

# Federal Tax Strategies — Cost Segregation, Qualified Improvement Property and Research and Development Credits

Presented by: Mathew Abraham and Jared Woiwode

WEALTH ADVISORY | OUTSOURCING | AUDIT, TAX, AND CONSULTING

Investment advisory services are offered through CliftonLarsonAllen Wealth Advisors, LLC, an SEC-registered investment advisor



Create Opportunities

# Disclaimers

*The information contained herein is general in nature and is not intended, and should not be construed, as legal, accounting, or tax advice or opinion provided by CliftonLarsonAllen LLP to the user. The user also is cautioned that this material may not be applicable to, or suitable for, the user's specific circumstances or needs, and may require consideration of non-tax and other tax factors if any action is to be contemplated. The user should contact his or her CliftonLarsonAllen LLP or other tax professional prior to taking any action based upon this information. CliftonLarsonAllen LLP assumes no obligation to inform the user of any changes in tax laws or other factors that could affect the information contained herein.*





# Research & Development (R&D) Tax Credit

WEALTH ADVISORY | OUTSOURCING | AUDIT, TAX, AND CONSULTING

Investment advisory services are offered through CliftonLarsonAllen Wealth Advisors, LLC, an SEC-registered investment advisor

# R&D Tax Credit – Background

- Tax incentive introduced in 1981 by the U.S. Government
- Applicable to C corporations, S corporations, LLCs, partnerships, sole proprietorships & JVs
- Current state of the credit:
  - Permanent (2015 Path Act)
  - Eligible Small Business can offset Alternative Minimum Tax
  - Start-up companies, R&D credit can offset employer portion of social security tax



# Research & Development Tax Credit

- “Four-Part” Test / Qualified Research Activity (QRA)
  - Permitted Purpose
    - ◇ Business Component: New or Improved
    - ◇ Product, Process, Computer Software, Technique, Formula or Invention
    - ◇ Held for sale, lease, license
    - ◇ Improve Functionality, Reliability, and/or Quality
  - Technological in Nature
    - ◇ Physical Sciences (not social/business science)
  - Elimination of Uncertainty
    - ◇ Buzzwords: Design, Prototype, Test
  - Process of Experimentation
    - ◇ Iterative / Trial & Error



# Research & Development Tax Credit

- Qualified Research Expenses (QRE)
  - Qualified Wages
    - ◇ Compensation for qualified services
    - ◇ Only includes wages for withholding purposes
    - ◇ Safe-Harbor 80% substantially all rule
  - Amounts Paid for Supplies
    - ◇ Supplies have to be used and consumed in the qualified research
  - Contract Research Expenses
    - ◇ 65% of payments paid to third-parties for qualified research
    - ◇ 75% of payments to certain research consortia



# Research & Development Tax Credit

- **Application of Requirements for Qualified Research**

- Separate Business Components
- Substantially All Rule
- Shrinking-Back Rule

- **Excluded Activities**

- Research after commercial production
- Adaptation or duplication of an existing business component
- Surveys and Studies
- Foreign Research
- Research in Social sciences
- Funded Research

## Research & Development Tax Credit: Applicable Industries

- Software & Technology
- Manufacturing & Distribution
- Pharmaceutical & Life Sciences
- Aerospace
- Architect & Engineering
- Agribusiness





# Benefits of an R&D Tax Credit Study

- Quantitative & Qualitative support
  - R&D credit is a permanent part of the tax law – Congress incentivizes companies to claim the tax benefit
  - Essential when presenting results to a taxing authority (e.g., IRS or a state department of revenue)
  - Properly documented R&D study will provide less scrutiny upon tax due diligence in the event of sale of business
  - It should provide confidence to company's auditor regarding financial statement benefit claimed
  - Establishing a methodology will assist in a refresh R&D study





# Cost Segregation Studies

WEALTH ADVISORY | OUTSOURCING | AUDIT, TAX, AND CONSULTING

Investment advisory services are offered through CliftonLarsonAllen Wealth Advisors, LLC, an SEC-registered investment advisor

# Fixed Asset Related Tax Reform Issue

## *Important Rules on “Qualified Property”*

- Qualified Leasehold/Retail/Restaurant Property – Combined into Qualified Improvement Property (QIP)
  - Per the CARES Act, QIP is defined as any improvement made by the taxpayer to an interior portion of a building that is nonresidential real property if the improvement is placed into service after the date the building was first placed in service. It excludes any enlargement of a building, any escalator or elevator, or the internal structural framework of the building. Rev. Proc. 2017-33 allows improvements to qualify even if 1 day after building goes into service.
- Qualified Improvement Property – Eligible for 15 year Tax Treatment and 100% Bonus Depreciation
- QIP also exists for Section 179 Purposes (so does roofs, HVAC, and security/alarm systems)
- Cost Segregation remains an important benefit of Real Property projects
- ADS for QIP is now 20 years
- Residential Real Property lowered to 30 years from 40

# Fixed Asset Study Opportunities

- All real property placed into service since 1987 likely has potential
- Retrospective studies can yield significant cash flow benefits
- Amended returns are not necessary (Automatic Consent Accounting Method Change / Form 3115)
- CLA has performed dozens of FA Studies on Fortune 1000 clients



# Our Process

- Prepare a free of charge cost benefit analysis; the documents we need are:
  - Purchases:
    - ◇ Settlement statement
    - ◇ Appraisal
    - ◇ Rent roll
    - ◇ Depreciation schedules

## Our Process (cont.)

- New Construction/Improvements:
  - ◇ Latest general contractor application for payment (form AIA G702/703)
  - ◇ Construction budget
  - ◇ Floor plan
  - ◇ GL Detail/CIP account

# Our Process (cont.)

## CONTINUATION SHEET

AIA DOCUMENT G703

PAGE 4 OF 5 PAGES

AIA Document G702, APPLICATION AND CERTIFICATION FOR PAYMENT, containing

Contractor's signed certification is attached.

In tabulations below, amounts are stated to the nearest dollar.

Use Column I on Contracts where variable retainage for line items may apply.

APPLICATION NO: 15

APPLICATION DATE: 6/25/08

PERIOD TO: 5/31/08

ARCHITECT'S PROJECT NO: 533520

| A<br>ITEM<br>NO. | B<br>DESCRIPTION OF WORK            | C<br>SCHEDULED<br>VALUE | D<br>WORK COMPLETED                     |                | F<br>MATERIALS<br>PRESENTLY<br>STORED<br>(NOT IN<br>D OR E) | G  |                | H<br>BALANCE<br>TO FINISH<br>(C - G) | I<br>RETAINAGE |
|------------------|-------------------------------------|-------------------------|---|----------------|---|--|----------------|--------------------------------------|----------------|
|                  |                                     |                         | FROM PREVIOUS<br>APPLICATION<br>(D + E) | THIS PERIOD    |   | TOTAL<br>COMPLETED<br>AND STORED<br>TO DATE<br>(D+E+F) | %<br>(G + C)   |                                      |                |
| 15000            | PLUMBING                            |                         |   |                |   |  |                |                                      |                |
|                  | Spinkler Subcontract                | 39                      | \$170,950.00                            | \$170,950.00   |   | \$170,950.00   | 100.00%        |                                      | \$17,095.00    |
|                  | Plumbing Subcontract                | 39                      | \$291,251.00                            | \$276,001.00   | \$15,250.00   | \$291,251.00   | 100.00%        |                                      | \$29,125.10    |
|                  | Plumbing Material                   | 39                      | \$100,468.00                            | \$90,468.00    | \$10,000.00   | \$100,468.00   | 100.00%        |                                      | \$10,046.80    |
| 15500            | HVAC                                |                         |   |                |   |  |                |                                      |                |
|                  | Sheet Metal Subcontract             | 39                      | \$400,808.00                            | \$400,808.00   |   | \$400,808.00   | 100.00%        |                                      | \$40,080.80    |
|                  | HVAC Material                       | 39                      | \$396,178.00                            | \$396,178.00   |   | \$396,178.00   | 100.00%        |                                      | \$39,617.80    |
| 16000            | ELECTRICAL                          |                         |   |                |   |  |                |                                      |                |
|                  | Electrical Subcontract              | 39                      | \$644,356.00                            | \$618,693.00   | \$25,663.00   | \$644,356.00   | 100.00%        |                                      | \$64,435.60    |
|                  | Electrical Material                 | 39                      | \$199,351.00                            | \$195,862.00   | \$3,489.00  | \$199,351.00   | 100.00%        |                                      | \$19,935.10    |
|                  | ALLOWANCES                          |                         |   |                |   |  |                |                                      |                |
|                  | Exterior Sign                       | 15                      | \$6,250.00                              | \$0.00         | \$6,250.00  | \$6,250.00   | 100.00%        |                                      | \$625.00       |
|                  | X-Ray Wiring                        | 5                       | \$18,336.00                             | \$16,114.00    | \$2,222.00  | \$18,336.00  | 100.00%        |                                      | \$1,833.60     |
|                  | MRI Wiring, RF Shielding & HVAC     | 5                       | \$23,393.00                             | \$20,235.00    | \$3,158.00  | \$23,393.00  | 100.00%        |                                      | \$2,339.30     |
|                  | Irrigation                          | 15                      | \$18,000.00                             | \$3,668.00     | \$14,332.00   | \$18,000.00  | 100.00%        |                                      | \$1,800.00     |
|                  | Landscaping                         | 15                      | \$48,060.00                             | \$3,060.00     | \$45,000.00   | \$48,060.00  | 100.00%        |                                      | \$4,806.00     |
|                  | Basketball Rim, Backboard & Support | 15                      | \$7,250.00                              |                | \$7,250.00  | \$7,250.00   | 100.00%        |                                      | \$725.00       |
|                  | PAGE TOTALS                         |                         | \$2,324,651.00                          | \$2,192,037.00 | \$132,614.00  | \$0.00   | \$2,324,651.00 | \$0.00                               | \$232,465.10   |

Users may obtain validation of this document by requesting of the license a completed AIA Document D401 - Certification of Document's Authenticity



Create Opportunities

## Our Process (cont.)

- Present the proposal and fee estimate prior to any engagement letter
- If agreeable, we request a few additional documents and schedule a site tour of the property
- It typically takes us 4-6 weeks to complete a study
- Prepare a final deliverable report
- We help prepare fixed assets in Excel and Form 3115 and any attachments if needed





# Bonus Depreciation

- Applicable Percentage

In the case of qualified property acquired and placed in service by the taxpayer after September 27, 2017, the percentages are as follow:

- 100% - For property placed in service after September 27, 2017, and before January 1, 2023,
- 80% - For property placed in service after December 31, 2022, and before January 1, 2024
- 60% - For property placed in service after December 31, 2023, and before January 1, 2025
- 40% - For property placed in service after December 31, 2024, and before January 1, 2026
- 20% - For property placed in service after December 31, 2025, and before January 1, 2027



# Bonus Depreciation (cont.)

- **Applicable Percentage**

In the case of qualified property acquired before September 27, 2017, and placed in service by the taxpayer after September 27, 2017, the percentages are as follow:

- 50% - For property placed in service before January 1, 2018
- 40% - For property placed in service in 2018
- 30% - For property placed in service in 2019
- 0% - For property placed in service after 2019



# Business Interest Expense Deduction Limitation

A real property trade or business can elect out of the limitation but will be required to use the ADS system (on prior assets too).

- Cut off method – Remaining basis is depreciated only remaining ADS life
- Applies only to Real Property (27.5, 31.5, 39, and 15 year QLIP, QRIP, QRP, & QIP)
- Personal Property not subject to ADS rules (unless elected). Cost Segregation Studies become more valuable.



# Final Thoughts on Fixed Asset Studies

- Opportunity Zone projects are excellent cost segregation projects
- Over 60% of internal depreciation schedules have misclassifications, many not to the taxpayers advantage – Retrospective FA Study will create benefit
- A significant number of taxpayers have not implemented the Tangible Property Regulations on historical assets
  - Even if a 3115 was filed in 2016 to declare implementation, historical asset analysis opportunities still exist
- Another differentiating factor of CLA, when we review depreciation schedules and/or construction documents, we are scoping for energy efficiency incentives as well



# Thank you!

Mathew Abraham, CPA  
Principal, Federal Tax Strategies  
813-384-2741  
mathew.abraham@CLAAconnect.com

Jared M.K. Woiwode  
Director, Federal Tax Strategies  
309-495-8707  
jared.woiwode@CLAAconnect.com

