employers whose gross receipts in a calendar quarter have declined by more than 90% from the same quarter in 2019 (or, in some cases, the same quarter in 2020 or the immediately preceding quarter). These employers may claim the credit for all wages, regardless of whether employees continue working, even if they have more than 500 employees.

Get the credit you deserve

Originally, under the CARES Act, the ERC wasn't available to businesses that received Paycheck Protection Program (PPP) loans. But the CAA permitted PPP recipients to claim the credit both prospectively and retroactively to March 13, 2020, to the extent it isn't based on wages paid with a forgiven PPP loan.

If your business has been affected by the pandemic, you're potentially entitled to tax credits as high as $33,000 in 2020 and 2021 for each employee you kept on the payroll ($5,000 in 2020 plus $7,000 per quarter, or $28,000, in 2021). Your CPA can help you amend your 2020 returns, if necessary, to claim the correct amount. ■

Are you ready for Industry 4.0?

Industry 4.0 — sometimes referred to as the fourth industrial revolution — isn't new. The term was first coined nearly 10 years ago. But the COVID-19 pandemic, by disrupting supply chains and normalizing remote work, seems to have accelerated the industry's transformation. Here's a brief introduction to the concept and how it's changing manufacturing.

The basics

Simply put, Industry 4.0 refers to the digitization of manufacturing. That is, the integration of traditional manufacturing processes and practices with cutting-edge "smart" technology to enhance productivity and quality, improve efficiency, minimize costs, and increase workplace safety. It accomplishes these goals by leveraging the latest technological developments, including the Industrial Internet of Things (IIoT), artificial intelligence, blockchain, machine learning, automation, robotics, virtual reality, advanced data analytics and additive manufacturing, such as three-dimensional (3D) printing.

Manufacturers that make the most of these technologies to create smart factories enjoy a competitive advantage. This became evident during the pandemic, as the spread of COVID-19 created supply chain challenges and necessitated stay-at-home orders and social distancing restrictions. Manufacturers that had adopted technologies that streamlined and automated the supply chain and allowed them to monitor and operate Internet-connected devices remotely had a definite advantage.

Potential benefits

Industry 4.0's integration of people, machines and data creates virtually limitless opportunities to improve manufacturing operations. Examples include:

Enhanced productivity. At one time, workers would wait for machines or equipment to break down before repairing or servicing them. This reactive approach led to significant downtime and lost productivity. In response, many manufacturers shifted to a preventive approach, replacing parts or performing maintenance according to a predetermined schedule (for example, every 1,000 hours of machine operation). A smart factory takes advantage of predictive maintenance: Wireless sensors embedded in manufacturing equipment can alert a technician when service is needed — even if the technician is off-site. It may even be possible, using robotics and artificial intelligence, to teach machines to fix themselves.

Supply chain and logistics flexibility. By taking advantage of interconnected supply chains, manufacturers can track materials and products throughout the process, obtain information about changing conditions (such as weather delays, natural disasters, health risks and political unrest) and make adjustments in real time.

Workplace safety. Industry 4.0 can improve factory safety in several ways. For example, sensors similar to those that notify you of the need for maintenance or repairs can also alert you to potentially dangerous conditions. They can provide warnings or even shut or slow down equipment if a worker enters a hazardous area. Plus, the ability to monitor and operate machinery or equipment remotely minimizes workers' exposure to risks of injury or, in the case of a pandemic, infection.

Cost savings. Adopting Industry 4.0 technologies can reduce costs in many ways. For example, robotics and automation can reduce labor costs and allow the factory to operate 24/7. Real-time monitoring and quality control can help reduce product returns and eliminate waste. Predictive maintenance helps avoid costly repairs and downtime, and fewer accidents and injuries mean reduced costs. Finally, technologies such as 3D printing can reduce costs by streamlining the manufacturing process and shortening delivery times.

Readiness assessment

Manufacturers interested in making the transition to Industry 4.0 should gauge their readiness. For example, is your current technology infrastructure equipped to handle the data storage and processing requirements of today's smart factory? Is your company's culture amenable to the type of change needed to make the transition? Are you prepared to shift your workforce to the more highly skilled labor required to oversee a smart factory? Are you prepared to adapt your product development processes to a more automated environment?

If you answered "yes" to these questions, it may be time to explore the competitive advantages and other benefits Industry 4.0 has to offer. ■

Operating in multiple states may have state tax implications

Nothing is certain but death and taxes. While this may apply to federal taxes, state taxes are a bit more uncertain. Manufacturers and distributors operating in more than one state may be subject to taxation in multiple states. But with proper planning, you can potentially lower your company's state tax liability.

What is nexus?

The first question manufacturers should ask when it comes to facing taxation in another state is: Do we have "nexus"? Essentially, this term indicates a business presence in a state that's substantial enough to trigger that state's tax rules and obligations.

Precisely what activates nexus depends on that state's chosen criteria. Common triggers include:

- Employing local workers,
- Using a local telephone number,
- Owning property in the state, and
- Marketing products or services in the state.

Depending on state tax laws, nexus could also result from installing equipment, performing services, and providing training or warranty work in a state, either with your own workforce or by hiring others to perform the work on your behalf.

A minimal amount of business activity in a state probably won't create tax liability there. For example, an original equipment manufacturer (OEM) that makes two tech calls a year across state lines probably won't be taxed in that state. As with many tax issues, the totality of facts and circumstances will determine whether you have nexus in a state.

What is market-based sourcing?

If your company licenses intangibles or provides after-market services to customers, you may need to consider market-based sourcing to determine state tax liabilities. Not all states have adopted this model, and states that have adopted it may have subtly different rules.

Here's how it generally works: If the benefits of a service occur and will be used in another state, that state will tax the revenue gained from the service. "Service revenue" generally is defined as revenue from intangible assets — not the sales of tangible personal property. Thus, in market-based sourcing states, the destination of a service is the relevant taxation factor rather than the state in which the income-producing activity is performed (also known as the "cost-of-performance" method).

Essentially, these states are looking to claim a percentage of any service revenue arising from residents (customers) within their borders. But there's a trade-off: Market-based sourcing states sacrifice some in-state tax revenue because of lower apportionment figures. (Apportionment is a formula-based approach to allocating companies' taxable revenue.) But these states feel that, even with the loss of some in-state tax revenue, they'll see a net gain as their pool of taxable sales increases.

Is it time for a nexus study?

If your company is considering operating in another state, you'll need to consider more than logistics and market viability. A nexus study can provide insight into potential out-of-state taxes to which your business activities may expose you. Once all applicable income, sales and use, franchise, and property taxes are factored into your analysis, the effect on profits could be significant.

> Nexus indicates a business presence in a state that's substantial enough to trigger that state's tax rules and obligations.

Bear in mind that the results of a nexus study may not be negative. If you operate primarily in a state with higher taxes, you may find that your company's overall tax liability is lower in a neighboring state. In such cases, it may be advantageous to create nexus in that state by, say, setting up a small office there. Your tax advisor can help you understand state tax issues and provide a clearer picture of the potential tax impact of your business crossing state lines. ■

Remote auditing: Is it here to stay?

The COVID-19 pandemic has had an enormous impact on the way companies conduct business, and audit firms are no exception. Restrictions on the ability of auditors to physically visit business premises have, in many cases, forced them to adopt remote auditing techniques.

Remote auditing isn't new. For years, auditors have taken advantage of technology tools to perform some audit activities remotely to save time and money. But the pandemic has substantially increased the need to rely on these techniques. Here are five examples of how auditing has adapted to the COVID-19 environment:

1. Greater emphasis on planning. Auditors and their clients must coordinate the process, especially for activities traditionally done on site that are now being done remotely. For example, is the technological infrastructure in place to support necessary information and document sharing and verification?

2. Increasing reliance on cloud-based solutions. Before COVID-19, many companies were exploring the benefits of cloud-based accounting software. The pandemic accelerated this trend. Similarly, cloud-based auditing solutions have become a critical tool for managing and conducting audit procedures.

3. Expanded fraud risks. The pandemic has led to new fraud risks, requiring auditors to reevaluate their risk assessments and, in some cases, modify planned procedures. Potential reasons for a heightened risk of fraud include increased financial pressure on employees and internal control challenges in a remote work environment.

4. A need for creative inventory observation solutions. One of the biggest challenges in a remote audit environment — especially for clients in the manufacturing sector — is the physical inventory count. The inability of auditors to observe the physical count in person has led to a variety of creative solutions, including the use of body cameras by personnel conducting the count and even the use of drones by auditors.

5. Focus on automation and big data. During the pandemic, auditors have relied more heavily on artificial intelligence and other technologies that allow for the automation of certain auditing procedures. Manufacturers enter thousands of journal entries into their accounting systems each month. Fortunately, auditors can use big data technologies to analyze large amounts of data from multiple sources. With the right software and hardware, auditors can quickly analyze *all* of a company's financial data, rather than a small sample, to identify risks and anomalies.

Many of the changes businesses made to adapt to the pandemic environment are expected to be part of the "new normal" going forward. It seems likely that auditors will continue to take advantage of the efficiencies and cost-savings that can be gained by using remote auditing techniques. ■

AMERICAN NATIONAL BANK
OF MINNESOTA

American National Bank of Minnesota
3210 W. Division St.
St. Cloud, MN 56301

Rick Virnig
President, Commercial Lender
Direct: 320-257-2835 | Fax: 320-257-2867
Cell: 320-493-4677 | rvirnig@anbmn.com
NMLS 1410584

Joy Schafer
Branch Manager
Direct: 320-257-2843 | Fax: 320-253-9045 | jschafer@anbmn.com
NMLS 413063

Tammy Reis
Vice President, Mortgage Specialist
Direct: 320-257-2840 | Fax: 320-257-2867 | treis@anbmn.com
NMLS 709753

American National Bank of MN is a full service, locally owned Community Bank. Whether you're looking to finance **real estate**, **equipment** or are in need of a **working capital** line of credit we can help you find a solution that fits your needs. With local, fast decision making we can help you take your business to the next level.