

The Tax Aspects of the Baxter International Medical Device Sustainability Supply Chain

By Charles R. Goulding, Jennifer Pariante and Charles G. Goulding

Charles R. Goulding, Jennifer Pariante and Charles G. Goulding describe Baxter's Sustainability Supply Chain environmental program and its attendant economic and tax benefits.

Baxter International (Baxter), the global medical device company, is one of the few companies that quantifies current and long-term economic fast return from environmental initiatives and provides an annual Environmental Financial Statement. The April 2012 issue of the CPA JOURNAL has a comprehensive, accounting reporting cover story on *Integrating Sustainability into the Reporting Process and Elsewhere: Obstacles and Best Practices for CPAs*¹ that includes a discussion of the Baxter program.

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This article is designed to describe the accompanying tax aspects of the type of Sustainability Supply Chain environmental program utilized by Baxter.

Code Sec. 179D

Under Code Sec. 179D, as enacted by the Energy Policy Act of 2005 (EPAct),² building owners who make 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 of \$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, HVAC and the building envelope. The building envelope covers every part of the building's exterior perimeter that touches the outside world including roof, walls, insulation, doors, windows and foundation.

Exhibit 1.**Baxter 2010 Environmental Financial Statement**Estimated Environmental Costs, Income, Savings and Cost Avoidance Worldwide¹

Environmental Costs (dollars in millions)	2010	2009	2008	2007
Basic Program				
Corporate Environmental – General and Shared Business Unit Costs ²	\$2.0	\$2.0	\$1.9	\$1.9
Auditor and Attorney Fees	0.6	0.4	0.3	0.4
Energy Professionals and Energy Reduction Programs	1.2	1.2	1.2	1.1
Corporate Environmental – Information Technology	0.4	0.4	0.4	0.3
Business Unit/Regional/Facility Environmental Professionals and Programs	8.3	8.1	7.8	7.3
Pollution Controls – Operation and Maintenance	3.7	3.6	3.4	3.4
Pollution Controls – Depreciation	2.5	3.1	2.4	0.9
Basic Program Total	\$18.7	\$18.8	\$17.4	\$15.3
Remediation, Waste and Other Response (proactive environmental action will minimize these costs)				
Attorney Fees for Cleanup Claims and Notices of Violation	\$0.0	\$0.1	\$0.1	\$0.1
Settlements of Government Claims	0.0	0.0	0.0	0.0
Waste Disposal	7.2	7.9	8.1	8.2
Carbon Offsets ³	0.3	0.2	0.2	0.1
Environmental Fees for Packaging ⁴	0.9	1.0	0.9	0.9
Environmental Fees for Electronic Goods and Batteries	0.1	0.1	0.1	0.1
Remediation/Cleanup – on-site	0.4	0.1	0.2	0.5
Remediation/Cleanup – off-site	0.8	0.4	0.1	0.0
Remediation, Waste and Other Response Total	\$9.7	\$9.8	\$9.7	\$9.9
Total Environmental Costs	\$28.4	\$28.6	\$27.1	\$25.2
Environmental Income, Savings and Cost Avoidance (dollars in millions; see Detail on Income, Savings and Cost Avoidance from 2010 Activities below)				
From Initiatives in Stated Year				
Regulated Waste Disposal	\$1.3	\$(0.5)	\$(0.1)	\$(0.7)
Raw Materials Associated with Regulated Waste ⁵	3.7	(1.1)	(1.5)	(3.1)
Non-hazardous Waste Disposal	0.3	0.3	0.7	0.1
Raw Materials Associated with Non-hazardous Waste ⁶	1.4	2.9	1.7	1.6
Recycling (Income)	5.9	3.5	5.5	4.4
Energy Conservation	(1.5)	5.1	5.7	3.7
Water Conservation	0.4	0.6	0.8	0.6
From Initiatives in Stated Year Total⁷	\$11.5	\$10.8	\$12.8	\$6.6
As a Percentage of Basic Program Costs	61%	57%	74%	43%
Cost Avoidance from Initiatives Started in the Six Years Prior to and Realized in Stated Year⁷	\$82.6	\$97.4	\$106.4	\$79.6
Total Environmental Income, Savings and Cost Avoidance in Stated Year	\$94.1	\$108.2	\$119.2	\$86.2
Detail on Income, Savings and Cost Avoidance from 2010 Activities (dollars in millions)				
	Income and Savings	Cost Avoidance	Total Financial Benefit	
Regulated Waste Disposal Cost Reduction	\$0.9	\$0.4	\$1.3	
Raw Materials Associated with Regulated Waste Cost Reduction	2.9	0.8	3.7	
Non-hazardous Waste Disposal Cost Reduction	(0.3)	0.6	0.3	
Raw Materials Associated with Non-hazardous Waste Cost Reduction	(0.3)	1.7	1.4	
Recycling Income	5.9	0.0	5.9	
Energy Consumption Cost Reduction	(6.9)	5.4	(1.5)	
Water Consumption Cost Reduction	(2.8)	3.2	0.4	
Total	\$(0.5)	\$12.1	\$11.5	
Cost Avoidance Detail from Efforts Initiated in the Six Years Prior to Report Year (dollars in millions)				
	2010	2009	2008	2007
Regulated Waste Disposal	\$0.9	\$0.1	\$0.2	\$0.2
Raw Materials Associated with Regulated Waste	1.2	0.1	(1.3)	0.3
Non-hazardous Waste Disposal	3.2	3.2	4.9	3.3
Raw Materials Associated with Non-hazardous Waste	18.7	24.9	24.2	17.9
Energy Consumption	51.4	62.6	72.3	53.6
Water Consumption	7.3	6.5	6.1	4.3
Total	\$82.6	\$97.4	\$106.4	\$79.6

¹Financial numbers rounded to nearest US\$100,000 to reflect appropriate degree of data accuracy. ²Corporate environmental costs comprise total environmental costs related to operating corporate environmental programs that report into Baxter manufacturing and legal groups. While corporate Environment, Health and Safety (EHS) and certain business unit EHS groups were integrated in 2003, total business unit program costs remain in the Business Unit/Regional/Facility Environmental Professionals and Programs line, as those environmental costs more directly support facility programs. ³Cost of carbon offsets includes expenses associated with purchasing renewable energy certificates, carbon credits purchased through the Chicago Climate Exchange (CCX, now IntercontinentalExchange) and the annual membership fee for that organization. ⁴Following completion of the 1996-2005 packaging-reduction goal, Baxter discontinued tracking program costs and financial savings associated with packaging-reduction initiatives at the corporate level. Baxter may reinstitute this line item in future financial statements. ⁵Reflects change (positive for decrease and negative for increase) for purchases of raw materials due to changes in material use efficiency and associated generation of waste. ⁶In calculating savings and cost avoidance for waste-, energy- and water-reduction activities, it is assumed that production and distribution activities grew proportionately with Baxter's publicly stated cost of goods sold, adjusted for changes in inventory and inflation. Baxter uses a three-year rolling average of the annual percentage change in growth in the cost of goods sold to determine the financial values for each stated year. For 2010, the three-year rolling average was 2%; for 2009, 3%; for 2008, 5%; and for 2007, 3%. This rolling average helps avoid distortions due to certain acquisitions/divestitures and the delayed environmental effects from changes in production. ⁷To be conservative, the accumulation of reported cost avoidance from conservation activities in prior years is terminated after seven years, the approximate duration of many facility conservation and process-improvement projects, after which additional process improvements and changes are possible.

Exhibit 2.

Baxter

Potential EPAct 179D Tax Deductions Available for Energy Efficient Building Improvements

Property	Total Square Footage	Lighting			HVAC		Building Envelope		Total	
		Minimum Deduction	Maximum Deduction	Maximum Deduction	Maximum Deduction	Maximum Deduction	Total			
Marion, NC	1,400,000	\$ 420,000	\$ 840,000	\$ 840,000	\$ 840,000	\$ 840,000	\$ 2,520,000			
Deerfield, IL	1,000,000	\$ 300,000	\$ 600,000	\$ 600,000	\$ 600,000	\$ 600,000	\$ 1,800,000			
Cleveland, Mississippi	900,000	\$ 270,000	\$ 540,000	\$ 540,000	\$ 540,000	\$ 540,000	\$ 1,620,000			
Bloomington, IL	600,000	\$ 180,000	\$ 360,000	\$ 360,000	\$ 360,000	\$ 360,000	\$ 1,080,000			
Los Angeles, CA	269,000	\$ 80,700	\$ 161,400	\$ 161,400	\$ 161,400	\$ 161,400	\$ 484,200			
7 Additional Properties in the U.S. (Approximately 800,000 sq ft each)	5,600,000	\$ 1,680,000	\$ 3,360,000	\$ 3,360,000	\$ 3,360,000	\$ 3,360,000	\$ 10,080,000			
Totals:	9,769,000	\$ 2,930,700	\$ 5,861,400	\$ 5,861,400	\$ 5,861,400	\$ 5,861,400	\$ 17,584,200			

The Baxter Environmental Financial Statement

The complete 2010 Baxter Environmental Financial Statement is presented in Exhibit 1. The statement presents the details for both environmental remediation, energy cost reduction measures and other initiatives for both the current year and six years prior to a report year.

Potential EPAct Benefits for Baxter

Baxter's potential tax benefits from energy efficiency measures are presented in Exhibit 2.

Typical Medical Device Company Energy-Efficiency Measures

Lighting

At the plant and warehouse level, most medical device companies are upgrading prior generation T-12 and metal halide lighting to more energy-efficient fluorescent, or LED lighting. For offices and laboratories, many medical device companies are now upgrading to very low-wattage LED lighting.

By reducing its own energy costs and encouraging its own suppliers to reduce their energy costs, the entire Baxter Supply Chain can support national health care cost reduction.

HVAC

The IRS has just issued a notice making it easier to qualify for HVAC EPAct tax deductions by achieving a 15-percent overall energy-cost reduction down from the previous law's 16-2/3 energy reduction standard.

For non-air-conditioned plant and warehouse spaces, many medical device companies are upgrading to natural gas heaters.³

For their air-conditioned spaces, medical device companies often use

a variety of highly energy-efficient equipment including chillers,⁴ geothermal,⁵ thermal storage,⁶ energy-recovery ventilation and chilled beam.

Baxter Supply Chain Position

A large portion of Baxter's product sales are to hospitals, therefore, Baxter itself is a Tier 1 supplier. Hospitals are also endeavoring to reduce their energy costs and utilizing the EPAct where applicable.⁷ Tier 2 and Tier 3 property owners supplying Baxter would include component supplier companies and packaging companies. Baxter can use its own reporting data to identify energy savings projects eligible for tax savings for itself and for its lower tier suppliers. By reducing its own energy costs and encouraging its own

suppliers to reduce their energy costs, the entire Baxter Supply Chain can support national health care cost reduction. Hopefully, more medical device companies will follow Baxter's lead.

ENDNOTES

¹ Jill D'Aquila, *Integrating Sustainability into the Reporting Process and Elsewhere: Obstacles and Best Practices for CPAs*, CPA JOURNAL, Apr. 2012, at 16. Available online at <http://viewer.zmags.com/publication/f0a1b93d#/f0a1b93d/1>.

- ² Energy Policy Act of 2005 (P.L. 109-58) ("EPAct").
- ³ Charles R. Goulding, Spencer Marr and Taylor Goulding, *Tax Incentives for Combined Heat and Power (CHP)*, CORP. BUS. TAX'N MONTHLY, Nov. 2011, at 9.
- ⁴ Charles R. Goulding, Jacob Goldman and Joseph Most, *The Energy Tax Aspects of Chillers*, CORP. BUS. TAX'N MONTHLY, Oct. 2010, at 15.
- ⁵ Charles R. Goulding, Joseph Most and Spencer Marr, *The Energy Tax Aspects of Geothermal Heat Pumps*, CORP. BUS. TAX'N MONTHLY, Dec. 2010, at 13.
- ⁶ Charles R. Goulding, Jacob Goldman and Taylor Goulding, *The Tax Aspects of Thermal Storage and Time-of-Day Pricing*, CORP. BUS. TAX'N MONTHLY, Nov. 2009, at 13.
- ⁷ Charles R. Goulding, Robert Goulding and Raymond Kumar, *The Energy Tax Aspects of Hospitals*, CORP. BUS. TAX'N MONTHLY, Nov. 2009, at 15.



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