New Tax Rules Create Opportunities for Green Hotel Investments

By **Charles R. Goulding & Daniel Audette** - September 10, 2018



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The travel industry is currently one of the fastest growing sectors, which is leading to increased real estate investments by hotel owners hoping to capitalize on this growth. Supplementing this increase, two major tax legislation pieces were passed over the past year that allow hotel owners higher rates of return on investments in new construction and renovations, especially ones which incorporate alternative energy or energy efficient technologies. The Tax Cuts and Jobs Act, passed on December 22, 2017, and the Bipartisan Budget Act of 2018, passed on February 9, 2018, both contribute to a climate that is likely, from a tax standpoint, historically the most beneficial for hotel owners who want to invest in alternative energy or energy efficient technologies for their sites.

New Opportunities Created by Tax Reform

The Tax Cuts and Jobs Act was enacted to increase business investments according to many of its supporters in Congress. To reach this goal, a number of tax treatments were created and updated that offer building owners quicker returns for real estate investments and construction projects which benefit hotel owners—in the form of increased bonus depreciation and expanded definitions of Section 179.



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For new hotel construction as well as purchases and renovations of existing hotels, cost segregation is a long-standing tax treatment which was made significantly more powerful with tax reform and its increase of bonus deprecation. Normally, purchased building property is depreciated over 39 years, meaning owners are able to take an annual 1/39th tax deduction of an item's cost over each of the 39 years. Cost segregation allows hotel owners to categorize some building property along faster depreciation schedules, such as 5- or 7-year (carpets, appliances, décor, furniture, shelving, washer/dryers, wiring and plumbing connected to appliances and machinery, etc), 15-year (land improvements, excavation of the site, exterior light posts, fencing, paving, and outdoor areas such as tennis courts, swimming pools, and basketball courts) or soft costs distributed evenly across all categories (architectural and engineering costs, blueprints, construction labor, insurance, job site security, permits, testing, and other fees). This allows an owner to realize these deductions faster and take advantage of the added Net Present Value (NPVs) created by shorter depreciation schedules. The items that remain as 39-year building property are building lighting, HVAC, roofs, walls, windows, etc.

What the Tax Cuts and Jobs Act did to make cost segregation more powerful was to increase bonus depreciation to 100 percent. Bonus Depreciation allows for an owner to take upfront depreciation for eligible items, in this case 100 percent. All items that are categorized as 5-, 7-, or 15-year or soft costs are eligible for depreciation, meaning that everything segregated is instead fully depreciated in the first year. This allows building owners to

fully take an upfront tax deduction for all personal property, land improvements and soft costs related to new construction or existing building purchases and renovations—provided they have completed a cost segregation study.

The Tax Cuts and Jobs Act also expanded bonus depreciation and Section 179 (which also allows for 100 percent expensing in the year of purchase) to include certain energy properties. Lighting retrofits are eligible for 100 percent bonus depreciation, which means that hotel owners who upgrade to energy-efficient LEDs can depreciate the costs in the year of purchase. Section 179 was expanded to include HVAC and roof replacements, so companies looking to upgrade to high efficiency HVAC systems or energy-reducing reflective or green roofs can incorporate the benefit from that first year write off in their calculations.

Revived Alternative Energy Tax Credits

A number of alternative energy Investment Tax Credits were enacted in 2005, which have significantly assisted in the growth of emerging alternative energy industries, especially the solar industry. A tax credit of up to 30 percent of a project's cost is available for a range of alternative energy technologies, including solar PV, wind, fuel cells, geothermal heat pumps, micoturbines and combined heat and power (CHP). On December 31, 2016, the tax credits for all of these technologies except for solar and wind evaporated but were retroactively revived this year as part of the Bipartisan Budget Act of 2018. This is beneficial to companies looking to incorporate geothermal heat pumps to heat and cool their building or installing a CHP system to generate on-site electricity while heating their building.

Solar Tax incentives especially have been a major driving force for hotel owners implementing solar installations to generate their site's electricity. An example of this is High Hotels Ltd., which in July 2018 announced that it will construct a $1.5 million solar array that will generate 100 percent of the electric demand for their existing 133-room Courtyard by Marriott-Lancaster in Lancaster, Pa. The planned development is estimated to produce 1,239,000 kWh of electricity, and the hotel, which consumes 1,177,000 kWh, will sell any excess generated power back to the utility.

The amount of the tax credit available to a hotel owner for an alternative energy installation depends on the type of technology and the year of the project's completion.

It is hoped that the reinstating of the expired credits for these other technologies will create the same sort of growth and investment that the solar industry has enjoyed.

EPAct 179D for New Construction & Energy Efficiency Retrofits

As part of the Bipartisan Budget Act of 2018, the EPAct 179D tax deduction was also extended. This often-overlooked benefit allows a tax deduction of up to $1.80/sq.ft. for any building that was newly constructed or has completed interior lighting, HVAC or building envelope projects. With this retroactive extension, any building that completed construction or retrofit from January 1, 2006 through December 31, 2017, can now take advantage of the benefit on their current tax returns. This means that there is a 12-year window of past energy efficiency projects, including LED upgrades, HVAC upgrades, and roof/window replacements, that a company can currently advantage of.

Hotels are a favored building category for the EPAct 179D tax incentive. If a hotel or apartment building installs a central HVAC system or efficient lighting, it has a high chance of qualifying for the full $1.80/sq.ft. tax benefit. Many companies completed eligible projects from 2006-2017 and are unaware of this lucrative tax incentive. Acting now, companies can still take advantage and receive a further tax benefit for their energy-efficient design and investments, potentially freeing up capital for further energy investments.

C**onclusion**

These new opportunities created by the Tax Cuts and Jobs Act and Bipartisan Budget Act of 2018 have created an atmosphere that greatly incentivizes hotel owners looking to upgrade to or incorporate new energy-efficient and alternative energy technologies into their properties. Whether it is a solar PV installation, geothermal heating and cooling or LED upgrade, a range of benefits including cost segregation, bonus deprecation, Alternative Energy Tax Credits and EPAct 179D exist to help reduce the initial costs of investment. Conducting these studies with a professional firm can help maximize the available benefits.

Charles Goulding, Attorney/CPA and Daniel Audette, PE, CEM, LEED GA, are with Energy Tax Savers, Inc. Energy Tax Savers, Inc. is a leading provider of building and energy tax services. We are an interdisciplinary firm with backgrounds specializing in tax law, accounting, engineering, and LEED certification. Energy Tax Savers is a recommended tax service provider for leading architecture, engineering, design & build firms, and lighting designers, and we represent many of the nation's leading retailers, warehouse owners, aerospace companies, industrial manufacturers, financial service firms and hotels. We have published over 300 articles on a range of energy tax incentives.



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