KBKG
SOLUTIONS FOR TAX PROFESSIONALS AND BUSINESSES
TAX CREDITS • INCENTIVES • COST RECOVERY

Our Team is Your Resource

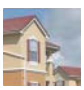
Established in 1999 with offices across the US, KBKG provides turn-key tax solutions to CPAs and businesses. By focusing exclusively on value-added tax services that complement your traditional tax and accounting team, we always deliver quantifiable benefits to clients.

Our firm provides access to our knowledge base and experienced industry leaders. We help determine which tax programs benefit clients and stay committed to handling each relationship with care and diligence. Our ability to work seamlessly with your team is the reason so many tax professionals and businesses across the nation trust KBKG.

Value Added Services

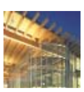
Research & Development Tax Credits

Federal credit worth approximately 6.5% of wages related to designing, developing and improving products, processes, formulae and software.



45L Credits for Energy Efficient Residential Developments

Newly constructed or renovated apartments, condos, and tract home developments that meet certain criteria are eligible for a $2,000 credit per unit.



179D Incentive for Energy Efficient Commercial Buildings

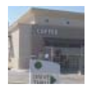
Federal deduction worth $1.80 per square foot of energy efficient buildings. Available to architects, engineers, design/build contractors and building owners.

Employment Tax Credits for Businesses

Employers with 10 or more employees can benefit from a wide range of federal and state business tax incentives designed to spur economic growth.

Cost Segregation for Buildings and Improvements

Any building improvement over $750,000 should be reviewed for proper classification of the individual components for tax depreciation, and retirement purposes.

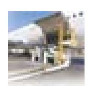


Repair vs. Capitalization Review & Compliance

Taxpayers often capitalize major building expenditures that should be expensed as repairs and maintenance such as HVAC units, roofs, plumbing, lighting and more. Retirement loss deductions for demolished building structural components are also identified.

Fixed Asset Tax Review

While a cost segregation focuses on buildings, a comprehensive Fixed Asset Tax Review encompasses all fixed assets a company owns including real property, machinery, furniture, fixtures, and equipment.



IC-DISC

The Interest Charge Domestic International Sales Corporation (IC-DISC) offers significant Federal income tax savings for making or distributing US products for export.

Property Tax Review (Real and Personal)

Overstated property values and failure to fully leverage available exemptions and abatements often result in substantial overpayment of property taxes.

Sales and Use Tax Review

Complex transaction tax laws vary from state to state and create opportunities to recover overpaid taxes, reduce future liabilities, and implement best practices.

Nationwide Service
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INDUSTRY MATRIX FOR TAX SAVING OPPORTUNITIES (updated 09-22-2015)

Industry	R&D Tax Credits	Repair /Asset Retirement	45L Tax Credits	179D Tax Deductions	Employment Tax Credits	Cost Segregation	IC-DISC	199 DPAD Deduction
Affordable Housing		X	X	X	X	X		
Agriculture, Forestry & Fishing	X				X	X	X	
Architecture & Engineering	X			X	X	X	X	X
Auto Dealerships		X		X	X	X		
Communications & Utilities	X	X		X	X	X		
Construction	X				X	X		X
Film & Music	X	X		X	X	X	X	X
Financial Services		X			X	X		
Government Contractors	X	X		X	X	X	X	
Healthcare		X		X	X	X		
Hotels		X		X	X	X		
Logistics & Distribution		X		X	X	X	X	X
Manufacturing	X	X		X	X	X	X	X
Mining	X				X	X	X	
Multifamily Developers		X	X	X	X	X		
Oil & Gas	X	X			X	X		
Pharmaceutical	X	X		X	X	X	X	X
Professional Services		X			X	X		
Real Estate		X			X	X		
Restaurants		X			X	X		
Retail		X		X	X	X		
Technology/Software	X	X		X	X	X	X	X
Transportation					X	X		
Wholesale Trade		X		X	X	X	X	

Call us today at **877-525-4462** to see how we can help you and your clients better understand these opportunities and secure these specialty tax incentives.

NATIONWIDE SERVICE

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Identifying Value-Added Tax Opportunities (updated 01-07-16)

KBKG Service	Description & Highlights	Applicable Clients/Industries	How much is it worth?	Years	Tax considerations
Research & Development Tax Credits (Federal & State)	Federal and State tax credit - designed to promote technological innovation in US companies. Research must be conducted in the US, not abroad. Most **Qualified Expenses are wages paid to employees conducting certain activities**. Payments to contractors doing R&D for Client may also qualify.	• **Manufacturing** • **Software Development** • **Architects** • **High Tech** • **Food Processing** • **Equipment or tools** • Clients developing prototypes, testing, applying for patents, upgrading systems/software • Clients improving products or • Improving their manufacturing processes	**Federal Benefit - Roughly 6.5% of their total Qualified R&D Expenses** Ex. Client has $1M/year of wages related to R&D. Benefit = $65k/year. Many states also allow an R&D credit. For example, CA R&D Credit is worth an additional 6% of Qualified R&D expenses.	Any open tax year. 3 year Federal Statute and 4 years for some states.	General Business Tax Credit • Dollar-for-dollar reduction in income tax liabilities. • 1 year Carryback / 20 year carryforward of unused credits. • Qualified small businesses can reduce alternative minimum tax liabilities. • Qualified start-up companies can offset up to $250,000 in payroll taxes.
Repair v. Capitalization Review **"Asset Retirement Study"** (Federal)	New rules allow you to **assign value to "structural" components removed from a building and write off the remaining basis!** Regs also clarify repair expense treatment of many types of building costs such as HVAC or roof replacements. KBKG also provides compliance consulting for repair and disposition regulations.	**Any building renovation costs > $400k** **Retirement Study**- Building is renovated AFTER owning it at least 1 year. Building should have **<u>>$500K of remaining depreciable basis left.</u>** **Repair Study**- renovations that include **roof, HVAC, windows, lighting, plumbing, ceilings, drywall, flooring,** etc.	Additional Year 1 deductions of **15%-40% of renovation costs <u>(on top of benefits from 1245 reclassification)</u>** Ex. Client spends $3M on structural renovations. Additional Year 1 deductions of $450K-$1.2M.	Any building renovated or improved in the last 15 Years. Use Form 3115 to claim missed deductions anytime.	• Depending on specific issue, may require a separate 3115 if doing concurrently with a depreciation change.
Fixed Asset Tax Review (Federal)	Comprehensive review of company's entire Fixed Asset listing & supporting documents to assign appropriate tax lives, identify retirements, and correct items that should be expensed. Includes Cost Segregation & Repair analysis.	Operations with > $40M in real property or > 1,000 lines of fixed assets. • Retail, Restaurant, Bank and Hotel Chains of 10 or more • Manufacturing • Utility Companies	Net Present Value of 5-8% of total building related costs. Ex. Manufacturing client has $60M of 39 year fixed assets. NPV Cash value = $3M - $4.8M	Use Form 3115 to claim missed deductions anytime.	• Reduces AMT • Generally, 2 year NOL carryback and unused deductions carryforward. • Must recapture personal property upon sale of building.
Residential Energy Credits (Section 45L) (Federal / States can have similar programs)	Federal credit for developers of **Apartments, Condos, or Spec Homes** that meet certain energy efficiency standards. Units must be certified by a qualified professional to be eligible.	Anyone that built Apartments, Condos, or Track Home Developments in the last 4 years. **Generally more than 20 units.**	**Federal Credit = $2,000 per apartment/home unit.** **Many states have similar credits.** Ex. 100 unit apartment/condo can get $200,000 of Federal Tax Credits.	Any open tax year. 3 year Federal Statute	General Business Tax Credit • Credit is realized when unit is first leased or sold, not placed in service. • 1 year Carryback 20 year carryforward. • Does not reduce AMT except for 2010. • 2010: ESB allows carry back 5 years.
Commercial Energy Deductions (Section 179D) (Federal/ States can have similar programs)	Federal deduction for **Architects, Engineers, and Design/Build Contractors** that work on Public or Government Buildings such as Schools, Libraries, Courthouses, Military Housing etc. **Also available to any commercial building owner.**	• **179D for Designers:** Architects, General Contractors, Engineers, Electrical & HVAC Subcontractors. • **Any Building Owner or Lessee:** That has constructed a commercial improvement greater than 40,000 SF since 1/1/2006.	**$.30 up to $1.80 per square foot in Federal Tax Deductions.** Ex. 100,000SF building is eligible for $180,000 in deductions.	Designers: Open tax years. 3 year Federal Statute Owners: Can go back to 2006 with Form 3115 to claim missed deductions.	• Reduces AMT • Generally, 2 year NOL carryback and 20 year carryforward. • Deduction reduces basis in real property.
Employment Related Tax Credits (Federal)	Federal Work Opportunity Tax Credit (WOTC) Federal Empowerment Zone Credits - Location Based Federal Health Insurance Premium Credits (FHIPC)	• **WOTC - 500 or more employees.** Location doesn't matter. • **Empowerment Zones - 10 or more employees** located in the designated area. • **FHIPC (Section 45R) - clients w/ under 50 employees** and paying health insurance.	**WOTC - up to $9,000 per eligible employee.** **Empowerment Zone - $3,000 per eligible employee.** **FHIPC - 35% to 50% of health insurance premiums.**	Any open tax year. 3 year Federal Statute	General Business Tax Credit • Various tax considerations can be discussed with KBKG.
CA Competes Credit (State)	California income tax credits designed to stimulate growth throughout the state.	**CA Competes Credit:** Growing business clients who anticipate hiring additional employees, constructing new buildings, or investing in new equipment.	Must apply for credits. Up to **$37,000 per eligible employee**, over a 5 year period. **Generally 15-35% of employees qualify.** **Equipment- Credit is equal to Sales Tax paid.**	Any open tax year. 4 year CA State Statute	• Credits will reduce taxes on owners W2 wages and personal return. • Credits flow through to owners. • Credits will offset tax at the S-Corp level.

Identifying Value-Added Tax Opportunities (updated 01-07-16)

Cost Segregation (Federal & State)	Allows **taxpayers who have constructed, purchased, expanded, or remodeled any kind of real estate** to accelerate depreciation deductions by reclassifying building components into shorter tax lives.	Any **building with over $750k** of depreciable tax basis. Any **leasehold improvement with over $500k** of depreciable tax basis.	Net Present Value = **3-6% of the total building cost.** Ex. $2M office can yield an NPV of $60k-$120k.	Assets acquired in the last 20 Years. Use Form 3115 to claim missed deductions anytime.	• Reduces AMT • Generally, 2 year NOL carryback and unused deductions carryforward. • Must recapture personal property upon sale of building.
IC-DISC Federal Income Tax Incentive (Federal)	The IC-DISC provides significant and permanent tax savings for producers and distributors of U.S.-made products and certain services used abroad.	**Any closely held, privately owned business with over $250,000 in profits from exports.** • Manufacturers • Distributors • Architects & Engineers • Agriculture and Food Producers • Software Developers • Other Producers	Minimum permanent **19.6% decrease in tax rate on half of export profits.** Benefits can be dramatically higher by performing a transaction-by-transaction analysis.	Benefits begin when entity is formed. Transaction-by-transaction analysis for existing IC-DISC calculations can be amended for any open tax year (3 year Federal Statute).	• Requires annual filing 1120 IC-DISC. • No changes to business operations.
Property Tax Consulting: Appeal and Compliance Services **• Personal Property** **• Real Estate**	Ensure that companies pay the minimal real estate and personal property tax amount, meet all compliance requirements and leverage available exemptions and abatements.	**Real Property: All states.** **$100k+** tax bill • Commercial real estate owners • Multi-Family, Hospitality • Manufacturing, Distribution, Oil & Gas	Immediate **reduction in current property tax** liability. Client pays a % of savings. Per return fee arrangements are typical for compliance engagements.	Year by Year	• Appraisal district must rely on mass appraisals techniques. • Assessed Value is an opinion of value and may not equate to market value. • Unique characteristics of building may not be accounted for.
Sales & Use Tax Review (State)	State tax codes are very specific regarding products & services which can be exempt from taxation. Ensure that clients did not overpay Sales and Use Taxes. Over/ Under payments are identified, quantified and submitted to the respective State for a refund.	**Non-taxable states:** NM, NH, OR, MT, AZ, DE. • **$30 million+ in sales**, greater than $100k in audit liabilities • **Multistate operations** • **Multiple vendor relationships** • **Poor accounting/tax software** • **Manufacturing, Oil & Gas, Hotels, Telecom, etc**	**Refund of overpaid sales and use tax on expenditures.** Can be significant when refund covers multiple years. Voluntary disclosures of unpaid tax can minimize penalties.	Any open periods allowed by statute of limitations. (SOL=4 years in most states)	• Sales & Use tax state law is complex and varies by State. • Over and Under payments are reviewed for a net assessment. • Sampling is used for large transaction data sets.

For an electronic copy of our service matrix, contact us at 877.525.4462 or email info@kbkg.com

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Qualified Improvements - Depreciation Quick Reference (last updated 3-22-2016)

	Applicable PIS Dates (inclusive)	MACRS GDS Recovery Period	Bonus Dep Eligible	3 Year Rule	Unrelated Parties Rule	179 Expense Eligible	Important Notes	Code Section
Qualified **Leasehold** Improvements (QLI): 2001 - 2004 Partial	09/11/01 - 10/22/04	39 Year / SL	Y	Y	Y	N/A	39 year QLI qualifies for Bonus. Landlord or lessee can make the interior improvement. See exclusions in definition.	168(e)(6)
Qualified **Leasehold** Improvements (QLI): 2004 Partial and onward	10/23/04 onward	15 Year / SL	Y [1]	Y	Y	2010 onward [6]	Landlord or lessee can make the interior improvement. See exclusions in definition.	168(e)(6)
Qualified **Retail** Improvement Property: 2009-2015	01/01/09 - 12/31/15	15 Year / SL	N [2]	Y	N	2010 onward [6]	Building can be owner occupied. See exclusions in definition.	168(e)(8)
Qualified **Retail** Improvement Property: 2016 onward	01/01/16 onward	15 Year / SL	Y	Y	N	2010 onward [6]	Building can be owner occupied. See exclusions in definition.	168(e)(8)
Qualified **Restaurant** Property: 2004-2007	10/23/04 - 12/31/07	15 Year / SL	N [3]	Y	N	N/A	Applicable to all improvements attached to building.	168(e)(7)
Qualified **Restaurant** Property: 2008	01/01/08 - 12/31/08	15 Year / SL	Y	Y	N	N/A	Applicable to all improvements attached to building.	168(e)(7)
Qualified **Restaurant** Property: 2009 onward	01/01/09 onward	15 Year / SL	N [4]	N	N	2010 onward [6]	Encompasses the entire building structure as well as interior costs. Can be an acquired building.	168(e)(7)
Qualified **Improvement** Property (QIP): 2016 onward	01/01/16 onward	39 [5] Year / SL	Y	N	N	N [7]	Applies to interior common areas. Building can be owner occupied. No 3-year rule. See exclusions in definition.	168(k)(3)

Bonus Depreciation Rates (inclusive dates)	
09/11/01 - 05/05/03 [8]	30%
05/06/03 - 12/31/04 [8]	50%
01/01/08 - 09/08/10 [8]	50%
09/09/10 - 12/31/11 [8]	100%
01/01/12 - 12/31/17 [8]	50%
01/01/18 - 12/31/18 [8]	40%
01/01/19 - 12/31/19 [8]	30%

Footnotes:

1) NOT eligible for bonus if placed in service 1/1/2005 - 12/31/2007.
2) Retail Improvements are not eligible for bonus depreciation unless it meets the criteria for QLI.
3) Qualified Restaurant Property is eligible for bonus depreciation if placed in service 10/23/2004 - 12/31/2004.
4) Improvements that also meet the criteria for QLI are eligible for bonus depreciation. After 2015, improvements that also meet the criteria for QIP are eligible for bonus depreciation.
5) Improvements that meet the definition of Qualified Improvement Property and meet the definition of QLI , Qualified Retail Improvements, or Qualified Restaurant Property can be depreciated over a 15-year straight line period.
6) Eligible up to $250k from 2010 - 2015, 2016 and onward are subject to normal 179 expense cap.
7) Improvements that meet the definition of Qualified Improvement Property and meet the definition of QLI , Qualified Retail Improvements, or Qualified Restaurant Property qualify for the 179 Expense.
8) Long Production Period (QLIs over $1M and construction period exceeds 1 year) - can be placed in service one year after bonus normally expires. QLI (that is also LPP) started before 1/1/2012 can be entirely eligible for 100% bonus if completed during 2012. Bonus is applicable if LPP is started before 1/1/2020. Only pre-1/1/2020 basis is bonus eligible on any LPP.

See Next Page For Definitions & Depreciation Rules

Definitions:

3 Year Rule: The improvements must have been placed in service by any taxpayer more than three years after the date the building was first placed into service.

Leased Between Unrelated Party Qualification: Improvements must be made subject to a lease between unrelated parties (see code section 1504). Can be made by lessees, sub-lessees or lessors to an interior portion of a nonresidential building. Parties are related when there is more than 80% ownership shared between them.

Long Production Period Property: 168(k)(2)(B) - Must have a recovery period of at least 10 years, is subject to section 263A, has an estimated production period exceeding 2 years, or an estimated production period exceeding 1 year and a cost exceeding $1,000,000.

Qualified leasehold improvement property (QLI)[A] 2001-onward: (A) Any improvement to an interior portion of a building which is nonresidential real property if— (i) such improvement is made under or pursuant to a lease (I) by the lessee (or any sublessee) of such portion, or (II) by the lessor of such portion, (ii) such portion is to be occupied exclusively by the lessee (or any sublessee) of such portion, and (iii) such improvement is placed in service more than 3 years after the date the building was first placed in service. (B) Certain improvements not included. Such term shall not include any improvement for which the expenditure is attributable to— (i) the enlargement of the building, (ii) any elevator or escalator, (iii) any structural component benefiting a common area, and (iv) the internal structural framework of the building.

Qualified retail improvement property[A] 2009-2015: Any improvement to an interior portion of a building which is nonresidential real property if— (i) such portion is open to the general public and is used in the retail trade or business of selling tangible personal property to the general public, and (ii) such improvement is placed in service more than 3 years after the date the building was first placed in service. QRIP shall not include any improvement for which the expenditure is attributable to— (i) the enlargement of the building, (ii) any elevator or escalator, (iii) any structural component benefitting a common area, or (iv) the internal structural framework of the building.

Qualified restaurant property[B] 2004-2008: an improvement to a building if— (A) Such improvement is placed in service more than 3 years after the date such building was first placed in service, and (B) more than 50 percent of the building's square footage is devoted to preparation of, and seating for on-premises consumption of, prepared meals.

Qualified restaurant property[B] 2009-onward: Any section 1250 property which is (i) a building or improvement to a building — if more than 50 percent of the building's square footage is devoted to preparation of, and seating for on-premises consumption of, prepared meals, and (ii) if such building is placed in service after December 31, 2008

Qualified improvement property[A] (QIP) 2016-onward: (A) Any improvement to an interior portion of a building which is nonresidential real property if such improvement is placed in service after the date the building was first placed in service. (B) Certain improvements not included. Such term shall not include any improvement for which the expenditure is attributable to— (i) the enlargement of the building, (ii) any elevator or escalator, (iii) the internal structural framework of the building.

Other notes:

A) Tenant improvements that include costs for HVAC rooftop units are excluded from the definition of Qualified Leasehold Improvements (QLI), Qualified Retail Improvements, and Qualified Improvement Property (CCA 201310028)

B) Restaurant tenant improvements located within a multi-tenant building where 50 percent of the building's total square footage is not leased to restaurants, do not meet the definition of Qualified Restaurant Property.

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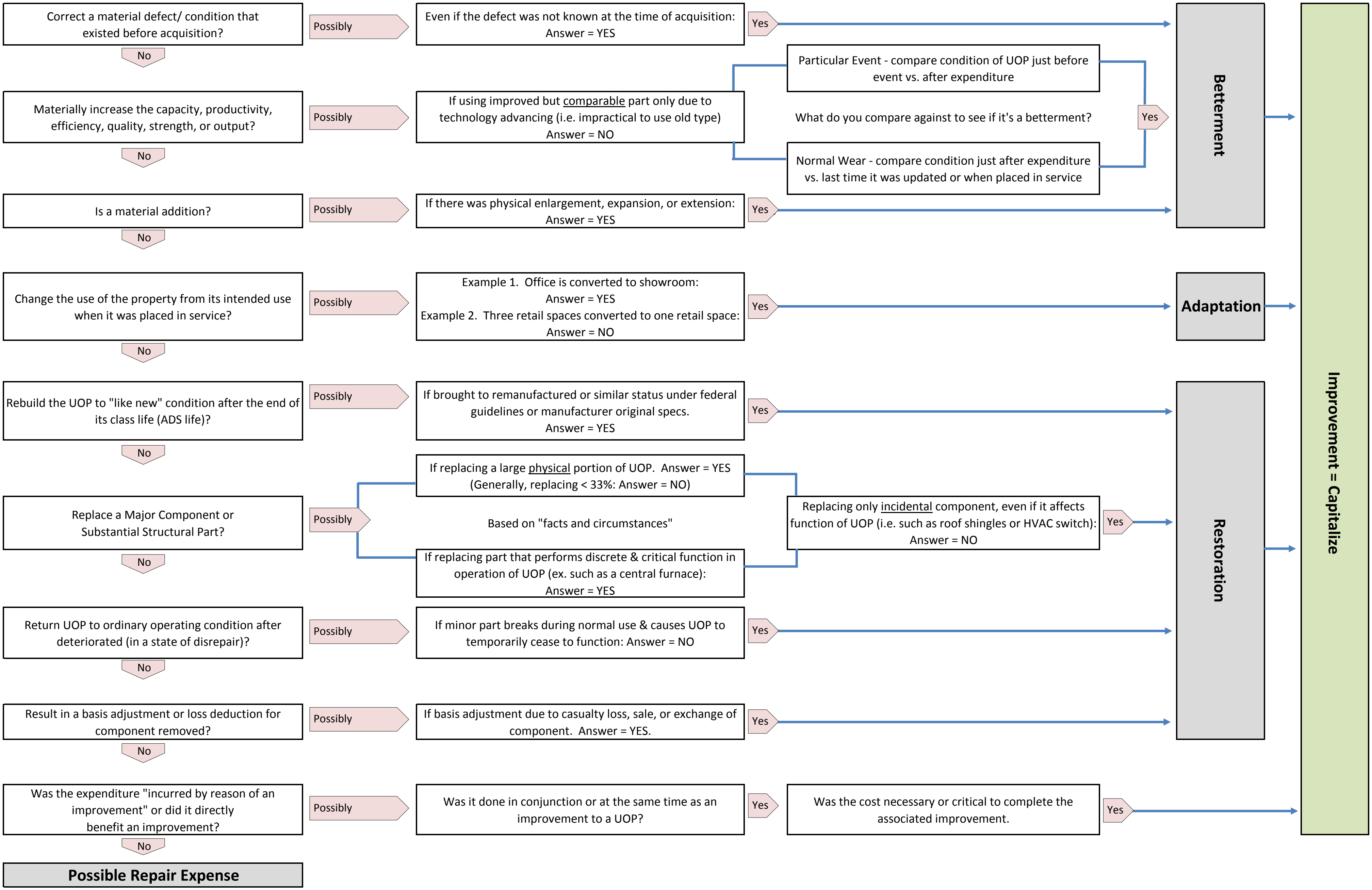
KBKG Repair vs. Capitalization: Improvement Decision Tree - Final Regulations

Considering the appropriate Unit of Property (UOP), does the expenditure:

(Last Updated 3-20-2015)



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KBKG Building Unit of Property & Major Components Chart (updated 3-20-2015)

This chart was created to help users identify building systems & typical "major components" in real estate assets. Replacing a major component is a capital expenditure, while replacing an incidental component can be expensed.

Real Estate Major Component (examples)

Building Structure	Land Improvements	HVAC System	Electrical System	Plumbing Systems	Fire Protection System	Security System	Gas Distribution System	Escalators	Elevators
•Roof System (membrane, insulation & structural supports) •Foundation •Other structural Load Bearing Elements, incl: stairs •Exterior Wall System •Ceilings •Floors •Doors •Windows •Partitions •Loading Docks	•Landscaping incl: shrubs, trees, ground cover, lawn, irrigation •Storm drainage incl: inlets, catch basins, piping, lift stations •Site lighting (pole lights, bollard lights, up lights, wiring) •Hardscape (retaining walls, pools, water features) •Site Structures (gazebo, carport, monument sign) •Paving (roads, driveway, parking areas, sidewalks, curbing)	•Heating System (boilers, furnace, radiators) •Cooling System (compressors, chillers, cooling towers) •Rooftop Packaged Units •Air Distribution (Ducts, fans, etc) •Piping (heated, chilled, condensate water)	•Service & Distribution (panel boards, transformers, switch gear, metering) •Lighting (interior & exterior building mounted) •Site Electrical Utilities •Branch Wiring (outlets, conduit, wire, devices etc.) •Emergency Power Systems	•Plumbing Fixtures (sinks, toilets, tubs etc.) •Wastewater System (drains, waste & vent piping) •Domestic Water (supply piping and fittings) •Water Heater •Site Piping Utilities	•Sprinkler System (piping, heads, pumps) •Fire Alarms (detection & warning devices, controls) •Exit lighting & signage •Fire Escapes •Extinguishers & hoses	•Building security alarms (detectors, sirens, wiring) •Building access & control System	•Gas piping incl: to/from property line & other bldgs.	•Stair and Handrail •Drive System (motors, truss, tracks)	•Elevator Car •Drive System (motors, lifts, controls) •Suspension system (counterweights, framing, guide rails)

* Building unit of property (UOP) rules apply to each building structure located on a single property.
** Building system components with a different tax life are separate units of property. For example, a cost segregation study separating HVAC into 5 year & 39 year categories for a restaurant creates two separate HVAC units of property.

Lessee of Building Must apply the same units of property above but only to the portion of the building being leased.
Personal Property UOP are parts that are "functionally interdependent" i.e. placing one part in service is dependent on placing the other part in service.
Plant Property UOP is each component that performs a discrete and critical function. Generally each piece of machinery or equipment purchased separately.
Network Assets UOP is determined by taxpayers particular facts

Definitions
Plant Property Machinery & Equipment used to perform an industrial process such as manufacturing, generation, warehousing, distribution, automated materials handling, or other similar activities
Network Assets Railroad track, oil & gas pipelines, water & sewage pipelines, power transmission & distribution lines, telephone & cable lines; -- owned or leased by taxpayers in each of those respective industries.
Major Component Part or combination of parts that performs a discrete and critical function in the operation of the unit of property
Incidental Component Relatively small, inexpensive, or minor part that performs a discrete and critical function for the UOP. Generally, not capitalized because of it's size, cost, or significance.
Examples: Asphalt sealer, HVAC thermostats, HVAC fan coils, HVAC registers, Plumbing valves and fittings, lighting or power control devices, hardware, escalator handrail, paint, roof shingles.

Tangible Property Repair vs. Capitalization Regulations:
Election Summary and Possible Accounting Method Changes (last updated 2-9-2015)

ELECTIONS UNDER THE FINAL REGULATIONS

Elections not requiring Form 3115	Statements required to make election	Application	Revocation Allowable?	Code Section
Capitalize certain materials and supplies (only rotable, temporary, or standby emergency spare parts); an optional method is available	No. Election made by treatment on timely filed return (including extensions).	Rotable, temporary, or standby emergency spare parts	Only by Private Letter Ruling	§1.162-3(d)
De minimis safe harbor ($5K with Applicable Financial Statements, $500 without)	Yes. Attach statement to the taxpayer's timely filed original Federal tax return (including extensions) each year.	All eligible materials and supplies & improvements	Irrevocable for tax year elected	§1.263(a)-1(f)
Capitalize employee compensation and overhead as amounts that facilitate an acquisition transaction	No. Election made by treatment on timely filed return (including extensions).	Each transaction, applies to either employee compensation or overhead, or both	Only by Private Letter Ruling	§1.263(a)-2(f)(iv)(B)
Safe harbor for small taxpayers with buildings (less than $10M in gross receipts, unadjusted building basis is less than $1M)	Yes. Attach statement to the taxpayer's timely filed original Federal tax return (including extensions) each year.	Only apply if total costs < $10,000 or 2% of the unadjusted building basis	Irrevocable for tax year elected	§1.263(a)-3(h)
Capitalize repair and maintenance costs (must be consistent with financial statements)	Yes. Attach statement to the taxpayer's timely filed original Federal tax return (including extensions) each year.	All repair and maintenance costs capitalized for financial accounting purposes	Irrevocable for tax year elected	§1.263(a)-3(n)
Partial Disposition Election (see below for Late Partial Disposition Election)	No. Election made by treatment on timely filed return (including extensions).	Any type of MACRS property	Only by Private Letter Ruling	§1.168(i)-8(d)

FINAL REGULATIONS - Rev. Proc. 2015 -14

Change #	General Topic	Specific Purpose	481(a) Adjustment	Stat Sampling Addressed?	Regulation	Notes	Concurrent Change on One Form 3115?
184	Repair and maintenance costs, amounts for improvements to tangible property	To deduct amounts for repair and maintenance or to capitalize amounts for improvements to tangible property and, if depreciable, to depreciating under §167 or §168. **Includes a change, if any, in the method of identifying the unit of property, or in the case of a building, identifying the building structure or building systems** for the purpose of making this change.	YES	YES	Reg. §1.162-4, 1.263(a)-3	No timing restrictions, Taxpayers are expected to comply for tax years beginning 1/1/2014	Can be combined with Changes #184 through #193 from section 10.11 of Rev. Proc 2015-14.
185	Regulatory accounting method	Change to the regulatory accounting method.	Cut-Off	NO	Reg. §1.263(a)-3(m)	No timing restrictions since this is optional.	Can be combined with Changes #184 through #193 from section 10.11 of Rev. Proc 2015-14.
186	Non-incidental materials and supplies	Change to deducting non-incidental materials and supplies when used or consumed.	Cut-Off	NO	Reg. §1.162-3(a)(1), Reg. §1.162-3(c)(1)	No timing restrictions, expected to comply for tax years beginning 1/1/2014	Can be combined with Changes #184 through #193 from section 10.11 of Rev. Proc 2015-14.
187	Incidental materials and supplies	Change to deducting incidental materials and supplies when paid or incurred.	Cut-Off	NO	Reg. §1.162-3(a)(2), Reg. §1.162-3(c)(1)	No timing restrictions	Can be combined with Changes #184 through #193 from section 10.11 of Rev. Proc 2015-14.
188	Non-incidental rotable and temporary spare parts	Change to deducting non-incidental rotable and temporary spare parts when disposed of.	Cut-Off	NO	Reg. §1.162-3(a)(3), Reg. §1.162-3(c)(2)	No timing restrictions, expected to comply for tax years beginning 1/1/2014	Can be combined with Changes #184 through #193 from section 10.11 of Rev. Proc 2015-14.
189	Optional method for rotable and temporary spare parts	Change to the optional method for rotable and temporary spare parts.	YES	YES	Reg. §1.162-3(e)	No timing restrictions since this is optional.	Can be combined with Changes #184 through #193 from section 10.11 of Rev. Proc 2015-14.
190	Commissions and other transaction costs that facilitate the sale of property (DEALER).	Change by a dealer in property to deduct commissions and other transaction costs that facilitate the sale of property.	YES	YES	Reg. §1.263(a)-1(e)(2)	No timing restrictions, expected to comply for tax years beginning 1/1/2014	Can be combined with Changes #184 through #193 from section 10.11 of Rev. Proc 2015-14.
191	Commissions and other costs that facilitate the sale of property (NON-DEALER)	Change by a non-dealer in property to capitalizing commissions and other costs that facilitate the sale of property.	YES	YES	Reg. §1.263(a)-1(e)(1)	No timing restrictions, expected to comply for tax years beginning 1/1/2014	Can be combined with Changes #184 through #193 from section 10.11 of Rev. Proc 2015-14.
192	Capitalizing acquisition or production costs	To capitalize acquisition or production costs and, if depreciable, to depreciating under section 167 or 168 / A change to capitalize inherently facilitative amounts allocable to real or personal property even if the property is not eventually acquired.	YES / Cut-Off	YES / NO	Reg. § 1.263(a)-2 / Reg. §1.263(a)-2(f)(3)(ii)	No timing restrictions, expected to comply for tax years beginning 1/1/2014	Can be combined with Changes #184 through #193 from section 10.11 of Rev. Proc 2015-14.
193	Costs for investigating or pursuing the acquisition of real property	Change to deducting certain costs for investigating or pursuing the acquisition of real property (whether and which).	Cut-Off	NO	Reg. §1.263(a)-2(f) (2)(iii)	No timing restrictions, expected to comply for tax years beginning 1/1/2014	Can be combined with Changes #184 through #193 from section 10.11 of Rev. Proc 2015-14.

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Tangible Property Repair vs. Capitalization Regulations:
Election Summary and Possible Accounting Method Changes (last updated 2-9-2015)

FINAL DISPOSITION REGULATIONS - Rev. Proc. 2015-14

Change #	General Topic	Specific Purpose	481(a) Adjustment	Stat Sampling Addressed?	Regulation	Timing	Concurrent Change on One Form 3115?
180	Late GAA election	To make a late General Asset Account (GAA) election; Late election to recognize gain or loss upon disposition of all assets, the last asset, or the remaining portion of the last asset; Late election to recognize gain or loss upon disposition of assets in a qualifying disposition.	Cut-Off	NO	Reg. §1.168(i)-1; Reg. §1.168(i)-1(e)(3)(ii); Reg. §1.168(i)-1(e)(3)(iii)	Tax year beginning on or after 1/1/2012 and beginning before 1/1/2014 – *May require single Form 3115 if filed with other changes.*	Should file one form 3115 for all assets that are subject to the GAA election
196	Late partial disposition election for MACRS Property (not in GAA)	Change to make a late partial disposition election for a portion of an asset. Used for most dispositions of building structural components (not listed in §1.168(i)-8(d)(1))	YES	NO	Reg. §1.168(i)-8	**Tax year beginning on/after 1/1/2012 and before 1/1/2015 §1.168(i)-8(d)(2)(i)** -or- 1st or 2nd tax year succeeding applicable tax year §1.168(i)-8(d)(2)(iv)(B)	Can combine with Change #7 (Depreciation) for the same asset in tax years before January 1, 2015
197	Revocation of GAA election	Change to revoke a General Asset Account (GAA) election.	YES	NO	Reg. §1.168(i)-1	Tax years beginning on or after 1/1/2012 and beginning before 1/1/2015.	See RP 2015-14 Sec 6.34 for list of possible combinations.
198	Partial dispositions of tangible depreciable assets to which the Service's adjustment pertains (not in GAA)	Change to make partial dispositions of tangible depreciable assets to which the Service's adjustment pertains.	YES	NO	Reg. §1.168(i)-8(d)(2)(iii)	Applicable when audited by IRS	Should file one form 3115 for all assets that are being changed under this section
199	Depreciation of leasehold improvements	Change to comply with § 1.167(a)-4 for leasehold improvements in which the taxpayer has a depreciable interest at the beginning of the year of change.	YES	NO	Reg. §1.167(a)-4	No timing restrictions, Taxpayers are expected to comply for tax years beginning 1/1/2014	Can combine with certain UNICAP changes. See RP 2015-14 Sec 6.36
200	Permissible-to-permissible accounting method for depreciation of MACRS property	Various changes involving permissible to permissible method of accounting for depreciable MACRS property. Applies to assets in GAA, Single Asset Accounts or Multiple Asset Accounts, and dispositions of property not in a GAA. (change in method of determining the unadjusted depreciable basis of the disposed portion of an asset from one reasonable method to another)	Cut-Off	NO	Regs. §1.168(i)-1(c); §1.168(i)-1(j)(2); §1.168(i)-1(j)(3); §1.168(i)-7; §1.168(i)-7(c); §1.168(i)-8(f)(2) or (3); §1.168(i)-8(g)	Tax years beginning on or after 1/1/2012 and beginning before 1/1/2015.	See RP 2015-14 Sec 6.37 for list of possible combinations.
205	Disposition of a building or structural component (not in a GAA)	Changes involving disposition of a building or structural component not in a General Asset Account. Typically used if a listed event occurs (see §1.168(i)-8(d)(1)); e.g. Casualty event, like kind exchange,	YES	YES	Reg. §1.168(i)-8(c)(4); Reg. §1.168(i)-8(f)(2) or (3); Reg. §1.168(i)-8(g), Reg. §1.168(i)-8(h)(1)	No timing restrictions, expected to comply for tax years beginning 1/1/2014. *May require single Form 3115 if filed with other changes.*	Can combine with Change #7 (Depreciation) for the same asset in tax years before January 1, 2015
206	Dispositions of tangible depreciable assets (other than a building or its structural components) (not in a GAA)	Changes involving dispositions of tangible depreciable assets (other than a building or its structural components) not in a General Asset Account.	YES	YES	Reg. §1.168(i)-8(c)(4); Reg. §1.168(i)-8(f)(2) or (3); Reg. §1.168(i)-8(g), Reg. §1.168(i)-8(h)(1)	No timing restrictions – *May require single Form 3115 if filed with other changes.*	Can combine with Change #7 (Depreciation) for the same asset in tax years before January 1, 2015
207	Dispositions of assets (in a GAA)	Various changes from impermissible to permissible methods involving disposition of tangible assets or portion of tangible assets in a General Asset Account.	YES	NO	Reg. §1.168(i)-1(e)(2)(viii); Reg. §1.168(i)-1(j)(2); §1.168(i)-1(j)(3)	No timing restrictions, Taxpayers are expected to comply for tax years beginning 1/1/2014	Can combine with Change #7 (Depreciation) for the same asset in tax years before January 1, 2015

Other Notable Accounting Method Changes for Consideration Rev. Proc. 2015-14

Change #	General Topic	Specific Purpose	481(a) Adjustment	Stat Sampling Addressed?	Regulation	Timing	Concurrent Change on One Form 3115?
7	Depreciation or amortization (impermissible)	Change from an impermissible method to a permissible method for changes allowed under Regulations section 1.446-1(e)(2)(ii)(d), and for depreciable property owned at the beginning of the year of change.	YES	NO	Reg. §1.446-1(e)(2)(ii)(d)	No timing restrictions.	
21	Removal Costs	Treatment of removal costs in disposal (entire or partial) of a depreciable asset	YES	NO	Reg. §1.263(a)-3(g)(2)(i)	No timing restrictions, expected to comply for tax years beginning 1/1/2014	Use a separate Form 3115 in accordance with the automatic change procedure described in Appendix Section 10.03(1) of Rev. Proc. 2015-14

"Cut-off method": use old accounting method for years prior to effective date and use new accounting method for items after the effective date.

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The Final Tangible Property Repair Regulations and Fixed Asset Review: Opportunities for 2016 and Beyond

All attendees are muted. The webinar will begin on time.
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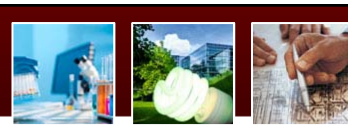
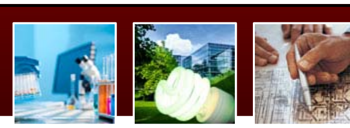
Administrative



- Best audio with your telephone
- Download power point slides from KBKG.com/resources
- Submit questions in the Questions panel

- CPE (Continuing Professional Education – for CPAs only)
  - Answer polling questions during the webinar
  - Fill out evaluation form
  - Submit your questions and we will answer as many as time permits.

About KBKG, Inc.



- Established in 1999 with offices across the US, including California, New York, Chicago, Dallas, Cleveland, and Columbus.
- Provide turn-key tax solutions to CPAs and businesses.
- R&D Tax Credits, Cost Segregation, Energy Tax Incentives, Repair vs. Capitalization Studies, IC-DISC Export Incentives.
- Performed thousands of tax projects resulting in hundreds of millions of dollars in benefits for our clients.
- Our team is a diverse mix of tax specialists, attorneys, energy consultants and engineers from various disciplines. This combination of talent allows us to focus on our areas of service and maximize results for our clients.
- A preferred provider for thousands of CPAs across the country.

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The Final Tangible Property Repair Regulations and Fixed Asset Review: Opportunities for 2016 and Beyond

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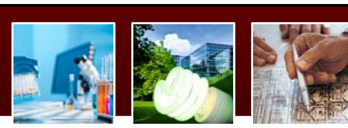
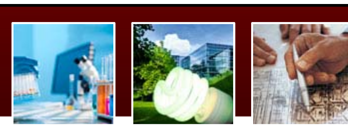
John Hanning, CCSP, MBA
Director

John Hanning, CCSP, MBA



- Director at KBKG in the Fixed Assets / Cost Segregation practice
- Member of the Accounting Methods and Credit Services Group (AMCS) specializing in Fixed Assets, Repairs & Maintenance, Construction Tax Planning and Cost Segregation Services
- Economics Management Degree - Ohio Wesleyan University
- MBA - Ohio University
- Holds his LEED Green Association credential
- ASCSP Certified Cost Segregation Specialist

Opportunities under the PATH Act: Bonus Deprecation and 179 Expensing



- Protecting Americans from Tax Hikes (PATH) Act of 2015 retroactively reinstates for 2015 tax extenders that expired at the end of 2014, many provisions permanently renewed.
- 50% Bonus Depreciation provisions would be extended through the end of 2017 and phases down to 40% in 2018 and 30% in 2019.
- Section 179's increased expensing amounts for small businesses have been made permanent at the $500,000 level (inflation indexed).
  - Businesses exceeding a total of $2 million of purchases in qualifying equipment will have the Section 179 deduction phase-out dollar-for-dollar and completely eliminated above $2.5 million.
  - Additionally, the Section 179 cap will be indexed to inflation in $10,000 increments in future years.

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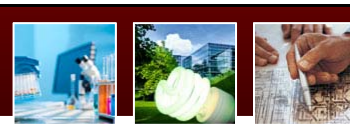
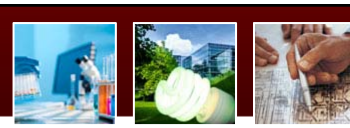
Opportunities under the PATH Act: Qualified Improvement Property



- Qualified Improvement Property (QIP) sets forth criteria making it available to a broader set of taxpayers than Qualified Leasehold Improvements (QLHI).
- QIP is defined as any improvement to an interior portion of a building that is nonresidential real property as long as that improvement is placed in service after the building was first placed in service.
- Like QLHI, items that do not qualify for QIP include expenditures for enlarging a building, any elevator or escalator, or the internal structural framework of the building.
- 39-year recovery period, bonus-eligible, no '3-year' rule, no lease requirement.
- Effective for property placed in service **after** December 31, 2015.

Opportunities under the PATH Act: Other Tax Planning Strategies



- **R&D Tax Credit** made permanent & modified. Additionally, beginning in 2016, eligible small businesses ($50 million or less in gross receipts) may claim the credit against their alternative minimum tax (AMT) liability, and the credit can be utilized by eligible small businesses against their payroll tax (i.e., FICA) liability.
- **Sec. 179D Energy Efficiency Deductions Extended for Commercial Buildings** through 2016, allows deductions of up to $1.80 per square foot. Designers of government-owned buildings remain eligible for these deductions as well. Slightly harder qualification standards for 2016 (i.e., ASHRAE 90.1-2007).
- **Sec. 45L Energy Efficiency Credits Extended for Multifamily & Residential Developers** through 2016. Low-rise apartment developers and homebuilders are eligible for a $2,000 tax credit for each new or rehabbed energy efficient dwelling unit.

Retail/Restaurant Industry Safe Harbor

- Rev. Proc. 2015-56 provides a safe harbor for certain taxpayers operating retail or restaurant establishments for determining whether expenditures incurred to "remodel" or "refresh" their property can be expensed under the TPRs.
- Generally, the safe harbor benefits those enhancing the physical appearance and layout of their building to maintain a contemporary and attractive environment for their customers.
- Through the adoption of the safe harbor, retailers and restaurateurs can now take advantage of the ability to immediately deduct 75% of "qualified" amounts spent to refresh certain property and are required to capitalize the remaining 25%.

Retail/Restaurant Industry Safe Harbor

- A **qualified taxpayer** is one who has an **Applicable Financial Statement** and:
  - Is in the trade of selling merchandise, including goods to resellers such as warehouse clubs, home improvement stores.
    - **EXCLUDED:** automotive dealers, other motor vehicle dealers, gas stations, manufactured home dealers, and non-store retailers
  - Is in the trade or business of preparing and selling meals, snacks, or beverages to customer order for immediate on-premises and/or off-premises consumption.
    - **EXCLUDED:** hotels and motels; civic or social organizations; or amusement parks, theaters, casinos, country clubs, or similar recreation facilities, special food services, food service contractors, caterers, and mobile food services.

See KBKG Tax Insight Article "Retail/Restaurant Industry Safe Harbor Under Tangible Property Regulations"

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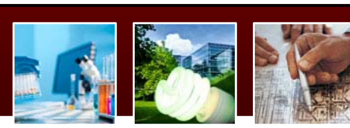
IRS Releases Audit Techniques Guide Related to Capitalization of Tangible Property



KBKG Tax Insight: IRS Releases Audit Techniques Guide Related to Capitalization of Tangible Property

On September 14th, 2016, the IRS issued an Audit Techniques Guide (ATG) for the Capitalization of Tangible Property. The ATG is a tool that IRS examiners can use for identifying potential tax issues and setting up their audit plans. Tax professionals who have implemented a change in accounting method to re-characterize the treatment of tangible property should be aware of the issues within the ATG guide and how potential audits will be structured. In the ATG, the IRS stresses that "the burden of proof rests with the taxpayer, and sufficient contemporaneous records are required."

> **KBKG Insight**: This new ATG is being released as the Service prepares for a substantial number of audits related to Tangible Property Regulations. To be prepared for IRS examination, taxpayers should ensure that the proper determination has been made with respect to each unit of property (UOP) and what is considered a repair and maintenance cost.

The IRS states "with the issuance of the final regulations, the demand for cost segregation studies is on the rise." As part of the audit plan, agents have been instructed to review all current and prior cost segregation studies to ensure they were completed properly. Overall, the ATG further heightens the need for detailed cost segregation studies that can help property owners determine each UOP and each major building component that could be replaced in the future.

To read Capitalization of Tangible Property: Treas. Reg. § 1.263(a) and related regulations, visit: http://kbkg.com/docs/irs-treas-reg-1.263a.pdf

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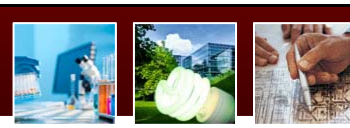
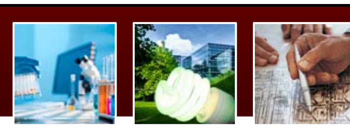
POLLING QUESTION #1

The Tangible Property Regulations: Repair v. Capitalization



- Determination is "highly factual"
- Guidance revolves around what constitutes the Unit of Property that is being repaired or improved.
- Must analyze each cost in the context of the "Unit of Property"
  - Ex. $30,000 cost for 5 new plumbing fixtures where Unit of Property (plumbing system) = small 5,000SF building; likely a capital improvement.
  - $30,000 cost for 5 same new plumbing fixtures where Unit of Property (plumbing system) = large 50,000SF building; more likely a repair.
  - Same items replaced, but facts and circumstances require a different treatment!
- Smaller the Unit of Property, more likely to capitalize

What is an "Improvement?"

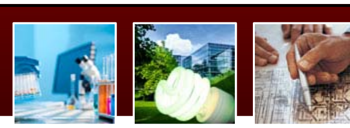


An "improvement" is defined under § 1.263(a)-3(d) as an amount paid after the property is placed in service which:

1. Is a **Betterment** to the UOP
2. **Adapts** the UOP to a new or different use
3. **Restores** the UOP

B-A-R = Improvement (Capitalize)

What is the Unit of Property (UOP)?

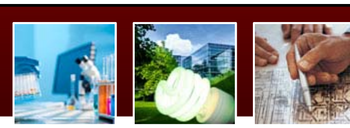


- **Functional Interdependence** test – all the components that are functionally interdependent comprise a single UOP.
- Components are functionally interdependent if the placing in service of one component is dependent on placing in service other components

Special Rules

- Plant Property
- Network Assets
- Buildings
- Leasehold Improvements, Condo's, Co-op

Buildings: What is the Unit of Property (UOP)?



- Building and its structural components is a single UOP § 1.263(a)-3(e)(2)(i)
- Building structure consists of "building and its structural components other than the structural components designated as ***building systems*** …" § 1.263(a)-3(e)(2)(ii)(B)

1. **HVAC**
2. **Plumbing systems**
3. **Electrical systems**
4. **All Escalators**
5. **All Elevators**
6. **Fire Protection & Alarm Systems**
7. **Security systems**
8. **Gas distribution systems**
9. **REST OF BUILDING**
   Walls, roof, floors, ceilings, windows, doors, finishes, structure, etc..

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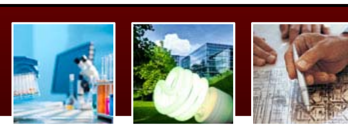
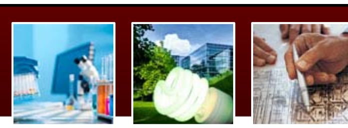


Leased Buildings - UOP

- Lessor – entire building UOP
  - For multi-tenant buildings, UOP is always the entire building
  - Must still evaluate "building systems"
- Lessee – UOP is portion of the building that is leased.
  - For multi-tenant buildings UOP is their space
  - Combine all future improvements to leased portion into the UOP being leased. Must still evaluate "building systems"
- Example - A <u>lessee</u> in large building remodels bathroom in their office. The expenditure is likely a capital improvement because work was done on a <u>major portion of the plumbing system located within their office space</u>.
- However, if <u>lessor</u> performed the same work, it might be a repair because work only affected <u>small amount of the building's entire plumbing system.</u>



Additional Rules for UOP

- Depreciation Consistency Rule
  - Component is treated as separate UOP if depreciating it as a separate class of property
  - 5, 7, 15 Year MACRS property are separate UOP from the building
- Example: Cost Segregation Study on hotel segregates Electrical System into categories with 5, 15, and 39 year lives.
  - 5 year property includes hotel decorative chandeliers and wall sconces
  - Future expenditures to replace decorative lighting are compared only to the 5 year lighting system costs; not all the lighting in the building.
- *Cost Segregation studies should summarize the buildings by Unit's of Property!!*

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POLLING QUESTION #2

What is a "Betterment?"



- Corrects a <u>material</u> condition or defect
- Is a <u>material</u> addition (enlargement, expansion, extension)
- Is a <u>material</u> increase in capacity, productivity, efficiency, strength, quality, or output (Ex. Replace asphalt shingles with new solar shingles)
  - Enhancement due to technological advancements not necessarily betterment. (ex. HVAC equipment is always going to be more efficient. Is it comparable?)
- "<u>Material</u>" - IRS has not defined this and may be an area of controversy.

"Betterment?" Examples

- Asbestos removal *not a betterment.*
- At time of purchasing Assisted Living Facility, taxpayer knows it needs work. Right after purchase & for a period of 2 years, while operating the facility, taxpayer pays for extensive repairs to bring facility to higher quality condition.
  - Ameliorates a previous material condition and *is a betterment*
- Reconfiguring office space to add more cubicles and spend $30k to add 50 more electrical outlets and V/D jacks. *Is likely a Betterment.*
- *Not Betterment* - Replace wooden shingles that are no longer available with comparable asphalt shingles that are stronger than wooden shingles. (Technological Advances)
- *Betterment* - Replace same shingles with lightweight composite shingles that are maintenance-free, a 50-year warranty and Class A fire rating

"Adaptation"

If you adapt something to new use it must be capitalized as an improvement

- Example – A converts its manufacturing building into a showroom for its business.
  - Replaces some lights, paints walls, and replaces other components to provide better layout for showroom and offices.
  - Taxpayer must capitalize

KBKG Comment: If they only did those items for their manufacturing operation, it may qualify as a repair deduction if it satisfies all other requirements and test.

What is a "Restoration?" 1.263(a)-3(k)

Restoration only if:

- Replacement of **<u>major component or substantial structural part</u>**
- Returns UOP to ordinary operating condition – if in state of disrepair & no longer functional
- Rebuilds UOP to like-new condition after end of class life
  - Class life - alternative depreciation system
- Replaces component deducted as loss; or adjusted basis taken into account for loss/gain
- Repair component after casualty loss/event if basis adjusted

Restoration

- <u>Major Component</u> – Parts that Perform a discrete and critical function for the building system or UOP
  - Ex. lighting, Air conditioning, flooring, water heater etc…
- <u>Substantial Structural Part</u> – large physical portion of building system or UOP
  - Ex. Replacing more than 50% of the lighting
- Consider all facts and circumstances – both quantitative & qualitative
  - Not just the cost, but the size, type, function etc.
- FINAL REGS: Replacement of "incidental component" of UOP will not constitute a major component even though it affects the function of the UOP
  - Example: HVAC Thermostat Controls

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POLLING QUESTION #3

Restoration Examples – Roofs



X owns retail store and discovers a leak in the roof

- X replaces 60% of roof decking, roof insulation, and roof membrane.
- Restoration = improvement

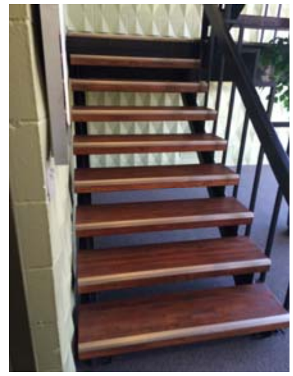
Y owns factory building with roof comprised of structural elements, insulation, and waterproof membrane.

- Y replaces only roof membrane with <u>comparable</u> but new membrane. (so it's not a betterment).
- Roof membrane is a minor portion of the roof system (even though it affects the function of the building)
- Not a Restoration. Not a betterment. = Repair Expense.

Restoration Examples

Roof Repairs

Parking Lot Maintenance



Stair Tread Replacement

Restoration

- Final Regs: Restoration standards must be applied to all major components of the building or UOP
  - Must first identify the major component of a building system. Then see if a significant portion was replaced.

Example: Office building HVAC System comprised of 3 furnaces, 3 AC units, and duct work throughout the building

  - 1 Furnace breaks down, replaced with a new furnace
  - 3 furnaces together perform critical function for HVAC system.
  - 3 Furnaces = Major Component
  - However replacing a single furnace (1/3) is not a significant portion of the major component.
  - Not a restoration

Restoration Examples
HVAC Systems

Example: Office building with one HVAC System

- Comprised of 1 chiller, 1 boiler, cooling tower, etc.
- Chiller is replaced with comparable unit
- Chiller functions to cool water to generate AC
- Chiller performs a discrete and critical function of HVAC system
- Must Capitalize

Assume same as above except there were 4 chillers and only one was replaced.

- Repair expense

Restoration Examples
HVAC Systems

Example: Office HVAC has 10 roof top units for different areas

- Controls allow for distribution of heat or A/C to various spaces
- Building experienced climate control problems in various offices
- Owner replaced three (3) of the roof mounted units
- 10 Units are a major component of HVAC system
- Replacement of the three (3) units:
  - Not a significant portion of the major component
  - Not a substantial structural part of HVAC system
- Not a restoration. If also not a betterment, Repair Expense

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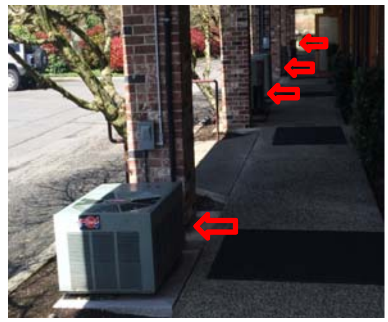
Restoration Examples
HVAC Systems



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POLLING QUESTION #4

Retirements and Dispositions (Final Regs Issued August, 2014)

New rules say you can now take a loss deduction when you remove anything from your building!

- Example: If you pay $50,000 for all new lighting in your building, you need to capitalize that amount over 39 years.
  - Can now calculate value of old lights and take immediate deduction for any remaining basis!
- **FINAL REGS**: "Partial Dispositions Election" is needed on timely filed tax return including extensions for year portion of asset is disposed.

Retirement of Structural Components

Example: Taxpayer acquired $5M building in 2009

- 2015 they spent $1M to remodel portion of 2nd floor (ceilings, walls, lighting, plumbing, ducting, electrical wiring, etc.)
- "Retirement Study" determines the original cost basis of demolished components is $470K (from the original $5M building)
- Recognize a loss of **$404K** (original cost basis less depreciation already taken)

Retirements create Permanent Tax Savings!

Retirements Convert Recapture Tax into Capital Gains

- If you incorrectly continue to depreciate 1245 & 1250 property that was removed from a building, you pay recapture tax upon sale
  - 1245 recapture is at ordinary rates (35%-39.6%);
  - 1250 recaptured at 25%
  - Capital Gains are typically taxed at 20%
- Note - Partial disposition of building component for normal repair is not a section 1231 loss. It is an ordinary loss.
- However retirement due to a disaster would be an involuntary conversion and is a 1231 loss.

Retirements create Permanent Tax Savings!!

Previous example – $5M building with $470K of retirements.

- If they continue to depreciate the $470K, they recapture all of it upon sale
  - Let's say $370K of that was 39 year & $100K was 7 year property
  - Recapture Tax = $127,500 ($370K * 25% + $100K * 35%)
- If they do a Retirement Study
  - Recapture tax on the $470K = 0
  - Capital gain tax = $94,000 ($470K * 20%)
- **Permanent tax savings of $33,500 upon sale**

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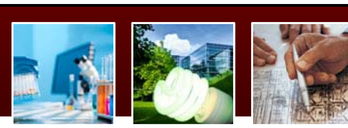
POLLING QUESTION #5

Removal Costs / Demolition



- **Old Rule:** Removal costs of an asset component needed to be capitalized with the new component.
- **New Rule:** Removal Costs of an asset component can be deducted if taxpayer realizes gain/loss on old component for tax.

Example: Landlord owns a 3 unit commercial building and pays $200K for improvements in each space in year 1.

- In year 5, one tenant leaves and new tenant requires landlord to gut and renovate the space costing $340K
  - Contractor cost detail shows $40K "demolition" cost to remove old improvements
  - Landlord can expense the $40K demolition costs and deduct remaining portion of $200K cost for the old tenant.

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Determining the Basis of Removed Building Component

Final Disposition Regulations:

- Can use a cost segregation study
- Can discount the cost of a replacement component to its placed-in-service year using the Producer Price Index (PPI)
  - Can be used for restorations but **PPI can not for betterments or adaptations.**
  - *Betterment Ex:* Replace old standard roof with more expensive solar reflective roof. Cannot discount cost of new solar roof.
  - *Adaptation Ex:* Replace HVAC in old office to convert into restaurant. Cannot discount cost of new restaurant HVAC to determine old stuff.
- **Use KBKG PPI Asset Search Tool to find index data**
  - www.kbkg.com/ppi-search-tool

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KBKG Caution: Discounting Method

Is useful but can grossly overstate retirement loss deduction if building component is replaced within 10 years of building's acquisition.

- Does not account for condition of building component at time of acquisition.

- ***Example:*** building acquired 3 years ago. Owner spent $200,000 to replace aluminum windows this year. Discount windows 3 years with PPI index = $186,000 for removed windows.
- However, this represents value of brand new windows. Windows had 3 years of life left. Appropriate "condition factor" should be applied.
- Normal life of aluminum windows is 20 years. Appropriate condition factor is 27%,* resulting in a value of $50,220 ($186,000 × 27%).

See BNA Tax Article "Dispositions of Tangible Property – IRS Restricts use of Discount Value Approach"

*condition factor and normal life obtained from valuation resource tables

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Plan of Rehabilitation is Obsolete

- **Old rule** said that if you did repairs to building as part of bigger rehab project, you had to capitalize.
- **New Rule** – Repair and maintenance costs "*not incurred by reason of improvement*" can be expensed. As long as the repair work had nothing to do with the improvements, you can expense.
  - Example 1 – B spends $500,000 to rewire building and for new lights. Because of electrical work, there was $30K of cost to cut some drywall, patch, and paint areas rewired.
    - All $530K is capitalized
  - Example 2 – B spends $500,000 to rewire the building and upgrade electrical. B spends $30K to paint and patch areas of the building unrelated to the electrical improvements
    - $30K can be expensed if it was repair unrelated to any improvement

Tax Planning Opportunities under the New Rules

- Taxpayer spent $3M on "Renovations" in 2010, KBKG performed a Cost Seg leaving $2.5M left in 39 year category.
- KBKG review of construction doc's - included work to "roof" (shingles replaced), "acoustic ceilings" (for only small portion of building), "asphalt paving" (for patching and resealing), "HVAC" (2 of 20 units replaced)…
- Based on new rules - $350K should be repair deductions.
- Recognize additional **$328K** on tax return by filing Form 3115. (original cost basis less depreciation already taken)
- **Permanent Tax Savings of $17,500 upon sale** by avoiding recapture ($350K * .25 - $350K * .20)

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Routine Maintenance Safe Harbor

- Expense if you reasonably expect (at time placed in service) to perform more than once during class life (alternative depreciation system)
  - **Safe harbor does not apply to Betterments, Adaptations** (see Reg. § 1.263(a)-3(i)(3))
- **FOR BUILDINGS:** must reasonably expect to perform more than once during the *ten year* period from when the building system was placed in service.
  - Ex. Expense - Every 5 years the escalator hand rails are replaced
- **KBKG Commentary**: It can fail safe harbor and still be considered an expense!
  - Ex. Every 12 years we replace HVAC unit. Fails Safe Harbor but can still satisfy the BAR standards.

Routine Maintenance Safe Harbor – Refractory Brick Example

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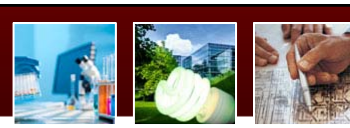
POLLING QUESTION #6

Safe Harbor for Small Taxpayers



- Can elect to expense amounts < or = $10,000 or 2 percent of unadjusted basis of the building, if
- Small taxpayer: < $10M in average annual receipts over last 3 years
- Eligible building = unadjusted basis of $1 million or less
- If amount > $10,000, safe harbor does not apply to any amounts (not even the first $10,000). Includes expenses under *de minimis* and routine maintenance safe harbor
- Elected annually on building-by-building basis

- **KBKG Tax Planning Idea**: Cost Seg Study may reduce real property basis enough to make you eligible for this election.
  - Ex. Before Cost Seg 39 year building basis is $1.3M
  - After Cost Seg 39 year basis is $900K and rest reclassified to 5 & 15 year

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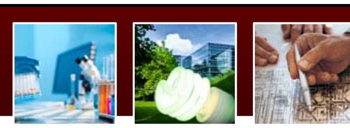
De minimis Rule Expensing Safe Harbor § 1.263(a)-1(f)



Taxpayer with an Applicable Financial Statement (AFS)

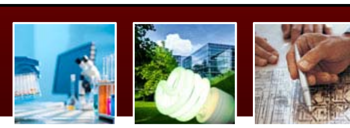
- $5,000 expensing threshold per *item* or invoice for property
- Must have written expensing policy stating such
- Must treat amounts as expenses on the AFS as well

Taxpayer without Applicable Financial Statement (AFS)

- $500 expense threshold per *item* or invoice (NEW - $2,500 for 2016)
- Do not need written expensing policies

- Can not split costs among multiple invoices
- If elected, must apply to all eligible materials & supplies except, rotable, temporary, and standby emergency spare parts.

Applicable Financial Statements Defined

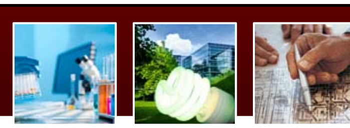


A. Financial statement filed with Securities and Exchange Commission (SEC) (the 10-K or the Annual Statement to Shareholders);

B. Certified audited financial statement accompanied by report of an independent CPA that is used for:
   1. Credit purposes;
   2. Reporting to shareholders, partners, or similar persons; or
   3. Any other substantial non-tax purpose; or

C. Financials required to be provided to any federal or state agency (other than SEC or the IRS).

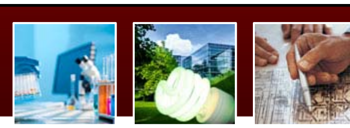
Materials and Supplies



Defined as tangible property used in taxpayer's business that is not inventory and:

- A component acquired to maintain, repair, or improve a UOP that is not acquired as part of any single UOP;
- Fuel, lubricants, water, & similar items expected to be consumed < or =12 months from beginning of use;
- UOP with a useful life of < or = 12 months;
- UOP < $200
- Property identified in published guidance in the Federal Register or in the IRS Bulletin as materials and supplies.

Materials and Supplies (Reg. §1.162-3)



- Incidental M&S – no records of consumption or physical inventories. (deducted when paid)
- Non-incidental M&S - records of consumption or inventories. (deducted when used)
- Election to capitalize and depreciate is now only available for rotable, temporary, or standby emergency spare parts.

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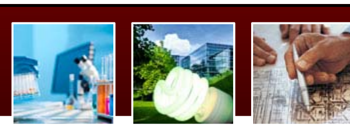
Materials and Supplies – Waste Receptacles



Taxpayer was unable to take De Minimis Safe Harbor for Waste Receptacles since it would cause a material misstatement for GAAP, but could treat them as M&S and immediately deduct them since there is no book-tax conformity requirement for supplies.

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POLLING QUESTION #7

2016 Method Changes

- Common Change of Accounting Methods include:
  - Depreciation Changes such as cost segregation and individual asset reclassification (7)
  - Disposition of a building or structural component for separately stated assets, such as tenant improvements or roof (205)
  - Partial Dispositions for non-separately stated assets such as replacement of a roof, HVAC system, or windows (no method change necessary as this only applies to current year dispositions)
    - Note: Late Partial Dispositions (196) – 2014 only
  - Removal Costs (21)
  - Repairs (184)
    - Note: Need to determine if "small business taxpayer", and if so, whether taxpayer elected out of Rev. Proc. 2015-20, whether taxpayer filed prior Form 3115s.

How KBKG can Help

Comprehensive Fixed Asset Review:

- Dedicated team of experts devoted to accelerating deductions within the fixed assets register by identifying:
  - Missed cost segregation opportunities;
  - Retirements and other dispositions;
  - Individual asset reclassifications to shorter lives;
  - Capital to expense opportunities; and
  - Depreciation errors for missed deductions.
- We can file all required 3115's or help CPAs in this process, suggest elections, and assist with related compliance.
- KBKG has developed proprietary software to quickly identify missed repair expenses and retirements, provide documentation, and calculated missed deductions.

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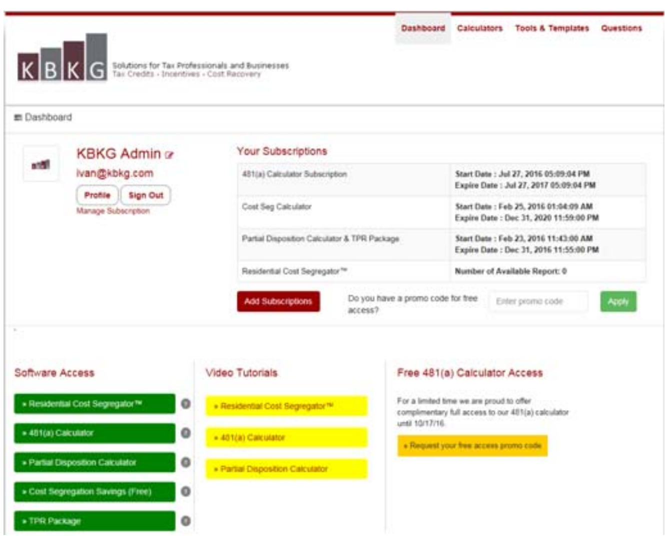
KBKG's Solutions Software

https://kbkgsolutions.com/dashboard

Software Access

- » Residential Cost Segregator™
- » 481(a) Calculator
- » Partial Disposition Calculator
- » Cost Segregation Savings (Free)
- » TPR Package

KBKG's Solutions Software



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POLLING QUESTION #8

QUESTIONS & ANSWERS

John W. Hanning MBA, CCSP
Director
614.929.3319
John.Hanning@kbkg.com

See if you qualify:
KBKG.com/qualify

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- R&D Tax Credits
- Green Tax Incentives
- Hiring Tax Credits
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- IC-DISC
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- Property Tax
- Sales & Use Tax

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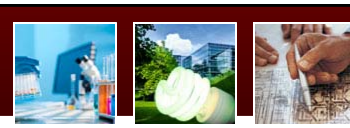
CPE Certificates



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