SOLUTIONS

NEWSLETTER - FIRST QUARTER 2017

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PARTIAL USE TAX EXEMPTION FOR MANUFACTURING AND R&D

From July 1, 2014 through June 30, 2022, businesses can take advantage of a partial sales and use tax exemption on purchases of qualified manufacturing and research and development (R&D) equipment. In order to qualify for the partial exemption for businesses in manufacturing or in R&D in the fields of biotechnology or physical, engineering, and life sciences, purchased or leased equipment must be used at least 50% of the time for manufacturing purposes, must remain in California for at least a year, and should have a useful life greater than one year. The partial exemption reduces the tax rate to 3.3125%, plus any applicable district taxes. The following is an overview of the partial exemption:

Allows a partial exemption of:

- 4.1875% from July 1, 2014 through December 31, 2016
- 3.9375% from January 1, 2017 through June 30, 2022

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NEW DISABILITY CLAIMS PROCEDURES FOR ERISA PLANS

On December 16, 2016, the U.S. Department of Labor (DOL) published final regulations altering the procedures for disability benefit claims for all plans governed by the Employee Retirement Income Security Act (ERISA). This includes both short-term and long-term disability plans and can also include qualified retirement plans if the benefit claim is based on the plan's determination that the participant is disabled. If the determination of disability is made by a party other than the retirement plan (e.g., the Social Security Administration), the new regulations would not apply. The final rules will apply to all claims for disability benefits made on or after January 1, 2018.

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KEEPING CURRENT ON REVENUE RECOGNITION AMENDMENTS

To be compliant with US Generally Accepted Accounting Principles (GAAP), private companies will need to adopt the new revenue recognition guidance (Topic 606, *Revenue from Contracts with Customers*) in 2019. As an update to the current status of the amended requirements, the following summarizes the guidance included in several Accounting Standards Updates (ASUs) issued in 2016:

PRINCIPAL VERSUS AGENT CONSIDERATIONS
(REPORTING REVENUE GROSS VERSUS NET)

The amendments relate to when another party is involved with an entity in providing a good or service to a customer.

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Purchaser must meet all three conditions:

- Be a qualified person
- Purchase qualified tangible personal property (TPP)
- Use the property for the purposes allowed by this law

Qualified Person – Defined

- Engaged in manufacturing as described in the North American Industry Classification System (NAICS) Codes 3111 to 3399
- Engaged in R&D in field of biotechnologies as described in NAICS Code 541711
- Engaged in R&D in the fields of physical, engineering, and life sciences as described in NAICS Code 541712

Qualified Tangible Personal Property (TPP) – Defined

- Machinery and equipment (purchased or leased)
- Machinery and equipment, including components parts and devices such as belts, shafts, moving parts, and operating structures
- Equipment or devices used or required to operate, control, regulate or maintain the machinery such as computers, data processing equipment, and computer software
- Property used in pollution control
- Solar power equipment
- Material handling equipment
- Out-of-state qualifying purchases
- Special purpose buildings (discussed below)

Qualified TPP does not include:

- Items that are expensed in a single tax year
- Property placed in service and disposed of in the same year
- Property used in a manner not qualifying for the exemption
- Property converted from exempt use to a non-qualifying use
- Items that are replaced on a regular basis of less than one year
- Items removed from California within one year

Special Purpose Buildings

- Special purpose buildings and foundations used as an integral part of the manufacturing, processing, refining, fabricating, or recycling processes such as clean rooms, climate controlled facilities, wind tunnels and linear accelerators, or that constitutes a research or storage facility used during these processes

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New Disability Claims Procedures

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The following are brief highlights of additional requirements of the regulations:

Independence and Impartiality – Benefit determinations must be made in a manner that ensures there is no conflict of interest of the decision-makers involved in the process. Plans cannot provide bonuses to claims adjudicators as a reward for denying claims. Plan administrators must ensure that a third-party service provider's polices, practices and decisions (i.e., hiring, firing, compensation, promotions, etc.) will not result in the denial of benefits.

Notices – Denial notices must provide a more detailed explanation of the reason for the rejection of a claim. For example, the notice must explain why the plan administrator disagrees with the opinions of the health care professionals or the Social Security Administration's determination of the disability. The claimants must be informed of their rights to access their claim files and other relevant documents free of charge. Benefit denial notices must be written in a linguistically and culturally appropriate manner. If the participant's address is located in a county where 10% or more of the population is literate only in the same non-English language: (i) the notice must include a prominent one-sentence statement in the relevant non-English language about the availability of language services; (ii) the plan will be required to provide oral language services; and (iii) written notices in the applicable non-English language must be provided upon request.

Claims Procedures – The plan administrator must explain the protocols that were used to determine the participant's benefit claim. If a plan failed to strictly adhere to the rules for processing initial disability claims and appeals, a claimant would be deemed to have exhausted the administrative procedures under the plan. This gives the claimant the right to file a lawsuit without further delay under a *de novo* standard of review, unless "minor exceptions apply." The claimant would not be permitted to file suit if the plan's violation was: (i) de minimis; (ii) non-prejudicial; (iii) attributable to good cause or matters beyond the plan's control; (iv) in the context of an ongoing good faith exchange of information; and (v) not reflective of a pattern of non-compliance.

Appeals – Before an appeal can be denied, claimants must be given notice and a fair opportunity to respond if the appeal is denied based on new or additional rationales or evidence. During any appeal process, plan administrators must automatically provide any new or additional evidence or rationale to the claimant as soon as it becomes available. Appeal denial letters must describe any applicable plan-imposed time limits on filing a lawsuit, as well as a date the limitation period expires.

Rescissions of Coverage – A rescission of disability coverage occurs when a plan administrator terminates a participant's coverage retroactively. Certain rescissions of coverage must be treated as a denial of benefits. As a result, participants may now appeal rescissions of coverage. However, a rescission based on the participant's non-payment of premiums is not considered a denial of benefits.

These modified procedures for ERISA-covered disability plans expand participant rights and the responsibility of plan sponsors to provide a fair, impartial and independent process with full disclosure to the claimant. We recommend that employers work with their service providers and insurers to begin reviewing their claims and appeals procedures for compliance with the new regulations.

If you have questions or would like more information, please contact Therese Cheevers at **tcheevers@windes.com** or **844.4WINDES** (844.494.6337).

Therese Cheevers, APA, ERPA
Senior Manager
Employee Benefit Services

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The entity must determine whether the nature of its promise is to provide (as a principal), or arrange to provide (as an agent), that good or service to the customer. The determination is based on whether control is obtained by the entity before it transfers the good or service to the customer. When this occurs, the entity is a principal and should report revenue gross. An entity that is a principal obtains control of:

- a good or another asset from the other party that it then transfers to the customer;
- a right to a service that will be performed by another party, which gives the entity the ability to direct that party to provide the service to the customer on the entity's behalf; or
- a good or service from the other party that it combines with other goods or services to provide the specified good or service to the customer.

Indicators and application guidance are provided to determine control. The assessment must include each specified good or service promised and the nature of each (a good, a service, or a right to a good or service).

Identifying Performance Obligations

An entity must first identify the promised goods or services in a contract before it can identify its performance obligations. To identify performance obligations in a contract, an entity evaluates whether promised goods and services are distinct. Topic 606 includes an amendment to determine whether a promise is distinct, one being that it is separately identifiable. Determining whether a promise is separately identifiable is primarily based on whether the nature of a promise in a contract is to transfer each of the goods or services or to transfer a combined item(s) to which the promised goods and/or services are inputs. Additional amendments include:

- There is no requirement to assess goods or services that are immaterial in the context of the contract.
- Shipping and handling activities occurring after the customer has obtained control of a good can be accounted for as an activity to fulfill the promise to transfer the good, rather than as an additional service.

Licensing

A promise to grant a license provides a customer with either a *right to use* the entity's intellectual property (which is satisfied at a point in time) or a *right to access* the entity's intellectual property (which is satisfied over time). Amendments are as follows:

- A promise to grant a customer a license to intellectual property that has significant stand-alone functionality does not include supporting or maintaining that intellectual property during the license period.
- A promise to grant a customer a license to symbolic intellectual property (does not have significant stand-alone functionality) includes supporting or maintaining that intellectual property during the license period.
- An entity considers the nature of its promise in granting a license, regardless of whether the license is distinct, in order to apply the other guidance to a single performance obligation that includes a license and other goods or services (whether a performance obligation is satisfied at a point in time, or over time, and how to measure progress).

Technical Corrections, Narrow-Scope Improvements and Practical Expedients

- The evaluation of the collectibility criterion is based on the validity of the substance of a contract as well as the customer's ability and intention to pay for transferred goods or services.
- Entities can elect to exclude sales taxes collected from customers from the transaction price.
- The measurement date for noncash consideration is contract inception and the variable consideration guidance applies only to variability resulting from reasons other than the form of the consideration.

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Nonprofit Training: Accounting Standards Update (ASU)

Mike Barloewen, Windes Nonprofit Practice Leader, conducted a training session on January 17 in the Windes Training Center focused on the Financial Accounting Standards Board (FASB) issuance of ASU 2016-14 *Not-for-Profit Entities (Topic 958)*. This update is the culmination of the work of the FASB Not-for-Profit Financial Statements Project and comprehensively addresses the accounting model utilized for nonprofit entities for the first time in over 20 years.

The resulting ASU updates the current financial statement model used by nonprofit organizations.

Key concepts that were covered in the training session included:

- improving presentation and disclosures for net asset classes;
- enhancing information about liquidity and availability of financial resources;
- providing better information about expenses and expense allocation;
- improving reporting of investment return; and
- allowing free choice between direct method and indirect method in presenting operating cash flows.

Due to overwhelming interest in the topic, we are conducting a second training session on **May 2, from 11:30 a.m. to 1:30 p.m.** at our corporate headquarters in Long Beach. Lunch will be provided. If you are interested in attending, please contact Carolyn De Baca at **cdebaca@windes.com** or toll free at **844.4WINDES** (844.494.6337).

Keeping Current on Revenue Recognition Amendments

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- A practical expedient permits an entity to reflect the aggregate effect of all modifications that occur before the beginning of the earliest period presented.
- A completed contract for purposes of transition is a contract for which substantially all of the revenue was recognized under legacy GAAP before the date of initial application. Application of the modified retrospective transition method either to all contracts or only to contracts that are not completed contracts is permitted.
- The disclosure of the effect of the accounting change is not required for the period of adoption when the retrospective application guidance is applied to each prior period; however, the disclosure of the effect of the changes on any prior periods is still required.
- Specific technical changes include loan guarantee fees, contract costs, provision for losses on construction- and production-type contracts, clarifications and options for disclosures, scope clarifications, examples and references.

The new revenue recognition requirement is quickly approaching. Planning for proper implementation takes time and there are retroactive accounting and disclosure requirements to consider for prior periods. For questions, more information or assistance with implementation, please contact Jeff Parsell at **jparsell@windes.com** or **844.4WINDES** (844.494.6337).

Jeffrey Parsell, CPA
Partner
Audit & Assurance Services

Partial Use Tax Exemption for Manufacturing and R&D

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Special Purpose Buildings (continued)

- For the entire building to qualify, no more than one-third of the usable volume of the building can be used for non-manufacturing or other non-qualifying uses
- A portion of the building may qualify
- Buildings used solely for warehousing after completion of the processes are not included

Qualified Use - Defined

- Any stage of manufacturing, processing, fabricating, refining, or recycling process
- Research and development
- Maintain, repair, measure, or test any qualified property
- Materials or fixtures furnished and installed by a construction contractor

Useful Life - Defined

- Property must have a useful life greater than one year
- Capitalized for state income or franchise tax purposes

Annual Purchase Limitation

- $200 million in qualified purchases per calendar year

Exemption Certificates

- For equipment and machinery purchases provide Form BOE-230-M (Partial Exemption Certificate for Manufacturing, Research and Development Equipment)
- For special purpose buildings provide Form BOE-230-MC (Construction Contracts - Partial Exemption Certificate for Manufacturing, Research and Development Equipment)
- Report the reduced amount use tax when filing the Sales and Use tax return

Qualified Property Partial Exemption not previously claimed

- Claim for refund is available when the full amount of sales tax was paid on a purchase qualifying for an exemption and the exemption was not previously claimed
- Purchase must fall within the annual purchase limitation
- Provide an exemption certificate along with supporting documents to the seller, who can issue a refund
- Seller files a claim for the overpaid sales tax on the return filed for the period in which the property was purchased
- If the transaction was subject to use tax, the purchaser may file a claim for refund directly with the BOE using Form BOE-101 (Claim for Refund or Credit)
- Statute of limitation for refunds is three years after the filing date

If you have questions or would like more information, please contact Lorena Venegas at **lvenegas@windes.com** or **844.4WINDES** (844.494.6337).

Lorena Venegas, EA, CPP
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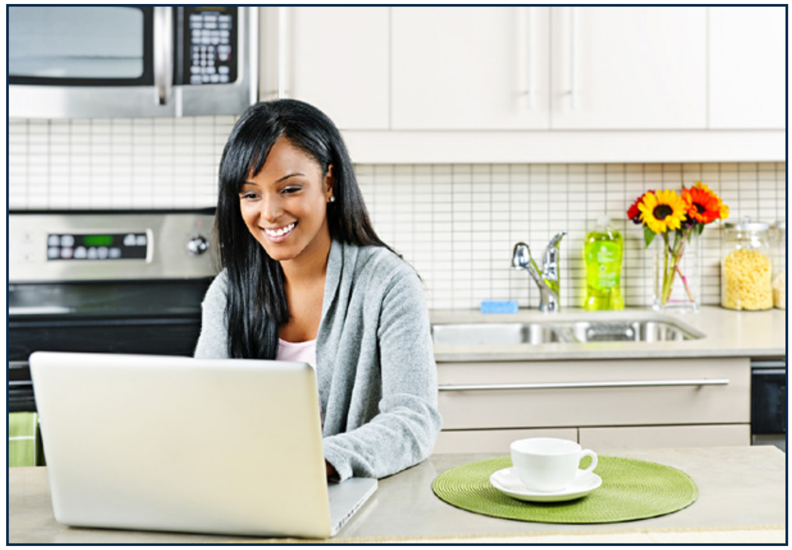
Virtual Classroom Training at a Kitchen Table Near You



The old-school classroom, where teachers and students meet face-to-face, is being pushed aside. Taking its place is the virtual classroom, where participants share educational content through on-line tools. More convenient and less expensive than traditional training, the virtual classroom has become commonplace in the corporate realm. The advantage over traditional classroom learning is clear: Virtual classrooms offer an interactive training experience from the comfort of one's home, office, or other learning environment.

Specialized software is enabling this shift to online learning. The use of virtual classroom software enables content to be delivered to any internet-connected devices, such as PCs, Macs, mobile tablets, or even smart phones. The virtual classroom environment offers many of the elements of the in-person training experience. Integrated video and audio creates a visual connection between instructors and students. Chat windows are used to pose questions to the instructor or to communicate with other students. Information, slides, a screen share, or an electronic whiteboard can be pushed from the instructor's device. Diagrams or hand-drawn artwork can be shared in real time. Other features include buttons for students to raise a hand, applaud, or laugh… although these should be used sparingly.

Most virtual classroom software is designed to run in the cloud. Cloud hosting decreases startup costs and improves scalability over on-premise software. Training providers can quickly implement a basic package, then add capabilities such as session recording and transcription. As usage grows, licensing can be increased to offer more classes or accommodate more students. Integration with related systems, such as learning management or continuing professional education tracking, is a commonly used add-on. Cloud-hosted virtual classrooms may be useful for a specialized training provider or to a company that provides in-house training to personnel.

Virtual classroom technology is changing the training landscape. Virtual classrooms can be established with just a few mouse clicks and create a personal connection with video and audio. The need to meet in a physical classroom has been removed, saving travel time. With all of the benefits of a virtual classroom, it is no surprise its popularity is increasing rapidly.

If you have questions or would like more information, please contact Norm DuBow at **ndubow@windes.com** or **844.4WINDES** (844.494.6337).

Norm DuBow
Director
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Windes in the Community

New Partner Finds Surprise Opportunity to Give Back

When Lorenzo Moran, President of the Los Angeles Chapter of International Society of Filipinos in Finance and Accounting (ISFFA), came across a Windes press release announcing the promotion of Guy Nicio to partner in its tax practice, he could not help noticing the Philippine connection. The press release mentioned that Guy had been an ongoing supporter of a children's orphanage in the Philippines. Having met Guy a number of years ago at a Cal State Long Beach recruiting event, Lorenzo invited him to be the keynote speaker of their upcoming ISFFA Holiday Gala.

Guy was honored and moved by the opportunity to speak to so many aspiring accounting and finance professionals. The theme of his speech would be Aspire and Inspire. Armed with the knowledge that the Philippines is still growing in terms of providing a mature system of higher education as compared to countries with more robust economies, he set his sights on hoping to inspire this group of primarily Filipino college students and graduates to continue to pave the way for their younger brothers and sisters behind them. For his part, Guy told them what he thought they needed to hear: A simple story about a guy who once walked in their shoes and aspired to achieve a certain level in his profession – he wanted to make partner at the accounting firm for which he worked.

The Windes Corporate Gallery Award

The Windes Corporate Gallery Award recognizes exceptional artists enrolled in the graduate level Studio Arts Program at California State University, Long Beach (CSULB). Windes has a long-standing tradition of community involvement and the Corporate Gallery Award is intended to actively encourage and support these art students and their work.

Managing Partner John Di Carlo congratulates artist Patrick Williams. His painting, "Orange Sea," is in the background.

Our awardee is Patrick Williams with his oil paintings "Orange City" and "Orange Sea." Patrick's paintings are visually stunning and intensely thought-provoking. His work has been displayed in a multitude of solo and group exhibitions in the United States, British Columbia, and England.

Patrick is a southern California native and currently lives in Long Beach. He received his Bachelor of Fine Art in Illustration Design from Art Center College of Design in Pasadena and will complete his Masters of Fine Art in Drawing and Painting from CSULB in spring 2017. Parallel to his arts practice, Patrick is heavily involved in arts education. He is the director of the Digital Media Conservatory at the Orange County School of the Arts and an adjunct faculty member at Orange Coast College.

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