

## **Tax Opportunities for New York State Warehouse and Industrial Building Natural Gas Heaters**

By Charles Goulding and Spencer Marr

As result of large recent natural gas finds and technology improvements, New York State has immediate access to tremendous volumes of natural gas. In fact, some commentators say that North America's recently identified natural gas reserves make it the "Saudi Arabia" of natural gas. The skyrocketing price of oil coupled with major federal and state tax incentives is causing New York State warehouse and industrial facility to quickly convert existing oil and other non-gas systems to natural gas or upgrade existing gas heating systems to more energy efficient gas heating systems.

### **The EPAct Section 179D Tax Opportunities**

Pursuant to Energy Policy Act (EPAct) Section 179D, commercial property owners in New York state 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 EPAct Section 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, HVAC (heating, ventilating, and air conditioning), 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.

### **Natural Gas Finds in New York**

New York is above the Marcellus Shale natural gas reserve which may contain 490 trillion cubic feet of gas energy. New York also has access to several smaller reserves, making New York one of the leading natural gas sources in the country. The timing couldn't be better. Oil is simply providing too costly and volatile to remain the primary energy source for industrial facilities and warehouses.

If soaring prices on traditional fuel sources weren't enough to motivate policymakers and property owners to consider using natural gas to power building heaters, the recent nuclear crisis in Japan and the BP oil crisis in the Gulf of Mexico have served to embolden natural gas supporters. It is highly likely that over the

course of the next several years there will be a bigger push towards utilizing the tremendous amount of natural gas that has been found in New York, Pennsylvania, and New Jersey especially when one considers the staggering size of the Marcellus find. Federal and state policies are currently aimed at incentivizing commercial property owners to install natural gas heating systems, which are cleaner burning and more efficient. New York's leading utilities, mainly National Grid, LIPA, and Con Edison supply natural gas and they offer a variety of large rebates to encourage these conversions. The Marcellus Shale find is creating a vast supply for these utilities to draw on in providing warehouse and manufacturing facilities cheaper, reliable natural gas for their building heating systems.

### **The New York State Warehouse and Manufacturing Sector**

Among its many economic attributes, New York is a surprisingly strong manufacturing and distribution state. New York State – including upstate New York, New York City (NYC), and Long Island alike – have many large, active warehousing and manufacturing facilities. The state's manufacturing sector includes printing and the production of garments, furs, railroad equipment and bus line vehicles. Many of these industries are concentrated in upstate regions. Albany and the Hudson Valley are major centers of nanotechnology and microchip manufacturing, while the Rochester area is important in photographic equipment and imaging. Despite some decline over the last decade, this manufacturing base still maintains a large presence in upstate New York. As of 2008, a plurality of all workers in that region were employed in manufacturing, and many analysts expect a surge in the manufacturing industry in coming years due to upstate New York's proximity to high-tech New York City firms.

Many of these facilities were built generations ago and are very energy inefficient. Compared to today's technology, manufacturing facility and warehouse owners are converting to gas to obtain substantial cost savings, primarily from existing oil systems or other less efficient heating systems.

Long Island warehouses, along with servicing its own large 2.5 million population, Long Island is a major support area for New York metropolitan area businesses and is also home to, or adjacent to, four airports. The four airports are JFK, LaGuardia, Islip, and Farmingdale. Long Island has a strong warehouse market that is relatively immune to economic cycles supports the airports. As of February 2010, Long Island had a warehouse vacancy rate of only 4.5%, which was the lowest of any major industrial market in the country. Although Long Island warehouse vacancies are low, rental rates have declined and owners need to reduce operating costs to retain tenants and prevent further rent declines. Accordingly, Long Island, with its 6,400 warehouses, is one of the nation's leading warehouse markets.

As a result of lighting product technology changes and abundant natural gas these warehouses are retrofitting to substantially reduce their energy costs.

## **Natural Gas Tax Planning for New York State Commercial Buildings**

The largest energy expense for most non-conditioned warehouse facilities is lighting. However, this fact actually helps building owners who are seeking large natural gas heating deductions. Importantly, the pathway to these large natural gas heater deductions is to first upgrade to energy efficient lighting, which most of these buildings have done or are in the process of doing.

The EPAct tax incentives from combining energy-efficient and natural gas heaters is presented below:

<b>Warehouse Properties Potential EPAct Tax Deductions</b>		
<b>Sample</b>	<b>EPAct Deductions</b>	
<b>Square Footage</b>	<b>\$1.20/sq. ft.</b>	<b>\$1.80/sq. ft.</b>
50,000	\$ 60,000	\$ 90,000
100,000	\$ 120,000	\$ 180,000
250,000	\$ 300,000	\$ 450,000
500,000	\$ 600,000	\$ 900,000
750,000	\$ 900,000	\$ 1,350,000
1,000,000	\$ 1,200,000	\$ 1,800,000

## **IRS Announces 3115 Claw Back Opportunity**

In January of 2011, IRS issued Rev Proc 2011-14 allowing property owned to recover, or claw back, EPAct tax deductions. Commercial buildings that previously upgraded to energy efficient lighting, but were not able to realize tax deductions above \$0.60/square foot even though overall building wattage was brought down the requisite amount, can now use the 3115 procedure in order to recover previously missed tax deductions; or trigger new tax incentives that can be used for roof and building envelope improvements. To obtain the \$1.80/square foot deduction, which requires an overall 50% energy cost reduction, the typical mix is 40% to 42% cost savings from lighting and 8% to 10% from the natural gas heater.

## **Tax Planning**

- 1) The tax planning opportunity is to first make sure that the lighting wattage is reduced to the level that will enable the lighting/heater combination to qualify for multiple EPAct tax deductions.

- 2) If the lighting has already been retrofitted to a qualifying wattage level, the technique is to install the natural gas heater for a current tax deduction and use the form 3115 claw back for the previously missed lighting tax deduction.

### **Conclusion**

Throughout New York industrial and warehouse property owners are moving quickly to capture the large cost savings from natural gas heating systems conversions arising from huge local natural gas finds. Those who already have or concurrently install energy efficient lighting can obtain large tax incentives that greatly improve the economic payback from these conversions.

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