

# Executive's Tax & Management Report

Wealth-building strategies plus  
late-breaking tax news

APRIL 2010  
VOLUME 73  
ISSUE 4

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## Tax Deductions for Energy-Efficient Buildings

By Angela Beasley Phyfer

The Energy Policy Act of 2005 [P.L. 109-58] encouraged property owners to build buildings to promote a reduction in energy consumption by establishing a new Internal Revenue Code Section ("Code Sec.") 179D deduction for energy-efficient commercial building property placed in service from January 1, 2006 through December 31, 2008. The Emergency Economic

Stabilization Act of 2008 [P.L. 110-343] extends the benefits through December 31, 2013.

**Deduction Criteria**

This deduction opportunity is a major incentive for building owners to design high-energy efficiency into new buildings and to improve energy efficiency in older buildings. Eligible commercial buildings include the following:

### Tax Extenders Bill Passes in Senate

At press time, federal lawmakers in the Senate and House of Representatives were expected to start resolving the differences between their versions of tax extenders legislation.

The House passed its version of the legislation in December, and the Senate followed suit in March.

Among other things, the Senate version of the American Workers, State and Business Relief Act (H.R. 4213) extends tax cuts for research and development, small businesses that continue to pay employees who have been called to active military duty, use of biodiesel and renewable energy, teachers who buy classroom supplies out of their own pocket, college tuition, home energy efficiency, state sales tax

deductions and business investment in low-income communities, according to Senate Finance Committee Chairman Max Baucus (D-MT), who introduced the bill with Majority Leader Harry Reid (D-Nev.).

In addition, the legislation extends unemployment insurance benefits and eligibility for the 65-percent COBRA health care tax credit through December 31, 2010.

Chuck Grassley (R-IA), ranking member of the Senate Finance Committee, was among those who voted against the bill. Although he supports extending unemployment benefits and tax provisions to encourage job creation, he said the bill includes "\$100 billion of spending that was not paid for under federal budget rules."

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EXECUTIVE'S TAX & MANAGEMENT REPORT (ISSN 1098-1594) is published monthly by CCH, a Wolters Kluwer business, 4025 W. Peterson Ave., Chicago, Illinois 60646. Subscription inquiries should be directed to 4025 W. Peterson Ave., Chicago, IL 60646. Telephone: (800) 449-8114. Fax: (773) 866-3895. Email: [cust\\_serv@cch.com](mailto:cust_serv@cch.com). ©2010 CCH. All Rights Reserved.

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- Offices
- Warehouses
- Retail buildings
- Industrial buildings
- Publicly owned buildings

LEED certified and "green" buildings are the most likely candidates for the deduction, although most energy-efficient construction is eligible.

The maximum tax deduction is \$1.80 per square foot. To qualify, the property must be otherwise depreciable or amortizable and it must be installed on or in any building located in the United States that is within the scope of Standard 90.1-2001 of the American Society of Heating, Refrigerating and Air-Conditioning Engineers and the Illuminating Engineering Society of North America (ASHRAE/IESNA). The property must be installed as part of the:

- building envelope;
- interior lighting systems; or
- heating, cooling, ventilation and hot water (HVAC) systems.

In addition, the property must be certified as being installed as part of a plan designed to reduce the total annual energy and power costs of these systems by 50 percent or more in comparison to a reference building that meets the minimum requirements of Standard 90.1-2001. The requirement is not for a 50-percent reduction in each system; rather, it is a 50-percent reduction in total. For example, a 16 2/3-percent reduction in each of the three systems would meet the 50-percent requirement. As discussed below, detailed certification requirements must be met in order to qualify for the deduction.

Also, in general, if the building does not meet the overall building requirement of a 50-percent energy savings, a partial deduction is allowed for each separate building

system (*i.e.*, the building envelope, the interior lighting systems and the HVAC systems) that makes up the energy-efficient property and that is certified as meeting or exceeding the applicable system-specific savings targets established by the IRS. The maximum allowable deduction is \$0.60 per square foot for each separate system.

If energy-efficient commercial building property is installed on or in property owned by a federal, state or local government (*i.e.*, a public school, a federal courthouse, *etc.*), the deduction will be allocated to the person primarily responsible for designing the property in lieu of the public entity owning the property. Who qualifies as the designer? The designer is the person that creates the technical specifications for installation of the energy-efficient property. The designer may be any of the following:

- Architect
- Engineer
- Contractor
- Energy services provider
- Environmental consultant

The deduction can be allocated among multiple designers. And, the government entity must provide the designer with a written declaration allowing the allocation of the deduction.

The basis of the energy-efficient building is reduced by the amount of the deduction allowed, which results in a temporary tax benefit to most taxpayers. However, when the deduction is allocated from the owner of the public building to the designer, the designer obtains a permanent benefit. The designer does not own the property, so the reduction in basis does not offset the deduction taken. In this situation, the owner of the public building must reduce the basis of the qualified property by the amount of the Code Sec. 179D deduction taken.

## Certification Process

There is a certification process, and specific requirements, as set forth in IRS Notice 2006-52 [IRB 2006-26, June 26, 2006] and Notice 2008-40 [IRB 2008-14, Apr. 7, 2008], that must be met in order to qualify for the deduction. There are certain methods for calculating and verifying the energy and power costs and qualified computer software that must be used. Also, an inspection of the building site is required, conducted by a licensed state engineer. The certification must include the following:

- Statement regarding the energy efficiency of the building
- Statement that the deduction has been determined under the rules of Notice 2006-52
- Address of the building

- Statement that the field inspections have been performed verifying the energy-saving assets
- Statement that approved software has been used for the calculations
- List of qualifying assets and projected annual energy costs
- Statement made by qualified individual (*I.e.*, a properly licensed engineer, not related to the taxpayer, must provide a written statement of qualification to the taxpayer that includes the qualified individual's name, address and phone number.)

With the detailed certification process, you might think that there is a special IRS form to claim the deduction. That is not the case. The deduction is included in the "other deductions" line of the taxpayer's tax return (*e.g.*, Form 1120 for corpora-

tions, Form 1120-S for S corporation, Form 1065 for partnerships, *etc.*).

## Other Incentives

Finally, in addition to the federal benefit, there are many states that have various state energy incentives as well. Also, some utility companies even offer incentives related to energy assets. It is important to take the time to look at all energy incentives available to your business. Along with the energy-efficient commercial buildings deduction, these incentives reduce the after-tax cost of "green" energy projects by reducing your cash tax liability and increasing your cash flow.

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