The EPAct and Alternative Energy Tax Aspects of Walmart's Supplier Sustainability Program

By Charles Goulding, Jacob Goldman and Christopher Winslow

Charles Goulding, Jacob Goldman and Christopher Winslow study Walmart's requirement that its third-party suppliers execute a Sustainable Supplier Assessment as part of its commitment to cost reduction and sustainability.

Walmart requires a huge volume of goods daily to fulfill its third-party supply chain and requires its suppliers to execute a Sustainable Supplier Assessment as part of its commitment to cost reduction and sustainability. Walmart's three focused goals are to produce zero waste be supplied by 100-percent renewable energysell sustainable products

Walmart makes clear that it will "reward those suppliers who have measured impacts and shown progress toward meeting aggressive sustainability goals." Walmart is a critical customer for many companies, large and small, so that Walmart suppliers throughout the country are working through their Walmart sustainability assessments. Walmart suppliers can use a variety of tax savings opportunities to reduce their investment costs as they begin to execute their new sustainability improvements.

Code Sec. 179D

Code Sec. 179D provides an immediate tax deduction of up to $1.80 per square foot for building investments that achieve specified energy cost reductions above ASHRAE 90.1-2001 building energy code standards. A one-time deduction $1.80 per square foot deduction is the maximum tax deduction, but deductions of up to 60 cents per square foot are also available for three types of building systems: lighting, HVAC systems and the building envelope.

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Tax Credits/Cash Grants

Pursuant to Code Sec. 48, companies or individuals installing various qualifying alternative energy technology can use a variety of 10 percent and 30 percent alternative energy tax credits. In addition, Sections 1104 and 1603 of the American Recovery and Reinvestment Act of 2009[1] allow for the taxpayer to take the tax credit in the form of a cash grant so long as their energy retrofitting project qualifies. This energy retrofitting option is exclusively made available for projects that have "begun construction" during 2009 or 2010.

The U.S. Department of Treasury has recently issued guidelines in order to clarify the meaning of construction that has "begun": there needs to have been actual physical work of a significant nature or, at a minimum, there needs to be a binding contract in place that guarantees the construction of a specified energy property. Also, once a property owner has paid five percent of the total cost of installation of the energy property, the requirements of Act Sec. 1603 will generally be satisfied. Property owners desiring to lock in cash grants should review the requirements carefully.

Understanding the 15 Sustainability Supplier Assessment Questions

Walmart has developed 15 Supplier Assessment questions in four categories, which are energy and climate, materials efficiency, nature and resources, and people and community

Walmart's questions by category are discussed below.

Energy and Climate: Reducing Energy Costs and Greenhouse Gas Emissions

Have you measured your corporate greenhouse gas emissions?

Have you opted to report your greenhouse gas emissions to the Carbon Disclosure Project (CDP)?

What is your total annual greenhouse gas emissions reported in the most recent year measured?

Have you set publicly available greenhouse gas reduction targets? If yes, what are those targets?

Material Efficiency: Reducing Waste and Enhancing Quality

If measured, please report the total amount of solid waste generated from the facilities that produce your product(s) for Walmart for the most recent year measured.

Have you set publicly available solid waste reduction targets? If yes, what are those targets?

If measured, please report total water use from facilities that produce your product(s) for Walmart for the most recent year measured.

Have you set publicly available water use reduction targets? If yes, what are those targets?

Natural Resources: Producing High Quality, Responsibly Sourced Raw Materials

Have you established publicly available sustainability purchasing guidelines for your direct suppliers that address issues such as environmental compliance, employment practices and product/ingredient safety?

Have you obtained third-party certifications for any of the products that you sell to Wal-Mart?

People and Community: Ensuring Responsible and Ethical Production

Do you know the location of 100 percent of the facilities that produce your product(s)?

Before beginning a business relationship with a manufacturing facility, do you evaluate the quality of, and capacity for, production?

Do you have a process for managing social compliance at the manufacturing level?

Do you work with your supply base to resolve issues found during social compliance evaluations and also document specific corrections and improvements?

Do you invest in community development activities in the markets you source from and/or operate within?

The Four Energy and Climate Questions

One of the best techniques to quickly reduce greenhouse gas emissions with a high economic payback coupled with large tax savings is to upgrade facilities to energy efficient lighting. It is particularly important to retrofit any now federally banned metal halide and T-12 lighting to new energy-efficient lighting. Many Walmart suppliers have manufacturing facilities and warehouses where these prior generation lighting technologies are still prevalent. The emission reduction computation from energy-efficient lighting is straightforward and easy to calculate. HVAC upgrades typically have a high investment cost, but often produce the best long-term economic return. For nonconditioned (heat only facilities), large EPAct tax deductions are available if the heater upgrade occurs after or concurrently with the energy-efficient upgrade lighting upgrade.[2]

Walmart has actually gotten more "hands on" with supplier energy reduction projects in what is called Supplier Energy Efficiency Program (SEEP). Some of the companies that have participated in this program are Burlen, Intradeco, Komar, Lone Star Plastics, Marck Recycling and von Drehle. The Walmart SEEP energy management program frequently uses lighting upgrades and energy-efficient upgrades that typically will qualify for the EPAct lighting tax deduction.

Nature and Resources

This set of sustainability nature and resource supplier assessment questions is a sophisticated way to drive sustainability goals through the entire supply chain. Tier 1 suppliers actually supply the final packaged good to be delivered to a retailer like Walmart. The Tier 2 supplier provides the processed materials used in making the final product, such as in our example, a frozen pizza maker will likely need several different suppliers in order to put together the dough, sauce, toppings and packaging to produce their product. Tiers, in this concept, extend out as far as the supply chain goes, where each lower tier is the direct suppliers to the tier above it.

Ordinarily, it is somewhat challenging for Tier 1 suppliers to probe into the affairs of their own vertical suppliers. However, by requesting this step, Walmart makes it easier for the Tier 1 suppliers to do so. Tier 1 suppliers should first consider upgrading their own facilities before questioning their lower tier suppliers. Vertical market sustainability inquires sometimes fleshes out sustainability sandwich issues. A sustainability sandwich issue arises when the end-user (say Walmart) and the second-tier supplier have achieved higher sustainability including energy-efficiency standards than the intermediate Tier 1 supplier.

100-Percent Renewable Energy Goal

This 100-percent renewable energy goal is very challenging goal and one that Walmart itself is far from accomplishing. Presumably Walmart intends to make some major strides in this area. Logically, Walmart couldn't ask its suppliers to seek to do what they haven't done themselves. Walmart stores typically have very large rooftops that are particularly suitable for solar P.V. In September 2010, Walmart announced a meaningful expansion of thin-film solar P.V. projects in California and Arizona.[3] Thin-film solar is one of the two major types of solar P.V. material, with crystalline being the other category. Based on current technology, thin-film has lower cost, but also lower efficiency.

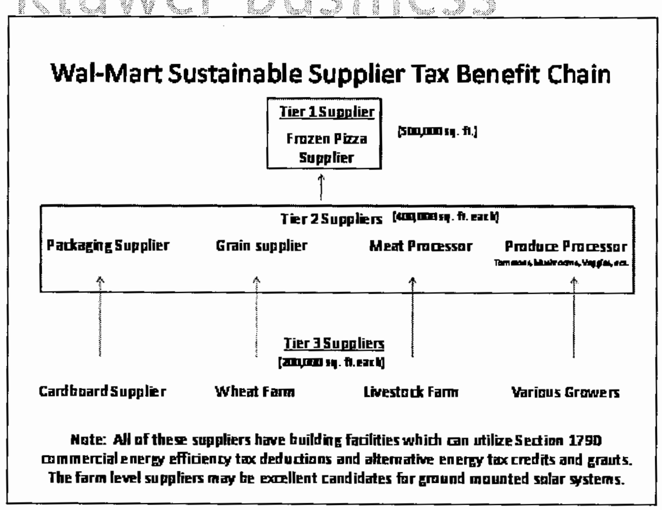
Walmart suppliers in California and New Jersey have an advantage in that their local incentives combined with falling solar prices and 30 percent federal tax credits are providing an increasingly better economic return from solar. Walmart family members are founding investors of First Solar, a major U.S. solar panel company, so Walmart has deep exposure to solar panel technology developments and the continuing decrease in the installed cost of solar. Walmart has a staggering amount of rooftop square footage approaching 500-million square feet.

Suppliers with large HVAC energy users may want to evaluate geothermal systems where both 10-percent tax credits and EPAct tax incentives are available.[4] Suppliers with large amounts of refrigeration have very large electricity consumption where fuel cells and 30-percent tax credits are also available.

Walmart Supply Chain Characteristics

The largest categories of Walmart suppliers presumably reflects Walmart's store layout where two large major sectors are (1) apparel and (2) food products. The supply chains for these two sectors will be different with apparel containing numerous offshore manufacturers and food products characterized by many domestic suppliers, including local suppliers of fresh and organic foods. With the offshore apparel suppliers, ocean shipping is a proportionally large energy-user and emissions generator. The domestic food products sectors have high-energy building costs, especially for the refrigeration aspects of running their facilities. Exhibit 1 presents some of the major suppliers involved in providing a frozen pizza to Walmart or any grocers' shelf along with sample facilities square footage.

Exhibit 1.



Walmart Local Produce Commitment Program

Walmart has also made a commitment as of October 14, 2010, to increase the amount of produce bought from local farms and to increase its fresh-food offerings. The company plans to double the percentage of locally grown produce it sells to nine percent. Walmart is a $405-billion dollar company where groceries account for roughly half of its revenue. This will equate to a sizeable increase to the number of Walmart suppliers, who if they want to become part of the Walmart supply chain will need to reduce their own energy usage to become a more attractive supplier choice.

Exhibit 2 presents the EPAct potential tax benefits available to the frozen pizza suppliers presented in the previous diagram.

Packaging System Waste Reduction

One of the major focuses with the zero-waste supplier initiative is reducing packaging costs. Product-packing cost is a major cost category for virtually all Walmart suppliers. In addition to reducing the amount of packaging material utilized, major opportunities exist to automate packing systems with new packaging equipment and to improve packaging processes and recycling. In addition to major labor cost reduction opportunities, the new packaging systems reduce both production cycle time and often use less energy. Although there are no tax incentives for energy-efficient packaging equipment, some utilities offer custom rebates for these measures. Suppliers with unique products may need to develop customized packing equipment where R&D tax credits may be available. Lastly, many states offer tax credits and incentives for recycling investments.

Integrating Programs

Those Walmart suppliers that act on the four categories of designated supplier initiatives will find themselves much better platformed for achieving the coveted LEED building status. The tax opportunities with LEED buildings relate to the large number of LEED ratings points involving energy cost reduction and alternative energy. Out of the 69 total LEED rating points, over 20 points relate to energy criteria, with 10 points specifically designed for energy optimization.[5] Additional LEED points are available for alternative energy integration. Also those suppliers from California, Austin, Texas, New York City and Seattle will improve their benchmarking status in those mandatory energy-efficiency benchmarking jurisdictions.[6]

Conclusion

The Walmart Supplier Sustainability program is going to drive multiple sustainability improvements through a deep supply chain. Facilities owners who lease to Walmart suppliers and suppliers who own their own facilities need to understand Walmart's sustainability goals and use a variety of energy-related Code Sec. 179D and alternative energy tax credits and tax savings opportunities to support these goals. Landlords who want to retain existing tenants who supply Walmart, or with vacant facilities who want to attract Walmart suppliers, also need to understand this supplier strategy and make it their own strategy.

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Exhibit 2.

Walmart Tiered Supplier Chain

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
Tier 1:						
Frozen Pizza Supplier	500,000	$150,000	$300,000	$300,000	$300,000	$900,000
Tier 2:						
Packaging Supplier	400,000	$120,000	$240,000	$240,000	$240,000	$720,000
Grain Supplier	400,000	$120,000	$240,000	$240,000	$240,000	$720,000
Meat Processor	400,000	$120,000	$240,000	$240,000	$240,000	$720,000
Produce Processor	400,000	$120,000	$240,000	$240,000	$240,000	$720,000
Tier 3:						
Cardboard Supplier	200,000	$60,000	$120,000	$120,000	$120,000	$360,000
Wheat Farm	200,000	$60,000	$120,000	$120,000	$120,000	$360,000
Livestock Farm	200,000	$60,000	$120,000	$120,000	$120,000	$360,000
Produce Farm	200,000	$60,000	$120,000	$120,000	$120,000	$360,000
Totals:	2,900,000	$870,000	$1,740,000	$1,740,000	$1,740,000	$5,220,000

ley, Jr., Co., SCt, 505 US 214, 231, 112 SCt 2447 (1992)(ruling sales representative's actions to resolve customer complaints was ancillary to solicitation activities protected from income-based taxation under P.L. 86-272).

14 The holding would apply to the newer Texas margin tax as well.

15 *Rylander v. Bandag Licensing Corp.*, Tex. App., 18 S.W.3d 296 (Tex. App. – Austin 2000, pet. denied).

16 *See, e.g.*, Conn. Gen. Stat. §90 (2010) ("Any company that derives income from sources within this state, or that has a substantial economic presence within this state, evidenced by a purposeful direction of business toward this state, examined in light of the frequency, quantity and systematic nature of a company's economic contacts with this state, without regard to physical presence, and to the extent permitted by the Constitution of the United States, shall be liable for the tax imposed under chapter 208 of the general statutes.").

17 Texas Tax Code §112.001 (2010).

18 *See supra* note 1, 317 SW3d at 843.

19 Texas Government Code §2001.173 (2010).

20 Texas Tax Code §112.054.

21 The deaths of the taxpayer's primary witnesses following the administrative hearing but before trial may have played a role in admitting these administrative actions.

22 *See supra* note 12, 505 US at 231.

23 *See supra* note 1, 317 SW3d at 845.

24 *Id.*

25 Comptroller Rule §3.554(d)(7).

26 *See supra* note 12..

27 *Id.*, 505 US at 232.

28 *Id*, 505 US at 235.

29 *Id.*

30 *Id.*

31 Comptroller Rule §3.554(d)(7) (2010) (emphasis added). The Rule also allows that such *de minimis* activity will not constitute doing business. *Id.*

32 *See supra* note 12, 505 US at 228–29.

33 As an example, the Comptroller claims that sending an out-of-state employee into Texas for a single day to attend an educational conference where no orders are offered, taken or accepted creates nexus for the out-of-state company for the next four years. *See Colonial Surgical Supply, Inc. v. Combs*, No. D-1-GN-07-1968 (Travis Cty., Tex., Dist. Ct. 2009); *Colonial Surgical Supply, Inc. v. Combs*, No. D-1-GN-07-1967 (Travis Cty., Tex., Dist. Ct. 2009).

Reinventing the *Quill*?

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State, Veterans and Military Affairs. Despite these failed repeal efforts in Colorado, the PI may at least deter other states from passing similar legislation.

Looking Forward

While the PI does not resolve the case, it suspends the notice and reporting obligations during the pendency of the Department's appeal and potentially the entire litigation. In the event that the PI is overturned or superseded by a final decision on the merits, the Department could only enforce the legislation prospectively, meaning that remote retailers would not be subject to penalties for noncompliance with the new law while the PI remains in effect.

The PI signifies an important victory for retailers engaging in interstate commerce. Some viewed Colorado's new regime as an attempt to further circumvent *Quill* by imposing cumbersome reporting obligations on out-of-state retailers in lieu of directly taxing them. Judge Blackburn applied *Quill*'s safe harbor to prevent this from happening, though. It remains to be seen whether his decision will revitalize *Quill* and be used as leverage in future cases.

The parties filed a joint status report agreeing to expedite a summary judgment hearing in regard to the Commerce Clause claims without further discovery on February 16, 2011. Nine days later, however, the Department appealed Judge Blackburn's decision on the PI to the Tenth Circuit Court of Appeals. Although the appeal is currently pending, the PI still stands and negates all reporting obligations.

Endnotes

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2 Justin R. Thompson, *DMA Challenges Colorado's "Non-Collecting Retailer" Notice and Rêporting Regime*, Jones Day State Tax Return, Sep. 2010. Reprinted in Corp. Bus. Tax'n Monthly, Nov. 2010, at 15.

3 *See* generally *Direct Mktg. Ass'n v. Huber*, DC-CO, Dkt. No. 10-CV-01546-REB-CBS (filed June 30, 2010).

4 Order Granting Motion for Preliminary Injunction, *Direct Mktg. Ass'n v. Huber*, DC-CO, Dkt. No. 10-CV-01546-REB-CBS (Jan. 26, 2011).

5 *Id.* at 13–15.

6 See H.B. 10-1193, 67th Gen. Assem., 2d Reg. Sess. (Colo. 2010) (amending Colo. Rev. Stat. §39-21-112).

7 Colo. Rev. Stat. §39-21-112(3.5)(c)(I), (d)(I)(A), (d)(II)(A).

8 39 Colo. Code Regs. §21-112.3.5(2)(f)(i), (3)(d)(i), (4)(f)(i).

9 *Id.* § 21-112.3.5(2)(f)(ii), (3)(d)(ii), (4)(f)(ii).

10 *See* generally Plaintiff's Original Complaint, *Direct Mktg. Ass'n v. Huber*, DC-CO, Dkt. No. 10-CV-01546-REB-CBS (filed June 30, 2010).

11 See *Id.* at ¶¶ 54–76.

12 *Id.* ¶¶ 54–64.

13 *Quill Corp. v. North Dakota*, SCt, 504 US 298, 112 SCt 1904 (1992).

14 Plaintiff's Original Complaint, *supra* note 9, at ¶¶ 65–76.

15 Order Granting Motion for Preliminary Injunction, *supra* note 3, at 4 (citing *Prairie Band of Potawatomi Indians v. Pierce*, CA-10, 253 F3d 1234, 1246 (2001)).

16 *Id.* at 7–8.

17 *Id.* at 10.

18 *Id.* at 11–12.

19 *Id.* at 13.

20 *Id.* at 13–14.

21 See S.B. 11-073, 68th Gen. Assem., 1st Reg. Sess. (Colo. 2011); S.B. 11-056, 68th Gen. Assem., 1st Reg. Sess. (Colo. 2011).

22 S.B. 11-073, 68th Gen. Assem., 1st Reg. Sess. (Colo. 2011).

23 S.B. 11-056, 68th Gen. Assem., 1st Reg. Sess. (Colo. 2011).

Walmart's Sustainability Program

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Endnotes

1 American Recovery and Reinvestment Act of 2009 (P.L. 111-5).

2 *See*, Charles Goulding, Jacob Goldman and Joseph Most, *Complete Warehouse Tax-*

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.

Supply Chain Management

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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.