Energy Efficient Commercial Building Property and Section 179D: New Tax Court Case Offers Guidance on Allocation of Deductions

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This article provides an overview of Section 179D, explains various sources of IRS guidance from the past two decades, and analyzes the newest Tax Court case on point, *Johnson v. Commissioner*.

Introduction

Disputes will arise when Congress enacts a tax incentive, it orders the Internal Revenue Service ("IRS") to supply details via regulations, the IRS publishes Notices instead, the Notices contemplate participation by multiple parties and the liberal allocation of tax benefits among them, the IRS issues guidance over the years echoing the Notices, and then the IRS suddenly changes its tune. This is exactly what has occurred when it comes to tax deductions for expenses incurred by taxpayers in connection with energy efficient commercial building property ("EECBP"). This article provides an overview of Section 179D, explains various sources of IRS guidance from the past two decades, and analyzes the newest Tax Court case on point, *Johnson v. Commissioner*.[1]

Overview of Section 179D

Congress enacted the Energy and Policy Act of 2005, which featured a long list of tax incentives.[2] Among them was a special deduction in Section 179D for expenses incurred by taxpayers with respect to EECBP.[3]

Section 179D contemplated unique allocation rules for deductions linked to public property, but Congress did not have all the specifics at the outset. There-

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fore, it tasked the IRS with working out the details. Specifically, Section 179D(d)(4) states that, in the case of EECBP installed on or in property owned by a federal, state or local government, the IRS "*shall promulgate a regulation* to allow the allocation of the deduction *to the person primarily responsible* for designing the [EECBP] in lieu of the owner of such property."[4]

Despite the clear congressional mandate from way back in 2005, the IRS has never issued any proposed, temporary or final regulations regarding Section 179D. Indeed, according to the Priority Guidance Plans published by the Treasury Department, the IRS never planned to issue regulations, and never devoted any resources to the matter after 2012.[5] Instead of going to the effort to formulate regulations and comply with the public-notice-and-comment requirements, the IRS released what it called "interim guidance" in the form of three Notices.[6] One of them, Notice 2008-40, addresses Section 179D(d)(4) in detail. It is the focus of this article.[7]

Possibility of Multiple Designers

After Congress creates a benefit, the IRS often comes to suspect that certain taxpayers are engaged in wrongdoing, deriving an advantage to which they are not entitled. This is precisely what happened with Section 179D. The IRS initiated a Compliance Campaign in late 2017 directed at allocations of deductions in situations involving government-owned buildings.[8]

In carrying out the Compliance Campaign, the IRS has started narrowly reading Section 179D(d)(4). It argues that, based on a strict reading of the provision, there can be only one "person primarily responsible for designing the property." This idea seems logical at first glance, but it becomes dubious when one begins to scrutinize the relevant authorities. A partial list is analyzed below.[9]

Notice 2006-52

Congress introduced in 2005 standards for energy-efficiency lighting that would reign "[u]ntil such time as the [IRS] issues final regulations."[10] The IRS issued Notice 2006-52 less than one year later. It contained "interim guidance" for all components of EECBP, not just lighting systems. Notice 2006-52 expressly states that it applies to EECBP that is installed as part of the (i) interior light systems, (ii) heating, cooling, ventilation, and hot water systems, or (iii) the building envelope or exterior. The rules contemplate the involvement of multiple Designers and the allocation of the Section 179D deductions among them. Notice 2006-52 states the following in this regard:

> *Application to Multiple Taxpayers.* If two or more taxpayers install [energy-efficient lighting property, heating, cooling, ventilation, or hot water property, or building envelope property] on or in the same building, the aggregate amount of the Section 179D deductions allowed to all such taxpayers with respect to the building shall not exceed the amount determined under [the relevant portion of Notice 2006-52].[11]

Notice 2008-40

Next came Notice 2008-40. The IRS told the public that it "clarified and amplified" the earlier guidance from Notice 2006-52, contained additional guidance, and was "intended to be used with Notice 2006-52."[12] In other words, Notice 2008-40 did not supersede Notice 2006-52; it expanded on it. Notice 2008-40 unveils the special rules related to government-owned buildings, which purchase EECBP, and which are eligible for a Section 179D deduction. It begins with the general rule that, in the case of EECBP installed on or in a government-owned building, the owner can allocate the deduction to "the person primarily responsible for designing the property."[13]

A "Designer" in these situations is a person that creates the "technical specifications" for the installation of the EECBP.[14] The non-exhaustive list of potential Designers includes architects, engineers, contractors, environmental consultants, and energy-service providers who create technical specifications for a new building, or for an addition to an existing building, which incorporates EECBP.[15] However, cautions the IRS, a person that merely installs, repairs, or maintains the property is not considered a Designer.[16]

Notice 2008-40 then contemplates the existence of multiple Designers collaborating on a single project. It explains that if "more than one Designer is responsible for creating the technical specifications" in connection with a government-owned building, then the owner can do one of two things. For starters, the owner can figure out which of the several Designers is the one "primarily responsible" and allocate 100 percent of the Section 179D deduction to that Designer. Alternatively, the owner, using its own discretion, can allocate the deduction "among several Designers."[17]

Process Unit – Audit Guide

The IRS issued guidance to its audit personnel in the form of a Process Unit focused on Section 179D deductions.[18] Because the IRS never published regulations, the Process Unit directs IRS personnel to consult various authorities, including Notice 2008-40.[19] Later, consistent with the special rules featured in Notice 2008-40, the Process Unit instructs IRS personnel to verify whether the government-building owner allocated the Section 179D deduction to multiple Designers. It then reminds IRS personnel that, in situations involving more than one Designer, the owner "must" either identify the Designer primarily responsible and fully allocate the deduction to that one Designer or, using its own discretion, "allocate the deduction among several Designers."[20] The Process Unit also presents IRS personnel with the following questions to answer during the audit process, all of which infer the participation of multiple Designers. The specific inquiries are as follows: "Are there other Designers? If so, how many and why are they considered Designers? Did other Designers receive an allocation of the [Section] 179D deduction?"[21]

The Process Unit also contains interesting perspectives from the IRS about the significance of Notice 2008-40. It explains that a Notice is a "public announcement" that may contain "substantive interpretations" of tax provisions, such as Section 179D. Expanding on this notion, it goes on to state that "Notices can be used to relate what regula-

tions will say in situations where the regulations may not be published in the immediate future."[22]

Bulletin in Federal Register

The General Services Administration published a bulletin in the Federal Register in 2011 supplying information to all agencies incurring expenses related to EECBP in government-owned buildings.[23] Among other things, the bulletin stated that IRS "guidance on the allocation of the [EECBP] for government-owned buildings is set forth in Notice 2008-40." More importantly, the bulletin said that the owners "may allocate [the Section 179D] deduction *to* the person or persons primarily responsible" for designing the EECBP.[24]

Early Case on Point

Several cases involve Section 179D in one way or another, but the specific issue of allocation of deductions to multiple Designers pursuant to Notice 2008-40 appeared in just one case for many years, *United States v. Quebe*.[25]

Decision by District Court

There are two major issues in *Quebe,* one of which was whether the taxpayer, QHI, was a Designer for purposes of Section 179D. The District Court determined that QHI was merely an installer, such that it was not a Designer, and was thus not eligible for an allocation of the deduction.

Despite the ultimate holding in *Quebe,* the reasoning and statements by the District Court contain several items that strengthen the position that a government-building owner can allocate the Section 179D deduction among many parties, provided that they all qualify as Designers. For instance, the District Court explained that the Department of Justice ("DOJ") argued that "QHI did not collaborate *with the architects and engineers who designed the buildings* – it was not a designer, but merely installed the lighting pursuant to *their* specifications." The District Court then clarified that the relevant projects involved at least six different architectural and designer companies.[26]

Citing Notice 2008-40, the District Court also said that "while the Notice recognizes that [EECBP] *may have more than one designer*, it specifically excludes a contractor who merely installs property." By doing so, the District Court necessarily recognized the validity and authority of Notice 2008-40. This is because the rule about excluding persons who merely install items from the definition of Designer is *only* found in Notice 2008-40. The District Court again acknowledged the possibility of multiple Designers in concluding that QHI "failed to create a genuine issue of material fact regarding their assertion that QHI *was one of the persons primarily responsible for designing the schools*."

Legal Brief Submitted by U.S. Government

The Department of Justice ("DOJ") filed a Memorandum of Law with the District Court in support of its Motion for Summary Judgment. As seen below, the DOJ argued that (i) more than one Designer can receive an allocation of the Section 179D deduction, (ii) the District Court and taxpayers can rely on Notice 2008-40, and (iii) Section 179D(d)(4) and Notice 2008-40 can be interpreted consistently.

The DOJ explained that Congress provided that a government-building owner may allocate the deduction only to "the person primarily responsible for designing" the EECBP. However, "Notice 2008-40 . . . expands on this requirement," allowing the owner to allocate the deduction among several parties when more than one Designer is responsible for creating the technical specifications. Demonstrating its support for the idea that it is acceptable for a government-building owner to allocate the deduction to all parties considered Designers, the DOJ stated the following to the District Court:

> The Notice [2008-40] thus recognizes that more than one person can be primarily responsible for the design, as when an architect and engineer work together to create the specifications, but specifically excludes a contractor who 'merely installs' the property. The architects and engineers who worked on each school building are the persons primarily responsible for designing the lighting systems. QHI, as the electrical contractor, was [merely] responsible for installing the lighting system.

Extending the reasoning of the DOJ, if QHI had been able to prove to the District Court that it, too, was a Designer, then allocation of the Section 179D to the architects, engineers, and QHI (instead of just to the architects and engineers) would have been fine.

Chief Counsel Advice AM 2018-005

Chief Counsel Advice ("CCA") AM 2018-55 perhaps provides the most extensive guidance, from the IRS itself, about the ability of taxpayers to allocate the Section 179D deduction to multiple parties that qualify as Designers. The CCA describes the evolution of Section 179D and the special rules applicable to government-owned buildings. In doing so, the CCA acknowledges that the IRS has never promulgated regulations, as mandated by Congress in 2005, but has issued three Notices, including Notice 2008-40. The CCA concedes that Notice 2008-40 offers "substantial guidance" on the special rule for government-owned buildings. The CCA then explains Sections 3.01, 3.02 and 3.03 of Notice 2008-40, which confirm that the owner of a government building can allocate the Section 179D deduction among multiple parties "if more than one Designer is responsible for creating the technical specifications." Finally, the CCA offers eight scenarios whose sole issue is which parties, among several, are entitled to an allocation of the Section 179D deduction. The scenarios are discussed below.

Scenario 1 involved a "design team," consisting of two separate persons, an architect and an engineer. It also involved a general contractor, who aspired to join the team in hopes of getting an allocation of the Section 179D deduction. The work of the general contractor did not rise to the level of technical specifications, such that it was not part of the "design team." In Scenario 1, the IRS held that two persons, the architect and the engineer, jointly constituted the "person primarily responsible" and thus were both Designers.

Scenario 2 involved an architect, design firms, and a construction manager. At the end of the project, the architect

requested and received the full allocation of the Section 179D deduction. Later, the design firms requested allocations, too, but were denied. The IRS determined that the architect was a Designer because he provided technical specifications for the building envelope. The IRS further explained that, because the architect was one of the Designers, the government-building owner had discretion under Notice 2008-40 to allocate the entire deduction to the architect. Importantly, the IRS confirmed that if the other Designers were to later claim an allocation of the deduction, they would not be entitled to any because the government-building owner already allocated the full amount to the architect.

Scenario 3 involved an architect and a construction manager. Only the architect created technical specifications, so he was the only Designer. The implication of Scenario 3 is that multiple parties, such as the architect and construction manager, could have each received a portion of the Section 179D deduction if they had both qualified as Designers.

Scenario 4 involved an engineer and a contractor. Only the engineer created technical specifications, so he was the sole Designer. Scenario 4 suggests that multiple parties, such as the engineer and contractor, could have each received a portion of the deduction if they had both qualified as Designers.

Scenario 5 involved an engineer, contractor, and subcontractor. Only the engineer created technical specifications; therefore, he was the Designer. The inference of Scenario 5 is that multiple parties, such as the engineer, contractor and subcontractor, could have each received a portion of the Section 179D deduction if they had all qualified as Designers.

Scenario 6 involved an engineer and a contractor. Only the engineer created technical specifications, such that he was the lone Designer. The significance of Scenario 6, like many of its predecessors, is that more than one party, like an engineer and a contractor, could have received a portion of the deduction, provided that each independently qualified as a Designer.

Scenario 7, which is particularly noteworthy, involved a lighting firm and an architect. Both parties created technical specifications and were thus Designers. However, the government-building owner allocated all the deduction to the lighting firm and none to the architect. The IRS explained the following, fortifying the notion that multiple persons could, together, form the "person primarily responsible" under Section 179D(d)(4) and Notice 2008-40:

> While it seems more appropriate for the lighting firm to receive a partial [Section] 179D deduction so that Designers of the other EECBP systems can also receive partial [Section] 179D deductions, Section 3.03 of the Notice [2008-40] 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 [IRS] has evidence that a government-building owner's allocation of the [Section] 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 [Section] 179D deduction among one or more Designers, the [IRS] should respect the owner's allocation.

Scenario 8 involved a mechanical engineer, who was part of the design team, and a specialty subcontractor hired to design and install various building systems. The subcontractor did not design the system which managed the EECBP for peak performance. The IRS determined that if the system were part of the EECBP, then both the mechanical engineer and the subcontractor would be Designers and entitled to an allocation of the Section 179D deduction. By contrast, if the system were not part of the EECBP, then only the mechanical engineer would be a Designer.

IRS National Office Correspondence

Various lawmakers have explicitly asked the IRS over the years to issue regulations regarding Section 179D, as Congress instructed it to do in 2005. In response, attorneys from the IRS's National Office told one lawmaker, in writing, that the IRS issued Notice 2006-52 and Notice 2008-40, they addressed "key issues" regarding Section 179D, and although such IRS guidance came in the form of Notices instead of regulations, "taxpayers may rely with confidence on those Notices.[27]

Compliance Campaign

As explained earlier in this article, the IRS, suspecting potential wrongdoing by taxpayers, initiated a Compliance Campaign in late 2017. In warning the public about its plan to audit Section 179D deductions allocated to Designers, the IRS confirmed that "[i]f the equipment is installed in a government-owned building, the deduction is allocated *to the person(s) primarily responsible for designing the EECBP.*"[28]

Newest Tax Court Case on Point

The most recent case addressing Section 179D, the definition of Designers, and the proper allocation of deductions is *Johnson v. Commissioner.*

Relevant Facts

The case, decided by the Tax Court in January 2023, involved Edwards Engineering, Inc. ("Edwards"), a company devoted to designing and installing heating, ventilation, and air conditioning ("HVAC") systems. Edwards employed several engineers, among other personnel.

In early 2012, Edwards signed an agreement with the Department of Veterans Affairs ("VA") to provide maintenance services for the HVAC systems at one of its hospital facilities. The medical campus is comprised of a number of structures, including Building 200, which is the main hospital. It is a critical healthcare facility whose systems, such as the HVAC, must remain functional at all times. The Tax Court emphasized that commercial HVAC systems are significantly more complex than residential ones, with the "control system" constituting the brains of the entire affair. Edwards kept a full-time staff at the hospital in order to perform all the services required, including a project manager and a site supervisor with technical training and certifications.

In late 2013, the VA asked Edwards to provide a quote to replace the control system for Building 200 because the existing one had become obsolete and ceased to function properly. Edwards did so, and the parties expanded the agreement accordingly. Edwards purchased the equipment necessary to complete the new project from South Side Control Supply Co. ("South Side"). Edwards also retained South Side to assist with programming the control system and providing drawings for the replacement of the control system because it possessed specialized software. South Side's main business is selling replacement components for commercial HVAC systems.

Edwards obtained technical information about the existing control system, identified the original sequence of operations, conducted a full assessment, and modified the sequence as appropriate. In addition, Edwards installed a new control system and added two components that were previously absent. The site supervisor for Edwards and an employee of South Side "worked together" to test and ensure that the new system and all its components were functioning properly.

Shortly thereafter, the VA asked Edwards to bid on another project, immediate replacement of a temperature control system for certain floors in Building 200 that was malfunctioning. Edwards presented its proposal, and the parties entered into another contract. As it had earlier, Edwards bought equipment for the new project from South Side and retained it to assist with programming. Edwards inspected the existing system, modified the sequence of operations, replaced the system, and installed some new equipment. Consistent with their previous collaboration, the site supervisor for Edwards and an employee of South Side both contributed to the programming of the computer.

A consulting firm ("Firm") centered on tax mitigation strategies prepared an EECBP study for Edwards with respect to Building 200 at the VA hospital facility. The Firm sent Edwards a letter concerning the allocation of the Section 179D deduction ("Allocation Letter") and instructed it to have the Chief of Maintenance and Operations at the VA execute it. The Allocation Letter stated that the owner of Building 200 (*i.e., the VA) allocates* "the full federal income tax deduction available under Section 179D attributable to the HVAC and hot water systems to [Edwards] for its work on the Building." Attached to the Allocation Letter was a chart with various data points, including the placed-in-service date of the property and its cost. The Firm completed the study for Edwards after obtaining the executed Allocation Letter from the VA. It concluded that Edwards was entitled to a deduction in 2013 of approximately $1 million.

Following the advice of the Firm, Edwards filed its Form 1120-S (U.S. Income Tax Return for an S Corporation) for 2013 claiming the deduction of around $1 million. This deduction flowed-through to the shareholders of Edwards, who promptly got audited by the IRS. In complete disagreement with the conclusion reached by the Firm, the IRS determined that Edwards, and thus its shareholders, should get a deduction of $0. The IRS issued Notices of Deficiency to this effect, which the shareholders challenged by filing Petitions with the Tax Court.

Legal Analysis Generally

The Tax Court threw a few jabs before getting to the substance of the case. Specifically, it punctuated that the IRS "has not yet promulgated any regulations with respect to Section 179D" even though the applicable law was enacted nearly 20 years ago, Edwards did not argue that Notice 2008-40 and others issued by the IRS were invalid because Congress expressly instructed the IRS to issue guidance via regulations, and the IRS challenged "nearly every applicable requirement of Section 179D."[29]

With respect to the third point raised by the Tax Court, the IRS broadly suggested that Edwards should get no deduction whatsoever because (i) the HVAC materials installed in Building 200 allegedly did not constitute EECBP, (ii) even if the materials met the definition of EECBP, they were not placed in service in 2013, (iii) the amount of the deduction attributed to 2013 was overstated, and (iv) the allocation of the de-

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1 *Johnson v. Commissioner*, 160 T.C. No. 2 (2023). This article is the second on the topic by the same author. *See* Hale E. Sheppard, "Section 179D Deduction for Energy Efficient Commercial Building Property: IRS Attacks Allocations as Part of Compliance Campaign," 135(6) *Journal of Taxation* 11 (2021), republished in 49(3) *Real Estate Taxation* 10 (2022).

2 Energy Policy Act of 2005, Public Law 109-58, August 8, 2005.

3 U.S. Joint Committee on Taxation. Description and Technical Explanation of the Conference Agreement of H.R., Title XII, Energy Tax Incentives Act of 2005. JCX-60-05 (July 28, 2005), pgs. 78-81.

4 Section 179D(d)(4)(emphasis added).

5 U.S. Treasury Department. 2007-2008 Priority Guidance Plan (April 22, 2008) (although full of instances where the government explicitly planned to release proposed, temporary or final regulations, the government only anticipated issuing "guidance" regarding Section 179D in the form of a Notice). *See also* U.S. Treasury Department. 2011-2012 Priority Guidance Plan (November 19, 2012).

6 Notice 2006-52, Notice 2008-40, and Notice 2012-16.

7 Other articles about Section 179D exist, but they do not wrangle with allocation of the Section 179D deduction to multiple Designers. *See, e.g.,* Larry R. Garrsion, "New Law Creates, Expands, and Extends Energy-Related Tax Incentives," 18(6) Practical Tax Strategies 351 (Dec. 2008); Robyn L. Dahlin and Alex R. Pederson, "Energy Act Offers Tax Benefits to Developers," 33(3) Journal of Real Estate Taxation (Second Quarter 2006); Charles R. Goulding et al, "Strategic Thinking: Seven Years of Code Sec. 179D EPAct," 13(12) Corporate Business Taxation Monthly 9 (2012); Pat McLaughlin, "Commercial Buildings: Achieving Energy Efficiency," Construction Accounting and Taxation (May/June 2009).

8 www.irs.gov/businesses/corporations/lbi-retired-campaigns

9 The IRS has published other authorities regarding Section 179D, but they do not address the key issue of allocation of deductions to Designers pursuant to Section 179D(d)(4). *See, e.g.,* Chief Counsel Advice 201451028; Chief Counsel Advice AM 2010-07; IRS INFO 2007-0031; IRS INFO 2011-0072, Revenue Procedure 2011-14, Appendix, Section 8; Revenue Procedure 2012-39, Section 1.09 through 1.11; Revenue Procedure 2016-29, Section 8; Revenue Procedure 2018-31, Section 8.01.

10 Section 179D(f). This provision cross-references Section 179D(d)(1)(B), which states that the IRS, after consultation with the Secretary of Energy, shall establish energy-efficiency targets.

11 Notice 2006-52, Section 2.03(2)(a)(ii), Section 2.04(2)(b), and Section 2.05(2)(b) (emphasis added). *See also*, Notice 2012-26, Section 3.04(2).

12 Notice 2008-40, Section 1.

13 Notice 2008-40, Section 3.01.

14 Notice 2008-40, Section 3.02.

15 *Id.*

16 *Id.*

duction by VA was improper because Edwards was not one of persons primarily responsible for designing the relevant property and/or because the Allocation Letter was flawed.

The Tax Court rejected nearly all the IRS's arguments and sub-arguments. The IRS prevailed on just one issue, and then only partially. The IRS garnered a limited victory regarding the correct amount of the Section 179D deduction because Edwards improperly included in its calculations costs from the original HVAC upgrade work performed *before* 2013, as well as certain projects done *after* 2013. The study performed by the Firm, and the only year at issue before the Tax Court, was 2013. Therefore, the amount was capped at the costs incurred in just that one year. The Tax Court did not question the accuracy of the costs; it was purely a matter of timing.

Focus on Deduction-Allocation Issue

This article addresses the IRS's final contention, which centered on the whether the VA could allocate the Section 179D deductions to Edwards given the role it played.

1. First Argument – Who Are the Designers?

The Tax Court first analyzed whether Edwards was a "person primarily responsible for designing the property." As explained earlier, Notice 2008-40 says that a Designer is a person that creates the technical specifications for installing EECBP, including, for instance, an architect, engineer, contractor, environmental consultant, or energy-services provider who produces technical specifications for a new building or for modification of an existing building that incorporates EECBP. Also, as indicated above, Notice 2008-40 warns that a person who merely installs, repairs, or maintains EECBP is not a Designer.

Unsurprisingly, the IRS argued that Edwards was not a Designer because it supposedly did not create any technical specifications and merely installed, repaired, or maintained the HVAC system for Building 200. The Tax Court swiftly rejected the IRS's position. The Tax Court first clarified that the work that Edwards performed exceeded installation, repair and maintenance. Both projects at issue obligated Edwards to replace the control systems. This, in turn, required Edwards to analyze the original sequence of operations, inspect the system to identify any failures or ad hoc changes occurring since inception, modify the sequence of operations, program the modifications into the new control system, conduct simulation tests on every aspect of the new system, and then reprogram any problematic items. The Tax Court concluded that Edwards had created technical specifications by completing these actions and thus was a Designer for purposes of Section 179D.

The Tax Court, based on the evidence presented by the parties, described South Side as a "control and parts distributor for commercial HVAC contractors and is primarily in the business of selling replacement parts and components for commercial HVAC systems."[30] Nevertheless, the IRS next argued that South Side was the sole Designer, the person primarily responsible for designing the EEBCP installed in Building 200, and, by extension, the only party to which the VA could have allocated the deductions.

It should not escape the attention of readers that South Side, coincidentally, did not claim any deductions and could not do so when the IRS raised its arguments because the relevant period had already lapsed. Applying the IRS's self-serving logic, the VA could not derive a benefit from the deductions because of its tax-exempt status, Edwards could not benefit because it was not a Designer, and South Side could not benefit because its chance had passed. Thus, if the IRS had things its way, Congress created the Section 179D deduction to encourage efficient energy use, yet none of the relevant parties could take advantage of such governmental incentive. Classic.

The Tax Court was not swayed by the IRS. It explained that the IRS had overstated the role of South Side, pointing out that it is mainly a distributor of components for commercial HVAC systems, it is not an architectural firm, it does not employee engineers, and most of the amounts that Edwards paid South Side was for equipment, not services. The Tax Court also referenced testimony to the effect that South Side's normal role as a subcontractor is to implement the design of the contractor (*i.e.*, Edwards) by assisting with the technical programming. Finally, the Tax Court emphasized that neither Section 179D, enacted by Congress, nor Notice 2008-40, issued by the IRS, prohibits the use of a subcontractor.

The Tax Court went on to explain that, assuming *both* Edwards and South Side were Designers, Notice 2008-40 explicitly gives the owner of the building (i.e., the VA) discretion on how to allocate the deductions between multiple Designers. The VA exercised such discretion by executing an Allocation Letter stating that the entire deduction should go to Edwards. The Tax Court summa-

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17 Notice 2008-40, Section 3.03.

18 Internal Revenue Service. LB&I Process Unit. IRC 179D Energy Efficient Commercial Buildings Deduction. COR-P-002 (Revised June 19, 2020).

19 Internal Revenue Service. LB&I Process Unit. IRC 179D Energy Efficient Commercial Buildings Deduction. COR-P-002 (Revised June 19, 2020), pg. 6.

20 Internal Revenue Service. LB&I Process Unit. IRC 179D Energy Efficient Commercial Buildings Deduction. COR-P-002 (Revised June 19, 2020), pg. 26.

21 Internal Revenue Service. LB&I Process Unit. IRC 179D Energy Efficient Commercial Buildings Deduction. COR-P-002 (Revised June 19, 2020), pg. 30.

22 Internal Revenue Service. LB&I Process Unit. IRC 179D Energy Efficient Commercial Buildings Deduction. COR-P-002 (Revised June 19, 2020), pg. 38.

23 Federal Register, Volume 76, Number 49, page 13617 (March 14, 2011).

24 *Id.*

25 *United States v. Quebe*, 123 AFTR 2d 2019-543; *See also University of Texas v. Alliant Group, LP*, 124 AFTR 2d 2019-5779, *Konkel v. Commissioner*, Tax Docket No. 4609-12W, 2012 WL 864737 (2012), *Hellmuth, Obata & Kassabaum, LP v. Efficiency Energy, LLC*, 2015 WL 4126911 (DC SD Tx 2015) and 2016 WL 164112 (DC SD Tx 2016).

26 *United States v. Quebe*, 123 AFTR 2d 2019-543.

27 INFO 2009-0226 (Nov. 25, 2009); *see also* INFO 2012-0004 (Feb. 1, 2012).

28 www.irs.gov/businesses/corporations/lbi-retired-campaigns

29 *Johnson v. Commissioner*, 160 T.C. No. 2 (2023), pgs. 15-16, and footnote 13.

30 *Johnson v. Commissioner*, 160 T.C. No. 2 (2023), pg. 7.

31 *Johnson v. Commissioner*, 160 T.C. No. 2 (2023), pg. 26.

rized matters as follows: "We conclude that [the] VA determined Edwards to be the person primarily responsible for designing the EECBP installed in Building 200. Accordingly, we find that Edwards was the person primarily responsible for designing the EECBP installed in Building 200."[31]

2. Second Argument – Was the Allocation Letter Proper?

The IRS next argued that, even if Edwards were a Designer, it should be deprived of the Section 179D deduction because the Allocation Letter from the VA was flawed. In other words, notwithstanding congressional intent, substance of the law, and efforts of the parties to comply with procedures, the IRS urged the Tax Court to give Edwards a deduction of $0 based solely on a technicality.

Notice 2008-40 states that a Designer must obtain a "written allocation" from the owner of a government building before it can claim a deduction. It also requires that the document contain various pieces of information, including the cost of the EECBP, the date it was placed in service, the amount of the deduction, and the signature of authorized persons of both the government-owned building and the Designer.

The IRS first contended that the Allocation Letter was not up to snuff because it did not feature the specific dollar amount of the deduction going to Edwards. The IRS reasoned that the dollar amount is necessary for government-building owners, like the VA, to be able to calculate the *aggregate* amount of deductions taken with respect to a building for purposes of *future* allocations. As explained earlier in this article, the Allocation Letter stated that "the owner of the Building allocates the *full federal income tax deduction* available under Section 179D attributable to the HVAC and hot water systems to [Edwards] for its work on the Building." The Tax Court held that the Allocation Letter did, indeed, state the "amount" of the deduction directed to Edwards; it said the "full amount," which equals 100 percent. Admonishing the drafter of the applicable standards (*i.e.,* the IRS), the Tax Court explained that if the Allocation Letter needed to specify the "dollar amount," then the IRS should have said as much in Notice 2008-40. The Tax Court continued by underscoring that the Firm issued a separate notice to the VA informing it of the precise dollar amount of deductions going to Edwards. Therefore, concluded the Tax Court, the VA was supplied all the information necessary to account for any subsequent allocations.

Still swinging, the IRS argued that Edwards should get a deduction of $0 because an "authorized representative" of the VA did not execute it. The Tax Court appeared to have little tolerance for this position. It explained that the Chief of Maintenance and Operations for the entire VA medical facility, including Building 200, signed the Allocation Letter. At trial, the gentlemen admitted that he lacked authority to sign contracts on behalf of the VA, but the Tax Court did not find this problematic since an Allocation Letter is not a contract. The Tax Court also noted that the VA has never attempted to reverse or invalidate the allocation to Edwards on grounds of insufficient authority of its Chief of Maintenance and Operations.

Conclusion

Most taxpayers would be stunned to learn that Congress enacted a law nearly 20 years ago fomenting energy-efficient buildings, Congress instructed the IRS to issue regulations clarifying the rules, the IRS ignored this mandate and issued informal Notices instead, the Notices expressly stated that multiple Designers might exist and owners of government buildings may allocate the deductions among several Designers as they see fit, the IRS later published various documents affirming the multiple-Designer and discretionary-allocation aspects of the earlier Notices, and then the IRS began taking positions during tax audits and litigation that directly conflict with its unwavering guidance over many years. This is surprising, yet true, as demonstrated by *Johnson v. Commissioner.* Taxpayers and their advisors will be watching to see if the IRS changes course after losing essentially all arguments in its most recent dispute.