COST SEGREGATION

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CFMA Lone Star Conference
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PARTNER

Education
B.S.C.E– University of Houston

Experience
10 years in design & construction
Licensed Prof. Engineer in 30+ states
• R&D Tax Credits
• 179D & 45L Energy Efficient Incentives
• Cost Segregation

Resides in Houston, TX with wife and 2 children
AFFILIATIONS & MEMBERSHIPS

American Institute of Architects - CES Provider & A’19 CE Theater Presenter

WHO WE ARE

Support CPA firms and their business clients with specialty tax incentives

Client value-focused

Engineers Attorneys CPAs
• Background and Tax Cuts & Jobs Act (TCJA) updates
• The deduction and capitalization of expenditures related to tangible property
• Bonus Depreciation/Section 179 Expensing
• 179D Energy Efficient Commercial Building Deductions & 45L Residential Energy Efficient Tax Credits
• MACRS and the accelerated depreciation of property

"You don't pay taxes-they take taxes."
- Chris Rock
COST SEGREGATION BACKGROUND

• Depreciable property
  • Acquired
  • New construction
  • Renovations
• Segregating costs
• Shorten recovery periods
• Accelerated deductions & increased cash flow

MACRS

<table>
<thead>
<tr>
<th>Years</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>39</td>
<td>39-Year Property (Commercial)</td>
</tr>
<tr>
<td>27.5</td>
<td>27.5-Year Property (Residential)</td>
</tr>
<tr>
<td>15</td>
<td>15-Year Property</td>
</tr>
<tr>
<td>7</td>
<td>7-Year Property</td>
</tr>
<tr>
<td>5</td>
<td>5-Year Property</td>
</tr>
</tbody>
</table>

No Cost Segregation

Depreciation Recovery

• 39 Years
Cost Segregation
Depreciation Recovery

9 yrs
5 yrs
3 yrs
39 Years

Cost Segregation w/ 100% Bonus Depreciation (TCJA)

Reclassification | Amount
--- | ---
5-Year | 750,000
15-Year | 750,000
Add. Deductions Year 1 | 1,400,000
NPV | 325,000

No Cost Segregation

$5M Office Building Example

Cost Segregation + $5M Office Building Example

YEARS

DEDUCTIONS

$0 $200,000 $400,000 $600,000 $800,000 $1,000,000 $1,200,000 $1,400,000 $1,600,000

$32 $33 $34 $35 $36 $37 $38 $39
COST SEGREGATION

Accelerated Depreciation

Examples

<table>
<thead>
<tr>
<th>5-Year</th>
<th>15-Year</th>
<th>39-Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Carpet</td>
<td>Parking Lot Paving</td>
<td>Building Structure</td>
</tr>
<tr>
<td>Window Treatments</td>
<td>Drainage</td>
<td>Doors &amp; Windows</td>
</tr>
<tr>
<td>Equipment</td>
<td>Retaining Walls</td>
<td>HVAC System</td>
</tr>
<tr>
<td>Deco &amp; Task Lighting</td>
<td>Fencing</td>
<td>Fire, Security</td>
</tr>
<tr>
<td>Certain Cabinetry</td>
<td>Landscaping</td>
<td>Elevators</td>
</tr>
<tr>
<td>Certain Plumbing</td>
<td>Sidewalks</td>
<td>Lighting</td>
</tr>
<tr>
<td>Certain Electrical</td>
<td>Pools</td>
<td>Plumbing</td>
</tr>
</tbody>
</table>

TAX CONSIDERATIONS

- Cost segregation and catching up deductions in prior year acquisitions, renovations, and newly built properties DOES NOT require amending returns
  - Form 3115 Change in Accounting Method
- Depreciation deductions reduce AMT (Alternative Minimum Tax)
- Unused deductions carry forward
- When building is sold, personal property depreciation must be recaptured and subject to Ordinary Tax

*** TAX TIP: Lessee and Lessor can create language in lease agreements to benefit one or the other in maximizing depreciation deductions
## CATCHING UP DEDUCTIONS

### CASE STUDY
- 20 Buildings, 300,000 SF Retail and Office
- 10 Years of Construction, Renovations
- Cost Segregation resulted in $1,500,000 in “catch up” deductions
- Example:

<table>
<thead>
<tr>
<th>2015 Renovation</th>
<th>Original Accumulated Deductions (39-Year)</th>
<th>New Accumulated Deductions (5-Year)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Task Lighting</td>
<td>3,500</td>
<td>35,500</td>
</tr>
</tbody>
</table>

“Catch Up” Deductions → 32,000

- $500k in repairs and partial dispositions which leads us to the next slide...

“The hardest thing in the world to understand is the income tax.”

- Albert Einstein
COST SEGREGATION

Accelerated Depreciation

Repairs vs. Improvements & Partial Dispositions

Betterment    Adaptation    Restoration

BETTERMENT EXAMPLE

• Ameliorates a material condition/defect that existed pre-acquisition or arose during production, OR
• Material addition, OR
• Material increase in:
  • Capacity,
  • Productivity,
  • Efficiency,
  • Strength, or
  • Quality.

Major Retail Company
• Energy Analysis 50+ Buildings, 5.5M Square Feet
• 2014 Installation of Variable Fan Drives
• $1.5M Construction Cost
• Materially increased energy efficiency = Betterment and therefore an Improvement and must be capitalized
• 179D Energy Efficient Commercial Building Deduction
  • $1.75M Tax Deduction
  • $700k Year 1 Increased Cash Flow
  • $350k Net Present Value
RESTORATION EXAMPLE

- Office Building
- 75% of Interior Lighting Replaced
  - Substantial part of Lighting Unit of Property, Restoration
  - Capitalize New Lighting
  - Loss Deduction for remaining basis
- HVAC Thermostat Controls Replaced
  - Not substantial part of HVAC Unit of Property, not Restoration
  - Not Betterment
  - Repair
  - Expense

UNIT OF PROPERTY

- Building Structure
- HVAC
- Plumbing
- Electrical
- Escalators
- Elevators
- Fire protection and alarm systems
- Security
- Gas distribution
- Other systems identified in published guidance
DISPOSITIONS

• Proper recognition of loss deductions for disposed property
• Partial dispositions for buildings & structural components
• Deduction for value (basis) plus cost to remove (demo)
• Basis determination:
  • Cost segregation
  • Producer Price Index (PPI)

COST SEGREGATION

- Accelerated Depreciation
- Repairs vs. Improvements & Partial Dispositions
  - Betterment
  - Adaptation
  - Restoration
- 179D Energy Efficient Building Deductions
  Up to $1.80/SF depreciation deduction
# 179D Energy Efficient Incentive Basics

<table>
<thead>
<tr>
<th>FOR BUILDINGS CONSTRUCTED</th>
<th>FEDERAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006 through 2017</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>QUALIFICATION</th>
<th>FEDERAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Designers / Builders of Govt. Owned Buildings</td>
<td>Subject to SOL. Requires Allocation</td>
</tr>
<tr>
<td>Commercial Building Owners</td>
<td>Subject to depreciation rules</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>ELIGIBLE QUALIFIED PROPERTY</th>
<th>FEDERAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>HVAC / Hot Water</td>
<td>New Construction</td>
</tr>
<tr>
<td>Interior Lighting</td>
<td>Renovation</td>
</tr>
<tr>
<td>Building Envelope</td>
<td>Addition</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>EXAMPLE QUALIFIED GOVERNMENT OWNERS</th>
<th>FEDERAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>K-12 Schools</td>
<td>State (Univ., etc.)</td>
</tr>
<tr>
<td>Local, City, County</td>
<td>GSA, Army Corp...</td>
</tr>
</tbody>
</table>

| VALUE | $0.30 - $1.80 per square foot federal tax deduction |

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# 45L Energy Efficient Home Tax Credit

<table>
<thead>
<tr>
<th>FOR HOMES SOLD/LEASED:</th>
<th>FEDERAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006 through 2017</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>QUALIFICATION</th>
<th>FEDERAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Must own basis in property during construction</td>
<td>New Construction</td>
</tr>
<tr>
<td>Requires testing/inspection in minimum 10% of units</td>
<td>Major Renovation</td>
</tr>
<tr>
<td>RESNET Certification</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>ELIGIBLE QUALIFIED PROPERTY</th>
<th>FEDERAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Apartments</td>
<td></td>
</tr>
<tr>
<td>Condos</td>
<td></td>
</tr>
<tr>
<td>Single Family Homes</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>TYPICAL BENEFICIARIES</th>
<th>Home Builders &amp; Residential Developers</th>
</tr>
</thead>
</table>

| VALUE | $2,000 tax credit per unit |
"A tax loophole is something that benefits the other guy. If it benefits you, it is tax reform."

- Russell B. Long
New Tax Law Impacts on Cost Segregation

• Bonus Depreciation (Changes start 9/28/2017)
  - Increased from 50% → 100%
  - Now applies to used property (huge benefit for acquisitions)

• Qualified Improvement Property (start 2018)*
  - 15-Year Life intended → Leasehold/restaurant/retail improvement categories eliminated
  - Bonus Depreciation intended to apply

• Interest Expense Limitation, 163(j) (start 2018)
  - Small Business Exemption (<25M avg GRs)
  - Real Property Trade or Business can elect out
    - Requires ADS Depreciation on real property, QIP for ALL properties
    - 5, 7, and 15-year property can still be segregated, and bonus depreciation applies

* The intent of Congress through the Conference Committee’s Joint Explanatory Statement was for QIP to be eligible for bonus depreciation. The actual legislation did not properly amend Section 168 to provide a 15-year life or bonus depreciation for QIP.

BONUS DEPRECIATION

• Additional 1st Year Depreciation
• Generally property < 20yr recovery period
• 50% → 100%
• Used property

<table>
<thead>
<tr>
<th>From</th>
<th>To</th>
<th>Bonus Depreciation</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>01/01/2012</td>
<td>09/27/2017</td>
<td>50%</td>
<td>2,3</td>
</tr>
<tr>
<td>09/28/2017</td>
<td>12/31/2022</td>
<td>100%</td>
<td>2,3</td>
</tr>
<tr>
<td>01/01/2023</td>
<td>12/31/2023</td>
<td>80%</td>
<td>2,3</td>
</tr>
<tr>
<td>01/01/2024</td>
<td>12/31/2024</td>
<td>60%</td>
<td>2,3</td>
</tr>
<tr>
<td>01/01/2025</td>
<td>12/31/2025</td>
<td>40%</td>
<td>2,3</td>
</tr>
<tr>
<td>01/01/2026</td>
<td>12/31/2026</td>
<td>20%</td>
<td>2,3</td>
</tr>
</tbody>
</table>

2. In order to qualify for 100% bonus depreciation, both the acquisition date and the placed-in-service date of the qualified property must fall after 9/27/2017. There are special rules for self-constructed property.
3. Bonus depreciation is potentially available for used property placed in service after 9/27/17.
QUALIFIED IMPROVEMENT PROPERTY (QIP)

<table>
<thead>
<tr>
<th>QUALITY IMPROVEMENTS</th>
<th>FROM</th>
<th>TO</th>
<th>MACRS</th>
<th>DEDUSSION</th>
<th>3-YR RULE</th>
<th>CODE SECTION</th>
<th>NOTES</th>
</tr>
</thead>
<tbody>
<tr>
<td>QUALIFIED LEASEHOLD IMPROVEMENTS (QLI)</td>
<td>2016</td>
<td>2017</td>
<td>30y</td>
<td>Y</td>
<td>N</td>
<td>N</td>
<td>1602(3)(i)</td>
</tr>
<tr>
<td>QUALIFIED LEASEHOLD IMPROVEMENTS (QLI)</td>
<td>2008</td>
<td>2017</td>
<td>15y</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
<td>1602(3)(i)</td>
</tr>
<tr>
<td>QUALIFIED LEASEHOLD IMPROVEMENTS (QLI)</td>
<td>2008</td>
<td>2017</td>
<td>15y</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
<td>1602(3)(i)</td>
</tr>
<tr>
<td>QUALIFIED RETAIL IMPROVEMENT PROPERTY (QRP)</td>
<td>2016</td>
<td>2017</td>
<td>15y</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
<td>1602(3)(i)</td>
</tr>
<tr>
<td>QUALIFIED RETAIL IMPROVEMENT PROPERTY (QRP)</td>
<td>2009</td>
<td>2015</td>
<td>15y</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
<td>1602(3)(i)</td>
</tr>
<tr>
<td>QUALIFIED RESTAURANT IMPROVEMENT PROPERTY (QRP)</td>
<td>2009</td>
<td>2015</td>
<td>15y</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
<td>1602(3)(i)</td>
</tr>
<tr>
<td>QUALIFIED RESTAURANT IMPROVEMENT PROPERTY (QRP)</td>
<td>2008</td>
<td>2008</td>
<td>15y</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
<td>1602(3)(i)</td>
</tr>
</tbody>
</table>

* The intent of QIP change was to essentially expense all renovation costs, with few exceptions. Technical corrections will need to be passed by congress to fulfill this intent.

INTEREST EXPENSE LIMITATION

- Deductible business interest expense limited to the sum of:
  1. the taxpayer’s business interest income for the year;
  2. 30% of the taxpayer’s adjusted taxable income (ATI) for the year; and
  3. the taxpayer’s floor plan financing interest expense for the year.

- Small Business Exemption (<25M avg GRs) (doesn’t include “syndicates”)
- Real Property Trade or Business can elect out
  - Requires ADS Depreciation on real property, QIP for ALL properties
  - 5, 7, and 15-year property can still be segregated, and bonus depreciation applies
"You must pay taxes. But there's no law that says you gotta leave a tip."

- Morgan Stanley

COST SEGREGATION

- Accelerated Depreciation
- Repairs vs. Improvements & Partial Dispositions
  - Betterment
  - Adaptation
  - Restoration
- 179D Energy Efficient Building Deductions
  - Up to $1.80/SF depreciation deduction
- Bonus Depreciation & Qualified Improvements
  (see BRAYN worksheet and make your life easier)
- Audit Support
### Manufacturing Facility
**105,000 SF**  
2017 - $5M Renovation

#### IMPROVEMENTS EVALUATION

<table>
<thead>
<tr>
<th></th>
<th>TRADITIONAL COST SEGREGATION</th>
</tr>
</thead>
<tbody>
<tr>
<td>REPAIR costs to be expensed (Roof, Ceiling, Misc)</td>
<td>$250,000</td>
</tr>
<tr>
<td>PARTIAL DISPOSITIONS (Lighting, HVAC, etc.)</td>
<td>$150,000</td>
</tr>
</tbody>
</table>

#### COST SEGREGATION

<table>
<thead>
<tr>
<th>Period</th>
<th>5-Year Recovery Period</th>
<th>15-Year Recovery Period</th>
<th>39-Year Recovery Period</th>
</tr>
</thead>
<tbody>
<tr>
<td>15%</td>
<td>15%</td>
<td>75%</td>
<td></td>
</tr>
<tr>
<td>10%</td>
<td>10%</td>
<td>75%</td>
<td></td>
</tr>
<tr>
<td>75%</td>
<td>75%</td>
<td>75%</td>
<td></td>
</tr>
</tbody>
</table>

#### BONUS DEPRECIATION (50%)  
$550,000  

#### 179D ENERGY EFFICIENCY DEDUCTION  
105,000 SF @ $1.80/SF  
$190,000  

### BENEFITS

<table>
<thead>
<tr>
<th></th>
<th>2017</th>
<th>Years 1-5</th>
</tr>
</thead>
<tbody>
<tr>
<td>Additional Tax Deductions</td>
<td>$1,250,000</td>
<td>$1,500,000</td>
</tr>
<tr>
<td>Increased Cash Flow</td>
<td>$500,000</td>
<td>$590,000</td>
</tr>
</tbody>
</table>

#### Net Present Value (after tax)*

<table>
<thead>
<tr>
<th></th>
<th>2017</th>
<th>5-Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>$400,000</td>
<td>$250,000</td>
<td></td>
</tr>
</tbody>
</table>

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### COST SEGREGATION

- Accelerated Depreciation Deductions
- Maximized with Repairs & Dispositions
- 100% Bonus Depreciation now applies to acquisitions
- Prior year tax returns don’t need to be amended
- 179D Energy Efficient Deduction
- 45L Energy Efficient Credit
BRAYN’S 3-PHASE PROCESS

Phase 1: Assessment
Phase 2: Detailed Calculations
Phase 3: Comprehensive Documentation

No Cost and No Further Obligation

FIXED FEE

Q&A
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