<u>Tax Deduction of $1.80 per Square Foot for Commercial Building Owners and Tenants</u>

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Commercial building owners and tenants who make expenditures to cause their buildings to be more energy efficient can qualify for a significant Federal tax deduction.

For buildings that qualify, a deduction of up to $1.80 per square foot is available.

Section 179D of the IRS Code

Expenditures eligible for the deduction are "energy-efficient commercial building property" that is: *Installed on or in any building located in the United States that is within the scope of Standard 90.1-2001, Energy Standard for Buildings Except Low-Rise Residential Buildings, of the American Society of Heating, Refrigerating, and Air Conditioning Engineers and the Illuminating Engineering Society of North America;*

Installed as part of (i) the interior lighting systems, (ii) the heating, cooling, ventilation, and hot water systems, or (iii) the building envelope; and

Certified as being installed as part of a plan designed to reduce the total annual energy and power costs of interior lighting systems, heating, cooling, ventilation, and hot water systems of the building by 50 percent or more when compared to a reference building, which meets the minimum requirements of Standard 90.1-2001 (effective April 2, 2003).

This tax credit is not new, but with its high dollar value and flexibility in expensing capital costs in the single year the property is placed in service, it is worthy of review. Section 1331 of the Energy Policy Act of 2005 enacted Sec. 179D of the IRS Code, which provides for the deduction. Originally effective for part or all of the cost of energy efficient commercial building property that the taxpayer placed in service after December 31, 2005 and before January 1, 2009. The Emergency Economic Stabilization Act of 2008 extends the provision for property placed in service prior to January 1, 2014.

Building Types

Eligible buildings include new construction and renovations of commercial buildings including offices, retail buildings, and warehouses; rental housing of four stories or more; and, publicly-owned buildings. Parking garages are eligible for the deduction in that garages are a space type covered by ASHRAE 90.1.

The IRS has provided guidance regarding the definition of a building, which as of 2008 is expanded to include a structure that "is unconditioned attached or detached garage space" (which may significantly expand the value of the deduction).

Tenants are Eligible

The determination of whether a tenant is eligible for the deduction is a function of who owns the property for tax purposes. It is a question of fact and the determination may depend on the agreement of the parties. If the tenant pays for the investment, constructs it according to its owns specs, and there are no concessions in the lease or from the landlord, it is likely that the tenant will be the owner of the improvements for tax purposes and eligible to claim the deduction.

Shared Deduction

If two or more taxpayers install property on or in the same building the deduction for the cost of the property may be taken by each and otherwise shared, subject to the limitation that the aggregate amount of the deductions allowed to all such taxpayers with respect to the building shall not exceed the amount otherwise available to a single taxpayer.

Government Allocation to Designers

In the case of federal, state and local public buildings, significantly, the IRS issued guidance that the law allows for the tax savings to be allocated to the person primarily responsible for designing the buildings, in lieu of the public entity.

Sophisticated bidders on public construction projects have made their bids more competitive factori9ng in the allocation for a designer that may include, “an architect, engineer, contractor, environmental consultant or energy services provider who creates the technical specifications” for a new public building or an addition to an existing public building that incorporates energy efficient commercial building property.

Partial Deductions are Eligible

In the instance of a building that does not meet the whole building requirement of a 50 percent energy savings, a partial deduction may be allowed with respect to each separate eligible building system: Heating/cooling and water heating systems, building envelope, and lighting system.

Each of the three energy using systems can be evaluated separately, and is eligible for a share of the tax deduction if it meets its share of the overall savings goal for the building, a 50 percent reduction in energy costs. Earlier IRS guidance changed the rules allowing a limited deduction for "partially qualifying property" that meet lower energy savings targets than the prior required 16 2/3 percent reduction for a tax deduction of 60 cents per square foot. Now, an income tax deduction is available for a 10 percent reduction in energy costs for interior lighting systems; a 20 percent reduction for heating, cooling, ventilation, and hot water systems; and, a 20 percent reduction for the building envelope. When all three systems qualify and total energy costs are reduced by 50 percent, the owner is eligible for the full tax deduction of $1.80 per square foot off the cost.

Spotlight on Lighting

There are also specific tax regulations for lighting efficiency. Because lighting systems are easy to upgrade and the precise energy savings gained by upgrades are already known, building owners and tenants are encouraged to focus on lighting improvements.

Lighting systems that reduce lighting power density by 40 percent (50 percent in a warehouse) and employ dual switching (i.e., the ability to switch roughly half the lights off and still have fairly uniform light distribution) qualify owners for a full tax deduction of 60 cents per square foot. The IRS outlines a prorated incentive schedule in which systems that reduce lighting power density by 25 to 40 percent may earn a partial deduction of 30 to 60 cents per square foot. The IRS guidance requires that lighting level and lighting control standards be met in order for owners to qualify for the tax deductions.

To Claim the Deduction

Before a taxpayer may claim the Sec. 179D deduction, the taxpayer must obtain a certification with respect to the property. The certification must be provided by a qualified individual, who may be a licensed professional engineer or contractor in the jurisdiction where the building is located. The certification must include a statement that approved computer software (a list has been issued by the US DOE) was used to calculate energy and power consumption and costs. These requirements are necessary only in the case of certifications that involve calculations of energy and power consumption and cost.

As was made clear in guidance issued on an interim lighting rule, a reduction in lighting power density may be computed using a spreadsheet for this provision. This computation does not require qualified computer software to model the entire building system or a determination of projected annual energy costs.

LEED Projects are Ideal Candidates

While this issue of modeling energy performance carries a dollar cost, LEED certified projects require similar (although not identical) energy modeling, such that once an energy consultant is engaged on a LEED project, the certification necessary for the Sec. 179D deduction certification is easily accomplished. Moreover, with the LEED 2009 prerequisite of a 10 percent improvement in the proposed building performance rating for a new building compared with the baseline in Appendix G of ANSI Standard 90.1-2007, many if not most LEED 2009 certified buildings will be eligible for this tax deduction!

There are opportunities for business to advantage government incentives in green building, including the significant Federal tax deduction described above. Many of the opportunities are best leveraged with a team approach to green building that includes a knowledgeable owner’s representative early in the process.

We work with a broad breadth of businesses, in giving each company 'an edge', including assisting in advantaging sources of government incentives and advising others about this still evolving regulatory environment of green building and sustainable business. If you are interested in how we can assist your company, please contact Stuart Kaplow.

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