the real estate owner's guide to specialty tax incentives

Highlights of second largest stimulus bill for small businesses

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TAX SERVICES

contents

introduction

Real estate owners and investors have numerous tax breaks at their disposal through a combination of deductions, credits, deferrals and more. Recent changes in federal law have greatly enhanced the opportunity to reduce tax liabilities and increase cash flow for further property reinvestment.

The only barrier to uncovering the greatest cost savings is the ability to understand key tax incentives and identify tax strategies. The purpose of this e-book is to provide an up-to-date guide to eight of the best incentives, including a brief overview of the opportunity, how you might qualify and next steps to take. We also have included a bonus revenue-generating idea that utilizes 5G technology.

For the past 20 years, Engineered Tax Services has provided full-service specialty tax services and tax planning to help property owners and investors capture significant federal and state incentives for their clients. You will find our contact information at the conclusion of this e-book

chapter 1

Tax Deductions Available to Real Estate Owners

Tax deductions provide a considerable source of tax relief for property owners. Along with a host of taxpayer deductions – many of them enhanced by COVID-19 relief legislation – there are two attractive deductions specific to real estate owners and investors.

1. Cost Segregation

Overview

Real estate is one of the only U.S. investments that can be depreciated for tax savings as long as property owners utilize cost segregation to maximize their cost recovery. Cost segregation is an important strategic tax tool that can help commercial real estate owners and investors increase cash flow and lower their tax liability through accelerated depreciation deductions and the deferral of federal and state taxes. In other words, whether newly constructed, purchased or renovated, portions of a building can be classified into shorter recovery periods for quicker depreciation.

Bonus depreciation enables property owners to deduct a percentage of the cost of their assets the first year they are placed in service. Tax reform in 2017 allows for 100% depreciation for assets in their first year of service.

Requirements

- Real property eligible for cost segregation includes buildings that have been purchased, constructed, expanded or remodeled since 1987.
- A cost segregation study is typically most effective for buildings that have been purchased or remodeled at a cost greater than $500,000; however, with the adoption of technology and improved processes, cost segregation can make sense for smaller properties, such as single-family rentals, with a purchase price as low as $100,000.

Legislative Update

- In 2020, the CARES Act expanded 100% bonus depreciation through 2022 and made it possible for qualified improvement property (QIP), the interior portion of a commercial building improved after the building was first placed in service, to be eligible for 100% depreciation.

- After December 31, 2022, bonus deprecation scales down annually through December 21, 2026.

Many real estate investors are familiar with cost segregation but may not know whether they can take advantage of accelerated depreciation for valuable cost savings.

Next Steps

Request a cost segregation study.

- The study enables real estate owners to both accelerate depreciation and significantly increase the pace of deductions by bonus depreciation.
- The study will identify personal property assets that are otherwise depreciated as one group with real property assets, such as a building.
- After those personal property assets are identified, they are separated from real assets for optimized IRS reporting purposes and faster depreciation time.
- A cost segregation study must be conducted by qualified engineering and tax professionals.

learn more.

2. 179D Commercial Buildings Energy-Efficient Tax Deduction

Overview

Commercial building owners and investors can earn tax deductions for qualified energy-efficient improvements they make to their properties. The 179D Energy Policy Act certification calculates the tax deduction achieved from the installation of energy efficient assets, including HVAC units, building envelope and lighting.

Commercial property owners may qualify for up to $5 per square foot for commercial buildings and residential structures of at least four stories. The deduction includes both new construction and improvements.

> **Commercial property owners may qualify for up to $5 per square foot for commercial buildings and residential structures of at least four stories.**

Requirements

- The IRS requires that there be a third-party verification of the existence of the building and that it is built to the specifications that were modeled for energy efficiency.
- An energy simulation is required to justify the deduction; the inspection and testing must be conducted by a qualified engineer or contractor registered within the jurisdiction.
- Documentation must meet standards required by the Department of Energy and the IRS.
- The deduction is taken on the “other deductions” line of the taxpayer’s tax forms.

Legislative Update

- In 2019, the 179D was retroactively extended to include tax years 2018 and 2019, and unused credits can be carried forward for up to 20 years.
- The 2020 CARES Act approved a five-year carryback option for net operating losses (NOL), making the 179D deduction eligible for immediate and retroactive savings.
- After being extended year after year, the 179D deduction was made permanent as part of the 2020 Consolidated Appropriations Act (CAA).
- The CAA upgraded energy requirements to qualify for this tax credit, requiring improvements to align with the most recent ASHRAE and IES standards in effect two years before construction of the property begins.

Next Steps

- The new five-year carryback option means that property owners should work with their specialty tax services provider to review all 179D tax deduction opportunities to generate immediate tax savings and potential retroactive refunds.
- Your cost segregation team should specialize in the energy certification processes required by the IRS. The certification calculates the tax deduction achieved from the installation of energy-efficient assets.

chapter 2

Real Estate Tax Credits

real estate tax credits

Real estate owners and investors can save tens of thousands each year by taking advantage of one or more of the following tax credits.

1. 45L Energy-Efficient Home Tax Credit

Overview

Builders, owners and developers of residential homes and apartment buildings have the opportunity to earn tax credits for energy efficiency, if their properties meet certain qualifications. These valuable credits are often overlooked due to a lack of understanding about the qualification process.

The **45L Tax Credit** is equal to up to $5,000 per residential unit or multifamily property. Qualifying properties include apartments and multifamily properties, single-family homes, units within an apartment building or condominium and warehouses. The property can be either the principal place of residence or a vacation home.

Engineered Tax Services provides 45L certifications that are evaluated, modeled and signed off by our licensed engineers.

Requirements

- Builders/owners/developers must incorporate energy-efficient features such as high R-value insulation and roofing, windows, doors and/or HVAC systems.

Legislative Update

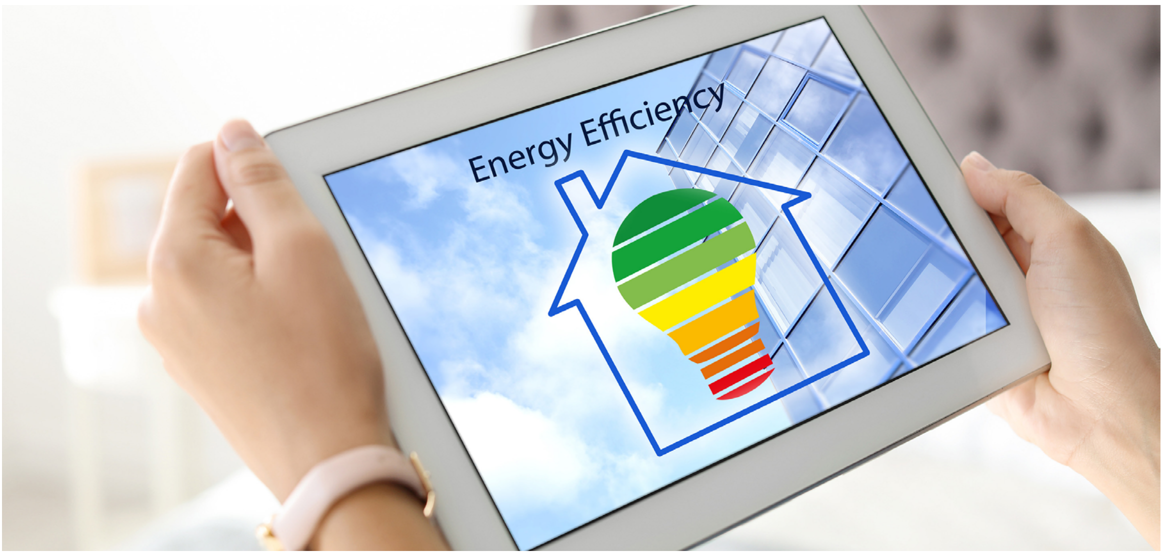
- The tax credit, which is typically extended each year, is currently extended through 2032.
- The tax credit can be claimed retroactively for up to three years.
- Any unused credits can be carried over for up to 20 years.

Next Steps

- After a detailed energy analysis, a 45L energy certification must be completed by a licensed professional that is an unrelated third party to the project.
- The certifier will conduct computer modeling and onsite testing.
- Taxpayers use Form 8908 to claim the energy-efficient home credit.

Next Steps

- After a detailed energy analysis, a 45L energy certification must be completed by a licensed professional that is an unrelated third party to the project.
- The certifier will conduct computer modeling and onsite testing.
- Taxpayers use Form 8908 to claim the energy-efficient home credit.



2. R&D Tax Credits

Overview

Research and development (R&D) tax credits are a permanent federal tax incentive designed to stimulate innovation, growth and competitiveness. The R&D tax credit – also offered by two-thirds of U.S. states – serves to maximize a company's cash flow through tax savings for conducting innovative activities.

Far too often, property owners do not know their activities are eligible for R&D tax credits. If your business is using science or technology to innovate or improve products or processes, you may be able to reduce federal and state taxes.

Real estate developers and contractors often use complex software to create alternative design options. They also may hire architects and engineers with specific skill sets to work on these options. These additional expenses are good candidates for the R&D tax credit.

> **Less than one-third of eligible companies realize they qualify for the R&D tax credit.**

Requirements

A simple four-part test helps to determine which activities constitute qualified research according to criteria established by the IRS:

1. Permitted Purpose

The activities must relate to new or improved business components, function, performance, reliability and quality.

2. Technological in Nature

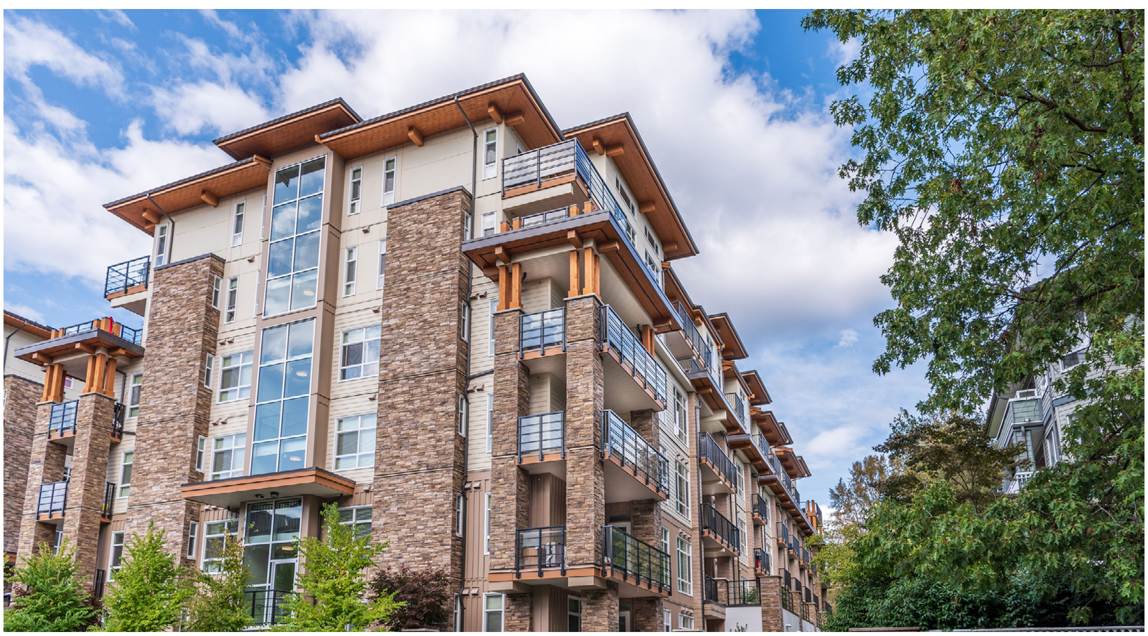
The activity performed must fundamentally rely on principles of physical or biological science, engineering or computer science.

3. Elimination of Uncertainty

The activity must be intended to discover information to eliminate uncertainty concerning the capability, method or design for developing or improving a product or process.

4. Process of Experimentation

The taxpayer must engage in an evaluative process that can identify and evaluate more than one alternative to achieve a result. This may include modeling, simulation or a systematic trial and error methodology.



Examples of eligible projects may include experimentation with:

- Energy efficiencies in building design and lighting
- Alternative energy design
- Water usage efficiencies
- Waste reduction
- New material combinations
- Building information modeling (BIM)
- New material combinations

Legislative Update

- There was some concern that forgivable loans under the CARES Act Paycheck Protection Program (PPP) would preclude the ability of business owners to claim R&D tax credits.
- As part of the second COVID-19 stimulus, Congress restored the deductibility of PPP loan expenses, which means these expenses can be used for calculating payroll-based R&D expenses used in qualifying for the R&D tax credit.

Next Steps

Request an R&D Tax Credit Study.

- A tax credit study can be conducted for all open tax years, the current year and the prior three years.
- Any unused credits carry forward for 20 years in federal and state income taxes in the current and future years.
- Claiming R&D tax credits calls for a fair amount of documentation required by the IRS. That's why it's important to seek professional help from a consultant with a strong expertise in helping engineers successfully claim these valuable tax credits.

3. Historic Tax Credits

Overview

Federal tax law offers an incentive to property owners and contractors who contribute to the preservation of the nation's old and historic buildings. The historic tax credit (HTC) is a 20% credit for qualified expenditures used on the rehabilitation of historic buildings. Buildings eligible for the rehabilitation credit include those used for rental residential as well as non-residential purposes. Most states offer parallel tax credits.

Requirements

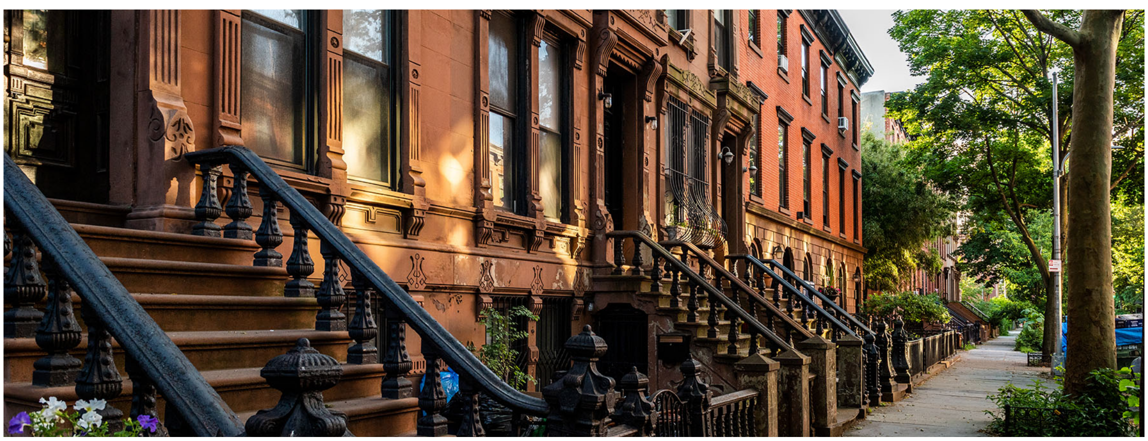
- The building must be a certified historic structure on the National Register of Historic Places (or be listed as a contributing building in a National Register or state or local historic district).
- Federal HTC: National Park Service determines if the building is a certified historic structure by approving Part 1 of the application.
- State Credits: Building owner generates credits by completing a certified rehabilitation on a qualified rehabilitation building.

Legislative Update

- The Tax Cuts and Jobs Act of 2017 retained the 20% tax credit, which is to be claimed ratably over the five-year period beginning when the building is placed in service.

Next Steps

- A three-part application is required to qualify for the 20% tax credit.
- Detailed drawings or sketches are required for proposed work to show planned alterations or new construction.
- Where replacement windows are proposed, applicants must demonstrate that the existing historic windows are deteriorated beyond repair.



4. New Markets Tax Credits

Overview

The New Markets Tax Credit (NMTC) was established in 2000 to provide an incentive for investment in distressed urban and rural communities through a flow of capital to businesses and low-income communities. NMTC investors provide capital to community development entities (CDEs) and are awarded credits against their federal tax obligations. Between 2003 and 2020, the NMTC program allocated $26 billion in credits through the U.S. (including Puerto Rico.)

Requirements

- Investors can claim their allotted tax credits in as little as seven years – 5% of the investment for each of the first three years; 6% of the project for the remaining four years – for a total of 39% of the NMTC project.
- Investors are primarily corporate entities – often large international banks or other regulated financial institutions – but any entity or person is eligible to claim NMTCs.
- A CDE can be its own investor or find an outside investor.
- Qualified active low-income community businesses (QALICBs) receive NMTC investments, which can be used to finance equipment, operations or real estate.

Legislative Update

- The NMTC was extended to 2025 as part of the Consolidated Appropriations Act (CAA).

Next Steps

- Once a CDE is formed, an NMTC allocation application must be submitted.
- After the CDE receives tax credit allocations, the CDE can source allocations to private investors.
- Taxpayer invests money based on tax credit allocations received.
- Investors interested in NMTCs should work closely with their accounting and legal advisors to explore the NMTC opportunity.

chapter 3

Tax Deferrals That Benefit Real Estate Owners

1. Opportunity Zones

Overview

Introduced as part of the Tax Cuts and Job Act of 2017 as a tax incentive, opportunity zone funds are meant to encourage growth in over 8,700 opportunity zones across the U.S. Rather than using taxpayer dollars to stimulate economic growth, the focus is on private investments.

The tax incentive provides developers with the opportunity to defer capital gains and develop distressed communities. Real estate investors place the capital gains they earned from selling an investment property into a qualified opportunity zone (QOZ) fund, allowing them to defer or pay no capital gains tax on their original investment. The IRS doesn't recognize a gain in an opportunity zone fund until Dec. 31, 2026, or until the investor sells or exchanges the interest.

Requirements

- Property investors gain temporary tax deferral until 2026 by rolling gains into a qualified opportunity fund (QOF).
- A QOF must have at least 90% of its assets invested in QOZ property, which includes one of three things: QOZ business property, QOZ stock or QOZ partnership interest.
- Step-up in basis: After five years, investors receive a basis increase of 10%; after seven years, investors receive an extra 5% basis increase, for a total of 15%.
- If an investor holds their investment in a QOF for 10 years or more, the basis will be equal to the fair market value of the investment, which creates a permanent capital gain.

Legislative Update

- The IRS and Department of Treasury, which govern this incentive, issued final regulations on Dec. 19, 2019.

Next Steps

- Partnerships or corporations can establish QOZ funds and then invest in a property located within a QOZ.
- Investors should file Form 8996 to certify that the corporation or partnership is a QOF.

2. 1031 Exchange Program

Overview

Real estate owners and investors typically sell a property they may have held for a number of years at a considerable profit. A 1031 exchange is a tax strategy that allows investors to defer capital gains taxes due upon the sale of an investment property by reinvesting the proceeds into another property.

Requirements

To complete a 1031 exchange, investment properties must meet the following criteria:

- The value of the replacement property must be equal to, or greater than, that of the resigned property.
- Properties in the transaction must be exchanged for some type of asset, such as a real estate investment trust (REIT).
- The exchanged property must be held for "productive purposes in business or trade."

Real estate investors can avoid paying capital gains taxes when they reinvest the proceeds from the sales into a property of like-kind and equal or greater value within a certain time frame.

Legislative Update

- The TCJA eliminated 1031 treatment for the exchange of personal property that took place after Dec. 31, 2017; however, properly structured "like-kind" exchanges of real property were left in place.
- As a result of the COVID-19 pandemic, the IRS issued **Notice 2021-10** on January 19, 2021, which extends the June 4, 2020 relief that it had previously granted by extending the 180-day investment requirement, relaxing the 90% investment standard for QOFs, extending the 31-month working capital safe harbor and extending the 30-month substantial improvement requirement.
- The Biden administration has proposed eliminating the 1031 Exchange Program for real estate investors with incomes above $400,000.

Next Steps

- In preparation for your exchange, contact an exchange facilitation company.
- Consult with your specialty tax services provider who can proactively advise you based on your particular circumstances as well as provide the names of facilitators.

chapter 4

5G Technology: A Revenue-Generating Opportunity

Overview

Fifth generation (5G) wireless technology is enabling the connection of 100 times more devices than its 4G predecessor. As 5G has rolled out across the country, it is revolutionizing connectivity, allowing for technological advancements in numerous industries and eliminating the need for data storage in devices. So how does 5G intersect with the real estate industry?

Revenue Generation Opportunity

- Commercial property owners, rental property managers, real estate developers and homeowners may have the opportunity for additional revenue by contracting with wireless carriers for the installation of 5G transmitters on their rooftops.
- Leases generally range from $5,000 to $20,000 each, and terms can extend for five to 20 years.
- The best opportunities include rooftops that work well in dense, populated areas where zoning does not permit for towers.

Requirements

There are more than one million cellular sites in the U.S. Unlike earlier telecom technology that depends on a single tower to cover a wide-ranging area, 5G uses a network of wireless antennas on rooftops every few blocks and boosters inside buildings. As a result, 5G will require the installation of more antennas and boosters at more locations.

Engineered Tax Services works with property owners to directly negotiate leases with various carriers and obtain the best lease rates on your behalf.

Next Steps

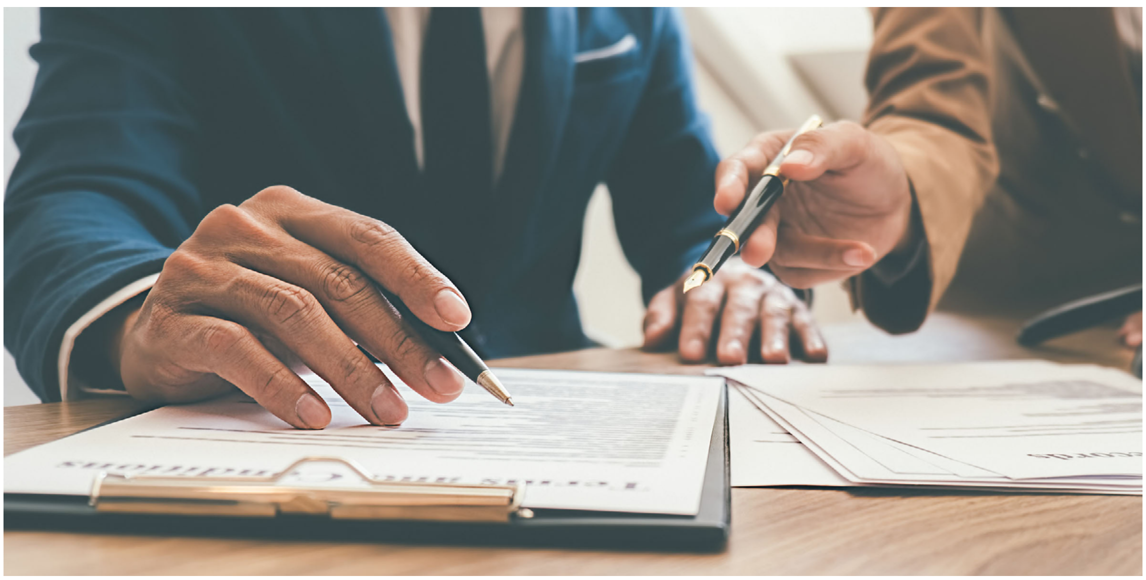
- Wireless carriers and tower construction companies are actively forging relationships with property owners and real estate developers to install 5G transmitters and boosters.
- Property owners who lease space to telecom carriers should enter into lease agreements that detail the type and amount of equipment to be installed.
- If the amount of equipment increases during the lease term, property owners may be able to ask for higher rents.
- Ask telecom carriers and construction companies to provide detailed information on equipment, which can weigh as much as 4,000 pounds.

Conclusion

Now that you have a better sense of what these IRS-sanctioned tax incentives can provide to your business, the next step is to determine a strategy.

First, consider the answers to these questions:

- Which of these tax incentives make the most sense for your real estate business?
- How can you reap the maximum benefits not only now, but well into the future?
- If you already are taking advantage of some of the incentives, when was the last time you checked with an expert to ensure you are maximizing every credit, deduction and deferral opportunity?



Engineered Tax Services is singularly focused on providing specialty tax services. That means our professionals have the experience to help you determine which tax incentives will reduce your tax liability and fully maximize your cash flow. We partner with property owners, investors and contractors nationally to provide independent, third-party certification as required by the IRS to help them take advantage of significant tax benefits.

Our experts closely monitor legislative action, including those proposals that could have an effect on your business. When new tax laws are proposed, we will check in with you to determine whether any changes are warranted.

TO LEARN MORE about tax incentives for the real estate industry, call Engineered Tax Services at **(800) 236-6519** or check out our [real estate industry](#) page for more information.

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