

Welcome to Cohen & Company's Real Estate Roundtable

*Get Current! The Latest on Tax &
Accounting Changes 2010 and Beyond*

January 13, 2011

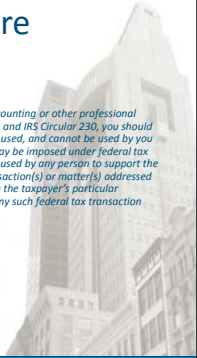
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Tax Relief/Job Creation Act of 2010

Presented By: Kim Palmer, CPA
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Extension of Individual Tax Cuts & Incentives

- All current individual tax brackets will be maintained through Dec 31, 2012
 - 10%, 15%, 25%, 28%, 33%, 35%
- Tax on Capital Gains & Qualified Dividends
 - 0%/15% through December 31, 2012
- Repeal of itemized deduction limitation
 - Through December 31, 2012
- Extends \$1,000 child tax credit through 2012

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AMT “Patch”

- Prevents AMT from encroaching on middle income taxpayers
- Provides higher exemption amounts
- Available for 2010 & 2011
- Exemptions (2010/2011)
 - Single: \$47,450/\$48,450
 - MFJ: \$72,450/\$74,450
 - MFS: \$36,225/\$37,225

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Bonus Depreciation

- 100% bonus depreciation
 - Available for qualified investments made after Sept. 8, 2010 and before Jan. 1, 2012
- 50% bonus depreciation
 - Available for qualified property placed in service after Dec. 31, 2011 and before Jan. 1, 2013

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Code Sec. 179 Expensing

- Dollar & Investment Spending increased to \$500,000 & \$2 million, respectively
 - For tax years 2010 & 2011
- In 2012, \$125,000 dollar limit & \$500,000 investment limit
 - Expires after Dec. 31, 2012

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Sec 179 & Qualified Leasehold Improvements

- Sec. 179
 - Extends treatment of off-the-shelf computer software as qualifying property
 - If placed in service before 2013
- Qualified Leasehold Improvements
 - 15 year recovery
 - For 2010 & 2011

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Energy Incentives

- Business credits/incentives extended for:
 - Qualified builders/manufacturers of energy efficient homes – for homes purchased before Jan. 1, 2012
 - Grants for energy property in lieu of tax credits
 - Energy efficient appliance credit
- Individual credits
 - Extended through Dec. 31, 2011
 - Lifetime cap reduced to \$500

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IRA Charitable Contributions

- Up to \$100,000 of tax-free distributions from IRAs for charitable purposes
 - For individuals 70 ½ or above
 - Extended for 2010 & 2011

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Payroll Taxes

- For 2011, employee share of social security taxes is reduced from 6.2% to 4.2%
- Wage base is \$106,800
- Reduction applies to self-employed individuals as well: 10.4% tax up to threshold
- SE individuals receive full benefit of above-the-line deduction at original rate (6.2%)

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Gift & Estate


- Gift Tax
 - 2010
 - Top rate of 35% & applicable exclusion of \$1 million
 - After 2010
 - Gift tax reunified with estate tax – Top rate of 35% & exclusion of \$5 million
- Estate Tax through Dec. 31, 2012
 - 35% maximum rate & \$5 million exclusion
 - State Deductions for state estate taxes paid replaces credit for taxes paid

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Renewable Energy Incentives

Presented By: Mike McGivney, CPA
Cohen & Company, Ltd.

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Renewable Energy Property

- Available incentives
 - Section 1603 Grants
 - 100% bonus depreciation
 - Ohio renewable energy law

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Section 1603 Grants

- 30% grants available from US Treasury
- Available for wind, solar, geothermal and other renewable energy installations
- Noncompetitive application process
- Begin construction by 12/31/2011

\$5.8B grants issued in USA so far
\$11.2M grants issued in Ohio so far

Bonus Depreciation

- 100% bonus depreciation
 - Available for qualified investments made after Sept. 8, 2010 and before Jan. 1, 2012
- 50% bonus depreciation
 - Available for qualified property placed in service after Dec. 31, 2011 and before Jan. 1, 2013

Other Incentives

- Ohio Renewable Energy Credits
- PACE/Advanced Energy District
- New Markets Tax Credit

Example

- \$1M solar installation
- Federal Incentives:
 - \$300,000 grant (30% US Treasury grant)
 - \$357,000 immediate tax reduction (depreciable basis at 42% combined marginal tax rate)

Out-of-pocket cost in year 1: \$343,000

Payback period: ~ 5 - 6 years

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New Markets Tax Credit
Historic Tax Credit &
Renewable Energy Tax Credit

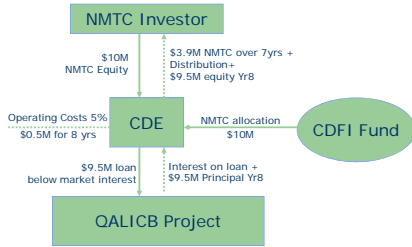
Presented by:

Radhika Reddy, MBA, MA-Tax (216) 344-9441
Partner, Ariel Ventures, LLC



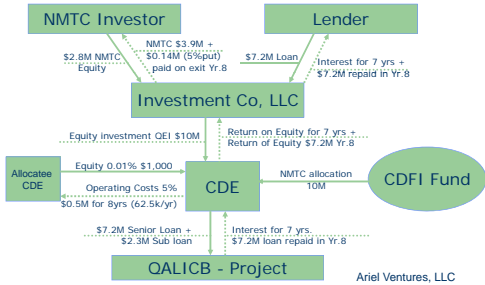
ARIEL Ventures, LLC
1375 East 9th Street, Ste 155
Cleveland, Ohio 44114
Ph: 216-344-9441

NMTC Structure w/o Leverage



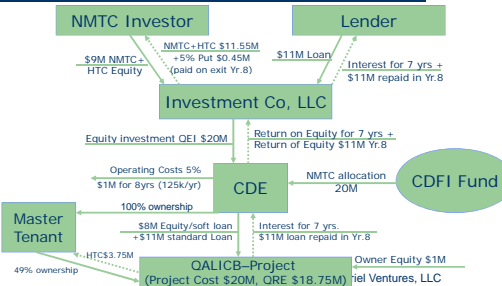
Ariel Ventures, LLC

NMTC with Leverage Structure



Ariel Ventures, LLC

NMTC + HTC Leverage Structure



Ariel Ventures, LLC



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International Financial Reporting Standards (IFRS): Overview and Update

Presented By: Nevin Nussbaum, CPA
Cohen & Company, Ltd.

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IFRS Overview and Update

- What is IFRS?
“International Financial Reporting Standards (IFRS) are principles-based Standards, Interpretations and the Framework (1989) adopted by the [International Accounting Standards Board \(IASB\)](#)”
- Convergence of US GAAP and IFRS – Why?
 - In February 2010, the SEC unanimously agreed to a statement that:
 - Continues its support for a single set of high-quality global accounting standards
 - Acknowledges that IFRS is best positioned to be the global standard

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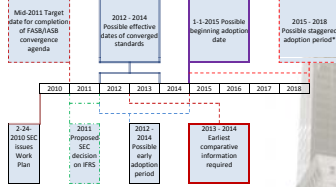
IFRS Overview and Update

- Mary Schapiro – SEC Chairman
 - SEC will allow a minimum of 4 years for public companies to adjust once the requirement is implemented
 - Additionally, while the commission still plans to vote next year on whether to require the use of IFRS, it is “not committed to a June 2011 decision date ... despite a common [misconception by the accounting] profession,” Schapiro said

IFRS Overview and Update

Possible Timeline Based on the SEC Statement

Assuming that the SEC determines in 2011 to incorporate IFRS into the US domestic reporting system, a possible timeline may be:



IFRS Overview and Update

- Some examples of differences between IFRS and US GAAP
 - Share based compensation
 - Lease accounting
 - Inventory – no LIFO under IFRS
 - Revenue recognition
 - Broad-based principles, no industry-specific guidance

A New Age for Leasing

Presented By: Nevin Nussbaum, CPA
Cohen & Company, Ltd.

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Overview

- Accounting change would require the capitalization of operating leases
- This change would affect any entity entering into a lease with certain exceptions
 - Exclusions include leases involving intangibles, explore or use natural resources, and biological assets

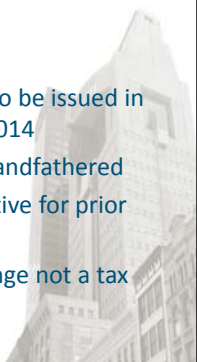
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Overview

- The final standard is expected to be issued in 2011 with implementation in 2014
- Existing leases would not be grandfathered
- Presentation must be comparative for prior periods presented
- This rule change is a GAAP change not a tax change

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Mechanics of Change-Lessee

- Lessees would record an intangible asset for the right to use the leased item equal to the present value of lease payments
- Lessees would also record a liability for the obligation to make the lease payments
- Lease expense replaced with interest and amortization expense on the income statement

Impact of Proposed Lease Accounting Changes - Lessee

Example – 10 year lease at annual rents of \$5,000 adjusting at 2.5% annually – Assumed borrowing rate is 7.5%



Mechanics of Change-Lessor

- Lessor would record an asset representing its right to receive lease payments
- Depending on the lessor's exposure to risks or benefits associated with the underlying asset, the lessor would:
 - 1) Recognize a lease liability while continuing to recognize the underlying asset, or

Mechanics of Change-Lessor

- 2) Derecognize the rights in the underlying asset that it transfers to the lessee and continue to recognize a residual asset representing its rights to the underlying asset at the end of the lease term
- Rental income will be replaced with interest income

Calculation of the Lease Asset/Liability

- Assumes the longest possible lease term that is more likely than not to occur, taking into account the effect of any options to extend or terminate the lease
- Uses an expected outcome technique to reflect the lease payments including expected contingent rentals and expected payments under term option penalties and residual value guarantees

Calculation of the Lease Asset/Liability

- Reassessment - Asset and liability are updated when changes in the facts or circumstances indicate that there would be a significant change since the previous reporting period

Determining Lease Term: Example

A lessee/lessor shall determine the lease term by the probability of occurrence for each possible term, taking into account options to extend or terminate the lease

Example...

An entity may have a lease that has a non-cancellable 10-year term, option to renew for 5 years at the end of 10 years and then an option to renew for 5 years at the end of 15 years. Assume the entity determines the following probability for each term as follows:

- 40% probability of a 10-year term
- 30% probability of a 15-year term
- 30% probability of a 20-year term

Based on these probabilities, there is a 100% chance the term will be 10 years, a 60% chance the term will be 15 years and a 30% chance the term will be 20 years.

Therefore, the term of the lease will be 15 years since it is the longest possible term more than likely to occur

Potential Unintended Consequences: Mindset Change

- Purchase vs. Lease – Will intents change?
 - Lack of off the balance sheet financing may result in tenants now choosing to own their own real estate
 - Developers/Contractors – Will future projects be “buy and holds” vs. a fee for building services
- Financing challenges – How will the banks react?

Potential Unintended Consequences: Lease Terms

- Is there a potential for lease terms to shorten due to impact on the tenant’s balance sheet?
 - Shorter term leases will impact financing of real estate
- Lease agreements may become more complex due to this change

Potential Unintended Consequences: Financial Statements

- Financial statements will need to be restated
- Result of restatement may have an impact on loan covenants
- Proposed rules require capitalization of all likely lease obligations so there will be added compliance and reassessment of lease terms, contingent rentals, residual value guarantees, and purchase options

Potential Unintended Consequences: Tax Changes

- This change is a GAAP change not a tax change, but this will create more complexity to preparing tax returns due to the significant book to tax differences
- There may be a state and local tax impact due to apportionment ratios and how some states calculate franchise taxes

What Should I Do Now?

- Watch for changes - Comments were due to FASB on December 15, 2010
- Update lease abstracts
- New leases - Document probability assumptions and right-of-use calculations



QUESTIONS?

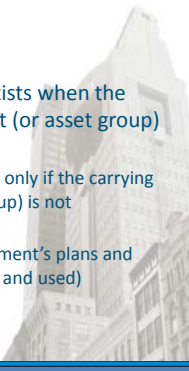
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Impairment Issues (FASB ASC 360)

Presented By: Chris Madison, CPA
Cohen & Company, Ltd.

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Impairment Defined

- “Impairment is the condition that exists when the carrying amount of a long-lived asset (or asset group) exceeds its **Fair Value**”
 - An impairment loss shall be recognized only if the carrying amount of a long-lived asset (asset group) is not recoverable and exceeds its fair value
 - Recognition is impacted by management’s plans and intentions (i.e. held for sale, or held and used)

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Applicability

- Any financial statement prepared in accordance with Generally Accepted Accounting Principals (GAAP)
 - Requirement is defined in ASC 360, formerly SFAS 144

When evaluated

- A long-lived asset (asset group) shall be tested for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable

Real Estate Indicators

- Cash flows are insufficient to meet debt service
- Inability to obtain additional financing
- Current occupancy is too low to fully recover the properties carrying amount
- The intended use of the asset has changed
- Major tenants are experiencing financial difficulties
- Significant lease is expiring
- Over supply of similar properties in local markets
- Discounts on sales of similar properties
- Other investors have reduced or backed away from commitments
- Demand less than projections

Management's Plans and Intentions

- If impairment indicators are present, the evaluation of impairment depends on management's plans and intentions for the asset
 - Available for sale
 - Held and Use
 - Held for Disposal (other than sale)

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Grouping of assets

- Can assets be grouped for consideration, or should each asset be evaluated individually?
 - Land or projects in development
 - Evaluated on a project by project basis
 - Held and Used
 - Grouped with other assets and liabilities at the "lowest level for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities"
 - Held for Sale or other disposal
 - Evaluated on the disposal group basis

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Real Estate Available for Sale

- Must meet all of the following criteria
 - Management commits to a plan to sell the asset
 - Asset is available for immediate sale subject to customary terms
 - Actions to implement the sale have been initiated and it is unlikely that there will be significant changes to the plan or the plan will be withdrawn
 - Asset's sale is probable and expected to occur within one year
 - Asset is being market at a reasonable price

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Real Estate to be Disposed of by Sale

- Evaluation of impairment:
 - Should be reported at the lower of net book value or fair value less selling costs
 - Selling costs include only the incremental costs to sell the property such as:
 - Sales commissions
 - Legal and transfer fees
 - Other closing costs
 - Holding costs other than selling costs are not considered

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Real Estate to be Disposed of by Sale

- Recognition of impairment
 - If carrying value exceeds fair value less selling costs, record a valuation allowance and impairment loss for the excess
 - In subsequent periods, adjust the valuation allowance either up or down for subsequent changes to fair value
 - As always, the asset should never be adjusted above historical net book value

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Real Estate to be Held and Used

- Evaluation of impairment
 - The carrying amount of the property should be compared to the total net future cash flows, undiscounted and without debt service, expected to be received from the property
 - If future net undiscounted cash flows are greater than the carrying value of the property no impairment loss is recognized
 - If future undiscounted net cash flows are less than the carrying value of the property, the property is impaired and an impairment loss should be recognized

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Real Estate to be Held and Used

- Measurement and recording of Impairment
 - Impairment loss is equal to the excess of the property's carrying amount over the property's "fair value" and is reported in income from continuing operations
 - Fair Value is defined by ASC 820 (SFAS 157)
 - Impairment is recognized by a direct write down of the property's carrying value. The impaired value becomes the new cost basis and is **not** increased for subsequent increases in fair value
 - Depreciation is calculated on the new cost basis over its remaining estimated life

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Key Terms and Concepts

- Fair Value (defined in SFAS 144)
 - The **price** that would be received to sell an asset or paid to transfer a liability in an **orderly transaction** between **market participants** at the measurement date

****Fair value is a market-based measurement****

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Example

- Book value: \$500,000 (HC \$700,000 – AD \$200,000)
- Fair Value: \$400,000
- Estimated Selling Cost: \$50,000
- Estimated Future Cash Flows: \$600,000

No impairment loss is recorded as undiscounted future cash flows exceed book value (even though fair value is less than book value)

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Example

- Book value \$500,000 (HC \$700,000 – AD \$200,000)
- Fair Value \$400,000
- Est. Selling Cost \$50,000
- Estimated Future Cash Flows \$450,000

An impairment loss of \$100,000 would be recorded, the historical cost of the asset would be reduced by \$300,000 and the prior accumulated depreciation would be eliminated

Estimating Future Cash Flows

- Cash flows include the future cash inflows to be generated from the use and ultimate disposal of the property less the necessary future outflows to obtain them
- Undiscounted and include no debt service
- Based on management's reasonable and supportable estimates
- If a range is estimated for either the amount or timing of cash flows, the likelihood of possible outcomes should be considered, usually through a probability – weighted evaluation (ASC 35-30)

Estimating future cash flows

- There are numerous sources of cash flows to be evaluated including
 - Costs to complete the property
 - Holding costs
 - Operating cash flows
 - Sale of the property
 - Disposition costs

Valuation Techniques

- Market Approach
 - Uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities
- Income Approach
 - Uses valuation techniques to convert future amounts to a single present amount
- Cost Approach
 - Is based on the amount that currently would be required to replace the service capacity of an asset (often referred to as current replacement cost)

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Recognizing Impairment on Equity Method Investments

- Loss in value of investment, which is other than a temporary decline, should be recognized
 - i.e. the Fair Value of the investment is less than the carrying value

Note that a decline in market value, or the existence of operating losses is not necessarily indicative of a loss in value that is other than temporary

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Indicators

- Evidence of a loss could be due to the absence of the ability to recover the investment
- Inability of investee to sustain earnings which would justify the value of the investment

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Issues to Consider

- Investor is to determine impairment of their “investment” not the impairment of the investee’s underlying assets
- Issues may exist at investor level that impact the fair value of the investment differently than the underlying assets
 - Ownership or distribution preferences
 - Buy-Sell rights
 - Liquidation preferences

Key terms and Concepts

- Fair Value (defined in SFAS 144)
 - The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date

Fair value is a market-based measurement

Key terms and Concepts

- Price
 - The amount at which the asset or liability would be exchanged in an orderly transaction between market participants

Key terms and Concepts

- **Orderly Transaction**

- A transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; **it is not a forced transaction**

Key terms and Concepts

- **Principal Market**

- The market in which the reporting entity would sell the asset or transfer the liability with the greatest volume and level of activity for the asset or liability

Key terms and Concepts

- **Market Participants**

- Buyers and sellers in the **principal (or most advantageous) market** for the asset or liability that are:
 - Independent of the reporting entity
 - Knowledgeable, having a reasonable understanding about the asset or liability and the transaction based on all available information
 - Able to transact for the asset or liability
 - Willing to transact for the asset or liability (motivated, but not forced)

Key terms and Concepts

- Most Advantageous Market
 - The market in which the reporting entity would sell the asset or transfer the liability with the price that maximizes the amount that would be received for the asset or minimizes the amount that would be paid to transfer the liability, considering transaction costs in the respective market

Key terms and Concepts

- Highest and Best Use
 - The use of an asset by market participants that would maximize the value of the asset or the group of assets within which the asset would be used

QUESTIONS?
