

May 8, 2019

The Honorable Charles Grassley  
Chairman  
Committee on Finance  
U.S. Senate

The Honorable Ron Wyden  
Ranking Member  
Committee on Finance  
U.S. Senate

The Honorable Richard Neal  
Chairman  
Committee on Ways and Means  
U.S. House of Representatives

The Honorable Kevin Brady  
Ranking Member  
Committee on Ways and Means  
U.S. House of Representatives

**Re: *Depreciation of Energy Efficient Building Equipment***

Dear Chairmen and Ranking Members:

Our coalition represents real estate business, energy efficiency, and environmental advocacy organizations. We encourage your committees to address an inadvertent deficiency in the *Tax Cuts and Jobs Act (TCJA)*. New bonus depreciation and cost recovery rules have an unintended consequence to *discourage* businesses from making energy efficiency investments and technological innovations to modernize our nation's building infrastructure, reduce energy consumption, and lower greenhouse gas emissions.

To correct this shortcoming, our groups urge you to consider legislation to establish a new category of Energy Efficient Qualified Improvement Property – or “E-QUIP” – with a 10-year cost recovery period. As we suggest, a uniform E-QUIP 10-year recovery period will promote productive business investment by spurring high performance upgrades in commercial and multifamily buildings. In turn, optimizing energy efficient building performance will help create well-paying jobs in the construction, design, and energy sectors; boost equipment manufacturing; enhance our country's energy independence; and reduce the built environment's carbon footprint.

The *TCJA* included sweeping changes in our nation's cost recovery system intended to encourage certain nonresidential building investments, known as Qualified Improvement Property (“QIP”). A drafting error, however, failed to incentivize QIP investments as Congress desired. Legislation is currently pending to fix this error, as discussed in the attachment that follows this letter. However, correcting the QIP drafting mistake will still not be sufficient to encourage expensive investments aimed at substantially improving energy efficiency in buildings. As this letter's attachment further explains: Even with anticipated QIP technical corrections in place, new cost recovery rules *increase* the after tax cost of certain building improvements and particularly *discourage* costly, high-performance energy efficiency upgrades. Moreover, as QIP technical corrections under consideration pertain to nonresidential properties, they would not to encourage high efficiency investments in multifamily residential properties.

Accordingly, to stimulate robust building investments in E-QUIP, our groups respectfully recommend legislation that includes the following elements:

- Elective 10-year, straight-line cost recovery period for a new category of E-QUIP expenditures for taxable income, as well as for earnings and profits purposes;
- Six year duration of incentive;
- Applies to improvements in commercial buildings – as well as multifamily buildings subject to the same code requirements;
- E-QUIP benefit available to all taxpayers, including an electing real property trade or business under section 163(j);
- Covers interior and exterior components of, and controls for, the main systems that most impact building energy consumption: (1) heating and cooling; (2) lighting; and (3) envelope;
- Pertains to equipment and systems manufactured to meet above-code, high performance specifications to be subsequently defined by statutory language, that exceed levels of performance ordinarily required through energy codes and standards; and
- Certification that E-QUIP is installed to maximize the performance for which it is designed, accompanied by an on-going operations and maintenance plan.

We look forward to working with your committees to develop bipartisan E-QUIP legislation that effectuates important tax, energy, business investment, technology innovation, and climate policy goals.

**The Real Estate Roundtable**  
**Alliance to Save Energy**  
**American Council for an Energy-Efficient Economy (ACEEE)**  
**American Hotel & Lodging Association**  
**American Institute of Architects**  
**American Resort Development Association**  
**American Seniors Housing Association**  
**Building Owners and Managers Association (BOMA) International**  
**CCIM Institute**  
**Green Building Initiative**  
**Home Innovation Research Labs**  
**Institute for Market Transformation**  
**Institute of Real Estate Management**  
**International Council of Shopping Centers**  
**NAIOP, the Commercial Real Estate Development Association**  
**Nareit**  
**National Apartment Association**  
**National Multifamily Housing Council**  
**Natural Resources Defense Council (NRDC)**  
**National Association of REALTORS®**  
**U.S. Green Building Council**

Cc: Members of the House of Representatives Ways and Means Committee  
Members of the Senate Finance Committee

## **A Proposal for 10-Year Cost Recovery for a New Category of Energy Efficient Qualified Improvement Property (“EE-QuIP”)**

The *TCJA* included sweeping changes in our nation’s cost recovery system intended to encourage certain nonresidential building investments, known as Qualified Improvement Property (“QIP”). A drafting error, however, failed to incentivize QIP investments as Congress originally desired. Legislation is currently pending to fix this error. These bills<sup>1</sup> properly effectuate Congress’s intent to: make QIP eligible for immediate bonus depreciation (through 2022); give QIP a 15-year depreciation period; and provide a 20-year QIP depreciation period in the case of taxpayers electing out of new limitations on the deductibility of business interest under *TCJA* section 163(j).<sup>2</sup>

However, correcting the QIP drafting mistake will still not be sufficient to encourage investments aimed at substantially improving energy efficiency in buildings – such as LED lighting upgrades, replacing old furnaces and HVAC systems with new high-performance models, and installing new energy saving roofs, windows and insulation. Even with anticipated QIP technical corrections in place, new cost recovery rules *increase* the after tax cost of building improvements and *discourage* energy efficiency upgrades. For example:

- Many real estate businesses will be subject to a longer 20-year recovery period for QIP because they elect out of the new limitation on the deductibility of business interest under *TCJA* section 163(j). In these cases, even if an energy efficiency improvement otherwise qualifies as QIP, it is subject to a recovery period that is 33% longer than prior law (20 years vs. 15 years).
- Improvements to residential rental property do *not* qualify as QIP. Such improvements are depreciated over 27.5 or 30 years.
- The definition of QIP does *not* cover *exterior* improvements.<sup>3</sup> Thus, exterior nonresidential building improvements were never intended as eligible for bonus, 15-year or 20-year depreciation under the *TCJA*’s regime:
  - Windows, roofs, outside wall insulation, and other parts of an asset’s exterior envelope are *not* QIP.
  - Heating or cooling systems located in a basement *are* QIP. However, building HVAC installed outside of a building on a roof is *not* QIP.

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<sup>1</sup> *Restoring Investment in Improvements Act* ([S. 803/H.R. 1869](#)).

<sup>2</sup> [26 U.S.C. § 163\(j\)\(7\)\(B\)](#).

<sup>3</sup> [26 U.S.C. § 168\(e\)\(6\)\(A\)](#). “Qualified Improvement Property” means **interior** improvements to non-residential property. Does not include: (1) building enlargement, (2) any elevator or escalator, or (3) internal structural framework of building.

- Lighting on the inside of a building *is* QIP, but if installed on an exterior façade is likely *not* QIP.

The TCJA classifies such non-QIP, nonresidential components and systems as 39-year property. Such a lengthy cost recovery period would not meaningfully encourage a real estate business to invest in exterior building improvements that stretch beyond ordinary code requirements – and reach for substantial reductions in energy usage and associated carbon emissions.

The key barrier for installation of energy efficient building systems and equipment is their higher upfront cost relative to less expensive, standard baseline equipment that complies with minimum energy code requirements. Considering the patchwork of varying depreciation periods for the same equipment, in many cases *TCJA* works as a disincentive for real estate owners to bear those initial higher costs and leads them to avoid or delay capital expenditures to improve their buildings' energy efficiency. The after-tax cost of improvements increases as the recovery period lengthens from zero, to 20, to 30, to 39 years. This result stands in contrast to the *TCJA*'s general direction and underlying philosophy – to encourage capital investment through accelerated cost recovery and a shift towards a cash-flow business tax system.

To stimulate investments in high performance building energy efficiency investments, real estate, energy, and environmental advocacy groups respectfully recommend legislation that includes the following elements:

- A new tax code category of Energy Efficient Qualified Improvement Property (“E-QUIP”);
- Elective 10-year, straight-line cost recovery period for E-QUIP expenditures for taxable income, as well as for earnings and profits purposes;
- Six year duration of incentive;
- Applies to improvements in commercial buildings – as well as multifamily buildings subject to the same code requirements;
- E-QUIP benefit available to all taxpayers, including an electing real property trade or business under section 163(j);
- Covers interior and exterior components of, and controls for, the main systems that most impact building energy consumption: (1) heating and cooling; (2) lighting; and (3) envelope;
- Pertains to equipment and systems manufactured to meet above-code, high performance specifications to be defined by statutory language, that exceed levels of performance ordinarily required through energy codes and standards; and
- Certification that E-QUIP is installed to maximize the performance for which it is designed, accompanied by an on-going operations and maintenance plan.