2023-2024 Construction Accounting and Tax Update

McKONLY & ASBURY

TAX | ASSURANCE | CONSULTING | ACCOUNTING

INTRODUCTIONS

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Tax

FIRM OVERVIEW

McKonly & Asbury is a team of CPAs and Business Advisors serving clients from our offices in Camp Hill, Lancaster, and Bloomsburg.

We provide **Advisory & Business Consulting**, **Audit & Assurance**, **Entrepreneurial Support & Client Accounting**, **Internal Audit**, **Professional Placement**, **Tax**, and **Technology** services to a variety of industries including:

- Affordable Housing
- Construction
- Employee Benefit Plans
- Family-Owned Business
- Healthcare
- Manufacturing & Distribution
- Nonprofits

179D Today and Tomorrow
The Future of Green Building Tax Incentives

Jesse Stanley
Director – Green Building Tax Incentive Services

Presented on November 16, 2023

ABOUT KBKG

Established in 1999 with offices in major markets throughout the US, KBKG is one of the oldest and largest independent providers of specialty tax studies in the country. By focusing exclusively on value-added tax services, we complement your traditional tax and accounting team.

SINGLE SOURCE SOLUTION

We are unique in the marketplace as we offer a single source solution for a number of specialty tax services.
We provide you with a single point of contact who will interject the appropriate subject matter expert within our team as necessary. We help determine which tax programs benefit clients and stay committed to handling each relationship with care and diligence.

SEAMLESS TEAMWORK & COLLABORATION

Our ability to work seamlessly with your team is the reason so many tax professionals and businesses across the nation trust KBKG.

Our practice is staffed by full-time specialists with engineering, valuation, "green" building, estimating, and construction backgrounds as well as tax professionals, attorneys, engineers, and economists.

SERVICES

- R&D Tax Credits
- Employee Retention Tax Credits
- Cost Segregation for Buildings and Improvements
- Green Building Tax Incentives
- Transfer Pricing Services
- IC-DISC
- Fixed Asset Review
- Repair vs. Capitalization Review
- Employment Tax Credits

NATIONWIDE SOLUTIONS

KBKG has offices strategically placed nationwide to better serve our clients.

Our representatives, located all over the country, are experienced in the local markets and regions they support.

WEST

Pasadena
Woodland Hills
West Los Angeles

SOUTHEAST

Atlanta

SOUTH

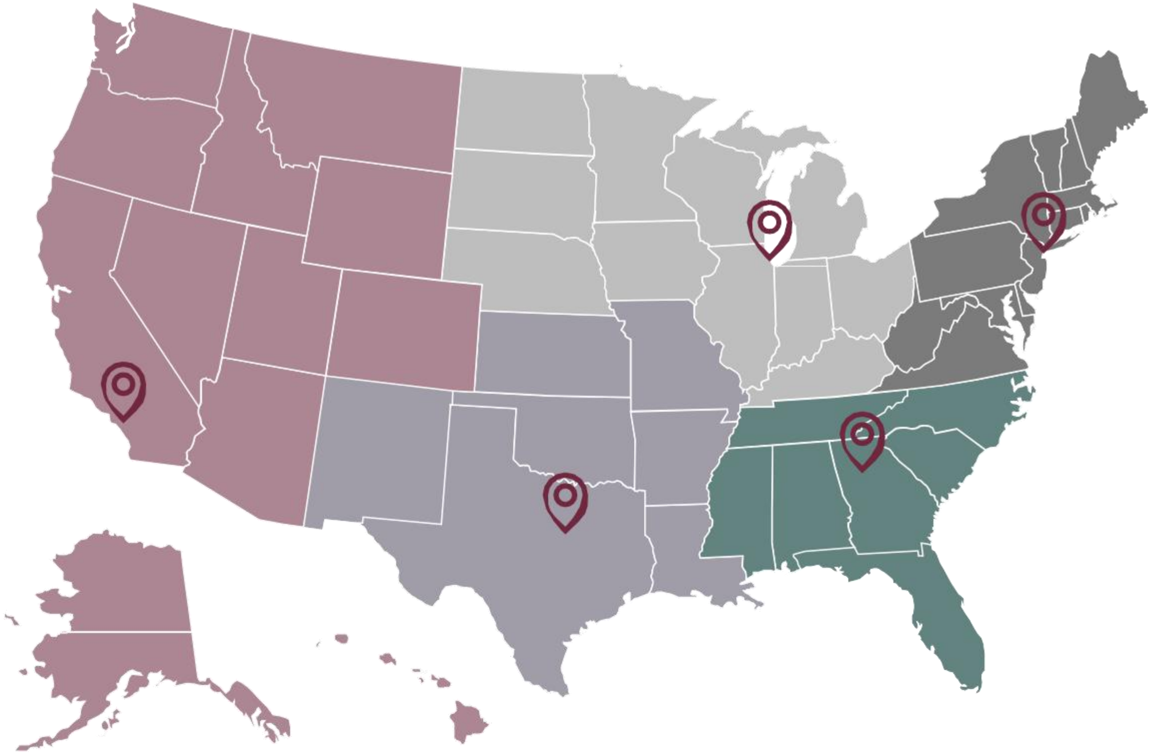
Dallas – Fort Worth

MIDWEST

Chicago

NORTHEAST

New York City
Philadelphia



JESSE STANLEY

Director – Green Building Tax Incentives

AARON MASSEY

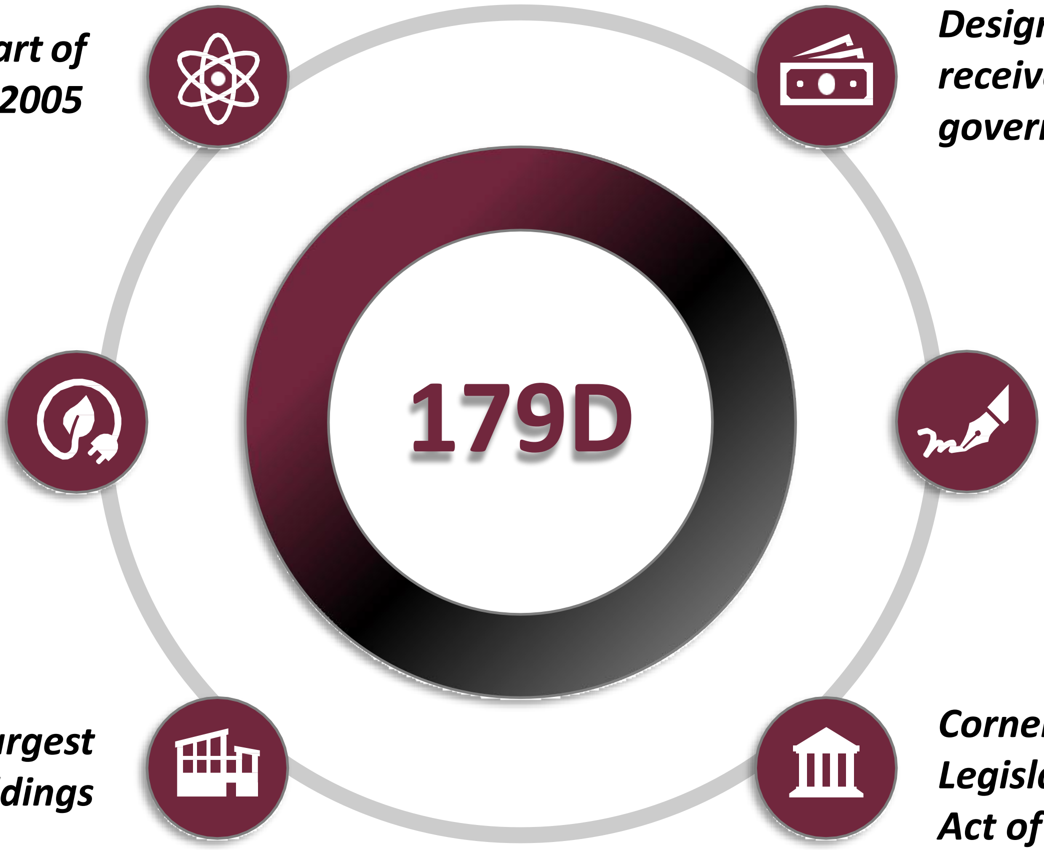
REGIONAL DIRECTOR – MID-ATLANTIC

OVERVIEW OF 179D

Created as part of EPACT 2005

Incentive to reduce energy use in buildings

The US Government is largest single owner of buildings



Designers of these buildings can receive the deduction from the government or tax-exempt owner

Made permanent in 2020

Cornerstone of Federal Energy Legislation in Inflation Reduction Act of 2022

CASE STUDY – MECHANICAL ENGINEER ACROSS THREE BUILDINGS

Building Size	Year Complete	Qualification Amount	Deduction Amount
175,000	2020	1.80 $/sf	$315,000
320,000	2023	4.50 $/sf	$1,440,000
215,000	2023	5.00 $/sf	$1,075,000

Total Deductions	**$2,830,000**

SUMMARY OF 179D TAX DEDUCTIONS

Compliance Path		Savings Requirement	Tax Deduction			
			taxable years before 2021	taxable year beginning 2021	taxable year beginning 2022	taxable year beginning 2023*
Fully Qualifying Property		25%	na	na	na	[redacted]
		50%	$1.80/ft^2	$1.82/ft^2	$1.88/ft^2	
Partially Qualifying Property	Envelope	10%	$0.60/ft2	$0.61/ft2	$0.63/ft2	
	HVAC and HW	15%				
	Lighting	25%				
Interim Lighting Rule		25% - 40% lower lighting power density (50% for warehouses)	$0.60/ft2	$0.61/ft2	$0.63/ft2	

WHAT DOES 179D LOOK LIKE IN 2022 AND PRIOR YEARS

2022 and prior

Available to:

- Designers of government entities
- Commercial building owners

Prevailing Wages

Requirements:

NONE!

Benefits

Qualifications:

- Was made permanent in 2020
- The maximum allowable benefit is **$1.88/sf**
- Partial allowances up to **$0.60/sf** for single systems
- Interim lighting rule available up to **$0.60/sf**

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HOW DOES THE INFLATION REDUCTION ACT MAKE 179D *MORE VALUABLE*?

NEW Eligibility

Tax-exempt entities

- charitable organizations
- churches & religious organizations
- private schools & universities
- private foundations
- political organizations
- other non-profits
- Native American tribal governments
- Alaska Native Corporations

Prevailing Wages

Requirements

Required for Max Benefit on Construction 1/29/2023 and later

Safe Harbor Exists

Benefit Changes

Significant increase!

- The Inflation Reduction Act expands both the impact and scope of the 179D tax deduction.
- Beginning January 1, 2023, the maximum allowable benefit increases from **$1.88/sf** to **$5.00/sf** of building area.

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HOW DOES THE INFLATION REDUCTION ACT MAKE 179D *MORE VALUABLE*?

Allocating Entities

- Federal, State, Local Governments
- charitable organizations
- churches & religious organizations
- private schools & universities
- private foundations
- political organizations
- other non-profits
- Native American tribal governments
- Alaska Native Corporations

Allocations are limited and typically first come first serve.

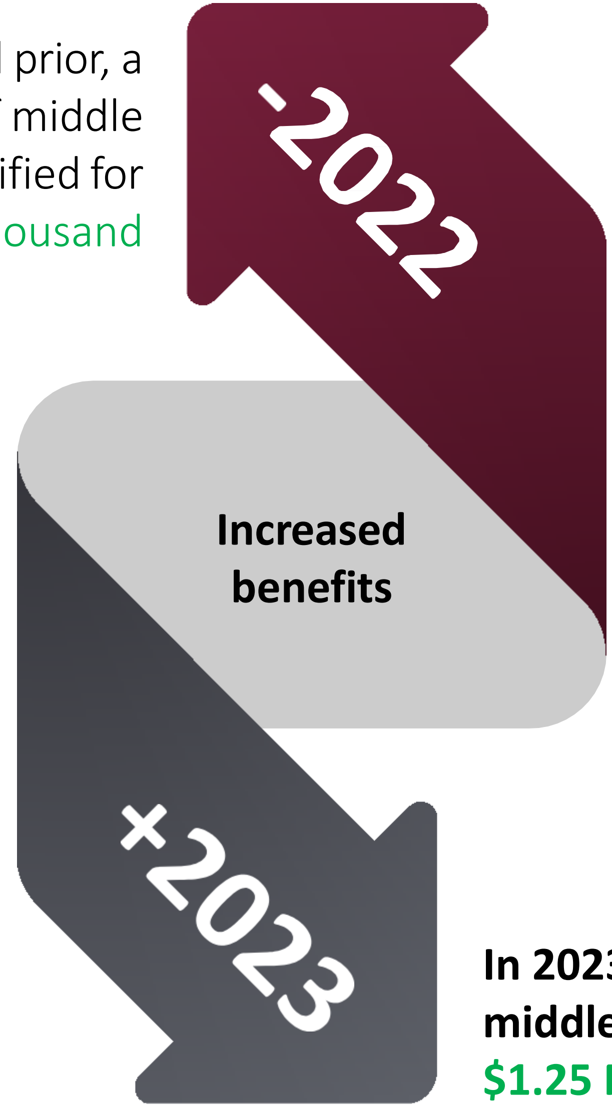
High likelihood of reduced or no benefit for last to act Designer

THE BENEFIT FOR THE CHANGES ARE SIGNIFICANT

THE MAXIMUM ALLOWABLE BENEFIT INCREASES FROM $1.88/SF TO $5.00/SF OF BUILDING AREA,

A 165% BENEFIT INCREASE

In 2022 and prior, a 250k sf middle school qualified for $470 thousand



In 2023+ the same middle school is now $1.25 MILLION!

SUMMARY OF 179D TAX DEDUCTIONS IN DETAIL

Compliance Path		Savings Requirement	Tax Deduction			
			taxable years before 2021	taxable year beginning 2021	taxable year beginning 2022	taxable year beginning 2023*
Fully Qualifying Property		25%	na	na	na	$2.5/ft^2$
		50%	$1.80/ft^2$	$1.82/ft^2$	$1.88/ft^2$	$5.00/ft^2$
Partially Qualifying Property	Envelope	10%	$0.60/ft2	$0.61/ft2	$0.63/ft2	na
	HVAC and HW	15%				
	Lighting	25%				
Interim Lighting Rule		25% - 40% lower lighting power density (50% for warehouses)	$0.60/ft2	$0.61/ft2	$0.63/ft2	na

with prevailing wages

Example Case Study:

- *3 New Construction High Schools each at 500,000 sf*
- *2022 year, Total Potential Deduction of **$2,820,000 at 1.88 $/sf***
- *2023+, Total Potential Deduction of **$7,500,000 at 5.00 $/sf***

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PREVAILING WAGES

01 **A prevailing wage rate is a basic hourly paid rate set by the Department of Labor (DOL) - that focuses on the workers' specific craft.**

2. **The rate is determined by the type of work and the location of the project.**

3. **The wages are based on average wages employees with similar roles receive in the area.**

TWO PATHS OF 179D QUALIFICATION

Traditional 179D

Strengthened via Inflation Reduction Act

Energy Efficient Commercial Building Property

- No More Partial Qualifications or Interim Lighting Qualifications
- Whole Building Only
- Energy Cost Savings compared to ASHRAE 90.1 Compliant Baseline Model
- Designed Building vs Simulated Building

Retrofit 179D

Created via Inflation Reduction Act

Alternative Deduction – Retrofit Property Retrofit

- Does not need to exceed ASHRAE Standards
- Focused on reductions compared to past actual usage
- No Energy Cost Component
- New Energy Usage vs Old Energy Usage
- Buildings Can Reclaim benefit
  - 3 Years for Owners
  - 4 Years for Tax Exempt

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WHAT IS THE ALTERNATIVE DEDUCTION – RETROFIT PROPERTY?

01 **Building Must be at least 5 years old**

02 **Requires a plan to reduce Site Energy Use Intensity by at least 25%**

03 **Comparison of actual historic use compared to post retrofit use**

04 **Can be difficult for buildings with high process use**

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WHAT TYPES OF COMPANIES CAN CLAIM 179D?

179D

- ***Architects***
- ***Design Build Contractors***
- ***Mechanical Engineers***
- ***Building Automation and Building Controls***
- ***Electrical Engineers***

WHAT TYPES OF PROJECTS QUALIFY?

01 Heating, Ventilating, Air Conditioning Systems and controls — HVAC Systems

02 Building Lighting and Daylighting Systems — Lighting

03 Exterior Building Envelope Systems — Building Envelope

WHAT TYPES OF BUILDINGS CAN CLAIM 179D?

- *Federal, State, and Local Government*
- *School and University*
- *Tribal Lands (New!)*
- *Non-Profit Projects (New!)*
- *Commercial Buildings owned by your company*

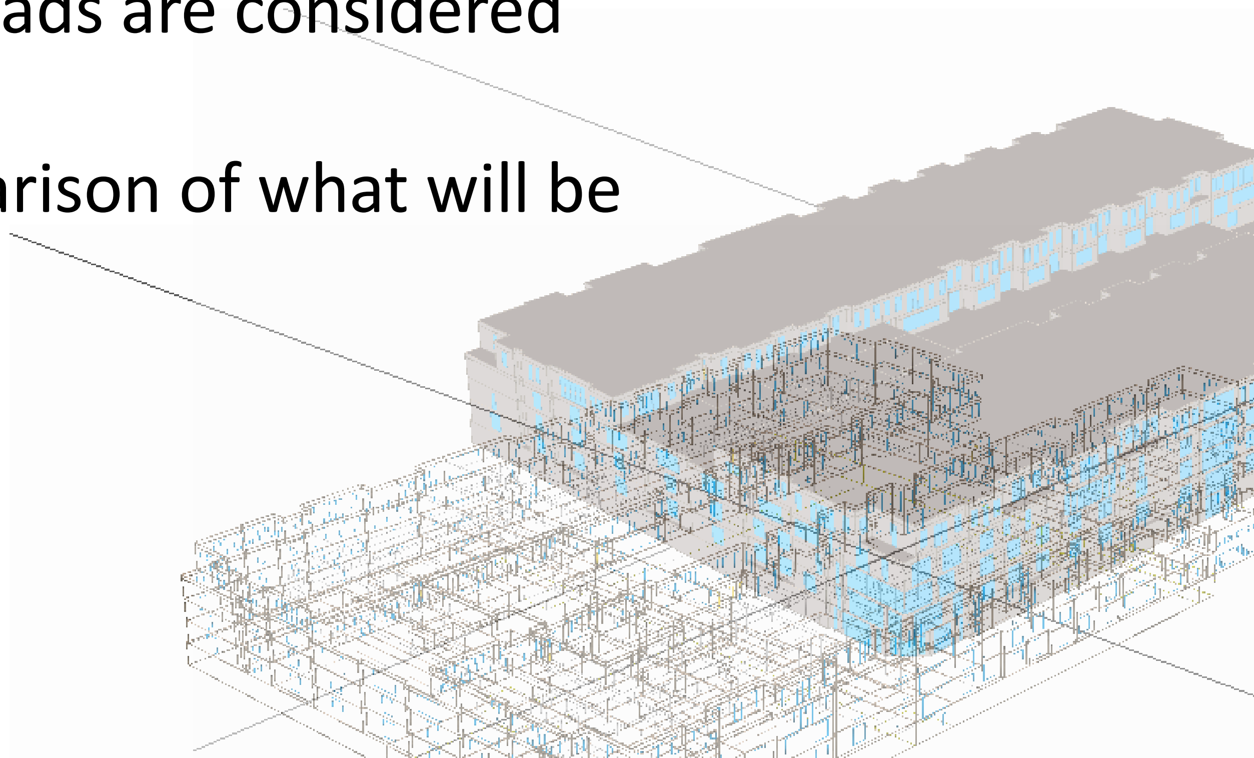
179D

CALCULATION METHODS – WHAT IS AN ENERGY MODEL?

01 3D simulation of every hour of building energy use across all 8760 hours of the year

02 All aspects of Heating, Ventilation, Air Conditioning, Lighting, Insulation, and internal loads are considered

03 Creates an apples-to-apples comparison of what will be versus what could be



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179D TAX DEDUCTION – MODIFIED FOR REITS

- **<u>REITs can now use 179D deductions</u>**

  - **REITs gain 179D earnings & profits conformity**
    - **Prior, 179D was taken over 5 years for calculating E&P**
    - **Now, 179D is taken as a 1 year deduction for calculating E&P**
      - **One less hurdle for taking advantage of 179D deductions and more potential for:**
        - **REIT’s to retain more cash**
        - **Shareholders to pay less tax on dividends**

SUMMARY OF 179D CHANGES

	179D (2006 through 2022)	179D (2023 and forward)
Range of Deductions	$0.30 to $1.88 per sf	$0.50 to $1.00+ per sf
Range of Deductions w Prevailing Wages + Apprenticeship	N/A	$2.50 to $5.00+ per sf
Ground Up Construction Baseline	ASHRAE 90.1	ASHRAE 90.1
Retrofit Baseline	ASHRAE 90.1	ASHRAE 90.1 or Pre-Retrofit EUI
Age Requirement for Building to be eligible for Retrofit Deduction	None	5 years or older
Eligibility for Retrofits of Low-Rise Residential (3 stories or less)	No	Yes
Applicable to REITs	No	Yes
Allocable to Designers of Government Buildings	Yes	Yes
Allocable to Designers of Tax Exempt Buildings	No	Yes
Deduction reset for Commercial Buildings	None	After 3 years
Deduction reset for Government & Tax Exempt Buildings	None	After 4 years

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GENERAL INDUSTRY 2023 TAX UPDATE

2023 TAX UPDATE

- Provisions in the Tax Cuts & Jobs Act currently scheduled to sunset at the end of 2025
- 2023 – bonus phase out begins
  - 2023 – 80% bonus
  - 2024 – 60% bonus
  - 2025 – 40% bonus
  - 2026 - 20% bonus
  - 2027 – 0% bonus
  - Section 179 depreciation is a good option for smaller/ mid-size taxpayers
- Capitalization of R&D expenses (section 174 expenses)
- Pennsylvania - Corporate net income tax rate reduced from 9.99% to 8.99%
  - Continue to decrease by 0.5% annually until 2031 when it reaches 4.99%

2023 TAX UPDATE

- Exemptions from using Percentage of Completion
  - Small Contractor Exemption
    - “Gross receipts test” adjusted for inflation – now $29 million
  - Homebuilder Exemption (regardless of size)
- If you meet one of the exemptions, you have more options!
  - Cash
  - Accrual
  - Completed Contract Method
  - Exempt-Contract Percentage of Completion (EPCM)
  - Percentage of Completion (PCM)
  - PCM – simplified cost method
  - PCM – 10% Method
  - PCM Capitalized Cost Method (PCCCM)

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TOP 10 REMINDERS FOR YEAR-END CLOSE

Your Guide to a Smooth Audit or Review

TOP 10 REMINDERS FOR YEAR-END CLOSE

1. Proactively communicate regarding unique transactions.
   a. Acquisitions and Disposals
      i. Have purchase agreements and purchase accounting documents available
      ii. Stock purchase/sale vs asset purchase/sale
   b. Creation of New Entities
      i. Have founding documents available
      ii. Related Party/VIE Considerations
      iii. Consolidation considerations

These events can fundamentally change your financial statements, and thus your bank's perception of your business.

TOP 10 REMINDERS FOR YEAR-END CLOSE

2. Prioritize the year-end work-in-process schedule:
   a. Does the WIP sufficiently tell the story and status of the project?
   b. Has it been appropriately adjusted to %-of-completion accounting?
   c. Does it agree to the year-end trial balance?
   d. Is there additional information that would help the team identify unique items?

The WIP Schedule is the critical driver of your financial statements. Make sure you get this right before you move on to closing your other accounts.

TOP 10 REMINDERS FOR YEAR-END CLOSE

3. Review for contract items that can produce unique accounting outcomes
    a. Uninstalled Materials
    b. Variable Consideration (Pending Change Orders, Incentives, Liquidated Damages)
    c. Costs of Waste and Rework

TOP 10 REMINDERS FOR YEAR-END CLOSE

4. Ensure that Accounting and Operations are Communicating
   a. Project review meetings
      i. Are ***all*** of the right individuals attending these? Operations **and** Accounting?
   b. Project site visits
   c. Leverage technology to facilitate field-to-office communication

TOP 10 REMINDERS FOR YEAR-END CLOSE

5. The new lease accounting standard (ASC 842) is here to stay
    a. Review for new leases (or lease amendments) that occurred during 2023
    b. Recognize on the balance sheet if necessary
    c. Consider a lease software solution

TOP 10 REMINDERS FOR YEAR-END CLOSE

6. Optimize the timing of fixed asset purchases: December vs January
    a. Covenant considerations
    b. Accelerated depreciation/write-offs
    c. Overall tax planning considerations

TOP 10 REMINDERS FOR YEAR-END CLOSE

7. Employee Retention Credit Preparation
    a. Gather and save the appropriate supporting documents

TOP 10 REMINDERS FOR YEAR-END CLOSE

8. Review last year's listing of Adjusting Journal Entries
   a. Are these entries that can be made internally as part of the close process?
   b. Improve/accelerate your visibility on the year's profitability
   c. Greater visibility = Better decision-making

TOP 10 REMINDERS FOR YEAR-END CLOSE

9. Learn from last year's audit/review. What were the challenges?
    a. Unreconciled accounts/WIP Schedule?
    b. Extensive time needed to locate supporting documents?
    c. New accounting standards?
    d. Improper balance of on-site vs remote time by auditors?
    e. Insufficient communication of timelines?
    f. Differences in account groupings: internal vs external?

TOP 10 REMINDERS FOR YEAR-END CLOSE

10. When in doubt, talk to your Bank, CPA, and other Service Providers
    a. Covenant ambiguities or challenges
    b. Differences between your expected profitability and your actual results
    c. New/unique transactions

For everyone involved, conversations around these topics are often more pleasant in November than in March.

TOP 10 REMINDERS FOR YEAR-END CLOSE

1. Proactively communicate regarding unique transactions
2. Prioritize the year-end Work-In-Process schedule
3. Review for contract items that can produce unique accounting outcomes
4. Ensure that Accounting and Operations are Communicating
5. Review for new leases (and amendments)
6. Optimize the timing of fixed asset purchases
7. Employee Retention Credit preparation
8. Review last year's listing of Adjusting Journal Entries
9. Learn from last year's audit/review challenges
10. When in doubt, talk to your Bank, CPA, and other service providers

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