KBKG

SOLUTIONS FOR TAX PROFESSIONALS AND BUSINESSES

TAX CREDITS • INCENTIVES • COST RECOVERY

NATIONWIDE SERVICE

Our Team is Your Resource

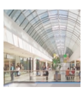
Established in 1999 with offices across the US, KBKG provides turn-key tax solutions to CPAs and businesses. By focusing exclusively on value-added tax services that complement your traditional tax and accounting team, we always deliver quantifiable benefits to clients.

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

Value Added Services

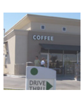
Research & Development Tax Credits

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



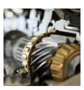
Cost Segregation for Buildings and Improvements

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



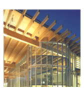
Repair vs. Capitalization Review §263(a)

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.



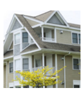
Fixed Asset Review

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.



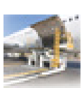
45L Credits for Energy Efficient Residential Developments

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



179D Incentive for Energy Efficient Commercial Buildings

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



IC-DISC

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

INDUSTRY MATRIX FOR TAX SAVING OPPORTUNITIES *(updated 01-23-18)*

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

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IDENTIFYING VALUE-ADDED TAX OPPORTUNITIES *updated 01-23-18*

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. Qualifying expenses can include wages paid to employees, supplies used in the research process, and payments made to contractors for performing qualified research.	• Manufacturing • Software Development • Architects • High Tech • Food & Beverage • Equipment or tools • Life Sciences • Agriculture • Clients developing brand new products, processes, software, or formula. • Clients materially improving existing products, processes, software or formula. • Clients that employ those with technical backgrounds (software development, engineering, etc..)	**Federal Benefit - Roughly 10% of their total Qualified R&D Expenses** Ex. Client has $1M/year of wages related to R&D. Benefit = $100k in gross credits per year. Many states also allow an R&D credit. For example, CA R&D Credit is worth an additional 7.5% of Qualified R&D expenses.	General Business Tax Credit • Dollar-for-dollar reduction in income tax liabilities. • 1-year Carryback / 20-year carryforward of unused credits. • Qualified small businesses can reduce alternative minimum tax liabilities. • Qualified start-up companies can offset up to $250,000 in payroll taxes.
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 b**uilding with over $750k** of depreciable tax basis (excluding land). Any **leasehold improvement with over $500k** of depreciable tax basis (excluding land). 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.** Ex. $2M office can yield an after-tax NPV of $100k.	• Reduces AMT • Starting in 2018, unused deductions carryforward. • Must recapture personal property and bonus eligible assets upon the sale of a building.
Repair v. Capitalization Review "Asset Retirement Study" (Federal)	New rules allow you to assign value to "structural" components removed from a building and write off the remaining basis! Regs also clarify repair expense treatment of many types of building costs such as HVAC or roof replacements. KBKG also provides compliance consulting for repair and disposition regulations.	**Any building renovation costs > $400k** **Retirement Study -** Building is renovated AFTER owning it at least 1 year. Building should have **>$500K of remaining depreciable basis left.** **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)** 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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IDENTIFYING VALUE-ADDED TAX OPPORTUNITIES (CONT.) *updated 01-23-18*

KBKG Service	Description & Highlights	Applicable Clients & Industries	How Much is it Worth?	Tax Considerations
Fixed Asset Tax Review (Federal)	Comprehensive review of company's entire Fixed Asset listing & supporting documents to assign appropriate tax lives, identify retirements, and correct items that should be expensed. Includes Cost Segregation & Repair analysis.	Operations with > $40M in real property or > 500 lines of fixed assets. • Retail, Restaurant, Bank and Hotel Chains of 10 or more • Manufacturing • Utility Companies	Net Present Value of 5-8% of total building-related costs. Ex. Manufacturing client has $60M of 39-year fixed assets. NPV Cash value = $3M - $4.8M	• Reduces AMT • Starting in 2018, unused deductions carryforward. • Must recapture personal property and bonus eligible assets upon the sale of a building.
Residential Energy Credits / Section 45L (Federal / States can have similar programs)	Federal credit for developers of **Apartments, Condos, or Spec Homes** that meet certain energy efficiency standards. Units must be certified by a qualified professional to be eligible.	Anyone that has built Apartments, Condos, or Production Home Developments in the last 4 years. **Generally, more than 20 units.**	**Federal Credit = $2,000 per apartment/ home unit.** **Many states have similar credits.** Ex. 100-unit apartment/condo can get $200,000 of Federal Tax Credits.	General Business Tax Credit • Credit is realized when unit is first leased or sold, not placed in service. • 1-year Carryback • 20-year carryforward. • Does not reduce AMT. • Subject to passive activity loss rules • Credit reduces basis.
Commercial Energy Deductions / Section 179D (Federal/ States can have similar programs)	Federal deduction for **Architects, Engineers, and Design/Build Contractors** that work on Public or Government Buildings such as Schools, Libraries, Courthouses, Military Housing etc. **Also available to any commercial building owner.**	• **179D for Designers:** Architects, General Contractors, Engineers, Electrical & HVAC Subcontractors. • **Any Building Owner or Lessee:** That has constructed a commercial improvement greater than 40,000 SF since 1/1/2006.	**$.30 up to $1.80 per square foot in Federal Tax Deductions.** Ex. 100,000SF building is eligible for $180,000 in deductions.	• Reduces AMT • Deduction reduces basis in real property. Designers must amend open tax years to claim Owners: Can go back to 2006 with Form 3115 to claim missed deductions.
CA Competes Credit (State)	California income tax credits designed to stimulate growth throughout the state.	**CA Competes Credit:** Growing business clients who anticipate hiring additional employees, constructing new buildings, or investing in new equipment.	Must apply for credits. Up to **$37,000 per eligible employee**, over a 5-year period. **Generally, 15-35% of employees qualify.** **Equipment - Credit is equal to Sales Tax paid.**	• Credits will reduce taxes on owners W2 wages and personal return. • Credits flow through to owners. • Credits will offset tax at the S-Corp level.
IC-DISC Federal Income Tax Incentive (Federal)	The IC-DISC provides significant and permanent tax savings for producers and distributors of U.S.-made products and certain services used abroad.	**Any closely held, privately owned business with over $250,000 in profits from exports** • Manufacturers • Distributors • Architects & Engineers • Agriculture and Food Producers • Software Developers • Other Producers	Minimum permanent **17% decrease in tax rate on half of export profits.** Benefits can be dramatically higher by performing a transaction-by-transaction analysis.	• Requires annual filing 1120 IC-DISC. • No changes to business operations. • Benefits begin when entity is formed.

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Qualified Improvements - Depreciation Quick Reference (updated 5/10/2019)

	Applicable PIS Dates (inclusive)	MACRS GDS Recovery Period	Bonus Dep Eligible	3 Year Rule	Unrelated Parties Rule	179 Expense Eligible	Important Notes	Code Section
Qualified **Improvement** Property (QIP): 2018 onward	1/1/18 onward	39 [9] Year / SL	N [9]	N	N	Y [10]	Applies to interior common areas. Building can be owner occupied. No 3-year rule. See exclusions in definition.	168(e)(6)
Qualified **Improvement** Property (QIP): 2016 - 2017	1/1/16 - 12/31/17	39 [5] Year / SL	Y	N	N	N [7]	Applies to interior common areas. Building can be owner occupied. No 3-year rule. See exclusions in definition.	168(k)(3)
Qualified **Leasehold** Improvements (QLI):2004 - 2017	10/23/04 - 12/31/17	15 Year / SL	Y [1]	Y	Y	2010 - 2017 [6]	Landlord or lessee can make the interior improvement. See exclusions in definition.	168(e)(6)
Qualified **Leasehold** Improvements (QLI):2001 - 2004 Partial	9/11/01 - 10/22/04	39 Year / SL	Y	Y	Y	N/A	39 year QLI qualifies for Bonus. Landlord or lessee can make the interior improvement. See exclusions in definition.	168(e)(6)
Qualified **Retail** Improvement Property: 2016 - 2017	1/1/16 - 12/31/17	15 Year / SL	Y	Y	N	2010 - 2017 [6]	Building can be owner occupied. See exclusions in definition.	168(e)(8)
Qualified **Retail** Improvement Property: 2009-2015	1/1/09 - 12/31/15	15 Year / SL	N [2]	Y	N	2010 - 2017 [6]	Building can be owner occupied. See exclusions in definition.	168(e)(8)
Qualified **Restaurant** Property: 2009 - 2017	1/1/09 - 12/31/17	15 Year / SL	N [4]	N	N	2010 - 2017 [6]	Encompasses the entire building structure as well as interior costs. Can be an acquired building.	168(e)(7)
Qualified **Restaurant** Property: 2008	1/1/08 - 12/31/08	15 Year / SL	Y	Y	N	N/A	Applicable to all improvements attached to building.	168(e)(7)
Qualified **Restaurant** Property: 2004-2007	10/23/04 - 12/31/07	15 Year / SL	N [3]	Y	N	N/A	Applicable to all improvements attached to building.	168(e)(7)

Bonus Depreciation Rates (inclusive dates)

9/11/01 - 5/5/03 [8]	30%
5/6/03 - 12/31/04 & 1/1/08 - 9/8/10 [8]	50%
9/9/10 - 12/31/11 [8]	100%
1/1/12 - 9/27/17 [8]	50%
9/28/17 - 12/31/22 [8, 11, 12]	100%
1/1/23 - 12/31/23 [8, 11, 12]	80%
1/1/24 - 12/31/24 [8, 11, 12]	60%
1/1/25 - 12/31/25 [8, 11, 12]	40%
1/1/26 - 12/31/26 [8, 11, 12]	20%

Footnotes:

1) NOT eligible for bonus if placed in service 1/1/2005 - 12/31/2007.
2) Retail Improvements are not eligible for bonus depreciation unless it meets the criteria for QLI.
3) Qualified Restaurant Property is eligible for bonus depreciation if placed in service 10/23/2004 - 12/31/2004.
4) Improvements that also meet the criteria for QLI are eligible for bonus depreciation. After 2015, improvements that also meet the criteria for QIP are eligible for bonus depreciation. Restaurant property that is acquired 9/28/2017-12/31/2017 is fully expensed (subject to written binding contract rules).
5) Improvements that meet the definition of Qualified Improvement Property and meet the definition of QLI , Qualified Retail Improvements, or Qualified Restaurant Property can be depreciated over a 15-year straight line period.
6) Eligible up to $250k from 2010 - 2015; 2016 and 2017 are subject to normal 179 expense cap.
7) Improvements that meet the definition of Qualified Improvement Property and meet the definition of QLI , Qualified Retail Improvements, or Qualified Restaurant Property qualify for the 179 Expense.
8) Long Production Period (QLIs over $1M and construction period exceeds 1 year) - can be placed in service one year after bonus normally expires. QLI (that is also LPP) started before 1/1/2012 can be entirely eligible for 100% bonus if completed during 2012. Bonus is applicable if LPP is started before 1/1/2027. Only pre-1/1/2027 basis is bonus eligible on any LPP.
9) Legislative committee reports indicate QIP will be 15-year property and bonus eligible. However, the actual law enacted does not reflect the legislative intent. Technical corrections to the law are expected, although the IRS has denied any guarantees of this presumed change in recovery period.
10) Section 179 rules are modified to include certain improvements to buildings. See 179 Expense notes on page 2.
11) Bonus depreciation is available for used property placed in service after 9/27/17, however it is does not apply to the portion where the taxpayer previously had a depreciable interest.
12) Bonus is not available to taxpayers with floor plan financing (motor vehicle, boat, farm machinery) unless they are exempt from business interest limitations.

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Section 179 Expense Limitations (Dates, Dollar Limit, Reduction)		
01/01/11 - 12/31/17	$500,000	$2,000,000
1/1/18 onward [1]	$1,000,000 [2]	$2,500,000 [2]

Footnotes:

1) In 2018 onward, the Section 179 expense includes improvements to the following non-residential real property that are placed in service after the date such property was first placed in service: roofs; heating, ventilation, and air-conditioning; fire protection and alarm systems; and security systems. 179 expensing does not apply to certain non-corporate lessors. See Sec. 179(d)(5)

Qualified Section 179 property now includes depreciable tangible personal property used to furnish lodging (e.g. residential rental properties, hotels, etc).

2) Any taxable year beginning after 2018, the dollar amounts will be indexed for inflation.

Definitions:

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

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

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

Qualified leasehold improvement property (QLI)[A] 2001-2017 (A) Any improvement to an interior portion of a building which is nonresidential real property if— (i) such improvement is made under or pursuant to a lease (I) by the lessee (or any sublessee) of such portion, or (II) by the lessor of such portion, (ii) such portion is to be occupied exclusively by the lessee (or any sublessee) of such portion, and (iii) such improvement is placed in service more than 3 years after the date the building was first placed in service. (B) Certain improvements not included. Such term shall not include any improvement for which the expenditure is attributable to— (i) the enlargement of the building, (ii) any elevator or escalator, (iii) any structural component benefiting a common area, and (iv) the internal structural framework of the building.

Qualified retail improvement property[A] 2009-2017: Any improvement to an interior portion of a building which is nonresidential real property if— (i) such portion is open to the general public and is used in the retail trade or business of selling tangible personal property to the general public, and (ii) such improvement is placed in service more than 3 years after the date the building was first placed in service. QRIP shall not include any improvement for which the expenditure is attributable to— (i) the enlargement of the building, (ii) any elevator or escalator, (iii) any structural component benefitting a common area, or (iv) the internal structural framework of the building.

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

Qualified restaurant property[B] 2009-2017 Any section 1250 property which is (i) a building or improvement to a building — if more than 50 percent of the building's square footage is devoted to preparation of, and seating for on-premises consumption of, prepared meals, and (ii) if such building is placed in service after December 31, 2008

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

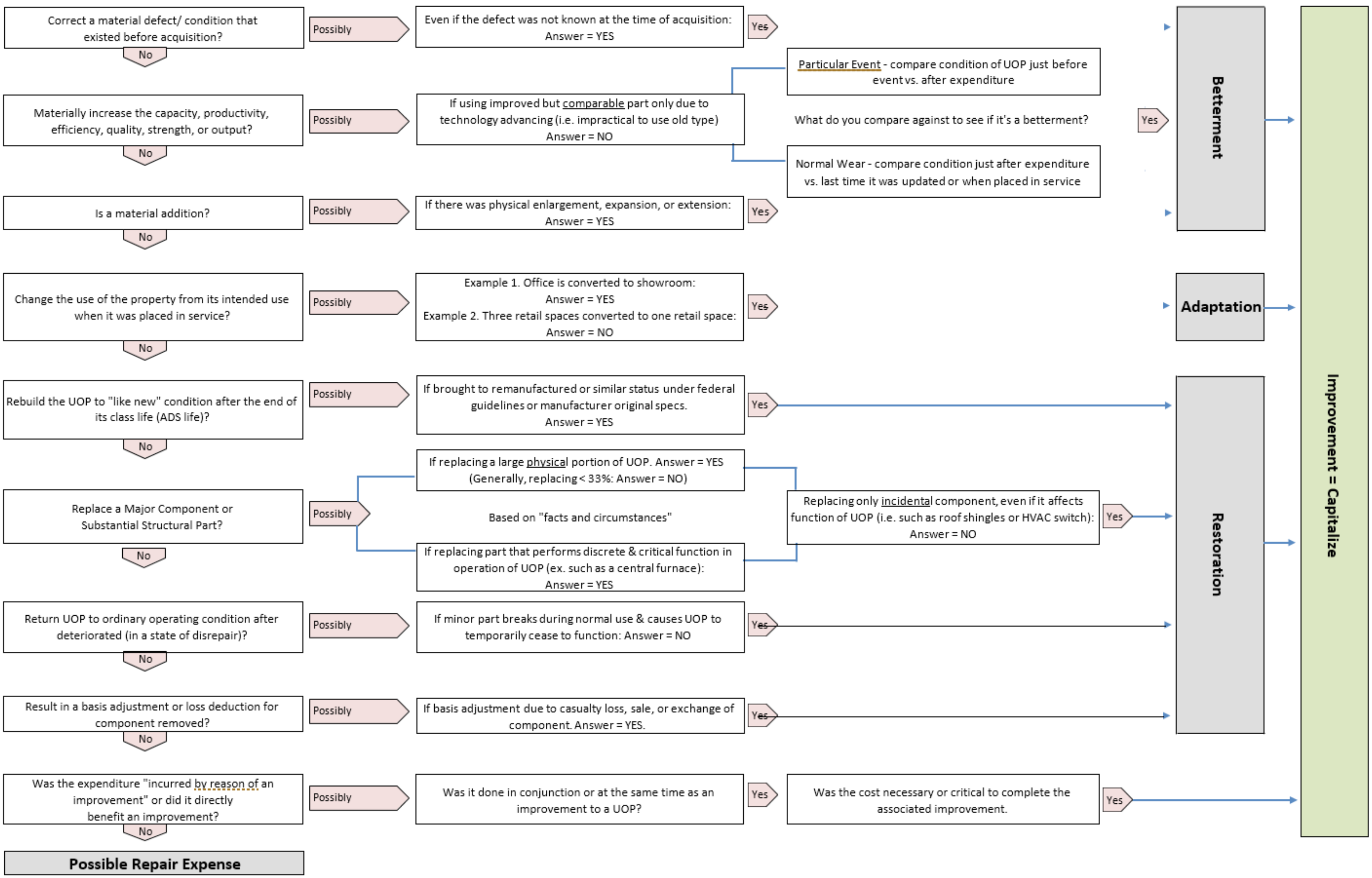
Other notes:

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

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

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

Considering the appropriate Unit of Property (UOP), does the expenditure *(Last Updated 03-20-2015)*:



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KBKG Building Unit of Property & Major Components Chart *updated 05-16-17*

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

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

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

Definitions

Plant Property Machinery & Equipment used to perform an industrial process such as manufacturing, generation, warehousing, distribution, automated materials handling, or other similar activities
Network Assets Railroad track, oil & gas pipelines, water & sewage pipelines, power transmission & distribution lines, telephone & cable lines; -- owned or leased by taxpayers in each of those respective industries.
Major Component Part or combination of parts that performs a discrete and critical function in the operation of the unit of property
Incidental Component Relatively small, inexpensive, or minor part that performs a discrete and critical function for the UOP. Generally, not capitalized because of its size, cost, or significance.

KBKG is a specialty tax firm that works directly with CPAs and businesses to provide value-add solutions to our clients. Our engineers and tax experts have performed thousands of tax projects resulting in hundreds of millions of dollars in benefits. Our services include Research & Development Tax Credits, Cost Segregation, Repair vs. Capitalization 263(a) Review, IC-DISC, Green / Energy Tax Incentives (179D for Designers, 45L for Multifamily), and Fixed Asset Depreciation Review.

Welcome and thank you for joining KBKG's live webinar

BEFORE WE GET STARTED

- We will start the live webinar at **12pm PT | 3pm ET**
- For the best audio, dial in using the telephone number provided
- Please enter questions into the Q&A module
- Download the slides from **KBKG.com/resources**
  - **"R&D Tax Credit for the Life Sciences Industry"**

RD 200:
Research & Development Tax Credit –
Life Sciences

Download PowerPoint slides from **KBKG.com/resources**

All attendees are muted.
The webinar will begin promptly at 12 PM Pacific / 3 PM Eastern

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ADMINISTRATION

AUDIO

- For the best sound, you should dial in and use the provided telephone number for audio.

HANDOUT MATERIALS –

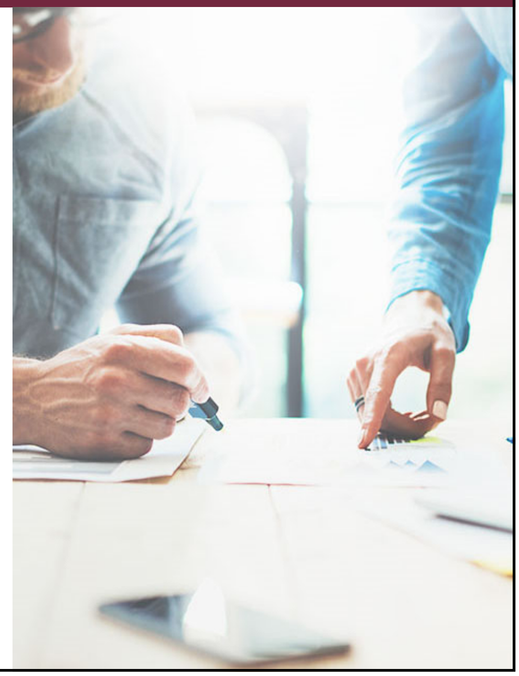
- Download power point slides from KBKG.com/resources

CPE (Continuing Professional Education – for CPAs only)

- Answer all polling questions during the webinar

QUESTIONS AND ANSWERS

- Please submit your questions and we will answer as many as time permits.



ABOUT KBKG

KBKG

Established in 1999, KBKG is a specialty tax and consulting firm providing nationwide service:

- Research & Development Tax Credits
- Cost Segregation
- Green Building Tax Incentives
- Repair & Maintenance Review
- Fixed Asset Depreciation Review
- IC-DISC
- Employment Tax Credits
- Domestic Production Activities Deductions

TODAY'S PRESENTERS

Paul McVoy

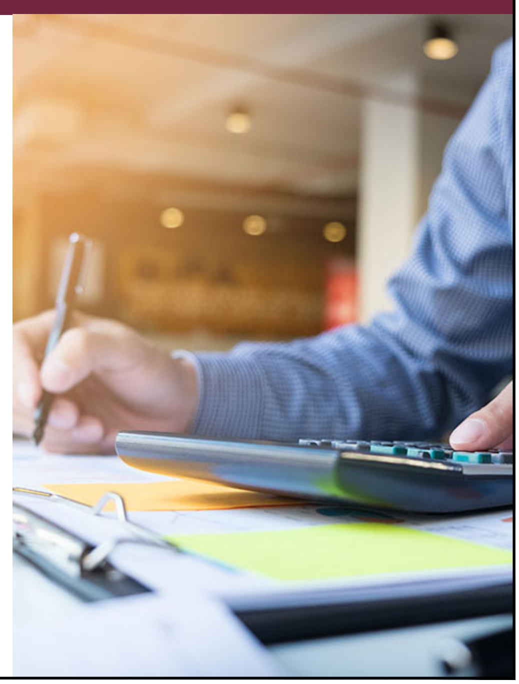
Director
Research & Development Tax Credit Services

Tetyana Guguchkina

Manager
Research & Development Tax Credit Services

AGENDA

- Benefits of the R&D Tax Credit
- What's New?
- R&D Tax Credit Overview
- Maximizing Value
- Other Considerations
- Questions



BENEFITS OF THE R&D TAX CREDIT

BENEFITS OF THE R&D TAX CREDIT

- Dollar-for-Dollar reduction in tax liability
- Provides cash relief needed to increase R&D activities, run clinical trials, launch new products, expand production facilities, hire additional employees, secure patents, etc.
- Increases the Return on Investment
- Lowers the effective tax rate
- Improves earnings per share
- Retroactive Claims (all open years or more if net operating losses)
- General Rule: 1 Year Carryback; 20 Year Carryforward
- S Corps & Partnerships – R&D tax credit flows through to the owners
- Many states offer an R&D tax credit


KBKG
POLLING QUESTION #1


KBKG
WHAT'S NEW?

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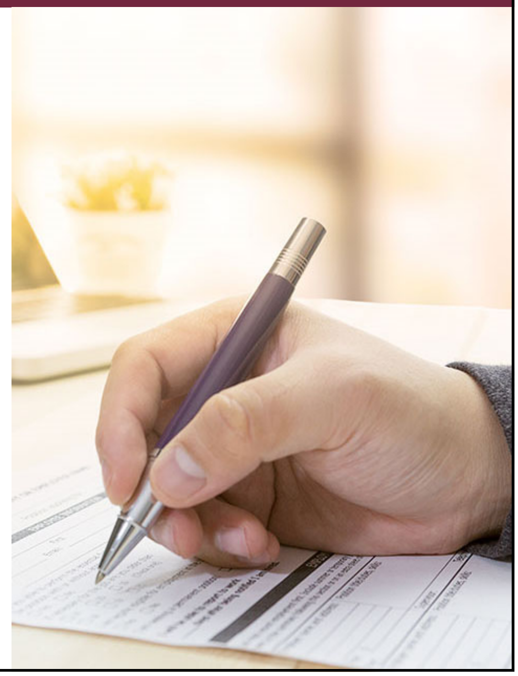
WHAT'S NEW?
THE TAX CUTS & JOBS ACT

The Tax Cuts and Jobs Act (H.R. 1) includes provisions impacting:

- Orphan Drug Tax Credits
- Sec. 199 Deduction
- Treatment of Research and Experimental Expenses

Effective for tax years **beginning after** December 31, 2017



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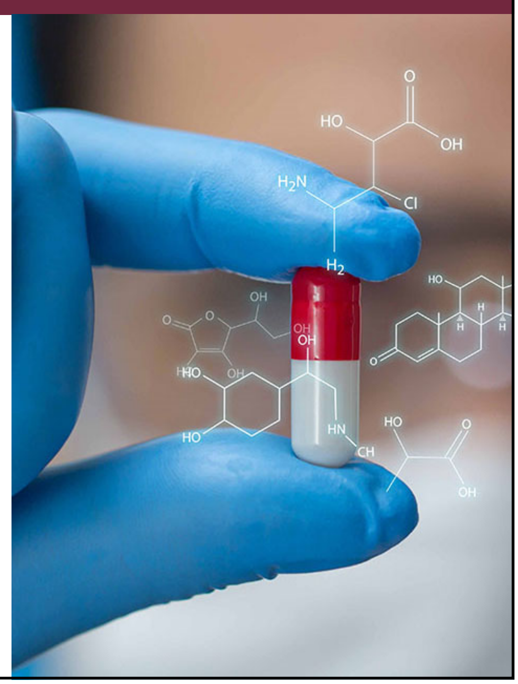
TAX CUTS & JOBS ACT
ORPHAN DRUG TAX CREDIT

The Orphan Drug tax credit was enacted in 1983 as part of the Orphan Drug Act.

Incentive for drug makers to develop new treatments for rare diseases and conditions (affecting fewer than 200,000 people)

- Credit reduced to 25% of qualified clinical testing expenses
- §280C Election available

Effective for tax years **beginning after** December 31, 2017



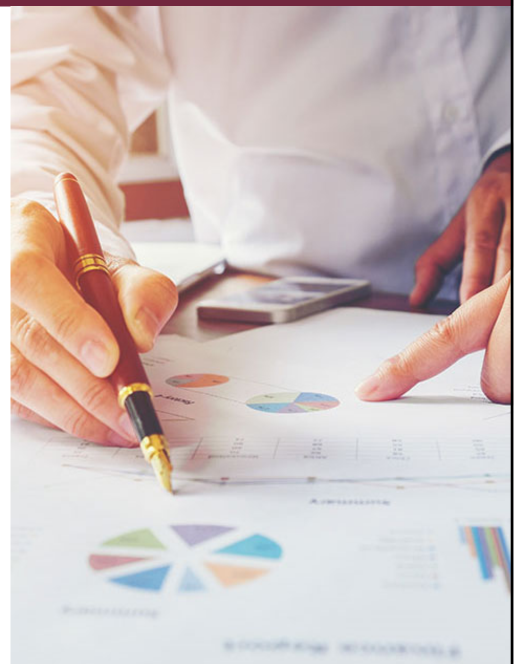
TAX CUTS & JOBS ACT
SEC. 199 DEDUCTION

Section 199 Domestic Production Activities Deduction ("DPAD")

Instituted in 2004, the Sec. 199 deduction allowed a deduction as a percentage (9%) of Qualified Production Activities Income ("QPAI")

- Sec. 199 deduction or DPAD Repealed
- Maximize historical benefit

Effective for tax years **beginning after** December 31, 2017



TAX CUTS & JOBS ACT
TREATMENT OF R&E EXPENSES

The Tax Cuts & Jobs Act modifies the expensing and capitalization rules of Research and Experimentation costs.

Current:

- Direct expensing
- Amortized or capitalize

Prospective:

- Domestic: Amortized over 5 years
- Foreign: Amortized over 15 years

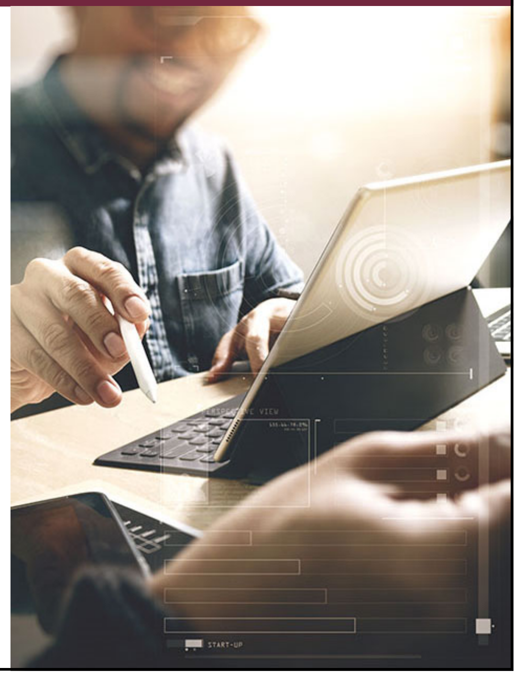
Effective for tax years **beginning after** December 31, 2021

WHAT'S NEW?
LB&I DIRECTIVE (ASC 730)

IRS Large Business & International (LB&I) division released guidance for taxpayers that expense R&D costs for financial statement purposes pursuant to ASC 730 (LB&I-04-0917-005)

If certain certification requirements are met:

- Examiners will not challenge QREs that are adjusted ASC 730 R&D costs for the credit year
- Any additional amount of QREs claimed by the taxpayer will be subject to risk assessment to determine the scope of the examination, if warranted



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WHAT'S NEW? - THE PATH ACT (2015)

The PATH Act (2015) made THREE major enhancements to the R&D Tax Credit

- Permanent Extension
- Payroll Tax Offset
- Alternative Minimum Tax (AMT)

PATH ACT (2015) - PAYROLL TAX OFFSET

Allows qualified startup businesses to claim up to $250,000 of the R&D tax credit against their payroll taxes

- A qualified startup is defined as a company with less than $5 million in gross receipts (for the current tax year) and no gross receipts for any tax year preceding the five tax year period ending with the tax year.
  - If first year of election is 2020, must have had no gross receipts in a tax year preceding 2016
- Cannot make election for more than 5 years
- Gross receipts are not required (companies with no gross receipts can make the election and use the credit).

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PATH ACT (2015) - PAYROLL TAX OFFSET (CONT.)

For companies that are <u>not</u> a partnership or S corporation, only the amount of the R&D credit that would be carried forward can be applied against the payroll tax

Election starts the first quarter after the return is filed

- If return is filed September 2019, would be able to use the credit against payroll taxes generated the 4th quarter of 2019

Good Candidates for the payroll election:

- Small business and Start-up companies
- Loss position companies
- Companies that have little or no federal tax liability

PATH ACT (2015) - PAYROLL TAX OFFSET EXAMPLE

ABC Pharma began operations in 2017 and is developing a new drug to treat infectious diseases. The company is a pre-revenue start-up operating as a C-Corp. and has 15 employees. Summary of 2018:

- Gross Receipts - $0
- Qualified Wages - $2,000,000
- R&D Credits - $200,000
- Qualified Payroll Taxes - $125,000

The Company will file their 2018 tax return in September 2018 and apply the credits to their payroll taxes in the fourth quarter of 2019. Unused credits will be carried forward.

Before law change R&D Credit Utilization = $0

*After law change R&D Credit Utilization = $ 125,000**

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PATH ACT (2015) - AMT OFFSET

Prior to PATH Act, Taxpayers in AMT could not use the research credit to offset AMT.

Eligible small businesses can use credit to offset AMT for tax years beginning after December 31, 2015

- An ***eligible small business*** is defined as a non-publicly traded company having an average of $50 million or less in gross receipts for the prior three tax years
- Provision is similar to the AMT relief in 2010
- Unused credits can be carried back or forward

Reminder: The Corporate AMT was repealed and the Individual exemption amounts were increased for tax years beginning after December 31, 2017 (Tax Cuts & Jobs Act, H.R. 1)


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POLLING QUESTION #2


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R&D TAX CREDIT OVERVIEW

OVERVIEW: R&D 4–PART TEST

1.Technological in Nature (§ 41)

The activity performed must fundamentally rely on principles of:

- Physical Science;
- Biological Science;
- Engineering; or
- Computer Science

2. Permitted Purpose (§ 41)

The activity must relate to a new/improved business component's:

- Function;
- Performance;
- Reliability; or
- Quality

3. Elimination of Uncertainty (§ 174)

The activity must be intended to discover information to eliminate uncertainty concerning the capability, method or design for developing or improving a product or process.

4. Process of Experimentation (§ 41)

The taxpayer must engage in an evaluative process designed to identify and evaluate more than one alternative to achieve a result.

For example: modeling, simulation or a systematic trial and error methodology.

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OVERVIEW - QUALIFIED RESEARCH EXPENSES

Wages

- (1) W-2, Box 1; (2) Partnership Earnings subject to SE tax; & (3) Schedule C
- Excludes 401k & pre-tax benefits, and wages used calculating Work Opportunity Credit under§51

Supplies

- Tangible property used or consumed in qualified research activities (i.e., compounds, chemicals active and inactive ingredients, materials for prototypes, etc.), excludes:
- (i) Land – acquisition & improvements; & (ii) Depreciable

Contract Research

- 65% of amounts paid to non-employees for qualified activities
- 75% of amounts paid to certain qualified research consortia
- 100% of amounts paid for energy research to eligible small businesses, universities, and Federal laboratories

OVERVIEW

Credit is equal to a percentage of the sum of:

- Current year Qualified Research Expenses (QREs) over a Base Amount;
- Basic Research Payments; and
- Amounts paid or incurred to an Energy Research Consortium

Activity Based Credit

- Determine Qualified Activities under the 4 *(or 7)* Part Test
- Identify related Qualified Research Expenses (QREs)

Incremental Credit

- QREs must exceed a Base Amount (Threshold Amount)
- Base Amount is recalculated each year

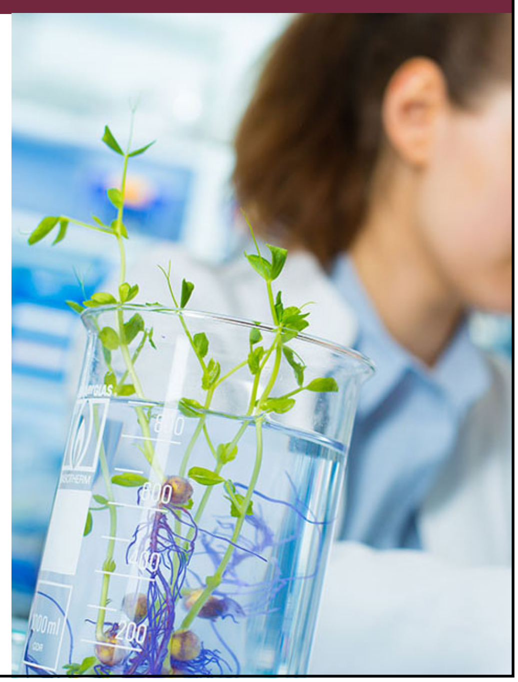
OVERVIEW - WHO QUALIFIES?

Any Employee who:

- Performs qualified activities
- Direct Supervision of other employees who perform qualified activities
- Direct Support of other employees who perform qualified activities
- Direct Supervision & Direct Support need not meet 4-Part Test

Outside Contract Service Providers:

- 65% of amounts paid or incurred for qualified research (paid to any person other than an employee of the taxpayer)



OVERVIEW - QUALIFIED ACTIVITIES

Qualified Activities

- Applied at the Business Component Level
  - Shrink-back rule
- Development of a new or improved
  - Product
  - Process
  - Software
  - Technique
  - Formula
- Design – new drugs, compounds, medical devices, diagnostics, packaging, etc.
- Prototype development – design and build
- Testing - clinical trials, prototypes, field tests
- Activities from concept through release to commercial production
- Success is not required

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OVERVIEW OF QUALIFIED ACTIVITIES - LIFE SCIENCES INDUSTRY

- Developing new or improved drugs, biologics, medical devices, etc.
- New or improved formulations to treat a new class of patients
- Developing improvements to increase shelf life
- Scaling up manufacturing and packaging trials or prototypes to full scale production batches
- Developing hardware and software systems for use in research and clinical development and medical device equipment
- Developing new uses for existing drugs
- Design and development of technology or manufacturing techniques for a new production line
- Developing technology for compliance with government regulations
- Replacements of new or alternative materials into existing processes as a result of a change in supplier

OVERVIEW OF QUALIFIED ACTIVITIES - LIFE SCIENCES INDUSTRY

- Development of new or improved safe packaging products, processes and technologies to meet USP requirements
- Phase IV clinical study activities that may involve studying a patient population not previously studied
- Tooling and equipment fixture design for medical devices
- Manufacture of clinical trial lots
- New or improved drug delivery systems
- 3D Bioprinting (ex: developing bioprinted kidneys)

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OVERVIEW - NON-QUALIFIED ACTIVITIES

- Activities outside the United States, Commonwealth of Puerto Rico, or any US possession
- Adaptation of an existing business component
- Duplication of an existing business component
- Social Sciences – “soft” sciences, arts, or humanities
- Studies related to efficiencies, management operations or profitability, style, taste, cosmetic or seasonal design factors
- Routine data collection
- Routine or ordinary QA testing
- Research after commercial production
- Funded Research – taxpayer must bear both the Economic Risk & Retain Rights in the results

OVERVIEW - CALCULATION METHODS

Two Available Credit Calculation Methods

- **Traditional Credit** - §41(a)(1) – "Old & Cold" Method
  - Base Period (1984 – 1988) or Start-up (1994 – forward)
- **Alternative Simplified Credit (ASC)** - §41(c)(5)
  - Effective for tax years ending after Dec. 31, 2006

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OVERVIEW – CALCULATION METHODS TRADITIONAL CREDIT

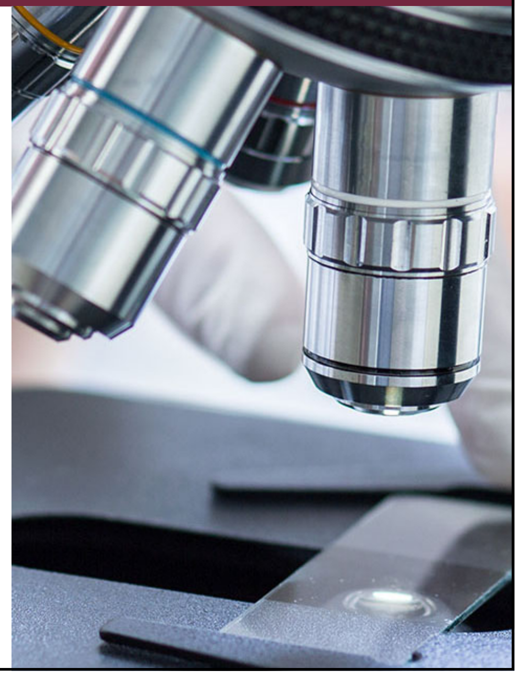
Traditional Credit – includes four components

1. Qualified Research Expenses (QREs)
2. Prior 4 Years Average Annual Gross Receipts (AAGR)
3. Fixed-Base % (FB%)
   - Fixed-Base % is the ratio of aggregate QREs over aggregate gross receipts for a specific period of time (typically 1984 -1988)
   - Maximum Fixed-Base % = 16%
4. Base Amount
   - GREATER of AAGR x FB% or 50% of current year QREs
   - Credit rate is applied to the increment of current R&D spend over the base amount

OVERVIEW – CALCULATION METHODS ALTERNATIVE SIMPLIFIED CREDIT (ASC)

ASC calculation – includes two components

1. QREs - same as defined under the Regular Credit:
   - Wages
   - Supplies
   - Contract Research
2. Base Amount = 50% x (Average QREs for the Prior 3 Years)



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OVERVIEW – CALCULATION METHODS ALTERNATIVE SIMPLIFIED CREDIT (ASC)

IRC §41(c)(5)

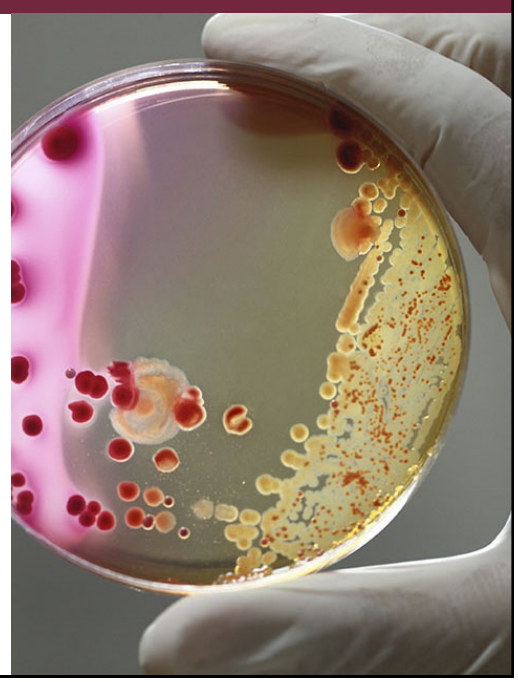
- Applicable for tax years ending after December 31, 2006

ASC Credit = 14% x QREs over Base Amount

- You can now amend into the ASC
- If no QREs in any 1 of 3 prior years, ASC Credit = 6% x Current Year QREs

Companies that may benefit from the ASC, include:

- Trouble establishing fixed-base percentage
- Large gross receipts
- Several subsidiaries

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POLLING QUESTION #3


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MAXIMIZING VALUE

MAXIMIZING VALUE

There are often additional benefits not fully claimed by many Life Science companies that may include:

- Bonuses and Stock Compensation
- Collaboration Agreements
- Contract Research
- Direct Support/Supervision
- Foreign Activities
- High-Level Executives
- Intragroup Transactions
- Job Titles
- Milestone Payments
- Non-traditional R&D Cost Centers
- Phase IV activities

The Key is Substantiation

OTHER CONSIDERATIONS

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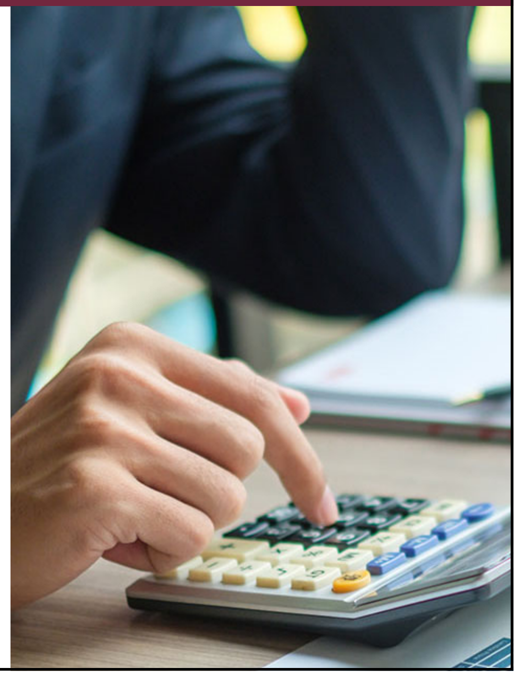
OTHER CONSIDERATIONS – IRS EXAMINATIONS

- Audit Technique Guide (ATG) outlines the areas agents will focus on when conducting their audits of R&D credit claims.
- LB&I Directive for the Pharmaceutical Industry (LB&I-04-1212-04)
- Coordinated Issue Paper for the Biotech and Pharmaceutical Industry (LMSB-04-1007-073)
- Judicial and Administrative Guidance
- Establishing Nexus
- The Key is **Substantiation**



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CONTEMPORANEOUS DOCUMENTATION

Concept Generation & Design
- Functional Requirements
- Project Authorization Requests
- Business Cases / Studies
- Project Schedules
- Budgets
- Design Documents & Revisions
- Architecture Documents
- PowerPoint Presentations
- Release Plans

Testing
- Test Data / Experimental Runs
- Lab Notebooks
- Progress Reports
- Issue Logs
- Meeting minutes / Notes / Agendas
- Predictive Modeling / CAD Analysis
- Emails relating to R&D

Record / Documenting Results
- R&D Projects List
- Product Evaluations / Reviews
- Data Sheets
- Reports to Management / Customer
- Lessons Learned
- Whitepapers
- Patents / Patent Applications
- Records of Invention
- Marketing Brochures


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POLLING QUESTION #4


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QUESTIONS?

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