The Tax Aspects of the EPA vs. Texas

By Charles Goulding, Spencer Marr and Taylor Goulding

Charles Goulding, Spencer Marr and Taylor Goulding discuss how businesses in Texas can take advantage of energy-related federal tax incentives, even while the state and the federal EPA battle for regulatory oversight of greenhouse gas emissions.

The federal Environmental Protection Agency (EPA) has locked horns recently with the state of Texas regarding greenhouse gas (GHG) emissions regulation oversight. As this epic power struggle plays out, Texas companies who merely sit on the sidelines risk foregoing major federal tax savings. Specific, energy-related federal tax incentives are currently available for a finite period, so regardless of Texas's state emissions laws, it is important for Texas industries to carefully consider their options while major tax incentives are still available.

Though the current battle is ostensibly about air permitting—specifically whether the state or federal government has the jurisdiction to issue permits—perhaps the greater concern is how Texas firms can best achieve energy and tax savings while getting mixed signals from the state and federal government. A late January ruling by District Court Judge Paul Friedman declined to extend the EPA's timeframe for resetting emissions regulations to reflect the outcry from industry representatives who viewed the original regulations as overly burdensome.[1] Friedman's decision is sure to please environmentalists, but is just as sure to invite further litigation. Fortunately, the opportunities to make substantial energy efficiency improvements in Texas are tremendous because of its access to natural resources and climate conditions. It may well behoove Texas companies to invest in multiple tax-supported solutions available to reduce emissions so that they can realize tax and energy savings while becoming a national leader in efficiency, even if state policies don't match federal ones.

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Air Permits

Air permits have been around since the creation of the Clean Air Act in 1963, but gained significant prominence after amendments to that act in 1990, as they represent the EPA's ability to limit a building owner's right to emit or discharge a specific volume of specified pollutants.[2] Before 2007, it was unclear whether the federal EPA had the jurisdiction to cap greenhouse gas emissions in addition to other particulates, but a Supreme Court ruling in that year held that GHGs fall within the purview of the EPA's air permitting.[3] Following that case, the federal EPA issued guidelines that were meant to serve as backstops for each state's own permitting standards; while 13 states have objected to the guidelines proffered by the federal EPA, Texas is the only one to have outright refused to comply.

The result is that the Lone Star State is the only place nationwide where factories and electricity-generating plants that emit substantial greenhouse gases can't apply for the necessary permits to make modifications or begin new construction. All this because Texas argues that the U.S. EPA's new rules for power plants, refineries and other large industrial facilities will "deprive Texas of its right to manage its air resources."[4]

While the concern in Texas is that the EPA's decision to sidestep the ordinary air permitting procedure—in which it is up to each state to issue permits that comply with the federal EPA guidelines at minimum—by issuing federal permits directly to Texas businesses "will create gale-force headwinds for growth in a state that is the U.S. energy capital,"[5] the truth is far less grim. Air permits that govern the type and quantity of GHG emissions large power and industrial projects can produce are only one factor that Texas companies may need to consider, and since electrical power plants are some of the largest emitters around, there is much to gain and little to lose by forging ahead with building retrofits and renewable energy installations.

Code Sec. 179D Tax Deductions

Code Sec. 179D, as enacted by the Energy Policy Act of 2005 (EPAct) allows Texas building owners making qualifying energy-reducing investments in their new or existing locations to obtain immediate tax deductions of up to $1.80 per square foot.

If the building project doesn't qualify for the maximum EPAct $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, heating, ventilating and air conditioning (HVAC) 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.

Alternative Energy Tax Credits and Grants

There are multiple 30-percent or 10-percent tax credits available for a variety of alternative energy measures with varying credit termination dates. For example the 30-percent solar tax credit expires January 1, 2017, and the 10-percent Combined Power tax credit also expires January 1, 2017. The 30-percent closed loop and open loop biomass credit expires January 1, 2014.

All alternative measures that are eligible for the 30-percent and 10-percent tax credits are also eligible for equivalent cash grants for the three years staring January 1, 2009 and ending December 31, 2011.

Unique 2011 Opportunity: Enhanced Bonus Tax Depreciation

Pursuant to the American Recovery and Reinvestment Act of 2009,[6] there are 10- to 30-percent tax credits available to buildings owners who install solar or wind-powered systems through January 1, 2017. These credits are ordinarily eligible for a five-year MACRS depreciation, but building owners who install these renewable energy systems after September 8, 2010, through December 31, 2011, can take the 100-percent depreciation tax bonus immediately. Even if building owners miss this 2011 window, they can enjoy a 50-percent tax depreciation bonus on equipment placed in service from January 1, 2011, through December 31, 2012.

Texas: A Booming State

The Texas economy is projected to increase by 2.6 percent in fiscal 2011 compared to the previous year, then by 2.8 percent in fiscal 2012 and 3.4 percent in fiscal 2013.[7] Texas has proven resilient in the face of economic turmoil around the rest of the country,[8] and for good reason: the state has a large energy sector, abundant natural resources and an ideal climate to support the transition to an efficient energy infrastructure.

The state's population has grown in recent years to mirror its economy. In fact, according to the initial data from the 2010 U.S. Census, of all the states, Texas saw the greatest increase in population over the past decade.[9] The state's economy gained 194,400 jobs from November 2009 to November 2010, an annual growth rate of 1.9 percent.[10] This surge presents an even greater need for a change in energy infrastructure, which is both a challenge and an opportunity. More people mean more of a strain is being placed on energy resources, but, as Texas leads the nation in being home to 57 Fortune 500 companies,[11] it has the unique capacity to act in a big way immediately. Nationally, many companies endeavor to upgrade their corporate headquarters to Leadership in Energy and Environmental Design (LEED) status, which means that Texas has the opportunity to also take the first position with the number of LEED headquarters.[12]

Texas Alternative Energy Opportunities

Population growth, combined with the fact that the Texas economy continues to outperform the U.S.

economy in the current recovery, means incrementally more needs to be done to meet the state's energy needs. In Texas, there are specifically three major emissions producers, namely utilities, refineries and industrial facilities. There are also three tax-supported alternative energy technologies that Texans can advantageously implement, namely solar, wind and biomass.

Utilities are quite familiar with the available emission reduction solutions and can use a variety of special tax incentives, some tailored for their industry to implement the necessary solutions. For example, utilities can now take advantage of the 30-percent tax credit for large-scale wind and solar PV installations at customer locations. These transactions help both the utility and the customer. The utility meets some of federal air permitting obligations and the customer locks in lower than market electricity cost for an extended time period.

Coal fired utilities are one of the biggest emissions generators. As a solution to reduce coal plant carbon dioxide emissions, a company can replace coal with less emission-intensive fuel sources. To that end, Texas Lt. Gov. David Dewhurst says he's drafting a plan to encourage utilities to shut down their dirtiest coal-fired power plants and replace them with facilities powered by natural gas.[13] Dewhurst said he would propose financial and regulatory incentives to get utilities to use more gas, a cleaner-burning fuel. But natural gas isn't the only new source gaining momentum amongst Texas utilities; starting a few years ago, Texas embarked on the transmission line project, known as Competitive Renewable Energy Zones, and work is currently being done to install a reliable transmission system to connect West Texas's wind farms with Texas's large cities.

One famous Texas Brand, Frito Lay, has been an early player in energy efficiency. As early as 1999, they began using natural gas to power their plant in Rosenberg, Texas, but in more recent years, they have adopted creative energy technologies to power their industrial processes. For instance, they installed the first "oven heat recovery" system at their plant in San Antonio. Some of the exhaust heat from Frito Lay's ovens is used in their fryers while other heat is used to heat their buildings.[14]

Solar

Texas is a sun-intensive state. It experiences an average of nearly 250 days of sunlight per year.[15] All this daylight translates into energy.

One of the first steps of solar tax planning is to analyze a building's current energy use to prepare the solar project economic payback proposal. A building should be made as energy efficient as possible before installing solar P.V., otherwise the extra electricity being generated by the P.V. system is simply being wasted and the amount of extra electricity available to sell into the grid for an enhanced economic return will be diminished.

The most direct path to building energy reduction is to install an energy-efficient lighting system and an energy-efficient HVAC system[16] while using the Code Sec. 179D EPAct benefits described above.

Wind

There are also large regions of open plains in Texas's rural areas. In fact, Texas already lays claim to the most wind power generated of any U.S. state, with 9,410 megawatts. The state has pledged to add 5,000 new megawatts of wind power by 2015, and, in 2006, Governor Rick Perry partnered with private investors to commit more than $10 billion in new wind energy infrastructure.[17]

Biomass

Valero, a large oil refiner headquartered in San Antonio, has recently committed $50 million towards upgrading its facilities in Michigan to become a cellulosic refinery.[18] While this plant is not in Texas, Valero has multiple refineries in Texas that may benefit from this initiative. Biomass refinery is also a candidate for alternative energy tax credits or cash grants.

Nothing to Lose

Texas is not the only state currently making news about emissions. Massachusetts and California have made national headlines for their recently issued comprehensive plans to cut GHG emissions. Ian Bowles, the Massachusetts Secretary of Energy and Environment, has thrown down the gauntlet challenging the naysayers by saying that, "people who have studied this find you can get your first 20-30 percent of greenhouse gas cuts without making significant economic trade-offs."[19] In then describing the Massachusetts plan, he continued that it "puts the lie to the Chicken Little-oriented debate on the national scene [that equates reduction of emissions with job loss and economic disruption]." Massachusetts and the EPA are following the global trend and steadily seeking to curtail GHG emissions. Massachusetts companies have variety of tax incentives they can use to help manage the process.[20]

In California, America's other big energy state, the government has been tasked with similar energy reduction targets. On the one hand, California enjoyed the comparable advantage of having pre-existing building energy codes on which it could piggyback GHG emissions and energy-efficiency measures.[21] This is tougher for Texas, which is being asked to play catch-up without laws that are already receptive to efficiency measures. However, Texas enjoys access to natural resources and climate that suits it perfectly for GHG emissions reductions as well as overall energy reductions while at the same time experiencing a much more robust state economy than California. And there's always something to be said to the "Bigger in Texas" mentality—they can get things done when they put their minds to it.

Complimentary Texas Incentives

Texas industries that are trying to remain ahead of the curve have placed great emphasis on reducing emissions for the transportation sector. For instance, in Houston, Walgreens has installed electric car battery charging stations as part of the company's larger initiative to "go green."[22]

Austin was one of the first movers on a major Smart Grid project. The city's smart-grid project is aimed at figuring out how to make the electricity grid work as homeowners begin to put huge numbers of solar panels on rooftops. "The goal of the Pecan Street Project is to provide one power plant's worth of clean, renewable energy, and to produce it within the city of Austin,"[23] said Brewster McCracken, the city's mayor *pro tem*, at a press conference during a clean-energy summit in the city. Ultimately, the project will prove to significantly reduce emissions. Austin is also one of the first five major jurisdictions to mandate the benchmark reporting of building energy use.[24] Austin is considered one of the nation's most creative cities and is a launching point for many car manufacturers' first electric vehicles.[25]

Conclusion

Texas companies confront GHG emissions uncertainty while the EPA and the state battle it out. This will work itself out in the federal courts. Meanwhile, major federal tax incentives are available to all building owners who retrofit their property with efficient lighting, HVAC or other energy-saving technologies, such as the installation of wind, solar or biomass energy facilities. Prudent companies will want to act on the currently available tax incentives.

Endnotes

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Intangible Property

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10 *In re Welty*, DC-BC-WY, No. 97-21243 (1998) (determining whether the debtor's LLC interest was exempt and stating that "[a]n equity ownership interest in a limited liability company is intangible personal property")

11 Reg. §§301.7701-1, 301.7701-2 and 301.7701-3.

12 *S.J. Pierre*, 133 TC 24, Dec. 57,910*supplemented*, 99 TCM 1436, Dec. 58,217(M), TC Memo. 2010-106.

13 *Id.* 133 TC at 35.

14 *Id.*

15 However, as further support for the *Pierre* holding, in e-mailed advice sent March 11, 2011 the IRS has confirmed that it cannot levy on the property of a disregarded LLC to satisfy its sole member's tax liability.

Service Arrangements

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ENDNOTES

1 Guidelines 7.1–7.42.
2 Guidelines 1.9.
3 Guidelines 7.1.
4 Guidelines 7.2.
5 Guidelines 7.3.
6 Guidelines 7.4.
7 Guidelines 7.5.
8 Guidelines 7.6.
9 Guidelines 7.7.
10 Guidelines 7.8.
11 Guidelines 7.9.
12 Guidelines 7.10.
13 *Supra* note 8.
14 *Supra* note 12.
15 Guidelines 7.11.
16 Guidelines 7.12.
17 Guidelines 7.13.
18 Guidelines 7.14.
19 Guidelines 7.15.
20 Guidelines 7.16.
21 Guidelines 7.17.
22 Guidelines 7.18.
23 Guidelines 7.19.
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25 Guidelines 7.21.
26 Guidelines 7.22.
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28 Guidelines 7.24.
29 Guidelines 7.29.
30 Guidelines 7.25.
31 Guidelines 2.134–2.139.
32 Guidelines 8.19.
33 *Supra* note 30.
34 Guidelines 7.26.
35 Guidelines 7.27.
36 Guidelines 7.16 and 7.17.
37 Guidelines 7.28.
38 Guidelines 7.29.
39 Guidelines 7.30.
40 Guidelines 7.31.
41 Guidelines 2.1–2.11.
42 Guidelines 2.4.
43 *Supra* note 40.
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49 Guidelines 1.60; Guidelines 1.62.
50 Guidelines 7.34.
51 Guidelines 7.35.
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53 Guidelines 7.37.
54 Guidelines 7.38.
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56 Guidelines 7.40.
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60 *Supra* note 56.
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63 *Supra* note 2.
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