ABOUT KBKG

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

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

SERVICES OVERVIEW

- **Research & Development Tax 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.

- **4SIL 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.

- **IC-DISC**
  
  The Interest Charge Domestic International Sales Corporation (ICDISC) offers significant Federal income tax savings for making or distributing U.S. products for export. IC-DISC benefits are available to qualified producers or distributors that are either directly involved in exporting, or selling products to distributors or wholesalers who resell for use outside of the U.S.

- **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.

- **Transfer Pricing Services**
  
  The cross-border transfer prices of goods, royalties, services, and loans drive how much income tax a multinational company pays by country. We assist US and international companies in establishing, documenting, and defending transfer pricing practices for the IRS and international tax authorities.

- **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.

KBKG is a national tax specialty firm with offices across the U.S. To see if you qualify, call us or visit KBKG.com/qualify for more information.
At KBKG, we are committed to identifying all possible tax saving opportunities for our clients and CPA partners. Our detailed Industry Matrix helps quickly determine which tax credits and deductions apply by industry at a glance. Our chart alone provides some insight to ensure that businesses are seeking out all potential benefits; however, KBKG’s certified engineers and technical experts perform a thorough assessment during the engagement process to be sure all possible incentives are identified and considered.

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

KBKG is a national tax specialty firm with offices across the U.S. To see if you qualify, call us or visit KBKG.com/qualify for more information.
# Identifying Value-Added Tax Opportunities

<table>
<thead>
<tr>
<th>KBKG Service</th>
<th>Description &amp; Highlights</th>
<th>Applicable Clients &amp; Industries</th>
<th>How Much Is It Worth?</th>
<th>Tax Considerations</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Research &amp; Development Tax Credits (Federal &amp; State)</strong></td>
<td>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.</td>
<td>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 including:</td>
<td>Federal Benefit - Roughly 10% of their total Qualified R&amp;D Expenses</td>
<td>• 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.</td>
</tr>
<tr>
<td><strong>Cost Segregation (Federal &amp; State)</strong></td>
<td>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.</td>
<td>Any building 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.</td>
<td>Net Present Value is roughly 5% of the total building cost.</td>
<td>• Reduces AMT • Starting in 2018, unused deductions carryforward. • Must recapture personal property and bonus eligible assets upon the sale of a building.</td>
</tr>
<tr>
<td><strong>Transfer Pricing (International)</strong></td>
<td>Federal credit for developers of apartments, condos, or spec homes that meet the transfer prices of goods, royalties, services, and loans drive how much income tax is paid by country. Corrections to transfer pricing may lead to significant improvements in a company’s global effective tax rate. Savings dependent on differences in tax rates between countries and can be significant. Tax reform provides incentives for companies to generate income in the US with lower rates certain energy efficiency standards. Units must be certified by a qualified professional to be eligible.</td>
<td>All US and foreign-owned multinational companies. Transfer pricing rules apply to goods, services, royalties, loans and other cross-border transactions in all industries Companies with supply chain restructuring programs, new R&amp;D facilities, or international subsidiaries are often best placed to realize benefits.</td>
<td>US tax reform has created opportunities to improve global effective tax rates through changes to transfer prices, e.g.</td>
<td>Companies without transfer pricing documentation can face additional tax, interest, non-deductible penalties and double tax for all open tax years. Tax authorities are concerned about multinational companies paying their “fair share” of income tax in each country where they operate.</td>
</tr>
</tbody>
</table>

---

**KBKG** is a national tax specialty firm with offices across the U.S. To see if you qualify, call us or visit KBKG.com/qualify for more information.
# Identifying Value-Added Tax Opportunities

<table>
<thead>
<tr>
<th>KBKG Service</th>
<th>Description &amp; Highlights</th>
<th>Applicable Clients &amp; Industries</th>
<th>How Much Is It Worth?</th>
<th>Tax Considerations</th>
</tr>
</thead>
</table>
| **Residential Energy Credits / Section 45L**<br>(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 (3 stories or less), 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. | • 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**<br>(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. <br><br>• 179D for designers: Architects, general contractors, engineers, electrical & HVAC subcontractors.  
• Any building owner or lessee: That has constructed a commercial improvement greater than 50,000 SF since 1/1/2006. | 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 (NPV) 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  
• 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. |
| **Fixed Asset Tax Review**<br>(Federal) | Comprehensive review of a company’s entire fixed asset listing and supporting documents to assign appropriate tax lives, identify retirements, and correct items that should be expensed. Includes cost segregation and repair analysis. | 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. |
| **Repair V. Capitalization Review “Asset Retirement Study”**<br>(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. | 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. | |
| **IC-DISC Federal Income Tax Incentive**<br>(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. |

*KBKG is a national tax specialty firm with offices across the U.S. To see if you qualify, call us or visit KBKG.com/qualify for more information.*
### Qualified Improvements - Depreciation Quick Reference (updated 3/30/2020)

<table>
<thead>
<tr>
<th>Qualified Improvement Property (QIP): 2018 - Onward</th>
<th>Applicable PIS Dates (inclusive)</th>
<th>MACRS GDS Recovery Period</th>
<th>Bonus Dep Eligible</th>
<th>3 Year Rule</th>
<th>Unrelated Parties Rule</th>
<th>179 Expense Eligible</th>
<th>Important Notes</th>
<th>Code Section</th>
</tr>
</thead>
<tbody>
<tr>
<td>01/01/18 – onward</td>
<td>15 Year / SL</td>
<td>Y</td>
<td>N</td>
<td>N</td>
<td>Y</td>
<td>Applies to interior common areas. Building can be owner occupied. No 3-year rule. See exclusions in definition.</td>
<td>168(e)(6)</td>
<td></td>
</tr>
<tr>
<td>1/1/16 – 12/31/17</td>
<td>39 Year / SL</td>
<td>Y</td>
<td>N</td>
<td>N</td>
<td>N</td>
<td>Applies to interior common areas. Building can be owner occupied. No 3-year rule. See exclusions in definition.</td>
<td>168(k)(3)</td>
<td></td>
</tr>
<tr>
<td>10/23/04 – 12/31/17</td>
<td>15 Year / SL</td>
<td>Y¹</td>
<td>Y</td>
<td>Y</td>
<td>2010 - 2017 ²</td>
<td>Landlord or lessee can make the interior improvement. See exclusions in definition.</td>
<td>168(e)(6)</td>
<td></td>
</tr>
<tr>
<td>9/11/01 – 10/22/04</td>
<td>39 Year / SL</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
<td>N/A</td>
<td>39 year QLI qualifies for Bonus. Landlord or lessee can make the interior improvement. See exclusions in definition.</td>
<td>168(e)(6)</td>
<td></td>
</tr>
<tr>
<td>1/1/16 – 12/31/17</td>
<td>15 Year / SL</td>
<td>Y</td>
<td>Y</td>
<td>N</td>
<td>2010 - 2017 ²</td>
<td>Building can be owner occupied. See exclusions in definition.</td>
<td>168(e)(6)</td>
<td></td>
</tr>
<tr>
<td>1/1/09 – 12/31/15</td>
<td>15 Year / SL</td>
<td>N²</td>
<td>Y</td>
<td>N</td>
<td>2010 - 2017 ²</td>
<td>Building can be owner occupied. See exclusions in definition.</td>
<td>168(e)(8)</td>
<td></td>
</tr>
<tr>
<td>1/1/09 – 12/31/17</td>
<td>15 Year / SL</td>
<td>N³</td>
<td>N</td>
<td>N</td>
<td>2010 - 2017 ²</td>
<td>Encompasses the entire building structure as well as interior costs. Can be an acquired building.</td>
<td>168(e)(7)</td>
<td></td>
</tr>
<tr>
<td>1/1/08 – 12/31/08</td>
<td>15 Year / SL</td>
<td>Y¹</td>
<td>Y</td>
<td>N</td>
<td>N/A</td>
<td>Applicable to all improvements attached to building.</td>
<td>168(e)(7)</td>
<td></td>
</tr>
<tr>
<td>10/23/04 – 12/31/07</td>
<td>15 Year / SL</td>
<td>N³</td>
<td>Y</td>
<td>N</td>
<td>N/A</td>
<td>Applicable to all improvements attached to building.</td>
<td>168(e)(7)</td>
<td></td>
</tr>
</tbody>
</table>

### Bonus Depreciation Rates (inclusive dates)

<table>
<thead>
<tr>
<th>Dates</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>9/11/01 - 5/5/03 ³</td>
<td>30%</td>
</tr>
<tr>
<td>5/6/03 - 12/31/04 &amp; 1/1/08 - 9/8/10 ⁸</td>
<td>50%</td>
</tr>
<tr>
<td>9/9/10 - 12/31/11 ⁹</td>
<td>100%</td>
</tr>
<tr>
<td>1/1/12 - 9/27/17 ⁸</td>
<td>50%</td>
</tr>
<tr>
<td>9/28/17 - 12/31/22 ⁸, 10, 11</td>
<td>100%</td>
</tr>
<tr>
<td>1/1/23 - 12/31/23 ⁸, 10, 11</td>
<td>80%</td>
</tr>
<tr>
<td>1/1/24 - 12/31/24 ⁸, 10, 11</td>
<td>60%</td>
</tr>
<tr>
<td>1/1/25 - 12/31/25 ⁸, 10, 11</td>
<td>40%</td>
</tr>
<tr>
<td>1/1/26 - 12/31/26 ⁸, 10, 11</td>
<td>20%</td>
</tr>
</tbody>
</table>

### 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.
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) Section 179 rules are modified to include certain improvements to buildings. See 179 Expense notes on page 2.
10) Bonus depreciation is available for used property placed in service after 9/27/17, however it does not apply to the portion where the taxpayer previously had a depreciable interest.
11) Bonus is not available to taxpayers with floor plan financing (motor vehicle, boat, farm machinery) unless they are exempt from business interest limitations.
Section 179 Expense Limitations (Dates, Dollar Limit, Reduction)

<table>
<thead>
<tr>
<th>Period</th>
<th>Limitation</th>
</tr>
</thead>
<tbody>
<tr>
<td>01/01/11 - 12/31/17</td>
<td>$500,000</td>
</tr>
<tr>
<td>1/1/18 onward</td>
<td>$1,000,000</td>
</tr>
</tbody>
</table>

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) 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, (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 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 benefiting a common area, or (iv) the internal structural framework of the building.

Qualified restaurant property 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 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 2016-2017: (QIP) 2016-2017: (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.

Qualified improvement property 2018-onward: (QIP) 2018-onward: (A) Any improvement made by the taxpayer 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:

Yes

No

Even if the defect was not known at the time of acquisition: Answer = YES

If using improved but comparable part only due to technology advancing (i.e. impractical to use old type) Answer = NO

If there was physical enlargement, expansion, or extension: Answer = YES

Ex. Office is converted to showroom; Answer = YES
Ex. 2. Three retail spaces converted to one retail space; Answer = NO

If brought to remanufactured or similar status under federal guidelines or manufacturer original specs. Answer = YES

If replacing a large physical portion of UOP: Answer = YES (Generally, replacing < 33%; Answer = NO)

Based on "facts and circumstances"

If replacing part that performs discrete and critical function in operation of UOP Answer = YES

If minor part breaks during normal use and causes UOP to temporarily cease to function: Answer = YES

If basis adjustment due to casualty loss, sale, or exchange of component. Answer = YES.

Was the expenditure "incurred by reason of an improvement" or did it directly benefit an improvement? Answer = No

Was it done in conjunction or at the same time as an improvement to a UOP? Answer = Yes

Was the cost necessary or critical to complete the associated improvement? Answer = No

Possible Repair Expense

KBKG, Inc. expressly disclaims any liability in connection with use of this document or its contents by any third party. Any US tax advice contained herein was not intended or written to be used, and cannot be used, for the purpose of avoiding penalties that may be imposed under the Internal Revenue Code (IRC) or applicable state or local tax law provisions. This document is for educational purposes only and is not intended, and should not be relied upon, as accounting or tax advice.

KBKG is a national tax specialty firm with offices across the U.S. To see if you qualify, call us or visit KBKG.com/qualify for more information.
## KBKG BUILDING UNIT OF PROPERTY & MAJOR COMPONENTS CHART

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.

<table>
<thead>
<tr>
<th>BUILDING STRUCTURE</th>
<th>LAND IMPROVEMENTS</th>
<th>HVAC SYSTEM</th>
<th>ELECTRICAL SYSTEM</th>
<th>PLUMBING SYSTEMS</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Roof system (membrane, insulation and structural supports)</td>
<td>• Landscaping (shrubs, trees, ground cover, lawn, irrigation)</td>
<td>• Heating system (boilers, furnaces, radiators)</td>
<td>• Service and distribution (panel boards, transformers, switchgear, metering)</td>
<td>• Plumbing fixtures (sinks, toilets, tubs etc.)</td>
</tr>
<tr>
<td>• Foundation</td>
<td>• Storm drainage (inlets, catch basins, piping, lift stations)</td>
<td>• Cooling system (compressors, chillers, cooling towers)</td>
<td>• Lighting (interior and exterior building mounted)</td>
<td>• Wastewater systems (drains, waste and vent piping)</td>
</tr>
<tr>
<td>• Other structural load-bearing elements, including stairs</td>
<td>• Site lighting (pole lights, bollard lights, up lights, wiring)</td>
<td>• Rooftop packaged units</td>
<td>• Site electrical utilities</td>
<td>• Domestic water (supply piping and fittings)</td>
</tr>
<tr>
<td>• Exterior wall system</td>
<td>• Hardscape (retaining walls, pools, water features)</td>
<td>• Air distribution (ducts, fans, etc.)</td>
<td>• Branch wiring (outlets, conduit, wire, devices etc.)</td>
<td>• Water heaters</td>
</tr>
<tr>
<td>• Ceilings</td>
<td>• Site structures (gazebos, carports, monument signs)</td>
<td>• Piping (heated, chilled, condensate water)</td>
<td>• Emergency power systems</td>
<td>• Site piping utilities</td>
</tr>
<tr>
<td>• Floors</td>
<td>• Paving (roads, driveway, parking areas, sidewalks, curbing)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Doors</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Windows</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Partitions</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Loading docks</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>FIRE PROTECTION SYSTEM</th>
<th>SECURITY SYSTEM</th>
<th>GAS DISTRIBUTION SYSTEM</th>
<th>ESCALATORS</th>
<th>ELEVATORS</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Sprinkler systems (piping, heads, pumps)</td>
<td>• Building security alarms (detectors, sirens, wiring)</td>
<td>• Gas piping including to/from property line and other buildings</td>
<td>• Stairs and handrails</td>
<td>• Elevator cars</td>
</tr>
<tr>
<td>• Fire alarms (detection and warning devices, controls)</td>
<td>• Building access and control systems</td>
<td></td>
<td>• Drive systems (motors, truss, tracks)</td>
<td>• Drive systems (motors, lifts, controls)</td>
</tr>
<tr>
<td>• Exit lighting and signage</td>
<td></td>
<td></td>
<td></td>
<td>• Suspension systems (counterweights, framing, guide rails)</td>
</tr>
<tr>
<td>• Fire escapes</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Extinguishers and hoses</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* Building unit of property (UOP) rules apply to each building structure located on a single property.

** Building system components with a different tax life are separate units of property. For example, a cost segregation study separating HVAC into 5-year & 39-year categories for a restaurant creates two separate HVAC units of property.

** Lessee of Building: Must apply the same units of property above but only to the portion of the building being leased.

** Personal Property: UOP are parts that are “functionally interdependent” (i.e. placing one part in service is dependent on placing the other part in service).

** Plant Property: UOP is each component that performs a discrete and critical function. Generally, each piece of machinery or equipment purchased separately.

** Network Assets: UOP is determined by taxpayer’s particular facts

### Definitions

** Plant Property: Machinery and equipment used to perform an industrial process such as manufacturing, generation, warehousing, distribution, automated materials handling, or other similar activities.

** Network Assets: Railroad track, oil and gas pipelines, water and sewage pipelines, power transmission and distribution lines, telephone and cable lines; -- owned or leased by taxpayers in each of those respective industries.

** Major Component: Part or combination of parts that performs a discrete and critical function in the operation of the unit of property.

** Incidental Component: Relatively small, inexpensive, or minor part that performs a discrete and critical function for the UOP. Generally, not capitalized because of its size, cost, or significance.

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 Review.

KBKG expressly disclaims any liability in connection with the use of this document or its contents by any third party. Any US tax advice contained herein was not intended or written to be used, and cannot be used, for the purpose of avoiding penalties that may be imposed under the Internal Revenue Code (IRC) or applicable state or local tax law provisions. This document is for educational purposes only and is not intended, and should not be relied upon, as accounting or tax advice.

KBKG is a national tax specialty firm with offices across the U.S. To see if you qualify, call us or visit KBKG.com/qualify for more information.
Welcome and thank you for joining KBKG’s live webinar

BEFORE WE GET STARTED

• We will start the live webinar at 1pm PT | 4pm 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 Software Development”
RD 300: Research & Development Tax Credits – Software Development

Download PowerPoint slides from KBKG.com/resources

All attendees are muted.
The webinar will begin promptly at 1 PM Pacific / 4 PM Eastern
ADMINISTRATIVE

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

- Research & Development Tax Credits
- R&D Audit Defense
- Cost Segregation
- Green Building Tax Incentives
- Repair & Maintenance Review
- Fixed Asset Depreciation Review
- Transfer Pricing
- IC-DISC
- Employment Tax Credits
TODAY'S PRESENTERS

Bill Taylor
Director –
Research & Development Tax Credit Services

Brian Applebaum
Senior Manager –
Research & Development Tax Credit Services
AGENDA

• Software Development Impacts

• R&D Tax Credit Overview

• Maximizing Value for Software Industry

• Other Considerations

• Questions
IMPACT OF SOFTWARE DEVELOPMENT

Industries:
- Aerospace & Defense
- Automotive
- Financial Services
- Healthcare
- Manufacturing
- Retail

Software Development Areas:
- Mobile Application Development
- Cyber Security
- Machine Learning
- Cloud Computing
- Natural Language Processing
OVERVIEW OF THE SOFTWARE INDUSTRY
SOFTWARE DEVELOPMENT LIFE CYCLE

Requirements Analysis & Specification
• Communication gaps could result in validation errors & bugs

Design / Coding
• Detailed functions & operations, screen layouts, business rules, process diagrams

Implementation / Product Release
• Modular and subsystems code, unit & module testing conducted

Testing
• Unit, system & user acceptance is conducted

Evolution
• Software revisions for next generation

By Clifffydcw - Own work, CC BY-SA 3.0, https://commons.wikimedia.org/w/index.php?curid=19054763
POLLING QUESTION #1
R&D TAX CREDIT OVERVIEW
R&D TAX CREDIT OVERVIEW

BENEFITS OF THE R&D TAX CREDIT

• Federal Tax Benefit: 7% to 10% of Qualified Research Expenses (QRE)
• Dollar-for-Dollar reduction in tax liability
• Provides cash relief needed to increase R&D activities, launch new software products, improve internal processes, hire additional engineers, 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
R&D TAX CREDIT 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.
R&D TAX CREDIT OVERVIEW R&D 4-PART TEST: SOFTWARE DEVELOPMENT

1. Technological in Nature (§ 41)
   The activity performed must fundamentally rely on principles of:
   • Computer Science
   • Software Engineering

2. Permitted Purpose (§ 41)
   • Programming for new modules, improved performance, increased speed, higher accuracy, enhanced features, new requirements, improved stability, etc.
   • Intent is key
   SUCCESS IS NOT REQUIRED

3. Elimination of Uncertainty (§ 174)
   Appropriate technology, optimal system performance, architecture, programming languages, effect on other modules, systems, apps, etc.

4. Process of Experimentation (§ 41)
   Evaluate alternative system designs, architectures, algorithms, new database management techniques, etc.
   Experiment with programming code, revising as necessary as the result of functional testing on the feature, module and system or platform levels.
R&D TAX CREDIT 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 to calculate Work Opportunity Credit under §51

Supplies – Typically do not apply to software industry
• Tangible property used or consumed in qualified research activities, excludes:
  • (i) Land – acquisition & improvements; & (ii) Depreciable

Contract Research
• 65% of amounts paid to non-employees for qualified activities

Rental/Lease of Computers/Cloud Computing
R&D TAX CREDIT 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

Outside Contract Service Providers:

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

Qualified activities must be performed in the United States
R&D TAX CREDIT OVERVIEW
QUALIFIED SOFTWARE ACTIVITIES

• Develop new or improved technologies
• Design and develop software architecture
• Establish functional relationships between software modules
• Program and test software source code
• Conduct unit, integration, functional, performance, and regression testing
• Develop feature enhancements
• Conduct analysis for new functional software end requirements, domain, software elements, or scope analysis for a new functional software enhancement
• Evaluate and establish functional specifications
• Many more....
R&D TAX CREDIT OVERVIEW
NON-QUALIFIED ACTIVITIES

• Routine maintenance of existing software applications or products
• Software application configuration
• Reverse engineering
• Performing studies or activities to select vendor products
• Upgrading to newer versions of hardware or software or installing vendor fix releases
• Data quality, data cleansing, and data consistency activities
• Bundling existing individual software products into product “suites”
R&D TAX CREDIT OVERVIEW INTERNAL USE SOFTWARE FINAL REGULATIONS

• Definition of Internal Use Software (IUS)
• Connectivity software
• Dual function software
  o Safe harbor
  o Third party definition
• High Threshold of Innovation Test
  o Software is innovative
  o Involved significant economic risk
  o Software is not commercially available
• The final regulations are prospective in nature
R&D TAX CREDIT OVERVIEW
EXAMPLE: INTERNAL USE SOFTWARE

A Salt Lake City-based company created a new billing system to replace its legacy system. The new system would automate several manual functions. Although it would have some client-facing features, it was primarily intended for internal use.

Started Operations: 2005
Number of Software Engineers: 4
Employee Wages: $4,600,000
Qualified Wages: $200,000
2022 Federal Credit: $20,000
2022 Utah Credit: $20,000

Total of $40,000 in federal & state credits for 2022.

Qualified Project:
- Programmed modules to allow improved customer and vendor access to data within the company’s database
- NOTE: Since this new billing system was considered dual use software, only the portion of the development dedicated to client-facing features and functionality were captured as qualified expenses.
R&D TAX CREDIT OVERVIEW
THE PATH ACT (2015)

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

- Permanent Extension
- Payroll Tax Offset up to $250,000*
- Alternative Minimum Tax (AMT)

  o 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)

*Increases to $500,000 for tax years beginning after December 31, 2022
R&D TAX CREDIT OVERVIEW
EXAMPLE: PAYROLL TAX OFFSET

ABC Software began operations in 2021 and is developing a new gaming app. The company is a pre-revenue start-up operating as an S-Corp and has 15 employees.

Summary of 2022:

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

The Company filed its 2022 tax return in April 2023 and will apply the credits to its payroll taxes in the 3rd quarter of 2023.Unused credits will be carried forward to the 4th quarter of 2023.

Before law change R&D Credit Utilization = $0
After law change R&D Credit Utilization = $125,000
R&D TAX CREDIT OVERVIEW
EXAMPLE: GAMING SOFTWARE

An Atlanta-based software company created a new gaming software for a popular video game series.

Started Operations: 2021
Number of Software Engineers: 10
Employee Wages: $1,400,000
Qualified Wages: $800,000
2022 Federal Credit: $73,000
2022 Georgia Credit: $62,000

Total of $135,000 in federal & state credits for 2022.
Able to offset payroll tax with R&D credits.

Qualified Projects:
• Programmed software to animate gaming assets
• Designed and coded custom 3D graphics and animation as well as sound effects
• Designed a proprietary motion capture software for realistic game character animation
• Developed a game networking architecture for multiplayer online games
R&D TAX CREDIT OVERVIEW
EXAMPLE: SOFTWARE AS A SERVICE (SAAS)

An Indianapolis-based software company developed a new cloud-based enterprise resource planning (ERP) software, which it licenses to customers on a subscription basis.

Started Operations: 2015
Number of Software Engineers: 12
Employee Wages: $2,500,000
Qualified Wages: $1,000,000
Taxable Position: Pays regular tax
Payroll Tax Credit: Ineligible (> 5 years)
2022 Federal Credit: $100,000
2022 Indiana Credit: $76,000

Qualified Projects:
• Programmed code to add new search functions, improved speed for data retrieval and generation of customizable reports
• Developed new application controls to improve data security
• Designed a new user-friendly mobile app for access via tablet or smartphone

Total of $176,000 in federal & state credits for 2022. Unable to offset payroll tax with R&D credits.
R&D TAX CREDIT OVERVIEW
EXAMPLE: AMT TAX OFFSET

R&D Tax Credit Utilization *for tax years beginning 1/1/2016*

2022 R&D Tax Credit Generated = $331,000
2022 Total Tax Liability = $219,000*
  * 2022 Regular Tax Liability = $188,000
  * 2022 AMT Liability = $31,000
  Total = $219,000

2022 R&D Credit Utilization = $178,250
2022 Total Tax Liability after Credit = $40,750

Total Tax Savings = $178,250
*Prior to PATH ACT Changes Total Tax Savings Would = 0*
R&D TAX CREDIT OVERVIEW
EXAMPLE: FINANCIAL SERVICES SOFTWARE

An Austin-based software company developed software tools designed to help banks, loan offices and investment firms perform their job functions, stay compliant with federal and state regulations and better service their clients.

Started Operations: 2021
Number of Software Engineers: 10
Employee Wages: $1,500,000
Qualified Wages: $750,000
Taxable Position: Not profitable
Payroll Tax Credit: Eligible
2022 Federal Credit: $75,000
2022 Texas Credit: $24,000

Total of $99,000 in federal & state credits for 2022. Able to offset payroll tax.

Qualified Projects:
• Programmed code to create a new lending platform to allow lenders to access data easier, view and share loan data and order services
• Designed a new compliance management software, allowing clients to streamline audit processes, provide improved visibility to customer documents and respond more quickly and accurately to customer concerns
OVERVIEW OF THE SOFTWARE INDUSTRY
EXAMPLE: DATA SCIENCE SOFTWARE

A Chicago-based software company created a new data science platform used by data scientists, data analysts and engineers to prototype, build and deliver their data products.

Started Operations: 2010
Number of Software Engineers: 23
Employee Wages: $3,500,000
Qualified Wages: $2,000,000
Taxable Position: Pays Regular Tax
Payroll Tax Credit: Ineligible (> 5 years)
2022 Federal Credit: $200,000
2022 Illinois Credit: $52,000

Total of $252,000 in federal & state credits for 2022.

Qualified Projects:
• Programmed code to optimize communication of data to over 20 data storage systems
• Designed a system enabling customers to detect fraud with predictive analytics.
• Programmed applications so customers could import data, use various proprietary modules to analyze various data sets across multiple platforms and from various devices.
R&D TAX CREDIT OVERVIEW
EXAMPLE: SALES & MARKETING SOFTWARE

A Los Angeles S Corp created software to manage prospecting activities in a single place, providing tools to efficiently manage the sales pipeline and automating sales campaigns.

Started Operations: 2019
Number of Software Engineers: 13
Employee Wages: $2,500,000
Qualified Wages: $1,300,000
Taxable Position: Owner pays AMT
Payroll Tax Credit: Eligible
2022 Federal Credit: $156,000
2022 California Credit: $97,000

Qualified Projects:
• Programmed code to automate manual data entry tasks
• Designed a system enabling customers access to data from various email accounts, content management systems, voicemail and call logs
• Programmed a pipeline management system with improved security and alert notification capability

Total of $253,000 in federal & state credits for 2022.
Owner able to offset AMT and payroll tax with R&D credits.
R&D TAX CREDIT OVERVIEW
EXAMPLE: SOFTWARE IN HARDWARE

A Philadelphia-based company manufactures kiosks and ATMs for airports, shopping malls and convention centers. Its software engineers develop the software that goes inside its kiosks.

Started Operations: 2008
Number of Software Engineers: 14
Employee Wages: $2,500,000
Qualified Wages: $1,300,000
Taxable Position: Pays Regular Tax
Payroll Tax Credit: Ineligible (> 5 years)
2022 Federal Credit: $135,000
2022 Pennsylvania Credit: $65,000

Qualified Projects:
• Programmed code to improve security through enhanced encryption
• Developed proprietary software for robotics equipment on the production line
• Programmed code to allow access to multiple applications without exiting the main dashboard

Total of $200,000 in federal & state credits for 2022. Unable to claim the credit against payroll tax.
POLLING QUESTION #3
MAXIMIZING VALUE FOR THE SOFTWARE INDUSTRY
MAXIMIZING VALUE FOR SOFTWARE INDUSTRY
SOFTWARE DEVELOPMENT EXAMPLES

• Mobile apps
• Software in hardware
• Manufacturing process control software
• Data science software
• Accounting and financial software
• Logistics management software
• Security software
• Claims processing software
• Content management software
• Database management software
• Video games and game creation software
• Medical and healthcare management software
• Sales and marketing software
• Software as a Service (SaaS)
MAXIMIZING VALUE FOR SOFTWARE INDUSTRY: ADDITIONAL BENEFITS

There are often additional benefits not fully claimed by many Software Development companies that may include:

• Bonuses, Stock Compensation and K-1 income, subject to SE Tax
• Contract Research
• High-Level Executives
• Job Titles
• Employees outside of the core software development departments
• Software development for customers
• Internally-funded software projects
• Internal-use software
• Cloud computing server rental expenses

*The Key is Substantiation*
OTHER CONSIDERATIONS
IRS AUDIT CONSIDERATIONS

IRS Chief Counsel Memorandum 20214101F

- Currently applies to amended or not timely filed returns
- Requires additional information to be submitted for a claim to be considered “valid”:
  - Identify all the business components to which the I.R.C. § 41 research credit claim relates for that year.
  - For each business component: identify all research activities performed; identify all individuals who performed each research activity; and identify all the information each individual sought to discover.
IRS AUDIT CONSIDERATIONS

Upcoming Sec 174 changes (effective 1/1/2022)
The new rules will require specified R&E expenditures to be capitalized and amortized beginning at the midpoint of the tax year incurred, over:
- 5 years for expenditures associated with the research conducted in the United States
- 15 years if research is conducted outside the United States
- Software development costs will be defined as specified R&E expenditures under IRC 174
- 3115 Adjustment will be required

Audit Technique Guide (ATG) outlines the areas agents will focus on when conducting their audits of R&D credit claims
• Highly-Compensated Employees
• Funded Research
• Contemporaneous Documentation
• Process of Experimentation
OTHER CONSIDERATIONS
CONTemporaneous Documentation

• Initiation & Concept Development
• Concept Proposal
• Systems Boundary Document
• Cost Benefit Analysis
• Risk Management Plan
• Feasibility Study
• Planning & Requirements Analysis
• Project Management Plan
• Functional Requirements
• Design & Development
• Systems Design Document
• Source Code Samples
• Test Readiness Review
• Revision Notes / Release Notes
• Screen Layouts

• Process Diagrams
• Integration & Testing
• Quality Assurance Test Procedures
• Test Analysis Reports
• Recommendations for Redesign
• Implementation
• Trouble-shooting Documents
• Lessons Learned
• Other Documents
• Patents / Patent Applications
• User Guides
• Technical Meeting Agenda / Minutes
• Emails Detailing Technical Issues
POLLING QUESTION #4
BILL TAYLOR

Director – Research & Development Tax Credit Services
877.525.4462 x380 | bill.taylor@kbkg.com

www.kbkg.com/management/bill-taylor
www.linkedin.com/in/billrtaylor/

BRIAN APPLEBAUM

Senior Manager – Research & Development Tax Credit Services
877.525.4462 x167 | brian.applebaum@kbkg.com

www.kbkg.com/management/brian-applebaum
www.linkedin.com/in/brian-applebaum-a384bb160/
CPE CERTIFICATES

KBKG

*Please allow 2-3 weeks for your CPE certificates to be available.

Login to solutions.kbkg.com
  • Get CPE certificates

Questions about your certificates?
877-525-4462 x162
webinars@kbkg.com

CPA Academy

Login to your account at CPAacademy.org
  • Fill out evaluation form
  • Get CPE certificates

Questions about your certificates?
877.510.5302
info@cpaacdemy.org
Prefer engaging people and being social vs. crunching numbers all day?

Our Business Development team is looking for CPAs or tax staff seeking a career that utilizes your social skills. Flexible work from any location!

Find out more: https://www.kbkg.com/careers