# Tax Impact

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# Switch on tax savings

## *Claiming the energy-efficient commercial buildings deduction*

Businesses that have invested in energy efficiency — or are considering doing so — shouldn't overlook the Section 179D deduction for energy-efficient commercial buildings. This tax break offers valuable deductions (up to $1.80 per square foot) for the cost of energy-efficient improvements to new or existing commercial and some residential rental buildings.

The Sec. 179D deduction was first added to the tax code in 2005 as a temporary incentive, but it has expired and been renewed several times over the years. Fortunately, tax legislation enacted in late 2020 made the deduction permanent and provided for the maximum deduction amount to be adjusted for inflation in future years.

### Who's eligible and what qualifies?

Generally, the deduction is available to the taxpayer who incurs the construction expenses associated with the project. Usually that means the building owner, but in some cases, it may be a tenant. For buildings owned by federal, state or local governments, the owner may allocate the deduction to the taxpayer primarily responsible for the design — typically, an architect, engineer, contractor or energy consultant.

The Sec. 179D deduction is available for commercial buildings of any size. It's also available for multifamily residential rental buildings that are at least four stories above grade. Eligible projects may include new construction, additions to existing buildings or renovations of existing buildings.

### What improvements are deductible?

Sec. 179D allows taxpayers to immediately deduct, rather than depreciate, the cost of eligible energy-efficient improvements. The maximum deduction is $1.80 multiplied by the building's square footage. Eligible improvements must otherwise be depreciable and installed as part of an eligible building's interior lighting system, HVAC and hot water systems, or building envelope (meaning its walls, insulation, exterior windows and doors, roof systems, and foundation).

The improvements must be part of a plan designed to reduce annual energy and power costs by at least 50% compared with a reference building constructed according to American Society of Heating, Refrigerating and Air-Conditioning Engineers (ASHRAE) standards. Note that the applicable standards have become increasingly strict over time. For example, improvements placed in service from 2006 to 2015 were subject to the 2001 ASHRAE standards and those placed in service from 2016 to 2020 were subject to the 2007 ASHRAE standards.

For improvements placed in service after 2020, the applicable ASHRAE standard will

## How to recover tax benefits you missed

What if you were entitled to Section 179D deductions for energy-efficient improvements placed in service in a previous year, but you neglected to claim them at the time? Is it possible to recover the tax benefits you missed? Possibly.

There are two ways to claim missed Sec. 179D deductions. One is to report them on an amended return for the tax year in question and seek a refund of the tax savings. The deadline for filing an amended return is usually three years from the filing date, so this isn't an option for older projects.

The second method is to file Form 3115, *Application for Change in Accounting Method*, and claim "catch-up" deductions in the current tax year. This method avoids the statute of limitations for amended returns, so conceivably you could use it to claim missed deductions going back to 2006.

be the one in effect two years before construction begins. To qualify, you'll need to obtain a certification from a licensed engineer or contractor stating that the improvements meet applicable energy-efficiency targets.

A couple of things to keep in mind: When measuring energy and power savings for purposes of the 50% test, you should consider only reductions in the cost of interior lighting, HVAC and hot water systems. Reductions in energy and power costs for other uses — such as refrigeration, elevators or certain manufacturing processes — don't count toward the 50% target.

Also, the $1.80 per square foot maximum deduction is a *lifetime* limit for the particular building. So, for example, if the owner of a 100,000-square-foot building claims a Sec. 179D deduction totaling $90,000 ($0.90 per square foot) in 2021, any Sec. 179D deductions in future years for the same building would be limited to a total of $90,000.

### Are partial deductions available?

As ASHRAE standards become more stringent, it's getting increasingly difficult to meet the 50% target previously described. However, even if a building fails to achieve an overall 50% reduction in energy and power costs, a partial deduction of up to $0.60 per square foot may be available for:

- Interior lighting systems that meet a 25% savings target,
- HVAC and hot water systems that meet a 15% savings target, or
- Building envelopes that meet a 10% savings target.

There's also a special "interim lighting rule" that permits prorated deductions for improvements that reduce lighting power density by 25% to 40% (50% for warehouses).

### Generating tax savings

If you plan to improve the energy efficiency of a new or existing building, be sure to consider the availability of Sec. 179D deductions. Your tax advisor can help you determine whether the project qualifies for the deduction, calculate the deductible amount, obtain the necessary certifications and document your deductible expenses. ■

# Do you have foreign assets?

## *Proper planning is necessary to avoid unintended outcomes*

You may live by the motto, "outta sight, outta mind," but don't apply that line of thinking when it comes to your assets. This is particularly true when accounting for foreign assets in your estate plan.

### Double taxation risk

If you're a U.S. citizen, you're subject to federal gift and estate taxes on all of your worldwide assets, regardless of where you live or where your assets are located. So, if you own assets in other countries, there's a risk of double taxation if the assets are subject to estate, inheritance or other death taxes in those countries. You may be entitled to a foreign death tax credit against your U.S. gift or estate tax liability — particularly in countries that have tax treaties with the United States — but in some cases those credits aren't available.

Keep in mind that you're considered a U.S. citizen if 1) you were born here, even if your parents have never been U.S. citizens and regardless of where you currently reside (unless you've renounced your citizenship), or 2) you were born outside the United States but at least one of your parents was a U.S. citizen at the time.

Even if you're not a U.S. citizen, you may be subject to U.S. gift and estate taxes on your worldwide assets if you're domiciled in the United States. Domicile is a somewhat subjective concept, but essentially it means you reside in a place with an intent to stay indefinitely and to always return when you're away. Once the United States becomes your domicile, its gift and estate taxes apply to your assets outside the United States (even if you leave the country), unless you take steps to change your domicile.

### Consider drafting more than one will

To ensure that your foreign assets are distributed according to your wishes, your will must be drafted and executed in a manner that will be accepted in the United States as well as in countries where your assets are located. Often, it's possible to prepare a single will that meets the requirements of each jurisdiction, but it may be preferable to have separate wills for foreign assets. One advantage of doing so is that separate wills, written in the foreign country's language (if not English) can help streamline the probate process.

If you prepare two or more wills, work with local counsel in each foreign jurisdiction to ensure that they meet each country's requirements. And it's important for your U.S. and foreign advisors to coordinate their efforts to ensure that one will doesn't nullify the others. Also, keep in mind that some countries have forced heirship or similar laws that can override the terms of your will.

### Beware transferring foreign assets to a trust

A typical U.S. estate plan uses one or more trusts for a variety of purposes, including tax planning, asset management and asset protection. And it's common for U.S. wills to provide for all assets to be transferred to a trust.

Be aware, however, that many countries don't recognize trusts. So, if your estate plan transfers foreign assets to a trust, there could be unwelcome consequences, including higher foreign taxes or even obstacles to transferring the assets as intended.

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### Turn to the professionals

Accounting for *all* of your assets — especially any foreign assets — in your estate plan is important. Thus, planning is best left to the professionals. Your estate planning advisor can help structure ownership of any foreign assets according to the laws of the United States and the country where they're located. ■

# Year-end tax planning for mutual funds

As the end of the year approaches, it's a good time to review your financial situation and consider strategies for lowering your tax bill. Following are a couple year-end planning tips for mutual fund investors.

### Harvest gains or losses

One of the most powerful year-end strategies for investors is to "harvest" gains or losses. This means selling investments to generate a gain or loss. For example, if you realized substantial capital gains earlier in the year, you might sell some mutual fund shares or other investments at a loss to soften the tax blow.

Conversely, if you have a net capital loss for the year, up to $3,000 of that loss can be offset against wages or other ordinary income. The remainder is carried forward to future years. To make the most of the loss this year, you might sell appreciated mutual fund shares or other investments and use the loss to wipe out the gain.

You can even buy the investment back immediately if you wish to hold onto it, with your cost basis

reset at its current market value. Note, however, that if you sell at a loss, there are different rules that apply with respect to the basis of the shares that you immediately reacquire.

## Manage basis in mutual fund shares

If you invest in mutual funds regularly, you'll likely buy shares at different times for different prices. So, the method you use to account for your cost basis can have a big impact on your gain or loss when you sell shares.

Your taxable gain or loss is equal to the difference between the sale price and your adjusted cost basis: The higher the basis, the lower the gain (or the greater the loss) and the lower the basis, the higher the gain (or the smaller the loss).

For mutual funds, generally there are three methods of accounting for basis:

1. First-in, first-out (FIFO), which assumes that the first shares purchased are the first shares sold,
2. Average cost, which assumes that all shares were purchased for their average price, or
3. Specific identification, which allows you to specify which shares are sold each time you make a sale.

Although the first two methods are simpler to use, specific identification gives you greater control over the tax consequences of mutual fund shares and facilitates tax planning. For example, suppose you own three lots of 1,000 shares of a mutual fund with a current market value of $100 per share, or $100,000. Lot 1 was purchased in 2017 and has a basis of $50,000, Lot 2 was purchased in 2018 and has a basis of $80,000, and Lot 3 was purchased in 2019 and has a basis of $110,000.

If you sell 1,000 shares for $100 and you haven't selected an accounting method, the fund will likely use FIFO by default. That means it will sell Lot 1, generating the highest possible gain: $50,000. Had you used the specific identification method, you could've instructed the fund to sell Lot 3, resulting in a $10,000 loss. Or, perhaps you have a net capital loss of $23,000 this year. In that case, you might sell Lot 2, generating a $20,000 gain to offset the portion of the loss that's not deductible from ordinary income.

***One of the most powerful year-end strategies for investors is to "harvest" gains or losses.***

## Choose the right method

To avoid tax surprises, it's critical to understand a mutual fund's options for calculating basis and to choose a method — usually specific identification — that gives you the most tax-planning flexibility. Keep in mind, however, that some popular online trading platforms make it difficult, or even impossible, to use the specific identification method. ■

# Tax Tips

## Is now the time for a home solar energy system?

Recent legislation delayed the phaseout of solar energy tax breaks, so now may be a good time to consider investing in a system for your home. Currently, a 26% tax credit is available for qualifying residential solar property, dropping to 22% after 2022 and expiring after 2023. For purposes of the credit, the expenditure is deemed to have been made when installation is completed or, in the case of expenditures in connection with a construction or reconstruction project, when the taxpayer's original use of the structure begins. ■

## Understanding the impact of earnings on Social Security benefits

You can start collecting Social Security benefits as early as age 62. But if you're still working, be sure you understand how earnings can reduce these benefits.

For example, say you begin collecting Social Security at age 62 but continue to work. Your Social Security payments will be reduced by $1 for every $2 of earnings over a specified threshold (currently, $18,960). If your Social Security benefit is $24,000 per year, for example, then earnings of $66,960 or more will reduce your benefit to zero.

In the year you reach full retirement age (for those born in 1955, age 66 and two months, with the age increasing two months per year for those born in 1956 through 1959, until it reaches 67 for those born after 1959), the impact of earnings is much less severe. Benefits are reduced by $1 for every $3 of earnings over a higher limit (currently, $50,520) up to the date of your full retirement age. When you reach full retirement age, you're eligible to receive your full Social Security Benefit regardless of the amount you earn from work.

Note that if your benefits are reduced, they aren't lost forever. When you reach full retirement age, they'll be returned to you in the form of higher Social Security payments. ■

## Consider a "reverse" sales and use tax audit

If your business purchases raw materials, supplies or other items in multiple states, consider conducting a "reverse" sales and use tax audit. Ordinarily, sales and use tax audits are conducted by state or local governments to reveal taxes that weren't properly collected and paid. In a reverse audit, a business seeks to identify and recover overpayments of sale and use tax.

Most states exempt certain purchases from sales and use tax — such as goods purchased for resale or materials consumed in a manufacturing process. The rules surrounding these exemptions vary from state to state and may change over time, so compliance can be a challenge. Because it's usually up to the purchaser to claim an exemption, it's not unusual for businesses to erroneously pay sales or use tax on exempt purchases. A reverse audit can help a business identify and correct these mistakes, boosting its cash flow in the process. ■

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