Profit-Boosting

Tax Strategies

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Astronauts never leave the launch pad without a plan. By doing their research, charting a course, and calculating needed resources, they develop a strategy to rocket themselves into orbit. Successful organizations do the same, and one way they eclipse their peers and competitors is by implementing smart tax strategies. Discover how this collection of smart tactics can deliver stellar results:

Like-Kind Exchange

Effective cash flow strategies are critical to grow your business and stay competitive. If you're planning on selling real estate or personal property in the near future then you'll want to know about a Section 1031 "like-kind" exchange. This tax strategy helps your company defer taxes, increase cash flow, reinvest for growth and maximize the return on your investment.

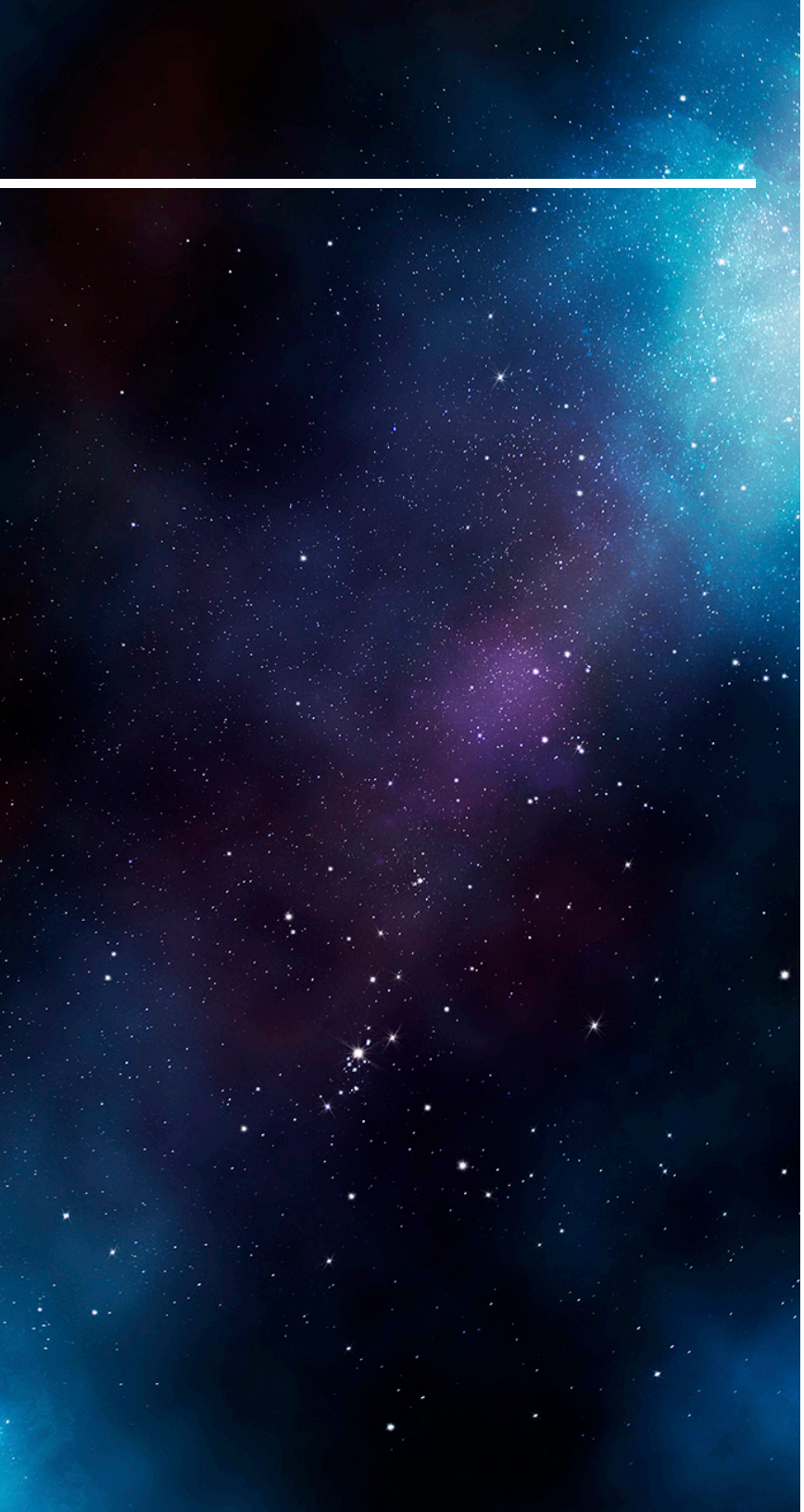
Cost Segregation

Has your company invested significant capital in real estate? Are you purchasing/constructing a new facility or renovating an existing one? Cost segregation is a smart tax strategy that can save money for many companies. Unfortunately, it is a tool that is often overlooked.

R&D Tax Credits

Think your business doesn't qualify for Research & Development (R&D) tax credits? Think again. Many companies fail to realize they can qualify for the federal R&D credit (and state R&D credits), essentially leaving money on the table. As the result of recent legislation, more companies than ever can benefit by claiming R&D credits.

Start the countdown to success with these three profit-boosting tax ideas.



Build Wealth With A

Like-Kind Exchange

A like-kind exchange goes by many names – a Section 1031 exchange, a Starker exchange, a “tax-free” exchange (although “tax-free, for now” would be a better term). Normally, when a taxpayer sells property at a gain, they will owe tax on that gain. However, with like-kind exchanges, if the owner uses the proceeds from that sale to reinvest in property that is similar in nature (i.e., equipment for equipment, or real property for real property), the gain from the sale, and the corresponding tax burden, can be deferred by reducing the basis of the new property. The original gain will therefore not be subject to tax until the new property is sold at some point in the future. The only catch is that both the old property and the new property must be held for investment, or for productive use in a trade or business – both of which have specific meanings for tax purposes. This tax strategy helps your company defer taxes, increase cash flow, reinvest for growth and maximize the return on your investment.

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Exchange Requirements

All like-kind exchanges must use a Qualified Intermediary (QI) to assist with both the selling of the old property and the acquisition of the new property. The QI holds the sales proceeds from the old property until the new property is acquired in order to comply with tax laws and ensure that the sales proceeds are used specifically to acquire the new property. After selling the old property, the new property must be identified by the taxpayer to the QI within 45 days of the sale. If the new property is acquired before the old property is sold, then the QI must hold the new property until the like-kind exchange is complete (i.e., the old property is sold).

In either case, the taxpayer must sell the old property and acquire the new property within 180 days, or six months, of each other. After the exchange is complete, however, the taxpayer will not owe any tax related to the gain on the sale of the old property in the year of the exchange. The gain from the old property is offset against the basis of the new property, which results in the gain, and the related tax burden, being deferred until the new property is sold at some point in the future.

Know Your Options

Looking for ways to defer taxes or increase cash flow?

If so, download the slides from our

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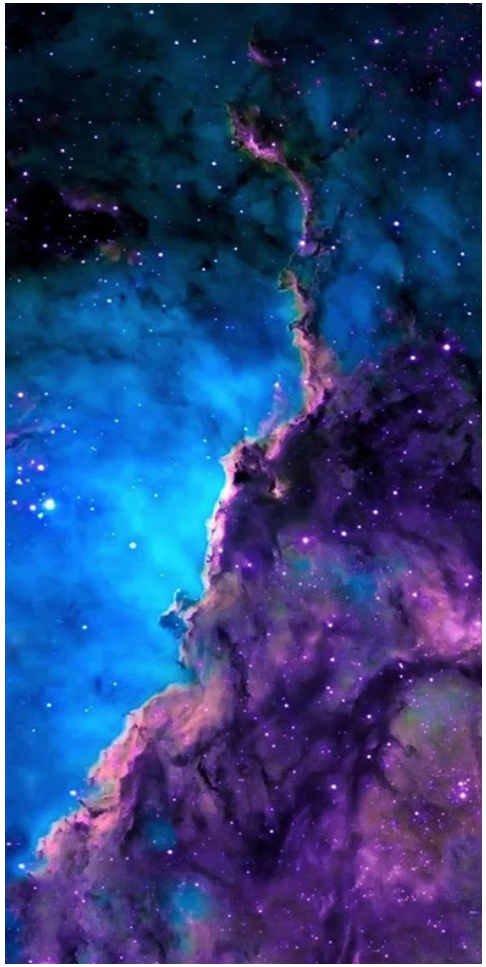

There are several variations on the direct property-for-property exchange for which the tax benefits of a like-kind exchange are available. Two examples include Improvement/Build-to-Suit Exchanges and Partial Exchanges.

Improvement/Build-to-Suit Exchanges

If you want to do a like-kind exchange, and make improvements to the new property with some of the proceeds from the sale of the old property, you could initiate an “improvement” or “build-to-suit” exchange. This allows you to add improvements to the new property and still defer the gain from the original sale. In this case, the title to the new property will sit with an Exchange Accommodation Titleholder (EAT) until it is ready to be transferred to the taxpayer. Again, the improvements to the new property will have to be completed within 180 days, but this option allows for some flexibility on how the cash from the old property is reinvested.

Partial Exchanges

Reinvesting some of the cash from a sale and taking the rest out at the end of the exchange is allowed; however, any cash taken out will be taxable in the year it is received. Conversely, if a taxpayer wants to add cash to the exchange in order to acquire or improve the new property, that is allowed as well – the cash given up will simply be added to the basis of the new property. Partial like-kind exchanges give business owners options and eliminate the “all or nothing” scenario when deciding how to best reinvest their cash.

Cost Segregation

Accelerate Depreciation and Increase Cash Flow

Cost segregation separates real property into various depreciable categories, and allows taxpayers to depreciate property over much shorter periods of time than the typical 39-year (or 27.5-year) period.

The goal of cost segregation is to increase the value of your deductions and get the quickest depreciation possible and the best possible expense treatment. Essentially, you can get a higher return on investment on the capital if you can write it off faster. The benefits include a rapid uptick in cash flow, a decrease in your existing tax liability, the ability to defer taxes, and the opportunity to reclaim past depreciation deductions.

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Here's How It Works:

Consider that when you purchase property, you acquire more than a structure: you've gained a set of building components. While you may look at this as one piece of property, it may surprise you to learn that, on average, 20% to 40% of the building's parts and pieces may be looked at differently by the IRS. While structures are normally depreciated over 39 years, it's possible that some components of your property can be depreciated over 5, 7 or 15 years.

The objective of a cost segregation study is to allocate each of your property-related costs into their appropriate property classes, in order to better calculate depreciation deductions. The idea is to analyze – and suitably separate – what's part of the building, and what's part of your business. As an example, portions of your electrical, plumbing and/or HVAC systems may be properly depreciated over 5 or 7 years.

Cost segregation is frequently beneficial to companies in a variety of industries.

What's Involved

Is your organization a good candidate for cost segregation?

Are you interested in learning if your company could increase cash flow and reduce taxes?

If so, download the slides from our

or contact
Brendan Walsh
to set up a no-fee cost segregation feasibility discussion.

To ensure that your time and money is well spent, you'll want to work with professionals who adhere to current tax authority, including the Internal Revenue Code, court decisions, revenue procedures, revenue rulings and Treasury regulations, and use the standards set forth in the Cost Segregation Audit Techniques Guide utilized by the Internal Revenue Service. During the study, cost segregation specialists will:

- Examine all construction drawings, construction contracts, payment applications, change orders, project costs breakdowns, and depreciation schedules, as available.
- Perform a thorough on-site inspection and visually identify or confirm the proper asset classes for the building and its components.
- Classify the building/construction cost into the appropriate depreciation categories as personal property or real property.
- Estimate the cost of property components using industry-standard cost estimating data, when actual project cost information is not available.
- Assemble the results of the asset classifications into easy-to-read tables showing how costs were allocated, how estimated costs were reconciled to actual building costs, and the proper tax life for each property component.
- Prepare a Cost Segregation Report, which details the above analysis and findings.
- Prepare, where necessary, Form 3115 (Application for Change in Accounting Method) to adopt the cost segregation class lives.

Case Study:
How One Manufacturer Boosted Profits with Cost Segregation

ABC Manufacturing Company acquired a new property and placed it in service in the current year, with a purchase price (less land cost) of $14,554,614. Wondering if they might improve cash flow and increase depreciation deductions, the company engaged in a cost segregation study. Here are the details of their case:

Background on Property

The property at ABC Manufacturing Company encompasses a single-story manufacturing facility and a connected one-story office building totaling about 175,336 square feet, on an 11.73 acre site. The structure is steel-framed, with a metal roof system. The manufacturing facility has a 24-foot eave height, three truck doors, two drive-in doors and power distribution throughout the facility and an electrical motor central center. The location is lit with metal halide main lighting, fluorescent task lighting, and skylights. The space includes restrooms, office space, manufacturing area, and warehouse. The office building includes office suites, an open bull pen area, storage and closets, as well as restrooms and a year-round HVAC system. Land improvements include asphalt and concrete paving, yard fire hydrants and yard lighting, an exterior break area, concrete curbing, site signage, underground utilities, truck scale, diesel fuel pump, diesel storage tank, and site and parking lot lighting.

Cost Segregation Results

COST BASIS (PURCHASE PRICE LESS LAND COST)

$14,554,614

COST REMAINING AT 39 YR REAL PROPERTY

$10,423,158

COST REALLOCATED TO 15 YR PERSONAL PROPERTY

$3,054,313

COST REALLOCATED TO 5 YR PERSONAL PROPERTY

$1,077,143

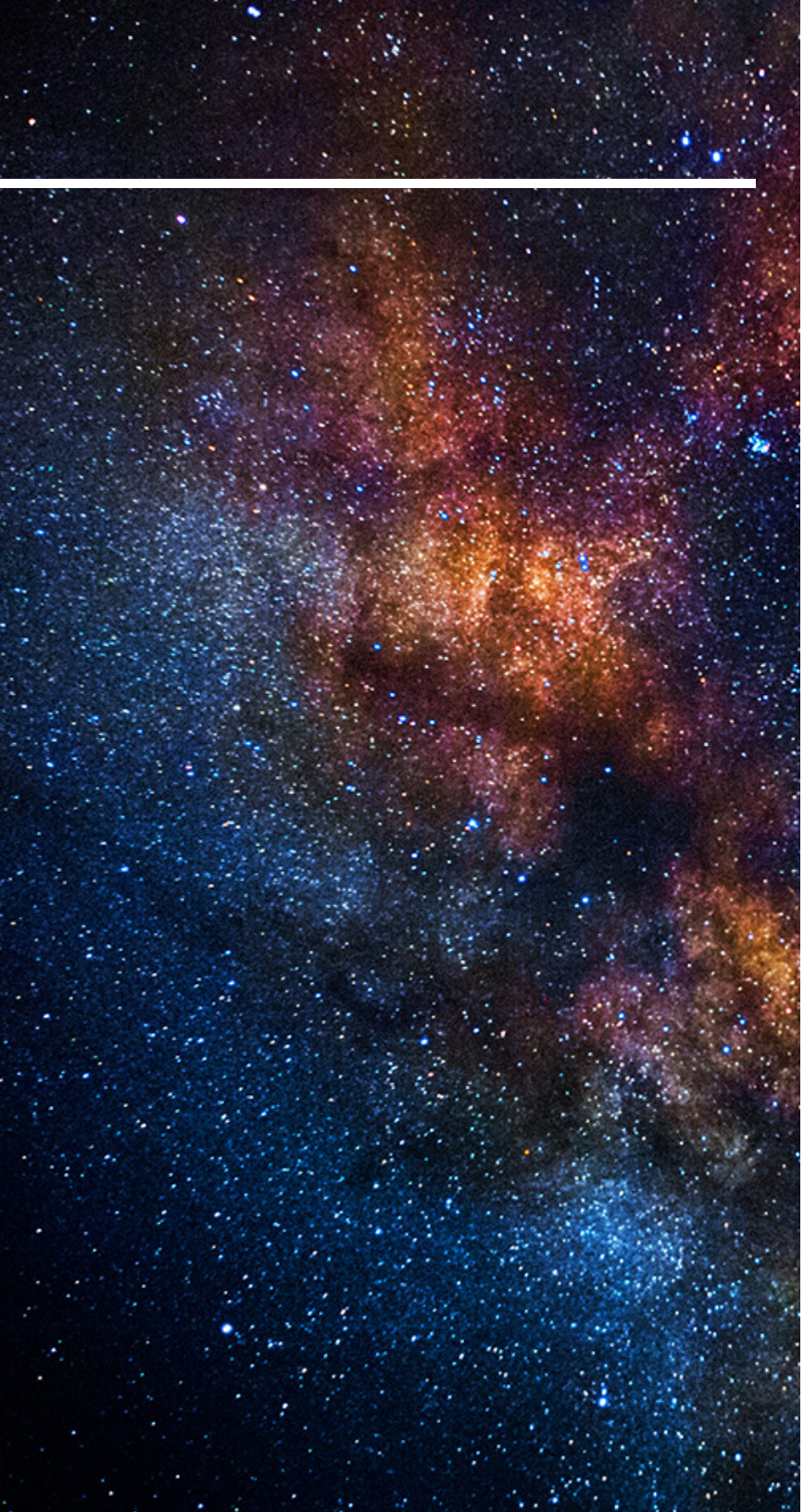
REALLOCATION PERCENT 28.4%

This asset allocation will provide the following depreciation benefit and return on investment (assuming an aggregate federal and state tax rate of 41% and a discount rate of 8%).

Increased depreciation (years 1-5):	$1,688,968
Increased cash flow (years 1-5):	$692,477
Present value benefit of tax deferral:	$634,366
Cost segregation study fee:	$12,500
After tax cost (cost seg fee is tax deductible):	$7,375
Return on investment:	**86 to 1**

For a manufacturer like ABC Company, the cost segregation study was extremely beneficial. Approximately 28% of the project's real property was reallocated to personal property which will result in accelerated depreciation. This acceleration in depreciation expense will result in increased cash flow in years 1-5 of $692,477. Additionally, the company will realize a $634,366 net present value benefit through the front-loading of depreciation expense and resulting increased cash flow in years 1-15 (remember that the time value of money tells us that money available at the present time is worth more than the same amount in the future due to its potential earning capacity). Given the NPV benefit of $634,366 and after tax cost segregation study fee of $7,375, the company realized a ROI of 86 to 1 by conducting the study.

Virtually every taxpayer who owns, constructs, renovates or acquires a commercial real estate facility stands to benefit from a cost segregation study.



R&D Tax Credits

Companies that design, develop, or improve products, processes, techniques, formulas, inventions or software may be eligible for federal and state R&D tax credits. In fact, if your company has simply invested time, money and resources toward the advancement and improvement of its products and processes, your activities may qualify. Understanding the qualifications for federal (and state) R&D credits is the difference between increasing profits and leaving money on the table. As a result of recent legislation, more companies than ever can benefit by claiming R&D credits.

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Do You Qualify?

The government is certainly not handing these credits out on a silver platter – they have purposely set the bar high. To be claimed, the R&D activities you have funded must pass the following four qualifications:

- Are they related to your business component's new or improved function, performance, reliability or quality?
- Are they meant to eliminate uncertainty? Specifically are you seeking clarity regarding the capability or method by which you develop or improve a product or process? Are you testing the appropriateness of the product design?
- Are they part of a process of experimentation that includes the evaluation of alternatives; the confirmation of hypothesis through trial and error, testing, and or modeling; and the refinement or elimination of the hypothesis?
- Do they rely on the principles of physical science, biological science, computer science or engineering?

If the above standards can be met, then documentation of your qualifying activity is of primary importance, because it will be needed for your credit application.

Some examples of industries that often qualify for the R&D tax credit include, but are not limited to:

- Manufacturing
- Information Technology
- Engineering
- Architecture
- Telecommunications
- Aerospace
- Software Development
- Tool & Die
- Energy
- Pharmaceutical

What you don't know could be costing you money.

If you have questions or need assistance evaluating if your activities qualify, watch our

Webinar
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or contact
Pete Turner.

Three Stages

Stage one: assessment and feasibility

This no-cost stage of service offers your business a risk-free way to examine your opportunity to capture R&D credits. Specialists review your projects, departments, processes, and technologies in light of eligibility standards. Your documentation of research expenditures is evaluated for conformity to current requirements. Then your projected tax savings will be estimated so you can evaluate moving ahead with tier two, a full R&D study.

Stage two: design and implementation

You'll receive a detailed work plan for an R&D study tailored to your business. The implementation strategy will include interviewing company personnel, analyzing contemporaneous documentation, linking personnel and projects to finalize the quantitative calculation, and gathering documentation. This phase entails a full analysis of technical issues related to qualified R&D projects, detailed collection of eligible expenditures, documentation of qualifying expenditures, and calculation of federal and state tax credits.

Stage three: report delivery

You will receive a detailed report including the R&D study methodology, which will serve as your documentation to support the R&D tax credits you claim. We'll also prepare your required, amended tax returns. The R&D report is designed and organized to provide a clear audit trail for the IRS or state taxing authority.

You can accomplish more when you have a strong crew behind you. Clark Schaefer Hackett's advisors can help you build a customized tax strategy that delivers galactic results!

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Webinar

Cost Segregation: A Smart Tax Strategy That Is Often Overlooked – download our webinar **HERE**.

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Set up a no-fee cost segregation feasibility discussion with Brendan Walsh **HERE**.

Webinar

R&D Tax Credits – What You Don't Know Could Be Costing You Money – download our webinar **HERE**.

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For R&D questions or assistance evaluating if your activities qualify, contact Pete Turner **HERE**.