Spend to Save:
How Current Tax Codes Offer Savings in Roofing and Energy Expenditures

We have all heard the tired phrase “you have to spend money to make money,” with one ear, while in the other we hear the shouts “efficiency” “optimize” and “a penny saved is a penny earned.” So which is it? Well you already know, it’s both. There are sparse opportunities to achieve both outcomes, and perhaps none which can deliver as high an ROI strategically planning your projects to take advantage of the tax code.

So how can you spend money to *save* money? By making timely, qualifying improvements to your properties and making sure your accounting department understands your intent. The best part? Many of the qualifying categories do not necessitate major changes to your use case, risk profile, or building. Basic systems such as security and fire systems, HVAC systems, new roofs, and simple energy efficiency improvements can qualify and save you significant cash while positioning your asset for long term performance. We will focus on roofing and energy improvements, because um, that is what we do.

There are two current tax modifications in effect that offer building owners - and in some cases tenants - to qualify for tax deductions for expenditures on qualifying projects. The first is the U.S. Tax Law (aka the “Trump Tax”,) passed in 2018, specifically section 179, which changes qualifying deductions to make CAPEX improvement investments more attractive. The second is section 179D, which is a tax deduction that has been in effect since January 1, 2006, but has now been retroactively extended to December 31, 2020. (Wait, you can retroactively extend? What does it *even* mean?).
{insert ron burgundy meme if email or web publication}

We will discuss the Trump Tax code changes first, then the 179D details and extension requirements.

What is the new U.S. Tax Code, or “Trump Tax”:

The new code allows most short-term capital expenditures to be considered for a full tax write-off for the same tax year that the investments were made. The previous tax codes required large capital outputs to be depreciated per IRS timetables, typically over the course of 39 years. Given that roofs typically deliver 15-25 year service lives, that 39 year table has historically hurt the owner’s ability to fully deduct the roof asset.

In addition to removing the depreciation timetable limitations, the maximum deduction and list of qualifying approved goods have been expanded, rather dramatically. The list of approved goods for this deduction now includes capital and building improvements with a usable lifespan of 20 years or less. The maximum annual deduction is set at $1,040,000 for 2020 and the benefit phases out if improvements exceed $2,590,000 in the tax year. The deduction begins to phase out on a dollar-for-dollar basis after $2,590,000 is spent by a given business. In other words, the entire deduction goes away once $3,630,000 in purchases is reached), so this makes it a true small and medium-sized business deduction. Given that many building owners own individual assets under a separate entity, it is worth exploring with your tax professional whether or not you can benefit from this deduction, even as a large business.

What this means for commercial building owners, managers, and tenants:

Commercial building improvements can now be written off in lump-sum entirety in the same tax year. That’s right, kids, 100% of the asset cost can be written off in year 1. This means, for instance, the entire expenditure on a new roof could be deducted from this year's earnings, provided that income meets the requirements to support the investment and write-off.

Industrial and commercial rent rates in every major market are at all time highs and owners are looking for smart capital placements. According to a new report by RCM Lightbox, investors are racing to place capital before the next downturn. With commercial and industrial inventories at record lows in major markets, vesting capital in the owner’s existing buildings is an attractive option. Roofs are the single most important protection of the entire asset, and leak free buildings report higher tenant satisfaction. Installing a new, quality roof to generate near term tax savings while positioning your asset for long-term performance and tenant satisfaction through the inevitable downturns in the market is just plain smart.

Lastly, the tax code expires in 2025 and could change before then. Aware of this risk and benefit, we are seeing smart building owners front load improvements and invest in their assets. It is certainly worth a chat with your tax professional to assess how this current code could be relevant to your business.

What is 179D:

Late in 2019, the Senate signed a $1.4 trillion dollar spending package that includes retroactive extensions of 179D Tax Deduction for projects put in service from January 1, 2018 to December 31, 2020. (Yes, it expires this year! And yes, you read that correctly, you can apply for 179D retroactively). It stipulates that a deduction equal to the cost - with inherent caps - of energy efficient commercial building property, will be allowed if placed in service during the taxable year.

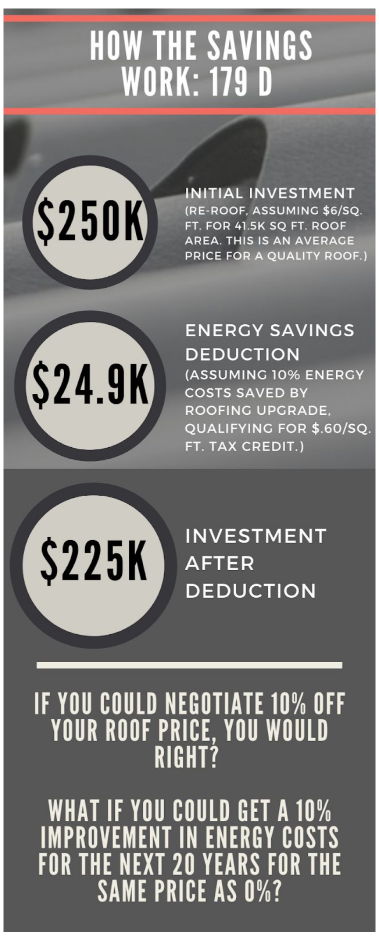
What this means for commercial building owners, managers, and tenants:

179D allows building owners to claim a tax deduction of up to $1.80 per square foot for installing qualifying energy saving systems and buildings. Tenants may also claim eligibility for deductions if they take on construction expenses. Qualifying installations include interior lighting; building envelope, including roofing; and heating, cooling, ventilation, or hot water systems. To qualify for the maximum $1.80/psf deduction, installations must total a 50% reduction in building energy and power costs, in comparison to buildings meeting minimum requirements set by ASHRAE standards. The breakdown of those percentages achieved by improvements is as follows: 10% for envelope improvements, 20% for lighting improvements, and 20% for HVAC improvements. For buildings which do not meet the 50% savings, the tax provision also allows for a partially qualifying system to receive benefit: $0.60/SF for HVAC systems meeting 15% savings, $0.60/SF for lighting systems meeting 25% savings, and $0.60/SF for building envelope systems meeting 10% savings. The Office of Energy Efficiency and Renewable Energy has specific software to be used to calculate these savings in order to have them qualify. You can find this, and more information on 179D at the Office of Energy Efficiency and Renewable Energy. There are also tax specialists whom we can refer you to if you are interested (we do not get paid for such referral!)

The bottom line:

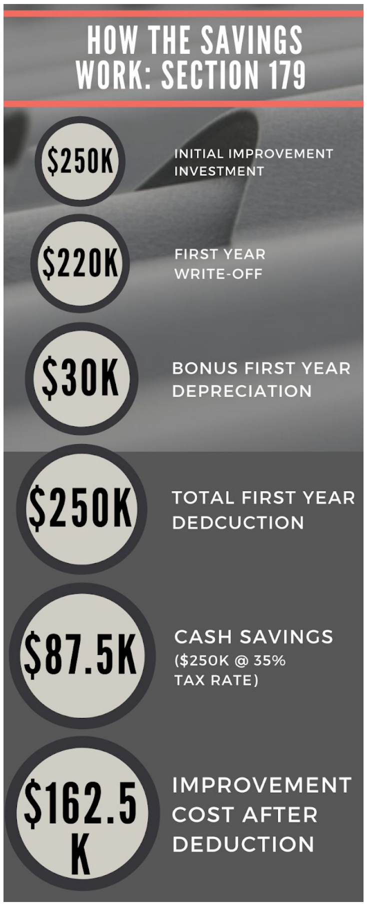
There are time-limited, low-hanging fruits in the current tax code that can significantly impact your bottom line and future performance. To be clear, we are not tax professionals and this is not tax guidance. It is certainly a conversation to have with a knowledgeable tax professional, but we have run some rough numbers here to illustrate how both of the codes function and the possible savings the offer.

Here is an example of how 179D works:



179D does not qualify for additional credits *on top* of the Section 179 credit *if your project is below the maximum deductions for Section 179*. However, if you are investing in multiple systems or a large system which exceed the limits of section 179, you can accrue additional tax benefits for qualifying projects under 179D.

And here's a look at Section 179:



Entire expenditure on a new roof could be deducted from this year's earnings, since Section 179 allows for 100% of the asset cost can be written off in year 1. (Provided that income meets the requirements to support the investment and write-off.)

Presented by these tax deductions and the current market, we have not seen a better time to replace or overlay your roof system than 2020. If you would like additional information, please feel free to contact us at support@integrativeroofingandenergy.com

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