ABOUT KBKG

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

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

SERVICES OVERVIEW

Research & Development Tax Credits

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

Cost Segregation for Buildings and Improvements

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

45L Credits for Energy Efficient Residential Developments

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

179D Incentive for Energy Efficient Commercial Buildings

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

IC-DISC

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

Transfer Pricing Services

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

Fixed Asset Review

While a cost segregation study focuses on buildings, a comprehensive Fixed Asset Tax Review encompasses all fixed assets a company owns including real property, machinery, furniture, fixtures, and equipment.

Repair vs. Capitalization Review §263(a)

Taxpayers often capitalize major building expenditures that should be expensed as repairs and maintenance such as HVAC units, roofs, plumbing, lighting and more. Retirement loss deductions for demolished building structural components are also identified.

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

INDUSTRY MATRIX FOR TAX SAVING OPPORTUNITIES

KBKG
SOLUTIONS FOR TAX PROFESSIONALS AND BUSINESSES
Tax Credits • Incentives • Cost Recovery

At KBKG, we are committed to identifying all possible tax saving opportunities for our clients and CPA partners. Our detailed Industry Matrix helps quickly determine which tax credits and deductions apply by industry at a glance. Our chart alone provides some insight to ensure that businesses are seeking out all potential benefits; however, KBKG's certified engineers and technical experts perform a thorough assessment during the engagement process to be sure all possible incentives are identified and considered.

INDUSTRY	R&D TAX CREDITS	REPAIR/ ASSET RETIREMENT	45L TAX CREDITS	179D TAX DEDUCTIONS	COST SEGREGATION / FIXED ASSET	IC-DISC	*TRANSFER PRICING	EMPLOYEE RETENTION TAX CREDIT
Affordable Housing		✓	✓	✓	✓			✓
Agriculture, Forestry & Fishing	✓				✓	✓	✓	✓
Architecture & Engineering	✓			✓	✓	✓		✓
Auto Dealerships		✓		✓	✓			✓
Cannabis	✓				✓			✓
Communications & Utilities	✓	✓			✓	✓		✓
Construction	✓				✓			✓
Film & Music	✓				✓	✓	✓	✓
Financial Services	✓	✓			✓		✓	✓
Government Contractors	✓			✓	✓	✓		✓
Healthcare	✓	✓		✓	✓		✓	✓
Home Builder			✓					✓
Hotels	✓	✓		✓	✓		✓	✓
Manufacturing & Distribution	✓	✓		✓	✓	✓	✓	✓
Mining	✓				✓	✓	✓	✓
Multifamily Developers		✓	✓	✓	✓			✓
Oil & Gas	✓	✓			✓		✓	✓
Pharmaceutical	✓	✓		✓	✓	✓	✓	✓
Professional Services	✓	✓			✓		✓	✓
Real Estate		✓		✓	✓			✓
Restaurants		✓			✓			✓
Retail	✓	✓		✓	✓			✓
Technology/Software	✓				✓	✓	✓	✓
Transportation	✓				✓		✓	✓
Wholesale Trade	✓	✓		✓	✓	✓	✓	✓

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

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

IDENTIFYING VALUE-ADDED TAX OPPORTUNITIES

SOLUTIONS FOR TAX PROFESSIONALS AND BUSINESSES
Tax Credits • Incentives • Cost Recovery

KBKG SERVICE	DESCRIPTION & HIGHLIGHTS	APPLICABLE CLIENTS & INDUSTRIES	HOW MUCH IS IT WORTH?	TAX CONSIDERATIONS
RESEARCH & DEVELOPMENT TAX CREDITS (FEDERAL & STATE)	Federal and State tax credit – designed to promote innovation. Expenses incurred in the United States and that meet the qualification criteria can result in a credit. Qualifying expenses can include wages paid to employees, supplies used in the research process, and payments made to contractors for performing qualified research.	Clients developing brand new products, processes, software, or formula. Clients materially improving existing products, processes, software or formula. Clients that employ those with technical backgrounds including: • Manufacturing • Software Development • Architecture • High Tech • Food & Beverage • Equipment or tools • Life Sciences • Agriculture	**Federal Benefit - Roughly 10% of their total Qualified R&D Expenses** Ex.: Client has $1M/year of wages related to R&D. Benefit = $100k in gross credits per year. Many states also allow an R&D credit. For example, CA R&D Credit is worth an additional 7.5% of Qualified R&D expenses.	• Dollar-for-dollar reduction in income tax liabilities. • 1-year carryback / 20-year carryforward of unused credits. • Qualified small businesses can reduce alternative minimum tax liabilities. • Qualified start-up companies can offset up to $250,000 in payroll taxes.
COST SEGREGATION (FEDERAL & STATE)	Allows **taxpayers who have constructed, purchased, expanded, or remodeled any kind of real estate** to accelerate depreciation deductions by reclassifying building components into shorter tax lives.	Any **building with over $750k** of depreciable tax basis (excluding land). Any **leasehold improvement with over $500k** of depreciable tax basis (excluding land). Any smaller **residential rental property with over $150k** of depreciable tax basis (excluding land) can utilize KBKG's online software to generate a cost segregation report.	Net Present Value is roughly **5% of the total building cost.** Ex.: $2M office can yield an after-tax NPV of $100k.	• Reduces AMT • Starting in 2018, unused deductions carryforward. • Must recapture personal property and bonus eligible assets upon the sale of a building.
TRANSFER PRICING (INTERNATIONAL)	Federal credit for developers of **apartments, condos, or spec homes** that meet The transfer prices of goods, royalties, services, and loans drive how much income tax is paid by country. Corrections to transfer pricing may lead to significant improvements in a company's global effective tax rate. Savings dependent on differences in tax rates between countries and can be significant. Tax reform provides incentives for companies to generate income in the US with lower rates certain energy efficiency standards. Units must be certified by a qualified professional to be eligible.	All US and foreign-owned multinational companies. Transfer pricing rules apply to goods, services, royalties, loans and other cross-border transactions in all industries Companies with supply chain restructuring programs, new R&D facilities, or international subsidiaries are often best placed to realize benefits.	US tax reform has created opportunities to improve global effective tax rates through changes to transfer prices, e.g. • Foreign Derived Intangible Income ("FDII") allows C-Corporations to pay a 13.125% rate on some export income • Changes to transfer prices of imported goods may also lead to tax savings at the 21% rate. • Substantial benefits when correcting transfer pricing to utilize tax net operating losses.	Companies without transfer pricing documentation can face additional tax, interest, non-deductible penalties and double tax for all open tax years. Tax authorities are concerned about multinational companies paying their "fair share" of income tax in each country where they operate.

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

IDENTIFYING VALUE-ADDED TAX OPPORTUNITIES

KBKG
SOLUTIONS FOR TAX PROFESSIONALS AND BUSINESSES
Tax Credits • Incentives • Cost Recovery

KBKG SERVICE	DESCRIPTION & HIGHLIGHTS	APPLICABLE CLIENTS & INDUSTRIES	HOW MUCH IS IT WORTH?	TAX CONSIDERATIONS
RESIDENTIAL ENERGY CREDITS / SECTION 45L (FEDERAL / STATES CAN HAVE SIMILAR PROGRAMS)	Federal credit for developers of **apartments, condos, or spec homes** that meet certain energy efficiency standards. Units must be certified by a qualified professional to be eligible.	Anyone that has built apartments, condos or production home developments (3 stories or less), in the last 4 years. **Generally, more than 20 units.**	**Federal credit = $2,000 per apartment/home unit.** **Many states have similar credits.** Ex.: 100-unit apartment/ condo can get $200,000 of Federal Tax Credits.	• Credit is realized when unit is first leased or sold, not placed in service. • 1-year carryback • 20-year carryforward. • Does not reduce AMT. • Subject to passive activity loss rules • Credit reduces basis.
COMMERCIAL ENERGY DEDUCTIONS / SECTION 179D (FEDERAL/ STATES CAN HAVE SIMILAR PROGRAMS)	Federal deduction for **architects, engineers, and design/build contractors** that work on public or government buildings such as schools, libraries, courthouses, military housing etc. **Also available to any commercial building owner.**	• **179D for designers:** Architects, general contractors, engineers, electrical & HVAC subcontractors. • **Any building owner or lessee:** That has constructed a commercial improvement greater than 50,000 SF since 1/1/2006.	**$.30 up to $1.80 per square foot in federal tax deductions.** Ex.: 100,000SF building is eligible for $180,000 in deductions.	• Reduces AMT • Deduction reduces basis in real property. • Designers must amend open tax years to claim. • Owners can go back to 2006 with Form 3115 to claim missed deductions.
FIXED ASSET TAX REVIEW (FEDERAL)	Comprehensive review of a company's entire fixed asset listing and supporting documents to assign appropriate tax lives, identify retirements, and correct items that should be expensed. Includes cost segregation and repair analysis.	Operations with > $40M in real property or > 500 lines of fixed assets. • Retail, restaurant, bank and hotel chains of 10 or more • Manufacturing • Utility companies	Net present value (NPV) of 5-8% of total building-related costs. Ex.: Manufacturing client has $60M of 39-year fixed assets. NPV Cash value = $3M -$4.8M	• Reduces AMT • Starting in 2018, unused deductions carryforward. • Must recapture personal property and bonus eligible assets upon the sale of a building.
REPAIR V. CAPITALIZATION REVIEW "ASSET RETIREMENT STUDY" (FEDERAL)	New rules allow you to assign value to "structural" components removed from a building and write off the remaining basis. Regs also clarify repair expense treatment of many types of building costs such as HVAC or roof replacements. KBKG also provides compliance consulting for repair and disposition regulations.	**Any building renovation costs > $400k** **Retirement Study -** Building is renovated AFTER owning it at least 1 year. Building should have **<u>> $500K of remaining depreciable basis left.</u>** **Repair Study** - renovations that include **roof, HVAC, windows, lighting, plumbing, ceilings, drywall, flooring, etc.**	Additional Year 1 deductions of **15%-40% of renovation costs (on top of benefits from 1245 reclassification)** Ex.: Client spends $3M on structural renovations. Additional Year 1 deductions of $450K-$1.2M.	• Depending on project specifics, may require a separate 3115 if doing concurrently with a depreciation change.
IC-DISC FEDERAL INCOME TAX INCENTIVE (FEDERAL)	The IC-DISC provides significant and permanent tax savings for producers and distributors of U.S.-made products and certain services used abroad.	**Any closely held, privately owned business with over $250,000 in profits from exports** • Manufacturers • Distributors • Architects & Engineers • Agriculture and Food Producers • Software Developers • Other Producers	Minimum permanent **17% decrease in tax rate on half of export profits.** Benefits can be dramatically higher by performing a transaction-by-transaction analysis.	• Requires annual filing 1120 IC-DISC. • No changes to business operations. • Benefits begin when entity is formed.

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

KBKG SOLUTIONS FOR TAX PROFESSIONALS AND BUSINESSES
TAX CREDITS · INCENTIVES · COST RECOVERY

Qualified Improvements - Depreciation Quick Reference (updated 3/30/2020)

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

Bonus Depreciation Rates (inclusive dates)

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

Footnotes:

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

SOLUTIONS FOR TAX PROFESSIONALS AND BUSINESSES
TAX CREDITS · INCENTIVES · COST RECOVERY

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

Footnotes:

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

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

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

Definitions:

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

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

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

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

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

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

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

Qualified improvement property[A] (QIP) 2016-2017: (A) Any improvement to an interior portion of a building which is nonresidential real property if such improvement is placed in service after the date the building was first placed in service. (B) Certain improvements not included. Such term shall not include any improvement for which the expenditure is attributable to— (i) the enlargement of the building, (ii) any elevator or escalator, (iii) the internal structural framework of the building.

Qualified improvement property[A] (QIP) 2018-onward: (A) Any improvement *made by the taxpayer* to an interior portion of a building which is nonresidential real property if such improvement is placed in service after the date the building was first placed in service. (B) Certain improvements not included. Such term shall not include any improvement for which the expenditure is attributable to— (i) the enlargement of the building, (ii) any elevator or escalator, (iii) the internal structural framework of the building.

Other notes:

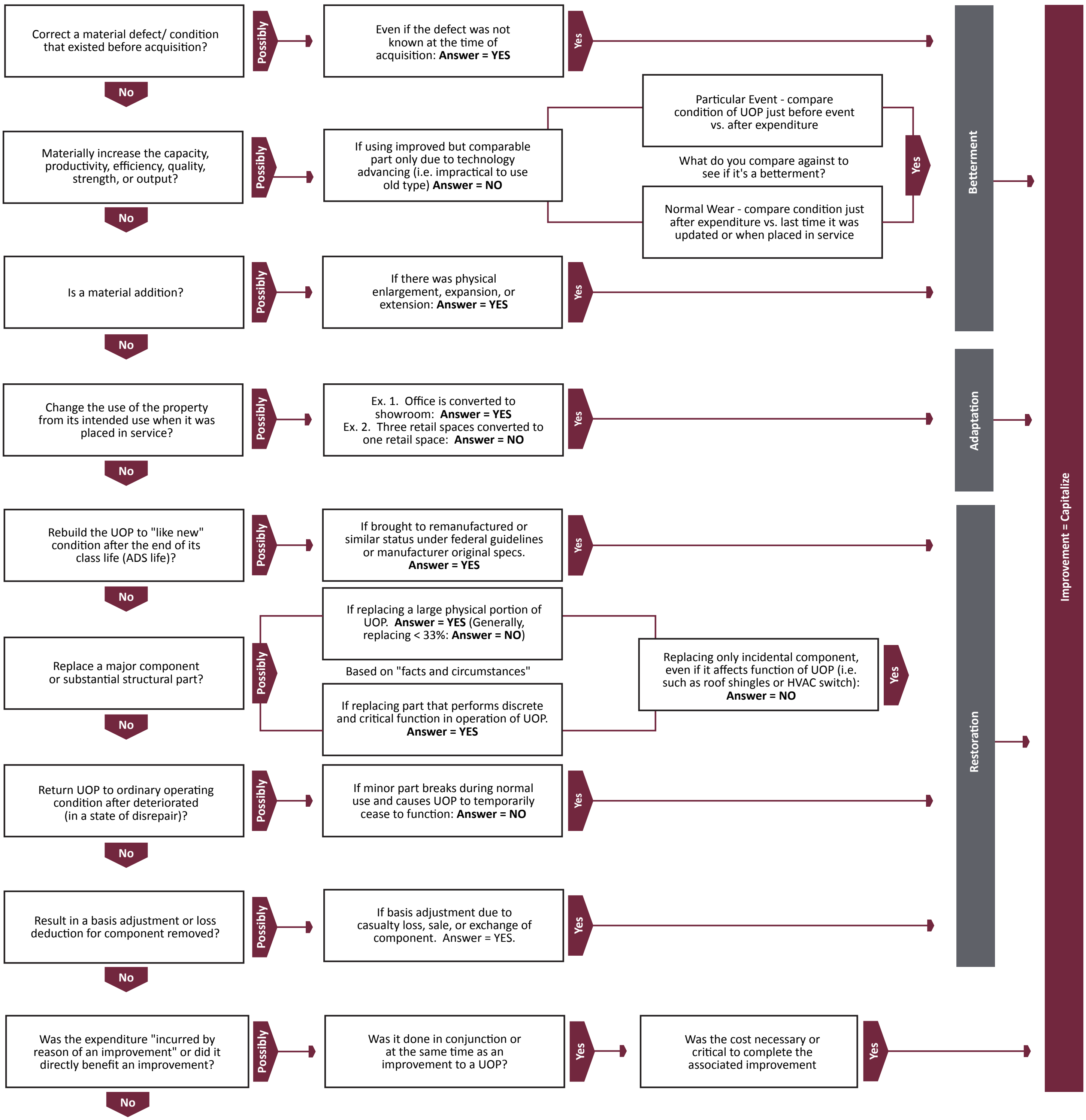
A) Tenant improvements that include costs for HVAC rooftop units are excluded from the definition of Qualified Leasehold Improvements (QLI), Qualified Retail Improvements, and Qualified Improvement Property (CCA 201310028)

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

KBKG REPAIR VS. CAPITALIZATION:
IMPROVEMENT DECISION TREE - FINAL REGULATIONS

KBKG
Solutions for Tax Professionals and Businesses
Tax Credits • Incentives • Cost Recovery

Considering the appropriate Unit of Property (UOP), does the expenditure: (Last Updated 3-20-2015)



Possible Repair Expense

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

KBKG BUILDING UNIT OF PROPERTY & MAJOR COMPONENTS CHART

SOLUTIONS FOR TAX PROFESSIONALS AND BUSINESSES
Tax Credits • Incentives • Cost Recovery

This chart was created to help users identify building systems & typical "major components" in real estate assets. Replacing a major component is a capital expenditure while replacing an incidental component can be expensed

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

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

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

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

__Definitions__

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

BEFORE WE GET STARTED

Welcome and thank you for joining KBKG's live webinar

- We will start the live webinar at **10 am PT | 1 pm ET**
- For the best audio, dial in using the telephone number provided
- Please enter questions into the Q&A module
- Download the slides from **KBKG.com/resources**
  - "Transfer Pricing Cash Savings Strategies and the New Audit Roadmap"

KBKG

TRANSFER PRICING CASH SAVINGS STRATEGIES AND THE NEW AUDIT ROADMAP MAY 3, 2023

All attendees are muted.
The webinar will begin promptly at 10 AM Pacific / 1 PM Eastern

ADMINISTRATION

AUDIO

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

HANDOUT MATERIALS – Were provided before class.

- KBKG.com/resources

CPE (Continuing Professional Education – for CPAs only)

- Answer all polling questions during the webinar

QUESTIONS AND ANSWERS

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

ABOUT KBKG

KBKG

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

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

ALEX MARTIN

- Full-time transfer pricing specialist for 25 years, including four years working overseas.
- Alex worked as an economist at a Big-4 firm for 12 years, six years at a top middle-market CPA firm and four years as an independent consultancy.
- KBKG's team was selected as one of the world's leading transfer pricing consultancies by *International Tax Review* for 2021-2022 and 2022-2023.
- Alex has also been an advisor to the World Bank, working with tax auditors in Bosnia-Herzegovina.

OVERVIEW

- Assessing transfer pricing opportunities and red flags
- The IRS loves Coca-Cola! (and why it matters to you)
- New transfer pricing audit rules of the road
- Transfer pricing tax savings
- Inflation Reduction Act of 2022
- Global Minimum Tax Developments (Pillars 1 & 2)
- Ten Transfer Pricing Takeaways

WHY IS TRANSFER PRICING IMPORTANT?

German Manufacturer Parent
$X profit

Auto parts
$Y charge

U.S. distribution subsidiary
$Z profit

Retailers

German taxes 30% of $X

U.S. taxes 21% of $Z

$Y transfer price drives taxes payable by country

Intercompany price of goods, royalties, service charges, and loans all impact taxes paid by country

WHY IS TRANSFER PRICING IMPORTANT?

Starbucks – U.S.
IP Owner

Royalties

Starbucks – U.K.
Retail Shops

Roasted Beans

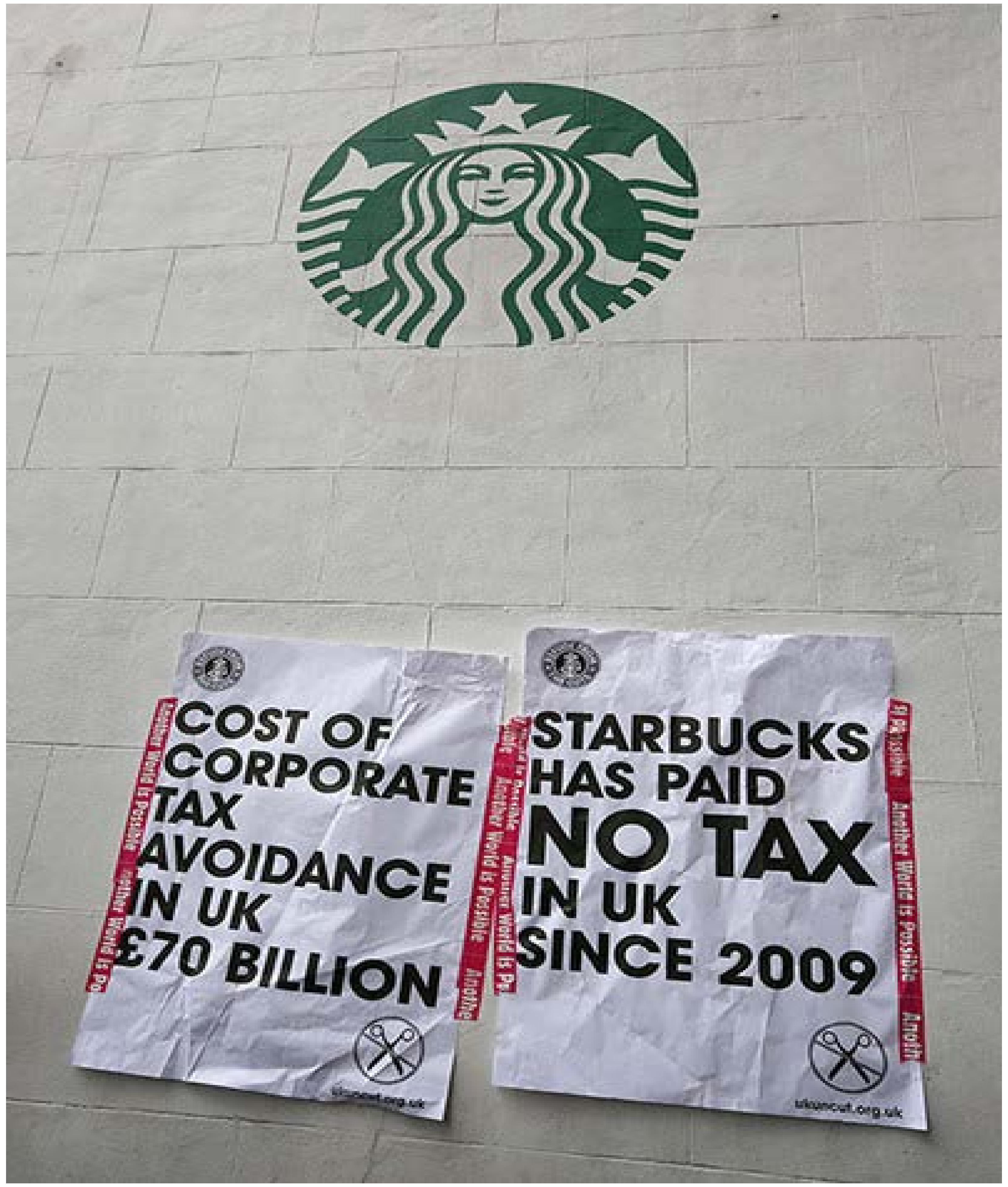
Starbucks – Switzerland

Coffee Beans

Starbucks – Netherlands
Coffee Roaster

<u>**Question: where should profits be generated?**</u>

IS YOUR COMPANY PAYING ITS FAIR SHARE?



"Why does Starbucks manipulate its accounts to avoid tax?"

- UK Member of Parliament Margaret Hodge

Insight #1

Tax auditors often argue that <u>subsidiary companies should not incur losses</u>

IT'S THE REAL THING – IRS VS. COKE

The IRS Wins in Tax Court Against Coca-Cola 2007-2009

- Coca-Cola (US) licenses its trademarks, product names, patents, formulas, and processes to subsidiaries
- IRS audited transactions with Brazil, Costa Rica, Egypt, Ireland, Mexico, and Swaziland

- US Tax Court released its decision on November 18, 2020
- IRS issued over $9 billion in transfer pricing adjustments
- Taxes due $3.2 billion

Insight #2

Tax auditors often argue that:
subsidiary companies should not earn excessive profits

WHAT COMPANIES ARE AFFECTED BY TP?

- Every US company with international operations
- Every international company with US operations
- Goods, royalties, services, loans – all transfer pricing issues
- Results, not policies, are generally the driving factor

- Treas. Reg. §1.482 is the "Arm's-Length Standard"
- OECD Transfer Pricing Guidelines are the global standard

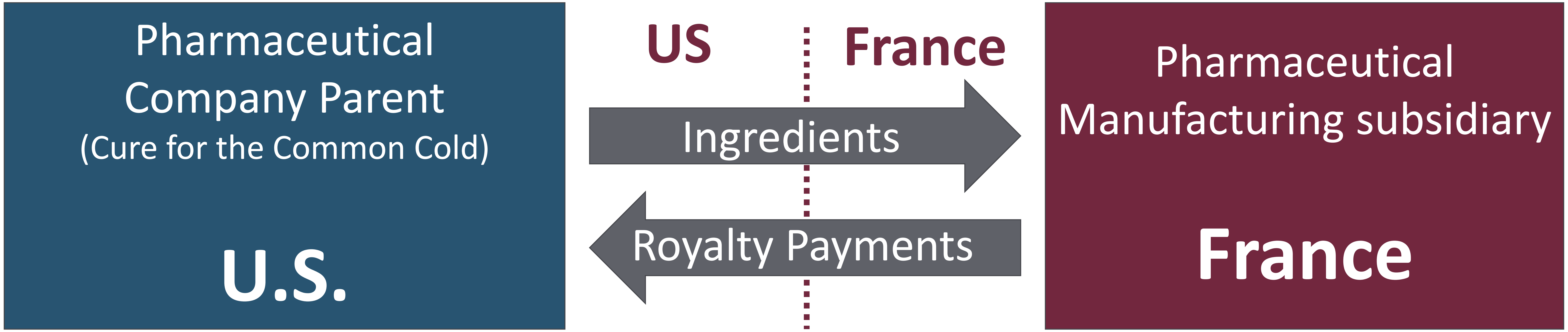
Insight #3

"Arm's-length standard" applies in over 100 countries

KBKG

POLLING QUESTION #1

HOW DO SOME COMPANIES APPROACH TRANSFER PRICING?

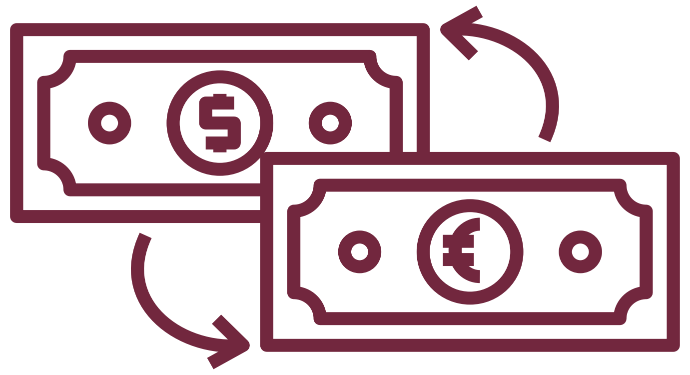


- Company has one cost plus policy – (Cost + 10%)
- Company operates as one "borderless" business
- US plant manager increases transfer prices → higher US profits → bigger personal bonus

Insight #4

Transfer pricing exposures may have nothing to do with tax strategies

WHAT IF THE IRS DISAGREES WITH TRANSFER PRICING?



Assume a total transfer pricing tax adjustment of $10m

Additional income tax owed: $10m x 21%* = $2.1m

Plus **non-deductible penalties** of 20% $420,000

$2.52 million payment + interest + US state taxes + likely double tax

20% penalties start at $5m, penalties increase to 40% at $20m

NO automatic refund of double tax on other side of the border

** Estimated 21% federal tax rate*

TP DOCUMENTATION - FIRST LINE OF DEFENSE

<u>Treas. Reg. §1.6662-6(d)</u> documentation rules – 10 items

Documentation generally includes the following:

- Analysis of how the business operates in the US and overseas
- Industry analysis
- Financial analysis of client and transactions
- Economic analysis demonstrates why TP is arm's-length
  - Often utilize 'comparable' databases

Best practices:

- One report complies with both sides of the border
- Most countries have similar documentation standards

Insight #5

<u>If a TP report does not make sense to you, it will not make sense to an auditor.</u>

INFORMATION INCLUDED IN A STUDY

Narrations prepared through interviews – e.g. for R&D

- Which country developed the product and how?
- What cross-border R&D assistance is provided?
- Who bears the risk of R&D failure?
- What process IP is utilized by related companies?

Similar interviews with sales, marketing, finance, and others on both sides of the border

- What business circumstances affected profitability? (COVID?)
- Essential for explaining value chain to tax authorities - what functions/assets are important, what are 'routine'?

IRS DISAGREES WITH TRANSFER PRICING, BUT WITH CONTEMPORANEOUS DOCUMENTATION

Assume a total taxable income adjustment of $10m

Additional income tax owed: $10m x 21% = $2.1m

~~Plus non-deductible penalties of 20% $420,000~~

$2.1 million + interest + US state taxes + likely double tax

Draft prepared by tax return filing date for penalty protection

- Not a guarantee that tax authorities will agree with you
- ***Reports need to be updated annually to be contemporaneous – supports answers on a tax return***

Insight #6

Reports need to be updated annually to be contemporaneous

TRANSFER PRICING ADDITIONAL INSIGHTS

IRS can resolve audits efficiently with good documentation

- Checklists are not sufficient – link facts with analysis
- What business circumstances affected profitability – and how?
- IRS audit practice rules require special permission to change ‘methodologies’ selected by the taxpayer.

‘Check-the-Box’ entities?

- The IRS applies transfer pricing principles to disallow foreign tax credits for overpaying tax to international tax authorities
- See Chief Counsel Memorandum: 201349015

Insight #7

The IRS is much more likely to accept taxpayer’s position if the company has prepared contemporaneous documentation.

POLLING QUESTION #2

STARTING POINT - WHAT TO REVIEW?

Off-the-Shelf Company Information

- Country-by-country income statement: current and past 3 years
- US tax return – especially 5471, 5472, 8858, 8865
- Any existing US or international TP documentation

- We have an information request list available for your use.

Strategy – Do the results make sense?

- Where are profits ending up (or not) by country?
- What are the volume of intercompany transactions?
- Are reports current, reasonable, and address all countries?

Consider Masterfile with Local Files for Each Country

- Required for companies with >US$850m in revenue

WHAT INFORMATION DO YOU NEED FOR TP?

KBKG SOLUTIONS FOR TAX PROFESSIONALS AND BUSINESSES
TAX CREDITS - INCENTIVES - COST RECOVERY

Transfer Pricing - Information Request Sheet

Contact Name & Title: ____________________ Company Name: ____________________
Address: ____________________ City, State, Zip: ____________________
Contact Phone: ____________________ Contact Email: ____________________

Transfer Pricing Services

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

In summary, we explain to the IRS and other tax authorities why the company is paying the correct amount of tax in each country. There also may be some tax savings available in certain situations.

To assist us in assessing transfer pricing issues, can you please provide the following:

Income Statements for the past 3 years segmented on a country-by-country basis (e.g. US, UK, Mexico, China)

- For US subsidiaries, we understand that you may only have access to US financial statements

US tax returns for the past three years

Any existing US or international transfer pricing documentation reports

- These are documents (50-100 pages plus) which may have justified transfer pricing in prior years

We have a Citrix ShareFile site for uploading documents securely-
https://kbkg.sharefile.com/r-r40ad0260a7d24ffbad188fa5de55f075

If you have questions regarding this request list, please contact the KBKG transfer pricing practice leader:

Alex Martin | *Principal – Transfer Pricing*
Direct: +1 313-636-2821 | Office: +1 877-525-4462 x170 | Fax: +1 626-449-3324 | alexander.martin@kbkg.com

Goal to Review

- Off-the-Shelf Financial and Tax Info
- Where are profits earned and losses incurred by country?
- What is the volume of intercompany transactions between countries?
- Are there any existing TP reports that can be leveraged or updated to comply with TP documentation standards?

You can request a copy of this form when answering the final CPE question

NO IRS TRANSFER PRICING ADJUSTMENT?

Great, but what if you had been overpaying tax in the US?

How would a foreign tax auditor react to a company overpaying tax in the US?

- What if a foreign auditor read the IRS report?
- A one-sided report could be a roadmap for a TP adjustment
- *“Our Canadian controller said they did a report.”*
- *“Our Mexican company already prepares documentation.”*

Most countries have similar documentation standards

- Best practice- report complies with both sides of the border
- Masterfile/ Local File approach

BENCHMARKING STUDY – AN ALTERNATIVE TO DOCUMENTATION?

TP Economic Analysis – Limited scope

- Benchmark profit margin target for subsidiary
- Focus on companies with similar activities
- Often used for transfer pricing in lower risk situations/fewer resources required
- Smaller scope deliverable

Example:

Company adjusts transfer prices to reach EBIT margin* between 5.0% to 8.2% for subsidiary

- Effectively the CPM/TNMM approach

*<u>*Earnings before interest and tax*</u> *as a percentage of revenue*

Benchmark Company	EBIT/Sales (not actual results)
Anixter International Inc.	16.3%
Arrow Electronics, Inc.	12.8%
Avnet, Inc.	8.2%
Graybar Electric Co Inc	6.3%
Houston Wire & Cable	5.5%
ScanSource, Inc.	5.0%
SYNNEX Corporation	0.3%
Tech Data Corp	(3.2%)

KBKG

TRANSFER PRICING TAX SAVINGS

IS THERE MORE TO TP THAN COMPLIANCE?

- Transfer pricing impacts where profits and losses accrue within an organization (by country)
- TP to utilize US/foreign tax NOLs = big tax/cash savings

- Transfer pricing can be an overlooked opportunity and/or impediment for companies struggling with Covid-19

Insight #8

Correcting transfer pricing to utilize tax Net Operating Losses is a 2-for-1 overlooked opportunity

REALIZING SAVINGS – UTILIZE TAX LOSSES

German parent with USCo subsidiary reseller

- Averaged ~$70m US revenue, purchases in Euros
- Facing market downturn – revenues down to $65m

- Assume ParentCo income is **$6m @ 30% rate = $1.8m tax**

USCo Subsidiary P&L	2022
US Revenue	$65.0m
EBIT*	**($2.5m)**
EBIT Margin	**(3.8%)**

*EBIT – Earnings Before Interest and Tax

UTILIZE TAX LOSSES + REDUCE AUDIT RISKS

From an audit risk perspective:

- Would an independent distributor continue to purchase products and incur losses?
- Who should bear the risk of foreign exchange?

USCo Subsidiary P&L	2023
Sales	$65.0m
EBIT*	**$0**
EBIT Margin	**0%**

Utilize 2023 Losses: Reduce transfer prices to US by $2.5m

- German parent taxable income $6m - > $3.5m
- Savings $2.5m x 30% = $750k in cash savings

TRANSFER PRICING CHANGES TO UTILIZE COVID-19 TAX LOSSES

Some longstanding transfer pricing polices may lead to suboptimal tax results under COVID-19

- Guaranteed **cost-plus X% margin** leads to large profits in one location while incurring losses elsewhere

Parent Company in Country A	←	Manufacturing Subsidiary in Country B
($2 million loss due to COVID) **Tax NOLs**	$10 million of inventory sales	$5 million in profit - 30% tax rate **$1.50 million in tax**

Parent Company in Country A	←	Manufacturing Subsidiary in Country B
Breakeven **No Additional Tax NOLs**	$8 million of inventory sales	$3 million in profit - 30% tax rate **$900,000 in tax**

- Tax Savings = $2 million x 30% tax rate = $600,000 in tax

KBKG

POLLING QUESTION #3

TAX COURT AND GLOBAL DEVELOPMENTS

BACK TO COCA-COLA

Tax Court Arguments

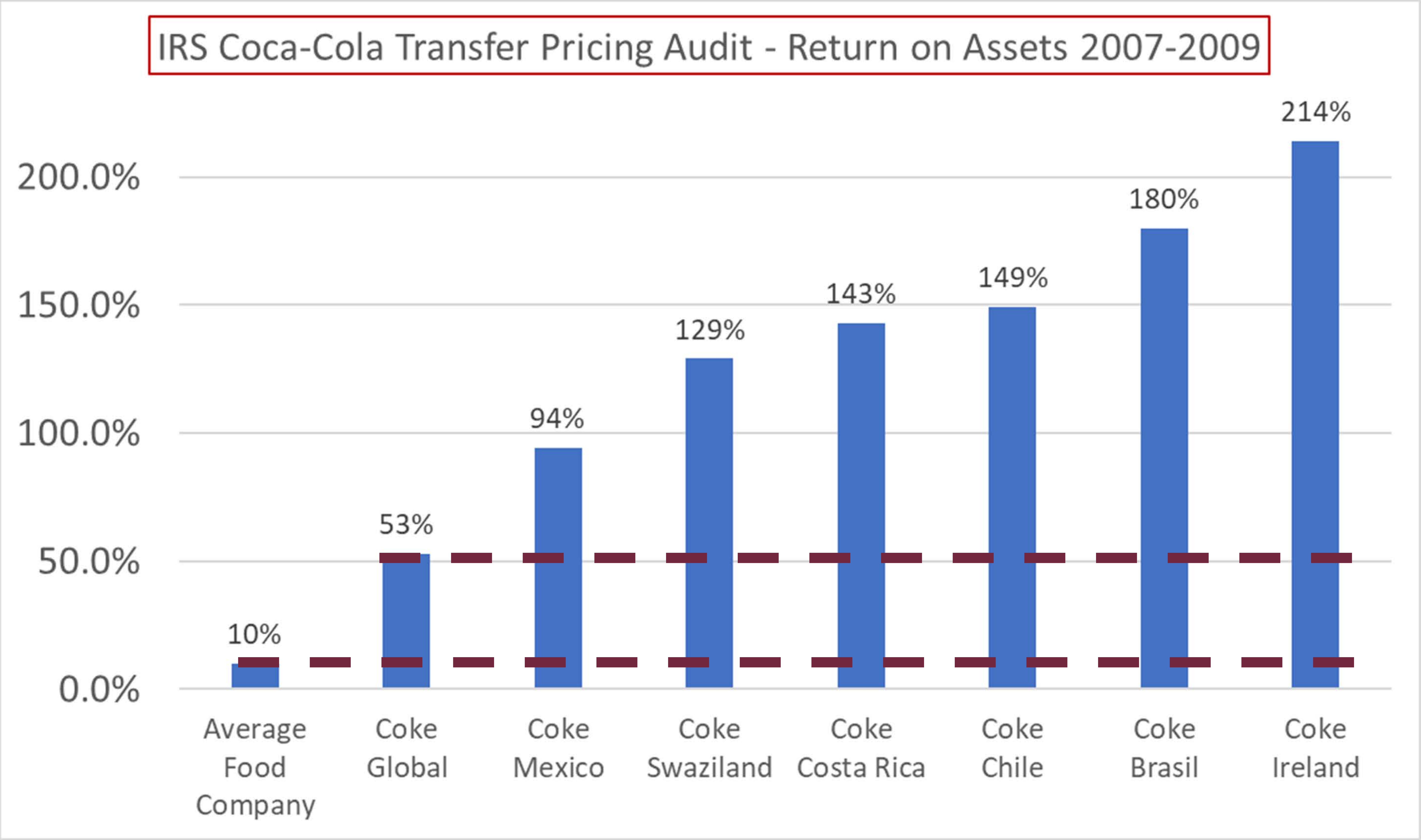
- Coke and the IRS had an audit closing agreement in 1996, which apportioned profits by formula
- <u>One Coke argument - since the IRS had not audited in over a decade, therefore transfer pricing must be acceptable</u>

- IRS responded that the 1996 closing agreement did not address go-forward transfer pricing.

Main Tax Court Questions

- Should low-risk contract suppliers earn large profits?
- Can Coke continue to rely upon the 1996 IRS settlement?
- Does a lack of audit activity imply that TP is acceptable?

WAS COCA-COLA UNDERPAYING US TAX?



COCA-COLA IMPLICATIONS

Transfer Pricing Court Results

- Huge win for the IRS, very expensive for Coca-Cola
- US companies with profitable subsidiaries face risks
- Companies should not rely on a lack of audit activity as assurance that pricing is reasonable

Coca-Cola lost its appeal in a decision released October 2021

- "Futility of the positions [Coca-Cola] seeks to advance"

- Coca-Cola's tax reserve for 2021 is only <u>$400 million</u>
- Estimated payments due if IRS prevails - <u>$13 billion</u>

Insight #9

<u>Coca-Cola court case is a template for big tax adjustments.</u>

ADDITIONAL OBSERVATIONS

Review <u>annual</u> book profit margins of each subsidiary

- Subsidiary losses/tax NOLs = Subsidiary tax risk
- Large profits in subsidiaries = Parent tax risk

Some state tax authorities now have amnesty programs

- Companies submit transfer pricing documentation
- New Jersey hired an outside economist to review transfer pricing documentation and settlements
- North Carolina and Indiana had similar programs

Many countries have low thresholds for transfer pricing documentation and high expectations of profits:

- Mexico – documentation required at ~$US 1 million
- India – Safe Harbours of Cost + 20%+ for service charges

GLOBAL MINIMUM TAX?

The OECD has been leading an initiative to
(Pillar 1) a digital sales tax for the largest companies; and
(Pillar 2) a global minimum 15% tax rate

- Goal 1 -New Digital Service taxing rights on companies with revenues greater than € 20 billion and profits over 10%

- Goal 2 - Largest companies (over $850 million) would pay at least 15% income tax in every country where they operate

- Negotiations more difficult than anticipated
- US Congress may not approve approach due to revenue losses

However, would a global minimum tax resolve TP issues?

INFLATION REDUCTION ACT OF 2022

Minimum 15% tax rate based upon book income

- Applies to US companies with $1 billion revenue or more

- Transfer pricing audits would raise more revenue at a 21% rate
- As of now, not coordinated with OECD global minimum tax rules (Pillar 2)

- Proposed minimum tax scenarios are backstops, but governments still generate more income from TP audits

WHAT ABOUT THAT GLOBAL MINIMUM TAX?

An example - The IRS would receive 2.5% of profits earned by a US multinational in Ireland (12.5%) without an audit

- A successful IRS transfer pricing audit would lead to 21% taxes payable on (most) of those profits + interest + penalties

- Example - Coca-Cola would still owe billions more tax under audit, even with a global minimum tax
- Same for US subsidiaries not earning 'reasonable' profits

Insight #10

Audits are a high return on investment, even with a global minimum tax.

POLLING QUESTION #4

TEN TRANSFER PRICING TAKEAWAYS

1. Tax auditors argue that subsidiary companies should not incur losses
2. Tax auditors often argue that subsidiary companies should not earn excessive profit margins
3. "Arm's-length standard" applies in over 100 countries,
4. Transfer pricing exposures may have nothing to do with tax strategies
5. If a TP report does not make sense to you, it will not make sense to an auditor

TEN TRANSFER PRICING TAKEAWAYS

6. Reports need to be updated annually to be contemporaneous
7. The IRS is much more likely to accept taxpayer's position if the company has prepared contemporaneous documentation.
8. Correcting transfer pricing to utilize tax Net Operating Losses is a 2-for-1 overlooked opportunity
9. Coca-Cola court case is a template for big tax adjustments
10. TP audits are a high return on investment, even with a global minimum tax

CONTACT DETAILS

ALEX MARTIN

Principal – Transfer Pricing
+1 (313) 636-2821
Alex.Martin@kbkg.com

kbkg.com/management/alex-martin

linkedin.com/in/alexmartin/

Book a meeting
SCAN ME

BOOK A MEETING: https://calendly.com/alexmartin-transferpricing

CPE CERTIFICATES

KBKG

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

Login to solutions.kbkg.com

- Get CPE certificates

Questions about your certificates?

877.525.4462 x162
webinars@kbkg.com

CPA Academy

Login to your account at CPAacademy.org

- Fill out evaluation form
- Get CPE certificates

Questions about your certificates?

877.510.5302

info@cpaacdemy.org

Prefer engaging people and being social vs. crunching numbers all day?

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

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