

Maximize credits and incentives with a facility review

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- > Purpose behind credits and incentives
- > Types of credits and incentives
- > Events or expenditures that trigger applicability of credits and incentives
- > Specific incentives available
 - Federal (namely statutory)
 - State and local (negotiated and statutory)
 - International (negotiated and statutory)
- > Case studies

***Who or what department
is responsible for
credits and incentives
in your company?***

Forms of credits and incentives



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- > Cash payments, refunds, rebates
- > Tax credits or abatements
- > Preferential tax treatment “super” deduction, accelerated depreciation, etc.
- > Forgivable loans
- > In-kind benefits
- > Grants and other subsidies

Types of credits and incentives



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Statutory

- > Satisfy governmental statutory or administrative definition and/or filing requirements
- > Normally do not require pre-approval from government
- > Most commonly take form of tax credits or exemptions

Negotiated

- > Must be approved by a unit of government
- > Often subject to annual caps or appropriation limits
- > Multiple levels of government/agencies
- > Include nontax incentives e.g., grants or longer term abatements
- > Binding contract with government agencies

Commonly negotiated incentives



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- > Discretionary grants
- > Low-cost land or lease rates
- > Employee training monies
- > Employee recruiting and screening assistance
- > Access to technical resources
- > Infrastructure improvements e.g., roads, parking lots
- > Utility rate reductions

- > Tax Increment Financing (TIF)
- > State business development loans (e.g., state energy loan program)
- > Local economic development authority financing
- > Other characteristic-based loans (e.g., brownfield, environmental, small business, minority, etc.)
- > State and federal bonding programs
 - Industrial revenue bonds
 - Midwestern disaster recovery

Underlying purpose of incentives



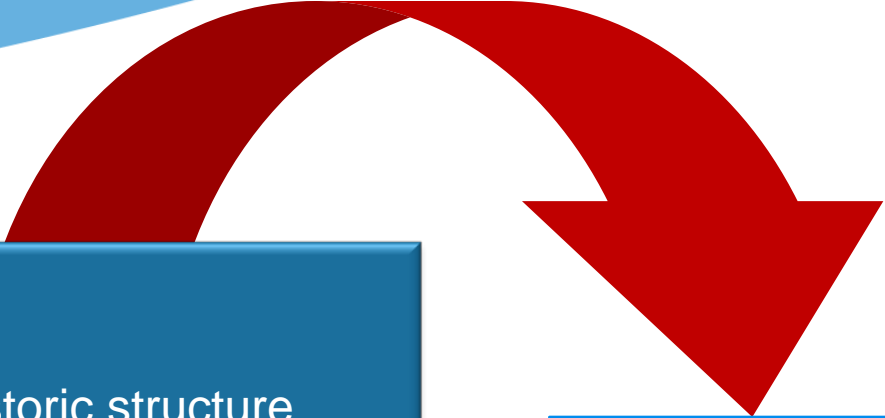
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- > Target specific industries or types of activity
- > Retain company presence
- > Increase resource capabilities or skill sets
- > Diversify industry segments in a region
- > Attract investment from other jurisdictions
- > Reward job creation and retention
- > Stimulate venture capital investments
- > Encourage development of economically disadvantaged areas

Corporate life events



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- > New construction
 - > Remodeling or retrofit
 - > Rehabilitation of old/historic structure
 - > New space vs. lease renewal (including leasehold improvements)
 - > Transferring equipment or employees from another facility
 - > Acquiring a business
 - > Job creation and/or retention
 - > Training needs/costs/requirements
 - > International expansion

**Tax considerations,
credits and incentive
opportunities**

If your company has experienced a corporate life event in the last 12 to 18 months, what was it?

Activity/cost	Applicable incentive/benefit												
	Traditional cost segregation	Section 174	Qualifying advanced energy facility (§48C)	Energy credit (§48)	Energy-efficient deductions (§179D)	Property tax abatements	Pollution control exemptions/credits	Property tax- Personal property classification	Renaissance zone, TIF, Development zone	State and local income tax	New Markets Tax Credits	Capital expenditure review	Research tax credit
Depreciation	X		X	X						X		X	
Current expense vs. capitalization	X	X								X		X	
Job creation/retention									X	X	X		
Proper asset classification	X	X	X	X				X		X		X	
Location of facility						X			X	X	X		
Type of facility	X	X	X		X	X	X	X	X	X	X	X	X
Lighting/electrical system/efficiency	X			X	X			X		X		X	
HVAC system type/efficiency	X			X	X			X		X		X	
Building energy efficiency				X	X			X		X		X	
Architecture and engineering fees	X	X										X	X
Pollution control systems								X		X		X	
R&D expenditures		X								X			X
LEED certification		X	X	X	X								X

Construction and Real Estate

- > Property Management/Development
- > Contractors: General, Electrical, Mechanical, Engineering, Foundations

Manufacturing and Distribution

- > All industry segments; evaluate the entire supply chain
- > Automotive, Food/Bev, Aerospace and Defense, Telecom, Oil/Gas, Pharmaceutical, Plastics, Bioenergy, Renewables, etc.

Services

- > Logistics, Transportation, Entertainment, Training, Testing, Consulting, Software Development, and related Information Technology Services

Agricultural

- > Consider the entire supply chain and related logistical considerations

Government Contractors

- > All industries with direct or indirect contracts with the government

Federal credits and incentives

Sample menu of federal programs



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- > New Markets Tax Credits
- > Cost segregation and bonus depreciation
- > Energy incentives, including renewable energy opportunities, qualified energy projects (Section 48C), and energy-efficient building deduction (Section 179D)
- > Research tax credit (Section 41), including current deduction of certain building expansion design and engineering costs (Section 174)
- > Domestic production activities deduction (Section 199)
- > Federal wage tax credit incentives
- > Capital gain exclusion for the sale of certain assets

Sample menu of federal programs



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- > Disguised sale exceptions allowed developers to defer the recognition of taxable income related to recapitalization events
- > Section 40(b)(6): Cellulosic biofuel producer credit at \$1.01/gallon
- > Section 45: Production Tax Credit
- > Section 48: Energy credit 30% credit for qualified energy equipment
- > Section 48D: Qualified Therapeutic Discovery Project Credits (expired)
- > Section 1603: Energy grant (cash) of 30% grant on qualified new production (CIP before 12/31/10)

- > Created New Markets Tax Credit (NMTC) in 2000
 - Encourages commercial investment in low-income communities (defined by census tract data)
- > Administered by the Treasury Department in partnership with Community Development Entities (CDE)
- > Selected CDEs are authorized to sell federal tax credits to investors and use proceeds to make low interest rate loans
 - Application process is competitive
 - Typically fund up to 20% of the capital needs in a subordinated, interest-only position for 7 years
 - Recipients are qualified businesses or real estate developments
- > Authorized through 2011 (\$3.5 billion allocated for next application cycle)

Cost segregation



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- > Utilized to accelerate depreciation – this is a timing difference
- > Prevents client from “pre-paying” taxes
- > Process involves segregating the capitalized cost into appropriate depreciable lives
- > Includes identification, quantification, and valuation of components of a building or leasehold improvements
- > Costs are typically reclassified from 39 years into increments of 15, 7, 5, 3 years
- > Based on processes used to complete the former investment tax credit computations
- > Beneficial for acquisition, remodel, new construction, look back, merger and acquisition, step-up, and other situations

- > Present value savings ranges from 1% to 5% of the capitalized cost of the project
- > Reclassifying a 39-year property to 5 or 7 years produces a present-dollar savings of 21 cents to 23 cents without bonus depreciation, significantly higher with bonus
- > Reclassifying a 39-year property to 15 years produces a present-dollar savings of 11 cents without bonus depreciation, significantly higher with bonus
- > If the property owner plans to hold the property for a limited time period, then benefits may be diminished due to recapture provisions

Research and development (R&D)



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- > Purpose: stimulate investment in R&D, science, engineering to preserve “know-how” in the US (Section 41)
- > Engineering-based activities create preferential tax results
- > 14% to 20% federal tax credit
 - Carry back 1 year and carry forward 20 years
 - Refunds for prior-year expenditures available
- > Includes costs related to wages, outside contract payments/supplier payments, and supplies (materials/scrap)
- > Green initiatives, green building/construction
- > Most states offer corresponding research tax credit
- > Additional immediate expense treatment allowed for costs related to engineering and design of products, processes, or improvements to designs, products, or processes (Section 174)

Expenditures: Capitalization vs. expense



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- > If expensed, ensure the proper documentation is prepared to support the position in the event of IRS exam
- > If capitalized, ensure they are classified in the correct tax lives and determine if further analysis through a cost segregation study is beneficial
- > Evaluate during planning process for new facilities or facility expansion
 - Consider with unique green building initiatives
 - Assist with fixed asset software-related questions and issues

How likely is your company to invest in “green” technologies as they relate to existing or new facilities?

Section 179D: Energy Efficient Building Deduction

- > Enhanced deduction for improvements made to facilities
- > Applies to new and existing buildings
- > Up to \$1.80/sq. ft. for certified energy-efficient improvements: Lighting/electrical fixtures, HVAC/mechanical, building envelope

Section 48C: Advanced Energy Manufacturers Credit

- > 30% ITC for manufacturers of renewable energy equipment
- > \$2.3 billion awarded in 2010; pending legislation up to \$5 billion for 2011

Section 48: Energy Credit

- > 30% credit on cost of qualified equipment including fuel cell, small wind energy, geothermal, solar
- > Equipment used to generate, produce, and distribute electricity from qualified property

Section 1603: Energy Grant

- > 30% grant for qualified energy property
- > Construction must have begun prior to 12/31/10

179D Energy Efficient Commercial Building Tax Deduction: background



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- > Most common is energy-efficient lighting retrofit of an existing building
- > For improvements/retrofits placed in service after Dec. 31, 2005, and before Jan. 1, 2013
- > Building must meet overall 50% energy savings threshold as compared to a “reference” building
- > May qualify for partial amounts for individual systems meeting 16 2/3% energy savings

179D Energy Efficient Commercial Building Tax Deduction



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- > Larger buildings equal greater potential deduction – based on square footage
- > Lighting is easiest energy savings to meet, followed by HVAC; building envelope is highest hurdle
- > Parking garage lighting is very good opportunity
- > LEED status is a guide and not a guarantee – some LEED buildings do not meet energy savings threshold
- > Early planning to identify the right components prior to installation
- > Property owners often unaware of 179D opportunity
- > Special provisions for government-owned building designers

Energy-efficient construction benefits



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- > Utility/energy cost savings
- > Local or state utility or fixture rebates and incentives
- > Sustainability conforming to company's image
 - Important in large corporations
 - More important in government-owned buildings
- > Tenants are attracted to energy-efficient buildings
- > Federal tax benefit through 179D

Incentive programs through local utilities

- > Smart Ideas – ComEd (Illinois) up to \$200,000
- > Focus on Energy – (Wisconsin) up to \$25,000 automatic, pre-approval unlimited
- > Xcel Energy – (Minnesota) incentives and rebates up to 30% of cost or investment
- > Detroit Edison – (Michigan) prescriptive and custom incentive programs up to 50% of cost
- > Alliant Energy – (Iowa, Minnesota, Wisconsin) cash-back award on certain types of equipment

Incentives may be based on both the materials and the usage

State and local credits and incentives

The “original” incentive



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The first state tax incentive for economic development is thought to have occurred in 1791. New Jersey offered a tax abatement to Alexander Hamilton to locate his manufacturing plant in the state.

- > Job creation or retention – offset against income tax liability or employer withholding taxes
- > Investment based
 - May be based on new capital investment (e.g., new building, equipment)
 - May be used to encourage venture capital investment
- > Targeted activities – research and development, brownfields remediation, corporate headquarters, etc.
- > Can be refundable or nonrefundable
- > Often have carryforward e.g., 15 years

Tax exemptions

- > Reduction of tax base that rate is applied to
- > Income/franchise, sales/use and property tax
- > Examples: manufacturing M&E, wages paid to new hires, R&D expenses, and pollution abatement equipment and supplies

Tax abatements

- > Permanent or temporary reduction in tax
- > Ranges from a partial abatement to 100%
- > Property tax most common application (e.g., Illinois, Indiana, Iowa, Michigan)

Enterprise/development zone incentives

- > Specific geographic sites
- > Zone configured to target business

TIF

- > Provide funding for infrastructure or other capital expenditures related to the project

Discretionary programs

- > Developed or underdeveloped building sites
- > Free or reduced price
- > Subsidized rent
- > Relocation expenses reimbursed
- > Deal-closing funds e.g., forgivable loan

Infrastructure grants – funding for improvements to property

- > Roads/parking/rail spurs
- > Sewers

Training grants/loans

- > Reimbursement programs
- > Consulting and facilities provided by voc-tech school or university
- > Job screening
- > Incentives programs through local utilities

If your company has ever sought participation in state and local tax credit and incentive programs, what were they?

Obtaining credits and incentives



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- > Compile solid data and information about project e.g., amount of investment and number of jobs
- > Develop a compelling story
- > Analyze state/local tax impacts for potential sites or retain outside expertise
- > Learn about available tax credits and incentives
- > Identify points of contact with state, regional, and local officials
- > Determine the “quarterback”
- > Plan meeting with state and local officials at one or more sites
- > Tour available sites (lease, buy, or build?)

Obtaining credits and incentives



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- > Request preliminary C&I proposal
- > Prepare application and gather requested financial and operational data
- > Complete second round of information requests
- > Anticipate “trouble spots” e.g., recent job reductions, environmental issues
- > Lock in the C&I package through contracts and final applications
- > Review by outside or corporate legal counsel is advisable
- > On-going compliance e.g., annual certification of jobs added/retained, valued added to site

Dodging pitfalls during the C&I process



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- > Allow adequate lead time to develop the business case for C&I assistance
- > Avoid premature public disclosure and actions e.g., land purchase
- > Have creditable estimates and business data ready for economic development agencies
- > Identify an internal point person for the negotiations
- > Prepare for public hearings – be aware of legal issues, zoning, and fiscal impacts
- > Meet deadlines for submitting applications and meeting documents
- > Caution: disclosure of business and/or owner financials may be required
- > Have C&I offers from other jurisdictions in hand
- > Analyze the final C&I agreements; understand the commitment
- > Fulfill all compliance requirements e.g., tax credit forms, job creation reports

Beware of “clawbacks”



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“Clawbacks” – repayment or recapture provisions of C&I contracts

- > Performance based (automatic)
- > Results based (optional)
- > Pro rata
- > Statutory penalties

Analyze in context of ROI

- > Can the clawback provision be negotiated?
- > Mitigation/hardship provisions?

International credits and incentives

Similar to US-based incentives, most foreign jurisdictions offer targeted economic and technical/R&D incentives and typically include

- > Capital investment in the country or location
- > Transfer of operations
- > Enhancements to information technology
- > Diversification of customer base
- > Addition of new manufacturing, assembly, packaging or service capabilities

Targeted activities

- > Jobs creation
- > R&D improvements
- > Worker capability expansions

Format

- > Statutory or negotiated
- > Tax credits/refunds or rebates
- > “Super” deductions
- > Cash incentives (direct deposit to bank account)

International incentives examples



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- > **Argentina:** Tax credit for up to 50% of qualifying research or engineering related expenses
- > **Australia:** 125%-175% deduction for R&D and supporting G&A
- > **Brazil:** 160% “super deduction” for all R&D-related expenses including supporting and G&A
- > **Canada:** 22% refundable “SR&ED” tax credit for current or prior-year qualified expenditures
- > **China:** 150% “super deduction” (nonrefundable) for technology development expenses - intellectual property must be owned in China
- > **Japan:** 15% incremental tax credit for R&D activities and supporting (G&A)
- > **Mexico:** 22%-35% cash incentive (via a grant-filing program) for current-year investments
- > **UK:** 130%-175% refundable “super deduction,” includes expenses incurred from outside the country (even wages)

Case studies

Federal credits and incentives example



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Situation

Global provider of equipment and services for electric power systems planned to open a new testing and R&D center with capabilities previously not available in the US.

Results

- > Obtained more than \$5 million for Qualifying Energy Project Credit under § 48C with additional deductions for energy-efficient building qualification under § 179D
- > Reclassified 75% of assets, yielding a \$1 million benefit from optimizing cost segregation
- > Reclassified \$1 million in engineering expenditures related to design costs for R&D benefit
- > Obtained numerous state and local incentives related to property tax, investment credits, job creation, sales and use tax

State credits and incentives example



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Situation

A large manufacturer of fluid power systems wanted to open a new plant, involving 110 jobs in total and an investment of more than \$30 million in plant, equipment and working capital. Evaluated sites in seven states.

Results

- > Company obtained an NPV benefit in excess of \$3.5 million
- > Included: cash award of \$800,000, training grants, partial property tax abatement, sales/use tax refunds, expanded R&D credit, investment credits, jobs credits, and in-kind assistance (e.g., state assistance with screening qualified job applicants)

International credits and incentives example



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Situation

A large US-based financial service organization looking to expand call center resources and capabilities to serve the South American market.

Results

- > Evaluated various incentives available in the identified countries
- > Cash incentives in Brazil were made available related to IT spend, job creation, and leasehold improvements
- > Further identified R&D tax benefits associated with new IT infrastructure

Questions?

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