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COMMERCIAL OBSERVER

Underutilized Tax Incentives and the Missed Opportunities for Growth

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Each year, the demand for efficient, structurally and aesthetically superior commercial real estate in the tri-state region grows. Tenants and owners seek space that will allow them to build their businesses and lower their operating costs. According to the U.S. Green Building Council, more than a third of all non-residential design and construction is green, lowering costs and adding value, and that share is expected to exceed one half of all construction in the entire U.S. over the next five years.

Two sections of the federal tax code are powerful economic incentives for architects, engineers, contractors and other commercial builders who are designing new state-of-the-art developments, redevelopments and retrofits that will meet this demand. These tax provisions—the Research and Development (R&D) Tax Credit and the Energy-Efficient Commercial Building Deduction, better known as section 179D of the tax code—are often unknown, underutilized or misunderstood by the real estate industry. As a result, the industry is leaving hundreds of millions of dollars on the table.

From the time that I served in Congress as chairman of the Housing Subcommittee to my current work in real estate in the private sector, I've been astonished that so few in the industry take advantage of these provisions. Sadly, this mirrors what is happening in other sectors of the economy beyond real estate. The largest public corporations, with big in-house tax departments, are accessing billions of dollars in federal R&D incentives while surveys show that less than 20 percent of small and mid-market businesses are aware that they may qualify.

The R&D Tax Credit: Evolving for the Benefit of U.S. Taxpayers

Originally passed in 1981 with the intent of incentivizing innovation and creating processes, methods and products that were new to the world, the R&D Tax Credit has been liberalized more than a dozen times over the past 25 years. In its current form, the federal credit is now available to encourage innovation resulting from U.S. labor that is simply new to the company, which has filed for the credit. Amendments, regulations and guidance over the years have greatly expanded eligibility to companies from a broad spectrum of industries.

As currently written into the tax code, the R&D Tax Credit rewards companies for improving a product, process, formula, invention, software or technique by offering additional tax savings to those companies that are taking active steps to improve their services.

For four years' worth of building projects, one California engineering firm specializing in almost all aspects of design (structural, mechanical, electrical, etc.) received $954,000 in federal R&D tax credits. Among a host of other qualifying projects, the company designed an addition to a pharmaceutical facility, specifically providing the designs to address the filtration and air loads in each room at the process development facility.

In the process of finding the optimal design, the company performed a series of design iterations to meet the project's quality specifications. The company built various modular designs for the installation of mechanical and electrical systems in the building and incorporated various components of equipment into the layout of the structure while taking into account spatial constraints at the site.

Section 179D: Rewarding Energy-Efficient Design

In the same vein as the R&D credit, the section 179D deduction is yet another overlooked opportunity for designers in the real estate industry. Established by Congress as part of the Energy Policy Act of 2005 to address broader energy usage concerns, 179D incentivizes designers and builders to surpass industry standards for energy efficiency in new constructions and renovations. Generally, the more energy efficient the building is and the more eligible systems a company improves, the larger the deduction will be (up to $1.80 per square foot).

The owner of a building may qualify for the deduction, as can a business improving the energy efficiency of a government-owned building at the federal, state and local levels. In the latter case, the government entity may allocate the deduction to the architect, engineer or contractor responsible for the energy-saving elements of the property.

As illustrated, many of the design and modification activities that must be performed to complete a contemporary construction project are eligible activities under the R&D credit and the section 179D deduction. They offer a substantial economic reward that was intended by Congress to incentivize innovation and efficiency in our commercial buildings, and the job creation and competitiveness that results.

Rick Lazio is a former U.S. Representative from New York serving in Congress from 1993-2001. While there, he became a strong advocate for small businesses by sponsoring the successful Small Business Tax Fairness Act. After Congress, Rick moved to the private sector working for JP Morgan Chase as a Managing Director and then Executive Vice President. Rick is committed to his continued interest and support of small to mid-sized businesses by brokering his insight and experience in the public and private sectors to provide strong incentives for job growth. This interest has extended into his civic and philanthropic work in New York with the Committee for Economic Development and the Association for a Better New York.

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