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BY RICH SHAVELL

Taking Advantage of IRC § 179D

IRC § 179D, the energy-efficient commercial buildings tax deduction or simply the Section 179D deduction, was enacted as part of the *Energy Policy Act of 2005*.¹ The provision encourages building owners to promote energy savings in new and remodeled buildings by providing an immediate tax deduction for costs incurred that reduce a building's energy consumption. As of this writing, IRC § 179D applies to qualifying property installed on or before December 31, 2016.

What Is Energy-Efficient Property?

Energy-efficient building property is installed to a building in the U.S.² for which depreciation or amortization is allowable.³ To qualify, the property must be installed as part of the interior lighting systems; hot water systems; heating, ventilation, and air conditioning (HVAC) systems; or the building envelope.⁴

The property must be certified as reducing the total energy and power costs with respect to the specified systems by 50% or more in comparison to a reference building⁵ that meets the minimum requirements of Standard 90.1-2007 of the American Society of Heating, Refrigerating, and Air Conditioning Engineers and the Illuminating Engineering Society of North America.⁶ If this standard is not met, another provision allows a partial deduction of \$0.60 per square foot rather than the full \$1.80 per square foot.⁷

Who Receives the Deduction?

Generally, the deduction belongs to the entity that is depreciating the energy-efficient property and becomes available at the time it is constructed or when the renovation is placed in service.

Government-Owned Buildings

A unique provision for government-owned buildings permits the owner to allocate the deduction to the building's "designer" (e.g., engineer, contractor, architect, environmental consultant, or energy services provider).⁸ Examples of government-owned buildings that may qualify for the deduction include schools, state universities, libraries, town halls, airports, transportation facilities, post offices, courthouses, and military bases.

Since the party or parties receive a tax benefit for providing services yet they do not incur the actual building construction costs, this is an attractive benefit to the party that qualifies as the building "designer."

As government entities do not traditionally pay tax, building owners can allocate the accrued tax savings to the business responsible for the energy-saving enhancements. In some cases, the jurisdiction may negotiate a reduction in service cost in exchange for the allocation.

Requirements

The allocation of the Section 179D deduction to the "designer" of a government-owned building must be in writing⁹ and should contain all of the following:

- "The name, address, and telephone number of an authorized representative of the owner of the government-owned building;
- The name, address, and telephone number of an authorized representative of the designer receiving the allocation of the deduction;
- The address of the government-owned building on or in which the property is installed;
- The cost of the property;
- The date the property is placed in service;
- The amount of the deduction allocated to the designer;
- The signatures of the authorized representatives of both the owner of the government-owned building and the designer or the designer's authorized representative; and
- A declaration, applicable to the allocation and any accompanying documents, signed by the authorized representative of the owner of the government-owned building in the following form:

'Under penalties of perjury, I declare that I have examined this allocation, including accompanying documents, and to the best of my knowledge and belief, the facts presented in support of this allocation are true, correct, and complete.'¹⁰

While the “designer” is not required to attach the allocation to the return, taxpayers must maintain records that establish the entitlement to, and amount of, any deduction.¹¹

Deduction Amount

IRC § 179D is unique in that the deduction amount is based on the square footage of the building and not just the cost of the improvement. This amount can range as high as \$1.80 per square foot of building space¹² and as much as \$0.60 per square foot for each qualifying energy-efficient building or system.¹³

The deduction is available for buildings or renovations placed in service after December 31, 2005, and before January 1, 2017.¹⁴ At the time of this writing, we await the new administration’s tax proposal to see if IRC § 179D will be extended.

Depending on the situation, for property placed in service in prior years, a taxpayer could possibly take the deduction on either an amended return or via Form 3115, Application for Change in Accounting Method.¹⁵

The energy savings must be certified by a qualified person, defined as an engineer or contractor that is licensed in the jurisdiction where the property is located and unrelated to the party claiming the deduction.¹⁶ The certification process must also be completed using IRS-approved software.¹⁷ Given these requirements, the cost of the study to document and certify the energy savings should be considered when determining the net tax benefit.

Calculating the Deduction

As previously discussed, the maximum deduction allowable is equal to \$1.80 per square foot. Several options exist for computing the deduction:

- The whole building approach requires that the project reduce total annual energy and power costs by at least 50% compared to a building satisfying the requisite energy standards.¹⁸ In this instance, the complete deduction is equal to the project costs capped at \$1.80 per square foot.¹⁹
- A partial deduction up to \$0.60 per square foot for each qualifying system (e.g., lighting, HVAC, or building envelope) is also available.²⁰

- Finally, a reduced deduction is available specifically for the lighting system under the Interim Lighting Rule. This complicated computation permits partial allowance equal to project costs with a cap of \$0.30 to \$0.60 per square foot, depending on percentage savings compared to a lighting density standard.²¹

Examples

During the current year, a building owner refits an existing building with a qualified energy-efficient interior lighting and HVAC system. The building’s interior space is 180,000 square feet, and the installed energy property costs \$300,000. Assuming a properly completed study is certified, the owner can deduct \$216,000 of his retrofit costs (180,000 square feet x \$1.20 for the lighting and HVAC) on his current tax return. These costs would generally be depreciated over 39 years. The property owner reduces the depreciable cost by \$216,000, leaving \$84,000 to be depreciated.

Let’s suppose this same building is government-owned. In that case, the \$216,000 deduction can pass through to the “designer,” who would deduct the amount on his tax return. Assuming a 40% income tax rate, the tax savings is \$86,000. The jurisdiction does not reduce its cost basis for depreciation purposes.

Summary

CFMs should consider IRC § 179D when undertaking projects that increase energy efficiency in one or more of the three building system categories: interior lighting, HVAC, or the building envelope. The deduction should be considered by contractors working with government-owned buildings because of the potential allocation of the deduction to the building’s “designer,” which can include the engineer, contractor, architect, environmental consultant, or energy provider.

Currently, the deduction is available for buildings or renovations placed in service after December 31, 2005 and before January 1, 2017. This includes property placed in service in recent tax years, as a taxpayer could take the deduction on an amended return or Form 3115.

Consult your tax advisor when considering contracts where significant energy-efficient property is installed. ■



Endnotes

1. H.R. 6, Pub. L. 109-58.
2. IRC § 179D(c)(1)(B).
3. IRC § 179D(c)(1)(A).
4. IRC § 179D(c)(1)(C).
5. IRC § 179D(c)(1)(D).
6. IRC § 179D(c)(2).
7. IRC § 179D(d)(1)(A).
8. IRS Notice 2008-40, www.irs.gov/irb/2008-14_IRB/ar12.html.
9. Ibid.
10. Ibid.
11. Ibid.
12. IRC § 179D(b)(1)(A).
13. IRC § 179D(d)(1).
14. IRC § 179D(h).
15. Rev. Proc. 2012-39.
16. IRS Notice 2006-52, www.irs.gov/irb/2006-26_IRB/ar11.html#d0e3999.
17. IRC § 179D(d)(3); IRS Notice 2006-52.
18. IRC § 179D(c)(1)(D).
19. IRC § 179D(b)(1).
20. IRC § 179D(d)(1)(A).
21. IRS Notice 2006-52.

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