

Introduction

On August 8, 2005, history was made when President George W. Bush signed H.R. 6, the Energy Policy Act of 2005. The legislation set a precedent by containing a market transformation incentive in the form of a tax deduction for owner investments in commercial building energy efficiency.

The Energy Policy Act of 2005 establishes a new deduction for expenses incurred for energy-efficient commercial building property. The deduction is equal to energy-efficient commercial building property expenditures made by the taxpayer, subject to a cap.

This document describes the tax deduction provision in general. Nothing in this material should be construed as a substitute for consultation with a qualified tax professional.

What types of buildings will qualify? What types of expenditures will qualify?

Section 1331 of H.R. 6 provides that energy-efficient commercial building property is defined as property that is:

1. Installed on or in any building located in the United States that is within the scope of *Standard 90.1-2001, Energy Standard for Buildings Except Low-Rise Residential Buildings*, of the American Society of Heating, Refrigerating, and Air Conditioning Engineers and the Illuminating Engineering Society of North America;
2. Installed as part of (i) the interior lighting systems, (ii) the heating, cooling, ventilation, and hot water systems, or (iii) the building envelope; and
3. Certified as being installed as part of a plan designed to reduce the total annual energy and power costs of interior lighting systems, heating, cooling, ventilation, and hot water systems of the building by 50 percent or more when compared to a reference building, which meets the minimum requirements of *Standard 90.1-2001* (as in effect on April 2, 2003).

What is the tax deduction amount?

The deduction is equal to energy-efficient commercial building property expenditures made by the taxpayer, subject to a cap. The deduction is limited to an amount equal to \$1.80 per square foot of the property for which such expenditures are made. The deduction is allowed in the year in which the property is placed in service. For tax purposes, "placed in service" generally means the time at which the property is ready for its intended use.

Are there certification requirements and if so, what are they?

Certain certification requirements must be met in order to qualify for the deduction. The secretary of treasury, in consultation with the secretary of energy, will promulgate regulations that describe methods of calculating and verifying energy and power costs, using qualified computer software based on the provisions of the *2005 California Nonresidential Alternative Calculation Method Approval Manual* or, in the case of residential property, the *2005 California Residential Alternative Calculation Method Approval Manual*. These regulations are currently being drafted by DOE in consultation with Treasury Department officials in advance of the implementation date of January 1, 2006.

How will calculation design methods impact various technologies?

The intention is that the calculation be fuel neutral: the same energy efficiency features qualify a building for the deduction, regardless of whether the heating source is a gas or oil furnace, or boiler, or an electric heat pump.

In addition, the calculation methods are to provide appropriate calculated energy savings for design methods and technologies not otherwise cred-

ited in either *Standard 90.1-2001* or in the *2005 California Nonresidential Alternative Calculation Method Approval Manual*, including the following:

- a. Natural ventilation;
- b. Evaporative cooling;
- c. Automatic lighting controls such as occupancy sensors, photocells, and timeclocks;
- d. Daylighting;
- e. Designs utilizing semi-conditioned spaces that maintain adequate comfort conditions without air conditioning or without heating;
- f. Improved fan system efficiency, including reductions in static pressure;
- g. Advanced unloading mechanisms for mechanical cooling, such as multiple or variable speed compressors;
- h. On-site generation of electricity, including combined heat and power systems, fuel cells, and renewable energy generation such as solar energy; or
- i. Wiring with lower energy losses than wiring satisfying Standard 90.1-2001 requirements for building power distribution systems.

The calculation methods may take into account the extent of commissioning (the initial operability of a system) in the building, and allow the taxpayer to take into account the amount of system performance that may exceed typical performance.

Will there be inspections of buildings to determine compliance? Who will do them?

The secretary of the treasury shall prescribe procedures for the inspection and testing for compliance of buildings that are com-

parable to the requirements in the *Mortgage Industry National Accreditation Procedures for Home Energy Rating Systems*. Individuals qualified to determine compliance shall only be those recognized by one or more organizations certified by the secretary of the treasury for such purposes. These compliance inspection requirements are currently under development.

Do public buildings qualify for this tax deduction?

For energy-efficient commercial building property expenditures made by a public entity, such as public schools, the secretary of the treasury shall promulgate regulations that allow the deduction to be allocated to the person primarily responsible for designing the property in lieu of the public entity.

Are partial deductions allowed for building subsystems instead of a whole building deduction?

In the case of a building that does not meet the whole building requirement of a 50 percent energy savings, a partial deduction is allowed with respect to each separate building system that comprises energy-efficient property and which is certified by a qualified professional as meeting or exceeding the applicable system savings targets established by the secretary of the treasury.

The applicable system savings targets to be established by the secretary are those that would result in a total annual energy savings of 50 percent for the whole building, if each of the separate systems met the system target; note that the maximum allowable deduction is \$0.60 per square foot. The separate building systems are the:

1. Interior lighting system;
2. Heating, cooling, ventilation, and hot water systems; and
3. Building envelope.

What are the interim rules for lighting projects?

Building owners are encouraged under the law to focus first on lighting systems for two reasons: first, their ease and availability of upgrading, and second, the known achievements in energy efficiency that will be gained. In the case of a lighting system (including the retrofit of an existing system), until such time as the secretary of the treasury issues final regulations, the system energy savings target for the lighting system is deemed to be met by a reduction in lighting power density of 40 percent (50 percent in the case of a warehouse) of the minimum requirements in Table 9.3.1.1 or Table 9.3.1.2 of *ASHRAE/IESNA Standard 90.1-2001* (as in effect on April 2, 2003). Note that in the case of other building systems (i.e., HVAC systems and the building envelope), partial deductions are generally not allowed until the secretary establishes system targets for such systems.

In the case of a lighting system that reduces lighting power density by 25 percent, a partial deduction of \$0.30 per square foot is allowed. A pro-rated partial deduction is allowed in the case of a lighting system that reduces lighting power density between 25 and 40 percent. Certain lighting level and lighting control requirements must also be met in order to qualify for the partial interim lighting deductions.

What is the effective date for taking advantage of this tax deduction?

The provision is effective for property placed in service after December 31, 2005, and prior to January 1, 2008.

For more information, please visit the American Society of Heating, Refrigerating, and Air Conditioning Engineers' website at <http://www.ashrae.org/>, or NEMA's Government Relations Energy Policy site at <http://www.nema.org/gov/energy/>.

EFFICIENCY BUILT-IN

The Energy Efficient Commercial Building Tax Deduction



AN OVERVIEW OF SECTION
1331 OF H.R. 6,
THE ENERGY POLICY ACT
OF 2005
(PUBLIC LAW 109-58)