

Unlocking Tax Savings Across Industries with Cost Segregation and Energy Efficiency Incentives

November 15, 2024



Written by: **Ryan Paquin**, and [David Diaz](#), Partner at Walker Reid

Tax incentives are crucial resources for businesses seeking to enhance financial performance and reduce tax liability. Among the most effective of these incentives are cost segregation studies and energy efficiency credits under Internal Revenue Code Sections 179D and 45L. By strategically leveraging these tools, businesses across various industries can unlock substantial tax savings and boost their cash flow. Understanding how to utilize these incentives effectively is key to optimizing investment returns.

Cost Segregation Studies provide businesses with a strategic advantage by accelerating the tax depreciation of their investments. Typically, commercial buildings are depreciated over 39 years and residential buildings over 27.5 years for federal tax purposes. However, with a cost segregation study, businesses can reclassify certain components of the property—such as electrical systems, plumbing, finishes, and HVAC—into a personal property category with a shorter depreciation period of 5, 7, or 15 years. This process involves dissecting a property's components to identify assets that qualify for these accelerated recovery periods.

Bonus Depreciation offers additional savings by allowing businesses to deduct a significant portion of qualifying assets' costs in the year they are placed into service, accelerating tax benefits and boosting cash flow. Assets with a class life of less than 20 years, which are identified through a cost segregation study, are eligible for bonus depreciation. As of January 1, 2024, the bonus depreciation rate is 60%, but this rate will decrease by 20% annually until it is fully phased out in 2027.

By accelerating depreciation, construction and consumer products companies can recover more of their capital investments upfront, while professional services firms with real estate clients can also leverage this strategy to enhance tax savings. For example, an acquired facility may have 20-30% of the depreciable basis qualify for personal property and bonus depreciation, resulting in substantial tax savings in the first few years of ownership. This increased depreciation can significantly enhance cash flow, freeing up additional funds for reinvestment or operational expenses. For larger properties, this could translate into millions of savings.

Cost segregation studies can be implemented for recently purchased or constructed properties and buildings acquired or constructed in previous years. This flexibility is achieved through a tax adjustment process known as Form 3115, which allows businesses to claim missed depreciation from previous years if there's depreciable basis left in the building. For instance, a property placed in service in 2019 can still benefit from a cost segregation study conducted in 2024, with adjustments reflected in the current year's tax return.

Section 179D, known as the Energy Efficient Commercial Buildings Deduction, offers a substantial tax deduction for businesses investing in energy-efficient improvements to commercial buildings. Eligible projects include new construction, major renovations, and retrofits that enhance a building's energy efficiency. To qualify, the building must meet specific energy efficiency standards. The deduction can be claimed by the building owner or, in cases where the property is owned by a government entity or non-profit organization, by the designer.

Originally introduced in 2005, Section 179D was made permanent in 2020. The benefit was further extended in 2022, increasing the deduction to \$5.36 per square foot for buildings placed in service in 2023 and to \$5.65 per square foot for those

placed in service in 2024. This expansion reflects the government's commitment to encouraging energy-efficient building practices and offers substantial financial incentives for businesses to invest in sustainable infrastructure. Businesses should carefully assess their projects to ensure they meet the criteria for Section 179D and fully capitalize on these potential deductions. The deduction is available for properties placed in service from December 31, 2005, through December 31, 2032.

Section 45L offers a tax credit for residential properties, rewarding developers, investors, and homebuilders for constructing energy-efficient homes. This credit applies to newly constructed or substantially renovated residential properties, including single-family homes, condominiums, and apartment buildings. The credit amount ranges from \$500 to \$5,000 per home, depending on the energy efficiency standards met, including:

- Energy Star program requirements;
- Zero energy ready home program requirements; and
- Prevailing wage requirements.

This incentive helps offset the upfront costs of energy-efficient construction and promotes long-term energy savings for homeowners. Furthermore, there is an opportunity to capture past projects that were placed in service in 2021 and 2022 under the legacy program, where qualification is very easy.

Section 179D provides valuable deductions for energy-efficient commercial projects, while its counterpart, Section 45L, offers credits for residential developments that meet stringent energy efficiency standards. Consumer products and manufacturing companies can leverage these tax incentives to boost cash flow and reduce tax burdens. These incentives not only reduce tax liabilities but also encourage investment in sustainable and energy-efficient real estate practices.

Cost segregation studies and energy efficiency credits under Sections 179D and 45L offer significant financial advantages for businesses in various industries. By leveraging these tax incentives, businesses can help themselves and their clients accelerate depreciation, improve cash flow, and maximize savings on eligible assets. Businesses should explore these potential opportunities to enhance their financial performance, contribute to environmental sustainability, and take full advantage of

the available tax benefits. For more information or to discuss how you can lower tax liabilities, please contact David Diaz, Partner at Walker Reid, or your Anchin Relationship Partner.