

# Using EAct Incentives to Enhance New Mandatory Building Energy Disclosure Requirements

*By Charles Goulding, Jacob Goldman and Joseph Most*

Charles Goulding, Jacob Goldman and Joseph Most discuss mandatory building energy reporting and how the EAct can be used to achieve above-average reporting status in jurisdictions with heightened requirements.

**T**ax advisors need to understand the substance of rapidly expanding mandatory building energy rules and use the Energy Policy Act<sup>1</sup> (EAct) to help their clients achieve above-average reporting status. Beginning in 2007 with California Assembly Bill 1103, there has been a fast growing national trend for jurisdictions to require commercial buildings to document and benchmark their energy use and for the information to be disclosed to members of the public. In these cities, and perhaps nationwide, the new energy benchmarking laws will cause energy use to be factored into the sale or lease markets, which may cause buildings, whether or not affected by the new laws, to hit benchmarking standards in order to stay competitive. By improving building energy efficiency, building owners and tenants should be able to reduce energy levels so that they can receive immediate large EAct tax deductions.

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## The EAct Tax Opportunity

Pursuant to Internal Revenue Code (the "Code") Sec. 179D, commercial building owners or tenants making qualifying energy-reducing investments can obtain immediate tax deductions of up to \$1.80 per square foot. If the building project doesn't qualify for the maximum \$1.80-per-square-foot immediate tax deduction, there are tax deductions of up to 60 cents per square foot for each of the three major building components: lighting, HVAC and the building envelope. The building envelope is every item on the building's exterior perimeter that touches the outside world including roof, walls, insulation, doors, windows and foundation.

## Commercial Energy Benchmarking Laws

Five major jurisdictions in the United States have passed commercial energy benchmarking laws since 2007. Those jurisdictions are the State of California; Washington, D.C.; Austin, Texas; New York City; and Seattle, Washington. These laws will eventually impact millions of buildings around the country. For example, the New York City law is expected to impact over one

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Chart 1

Commercial Properties Potential EPartax Deductions					
Sample Square Footage	Minimum Deduction	Maximum Deduction	BVAC Maximum Deduction	Building Envelope Maximum Deduction	Total
50,000	\$ 15,000	\$ 30,000	\$ 30,000	\$ 30,000	\$ 90,000
100,000	\$ 30,000	\$ 60,000	\$ 60,000	\$ 60,000	\$ 180,000
250,000	\$ 75,000	\$ 150,000	\$ 150,000	\$ 150,000	\$ 450,000
500,000	\$ 150,000	\$ 300,000	\$ 300,000	\$ 300,000	\$ 900,000
750,000	\$ 225,000	\$ 450,000	\$ 450,000	\$ 450,000	\$ 1,350,000
1,000,000	\$ 300,000	\$ 600,000	\$ 600,000	\$ 600,000	\$ 1,800,000

million buildings alone. All of these laws will be at least partially implemented by June 2011, and all of them, at minimum, require commercial buildings of at least 50,000 square feet to benchmark and disclose energy use. Chart 1 illustrates the magnitude of potential EPartax tax benefits available at various square footages, starting at the 50,000-square-foot minimum:

Therefore, even the smallest buildings that may be affected by the benchmarking laws can potentially obtain immediate EPartax tax deductions of up to \$90,000.

To complete the benchmarking process, each jurisdiction requires buildings to use the Environmental Protection Agency's (EPA) "Portfolio Manager" to benchmark energy use, in accordance with the Energy Star rating system.<sup>2</sup> The EPA software generates an Energy Star score for individual buildings based on factors such as past utility bills, square footage, building area that is heated/air conditioned and weekly operating hours. The score is based upon a scale of up to 100 and represents the percentage of buildings, with similar operations, which have more efficient energy use than the individual building being scored.

For example, a score of 75 indicates that the building performs better than 75 percent of its peers. A score of 75 makes the building eligible for the Energy Star and is also a typical target used for benchmarking. After reducing energy use to the benchmarking levels, building owners and tenants may already be in position to take large immediate EPartax tax deductions, or they may only have to make relatively small energy use reduction investments to get the tax benefits. Aside from the above factors, the benchmarking laws tend to vary by jurisdiction.

There are three major areas of differences between the benchmarking laws:

- the type of disclosure required;
- whether or not smaller government-owned buildings are required to benchmark; and
- the law's implementation method.

## Disclosure

In general, there are two forms of disclosure required by the benchmarking laws. New York City and Washington, D.C., require general public disclosure of a building's energy benchmarking numbers. Austin, Seattle and California only require disclosure to current and prospective purchasers or tenants. Because in New York City and Washington, D.C., the energy benchmarking information will be readily available to the public, these cities are the most likely to have energy benchmarking factor into the commercial building sales and leasing markets the quickest. Those cities would also be more likely to have buildings in position to qualify for EPartax tax benefits long before other cities without the rules. Tax advisors would be wise to suggest that clients retrofit their buildings before energy-use disclosure is mandated.

## Government-Owned Building Distinction

Under the energy benchmarking laws, city-owned buildings in both New York City and Washington D.C. are distinguished from privately owned buildings. As opposed to privately owned buildings with over 50,000 square feet, which under full implementation will be required to benchmark and disclose, in both cities, only city-owned buildings larger than 10,000 square feet are required to benchmark and disclose energy use.

## Benchmarking Law Implementation Scheme

The new energy benchmarking laws are being implemented in two ways. New York City and Austin require all buildings governed by the new laws to conform

Chart 2

Energy Benchmarking Laws			
City	Effective Date	Building Size	Type of Disclosure
New York City	5/1/10 for city owned buildings	10,000sq ft +	Public disclosure by Dept. of Finance
	5/1/11 for private buildings	50,000sq ft +	
Seattle	4/1/2011	50,000sq ft +	Disclose to current and prospective tenants and buyers upon request
	4/1/2012	10,000sq ft + and multi-family housing	
Austin	6/16/11	All buildings	Must disclose to a buyer or prospective buyer
Washington D.C.	2009 for District owned buildings	10,000sq ft +	Public disclosure after 2nd year of reporting
	2010 for private buildings	200,000sq ft +, reduces by 50,000 ever year until all 50,000sq ft +	
California	1/1/11	50,000sq ft +	Must disclose to prospective parties as part of a whole-building transaction
	1/1/12	10,000sq ft +	
	7/1/12	All buildings	

Chart 3

Typical 50,000 Sq. Ft. City Properties Lighting Wattage per Sq. Ft. Targets		
Building Type	Disclosed	179D Deduction
Office	0.975	0.78
Hotel	1.275	1.02
Sports Arena	1.125	0.90
Self Storage Facility	—	0.60
Manufacturing	1.650	1.32
Warehouse	—	0.60
Data Center	0.975	0.78
Hospital	1.200	0.96

to the law as of the date it takes effect. Washington, D.C., Seattle and California all apply some sort of phase-in scheme, where only the largest subset of buildings are effected by the law as of the date that the law takes effect. Then, each year, smaller buildings will gradually be affected by the law, depending on size, until all buildings over a certain square footage have to comply with the benchmarking law. However, because of the effect that benchmarking by the largest buildings will have on the market for buying and leasing commercial buildings, smaller buildings may find it advantageous to benchmark energy use before their mandatory disclosure date. This enables smaller buildings to stay competitive in the market. Also, as said earlier, it would be wise for smaller buildings to reduce energy use enough to receive between a \$.20 and \$1.80-per-square-foot tax deduction.

Chart 2 summarizes some of the key elements of the first five benchmarking laws

## Integrating Benchmarking & EPAct Tax Incentives

### Lighting

The maximum Code Sec. 179D tax deduction for lighting upgrades requires a 40-percent wattage reduction compared to ASHRAE 2001. Achieving these wattage percentile targets is exactly what a building will need to do to achieve or maintain a 75-percent status in

the lighting benchmarking area. Those buildings that use extremely low-wattage interior applications, such as LED lighting or induction lighting, should be able to leapfrog into the top quartile for bench-marked lighting energy usage.

Chart 3 shows the wattage per square foot required in order to get EPAct tax lighting deductions in typical commercial spaces.

### HVAC

The key to achieving top quartile performance is upgrading to energy-efficient HVAC at the EPAct tax deduction level. The Code Sec. 179D tax deduction for HVAC upgrades requires at least a 16.67-percent total building energy cost reduction from HVAC alone. Although this requires a very efficient HVAC system, so few buildings in the country are at that level that achieving the tax deduction result will clearly place buildings into the top 75 to 100 energy performance benchmarking quartile. HVAC is generally expensive, but often, making the incremental investment and stepping up to a more efficient system can be the better economic decision if utility rebates and EPAct tax deductions are taken into account.

## Private Efforts to Encourage Benchmarking

Recently, the Deutsche Bank Foundation financed the creation of a public database of several hundred energy-efficient retrofitted buildings in New York

City.<sup>3</sup> Appearing in this database will be advantageous for any building owner looking to sell or lease their building at the most competitive price. Therefore, by installing energy-efficient lighting and HVAC, a building in New York City can satisfy the new benchmarking law, appear on the retrofitted buildings list and immediately save up to \$1.80 per square foot in EPAAct tax deductions all at once.

### **Conclusion**

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Although at first glance the new commercial energy benchmarking laws may seem to be a burden on building owners and tenants, the laws actually provide a great opportunity to reduce energy costs and take large tax deductions. Most building owners and, particularly, landlords with tenants do not want to find themselves obligated to publicly report an energy inefficient building. Building owners and tenants may be able to achieve energy efficient status and qualify for EPAAct tax deductions while reducing energy use simply to the benchmarking levels or just a little further.

Even though these laws are currently in place in only five jurisdictions, it is predicted that more

jurisdictions are likely to pass similar laws. In addition, because several of the largest American cities are affected by these benchmarking laws (e.g., New York City, Los Angeles, Washington D.C.), the effect of forced benchmarking on the commercial building sale and lease markets will likely have a wide-sweeping national effect, since many large companies either have offices of their own in one of the cities or are in competition with companies that have offices in these cities. This is likely to encourage energy use benchmarking compliance and disclosure throughout the country, which in turn may cause a nationwide "race to the top" for efficient energy use. Informed companies will use the benefits of the EPAAct to accelerate the process, cutting energy costs and improving energy efficiency, while obtaining substantial tax benefits.

### **ENDNOTES**

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- <sup>1</sup> Energy Policy Act of 2005 (P.L. 109-58).
- <sup>2</sup> The Portfolio Manager is free to use and is available at <https://www.energystar.gov/istar/pmpam/>.
- <sup>3</sup> See Julie Satow, *Showing the Benefits of 'Green' Retrofits*, *NEW YORK TIMES*, June 1, 2010, [www.nytimes.com/2010/06/02/realestate/commercial/02deutsche.html?sq=deutsche%20bank&st=cse&scp=2&pagewanted=print](http://www.nytimes.com/2010/06/02/realestate/commercial/02deutsche.html?sq=deutsche%20bank&st=cse&scp=2&pagewanted=print).

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