



Energy Efficient Commercial Buildings Deduction Under §179D Updated January 2020

What is the §179D Energy Efficient Commercial Buildings Deduction?

The Energy Efficient Commercial Buildings Deduction (CBD) is a tax deduction of up to \$1.80 per sq. ft. that can be taken by commercial building owners and lease holders when investing in building systems that substantially reduce energy usage. For property owned by a Federal, State, or local government, or a political subdivision thereof, the deduction may be allocated to the person primarily responsible for designing the property. (See below for timing limitations on this allocation.)

The Energy Policy Act of 2005 created (and subsequent legislation has extended) the CBD to encourage investment in energy efficient building systems. This incentive establishes a tax deduction for capitalized assets that were placed into service after December 31, 2005, and before January 1, 2021. See §179D(h) as amended by the Further Consolidated Appropriations Act, 2020.

What kinds of building investments qualify?

A full tax deduction of up to \$1.80 per sq. ft., or a partial tax deduction of \$0.60 per sq. ft. may be earned for capitalized investments into any of the following building sub-systems:

Interior lighting systems - \$0.60 per sq. ft.

Building envelope systems - \$0.60 per sq. ft.

Heating, cooling, ventilation, and hot water systems - \$0.60 per sq. ft.

Improvements placed in service before January 1, 2016: The improvements that are made to any one of these three subsystems are compared to a baseline model established for each subsystem under ASHRAE Standard 90.1-2001 (as in effect on April 2, 2003, and including addenda 90.1a-2003, 90.1b-2002, 90.1c-2002, 90.1d-2002, and 90.1k-2002 as in effect on that date).

Improvements placed in service after December 31, 2015: The improvements that are made to any one of these three subsystems are compared to a baseline model established for each subsystem under ASHRAE Standard 90.1-2007 (as in effect on the day before the date of the adoption of Standard 90.1-2010). See P.L. 114-113, §341DivQ.

If, after the new technologies are installed, the entire building shows a reduction in energy use of 50% or more beyond the standard, the taxpayer can earn a CBD of up to \$1.80 per sq. ft.



Energy Efficient Commercial Buildings Deduction Under §179D Updated January 2020

If the entire building cannot meet the 50% requirement, the taxpayer can still earn a tax deduction of up to \$0.60 per sq. ft. per building sub-system that meets IRS prescribed efficiency savings requirements. These savings requirements have varied over time, and are summarized as follows:

Summary of §179D Tax Deductions

	Fully Qualifying Property	Partially Qualifying Property				Interim Lighting Rule
		IRS Notice (Effective Dates)	Envelope	HVAC and HW	Lighting	
Savings Requirements *	50%	2006-52 (1/1/06 - 12/31/08)	16.67%	16.67%	16.67%	25%-40% Lower LPD (50% for Warehouses)
		2008-40 (1/1/06 - 12/31/13)	10%	20%	20%	
		2012-26 *** (3/12/12 - 12/31/13)	10%	15%	25%	
Tax Deduction (Not to exceed cost of qualifying property)	\$1.80/sq ft		\$0.60/sq ft	\$0.60/sq ft	\$0.60/sq ft	\$0.60/sq ft times applicable percentage **

* Savings refer to the reduction in the energy and power costs of the combined energy for the interior lighting, HVAC, and HW systems as compared to a reference building that meets the minimum requirements of ASHRAE Standard 90.1-2001 (pre-January 1, 2016) or 90.1-2007 (post-December 31, 2015).

** The tax deduction is prorated depending on the reduction in LPD. See IRS Notice 2006-52 for the definition of "applicable percentage."

*** If §179D is extended beyond December 31, 2013, the Internal Revenue Service and the Treasury Department expect, in the absence of other changes to §179D, that the substitute energy savings percentages set forth in Notice 2012-26 will be the only energy savings percentages used in determining whether property placed in service after December 31, 2013, is partially qualifying property.



Energy Efficient Commercial Buildings Deduction Under §179D Updated January 2020

Please note, if a deduction is allowed under §179D with respect to any energy efficient commercial building property, the basis of such property shall be reduced by the amount of the deduction so allowed. While this does reduce the benefit of the deduction to the taxpayer, there is still substantial value to be gained from the acceleration of the deduction. Typically, interior lighting systems, HVAC systems, hot water systems, and the building envelope are considered to be §1250 property and will therefore have a 39-yr recovery period (or a 15-yr recovery period if they qualify as qualified leasehold improvement, retail improvement, or restaurant property if placed in service prior to 1/1/2018). Using §179D, a taxpayer can write off a large portion of an otherwise long-life asset in year one.

The deduction for each system (interior lighting systems, HVAC & hot water systems, and the building envelope) is limited to \$0.60 per sq. ft. Therefore, the sum of all partial §179D deductions claimed cannot exceed the excess (if any) of (i) the product of \$1.80 and the sq. ft. of the building, over (ii) the aggregate amount of the §179D deductions allowed with respect to the building for all prior taxable years. See Notice 2012-26, §3.04(1).

If two or more taxpayers install property on or in the same building and the deduction for the cost of the property is subject to the limitation in Notice 2012-26, §3.04(1), the aggregate amount of the §179D deductions allowed to all such taxpayers with respect to the building shall not exceed the amount determined under §3.04(1). See Notice 2012-26, §3.04(2).

The amount of any §179D deduction is subject to potential recapture under §1245 upon disposition of the related property. §1245(a)(2)(C) requires that the amount of any §179D deduction be used to calculate the recomputed basis of the property under §1245. §1245(a)(3)(C) treats the amount of any §179D deduction as §1245 property.

What size and type of building makes the most sense for this kind of study?

Although it is possible to perform studies that still make financial sense for the taxpayer on smaller buildings, we advise clients to look for buildings that are larger than 40,000 sq. ft. Regardless of the size, there are many different types of buildings that will work including warehouses, parking garages, office buildings, manufacturing facilities, movie theatres, retail stores, fitness centers, dormitories, and public buildings.



Energy Efficient Commercial Buildings Deduction Under §179D Updated January 2020

What does a building owner have to do in order to claim the deduction?

Building owners and lease holders claim the CBD for the tax year in which the energy efficient commercial building property was placed in service on the “Other Deductions” or “Other Expenses” section of their tax return. The CBD can also be claimed retroactively for qualifying projects capitalized in previous tax years (a look-back study) by filing an amended return (if the taxable year is still open), or through the filing of an automatic change in method of accounting on Form 3115 (DCN 152 under Rev. Proc. 2019-43, §8.01).

Note that the use of an automatic accounting method change is not available for deductions to be allocated to the primary designer of the energy efficient commercial building property. However, the use of an amended return for an open tax year is still available. See Rev. Proc. 2019-43, §8.01(3).

An owner will need to obtain a written certification, conforming to specific IRS standards, which verifies that the building system meets the energy efficiency requirements for the CBD. This certification must be prepared and signed by a qualified individual. A qualified individual is an individual that is not related (within the meaning of §45(e)(4)) to the taxpayer, that is an engineer or contractor properly licensed as a professional engineer or contractor in the jurisdiction in which the building is located, and has represented to the taxpayer in writing that they have the requisite qualifications to provide the certification. See Notice 2006-52, §5.05. The certification does not have to be attached to the return on which the deduction is claimed but must be retained by the taxpayer in order to support the deduction.

What does Scarpello Consulting Do?

We partner with CPA's, building owners, and lease holders as the qualified individual for purposes of the written CBD certification. We'll review what investments have been made in energy efficient building systems and make a preliminary judgment as to whether or not the system may qualify for the deduction. We'll work with a group of contractors and engineers from around the country to inspect the property and determine how much of a deduction the taxpayer has earned. Finally, we'll issue the written certification and any other supporting documents required by the IRS. Additionally, for look-back studies, we'll complete the Form 3115 and work with the taxpayer's return preparer to ensure that it is correctly filed. As always, we provide unlimited audit support to our clients.



Energy Efficient Commercial Buildings Deduction Under §179D Updated January 2020

How to Get Started

Stage One: We'll collect preliminary information from the client in order to complete an assessment of the potential benefit, and then issue a proposal for work.

Stage Two: We'll perform the Commercial Building Tax Deduction 179D study on the properties in question. This may include any or all of the following: phone interviews, document analysis, fixed asset review, invoice and document research, computer modeling, site inspection, & final calculations.

Stage Three: We'll issue the final report. This will include a project summary, the written certification, and any supporting documents. In the case of a look-back study, this will also include the preparation of the Form 3115.

CASE STUDIES

Warehouse in Texas Lighting System Upgrade

Owner replaced all lighting fixtures
in 410,000 sq ft space

Cost of Lighting Upgrade: \$192,000

Qualified for a Commercial Building
Tax Deduction of \$192,000

Processing Facility in California HVAC System Upgrade

Owner replaced part of the Heating
and Air system in 75,000 sq ft space

Cost of HVAC upgrade: \$88,000

Qualified for a Commercial Building
Tax Deduction of \$45,000

5 of 5



SCARPELLO CONSULTING

ScarpelloConsulting.com • 877.410.5040

Launched in 2001, Scarpello Consulting provides cost segregation services that allow clients to maximize their depreciation deductions while minimizing audit risk. The firm works with Fortune 500 companies and some of the largest national CPA firms through their multiple offices in Omaha, NE, Overland Park, KS, Sarasota, FL, and Denver, CO.