

Capturing the Energy Tax Opportunities in Managed Buildings

By Charles Goulding, Jacob Goldman and Raymond Kumar

Charles Goulding, Jacob Goldman and Raymond Kumar discuss how large real property managers can use tax incentives available to owners and tenants under Code Sec. 179D as a large-scale tax planning opportunity.

The vast majority of large scale commercial real estate in the United States, which totals billions in square feet, is managed by just a few top real estate management companies. When it comes to using federal energy efficiency tax incentives available to building owners, an intermediary real property manager, who is not knowledgeable about energy efficiency initiatives, has historically been a barrier to change. But this problem can easily be converted into a large-scale tax planning opportunity. The opportunity arises once the large real property managers understand the magnitude of the Energy Policy Act of 2005 (EPAAct),¹ tax incentives available to owners and tenants and set their retrofit energy efficiency targets at the Code Sec. 179D tax deduction levels or better.

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Role of Large Real Estate Management Companies

The largest real estate management companies with a major presence in the United States include Cushman & Wakefield, Colliers International, CB Richard Ellis (commonly called CBRE), Jones Lang LaSalle, Trammel Crow and Grubb & Ellis. These six firms each manage well over 100 million square feet of U.S. real estate and collectively manage over 2 billion square feet of U.S. property.

The magnitude of EPAAct tax deductions potentially available to large-scale professionally managed portfolios is presented in Chart 1.

The EPAAct Tax Incentive Opportunity

Pursuant the EPAAct, under Code Sec. 179D, building 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 does not qualify for the maximum \$1.80-per-square-foot immediate tax de-

Chart 1.

Potential EAct Tax Deductions for U.S. Managed Properties					
10,000,000	\$ 3,000,000	\$ 6,000,000	\$ 6,000,000	\$ 6,000,000	\$ 18,000,000
100,000,000	\$ 30,000,000	\$ 60,000,000	\$ 60,000,000	\$ 60,000,000	\$ 180,000,000
200,000,000	\$ 60,000,000	\$ 120,000,000	\$ 120,000,000	\$ 120,000,000	\$ 360,000,000
500,000,000	\$ 150,000,000	\$ 300,000,000	\$ 300,000,000	\$ 300,000,000	\$ 900,000,000

Chart 2.

Building Type	2001 Standard LPD, W/ft2	25% Improvement: Min. Deduction (\$0.30 per sq. ft.)	40% Improvement Max. Deduction (\$0.60 per sq. ft.)
Office	1.3	0.975	0.78
Retail	1.9	1.425	1.14
Parking Garage	0.3	0.225	0.18
Rental Apartments	1.0	0.75	0.60
Warehouse	1.2	50% required reduction to 0.60	

Ventilation and Cooling (HVAC) systems are typically available from installing very efficient HVAC systems and features including chillers, geothermal, thermal storage, energy re-

covery ventilation and chilled beam technologies.³ Chillers are the most common HVAC energy efficient technology used in professionally managed buildings. The list below presents five different potential chiller tax deduction opportunities.

Typical EAct Qualifying Chiller Installations :

- (1) high efficiency chiller included as part of overall energy efficient HVAC system
- (2) high efficiency chiller installed in less than 150,000 square foot building
- (3) high efficiency chiller installed in residential and hotel facilities
- (4) hybrid gas driven/electric chillers that take advantage of demand charges
- (5) chillers in central plant environment

To qualify for the EAct tax deduction for HVAC, a building's system must be modeled using IRS-approved building energy simulation software. The IRS has approved 13 modeling software programs and virtually all of the major HVAC vendors will model a building using the required software, as part of the HVAC equipment sale package.

Real Estate Management Company Standards Setting

Lighting

In the lighting area, it is relatively easy for management companies to establish standards that will provide large tax deductions for building owners.

Large EAct tax deductions become available merely by having the real estate management companies direct the lighting retrofitters and lighting specialists, involved with existing building lighting projects, to install lighting that meets standards taking into account,

- the building owner's lighting energy savings goals;
- local building codes; and
- the EAct tax deduction requirements.

The EAct lighting tax deduction wattage targets for the typical major space categories managed by the large real estate management companies are listed in Chart 2.

HVAC

The large real estate management companies should make sure that property owners benefit from the EAct tax deductions, which for Heating,

LEED Building EAct Tax Deductions

LEED, which stands for Leadership in Energy and Environmental Design, is the fast-growing marquee standard for the certification of environmentally sustainable buildings. The LEED certification system was established by the U.S. Green Building Council (USGBC). There are four certification levels starting at the

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addition, the parent of a wholly owned subsidiary will be deemed to be the seller of Washington real property, when the subsidiary is the transferor to a third party transferee and the subsidiary is dissolved before the real estate excise tax has been paid.

Other Changes

The bill also includes various other changes, including but not limited to the following:

- Effectively nullifies the Washington Supreme Court's ruling in *Puget Sound National Bank*⁸ by limiting the bad debt deduction. Under the new provisions, "bad debts" do not include "debts sold or assigned by the seller to third parties, where the third party is without recourse against the seller...." These provisions apply to refund/credit claims filed with the department after June 30, 2010.
- Repeals the sales/use tax exemptions for bottled water and candy, effective June 1, 2010. The tax, however, does not apply to sales of bottled water dispensed or to be dispensed to patients pursuant to a prescription for use in the cure/treatment of disease or medical condition.

The Washington Department of Taxation has been issued guidance on these changes.

ENDNOTES

¹ *RR Donnelley and Sons Co. v. Arizona Department of Revenue*, Ariz. Ct. App., No. 1 CA-TX 08-0007 (2010).

² *Arizona Dept. of Rev. v. Talley Industries, Inc.*, Ariz. Ct. App., 182 Ariz. 17 (1994).

³ The IHC received all of its royalty income from its parent and, even though it had a nonexclusive licensing agreement, it did not license the use of the trademarks to any other entity.

⁴ *Graphite Metallizing Holding Inc.*, N.Y. Div. of

Tax App., DTA No. 822416 (April 29, 2010).

⁵ Apportionable activities are those activities taxed under: RCW 82.04.255; RCW 82.02.260(3) through (9) and (12); RCW 82.04.280(5); RCW 82.04.286; RCW 82.04.290; RCW 82.02.2907; RCW 82.04.2908; RCW 82.04.263 (limited); and RCW 82.04.260(13) and 82.04.280(1) (limited to advertising).

⁶ *DOT Foods, Inc. v. Washington Dept. of Rev.*, Wash. SCt, 215 P3d 185 (2009).

⁷ *Agrilink Foods, Inc. v. Washington Dept. of Rev.*, Wash. SCt, 103 P3d 1226 (2005).

⁸ *Puget Sound National Bank v. Washington Dept. of Rev.*, Wash. SCt, 868 P2d 127 (1994).

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basic LEED level and proceeding to the higher LEED silver, gold and platinum certification levels, which depend on the number and type of environmentally friendly features incorporated into the building.

LEED certified buildings that use a meaningful number of energy efficiency measures to achieve certification are excellent candidates for large EAct tax deductions.⁴ The major real estate management companies are aggressively pursuing LEED certification for properties that they manage. For example, recent public reports indicate that CBRE, alone, has already helped establish LEED certification for 57 million square feet of commercial properties.

New Building Energy Efficiency Benchmarking Rules

Many of the country's major cities including New York City, Los Angeles and Washington, D.C., where the major property management companies operate, have recently enacted public disclosure benchmarking rules, typically re-

quiring buildings that are 50,000 square feet or larger to report their building energy use over the internet on scheduled dates. This disclosure is intended to inform tenants and make it obvious which properties have been managed to accomplish energy efficiency and which have not. The best business and tax planning strategy is to use EAct tax incentives to retrofit existing systems to achieve higher energy efficiency levels, before the first mandatory disclosure date. Presumably, it will be detrimental to tenant occupancy rates and property values to report an energy inefficient building. Property managers with a high proportion of energy inefficient buildings may put their management contracts at risk.⁵

Conclusion

The large real estate management companies are positioned to help property owners achieve major energy usage and cost reductions and take advantage of the potential large EAct tax deductions. These energy efficiency improvements also help tenants, who in reality pay the energy bills, since these costs are usually allocated to tenants under common commercial lease terms. With some easily established policy changes and standard-setting goals, these opportunities can be readily accomplished as part of the large real estate management companies' normal business and management operations. New public disclosure rules are going to make clear which buildings are energy efficient and which are not. There is no way to hide from the new energy efficiency rules, so property owners and management companies might

as well do all they can to benefit from them.

ENDNOTES

- ¹ Energy Policy Act of 2005 (P.L. 109-58).
- ² Charles Goulding, Jacob Goldman, and Nicole DiMarino, *EPA Act Tax Deductions for Lighting Gain Wider Use*, BUILDING OPERATING MGMT., Jul. 2008, at 68.
- ³ Charles Goulding, Raymond Kumar and Kenneth Wood, *New Efficient HVAC Drives Large Tax Deductions for Buildings*, CORP. BUS. TAX'N MONTHLY, May 2009, at 11. Charles Goulding, Jacob Goldman and Kenneth Wood, *Tax Deductions for HVAC Efficiency*, BUILDING OPERATING MGMT., Apr. 2010, at 58.
- ⁴ Charles Goulding, Taylor Goulding and Amelia Aboff, *How LEED 2009 Expands EPA Act Tax Savings Opportunities* CORP. BUS. TAX'N MONTHLY, Sep. 2009, at 11.
- ⁵ Naomi Millán, *NYC To FMs: Show Us Your Energy Use*, BUILDING OPERATING MGMT., Mar. 2010, at 23.

Hotel Chains

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one and 1/2 inch, and a T-8 lamp is one inch in diameter. Companies with large purchases of T-12 replacement lamps should expect price increases for future replacements. It wasn't until 2005 that the number of T-8s sold exceeded the number of T-12s sold, thus showing that there are still a tremendous number of existing T-12 lamps destined for replacement.

The second mainstay commercial lighting product that was made illegal to manufacture, as of January 1, 2009, is a standard probe-start metal halide fixture. Pursuant to the Energy Independence and Security Act of 2007,⁷ a metal halide lamp fixture with lamps greater than or equal to 150 watts but less than 500 watts must contain,

- a pulse-start metal halide ballast with a minimum ballast efficiency of 88 percent;

- a magnetic-start ballast with a minimum ballast efficiency of 94 percent; or
- a nonpulse state electronic ballast with either,
 - a minimum ballast efficiency of 92 percent for lamp wattages greater than 250 watts, or
 - a minimum ballast efficiency of 90 percent for lamp wattages of 250 watts or less.

There are some exceptions to these rules for certain specialized fixtures.

LEDs MAGAZINE describes the impact of the federal lighting bans in this way:

Legislation banning inefficient lamps, coupled with customer awareness of the cost of ownership analysis, will create a strong demand for replacement LED lamps. Market conditions are right for the LED replacement lamp market to accelerate in the next few years, according to a new report from Strategies Unlimited. Although the market for LED replacement lamps is still in its early stages of development, lamp revenues are forecast to grow at an CAGR [compound annual growth rate] of 107% through 2013.⁸

New Building Energy Efficiency Benchmarking Rules

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to report their building energy use over the internet on scheduled dates. This disclosure is intended to inform tenants and investors and make it obvious which properties have been managed to accomplish energy efficiency and which have not. The best business and tax planning strategy is to use EPA Act tax incentives to retrofit existing fixtures to attain higher efficiency levels, *before* the first mandatory disclosure date. Presumably, it will be detrimental to tenant occupancy rates and property values to report an energy inefficient building.⁹ Acting early on the 3, 2, 1 LED countdown will put property owners in a position to report greater energy savings, when public disclosure is required by major cities during the coming years.

Conclusion

There are many compelling reasons to convert to low wattage LED interior lighting. A massive market shift for lighting products has already begun and most low wattage LED lighting for commercial uses are eligible for large Code Sec. 179D tax deductions. Tax professionals need to work closely with building owners and operators during the next three years to stay on top of the EPA Act 3, 2, 1 tax deduction countdown period, and should keep up with the new energy efficiency technologies and product driven market changes.

ENDNOTES

- ¹ Energy Policy Act of 2005 (P.L. 109-58).
- ² Goulding, Charles, Goulding, Taylor & Kumar, Raymond, *LED Parking Garage Lighting Installations Accelerate with EPA Act Tax Savings*, CORPORATE BUSINESS TAXATION MONTHLY, September 2009, at 15.