

Construction

Accounting and Taxation

SECTION 179D EXTENDED: What Every Builder and Designer Needs to Know

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Here is everything you need to know about 179D's recent extension and the steps eligible businesses should be taking to continue to leverage the deduction.

Beginning in tax year 2016, one of the most valuable energy incentives for architects, engineers and contractors will be subject to compliance changes. At the end of last year, Congress passed and the president signed into law a landmark tax bill that extended or made permanent a number of pro-business tax incentives. Among the highlights of the legislation that should be of immense interest to architects, engineers and contractors is the two-year retroactive extension of the energy-efficient commercial building deduction—better known as **Section 179D** of the tax code.

Since it was initially passed as part of the Energy Policy Act of 2005, Section 179D has proven not only to be sound energy policy, but a vital incentive in terms of promoting U.S. job creation and economic growth. **Just at my firm alone, we have over the years seen 179D put over \$1.2 billion in tax deductions back into the pockets of U.S. businesses**, providing designers and builders from across the nation the means to hire new employees and the financial resources to do what they do best—create dynamic and innovative structures.

Just last year, **one mechanical contractor received over \$600,000 in Section 179D tax deductions** for energy-

saving enhancements made to a police department and an international airport. While a six-figure or higher result will not be in the cards for every qualifying business, this example does show how impactful the deduction can be—especially considering that many of the energy-efficient improvements made by this company are quite commonly performed by design- or construction-based businesses. Due to the good work put in by our policymakers, 179D will continue to be an option for tax years 2015 and 2016, ensuring much-needed dollars for American architecture, engineering and construction companies.

However, the extension does come with key compliance changes that companies will need to be aware of and account for moving forward. But before we get to these modifications, let us take a moment to review 179D for those that may not be as familiar with the basics of the deduction.

Section 179D: Background, benefits and requirements

Section 179D was originally implemented more than a decade ago as part of broader legislation to promote energy independence and to address environmental concerns. According to data released from the U.S. Department of Energy (DOE), end-user buildings account for 73 percent of all electricity consumption in the United States and, according to the U.S. Green Building Council (USGBC), around 40 percent of carbon emissions. By

providing a financial incentive for companies to design and build energy-efficient structures, Congress sought to promote private sector solutions to improve conservation practices and modernize national infrastructure.

The owner of an eligible building can claim 179D, as can architects, engineers, contractors and energy service providers who are making energy-efficient enhancements to government-owned buildings at the federal, state or local levels. As government entities do not traditionally pay taxes, the owners of these buildings can allocate the accrued tax savings to the business responsible for the energy-saving elements.

Qualifying buildings and systems

The list of buildings eligible for 179D is very broad and includes a variety of structures such as schools, universities, libraries, airports, post offices, courthouses, military bases, government offices and correctional institutions—basically any structure that is built for any level of government. Buildings that were placed into service during all open tax years (this is generally a look-back period of three years, with some notable exceptions) can still qualify, meaning design- and construction-based companies would be wise to think of 179D when reviewing their previous building projects.

For a structure to qualify, the energy-based improvements must be made to either the heating, ventilation, and air conditioning (HVAC) system, the interior lighting system, or the building's envelope. Renovations and new construction must surpass the established baseline standard (more on that in the following section) by 50 percent to receive the full \$1.80 per square foot tax deduction (although a building could still receive a partial deduction if one or two of the previously named systems qualifies).

Bringing this to the real world, the mechanical contractor we mentioned earlier received its six-figure result by hitting all requirements on two of its eligible buildings, proving that there is real value here depending upon the number of eligible buildings and the size and scope of a company's projects.

Allocation and certification of the tax savings

As discussed previously, the government-owning entity (be it a school, university, or other governmental institution) must allocate the tax savings to the business responsible for improving the energy efficiency of the building. This must be accomplished through a specific "allocation letter" that must be signed by the government entity. Any company interested in claiming the deduction should secure the letter as quickly as possible, particularly if multiple designers or contractors were involved in the project. 179D is a first-come, first-served proposition, and any hesitation could lead to another business claiming the deduction.

Finally, qualifying for 179D requires certification of the energy-saving improvements from a licensed third-party engineer.

Now that we have reviewed the basics, let us discuss 179D's compliance changes—and more importantly, what architects, engineers and contractors can do to put themselves in the best position to claim the deduction moving forward.

Raising baseline standards

In the past, in order to qualify for 179D, any energy-saving enhancements were required to exceed 2001 American Society of Heating, Refrigerating, and Air-Conditioning Engineers (ASHRAE) standards. While this old baseline still applies to any buildings placed into service before 2016, the most recent extension now requires buildings placed into service this year to surpass 2007 ASHRAE standards. The bump up in the baseline is a policy nod to modernizing energy-usage techniques and the need to raise thresholds accordingly.

So what does this mean for architects, engineers and contractors in their future tax planning? What should companies do to ensure they continue to reap the full rewards of 179D? To ensure businesses remain in full compliance with the new baseline and are claiming the full amount to which they are entitled, I would advise companies to follow three specific steps.

Make sure you are using the best modeling software possible to claim the deduction. With the increase in baseline standards and ongoing innovations in design and construction, when it comes to doing the energy analysis for 179D deductions, using software that is open source with (and continually updated by) the DOE is crucial to maximizing the full deduction opportunity.

The reason? The DOE's open-source energy modeling software is used by the IRS to calculate 179D tax deductions, and our firm has seen firsthand the importance of implementing such software in producing accurate and specific calculations—and in optimizing results.

Whoever you choose to certify the energy savings, make sure that the certification process is not being “shipped out.” There are many tax consultants out there with respect to 179D, but few actually have the engineers on staff capable of certifying the energy savings. Seeking the assistance of a consultant with both tax expertise and in-house engineers capable of certifying the savings will greatly speed up the process and ensure compliance with IRS standards.

Carefully review all steps necessary before filing for 179D—and identify a provider who can help.

From identifying qualifying buildings to securing the proper allocation letters to energy modeling and final certification, 179D does involve several steps—and everyone can use help now and then to keep the process in order.

A one-stop shop 179D provider can greatly reduce the amount of time spent on claiming the deduction, from helping to secure the allocation letters to ensuring your claims are in line with the latest baseline standards.

By following these three steps, designers and builders can continue to enjoy the benefits of 179D. Whether you have claimed the deduction in the past or are hearing about 179D for the first time, I would highly encourage you to explore this valuable and widely claimed energy incentive.



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