

## Energy Efficient Property Owners More Likely Than Ever to Benefit From Tax Deduction

By: Cory Ouellette, CPA

**Energy efficiency** isn't merely a feel good initiative; it can also mean immediate tax savings. The deduction for energy efficient commercial buildings, for up to \$1.80 per square foot of newly constructed or improved space, is now becoming more practical. To qualify for the deduction, the energy efficient property must be placed in service between January 1, 2006 and December 31, 2013. If you have missed the deduction for property already placed in service, you may be eligible to amend your prior year returns and capture the deduction. Even if you aren't the owner of an energy efficient building, this deduction may still benefit you.

Commercial property is deemed to be energy efficient if the total annual energy and power costs related to interior lighting, HVAC and building envelope systems of the structure are reduced by 50 percent or more in comparison to the baseline standard established by the American Society of Heating, Refrigerating and Air-Conditioning Engineers (ASHRAE) 90.1-2001. Since the majority of states' standard building codes are based on the subsequently developed ASHRAE 90.1-2004 or later iterations, virtually all buildings in these states will qualify for some or all of the deduction, even if built to meet only the minimum standards.

So how is the deduction calculated? For each of the three systems (interior lighting, HVAC, and building envelope), there is a \$.60 per square foot deduction. The \$1.80 maximum deduction that is allowed is taken the year the building was placed in service and the depreciable basis of the building is reduced by the amount of the deduction. So it essentially results in an accelerated deduction in year one; a deduction that is not subject to depreciation recapture upon the sale of the property.

This deduction is for energy efficient commercial property not just energy efficient commercial buildings and therefore would apply to improvements made to a building. As such, tenants who lease property and install an energy efficient lighting system or HVAC would qualify for the deduction.

In order to claim the deduction, the taxpayer must obtain a certification required by the IRS that must be retained with the taxpayer's other books and records. The certification requirements include:

1. Certification provided by properly licensed professional engineer or contractor.
2. The party certifying the qualified property cannot be related to the taxpayer claiming the deduction.
3. The party certifying must represent to the taxpayer in writing that they are qualified to certify.
4. The certifier must use IRS-qualified computer software.

Let's walk through an example so you can see the true benefit of this deduction.

### Assumptions

- 60,000 square foot retail building
- Construction costs of \$120/sq. foot
- Interior lighting, HVAC and building envelope all meet the minimum standards
- Building is placed in service in December of 2010
- Tax rate of 40% (federal and state)

The total cost of this commercial building is \$7,200,000. With the three systems meeting the minimum standards for the 179D deduction (the section of the Internal Revenue Code from which this deduction originates), this taxpayer is eligible for a \$108,000 (\$1.80 x 60,000 s.f.) deduction. At a tax rate of 40%, this results in current year cash savings of \$43,200.

Use of the 179D deduction does not preclude the taxpayer from also taking advantage of the benefits of a cost segregation study. A cost segregation study breaks out the smaller components of a building therefore allowing them to be depreciated throughout a shorter life. In this instance, combining a cost segregation study with the 179D deduction would total approximately \$125,000 of 2010 tax savings.

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One final point to mention about the 179D deduction is that when the building is owned by a governmental entity, the taxpayer primarily responsible for the design of the building may be allowed to take the deduction in lieu of the governmental entity. A designer is a person that creates the technical specifications for installation of energy efficient property and may include the architect, engineer, contractor, environmental consultant or energy services provider. The deduction is calculated the same as if the owner was claiming the deduction; however the taxpayer doesn't own the property and therefore doesn't have to reduce his basis in property he owns. Whereas in the typical situation the taxpayer is just accelerating future depreciation deductions, with governmental buildings the designer is receiving a deduction that it never would have received to begin with.

As previously stated, the certification process requires a professionally licensed engineer to conduct the study and issue the certification. For that reason Elliott Davis, LLC has partnered with an engineering firm and now has the full capabilities of determining the energy efficiency of your commercial property. If your property meets the minimum standards, we can provide you with the necessary certification you can use to support your 179D deduction. Please consult with your Elliott Davis tax or real estate advisor to determine your eligibility for the energy efficiency deduction.

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