Cost Segregation Services Incorporated

Oregon Restaurant & Lodging Association

Tax Benefits Overview

For Business Owners who Own or Lease Commercial Real Estate

Using the CARES Act to Obtain Additional Cash Flow to Address COVID-19

May 26, 2020

Objectives

1. What CARES Act changes apply to building owners and tenants who have paid for improvements
2. How to capture these benefits if you have already filed or are planning to extend
3. What is Cost Segregation and how it lends itself to maximize cashflow available from the CARES Act
4. What is Partial Asset Disposition and how will it reduce taxes
5. What changes have taken place to interior improvements defined as Qualified Improvement Property
6. How a Cost Segregation study saved a restaurant owner who opened a second location in 2008 from a cash flow disaster
7. The secret to maximizing the amount of your real estate income that is active (vs passive)
8. Action steps to take to capture these benefits

Executive Summary

1. Many of you have pursued the Paycheck Protection Program (PPP) process via The CARES Act by asking your tax professional to provide info to your banker.
2. The CARES Act includes other cash flow processes by asking a cost segregation company to provide info to your tax professional
3. The foundation of these processes is an engineering-based cost segregation study.
4. A cost segregation study identifies components eligible for rapid depreciation.
5. In normal times – owners defer income taxes up to 39 years taking advantage of time value of money that requires 0 interest.
6. The CARES Act allows business owners the option to recover previous paid income taxes as far back as 2014
7. If you purchased a building for your business or trade in 2019 or 2020 using a separate entity you may have options to have deductions for the building offset income from your business

How Does This Affect You and Your Business?

1. Business are looking for cash flow to address this critical time.
2. Generally want to decrease federal income taxes and increase cash flow.
3. Many who have already filed your taxes for 2019 could possibly receive a refund using Form 1045 (carryback form).
4. Those who have extended their filing date could possibly reduce their tax burden and free up additional cash flow
5. Those paying quarterly estimates for 2020 could possibly reduce the estimates with the cost segregation / Cares Act results.

The CARES Act for Businesses

1. Allows for a 5-year carryback of net operating losses (NOL) arising in 2018, 2019 or 2020.
2. The 5-year carryback rules require the tax payer to go back 5 years (2014 tax year) and roll forward from there if the loss is in excess of the carry year's income.
3. Example – John Smith has income for the past 5 years, and a loss in 2019 generated from a cost segregation study as follows:

	Income	Taxed Paid	Loss Carryback	Refund Due
2014	$ 75,000.00	$ 14,606.25	$ (75,000.00)	$ 14,606.25
2015	$ 150,000.00	$ 35,071.25	$ (150,000.00)	$ 35,071.25
2016	$ 400,000.00	$ 115,529.25	$ (200,000.00)	$ 66,000.00
2017	$ 350,000.00	$ 95,906.75		
2018	$ 195,000.00	$ 44,089.50		
2019	$ (425,000.00)			
			Total Refund	$ 115,677.50

Potential Result: $115,677.50 refund for 2019 tax year

The CARES Act

Qualified Improvement Property (QIP)

1. Corrects Congressional oversight in 2017 Tax Cut & Jobs Act (TCJA) and now defines Qualified Improvement Property as 15-year property.
2. Any Qualified Improvement Property acquired and placed in-service after 9/27/2017 is eligible for 100% Bonus Depreciation.
3. Impact: You can now retroactively apply bonus depreciation to Qualified Improvement Property.
4. Result: Increases your loss to offset gains and could either reduce taxes now or create an opportunity for a refund now.

The CARES Act

Real Estate Losses that Can Offset Investment Income

1. Temporary Suspension of Net Business Loss Limitation
2. Individuals and owners of a trade or business that generate a "net business loss" to offset income from other sources. The amount was capped at $250k/$500k
3. Removes Cap of $250,000 (single)/ $500,000 (Married Filing jointly)
4. Applicable for taxable years beginning in 2018, 2019, or 2020.
5. Individual taxpayers that had a net business loss in excess of these deductions in 2018 can amend to capture this benefit

Huge Economic Benefit for Those Who Access Expertise

Who can benefit from this?

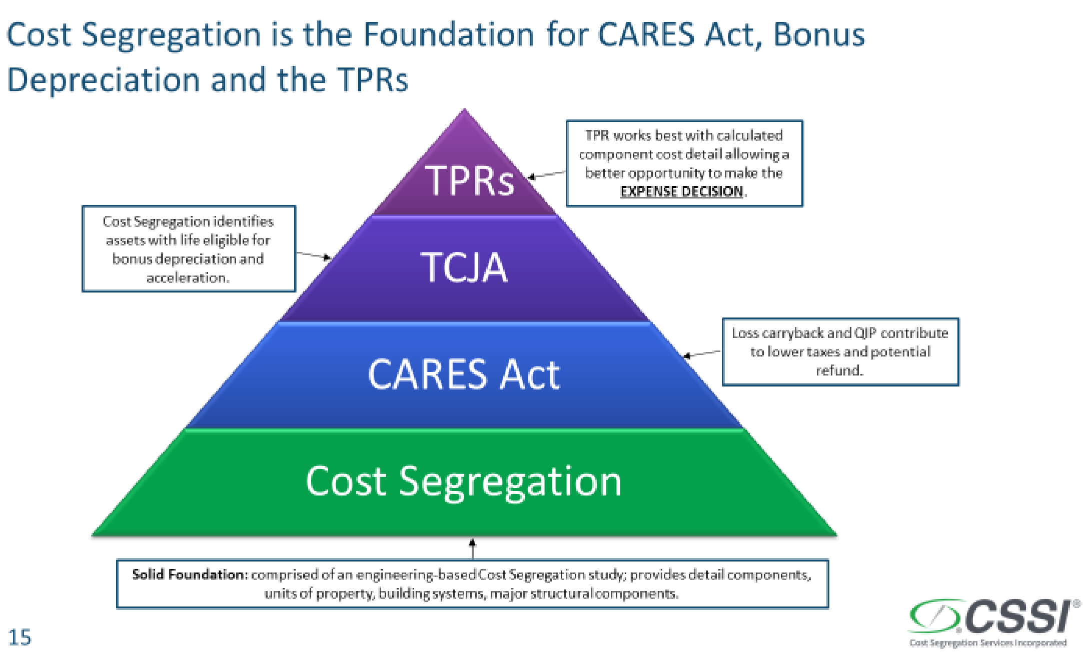
1. Owner of recently purchased or built building
2. Owner who has owned a building for several years
3. Owner/tenant who has paid for past improvements or repairs
4. Estate planning & trusts
5. Triple Net (NNN) Lease tenants and owners

Largest beneficiaries will be landlords & multi-property owners

Who can benefit from this?

1. <u>Restaurants</u> (also leased space if owner paid for improvements)
2. <u>Hotels</u>
3. Self storage, warehouses
4. Nursing homes, assisted living, apartments
5. Hospitals, medical, dental
6. Offices, banks, auto dealers
7. Retail Strip Centers, malls, supermarkets
8. Any building type

Cost Segregation is the Foundation for CARES Act, Bonus Depreciation and the Tangible Property Regulations (TPRs)



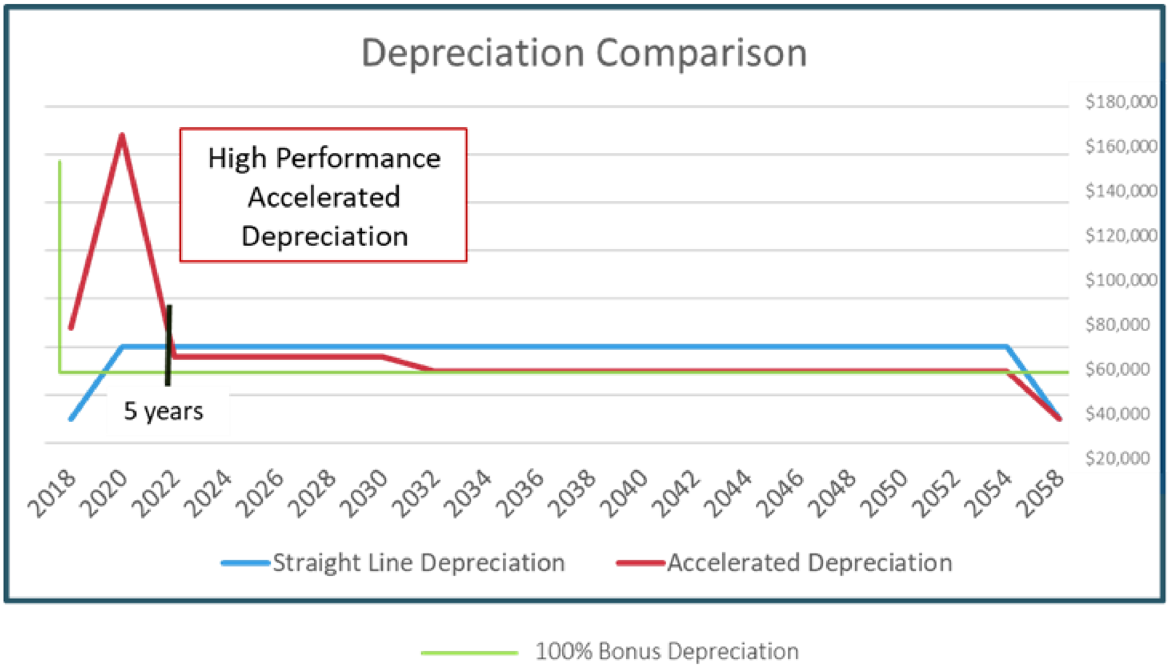
What Is Cost Segregation?

Cost Segregation = Cash Flow

1. The process of analyzing and identifying commercial building components that are eligible for accelerated depreciation
2. Result is deferred income taxes with more cash flow in early years
3. An input calculation to the U.S. Tax Code – Building Systems Valuation
4. Allows building owners to use cash today instead of leaving it with the government for 39 years – time value of money
5. Property with class life of 5, 7 or 15 years is segregated from 39-year property
6. **Benchmark: $30K-$80k per $1Million in cost over five years**
7. Buildings or tenant improvements as small as $200,000 in cost

Items that can be Accelerated

1. 5- and 7-Year Property
    a. Decorative building elements, wall coverings
    b. Special electrical, plumbing and mechanical
    c. Carpet, flooring, decorative molding
    d. Built in cabinets and counter tops
    e. Interior doors, moveable wall partitions
    f. Security, decorative and special lighting
    g. Window treatments and coverings
    h. Communications, cable
    i. Kitchen fixtures, refrigeration equipment
2. 15-Year Property
    a. Landscaping/Hardscaping
    b. Paving
    c. Fencing
    d. Parking lot
    e. Signage
    f. Sidewalks
    g. Irrigation



Cost Segregation: Case Studies

1. Restaurant
   Building cost: $1,587,087

   Tax deferral: $136,977

2. Leasehold Improvements
   Improvements: $224,487

   Tax deferral: $24,608

3. Hotel
   Building cost: $3,732,815

   Tax deferral: $374,430

Partial Asset Disposition Election

Ability to write off assets that are no longer in use

1. Renovations, remodels, and replacements
2. Abandoned in place
3. Common items – roofs, HVAC, electrical
4. Retirement of a structural component of or improvement to a building
5. LED Retrofit Projects
6. Partial Asset Dispositions must be taken in the same year as the renovation
7. Tax savings at sale of property = decreases taxable Section 1245 property
8. Action: Did you renovate in 2019 or 2020?
9. Whether 2019 has been filed or not!

Partial Asset Disposition Case Study with Cost Segregation

Auto Dealership Renovation Tax Savings			
	Original Building	**Demolition**	**Renovation**
Cash Flow	$134,718	$53,297	$126,243
Total Tax Savings		**$314,240**	

2017 Tax Cuts and Jobs Act (TCJA)

More Deductions for You

1. 100% Bonus Depreciation for properties purchased or built after September 27, 2017
2. CARES Act change: Any Qualified Improvement Property (now defined as 15-year) placed in-service after 9/27/2017 is eligible for 100% Bonus Depreciation.
3. New purchase, new construction, addition, or renovation
4. The assets must have a **depreciable life of less than 20 year**
5. Cost Segregation Studies identify 5-, 7-, & 15-year assets within buildings
6. <u>Benchmark: $30K-$80k per $1Million in cost in first year</u>

Benefit Before and After 2017 Tax Reform (TCJA)

Actual Cash Flow Generated by Applying Cost Segregation Studies			
Facility Type	Total Property Cost	First Year Cash Flow from Tax Deferral	Five Year Cash Flow or 100% Bonus (1st Year)
Leasehold Impr	$224,487	$8,309	$24,608
Restaurant	$850,000	$12,809	$81,858
Leasehold Impr	$1,400,000	$53,751	$131,569
Restaurant	$1,587,087	$72,617	$136,977
Hotel	$3,732,815	$374,430	$374,430
Strip Center	$7,400,000	$323,673	$605,133
Hotel	$7,600,000	$87,501	$587,107
Hotel	$8,389,000	$692,183	$973,836

I Haven't Filed 2019 Taxes! How Can I Benefit?

1. Engage to complete a Cost Segregation Study
2. File 2019 Tax Return applying Study
3. File 2019 Tax Return with Form 1045 for Loss Carryback
4. Likely result: increased depreciation
5. Refund from taxes paid in previous years
6. ACTION: Doing this now will generate cash flow to address the current crisis.
7. NOTE: No need to amend returns for previous years (2014-2018) when using this process

The Secret to Maximizing the Portion of Your RE Income That Is Active (vs Passive)

Common Situation

1. Client owns building and business, but building and business are held in separate entities
2. Income generated in business, only income in building entity is rents
3. Cost Segregation applied to building is limited to offsetting only rental income

Solution: Grouping of Activities – Reg § 1.469

1. If entities form an "economic unit" they can be grouped – election on tax return
2. Once grouped, losses from real estate entity become active losses and fully deductible

I Already Filed my Taxes! Can I Still Benefit?

Scenario 1: Purchased or Built a Building in 2019

1. Engage to complete a Cost Segregation Study
2. Amend 2019 Tax Return
3. Amendment must be filed before you file 2020 taxes
4. Likely result: increased depreciation
5. Refund from overpaying your taxes
6. ACTION: Doing this now will generate cash flow to address the current crisis.
7. NOTE: Refunds and amendments during economic downturns, such as in 2008, are offered as tax incentives and have not triggered audits in prior history. It is not expected to do so now.

Scenario 2: Owned the building prior to 2019 and previously filed taxes on it

1. Referred to as an automatic extension
   This allows certain forms to be used in an amendment (not normally allowed).
2. Engage a Cost Segregation Study
3. File a 3115 Change of Accounting Form to apply the Cost Segregation Study results to the 2019 tax return
4. Must be filed in six months
   This coincides with the September/October extension deadlines
5. Result: increased depreciation
6. Refund from overpaying your taxes

Can I Still Capture this if I Extended?

All these options provide cash flow now.

1. Most owners had to pay their taxes based on an estimate and will file at extension time
2. Engage in a Cost Segregation Study
3. Applications
   a. Apply to 2019 taxes to get a refund back at filing
   b. If you haven't paid, pay less taxes than estimated and use the cash flow elsewhere
   c. Apply to 2020 taxes to decrease quarterly estimates

CSSI Case Study

CSSI Provided Help During the 2008 Economic Downturn

1. Sept. 2008 - Successful restaurant owner had grand opening on 2nd location.
2. Similar to today, when it was ready to open, the economy took a turn for the worst.
3. No one was eating out, and restaurants were struggling.
4. Client owed $70,000 in taxes from successful prior year.
5. CSSI completed the study and we freed up the $70K the client needed.
6. Months later the client called us and said because of CSSI they were able to stay afloat during this hard time and keep their employees. If they would have had to pay those taxes, she didn't know if they would have stayed in business.
7. **Opportunity to free up cash flow to stay in business during this difficult time.**

How to Get Started

Let us Provide a No-Cost Predictive Analysis!

1. Download the questionnaire:
   a. Fill out (feel free to call or email Scott with questions)
   b. Email filled out questionnaire to Scott at SJM@CostSegregationServices.com

2. CSSI will generate an analysis at no-cost with fixed fee and potential savings.
3. We will work with you and your tax professional to complete the work.

Who is CSSI?

We are the calculation experts of the industry.

1. We are the nation's premier engineering-based consulting firm specializing in the tax laws surrounding commercial buildings.
2. Performing engineering-based studies for over 18 years
3. 20,000+ studies performed in all 50 states
4. Our CEO, Jim Shreve, has been involved in Cost Segregation since the original court case in 1997.
5. Completed studies in 6-8 weeks
   a. Cost Segregation and Disposition
   b. Capital to Expense Reversals
   c. LED Lighting & HVAC Retrofits and Tax Benefits Analysis
   d. R&D Tax Credit Analysis
6. We represent our study in the event of an audit at no cost to our clients

Action Items

For Building Owners and Tenants:

1. Contact CSSI for a pre-analysis
2. Use the pre-analysis for a discussion with your tax professional on:
   a. Cost Segregation
   b. Partial Asset Disposition
   c. Qualified Improvement Property
   d. Loss Carryback
   e. Amended Returns
   f. Grouping decisions on buildings purchased in 2019 or 2020

For Tax Professionals

1. Review clients with buildings for a cost segregation study to reduce taxes.
2. Review your clients for QIP since 2018.
3. Does it merit bonus depreciation changes?
4. Does the change merit a loss carryback and amended returns?
5. Would grouping decisions allow access to more cash flow?

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Portland Skyline - Josh Herrington

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