

Energy Efficient Commercial Buildings Deduction: Enhancements Due to Passage of the Inflation Reduction Act

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The federal Energy Efficient Commercial Buildings Deduction (179D) allows building owners to claim a tax deduction for installing qualifying energy-efficient systems and components in their buildings. Congress established this deduction as part of the 2005 Energy Policy Act and made it permanent in 2020 as part of a tax reform law. With the passage of the Inflation Reduction Act (IRA) earlier this year, Congress enhanced and expanded 179D to better encourage both new construction and energy efficiency retrofits in commercial and public buildings of over 50,000 square feet in size across the country. This brief overviews the uses for 179D, the enhancements that the IRA makes to this deduction, and how State Energy Offices can leverage this deduction to implement energy efficiency measures in buildings throughout their states.

Under the new framework taking effect on January 1, 2023, 179D will be available to commercial, nonprofit, and public building owners. Building owners of new or existing buildings who install lighting, building envelope, or heating, cooling, or ventilation systems that achieve energy performance at least 50% better than the ASHRAE 90.1-2007 (current ASHRAE baseline) standard are eligible for the deduction (the relevant 90.1 standard will be updated over time to more recent versions).^{1,2} Additionally, building owners retrofitting existing buildings can receive the deduction for demonstrating energy use intensity improvement of 25% to 50% versus the pre-retrofit baseline performance. Commercial building owners are allowed to take the deduction themselves when they install qualifying measures in their properties; public building owners and nonprofit organizations can transfer the tax benefit to the person or company responsible for the design of the installation on the property.³ In 2023, there will be two methodologies that designers can use to calculate the energy savings which are the basis of the deduction. One is a building model that is similar to the current standard, while the other is a new methodology based on a building's Energy Use Index (EUI). Finally, according to recently-released Treasury guidance, the existing ASHRAE 90.1-2007 standard will remain effective until 2027, and projects started before 1/30/2023 will be exempt from prevailing wage and apprenticeship requirements.

Critically, 179D enables public facilities owned by states and local governments to leverage this deduction to help finance the costs of energy retrofits for public buildings. Because 179D allows public building

¹ At 25 percent, the 179D amount is \$2.50. For efficiency beyond 25 percent, the amount is increased up to \$5.00 per square foot at 50 percent greater energy performance from the ASHRAE baseline affirmed by the U.S. Department of Energy (DOE)/Treasury.

² To achieve the \$2.50 - \$5.00 tax credit, installers must meet prevailing wage and apprenticeship requirements. Otherwise, the amounts fall to \$.50 - \$1.00. For more information and guidance on prevailing wage requirements under the IRA, please see Internal Revenue Service, "Prevailing Wage and Apprenticeship Initial Guidance Under Section 45(b)(6)(B)(ii) and Other Substantially Similar Provisions," Federal Register Vol. 87, no. 229 (November 30, 2022): 73580-73585, <https://www.federalregister.gov/documents/2022/11/30/2022-26108/prevailing-wage-and-apprenticeship-initial-guidance-under-section-45b6bii-and-other-substantially>. Additional resources on prevailing wage standards, including informational webinars, can be found at U.S. Department of Labor, "Prevailing Wage and the Inflation Reduction Act," accessed December 14, 2022, <https://www.dol.gov/agencies/whd/IRA>.

³ U.S. Department of Energy, "179D Commercial Buildings Energy-Efficiency Tax Deduction," accessed December 14, 2022, <https://www.energy.gov/eere/buildings/179d-commercial-buildings-energy-efficiency-tax-deduction>.

owners to transfer ownership of the deduction to the designer of the upgrades, this means that they can leverage the value of the credits to an ESCO as part of an ESPC or Energy-as-a-Service (EaaS) contract, if the ESCO is the party responsible for designing the improvements to the building. The party needs to also obtain an allocation letter that allows the government entity that owns the building to transfer the benefit.

State Energy Offices providing technical assistance to customers throughout the ESPC financing process may wish to inform their customers of the changes to this tax deduction and how that may impact the potential upgrades they want to pursue for their buildings. The following table summarizes the changes made to 179D due to the passage of the IRA:

Tax Credit Aspect	Baseline	IRA Change
<i>Minimum Required Savings</i>	50 percent over ASHRAE 90.1	Sliding scale of 25 – 50 percent over ASHRAE standard affirmed by DOE/Treasury four years prior to the building being placed into service.
<i>Eligible Facilities</i>	Commercial and public buildings	Commercial, public, and tax-exempt/nonprofit buildings
<i>Deduction Amounts</i>	Up to \$1.88/sqft deduction for fully-qualifying properties. Partially-qualifying properties can get reductions of \$.63/sqft for envelope/HVAC/lighting improvements of 10/15/25 percent, respectively.	If prevailing wage requirements are met: \$2.50/sqft minimum, each additional percentage of energy reduction above standard increases deduction up to \$5.00/sqft. If prevailing wage requirements are not met: \$.50/sqft minimum. Each additional percentage of energy reduction will increase the deduction up to \$1.00/sqft.
<i>Deduction Timeframe</i>	Deduction can only be taken once for the lifetime of the building. No potential to take deduction for subsequent energy improvements.	Can be taken every three years after the building goes into service.

For questions on 179D or other tax changes made by the passage of the IRA, please contact Sam Cramer, Senior Program Director, at scramer@naseo.org.