The Changing Role of Utility Tax Departments

By Charles Goulding, Jacob Goldman and Taylor Goulding

Charles Goulding, Jacob Goldman and Taylor Goulding discuss the expanded role of tax departments in utilities because of changes in federal policy.

Utility tax departments have a much more expanded and important role within their companies than in the past because of new tax provisions involving:

1. commercial energy efficiency,
2. smart grids and smart meters, and
3. the ability to earn substantially more energy tax credits.

Commercial Energy Efficiency Tax Deductions

Utilities have two specific tax opportunities:

- First, they can obtain EPAct Code Sec. 179D commercial building energy tax deductions for their own facilities.
- Second, if companies have efficiency programs for ratepayers, they can integrate the Code Sec. 179D benefits into their own energy efficiency promotion programs.

Pursuant to the Energy Policy Act (EPAct),[1] Code Sec. 179D provides that building owners or tenants making qualifying energy-reducing investments can obtain immediate tax deductions of up to $1.80 per square foot.

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If the building project does not qualify for the maximum $1.80 per square foot immediate tax deduction, there are tax deductions of up to 60 cents per square foot for each of the three major building subsystems: lighting, HVAC, and the building envelope. The building envelope is every item on the building's exterior perimeter that touches the outside world, including the roof, walls, insulation, doors, windows, and foundation.

Using EPAct for Their Own Utility Properties

Utilities are often large organizations with property portfolios that typically include office buildings, auto/truck garage facilities, workshops, power plants, and substations. It is important for utilities to install energy efficient lighting, lighting controls, HVAC, and HVAC controls that in many cases will be eligible for Code Sec. 179D benefits. Some utilities will install new product technologies in their own facilities before recommending them to rate payers. Utility tax departments should make sure that their own operations are aware of the EPAct lighting wattage targets so that the utility itself qualifies for the same benefits that rate payers are encouraged to meet. It is particularly important for utilities to replace prior generation metal halide and T-12 lighting that is barred from further manufacture in the United States. Utility tax departments should ensure that they are achieving the same EPAct tax benefits for replacing these products as are their commercial ratepayers.

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Using EPAct to Augment Utility Efficiency Programs

Many utilities have large sales forces whose sole functions are to promote energy efficiency to the utility's customers. It may seem counterintuitive, but utilities can actually save money by deferring large power plant investments. The public service commissions that approve rate increases often require demonstrated achievements in energy reductions before approving further utility rate increases. For example, most utilities in the major demand-constrained markets (including the Northeast, California, and Texas) have efficiency programs. Ratepayers will only participate in these programs if it makes economic sense, and the addition of EPAct tax savings to the energy savings and utility rebate program is often exactly what is needed to make an efficiency investment economically worthwhile. Accordingly, it is very important that utility tax departments guide their energy efficiency team members in promoting EPAct tax commercial energy efficiency tax benefits simultaneously with efficiency programs.

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Figure 1. Sample Utility Property EPAct Tax Deductions
Tax Deductions Available for Energy Efficient Building Improvements Under Current Legislation

Facility	Square Footage	Lighting		HVAC Maximum Deduction	Building Envelope Maximum Deduction	Total
		Minimum Deduction	Maximum Deduction			
Office Building	200,000	$60,000	$120,000	$120,000	$120,000	$360,000
Auto/Truck Garage	200,000	$60,000	$120,000	$120,000	$120,000	$360,000
Workshop	100,000	$30,000	$60,000	$60,000	$60,000	$180,000
Power Plant	500,000	$150,000	$300,000	$300,000	$300,000	$900,000
Total	**1,000,000**	**$300,000**	**$600,000**	**$600,000**	**$600,000**	**$1,800,000**

Figure 2.

Utility	ARRA Smart Grid Investment
Public Service Electric & Gas	$76 million ARRA request for improvements to the N.J. electric grid as part of $152 million smart grid modernization project.
National Grid	$200 million ARRA request to develop "end-to-end" smart grid technologies to serve 200,000 customers in the Northeast.
Duke Energy	$200 million ARRA request to accelerate installation of 800,000 smart meters as part of a $1 billion grid modernization.
Vermont Electric Power Co.	$66 million ARRA request for smart grid improvements as part of a statewide $133 million modernization project.
Southern Company	$360 million ARRA request to speed up existing smart meter and smart grid programs.
Florida Power & Light	$200 million ARRA request for smart meters, electric network upgrades, and solar panels on municipal buildings and schools.

Figure 3. Sample Utility Alternative Energy Initiatives

Utility	Alternative Energy Source
Austin Energy	Austin Energy's GreenChoice program is powered by wind, biogas and solar photovoltaics.
Florida Power & Light	Wind farms and solar photovoltaics; FPL's wind farms alone account for 25% of U.S. wind-generated electricity.
Portland General Electric	PGE uses biogas, wind, solar p.v. and hydroelectric power.
PacifiCorp	PacifiCorp's mix includes wind, geothermal and hydro.
SMUD	Sacramento Municipal Utility District features solar photovoltaics, biomass, wind, and concentrating solar.
Xcel Energy	Xcel operations include wind farms and hydro facilities.
Public Service Electric & Gas Co.	The largest utility in New Jersey has committed to 80 MW of installed solar by 2013.
Pacific Gas & Electric	PG&E has embarked on a five-year program to provide 500 MW of power from distributed solar photovoltaics.

Endnotes

1 Feinschreiber, R. and Kent M., Singapore Issues Transfer Pricing Guidelines for Related-Party Loans and Services, Corporate Business Taxation Monthly, June 2009. p. 41.
2 33 FR 5849; *see,* Feinschreiber, R., Paying for Intercompany Services, Prentice-Hall U.S. Taxation of International Operations Service, January 14, 1981.
3 68 FR 53448.
4 71 FR 44466.
5 T.D. 9456, I.R.B. 2009-33, 188.
6 A.1.g.
7 2007-1 CB 269.
8 2007-1 CB 295.
9 Transfer Pricing Guidelines for Related Party Loans and Related Party Services, 3.3.14.
10 Transfer Pricing Guidelines for Related Party Loans and Related Party Services, 3.3.15.
11 IRAS Transfer Pricing Guidelines for Related Party Loans and Related Party Services, 3.3.16.
12 IRAS Transfer Pricing Guidelines for Related Party Loans and Related Party Services, 3.3.16.
13 IRAS Transfer Pricing Guidelines for Related Party Loans and Related Party Services, 3.3.16

Multistate Taxation

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will eventually sell in a permanent retail establishment anywhere in the chain of distribution." Prior to this change in the statute's interpretation, the taxpayer qualified for the exemption. Under the new interpretation, the Department found, and the appellate court agreed, that the taxpayer no longer qualified for the exemption because some of its products were eventually sold in permanent retail establishments.

In reversing this ruling, the Washington Supreme Court rejected the Department's contention that the word "exclusively" modified the type of purchases that a direct seller's representative must make (consumer v. non-consumer) in order to qualify for the tax exempt status. Such an interpretation would add words to the statute that the legislature chose not to include. Applying the law to the facts, the court concluded that the taxpayer met the requirements of the statute—*i.e.,* it was an out-of-state seller that made sales exclusively through its direct seller's representative.

The court also rejected the Department's argument that the taxpayer did not qualify because some of its products ultimately ended up in permanent retail establishments due to downstream commerce. The court held that "[u]nder the statutory provision, the Department cannot hold [the taxpayer] responsible for taxes on sales it essentially has nothing to do with." The statute applies to sales exclusively to or through a direct seller's representative. It does not apply to downstream purchases occurring after the out-of-state seller has made its final sale to or through its direct seller.

Endnotes

1 DC Code §47-1803-03(d)(8).
2 *Town Fair Tires, Inc. v. Mass. Comm'r of Tax'n,* SJC-10360 *slip op.* (Mass. Aug. 25, 2009).
3 *AccuZip, Inc. v. Dir., Div. of Tax'n,* No. 005744-2003 (N.J. Tax Ct. Aug. 13, 2009) and *Quark Inc. v. Director, Div. of Tax'n,* No. 004692-2002 (N.J. Tax Ct. Aug. 13, 2009).
4 *West Virginia Tax Comm'r v. MBNA Am. Bank, N.A.,* 640 S.E. 226 (W.V. 2006), *cert. denied,* 551 U.S. 1141 (2007).
5 *Lanco, Inc. v. Director, Div. of Taxation,* 188 N.J. 380 (2006), *cert. denied,* 551 U.S. 1131 (2007).
6 17 U.S.C.A. §202.
7 *DOT Foods, Inc. v. Washington Dept. of Rev.,* No. 81022-2 (Wash. Sup. Ct. Sept. 10, 2009).

Utility Tax Departments

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Smart Grid/Smart Meter Investments

Many companies, ranging from venture capital startups to large companies like IBM, Cisco and GE, are investing in smart grid/smart meter equipment, or making other investments that require additional smart grid/smart meter investments.

Smart grids enable utilities to greatly improve efficiency. These smart grids are critical for handling the two-way electricity arising from the net metering related to fast-growing alternative energy investments such as solar and wind. Smart meters enable electricity end users to view their electric usage information and consequently decide how to manage energy use.

Over ten million utility end users are in the process of receiving smart meters.[2] Prospectively, many new mainstream household appliances will incorporate smart meter functionality. Recent tax law changes allow for quicker depreciation of eligible smart grid and smart meter equipment, and many utilities have received large stimulus grants to support smart grid and smart meter purchases. The American Recovery and Reinvestment Act (ARRA)[3] contains $4.5 billion in stimulus grants for smart grid projects. The chart presented below illustrates some of the many smart grid stimulus requests filed by utilities throughout the country.

Sample Smart Grid Utility Stimulus Funding Requests

There is an increasing convergence between smart grid and software applications. Utility tax departments should be upgrading and tagging their fixed asset systems to recognize eligible equipment purchases, and developing tax depreciation polices covering smart grid versus software depreciation determinations.

Utilities as Tax Credit Beneficiaries

Pursuant to the Emergency Economic Stabilization Act of 2008,[4] the prior prohibition on utilities obtaining tax credits from power purchase agreements related to customers has been removed. This is a major policy change and provides powerful financial incentives for utilities that need to expand alternative energy use both for demand management and for required emission reduction.

Moreover, because of the expansion and extension of a wide range of alternative energy tax credits, the utilities have a lot more energy tax credits to work with and the certainty of availability. This means that many ratepayers that don't have tax capacity may be interested in structuring a power purchase agreement with the utility, whereby the utility will utilize the tax credit. In addition, in July 2009 the government announced the details of the new grant program that provides the economic equivalent of all the tax credits in the form of a grant. Forward-looking utility tax departments should be working closely with their legal and operational counterparts to ensure that tax is properly integrated into all of these fast growing initiatives.

Some major utilities are involved in various alternative energy projects, including Austin Energy, Florida Power & Light (FPL), Portland General Electric (PGE), PacifiCorp, Sacramento Municipal Utility District (SMUD), Xcel Energy and Public Service Electric & Gas Co., along with California utility Pacific Gas & Electric (PG&E). "Because PG&E has a 'tax appetite' and can take advantage of the tax credit, the utility is investing directly in solar energy," according to PG&E CEO Peter Darbee in a CNET article this spring. The table below summarizes some of the major utilities' alternative energy investments.

Conclusion

As a result of major changes in federal policy involving commercial building energy efficiency, smart grids, smart meters, alternative energy credits, and grants, the role of tax departments in utilities has greatly expanded. This is a new and exciting area for tax professionals interested in implementing America's energy policy initiatives.

Endnotes

1 Energy Policy Act of 2005 (P.L. 109-58).

2 See Charles Goulding, Jacob Goldman and Taylor Goulding, *New Tax Incentives for Electricity Smart Meters and Smart Grid Investments*, Corp. Bus. Tax'n Monthly, Apr. 2009, at 29.

3 American Recovery and Reinvestment Act (P.L. 111-5).

4 Emergency Economic Stabilization Act of 2008 (P.L. 110-343).

Thermal Storage

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tion. The chart below demonstrates how even small equipment efficiency improvements, when combined with time-of-day pricing and thermal storage, can generate the requisite cost improvement to qualify for the 60 cent per square foot tax deduction.

Existing thermal storage systems in buildings at the 50 percent energy cost savings threshold can use the EPAct whole building free riding concept to obtain a 1.80 per square foot tax deduction for a wide range of further energy cost reducing investments. To utilize this opportunity, a new further energy reducing investment must occur during an EPAct year. Accordingly, tax managers dealing with facilities that already have thermal storage systems should give strong consideration to making further energy cost reducing investments before December 31, 2013.

Central Plant and District Thermal Storage Systems

Large-scale storage systems are sometimes used in central plants supporting multiple buildings or district wide systems supporting multiple independent buildings. When thermal storage is used with these systems, there is an opportunity for tremendous HVAC and whole building tax savings for every building supported by the central plant thermal storage system. One of the most prominent examples of this type of large-scale ice thermal storage system is the Northwind Phoenix cooling system in Phoenix, Arizona. This cooling system serves buildings ranging from 3,000 to more than 1,900,000 square feet.[3] As of July 2009, Northwind Phoenix serves 12,863,008 square feet of downtown Phoenix.[4]