

# Energy Efficient Tax Incentives - Inflation Reduction Act of 2022



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The Inflation Reduction Act of 2022 (IRA) significantly expanded tax incentives related to energy efficiency for real estate owners and designers, including the Section 179D tax deduction and Section 45L tax credit.

## Section 179D Tax Deduction

Prior to the passage of the IRA, the Section 179D tax deduction was available to commercial building owners and designers of buildings owned by government entities. The IRA extends the deduction to designers of commercial buildings owned by tax-exempt entities, which can allocate the 179D deduction to architects, engineers and designers for designing a building's energy-efficient systems.

The IRA lowers the qualification threshold for the 179D deduction from 50% to a 25% reduction in total annual energy and power costs, which is determined using an Applicable Dollar Value (ADV) multiplication factor. The initial value and eventual cap for the ADV varies depending on whether prevailing wage and apprenticeship requirements are satisfied.

Laborers and mechanics employed by the taxpayer and all contractors or subcontractors must be paid wages at least at the locality's prevailing rates for five years beginning when the project is placed into service. To satisfy the apprenticeship requirement, a certain percentage of the labor must be performed by people employed through registered programs.

The IRA also increases the 179D deduction per square foot using a sliding scale, for energy-efficient commercial buildings four stories or taller. Previously, the deduction ranged from 63 cents per square foot for each of the three

eligible systems (HVAC and hot water, interior lighting and building envelope) to a maximum of \$1.88 per square foot.

Under the IRA, projects that do not meet the prevailing wage requirements but which achieve a 25% energy cost savings are eligible for a base deduction of 50 cents per square foot. The deduction is increased for each percentage point above 25% that energy usage is reduced, capped at \$1.00 per square foot.

For projects that do meet the prevailing wage requirements and achieve an energy cost saving of at least 25%, the 179D deduction is equal to \$2.50 per square foot. With each additional percentage point of energy usage reduction, the bonus deduction is increased to a maximum of \$5.00 per square foot for 50% energy cost savings or higher.

## Section 45L Tax Credit

The Section 45L tax credit incentivizes residential homebuilders and multifamily developers to reduce energy usage in newly constructed residences. The IRA extends the current credit through 2022 and modifies it beginning in 2023 through 2032.

Through the end of 2022, 45L provides a maximum credit of \$2,000 per unit. For years 2023–2032, the maximum credit will increase to \$5,000 per unit for both single-family and multifamily developments.

The energy-efficient criteria and testing requirements for the Section 45L credit have been changed. New homes certified under the Department of Energy's Star Residential New Construction or Energy Star Manufactured

New Homes Programs will be eligible for a \$2,500 tax credit if the units are sold or rented after December 31, 2022. The credit increases to \$5,000 if the new housing units are certified under the Zero Energy Ready Homes Program.

Dwellings certified under the Energy Star Multifamily New Construction National Program will also be eligible for these benefits, including high-rise projects, though the amount of the credit will be reduced if prevailing wage requirements are not met. These credits will remain in effect through 2032.

Contractors and subcontractors must pay laborers and mechanics employed under the contract no less than locally prevailing wages and fringe benefits for corresponding work on similar projects in the area.

A benefit of the change to align with DOE programs: building height is no longer restricted, making all residential developments eligible.

The Section 45L tax credit can now be used in conjunction with the Section 179D tax deduction for multifamily projects four stories or taller. With these changes to existing energy efficient tax incentives, Congress intends to make a greater effort to combat climate change. These expansive updates can provide significant relief to property owners, developers, investors, homebuilders, architects, engineers, designers and more.

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