Capstan's 4th Annual Year End Top Ten Episode

Helena Carmel

Hello, welcome to another episode of Capstan Live. I'm Helena Carmel and today's episode is our Fourth Annual Year End Top 10. It's the best episode of the year. We're going to hit all the highs and maybe some of the lows of the last 12 months. So you'll be totally up to date and ready to jump into tap season. Now we can't jump into the top 10 without introducing the top four.

Today is the day that all the Capstan stars come out to shine. And I have with me in the studio, Terri Johnson, Bruce Johnson, Jacob Wood. And for the first time on the year end episode, welcome to Bill Harbison, our new Director of Energy Incentives. Hi Bill

Bill Harbeson

Hi everybody. So happy to be on with you guys.

Helena Carmel

It's a lot of fun and we're glad you could join us. Jacob, Terri, Bruce, you guys have been here before and we couldn't do it without you. I know you're so busy prepping.

Jacob

Yeah, this is the highlight of the year.

Terri S Johnson

I look forward to this every year.

Helena Carmel

It is, it's a fun episode, it is. And we'll jump right in. Our Number 10 this year is nothing too exciting, but it is important. Can we talk about Section 179 expensing, Terri? I know the limits have increased again, which is good...

Terri S Johnson

Yes, Helena, great to be here today. I'm, you know, it's always amazing. It seems like just yesterday we were doing this at the end of 2023. So let's talk about Section 179. As we have seen from year to year, the limits have increased again. So for 23, we were at 1.16 million for overall expensing limitations. That's gone up to 1.22 million. And then the phase out threshold is $3,050,000, whereas in 23 it was $2.8 million. So what I find interesting about 179 expensing is first you've got to think in terms of who gets to take advantage of that. So if you're a trade or business, you can take advantage of that. And if you're not, then you can't.

And you also can't take advantage of it if you're multi-family. So just keep that in mind. But what I really like about 179 expensing is that, you know, back when bonus depreciation was 100%, I think they were very equal. You know, as long as you were a trade or business, you kind of had a choice. Do I use, kind of max out my 179 expensing or take advantage of bonus.

But now that bonus has gone down, which we'll talk about in a little bit later, I think that since 179 still permits expensing 100% of an asset, you're in a much better position to get a larger deduction until you hit that threshold. So we're seeing a lot of people taking advantage of this because of the bonus going down and being 60 % this year.

Helena Carmel

That makes sense. 179 expensing is kind of rising to the occasion and sort of filling in that gap for a lot of taxpayers.

Terri S Johnson

Exactly. And one of the things just keep in mind, whereas bonus you can, you know, carry forward with the 179 expensing, you need to be a profitable entity. So you have to be able to take advantage of that. And we see for the most part, small and medium sized businesses taking advantage of 179 expensing because if you're a very large company, you're going to hit those thresholds really quickly. for, for tax year 2024,

Companies that spend more than 4.27 million on qualified assets would no longer be eligible for the deduction. So you can see if you're a really large company, you wouldn't probably be able to take advantage of it.

Helena Carmel

Amazing. Thank you. That was a great explanation. And just to remind people, qualifying assets that can be taken under that deduction are things like improvements to like HVAC and roofing, assets that qualify as QIP, that sort of thing.

We're going to move right on to number nine and Terri, I'm going to call on you again. This is the first time we've had land allocation on our list, but it's really important that people be careful with it and recognize that all methodology isn't equal. We've seen some people make mistakes this year and we don't want that to happen to our clients. Terri, how can you advise us?

Terri S Johnson

Well, number one, when I'm talking to a client, they call with an opportunity. One of the first things I'm going to ask is, if it's an acquisition, what are you allocating to land? And the PFA method, "Plucked From Air," is probably not the best method. I strongly encourage folks to understand that we're not appraisers, so we can't choose your allocation.

But you need to use a reasonable method per the IRS. So, you know, what does that look like? Well, it can be the values that you get from the tax assessor, which a lot of people use. And, you know, most real estate deals, you're going to have appraisals done. They don't always include the land allocation appraisal. But if you're doing a lot of deals, you should ask to have it included. And so that's really sound is to have that in the appraisal. But the value, you know, I don't think people think too much about it like, "I've got to allocate something to land." It's not included in the depreciable basis, so obviously people are trying to make it low, but you also need to be thinking about the fair market value and making sure that it's reasonable and defensible with the IRS.

And one of the things I want to point out in addition - if the property acquisition is part of the acquisition of a trade or business, the allocation must agree with what the buyer and seller report on their Form 8594.

One of the things that we've seen is when the IRS is auditing, this is what I call low-hanging fruit. So one of the first things they're going to ask you if you get audited is, “How did you come up with the land allocation?” So if you tell them you plucked it from air, the PFA method, probably not too defensible. But if you show them that you used a reasonable methodology, then you should be OK. I always encourage folks - maybe they're reaching out to brokers and finding out what does actual raw land cost in the area? And using this information.

Whatever you're doing with the land allocation, you should have that in your file marked “land allocation.” Should you be audited, it's easy to find because I will tell you, they will ask. It's one of the first things. So if you've used a reasonable method, you're fine. And if you said, “You know, we use the tax assessor number or we use the appraisal or we did research and looked at what land was actually selling for in the area and came up with a whole bunch of comps, and here's all the documentation,” you should be fine. That would be considered reasonable.

So it's just something that you need to be aware of, and it comes up on every single acquisition pretty much, unless it's like you're buying a condo and the land's not included, or you're buying a building where the land isn't included in the deal.

Helena Carmel

So, okay, that is great advice. So really, everybody who's looking at acquisition, unless they're buying a condo or some kind of urban property where there's no land, needs to be mindful about using a reasonable method for land allocation. Because if not, like you said, unfortunately, it's something they're gonna ask about. Okay, amazing. Let's switch gears for a bit. And number eight, we're going to head over into R&D world. Jacob, how are you? You live in R&D world.

Jacob

Hey, I am doing great. yeah, I live there. I live there. Actually, I sometimes live in cost segregation or 179D world, but my home is R&D world.

Helena Carmel

Yeah, you're a native, a natural born citizen.

Jacob

I've got a good passport though, a lot of stamps.

Helena Carmel

Aw, thank you for running with me with that. We have a bunch of R&D stuff on the list, but the first thing I want to talk about is that Chief Counsel Memorandum, that very famous memorandum that came out in 2021.

Jacob

Who could forget Number 20214101F? Just rolls off the tongue.

Helena Carmel

Honestly all the songs they've written about it, yeah, you can't get them out of your head... So first of all, give us a little history. Like what was the initial impetus for this memorandum?

Jacob

So this is actually a really interesting piece of administrative law. And I'm going to put my lawyer hat on for just a second. So kind of the landscape is typically when an administrative body like the Internal Revenue Service issues guidance, they do what's called a “comments period.” And they put things out. They kind of ask for suggestions. because they're not actually making law, they're really more clarifying what the intent of the law is through some administrative action.

And most of the time you'll see that if you're in a certain industry, you'll get notices from the EPA or the IRS and they'll say, “Hey, we want to have a comment period and we want to get everybody's thoughts and we're to come up with kind how we're going to get this thing accomplished.” In this case for this Chief Counsel Memo, they actually released this in 2021 kind of at the end of the year and they did not have any comments period or anything. So it wasn't something that people were really expecting.

And what it did is it put a burden on the taxpayers to submit more information with a claim of refund. So this is not an original claim. It's only a claim of refund involving an R&D credit. So if you're amending a tax return and you have an R&D credit, but you're in losses and there's no refund, this doesn't apply. It's only if you are requesting a refund. A lot of people when they do an R&D study, they go back three years, they claim a bunch of refunds, and then they move forward into the future.

So the IRS was kind of trying to get some more info on those larger claims. That's definitely a reasonable goal, but the interesting legislative kind of piece of it, the administrative law piece is that they really didn't seek any comments or anything. And so as a result, they've been tweaking this kind of ever since.

Helena Carmel

Meaning because they didn't get the feedback initially, so now they kind of having to play catch up on the back-end.

Jacob

Absolutely. So what they've done essentially with this memo is they've augmented it a couple of times. Now, the other interesting thing, the last thing I'll say with my lawyer hat on, is that with Chevron deference to administrative law going away, meaning basically if you're construed as creating law as an administrative body, you have to be very careful with that and people can essentially sue based on it.

So this memo is in a little bit of long-term jeopardy because not only were they kind of creating some new burdens on the taxpayer, but also they didn't really even follow the standard processes. So again, it's not that the intent is bad. We want to get more information. That's a reasonable goal, but kind of the way that it went out is a little weird. And so again, they've been kind of tweaking it.

So what they did recently is they basically said, you don't have to put quite as much info into that filing. So they used to require you to put every person that worked on the project for R&D and all the information that they were seeking to discover. Well, you have to get into somebody's intent and ideas to get into that. And that's a very high burden. And so they took that off. They did say you still have to have that info in general. Like if you were selected for audit, you may be required to produce it, but it's not going to be a standard part of that submission.

The other thing that they did recently is they also, if you don't meet these requirements or whatever the requirements from this memo, they have a 45-day cure period. So the IRS can say, “Hey, you didn't meet these requirements.” They've extended that now for a couple of years and recently they just extended it again. I think partly they're worried about denying claims and then getting sued. Anyway, good stuff to include, but IRS is walking back the requirements at least for filing.

Helena Carmel

Whoa, that was more dramatic than I was expecting it to be. Gosh, people, no, it really is. No, there could be suing, there’s no more Chevron deference... Yeah, wow.

Jacob

It's a dramatic landscape, the R&D world.

Helena Carmel

But essentially though, even though they're making changes and walking back things on the memorandum, you still need to have that info just in case, right?

Jacob

You still need to have that information.

Helena Carmel

We're going to pivot to our number seven. We're going back to cost seg world and everybody knows that bonus rates are declining. Terri, I'm sad about it. Everyone's so sad about it. What’s to be done?

Terri S Johnson

Well, I guess I look at it differently. I feel like we had a hundred percent bonus from Q4 of 2017 through the end of 2022, and then it started declining 20% a year. When you look at the impact of bonus, it's pretty significant. And we had that long run of a hundred percent, which was, it just created so much value for the cost segs. So for example, this year, it's 60% bonus. So for those of you that aren't familiar with bonus, that means that anything we accelerate in the cost segregation study, you're going to get bonus depreciation on any life of 20-years or less. So if your personal property, land improvements, qualified improvement property, all fall in bonus, you would get the bonus that is eligible in that particular year.

So next year it will be 40%. So, I guess my optimistic side of me, Helena, that doesn't get sad about these things is I have never seen the government not come back to this, not to update it and make it retroactive. So that being said, you know, we're gonna be keeping a close eye on decisions to go back to 100 % bonus, to update that legislation.We'll be keeping a close eye on it. I think we're going to talk about that towards the end of for the number one. But so I'm not going to get in that too much right now.

But there's a point here that is very important. So we have a lot of clients that have projects that go into service towards the end of the year. And I'm getting those calls now where, well, “We think it's going to be December, but it may be January.” And my comment is, “Can you get a temporary certificate of occupancy, a TCO, by year end?” If you can and you can place that into service, you'll be at 60 % bonus versus 40 % bonus. So you want to try to get as much close out by year end as absolutely positive, you know. And there are, as long as you are ready to receive tenants, you can place that building into service. And so if you have a few items that need to be, you know, like punch list type items, but you've got your TCO, you should be fine. So it's just something to keep a really close eye on when you're doing planning with clients at the end of the year to ask these questions and make sure you're explaining that the bonus can, it can affect the project a lot by that 20%.

Helena Carmel

Thank you for reminding me to be optimistic, Terri. I do appreciate it. And you're right, it's almost Thanksgiving and we should be thankful for all the 100 % bonus that we had. [laughter]

Terri S Johnson

Yeah, mean it's, I have just, it's been something that I've just noticed. I mean bonus depreciation first came out after 9-11 in 2001. So it's been a long time and there have been very few years that we didn't have bonus depreciation and to have it on acquisitions was just such a huge thing. So I'm, I'm optimistic that -- kind of like Jacob is about the 174 issues -- that we're going to maybe see some positive changes.

Helena Carmel

We are hoping, and in the meantime, I do want to reiterate, cost segregation still brings so much benefit, even at lower bonus rates. So I did not mean to be negative Nancy all over this podcast. Okay, Bill, you're up. Welcome, Bill. We're now totally moving on to new horizons, moving over to energy, and no one more qualified than Bill to speak on that. And Bill, speaking of energy. I want to talk about the prevailing wage and apprenticeship requirements. I know in June final regs were released that gave us a little bit more clarity, but first can you just remind our listeners about the PWA requirements, what they are and why they're so crucial?

Bill Harbeson

Sure, so the Inflation Reduction Act, of course, made billions of dollars, particularly in the energy field, in the form of energy incentives, tax incentives that emphasize the design, construction, implementation of energy-efficient features in commercial spaces, as well as residential spaces. And as part of these incentives,included in about, like I said, about a dozen of them, a five times multiplier for the amount available if you meet certain requirements. those requirements are that you paid a prevailing wage to all laborers, all contractors, all subcontractors, all mechanics, anybody that is part of that construction project was paid a prevailing wage and you made a good faith effort to participate in an apprenticeship program.

Helena Carmel

And a prevailing wage just means like according to the standard for that area in that job, right? That particular position?

Bill Harbeson

That's correct. So the Department of Labor, they publish lists for what the going rate for a particular craft is in a particular location at a particular time. So if we take 179D, for example, which is kind of our fastball in the energy team here at Capstan, the deduction is a dollar per square foot adjusted for inflation every year. So right now it's a $1.13. However, if you met what they call PWA, the

Prevailing Wage and Apprenticeship Requirements, the deduction goes up to $5 per square foot adjusted for inflation. So it's $5.65. So a significant update. But that's been around now for a couple of years. That was implemented, of course, as the Inflation Reduction Act. So it's been around since 2022.

The big update that we got this year was in the form of “final guidance”. And I use finger quotes for final guidance. It's a 300 page document. It's a pretty dry read. For our listeners, I encourage you to not read it unless you really have to [laughter]. But it is all about what it means to meet the prevailing wage requirements, how to correctly document them if you're going to claim these enhanced deduction or credit amounts and also the penalties for not meeting those requirements. It also includes the grandfather period. So if you have a construction project that began before January 30th of 2023, you're exempted from those requirements. You automatically get the enhanced credit or deduction amount so long as you meet all the other requirements.

And then there's a significant portion of that document that kind of focuses on what does it mean to start construction. You've broken ground or you've incurred enough costs to consider the construction. So the nice thing about that is that we know now exactly what it means to correctly document these requirements. We've known for some time now that, yes, you must pay prevailing wage, but now we have an understanding of what all we need to prepare.

Not necessarily attached to a return, but what we need to have ready in case the IRS has any questions as part of a review. So, and then in addition to that, as part of the requirements, we now attach a statement to any return that is going to claim these enhanced deduction or credit amounts, saying that they've met these requirements in this fashion, and this is what we've used to document them. And the last thing I'll say about that is, that 179D of course is what Capstan does the most of in our energy field. And the final guidance directly addresses 179D. And says that further guidance is forthcoming. When that happens, we don't know.

But we do know that the IRS has at least acknowledged that there is, you could say an undue burden for some of these items with regards to the prevailing wage requirements and 179D. But yeah, overall, that's the big changes for this year.

Helena Carmel

So, okay, so these final regs, do clarify a lot in terms of documentation required, in terms of penalties if you don't. But I just wanted to point out there's one thing that the final regs don't talk about, and they don't talk about the PWA requirements in the context of a designer who wants to take, who wants to have the deduction allocated to them, right? That's still like a big question mark.

Bill Harbeson

That's correct. That's correct for the 179D as I mentioned, they specifically address that if you're an architect or an engineer who wants to claim a 179D deduction for a tax exempt project, which that's a large portion of our client base, the final regs acknowledge that if I'm an architect, I have no control or even knowledge of a construction project that pays prevailing wages or not. You an architect is, usually pretty divorced from that part of the process unless they're part of a design build relationship or a joint venture or something like that. But for the most part, I'm an architect. I provide a design to a building owner. That building owner then takes that design and sends it to a general contractor who then pays the wages for the craft. So the way it's set up now, as I mentioned, it's a bit of an undue burden and the IRS recognizes that. So we anticipate getting further guidance on that shortly, but for now, that is the law and we're helping our clients navigate those waters.

Helena Carmel

Thank you for clarifying. Yeah, it does seem to me it's just so strange - an architect has nothing to do with it, why should they have to be penalized? Okay. Thank you for clarifying that Bill. Jacob you got to put your lawyer hat back on. Because in Number Five we need to talk about some major R&D Case law that came out this year and they did set some impressive precedents. There's some wide-ranging implications here. Can you talk to us first about the *Harper* case, speaking of architects? This is actually quite relevant.

Jacob

Yeah absolutely so you know what we've seen last couple years has been some cases that have come out on our R&D tax credits and what the IRS kind of tries to push is more documentation which i think everybody agrees with this is a good thing to push for, we should have the documentation.

The question is agreeing on what the business components you can claim for the credit are and then how you support them, there's been a little bit of a push and a pull. *Harper V Commissioner* essentially, was a case where the IRS told a design build firm their activities failed because their design was not a product. Tax court disagreed and basically said, “Hey, a design could be a process, it could be a technique, it could be an invention. These are all business components of the tax code.” The Tax Code does say you have to be developing a product process formula invention software or technique.

The IRS doesn't necessarily like engineering or architecture designs sometimes, because it feels very kind of fuzzy. It's not a physical thing. Where the IRS loves to see is a physical product like a widget that you're actually manufacturing. Or software, something clear like that listed out in the code.

But things like an engineer, they're doing designs. You may call the design a product, but IRS didn't like that.

Helena Carmel

So, okay, so yes, so the IRS really, they were told a lesson here, basically. I mean, if they only wanted to see a business component as something more tangible, but it was made very clear by the Tax Court that a design is a business component. And moving forward, architecture firms and engineering firms are able to move forward and confidently claim the R&D tax credit thanks to Harper versus commissioner. So that's important for our listeners and important in general moving forward.

Can I also ask you to talk to us about *Bets*? *Bets* is a rough one.

Jacob

Sure. yeah, *Bets V. Commissioner*. So again, there have been a couple of cases that have kind of gone against the taxpayers. You know, have they gone too far? Who knows? I mean, this is the push and the pull of litigation on these sorts of issues. But again, what the IRS has really pushed on, these guys basically made custom oxidizers. So they actually did make a physical product. IRS didn't like the argument because the argument again was that these were basically totally brand new business components.

And the IRS essentially made the argument that they were not totally brand new and Tax Court agreed with that. So basically the taxpayer was supposedly supposed to prove out what discrete components in that overall design were new or improved. And they really just took an all or nothing approach. And so we've seen that with a couple of cases like TG Missouri came out last year with a ship builder that was basically saying the ships are totally brand new. And the IRS and tax courts and the federal courts that have looked at this, they basically, want to see some kind of breakdown. Now, question for the taxpayers is exactly what that is. Like what is that breakdown? Is it a list? Is it a spreadsheet? Is it time tracking? So that's kind of still up in the air. But you do want to make sure you have wages and your expenses tied into the projects and you also have some kind of data on what those people are doing. So it's not like a time tracking system is expressly required, but tangentially it may be required in the future.

I would say if you're looking at these cases, take away, practical take away is just whatever you're doing, try to track it even better and be very clear about what argument you are making. What type of business component is this? How does it qualify? And then how are you proving that out? Beyond just interviews, you want to have documentation as well.

Helena Carmel

Yeah, that's exactly it. You said prove, right? That's what I was gonna say, that the end of the day, the burden of proof is on the taxpayer. And the IRS is the one who could just be like, “Eh, you didn't prove it.” So like you said, document, document, document. And we're actually going to even speak about that a little bit more.

But now, Bruce, you've been awfully quiet. Bruce, I want you to talk to us about your favorite thing, 1031 exchanges.

Sometimes it can be tricky though to complete them in the mandated 180 days. We had a great podcast earlier this year introducing some 1031 “workarounds,” quote unquote. Instead of a replacement property, people are using Delaware statutory trusts or bonus depreciation funds. And we wanted to talk about these exciting alternatives on our year-end top ten. Bruce, why would somebody choose to use one of these?

Bruce Johnson

Well, as you pointed out, Helena, I do enjoy getting involved in some of these things. And what happens typically is that we have clients that call us up and actually we get them more frequently to ask us some things that are not in scope for what we typically do. And to your point, we've certainly had the opportunity to be around and be asked to evaluate things with regard to Delaware Statutory Trusts.

So from what we understand those can be great tools for individuals or entities that have been running a property for a number of years, still want the revenue, but they don't want to be operating the property. They just basically kind of almost step back into a passive role. So we see a lot of that activity from a cost seg perspective to help people still gain the traditional federal fixed asset strategies like cost seg or maybe some of the TPRs. So from our perspective, it really doesn't change our analysis that much. But if it is a passive now passive investment, obviously, as most listeners are aware, that kind of changes perhaps how the investors will be able to use the traditional cost segregation benefits.

Helena Carmel

So from Capstan's perspective, we perform the cost segregation study on that replacement property. But if somebody chooses to use a Delaware Statutory Trust as that replacement property, that obviously changes the game there.

Bruce Johnson

Yeah, from their perspective, evaluating the economic benefits of say, cost segregation definitely could be a different thing for them. Because from what I understand, the DSTs are typically people that are moving from an active participation in property management to a more passive. say you and I are investors in a property and we're kind of going in.   But we're both moving off into a different business. We could roll up our proceeds from our relinquished property into a DST. And someone else manages the property while we're able to reap the economic benefits of the rents and all those other things that come from that.   Similar to your traditional 1031s, we're only looking at the excess basis. So I'm sure we're all aware, and that's a much more detailed conversation, but it's not the raw acquisition price of the replacement property. Like you mentioned, it's the excess basis, the difference between between the relinquished and replacement property basis.

Helena Carmel

Yes. And I really did just want to kind of highlight this because it did come on our radar this year. And it is just a useful thing to have in your back pocket as an investor. 180 days goes fast, right? And what if you can't find the right thing? Or let's say you found the right thing and it fell through. I mean, things happen. So it's kind of a useful thing to have in your back pocket just in case.

And I think investors are even encouraged to make a habit of identifying a DST as a replacement property, kind of as a just in case. Would you agree, Bruce?

Bruce Johnson

I mean, from what I hear from our clients, yes, and kind of to your point, Helena, and I alluded to this a little bit ago, we're hearing more often of people that started or got a 1031 process started and they aren't able to complete it because for a variety of reasons - they couldn't find the right property, the deal fell through, and we regularly are getting calls or emails of people to say, "Hey the deal didn't work." And as we well know there's some negative ramifications if you can't close the process within that hundred eighty-day window.

Helena Carmel

So, DSTs are just a good alternative and especially attractive, like you said, for an investor who's looking to transition away from active hands-on property management or to somebody who just likes to kind of have an ace in the hole just in case.

Bruce Johnson

Yeah, I think Helena, if I could just dovetail off of that, let's talk about the Bonus Depreciation Fund option.

You have been actively trying to close a 1031 process, but you fell outside that that 180-day window. What do you do with the proceeds? You're trying to avoid some punitive tax liability. So the bonus depreciation funds, which I know we had done a podcast on earlier this fall, might be a strategy for people to explore if they if they are in that scenario -- they made every effort to close the 1031 as the requirements outline but the deal fell through.

Helena Carmel

Thank you so much for bringing that up, the bonus depreciation fund. So that primarily means that a person would roll those funds into like triple net lease properties, car washes, gas stations, things like that, that are owned and managed by a bonus depreciation fund. And then the investor can still benefit from things like bonus and accelerated depreciation and only be involved in a passive way.

Bruce Johnson

Right and those funds are designed to allow you to get access to the liquidity of those funds and a fairly quick and basic process. It's just another interesting thing that, you know, in our travels as Capstan, we run across people coming up with unique strategies to help people in unique circumstances. It's interesting because I know I get these calls from people one or two a month where, "Hey, Bruce, I sold that property, you did a cost seg for me on four or five years ago, but I couldn't close the 1031 deal."

And now I've been able to actually refer them over to this organization to kind of explore whether or not there are other alternatives to help kind of mitigate that punitive tax liability. So I think that it's interesting the market is certainly adapting to a lot of the complexities that some of our clients face with ideas and strategies.

Helena Carmel

That's wonderful. Yeah, it's really very fulfilling to be able to provide like a new and unique, you know, potential solution to what's been a long-standing problem. So Bruce, thank you so much. Thank you for your insight on both of these strategies. And we're going to pivot now and move on to the next item on our list.

Now, number three, number three is a big one. I want to talk to Bill about changes that are coming to the Investment Tax Credit. And actually we've never had the ITC on our Top 10 list before, so it's another new one for us. Bill, yeah, it's exciting for us. It's the first time it's made the list. Could you start by giving our listeners a little bit of background about the credit?

Bill Harbeson

Sure. So the Investment Tax Credit's been around for actually quite some time, just like with 179D and a lot of the other energy incentives that that we cover. But just like 179D, it was enhanced quite a bit as part of the Inflation Reduction Act. It allows for a credit to install certain quote "energy property."

The most popular application for that is things like solar systems, solar panels, the infrastructure to install solar, both at the commercial and multifamily applications. But there's also other parts of the Investment Tax Credits such as wind, geothermal systems, photovoltaic glass, and other features that are designed to reduce your overall carbon footprint.

Helena Carmel

These are all those renewable energy systems, right Bill? Okay. So, and up until now, there's been kind of like the traditional, the legacy version of the credit. We would call it this the Section 48 version of the credit. But from what I understand, a new version is coming. There's going to be what you're calling a technology neutral version of the credit starting in 2025. What do taxpayers need to know Bill? Tell us.

Bill Harbeson

Right. So for our typical customer base - small, medium sized businesses - they will experience little change. But overall, the Investment Tax Credit as well as the Production Tax Credit, which we won't really get into today, both of them are kind of updating to the Clean Energy Investment Tax Credit and the Clean Energy Production Tax Credit respectively.

So they are kind of a continuation but also an adjustment of these credits. The goal is still the same, to claim a credit. The credit is 6% of the total cost of implementing this equipment, which can go, of course, to 30% if you do meet those Prevailing Wage requirements we mentioned earlier.

And then there's several bonus add-ons, like for instance, 10 % for using domestic content for your equipment, that sort of thing. And, you know, it gets bigger after that. The biggest change is that the new Clean Energy Investment Tax Credit, which is Section 48E, is again, this very similar approach, except now it is technology agnostic, which is to say that any kind of energy generating equipment that generates no greenhouse gases would be eligible for the Investment Tax Credit. So now things like a nuclear power plant, they don't emit greenhouse gases, so they could be eligible for the Clean Energy Investment Tax Credit.

But again, for a typical customer who's mostly interested in the solar, they will experience very little change. The one thing to keep in mind is that as the United States gets closer to its greenhouse gas emission targets, the credit will start to phase out. So as we hit those targets, you'll see the credit evaporate basically. But before that, the credit is 30%, all the way up to even 70% if you meet those additional requirements.

Helena Carmel

And correct me if I'm wrong, Bill, but that won't be for a while, right? I think they said 2032?

Bill Harbeson

Yeah, we've got about 10 years before that before that takes effect. And so so we've got quite a bit of time. If you're interested in implementing some energy features, solar, course, being the most popular, you've got time. But I would encourage you to meet with a consultant like us earlier rather than later.

Helena Carmel

Thank you, Bill. That is a new topic for us, the ITC, and we're excited to have it on our list this year. Okay, here's a huge one, and we're back to R&D, and we're back to Jacob. We're getting a new Form 6765, right, Jacob? And it's gonna change our lives.

Jacob

Absolutely. It is going to change all of our lives. Actually, hopefully for the better. This is actually the flip side of kind of the Chief Counsel Memo we talked about a little earlier. That was only for amended claims of refund. What the new forms are, these are going to be for basically forward looking. They may be backward looking, but right now they're going to be forward looking. So if you're going claim the credit for 2020, you know, four or five, six, et cetera, this is what you're going to have to consider.

Now, they did push this back. It was actually going to be implemented for the current tax year 2024, but it's actually going into effect for the 2025 tax year, partly because they did follow the routine comments, notice period, and so on before this went into effect. So basically, people have time to prepare for it. Essentially, what this is, it's just requesting more information for an R&D client.

We've had times in the past where people have, they come to us for an RD study, we start doing the work, we look and we say, “Hey, you guys have already claimed a little credit, what is this?” And somebody will just say, “Well, we had kind of an overzealous controller and they looked this up and they wanted to figure out if they could claim something and they put something on the return.” That kind of a “study,” quote unquote study in air quotes, would not fly under the new method, no.

Helena Carmel

That's not going to fly. No. [laughter]

Jacob

So putting something on a return is not going to pass muster. And so, you know, this Form essentially adds sections that go into what sorts of business components you're developing, who works on them. There are some sections that are very important that basically indicate, “Did you change your methodology?” “Did you acquire a new business component this year or did you claim a new business component?”

One of the things that we're telling people is you absolutely want to have your methodology locked in for the 2024 tax year. So when you get to 2025, you don't have to raise your hand up and say, “Yep, I made some changes.” You wanna have a consistent methodology in line with effects. Doesn't mean you're gonna get audited, but if you are checking a lot of boxes that say, “Hey, I did all this other stuff, it probably will raise your profile a little bit.”

There are some exemptions for small businesses. So qualified small businesses, if you have less than 1.5 million in QREs, qualified research expenses, and gross receipts under $50 million. Who knows that that'll be indexed to inflation? It might be. It might not be. But essentially, end of the day, you're going to have to have a little more detail on the actual tax return, notwithstanding the fact that you probably had to have this level of detail for a legitimate study anyway.

Helena Carmel

Right, but maybe not everybody did, Jacob. So moving forward, people are going to have to maybe change some processes to ensure compliance with this new level of granular detail that's required. What do you suggest taxpayers start thinking about now?

Jacob

Absolutely.

I would say in light of the case law and these changes, the burden of proof is on the taxpayer and that burden has become more clear the last couple of years. You just need to be reviewing what your process is and ensuring that it does meet the documentation, the kind of ticking and tying and formatting. And conceptually, it still matches the credit of 2024. I would say this is good time to just review what you're doing.

If you're not doing anything, it's a good year to start. If you are doing something, good year to review what you're doing. And that's where a trusted provider like Capstan can help, you know, review that, give you a clean bill of health and so on.

Helena Carmel

We also have a new webinar coming out specifically about the new version of this Form. So keep your eyes out for that.

Jacob

If you're looking for that detail where it goes line by line and looks at the Form, and then there are still a few things that we're waiting on regs for, that's a great presentation for that. So I know we're talking conceptually right now, but if you want to look at the actual line items and the potential impact, that webinar is going to be fantastic.

Helena Carmel

If you want Jacob to even bring it to your firm, you know where he lives. He'll hook you up with that info. Thank you, Jacob.

And our number one this year is of course, you know, what's next? What's next? We're kind of in this uncertain period post-election and there are some taxpayer friendly provisions that we'd love to see make a comeback. What's on your mind, you guys? What are you thinking of as we move into the next administration?

Jacob

Yeah, one thing that comes top of mind is the Section 174 amortization requirement. There was some bipartisan support to get that deferred or retroactively changed. That's made it tough for R&D claimants to claim because it spikes their income in the first few years. And then they eventually get that money back in the future. But it's bad from a cash flow standpoint. And there's been some thought that that will get extended. It really just got caught up in the election in general and so I think both parties are going to really want to see that get fixed now that the uncertainties gone.

Bill Harbeson

Anecdotally, I can say that I've been fortunate enough to be in contact with some people that are on the Hill and I understand that early in the next administration that the Inflation Reduction Act is at the table. There is discussions about edits, changes, rollbacks, but really nobody knows at this point, what they'll try to do and what they'll be able to do. I can say that the Inflation Reduction Act is very pro-business, especially when you think about like 179D, which primarily benefits small, medium-sized businesses, multifamily developers, commercial spaces, things like that.

So the next administration promises to be pro-business and the incentives that we're talking about today that Capstan provides really are very pro-business incentives. So I see them staying strong. A lot of these are permanent incentives. So I see them continuing to benefit taxpayers in the future.

And the last thing I'll say about it is that these incentives that we work with, 179D, R&D received bipartisan support since their implementation. 179D 20 years ago, R&D, even earlier than that. So I say the people that we work with are going to continue to benefit.

Terri S Johnson

Yeah, I would say the same thing if you look at bonus depreciation. I think it's had bipartisan support to some degree over the years just because it is so good for the economy and for stimulating growth and activity. So I would not be surprised at all if we see that included in a package to at least extend past 2026 and possibly bring back 100% bonus. I know a lot of people are hopeful about that. So, you know, that's certainly one of the things I'm going to be keeping my eye on.

Helena Carmel

Yes, I think we'll all be keeping our eye on it. And listeners, if you want to keep your eye on our LinkedIn page, that's where we'll be posting breaking news and updates, analysis, anything with new legislation – we'll be on top of it.

Thank you so much for joining us, Bruce, Terri, Bill, Jacob. It was a pleasure as always. Thank you guys.

Terri S Johnson

It was great to be here. Thank you, Helena, as always.

Jacob

Absolutely.

Bill Harbeson

Thank you.

Jacob

Thank you, Helena.

Helena Carmel

And thank you listeners for joining us. We really enjoyed having you. If you enjoyed what you heard, why not subscribe? We're on Apple Podcasts, Google Podcasts, Spotify, Podbeam, or just go to our website at capstantax.com/podcasts. I'm Helena Carmel. Thank you so much for tuning in to Capstan Live. We'll see you next time.