

# Manufacturing



## *Tools for thought:*

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### **Energy Efficient Commercial Building Deduction:**

The Energy Policy Act of 2005 introduced a tax incentive directed at improving commercial building energy efficiencies. The Energy Efficient Commercial Building Deduction, codified as IRC § 179D, (the “Deduction”) encourages building owners and companies to improve facilities’ energy usage. Hence, “Going Green” not only saves on utility bills, but it can also save taxes!

The Deduction also provides tangential benefits in the form of rebates from utility providers such as American Electric Power and low interest financing sponsored by the Ohio Department of Development.

Regrettably, this deduction is used by only about ten percent (10%) of otherwise qualifying projects. And, it is probably even less frequently considered in the cost/benefit analyses of most renovation projects. Don’t have regrets; save money and taxes!

#### ***How Does the Deduction Work?***

The Deduction can reward companies and building owners who make qualifying improvements to a building’s envelope (the “Envelope”), the HVAC/hot water systems (collectively, the “HVAC”), and the interior lighting systems (“Lighting”). You should bear in mind that this Deduction is a source of ordinary income for recapture purposes on the disposition of depreciable personal and real property.

The technical standards for the Deduction are beyond the scope of this piece. However, in general terms, if these building system improvements result in a fifty percent (50%) reduction in the building’s energy/power costs (when compared to a “reference building”) this Federal tax deduction can equal as much as the product of \$1.80 per square foot (or \$ 0.60 per square foot for each system {*i.e.* the Envelope, HVAC and the Lighting}) and the building’s floor area.

Analysis suggests that this makes energy improvements made in building with areas of 20,000 square feet or more quite attractive. Although, both larger and smaller building do qualify, and therefore the Deduction should be seriously considered wherever renovations touch on the Deduction’s areas of interest.

Each system has its system specific energy targets (at least until regulations are promulgated).

As for Lighting, the lighting power density must be reduced forty percent (40%) (or fifty percent (50%) in the case of warehouses). Also, if the new Lighting reduces its power density by twenty-five percent (25%) the Deduction is equal to \$ 0.30 per square foot with the rate prorated for power density reductions between 25% and 40%.

The Deduction is allowed for both new construction and remodeling and these improvements must be placed in service between 2006 through 2013.

Note that this Federal tax incentive is a “deduction” rather than a “tax credit”, meaning that the cash benefit is calculated by multiplying the deduction times the tax rate. We can assist you to compute your estimate your tax savings.

### ***Examples of Energy-Efficient Building Materials and Systems:***

- Envelope - High-efficiency insulation in walls, ceilings and floors
- HVAC - Automatic thermostats and other monitoring equipment
- Lighting - Energy-efficient fixtures, controls and monitoring equipment
- HVAC - Ultra-efficient air conditioners and furnaces
- Envelope - High-performance glazing and other energy-efficient materials on the building envelope
- HVAC - Natural ventilation
- Lighting - Day-lighting
- HVAC - Improved fan efficiency

### ***Claiming the Deduction:***

- The building must meet energy and power costs reduction standards as detailed in **ASHRAE** Standard 90.1-2001; Energy Standard for Buildings Except Low-Rise Residential Buildings (effective April 2, 2003).
- An independent, qualified individual must verify and certify that the property installed satisfies specific energy efficiency requirements using IRS-approved software.

### ***How Can H&M Help?***

As with most governmental incentive programs, this Deduction provides many obstacles that frustrate taxpayers' full utilization of it. H&M can assist you through-

- We can calculate the amount of the Deduction;
- We can effectively claim the Deduction on your federal income tax return; We can secure necessary government agency assignment where/if necessary;
- We can file amended tax returns to claim the Deduction;
- We can request necessary accounting method changes to permit claiming the Deduction;
- We provide necessary energy efficiency certifications through a network of technical specialists—
  - Review construction documents;
  - Make site visits; and
  - Hold discussions with building designers, project managers and related personnel.

*If the Deduction is appealing to you, please contact Stephen C. Smith, or your H&M tax advisor to explore the Deduction's use your situation. We facilitate such Deductions for growth-minded clients.*

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