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Guide to Green Building Tax Incentives *for* Construction and Real Estate

Commercial real estate is responsible for up to one-fifth of nationwide energy emissions each year.

Globally, the built environment contributes 37 percent to carbon emissions (about ten percent from materials like cement and steel) and 34 percent of energy demand; buildings also impact air, water, and land pollution to varying degrees.

Reducing the carbon footprint presents an opportunity to attract additional capital, new tenants, and new revenue sources. Upgrading, replacing, or building renewable energy systems now come with generous tax incentives.

In this guide, learn more about changes to these green tax incentives:

- 179D Commercial Buildings Energy-Efficiency Tax Deduction
- 45L Residential Energy Efficiency Credit
- 48(e) Clean Electricity Investment Tax Credit
- 45W Commercial Clean Vehicle Credit

179D Commercial Buildings Energy-Efficiency Tax Deduction

179D is a tax deduction for energy-efficient improvements to the commercial building envelope, interior lighting, and HVAC. It is now a permanent part of the U.S. tax code. Beginning in 2023, the base deduction amount is worth **$0.50 per square foot for a 25 percent reduction in building energy use, or $1.00 per square foot for a 50 percent reduction.**

There are **additional opportunities for a higher deduction** if the project meets new prevailing wage and apprenticeship requirements.

- $2.50 per square foot: 25 percent energy reduction in the overall building plus prevailing wage and apprenticeship hours
    - Plus an extra $.10 per square foot for each percentage point above 25 percent energy reduction up to $5.00
- $5.00 per square foot: 50 percent energy reduction in the overall building plus prevailing wage and apprenticeship hours

Beginning in 2023, REITs and designers of tax-exempt buildings can use the deduction. **Examples of eligible projects could include schools, non-profit hospitals, universities, places of worship, museums, and government, municipal, or Tribal buildings.** Projects can claim 179D every three years with qualifying upgrades.

The IRA also changed the reference date for energy standards to the date the property is placed in service.

- For buildings placed in service before January 1, 2015, taxpayers would use the reference standard 1-2001.
- Buildings placed in service between January 1, 2015 and December 31, 2026 must use standard 1-2007.
- Buildings placed in service after December 31, 2026 must use standard 1-2019.

Version 90.1-2007 can be used for construction that began before January 1, 2023 regardless of when the building is actually placed in service.

179D can apply to building retrofits where the building was placed in service at least five years ago. The building must be subject to depreciation or amortization and certified as meeting certain energy saving requirements.

Section 45L Residential Energy Efficiency Credit

Starting in 2023, single- and multi-family dwellings that meet certain energy requirements can qualify for the 45L tax credit. Examples of eligible dwellings include:

- Single- and multi-family homes
- Rental properties and primary residences
- Student housing
- Senior living facilities
- Condominiums
- Townhomes

In a change from previous rules, buildings can be more than three stories tall.

The credit is available as follows:

- $500 for each multi-family dwelling that meets ENERGY STAR® Multifamily certification standards
- $1,000 for each multi-family dwelling that meets Zero Energy Ready Home requirements
- $2,500 for each unit that meets ENERGY STAR® requirements and prevailing wage rules
- $5,000 for each unit that meets Zero Energy Ready Home requirements and prevailing wage rules
    - o *Prevailing wage only applies to multi-family dwellings placed in service in 2023 and after.*

45L has been extended through 2032. Builders can claim 45L for the year the project is placed in service, even if the credit can't be used immediately. It can be carried forward up to 20 years. 45L can also be combined with the 179D commercial building energy-efficient tax deduction.

Section 48(e) Clean Electricity Investment Tax Credit

The Section 48 Investment Tax Credit (ITC) was updated and expanded as part of the Inflation Reduction Act (IRA) to lower the cost of installing and operating renewable energy projects (wind, solar, and hydropower equipment).

The base credit is six percent and phase out doesn't start until 2032. It can go as high as 30 percent for projects that meet wage and apprenticeship requirements outlined in the IRA or for facilities generating less than one megawatt of renewable energy. Additional stackable bonus credits, described below, can increase the credit's value substantially.

There are different ways to qualify for bonus credits with Section 48.

- Domestic materials (steel, iron, or other manufactured product) bonus: 10 percent
- Energy Community (brownfield area) bonus: 10 percent
- Low-income communities and Indian land bonus: 20 percent
- Affordable housing and economic benefit projects bonus: 20 percent

Another option is to site a qualified renewable energy project in a low-income community. **The Low-Income Communities Bonus Credit is a 10 or 20 percent bonus** depending on which category the project is in, as noted below.

- 10 percent bonus credit: facilities located in designated low-income communities (A) or on Indian land (B)
- 20 percent bonus credit: qualified low-income residential building project (C) or a qualified low-income economic benefit project (D)

The Bonus Credit applies to smaller solar or wind projects that produce up to five megawatts of alternative current. The bonus credit is allocated according to the facility's capacity and is limited to 1.8 gigawatts of direct current in 2023 and 2024, and zero gigawatts after that. If there are excess gigawatts not allocated in 2024, they may be carried over to 2025.

Categories A and D can allocate more gigawatts to a project than Categories B and C. If a project could be eligible for both a Category A and Category C, for example, the higher credit amount would be used.

Projects must apply for the bonus credit; the application with the Department of Energy is expected to open later in 2023.

Certain projects may carry more weight in the application process. Projects that are market-ready, owned by a community organization, "encourage new market participants," and benefit low-income and marginalized communities may receive more emphasis.

Section 45W Commercial Clean Vehicle Credit

This is a new business credit for qualified commercial clean vehicles.

It's equal to the lesser of 15 percent (or 30 percent for a vehicle not powered by a gas or diesel internal combustion engine) of basis, or the incremental cost of the vehicle, up to $7,500 (or $40,000 for a vehicle with a gross vehicle weight rating of at least 14,000 pounds).

Vehicle requirements:

- Qualified manufacturer according to the updated IRS list
- **Either a plug-in EV** with a battery capacity of 7 kilowatt (kW) hours (for vehicles under 14,000 pounds) or 15 kW (for vehicles over 14,000 pounds) **OR a fuel cell motor** that meets IRS requirements
- Not previously qualified under Section 30D or 45W
- Use for business only and in the U.S.
- Classified as a motor vehicle under title II of the Clean Air Act OR mobile machinery classified in Internal Revenue Code 4053(8).

For-profit and not-for-profit organizations can claim the credit. It's non-refundable, which means 45W can't exceed the amount the organization owes in taxes. The credit can be carried over as a general business credit.

Tip: Not using EVs for business, but still looking for tax credits? The following tax credits have been extended through December 31, 2024.

- Alternative fuel credit
- Alternative fuel mixture credit
- Second generation biofuel producer credit
- Biodiesel and renewable diesel credit
- Biodiesel and renewable diesel mixture credit

Eligible fuel sold or used in 2023 and 2024 no longer includes liquefied hydrogen or fuel derived from biomass that meets the requirements of military jet fuel or aviation turbine fuel; kerosene as diesel fuel is also disallowed.

Carbon-Reduction Strategies for Real Estate & Construction

Many of the processes and best practices to reduce carbon in construction and real estate already exist. For new projects, decisions about how to reduce the building's carbon footprint can be made during the design and construction phases: setting policies and standards, energy usage objectives, mapping out the building lifecycle all the way through deconstruction.

For existing buildings and retrofits, a good place to start is by mapping out current overhead costs as part of an energy audit. **Energy audits analyze current energy usage and identify opportunities to reduce energy consumption.** The audit will reveal where to incorporate renewable energy sources and alternative fuels. Based on the audit results, property managers, owners, and investors can set property-specific goals for operational emissions.

It's important for the energy audit to produce reliable, comprehensive data that can be used in financial decision-making. This data will set the foundation for determining whether a specific building or assets within a portfolio are meeting carbon reduction metrics.

Real estate investors will need to consider ways to incorporate portfolio-wide decarbonization strategies. Assembling a team of stakeholders, from investors to property managers and executives, should be involved. Once the audit is completed, gaps identified, and the team established, the goal is to continuously make improvements on energy efficiency. Depending on the portfolio size, investors will need to prioritize which assets to replace, upgrade, or retrofit and allocate capital accordingly.

As part of the shift to renewable energy, electrification is a key component. HVAC, smart building systems, and electrifying the fleet of vehicles (if applicable) are all areas to look at. There are other alternative fuel sources to consider depending on the portfolio or asset goals. Solar, solar thermal, wind, geothermal, and biofuels all now come with substantial tax benefits for both new and retrofit projects.

Moving You Forward

Want to learn more about these green tax incentives for a current or future project? Get in touch with our Construction & Real Estate team today.

About PBMares

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