Meet the New 179D and 45Q, Two US Tax Benefits Aimed at Helping Property Owners Go Green

Inflation Reduction Act Offers Incentives To Meet Environmental Standards

By Katherine Hamilton

While much of the Inflation Reduction Act of 2022 is geared toward consumers, changes to two pieces of the U.S. tax code tucked inside the new law promise to benefit commercial real estate owners, making it more financially viable for them to meet environmentally sustainable building standards.

President Biden signed the $437 billion legislation Aug. 16, enacting a swath of domestic policies focused on healthcare, climate change and the economy. As part of an effort to curb carbon emissions, the law includes an expansion and changes to tax deduction 179D and tax credit 45Q, both of which will likely affect property owners.

“These tax rebates could result in tens and tens of billions of dollars of retrofits that otherwise might not have happened because they wouldn’t have been cost effective enough to meet the investment threshold,” said Billy Grayson, executive vice president of centers and initiatives at Urban Land Institute, a Washington-based nonprofit research and education organization. “This really could accelerate decarbonization in ways that cities are not able to match and federal programs have not attempted to do.”

Commercial real estate’s carbon emissions rate is relatively lower than most other sectors, such as transportation, industrial and power generation. As a whole, buildings release about 700 million metric tons of carbon dioxide annually, a number that has stayed roughly the same over the past two decades, according to research firm Rhodium Group. The other three sectors release between 1,600 million and 1,800 million metric tons per year.

The federal government has a goal of net-zero emissions for all buildings by 2045, including a 50% reduction by 2032, per the Office of the Federal Chief Sustainability Officer’s website. To execute this, the government has plans to implement a federal building performance standard to drive emission reductions for existing buildings. Additionally, all new construction and modernization projects larger than 25,000 square feet are to have net-zero emissions by 2030.

The Inflation Reduction Act uses tax breaks to take steps toward these federal emissions goals.

Expanded Benefits

The 179D tax deduction already existed before Inflation Reduction Act, but the new law expands it significantly. The tax code offers a deduction for energy-efficient commercial and multifamily buildings of four stories or larger. Previously, the deduction was capped at $1.80 per square foot, but now real estate owners can deduct between $2.50 and $5 per square foot if their building meets certain sustainability standards.

Meeting those standards will also be easier under the Inflation Reduction Act, said Cliff Majersik, a senior adviser at the Institute for Market Transformation, a Washington nonprofit group focused on energy efficiency in buildings. Before the new law, building owners were only eligible for a 179D deduction if their property was better than Standard 90.1, the one-size-fits-all U.S. energy efficiency benchmark set by the American Society of Heating, Refrigerating and Air-Conditioning Engineers, or ASHRAE. This was a particularly difficult criterion to meet for existing buildings constructed before the standard was established in 1975, so, for the most part, only newly built properties could access the tax deduction.

Now, under the Inflation Reduction Act, a property simply has to show improvement relative to itself to be eligible for a deduction. For example, if a commercial real estate owner reduces a building's energy use by 25%, he or she is eligible for a deduction of $2.50 per square foot. This scales up to $5 per square foot if a property owner reduces energy use by 50%.

"So, actually, very energy-intensive buildings that use a lot of energy will typically have an easier time qualifying for this incentive than any other building. The more energy a building uses, usually, the more it can save as an incentive," Majersik said.

Secondly, the law increases federal tax credits for new carbon-capture projects under 45Q. Carbon capture is a way to isolate or remove carbon dioxide from the air and is used for utilities and new and existing buildings to reduce carbon emissions. The 45Q tax credit, which was introduced in 2008, previously provided $20 per metric ton of carbon dioxide permanently stored. Now, building owners can get $60 per ton. The law also lowers the threshold to access the tax credit, reducing the minimum requirement from 25,000 metric tons of carbon dioxide stored to 12,500 metric tons.

Landlords that add a carbon capture system to their properties will have the option to get the tax credit for the first five years of use.

Beyond the two expanded bits of the tax code, the Inflation Reduction Act also offers a tax rebate for installing solar panels, heat pumps and charging stations for electric vehicles to properties. There is also a special group of incentives for decarbonizing affordable housing properties, both single-family homes and apartments.

Potential Challenges

The Inflation Reduction Act builds on local building performance standards, which cities across the country have installed to mitigate carbon emissions related to real estate. Municipal guidelines typically limit certain energy use or greenhouse gas emissions per square foot, but the new law's tax incentives will help property owners meet and possibly exceed these standards with less financial strain, Majersik said.

"A building owner can take advantage of these taxes to improve their building performance and bring their building into compliance with the performance standard," Majersik said, adding that local emissions requirements usually increase every five years. "It'll help money to flow through to cities and states, [and] some of that money will ultimately flow through to building owners."

While the tax incentives promise to make sustainability efforts more financially feasible for real estate owners, they are just barely keeping up with the rate of inflation, Grayson said.

"The cost of the heat pump or a solar panel, and the cost of installing those things, is more than 10% more expensive than it was three years ago. A tax incentive … will make things more cost effective than they were yesterday, but maybe not more cost effective than they were three years ago," he said.

The updates to the tax code also pose a challenge for real estate investment trusts, which do not pay taxes, but Majersik said there is a way around. REITs can now include the 179D deduction when calculating profits and losses for tax return purposes. Other tax-exempt owners such as the federal government can pass the tax incentives on to taxable entities such as architects and construction firms, he added.