March 28, 2018

The Honorable Kevin Brady	The Honorable Vern Buchanan
Chairman	Subcommittee Chairman
Committee on Ways and Means	Subcommittee on Tax Policy
U. S. House of Representatives	U. S. House of Representatives
1102 Longworth House Office Building	1102 Longworth House Office Building
Washington D.C. 20515	Washington D.C. 20515

Written Testimony to the Hearing Entitled *Post Tax Reform Evaluation of Recently Expired Tax Provisions* on Mar 14, 2018

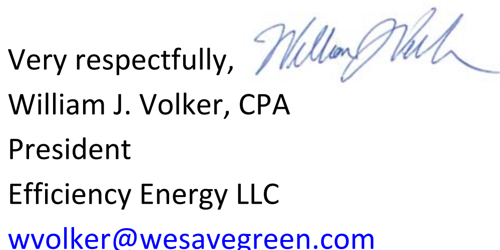
Dear Chairman Brady and Subcommittee Chairman Buchanan:

I am the President of Efficiency Energy LLC, a tax consultancy business specializing in Section 179D, the Energy Efficient Commercial Buildings Deduction, and specifically, the special rule for allocating the deduction with respect to government-owned buildings in Section 179D(d)(4). Our firm's clients include four of the five largest State University Systems, six of the ten largest University campuses, and three of the top ten largest school districts in the country. (Complete list provided below.) On behalf of this constituency, I want to thank the Subcommittee for holding hearings on the effect of tax reform on recently expired tax provisions, and in particular to speak regarding the interests of government entities and state taxpayers in the renewal of Section 179D.

Public entities are important stakeholders in the Section 179D program because, by extension, they represent the interests of the state and local taxpayers that fund them. **To Chairman Buchanan's question "What role does this provision play in the new tax code?" I would answer that the unique benefit to the public sector from the potential transfer of tax benefits under Section 179D is presently absent from the new tax code, and should be restored and continued.** The unique treatment of government buildings is an important part of the conversation that must be understood and considered as Congress begins to evaluate the role of Section 179D and the potential implications of decisions that will be made for future tax years. My testimony identifies the special rule's single most controversial element and proposes potential solutions, with supporting legal and policy rationales. I am also available to provide examples of the application of these rules in the districts of every Subcommittee-member, or indeed practically every district in the country.

I have great respect for the work the Subcommittee has done and continues to do to improve the U.S tax code, and I look forward to helping clarify this important public component of the Section 179D incentive.

Very respectfully,



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Government buildings are an integral part of our national infrastructure. Permanence in the Section 179D program would allow public building owners to better incorporate the tax benefit into their long-term project financing plans, thereby reducing the cost of energy efficient capital projects. The Section 179D program provides an effective incentive for job creation while reducing construction and operational cost to taxpayers and lowering energy usage in public buildings. The benefits of this sound economic and public policy have already been presented to the Subcommittee by other witnesses.

I write to you today to highlight the importance of this incentive to taxpayers and public building owners, and to address common points of misunderstanding and some misstatements that have been made regarding the 179D special rule for government-owned buildings.

I. The Code Affords Governmental Entities Discretion in Allocating Section 179 Deductions

Section 179D of the Internal Revenue Code ("Code") provides a deduction (the "Deduction") for the cost of certain property in energy efficient commercial buildings, subject to various statutory maximums. Section 179D(d)(4) provides that in the case of energy efficient commercial buildings placed on property owned by a governmental entity, the Secretary of Treasury shall promulgate regulations to allow the allocation of the Deduction to the person primarily responsible for designing the property. However, the Secretary has not promulgated such regulations to date. IRS Notice 2008-40 provides that, in the case of energy efficient commercial buildings that are constructed on government owned property, the owner of the property "may" allocate the Deduction to the person "primarily responsible" for designing the property. Notice 2008-40 further provides that if more than one designer is responsible for the property, the owner may determine which designer is primarily responsible and allocate the full deduction to that designer, or at the owner's discretion, allocate the deduction among several designers. See also IRS Legal Memorandum No. 201451028 (Dec. 4, 2012).

The use of permissive language such as "allow" and "may," rather than "must" or "shall," in all of these authorities, including specifically the statute itself, demonstrates that the allocation of the Deduction by a governmental entity was not intended by the IRS to be mandatory, and that the governmental entity's decision whether to allocate any, all, or none of the Deduction to a particular designer is discretionary. As discussed in more detail below, I believe that there are good policy reasons, and grounds under state and local law, for continuing to treat allocations of the Deduction by publicly-owned buildings as discretionary, not mandatory.

Deference should be given to the reasonable discretion of the IRS in its interpretation of the statute. Specifically, Congress has already decided that the IRS should be permitted to

determine what constitutes "primary responsibility" and "technical specifications" with respect to a project, the criteria for determining which designer or designers should be allocated the Section 179D Deduction, and what substantiation of those decisions is required. Further, it is abundantly clear that neither Section 179D nor the relevant IRS guidance obligates a governmental entity to allocate the Section 179D Deduction automatically. Rather, a governmental entity may or may not allocate the Section 179D Deduction, and has discretion to decide how to allocate the Deduction in the event it chooses to do so. We believe this discretion is fully in accord with the intent behind Section 179D. It is good policy as well, for it leaves the decision of who should receive the benefit of the Deduction with the building owner – the government agency with responsibility for the particular project at issue, and the entity making the decision whether to invest in energy efficient property as part of that project.

II. A Governmental Entity Should Receive Value in Return for Section 179D Allocations

The Code itself does not directly address whether a governmental entity may properly receive value in exchange for the allocation of a Section 179D Deduction. Our research, however, reveals that there certainly is no prohibition against such a practice, in the statute or elsewhere. Furthermore, state and local laws often obligate a government agency to receive value in exchange for the allocation of this benefit, in keeping with its fiduciary responsibility for transparent stewardship of taxpayer funds invested in energy efficient public buildings. We believe the following three factors support the view that it is right and proper for governmental entities to obtain value in exchange for allocating the Deduction:

(1) The Policy Underlying Section 179D. The legislative intent behind Section 179D supports a governmental entity's right to receive value in exchange for the allocation of the Deduction to a private party. In allowing a commercial owner of an energy efficient commercial property to receive the Deduction under the general use of Section 179D, Congress's intent was clearly to encourage the owner, via this tax incentive, to invest in an energy efficient building. The Deduction reduces the ultimate net cost of the construction project, and increases the owner's return on investment. In the context of commercial buildings, no engineer, architect or other "designer" receives any tax benefit, because those parties are not the decision makers that Congress intended to influence through this tax incentive. Commercial owners investing in the energy efficiency of their buildings receive the benefit of the 179D deduction; while Government building owners making identical investments cannot directly benefit from the deduction they should nevertheless receive some sort of equivalent benefit in return for the allocation.

Section 179D(d)(4) is the special rule created for property owned by governmental entities, which authorizes governmental entities to allocate the Deduction. Allowing a

governmental entity to receive a reduction in the project's cost in return for the allocation provides the entity an incentive to construct an energy efficient building that is analogous to the incentive provided to a commercial builder. But if no value is received by the governmental entity through a rebate or a reduction in design fees, then the allocation of the Deduction to the designer only increases the designer's profit, and provides no incentive to the decision-maker, the property owner. Under such a policy, the provision would give no incentive to government agencies to construct or renovate energy efficient buildings. No rational governmental entity would make its construction decisions based on the ability to increase a private vendor's bottom line – nor would it grant a private benefit derived from public expenditures without public benefit or due process. In order to achieve the Section 179D policy goal of promoting the construction of energy efficient buildings, the law should be applied in a manner that will influence the governmental entities' construction decisions. Any other interpretation of the statute would be inconsistent with the clear policy goals underlying Section 179D.

This interpretation of the application of Section 179D(d)(4) is not new. Under existing law, the national law firm Sherman and Howard reached this conclusion in 2011,[1] and it has been confirmed by multiple subsequent independent analyses by public finance and tax law experts and by state and local governmental entities themselves. More importantly, state and local governments have been encouraged to negotiate savings to the public based on this logic.[2]

(2) A Governmental Entity's Responsibilities. While the policy goal outlined above may not be fully achievable for already-completed projects, governmental entities should nevertheless be entitled to receive value in exchange for allocating Section 179D Deductions, because the government entities assume both risk and responsibility in administering the allocations. A designer may not claim the Section 179D allocation without a form properly completed and signed by an authorized officer of the governmental building owner (the 'Allocation Form'). Notice 2008-40, Section 3.04 requires an allocation to include "[a] declaration, applicable to the allocation and any accompanying documents, signed by the authorized representative of the owner of the government-owned building, in the following form:

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[1] https://shermanhoward.com/publications/internalrevenuecodesection179dmayprovidefinancialbenefittogovernments

[2] http://ncbarblog.com/2018/03/an-untapped-source-of-savings-for-state-and-local-government-owners-of-property/

> 'Under penalties of perjury, I declare that I have examined this allocation, including accompanying documents, and to the best of my knowledge and belief, the facts presented in support of this allocation are true, correct, and complete.'"

Further, a governmental entity has record-keeping obligations to document Section 179D Deductions related to its buildings, and to properly reflect Section 179D Deductions as a reduction of basis. *See* IRS Notice 2008-40, Section 3.07 ("Tax Consequences to Owner of Public Building. The owner of the public building is not required to include any amount in income on account of the § 179D deduction allocated to the designer. The owner of the public building is, however, required to reduce the basis of the energy efficient commercial building property (or partially qualifying commercial building property) by the amount of the §179D deduction allocated.").

To secure allocation signatures, designers (and their intermediaries) have employed various questionable methods such as altering the required forms, omitting material facts and providing misleading guidance or misinformation, and circumventing government internal controls, oversight, and due diligence. Some designers (and their intermediaries) have solicited the required signature from unauthorized and/or uninformed government employees, potentially circumventing government representatives with financial reporting responsibilities and established authorities. Some designers and for-profit third parties have misrepresented that Section 179D allocations are somehow mandatory under the statute, in order to induce state agencies to make allocations. The result is that government agencies sometimes are confronted with potentially duplicative prior allocations that were improperly made without the knowledge of responsible financial officials of the agencies. Governmental entities have a duty to document allocations, apply basis reductions, and appoint/authorize a central signatory to prevent unauthorized or duplicate allocations.

Moreover, allocations without proper documentation, authorization, and/or compensation could potentially be in violation of state or local law. Many states have constitutional and/or statutory restrictions which actually prohibit a governmental entity from transferring anything of value to a private entity without receiving compensating value in return. Many government agencies have also taken the legal position that they may not sign the allocations at all because of anti-augmentation or anti-gift laws that might constitute granting a public benefit without receiving value. Arguably these provisions would make it illegal in many states for the agencies to allocate the benefit with no consideration.

In short, the allocation process imposes substantial responsibilities that a governmental entity must undertake. It is reasonable for governmental entities that elect to participate in

Section 179D allocations to obtain consideration for assuming these additional obligations, and as noted in many states it is even required that they do so[3].

(3) There Was No Congressional Intent to Preclude the Receipt of Value by Governmental Entities. Section 179D provides a rare opportunity for non-tax paying government entities to benefit from an IRS tax incentive. While government entities do not generally pay taxes, they may allocate the benefit to a tax-paying 'Designer' of the project and receive savings in return for that allocation. State and local laws often obligate the receipt of value by a government agency in return for granting this benefit. These savings can spur reinvestment and leverage recent improvements retroactively to add jobs, expand project scope, defray cost, and provide a private economic benefit to the Designer recipient.

A Designer may not claim the Section 179D allocation without a properly signed form executed under penalty of perjury from an authorized government representative. Unfortunately, some designers and their intermediaries have solicited waivers from their governmental customers to void the governmental entity's interest in the Deduction and unwittingly transfer the full value of the tax deduction to the Designer. To induce government employees into signing such allocation forms, Designers and their intermediaries have asserted that federal or state law mandates the governmental entity must sign the allocation form to a specific designer and/or have refused to allow the government agency to fulfill its responsibilities of proper due diligence, accounting or negotiating savings. Many states have constitutional and/or statutory restrictions that actually prohibit the governmental entity from transferring a previously uncontracted-for item of value to a private entity without a negotiated and properly transacted exchange of consideration.

In many instances, Section 179D allocations were not included in the original contract and no additional work was needed to qualify. Section 179D allocations were not originally negotiated, contemplated by, or included in the agreements for the original projects that qualify for the Section 179D Deduction. After executing a final construction contract, government entities are later being asked to sign an allocation that confers a value that was not contracted for and that is derived from a taxpayer funded project. Not only is it reasonable for a government entity to seek compensation in return, in order to defray cost in a similar manner to the deduction's benefit to commercial owners. But one could argue (as have numerous public finance attorneys) that it would be a failure of the government entity's fiduciary duty to fail to seek such compensation for this post-contractual term. Furthermore many state, local, and federal entities have laws and due diligence processes to cover the conveyance of values

[3] https://www.calstate.edu/CPDC/AE/memos/PB-17-006-FED-Energy-Policy-Tax-Credit.pdf

exceeding certain amounts and some designers circumvent these processes without an accounting and exchange of value.

The suggestion that an agency cannot share in the benefit of the tax allocation lacks any explicit statutory or legal analysis and disregards the plain meaning of the statute's language, not to mention the policy rationales favoring the return of value to taxpayers. However, the notion that tax dollars paid back to the state taxpayers is somehow improper demonstrates how aggressively some parties will argue that they should receive precious and scare tax dollars for free. Such claims distract from the real and positive greater good of the Section 179D program. Therefore, I would ask Congress to clarify and protect the rights and responsibility of government agencies to negotiate savings to taxpayers for taxpayer-funded investments in Section 179D-qualifying projects in government-owned buildings.

III. 179D is a Uniquely Successful Public Finance Program

Section 179D has achieved its legislative goal of incentivizing the investment in energy efficient buildings and reduced the net cost of those investments to the public and private building owners. Section 179D is a literal public-private partnership that provides a unique opportunity for non-taxpaying government entities and all state taxpayers to benefit from an IRS tax incentive. While government entities do not generally pay taxes, they may allocate the benefit to a taxpaying 'Designer' of the project and negotiate savings in return for that allocation. Similar programs exist with transferable utility rebates and other financial incentives that defray the cost to building owners of making qualified building investments. Those additional savings can spur reinvestment and leverage recent improvements retroactively to add jobs, reduce costs to the government, and still provide a private economic benefit to the designer recipient. Representative and notable examples include:

$ 1,377,682 savings to the University of Texas at Austin[4]

$ 1,135,327 savings to Miami-Dade County[5]

$ 400,000 savings to the Port Authority of NY&NJ at One World Trade Center[6]

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[4] https://utilities.utexas.edu/sites/uem.utexas.edu/files/179D-Press-Release-UT-Austin.pdf

[5] http://www.miamidade.gov/environment/releases/2014-07-16-chilled-water-system-savings.asp

[6] http://www.panynj.gov/press-room/press-item-print.cfm?headLine_id=2550

Despite being law for a decade, Section 179D is not well-understood. Like other energy-related tax incentive programs, it is subject to an almost yearly process of expiration and extension. The uncertainty whether the incentive will be renewed has caused it to be omitted from the original contracts for otherwise qualifying projects. This has resulted in confusion and uneven implementation of the program, and has created opportunities for fraud, waste, and abuse. Permanence in the program would allow public and private building owners to incorporate the incentive into their project financing and stretch taxpayer dollars further. The Section 179D model could easily be replicated in support of other sustainable energy investments via the Code.

In conclusion, I would propose the following recommendations as potential solutions for your consideration to continue and enhance the success of the 179D program:

1. Reconfirm the discretion afforded federal, state, and local government building owners to negotiate Section 179D savings in return for allocations.

2. Increase the maximum allocation and/or make Section 179D Permanent.

3. Address the 4+ story ASHRAE multi-family building definition to not preclude the vast majority of public housing stock, which have fewer than 4 stories[7].

4. Expand 179D allocations to include other non-taxpaying building owners that were not meant to be precluded by Congress such as REITs, nonprofits/private colleges, and tribal governments.

[7] The current law uses the ASHRAE 90.1-2001 and 2007 standards as the savings benchmark and the standard multifamily commercial building definition is 4 stories or greater. Thus, the vast majority of otherwise 179D qualifying public housing stock is excluded from the program.

EFFICIENCY ENERGY LLC GOVERNMENT AGENCY CLIENT LIST

MA
Boston Housing Authority
Commonwealth of Massachusetts

NY
Port Authority of New York and New Jersey
(EWR, LGA, JFK etc.)
New York City Housing Authority

PA
Philadelphia Housing Authority

MD
Harford County Schools
Frederick County (MD) Schools

DC
DC Public Schools
DC Dept of General Services

NC
Wake County NC
City of Raleigh NC
Wake County Technical College, NC
NC Global Transpark
NC Dept of Administration

FL
Florida State University System
(UCF, USF, FSU, UF)
City of Orlando
Orange County FL
Manatee County FL
Palm Beach County (and PBI Airport)
Broward County (and FLL Airport)
Miami-Dade County (and MIA Airport)
Miami-Dade Schools
Port Tampa

IL
Chicago Housing Authority
Chicago Public Schools

MN
University of Minnesota System

TX
University of Texas System (14 institutions)
University of Houston System (4 institutions)
Texas A&M System (11 institutions)
Tarrant County Community College (6 campuses)

CO
Cherry Creek Public School District No.5
Littleton Public Schools
Aurora Public Schools
Denver International Airport (DEN)

CA
Los Angeles Unified Schools
Los Angeles Community College District (9 Colleges)
Los Angeles County
University of California System (10 campuses)
California State University System(23 campuses)
San Francisco Housing Authority
Cajon Valley Unified Schools
Capistrano Unified School District