

The 179D Tax Deduction

January 2013

Section 179D, the Energy Efficient Commercial Building Tax Deduction, can represent a large tax deduction for building owners—as much as \$1.80 per square foot. Building owners need to work with an energy professional to qualify for and claim the 179D deduction. Along with the owner’s tax consultant, you are a critical member of the 179D team.

Understanding the 179D Deduction

As an energy professional, you will help the owner or lessee—whoever paid for the improvements—determine whether the energy-efficiency improvements qualify for the deductions. In some cases, the designer/consultant may be able to take the deduction. Improvements must meet several conditions.

- ☑ **“The costs must be associated with depreciable or amortizable property in a Standard 90.1-2001 domestic building.”**
 - For 179D, “property” means the equipment that was installed, such as lighting fixtures or HVAC equipment. “Depreciable property” means that the equipment has an estimated useful life of 3 years or more.
 - 179D covers American Society of Heating, Refrigeration, and Air-Conditioning Engineers (ASHRAE) Standard 90.1 buildings, which are all buildings **except** single-family homes and low-rise multifamily (fewer than four above-ground stories).
 - The building must be in the United States. Also, the building must have been placed in service between January 1, 2006 and December 31, 2013.
- ☑ **The 179D deduction covers improvements to these building systems only:** interior lighting; heating, cooling, and ventilation; service hot water; and building envelope
- ☑ **The energy-efficiency improvements must be part of an energy reduction plan.**
 - You will need to create a building energy model showing 50% savings compared to an ASHRAE 90.1-2001 reference building. You must use qualified software (eQUEST or other approved software, shown at right). Note that TREAT is not approved for 179D.
 - You must use the **Performance Rating Method** (from Appendix G of ASHRAE 90.1-2004) as a modeling guideline to compute the percentage reduction in total annual energy costs:
 - * **Reference building energy and power costs** equal the sum of the energy and power costs for interior lighting; heating, cooling, and ventilation; and service hot water.
 - * **Proposed building energy and power costs** equal the sum of the energy and power costs for the same components of the proposed building.
 - * **Percentage reduction** in energy and power costs is determined by subtracting proposed building energy and power costs from reference building energy and power costs; and
 - * expressing the difference as a percentage of reference building energy and power costs.



Qualified Individual

- Professional engineer or contractor licensed in the jurisdiction where the building is located
- NOT related to the taxpayer
- NOT the designer of the building
- Must use DOE approved modeling software
- Has represented in writing to the taxpayer that he or she has the requisite qualifications to provide the certification.

A qualified individual must also:

- Conduct site visit to perform inspection and testing
- Gather additional information not included in plans
- Follow NREL’s “Energy Savings Modeling and Inspection Guidelines for Commercial Building Federal Tax Deductions” to verify property meets energy savings targets
- Use industry-standard cost estimation techniques to determine cost of the qualifying energy efficient property.

Qualified Software

The list of approved software is posted on the U.S. Department of Energy website:

http://www1.eere.energy.gov/buildings/commercial/qualified_software.html

Check the website for a complete up-to-date list with approved versions of each program.

Autodesk Green Building Studio, DesignBuilder, DOE-2.2, EnergyGauge, EnergyPlus, EnergyPro, EnerSim, eQUEST, Hourly Analysis Program (HAP), IES <Virtual Environment>, Trace 700

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Key Point

Buildings eligible for the Section 179D deduction include—

- New commercial buildings
- Retrofitted buildings
- LEED buildings
- Buildings built from 2006 until end of 2013 (as of January 2013)
- Multi-family buildings with more than three floors.

Legislative History

1. Energy Policy Act of 2005

(EPA Act 2005)

- Deduction for Energy Efficient Commercial Buildings

- Effective 1/1/06 - 12/31/07

2. Notice 2006-52 – IRS issues interim guidance

- Extended to 12/31/08

3. Notice 2008-40

- Amplification of Notice 2006-52

4. Emergency Economic Stabilization Act of 2008

- Extends EPA Act - 12/31/13

5. Notice 2012-26

- Amplification of Notice 2008-40 (No extension yet)

Key Point

The projected energy savings must be tied directly to the new equipment. Reducing energy use through other means (examples: lower process loads or plug loads) or other equipment (examples: refrigeration or elevators) **does not count** towards the energy-reduction goal.

Why is Section 179D important?

The 179D deduction is a powerful means for building owners to finance energy improvements. As a building energy professional, you can tell your clients—and potential clients—about this opportunity. In the case of buildings owned by public entities, the primary designer/consultant may even be able to take the deduction for themselves as discussed below.

What about publicly owned buildings?

When energy-efficient equipment is installed in a building owned by a government, then that government or other public entity—including public housing authorities—may allocate the deduction to the person primarily responsible for **designing** the energy-efficiency measures. The owner also has the option of allocating the deduction to more than one designer. This designer can be an energy services provider or consultant or an architect or engineer. A person who only installs, repairs, or maintains the property is not a designer.

Can you claim this deduction for energy improvements done in past years?

Yes. Taxpayer no longer needs to amend past-year's tax return to claim the 179D deduction according to IRS revised procedure 2011-14. Keep in mind the lifetime cap of \$1.80 per square foot.

What if the building energy model shows less than 50% energy savings?

The building owner can take a partial deduction of up to \$0.60 per square foot (for each qualifying systems) if modeled whole-building energy savings are lower than 50%. The rules are complicated, so dig into the following references or speak with your tax professional.

Important: You may claim the partial deduction in more than one year. But, you may not go over the lifetime cap of \$1.80 per square foot.

Is the deduction for the whole building?

No. When you calculate the deduction, you may only count the area affected by the specific improvement. For example, if the improvement is for corridor or common-area lighting only, you may count the area affected by that improvement only. You may not take the deduction for the entire area of the building. This is an important consideration because you cannot exceed the maximum deduction for any given building of \$1.80 per square foot for the building's gross square footage.



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Sample Certification

Your written certification to the owner must contain the following information.

- Your name, address, and telephone number.
- The address of the building to which the certification applies.
- One of the following statements (as applicable):
 - **for energy efficient commercial building property:**
The interior lighting systems, heating, cooling, ventilation and hot water systems, and building envelope that have been, or are planned to be, incorporated into the building will reduce the total annual energy and power costs with respect to combined usage of the building's heating, cooling, ventilation, hot water, and interior lighting systems by 50 percent or more as compared to a Reference Building that meets the minimum requirements of Standard 90.1-2001.
 - **for energy efficient lighting property that satisfies the requirements of the permanent rule of section 2.03(1)(a)**
The interior lighting systems that have been, or are planned to be, incorporated into the building will reduce the total annual energy and power costs with respect to combined usage of the building's heating, cooling, ventilation, hot water, and interior lighting systems by 16²/₃ percent or more as compared to a Reference Building that meets the minimum requirements of Standard 90.1-2001.
 - **for energy efficient lighting property that satisfies the requirements of the interim rule of section 2.03(1)(b) :**
The interior lighting systems that have been, or are planned to be, incorporated into the building satisfy the requirements of the interim rule of section 2.03(1)(b) of Notice 2006-52.
 - **for energy efficient heating, cooling, ventilation, and hot water property:**
The heating, cooling, ventilation, and hot water systems that have been, or are planned to be incorporated into the building will reduce the total annual energy and power costs with respect to combined usage of the building's heating, cooling, ventilation, hot water, and interior lighting systems by 16²/₃ percent or more as compared to a Reference Building that meets the minimum requirements of Standard 90.1-2001.
 - **for energy efficient building envelope property:**
The building envelope that has been, or is planned to be, incorporated into the building will reduce the total annual energy and power costs with respect to combined usage of the building's heating, cooling, ventilation, hot water, and interior lighting systems by 16²/₃ percent or more as compared to a Reference Building that meets the minimum requirements of Standard 90.1-2001.
- A statement that the amount of such reduction has been determined under the rules of Notice 2006-52.
- A statement that field inspections of the building performed by a qualified individual after the property has been placed in service have confirmed that the building has met, or will meet, the energy-saving targets contained in the design plans and specifications, and that the field inspections were performed in accordance with any inspection and testing procedures that (1) have been prescribed by the National Renewable Energy Laboratory (NREL) as Energy Savings Modeling and Inspection Guidelines for Commercial Building Federal Tax Deductions and (2) are in effect at the time the certification is given.
- A statement that the building owner has received an explanation of the energy efficiency features of the building and its projected annual energy costs;
- A statement that qualified computer software was used to calculate energy and power consumption and costs and identification of the qualified computer software used.
- A list identifying the components of the interior lighting systems, heating, cooling, ventilation, and hot water systems, and building envelope installed on or in the building, the energy efficiency features of the building, and its projected annual energy costs.
- The following declaration, applicable to the certification and any accompanying documents, signed by you,.

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

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Resources

After Congress enacted EPACT, the IRS was tasked with writing rules and procedures for implementing the new law. The IRS issued three notices that spell out these procedures, listed below. In the 2006 notice, temporary or "interim" rules were put into effect because of time restraints. The 2008 and 2012 notices spell out the permanent rules.

U. S. Code, Section 179D

<http://www.gpo.gov/fdsys/pkg/USCODE-2010-title26/pdf/USCODE-2010-title26-subtitleA-chap1-subchapB-partVI-sec179D.pdf>

National Renewable Energy Laboratory (NREL), "Energy Savings Modeling and Inspection Guidelines for Commercial Building Federal Tax Deductions"

<http://www.nrel.gov/docs/fy07osti/40467.pdf>

From the IRS:

Notice 2006-52

Notice 2008-40: alternative energy savings percentages that taxpayers can use to qualify for the partial deduction

Notice 2012-26

Revised Procedure 2011-14

IRS Publication 542, "Corporations," p. 10, March 26, 2012

IRS Publication 946, "How To Depreciate Property," p. 16, March 22, 2012

U.S. Department of Energy, list of approved software:

http://www1.eere.energy.gov/buildings/commercial/qualified_software.html

ASHRAE Standard 90.1-2001, *Energy Standard for Buildings Except Low-Rise Residential Buildings*

Summary of Energy Savings Percentages Provided by IRS Guidance

	Energy Savings Percentages permitted under Notice 2006-52	Energy Savings Percentages permitted under Notice 2008-40	Energy Savings Percentages permitted under Notice 2012-26
Interior Lighting Systems	16⅔ %	20%	25%
Heating, Cooling, Ventilation, and Hot Water Systems	16⅔ %	20%	15%
Building Envelope	16⅔ %	10%	10%
Effective for Property Placed in Service	January 1, 2006 through December 31, 2008	January 1, 2006 through December 31, 2013	Effective date of Notice 2012-26 through December 31, 2013. If §179D is extended beyond December 31, 2013, also effective (except as otherwise provided in an amendment of §179D or the guidance thereunder) during the period of the extension