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Tax Incentives for Building Green

To encourage green building, Congress over the last several years has enacted a variety of tax incentives. The incentives take the form of credits, deductions, and grants. For a commercial building, the benefit available depends on what the cost is incurred for. If a developer or owner invests in energy producing property for its building, the developer may be entitled to a credit or a grant, in addition to accelerated depreciation deductions. Expenses incurred for increasing energy efficiency may entitle the developer or owner to an immediate deduction of up to $1.80 per square foot, depending on the degree of energy efficiency attained.

Tax Incentives for Renewable Energy Property

There are a number of incentives directed at projects that generate electricity or thermal energy using solar power, wind turbines, geothermal property, micro-turbines, or combined heat and power systems.

These incentives are available to builders or property owners who are interested in generating energy on-site instead of purchasing all of a building's electricity from energy producers.

Tax Credits – Section 48

The tax credits available for eligible systems were greatly expanded in 2008 and early 2009. The business energy investment tax credit provides a tax credit equal to either (1) thirty percent (30%) of expenditures incurred with respect to eligible solar energy property, fuel cells, and small wind turbines; or (2) ten percent (10%) of expenditures incurred with respect to eligible geothermal energy property, micro-turbines, and combined heat and power systems. Although there is no maximum credit for most of the property, the credit for fuel cells is limited to $1,500 per 0.5 kW of capacity and the credit for micro-turbines is limited to $200 per kW.

The ability to take advantage of the credits is subject to certain limitations:

1. Eligible systems (except for geothermal property) must be placed in service before January 1, 2017.
2. Taxpayers must reduce their basis in the underlying property by an amount equal to fifty percent (50%) of the credit.
3. The credit can not be used in combination with the energy production tax credit (directed at energy producers) or the qualifying advanced energy project investment tax credit (directed at manufacturers of energy producing property).
4. Any disposition of the property within five (5) years would be subject to a pro-rated recapture of the credit.
5. The credit may be limited by the passive loss and at-risk rules.

The investment tax credit may be carried back one (1) year and forward twenty (20) years. Other advantages of the credit are that it may offset the alternative minimum tax and may be combined with the low-income housing tax credit. Note that any state energy investment tax credits and grants that are received with respect to qualifying property may increase the federal tax credit available if the state incentives are included in income.

Cash Grants Instead of Credits

Tax credits are only beneficial to the extent that a taxpayer owes a tax that can be offset with the credits. In light of the current economic situation, Congress enacted a grant program for energy producing property under which taxpayers may receive lump-sum cash grants from the Treasury Department in lieu of tax credits. The Department of Energy and the Treasury Department are working in partnership to develop and implement the program. In order to be eligible for the grants for energy producing property, a taxpayer must qualify for the investment tax credit under Section 48.

Property eligible for the grants must either be placed in service in 2009 or 2010. If property is placed in service by January 1, 2017, it would still be eligible for the grants if construction begins in 2009 or 2010.

The amount of the grant is equal to the tax credits that the taxpayer would be eligible to receive with respect to the property.

Applications for grants can be received by the Treasury Department beginning in July 2009 through December 31, 2011. Treasury anticipates having the application package and guidance available no later than July 2009. The grant will be paid to the taxpayer on the later of (1) sixty (60) days after the grant is applied for and (2) the date the property is placed in service. The IRS will provide recapture rules in the event that property for which a grant was received is disposed of or ceases to qualify. Governments and other non-taxpaying entities will not be eligible for grants.

The grants are not included in a recipient's taxable income.

Accelerated Depreciation

Property that is eligible for the investment tax credit is also entitled to faster depreciation than the property would generally receive. This enables a taxpayer to recover the cost of the property through larger deductions taken over a shorter period of time. Eligible property is generally depreciated over a five year period. The period is seven years for certain biomass property.

In addition, a fifty percent (50%) depreciation bonus is available for eligible renewable-energy systems acquired and placed in service in 2008 or 2009. If property qualifies, the taxpayer may deduct fifty percent (50%) of the adjusted basis of the property in 2008 or 2009 (as applicable) with the remaining basis depreciated over the ordinary depreciation schedule.

It is important to keep in mind that the depreciable basis of eligible property is reduced by fifty percent (50%) of the investment tax credits for which the property qualifies.

Example: Assume that the cost of solar energy property that is placed in service in 2009 is $100,000. The costs qualify for an investment tax credit of $30,000 that may be taken as a grant. The tax basis of the property is then reduced to $85,000. The depreciation deduction for the property in 2009 using a half-year convention is $51,000 ($42,500 bonus depreciation plus $8,500 regular depreciation). The remaining $34,000 of basis is depreciated over the next five years ($13,600, $8,160, $4,896, $4,896, and $2,448).

Tax Incentives for Energy Efficient Expenditures

Commercial buildings placed in service before January 1, 2014 may qualify for a deduction for the costs of energy efficiency expenditures.

A tax deduction of up to $1.80 per square foot is available to owners of new or existing buildings who install (1) interior lighting (including lighting controls); (2) building envelope (includes roof, walls, windows, doors and floor/foundation); or (3) heating, cooling, ventilation, or hot water systems that reduce the building's total energy and power cost by fifty percent (50%) or more in comparison to a building meeting minimum requirements set by ASHRAE Std. 90.1-2001. The energy savings must be calculated using qualified software that is approved by the IRS. The IRS has issued rules for taxpayers to follow to obtain a certification that the property satisfies the energy efficiency requirements.

Deductions of $0.60 per square foot are available if the systems installed meet target levels that would reasonably contribute to an overall building savings of fifty percent (50%) if additional systems were installed. Although the deductions are primarily availed of by building owners, tenants may be eligible for the deduction if they make construction expenditures.

Further, if the energy efficient system is installed on or in government property, the person primarily responsible for the systems' design would be entitled to the deduction.

Since 2005, the primary categories of property owners who have taken advantage of the tax deductions are parking garage owners, retailers (for both stores and distribution centers), and warehouse owners. [1] Due to the large amount of lighting in parking garages and the high cost of energy, many garage owners have been able to recover their costs in less than two (2) years. [2] In addition, because LEED standards are more rigorous than the IRS standard, achieving LEED status should enable a building to obtain tax deductions. It is important, however, to use an IRS-approved modeling software for both the LEED and tax deduction process.

Monetizing Tax Incentives

As noted above, tax incentives (with the exception of grants) are only beneficial to the extent that there is taxable income. Without taxable income, the deductions for expenditures and depreciation would not provide any benefit and without a tax liability, tax credits are essentially worthless. Some taxpayers may have sufficient losses already or do not expect to have enough income to justify the deductions and credits. These taxpayers may be able to obtain financial benefits from the tax incentives without using the tax incentives themselves.

The tax incentives may be used by builders or property owners to attract investment in a project from others who may better be able to utilize them. By obtaining the third party's capital, the builder (1) decreases his own expenditures; (2) may be able to obtain more favorable financing terms; and (3) shares the risk associated with building. The builder may be able to structure the investment in a way that ensures the builder current cash payments either through distributions or fees and retains long-term ownership benefits with respect to the property. There are advantages for the investor as well. In addition to obtaining an ownership interest in a commercial building, the investor at the very least is entitled to a return on his investment based on the tax incentives, thus limiting the investor's risk.

Even though the grants discussed above are not dependent on a taxpayer's tax liability, the grants themselves may not be received by the taxpayer until after the project is completed. Therefore, the builder would still have to incur the expenses and financing charges necessary to construct the building and take all of the risk with respect to whether the building will be successful. Accordingly, it may be advantageous for a developer to attract third party investment based on a share of the grants.

More details on "green" tax incentives and methods for taking advantage of them are available at www.Venable.com or by contacting any of the following members of Venable's Tax and Wealth Planning group:

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[1] In fact, Walmart, Inc. recently won an award for Corporate Energy Efficiency at the Aspen Environmental Forum. Walmart has articulated the following goals: (1) Reducing greenhouse gases at their existing store, club and distribution center base around the world by 20 percent by 2012; (2) Designing their new prototype to be 25 to 30 percent more efficient by the end of 2009; and (3) Developing and implementing innovative energy efficient technology into their existing and new stores. Among their three long-term sustainability goals is to be supplied 100 percent by renewable energy. To achieve that, they are currently using renewable energy sources, including wind energy in Texas and solar power in California and Hawaii.

[2] Charles Goulding, et. al., EPAct Tax Deductions for Parking Garage Lighting Projects Gain Wider Use, The Parking Professional (Sept. 2008).

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