

The EAct Tax Aspects of the U.S. Military Supply Chain

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Charles Goulding, Raymond Kumar and Jonathan Saltzman discuss how defense contractors can remain viable in the military market by reducing energy costs and taking advantage of the tax incentives available under Code Sec. 179D.

Introduction

Beginning in January of 2013, \$55 billion in military budget cuts are set to take place. These cuts in military spending are only a fraction of the \$487 billion in projected defense spending reductions set to take place over the next 10 years.¹ Of the major defense contractors, almost all but one get over 50 percent of their sales from the U.S. government, Northrop Grumman being the largest at 90 percent.² Defense contractors must adapt to these deficit-reducing measures. These corporations should examine energy-efficiency projects and tax incentives to cut costs and help remain viable in this volatile market.

The Code Sec. 179D EAct Tax Opportunities

Pursuant to Code Sec. 179D, enacted as part of the Energy Policy Act (EAct),³ commercial property owners making qualifying energy-reducing investments in their new or existing locations can

obtain immediate tax deductions of up to \$1.80 per square foot. If the building project doesn't qualify for the maximum Code Sec. 179D \$1.80-per-square-foot immediate tax deduction, there are tax deductions of up to \$0.60 per square foot for each of the three major building subsystems: lighting; heating, ventilating and air conditioning (HVAC); and the building envelope. The building envelope is every item on the building's exterior perimeter that touches the outside world, including roof, walls, insulation, doors, windows and foundation.

Facilities Retrofits

In manufacturing and warehouse facilities, lighting is the largest energy consumer. Defense contractors should first focus on retrofitting federally banned certain metal halide and all T12 lighting fixtures in their facilities and then focus on their most inefficient facilities. With today's energy-efficient lighting, retrofits in warehouse and manufacturing facilities often qualify for the full \$1.80-per-square-foot EAct deductions. Lighting retrofits in these types of facilities are very economically feasible and after considering all rebates and incentives often have paybacks of about two years. Chart 1 demonstrates the total potential EAct incentives for four major defense contractors.

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Chart 1.

Company Name	Facilities Square Footage	Total Potential EAct Deduction
Boeing	84,776,000	\$152,596,800
General Dynamics	52,800,000	\$95,040,000
Northrop Grumman	37,397,000	\$67,314,600
Raytheon	29,430,973	\$52,975,751

Military Embraces EAct

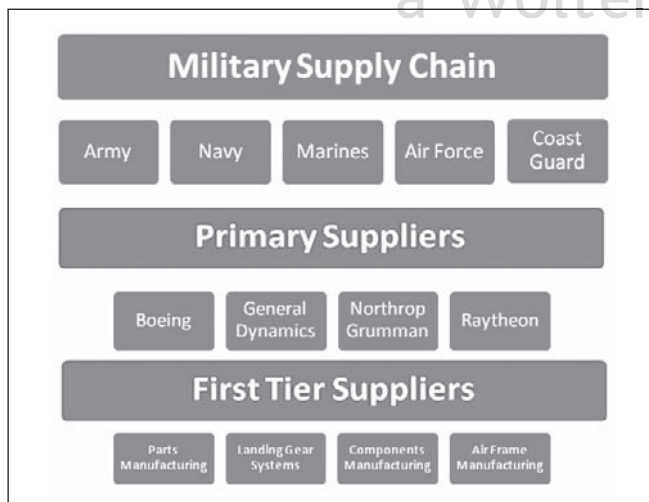
At the top of the defense supply chain is the military themselves, and they have already embraced energy efficiency as a major policy goal. Primary designers of the military’s energy-efficient projects can claim the EAct deductions under the primary designer laws. In this case, the military benefits from the perpetual energy savings, and designers have an incentive to design these energy-efficient projects.

The U.S. Army and Navy have both greatly benefitted from this program and have both developed military protocols to process these deductions in a fair and efficient manner.⁴ In the Army’s case, they currently have an energy-efficiency task force, and these energy-efficient retrofits will help them achieve their energy reduction goals.⁵

Augmenting the Defense Supply Chain

Once defense contractors analyze and retrofit their own facilities they should focus supply chain initiatives to incentivize their suppliers to follow suit. Walmart has enacted an energy-efficiency program for their suppliers.⁶ By sending their employees to audit their suppliers’

Chart 2.



facilities, they were able to cut their suppliers’ and their own costs. With the impending defense spending cuts, the defense contractors should aim to be as efficient as possible in their operations, and that includes utilizing energy-efficient suppliers.

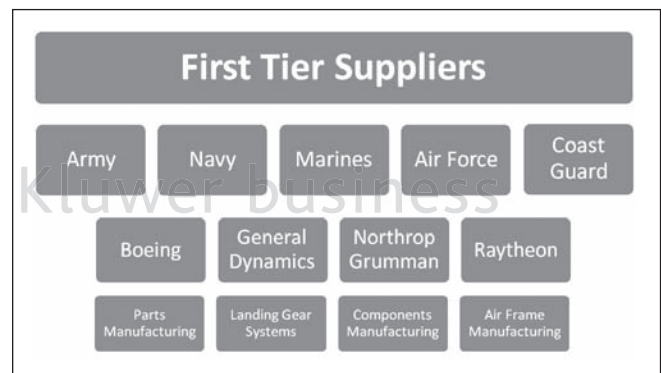
LEED EAct Opportunities

LEED, or Leadership in Energy and Environment Design, is a building standard developed by the U.S. Green Building Council (USGBC).⁷ Buildings built to this standard are, by definition, efficient and often qualify for \$1.20–\$1.80 in EAct deductions. Many defense contractors have LEED buildings in their portfolio. They should certainly evaluate their portfolio and make an effort to capture EAct deductions on their existing and future facilities.⁸

Change of Accounting

Since the enactment of EAct in 2005, defense contractors have most likely completed qualifying retrofits and new constructions. The IRS allows for corporations to submit a Form 3115, *Application for Change in Accounting Method*, to go back and claim previously missed deductions. Defense contractors should evaluate previous completed retrofits; these projects will be a source of “easy money” for the industry and will require minimal work to capture.

Chart 3.



Conclusion

Defense contractors should follow the military’s lead and work on reducing their facilities’ energy costs and operations. Energy-efficiency projects typically have good economic paybacks. A leaner military budget will mean lower revenue for defense contractors so these corporations should consider all opportunities to reduce operating costs.

ENDNOTES

- ¹ Donna Cassata, *Report: Automatic defense cuts undercut Obama plan*, Associated Press, Jun. 7, 2012. Available online at <http://finance.yahoo.com/news/report-automatic-defense-cuts-undercut-obama-plan-203116549.html>.
- ² Nathan Hodge, *Defense Chiefs Signal Job Cuts*, WALL ST. J., Jun. 12, 2012.
- ³ Energy Policy Act of 2005 (P.L. 109-58) (“EPAct”).
- ⁴ U.S. Army Corps of Engineers—Engineering and Construction Bulletin, Issue No. 2011-8. NAVFAC—Engineering & Construction Bulletin, Issue No. 2012-04.
- ⁵ Press Release, *Huntsville Center Requests Comments on Draft Request for Proposal Related to Energy Contracts*, Feb. 24, 2012. Available online at www.prnewswire.com/news-releases/huntsville-center-requests-comments-on-draft-request-for-proposal-related-to-energy-contracts-140338293.html.
- ⁶ Charles Goulding, Jacob Goldman and Christopher Winslow, *The EPAct and Alternative Energy Tax Aspects of Walmart’s Supplier Sustainability Program*, CORP. BUS. TAX’N MONTHLY, Jun. 2011, at 13.
- ⁷ Available online at www.usgbc.org/DisplayPage.aspx?CMSPageID=1988.
- ⁸ Charles Goulding, Jacob Goldman and Daniel Audette, *Advanced LEED Building Energy Tax Planning*, CORP. BUS. TAX’N MONTHLY, Dec. 2011, at 9.



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