BPM

Credit When Due: Tax Incentives for Green Improvements

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We live in an environment where more and more people are conscious of how their decisions impact the quality of life. Purchasing recyclable and earth friendly products, driving hybrid vehicles and installing energy-efficient lighting are some actions we take to be green. Businesses are aware of the importance of meeting customer and employee expectations and simply want to do the right thing. Real-estate developers and landlords are faced with government, investor and tenant demands to cut energy use and waste and to be mindful of planetary health. The good news is that Washington policymakers are using the tax code to help homeowners and commercial-property owners become greener. As we all take a sigh of relief that the 2010 tax season is behind us, it is not too soon to start thinking about maximizing tax savings for the year ahead.

Tax credits and tax deductions are not the same. A tax credit reduces tax liability. If you owe $100,000 in income taxes, but you have a $10,000 credit, your net tax liability is $90,000. A tax deduction reduces your taxable income but not on a dollar-for-dollar basis. Instead, you apply your tax rate to quantify the cut. So, if you have a $100,000 tax deduction and you are in the 35 percent tax bracket, your tax benefit is $35,000.

Generally, federal tax incentives aim at reducing energy consumption and encouraging renewable energy use. Under current code, businesses that purchase a so-called “energy property” to use in the course of commerce can claim a tax credit for up to 30 percent of the cost. An energy property is equipment that uses solar or wind to generate electricity or to heat, cool or light a building. Taxpayers can claim the credit whether they buy equipment or build it.

The federal code also allows a deduction of up to $1.80 a square foot for improvements to make commercial property more energy efficient. The upgrades must improve interior lighting systems, heating, cooling, ventilation and hot water systems, or the building envelope. If improvements don’t meet every code requirement, a partial deduction is allowed of $0.60 a square foot. The dollars can be substantial. A landlord with a 50,000 square-foot commercial building who upgrades lighting, building envelope and HVAC systems could achieve a $90,000 tax deduction (50,000 square feet x $1.80).

With limited exceptions, the energy-saving investments must be in service after Jan. 1, 2006, but before year-end 2013. Deductions are open to tenants that make energy-efficient improvements, too. Building owners, whether they developed or bought a property, can seize the benefit as long as they are first to place it in service. The improvements must be certified by a qualified individual.

The government also has incentives to make public buildings like schools or universities more energy efficient. Because government pays no taxes, the person primarily responsible for designing the technology gets the deduction. Under the code, the designer is the person who creates the technical specifications for the installation and can include an architect, engineer, contractor, environmental consultant or energy-service provider. If there is more than one involved, the owner can decide how to allocate the perk.

Energy Star labels and LEED certifications do not guarantee that federal requirements for this deduction are met. However, professionals in the field routinely complete complimentary analyses to evaluate if a new building or improvement qualifies. All that is needed to start are blueprints and project specifications.

The code also offers individual tax credits. Under the “residential energy-efficient property” credit, 30 percent of an expenditure for solar-electric equipment, solar water-heating equipment, fuel-cell equipment, small wind-energy equipment and geothermal heat pumps can be claimed. Some credits, but not all, are available only on principal residences. Home-based workers must be careful. The expenditure must be for a nonbusiness purpose; if less than 80 percent of the use of an item is for a nonbusiness (such as living in your house), only that portion of the expenditure qualifies.

For example, say Bob purchases a $6,000 solar panel for his home. If he uses 30 percent of his house for business, his credit is limited to 70 percent. That would be $1,260 ($6,000 multiplied by 30 percent and then by 70 percent). Conversely, if the business use of his home absorbs only 10 percent of its square footage, he would be eligible for the full credit of $1,800 (30 percent of $6,000).

Even individuals who are tenant-stockholders of a cooperative housing development or members of a condominium-management association (a type of homeowners association) are treated as having made the individual’s proportionate share of any expenditure by the co-op or association. The credit is available through 2016.

The code limits the aggregate credit that can be claimed in any two years for energy-efficiency improvements and residential energy-property expenditures. Examples of qualified energy-efficiency improvements include insulation to reduce heat loss or gain and exterior doors and windows designed to reduce heat gain. Qualified energy property includes some natural gas, propane and oil furnaces, natural gas and propane-oil hot-water boilers and some water heaters and central air-conditioners. The total allowable credit for 2009 and 2010 is $1,500, and it expires at the end of this year.

The rules surrounding these incentives are confusing and intimidating, but the bother to heed them can lead to good rewards. Credits and deductions don’t pay for up-front costs. But making improvements can give you legitimate green bragging rights. You also could end up with some green in your pocket—not an outcome often associated with income taxes.

The good news is that Washington policymakers are using the tax code to help homeowners and commercial-property owners be a little greener.