



## 179D Energy Efficient Commercial Building Tax Deduction:

*A Federal Financing Tool for Public Sector **Green Building** Projects*



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## 179D Energy Efficient Commercial Building Tax Deduction: A Federal Financing Tool for Public Sector Green Building Projects

The Energy Efficient Commercial Building Tax Deduction is a federal tax incentive that allows owners of commercial property to deduct from their taxes up to \$1.80 per square foot for qualifying energy efficient property. It also contains a provision that allows public entities to give this tax incentive to the designer of the energy efficient property, since public entities do not pay taxes. This provision provides federal, state, and local entities a cost-effective way to improve energy efficiency in new or retrofit projects.

The American Institute of Architects represents over 80,000 architects and emerging professionals across the world. As a leader in the design and construction industry, the AIA supports incentivizing energy efficiency in a myriad of ways, but particularly through provisions like 179D, that have proven to be quite successful in the field.

### Background

The Energy Policy Act of 2005 created the Energy Efficient Commercial Building Tax Deduction, recognizing that a substantial portion of U.S. energy consumption is attributable to commercial buildings, and to provide building owners with a tax incentive to help offset the costs associated with enhancing the energy efficiency of commercial buildings. The provision, codified in 26 U.S.C §179D and therefore sometimes referred to as “179D”, allows the owner of a commercial building to deduct the installation costs of energy efficiency enhancements, up to \$1.80 per square foot.

Moreover, to encourage the public sector to utilize these same energy efficient enhancements, Congress provided a federal, state, or local government owner of a commercial building an election to allocate the tax deduction to the primary person responsible for designing the technical specifications for the installation of energy efficient enhancements.

The overarching purpose of the deduction is to encourage energy efficiency by creating a tax incentive intended to benefit a commercial building owner. If the owner of a commercial building is a private entity, the deduction may be taken by the building owner and is not allocated to the design firm. However, in cases where the building owner is a public entity, which does not pay taxes, the law allows for this deduction to be allocated to the design firm. Many agencies have used this allocation to finance energy efficient enhancements, despite not being able to receive a deduction directly for these enhancements.





## The AIA and 179D

The AIA strongly supported this provision when it was enacted. AIA also helped form a partnership with other concerned stakeholders and through this partnership, developed implementation recommendations for building owners to obtain this tax deduction. In 2008, the AIA helped pass legislation to extend the life of the deduction so that it covers property placed in service by December 31, 2013. That same year, at the AIA's urging, the [IRS issued guidance](#) on how the deduction could be allocated to the designer.

The guidance established that a designer, for purposes of this section, included an “architect, engineer, contractor, environmental consultant, or energy services provider who creates the technical specifications for a new building or an addition to an existing building that incorporates energy efficient commercial building property.” This definition did not include someone that merely installs, repairs, or maintains the property.

Also, before a designer may claim the § 179D deduction, with respect to property installed on or in a government-owned building, the designer must obtain the written allocation from the “authorized representative.”

It also established that, in cases where there is more than one designer, the owner may either allocate the deduction to the primary designer, or, at the owner's discretion, allocate the deduction amongst all of the designers.

The AIA was pleased with the initial clarification that this IRS guidance provided, and many agencies on the Federal and State level followed suit by issuing policies on the allocation of this deduction.

Federal agencies that already have established policy regarding the allocation of the 179D deduction include the Department of Defense and the General Services Administration. These policies guide project managers in understanding to whom the deduction should be allocated and the standard approach in doing so. State agencies also have established state-wide policy regarding this allocation, including North Carolina and Texas.

## How Does 179D Work?

A building qualifies for the full \$1.80 deduction when the reduced energy use of its heating, cooling, ventilation, hot water, interior lighting systems, and building envelope is certified to exceed ASHRAE Standard 90.1-2001 by at least 50 percent.



Partial deductions of \$0.60 per square foot are available for each individual component certified to reduce total energy use by 16 2/3% or more beyond ASHRAE 90.1-2001. These individual components are the interior lighting system; building envelope (defined as the outer shell used to protect the indoor environment); and the heating, cooling, ventilation and hot water system.

When the owner of the building is a public entity, the person(s) primarily responsible for designing the specifications of the qualifying components may request an allocation of this deduction. The designer will typically request a “letter of intent” so that he/she may begin the process of designing and certifying the property with the assurance that the public entity will follow through with the allocation afterwards.

Once the building is certified to meet energy requirements by a qualified individual using IRS-approved software, the agency may allocate this deduction by simply signing an allocation letter. The agency must reduce its “basis” by the amount of the allocated deduction, which is a bookkeeping requirement typically taken care of by the agency accountants.

Public entities that allocate this deduction incur zero liability for doing so. If a design firm is audited, and the allocation is reviewed, the public entity will not be held accountable for any denied deductions, and likely—will not have any involvement in the matter whatsoever.

### Who benefits from 179D?

Building owners who take advantage of 179D not only enjoy a deduction for qualifying levels of efficiency but also enjoy significantly lower energy costs, leading edge design and construction which enhances the building’s long term market value, and the benefits of a cleaner environment overall.

Although a public entity cannot take direct advantage of the tax proceeds from the 179D deduction allocation, it will also receive other benefits in the form of energy savings and market value, often totaling more than the deduction proceeds received by the designer.

The average 179D project (typically \$0.60/ sq. ft. for lighting upgrades) can save an agency an average of 20 percent or more on their energy expenses. However even in cases where there are minimal upgrades qualifying for 179D, agencies have saved relatively large amounts.

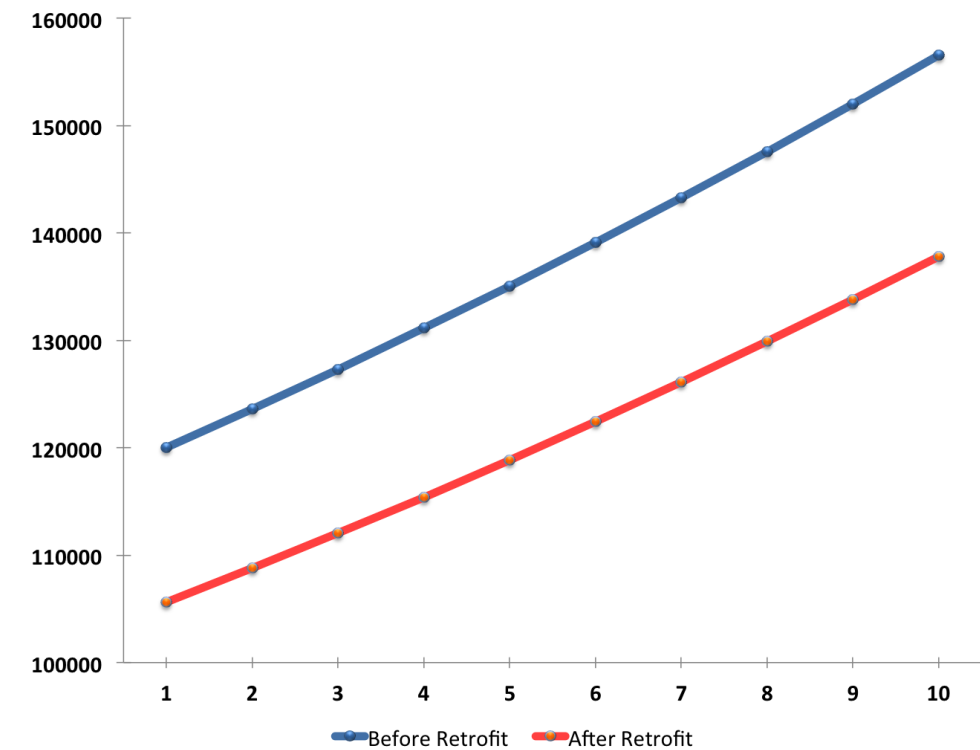
For example, when a school district retrofitted the lighting system in one of its middle schools, an architect worked to find 12 percent energy savings just on that single lighting system, enabling the





Sample Middle School Energy Costs Per Year

Total Savings over 10 years: \$165,080



project to qualify for the 179D partial lighting deduction. In return, the school saved \$15,000 on its energy bill in that year alone. It saved even more the next year, and will continue to save each year. Over 10 years, that totals to over \$150,000, for a single school. (Fig. 1) School districts that take advantage of 179D for five , 10, or 20 schools can save millions of dollars over 10 years, at no additional cost to them, by using 179D as a financing mechanism to achieve more energy efficient designs.

This example illustrates the impact of just 12 percent savings in a single school. There are hundreds of other examples of the deduction providing even greater benefits to school districts, army bases, convention centers, and other publicly owned buildings across the nation.