Michael Johnson et al. v. Commissioner of Internal Revenue, 160 T. C. No. 2 (U. S. Tax Court 2023)

In a significant ruling, the U. S. Tax Court upheld the eligibility of Edwards Engineering, Inc. , for a $304,640 deduction under I. R. C. § 179D for energy-efficient upgrades at a Veterans Affairs hospital. The decision clarifies the criteria for claiming the Energy Efficient Commercial Building Property (EECBP) deduction, affirming that contractors can claim the deduction when designated by government entities, and that the deduction is limited to the cost of property placed in service during the tax year.

Parties

Michael Johnson and Cynthia Johnson, Brant Lieske and Laura Lieske, Scott Lieske, and Todd Lieske (Petitioners) v. Commissioner of Internal Revenue (Respondent). The Petitioners were shareholders in Edwards Engineering, Inc. , which sought the deduction at issue.

Facts

Edwards Engineering, Inc. , an S corporation, entered into a maintenance contract with the U. S. Department of Veterans Affairs (VA) for the Edward Hines, Jr. VA Hospital. In 2013, Edwards was tasked with updating control systems for air handling units (S4/S5 project) and emergency replacement of temperature control systems for several floors (emergency project) in Building 200 of the hospital. Edwards modified the sequence of operations, programmed new Johnson Controls systems, and ensured functionality through simulation tests. Alliantgroup conducted an Energy Efficient Commercial Building Tax Deduction Study, which included a certification of compliance and an allocation letter signed by the VA’s Chief of Maintenance and Operations, allocating the full I. R. C. § 179D deduction to Edwards. The Petitioners, as shareholders, claimed their proportionate shares of the deduction on their individual tax returns, which were subsequently disallowed by the IRS.

Procedural History

The Commissioner of Internal Revenue issued notices of deficiency to the Petitioners, disallowing the § 179D deductions claimed by Edwards for 2013. The Petitioners filed petitions with the U. S. Tax Court, contesting the deficiencies. The cases were consolidated for trial, briefing, and opinion. The court had jurisdiction to determine the correctness of the adjustments, as they involved both S corporation items and other adjustments in the shareholder-level deficiency proceedings.

Issue(s)

Whether the property installed by Edwards in Building 200 qualified as Energy Efficient Commercial Building Property (EECBP) under I. R. C. § 179D(c)(1)?

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Whether the VA's Chief of Maintenance and Operations properly allocated the § 179D deduction to Edwards as the person primarily responsible for designing the EECBP?

Whether the EECBP was placed in service during the 2013 tax year?

What is the amount of the § 179D deduction to which Edwards is entitled for the 2013 tax year?

Rule(s) of Law

I. R. C. § 179D(a) allows a deduction equal to the cost of EECBP placed in service during the taxable year. I. R. C. § 179D(c)(1) defines EECBP as property that is depreciable, installed in a U. S. building within the scope of Standard 90. 1-2001, part of specified building systems, and certified as reducing energy costs by 50% or more compared to a reference building. I. R. C. § 179D(d)(4) allows government entities to allocate the deduction to the person primarily responsible for designing the property. I. R. S. Notice 2006-52 provides interim guidance on certification requirements, and I. R. S. Notice 2008-40 provides guidance on allocation for government-owned buildings.

Holding

The court held that the installed property qualified as EECBP under I. R. C. § 179D(c)(1), the VA's chief maintenance officer properly allocated the deduction to Edwards as the designer, the property was placed in service during the 2013 tax year, and Edwards was entitled to a § 179D deduction of $304,640.

Reasoning

The court reasoned that Edwards's modification of the sequence of operations and programming of the new control systems constituted designing the EECBP, as per Notice 2008-40's definition of a "designer. " The court rejected the Commissioner's argument that the projects were not part of a plan to achieve energy savings, relying on the plain text of Notice 2006-52, which did not require such intent. The energy modeling by Alliantgroup, using the Performance Rating Method, showed a 50. 01% reduction in energy costs, satisfying the certification requirement under § 179D(c)(1)(D). The court also found that the VA's allocation letter, signed by an authorized representative, properly allocated the full deduction to Edwards. The property was deemed placed in service in 2013, as it was ready and available for its assigned function by the end of that year. The court determined the deduction amount based on the cost of EECBP placed in service in 2013, which was $304,640, the amount billed by Edwards to the VA.

Disposition

The court ruled that Edwards is entitled to a § 179D deduction of $304,640 for the

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2013 tax year. Decisions were to be entered under Rule 155 of the Tax Court Rules of Practice and Procedure.

Significance/Impact

This decision provides crucial guidance on the application of the § 179D deduction for contractors working on government-owned buildings. It clarifies that the deduction can be allocated to the contractor as the designer, even when the project involves maintenance or replacement rather than new construction. The ruling also emphasizes the importance of proper certification and allocation procedures, as outlined in IRS Notices, in claiming the deduction. The case may influence future interpretations of what constitutes “designing” EECBP and the criteria for property being “placed in service. ” It also highlights the need for clear documentation and adherence to IRS guidelines to substantiate the deduction claim.

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