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SUSTAIN ALABAMA

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The Interim Lighting provision offers businesses a tax deduction of \$.30 to \$.60 per square foot for installing energy-efficient lighting. Photo courtesy of WAV Architects

Sustainability Becomes Mainstay Tax Strategy

Sizable businesses can't afford not to build a capital plan that incorporates the tax incentives of the Energy Policy Act of 2005.

By Amanda Bray,
Brave Consulting LLC

FROM DIAPERS TO DOG FOOD, companies are racing to position their brand as eco-friendly in a market that is turning greener by the day. "Going green" is more than a marketing catchphrase however; businesses across the country are seeing measurable returns by implementing energy savings practices throughout their operations.

While there are many federal incentives available to encourage energy efficiency, such as credits for solar and wind energy or geothermal HVAC systems, this article will focus on the tax benefits found in Section 179D of the Internal Revenue Code. This

deduction for energy efficient commercial buildings allows building owners (or tenants in certain cases) to claim a tax deduction of \$.30 to \$1.80 per square foot for reducing a property's total energy and power. Known alternately as "green" or "sustainable" construction, such energy efficient building practices are becoming increasingly common nationwide.

Alabama already is home to numerous "green" buildings. One notable example is Faulkner State Community College's Health and Natural Sciences Building; soon to be the first certified green building in Alabama's two-year college system. Designed by Walcott Adams Verneuille Architects with Watershed Green Consulting, the building's design is projected to reduce energy costs by 38 percent, a savings of over \$20,000 annually. Clearly, building green can add black to a

company's bottom line.

Section 179D also applies to renovations that improve energy efficiency, so businesses don't have to invest in a new building to realize significant tax savings. According to some reports, "green" retrofits could account for up to 13 percent of all commercial renovations by 2015, a sharp increase over the estimated 7 percent market share today. The advantages of retrofitting existing space can be compelling: In addition to immediate tax benefits, a well-planned renovation can lower operating costs, resulting in significant savings over the life cycle of the building.

Investing in energy efficient design makes sense on paper, but deciphering the current tax law can be a challenge. To help explain these issues, we turned to Melissa Thomas, CPA, director of tax services for Hartmann Blackmon & Kilgore PC; and



Rebecca Bryant, AIA, senior green building consultant with Watershed.

Current Law

Section 179D is part of the Energy Policy Act of 2005, which created incentives for investment in commercial energy efficiency measures and has been extended to include qualifying new construction or renovations completed between January 1, 2006 and December 31, 2013. In order to qualify, the improvements must measurably reduce the energy and power usage of a property over the ASHRAE 90.1-2001 standard, not the property's own prior expenditures.

Thomas explains, "Businesses should be aware that Section 179D actually allows for incremental deductions in three separate areas: interior lighting systems, building envelope and the heating, air conditioning, ventilation and hot water systems." The maximum allowable deduction for each of these three systems is \$.60 per square foot, which together equal the maximum allowable deduction of \$1.80 per square foot.

In most cases, meeting the 50 percent reduction in overall energy usage for any building is a challenge, Bryant says, although she adds that the incremental gains in any of those three areas is very achievable.

Thomas estimates that a business operating a 100,000-square-foot property could claim a tax deduction of up to \$60,000 in one of the three approved areas for completing qualified improvements that reduce total energy use by 10 to 20 percent. Those efficiency gains must be verified both by computer modeling and an inspection, so, for smaller buildings, the cost of documentation should be weighed against the tax benefits.

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Interim Lighting Provision

According to the Department of Energy, 80 percent of existing commercial buildings operate lighting systems that were installed before 1986, and lighting generally accounts for about 40 percent of an average company's power bill. Today's lighting products use 40-60 percent less energy than earlier generations, and upgrading interior lighting systems is often the easiest and smartest way to go about claiming a partial deduction, Bryant says. Since lighting generates heat, lighting upgrades also can have a ripple effect by reducing energy used by HVAC as well, she explains. Installing efficient lighting systems and making simple improvements like reducing air infiltration can actually reduce the size of the air conditioning equipment needed for a building. When prioritizing energy efficiency retrofits, Bryant recommends installing new lighting before replacing HVAC units.

Thomas suggests that businesses look closely at the "Interim Lighting" provision of the tax code, which allows for a \$.30 to \$.60 per square foot deduction for lowering lighting power density from anywhere from 25-40 percent. Those improvements can be verified using a simple spreadsheet and a site inspection. Bryant recommends that if a business recently has upgraded their lighting, they should check an energy expert to see if their new systems already qualify.

Given that the average office building is 15,000 square feet, the owner could potentially claim a \$9,000 tax deduction with minimal paperwork.

These deductions could create tax savings even if the business has an operating loss. According to Thomas, "The 179D deduction can be taken even if it creates a net operating loss. Depending on the type of entity, that NOL can, in some cases, be carried back to obtain a refund from prior years." She notes that while government buildings and not-for-profit organizations cannot take the deductions, the primary designer can claim the deductions. Owners of these properties should discuss potential tax incentives with their design team at the start of a project so they can be written into contracts, or leveraged as performance incentives.

Thomas cautions that for businesses to successfully claim Section 179D credits, they must comply with the requirements outlined by the IRS. "The code is very specific about the types of systems that qualify and the ways in which the improvements must be documented," Thomas says. When claiming these tax deductions and credits, a business must have certification on file from a qualified professional. "Taxpayers do not have to submit the certification with their filings, but they need to retain it on file, in case the IRS requests it."

So where do you start if your

organization wants to cash in on incentives for energy efficiency improvements? Both Thomas and Bryant agree: with an expert opinion. Although green building practices are becoming more mainstream, it is important to work with professionals who understand the tax incentives and who have actually completed qualifying retrofits. If your business is not ready to undertake a major renovation, you can still realize savings and benefits by giving your property an energy "tune-up" using the tips on this page. With a little research and sound guidance, investing in green building now can help boost the bottom line for years to come.

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TEN STEPS TO REDUCING ENERGY USE— WITHOUT UNDERTAKING A MAJOR RENOVATION

- 1** Benchmark your current energy use: You can't manage it unless you measure it.
- 2** Adjust workplace temperature a few degrees higher in the summer months.
- 3** Replace HVAC filters on a regular schedule.
- 4** Air seal doors, windows, and all openings that connect conditioned and non-conditioned spaces.
- 5** Consolidate printers and copiers and upgrade to Energy Star models.
- 6** Replace old CRT monitors with LCD monitors and ask your IT department to configure them to an energy saving mode.
- 7** Relamp existing light fixtures with more energy efficient bulbs.
- 8** Install motion sensors on lighting to save energy in restrooms and storage areas.
- 9** Take advantage of free daylight with photo-sensing switches that turn off electric lights when enough natural light is present.
- 10** Install flow-restricting aerators on faucets to save both water and water heating costs.