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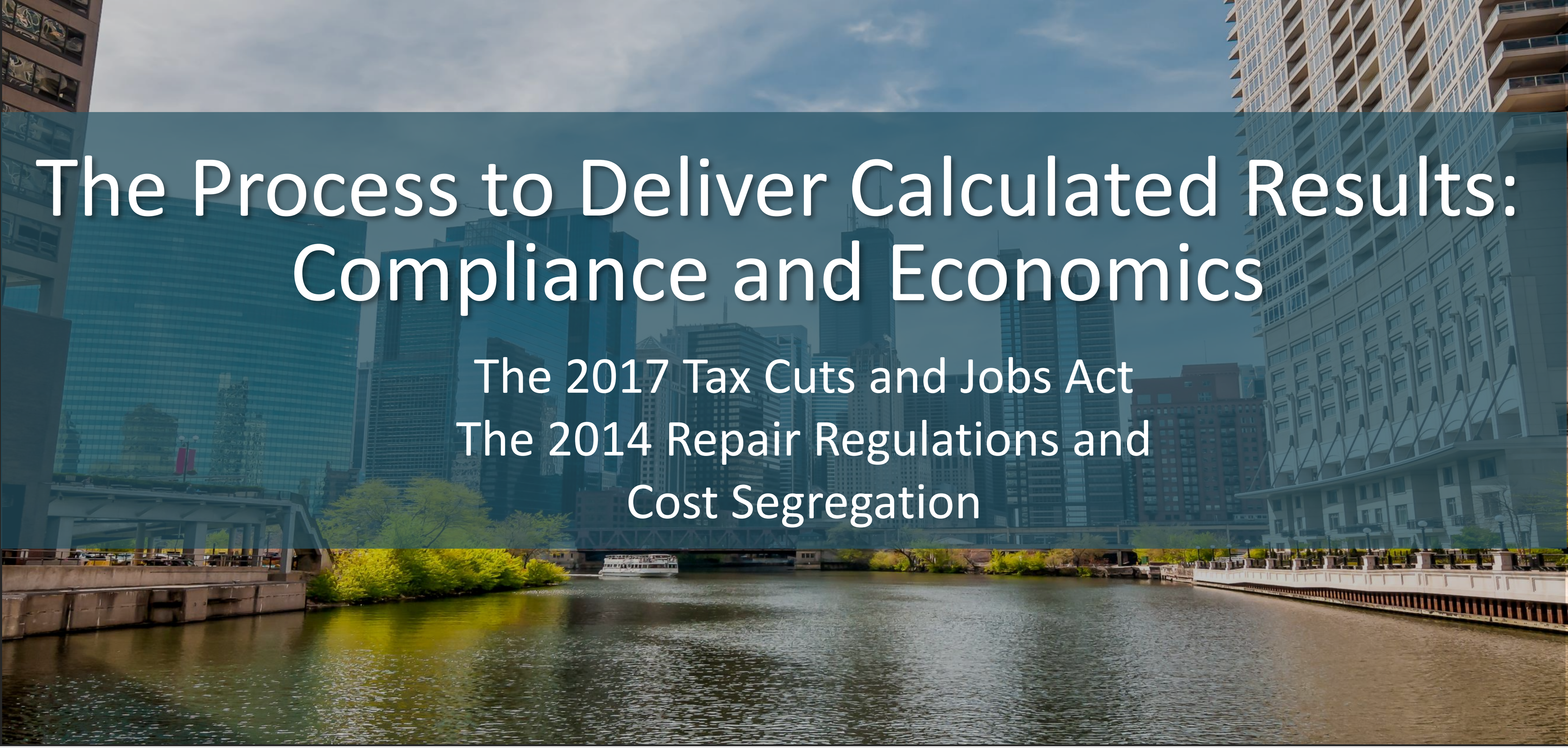
The Process to Deliver Calculated Results: Compliance and Economics

The 2017 Tax Cuts and Jobs Act
The 2014 Repair Regulations and Cost Segregation



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Discussion Points

How are these related? It's in the calculations which must be coordinated for the tax return.

- The 2014 Repair Regulations
- The 2017 Tax Cuts and Jobs Act
- Qualified Improvement Property (QIP)
- Cost Segregation
- Application Documents

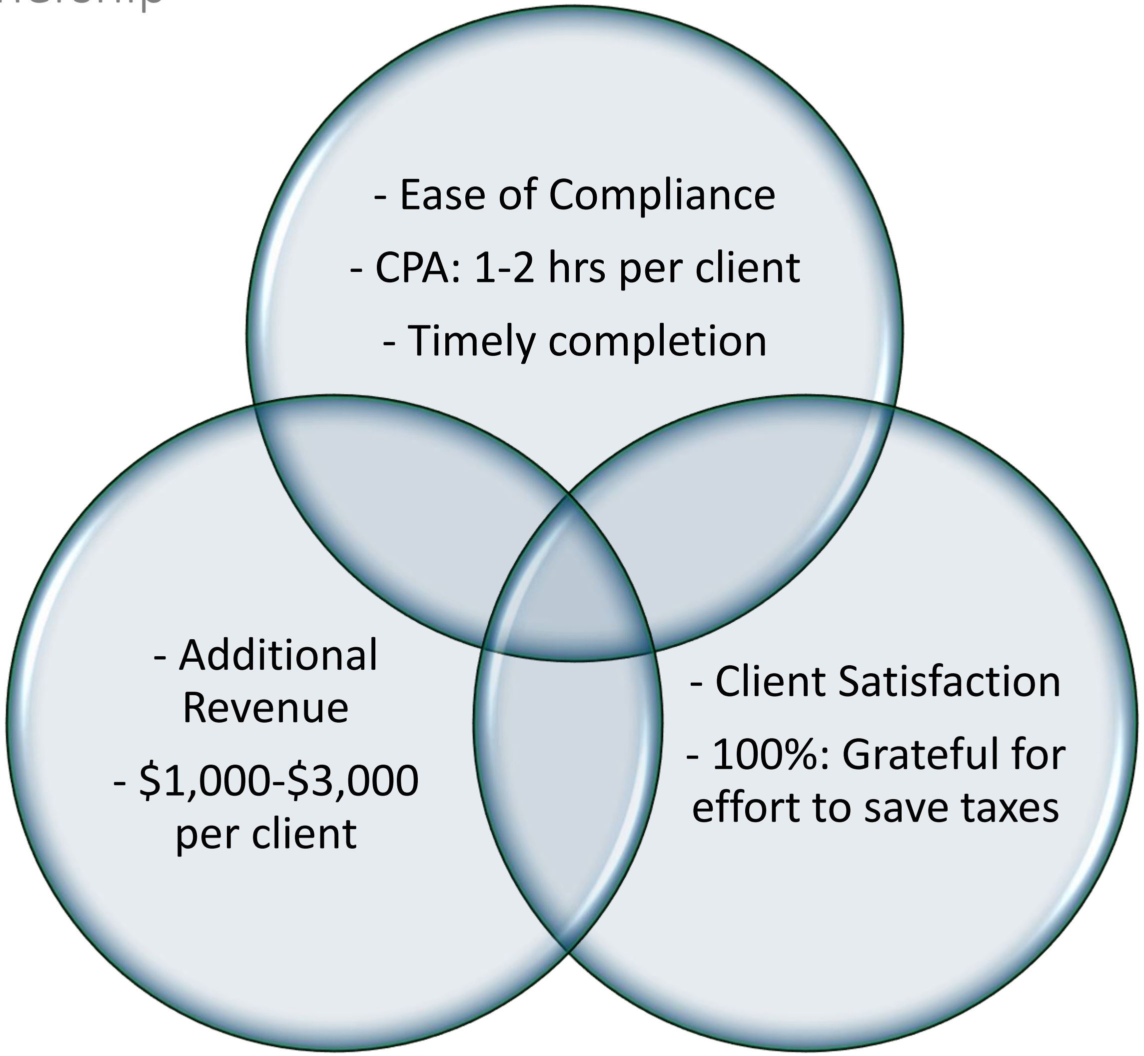
How do you apply these calculations to a tax return?

What is its impact?

How do we get it done?

Expected Results of Our Process

A Beneficial Partnership



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The 2014 Repair Regulations

How to Determine the Impact on your clients

- Steps to the solution… it’s easy.
  - Step 1: Analyze the economic impact of the 2014 Repair Regulations
    - Are your clients compliant?
    - Do your clients have a basic understanding of expense versus capitalization?
    - Are your clients aware of their potential tax savings?
  - Step 2: Predict the impact of the regulations for your client’s property portfolio
  - Step 3: CSSI provides the calculations of the repair regulations for your client’s tax record
    - Provides for compliance
    - Provides economic benefits

The 2014 Repair Regulations for Your Client

Why?

- Affects the accounting for the assets of every commercial property owner in America.
- Changes capitalization versus expense decisions for assets (buildings) currently in service
  - How does this affect your client?
  - What do you need to do for your client?
  - Do your clients understand the basics?
- This is a compliance issue, i.e. it is a legal issue.
- This is an economic opportunity, i.e. it is your client's money.

Are You Aware of the 2014 Repair Regulations?

Its Impact

- How are you accounting for expenditures?
  - The expense vs. capital decision
- How do you account for the removal of an asset?
  - The partial asset disposition decision
- What did you do historically that was capitalized and now can be considered expensed?
  - The reversal from capital to expense decision.

The 2014 Repair Regulations: Expense or Capitalize?

The Decision

- Why were the 2014 Tangible Property Regulations issued?
- US Courts have outlined how to treat improvements or repairs on commercial buildings as items you must either:
  - CAPITALIZE: and carry on a depreciation schedule
  - EXPENSE: allowed to expense in the year of the expenditure
- The 2014 Repair Regulations define the elements outlined in those procedures.

The 2014 Repair Regulations: Application Documents

What You Need to Know to be in Compliance

- REV-PROC 2015-20
  - February 13, 2015: IRS issues RP 2015-20 that modified Rev. Proc. 2015-14 to permit a small business taxpayer, (defined as a business with total assets of less than $10 million or average annual gross receipts of $10 million) to automatically (deemed) opt into the regulations without the filing of a Form 3115.
  - RP 2015-20 is written for non-profits and taxpayers with N.O.L.'s or passive activities to reduce paperwork for Tax Professionals.
  - Just because a 3115 was not sent to the IRS, doesn't mean a change of accounting is not on file with the IRS. Which means the regulations cannot be ignored. Under section 481a, depreciation schedules still must be scrubbed and the regulations followed.

The 2014 Repair Regulations: Expense Decision

Annual Safe Harbors Summary… The Rules… The Calculations

- The final TPRs adopted an overall, revised, and simplified de minimis safe harbor (DMSH) under Reg. §1.263(a)-1(f) to $2,500 for a non AFS and $5,000 for an AFS.
- Extended the safe harbor for routine maintenance (RMSH) under Reg. §1.263(a)-3(i) to buildings. Routine and recurring amounts paid to keep a building in its ordinary and efficient working condition may be treated as repairs. The taxpayer must reasonably expect to perform the activity more than once during 10-year period beginning with the placed in service date. Consider the recurring nature of the activity, taxpayer's experience, manufacturer recommendations, and industry practice. Use of safe harbor constitutes a method of accounting
- The final TPRs added a safe harbor for small taxpayers (SHST) under §1.263(a)-3. A taxpayer may elect not to capitalize improvements or repairs to an eligible building property if the total amount paid during the taxable year for repairs, maintenance, improvements, and similar activities performed on the eligible building property does not exceed the lesser of 2% of the unadjusted basis of the eligible building property; or $10,000.

The 2014 Repair Regulations: Rules for Expense

The Expense Decision

- Must expense if
  - The expenditure does not materially increase capacity, productivity, efficiency, strength, quality, or improve output of the building system, structural component, or Building (Unit of Property).
- A repair keeps the building, the building structure, the building system, and all subcomponents that serve a major and critical function in ordinary and efficient operating condition.

The 2014 Repair Regulations: Rules for Capital

The Capital Decision

- Must capitalize if:
  - RABI
    - Restoration: if the expenditure occurred less than two years after owning the building
    - Adaptation: if the expenditure changed the original intent and function of the building
    - Betterment: the expenditure materially increases the capacity, productivity, efficiency, strength, quality, or improves the output of the building system, structural component, or any component that serves a major and critical function
    - Improvement: the expenditure modifies a major portion (greater than 33%) of the building, building structure, or building component that serves a major and critical function
  - Major Expenditure: Capitalized if more than 30%-35% of the replacement cost of the building system, structural component, or unit of property.
- A capital expenditure is generally considered to be a more permanent, increment in the longevity, utility, or worth of the property.

The 2014 Repair Regulations: Capital Assets Disposed

The Partial Asset Disposition Decision

- The ability to write off assets that are no longer in use due to
  - Renovations/Remodels/Replacements
  - Abandoned in Place
  - Common Items – Roofs, HVAC, Electrical
  - Retirement of a structural component of, or improvement to a building
  - LED Retrofit Projects – energy savings and tax savings
- Partial Asset Dispositions must be taken in the same year as the renovation
- Removal costs are not required to be capitalized if a PAD is employed.

The 2014 Repair Regulations: Calculation Results

Partial Asset Disposition (PAD) Example

Auto Dealership Renovation Tax Savings			
	Original Building	**Demolition**	**Renovation**
Cash Flow	$134,718	$53,297	$126,243
Total Tax Savings		**$314,240**	

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The 2014 Repair Regulations: Changing Historical Capital

Capital Reversal to Expense Decision

- The regulations allow you to go back to your depreciation schedule—and your repair costs—for all prior years and ask one key question:
  - “Under the new regulations, would these expenditures have to be capitalized or could they be expensed?”
- Look back at items you have capitalized since you owned the building, and if they fail the RABI tests, expense them in the current tax year.
- This creates economic opportunities: cash flow!
- Let CSSI calculate and implement this for you.

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The 2014 Repair Regulations: Example

Capital Reversal to Expense Decision

A CSSI Case Study

- Multi-story Apartment Complex
  - Purchased in 1993
  - Cost $1.1 Million
  - Improvements over years:
    - $4M, $160K, $2.7M, $70K, $26K, $900K
- Created -481(a) adjustments of $1,387,016 at 40% tax rate
- Resulted in client tax savings of $554,000

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The 2014 Repair Regulations: Example

Capital Reversal to Expense Decision

A CSSI Case Study

- Office Building converted to Hotel
  - 11-story
  - Purchased in 2000
  - Cost $1.6 Million
  - Improvements over years
    - $10M, $1.2M, $41K, $30K
- Created -481(a) adjustments of $3,138,017 at 34% tax rate
- Resulted in client tax savings of $1,100,000

Building Systems: Basis for Calculating Ratio Test

Each building or leased space is a single unit of property.

Each of the following structural components including the following components constitutes a building system that is a subset of the unit of property. The RABI rules must be followed and compared to the building system or affected component within that serves a critical and major function within each building system.

- (1) Heating, ventilation, and air conditioning ("HVAC") systems
- (2) Plumbing systems
- (3) Electrical systems
- (4) All escalators
- (5) All elevators
- (6) Fire-protection and alarm systems
- (7) Security systems for the protection of the building and its occupants
- (8) Gas distribution system
- (9) Or within the building systems or building structure, any item that performs a major and discrete function, i.e. doors, windows, toilets, cabinetry, lighting fixtures etc.

The 2014 Repair Regulations: Building Systems Ratio Test

The Capital vs. Expense Decision Example Calculations

Building Structure		
Structural Components	$	559,508.38
Roofing Systems	$	66,975.93
Foundations	$	234,535.89
HVAC	$	179,747.78
Electrical	$	242,472.40
Plumbing	$	68,844.81
Masonry	$	40,657.35
Doors & Windows	$	17,063.50
Insulation	$	43,168.87
Gas Distribution	$	4,989.84
Drywall	$	13,092.14
Painting	$	23,796.64
Fire Protection & Alarm	$	15,192.82
Gutters & Downspouts	$	12,335.58

Site Work / Improvements		
Water Well	$	19,318.45
Site Drainage	$	48,990.57
Parking Lot	$	138,639.38
Exterior Signage Structure	$	17,790.84
Parking Lot Striping / Barriers	$	23,325.00
Sidewalks	$	711.12
Landscaping	$	68,635.17
Security Lighting Poles	$	6,374.77
Aggregate Base Paved Area	$	192,436.06
Exterior Fencing / Decking	$	31,986.93
Retaining Walls	$	16,024.07
Fabricated Steel - Bollards	$	2,926.12
Patio Concrete	$	10,848.65
Exterior Wood Trellis Systems	$	2,783.73
Gazebo	$	4,605.26

- EXP/CAP TEST - Client spends $28,000 on repairing the roof.
- TPR ratio test is 30-35% (40% for roof).
- 28,000/66,975 = 42%.
- TPRs say CAPITALIZE.

- Spend $70,000 on electrical rewire.
- Ratio test is 30-35%
- 70,000/242,472 = 29%.
- TPRs say EXPENSE.

Building Components		
Cabinets / Millwork	$	20,085.41
Moldings	$	8,286.30
Wood Paneling	$	2,062.22
Flooring - Vinyl Tile	$	519.68
Flooring - Carpet	$	9,084.00
Window Treatments	$	187.90
Air Curtain	$	1,709.08
Building Signage	$	122.56
Specialty Electrical - Kitchen Equip.	$	15,216.78
Communication / Data	$	32,356.35
Specialty Plumbing - Cooler Equip. / Kitchen Sinks	$	10,181.63
Security / Exterior Lighting	$	9,827.88
FRP Wall Panels	$	1,003.24
Rear Entry Canopy	$	20,084.92
Interior Overhead Doors - Security	$	21,931.82
Slatwall / Pegboard Paneling	$	9,657.00
Surveillance System	$	4,375.25
Interior Wood Trellis Systems	$	6,046.21
Liner Panels	$	109,271.70
Paging System	$	1,688.23
Windmill	$	17,244.53
Exhaust Hood	$	11,258.61
Fire Extinguishers	$	1,833.25
Cooler	$	10,635.63
Movable Storage Units	$	30,431.69

Building Systems: Updated Value using Producer Price Index

The study calculations for a CPA to make decisions for clients.

Building Components	Depreciable Cost	Current Replacement Cost
Ceiling Systems	$174,272.97	$271,655.41
Doors and Frames	$183,566.64	$286,142.31
Electrical	$507,935.61	$791,766.25
Elevators	$82,050.82	$127,900.21
Fire Protection & Alarm	$244,652.21	$381,362.05
HVAC	$308,255.67	$480,506.65
Interior Framing/Partitions	$460,706.52	$718,145.89
Miscellaneous Building Components	$2,914,064.09	$4,542,421.42
Painting	$85,818.04	$133,772.52
Plumbing	$507,881.40	$791,681.75
Roofing Systems	$85,246.26	$132,881.14
Security	$37,199.10	$57,985.68
Windows	$203,239.82	$316,808.72
Total Building Cost:	**$5,794,889.10**	**$9,033,030.00**

The building structure consists of the building and its structural components including exterior doors, windows, roof , foundation, etc.

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Good News: 2017 Tax Cuts and Jobs Act: The Conditions

More Deductions for Building Owners

- 100% Bonus Depreciation for properties purchased or built after September 27, 2017
  - New purchase, new construction, addition, or renovation
- Section 179 now has a $1,000,000 limit. The assets however must have a depreciable life of less than 20 years… Thus,
  - Cost Segregation Studies identify 5-, 7-, & 15-year assets.
  - Leasehold improvements under QIP are 15 years and qualify for Bonus (CARES Act).
  - Cost segregate leasehold improvements to take advantage of §179 deductions

2017 Tax Act: Example of Difference

Bonus Depreciation Tax Savings

$8M Self Storage Facility Purchased in November 2017	
Deductions:	
Straight-line	$26,000
Accelerated	$154,000
Bonus	$700,000

$26,000 vs $700,000

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2017 Tax Act: Qualified Improvement Property (QIP)

Congressional Oversight: Good News for Taxpayers

- As a result, as part of the Tax Cuts and Jobs Act, in an attempt to streamline the depreciation of leasehold improvements, after January 1, 2018, the only category will be qualified improvement property (QIP).
- Section 168 was amended to eliminate any reference to qualified leasehold, restaurant, and retail improvements. Instead, the definition of qualified improvement property was moved from Section 168(k) -- the bonus depreciation subsection -- to Section 168(e)(6) -- the "classification of property" subsection.
- The 2020 CARES ACT provides a 15-year depreciation life to a qualified improvement property which makes it available for 100% bonus Depreciation.
- Retroactively apply bonus depreciation to Qualified Improvement Property.
    1. Amended return or amended partnership return 1065 or
    2. Change in Method of Accounting with Form 3115
        - DCN 244 – Change QIP Calculation

QIP Example

Cost Segregation Study on a $202K Building Renovation

Total Building Cost	$	202,323.85
Building Components: 5 year	$	57,951.47
% of Building Cost		28.6%
Building Structure: 39 year	$	17,211.64
% of Building Cost		8.5%
Building Structure: 15 year - QIP	$	127,160.74
% of Building Cost		62.9%

QIP Example

Cost Segregation Study on a $202K Building Renovation

Property Category	Cost	5 Year	39 Year	15 year QIP
Building Components				
Cabinets / Millwork	$ 8,435.25	$ 8,435.25		
Moldings	$ 1,835.71	$ 1,835.71		
Flooring - Carpet	$ 29,165.06	$ 29,165.06		
Wall Coverings	$ 1,195.00	$ 1,195.00		
Specialty Electrical - Appliances	$ 488.48	$ 488.48		
Communication / Data	$ 14,408.07	$ 14,408.07		
Specialty Plumbing - Break Sinks	$ 755.64	$ 755.64		
Interior Windows	$ 1,668.26	$ 1,668.26		
Building Structure				
Site Utilities	$ 17,211.64		$ 17,211.64	
HVAC - QIP	$ 37,181.95			$ 37,181.95
Electrical - QIP	$ 38,749.65			$ 38,749.65
Fire Protection & Alarm - QIP	$ 7,163.94			$ 7,163.94
Doors & Frames - QIP	$ 7,590.86			$ 7,590.86
Ceiling Systems - QIP	$ 7,644.37			$ 7,644.37
Interior Framing / Partitions - QIP	$ 19,826.60			$ 19,826.60
Painting - QIP	$ 8,173.46			$ 8,173.46
Emergency Lighting - QIP	$ 829.91			$ 829.91
Total Building Cost	$ 202,323.85	$ 57,951.47	$ 17,211.64	$ 127,160.74
% of Building Cost		28.6%	8.5%	62.9%

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QIP Example

Actual Savings Overview from a Cost Segregation Study Including Bonus Depreciation

Building Cost	$	3,075,000
Date Acquired:		December 2020
Tax Year:		**2021**
Current Method		
Accumulated Depreciation Reported		
39 year straight line method	$	82,133
Alternative Method		
Cost Segregation Study Accumulated Depreciation		
100% Bonus	$	645,750
5 yr.	$	-
15 yr.	$	-
39 yr.	$	64,885
Total	$	710,635
Results for Tax Year:		**2021**
Increased Accumulated Depreciation Expense	$	628,502
Tax Rate (Estimated)		37.0%
Estimated Accumulated Tax Savings Benefit	**$**	**232,546**

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Calculations are Combined: Latest Developments

Good News

- What's new that I need to know about?
  - The 2017 Tax Cuts and Jobs Act
- How does it all fit together?
- CARES Act Changes and Opportunities
  - QIP eligible for Bonus
  - Five Year NOL Carryback for 2018-2020

The Calculations: Cost Segregation “Certain Method”

Combine Calculations for a Compliance Solution

- Provides the calculations to incorporate cost segregation asset tax lives, 2014 repair regulations, QIP, Tax Cuts and 2017 Jobs Act for accounting compliance. Method for the input calculations to the Repair Regulations
- Method for the calculation for tax savings from 2017 Tax Cuts and Jobs Act and the CARES Act – Five Year NOL Carryback for a refund
- The process of analyzing and identifying commercial building components that are eligible for accelerated depreciation providing a significant tax benefit for the taxpayer.
- U.S. tax code refers to this as the “certain method”

Cost Segregation: Continues to Provide Catch Up

Clients who purchased property prior to 2017 Tax Act

Actual Savings Generated by Cost Segregation Studies			
Facility Type	**Total Property Cost**	**First Year Cash Flow from Tax Savings**	**Five Year Cash Flow or 100% bonus/first year**
Funeral Home	$562,550	$19,699	$37,239
Medical Facility	$663,000	$6,962	$36,124
Leasehold Improvements	$1,400,000	$53,751	$131,569
Office Park	$1,712,000	$98,222	$125,471
Self Storage	$2,730,000	$41,418	$219,450
Assisted Living	$7,400,000	$323,673	$605,133
Hotel	$8,389,000	$692,183	$973,836

The Calculations: It’s a process. Let’s get started.

Workflow for 481(a) adjustment in Change in Accounting Form 3115

STEP 1

ALLOW CSSI TO ANALYZE DEPRECIATION SCHEDULES

Send CSSI all fixed asset schedules. CSSI will illustrate estimated tax savings for client at no cost.

STEP 2

REVIEW WITH CLIENT: COMPARE ANALYSIS TO CLIENTS TAX SITUATION

Will the additional depreciation offset an existing tax liability?
Is the tax savings substantial to the client?

STEP 3

CSSI STUDY RESULTS

If yes, engage CSSI to perform CSSI study.

STEP 4

POPULATE THE 3115

If needed apply Change in Accounting Form 3115 for 481(a) adjustment to tax schedule.

STEP 5

ATTACH ORIGINAL TO TIMELY FILED RETURN

Attach 3115 to timely filed tax return.
Internal Revenue Service
201 West Rivercenter Blvd.
PIN Team Mail Stop 97
Covington, KY 41011-1424

The Calculations: The Tax Return

Tax Form 4562: 481(a) Adjustment… the numbers.

Part II **Special Depreciation Allowance and Other Depreciation** (Don't include listed property.) (See instructions.)

14	Special depreciation allowance for qualified property (other than listed property) placed in service during the tax year (see instructions)	14	
15	Property subject to section 168(f)(1) election	15	
16	Other depreciation (including ACRS)	16	

Part III **MACRS Depreciation** (Don't include listed property.) (See instructions.)

Section A

17	MACRS deductions for assets placed in service in tax years beginning before 2016	17	
18	If you are electing to group any assets placed in service during the tax year into one or more general asset accounts, check here ► ☐		

Section B – Assets Placed in Service During 2016 Tax Year Using the General Depreciation System

(a) Classification of property	(b) Month and year placed in service	(c) Basis for depreciation (business/investment use only — see instructions)	(d) Recovery period	(e) Convention	(f) Method	(g) Depreciation deduction
19a 3-year property						
b 5-year property		611,753.	5	MQ	200DB	20,392.
c 7-year property		32,553.	7	MQ	200DB	775.
d 10-year property						
e 15-year property		371,592.	15	MQ	150DB	3,097.
f 20-year property						
g 25-year property			25 yrs		S/L	
h Residential rental property			27.5 yrs	MM	S/L	
			27.5 yrs	MM	S/L	
i Nonresidential real property	11/23/16	2,266,860.	39 yrs	MM	S/L	7,277.
				MM	S/L	

Section C – Assets Placed in Service During 2016 Tax Year Using the Alternative Depreciation System

20a Class life					S/L	
b 12-year			12 yrs		S/L	
c 40-year			40 yrs	MM	S/L	

Part IV **Summary** (See instructions.)

21	Listed property. Enter amount from line 28	21	
22	**Total.** Add amounts from line 12, lines 14 through 17, lines 19 and 20 in column (g), and line 21. Enter here and on the appropriate lines of your return. Partnerships and S corporations — see instructions	22	31,541.
23	For assets shown above and placed in service during the current year, enter the portion of the basis attributable to section 263A costs	23	

BAA For Paperwork Reduction Act Notice, see separate instructions. FDIZ0812L 01/24/17 Form **4562** (2016)

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You Need a Calculation Expert. Who is CSSI?

And how did we become the Repair Reg, Tax Act, and Cost Segregation calculation company?

- We are the nation's premier engineering-based cost segregation firm.
- Performing engineering-based studies for over 16 years
- 25,000+ studies performed in all 50 states
- Cost Segregation Studies
- Application of 2014 Repair Regulations
  - Consulting for Spending Analysis for Capital or Expense Decision
  - Partial Disposition Study
  - Building Systems Definition Study
  - Capital Reversal To Expense Study

We are the calculation resource to help you become compliant

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How to Get Started: It’s Easy

Contact us for a no cost, predictive analysis.

- For the most accurate analysis, provide your client’s tax depreciation schedule. We will give you a no-cost predictive analysis of your client’s tax savings including:
  - Economic benefits
  - Cost of the study
- Turnkey coordination to satisfy the Repair Regulations and the Tax Cuts and Jobs Act
- We will coordinate all activity with each CPA for each client.

Let’s get started…

Bring your clients into compliance with economic results!

The Repair Regulations: Discussions Become Calculated

The reading material needs a process to convert to a calculation.

- §263(a)(3) 1-3
- RP 2013-56
- RP 2014-16
- RP 2015-20
- RP 87-56
- 9363
- Treasury Decision 97
- §168
- Publication 946

Let’s Get Started. Thank you for attending.

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