

The Energy Tax Aspects of Discount Retail Stores

By Charles Goulding, Jacob Goldman and Joseph Most

Charles Goulding, Jacob Goldman and Joseph Most discuss how discount retailers can use the EAct and Code Sec. 179D to save energy costs on their retail units and reduce taxes.

The discount retail sector has been experiencing rapid growth that has actually accelerated during the economic downturn. In many shopping centers, discount retailers have assumed the critical anchor store role, as neighborhood supermarkets have been replaced by larger, stand-alone big-box retailers. By stepping into the available anchor store position during a weak commercial real estate market, discount retailers have the market leverage to obtain very favorable lease terms. After they secure the store space at reduced prices, discount retailers also have the leverage to use their increasing scale to obtain volume pricing for lighting and HVAC upgrades to obtain substantial reductions in energy operating costs. With proper tax planning major tax incentives are available to further support these already desirable objectives.

The EAct Tax Opportunity

Pursuant to the Energy Policy Act ("EAct"), which enacted Code Sec. 179D,¹ discount retail store owners or tenants making qualifying energy-reducing investments can obtain immediate tax deductions of up to \$1.80 per square foot. If the building project doesn't

qualify for the maximum \$1.80-per-square-foot immediate tax deduction, there are tax deductions of up to 60 cents per square foot for each of the three major building subsystems: lighting, HVAC and the building envelope.²

Chart 1 illustrates the potential total EAct tax deduction for several prominent discount retail chains.

Discount Retail Store Tax Planning

Lighting

Building lighting comprises a large portion of retail store energy use. Most retail stores that have not had a lighting upgrade to energy-efficient lighting in the last seven or eight years use prior-generation metal halide or T-12 fluorescent lighting. It is also important to realize that effective January 1, 2009, most probe-start metal halide lighting may no longer be manufactured or imported into the United States; and, effective July 1, 2010, most T-12 lighting may no longer be manufactured or imported into the United States. This means that retail stores that still have this lighting technology will soon be subject to large price increases for replacement lamps and bulbs.

This prior generation T-12 and metal halide lighting is very energy inefficient compared to today's LED lighting, and a lighting retrofit can easily reduce lighting electricity costs by 40 to 60 percent. Chart 2 shows when EAct tax savings are applicable for typical discount retail store spaces.

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Chart 1

Small Footprint Discount Retail Chains Potential Energy Efficiency EAct Tax Deductions							
Chain	Stores	Gross Square Footage	Lighting		HVAC Maximum Deduction	Building Envelope Maximum Deduction	Total
			Minimum Deduction	Maximum Deduction			
Dollar General ¹	8,877	63,026,700	\$18,908,010	\$37,816,020	\$37,816,020	\$37,816,020	\$113,448,060
Family Dollar	6,664	56,700,000	\$17,010,000	\$34,020,000	\$34,020,000	\$34,020,000	\$102,060,000
Dollar Tree	3,806	41,100,000	\$12,330,000	\$24,660,000	\$24,660,000	\$24,660,000	\$ 73,980,000
Aldi ²	1,100	18,260,000	\$ 5,478,000	\$10,956,000	\$10,956,000	\$10,956,000	\$ 32,868,000
99 Cents Only	275	5,857,500	\$ 1,757,250	\$ 3,514,500	\$ 3,514,500	\$ 3,514,500	\$ 10,543,500

Notes:
¹ store square footage based on average store size of 7,100 square feet
² store square footage based on average store size of 16,600 square feet

Chart 2

Retail Store Space	25% Improvement as compared to 2001 Standard \$0.30/sq.ft. Deduction Watts/sq.ft.	40% Improvement as compared to 2001 Standard \$0.60/sq.ft. Deduction Watts/sq.ft.
	Retail Sales Area	1.575
Restaurant-Dining	1.650	1.32
Mall Concourse	1.350	1.08
Corridors	0.525	0.42
Restrooms	0.750	0.60
Food Prep	1.650	1.32
Enclosed Office	1.125	0.90
Electrical/Mechanical	0.975	0.78
Storage	0.825	0.66
Stairways	0.675	0.54

Chart 3

Discount Retail Chains Distribution Centers Potential Energy Efficiency EAct Tax Deductions						
Chain	Gross Square Footage	Lighting		HVAC Maximum Deduction	Building Envelope Maximum Deduction	Total
		Minimum Deduction	Maximum Deduction			
Dollar General	9,630,000	\$2,889,000	\$5,778,000	\$5,778,000	\$5,778,000	\$17,334,000
Dollar Tree	5,872,000	\$1,761,600	\$3,523,200	\$3,523,200	\$3,523,200	\$10,569,600
Family Dollar	900,000	\$ 270,000	\$ 540,000	\$ 540,000	\$ 540,000	\$ 1,620,000

It is widely presumed that virtually all buildings will eventually be converting to LED lighting. Many multi-location retailers are beginning the conversion now. Discount store facility managers should consider testing alternative LED lighting solutions at this time. For example, one retailer with over 800 locations recently tried LED applications in 10 beta locations before upgrading all locations. The best economic payback will come from those locations with high electricity rates and large util-

ity rebates. For example, Connecticut is offering 50-percent rebates for the installed costs of LED and induction lighting.

HVAC

Discount retailers should take their most efficient store, combining the LED lighting discussed above and the most efficient HVAC, and have it modeled using IRS-approved software to see if

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of an obligation, outstanding on March 18, 2012, subject to an exception for obligations that have been materially modified after March 18, 2012. For this purpose, an obligation is defined as any "legal agreement that produces or could produce withholding payments," but does not include any instrument treated as equity under U.S. tax law or any legal agreement that lacks a definitive expiration or term.

Proposed Regulations Planned

The IRS will issue proposed regulations incorporating the guidance in the Notice and will publish a draft FFI agreement and draft information reporting and certification forms.

ENDNOTES

- ¹ Hiring Incentives to Restore Employment Act (P.L. 111-147).
- ² Notice 2010-60, IRB 2010-37, August 27, 2010.

Discount Retail Stores

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it qualifies for multiple EAct tax deductions. With this approach, they could plan for \$1.20- to \$1.80-per-square-foot EAct tax deductions for every store retrofitted to that energy-efficiency level or better on or before December 31, 2013. If they have any existing LEED (Leadership in Energy and Environmental Design) stores, they already have a store that has an energy-simulation model, and it could quickly be evaluated to see if multiple EAct tax deductions are in the offing. For

example, Family Dollar has a LEED-certified store in Spartanburg, South Carolina, and Aldi has one in Ann Arbor, Michigan. This gives these organizations an advantage. These companies should first determine whether existing LEED models already qualify them for tax savings.

Distribution Center Tax Savings

Discount retail chains can also obtain large immediate EAct tax deductions by retrofitting their distribution centers and warehouses. In addition to retrofitting lighting, installing new energy-efficient Cambridge heating systems can provide energy cost savings of eight percent or more over the ASHRAE 2001 building code standards. There are multiple heater technologies suitable for the distribution center market, including direct-fired gas heaters, unit heaters and infrared (radiant) heaters. If feasible, the heater should be mounted on an exterior wall to optimize the roof top solar P.V. space. As can be seen by the Chart 3, some of the retailers mentioned have very large amounts of distribution center space that are potential candidates for EAct deductions

Conclusion

Discount retailers have become a very important property category that has recently experienced a large increase in store units. Even though the sector has enjoyed a period of success and growth during the recent economic downturn, building managers and owners need to closely manage all costs including energy cost

and maintenance costs. Energy-reduction investments are a great way to keep costs down in the long-term, while receiving immediate tax deductions in the short-term. Installing energy-efficient equipment, combined with the appropriate tax planning, will be a key for continued success in the discount retail sector.

ENDNOTES

- ¹ Energy Policy Act of 2005 (P.L. 109-58).
- ² 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.

Drug Stores

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Sometimes the forgotten EAct tax deduction opportunity, improvements to the building envelope, can contribute in large ways to receiving full \$1.80-per-square-foot EAct tax deductions.

LEED Certified Stores

Any drug store chain with at least one existing LEED (Leadership in Energy and Environmental Design) store already has an energy-simulation model. Drug store owners can quickly evaluate the store to see if multiple EAct tax deductions are in the offing. For example, Walgreen's has LEED stores in Mira Mesa, Calif. and in Chicago, and has four more LEED projects in the process.⁹ CVS has a LEED store in La Quinta, Calif.¹⁰ Rite Aid uses architecture and engineering firms with LEED accredited staff.¹¹ This gives these organizations an advantage. These companies should first determine whether existing LEED models can be converted to EAct models that already qualify them for tax savings. One planning