



## Implementation of the 179D Special Rule by Government Entities

### Background:

It has been reported that more than 90% of 179D-qualifying projects have failed to use the deduction since its inception. The US Energy Information Administration reported a *decrease* in the use of the deduction from \$168million in FY2007 to \$50 million in FY2010. While fairly straight forward for commercial entities, the 2005 Energy Policy Act created the 179D deduction with a Special Rule that allows Government Entities to transfer a tax deduction of up to \$1.80/sq ft to tax-paying 'Designer' entities from qualifying lighting/HVAC/and envelope retrofit and new construction projects placed in service between January 1, 2006 and December 31, 2014. IRS guidance on the incentives covers the engineering 3<sup>rd</sup> party certification by a qualified individual using DOE-approved software to model energy use vs. the ASHRAE 90.1-2001 Standard. What is wholly lacking from this guidance is the related valuation and accounting of the transfer. This has resulted in the deduction being virtually unused in the public realm.

Efficiency Energy seeks to provide a complete solution to the Government Entity's needs in managing the 179D incentive and increase the use of the program. Our success in aiding government clients establish 179D policies and generate interest and buy-in by Designers has produced a win-win model that maximizes the benefit's value to its stakeholders to defray cost, expand scope and/or provide rebates or savings to the governmental entity owners of qualifying systems. The result is an open book method that properly accounts for and negotiates value, is flexible enough to accommodate various public oversight policies and procedures, and will incentivize more effective investment of taxpayer funds in a similar manner as it does in the commercial realm.

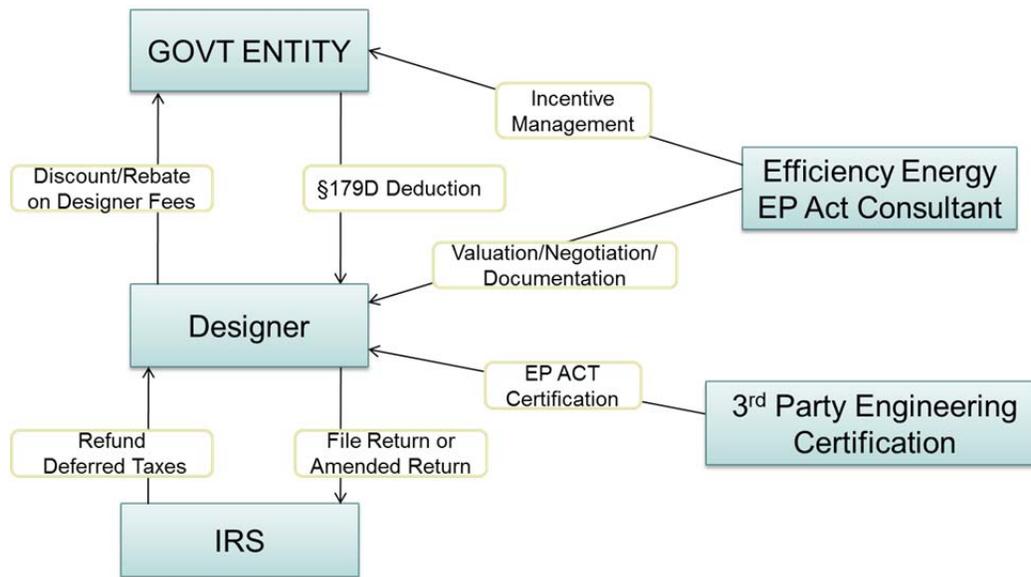
Commercial owners of qualifying projects take the 179D deduction during the year in which a project is placed in service, the reduced tax liability increases project ROI, hastens payback period and helps to defray the project cost. Government Entities do not pay taxes and in order to similarly benefit *may* allocate the benefit to a tax paying Designer. One question in particular arises as to 'ownership' of the deduction and/or how to 'split' the benefit between multiple stakeholders? Simple tax accounting and open-book procedures can result in a transparent transaction that provides public and private benefit.

While future projects may include language to 'level the field' for all Designers, the 179D deduction was not contemplated in the original agreements and many times needs to be contracted for via a new agreement. A simple analogy is the disposition of an unused asset. If the government entity wishes to dispose of an asset they receive the market value of that asset in cash or perhaps exchange it for an asset of equal value. Efficiency Energy formalizes this process via a Transfer Agreement that values the Deduction's tax benefit value, deducts the costs necessary to process the transaction (certification, legal, accounting, data gathering fees), and equitably splits the remainder. This Transfer Agreement details the conditions upon which

the Government Entity will allocate a deduction as well as the conditions upon which the Designer will accept that allocation. It is the government entity's fiduciary duty to manage and account for the value it is allocating in order to more effectively invest taxpayer funds in qualifying projects.

**Process:**

The following chart depicts the various roles and responsibilities required in connection with an assignment of the 179D Depreciation Benefit to a Designer:



In addition to certification and modeling costs, the true cost to allocate a 179D deduction also includes accounting and legal fees associated with the review and integration of the benefit by its stakeholders: the government entity, the vendor/designer, and the certifying entity. These costs may not be directly incurred by the Government Entity but must be accounted for and managed by the EP ACT Coordinator or internal staff in order to maximize the benefit to all parties. The following model is typical of a Transfer Agreement that governs 179D allocation conditions, valuation; and is generally adapted to the particular regulatory, procurement, etc requirements of EE clients:

Area Affected:				500,000	sqft
179D Allocation			x	\$ 1.80	/sqft
Commercial Building Tax Deduction				\$ 900,000.00	*
Design-Builder Tax Rate				35%	Fed + State
Tax Benefit Value				\$ 315,000.00	**
<b>Rebate to GOVT</b>	<b>\$</b>	<b>175,862</b>	<b>Value to DESIGNER</b>	<b>\$</b>	<b>139,138</b>
Less:			Less:		
EP Act Coord Fee	\$	35,172	Cert/Legal/Accounting Fees	\$	(60,000)
			Add: Rebate Deductibility	\$	61,552
<b>Net Value to GOVT</b>	<b>\$</b>	<b>140,690</b>	<b>Net Value to DESIGNER</b>	<b>\$</b>	<b>140,690</b>

An equitable split after all associated costs provides a reference point for negotiations however consideration should be given to project size (project cost relative to project tax benefit value), complexity (#of building systems affected and certified), and Designer (tax entity status, tax appetite, and respective costs).

A standard project format may be used on retroactive and go-forward projects:

- Retroactive program
  - Develop list of projects to be considered
  - Review for potential value and prioritize based on size, common Designer
  - Meet with Designers to educate and determine tax position
  - Develop negotiation strategy based on relative tax position & Government Entity
  - Negotiate with Designers and obtain commitment
  - Coordinate certification services
  - Develop allocation documentation package, affect allocation, exchange of value
  - Close project
  
- Go-forward program
  - Create language for Government Entity to use in bid packages
  - Integrate incentive management with Government Entity project schedule
  - Meeting with selected Designer and their tax preparer and/or counsel
  - Determine wherewithal and appetite of Designer
  - Recommend appropriate language for Designer contract to provide savings
  - Monetization follows approximately same steps as in retroactive program above

While the above described “transfer monetization” approach provides an economic return in many instances, there are situations where it is not economically viable. The approach relies on the Designer having a tax appetite large enough to be offset by the tax write off. The value is also affected by the tax bracket of the Designer as well as tax-entity status. Flow-through entities such as LLCs, LLPs, and Subchapter S Corporations require a reduction in basis that limits the use of the benefit by many small or disadvantaged firms. Finally, complicated ownership structures and situations can complicate retroactive amendments of tax returns. These factors could significantly diminish the value of the incentive and in some instances render the incentive valueless. Furthermore, while the 179D opportunity exists for all projects placed in service January 1, 2006 – December 31, 2014. For retroactive projects, the ability to amend previous year tax returns may be limited to a three (3) year look-back period. Designer ability to amend previous returns will be limited by the date of their earliest open tax period and/or personal tax situations of the owners. Future legislation, regulations, or alternative methodologies may relieve some of the obstacles and improve utilization of the 179D such as increasing value, conversion to a credit, or some other form of market-based monetization. A properly implemented 179D policy provides a structure to deal with a current law that is flexible in order to adopt these changes and ideally benefit from maximized values.

**Resources and Links:**

IRS Notice 2006-52

[http://www.irs.gov/irb/2006-26\\_IRB/ar11.html](http://www.irs.gov/irb/2006-26_IRB/ar11.html)

IRS Notice 2008-40 Amplification of IRS 2006-52

[http://www.irs.gov/irb/2008-14\\_IRB/ar12.html](http://www.irs.gov/irb/2008-14_IRB/ar12.html)

IRS 2012-17 Revision of energy savings targets for partial building system deductions:

<http://www.irs.gov/pub/irs-irbs/irb12-17.pdf>

Legal Position Paper on 179D savings to government entities:

<http://shermanhoward.com/publications/internalrevenuecodesection179dmayprovidefinancialbenefittogovernments/>

US EIA Direct Federal Financial Interventions and Subsidies in Energy in Fiscal Year 2010:

<http://www.eia.gov/analysis/requests/subsidy/pdf/subsidy.pdf>

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