The EPAct Tax Aspects of Resurging U.S. Manufacturing Investments

By Charles Goulding, Daniel Audette and Spencer Marr

Charles Goulding, Daniel Audette and Spencer Marr look at the recent resurgence in multinational corporations investing in U.S. manufacturing facilities and how these companies can design facilities to save energy and earn tax and alternative energy credits.

Recently there has been resurgence in manufacturing facilities investment by multinational corporations, who sense a strengthening U.S. demand for products such as automobiles and energy infrastructure. For some companies, this is the first time they've entered the U.S. market, while others are returning after spending years building manufacturing facilities abroad. As these companies complete the design stage for their new buildings, they have the opportunity to platform substantial energy savings while earning EPAct tax and alternative energy credits.

The EPAct Tax Opportunity

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Pursuant to Code Sec. 179D, enacted as part of the Energy Policy Act of 2005 (EPAct),[1] multinationals making qualifying energy-reducing investments in their new or existing manufacturing facilities can obtain immediate tax deductions of up to $1.80 per square foot.

If the building project doesn't qualify for the maximum $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.[2]

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New Large U.S. Manufacturing Plant Investments

Major household brand names like Whirlpool, Caterpillar, Volkswagen and Toyota are not the only companies seizing the opportunity to invest in manufacturing facilities in the United States. Up and coming companies, like Brazilian denim manufacturer Santana Textiles, are also making headway in the U.S. market. Below is a table presenting some of the most recent new manufacturing facilities announcements, along with their potential EPAct tax deductions.

For each of these companies, implementing an energy-efficient design to meet the EPAct targets will be made easier by the fact that they must comply with current more rigorous state building energy codes. Those codes set a standard that is often similar to what is required to qualify for the EPAct tax deductions. With new construction it is typically very easy to adjust designs to meet the EPAct tax savings requirement.

Because EPAct tax deductions drive off of square footage, these facilities are prime candidates for the program. In order to achieve the EPAct target energy

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Major New U.S. Manufacturing Projects' Potential EPAct Tax Deductions

Potential Tax Deductions Available for Energy Efficient Building Improvements Under Current Legislation

Property	Total Square Footage	Lighting Minimum Deduction	Lighting Maximum Deduction	HVAC Maximum Deduction	Building Envelope Maximum Deduction	Total
Whirlpool, Cleveland, OH	1,400,000	$420,000	$840,000	$840,000	$840,000	$2,520,000
Caterpillar, Seguin, TX	600,000	$180,000	$360,000	$360,000	$360,000	$1,080,000
Tesia, Fremont, CA	1,100,000	$330,000	$660,000	$660,000	$660,000	$1,980,000
First Solar, Perrysburg, OH	500,000	$150,000	$300,000	$300,000	$300,000	$900,000
Volkswagon, Chattanogga, TN	2,000,000	$600,000	$1,200,000	$1,200,000	$1,200,000	$3,600,000
Santana Textiles, Edinburg, TX	300,000	$90,000	$180,000	$180,000	$180,000	$540,000
Toyota, Blue Springs, MS	1,500,000	$450,000	$900,000	$900,000	$900,000	$2,700,000
Totals:		$2,220,000	$4,440,000	$4,440,000	$4,440,000	$13,320,000

reductions, they should consider a mix of LED or other energy-efficient lighting, energy-efficient HVAC, building controls, a white roof and extra insulation.[3]

Nonconditioned Building Tax Opportunities

The manufacturing facilities presented in the table have a good opportunity to generate very large EPAct tax deductions. Most industrial building facilities are nonconditioned, meaning the actual manufacturing portion of the building is typically heated but not air conditioned.[4]

In these buildings it is lighting rather than HVAC that makes up the largest portion of energy cost. Accordingly by combining energy-efficient lighting with energy-efficient heaters at the EPAct standard level obtaining $1.20 to $1.80 EPAct tax deductions is very achievable.

Intersecting LEED and EPAct

Going one step further, these multinationals can have their facilities become Leadership in Energy and Environmental Design (LEED) certified by driving down their energy consumption. LEED is the fast-growing marquee standard for sustainable buildings. LEED is the certification system established by the U.S. Green Building Council (USGBC). The four certification achievements start at the LEED-certified level and proceed to the higher LEED silver, gold and platinum levels. On April 27, 2009, the new LEED 2009 system replaced the previous LEED rating point system for certifying LEED buildings and produced extra LEED points for energy efficiency. Therefore, energy-efficient building projects that are completed post-2009 have a better platform for achieving LEED status.[5]

Importantly, achieving LEED certification offers multinational corporations who typically make public disclosure of their sustainability efforts a major reportable accomplishment. It also enables companies to take advantage of many state and local incentive programs to help finance the project. But, perhaps most importantly, it is much easier to model a new plant for tax savings when it is LEED certified since all of energy performance characteristics of the lighting, mechanicals and building envelope are already in the architectural CAD drawings and the required compliance documents.

Solar P.V. Opportunities with Large Roofs

The large flat roofs associated with large manufacturing buildings make them ideal solar P.V. installation candidates. Solar P.V. installations completed before December 31, 2016, are eligible for 30-percent tax credit and five-year MACRS depreciation. With new facilities, designers have the opportunity to incorporate roofs that have solar P.V. load bearing capability and to minimize the installation of any roof building equipment thereby maximizing solar P.V. system size. With this approach integrated solar P.V. system and roof warranties are easily obtainable.

Conclusion

A resurgence in U.S. large square footage manufacturing plant investment is a welcomed development. The ability to operate these new facilities with much lower energy-related operating costs coupled with tax incentives can serve to make these large investments more profitable. The best outcome would be demonstrated success

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Enhanced Energy-Efficient Design, CORP. BUS. TAX'N. MONTHLY, Aug. 2010, at 11.

[3] *See,* Press Release, Sep. 20, 2010 *Walmart Uses Innovative Thin Film Solar Technology to Increase Renewable Energy Use,* available online at *http://walmartstores.com/pressroom/news/10303.aspx.*

[4] See Charles Goulding, Joseph Most and Spencer Marr, *The Energy Tax Aspects of Geothermal Heat Pumps,* CORP. BUS. TAX'N. MONTHLY, Dec. 2010, at 13.

[5] *See,* Charles Goulding, Jacob Goldman and Nicole DiMarino, *LEED Building Tax Opportunities,* CORP. BUS. TAX'N. MONTHLY, Jan. 2008, at 17.

[6] *See,* Charles Goulding, Jacob Goldman and Joseph Most, *Using EPAct Incentives to Enhance New Mandatory Building Energy Disclosure Requirements,* CORP. BUS. TAX'N. MONTHLY, Oct. 2010, at 11.

Resurging Investments

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leading to more of these important job-creating initiatives.

ENDNOTES

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

[2] Charles Goulding, Jacob Goldman and Nicole DiMarino, *EPAct Tax Deductions for Lighting Gain Wider Use,* BUILDING OPERATING MANAGEMENT, July 2008, at 68.

[3] Charles Goulding, Kenneth Wood and Raymond Kumar, *Optimizing the 3,2,1 LED Lighting Tax Deduction Countdown,* CORPORATE BUSINESS TAXATION MONTHLY, July 2010, at 13.

[4] Charles Goulding, Taylor Goulding and Amelia Aboff, *How LEED 2009 Expands EPAct Tax Savings Opportunities,* CORPORATE BUSINESS TAXATION MONTHLY, September 2009, at 11.

[5] Charles Goulding, Jacob Goldman and Malcom Thomas, *The Energy Tax Aspects of Warehouses and Distribution Centers,* CORPORATE BUSINESS TAXATION MONTHLY, October 2009, at 15.

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the foreign parent's effectively connected income associated with such USTB is not subject to U.S. federal income tax by virtue of the fact that under the 2006 U.S. Model Treaty, the foreign parent does not have a PE in the United States to which the income is attributable. It should also be noted that the income tax exposure must be considered and addressed for each state in which the foreign manufacturer is doing business. The state definitions of "doing business" often differ from the U.S. federal concept of a trade or business, and the States are not bound by the income tax treaties that are entered into by the U.S. government.

ENDNOTES

[1] The views expressed in this article are those of the authors and do not reflect the views of Ernst & Young LLP or any other member of Ernst & Young Global Limited.

[2] Convention between the Government of the United States of America and the Government of ____ for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, November 15, 2006 ("2006 U.S. Model Treaty").

[3] Code Sec. 864(c). All "Code Sec." references refer to the Internal Revenue Code of 1986, as amended.

[4] *InverWorld, Inc. et al.,* 71 TCM 3231, Dec. 52,045(M), TC Memo. 1997-226.

[5] *See,* for example, *Spermacet Whaling & Shipping Co.,* CA-6, 60-2 USTC ¶9645, 281 F2d 646.

[6] *Id.; See also, Scottish American Investment Co., Ltd.,* 12 TC 49, 56–57, Dec. 16,773 (1949).

[7] *Id.*

[8] *Balanovski,* DC-NY, 55-1 USTC ¶9302, 131 FSupp898, aff'd in part, CA-2, 56-2 USTC ¶9832 , 236 F2d 298, *cert. denied,* 352 US 968, 77 SCt 357 (1957); *Spermacet Whaling and Shipping Co. S/A,* 30 TC 618, CCH Dec. 23,035, aff'd, 60-2 USTC ¶9645, 281 F2d 646.

[9] Rev. Rul. 73-522, 1973-2 CB 226.

[10] *Id.*

[11] Rev. Rul. 70-543, 1970-2 CB 172; *Johansson,* CA-5, 67-1 USTC ¶9332, 374 F2d 890.

[12] Rev. Rul. 58-63, 1958-1 CB 624 and Rev. Rul. 60-249, 1960-2 CB 264.

[13] Regulatory guidance relating to the attribution of an "office or fixed place of business" does exist under Code Sec. 864.

[14] *Lewenhaupt,* 20 TC 151, Dec. 19,606 (1953).

[15] *Supra* note 3.

[16] As in the domestic law context, the United States taxes foreign corporations, as well as their U.S. branches and partnerships, on income that is associated with a PE. Income associated with a PE is taxed on a net basis at graduated rates comparable to the tax imposed on U.S. corporations.

[17] The 2006 U.S. Model Treaty makes specific reference to the Commentary to the OECD Model Treaty ("OECD Commentary") when determining whether a PE is deemed to exist. The U.S. Treasury Regulations are helpful in providing a definition of terms that are used in tax treaties but have not been defined.

[18] Inter alia, the U.S. treaties with Switzerland, Belgium, the United Kingdom, Ireland and the Netherlands are examples that include the broader language of the 2006 U.S. Model Treaty.

[19] Generally, agents are able to conclude contracts regarding ancillary activities to the business, *e.g.,* the purchase of office supplies from a third-party vendor, without creating a PE. However, if an agent concludes contracts in the name of the principal that relate to the essential business operations of the enterprise, there is a risk of a PE.

[20] OECD Commentary, Article 5.5, ¶32.1.

[21] OECD Commentary, Article 5.5, ¶33.

Ngai Lik Case

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The Board's Approach to the Exercise of the Section 61A(2) Power

The Board of Review made their assessment under Section 61A(2)(a) rather than under Section 61A(2)(b). The Board stated that the taxpayer's manufacturing activities were clearly not wholly offshore. The taxpayer had not made any claim for apportionment and had not made good any claim for apportionment of more than 50 percent of the manufacturing profits as offshore profits, the onus being on the taxpayer to prove that the assessments appealed against were incorrect or excessive. Unless the taxpayer could make good any claim for apportionment, which it might make of the more than 50 percent the manufacturing profits as offshore profits, the best it could hope for was a 50/50 apportionment under the Revenue's Departmental Interpretation and Practice Notes No. 21.

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