Inflation Reduction Act Multiplies Tax Benefits For Building Green

By Dees Stribling

Two pieces of the U.S. tax code that incentivize decarbonization were dramatically expanded with Tuesday's passage of the Inflation Reduction Act of 2022, making green building elements more financially attractive to developers and property owners.

The sweeping $430B legislation takes aim at a wide swath of President Joe Biden's domestic priorities, including curbing emissions in an effort to slow climate change. To that end, the new law tripled a tax credit and doubled a tax deduction meant to spur sustainable development.

"There is undeniably more to do, but the legislation will catalyze action to decarbonize our economy," said BREEAM U.S. Director of Operations Breana Wheeler, whose organization oversees assessing and certifying building sustainability.

"The bill shifts the momentum to federal efforts to decarbonize key areas of the built environment and transportation," she said.

Under the bill, any carbon capture project beginning construction in the next 10 years can qualify for a federal tax credit known as 45Q.

"The credit has been around for some time, but the bill has dramatically improved it," CarbonQuest Vice President of Strategy and Market Development Anna Pavlova said. Her company develops carbon capture technology for buildings.

Previously, 45Q provided a credit of $20 per metric ton of carbon dioxide that is permanently stored. The bill raises that to $60 per ton, Pavlova said.

Developers will have the option to take full value of the tax credit for the first five years of a project, once the carbon capture equipment has been placed in service.

Also, Pavlova said, claiming the credit used to mean capturing a minimum of 25,000 metric tons of carbon. The new law has dropped that threshold to 12,500 metric tons.

Though carbon capture has traditionally been associated with utilities and other direct producers of carbon emissions, the technology is increasingly applied to new or existing buildings. The goal is building structures with materials and systems that either sequester carbon dioxide or remove it from the air.

The improved tax credit will go a long way in promoting this kind of tech, Pavlova said.

The bill does not allow tax credits earned through carbon sequestration to be traded, Pavlova said.

"There is some precedent in industrial setting, with an advanced manufacturing credit that you can trade now under the terms of the new law, but it's not applicable to buildings or carbon capture yet," Pavlova said. "That would be a good thing to do one day, and I can see it happening."

Especially important for building owners who want to take advantage of the credit is the fact that any number of buildings — say, an entire portfolio — can be aggregated to meet the 12,500 metric ton threshold.

The Inflation Reduction Act also modifies section 179D of the tax code, allowing larger tax deductions for commercial property owners undertaking green projects. The deduction has increased from the previous maximum of $1.88 per SF to $5 per SF.

REITs will now have the ability to use these deductions for computing earnings and profits, reports Accounting Today.

If a real estate investor purchases a new energy-efficient building or makes a thorough energy retrofit to an existing structure, a large part of the cost can be deducted in the first year instead of spread out over several years as a depreciation.

Mostly this accelerated deduction will apply to the development of large properties — such as apartments or hotels — and it isn't something to be claimed without expert preparation, according to Nelson.

The bill also promotes solar panel installation via the tax code. The bill extends the commercial tax credit for solar panels to 2034, with a phase-out beginning in 2032. Beginning retroactively on Jan. 1, 2022, tax savings for installing panels will be 30% of the panels' cost.

Besides extending the tax credit, it accelerates the depreciation schedule for the panels.

“If a landlord installs a solar energy system on a building it owns and rents to tenants...not only will the [Internal Revenue Service] pay for up to 30% of the cost of the solar panels, but the panels get depreciated over just five years, even though in reality the panels will likely last for 25 to 30 years,” Nelson CPA partner Beth Nelson writes.

The sustainability provisions of the bill mean that those in the real estate sector who are already taking action will now be able to leverage their market advantage, while the remainder of the sector will be incentivized to do some catching up, BREEAM's Wheeler said.

Federal inaction on decarbonization for the last five years has driven many local and state governments to start taking action through policy, while the real estate sector has concurrently been driven by investor concerns over climate-related risks threatening assets, Wheeler said.

While green building advocates seem generally pleased with the legislation — the U.S. Green Building Council calls the bill's provisions “the most critical and consequential climate policies we have ever seen” — not everyone is happy about all the pieces of the measure.

“Some of our main concerns are about the way Congress has structured the new energy tax credits, and the impact that would have on many of our members,” Associated Builders and Contractors Senior Director of Legislative Affairs Peter Comstock said.

There are also some unwelcome strings attached when it comes to labor, Comstock said, noting that the bill will put many contractors who use nonunion labor at a serious competitive disadvantage when it comes to winning contracts for these energy projects.

“Putting these restrictions on who is qualified to work on these critical projects is going to cause a bottleneck when it comes to getting them done,” Comstock said. “So while the investment in sustainable building projects might be good, the labor caveats attached to it really poisoned the well for us.”