

S. 3591, “Commercial Building Modernization Act”
Reforms the 179D Tax Deduction for Energy Efficient Commercial and Multifamily Buildings

- ***What is the 179D tax deduction?***

The tax deduction at Section 179D of the Internal Revenue Code encourages energy efficiency in building design and construction. 179D covers private sector commercial buildings like offices, stores, hotels, warehouses, plants, and apartments. It also covers government buildings like schools, hospitals and military facilities. Section 179D was first enacted as part of the 2005 Energy Policy Act, and was last extended in 2008. It is important to note that 179D provides a tax *deduction* on the income subject to taxation, not a *credit* that lowers tax liability on a dollar-for-dollar basis.

- ***What does the Commercial Building Modernization Act (S. 3591) accomplish?***

S. 3591 would extend the 179D tax deduction (scheduled to expire at the end of 2013) for five more years. The bill makes key improvements to 179D to improve its usefulness to building owners – and would help achieve major reductions in our nation’s energy consumption, spur American construction jobs, and move us closer to energy independence.

- ***Energy efficiency is often called the “fifth fuel.” What does that mean?***

Efficiency should join coal, petroleum, nuclear and renewables to meet Americans’ demands for energy. Taxpayers get more “bang for the buck” by investing in building efficiency projects that avoid energy use, compared to more expensive technologies to develop new energy sources.

- ***How much energy is consumed by commercial buildings and their occupants?***

The Energy Information Administration reports that all buildings account for 41% of energy consumption in the U.S. Of this amount, about half is attributed to homes and the other half to commercial buildings. Sound energy policy should thus include incentives to encourage more efficient commercial and larger multifamily properties.

- ***Does 179D favor specific products or technologies?***

No. The 179D deduction is a technology-neutral incentive that does not pick “winners and losers.” It encourages retrofit *projects* and not specific *products*. It gives building owners the opportunity to select the best mix among a suite of measures to achieve optimal energy efficiency gains.

- ***It’s been said that 179D corrects a flaw in the tax code. How so?***

The tax code allows businesses to deduct utility bills as part of their ordinary operating expenses – but retrofit investments can only be depreciated over long time periods as capital expenses. More inefficient structures with higher utility bills may thus benefit from a larger tax deduction compared to buildings that use less energy. 179D aligns the code so that it awards investments to *save* energy, as opposed to the operating expenses deduction that can otherwise be claimed for *wasted* energy.

- Has 179D been successful in encouraging building efficiency?***
 It has achieved success, but there is room to improve. In FY'10, 179D's actual expense was only \$60 million -- \$120 million *less* than the score it received from JCT that year. To date, 179D has been largely used for "partial" building system upgrades (especially lighting). It has also encouraged greater efficiency in simple, single-use structures (like warehouses and owner-occupied, low-rise offices). To date, 179D has also been geared to encourage energy efficient *new* construction, which has fallen-off due to the recession. But 179D has not yet proved to be a meaningful incentive for energy efficient upgrades to retrofit existing buildings.
- Why does S. 3591 place more focus to improve energy efficiency in existing buildings?***
 The bill's focus to encourage greater efficiency in existing structures is sound policy, because up to 80% of the buildings standing today will still be here in 2050. Current energy codes are already making new construction significantly more efficient anyway, and a boost is needed for older structures. S. 3591 would spur *deep whole-building* retrofits of existing structures – to encourage more projects like the landmark upgrade at the Empire State Building, which is under a contract to lower energy consumption by almost 40%. (The ESB, incidentally, could not qualify for a 179D deduction under the law's current structure.)
- How does S. 3591 encourage existing building retrofits?***
 S. 3591 includes a "performance-based" component to reward retrofits that produce actual and verified energy savings when existing buildings lower utility consumption. Also, S. 3591 scales the tax deduction so that incentive amounts increase with greater energy savings. In this manner the bill encourages ambitious projects, while also rewarding projects that achieve meaningful yet more moderate levels of energy savings.
- How does S. 3591 encourage REITs to commit to efficiency retrofits?***
 Entities like real estate investment trusts (REITs) and limited liability partnerships (LLPs) have no or minimal tax liability, so tax deductions are of little use to them. S. 3591 would reform current provisions which permit "allocation" of the tax deduction and allow REITs, LLPs, and other real estate holding structures with minimal tax appetite to also allocate the incentive to their contractors, engineers, lenders, and other parties responsible for retrofit projects.
- What's the jobs creation impact of S. 3591's reforms to the 179D deduction?***
 An analysis by the Natural Resources Defense Council, The Real Estate Roundtable, and the U.S. Green Building Council reports that over 77,000 jobs would be created if 179D is amended with S. 3591's reforms, to encourage more existing building retrofit projects.

S. 3591, Commercial Building Modernization Act
Section-by-Section Analysis

SECTION 1: Short title of bill is “Commercial Building Modernization Act.”

SECTION 2 (p. 2 line 4): Extends and improves 179D deduction.

Subsection (a) (p. 2, line 7): “Extension”

- Extends 179D from December 31, 2013 until December 31, 2016.
- Clarifies definitions for “commercial building” and “multifamily building.”

Subsection (b) (p. 3, line 7): Increase in Deduction Amounts

- Increases amount of maximum deduction from \$1.80 per square foot (under current law) to \$3.00 per square foot, for “whole-building” efficiency improvements.
- Increases amount of “partial allowance” from \$.60/sf (current law) to \$1.00/sf, for any single system (efficient lighting; heating and cooling; envelope) that meets energy savings targets established by DOE.
- Allows a “partial allowance” of \$2.20/sf (current law) where heating and cooling systems, and envelope systems, together satisfy energy savings targets established by DOE.
- Directs DOE to issue regulations and “safe harbors” for specific efficiency targets and levels regarding building systems, for purposes of the “partial allowance.”

Subsection (c) (p. 5, line 17): “Denial of Double Benefit”

- Prohibits a “double benefit” with the retrofit deduction allowed by section 179F.
- Clarifies that the basis of installed energy efficiency measures is reduced by any deduction allowed under this section – except when those measures are installed in homes financed with low-income housing tax credits.

Subsection (d) (p. 6, line 7): “Allocation of Deduction”

- Improves existing “allocation” provision in current law, whereby only owners of government buildings are permitted to allocate the deduction to architects or designers.
- Enables Real Estate Investment Trusts (REITs), Limited Liability Partnerships (LLPs), and other real estate holding structures that can’t use the incentive to allocate the deduction to a building professional (*e.g.*, architect, contractor, engineer, lender, office tenant) primarily responsible for the energy efficient construction.

Subsection (e) (p. 7, line 3): “Earnings and Profits Conformity for REITs”

- Provides an accounting fix for Real Estate Investment Trusts to use the tax deduction by allowing such entities to claim the entire deduction amount in the year the energy efficiency measures are placed in service.

Subsection (f) (p. 11, line 20): “Updated Standards”

- Provides that the 2004 version of the ASHRAE 90.1 energy standard for commercial buildings provides the baseline to measure improvements for purposes of awarding the deduction, during years 2012, 2013, and 2014.

- Provides that the 2007 version of the ASHRAE 90.1 energy standard for commercial buildings provides the baseline to measure improvements for purposes of awarding the deduction, during years 2015 and 2016.

Subsection (g) (p. 12, line 12): “Treatment of Lighting Systems”

- Improves existing law by enabling deduction’s use for exterior (as well as interior) building lighting systems.

Subsection (h) (p. 12, line 19): “Voluntary Reporting Program”

- Directs DOE and Treasury to develop a voluntary program to provide whole-building energy consumption data from commercial owners and tenants, with regard to buildings that receive the maximum incentive amount.

Subsection (i) (p. 13, line 1): “Effective Date”

- New revisions to 179D apply to property placed in service the year after enactment.

SECTION 3 (p. 13, line 5): Gears the deduction to specifically encourage retrofits of existing buildings in section 179F.

Subsection (a) (p. 13, line 10): “Allowance of Deduction”

- Sets a maximum deduction amount as *either* the sum of the “design deduction” plus the “realized deduction,” *or* 50% of the costs of certified retrofit plan.

Subsection (b) (p. 13, line 20): “Deduction Amounts”

- Allows a “design deduction” based on the energy savings that a retrofit plan is projected to achieve at the time measures are installed, at 60% of the amount allowed under a “sliding scale” of energy savings.
- Allows a “realized deduction” based on the verified energy savings that a retrofit plan actually achieves after it has been implemented, at 40% of the amount allowed under a “sliding scale” of energy savings.
- Creates a “sliding scale” which allows greater deduction amounts as correlated to higher levels of energy savings and performance:

| Energy Savings | Deduction Allowed (per sq. ft.) |
|-----------------------|--|
| 20%-24% | \$1.00 |
| 25%-29% | \$1.50 |
| 30%-34% | \$2.00 |
| 35%-39% | \$2.50 |
| 40%-44% | \$3.00 |
| 45%-49% | \$3.50 |
| 50% or more | \$4.00 |

- Gives a 20% boost in incentive amounts to retrofits of historic buildings.

Subsection (c) (p. 16, line 14): “Calculation of Energy Savings”

- For purposes of eligible tax deduction amounts under the sliding scale, energy savings are determined by a before-and-after comparison of the building’s starting line benchmark prior to a retrofit, and then its energy consumption after the retrofit.
- The starting line benchmark is determined using 1-year of energy consumption data (such as through utility bills) before the retrofit, as determined by inputs to EPA’s widely-used and adopted on-line benchmarking tool.¹
- Licensed Professional Engineers (“P.E.”) must calculate and certify the “before –and-after” energy consumption and savings for purposes of both the “design deduction” and the “realized deduction.”

Subsection (d) (p. 18, line 6): Definitions

- Defines “certified retrofit plan” as a plan certified by a licensed P.E. (under penalty of perjury) to lower energy use in buildings, so that after a retrofit project the building’s energy performance is at least at an average level of energy usage intensity.
- Defines “commercial building” and “multifamily buildings” as those which are at least 10 years old.
- In the case of large shopping centers, clarifies that a “commercial building” is an area that is at least 50,000 square feet or larger (such as an anchor store, “big box” retailer, atrium, parking lot)
- Defines “energy efficient measures” to include all of the building systems covered by 179D, as well as commissioning contracts and building operation systems to encourage actual improvements in energy performance.

Subsection (e) (p. 23, line 3): “Timing of Claiming Deductions”

- Explains that a “design deduction” can be claimed in the taxable year that energy efficiency measures are placed in service.
- Explains that a “realized deduction” for actual improvements in energy performance can be claimed 2 years after a design deduction is claimed.

Subsection (f) (p. 23, line 11): Regulations

- Directs the Treasury Department to issue implementing regulations, in consultation with DOE and EPA.
- Regulations should rely on established industry best practices and guidelines.

Subsection (g) (p. 24, line 17): “Notice to Owners”

- Tracks provision in current 179D that building owners must be notified of energy efficient measures placed in service.

Subsection (h) (p. 21, line 9): “Allocation of Deduction”

- Tracks provision in revised 179D (see subsection 2(d), above) regarding improved allocations of the deduction.

¹ *i.e.*, “Portfolio Manager”: http://www.energystar.gov/index.cfm?c=evaluate_performance.bus_portfoliomanager.

Subsection (i) (p. 25, line 16): “Basis Reduction”

- Tracks basis provision in revised 179D, including exception for low income tax credit housing (see subsection 2(c), above).

Subsection (j) (p. 25, line 11): “Tax Incentives Not Available”

- Tracks the prohibition on “double benefits” provision in revised 179D (see subsection 2(c), above).

Subsection (k) (p. 26, line 8): “Report to Congress”

- Requires biennial report to Congress on retrofit projects realized, energy saved, measures implemented, and jobs created as a result of the 179F deduction.

Subsection (l) (p. 27, line 12): “Termination”

- Provides that retrofit deduction expires on December 31, 2016.

Page 27, line 15: “Effect on Depreciation on Earnings and Profits”

- Allows same REIT accounting fix for 179F retrofit incentive as provided by revised section 179D (see subsection 2(e), above).