

Save green by going green

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- > **“Green” initiatives**
- > **Section 179D: Energy Efficient Building Deduction**
- > **New Markets Tax Credits**
- > **Federal grants – Section 1603 of the American Recovery and Reinvestment Act of 2009**

“Green” initiatives

- > Related tax-advantaged programs where “green” activities might result in additional federal or state tax benefits
 - Cost segregation
 - Bonus depreciation
 - Energy incentives – e.g., LEED buildings
 - Research tax credits
 - Other federal tax credits and negotiated state incentives

**How important is being
“green” for your
company’s image?**

Section 179D: Energy Efficient Commercial Building Tax Deduction

Financial and nonfinancial benefits of energy-efficient construction



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- > Utility/energy cost savings
- > Local or state utility or fixture rebates and incentives
- > Sustainability conforming to company's image
 - This can be very important in large corporations or certain industries
 - It is often a priority for government-occupied buildings
- > Tenants are more attracted to energy-efficient buildings
- > Federal tax benefit through 179D

**Have you investigated
energy-efficient lighting
for your facility?**

- > Referred to as Energy Efficient Commercial Building Deduction or 179D deduction
- > Derived from the 2005 Energy Policy Act
- > Current-year deduction for energy-efficiency expenses
- > This is a deduction, not a credit
- > Applies to new construction and to remodel or retrofit of existing buildings
- > Three separate systems – maximum of 60 cents per square foot each:
 - Lighting
 - HVAC/hot water
 - Building envelope

Background and qualifications (cont.)



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- > Available for improvements/retrofits placed in service after Dec. 31, 2005, and before Jan. 1, 2014
- > Can file in the current year, file an amended return, or submit a Form 3115
- > Building must meet overall 50% energy-savings threshold as compared to a “reference” building
- > Also applicable to residential rental structures of more than three stories

Background and qualifications (cont.)



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- > Energy-savings measurement based on ASHRAE 90.1-2001 standards
- > Requires certification of savings using IRS-approved software and attestation of contractor or engineer licensed in jurisdiction where property is located
- > Applies to all “conditioned space” of a structure which can include attached or adjacent parking structures but does NOT include parking lot lighting or exterior lighting
- > Deduction is limited to the net cost of energy-efficient property installed (generally adjusted after potential local utility rebates)
- > Lifetime limit of \$1.80 per square foot for any building

Who can claim the deduction?



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- > Building owners
 - Deduction follows depreciation
- > Special provision for government-owned building's "designer" (engineer, contractor, architect, environmental consultant, or energy-services provider)
 - Deduction may be assigned to the "designer" for the taxable year in which the property is placed in service
 - Very attractive benefit to the building designer: "found" money

- > Larger buildings equal greater potential deduction—based on square footage
- > Property owners often unaware of 179D opportunity
- > Lighting is easiest energy-savings threshold to meet, followed by HVAC, with building envelop often the most difficult
- > Parking garage lighting is very good opportunity
- > LEED status is a guide and not a guarantee—some LEED buildings do not meet energy-savings threshold
- > Consulting before costs are incurred can help in planning for the right components

179D example



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- > Client retrofits 300,000-square-foot warehouse with new energy-efficient lighting
- > Installed lighting qualifies for the full 60-cents-per-square-foot deduction, yielding potential \$180,000 179D deduction before adjusted basis modification
- > Cost of materials and installation of new lighting is \$200,000
- > Client applies for and receives \$50,000 in utility rebates
- > Adjusted cost basis of lighting is \$150,000 (\$200,000 cost less \$50,000 in rebates)
- > 179D deduction limited to \$150,000

New Markets Tax Credits

- > Congress passed the Community Renewal Tax Relief Act of 2000
 - Created the New Markets Tax Credit (NMTC) program
 - Encouraged investment in low-income communities (LICs)
 - Designed to generate \$15 billion in new private sector investments in LICs through 2007
 - Extended through 2011
- > The Community Development Financial Institutions (CDFI) Fund, a branch of the Department of the Treasury, administers the program
- > Annual allocations of tax credits are made to community development entities (CDEs) through an application process; the CDEs then have 3 years to put the credits to work in qualified projects

- > Must be a qualified, active, low-income community business (QALICB)
- > Geographic requirements
 - Business located in an LIC
 - > Poverty rate for census tract is at least 20%
 - > Median family income does not exceed 80% of the surrounding area
 - Other factors, such as:
 - > Brownfield
 - > HUD
 - > TIF
 - > Medical
 - Determined using 2000 census tract information

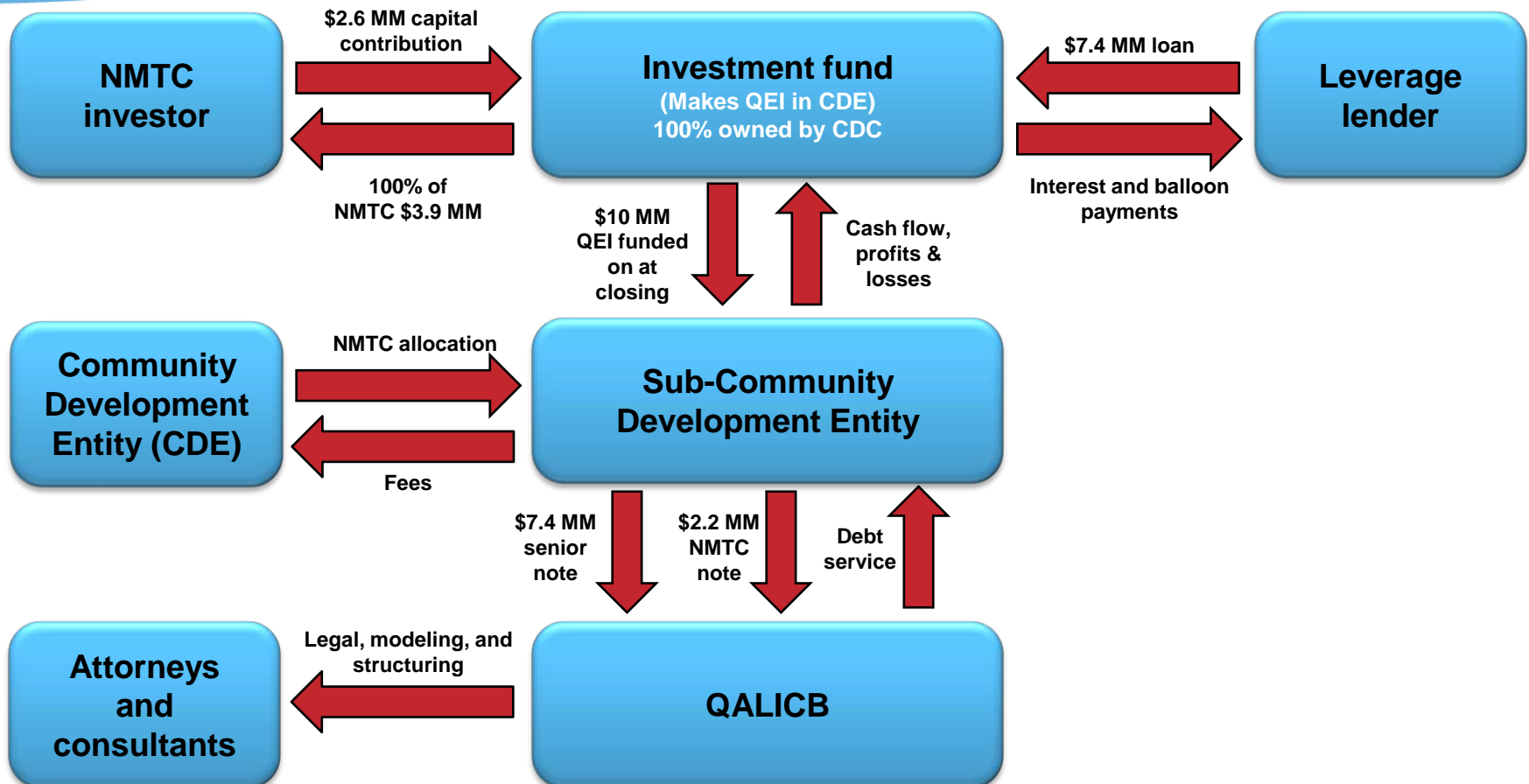
Ineligible activities



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- > Residential rental property (80% or more of income from residential dwelling units)
- > Certain businesses:
 - Race tracks
 - Golf courses
 - Gambling facilities
 - Liquor stores
 - Certain farming businesses
 - Massage businesses

Example: \$10 million NMTC transaction diagram



Note: Assumes credits purchased at \$0.68/\$1 of NMTC received

Example



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Sources and Uses		
	\$10 MM	\$40 MM
Leveraged lender	7,400	29,600
NMTC investor	2,600	10,400
Total sources	<u>10,000</u>	<u>40,000</u>
Project costs	9,200	38,000
Fees and expenses	800	2,000
Total uses	<u>10,000</u>	<u>40,000</u>
Year 7 analysis		
	\$10 MM	\$40 MM
NMTC note	2,200	8,800
Exit fee	(600)	(2,400)
Initial legal and closing costs	(400)	(400)
"Free money"	<u>1,200</u>	<u>6,000</u>
% of transaction	12%	15%

Economic benefit to recipient

- > Additional capital to fund capital projects, expansions or debt refinancing
 - Tax credits are monetized to bring additional capital to the capital structure
- > Low cost of capital
- > Below-market interest rates
- > Flexible loan terms including longer amortization and higher LTV ratios
- > Debt forgiveness
 - At the end of the 7-year compliance period the debt is acquired for cents on the dollar

Community benefit

- > Create additional economic development for the local community
- > Attract and retain skilled workforce
- > Capital investment to underserved LICs

Availability of credits

- > Supply/demand characteristics
- > Scarce resource

Lender requirements

- > 7-year forbearance agreement (the compliance period)
- > No principal amortization for length of NMTC investment
- > In the event of a default, required to re-lend funds to another QALICB for the duration of the compliance period
- > Indirect lien on collateral assignment of LLC interests as compared to direct lien on collateral

Borrower requirements

- > Must be compliant for 7 years with QALICB requirements
- > Personal guarantee on QALICB status often required
- > Additional reporting requirements

Is your organization planning to make, or have you recently made, a capital expenditure of at least \$8 million?

Federal grants – Section 1603 of the American Recovery and Reinvestment Act of 2009

Where are the 1603 projects?



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STATE	GRANT	STATE	GRANT
AZ	\$ 147M	NJ	\$ 166M
CA	656	NY	319
FL	205	OR	352
IL	681	PA	286
IN	346	TX	1,548
MI	346	WA	475
MN	186	WI	9

- > Vast majority is wind and solar
- > \$7.8 billion awarded as of 6/29/11
- > 3,160 projects as of 6/29/11
- > There is no cap on this program

Examples of largest grant projects in their respective states



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Illinois

> Streator – Cayuga Ridge Wind Power, LLC \$170M

Michigan

> Heritage Stoney Corners Wind Farm I, LLC \$ 22

Minnesota

> Elm Creek Wind II, LLC \$ 96

Wisconsin

> Epic Systems – Geothermal Heat Pump \$ 3.4

Awards granted to nonsolar and nonwind projects



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- > Biomass (cellulosic) – six projects, averaging \$17 million
- > Biomass (dairy farms) – 12 projects; largest is in California (\$7.5 million)
- > Landfill gas – five projects, averaging \$1.7 million
- > Trash facilities (MSW) – three in Ohio, averaging \$1.8 million

Example



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Sources and Uses		
	\$40 MM	\$40 MM with 1603
Leveraged lender	29,600	22,200
NMTC investor	10,400	7,800
1603*	-	10,000
Total sources	<u>40,000</u>	<u>40,000</u>
Project costs	38,000	38,400
Fees and expenses	2,000	1,600
Total uses	<u>40,000</u>	<u>40,000</u>
Year 7 analysis		
	\$40 MM	\$40 MM with 1603
NMTC note	8,800	6,600
1603	-	10,000
Exit fee	(2,400)	(1,800)
Initial legal and closing costs	(400)	(400)
"Free money"	<u>6,000</u>	<u>14,400</u>
% of transaction	15%	36%
*Assumes approximately 88% of the project costs are qualified		

- > Start construction by Dec. 31, 2011
- > Obtain DUNS number from Dun & Bradstreet
- > Register with Central Contractor Registration (CCR) at www.ccr.gov/startregistration.aspx
- > Submit application to US Treasury by Oct. 1, 2012 (use estimates if project is not completed) www.treasury.gov/recovery
- > Place property in service before credit termination date:
 - Large wind (Jan. 1, 2013)
 - Biomass, landfill gas, trash, hydropower (Jan. 1, 2014)
 - Solar, fuel cells, microturbines, CHP, geothermal heat pumps (Jan. 1, 2017)

The process (cont.)



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- > Obtain a commissioning report to prove that the property is placed in service
- > If interconnected with a utility, obtain an interconnection agreement
- > Independent CPA to certify detailed breakdown of costs if project exceeds \$500,000
- > Obtain proof that construction started by Dec. 31, 2011
- > Supplemental information must be submitted to US Treasury within 90 days after property has been placed in service
- > US Treasury will review submission and make payment within 60 days

Poll



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**Do you plan on applying
for a 1603 grant?**

Start construction by Dec. 31, 2011

1. Physical work of a significant nature
2. 5% safe harbor

Either test can show that construction has begun; if possible, meet both tests

Physical work of a significant nature (PWSN)



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- > Written report from project engineer or installer is required—this report must include a detailed construction schedule, estimated budget, description of the work that commenced by Dec. 31, 2011, and invoices for that work
- > Report must be from an independent engineer if project's cost is \$1 million or more
 - For example: installing a single foundation for a 50-turbine wind farm can meet this test if construction is “continuous” and completed within a reasonable time
- > This test has nothing to do with dollars
- > Preliminary work such as clearing land, obtaining permits, or installing fencing does not qualify as PWSN

- > Engineering, accounting, banking services may not be PWSN
- > PWSN must occur on eligible property—not work on building and/or transmission tower
- > PWSN can also be met off-site by manufacturer of energy property if binding written contract was entered into before work commenced
 - For example: PWSN can be met if a contractor can show that he started manufacturing the solar panels for the applicant under a written binding contract before Dec. 31, 2011
- > PWSN test can, therefore, be met even if a location for the energy property has not yet been purchased or even identified

- > Independent CPA must attest to the applicant's method of accounting used for federal income tax purposes. That report must state the amount paid by Dec. 31, 2011 (if on cash method), or incurred by Dec. 31, 2011 (if on accrual method). Evidence must be submitted.
- > At least 5% of the total eligible costs must be paid or incurred by Dec. 31, 2011, depending on applicant's accounting method.
- > Treasury has verbally indicated that when a new entity has not filed a tax return yet, the CPA can indicate the accounting method they intend to use.
- > It appears that a cash method applicant can simply make a 5% deposit by Dec. 31, 2011, and meet this test. Any eligible costs would qualify—watch out for land, building, fencing, transmission towers, etc.
- > Who can use the cash method?

5% safe harbor (cont.)



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- > Accrual method applicants must “incur” costs: (1) the fact of the liability is fixed, (2) the amount can be determined with reasonable accuracy, and (3) economic performance test is met (with one exception)
- > Economic performance occurs when property is provided to the applicant if title to the property has passed to the applicant or when it is delivered to or accepted by the applicant. Property that the applicant reasonably expects to be provided within 3½ months of the date of payment will be considered provided on the payment date
 - For example: an accrual method applicant might meet the 5% safe harbor test by making a \$1 million payment on Dec. 31, 2011, for \$1 million of solar panels that they reasonably expect to receive by April 14, 2012, on a total project of \$20 million

5% safe harbor (cont.)



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- > The exception to the economic performance rules allows the applicant to include costs incurred by their contractor or manufacturer if incurred after a binding written contract has been executed on or before Dec. 31, 2011
 - For example: an accrual method applicant enters into a binding written contract with a turbine supplier for 20 wind turbines on Nov. 1, 2011. The turbine supplier orders parts (and makes a deposit) but the parts are not expected until May 2012. The turbine supplier also pays employees to design and plan for their production. Only the employee costs incurred in 2011 by the turbine supplier qualify as incurred by Dec. 31, 2011; the parts do not qualify because they are not provided by Dec. 31, 2011.

- > It appears that a binding written contract is only required when the applicant must look through to the costs incurred by its contractor or supplier under the exception to the economic performance test
- > It does not seem that a binding written contract is needed if the applicant can directly incur costs by Dec. 31, 2011
 - For example, purchasing a \$3 million generator for an agricultural waste anaerobic digester and taking title by Dec. 31, 2011, should qualify a \$60 million project. This would be so even if the generator was manufactured and sitting on the dealer's floor at the time the applicant purchased it.

5% safe harbor observations (cont.)



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- > Just as payment is necessary on the cash method of accounting, it would appear payment is normally not relevant to pass the “incurred” test for an accrual method taxpayer. So, if a dealer was willing to sell and deliver a \$3 million generator with only a \$1 million down, the full \$3 million may have been “incurred” when the generator is delivered to the applicant.
- > Be as conservative as possible—comfortably exceed 5% and take steps to alleviate all doubt.

Questions?

Contact information



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