Florida TaxWatch

BRIEFING

FLORIDA MISSING OPPORTUNITIES TO TAKE ADVANTAGE OF FEDERAL PROGRAMS FOR ENERGY-SAVING MEASURES

INTRODUCTION

Historically, Florida has failed to capture all of the federal money for which it is eligible, meaning that Floridians are losing out on various federal tax incentives designed to return money to the states. While Florida TaxWatch has highlighted this issue many times in the past, a new avenue for ensuring that Florida taxpayers are benefiting as much as possible from federal programs is an energy efficiency building program implemented in 2005.

Florida public entities, including state government, local governments, school districts, and the higher education system (the State University System and the State College System) are significant employers and land owners in the state. Florida state government alone has a total of 20,689 buildings covering approximately 222 million gross square feet.[1] The largest segments of these buildings (64%) are owned by state universities and colleges.[2] The 2005 federal energy efficiency incentive program may offer a great fiscal opportunity for state and local governments to recoup some of the costs borne by Florida taxpayers.

BACKGROUND

In an effort to reduce the perpetual rise in energy consumption in public and commercial buildings and the environmental impact therein, the U.S. Congress enacted the Energy Policy Act of 2005, Public Law 109-58, which is codified as Section 179D of the Internal Revenue Code. Section 179D provides a tax incentive for implementing energy efficient enhancements (hereafter "enhancements") either in new buildings or through retrofitting old buildings. Specifically, the section provides a federal income tax deduction (hereafter "deduction") for a portion of the costs incurred during the installation of these enhancements.[3]

To qualify for the Section 179D deduction, enhancements must be certified by a licensed third party engineer or contractor using the U.S. Department of Energy approved software to model energy consumption. In addition, enhancements must be within building code standard ASHRAE 90.1-2001.

Qualified enhancements are eligible for the deduction if made on depreciable property, new or retrofitted, placed in service between January 1, 2006 and December 31, 2013.[4]

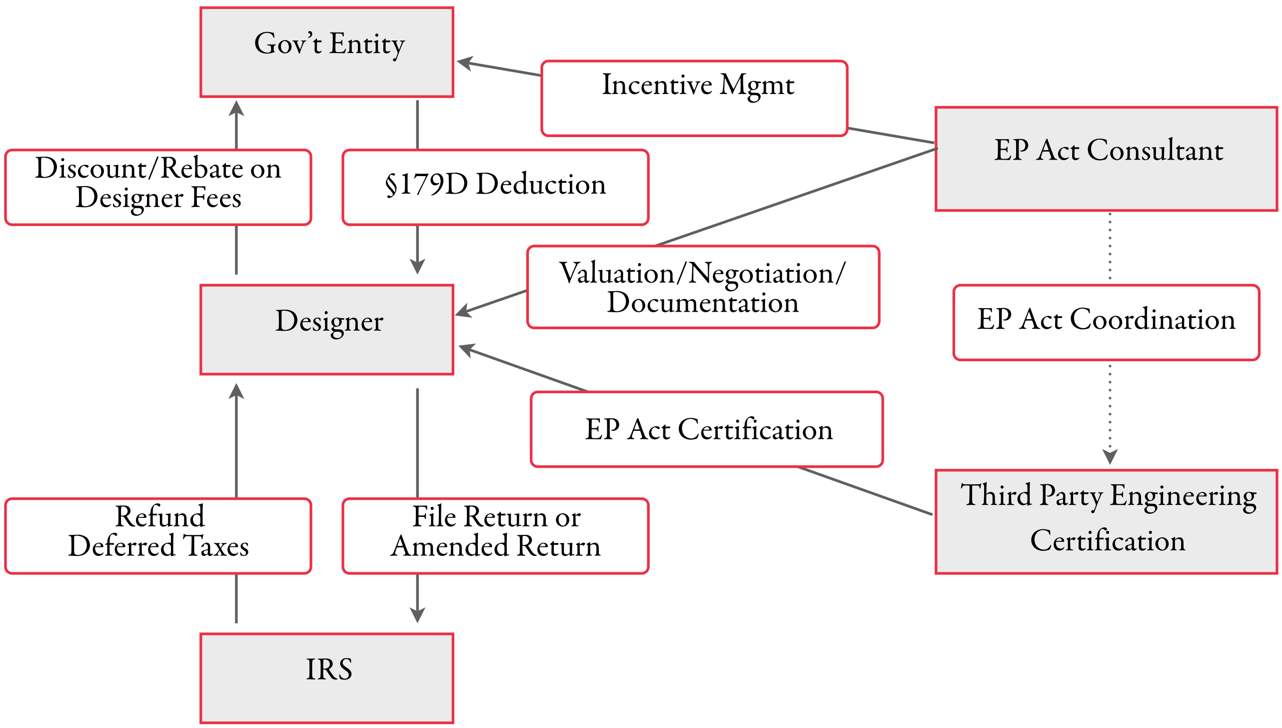
Eligible enhancements within Section 179D include three main categories, lighting, heating/cooling and ventilation (HVAC), and building envelope (roofing, windows, insulation etc.).[5] A full tax deduction is available to government entities who install enhancements in all three categories which result in total energy cost reduction of 50 percent or more. Partial deductions are granted to qualifying enhancements that result in a total energy cost reduction of at least 16 and 2/3 percent.[6] Recently, Section 179D was further amended through Notice 2012-26 for projects between April 23, 2012 and December 31, 2013. The modification changes the energy savings requirements to include 25 percent for lighting, 15 percent for HVAC, and 10 percent for building envelope.[7]

Figure 1: Deduction Categories

Lighting ($0.60)	**HVAC ($0.60)**	**Building Envelope ($0.60)**
		

The deductions in Section 179D range from $0.30 to $1.80 per square foot depending on the type of enhancements completed and the certification received. The allowable deductions are $0.60 per square foot for each of the three categories (lighting, HVAC, and building envelope). The building must qualify for a full deduction at 50 percent energy cost reduction to receive the $1.80 per square foot deduction. Buildings that qualify for partial deductions may receive up to $0.60 per square foot.[8] In some cases, government entities with fully qualified buildings receiving $1.80 per square foot are able to offset the entire cost of the enhancement. Figure 2 on the next page shows the possible tax deduction for different size projects and deduction levels.

Figure 2: Available Section 179D Partial Deduction Examples



HOW FLORIDA COULD USE SECTION 179D

Section 179D provides incentives for qualified energy efficiency enhancements to public and private entities. However, since government entities do not pay federal income taxes, Section 179D contains a specific provision allowing for the deduction to be transferred from the qualifying government entity to a tax-paying "designer" entity, primarily responsible for creating the technical specifications for the installation of the eligible energy efficient enhancements. The designer(s) may include an architect, engineer, contractor environmental consultant, or energy service provider.[9] Section 179D provides discretion to the government entity in determining the qualifications for a designer. Once the designer(s) is(are) selected, a number of additional steps are needed to receive the tax deduction and complete the transfer to a private company.

Florida government entities should take advantage of the opportunity to recover taxpayer investment in recently completed building or retrofits through the look-back provisions of Section 179D, and help defer future costs of building and retrofitting. All taxpayer backed entities, including the state, county, and municipal governments, as well as school districts, the State University System, the State College System, and special taxing districts (if eligible) should fully utilize this federal incentive. However, given the complexity of utilizing Section 179D under the special provision extending it to government entities, especially for smaller government entities (i.e., other than the state government), contracting with a third party management company with expertise in the area may be the best option.

THE PROCESS

The process for a government entity to realize the financial benefit under Section 179D can prove challenging, even if the energy efficiency enhancements clearly qualify under the law. Government entities must first designate a designer who has enough tax liability to offset the tax deduction. Secondly, a deduction valuation must be completed for negotiation using a variety of factors. Next, governments must develop a transfer agreement for the deduction that is equitable for both parties. Then, enhancements must be installed by the designated designer and certified by a third party engineer or contractor using specialized software. Finally, the deduction must be applied to current and previous tax returns. A detailed representation of the process is depicted in Figure 3.

Figure 3: ENERGY POLICY ACT OF 2005 - SECTION 179D
DEDUCTION PROCESS THROUGH A DESIGNER[10]

Sample Project (sq. Ft)	Lighting ($.30 - $.60)	HVAC ($.60)	Building Envelope ($.60)	Total Possible Deduction ($1.80)
100,000	$30,000 - 60,000	$60,000	$60,000	$180,000
500,000	$150,000 - 300,000	$300,000	$300,000	$900,000
1,000,000	$300,000 - 600,000	$600,000	$600,000	$1,800,000

To assist in navigating the complexities of Section 179D and meeting the various levels of eligibility, third party firms are a viable option. Third party firms are experienced in providing the technical assistance needed to successfully achieve the deduction and maximize taxpayer savings. These firms are able to attract designers best suited to achieve the full deduction for projects, thus offsetting initial enhancements costs and maximizing taxpayer savings. An example of a typical transfer agreement outlining the costs and potential savings from a Section 179D tax deduction is on the next page.

Enhancement Area (sq ft.)	5,000,000	
179D Allocation (per sq ft.)	$0.60	
Total Tax Deduction	$3,000,000	
Designer Tax Bracket	35%	
Total Benefit Value	**$1,050,000**	
	Government Entity	*Designer*
Tax Benefit Allocation Division	60%	40%
Value of Allocation	$630,000	$420,000
Administrative Fees	($94,500)	--
Certification	--	-$75,000
Accounting	--	($25,000)
Rebate Deductability	--	220,500*
Total Net Value of Deduction	**$535,500**	**$540,500**

* Value is based on designer(s) taxable income [11]

In this simple example, a government entity with 5,000,000 square feet of qualifying enhancement area (i.e., enhancements made to depreciable property, new or retrofitted, placed in service between January 1, 2006 and December 31, 2013) could realize more than $535,500 in revenues for projects already completed using taxpayer resources. In this same example, if the enhanced property is eligible for the maximum Section 179D deduction, the revenues would triple to $1,606,500. If this simple example could be applied to larger entities like the State University System or local school districts, which have a significant number of buildings, the savings could be substantial.

CONCLUSION

It has been estimated by industry experts that more than 90% of the energy efficiency enhancements eligible for tax deductions through Section 179D have not taken advantage of the incentive.[12] According to the U.S. Energy Information Administration, the use of the 179D deduction decreased from $168 million in 2007 to just $50 million in 2010.[13] This underutilization may be due to a simple lack of awareness or understanding of Section 179D, or to the complexity of monetizing the tax deductions for state and local governments; however, the fact is that public entities across the country, including Florida, are missing the opportunity to recover state taxpayer resources.

With over 222 million square feet of state owned buildings alone, Florida is missing a valuable opportunity to offset the cost of energy efficiency enhancements while reducing state energy consumption. Capturing all the eligible deductions can be difficult and understanding the complexities of 179D is often outside the scope of many local and state facilities managers.

By aggressively pursuing the incentives available under Section 179D and monetizing those deductions through designers, state and local governments across Florida could generate revenues on energy efficiency enhancements in two ways: 1) for previously completed projects (since January 1, 2006) and 2) for current and future qualifying projects. Essentially, public entities throughout Florida may be able to generate revenue on thousands of buildings with already completed energy efficiency enhancements.

RECOMMENDATION

As with other avenues for capturing Florida's fair share of federal money, Florida should pursue this opportunity to the fullest extent possible. Provisions in Section 179D are specifically designed to expand the tax deduction to government entities through the mechanism of designers. Although the process is complex, as is tax code by nature, viable options are available to governments through third party energy firms. These firms specialize in acquiring appropriate designers, formulating transfer agreements, and most importantly, navigating the bureaucracy of the Federal Government. There are numerous completed buildings and finished retrofits currently eligible for this tax deduction. Whether state or local governments across Florida obtain Section 179D deductions through internal or external means, the bottom line is simple; monetary incentives are available for energy efficient enhancements and Florida is failing to take full advantage of the opportunity.

Footnotes

i. Florida Department of Management Services. Solaris Database. Personal Email Communication. April 2012.
ii. Florida Department of Management Services. Solaris Database. Personal Email Communication. April 2012.
iii. Internal Revenue Service. Deduction for Energy Efficient Commercial Buildings. http://www.irs.gov/irb/2008-14_IRB/ar12.html
iv. Internal Revenue Service. Deduction for Energy Efficient Commercial Buildings. http://www.irs.gov/irb/2012-17_IRB/ar08.html#d0e368
v. Internal Revenue Service. Deduction for Energy Efficient Commercial Buildings. http://www.irs.gov/pub/irs-drop/n-06-52.pdf
vi. Internal Revenue Service. Deduction for Energy Efficient Commercial Buildings. http://www.irs.gov/pub/irs-drop/n-06-52.pdf
vii. Internal Revenue Service. Modification of Notice 2008-40; Deduction for Energy Efficient Commercial Buildings. http://www.irs.gov/irb/2012-17_IRB/ar08.html#d0e368
viii. Internal Revenue Service. Deduction for Energy Efficient Commercial Buildings. http://www.irs.gov/pub/irs-drop/n-06-52.pdf
ix. Internal Revenue Service. Deduction for Energy Efficient Commercial Buildings. http://www.irs.gov/irb/2008-14_IRB/ar12.html
x. Volker, William. Memorandum: Implementation of the 179D Deduction Special Rule by Government Entities. Efficiency Energy.
xi. Excludes Rebate Deductibility.
xii. Volker, William. Memorandum: Implementation of the 179D Deduction Special Rule by Government Entities. Efficiency Energy.
xiii. U.S. Energy Information Administration. Direct Federal Financial Interventions and Subsides in Energy in Fiscal Year 2010. http://www.eia.gov/analysis/requests/subsidy/pdf/subsidy.pdf

ABOUT FLORIDA TAXWATCH

Florida TaxWatch is a statewide, non-profit, non-partisan taxpayer research institute and government watchdog that over its 32-year history has become widely recognized as the watchdog of citizens' hard-earned tax dollars. Its mission is to provide the citizens of Florida and public officials with high quality, independent research and education on government revenues, expenditures, taxation, public policies, and programs, and to increase the productivity and accountability of Florida Government.

Florida TaxWatch's research recommends productivity enhancements and explains the statewide impact of economic and tax and spend policies and practices on citizens and businesses. Florida TaxWatch has worked diligently and effectively to help state government shape responsible fiscal and public policy that adds value and benefit to taxpayers.

This diligence has yielded impressive results: in its first two decades alone, policymakers and government employees implemented three-fourths of Florida TaxWatch's cost-saving recommendations, saving the taxpayers of Florida more than $6.2 billion -- approximately $1,067 in added value for every Florida family, according to an independent assessment by Florida State University.

Florida TaxWatch has a historical understanding of state government, public policy issues, and the battles fought in the past necessary to structure effective solutions for today and the future. It is the only statewide organization devoted entirely to Florida taxing and spending issues. Its research and recommendations are reported on regularly by the statewide news media.

Supported by voluntary, tax-deductible memberships and grants, Florida TaxWatch is open to any organization or individual interested in helping to make Florida competitive, healthy and economically prosperous by supporting a credible research effort that promotes constructive taxpayer improvements. Members, through their loyal support, help Florida TaxWatch bring about a more effective, responsive government that is accountable to the citizens it serves.

Florida TaxWatch is supported by all types of taxpayers -- homeowners, small businesses, large corporations, philanthropic foundations, professionals, associations, labor organizations, retirees -- simply stated, the taxpayers of Florida. The officers, Board of Trustees and members of Florida TaxWatch are respected leaders and citizens from across Florida, committed to improving the health and prosperity of Florida.

With your help, Florida TaxWatch will continue its diligence to make certain your tax investments are fair and beneficial to you, the taxpaying customer, who supports Florida's government. Florida TaxWatch is ever present to ensure that taxes are equitable, not excessive, that their public benefits and costs are weighed, and government agencies are more responsive and productive in the use of your hard-earned tax dollars.

The Florida TaxWatch Board of Trustees is responsible for the general direction and oversight of the research institute and safeguarding the independence of the organization's work. In his capacity as chief executive officer, the president is respon- sible for formulating and coordinating policies, projects, publications, and selecting professional staff. As an independent research institute and taxpayer watchdog, Florida TaxWatch does not accept money from Florida state and local govern- ments. The research findings and recommendations of Florida TaxWatch do not necessarily reflect the view of its members, staff, distinguished Board of Trustees, or Executive Committee, and are not influenced by the positions of the individuals or organizations who directly or indirectly support the research.

Florida TaxWatch Values
Integrity • Productivity • Accountability • Independence • Quality Research

This *Briefing* was written by **Dustin Fusillo,** Research Analyst,
under the direction and supervision of **Robert Weissert, Esq.,** Vice President for Research

Dominic M. Calabro, President, Publisher & Editor

Florida TaxWatch

Improving Taxpayer Value, Citizen Understanding, and Government Accountability

106 N Bronough St
Tallahassee, Florida 32301

Phone - 850.222.5052
Fax - 850.222.7476

www.floridataxwatch.org