

Energy Efficient Commercial Buildings Tax Deduction

Code Section 179D of the Internal Revenue Code, the little-known Section

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Defining 179D

The Energy Efficient Commercial Buildings Tax Deduction, included in Internal Revenue Code Section 179D, is commonly called the Commercial Building Deduction or the 179D deduction. The incentive was originally enacted as part of the Energy Policy Act of 2005, but was largely overlooked by tax advisors because of its original expiration date of December 31, 2007 for commercial buildings placed in service after December 31, 2005. It was extended through various tax acts for buildings placed in service prior to December 31, 2016. There is a possibility that under President Trump's proposals, this law will be extended to future tax years. Although presently expired, the law will benefit contractors who may not have been aware of the legislation through utilization of the statute of limitations for amending tax returns. The provisions encourage building owners to increase energy efficiency in new and remodeled buildings by providing an immediate tax deduction for costs incurred to increase the energy efficiency of a building. Those costs would otherwise be generally depreciated over 15, 27.5, or 39 years.

The Deduction and Limitations:

The maximum deduction that can be taken annually is \$1.80/square foot of building space, less the related aggregate amount of deductions taken in prior years. The cost of the building is reduced by the amount of the deduction. To achieve the maximum benefit, the building must achieve a reduction in energy cost of at least 50 percent in total annual energy and power costs, as compared to a "reference building" that meets the minimum standards of ASHRAE 90.1-2001 if placed in service prior to Jan. 1, 2016 (90.1-2007 if placed in service after Dec. 31, 2015). This standard sets minimum requirements for the energy-efficient design of new buildings so they may be constructed, operated, and maintained in a manner that minimizes energy use without constraining the building function or the comfort and productivity of the occupants. Since the deduction is based on the square footage, 179D is more beneficial to large buildings.

The energy savings are measured by reference to three main building system categories:

- Interior lighting
- Heating, cooling, ventilation, and hot water systems
- Building envelope

Additionally, a partial deduction is available of up to 60¢/square foot per system for buildings where the overall building does not meet the 50 percent energy savings threshold. In these instances, the individual systems for which the deduction is claimed must meet various reductions in energy usage.

Buildings That Qualify

New construction of a commercial building of any size qualifies. New construction of residential rental buildings, such as apartments, qualifies if they are four or more stories. Additionally, renovations and retrofits of existing structures are also eligible to receive the deduction. These buildings must be located in the United States.

The Beneficiary of the Deduction

The deduction is available to the owner of the building at the time it is constructed or when the renovation is made. Generally, the deduction belongs to the entity that is depreciating the energy-efficient property. An interesting application of this benefit occurs when the building is owned by a government, school or municipality. Congress's intent was to encourage energy-conscious construction. Many energy efficient buildings across the country are owned by government agencies (which of course do not pay taxes). There was a concern that the impact of the incentive would be greatly reduced since it was not useful for these properties. To address this concern, Congress made the unusual decision to allow the buildings' "designer" (engineer, contractor, architect, environmental consultant, or energy services provider) for the taxable year in which the property is placed in service to take the deduction. This is a very attractive benefit to the building designer because it is essentially "found" money as the government is allocating a tax benefit to parties that provided services and did not incur any building construction costs.

Timing of The Deduction

The deduction is available for buildings or renovations placed in service after Dec. 31, 2005, and before Jan. 1, 2017. The deduction is taken in the year in which the building is placed in service. For property placed in service in prior years and depending on the situation, a taxpayer may take the deduction on an amended return or possibly via a form 3115, Application for Change in Accounting Method. For taxpayers' that may have a deduction limitation, the deduction may be carried back two tax years prior to the limitation year and carried forward twenty years.

The Calculation

The energy savings must be certified by a qualified person, who is defined in Treasury guidance as an engineer or contractor who is licensed in the jurisdiction where the property is located and is unrelated to the party claiming the deduction. The certification is done using a software program that is approved by the IRS for making the 179D energy savings calculation. Therefore, the cost of this certification must be considered when determining the net benefit of the deduction.