subject: Eligibility for Allocation of the Deduction for Energy Efficient Commercial Building Property under Section 179D(d)(4)

This Chief Counsel Advice responds to your request for assistance dated July 12, 2018. This advice may not be used or cited as precedent.

ISSUES

(1) In various factual scenarios discussed below, does the taxpayer qualify as a Designer of energy efficient commercial building property under section 179D(d)(4) of the Code?

(2) If a Designer only designed one system of energy efficient commercial building property in a government-owned building, can the Designer qualify for the maximum § 179D deduction of $1.80 per square foot?

CONCLUSIONS
(1) A taxpayer can qualify as a Designer of energy efficient commercial building property under § 179D(d)(4) if the taxpayer created technical specifications for construction contract documents for the design of the energy efficient commercial building property.

(2) If a building owner could have qualified for the maximum § 179D deduction of $1.80 per square foot for the installation of certain energy efficient commercial building property, then the government building owner has discretion to allocate the full $1.80 per square foot deduction to the primary Designer of one system of such property or to allocate the $1.80 per square foot deduction among several Designers.

BACKGROUND

General Types of Contracting Methods Used by the Construction Industry

An owner that plans to construct or renovate a commercial building may use at least three different general types of contracting methods for the design and construction of the project. First, an owner could contract separately with a design firm (usually an Architect), a General Contractor, and other construction professionals to complete the project. In this situation the construction professionals involved in the project do not have a contractual relationship with each other. This contracting method involves an additional bidding process so this type of contracting is often referred to as Design-Bid-Build contracting.

Second, an owner could contract with a joint venture (Design Builder) comprised of an Architect, General Contractor, and other construction professionals to complete the project. This contracting method is referred to as Design-Build contracting and requires only one contract between the owner and the Design Builder.

Third, an owner could contract with a Construction Manager, who can be either an adviser to the owner or a construction professional who contracts with the owner for increased responsibilities. When the owner engages a Construction Manager, there is usually a separate document between the owner and the Construction Manager that is part of the construction contract.

General Types of Documents Used by the Construction Industry

Sealed drawings are design drawings stamped, sealed, and signed by a professional Architect or Engineer. Specifications with sealed drawings are typically bid upon in Design-Bid-Build contracts. Substantive modifications to design specifications that occur during the construction process result in modified sealed drawings. Local government authorities overseeing large construction projects may also require final as-built, sealed drawings at the completion of the construction project. Specifications of a building design, once approved, become a part of the “contract documents.”
Shop drawings are drawings, diagrams, schedules, and other data specially prepared for the construction work by a construction professional such as a Contractor, Subcontractor, Manufacturer, Supplier, or Distributer to illustrate some portion of the work. The purpose of shop drawings is to demonstrate how the professional proposes to conform to the design concepts expressed in the contract documents. Importantly, shop drawings do not become part of the “contract documents.”

LAW


Section 179D(a) provides that a property owner who installs “energy efficient commercial building property” may be allowed as a deduction an amount equal to the cost of such property placed in service during the taxable year.

Section 179D(b)(1) provides that the maximum amount of the § 179D deduction is the product of $1.80 and the square footage of the building. Section 179D(b)(2) provides a lifetime limitation on the amount of the deduction allowed with respect to any building to the product of $1.80 and the square footage of the building.

Section 179D(c)(1) defines “energy efficient commercial building property” (EECBP) as property with respect to which depreciation (or amortization in lieu of depreciation) is allowable. EECBP must be installed on or in any building which is located within the United States and within the scope of Standard 90.1-2007.¹

Section 179D(c)(1) further provides that EECBP is property installed as part of (1) an interior lighting system; (2) a heating, cooling, ventilation, or hot water (HVAC/HW) system; or (3) a building envelope. To qualify for the § 179D deduction, EECBP must be certified as installed as part of a plan designed to reduce the total annual energy and power costs with respect to these systems by 50 percent or more in comparison to a reference building that meets the minimum requirements of Standard 90.1-2007.

Section 179D(d)(1) provides that if EECBP cannot meet the 50 percent reduction in total annual energy and power costs in comparison to the reference building, a property owner may deduct the cost of EECBP installed as one of the three systems if that system satisfies a certain energy savings percentage, except that the deduction is limited to the product of $.60 and the square footage of the building. The Service has issued three notices that provide alternative energy savings percentages that taxpayers

may use to qualify for a partial § 179D deduction for one of the three systems. Alternatively, for interior lighting systems, § 179D(f) provides an Interim Lighting Rule that may be satisfied by a reduction in lighting power density. Section 179D(d)(4) allows a government building owner to allocate the § 179D deduction to a Designer of EECBP in certain circumstances. That section provides:

In the case of energy efficient commercial building property installed on or in property owned by a Federal, State, or local government or a political subdivision thereof, the Secretary shall promulgate a regulation to allow the allocation of the deduction to the person primarily responsible for designing the property in lieu of the owner of such property. Such person shall be treated as the taxpayer for purposes of this section.

The Secretary has not promulgated a regulation to implement § 179D(d)(4). However, on April 7, 2008, the Service published Notice 2008-40 (Notice), which provides substantial guidance on the special rule for government-owned buildings. Section 3.01 of the Notice provides that “[i]f the allocation of a § 179D deduction to a designer satisfies the requirements of this section, the deduction will be allowed only to that designer.”

Section 3.02 of the Notice defines the “Designer” of a government-owned building as follows:

A designer is a person that creates the technical specifications for installation of energy efficient commercial building property (or partially qualifying commercial building property for which a deduction is allowed under § 179D). A designer may include, for example, an architect, engineer, contractor, environmental consultant or energy services provider who creates the technical specifications for a new building or an addition to an existing building that incorporates energy efficient commercial building property (or partially qualifying commercial building property for which a deduction is allowed under § 179D). A person that merely installs, repairs, or maintains the property is not a designer.

Section 3.03 of the Notice addresses the allocation of the § 179D deduction by providing that “[i]f more than one designer is responsible for creating the technical specifications for installation of energy efficient commercial building property (or partially qualifying energy efficient commercial building property for which a deduction is allowed under § 179D) on or in a government-owned building, the owner of the building shall—

(1) determine which designer is primarily responsible and allocate the full deduction to that designer, or

(2) at the owner’s discretion, allocate the deduction among several designers.”

Section 3.04 of the Notice requires that the allocation of the § 179D deduction to a Designer by the owner of a government building be in writing and include a list of specified information.

Section 3.05 of the Notice further requires that before a Designer may claim the § 179D deduction with respect to EECBP installed on or in a government-owned building, the Designer must obtain the written allocation described in section 3.04 of the Notice.

Section 3.06 of the Notice provides that the maximum amount of the § 179D deduction to be allocated to the Designer is the amount of the costs incurred by the owner of the government-owned building to place the EECBP in service, limited to the product of $1.80 and the square footage of the building.

FACTS AND ANALYSIS

Unless otherwise indicated, the following facts are assumed for purposes of the scenarios described below:

(1) the taxpayer claimed a § 179D deduction as a Designer of EECBP installed on or in a government-owned building;

(2) the taxpayer claimed the § 179D deduction for the tax year in which the EECBP was placed in service;

(3) the taxpayer obtained from the government building owner a written allocation meeting the requirements described in section 3.04 of Notice 2008-40 with respect to the deduction the taxpayer claimed as Designer of EECBP;

(4) the government building owner was provided a certification meeting the requirements of section 4 of Notice 2006-52 or section 5 of Notice 2008-40; and

(5) other than the determination of whether the taxpayer is a Designer of EECBP for a government-owned building, all other requirements for the taxpayer to qualify for the § 179D deduction have been met.

Scenario 1

Facts
For the construction of a government warehouse, a government building owner entered into separate Design-Bid-Build contracts with a design team (composed of an Architect who engaged Engineers) and with a General Contractor for construction. The General Contractor’s contract with the owner stated that the design team is responsible for the warehouse’s design. The design team designed specifications for the project, creating the contract documents that were approved by the owner. During pre-construction, the General Contractor suggested changes to the placement of roof-top HVAC/HW units and corresponding electrical conduit and ductwork for the HVAC/HW units to avoid interference with the roof support structure. These suggested changes were approved by the design team. The General Contractor’s suggestions did not include changes to the technical specifications for the HVAC/HW system. The General Contractor requested an allocation of a portion of the § 179D deduction for the HVAC/HW system from the government building owner. The government building owner made the requested allocation of a portion of the § 179D deduction to the General Contractor.

Analysis
The design team had design responsibilities for the project. The General Contractor had no legal obligation for the work of the design team. The design team designed technical specifications for the project, creating the construction contract documents. While the General Contractor’s suggestions addressed constructability of the design and resulted in changes in placement, these suggested changes did not rise to the level of technical specifications. As a result, the General Contractor did not meet the requirements to qualify as a Designer under section 3.02 of the Notice. Although section 3.03 of the Notice gives the government builder owner discretion to allocate the § 179D deduction among several Designers, it does not give the government building owner discretion to allocate the § 179D deduction to a person who was not a Designer of EECBP. The General Contractor’s claimed portion of the § 179D deduction should be disallowed. (Note: the design team could qualify as the Designer of EECBP in this scenario but must receive an allocation of the § 179D deduction before claiming the full or partial § 179D deduction.)

Scenario 2

Facts
An Architect entered into a contract with a government building owner to design the exterior shell of a building. This contract was one of several contracts the owner entered into with design firms to design the government building. The Architect’s only responsibility was to design the building envelope. The Architect had no responsibility for designing the other building systems. The design process was coordinated by a Construction Manager. The building qualified for the maximum § 179D deduction of $1.80 per square foot. At the end of construction, the Architect requested and was granted an allocation of the full § 179D deduction by the government building owner. Designers of other building systems requested but were denied an allocation of the § 179D deduction by the government building owner.
Analysis
The Architect provided design specifications for the building envelope, one of the building systems which qualified as EECBP and is therefore a Designer within the meaning of § 179D. The EECBP systems in the building together qualified for the maximum § 179D deduction. Had the building owner not been a government entity, the building owner could have claimed the maximum § 179D deduction. Section 179D(d)(4) permits a government building owner to allocate the deduction to “the person primarily responsible for designing the property in lieu of the owner of such property.” [emphasis added]. Accordingly, the government building owner had discretion to allocate the full § 179D deduction to the Architect and the Architect’s claimed full § 179D deduction should be allowed. (Note: if Designers of other EECBP for this building claim § 179D deductions, those deductions should not be allowed, as the government building owner did not allocate a portion of the § 179D deduction to other Designers and has already allocated the maximum amount of § 179D deduction for the building.)

Scenario 3

Facts
A government building owner contracts directly with various trades for the design and installation of EECBP using the services of an Architect and a Construction Manager to oversee the construction project. The government building owner entered into a contract with the Construction Manager as adviser. Under the terms of this contract, the Construction Manager was not contractually responsible for the design of the EECBP. Moreover, the Construction Manager did not have a contractual relationship with the various trades that designed and installed the EECBP for the project. The Construction Manager reviewed plans, provided progress reports, determined if work complied with specifications, and certified completion of work for the owner. At the end of construction, the Construction Manager requested that the government owner allocate the § 179D deduction to the Construction Manager and the government owner did so.

Analysis
The Construction Manager who entered into the contract with the building owner as an adviser had no design responsibilities and no direct contractual relationship with the Designers of the EECBP. The Construction Manager did not create technical specifications for the EECBP. Accordingly, the Construction Manager was not a Designer of EECBP and the Construction Manager’s claimed § 179D deduction should be disallowed.

Scenario 4

Facts
A government building owner decided to replace a building’s HVAC/HW system by using Design-Bid-Build contracts with various professionals. The government building owner first entered into a contract with an Engineer to evaluate the existing HVAC/HW system and to design new portions of the system. The Engineer determined that
chillers and roof top units needed to be replaced and that new HVAC/HW system controls were needed. The Engineer created sealed design drawings and technical specifications that included the location, type, and size of chillers, roof top units, and system controls. The government building owner then entered into a contract with a Contractor to install the designed items. The Contractor did not have responsibility for design. After installing the new HVAC/HW system, the Contractor asked for and received an allocation of the § 179D deduction from the government building owner. The Contractor claimed the full § 179D deduction related to the HVAC/HW system installed in the government building.

Analysis
The Contractor who installed the HVAC/HW system in the government-owned building did not design the HVAC/HW system. Additionally, the Contractor had no legal obligations under the Design-Bid-Build contract to provide professional design services to create the contract documents. Although section 3.03 of the Notice gives the government builder owner discretion to allocate the § 179D deduction among several Designers, it does not give the government building owner discretion to allocate the § 179D deduction to a person who was not a Designer of the EECBP. The Contractor’s claimed § 179D deduction should be disallowed. (Note: while the Engineer who designed the HVAC/HW system in this scenario was a Designer of EECBP, the Engineer cannot claim the § 179D deduction without an allocation of the deduction from the government building owner.)

Scenario 5

Facts
Assume the same facts as Scenario 4 except that the Engineer did not produce sealed drawings showing the location of the new chillers, roof top units, and HVAC/HW system controls. Instead, the Engineer specified the requirements of these items in technical specifications. The Contractor then bid and was awarded a contract to provide these items. Using a professional Engineer on the Contractor’s staff, the Contractor sized and installed the chillers and roof top units. The Contractor then used a Subcontractor to provide the required HVAC/HW system controls. The Subcontractor provided shop drawings for the HVAC/HW system controls. At the completion of construction, the Contractor provided sealed drawings showing the as-built location, type, and size of the chillers and roof top units for the HVAC/HW system. Both the Engineer and the Subcontractor were allocated a portion of the § 179D deduction by the government building owner and both claimed a portion of the § 179D deduction for the HVAC/HW system.

Analysis
The Engineer was one of the Designers of the HVAC/HW system, as the Engineer created technical specifications for the system. Because the Subcontractor merely installed the HVAC/HW system controls, the Subcontractor was not a Designer of the HVAC/HW system. Although section 3.03 of the Notice gives the government builder
owner discretion to allocate the § 179D deduction among several Designers, it does not give the government building owner discretion to allocate the § 179D deduction to a person who was not a Designer of the EECBP. The § 179D deduction claimed by the Engineer should be allowed, as the Engineer was the Designer of the HVAC/HW system. However, the § 179D deduction claimed by the Subcontractor should be disallowed, as the Subcontractor was not a Designer of the HVAC/HW system.

Scenario 6

Facts
Assume the same facts as Scenario 4 except that in addition to new chillers, roof top units, and HVAC/HW system controls, new ductwork was installed. The Engineer provided sealed drawings and technical specifications for the chillers, roof top units, and the HVAC/HW system controls but did not provide drawings and specifications for the size and location of the ductwork. The Contractor sized and located the needed ductwork as part of its contract with the owner and the Contractor created shop drawings for the ductwork. At the completion of construction, the Contractor was allocated a portion of the § 179D deduction by the government building owner and the Contractor claimed a portion of the § 179D deduction for the HVAC/HW system.

Analysis
The Contractor created shop drawings for the ductwork. Because shop drawings are not contract documents and are not considered technical specifications for purposes of the § 179D deduction, the Contractor is not a Designer of the HVAC/HW system and its claimed § 179D deduction should be disallowed.

Scenario 7

Facts
A government building owner hired a specialty Lighting Firm to design and install a unique interior lighting system for a government building that was not included in the general construction contract. The lighting system was built to general parameters specified by the Architect, such as maximum power usage per square foot. The specialty Lighting Firm’s design for the interior lighting system incorporated low power lighting sources along with solar panels. The general construction contract included the building envelope and HVAC/HW systems. The Lighting Firm created design specifications for the building’s lighting system but did not design the building envelope or HVAC/HW systems. Either of the following sub-scenarios occurred:

(1) At the completion of construction, the Lighting Firm requested the government building owner allocate the full § 179D deduction of $1.80 per square foot to the Lighting Firm. The building owner made this allocation and the Lighting Firm claimed the full §179D deduction.
(2) At the completion of construction, the Lighting Firm requested the government building owner allocate a partial § 179D deduction for the lighting system of $.60 per square foot. The building owner made this allocation and the Lighting Firm claimed the partial § 179D deduction of $.60 per square foot. The building’s design team also requested, received, and claimed partial § 179D deductions for the HVAC/HW systems and building envelope, totaling $1.20 per square foot.

Analysis
The Lighting Firm was a Designer of the interior lighting system, which was one of the building systems which qualified as EECBP. While it seems more appropriate for the Lighting Firm to receive a partial § 179D deduction so that Designers of the other EECBP systems can also receive partial § 179D deductions, section 3.03 of the Notice gives the government building owner discretion to allocate either the full deduction to the primary Designer or to allocate portions of the deduction among several Designers. Unless the Service has evidence that a government building owner’s allocation of the § 179D deduction was improper, such as when the person to whom the deduction was allocated was not a Designer or when the government building owner allocated more than the maximum amount of the § 179D deduction among one or more Designers, the Service should respect the owner’s allocation.

Scenario 8

Facts
A Mechanical Engineer on a design team hired a specialty Subcontractor to design and install control systems for the HVAC/HW, interior lighting, elevator, escalator, automatic door, back-up power and several other building systems that use power. These control systems are collectively called the Energy Management System. The Subcontractor did not design any of the § 179D qualifying EECBP systems but the Energy Management System manages those systems for peak energy efficiency. At the end of the project, the Subcontractor requested and was allocated the § 179D deduction for the HVAC/HW and lighting systems, totaling $1.20 per square foot.

Analysis
Whether the Energy Management System is part of the HVAC/HW and lighting systems, and therefore EECBP, is a factual determination. If the Energy Management System that controlled the HVAC/HW and lighting systems is part of the EECBP systems for purposes of § 179D(d)(4), then the Subcontractor qualifies as a Designer and could be allocated and claim the § 179D deduction for these systems. If the Energy Management System is not part of the EECBP systems for the government building, then the Subcontractor was not a Designer of EECBP for purposes of § 179D and the Subcontractor’s claim of a partial § 179D deduction should be disallowed.

Please call Jennifer Bernardini at (202) 317-6853 if you have any further questions.