MANUFACTURING NET

The Tariff Remedy Manufacturers Aren't Talking About

While uncertainty abounds, a legacy tax credit could help weather the storm.

By
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As the Trump administration moves forward with his tariff promises, hitting America's biggest trading partners – we know for certain the impacts will be wide and felt across various industries. Fortunately for manufacturers, the Research and Development Tax Credit (R&D Credit) can help bridge the gap and provide the capital they need to remain competitive.

More excitingly, this decades-old incentive will have new life breathed into it, as Congress is poised to return R&D expensing to its prior, more powerful form. Additionally, the administration has also proposed to offer manufacturers full "bonus" expensing of machinery and equipment, instead of forcing them to amortize the expense over five years. These moves will provide manufacturers with more flexibility to deal with 2025's changes.

The businesses I've talked to have typically dealt with the effects of tariffs in several key ways. The quickest and most effective way has been to raise prices so that consumers absorb the added costs, but this risks alienating customers and driving them to lower-priced options. Another way we've seen manufacturers offset tariffs consists of finding alternate suppliers, either domestic or from other countries taxed at lower rates.

Manufacturers have also reformulated their products to rely on cheaper or more available raw materials, though redesigned products take weeks if not longer to bring to market. I've even seen companies uproot and move manufacturing operations. All of the above remedies have their own disadvantages – however, manufacturers have another, severely underutilized resource, at their disposal.

Section 41

As business owners evaluate the above mitigation measures, they should understand how they qualify for Section 41, also known as the R&D Credit. This incentive can provide up to six figures in savings, and many activities related to product or process reformulations are eligible.

For example, if a manufacturer uses a new steel supplier and is uncertain as to the quality or durability of the material, they will need to build and test prototypes. Similarly, introducing alternate components such as sensors, pumps, or motors into an existing design requires prototyping and testing. Engineering time spent on prototype development, as well as the materials consumed in their construction, all comprise qualifying expenses.

Alternately, if a manufacturer decides to wholly redesign a product to use different raw materials or components altogether, it can claim Section 41 credits for concept development, design iterations, prototype development and testing, as well as testing the production line, which may require upgraded or new equipment. Even third-party testing labs or cloud computing provider expenses can qualify, as long as they are in the furtherance of product performance.

As a case in point, we recently worked with a custom tubing manufacturer that was able to secure almost half a million dollars in federal and state refunds for their day-to-day work. The company's qualified activities included the development of manufacturing tools and dies, design development and testing using computer-aided design tools, and prototyping.

As any manufacturer knows, new or improved product and process designs can take months, if not more, to bear fruit. Fortunately, Section 41 is a permanent fixture in the tax code. Companies claiming the credit for a current year will see an immediate reduction in their quarterly tax payments, providing a short-term boost to power development expenses. Claiming for prior years will result in additional refunds, or cash back from taxes paid for those years.

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