
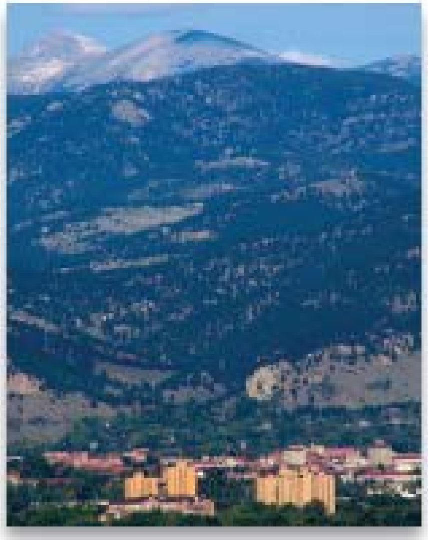
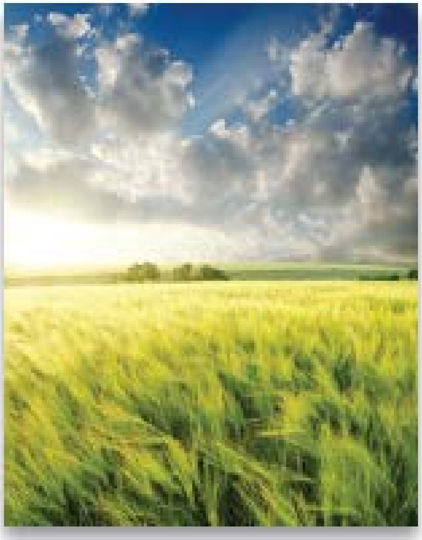
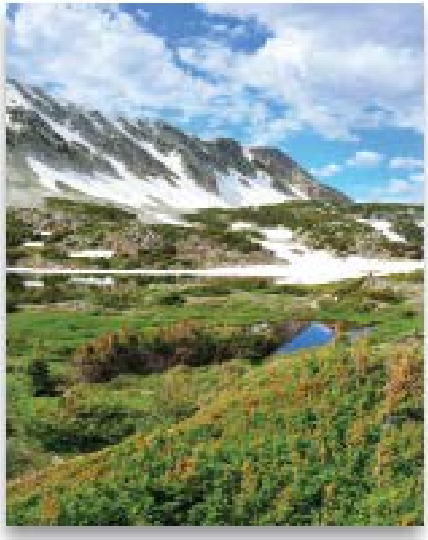

Welcome

ACM/BDO Year-End Update

Agenda

Opening Remarks	8:00am - 8:15am
Tax Issues in Structuring M&A Transactions and Tax Hot Topics	8:15am - 9:05am
Audit and Accounting Update	9:05am - 9:55am
Break	9:55am - 10:15am
R&D Tax Credits: Rethinking Opportunities and Cost Segregation Opportunity Overview	10:15am - 11:05am
Teamwork and Leadership in a Changing World – Karl Mecklenburg	11:05am - 12:00pm
Lunch	12:00pm - 12:45pm
When Good CPAs Go Bad – Paul R. Harrison	12:45pm - 4:30pm

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Housekeeping

- Sign in sheets on tables – please write legibly!
- Questions to: http://townhall.acmllp.com
- Certificates will come from BDO in about 30 days
- You will receive an email a few days after the event with a link to download the materials and sign up for newsletters and invites to more events

ACM Year in Review

- **3 New Tax Partners**
  - Bryan Adam
  - Brandon Powers
  - Caleb Crandell
- **Best Accounting Firm in Colorado**
- **Best Companies to Work for in Colorado**
- **Rumblesum Win!**
  - Third year victory and donation to Judy's House

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ACM Year in Review

- **Melissa Hooley**
  - **Most Powerful Women in Accounting**
- **Sean McDonald**
  - **COCPA Everyday Hero**
- **Andrea Geerdes**
  - **Women to Watch Emerging Leader Honoree**
- **Abbey Hagerman**
  - **20 Under 40 Recipient**

Tax Structures in Acquisitions & Year End Update

November 29, 2017

David Shellan & Mei Lin Kis

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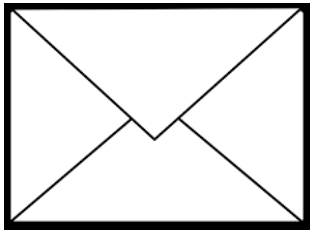

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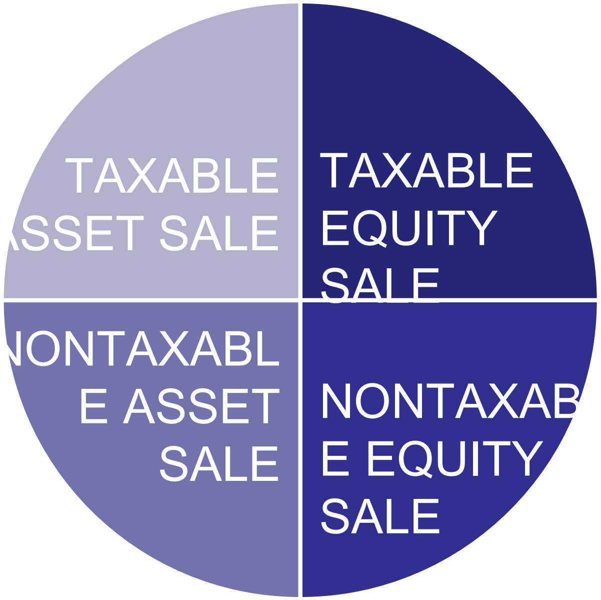
Topics Covered:



- C corporation acquiring an S corporation and the benefits of a IRC §338(h)(10) election
- Flow-through entity acquiring a C corporation
- Earn-outs and installment sale agreements
- Mergers that could qualify as tax free (§368)
- Overview of proposed congressional tax plan

Taxable acquisition – Asset vs. stock sale

ASSET SALE

Advantages:

- Acquirer obtains step-up in purchased assets that can be depreciated/amortized.
- Acquirer can be selective regarding assets acquired and liabilities assumed.

Buyer does not obtain seller attributes (NOLs, R&D credits)

Disadvantages:

- May require approval from creditors.
- Cumbersome and expensive.
- Buyer does not obtain seller attributes (NOLs, R&D credits)

STOCK SALE

Advantages:

- Low cost and simple
- Roll-over equity
- Generally **lower tax to seller** compared to asset sale (including low tax states)
- Tax attributes are preserved

Tax attributes are preserved

Disadvantages:

- No tax basis step-up:
  - Goodwill amortization is nondeductible
  - Fixed assets continue depreciation using historical lives & methods
- Buyer assumes all liabilities

C Corp Acquiring S Corp

- Ascension Inc. is a multinational strategy consulting firm
  - Based in Colorado
  - Organized as a C corporation
  - Seeks a market presence in Salt Lake City and surrounding areas

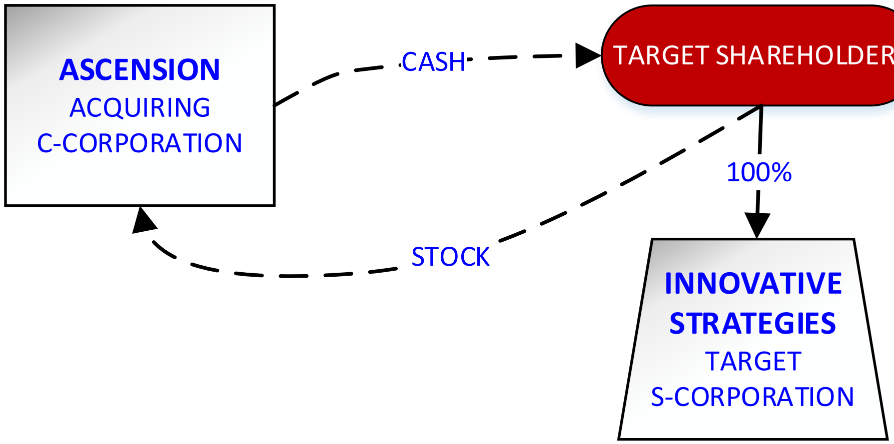
ASCENSION INC.
ACQUIRING
C-CORPORATION

- Innovative Strategies is a highly successful management consulting firm in Salt Lake City
  - Strong financials
  - Cultural and operational fit
  - Organized as an S corporation
  - Owners are nearing retirement

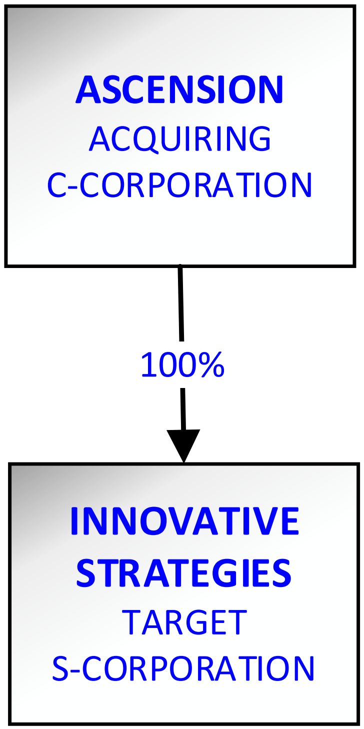
INNOVATIVE STRATEGIES
TARGET
S-CORPORATION

Basic Stock Acquisition

EXCHANGE



RESULTS



TERMINATION OF S-ELECTION

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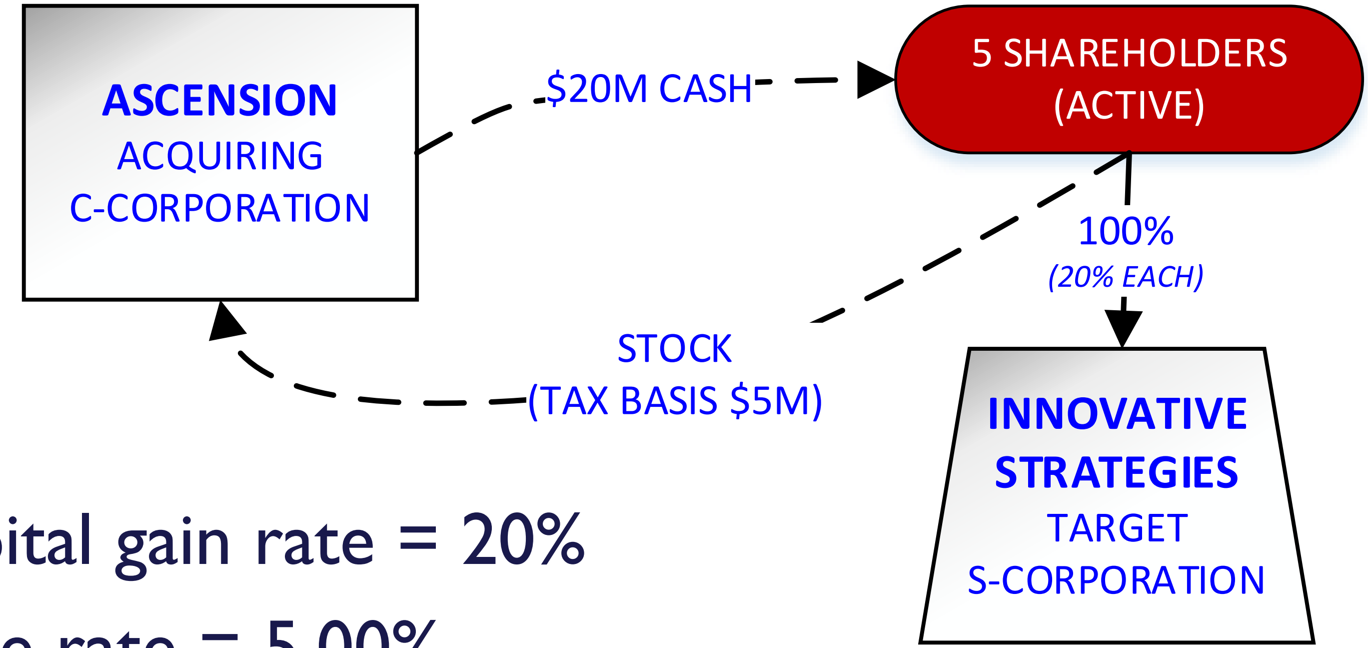
Stock Acquisition

Walk-through of tax impact of acquisition of Innovative Strategies:



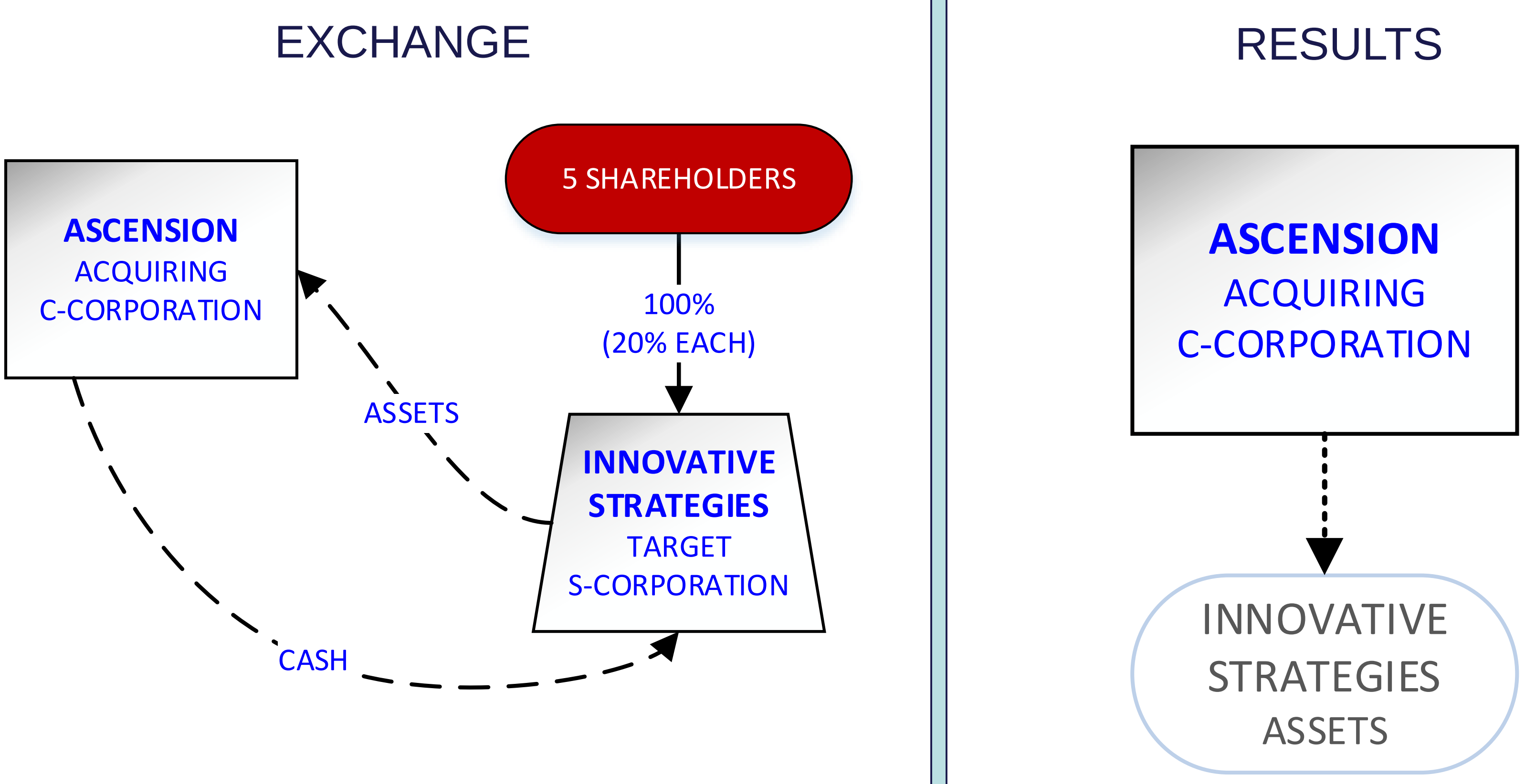
- Capital gain rate = 20%
- State rate = 5.00%

Stock Acquisition

Proceeds (in millions)	$ 20,000,000
Stock basis	5,000,000
Total gain	15,000,000
Federal tax at 20%	3,000,000
State tax at 5.00%	750,000
Total tax	3,750,000

- Taxed at low rate with no net investment income tax, assumes no federal benefit from state tax deduction.
- Acquirer is missing out on the tax depreciation / amortization on $15M gain
- Present value of missed step-up assuming 10% cost of capital, 35% tax rate and 15 year life = $2,928,341 or roughly 20%

Basic Asset Acquisition



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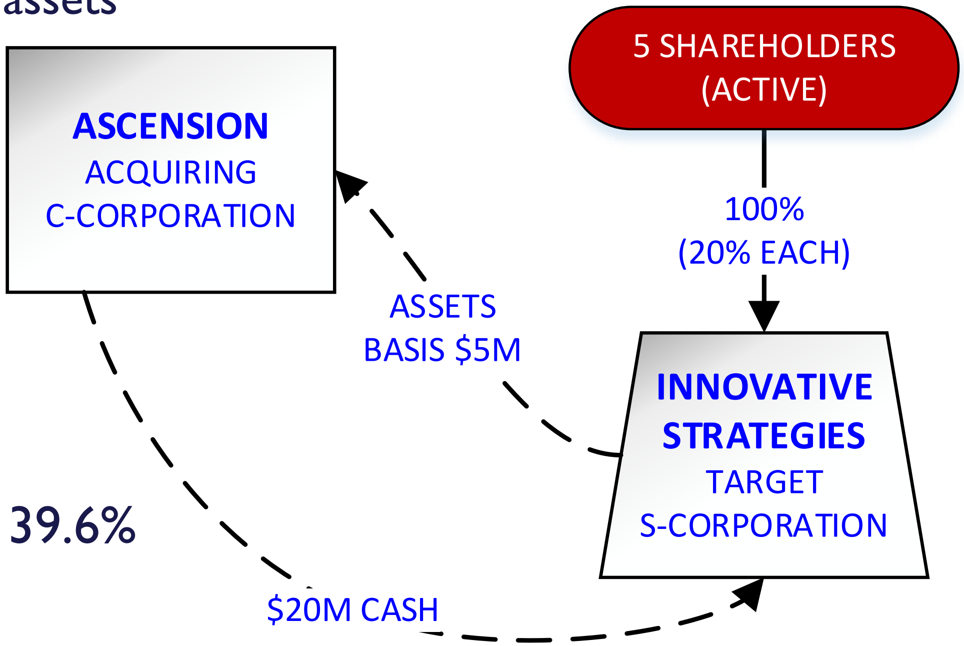
Asset Acquisition

Walk-through of tax impact of acquisition of Innovative Strategies:

- Tax basis in assets is as follows:
  - $4M in accounts receivable
  - $200k in prepaids and other assets
  - $800k in fixed assets



- Ordinary income rate = 39.6%
- Capital gain rate = 20%
- State rate = 5.00%
- Assume Innovative is accrual basis

Asset Acquisition

Asset Allocation	Purchase Price	Basis	Gain
Accounts Receivable	4,000,000	4,000,000	
Prepaids and other	200,000	200,000	
Fixed assets	1,800,000	800,000	1,000,000
Customer-based intangibles	2,000,000		2,000,000
Workforce intangible	1,000,000		1,000,000
Goodwill	11,000,000		11,000,000
Total	**20,000,000**	**5,000,000**	**15,000,000**

Capital gain tax			2,800,000
Ordinary income tax			396,000
State income tax			750,000
Total			**3,946,000**

Asset Acquisition

Asset	Amortization Period	Character of gain
Inventory	Generally 1 year	Ordinary
Accounts Receivable	Generally 1 year	Ordinary (cash basis)
PP&E	Land – non-depreciable Equipment – 5 Furniture – 7 years Buildings – 39 years	Capital, except to extent of ordinary income recapture
Identified intangibles and goodwill	15 years	Capital, except to the extent of ordinary income recapture

Asset Acquisition

- After significant asset sale, target S-corporation usually liquidates
  - Outside basis considerations
- Generally no double taxation of gain for S Corp
  - Exception: Built-in gains tax

Comparison

	Stock Sale	Asset Sale
Proceeds	20,000,000	20,000,000
Basis	5,000,000	5,000,000
Gain	15,000,000	15,000,000

Total Tax	3,750,000	3,946,000
Tax Difference	196,000	
Buyer Step-Up		15,000,000
PV of Step-Up		3,000,000

IRC §338(h)(10) Election

- Stock purchase treated as asset purchase for federal income tax purposes
- Ease and low cost of a stock purchase
- Tax benefits of an asset purchase in the form of depreciable/amortizable step-up

Sec 338(h)(10) Election

REQUIREMENTS

ACQUIROR

- "C" Corporation
- "S" Corporation
- LLC

TARGET

- "S" Corporation
- "C" Corporation (subsidiary of US consolidated group)

PURCHASE

- At least 80% of target stock (by vote and value)
- Fully taxable sale by seller
- Buyer and seller must not be related

Sec 338(h)(10) Election

Deal Economics for 338(h)(10)

- Difference between inside (basis of assets/liabilities) and outside basis (stock basis) *is small*
- Difference between fair market value and basis *is large*

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Sec 338(h)(10) Election

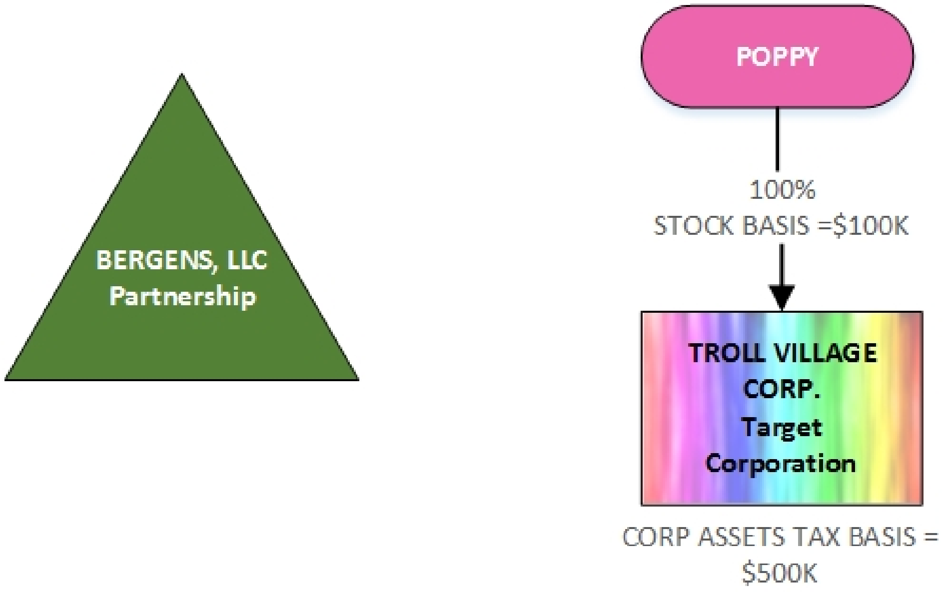
- Form 8023 must be filed
  - Separate from tax return
  - Both buyer and seller must sign
  - Must be filed by 15th day of 9th month following acquisition date
- Due diligence
  - Valid S election
  - State tax
    - Conformity to federal 338(h)(10) election
    - Transfer/sales tax issues
    - Business verses non-business income

Other Items

- Covenant not to compete
- Consulting agreement
- Transaction costs
  - Acquisition costs are capitalized with basis of asset
  - Financing costs are deducted over life of debt
  - Equity financing costs are nondeductible
  - Success-based fees allows 70% immediate deduction

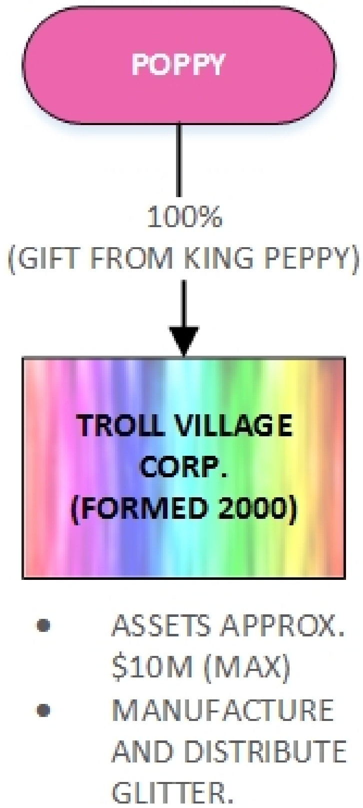
Flow-Through Acquisition of Corporation

- Bergen LLC wants to purchase Troll Village Corp.
- Poppy wants $7M after tax and Bergen wants to pay $10M max for Troll Village Corp.



IRC §1202 - QSBS

- Qualified Small Business Stock
  - C-Corporation stock originally issued after 8/10/1993;
  - Stock acquired at its original issue, or as a gift, inheritance, or partnership distribution
  - Aggregate gross assets < $50M since inception
  - Corporation – active business
  - Held > 5 years



Flow-Through Acquisition of Corporation

- How much will Bergens have to pay to get Poppy $7M after tax?

	ASSETS	STOCK
Poppy		
Purchase price	13,430,000	8,110,000
Corporate income tax	4,822,890	
Individual income tax	1,105,382	1,105,781
Net Cash to Poppy	**7,001,728**	**7,004,220**
Bergens		
Cash paid	13,430,000	8,110,000
Tax upon liquidation of corporation	-	3,123,730
Total Cost to Bergens	**13,430,000**	**11,233,730**

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Flow-Through Acquisition of Corporation (detailed computation)

		ASSETS		STOCK
Purchase price		13,430,000		8,110,000
Basis		500,000		100,000
Gain		12,930,000		8,010,000
Corporate tax				
Federal (net of state tax deduction)	34%	4,176,390	34%	*2,723,230*
State	5%	646,500	5%	*400,500*
Total tax		4,822,890		*3,123,730*
Seller Tax				
Liquidating distribution		8,107,110		
Basis		100,000		
Capital Gain		8,007,110		8,010,000
§1202 Exclusion	50%	(4,003,555)		(4,005,000)
Net Taxable Gain		4,003,555		4,005,000
Federal	24%	905,204	24%	905,531
State	5%	200,178	5%	200,250
Total tax		1,105,382		1,105,781
**Assumes state conforms on 1202 exclusion*				
Liabilities paid		-		-
Net Cash to Poppy		**7,001,728**		**7,004,220**
Cost to Buyer				
Cash paid		13,430,000		8,110,000
Tax upon liquidation of corporation		-		3,123,730
Total Cost to Bergens		**13,430,000**		**11,233,730**

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Bridging the Gap

	ASSETS	STOCK
Net Cash to Poppy	7,001,728	7,004,220
Total Cost to Bergens	13,430,000	11,233,730
Excess over max	(3,430,000)	(1,233,730)

- Alternatives –
  - Consolidation with other corporations
  - Management fee charge to Troll Village Corp.
  - Valuation discounts on liquidation of stock
  - Creative allocation of purchase price

Personal Goodwill

- Positive cases:
  - Martin Ice Cream
  - Norwalk
- Negative cases:
  - Muskat

	STOCK	PERS. GOODWILL	TOTAL
Poppy			
Purchase price	6,000,000	2,000,000	8,000,000
Corporate income tax			
Individual income tax	814,495	480,000	1,294,495
Net Cash to Poppy	**5,185,505**	**1,520,000**	**6,705,505**
Bergens			
Cash paid	6,000,000	2,000,000	8,000,000
Tax upon liquidation of corporation	2,336,700		2,336,700
Total Cost to Bergens	**8,336,700**	**2,000,000**	**10,336,700**

Personal Goodwill (detailed computation)

		STOCK		PERS. GOODWILL	TOTAL
Purchase price		6,000,000		2,000,000	8,000,000
Basis		100,000			100,000
Gain		5,900,000		2,000,000	7,900,000
Corporate tax					
Federal (net of state ta	34%	*2,041,700*			
State	5%	*295,000*			
Total tax		*2,336,700*			
Seller Tax					
Liquidating distribution					
Basis					
Capital Gain		5,900,000		2,000,000	7,900,000
§1202 Exclusion		(2,950,000)			(2,950,000)
Net Taxable Gain		2,950,000		2,000,000	4,950,000
Federal	24%	666,995	20%	380,000	1,046,995
State	5%	147,500	5%	100,000	247,500
Total tax		814,495		480,000	1,294,495
**Assumes state conforms on 1202 exclusion*					
Liabilities paid		-			
Net Cash to Poppy		**5,185,505**		**1,520,000**	**6,705,505**
Cost to Buyer					
Cash paid		6,000,000		2,000,000	8,000,000
Liabilities paid at closing					-
Tax upon liquidation of corpo		2,336,700			2,336,700
Total Cost to Bergens		**8,336,700**		**2,000,000**	**10,336,700**

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Installment Sales

- Deferral of gain
- Default treatment (required to elect out)
- Performance based contingent payments
- Ordinary income reported in year of sale regardless of when payment is made
- Gain is generally recognized ratably using gross profit percentage = $\dfrac{\text{Gross Profit}}{\text{Contract Price}}$

Installment Sales

Maximum selling price known, payment period unknown

- Assume all contingent payments will be paid in sellers favor
- Recognize ratably by applying gross profit % to each payment
- When maximum stated selling price is reduced, gross profit percentage is recomputed
- Overstates gain if seller ultimately fails to receive maximum contract price!

Gross profit % X payment

Gross profit % X payment

Gross profit % X payment

Installment Sales

Maximum selling price unknown, payment period unknown

- Sellers basis in property sold is allocated to equal increments to each tax year in which payments will be received
- Cannot recognize loss until final installment period

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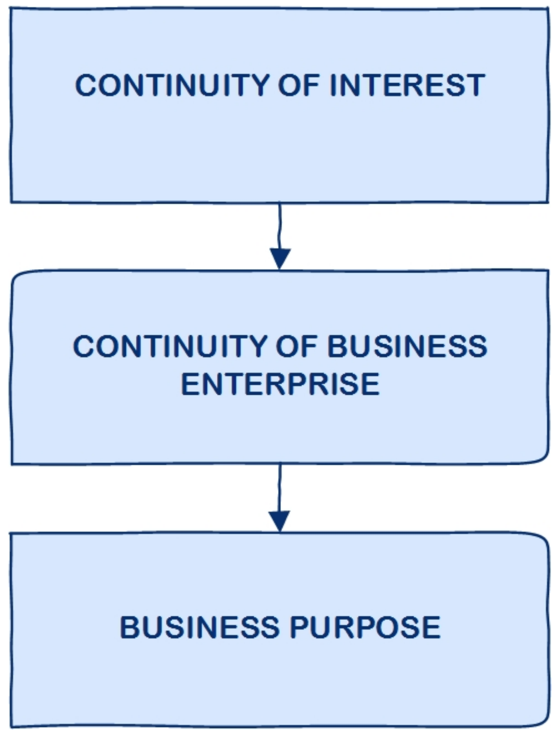
Tax Deferred Reorganizations

IRC §368(a)

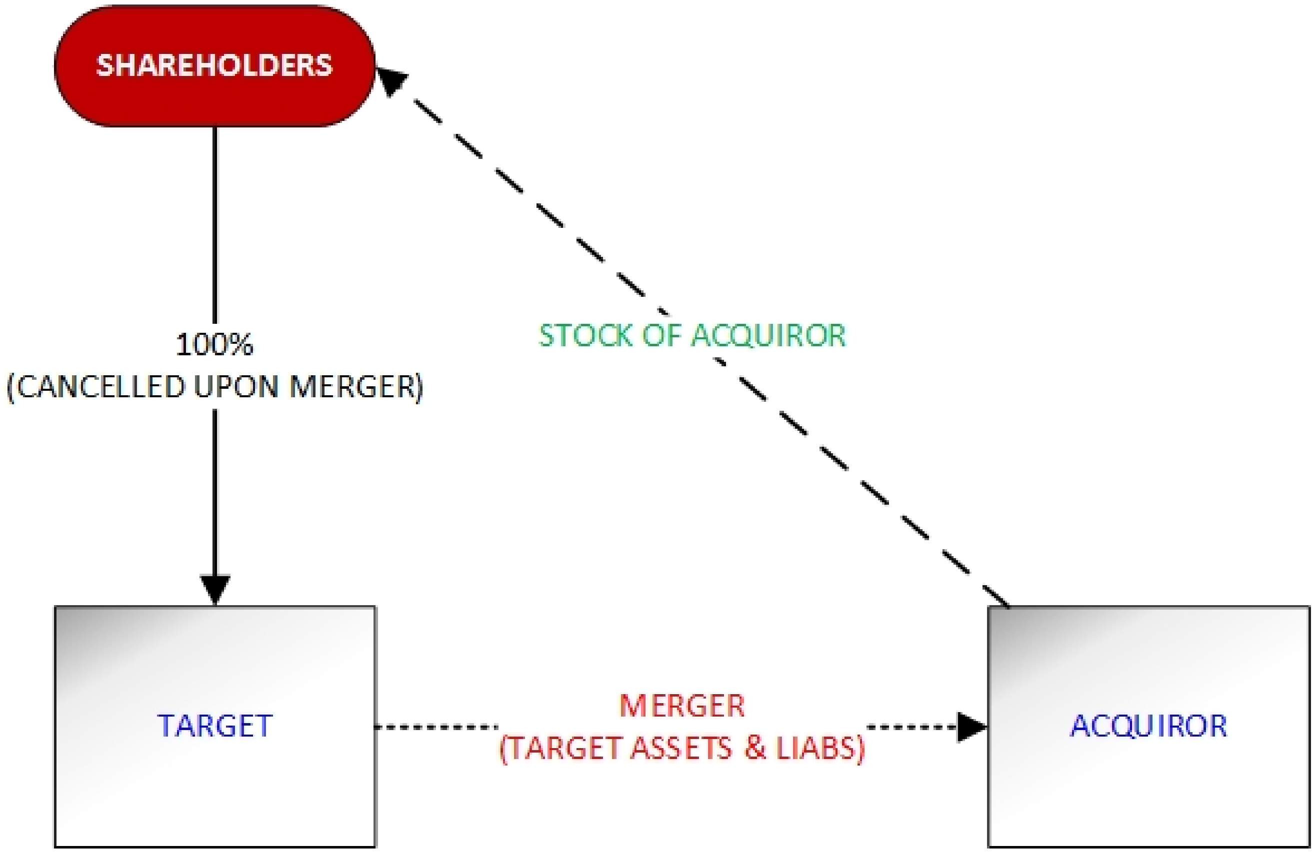
Requirements:



Types of Reorganizations IRC §368(a)(1)

Reorganization ¶	Description
A	Statutory Merger/Consolidation
B	Stock for Stock Exchange
C	Assets for Stock Exchange
D	Target controls Acquiring entity
E	Recapitalization
F	Change of identity
G	Bankruptcy

"A" Merger – IRC §368(a)(1)(A)



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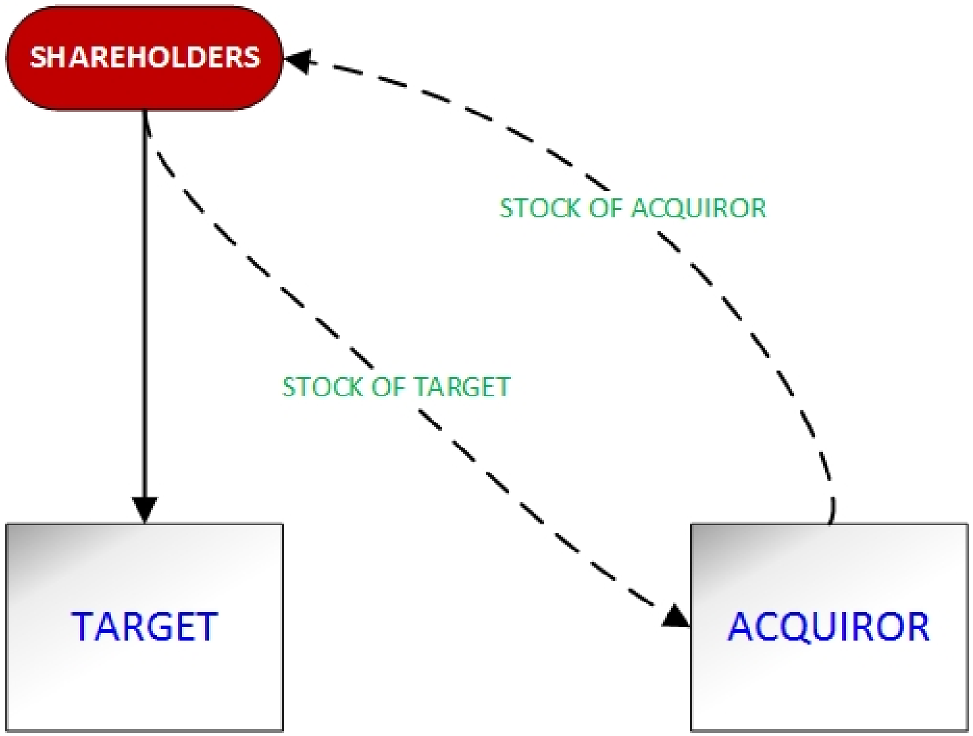
“B” Merger – IRC §368(a)(1)(B)



RESULTING STRUCTURE

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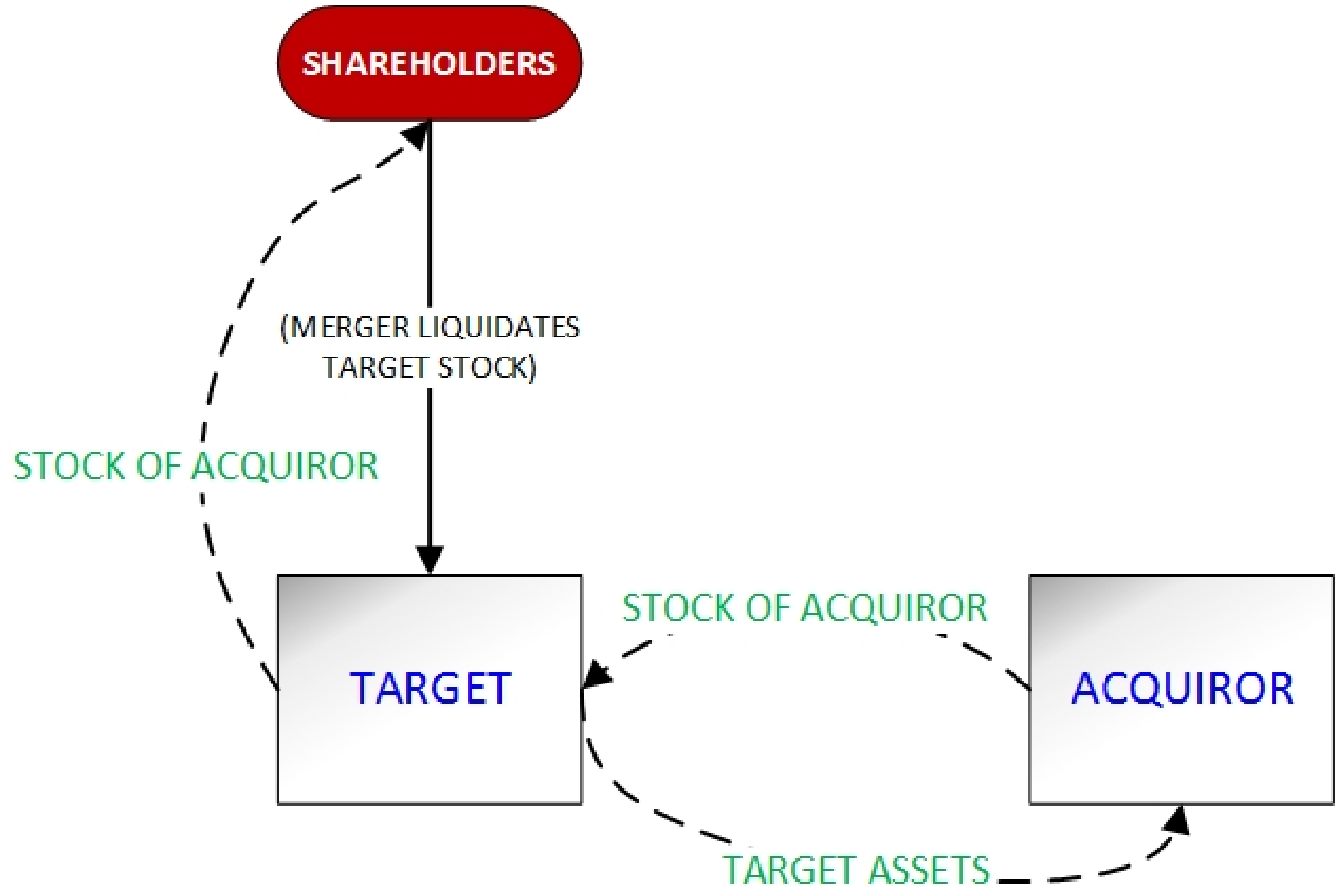
“C” Merger – IRC §368(a)(1)(C)



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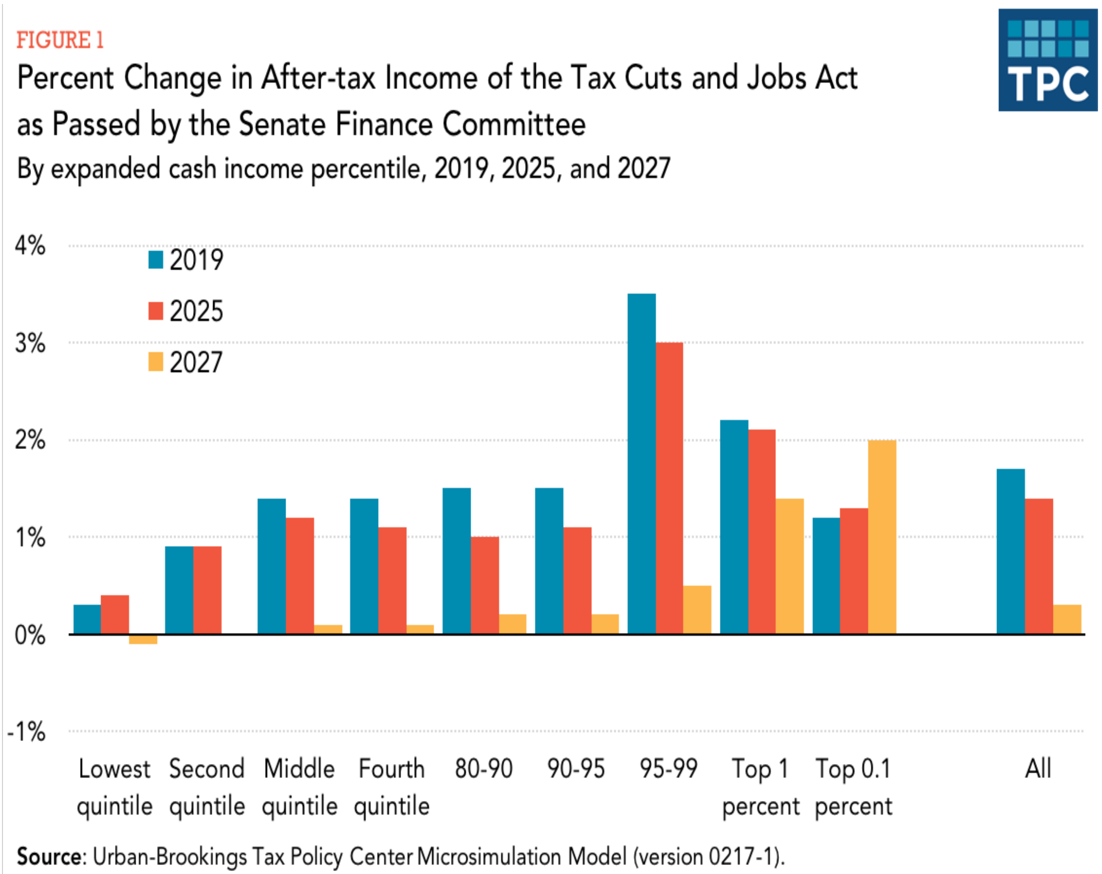
Analysis of the Tax Cuts and Jobs Act



- Will reduce taxes on average for all income groups in 2019 and 2025
- Higher income households will receive larger tax cuts
- The largest cuts will go to tax payers in the 95th -99th percentile
- By 2027 taxes will rises for the lowest income group
- 9% of tax payers will pay more by 2019
- 12% of tax payers will pay more by 2025
- 50% of tax payers will pay more by 2027

Source: Tax Policy Center

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Comparing Current Law and “Tax Cuts and Jobs Act” Individuals

	Current Law	House - 2018	Senate - 2018
Individual Tax Rates - Top Rate starting points	$426,700 (single) $453,350 (Head) $480,050 (Joint)	$500,000 (Single / Head) $1,000,000 (Joint)	$500,000 (Single / Head) $1,000,000 (Joint) -Sunsets after 2025
Alternative Minimum Tax	Yes	Repealed	Repealed Individual repeal sunsets after 2025
Personal Exemptions	$4,150	Repealed	Repealed Sunsets after 2025
State / Local Deduction	Real Estate, personal property and income / sales tax	Only real estate up to $10,000 are deductible	Repealed Sunsets after 2025
Mortgage Interest Deduction	Interest payments on up to $1.1million of debt are deductible Principle residence and one other	Interest payments on debt accrued after 2017, limited to $500,000 Principle residence only	Interest payments up to $1 million of acquisition debt Principle residence and one other

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Comparing Current Law and "Tax Cuts and Jobs Act" Businesses

	Current Law	House - 2018	Senate - 2018
Top Tax Rate for Pass-through Entities	39.6%	25% - "Passive" Net Income 35.22% - "Active" net income 39.6% - Personal services income	31.8% (38.5% to qualifying business income after 17.4% deduction) 38.5% - Personal services income Limit: $250,000 (single) $500,000 (joint)
Top Corporate Income Tax Rate	35%	20%	20% Delayed until 2019
New Investment Purchases	2018: 40% bonus dep 2019: 30% bonus dep 2020: 20% bonus dep Sec 179: Up to $500,000	100% bonus depreciation - expires in 2023 Sec 179: Up to $5,000,000	100% bonus depreciation - expires in 2023 Sec 179: Up to $1,000,000
Business Interest Deduction	Fully deductible	Disallowed for interest in excess of 30% of business income Exemption for business with gross receipts of $25 million or less	Disallowed for interest in excess of 30% of business income Exemption for business with gross receipts of $15 million or less

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Comparing Current Law and “Tax Cuts and Jobs Act” Businesses

	Current Law	House - 2018	Senate - 2018
US Multinational Companies	Worldwide system with deferral and foreign tax credit	Modified territorial system with erosion provisions Excise tax on certain payments to foreign corporations One-time tax on un-repatriated foreign earnings at 7%	Modified territorial system with erosion provisions “Anti-abuse” tax on certain payments to foreign corporations One-time tax on un-repatriated foreign earnings at 5%
Estate Tax - Top Rates	40% on estates above $5.6 million (single) $11.2 million (couples)	40% on estates above $11.2 million (single) $22.4 million (couples) Tax Repealed after 2024	40% on estates above $11.2 million (single) $22.4 million (couples) Sunsets after 2025

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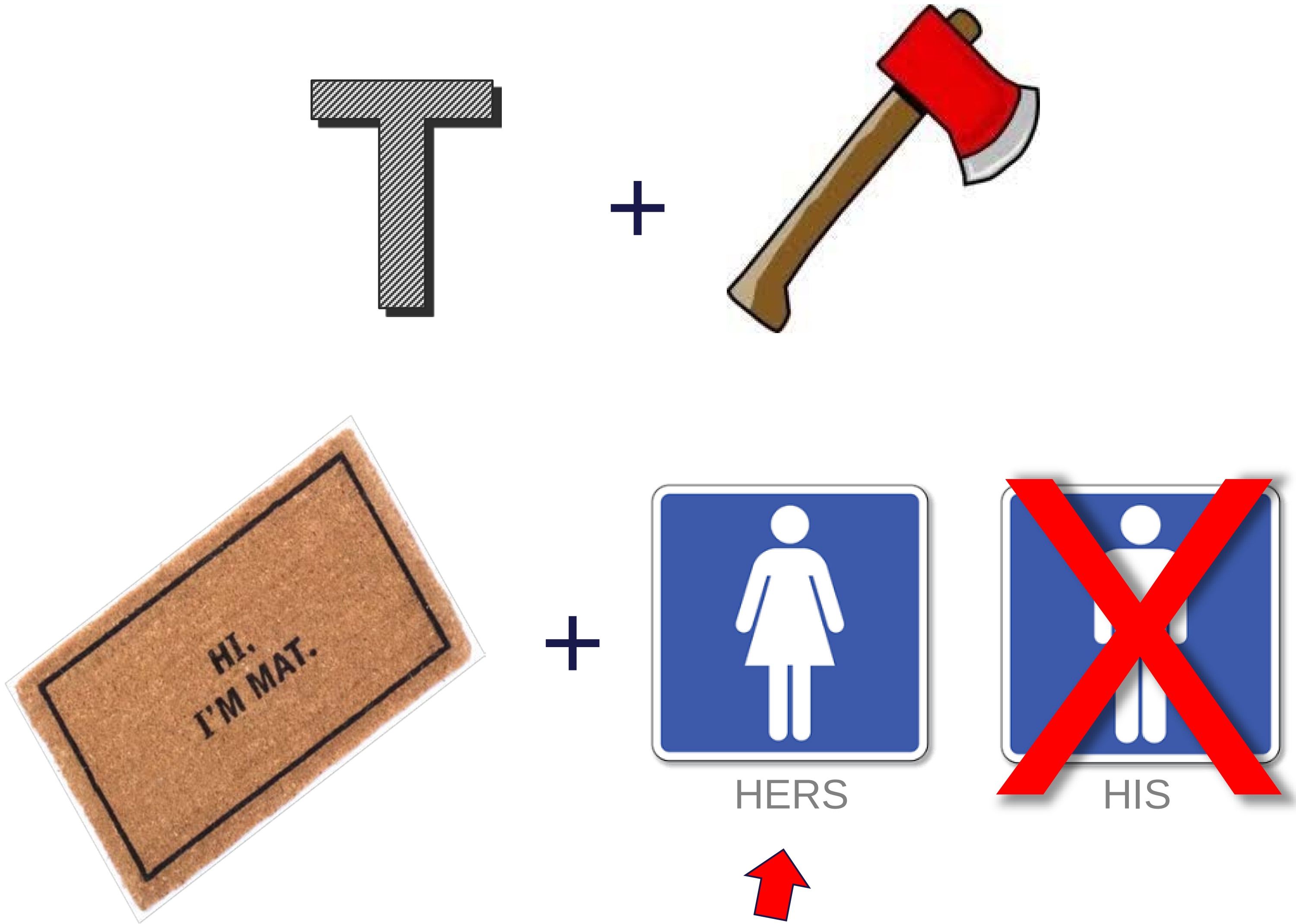
HI, I'M MAT.
HERS
HIS

QUESTIONS
http://townhall.acmllp.com

ANSWERS

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Audit and Accounting Update

November 29, 2017

Marc Furton, CPA

David Gantos, CPA

ACM Anton Collins Mitchell LLP
Accountants & Consultants

Agenda

- ASC 842, Leases
- ASC 606, Revenue from Contracts with Customers
- FASB Accounting Standards Updates

ASC 842 - Accounting for Leases

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Overview

- Lessees
  - Right of use model – recognize ROU asset and lease liability at inception for all leases
  - Classify all leases as finance or operating
    - Finance lease – lessee effectively obtains control of underlying asset
    - Operating lease – lessee does not effectively obtain control of underlying asset
  - Similar balance sheet impact; different income statement and cash flow results
- Lessors
  - Classify all leases as sales-type, direct finance, or operating (similar to existing U.S. GAAP) based on same criteria as lessees
  - Subsequent accounting is consistent with existing U.S. GAAP

Overview

- Effective Date
  - Annual periods beginning after December 15, 2018 (public companies)
  - Annual periods beginning after December 15, 2019 (private companies)
  - Early adoption permitted
- Applies to all leases and subleases, except:
  - Leases of intangible assets (Topic 350)
  - Leases for exploration or use of certain natural resources (Topics 930 & 932)
  - Leases of biological assets (Topic 905)
  - Leases of inventory (Topic 330)
  - Leases of assets under construction (Topic 360)
  - Scope exception for short-term leases (term less than 12 months) Accounting policy must be made and disclosed

Lessee Accounting

- Step 1: Identify the Lease
  - A contract, or part of a contract, that conveys the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration
- Step 2: Identify the Classification of the Lease (5 criteria)
  - If one or more of the below are met, classify as finance lease.

1. Transfer of ownership of underlying asset to lessee by end of lease term
2. Option to purchase underlying asset that lessee is reasonably certain to exercise
3. Lease term = major part of remaining economic life of underlying asset
4. Sum of PV lease payments and PV any residual value guaranteed by lessee ≥ substantially all of the FV of underlying asset
5. Underlying asset is of such a specialized nature that it is expected to have no alternative use to lessor at end of lease term

Lessee Accounting

- ## Step 3: Identify the Lease Term
  - Estimated as the non-cancellable period of the lease
  - Include periods under option to extend IF lessee is *reasonably certain* to exercise option. Includes assessment of economic incentives
- ## Step 4: Identify Lease Payments
  - Fixed lease payments (less incentives to be paid by lessor)
  - Variable payments tied to an index (i.e. CPI). Measurement based on the rate at commencement
  - Variable payments which are in-substance fixed payments
  - Residual value guarantees (probable amount)
  - Exercise price of purchase option IF lessee is reasonably certain *to exercise* option
  - Termination penalties IF lease term reflects lessee exercising option
  - %Rent or Triple Net Leases???

Lessee Accounting

- Step 5: Record the Right of Use Asset
  - Initial Measurement of ROU and Lease Liability (BS)
    - Present value (PV) of lease payments.
    - Discount Rate - use the rate implicit in the lease if determinable, otherwise use incremental borrowing rate. Nonpublic entities may elect to use risk-free rate
    - Calculation the same for Operating and Finance Leases
  - Subsequent Measurement (IS)
    - Operating Leases – Display interest on lease liability and amortization of ROU asset as "lease expense." Lease expense will be similar to current GAAP (i.e. straight-line)
    - Finance Leases – Display interest on lease liability as "interest expense" and amortization of ROU asset as "amortization expense"

Lessee Accounting

- Cash Flow Statement (CF)
  - Operating Leases – cash payments will be included in operating activities
  - Finance Leases - repayments of the principal portion of the lease liability within financing activities and payments of interest on the lease liability within operating activities

Example

- Facts
  - Lease Term: Retailer enters into a 5-year lease agreement with a mall operator that includes three 5-year renewal options.
  - Lease Payments: Rent payments are $5,000/month plus 1% of sales during the initial term. Base rent shall increase 10% in each renewal period.
  - Additional Information: *Retailer incurs* costs of $125,000 installing leasehold improvements to customize space to its brand requirements. LHI has a useful life of 8 years. The Retailers Borrowing rate = 5.87%
- Questions
  1. Is this a contract that meets the definition of a lease (Step 1)?
  2. How should the lease be classified (Step 2)?
  3. What should be used as the lease term (Step 3)?
  4. What are the identified payments that should be included in ROU Calculation?

Example

- Answers
  1. **Lease**: Yes - this contract meets the definition of a lease. There is a specific asset being utilized by the Retailer.

  2. **Classification**: Operating – All classification criteria would be presumed to be no

  3. **Lease Term:** 10 Years - The existence of significant leasehold improvements with a useful live longer than the base lease term indicates that Retailer would incur an economic loss from not exercising the first renewal option.

  4. **Identified payments:** (1) the base rent during the initial period: $60,000/year; and (2) the first renewal option: $66,000/year after first renewal. The Percentage rent is variable, and thus is not included in lease payments. Instead expensed as incurred.

Example

Initial Entry of Right of Use Asset and Liability			
Right of Use Asset	490,610		(1)
Lease Liability		(490,610)	
Entry to record Year 1 Payment			
Lease Liability (Represents Cash Paid)	60,000		(2)
Cash		(60,000)	
Entry to record Year 1 Expense			
DR: Lease Expense	63,000		(3)
CR: Lease Liability		(25,277)	(4)
CR: ROU Asset		(37,723)	(5)

Calculations

(1) Calcuated in excel using PV Calc

(2) Represents the first years cash paid for rent

(3) Calculated as follows: $630,000 / 10 years

(4) Calculated as follows: ($490,610 - $60,000) * 5.87%

(5) Calculates as the difference between (3) and (4) above

Example

As of December 31,20XX	Before	After
Assets		
Current assets:		
Cash and cash equivalents	450,000	450,000
Accounts Receivable	25,000	25,000
Inventory	65,000	65,000
Noncurrent assets		
Total property, plant, and equipment, net	150,000	150,000
Right of use asset	-	452,887
Total assets	690,000	1,142,887
Liabilities and shareholders' equity		
Current liabilities		
Accounts payable	75,000	75,000
Other noncurrent liabilities		
Note payable	150,000	150,000
Lease liability	-	455,887
Deferred rent	3,000	-
Total liabilities	228,000	680,887
Total members' equity	462,000	462,000
Total liabilities and shareholders' equity	690,000	1,142,887

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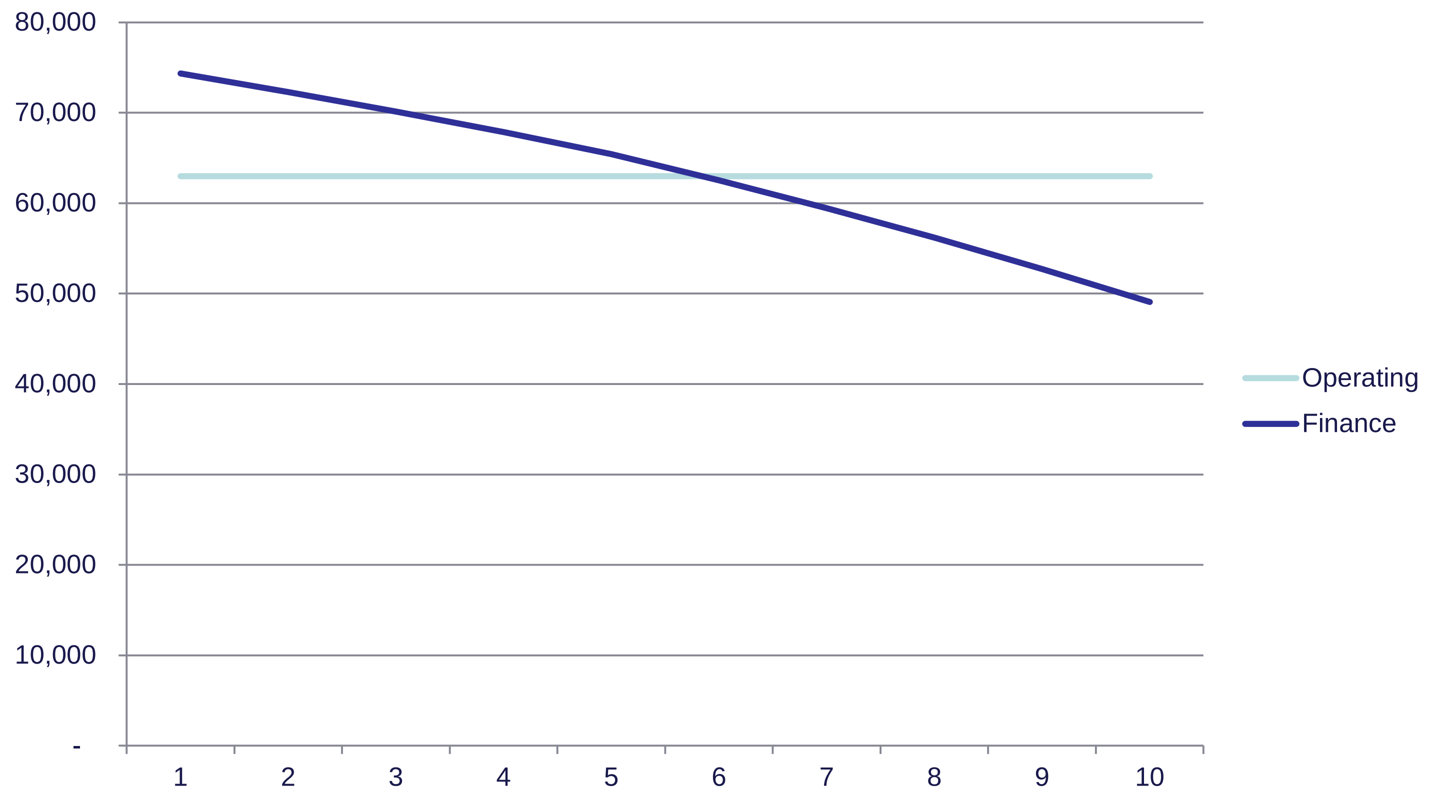
Example


80,000
70,000
60,000
50,000
40,000
30,000
20,000
10,000
-
1
2
3
4
5
6
7
8
9
10
Operating
Finance

ASC 606 - Revenue from Contracts with Customers

Overview

- ASC 606 Revenue from Contracts with Customers issued in May 2014
- A single, principle-based revenue standard for U.S. GAAP and IFRS that replaces almost all existing guidance
- The new revenue standard aims to improve accounting for contracts with customers by:
  - Providing a more robust framework for addressing revenue issues as they arise
  - Increasing comparability across industries and capital markets
  - Requiring enhanced disclosure

Overview (continued)

- Accounting Standard Updates 2016 and Forward
  - ASU 2015-14, Deferral of the Effective Date
  - ASU 2016-08, Principal versus Agent Considerations (Reporting Revenue Gross versus Net)
  - ASU 2016-10, Identifying Performance Obligations and Licensing
  - ASU 2016-12, Narrow Scope Improvements and Practical Expedients
  - ASU 2016-20, Technical Corrections and Improvements to Topic 606

Effective Dates

- Effective Dates
  - Public Business Entities - Fiscal years beginning after 12/15/17 (and interim periods within)
  - Nonpublic entities - Annual reporting periods beginning after Dec 15, 2018
- Applies to all industries, with certain transactions excluded:
  - Leases, insurance contracts, financial instruments, guarantees, and certain nonmonetary exchanges

Transition

- ASC 606 is required to be applied retrospectively by one of the following methods:
  - Retrospective application to each reporting period presented in accordance with ASC 250-10-45-5 through 45-10 (i.e. full restatement of comparative figures)
  - Modified retrospective with one or more practical expedients (i.e., completed contracts, use of hindsight for variable consideration, etc.)
  - Cumulative effect of change at adoption date (disclose effect of applying new standard)

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Introduction (continued)

- Core principle

> Recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity *expects to be entitled* in exchange for those goods or services

- Steps to apply the core principle are:

STEP ONE:	STEP TWO:	STEP THREE:	STEP FOUR:	STEP FIVE:
Identify the contract	Identify separate performance obligations	Determine transaction price	Allocate transaction price to performance obligations	Recognise revenue when each performance obligation satisfied

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Step #1 – Identify the Contract

- Contracts can be written, oral, or implied by the entity's business practices
- Contracts with customers must meet ALL the following criteria:
  - The parties to the contract must approve it and be committed to perform their respective obligations;
  - Each party's rights regarding goods and services to be transferred can be identified;
  - The payment terms for goods and services to be transferred can be identified;
  - The contract must have commercial substance; and
  - It is probable that the entity will collect substantially all of the consideration to which it is entitled in exchange for the goods or services that will be transferred to the customer.
- Combining contracts – one or more contracts that are entered into at (or near) the same time with the same customer (or related party) are accounted for as a single contract if certain conditions are present
- Contract modifications

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Step #2 –Identify Separate Performance Obligations

- A performance obligation is a promise to provide goods or services (or a bundle of goods or services) that are either:
  - Distinct (‘stand alone value’ and separable)
  - Series of similar distinct good/services, whereby:
    - Each distinct good or service is a promise satisfied over time and
    - The same method would be used to measure the entity’s progress towards complete satisfaction to transfer each distinct good or service to the customer

Step #2 –Identify Separate Performance Obligations

Definition of a 'Distinct' Good or Service:

Can the customer benefit from the good or service, either on its own, or with other readily available resources?

('readily available resources' are those that the customer possess or is able to obtain from the entity or another third party)

No

The good or service is not 'distinct'

(these are then grouped into 'bundles' of goods and services that are themselves 'distinct')

Yes

Is the promise to transfer a good or service separate from the other promised goods or services in the contract?

Indictors that it is <u>not</u> separately identifiable may include:

- The entity provides a significant service of integrating the goods and services.
- A good or service significantly modifies or customizes the other goods and services.
- A good or service is highly dependent or interrelated with the other goods and services.

No

Yes

The good or service IS 'distinct'

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Step #3 – Determine the Transaction Price

- The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer (fixed or variable)
  - Excludes amounts collected on behalf of third parties – e.g. sales taxes etc.
- The consideration promised in a contract with a customer can vary in terms of nature and timing, and this affects the determination of the transaction price
- Specific consideration is given to:
  - Customer's credit risk (where appropriate)
  - Variable consideration (discounts, incentives, bonuses)
  - The existence of a significant financing component in the contract
  - Non-cash consideration
  - Consideration payable to a customer

Step #4 – Allocate the Transaction Price to Performance Obligations

- An entity allocates/splits the transaction price between its performance obligations
- The allocation is based on the relative standalone selling prices (the price at which an entity would sell a promised good or service separately to a customer) of each identified performance obligation
  - If an observable price of a good or service for sales in similar circumstances and to similar customers exists, that price should be used
  - If an observable price does not exist, the standalone selling price must be estimated, maximizing the use of observable inputs and considering all available information (e.g., market conditions, entity specific, customers). Several methods are available for estimating
- Discounts are allocated to either a specific performance obligation(s) or proportionately among all performance obligations, depending on circumstances

Step #5 – Recognize Revenue

- Revenue is recognized as/when an entity satisfies each performance obligation
- Satisfaction occurs as/when the entity transfers 'control' of the goods or services to the customer
  - 'Control' is the ability to direct the use of and obtain substantially all of the remaining benefits from an asset (or prevent others from doing so)
- Common examples where a customer would usually obtain 'control' include:
  - Using the asset to produce goods or provide services (including public services)
  - Using the asset to enhance the value of other assets
  - Using the asset to settle liabilities or reduce expenses
  - Selling or exchanging the asset
  - Pledging the asset to secure a debt liability
  - Holding the asset

Step #5 – Recognize Revenue (continued)

Revenue is recognized either:

- Overtime, when any of the following indicators exists:
  - A customer simultaneously receives and consumes all of the benefits as the entity performs
  - The asset that is created or enhanced is controlled by the customer
  - The entity's performance does not create an asset with an alternative use to the entity and there is enforceable right for payment as performance is completed
- At a point in time:
  - Shipment of product, transfer of the good or service

Presentation

Balance sheet

- An entity is required to present the following items separately:
  - Receivables
  - Contract assets
  - Contract liabilities
    - Receivables represent an unconditional right to receive consideration, whereas contract assets represent a right to consideration in exchange for providing additional goods or services.

Income statement and other comprehensive income

- An entity presents revenue from contracts with customers separately from other revenue streams.
- Impairment on both receivables and contract assets is presented separately.

Disclosure

- The entity's contracts with customers
  - Disaggregation of revenue
  - Information about an entity's contract assets and contract liabilities (including reconciliations)
  - Information about the entity's performance obligations
  - The entity's remaining performance obligations at the end of the reporting period
- Significant judgments in the application of the guidance
  - Determining the timing of satisfaction of performance obligations
  - Determining the transaction price and amounts allocated to performance obligations
- Assets recognized from the costs to obtain or fulfill a contract with a customer
- Use of practical expedients

Other Considerations

- Costs to Obtain or Fulfill a contract
  - Acquisition Costs: Sales commissions, set up, engineering, design, etc. (direct, incremental, and recoverable = capitalization)
    - Practical expedient to expense costs as incurred for contracts with a duration less than one year
  - Fulfilment costs: If not in scope of other GAAP, then evaluate under 606. (direct, generate or enhance future performance and recoverable= capitalize)
  - Amortization - consistent with the pattern of transfer of the good or services to which the asset relates to

Other Considerations

- Shipping Costs: Either a performance obligation or fulfilment cost (policy election)
  - P/O: Portion of transaction price allocated to shipping
  - Fulfillment: Revenue recognized when control is transferred and related cost is accrued
    - Both scenarios can produce different timing on when revenue is recognized

Other Considerations

- Warranties:
  - Customer has option to purchase warranty separately = a separate performance obligation
  - Warranty provides a customer with a service in addition to assurance that the product complies with specification = a separate performance obligation
  - Standard warranty that product works as intended = accrue expected costs, not a separate performance obligation

FASB Updated

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Final ASUs Issued in 2017*

ASU 2017 -	Title
01	**Clarifying the Definition of a Business**
02	Clarifying When a Not-for-Profit Entity That Is a General Partner or a Limited Partner Should Consolidate a For-Profit Limited Partnership or Similar Entity
03	Amendments to SEC Paragraphs Pursuant to Staff Announcements at the September 22, 2016 and November 17, 2016 EITF Meetings
04	**Simplifying the Test for Goodwill Impairment**
05	Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets
06	**Employee Benefit Plan Master Trust Reporting**
07	**Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost**
08	Premium Amortization on Purchased Callable Debt Securities

** ASUs issued through October 30, 2017*

Final ASUs Issued*

ASU 2017 -	Title
09	**Scope of Modification Accounting (Stock Compensation)**
10	Determining the Customer of the Operation Services
11	(Part I) Accounting for Certain Financial Instruments with Down Round Features, (Part II) Replacement of the Indefinite Deferral for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests with a Scope Exception
12	**Targeted Improvements to Accounting for Hedging Activities**
13	Amendments to SEC Paragraphs Pursuant to the Staff Announcement at the July 20, 2017 EITF Meeting and Rescission of Prior SEC Staff Announcements and Observer Comments

** ASUs issued through October 30, 2017*

ASU 2017-01, Clarifying the Definition of a Business

- Effective
  - Annual periods beginning after December 15, 2017 (public companies)
  - Annual periods beginning after December 15, 2018 (private companies)
  - Early adoption permitted

- Summary
  - Narrows the definition of a business; key concepts in revised definition include:
    1. A business is an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs, or other economic benefits directly to investors or other owners, members, or participants
    2. Two essential elements—inputs and <u>substantive process</u> applied to those inputs

ASU 2017-01, Clarifying the Definition of a Business

- Summary (Continued)
  - Includes practical "screen" – if substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar identifiable assets, the set is not considered a business
  - Industry examples provided within the ASU

  http://www.fasb.org/jsp/FASB/Document_C/DocumentPage?cid=1176168739996&acceptedDisclaimer=true

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ASU 2017-04, Simplifying Goodwill Impairment

- Eliminates Step 2 from the goodwill (GW) impairment test
- New one step test comparing the fair value of a reporting unit (RU) with its carrying amount
- Recognize impairment charge for amount by which carrying amount exceeds RU's fair value (up to amount of GW attributed to that RU)
- Retains optional qualitative impairment test ("Step 0")
- Eliminates requirement to perform Step 0 for RU with zero or negative carrying amount, but requires additional disclosure
- Does not eliminate private company alternative in ASU 2014-02*
  - If previously elected 2014-02, can voluntarily adopt 2017-04 (no preferability assessment)
  - If previously elected ASU 2014-18** must demonstrate preferability to adopt 2017-04

**Accounting for Goodwill (a consensus of the Private Company Council)*

***Accounting for Identifiable Intangible Assets in a Business Combination (a consensus of the Private Company Council)*

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ASU 2017-04,
Simplifying Goodwill Impairment

(continued)

- Effective dates
  - Public entities (SEC filers) – fiscal periods beginning after 12/15/19
  - Public entities (non-SEC filers) – fiscal periods beginning after 12/15/20
  - Nonpublic entities – annual periods beginning after 12/15/21

- Early adoption permitted for interim or annual GW impairment tests performed after 1/1/17

BDO Alert: https://www.bdo.com/insights/assurance/fasb/fasb-flash-report-february-2017-(1)

ASU 2017-06,
EBP Master Trust Reporting

- Employee benefit plans must present interest in a master trust and the change in interest in that master trust as single line items in the statement of net assets available for benefits and the statement of changes in net assets available for benefits
- Updated disclosure requirements for interest in a master trust:
  - Undivided (proportionate) interest - continue to disclose %
  - Divided interest - disclose dollar amount of interest in specific investments of the trust
  - Disclose a master trust's other asset and liability balances and the dollar amount of the plan's interest in each of those balances
  - Eliminates health and welfare plans' investment disclosures for 401(h) account assets; instead, the plan financials will disclose the name of the defined benefit pension plan which includes such investment disclosures
- Effective for fiscal years beginning after 12/15/18

BDO Alert: https://www.bdo.com/insights/assurance/fasb/fasb-flash-report-march-2017

ASU 2017-07, Net Benefit Cost Presentation

- An employer that sponsors a defined benefit plan must disaggregate components of net benefit cost
  - Service cost
    - Present within same line item(s) as other employee compensation costs
    - Generally included within income from continuing operations, but in some cases may be eligible for capitalization
  - All other components of net benefit cost
    - Present in income statement separately from service cost component and outside a subtotal of income from operations, if one is presented
    - E.g., interest cost, actual return on plan assets, amortization of prior service cost included in AOCI, and gains or losses from changes in the value of the projected benefit obligation or plan assets
    - These costs may not be capitalized
- Effective dates
  - Public entities – annual and interim periods beginning after 12/15/17
  - Nonpublic entities – annual periods beginning after 12/15/18; interim periods beginning after 12/15/19

ASU 2017-09, Scope of Modification Accounting

- Clarifies that modification accounting applies to changes in the terms or conditions of a share-based payment award unless all of the following criteria are met:
  - Fair value (or calculated value or intrinsic value) is the same before and after modification
    - Practical expedient - if the modification does not affect any valuation inputs, no requirement to value award immediately before and after modification
  - Vesting conditions are the same before and after modification
  - Classification as an equity or liability instrument is the same before and after modification
  - Effective date – annual and interim periods beginning after 12/15/17 (all entities)

ASU 2017-12, Targeted Improvements to Accounting for Hedging Activities

- Simplifies and expands the eligible hedging strategies for financial and nonfinancial risks and also simplifies its application with targeted improvements in key practice areas through:
  - Expansion of the list of items eligible to be hedged
  - Amendment of the methods used to measure the effectiveness of hedging relationships
  - Prescribing how hedging results are presented and disclosed
  - Partial relief on the timing of certain aspects of hedge documentation
  - Eliminating the requirement to recognize hedge ineffectiveness separately in earnings in the current period
- Effective Date of ASU 2017-12
  - Public business entities - fiscal years and interim periods beginning after 12/15/18
  - All others - fiscal years beginning after 12/15/19, and interim periods within fiscal years beginning after 12/15/20

BDO Alert: [*https://www.bdo.com/insights/assurance/fasb/fasb-flash-report-september-2017*](https://www.bdo.com/insights/assurance/fasb/fasb-flash-report-september-2017)

Links to Further Guidance

- BDO Knows – Leases
- BDO Knows - Revenue Recognition
- Journal of Accountancy - Revenue Recognition
- PWC Revenue Guidance

QUESTIONS
http://townhall.acmllp.com

ANSWERS

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R&D TAX CREDITS: RETHINKING OPPORTUNITIES

Laura Morris, Managing Director – Specialized Tax Services

Agenda

- Overview of the R&D Tax Credit
- New IRS LB&I Directive
- PATH Act of 2015
- Change in Definition of Internal Use Software
- Questions

WHAT IS THE R&D CREDIT?

- Benefit = Up to 9.1 cents on every qualified dollar spent, states vary.
- Directly reduces regular income tax and effective tax rate
- Unused credits carry forward for 20 years
- Increase cash flow and valuation

Qualified Research Expenses:

- Wages, supplies, contractors, computer lease costs

What is Qualified Research?

- Activities meeting the “4-part test”
- Technological development and improvements to new or existing products, manufacturing processes, software, techniques, formulas, etc.

NEW IRS LB&I DIRECTIVE

NEW IRS LB&I DIRECTIVE SUMMARY

- Optional safe harbor for taxpayers with assets >$10M
- LB&I examiners are directed not to challenge "Adjusted ASC 730" QRE amounts that meet the directive guidance
- ASC 730 must be expensed on GAAP audited financial statements as a separate line item or note
- To elect safe harbor certification and disclosure statements are required either with tax return, or at beginning of examination.
- Intended to provide an efficient approach for determining qualified expenses for IRS examiners (and taxpayers)

NEW IRS LB&I DIRECTIVE
RECONCILIATION AND APPLICATION PROCESS

- ASC 730 to “Adjusted ASC 730” statement
  - Remove overhead, quality control, depreciation, amortization, training, rent, G&A, non sec. 41 costs, etc.
  - Compute 95% and 10% upper level manager wage limitations
  - Remove all expenses incurred or paid as part of a contract/agreement

- “Adjusted ASC 730” to Form 6765 QREs statement
  - Additional expenses may be included, but must be disclosed and will not be part of the safe harbor amount.

- Additional required statements: Financial statements, GL detail, chart of accounts, reconciliation statements, organization chart, all executed contracts for research, detailed list of employees with W-2 amounts

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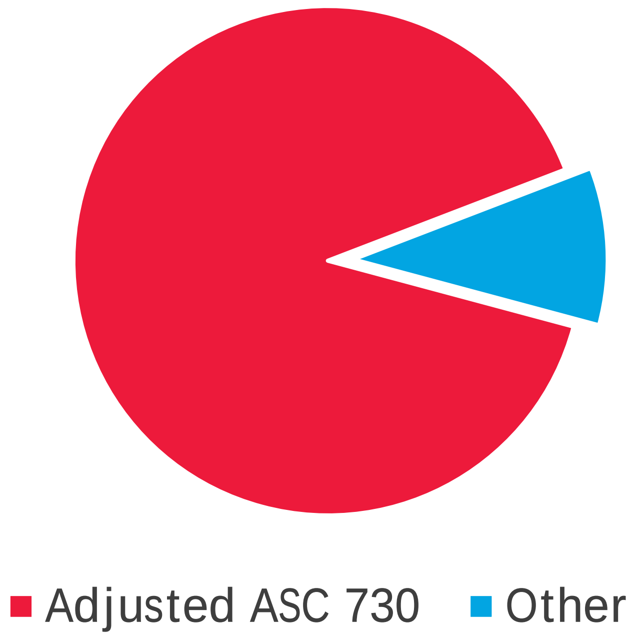
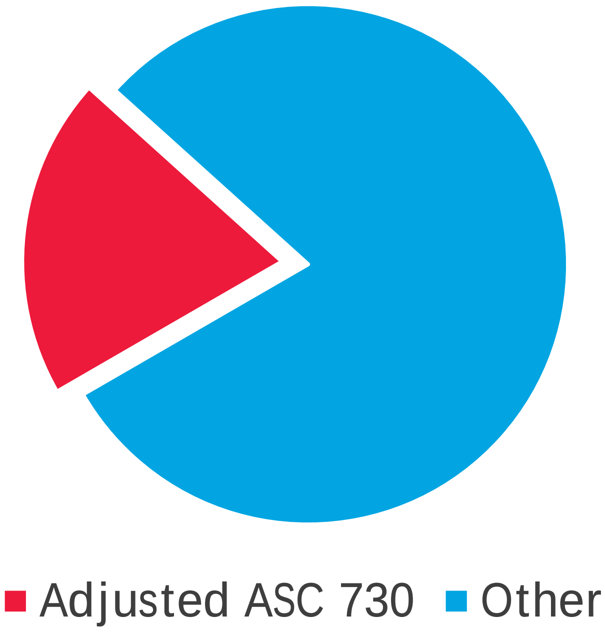
WHO BENEFITS?

COMPANY A: YES



COMPANY B: MAYBE



NEW IRS LB&I DIRECTIVE TAKEAWAYS

- Ensure proper R&D (ASC 730) expense accounting and <u>disclosure</u>

- Compare adjusted ASC 730 expense to R&D Credit qualified expenses to evaluate benefit

- May be an opportunity to reduce ASC 740-10 reserves

PATH ACT OF 2015

PROTECTING AMERICANS FROM TAX HIKES ("PATH") ACT OF 2015

- R&D tax credit is permanent
  - Current tax reform keeps the credit in its current state
- Eligible Small Business Credits – AMT
  - Ability to use R&D credits to offset AMT starting in 2016
- Start-up payroll tax credits
  - Ability to use R&D credits to offset employer payroll tax (FICA) in addition to regular income tax even if taxpayer is not profitable (up to $250,000) starting in 2016

FOLLOW THE PATH TO R&D TAX SAVINGS

Don't miss out on **new ways to monetize R&D tax credits!**

The PATH Act, passed in December 2015, made the federal R&D tax credit permanent, enabling businesses to plan ahead. It also included additional enhancements to expand benefits to smaller businesses and startups, resulting in significant cash savings opportunities.

ALTERNATIVE MINIMUM TAX (AMT) OFFSET

*Eligible **small businesses** can now use the R&D tax credit against their AMT.*

ARE YOU ELIGIBLE

- Privately held
- Paying AMT in 2016
- ≤$50 million in annual average gross receipts for the preceding 3 tax years

POTENTIAL SAVINGS **Up to 20% of qualified research expenditures**

QUALIFIED ACTIVITIES

Don't discount everyday innovation. You may already be performing R&D activities that qualify.

ARE YOU...

- Trying to develop a product, process or software? or make it better, faster, cheaper, or greener?
- Paying for employees or consulting services regarding engineering, software development, or the physical or biological sciences?

NOW WHAT?

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FOLLOW THE PATH TO R&D TAX SAVINGS

Don't miss out on **new ways to monetize R&D tax credits!**

The PATH Act, passed in December 2015, made the federal R&D tax credit permanent, enabling businesses to plan ahead. It also included additional enhancements to expand benefits to smaller businesses and startups, resulting in significant cash savings opportunities.

PAYROLL TAX OFFSET

***Startup companies** may now use the R&D tax credit against the employer's payroll tax – or FICA - even if they are not profitable.*

ARE YOU ELIGIBLE?

- Gross receipts of <$5 million in 2016
- No gross receipts prior to 2012

POTENTIAL SAVINGS

Up to $250,000 for each eligible year for up to five years.

QUALIFIED ACTIVITIES

Don't discount everyday innovation. You may already be performing R&D activities that qualify.

ARE YOU...

- Trying to develop a product, process or software? or make it better, faster, cheaper, or greener?
- Paying for employees or consulting services regarding engineering, software development, or the physical or biological sciences?

NOW WHAT?

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CHANGE IN DEFINITION OF INTERNAL USE SOFTWARE

CHANGE IN DEFINITION OF INTERNAL USE SOFTWARE

Old definition of internal use software:

- eCommerce, SaaS, free apps, banking, social media
- Increased scrutiny from IRS
- Increased ASC 740-10 reserves (~40-50% for expenses related to IUS)

New definition of IUS after final regulations (T.D. 9786):

- Less scrutiny from IRS if software interacts with 3rd parties (e.g. customer log in or web portals to access info online)
- Decrease in ASC 740-10 reserves
- Software for G&A functions still considered internal use

Thank you!

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Cost Segregation

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What is it?

- Engineering based segregation of assets
  - Personal property vs. real property
  - Personal = desks, decorative light fixtures, carpet
  - Real = the building core and structure
  - Three main benefits
    - Acceleration of depreciation deductions
    - Disposal of assets
    - Allocation of sale price when you sell the property

Acceleration of Depreciation

- Example:
  - $12,000,000 Office Building
  - $2,000,000 Allocated to land
  - $10,000,000 Allocated to the building

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Acceleration of Depreciation

2016 DEPRECIATION AND AMORTIZATION REPORT

Cost Seg presentation R- 1

Asset No.	Description	Date Acquired	Method	Life	Conv	Line No.	Unadjusted Cost Or Basis	Bus % Excl	Section 179 Expense	* Reduction In Basis	Basis For Depreciation	Beginning Accumulated Depreciation	Current Sec 179 Expense	Current Year Deduction	Ending Accumulated Depreciation
1	BUILDING	01/01/16	SL	39.00	MM	19I	10000000.				10000000.			245726.	245726.
2	LAND	01/01/16	L				2000000.				2000000.			0.	
	* Total Rental Depreciation						12000000.				12000000.	0.		245726.	245726.
	Current Year Activity														
	Beginning balance						0.		0.	0.	0.	0.			0.
	Acquisitions						12000000.		0.	0.	12000000.	0.			245726.
	Dispositions						0.		0.	0.	0.	0.			0.
	Ending balance						12000000.		0.	0.	12000000.	0.			245726.

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(D) - Asset disposed

* ITC, Salvage, Bonus, Commercial Revitalization Deduction, GO Zone

11.1

Acceleration of Depreciation

- Engineer walks the building
  - Goes into each suite, mechanical room, reviews all of the electrical boxes, common areas, surrounding property, parking lot/structure, etc.
  - Produces engineering report
  - Assets broken out by class
  - Five, seven and 15 year assets broken out from 39 year asset

Acceleration of Depreciation

2016 DEPRECIATION AND AMORTIZATION REPORT

Cost Seg presentation - post study R- 2

Asset No.	Description	Date Acquired	Method	Life	Conv	Line No.	Unadjusted Cost Or Basis	Bus % Excl	Section 179 Expense	* Reduction In Basis	Basis For Depreciation	Beginning Accumulated Depreciation	Current Sec 179 Expense	Current Year Deduction	Ending Accumulated Depreciation
3	Building Shell and Core	01/01/16	SL	39.00	MM	19I	4000000.				4000000.			98291.	98291.
4	Elevator Car # 1	01/01/16	SL	39.00	MM	19I	75000.				75000.			1843.	1843.
5	Elevator Car # 2	01/01/16	SL	39.00	MM	19I	75000.				75000.			1843.	1843.
6	Parking lot	01/01/16	150DB	15.00	HY	19E	500000.			250000.	250000.			262500.	12500.
7	Carpet Common Area Floor 5	01/01/16	200DB	5.00	HY	19B	4750.			2375.	2375.			2850.	475.
8	Carpet Common Area Floor 3	01/01/16	200DB	5.00	HY	19B	5750.			2875.	2875.			3450.	575.
9	Lobby Furniture	01/01/16	200DB	5.00	HY	19B	27500.			13750.	13750.			16500.	2750.
10	Specialty electrical Suite 504	01/01/16	200DB	5.00	HY	19B	8200.			4100.	4100.			4920.	820.
11	Land Improvements - Landscaping	01/01/16	150DB	15.00	HY	19E	95000.			47500.	47500.			49875.	2375.
12	Bathroom fixtures - lobby	01/01/16	200DB	5.00	HY	19B	2500.			1250.	1250.			1500.	250.
13	carpet Common Area Floor 4	01/01/16	200DB	5.00	HY	19B	5400.			2700.	2700.			3240.	540.
14	specialty electrical Suite 306	01/01/16	200DB	5.00	HY	19B	6850.			3425.	3425.			4110.	685.
15	specialty plumbing Suite 250	01/01/16	200DB	5.00	HY	19B	3250.			1625.	1625.			1950.	325.
16	windows floor 3	01/01/16	SL	39.00	MM	19I	75000.				75000.			1843.	1843.
17	bathroom fixtures floor 4	01/01/16	200DB	5.00	HY	19B	2500.			1250.	1250.			1500.	250.
18	carpet Common Area lobby	01/01/16	200DB	5.00	HY	19B	8250.			4125.	4125.			4950.	825.
19	specialty lighting - lobby	01/01/16	200DB	5.00	HY	19B	3150.			1575.	1575.			1890.	315.
20	specialty plumbing -lobby	01/01/16	200DB	5.00	HY	19B	5400.			2700.	2700.			3240.	540.

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(D) - Asset disposed

* ITC, Salvage, Bonus, Commercial Revitalization Deduction, GO Zone

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Acceleration of Depreciation

Cost Seg - Presentation
Purchase Date 2016
Proposal - 10000 S. Cost Seg Way

Cumulative present value on taxes deferred at 6.0%	**$568,401**
Total taxes deferred 2016-2023	**$909,223**
Total additional depreciation claimed 2016-2023	**$2,055,670**

Results of Cost Segregation Study	Segregated	Difference	Original
Building - 39 Yr	$7,000,000	($3,000,000)	$ 10,000,000
Land Improve - 15 Yr 150% DB	$750,000	750,000	-
Furnishings - 7 Yr 200% DB	1,350,000	1,350,000	-
Equipment - 5 Yr 200% DB	900,000	900,000	-
Total Recovery Property	$ 10,000,000	$ -	$ 10,000,000
Land (Non-depreciable)	2,000,000	-	2,000,000
Total per Draw Disbursement Sheet	$ 12,000,000	$ -	$ 12,000,000

Assumptions	
Current Tax Year	2016
Discount Rate	6.0%
Effective Fed'L Tax Rate	39.6%
Effective State Tax Rate	4.63%

	Depreciation as originally reported				(A)	Depreciation Based on Segregated Cost Recovery				(B)	(B)-(A)					
					Total					Total	Additional	Federal	State	Total	Sub-total	Present
					Original					Segregated	Depreciation	Taxes Deferred	Taxes Deferred	Taxes	By	Value of
Year	39 Yrs	15 Yrs	7 Yrs	5 Yrs	Cost Deprec	39 Yrs	15 Yrs	7 Yrs	5 Yrs	Cost Deprec	Computed	39.6%	4.63%	Deferred	Year	Taxes Deferred
2016	245,717	0	0	0	245,717	172,002	37,500	192,915	180,000	582,417	336,700	133,333	15,589	148,922	148,922	148,922
2017	256,400	0	0	0	256,400	179,480	71,250	330,615	288,000	869,345	612,945	242,726	28,379	271,105	271,105	255,759
2018	256,400	0	0	0	256,400	179,480	64,125	236,115	172,800	652,520	396,120	156,864	18,340	175,204	175,204	155,931
2019	256,400	0	0	0	256,400	179,480	57,750	168,615	103,680	509,525	253,125	100,238	11,720	111,958	111,958	94,002
2020	256,400	0	0	0	256,400	179,480	51,975	120,555	103,680	455,690	199,290	78,919	9,227	88,146	88,146	69,820
2021	256,400	0	0	0	256,400	179,480	46,725	120,420	51,840	398,465	142,065	56,258	6,578	62,836	62,836	46,955
2022	256,400	0	0	0	256,400	179,480	44,250	120,555	0	344,285	87,885	34,802	4,069	38,871	38,871	27,403
2023	256,400	0	0	0	256,400	179,480	44,250	60,210	0	283,940	27,540	10,906	1,275	12,181	12,181	8,101
2024	256,400	0	0	0	256,400	179,480	44,325	0	0	223,805	(32,595)	(12,908)	(1,509)	(14,417)	(14,417)	(9,045)
2025	256,400	0	0	0	256,400	179,480	44,250	0	0	223,730	(32,670)	(12,937)	(1,513)	(14,450)	(14,450)	(8,553)
2026	256,400	0	0	0	256,400	179,480	44,325	0	0	223,805	(32,595)	(12,908)	(1,509)	(14,417)	(14,417)	(8,050)
2027	256,400	0	0	0	256,400	179,480	44,250	0	0	223,730	(32,670)	(12,937)	(1,513)	(14,450)	(14,450)	(7,612)
2028	256,400	0	0	0	256,400	179,480	44,325	0	0	223,805	(32,595)	(12,908)	(1,509)	(14,417)	(14,417)	(7,165)
2029	256,400	0	0	0	256,400	179,480	44,250	0	0	223,730	(32,670)	(12,937)	(1,513)	(14,450)	(14,450)	(6,775)
2030	256,400	0	0	0	256,400	179,480	44,325	0	0	223,805	(32,595)	(12,908)	(1,509)	(14,417)	(14,417)	(6,377)
2031	256,400	0	0	0	256,400	179,480	22,125	0	0	201,605	(54,795)	(21,699)	(2,537)	(24,236)	(24,236)	(10,113)
2032	256,400	0	0	0	256,400	179,480	0	0	0	179,480	(76,920)	(30,460)	(3,561)	(34,021)	(34,021)	(13,392)
2033	256,400	0	0	0	256,400	179,480	0	0	0	179,480	(76,920)	(30,460)	(3,561)	(34,021)	(34,021)	(12,634)
2034	256,400	0	0	0	256,400	179,480	0	0	0	179,480	(76,920)	(30,460)	(3,561)	(34,021)	(34,021)	(11,919)
2035	256,400	0	0	0	256,400	179,480	0	0	0	179,480	(76,920)	(30,460)	(3,561)	(34,021)	(34,021)	(11,244)
2036	256,400	0	0	0	256,400	179,480	0	0	0	179,480	(76,920)	(30,460)	(3,561)	(34,021)	(34,021)	(10,608)
2037	256,400	0	0	0	256,400	179,480	0	0	0	179,480	(76,920)	(30,460)	(3,561)	(34,021)	(34,021)	(10,007)
2038	256,400	0	0	0	256,400	179,480	0	0	0	179,480	(76,920)	(30,460)	(3,561)	(34,021)	(34,021)	(9,441)
2039	256,400	0	0	0	256,400	179,480	0	0	0	179,480	(76,920)	(30,460)	(3,561)	(34,021)	(34,021)	(8,907)
2040	256,400	0	0	0	256,400	179,480	0	0	0	179,480	(76,920)	(30,460)	(3,561)	(34,021)	(34,021)	(8,402)
2041	256,400	0	0	0	256,400	179,480	0	0	0	179,480	(76,920)	(30,460)	(3,561)	(34,021)	(34,021)	(7,927)
2042	256,400	0	0	0	256,400	179,480	0	0	0	179,480	(76,920)	(30,460)	(3,561)	(34,021)	(34,021)	(7,478)
2043	256,400	0	0	0	256,400	179,480	0	0	0	179,480	(76,920)	(30,460)	(3,561)	(34,021)	(34,021)	(7,055)
2044	256,400	0	0	0	256,400	179,480	0	0	0	179,480	(76,920)	(30,460)	(3,561)	(34,021)	(34,021)	(6,656)
2045	256,400	0	0	0	256,400	179,480	0	0	0	179,480	(76,920)	(30,460)	(3,561)	(34,021)	(34,021)	(6,279)
2046	256,400	0	0	0	256,400	179,480	0	0	0	179,480	(76,920)	(30,460)	(3,561)	(34,021)	(34,021)	(5,923)
2047	256,400	0	0	0	256,400	179,480	0	0	0	179,480	(76,920)	(30,460)	(3,561)	(34,021)	(34,021)	(5,588)
2048	256,400	0	0	0	256,400	179,480	0	0	0	179,480	(76,920)	(30,460)	(3,561)	(34,021)	(34,021)	(5,272)
2049	256,400	0	0	0	256,400	179,480	0	0	0	179,480	(76,920)	(30,460)	(3,561)	(34,021)	(34,021)	(4,973)
2050	256,400	0	0	0	256,400	179,480	0	0	0	179,480	(76,920)	(30,460)	(3,561)	(34,021)	(34,021)	(4,692)
2051	256,400	0	0	0	256,400	179,480	0	0	0	179,480	(76,920)	(30,460)	(3,561)	(34,021)	(34,021)	(4,426)
2052	256,400	0	0	0	256,400	179,480	0	0	0	179,480	(76,920)	(30,460)	(3,561)	(34,021)	(34,021)	(4,176)
2053	256,400	0	0	0	256,400	179,480	0	0	0	179,480	(76,920)	(30,460)	(3,561)	(34,021)	(34,021)	(3,939)
2054	256,400	0	0	0	256,400	179,480	0	0	0	179,480	(76,920)	(30,460)	(3,561)	(34,021)	(34,021)	(3,716)
2055	10,683	0	0	0	10,683	7,478	0	0	0	7,478	(3,205)	(1,269)	(148)	(1,417)	(1,417)	(146)
Total	**9,999,600**	**$0**	**$0**	**$0**	**$9,999,600**	**$6,999,720**	**$750,000**	**$1,350,000**	**$900,000**	**$9,999,720**	**$120**	**$55**	**$14**	**$69**	**$69**	**$568,401**

Acceleration of Depreciation

- Timing of a Cost Segregation Study
  - When the property is purchased/built
  - Some time down the road
    - – Can be five years after purchase
    - – Catch up of depreciation deduction
      - » Form 3115 – Change in Accounting Method
      - » Section 481a - Calculation

- Takeaway – Accelerated depreciation is an ordinary deduction.

Detour – History of Cost Seg

- Came about in 1962 with the Investment Tax Credit (ITC)
  - The procedures used to segregate assets to calculate ITC same for Cost Segregation Study
  - Faded away in 1986 when ITC was repealed
  - Landmark case in 1997 – Hospital Corp. of America v. Commissioner

History of Cost Segregation

- Other relevant dates
  - 2001 IRS allowed for catch up of depreciation
    - 481a Adjustment
  - 2002 IRS allows for automatic change in accounting method
    - No more request for change

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Disposal of Assets

- Second main benefit
  - What can we do with this more detailed depreciation schedule?
  - Example – We now have all of the elevator cars and bathroom fixtures broken out. Comes time to replace an elevator car or remodel the bathroom. What do we do with the old assets? With no cost seg, how do we determine the value?

Disposal of Assets

- Easy way to think about it.
  - If your building had one bathroom before the remodel and one bathroom after the remodel, how many bathrooms should be on the depreciation schedule?
  - Without a cost segregation study you would end up with two; one buried in original building and one capitalized after the remodel.

Allocation of Sales Price

- Doesn't get the credit it deserves
- Original Example:
  - $12,000,000 building, $2,000,000 allocated to land
  - Cost Segregation performed on $10,000,000 allocated to building
  - Sales Price = $24,000,000

Allocation of Sales Price

- What is reasonable?
  - Is it reasonable that the building and land doubled in value?
  - What about the carpet in the common areas? The lobby furniture?
  - These items wear out. If you sold them you would get very little or nothing in return. This allows us to allocate the sales price.

Allocation of Sales Price

- Why do we care?
  - Many five, seven and 15 year assets are subject to Sec. 1245 and 1250 recapture
  - This is the accelerated depreciation taken on these assets. The code says this is recaptured at ordinary income rates instead of capital gain ones, **to the extent of gain**.

Allocation of Sales Price

- Tax Rate Play
  - Allocate zero or something nominal that represents the FMV of these assets
  - This shifts income from a potential 39.6% rate down to a 20% rate
  - 20% potential savings
- Coming Full Circle
  - We took ordinary deductions and are reporting capital gain on the back end

Cost Segregation Study

- Why I enjoy them so much!
  - Substantial tax savings for clients
  - Easy to quantify and explain
    - Accelerated depreciation
    - Disposal of assets
    - Sales price allocation

Conclusion

- Types of properties
  - Office buildings, strip malls, hotels, industrial properties, multi-family residential, single family rental properties, etc.
  - Many firms put a lower floor on when they will perform a cost segregation study based on purchase price

QUESTIONS
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ANSWERS

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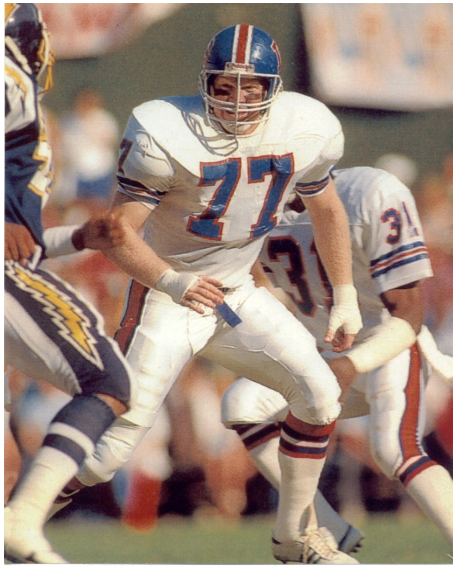

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