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Certified Public Accountants & Profitability Consultants

RSSM Alert

Green Building Tax Deductions

President Bush recently signed a bill extending the Energy Efficient Commercial Building Tax Deduction. This presents an opportunity for building owners to reduce energy costs with a very favorable tax treatment and an excellent marketing tool for construction contractors.

On October 3, 2008, President Bush signed into law H.R. 1424 and extended the Energy Efficient Commercial Building Tax Deduction as part of the Emergency Economic Stabilization Act of 2008.

If your company owns or leases commercial buildings - which includes most types of buildings, including residential buildings with four or more stories above grade - and you have installed or retrofitted the property to be more energy efficient, you may be eligible for a deduction for part or all of the costs associated with the installation or retrofit. This opportunity allows for the potential immediate expensing of costs that would otherwise be capitalized and recovered through depreciation over 27.5 or 39 years.

Background

The Energy Policy Act of 2005 included a new tax incentive to improve the energy efficiency of commercial buildings. The "Commercial Building Tax Deduction" establishes a tax deduction for expenses incurred for energy efficient building expenditures made by a building owner. The deduction is limited to \$1.80 per square foot of the property, with allowances for partial deductions for improvements in interior lighting, HVAC and hot water systems, and building envelope systems.

The Emergency Economic Stabilization Act of 2008 (HR-1424), approved and signed on October 3, 2008, extends the benefits of the Energy Policy Act of 2005 for property placed in service after December 31, 2005, and prior to January 1, 2014.

Qualifying Buildings

An energy-efficient commercial building property is defined as:

- Installed on or in any building located in the United States that is within the scope of Standard 90.1-2001, Energy Standard for Buildings Except Low-Rise Residential Buildings, of the American Society of Heating, Refrigerating, and Air Conditioning Engineers and the Illuminating Engineering Society of North America;
- Installed as part of (i) the interior lighting systems, (ii) the heating, cooling, ventilation, and hot water systems, or (iii) the building envelope; and

- Certified as being installed as part of a plan designed to reduce the total annual energy and power costs of interior lighting systems, heating, cooling, ventilation, and hot water systems of the building by 50 percent or more when compared to a reference building, which meets the minimum requirements of Standard 90.1-2001 (which came into effect on April 2, 2003).

Tax Deduction Amount

The deduction is equal to energy-efficient commercial building property expenditures made by the taxpayer, subject to a cap. The deduction is limited to an amount equal to \$1.80 per square foot of the property for which such expenditures are made. The deduction is allowed in the year in which the property is placed in service. For tax purposes, "placed in service" generally means the time at which the property is ready for its intended use.

Certification Requirements

Certain certification requirements must be met in order to qualify for the deduction. The secretary of treasury, in consultation with the secretary of energy, promulgated guidance on June 2, 2006 in Notice 2006-52 that describes methods of calculating and verifying energy and power costs, using qualified computer software based on the provisions of the 2005 California Nonresidential Alternative Calculation Method Approval Manual or, in the case of residential property, the 2005 California Residential Alternative Calculation Method Approval Manual.

Building Inspection To Determine Compliance

IRS Notice 2006-52 requires that before a taxpayer may claim the deduction, the taxpayer must obtain a certification with respect to the property. Inspections must meet guidelines of the National Renewable Engineering Laboratory. Certification of the property must be made by a qualified individual not related to the taxpayer claiming the deduction and who is properly licensed as a professional engineer or contractor in the jurisdiction in which the building is located.

Those Who Can Benefit From The Deduction

The person or organization that pays for construction is generally the recipient of the deduction. This is usually the building owner, but for some HVAC or lighting efficiency projects, it could be the tenant.

Government-Owned Buildings

For government-owned energy-efficient commercial buildings, such as public schools, the IRS issued guidance on March 12, 2008 that allows the deduction to be allocated to the person primarily responsible for designing the property in lieu of the public entity.

Partial Deductions Allowed For Building Subsystems

In the case of a building that does not meet the whole building requirement of a 50 percent energy savings, a partial deduction is allowed with respect to each separate building system that comprises energy-efficient property and which is certified by a qualified professional as meeting or exceeding the applicable system savings targets established by the secretary of the treasury.

The applicable system savings targets to be established by the secretary are those that

would result in a total annual energy savings of 50 percent for the whole building, if each of the separate systems met the system target; note that the maximum allowable deduction is \$0.60 per square foot. The separate building systems are the:

1. Interior lighting system;
2. Heating, cooling, ventilation, and hot water systems; and
3. Building envelope.

Subsystem targets range from 10-20% for interior lighting, HVAC & hot water, and building envelope.

Prescriptive Rules For Lighting Projects

Building owners are encouraged under the law to focus first on lighting systems for two reasons: first, their ease and availability of upgrading, and second, the known achievements in energy efficiency that will be gained. In the case of a lighting system (including the retrofit of an existing system), the system energy savings target for the lighting system is deemed to be met by a reduction in lighting power density of 40 percent (50 percent in the case of a warehouse) of the minimum requirements in Table 9.3.1.1 or Table 9.3.1.2 of ASHRAE/IESNA Standard 90.1-2001 (as in effect on April 2, 2003).

In the case of a lighting system that reduces lighting power density by 25 percent, a partial deduction of \$0.30 per square foot is allowed. A pro-rated partial deduction is allowed in the case of a lighting system that reduces lighting power density between 25 and 40 percent. Certain lighting level and lighting control requirements must also be met in order to qualify for the partial interim lighting deductions.

Effective Date To Take Advantage Of This Tax Deduction

The provision is effective for property placed in service after December 31, 2005, and prior to January 1, 2014.

Remaining Asset Value Depreciation

The basis of the property is reduced by the deduction amount and the remaining asset value is depreciated over its tax life for the class of property.

Components Of The "Cost" That Can Be Written Off

Includes anything that can be capitalized, including labor.

We hope this information is helpful. If you would like more details about these changes, or any other aspects of the new law, please feel free to contact us at 212-303-1880 or e-mail at info@rsmcpa.com. Visit our website at www.rsmcpa.com.

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