

The Energy Tax Savings Opportunity for Renovating Retailers with Vacant Stores

By Charles Goulding, Jacob Goldman and Taylor Goulding

Charles Goulding, Jacob Goldman and Taylor Goulding discuss tax savings under Code Sec. 179D resulting from retail store renovations that yield energy savings.

The severe economic downturn is resulting in record levels of vacant retail space in stand-alone stores, strip malls and mall spaces. Major categories of vacant retail space include general retail, restaurants and banks. Many of these vacant stores will be absorbed by new businesses and other existing retailers.

Regardless of the amount of anticipated renovation, vacant spaces require some level of energy related investment. Electrical, heating, ventilation and air conditioning (HVAC) and roof systems need to be inspected, where it is often determined that repair and/or replacement is required.

It is important for tax departments and facilities managers to work together from the outset to optimize the intersection of recent building energy code and product legal changes, energy savings, utility rebated and tax savings.

The Current Economic Environment

An unprecedented number of large retailers have recently either gone out of business or shut down a

Charles Goulding, an Attorney and Certified Public Accountant, is the President of Energy Tax Savers, Inc., an interdisciplinary tax and engineering firm that specializes in the energy efficient aspects of buildings.

Jacob Goldman is an Engineer and Tax Consultant with Energy Tax Savers, Inc.

Taylor Goulding is an Analyst with Energy Tax Savers, Inc.

large number of stores. What is particularly unusual about this economic downturn is that struggling retailers are finding they are unable to use the first-step bankruptcy restructuring provisions and obtain the so called DIP, or debtor-in-possession, financing, and are instead being forced into complete liquidation.

The result is a large number of vacant retail spaces. As of the end of November, the following store closing counts were available:

Figure 1

Company	Closings	Company	Closings
Ann Taylor	117	Linens & Things	371
Bombay Stores	384	Macy's	9
Boscov's	10	Mervyn's	149
Cache	14	Movie Gallery	378
Catherine's	10	Pep Boys	33
Circuit City	155	Pacific SunWear	154
Club Libby Lu	78	Pier 1	25
Dillard's	20	Sharper Image	96
Disney	98	Sigrid Olsen	54
Eddie Bauer	27	Sprint Nextel	133
Lane Bryant	40	Zales	105
Ethan Allen	12	Starbucks	600
Fashion Bug	100	Steak & Ale	58
Foot Locker	140	Steve & Barry	240
Gap	85	Talbots	100
Home Depot	15	Whitehall Jewelers	373
KB Toys	356	Wilson Leather	158
Levitz Furniture	76		

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Missing from this chart are the well-publicized shut-downs of numerous smaller retailers, over 1,000 car dealerships and numerous consolidating bank branches. It is estimated that at least 6,000 retail locations will close in 2008.

These developments are providing the strong retailers with some unique opportunities to purchase or lease some prime locations.

Review Current Building Energy Code and Product Legal Changes

Substantial renovations normally require compliance with current building energy codes. As a result of major recent technology improvements, current building codes mandate the use of products that use considerably less energy. For example, for some facilities, 2007 building energy code compliance may require a 40-percent energy reduction as compared to 2001 building energy codes. Even if a renovation doesn't legally require current building energy code compliance, it is a good idea to use current code standards as one of the benchmarks for energy savings opportunities. Certain mainstream prior-generation lamp technologies, such as T-12 lighting and various incandescent bulbs, are subject to federally mandated manufacturing phase-out. Although it will still be permissible to buy replacement lamps and bulbs for these fixtures, the prices will be going up as the finite supply of previously manufactured product declines.

The Energy Tax Savings Opportunities

The Emergency Economic Stabilization Act of 2008 (P.L. 110-343), signed by President Bush on October 3, 2008, extended the Code Sec. 179D immediate commercial building deduction for the cost of energy-efficient lighting, HVAC and building envelope for five years through 2013.¹ Renovating retailers may claim the Code Sec. 179D deduction for qualified energy-efficient property placed in service before January 1, 2014.

To qualify for the deduction, the property must be certified by a qualified professional as part of a plan to reduce total annual energy and power costs of the lighting, HVAC and building envelope systems of the building by 50 percent or more when compared to a similar reference building that meets the minimum

specified energy standards described in Standard 90.1-2001 of the American Society of Heating, Refrigerating, and Air Conditioning Engineers and the Illuminating Engineering Society of North America.² The deduction is limited to \$1.80 per square foot and is reduced by the aggregate amount deducted in any prior tax year.³ If the energy-efficient property does not satisfy the 50-percent energy reduction standard, a partial deduction is available for each separate system if it is certified to meet certain energy savings targets provided in IRS guidance.⁴ The partial deduction is limited to 60 cents per square foot.⁵

For purposes of certifying the required energy savings, the qualified professional must use IRS-approved software to calculate the power consumption and energy costs.⁶ The list of IRS approved software to date is as follows:⁷

Figure 2

EnergyPlus	Version 2.2.0.023
	Version 2.1.0.023
	Version 2.0.0.025
	Version 1.4.0.025
	Version 1.3.0.018
DOE-2.1E	Version 119
DOE-2.1E-JH	Version 130
EnergyGauge Summit	Version 3.14
	Version 3.13
	Version 3.11
	Version 3.1
EnerSim	Version 07.11.30
Green Building Studio	Version 3.1
	Version 3.0
Hourly Analysis Program (HAP)	Version 4.34
	Version 4.31
Owens Corning Commercial Energy Calculator (OC-CEC)	Version 4.31
TRACE 700	Version 6.1.2.0
	Version 6.1.1.0
	Version 6.1.0.0
	Version 6.0.2.1
VisualDOE	Version 4.1 build 0002

Lighting

Renovating retailers may claim the Code Sec. 179D 60-cent-per-square-foot immediate tax deduction for energy-efficient lighting. The recommendation

for renovating retailers is to set their lighting standards at the better of local building energy code requirements, local utility rebate requirements or EAct watts-per-square-foot standards. With this approach, the retailer should be positioned to maximize economic return by minimizing electricity energy charges at the lowest after-tax cost.

HVAC & Building Envelope

To minimize energy uses and position themselves for the extended Code Sec. 179D 60-cent-per-square-foot tax deduction for each category, the renovating retailers should have a knowledgeable engineer provide a building simulation model reflecting his or her recommendations, including the new lighting described above. The renovating retailers should direct the engineer to use IRS-approved software, as required under Code Sec. 179D, to be eligible for HVAC and building envelope tax deductions.

Multi-Store Retailers Opportunity

Multi-store retailers can work with an engineering firm to model into the most appropriate energy-efficient store prototype. Once the multi-store retailer establishes a computer model based prototype, that

store design and its Code Sec. 179D tax attributes can become the required standard.

Conclusion

Vacant stores present voluntary and mandatory opportunities for tremendous energy cost reduction and tax savings. . Upgrading to energy-efficient lighting in addition to HVAC and building envelope yields tax savings to renovating retailers by allowing them to claim an immediate deduction of all or part of the upgrading costs under Code Sec. 179D. Tax and financial executives should assist facility managers at the renovation stage by recommending IRS-approved modeling software. The real goal is to reduce energy operating costs, and tax modeling is the tool and tax savings is the reward for doing so.

ENDNOTES

- ¹ Code Sec. 179D(h).
- ² Code Sec. 179D(c).
- ³ Code Sec. 179D(b).
- ⁴ Notice 2006-52, 2006-1 CB 1175, clarified and amplified by Notice 2008-40, I.R.B. 2008-14, 725.
- ⁵ Code Sec. 179D(d)(1).
- ⁶ Code Sec. 179D(d)(3), Notice 2006-52, clarified and amplified by Notice 2008-40.
- ⁷ The list of approved software is maintained by the Department of Energy and is available at http://www1.eere.energy.gov/buildings/qualified_software.html.

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