KBKG

SOLUTIONS FOR TAX PROFESSIONALS AND BUSINESSES

Tax Credits • Incentives • Cost Recovery

# CPA Handbook


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# ABOUT KBKG

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.

## SERVICES OVERVIEW

### Research & Development Tax Credit

Federal credit worth approximately 10% of every qualified dollar spent on developing brand new or improving existing products, processes, software, and formulas.

### Cost Segregation

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

### 179D Tax Deduction

Federal deduction worth up to $5.36 per square foot of energy-efficient buildings. Available to architects, engineers, design/build contractors and building owners.

### 45L Tax Credit

Newly constructed or renovated apartments, condos, and tract home developments that meet certain criteria are eligible for a credit ranging from $500 to $5,000 per unit.

### Employee Retention Credit

Refundable federal credit for companies that had a significant reduction in gross receipts or a government shutdown in 2020 and/or 2021. Eligible employers can receive refunds of up to $26,000 per eligible employee.

### Transfer Pricing & IC-DISC

The cross-border transfer prices of goods, royalties, services, and loans drive how much income tax a multinational company pays by country. IC-DISC offers significant Federal income tax savings for making or distributing U.S. products for export.

### Fixed Asset Review

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

### Repair vs. Capitalization Review §263(a)

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.

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# INDUSTRY MATRIX FOR TAX SAVING OPPORTUNITIES

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At KBKG, we are committed to identifying all possible tax saving opportunities for our clients and CPA partners. Our detailed Industry Matrix helps quickly determine which tax credits and deductions apply by industry at a glance. Our chart alone provides some insight to ensure that businesses are seeking out all potential benefits; however, KBKG's certified engineers and technical experts perform a thorough assessment during the engagement process to be sure all possible incentives are identified and considered.

| INDUSTRY | R&D TAX CREDITS | REPAIR/ASSET RETIREMENT | 179D TAX DEDUCTIONS | 45L TAX CREDITS | COST SEGREGATION / FIXED ASSET | IC-DISC | *TRANSFER PRICING | EMPLOYEE RETENTION TAX CREDIT |
|---|---|---|---|---|---|---|---|---|
| **Affordable Housing** | | ✓ | ✓ | ✓ | ✓ | | | ✓ |
| **Agriculture, Forestry & Fishing** | ✓ | | | | ✓ | ✓ | ✓ | ✓ |
| **Architecture & Engineering** | ✓ | | ✓ | | ✓ | ✓ | | ✓ |
| **Auto Dealerships** | | ✓ | ✓ | | ✓ | | | ✓ |
| **Cannabis** | ✓ | | | | ✓ | | | ✓ |
| **Communications & Utilities** | ✓ | ✓ | | | ✓ | ✓ | | ✓ |
| **Construction** | ✓ | | ✓ | | ✓ | | | ✓ |
| **Film & Music** | ✓ | | | | ✓ | ✓ | ✓ | ✓ |
| **Financial Services** | ✓ | ✓ | | | ✓ | | ✓ | ✓ |
| **Government Contractors** | ✓ | | ✓ | | ✓ | ✓ | | ✓ |
| **Healthcare** | | ✓ | ✓ | | ✓ | | ✓ | ✓ |
| **Home Builder** | | | | ✓ | | | | ✓ |
| **Hotels** | | ✓ | ✓ | | ✓ | | ✓ | ✓ |
| **Manufacturing & Distribution** | ✓ | ✓ | ✓ | | ✓ | ✓ | ✓ | ✓ |
| **Mining** | ✓ | | | | ✓ | ✓ | ✓ | ✓ |
| **Multifamily Developers** | | ✓ | ✓ | ✓ | ✓ | | | ✓ |
| **Oil & Gas** | ✓ | ✓ | | | ✓ | | ✓ | ✓ |
| **Pharmaceutical** | ✓ | ✓ | ✓ | | ✓ | ✓ | ✓ | ✓ |
| **Professional Services** | ✓ | ✓ | ✓ | | ✓ | | ✓ | ✓ |
| **Real Estate** | | ✓ | ✓ | | ✓ | | | ✓ |
| **Restaurants** | | ✓ | | | ✓ | | | ✓ |
| **Retail** | | ✓ | ✓ | | ✓ | | | ✓ |
| **Technology/Software** | ✓ | | | | ✓ | ✓ | ✓ | ✓ |
| **Transportation** | ✓ | | | | ✓ | | ✓ | ✓ |
| **Wholesale Trade** | | ✓ | ✓ | | ✓ | ✓ | ✓ | ✓ |

**May apply to any industry as long as the company has cross border subsidiaries. Industries indicated are more likely to have multinational business.*

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# IDENTIFYING VALUE-ADDED TAX OPPORTUNITIES

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| KBKG SERVICE | DESCRIPTION & HIGHLIGHTS | APPLICABLE CLIENTS & INDUSTRIES | HOW MUCH IS IT WORTH? | TAX CONSIDERATIONS |
|---|---|---|---|---|
| **RESEARCH & DEVELOPMENT TAX CREDITS** (FEDERAL & STATE) | Federal and State tax credit – designed to promote innovation. Expenses incurred in the United States and that meet the qualification criteria can result in a credit.<br><br>Qualifying expenses can include wages paid to employees, supplies used in the research process, and payments made to contractors for performing U.S. based qualified research. | Clients developing brand new products, processes, software, or formula.<br><br>Clients materially improving existing products, processes, software or formula.<br><br>Clients that employ those with technical backgrounds including:<br>• Manufacturing<br>• Software Development<br>• Architecture<br>• High Tech<br>• Food & Beverage<br>• Equipment or tools<br>• Life Sciences<br>• Agriculture | **Federal Benefit - Roughly 10% of their total Qualified R&D Expenses**<br><br>Ex.: Client has $1M/year of wages related to R&D. Benefit = $100k in gross credits per year.<br><br>Most states also allow an R&D credit that can be added on top of the federal credit. These state credit qualifications may vary. | • Dollar-for-dollar reduction in income tax liabilities.<br>• 1-year carryback / 20-year carryforward of unused credits.<br>• Qualified small businesses can reduce Alternative Minimum Tax (AMT) liabilities.<br>• Qualified startup companies can offset up to $500,000 in payroll taxes starting in tax year 2023. |
| **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 (excluding land).<br><br>Any **leasehold improvement with over $500k** of depreciable tax basis (excluding land).<br><br>Any smaller **residential rental property with over $150k** of depreciable tax basis (excluding land) can utilize KBKG's online software to generate a cost segregation report. | Net Present Value is roughly **5% of the total building cost.**<br><br>Ex.: $2M office can yield an after-tax NPV of $100k. | • Reduces AMT<br>• Starting in 2018, unused deductions carryforward.<br>• Must recapture personal property and bonus eligible assets upon the sale of a building. |
| **COMMERCIAL ENERGY DEDUCTIONS / SECTION 179D** (FEDERAL/ STATES CAN HAVE SIMILAR PROGRAMS) | Federal deduction for **Architects, engineers, and design/build contractors** that design tax-exempt owned buildings (government/municipal & non-profit) such as schools, libraries, courthouses, etc.<br><br>**Also available to any commercial building owner.** | • **179D for designers:** Architects, Mechanical Engineers, Electrical Engineers, Design/Build Contractors, and Building Automation companies.<br><br>• **Any building owner or lessee:** That has constructed a new construction or significant renovation after 1/1/2006. | **A federal tax deduction up to $5.36 per square foot.**<br><br>Ex.: 100,000 square foot building is eligible for up to $500,000 in deductions. | • Reduces AMT<br>• Deduction reduces basis in real property for building owners.<br>• Designers must amend open tax years to claim.<br>• Owners can go back to 2006 with a Form 3115 to claim past deductions. |
| **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.<br><br>Units must be certified by a qualified professional to be eligible. | Anyone that has built apartments, condos or production home developments (3 stories or less), in the last 4 years.<br><br>**Generally, more than 20 units.** | **Federal credit can be up to $5,000 per apartment/ home unit.**<br><br>**Many states have similar credits.**<br><br>Ex.: 100-unit apartment/ condo can get $200,000 of Federal Tax Credits. | • Credit is realized when unit is first leased or sold, not placed in service.<br>• 1-year carryback<br>• 20-year carryforward.<br>• Does not reduce AMT.<br>• Subject to passive activity loss rules<br>• Credit reduces basis. |

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|---|---|---|---|---|
| **EMPLOYEE RETENTION CREDIT** (FEDERAL & STATE) | The Employee Retention Credit (ERC) is a refundable tax credit for businesses that continued to pay employees while shut down due to the COVID-19 pandemic or had significant declines in gross receipts from March 13, 2020 to September 30, 2021. | Businesses that<br>1. Sustained a full or partial suspension of operations due to COVID-19 and orders from an appropriate governmental authority or<br>2. Experienced a significant decline in gross receipts during 2020 or the first three quarters of 2021 compared to 2019 or<br>3. Qualified in the third or fourth quarter of 2021 as a recovery startup business. | For 2020 , there is a maximum credit of $5,000 per eligible employee.<br><br>For 2021, there is a maximum credit of $7,000 per eligible employee, per quarter (Q1- Q3 only). | The deadline for filing 2020 is April 2024 and the 2021 deadline is April 2025. |
| **TRANSFER PRICING** (INTERNATIONAL) | The transfer prices of goods, royalties, services, and loans drive how much income tax is paid by country. Corrections to transfer pricing may lead to significant improvements in a company's global effective tax rate.<br><br>Savings dependent on differences in tax rates between countries and can be significant. | All US and foreign-owned multinational companies.<br><br>Transfer pricing rules apply to goods, services, royalties, loans and other cross-border transactions in all industries<br><br>Companies with supply chain restructuring programs, new R&D facilities, or international subsidiaries are often best placed to realize benefits. | US tax reform has created opportunities to improve global effective tax rates through changes to transfer prices, e.g.<br>• Foreign Derived Intangible Income ("FDII") allows C-Corporations to pay a 13.125% rate on some export income<br>• Changes to transfer prices of imported goods may also lead to tax savings at the 21% rate.<br>• Substantial benefits when correcting transfer pricing to utilize tax net operating losses. | Companies without transfer pricing documentation can face additional tax, interest, non-deductible penalties and double tax for all open tax years.<br><br>Tax authorities are concerned about multinational companies paying their "fair share" of income tax in each country where they operate. |
| **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**<br>• Manufacturers<br>• Distributors<br>• Architects & Engineers<br>• Agriculture and Food Producers<br>• Software Developers<br>• Other Producers | Minimum permanent **17% decrease in tax rate on half of export profits.**<br><br>Benefits can be dramatically higher by performing a transaction-by-transaction analysis. | • Requires annual filing 1120 IC-DISC.<br>• No changes to business operations.<br>• Benefits begin when entity is formed. |
| **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.<br><br>KBKG also provides compliance consulting for repair and disposition regulations. | **Any building renovation costs > $400k**<br><br>**Retirement Study** - Building is renovated AFTER owning it at least 1 year. Building should have **<u>> $500K of remaining depreciable basis left.</u>**<br><br>**Repair Study** - renovations that include **roof, HVAC, windows, lighting, plumbing, ceilings, drywall, flooring, etc.** | Additional Year 1 deductions of **15%-40% of renovation costs (on top of benefits from 1245 reclassification)**<br><br>Ex.: Client spends $3M on structural renovations. Additional Year 1 deductions of $450K-$1.2M. | • Depending on project specifics, may require a separate 3115 if doing concurrently with a depreciation change. |

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# RESEARCH & DEVELOPMENT TAX CREDIT

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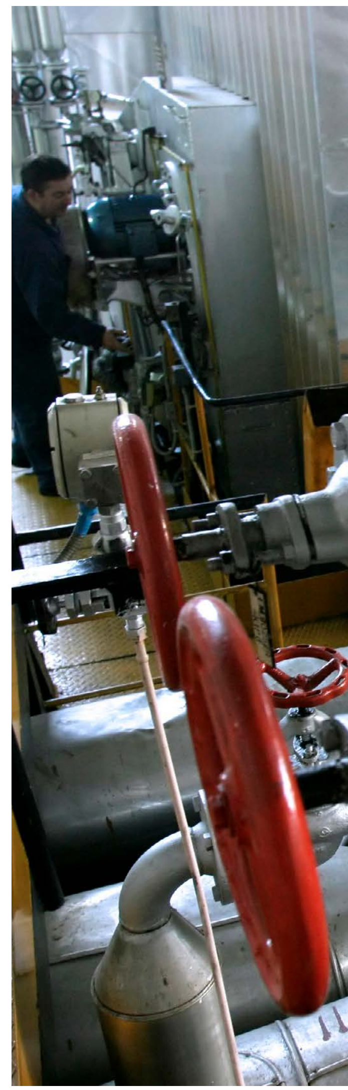
## THINKING BEYOND THE TECH WORLD

The term “Research & Development” often times provokes thoughts of lab coats and test tubes to taxpayers that are initially presented with the subject. However, for tax purposes, the definition of research & development is quite broad. Companies engaged in the development, improvement or refinement of products, processes, formulas, and software should speak to an R&D tax credit expert for a review of their facts and circumstances.



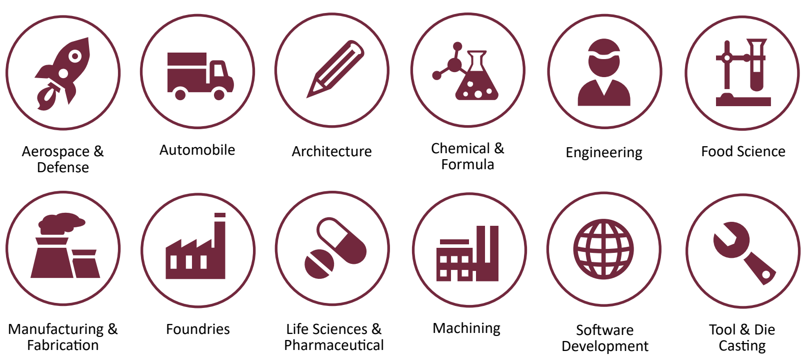
## WHAT IS THE R&D TAX CREDIT?

The R&D Tax Credit is a federal tax incentive (also available in most states) designed to promote innovation in the United States. The credit is a dollar-for-dollar reduction in a taxpayer’s tax liability for a given year.

Primarily an activity-based incentive, qualifying expenditures can apply to a broad range of activities including, but not limited to:

- Developing or testing new products or materials
- Developing new or enhanced formulations
- Testing new concepts
- Improving existing products
- Trial and error experimentation
- Designing tools, jigs, molds and dies
- Design and analysis of prototypes or models
- Developing or improving production or manufacturing processes
- Developing, implementing or upgrading systems/software
- Paying outside consultants/contractors to perform any of these activities

## QUALIFYING INDUSTRIES:




## WHY NOW AND NOT BEFORE?

Monetization has never been easier. Qualified small businesses may now apply for the R&D Tax Credit against Alternative Minimum Tax (“AMT”). Additionally, qualified startup companies may elect to use up to $500,000 of R&D credits against their payroll taxes. The R&D Tax Credit is an often overlooked and misunderstood tax benefit. Most tax preparers only associate R&D with technology, biotechnology, and pharmaceutical activities. Treasury regulations have substantially broadened the range of taxpayers eligible for the credit. As a result, more companies can take advantage of these benefits.

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# RESEARCH & DEVELOPMENT TAX CREDIT CASE STUDY

## WHO CAN BENEFIT FROM THE RESEARCH & DEVELOPMENT CREDIT?

The Research and Development Tax Credit is available to companies that invest in developing brand new or improving existing products, processes, techniques, software or formulas. The Credit was enacted in 1981 as an incentive to companies making these types of investments in the United States. Qualification for the Credit depends on the nature of the activities performed by a company and the expenditures incurred for those activities.

The following case study presents a fictitious start-up company operating in the retail space which performs activities qualifying for the research credit. In the current tax year, Green, Inc. undertook efforts to develop a mobile application which allows customers to directly purchase products using decentralized blockchain technology. Green, Inc. incurs the following costs in performance of the development activities:

## CASE STUDY

The following case study presents a fictitious start-up company operating in the retail space which performs activities qualifying for the research credit. In the current tax year, Green, Inc. undertook efforts to develop a mobile application which allows customers to directly purchase products using decentralized blockchain technology. Green, Inc. incurs the following costs in performance of the development activities:

**Employee Wages**

| Name | Title | Wages | Qual % | Qual Wages |
|---|---|---|---|---|
| Jim Smith | Sr. Software Engineer | 80,000 | 100% | 80,000 |
| Tom Johnson | Programmer | 75,000 | 60% | 45,000 |
| Phil Floyd | Chief Architect | 103,000 | 100% | 103,000 |

**Contractors**

| Name | Task | Amount Paid | Qual % | Qual Contractors |
|---|---|---|---|---|
| George White | Cyber Security Analysis | 20,000 | 65% | 13,000 |
| Helen Jones | Backend Development | 20,000 | 65% | 13,000 |
| Sciences LLC | Beta Testing | 40,000 | 65% | 26,000 |

**Total Qualified Research Expenses** $280,000

## QUALIFICATION CRITERIA

- The activities must be **Technological in Nature**, and rely on the principles of a hard science (ex: computer science, engineering, physics).
- Activities must have **Permitted Purpose**, meaning involve the development of new or improved products, processes, software, or formulas.
- There must be **uncertainty** of the capability, method or appropriate design for developing or improving the business component.
- There must be a process for evaluating alternatives through [experimentation].

## QUALIFYING COSTS REVIEWED INCLUDE:

- Wages for employees that are either engaged in, support, or supervise qualifying activities.
- 65% of amounts paid to U.S. based non-employees to perform qualified activities (contract research).
- Supplies (non-depreciable property) used and consumed during the development process.

## KBKG RESULTS

The calculation of the credit requires several other attributes not included in this case study.
In this case study, the current year federal credit for Green, Inc. could be up to $28,000.

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# SECTION 41 RESEARCH & DEVELOPMENT TAX CREDITS

## WHAT?

- Federal credit that is also available in some states and designed to promote innovation
- Federal benefit can be up to 10% of every qualified dollar spent on R&D with state credits added on top of that
- Dollar-for-dollar reduction in a taxpayer's income tax liablity

## QUESTIONS TO ASK

- Have you claimed the R&D credit before?
- What type of industry are you in?
- Do you develop, design, or enhance any products, processes, formulas, techniques, or softwares?
- About how many employees do you have participating in this development/enhancement?
- What is the average salary of those employees involved in the R&D?
- How much do you spend on supplies used and consumed in the R&D process?
- When do you plan to file your taxes?

## IDEAL CANDIDATES

- The industries previously outlined
- Those that are creating brand new or improving existing products, processes, formulae, or software
- Those that employ or contract individuals with technical backgrounds
- Companies with a large tax liability or Qualified Startups can offset their payroll tax

## TIMING

- Annual credit – can be taken advantage of every year
- Statute of Limitations – Normally three years for federal purposes and four years for many states
- If in a Net Operating Loss (NOL) position, can look back more than 3 years

## STUDY TIME

- Total Project: Allow 6-12 Weeks depending on client size and availability
- Allow 3-6 Weeks for calculation work only / allow additional 4 – 5 weeks for documentation work

## TAX PLANNING

- General Business Tax Credit – Unused credits are carried back 1 year and carried forward 20 years
- Protective 280C claims will allow taxpayers to amend the credit and still make a Section 280C election
- Companies with little-to-no tax liability and that are qualified startups can monetize up to $500,000 of research credits by using them against payroll taxes

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# SECTION 41 RESEARCH & DEVELOPMENT TAX CREDITS

## PRICING

KBKG offers several fee structures and engagement scopes. We can provide fixed fees or percentage based fees for a variety of scopes from calculation only to full documentation and even audit support studies.

## ITEMS TO REQUEST

- Organization Chart – Including employee names & titles
- Employee Listing – Include name, department, title, date of hire &/or date of termination
- Current & prior 3-year's financial statements (balance sheets, summary of supplies)
- Prior 4-years tax returns
- If R&D credit previously claimed – Get copies of Form 6765 & supporting paperwork

## ACCOUNTS / DEPARTMENTS TO LOOK FOR ON FINANCIAL STATEMENTS

- Engineering
- Software Development
- Computer Automated Design (CAD) or Drafting
- Product or Systems Development
- Laboratory or Test Facility
- Quality Control / Testing
- Prototypes or Samples
- Outside Consultants / Services / Labs or Test Facilities

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# RESEARCH & DEVELOPMENT TAX CREDITS: DECISION TREE

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## DETERMINE YOUR ELIGIBILITY

**Is the taxpayer developing new or improved products, processes, software, formulas, or techniques?**

**YES?** NO? NOT QUALIFIED.

### TECHNOLOGICAL IN NATURE

Does the work rely on the principles of science (i.e. biological science, computer science, physical science (physics or chemistry), engineering, etc.)?

**YES?** NO? NOT QUALIFIED.

### PERMITTED PURPOSE

Is the development of the new or improved products, processes, software, formulas or techniques intended to be brand new or materially improve the functionality, performance, reliability, or quality?

**YES?** NO? NOT QUALIFIED.

### TECHNICAL UNCERTAINTY

Is there uncertainty surrounding the capability, methodology, or appropriate design of the new or improved products, process, software, formulas or technique? *Uncertainty generally leads to the consideration of alternatives.*

**YES?** NO? NOT QUALIFIED.

### PROCESS OF EXPERIMENTATION

Does the process of experimentation allow for the testing or evaluation of alternatives? *Depending on those results, a taxpayer would either continue with the current selection, modify or retest it, evaluate additional alternatives, or discard it.*

**YES?** NO? NOT QUALIFIED.

### RIGHTS

Does taxpayer retain rights to the research? Can the taxpayer use the results of the research in their trade or business without requesting permission or paying a third party?

**YES?** NO? NOT QUALIFIED.

### RISKS

Is the taxpayer at risk for the research (i.e. is a payment by the taxpayer contingent on a result verses they will be compensated regardless of the result)?

**YES?** NO? NOT QUALIFIED.

## QUALIFIED OPPORTUNITY!

The new or improved products, processes, software, formulas or techniques are qualified and the expenses associated with them can be applied to the credit. Expenses include wages, supplies and contract research.

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# NEW SECTION 174 RULES

For tax years beginning after 12/31/2021, Specified Research and Experimentation expenditures are no longer allowed to be currently deducted.

- Domestic R&E is to be capitalized and amortized over 5 years
- Foreign R&E is to be capitalized and amortized over 15 years
- Amortization begins in the midpoint of the taxable year in which expenses are paid or incurred

Software Development - While previously deductible under Rev. Proc 2000-50, the new 174 rules specify that software development must be capitalized and amortized

R&E expenditures are research and development costs in the experimental or laboratory sense, which includes all costs that are incident to the development or improvement of a product. - Much more expansive than Section 41 QREs (wages, supplies, and contract research)

Examples of expense categories with differing treatment between Sec. 174 & Sec. 41:

| Type | Sec. 174 Required Amortization Treatment | Sec. 41 R&D Tax Credit Treatment |
|---|---|---|
| Direct research expenses: wages & supplies | Amortization Required | R&D tax credit eligible |
| Direct research expenses: outside service providers | Amortization Required | R&D tax credit eligible at 65% of costs incurred, if rights and risk to research are with taxpayer |
| Supervision of research | Amortization Required | R&D tax credit eligible for first-line supervisors |
| Indirect research expenses such as rent, utilities, overhead, and depreciation of buildings and equipment related to research | Amortization Required | Not eligible for R&D tax credit |
| Foreign research | Amortization Required | Not eligible for R&D tax credit |
| Patent-related expenses | Amortization Required | Not eligible for R&D tax credit |
| Research funded by a third party | Amortization Required | Not eligible for R&D tax credit |

*Note: The ultimate success, failure, sale, or use of the product is not relevant to a determination of eligibility.*

## TAX IMPACT OF SECTION 174 CHANGES

Example: Taxpayer conducts all R&D in the US and R&E expenses remain consistent year over year (assume QREs are the only R&E expenses for simplicity)

| | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 | Total | |
|---|---|---|---|---|---|---|---|---|---|
| Section 174 Expenses | $1,000,000 | $1,000,000 | $1,000,000 | $1,000,000 | $1,000,000 | $1,000,000 | $1,000,000 | **$6,000,000** | |
| Amount Recovered | ($1,000,000) | ($100,000) | ($300,000) | ($500,000) | ($700,000) | ($900,000) | ($1,000,000) | **($3,500,000)** | |
| Remains Capitalized | — | $900,000 | $700,000 | $500,000 | $300,000 | $100,000 | — | **$2,500,000** | |
| Tax Rate | 21% | 21% | 21% | 21% | 21% | 21% | 21% | | |
| Tax Impact w/o R&D Credit | — | $189,000 | $147,000 | $105,000 | $63,000 | $21,000 | — | **$525,000** | Tax without R&D credit |
| R&D Credit = 10% of QRE | $100,000 | $100,000 | $100,000 | $100,000 | $100,000 | $100,000 | $100,000 | **$600,000** | R&D credit savings |
| Change in Tax w/ R&D Credit | ($100,000) | $89,000 | $47,000 | $5,000 | ($37,000) | ($79,000) | ($100,000) | **($75,000)** | Tax with R&D credit |

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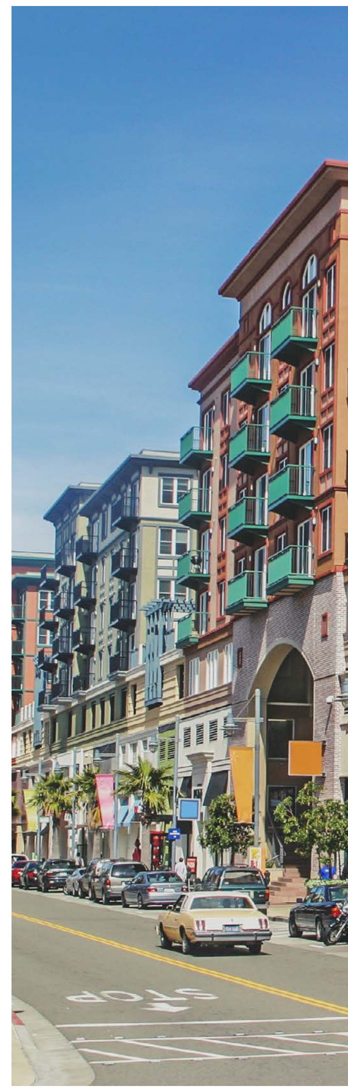
# COST SEGREGATION SERVICES

## WHAT IS COST SEGREGATION?

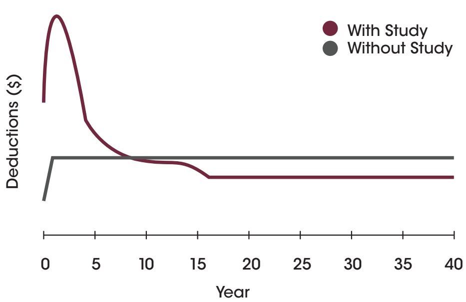
Cost Segregation is a strategic tax savings tool that allows companies and individuals, who have constructed, purchased, expanded or remodeled any kind of real estate, to increase cash flow by accelerating depreciation deductions and deferring federal and state income taxes.

In general, it is easy to identify furniture, fixtures, and equipment (FF&E) that are depreciated over 5 or 7 years for tax purposes. However, a Cost Segregation Study goes far beyond that by dissecting construction costs that are usually depreciated over 27 ½ or 39 years. The primary goal of a Cost Segregation Study is to identify all construction-related costs that can be depreciated over 5, 7 or 15 years. Reducing tax lives results in accelerated depreciation deductions, reduced tax liability, and increased cash flow. Conducting a quality study involves review of cost details and blueprints, site inspection, photo documentation, cost estimation, and preparation of the report.



## BENEFITS OF ACCELERATED DEPRECIATION

The depreciation of a property with a Cost Segregation Study allows for a significant increase in deductions within the first 5 years.

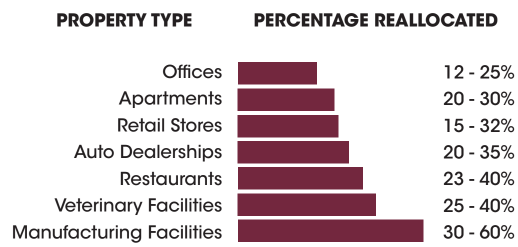



Assuming a combined tax rate of 41% and a return on investment factor of 8%, every $100,000 of costs shifted from 39-year property to 5-year property creates a present value tax benefit of approximately $22,000. Every $100,000 of costs shifted from 39-year property to 15-year property creates a present value tax benefit of approximately $12,000.

< The graph illustrates how a building's depreciation schedule would look with a study vs. without a study.

## WHO CAN BENEFIT?

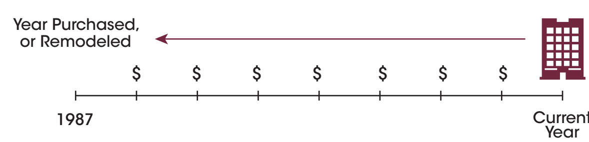
Any structure used for business or as rental property is eligible for the benefits of Cost Segregation. Leasehold improvements or renovation costs may also qualify. These are just a few examples of the types of results from a study. Please contact us for more information on your specific property type.




^ The above graph represents typical percentages of costs that are reclassified from either 27½ or 39-year real property to 5, 7, or 15-year property.

## TIMING IS EVERYTHING

The ideal time for a Cost Segregation Study can vary depending on an owner's tax situation. Although the optimum time for a study is during the year a building is constructed, purchased, or remodeled, a study can be completed anytime afterward. In fact, current Internal Revenue Service procedures make it easy to go back and claim missed depreciation on assets acquired as far back as 1987 without amending prior tax returns. Our experts will help analyze your tax situation to identify the right timing for you.

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# COST SEGREGATION SERVICES

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## WHAT IS COST SEGREGATION?

- Identifying, segregating, and reclassifying components of commercial property or residential rental into shorter depreciable tax lives.
  - Example – Reclassify parking lot and landscaping from 39-year (or 27.5 years for Residential) to 15-year.
  - Example – Reclassify certain electrical and plumbing systems from 39-year (or 27.5 years for Residential) to 5-year.
- IRS prefers specialists with construction/engineering expertise with in-depth knowledge of the tax laws.

## IDEAL CANDIDATES / PROSPECTS

- Buildings acquired, improved, or built by the client in the last 15 years.
- Cost Basis of $750K or more for a freestanding building (not including land). ($500K or more for improvements to a building).
- Smaller residential properties with more than $150K of cost basis (not including land), and have 6 units or less can use KBKG's online software to generate a cost segregation report.
- Client is paying state or federal income tax – requires taxable income to enjoy a tax benefit.
- Properties that will be held for 5 or more years. Depreciation recapture can be an issue for short-term holders (unless they do a 1031 exchange).
- REITs that are interested in controlling dividend distributions to shareholders

## POOR CANDIDATES

- Non-profits, Hospitals, University
- REITs (unless they are interested in controlling dividends that must be distributed)
- Cooperatives
- Short term RE holders (unless they plan on doing a 1031 exchange)

## BENEFIT TO THE CLIENT

- Time Value of Money - Benefit is measured in terms of the Net Present Value (NPV) of the deferred income tax liability.
- Net Present Value benefit is generally 20+ times the cost of the study.
- Overall NPV Benefit is typically 5% of the depreciable tax basis of Building and Tenant Improvements:
  - Example - $5M Building basis = ±$250k NPV Benefit
- Provides cost basis for building components that may be replaced in future years (i.e. windows, doors, lighting etc.)
- Bonus Depreciation on new property is applicable 2001-2004 and 2008-2026. Available on used property if placed in service after 9/27/2017.

## PROCESS / IN-DEPTH STUDY

- Detail review of available cost records and invoices.
- Review of building blueprints to reconstruct the component costs of the building.
- Site inspection for additional data collection and measurements.

## PRELIMINARY REVIEW - NO CHARGE

With very little information about the property, we can provide an estimate of the tax benefits and fee.

## PRICING

Fixed fee. Generally between $5k-$15k depending on size and type of property.

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# COST SEGREGATION SERVICES

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## STUDY TIME

Studies take up to 30-60 days from date of receipt of all pertinent project data

## QUESTIONS TO ASK

- Have you added or acquired significant Building additions in the last 15 years?
- How much did you spend?
- Do you plan on holding the property? If not, do you plan on doing a 1031 exchange?

## INFORMATION NEEDED:

- Tax Depreciation Schedule (if acquired in prior year)
- Type of building
- Square Footage of Building
- Size of Land Parcel
- Building Address
- Purchase Date
- Purchase Price

## SUCCESS STORIES

- KBKG reviewed two restaurants that cost $1.5M each. Saved client $250,000
- KBKG reviewed acquired office building purchased for $10.5 million. Saved client $600,000
- KBKG reviewed manufacturer with $55 million of asset additions. Our study reclassified $25M (45%) into 5 & 7 year tax lives. Yielded approximately $5 million NPV benefit over the life of the assets
    - This study was reviewed by 3 IRS Engineers and resulted in no adjustments
- KBKG did a statistical sampling study of 125 locations for a public retailer. Generated $13M in additional first-year deductions or $5.3M in tax savings the first year
    - This was audited by the IRS and there were no adjustments

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Lighting HVAC Envelope

# ENERGY EFFICIENT BUILDING DEDUCTIONS

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## §179D TAX DEDUCTION FOR ARCHITECTS & DESIGNERS

Architects and designers are eligible for a deduction of up to $5.36 per square foot for the design of energy efficient buildings owned by tax-exempt entities.

### WHO QUALIFIES?

- Architects
- Engineers
- Design/Build Contractors
- Building Automation Companies

### IDEAL PROJECTS

- K-12 schools
- Museums*
- Universities
- Hospitals
- Non-profit*
- Private Universities*
- Military bases
- Courthouses
- Religious Buildings*
- Dormitories
- Convention Centers
- Sports Arenas

*Effective 1/1/2023, these project types also qualify for 179D

## THE PROCESS

The basis for developing and supporting this deduction is a detailed engineering analysis, as prescribed by the IRS. Our multi-disciplinary team of engineers and tax experts will ensure that you obtain the maximum deductions available, following IRS guidance. In addition to performing energy simulation modeling or lighting power density calculations, our studies meet all requirements of the tax code.

## KBKG CLIENT SUCCESS STORIES

**Architect**
*Middle School - 225,000 sf*

2023 DEDUCTIONS AT $5.36/SF MAX.
**$1,206,000**

**Engineering Firm**
*Public University Building - 80,000 sf*

2023 DEDUCTIONS AT $5.36/SF MAX.
**$428,800**

**Design Build General Contractor**
*Courthouse - 500,000 sf*

2023 DEDUCTIONS AT $5.36/SF MAX.
**$2,680,000**

**Building Automation Company**
*Convention Center - 400,000 sf*

2023 DEDUCTIONS AT $5.36/SF MAX.
**$2,144,000**

**MAXIMUM BENEFIT OF $5.36/SF IN 2023 AND $5.65/SF IN 2024**

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Lighting HVAC Envelope

# ENERGY EFFICIENT BUILDING DEDUCTIONS

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## §179D TAX DEDUCTION FOR COMMERCIAL BUILDING OWNERS

Commercial building owners are eligible for a deduction of up to $5.00 per square foot for the installation of energy-efficient equipment into their property.

### WHAT QUALIFIES?

- New Construction
- Renovations/Retrofits

### ELIGIBLE BUILDINGS

- Warehouses
- Manufacturing Facilities
- Office Buildings
- Hotels
- Retail
- Multi-family (4 stories or greater)
- Data Centers`
- Casinos

### THE PROCESS

**STEP 1 — ENERGY MODELING**

*KBKG will perform a simulation comparing your building's energy performance to a minimally efficient code compliant standard as per IRS requirements.*

**STEP 2 — ON-SITE INSPECTION**

*A KBKG engineer, who is licensed in the state, will perform a visual inspection to verify the energy efficient property has been placed into service and matches the modeled plans (a pre-requisite to certification).*

CERTIFIED

### KBKG CLIENT SUCCESS STORIES

**Office Building**
*120,000 sf*

2023 DEDUCTIONS AT $5.36/SF MAX.

**$643,200**

**Warehouse**
*800,000 sf*

2023 DEDUCTIONS AT $5.36/SF MAX.

**$4,288,000**

**MAXIMUM BENEFIT OF $5.36/SF IN 2023 AND $5.65/SF IN 2024**

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# SECTION 179D ENERGY EFFICIENT COMMERCIAL BUILDING DEDUCTION

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## WHAT IS THE 179D DEDUCTION?

The 179D Deduction, also known as the Energy-Efficient Commercial Buildings 179D Tax Deduction, is a tax incentive first introduced in 2005 as part of the Energy Policy Act. The program's intent is to drive commercial building owners and Designers of tax-exempt buildings to reduce their energy use by rewarding the implementation of energy-efficient building components, specifically, the HVAC system, interior building lighting, and the building envelope for newly constructed buildings or renovations. In 2020, 179D became a permanent part of the tax code. In 2022, the Inflation Reduction Act increased the maximum available benefit up to $5.36 per square foot of building area.

## IDEAL CANDIDATES

- Architects, Mechanical Engineers, Electrical Engineers, Design Build Contractors, and Building Automation or Controls Companies who design government-owned or tax-exempt buildings
- Real Estate Owners of Commercial Buildings that own buildings over 50,000 sf in size

## BENEFIT TO THE CLIENT

- Up to $5.36 per square foot of building area in Federal tax deductions
- A 250,000 square foot building can have a tax deduction of $1,250,000
- Government and Tax-Exempt Entities can allocate deductions to Architects, Engineers, and some Contractors

## REQUIREMENTS

- Before 2023, commercial government or high-rise residential properties needed to outperform specific energy standards from previous years
- Going forward, there are different ways to pursue a deduction, requiring comparison to the ASHRAE standards
- Must be analyzed and confirmed by a qualified third party

## TIMING

- Architects, Engineers, Design Build Contractors, and Controls Companies with Amendable Tax Years
- For Real Estate Owners, buildings constructed or renovated after January 1, 2006 (Form 3115)
- 179D can be reclaimed every 3 years for Owners and 4 years for Designers with qualifying activities

## REAL ESTATE INVESTMENT TRUSTS (REITs) + 179D

- Inflation Reduction Act makes 179D useful for REITs
- 179D can now be taken as a 1-year deduction for calculating Earnings and Profits instead of over 5 years
- This deduction allows REITs to retain more cash and have additional flexibility

## TAX PLANNING

- Subject to 1245 recapture for building owners (Designers of tax-exempt buildings not subject to recapture)
- Up to 2-year Net Operating Loss (NOL) carryback and 20-year carryforward, depending on tax year
- Reduces Alternative Minimum Tax (AMT)
- Deduction reduces basis in real property for Commercial Building Owners

## KBKG ADVANTAGE

- KBKG secures allocation letters for Architects, Engineers, and Design Build Contractors from allocating entities
- Expertise in tax code & energy codes necessary for maximizing deductions due to in-house engineering team
- Audit support included

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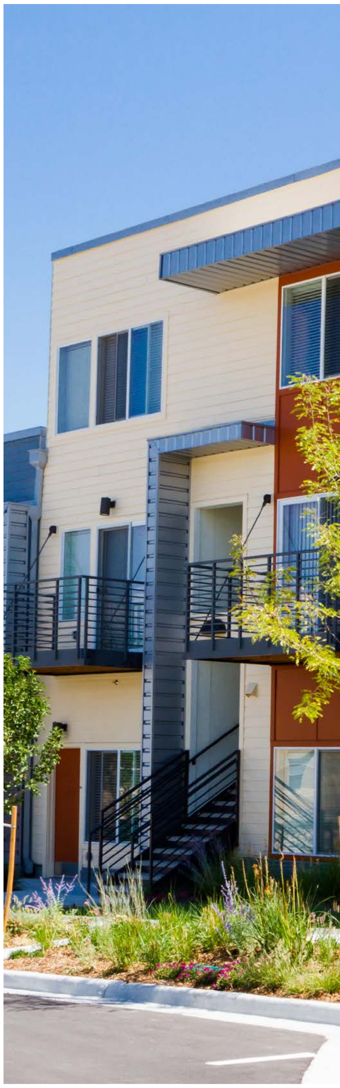
# §45L RESIDENTIAL DWELLING TAX CREDIT

## ABOUT THE §45L TAX CREDIT

The 45L Tax Credit is a Federal Tax Credit designed to reward multifamily developers, investors, and homebuilders for building energy efficient homes. Starting in 2023, the maximum tax credit increases to $5,000 per dwelling unit. Additionally, the energy efficiency requirements change to align with the Energy Star and Zero Energy Ready Homes energy efficiency programs.
Also, all residential developments become eligible whereas prior, only low-rise residential developments were eligible.



## INFLATION REDUCTION ACT - 45L

| | 2022 & EARLIER | | | | |
|---|---|---|---|---|---|
| | 50% SAVINGS OVER 2006 IECC | ENERGY STAR | ENERGY STAR PLUS PREVAILING WAGES | ZERO ENERGY READY | ZERO ENERGY READY PLUS PREVAILING WAGES |
| MULTIFAMILY DEVELOPER | $2,000 | $500 | $2,500 | $1,000 | $5,000 |
| HOMEBUILDER<br>Single Family For Sale or Build to Rent | $2,000 | $2,500 | $2,500 | $5,000 | $5,000 |

*Starting in 2023, a "bonus" rate (5x multiplier) was introduced to reward multifamily developers who pay prevailing wages.

## PREVAILING WAGES

Prevailing Wages are determined by the Department of Labor and establish a minimum pay requirement for laborers and mechanics employed on a work site based on activity, project type, and location. Affordable Housing (LIHTC) developers may be required to pay prevailing wages as a condition of certain funding. HUD (d)(4) Loans and HUD HOME Funds are good examples. In some cases, employers may be paying prevailing wages but may not be aware.

## IDEAL CANDIDATES

Low-Rise, Mid-Rise, High-Rise, and mixed-use buildings consisting of at least 50% residential occupancy can all now be assessed for energy tax credits and ideal candidates are multi-family developers who pay prevailing wages. Eligible construction also includes certain reconstruction and rehabilitation projects.

## PROCESS

The basis for developing and supporting this tax credit is a detailed energy analysis that begins pre-construction and must be certified by a qualified third-party. Our multi-disciplinary team of engineers and tax experts will ensure that you obtain the maximum tax credits and provide all the documentation necessary to sustain an IRS audit.

**"Every residential developer should consider 45L tax credits as part of their tax reduction strategy"**

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# SECTION 45L ENERGY EFFICIENT DWELLING UNIT TAX CREDITS

## WHO?

- Apartment/multifamily developers (includes investors with basis)
- Affordable housing developers
- Assisted living facility developers
- Condominium developers
- Production homebuilders & manufactured

## WHAT?

- Federal credit ranging from $500 to $5,000 per qualified unit
- Other State and Local incentives may be applied if engaged prior to construction

## TIMING

- Unit must be leased or sold within the 3-year Federal Statute of Limitations

## REQUIREMENTS

- Through the end of 2022:
  - Building must be less than 3 stories above grade (potential for 3 stories above 1-level podium parking)
  - Heating & cooling consumption needs to be 50% better than 2006 energy standards (2006 IECC) – In the real world, the energy consumption is mostly impacted by the building envelope (windows, doors, insulation, roof)
  - Requires energy simulation analysis that meets IRS requirements and certification by qualified third party
- 2023 until 2032, a taxpayer has different qualifications to get different tiers of the credit

## IDEAL CANDIDATES

- 20+ Unit community
- California projects
- Participation in Energy Star, HUD programs,
- LEED, energy efficiency or utility rebate programs
- LIHTC projects

## POOR CANDIDATES

- In colder climate zones (Northern US), units with ducted electric heat systems are poor candidates
- In warmer climate zones (Southern US), AC units with a SEER rating lower than 14 are poor candidates
- Custom homebuilders

## TAX PLANNING

- Tax credit is a General Business Credit. Forms 8908 and 3800 apply.
- Tax credit is not “refundable”; tax liability is necessary to offset
- Generally, 1-year carryback and 20-year carryforward
- Tax credit doesn’t reduce AMT
- Credit reduces basis; for apartment property, 27.5-year property is reduced
- No recapture on credit
- Credit is subject to passive activity loss rules

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# SECTION 45L ENERGY EFFICIENT DWELLING UNIT TAX CREDITS

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## PRICING

For leased units, fees start at 20% of the credits multi-family properties and decrease as more units qualify. For homebuilders, pricing is only detirmined after an initial scoping call, but fees usually start at 30% of the credits and decrease as more units qualify.

## ADVANTAGE

- No upfront fees; risk-free phase I analysis protects client from unnecessary costs
- Stellar track record in maximizing credits (over $300m) for the country's top homebuilders and developers (i.e. Lennar, DR Horton, KB Home,etc) where others have failed
- Audit support included
- Expertise in tax code & energy codes necessary for maximizing credits
- Helped to shape 45L legislation and guidance (working with builder advocacy groups, DOE, IRS)

## QUESTIONS TO ASK

- Where is property located? Number of Units? Number of stories?
- When were units sold or leased?
- If a private company, how many shareholders or partners (recipients of K-1's)?
- Can general business credits be utilized by company or K-1 recipients?
- When does tax return typically get filed?
- Can returns be amended? If so, what years are still open for amending?

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# EMPLOYEE RETENTION CREDIT (ERC)

## EMPLOYEE RETENTION CREDIT (ERC) SERVICES OVERVIEW

The Employee Retention Credit (ERC) was created as part of the CARES Act to encourage businesses to continue paying employees by providing a credit to the eligible employer for wages paid to eligible employees. The refundable credit is available from March 13, 2020 through September 30, 2021 and can be utilized even if companies received PPP loans. Businesses that started up after February 15, 2020 are eligible for up to $100,000 of credits on wages paid from July 1, 2021 through December 31, 2021.

**KBKG is providing the following services to assist with ERC:**

- Determine if the employer qualifies, and if so, for which quarters
- Determine which employee wages qualify
- Calculate credits, including analysis of PPP interplay
- Reconcile actual credits with advance credits requested
- Prepare reconciled data for Form 941-X
- Prepare documentation supporting eligibility

## ERC ELIGIBILITY

***Recipients of PPP loans are eligible to qualify retroactively for the credit in 2020 and 2021.***

For 2021, there is a maximum credit of $7,000 per eligible employee, **per quarter (Q1-Q3 only)**. The 2021 credit is computed at a rate of 70% of qualified wages paid, up to $10,000 per eligible employee, **per quarter (Q1-Q3 only)**. For Eligible Employers with less than 500 average full-time employees in 2019, the credit is available for **all** employees receiving wages in 2021.

For 2020, there is a maximum credit of $5,000 per eligible employee. The 2020 credit is computed at a rate of 50% of qualified wages paid, up to $10,000 per eligible employee for the year. For Eligible Employers with less than 100 average full-time employees in 2019, the credit is available for **all** employees receiving wages in 2020.

**An Eligible Employer (including all members of a control group) must either:**

1. Have their operations fully or partially suspended due to orders from a governmental authority OR
2. Suffer a significant decline in quarterly gross revenue as measured against 2019
    - 50% decline for 2020
    - 20% decline for 2021

**A governmental employer is not eligible.**
*Additional rules and limitations apply.*

## FAQS

**Q: For ERC eligibility, does the company need to calculate full-time equivalents or just the total of all full-time employees and exclude part-time employees?**

**A:** For ERC, unlike PPP, the employee threshold is determined by looking at full-time employees rather than full-time equivalents. A full-time employee in this case is defined as someone working an average 30 hours per week or 130 hours per month.

**Q: What medical benefits can we include for ERC?**

**A:** Health care costs that employers pay on behalf of their employees to provide and maintain a group health plan can be included as qualified costs for determining the credit.

**Q: Did the new law change the gross receipts test to a 20% reduction rather than a 50% reduction?**

**A:** No, the gross receipts test for the 2020 credit is still a 50% or more reduction in gross receipts when comparing a quarter in 2020 to the corresponding quarter in 2019. The 20% reduction test applies only for the 2021 credit.

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# EMPLOYEE RETENTION CREDIT (ERC) - 2020 FLOWCHART

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**Was your business partially or fully suspended due to governmental order in 2020?**
**OR**
**Did your business experience a significant decline in gross receipts equal to 50% or greater in a calendar quarter of 2020 compared with the same quarter in 2019?***

**NO** — ***Not Eligible***

**YES**

**Did your company have 100 or less Full-Time Employees in 2019? (A full time employee is defined as someone who works an avg of 30hrs per week or 130hrs per month and commonly controlled groups must aggregate)**

**NO**

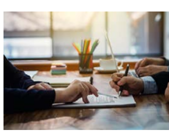
*more than 100 full-time*

**Only wages and health care costs paid to employees NOT TO PERFORM SERVICE (not to work) are eligible as qualified wages for the credit.**

**YES**

*less than 100 full-time*

**Wages and health care costs paid to all employees, including part-time employees are potentially eligible for the credit.**



**Did your company receive a PPP loan applicable to 2020 payroll?**

**NO**

**YES**

**Wages used in applying for PPP forgiveness cannot be used as qualified wages for the credit.**

**The credit will be calculated as 50% of up to a maximum of $10,000 in qualified wages and health care costs for the whole year per employee.**

**For government shutdown, the credit becomes eligible on wages and health care costs paid during that period of time the shutdown is in effect. For the gross receipts test, the eligibility of the credit extends from the first day of the first quarter in which the test is met until the first day of the quarter subsequent to the quarter in which gross receipts return to at least 80% of the comparable quarter in 2019. Additional rules apply for commonly controlled groups.*

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# EMPLOYEE RETENTION CREDIT (ERC) - 2021 FLOWCHART

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**Was your business partially or fully suspended due to governmental order in 2021?**

**OR**

**Did your business experience a significant decline in gross receipts equal to 20% or greater in a calendar quarter of 2021 compared with the same quarter in 2019?***

***(Q4 2020 can be used to determine eligibility for Q1 2021)***

**NO** — ***Not Eligible***

**YES**

**Did your company have 500 or less full-time employees in 2019? (A full-time employee is defined as someone who works an average of 30 hours per week or 130 hours per month and commonly controlled groups must aggregate)**

**NO**

*more than 500 full-time*

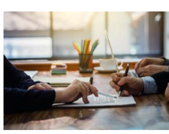
**Only wages and health care costs paid to employees NOT TO PERFORM SERVICE (not to work) are eligible as qualified wages for the credit.**

*(A 90% reduction in gross receipts enables all wages and health care costs to be eligible even if more than 500 FTEs)*

**YES**

*less than 500 full-time*

**Wages and health care costs paid to all employees, including part-time employees are potentially eligible for the credit.**



**Did your company receive a PPP loan applicable to 2021 payroll?**

**NO**

**YES**

**Wages used in applying for PPP forgiveness cannot be used as qualified wages for the credit**

**The credit will be calculated as 70% of up to a maximum of $10,000 in qualified wages and health care costs per quarter, per employee.**

**For government shutdown, the credit becomes eligible on wages and health care costs paid during that period of time the shutdown is in effect. Additional rules apply for commonly controlled groups.*

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# 2020 VS. 2021
# EMPLOYEE RETENTION CREDIT COMPARISON CHART

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| OLD LAW | NEW LAW | |
|---|---|---|
| **ELIGIBLE EMPLOYERS** | **2020** | **2021** |
| Eligible employers can receive a refundable payroll tax credit of 50% of wages paid to employees between March 13th, 2020 and December 31st, 2020. | No Change | Eligible employers can receive a refundable payroll tax credit up to 70% of qualifying wages paid between January 1, 2021 and September 30, 2021. Recovery Startup Businesses that began operations after February 15, 2020 are eligible for up to $100,000 of credits on wages paid from June 1, 2021 through December 31, 2021. |
| An eligible Employer may not receive the Employee Retention Credit if the Eligible Employer receives a Small Business Interruption Loan under the Paycheck Protection Program that is authorized under the CARES Act ("Paycheck Protection Loan"). An Eligible Employer that receives a paycheck protection loan should not claim Employee Retention Credits. | This is no longer applicable. **Employers that received a PPP loan can in fact qualify for the ERC credit.** | Employers may receive both a PPP2 loan and the Employee Retention Credit. |
| **ELIGIBLE EMPLOYERS MUST MEET THE FOLLOWING CRITERIA:** | | |
| Eligible Employers for the purposes of the Employee Retention Credit are those that carry on a trade or business during calendar year 2020, including a tax-exempt organization, that either: | | |
| Fully or partially suspends operation during any calendar quarter in 2020 due to orders from an appropriate governmental authority limiting commerce, travel, or group meetings (for commercial, social, religious, or other purposes) due to COVID-19; **or** | No Change | Eligible employers for the purpose of the Employee Retention Credit are those that carry on a trade or business duing the quarter in which the credit is determined. |
| Experiences a significant decline in gross receipts during the calendar quarter. | No Change. Requires a quarter that is less than 50% of the revenue when comparing against the same quarter in 2019 to qualify. | Employers that have revenue that is less than 80% of the revenue when comparing against the same quarter in 2019. Employers that were not in existence in 2019 would substitute 2020 for 2019 above. A reduction in Q4 2020 can qualify a company for Q1 2021. |
| **Note:** Governmental employers are not Eligible Employers for the Employee Retention Credit. Also, Self-employed individuals are not eligible for this credit for their self-employment services or earnings. | | This section does not apply to any organization described in section 501(c)(1) of the Internal Revenue Code of 1986 and exempt from tax under section 501(a) of such Code, or (B) any entity that is a college or university, or the principal purpose or function of such entity is providing medical or hospital care. |
| **DEFINITION OF QUALIFIED EMPLOYER BUSINESS** | | |
| The operation of a trade or business may be partially suspended if an appropriate governmental authority imposes restrictions upon the business operations by limiting commerce, travel, or group meetings (for commercial, social, religious, or other purposes) due to COVID-19 such that the operation can still continue to operate but not at its normal capacity, or | No Change | No Change |

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# 2020 VS. 2021

# EMPLOYEE RETENTION CREDIT COMPARISON CHART

| OLD LAW | NEW LAW | |
|---|---|---|
| **ELIGIBLE EMPLOYERS** | **2020** | **2021** |
| A significant decline in gross receipts begins with the first quarter in which an employer's gross receipts for a calendar quarter in 2020 are less than 50 percent of its gross receipts for the same calendar quarter in 2019. The significant decline in gross receipts ends with the first calendar quarter that follows the first calendar quarter for which the employer's 2020 gross receipts for the quarter are greater than 80 percent of its gross receipts for the same calendar quarter during 2019. | No Change | An employer is an eligible employer with respect to any calendar quarter for which its gross receipts for the calendar quarter are less than 80 percent of its gross receipts for the same calendar quarter in 2019. Employers that were not in existence in 2019 would substitute 2020 for 2019 above. |
| Example: A state governor issues an executive order closing all restaurants, bars, and similar establishments in the state in order to reduce the spread of COVID-19. However, the executive order allows those establishments to continue food or beverage sales to the public on a carry-out, drive-through, or delivery basis. This results in a partial suspension of the operations of the trade or business due to an order of an appropriate governmental authority with respect to any restaurants, bars, and similar establishments in the state that provided full sit-down service, a dining room, or other on-site eating facilities for customers prior to the executive order. | **No Change** | Employers may receive both a PPP2 loan and the Employee Retention Credit. |
| **ELIGIBLE EMPLOYERS MUST MEET THE FOLLOWING CRITERIA:** | | |
| Eligible Employers for the purposes of the Employee Retention Credit are those that carry on a trade or business during calendar year 2020, including a tax-exempt organization, that either: | | |
| Fully or partially suspends operation during any calendar quarter in 2020 due to orders from an appropriate governmental authority limiting commerce, travel, or group meetings (for commercial, social, religious, or other purposes) due to COVID-19; **or** | No Change | Eligible employers for the purpose of the Employee Retention Credit are those that carry on a trade or business duing the quarter in which the credit is determined. |
| Experiences a significant decline in gross receipts during the calendar quarter. | No Change. Requires a quarter that is less than 50% of the revenue when comparing against the same quarter in 2019 to qualify. | Employers that have revenue that is less than 80% of the revenue when comparing against the same quarter in 2019. Employers that were not in existence in 2019 would substitute 2020 for 2019 above. A reduction in Q4 2020 can qualify a company for Q1 2021. |
| **Note:** Governmental employers are not Eligible Employers for the Employee Retention Credit. Also, Self-employed individuals are not eligible for this credit for their self-employment services or earnings. | | This section does not apply to any organization described in section 501(c)(1) of the Internal Revenue Code of 1986 and exempt from tax under section 501(a) of such Code, or (B) any entity that is a college or university, or the principal purpose or function of such entity is providing medical or hospital care. |

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# EMPLOYEE RETENTION CREDIT (ERC) CLIENT SUCCESS STORIES

## EMPLOYEE RETENTION CREDIT (ERC) SERVICES OVERVIEW

The Employee Retention Tax Credit (ERTC) was created as part of the CARES Act to encourage businesses to continue paying employees by providing a credit to the eligible employer for wages paid to eligible employees. The refundable credit is available from March 13, 2020 through September 30, 2021.

## KBKG CLIENT SUCCESS STORIES

Trucking Company
*200+ employees*
**$1M CREDITS**

Restaurant Group
*5 restaurants*
**$750K CREDITS**

Entertainment Company
*nearly 500 employees*
**$2M+ CREDITS**

Fitness Company
*100 employees*
**$1M CREDITS**

Restaurant Group
*75 employees*
**$1M IN CREDITS**

## ERC ELIGIBILITY

For 2021, there is a maximum credit of ***$7,000 per eligible employee***, **per quarter (Q1-Q3 only)**.

For 2020, there is a maximum credit of ***$5,000 per eligible employee***.

## KBKG PROVIDES THE FOLLOWING SERVICES

- Determine if the employer qualifies, and if so, for which quarters
- Determine which employee wages qualify
- Calculate credits, including analysis of PPP interplay
- Reconcile actual credits with advance credits requested
- Prepare reconciled data for Form 941-X
- Prepare documentation supporting eligibility

KBKG has claimed an average of **$550,000** in employee retention credits per business.

**Contact us today for a free assessment.**

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# TRANSFER PRICING SERVICES

WORLD TP RECOMMENDED FIRM 2023

WORLD TP RECOMMENDED FIRM 2022

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KBKG has been named one of the world's leading transfer pricing consultancies by International Tax Review. Alex Martin is the transfer pricing practice leader for KBKG.

## HOW CAN TRANSFER PRICING HELP YOUR COMPANY?

The cross-border transfer prices of goods, royalties, services, and loans drive how much income tax a multinational company pays by country. Governments are concerned about companies shifting profits offshore, and transfer pricing audits are a high return on investment in over 100 countries worldwide.

We assist US and international companies in establishing, documenting, and defending transfer pricing practices consistent with IRS and international tax authorities' regulations.

While transfer pricing is a contentious tax issue, many US and foreign-owned companies can **generate significant tax benefits through new transfer pricing strategies**.

## WHY SHOULD COMPANIES REVIEW TRANSFER PRICING?

All companies with cross-border operations can be audited for transfer pricing issues in every country where they operate. Compliance is essential, but intercompany pricing also affects a multinational's global effective tax rate, cash flow, and tax Net Operating Loss position.

In our experience, a company's transfer pricing approach can facilitate growth opportunities or serve as an impediment to expansion. A review of transfer pricing strategies after a business restructuring or during significant market changes, including COVID-19, is a valuable exercise.

## WHAT TRANSFER PRICING SERVICES DOES KBKG PROVIDE?

- US, OECD, and Global Transfer Pricing Documentation
- "Masterfile" and "Local File" Documentation
- Documentation Report Annual Updates"
- Transfer Pricing Comparable Benchmarking
- IRS, State, and Foreign Audit Defense
- Mergers & Acquisitions, Due Diligence, and Uncertain Tax Position Reviews
- Business Restructuring
- Advance Pricing Agreements – Unilateral and Bilateral

## WHY CHOOSE KBKG?

KBKG has the expertise of the largest firms but with a focus on tax savings. With our economist-led team, we understand how the IRS and international tax authorities approach audits and help clients mitigate risks accordingly. Moreover, we implement practical transfer pricing strategies to improve company cash flow and reduce global effective tax rates.

### KBKG IS A PREFERRED PROVIDER FOR CPAS AND ATTORNEYS

We work seamlessly with our CPA and attorneys to complement tax and accounting services. Our practical approach to transfer pricing is designed to support client services provided to multinationals.

**We regularly host CPE and CLE transfer pricing webinars to give service providers the tools to identify, assess, and discuss transfer pricing issues with clients from a practical perspective.**

### WHERE DO WE START?

Alex Martin leads the KBKG transfer pricing practice. He has over 24 years of transfer pricing experience as an economist, working both in the US and internationally. We welcome your calls and correspondence to start discussions.

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# TRANSFER PRICING FOR MULTINATIONAL COMPANIES

## WHAT IS TRANSFER PRICING?

Transfer pricing rules govern the cross-border prices of goods, services, royalties, and loans charged within multinational companies. As such, transfer prices drive how much income tax is paid by a country. Transfer pricing is often a significant tax risk for multinational companies. However, many companies can optimize transfer pricing to reduce their global effective tax rate.

## WHO CAN BENEFIT FROM TRANSFER PRICING SERVICES?

Companies who qualify:

- Any US company with foreign subsidiaries.
- Any foreign-owned company with a US subsidiary.

Our focus is on Tax Savings Opportunities with the following companies:

- Profitable companies with NOLs in certain countries. Global revenues > $25M. See example 1 below.
- Multinational companies with global revenues > $50 million. See example 2 on the next page.

We also prepare U.S. and international transfer pricing documentation, documentation report updates, and benchmarking studies for all multinational companies.

## EXAMPLE 1: MULTINATIONAL COMPANY UTILIZING TAX NET OPERATING LOSSES

A profitable US parent company sells $7 million in products to its foreign subsidiary that is incurring losses. The company relies upon a “Cost-Plus” policy.

**Strategy:** After preparing a transfer pricing analysis, KBKG recommends reducing transfer pricing on cross- border inventory sales by $3M

**BEFORE TRANSFER PRICING STUDY**

**US Parent Company**
**$5 milion taxable profit @ 21%**

↓ $7 million inventory sales

**Foreign Subsidiary**
**$2 milion tax loss @ 30% rate**

**AFTER TRANSFER PRICING STUDY**

**US Parent Company**
**$2 milion taxable profit @ 21%**

↓ $4 million inventory sales

**Foreign Subsidiary**
**$1 milion taxable profit @ 30%**

| Current State Taxes Payable | Future State Taxes Payable | Annual Tax Savings |
|---|---|---|
| US - 21% x $5m = $1.05m | US – 21% x $2m = $420,000 | |
| Foreign taxes (loss) = $0 | Foreign taxes<br>30% x $1m = $300,000 | |
| **Total Taxes = $1.05 m** | **Total taxes = $720,000** | **$330,000** |

Reducing inventory transfer prices by $3 million leads to **$330,000 of annual tax savings!**

- This strategy is also applicable to foreign-owned companies with US subsidiaries.
- This strategy is also applicable for royalties and service charges.
- Reduces transfer pricing audit risk in foreign country. Tax authorities regularly challenge lossmaking subsidiaries.

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# TRANSFER PRICING FOR MULTINATIONAL COMPANIES

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## EXAMPLE 2 – OPTIMIZE TRANSFER PRICING FOR US TAX REFORM

US based C-Corp with global revenue of $50M. Historically minimized their tax footprint in the US (due to old 35% tax rate). New investments in R&D and manufacturing have justified increasing transfer prices for goods, royalties and services to subsidiaries

**Strategy:** Increase transfer prices to capitalize on lower US tax rates (21%) through tax reform. Higher transfer prices generate more deductions overseas at higher rates.

- A $1 million increase in goods, royalties and/or service charges to subsidiary in a 30% tax jurisdiction yields income tax savings of $90,000 annually ((30%-21%) x $1m)
- This strategy also applies to foreign-owned companies with US subsidiaries

Additional benefit - New incentive for C-Corp exporters, Foreign Derived Intangible Income (“FDII”):
allows some export income, including goods, royalties and services, to be taxed at a rate of 13.125%.

- Increases to transfer prices could lead to even higher tax savings: e.g. (30% - 13.125%) = **$168,750 annual savings.**

## HOW LONG DOES IT TAKE?

Our transfer pricing projects normally require 45-60 days, which depends on the availability of management for interviews. In audit situations, the timeline can be shorter.

## KBKG SERVICES & DELIVERABLES

Depending on the situation, KBKG services and deliverables can include:
- U.S., OECD, and International Transfer Pricing Documentation Study – Full Scope
  - Penalty protection document
  - Requires interviews
- Transfer Pricing Documentation Annual Updates
- Transfer Pricing Benchmark Analysis – Limited Scope
  - For lower-risk situations
  - Used to target a profit margin earned by a subsidiary company
- Transfer Pricing Planning & Consulting
- Transfer Pricing Audit Defense
- Advance Pricing Agreements

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# IC-DISC FEDERAL EXPORT TAX INCENTIVE

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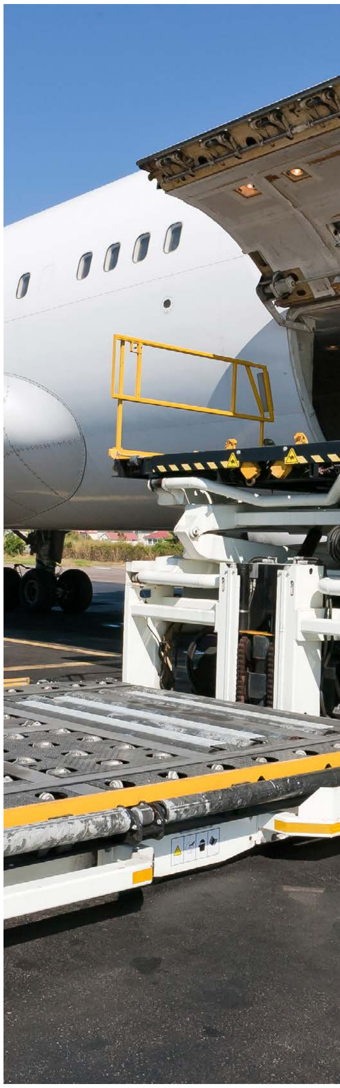
## WHAT IS THE IC-DISC FEDERAL EXPORT TAX INCENTIVE?

The Interest Charge Domestic International Sales Corporation (IC-DISC) offers significant Federal income tax savings for making or distributing US products for export. The IC-DISC was originally created by Congress to promote export sales by allowing companies to defer income, with interest charged on the deferred tax. Now, the IC-DISC provides significant and permanent tax savings for producers and distributors of U.S. made products used abroad.



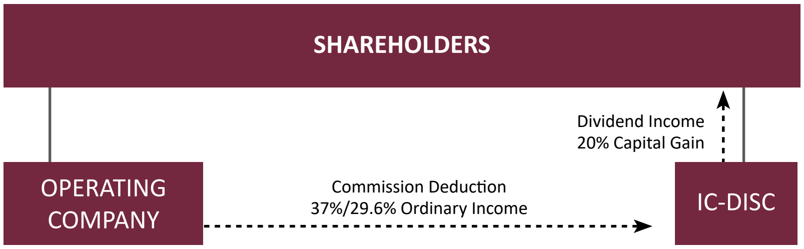
## WHO CAN BENEFIT?

IC-DISC benefits are available to qualified producers or distributors that are either directly involved in exporting or selling products to distributors or wholesalers who resell for use outside of the U.S. This includes traditional manufacturers as well as those who grow agriculture products, extract minerals, distribute U.S. made goods, and develop software. Engineering and architectural services related to foreign construction projects are also included.

## HOW DOES IT WORK?

The owner of the operating company forms a tax-exempt IC-DISC. The IC-DISC must maintain its own bank account, accounting records, and file U.S. tax returns, but otherwise, there are no changes to business operations.

- The operating company pays a tax-deductible commission to the IC-DISC, of either 4% if the operating company's gross receipts from qualified exports, or 50% of the operating company's net income from qualified exports, whichever is greater.
- The operating company expenses the commission and reduces ordinary income taxed at a maximum 37%, (or 29.6% with full QBI deduction)
- The IC-DISC is tax exempt and is not taxed on the commission income it receives from the operating company.
- The IC-DISC pays dividends to its shareholders, which are taxed at a 20% rate.
- The result yields a 17/9.6% permanent tax rate arbitrage (3.8% net investment income tax may yield different results).




**Net Effect: 17%/9.6% Rate Reduction**

## CASE STUDY

**ABC Co. has $2M in gross export sales and $500,000 in net income from those exports. It will pay a commission of $250,000 to the IC-DISC (50% of export net income).**

**Results:** ABC Co. pays $250,000 in deductible IC-DISC commissions, saving its shareholders $92,500 in tax (at a 37% tax rate). The IC-DISC pays dividends to its shareholders who pay only $50,000 in tax (using a 20% dividend rate). The net result is an annual $42,500 permanent tax reduction.

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# IC-DISC FEDERAL INCOME TAX INCENTIVE

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## WHAT?

IC-DISC Federal Income Tax Incentive for Exporters and Producers/Distributors of Products and Services used outside the U.S. Benefits can be dramatically higher by performing a transaction-by-transaction analysis.

## QUESTIONS TO ASK

- Do they produce, grow, extract, or distribute U.S. goods?
- Do they perform architectural or engineering services located outside the U.S.?
- Do they sell to businesses who then export their products outside of the U.S.?
- Is the company a closely held, privately owned business?
- Do they earn over $250,000 in exports per year?

## IDEAL CANDIDATES

- Manufacturers
- Distributors
- Architects & Engineers
- Agriculture and Food Producers
- Software Developers
- Other Producers

## TIMING

- Eligible companies can begin taking IC-DISC benefits usually in less than 24 hours
- Completed setup usually takes less than two weeks

## STUDY TIME

Completed setup usually takes less than two weeks

## PRICING

- Setup of IC-DISC typically costs $7k - $8k and Basic Yearly Calculation Work typically costs $7k -$8k
- More complex Yearly Calculation Work can vary

## TAX PLANNING

There are no changes to business operations

## EXCLUSIONS

- Companies whose products are used strictly within the U.S.
- Publicly traded companies and widely-held businesses
- Exports of Oil or Gas as well as Unprocessed Softwood Timber

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# FIXED ASSET TAX REVIEW

## WHAT IS A FIXED ASSET DEPRECIATION REVIEW

A Fixed Asset Depreciation Review evaluates a company's federal tax depreciation schedule over the last 15 years to identify assets that have been misclassified and are being written off over a longer period than necessary. The goal is to reclassify them into appropriate shorter tax lives or as a repair and maintenance expense.

## UNDERSTANDING A FIXED ASSET DEPRECIATION REVIEW

While a cost segregation study focuses on buildings and large improvements, a Fixed Asset Capitalization Review encompasses all fixed assets a company owns including real property, machinery, furniture, fixtures, and equipment. Misclassifications are generally caused due to:

- Companies using "book" lives for tax purposes
- Changes to case law and lack of in-depth knowledge needed by the taxpayer
- Lack of understanding of how assets may be interrelated
- Misapplication of the appropriate tests to determine correct treatment

A proper Fixed Asset Capitalization Review requires not only tax expertise, but also an understanding of engineering and construction concepts. Our team of engineers will visit your locations to inspect assets, identify their use and function, interview your team, and review supporting documentation.

## BENEFITS

Current laws allow for a taxpayer to correct these errors and realize any missed deductions in the current tax year. Other benefits include accurate reporting of book-tax differences and accurate tax filings.

## IDEAL CANDIDATES

While anyone can take advantage of these rules, clients that stand to benefit most have significant annual expenditures in real property improvements.

- Retail, Hotel, Supermarket, Restaurants, and Banks with more than 10 locations
- Franchise operations requiring corporate rebranding/re-imaging
- Manufacturing Operations
- Utility Companies

## THE PROCESS

Under current Revenue Procedures, the change in accounting method to reclassify previously capitalized assets or repair and maintenance expenses is considered automatic. Proper filing of the IRS Form 3115 with specific representations and documentation for each asset is needed. This change in accounting method can be filed any time before the extended tax return due date in the year of change.

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# REPAIR VS. CAPITALIZATION REVIEW

## UNDERSTANDING THE TANGIBLE PROPERTY REPAIR REGULATIONS

The IRS issued comprehensive Repair Regulations regarding the deduction and capitalization of expenditures related to tangible property also known as the "Repair Regulations." The rules are applicable to businesses in all industries that acquire, produce, replace or improve tangible property. In most cases, these regulations present an opportunity for taxpayers to claim missed deductions, especially if buildings, owned or leased, have been renovated or improved. Even if a cost segregation study has already been performed, taxpayers should have those costs re-analyzed by an expert in this area. Application of the new Repair Regulations requires an in-depth understanding of various tax cases, regulations, and circumstances that must be met.

IRS procedures allow you to apply these rules retroactively and claim any missed deductions using IRS Form 3115. Correcting these errors is considered an Automatic Change of Accounting Method and does not require amending any returns.

## WHO CAN BENEFIT?

**Taxpayers that acquire, renovate or improve real estate.**
Generally, anyone that has incurred significant costs for renovations to their existing real property in the last 20 years is an ideal candidate. These rules are particularly beneficial when the original improvements are placed in service for one year before renovations occur. KBKG recommends a detailed review if $350,000 or more is spent on renovations.

## SIGNIFICANT CHANGES

**Whether building expenditures are capital improvements or repair expenses.** The IRS outlines numerous subjective factors that must be considered when deciding if the building expenditure is an improvement or a repair expense. KBKG engineers will help you determine when it's appropriate to expense things such as windows, roofs, HVAC, plumbing and electrical based on your unique situation.

**Write-off structural components of buildings when retired or demolished.** Structural components of a building include items with a long tax life (generally 39, 27.5 or 15 years) such as lighting, roofs, HVAC systems, interior and exterior walls, etc. The new regulations allow you to assign a value to those items and write them off when replaced.

> **Example:** ABC Corp acquires an office building for $5M. Five years later they spend $1M to remodel the second floor. An Asset Retirement Study identifies $450,000 of 39-year life items that were removed during the remodel. This might include lighting, drywall, doors, floor coverings, acoustic ceilings, etc.
>
> **Results: $400,477 of additional deductions on current year return.**

**"Plan of Rehabilitation Doctrine" is now obsolete!** Under the old rules, you had to capitalize any routine repair work that was performed at the same time as other major improvements. If you did not expense repair work done in the past under the old rules, you are now able to claim those missed deductions without amending tax returns.

> **Example:** Client capitalized $4M of "renovation" costs to their building four years ago. KBKG engineers find that $300,000 was incurred to replace certain windows, asphalt patchwork, painting, roof tiles, some plumbing fixtures and one HVAC unit. KBKG determines all these costs are repair expenses.
>
> **Results: Filing Form 3115 and claiming an additional $266,985 of deductions on current year return.**

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# REPAIR VS. CAPITALIZATION & ASSET RETIREMENT STUDIES

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## WHAT TO LOOK FOR?

For clients that have owned property for more than a year, and then renovate or replace parts of the building. This can include things such as HVAC, roofing, ceilings, drywall, ceramic floor tile, building lighting, and more.

KBKG performs a detailed review of building expenditures to appropriately classify them as a repair expense or as a capitalized asset. If expenditures do not qualify as a repair expense, the old building components being replaced or removed can be "retired" and written off for tax purposes.

## QUESTIONS TO ASK

- Have you undertaken a major renovation or repairs on your property?
- How much did you spend on renovations or repairs? What year were they done?
- How much depreciable tax basis is in the original property being renovated?
- How long did you own or lease the property prior to undertaking the renovation or repair work?
- Do you have a schedule of costs including descriptions of the items repaired or replaced?
- What type of work did you perform?
    - Replace rooftop air conditioning units? How many? What kind of HVAC system is it?
    - Replace roof or part of roof?
    - Was the purpose of the construction to give the building a "facelift"
    - Was it a complete gut and renovate project?
    - Replace any plumbing fixtures or electrical? Please describe?
    - Replace any windows? How many replaced?
    - Were any repairs done to the property?
    - Was the building expanded?

## IDEAL CANDIDATES

- Any renovations > $400K in last 15 years
- Retail, hotels, banks, restaurants
- Manufacturing
- Commercial & Multifamily property owners

## POOR CANDIDATES

- Repair or renovation spend less than $250,000
- Buildings acquired with the intent to immediately renovate
- Renovations that occur shortly after building purchase (generally less than a year)

## TIMING

- Retirements: Closing window to change prior year missed retirements
- Repairs: Can correct any prior year by filing Form 3115 with tax return

## STUDY TIME

Studies take up to 30-60 days from date of receipt of all pertinent project data

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# REPAIR VS. CAPITALIZATION & ASSET RETIREMENT STUDIES

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## BENEFIT TO THE CLIENT

- Claim immediate deductions that would normally depreciate over 39 years
- Avoid recapture on all items that are now retired or expensed
- Benefits are in addition to any benefit received under a cost segregation study

## PRICING

- Preliminary Review to estimate tax benefit – No charge
- Formal Study Fee Range generally $5k - $20k and can be higher depending on the extent of renovations

## ITEMS TO REQUEST

- Schedule of repair or renovation expenditures
- Prior year's depreciation schedules

## QUESTION TO ASK

Have they filed a method change for Repairs in the past?

## PROJECT EXAMPLES

**Example:** KBKG Client acquired a 3-story office building in 2012 for $5M. In 2017 they spent $1M to remodel the 2nd floor (ceilings, walls, lighting, plumbing, ducting, electrical wiring, etc)

- KBKG did a cost segregation study on the original building and the $1M remodel
- For the 2017 tax return, KBKG performs a Repair vs. Capitalization review to identify everything that was removed from the original 2012 acquired building
- KBKG's engineer identifies an additional $450k (from the original $5M building) of 39-year items that were removed during the 2017 renovation
- Client claims $380,772 of additional deductions on the 2017 tax return (450,000 less previous depreciation of $69,228)

**Example:** KBKG client spends $4M on renovation costs to their building in 2016. All costs were capitalized and depreciated

- For the 2017 tax return, KBKG reviews costs and finds that $300,000 of these costs should be repair expenses
- Client claims an additional $292,307 on their 2017 return ($300,000 less depreciation of $7,692)

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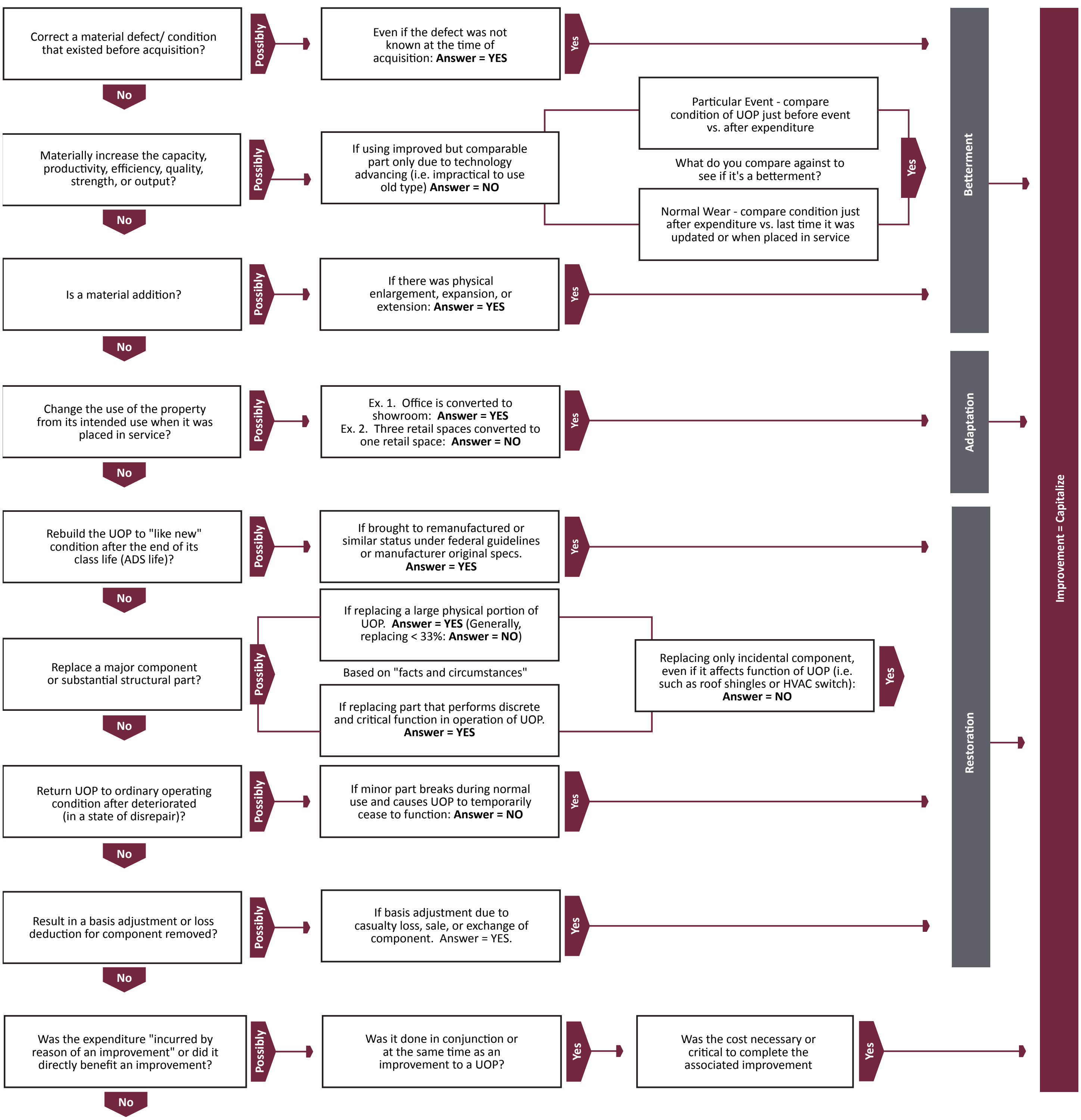
# KBKG REPAIR VS. CAPITALIZATION:
## IMPROVEMENT DECISION TREE - FINAL REGULATIONS

Considering the appropriate Unit of Property (UOP), does the expenditure: (Last Updated 3-20-2015)




**Possible Repair Expense**

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# KBKG BUILDING UNIT OF PROPERTY & MAJOR COMPONENTS CHART

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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

| BUILDING STRUCTURE | LAND IMPROVEMENTS | HVAC SYSTEM | ELECTRICAL SYSTEM | PLUMBING SYSTEMS |
|---|---|---|---|---|
| • Roof system (membrane, insulation and structural supports)<br>• Foundation<br>• Other structural load-bearing elements, including stairs<br>• Exterior wall system<br>• Ceilings<br>• Floors<br>• Doors<br>• Windows<br>• Partitions<br>• Loading docks | • Landscaping (shrubs, trees, ground cover, lawn, irrigation)<br>• Storm drainage (inlets, catch basins, piping, lift stations)<br>• Site lighting (pole lights, bollard lights, up lights, wiring)<br>• Hardscape (retaining walls, pools, water features)<br>• Site structures (gazebos, carports, monument signs)<br>• Paving (roads, driveway, parking areas, sidewalks, curbing) | • Heating system (boilers, furnaces, radiators)<br>• Cooling system (compressors, chillers, cooling towers)<br>• Rooftop packaged units<br>• Air distribution (ducts, fans, etc.)<br>• Piping (heated, chilled, condensate water) | • Service and distribution (panel boards, transformers, switchgear, metering)<br>• Lighting (interior and exterior building mounted)<br>• Site electrical utilities<br>• Branch wiring (outlets, conduit, wire, devices etc.)<br>• Emergency power systems | • Plumbing fixtures (sinks, toilets, tubs etc.)<br>• Wastewater systems (drains, waste and vent piping)<br>• Domestic water (supply piping and fittings)<br>• Water heaters<br>• Site piping utilities |
| **FIRE PROTECTION SYSTEM** | **SECURITY SYSTEM** | **GAS DISTRIBUTION SYSTEM** | **ESCALATORS** | **ELEVATORS** |
| • Sprinkler systems (piping, heads, pumps)<br>• Fire alarms (detection and warning devices, controls)<br>• Exit lighting and signage<br>• Fire escapes<br>• Extinguishers and hoses | • Building security alarms<br>• (detectors, sirens, wiring)<br>• Building access and control systems | • Gas piping including to/from property line and other buildings | • Stairs and handrails<br>• Drive systems (motors, truss, tracks) | • Elevator cars<br>• Drive systems (motors, lifts, controls)<br>• Suspension systems (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 taxpayer's particular facts

**Definitions**

**Plant Property**: Machinery and 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 and gas pipelines, water and sewage pipelines, power transmission and distribution lines, telephone and 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 its size, cost, or significance.