Tax Incentives for AEC and Real Estate

May 23, 2024

Introductions

Dave McGuire
Shareholder

Dave McGuire is a leading expert on cost segregation, fixed assets and depreciation law and a co-founder of McGuire Sponsel. He has reviewed real estate portfolios ranging in size from six-figure acquisition costs to billions of dollars in value and has provided cost segregation services for companies in a wide variety of industries. McGuire continues to grow McGuire Sponsel's national presence in cost segregation and depreciation.

Mike Hammel, MAcc
Relationship Manager

As a Relationship Manager at McGuire Sponsel, Michael "Mike" Hammel focuses his time on building and nurturing relationships with CPA firms and other service providers in the Southeast. Across practice lines and industry verticals, Mike is well-versed in understanding client challenges as it relates to specialty tax and identifying best fit services to fit client needs.

About Us

- McGuire Sponsel is a national consulting firm focused on delivering trusted and proven specialty tax solutions
- Practices
  - Fixed Asset Services
  - R&D Tax Credit Services
  - Global Business Services
  - Location Advisory Services
- Partner with more than 500 CPA and real estate firms

McGuire Sponsel Services

Fixed Assets

Cost Segregation

Fixed Asset/Depreciation Management

179D Tax Deduction

45L Energy Efficient Tax Credit

Property Tax Consulting

IRA Credits

R&D Tax Credits

State and Federal Tax Credit Studies

Retroactive Studies

Current Year Reviews

Tax Credit Review

IRC 174 Studies

Federal and State Audit Defense & Risk Advisory

Global Business

Global Expansion

Global Structuring

Cross-Border Transactions: Operational, M&A Transactions

Transfer Pricing Studies

International Tax Planning: IC-DISC, International Tax Compliance

Location Advisory

Location Advisory

State and Local Incentive Management

Single or Multi-Site Incentive Benefit Analysis

Incentive Procurement

Compliance & Reporting

Agenda

- How R&D Tax Credits Affect AEC Companies
- How to Access Inflation Reduction Act Incentives
- Cost Segregation As a Planning Tool

R&D Tax Credit

If a business attempts to develop or improve ***products, processes, techniques, formulas, or software,*** the R&D Tax Credit may apply.

Research & Development Tax Credits

Eligibility

- Non-refundable income tax credit – General Business Credit, Section 41
- Qualified start-up businesses can claim the credit against payroll taxes
- Wage-driven Credit: Does the company employ engineers, developers, chemists, scientists, technicians?

Benefits

- Effective federal credits are typically 6-8% of annual qualified research expenditures
- Credit can be carried back 1 year and forward 20 years, certain state credits apply as well

Industries

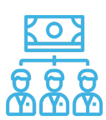
- Applicable industries include manufacturing, automation, design/build, chemical, software, and others

R&D Qualification Criteria

Four-Part Test

Permitted Purpose §41(d)(I)(B)(ii)	• New or improved product, process, technique, formula, invention, or computer software • The purpose of the research must relate to a new or improved function, performance, reliability or quality
Technological in Nature §41(d)(I)(B)(i)	• The activity is undertaken to discover information that is technological in nature
The Uncertainty Test §41(d)(I)(A)	• The activity must involve technical uncertainty or risk related to: • Capability (if it can be done), or • Method (how it can be done), or • The Appropriate Design
Process of Experimentation §41(d)(I)(C)	• The qualified activity must involve the evaluation of one or more alternatives where the capability and method of achieving the result is uncertain at the outset

Defining §41 Qualified Expenses



Wages

- Performing qualified research
- Technical supervision of qualified research
- Technical support of qualified research

Supplies

- Tangible personal property utilized during the process of qualified research
- Cannot be subject to depreciation

Computer Leasing

(Cloud Computing)

Contract Research

- Any amount paid or incurred by the taxpayer to any person/company other than employees for qualified research
- Includable up to 65% (75% for research consortia)

R&D Tax Credits for the Construction Industry

- The construction industry is very different than it was just 10 years ago when contractors were build-to-print
- Currently, the line between "engineering" and "construction" is blurred as more and more contractors have the responsibility of performing certain engineering functions within the scope of their services
- A contractor's ability to demonstrate that they have the design and engineering responsibilities within a project is paramount in building their annual R&D Tax Credit
- Contract language is vital in exhibiting that the taxpayer bears the economic risk for the services that are being performed within the scope of work

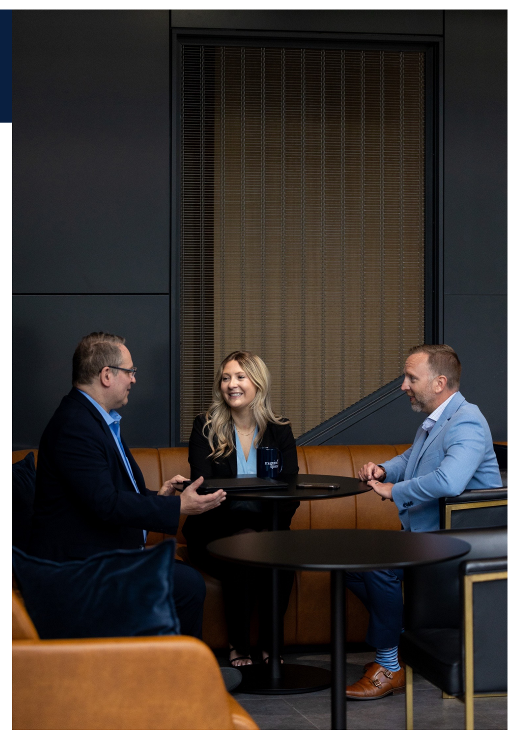
Defining Funded Research

- How to determine whether a project is considered "funded":
  - Economic risk
  - Research rights
- Payment contingent upon success of research
- Taxpayer retains substantial rights
- Language specifying rights in contract

Inflation Reduction Act

Section 48 Tax Credit

- Base credit reduced to 6%, (§48(a)(2)(A)(i))
- Includes energy storage technology
- Energy property credits apply only for projects where construction begins prior to January 1, 2025
  - The §48 Tax Credit is replaced with §48E moving forward
- Base credit increased to 30% if:
  - Maximum output is less than 1 megawatt,
  - Prevailing wage requirements are met, or
  - Construction began prior to January 29, 2023

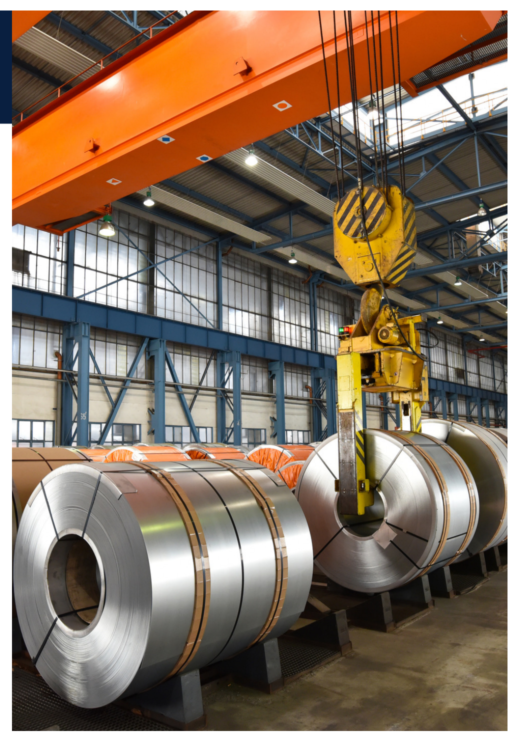


Energy Community Bonus Credit

- Increased credit for Energy Communities
  - 2% in the case of the 6% credit
  - 10% in the case of the 30% credit

- Follows definition of Energy Community under §45(b)(11)(B)
  - Brownfield site
  - Metropolitan area or non-metropolitan area which
    - Has 0.17 or greater direct employment or 25% of local tax revenues related to fossil fuels, and
    - Has an unemployment rate at or above national average for the previous year
  - Census tract which
    - After December 31, 1999, had a coal mine closed, or
    - After December 31, 1999, had a coal-fired electric generating unit retired, or
    - A directly adjoining census tract

Domestic Content Bonus Credit



- Domestic Content Bonus Credit – follows §45(b)(9)(B)
  - 2% in the case of the 6% credit
  - 10% in the case of the 30% credit
- Requires 100% of steel to be manufactured in the U.S.
- Requires 40% of the manufactured products to be produced in the U.S.
- Notice 2023-38
  - Manufactured component test based on cost
  - Only direct costs are included

Calculation of Credit

- Credit is based on all costs
- Includes applicable indirect costs, supports, etc.
- Basis is reduced by 50% of credit taken
- Remaining basis is 5-year property subject to bonus
- Subject to recapture under Section 50
- Subject to passive limitations

Example

- Installation of $100,000 in solar panels
- Steel supports cost $10,000
- Electrical connections/installation $10,000
- Installation cost/overhead/design $10,000
- **Tax Credit calculated on total cost of $130,000**

Example

- Total installed cost $130,000

- If 50% tax credit (30% plus both 10% bonus credits)
  - Tax credit $65,000
  - Depreciable basis of $97,500
  - For 2023, bonus of 80% means a bonus deduction of $78,000 plus standard depreciation of $3,900 at a 5-year rate

- **Assuming a 30% tax rate, total first year savings of $89,570 (69% of total)**
  - If tax credit is 30%, drops to $66,846 (51% of total)
  - If tax credit is 40%, drops to $78,208 (60% of total)

Solar Credits – Eligible Costs

- Many solar installers are offering tax advice as to elements that are eligible for tax credits

- Many will argue that replacing a roof at the same time will allow for the entire roof to be credit eligible (this is often not the case)
  - PLR 200947027: Reflective roof system installed on top of roof is credit eligible
  - PLR 201450013: Reflective roof eligible "to the extent that the cost of the reflective roof exceeds the cost of reroofing taxpayer's building with a non-reflective roof"

- It is important to note that only the incremental cost is eligible

- Cost segregation can help maximize and document this as well as other eligible costs

179D and 45L

What Is 179D?

- Tax provision that allows for a tax deduction for energy efficient buildings
- Available for renovations and new builds that include energy saving improvements to:
  - HVAC system
  - Lighting system
  - Building envelope
- Improvements must meet or exceed a 50% savings in energy costs in comparison to ASHRAE standards
  - Allows for partially qualifying if 50% threshold is not met
- Who can benefit:
  - Owners of commercial buildings
  - Owners of residential buildings (four stories or higher)
  - Designers of government-owned buildings
- From a cost to benefit perspective, buildings with at least 30,000 square feet

179D Changes

Key Relevant Changes — Placed in service January 1, 2023

- Tax-exempt building owners may now allocate the §179D to designers of energy efficient commercial buildings.
- Expectation is that rules will mirror the allocation of the §179D to the designers that currently exist.
- New qualifying methodology analyzing energy use intensity for retrofits.
- Same buildings will be able to be recertified if additional energy improvements are made every 3 years for privately owned and every 4 years for government/tax-exempt owned.
- REIT will now be able to benefit from §179D in the year in which the EECBP was placed into service.

Transfer to Architects/Engineers Post-IRA

- Transfer changes starting January 1, 2023
  - Based on placed in service date of building
  - Not related to when architect/engineer does work
- Now can transfer from tax-exempt entities
- Requirement to be a designer does not change
- Will create new opportunities

179D: Pre-IRA vs. Post-IRA

Pre-IRA 179D Triggers

- New builds in excess of 30,000 square feet
- Renovations to lighting or HVAC systems
- Architects or system engineers that design government facilities
  - Public schools/universities, military bases, police stations, libraries, etc.

Max Deduction
$1.80*
per square foot

Post-IRA 179D Triggers

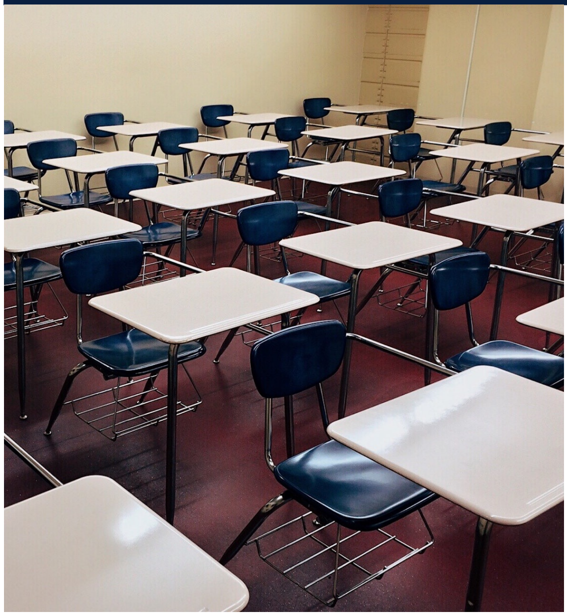
- New builds or renovations in excess of 30,000 square feet
- Architects or system engineers that design buildings owned by government or tax-exempt entities

Max Deduction
$5.00*
per square foot

**Indexed for inflation*

Section 179D – Designer

Success Story



Client Profile

- Engineering firm performed design work for K-12 public schools
- Over 1.1 million square feet combined

Process

- Analysis performed over a five-week period
- Benefit ranged from $1.20-$1.80 per sqft

Results

- Deduction of $1,913,455
- 29.6% tax rate results in $566,382 tax savings

Taking 179D for Prior Years

Owner Deduction

- Considered an accounting method
- Can be done on a 3115 on the next return

Designer Deduction

- Not an accounting method
- Must be done through amended return (three-year window)

What Is 45L?

- Builders, owners, and developers of residential homes and apartment buildings have the opportunity to earn tax credits for energy efficiency, if properties meet certain qualifications
  - Properties must be three stories or lower
  - Builders/owners/developers must incorporate energy-efficient features such as high R-value insulation and roofing, windows, doors, and/or HVAC systems

45L Changes — Inflation Reduction Act

- Extension and modification of 45L
  - Extended through 2031
  - Increased to $2,500 for single-family homes, requires Energy Star Single-family National Home Program
  - Credit can increase to $5,000 for eligible homes certified as zero energy ready under the Department of Energy Zero Energy Ready Home program

- Multi-family homes
  - Credit of $500 if meets Energy Star Multi-family New Construction
  - Credit of $1,000 if meets Zero Energy Ready Multi-family New Construction
  - 500% increase to $2,500-$5,000 if prevailing wage requirements are met

45L Changes

Key Relevant Changes

The Current Version

Of §45L which includes a **$2,000** per unit, has been extended for residential homes or apartments placed in service through December 31, 2022

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New Homes & Multi-family*

Certified under the ENERGY STAR residential new construction or the ENERGY STAR manufactured new homes programs sold or rented

a) After December 31, 2022, will be eligible for a **$2,500** tax credit

b) New homes qualifying under the zero energy ready homes program (ZER) can achieve **$5,000** per unit

* Multi-family projects need to be completed using prevailing wages. Single-family projects do not need to meet prevailing wages.

Multi-family

That does not meet the prevailing wages criteria the amount will be reduced to **$500** per unit (ENERGY STAR) and **$1,000** per unit (ZER)

45L: Pre-IRA vs. Post-IRA

Pre-IRA 45L Triggers

- Newly constructed residential facilities since 2017 with 30 units or more
- Substantially renovated residential facilities since 2017

Max Credit
$2,000
per unit

Post-IRA 45L Triggers

- Newly constructed residential facilities with Energy Star certification
- For multi-family, tax credits start at $500 per unit
- Requires early action as pre-drywall inspections are required

Credit Starting At
$500
per unit*

** $500 credit increases for single family homes or properties built using prevailing wage. The max credit can be as high as $5,000 per unit.*

45L – Single Family Homes

Success Story

Client Profile

- 308 single family homes located throughout central Tennessee
- Constructed over multiple years

Process

- Analysis performed over a five-week period

Results

- All homes qualified
- $616,000 tax credit

Interaction with Cost Segregation

What Is Cost Segregation?

- Accelerating depreciation deductions and increasing cash flow on real estate and leasehold improvements
- Most taxpayers overstate 39-year real property. A cost segregation study:
  - Optimizes depreciation deductions while documenting and supporting asset reclassifications
  - Maximizes personal property which results in substantial cash flow benefits
  - Reclassifies assets into 5-, 7-, or 15-year property, including:

Decorative millwork	Dedicated electrical distribution	Reinforced foundations	Carpet
Specialized HVAC	Specialized plumbing	Paving	Alternative energy sources

A dollar is worth more today than 30+ years from now!

Affect on 179D

- Can work hand-in-hand on new construction
- On renovations it is important to ensure that the assets need 179D
- 179D is a reduction in basis not a credit
- With increase to bonus/179 often same benefit can be achieved in other ways
  - Bonus/179 on lighting
  - 179 on roof/HVAC replacements

45L and Cost Segregation

- Can work together on long hold projects
  - Apartment complex being held for a few years
  - New homes being rented
- 45L Credit causes an offset in basis
- Basis reduction comes out of 27.5-year property

Risk of Waiting

- Due to depreciation being an "accounting method" adjustments are done on a current return (through a 3115)
- Post TCJA carry back NOLs are prohibited
  - Temporarily changed under the CARES Act
  - Can be carried forward indefinitely, offsets 80% of taxable income
- If income drops due to recession, deductions may become less valuable

Risk of Waiting Example

- In 2022, company purchased a $10 million property (assuming no land for example)
- Cost segregation study not completed in 2022
- 2022 net income is $2 million and tax rate is 30%
- 2023 net income is $3 million and tax rate is 30%
- Due to recession, 2024 income drops to $1 million

Risk of Waiting

Example

- Cost segregation would move 20% or $2 million to bonus eligible
- If cost segregation performed prior to filing the 2023 return, taxpayer has two options:
  - Amend 2022 (since accounting method not established)
  - File 3115 in 2023
  - Either will generate approximately $600,000 of positive cash flow
- If cost segregation NOT performed prior to filing 2023 return, taxpayer has to file 3115 in 2024
  - Due to lack of taxable income in 2024, taxpayer can only use half of deductions created at that point
  - Short term cash flow drops in half

Planning Opportunities

- Cash allows businesses to make decisions
- For most businesses maximizing deductions in current year a good strategy
- Waiting could mean business can't access cash flow in recession

Questions?

Contact

Scan QR code for more info

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