

Energy Policy Act of 2005 - Energy-Efficiency Tax Incentives for Individual Consumers and Businesses

The recently enacted *Energy Policy Act of 2005* seeks to promote energy efficiency practices by consumers and businesses through use of tax incentives. The legislation provides tax incentives for individual homeowners who invest financial resources in 2006 and 2007 for installation of specific energy-saving devices. In addition, starting in 2006, a new tax credit will be available for the purchase of some hybrid vehicles, as well as the purchase of some other, more exotic "green" vehicles. Beyond homeowners, businesses will also be eligible to receive tax credits for the installation of energy savings equipment.

Consumer Incentives

There are three new tax incentives available to individual consumers:

1. Residential Energy-Efficient Property Credit;
2. Home Improvement Energy Credit; and
3. Alternative Fuel Vehicle Credit.

1. Residential Energy-Efficient Property Credit

This credit provides an incentive to homeowners to convert residential property to solar energy. There are three ways the credit can be earned, and three separate amounts allowed for doing it. The new law makes available:

- A 30 percent credit up to a maximum \$2,000 per year for the cost of purchasing and installing of residential solar water heating;
- A 30 percent credit up to a maximum \$2,000 per year for the cost of purchasing and installing photovoltaic equipment for solar-generated electricity; and
- \$500 for each 0.5 kilowatt-of fuel cell property capacity.

The \$2,000 credits for solar water and electricity applies to any residence, including secondary property (i.e., vacation property), while the fuel cell credit is restricted to installation in your principal residence. The credit is available for equipment put in place after December 31, 2005 and before January 1, 2008.

2. Home Improvement Energy Credit

This incentive encourages the installation of certain energy saving improvements in residential homes by offering a \$500 tax credit. The credit may be taken either as a dollar-for-dollar credit for expenditures, 10-percent of the cost of the qualified energy efficient improvement, or any combination thereof.

Expenditures that qualify for this credit include the following equipment:

- Up to \$50 for an advanced main air circulating fan;

- Up to \$150 for any energy-efficient qualified natural gas, propane, or oil furnace or hot water boiler, and
- Up to \$300 for energy-efficient building property, including electric and geothermal heat pumps, open loop, direct expansion, central air condition and natural gas, propane or oil water heaters.

"Qualified energy-efficiency improvements"--for which 10 percent of your purchase and installation costs are allowed to count toward the \$500 home improvement energy credit--consist of "energy-efficient envelope components satisfying the 2000IEC Code." They include insulation materials; exterior doors and metal roofs with special pigmented coatings. Exterior windows, including skylights, are also on the list, but they are subject to a special expense limit. The list specifically does not include insulated drapes. It also does not include any improvement that does not meet 2000IEC Code. The IRS is expected to come out with a more detailed list soon.

Qualifying property must be installed in your principal residence between January 1, 2006 and December 31, 2007. Vacation, second homes, rental properties or a foreign residence do not qualify for any part of this credit. And while most do-it-yourself installations are allowed, you will need to prove date of installation. The cost of your own time cannot be calculated into the expenditure.

3. Alternative Fueled Vehicles

New tax credits are available for hybrid, fuel cell, advanced lean burn diesel and other alternative power vehicles, replacing the current deduction for clean fuel (including hybrid) vehicles. The credits are collectively claimed under the title of the "Alternative Motor Vehicle Credit." This credit is equal to the sum of the four separate credit components:

- New qualified fuel cell motor vehicle credit;
- New advanced lean burn technology motor vehicle credit;
- New qualified hybrid motor vehicle credit;
- New qualified alternative fuel motor vehicle credit.

The qualified hybrid-vehicle will be the dominant credit for consumers, considering these vehicles are the most common in mass production by automakers. Unlike the rules for 2005 however, a qualified hybrid motor vehicle no longer includes many heavy SUVs. Nor will it include many high-performance hybrids that do not appreciably decrease fuel consumption from their smaller-engine gasoline counterparts. Also, unlike the 2005 hybrid deduction, the new credit is available whether you buy or lease.

The amount of the credit for a hybrid vehicle is based upon the percentage increase in fuel economy from an all-gasoline model, and varies from \$400 to \$2,400 based-on fuel savings ranging from 125 to 250 percent of a base amount. An additional conservation credit is awarded to hybrid vehicles with certain lifetime fuel savings ratings, ranging from \$250 to \$1,000.

Businesses Incentives

There are five new energy-efficient tax incentives for businesses:

1. Deduction for Energy-Efficient Commercial Property;
2. Business Solar Investment Tax Credit;
3. Credit for Qualified Fuel Cell Property/Stationary Microturbines;
4. New Credit for Manufacturing Energy-Efficient Appliances; and
5. Homebuilder Credit for New Energy-Efficient Homes.

1. Deduction for Energy- Efficient Commercial Property

- Proprietors of commercial buildings are eligible to deduct the costs of improving the property's energy efficiency. The maximum deduction is \$1.80 per square foot and requires the following criteria be met:
- The property for which costs are claimed must be depreciable (or amortizable) property, installed in a domestic building, and within the scope of Standard 90.1-200 I;
- The property must be installed as part of the building's interior lighting system, heating and cooling ventilation, hot water systems, or the building envelope; and
- The property must be installed based on a plan to reduce total annual energy and power costs by 50 percent or more when referenced against a building meeting certain minimum requirements. (The IRS has been instructed to issue rules to allow a reduced deduction if specific energy-efficiency targets are met but the 50-percent mark is not reached).

All deductions must be taken for expenditures made between January 1, 2006 and December 31, 2007.

2. Business Solar Investment Tax Credit

Under the *Energy Policy Act of 2005*, the business investment credit for solar energy property is increased from 10 percent to 30 percent. The increased credit applies to (1) equipment which uses solar energy to generate electricity, to heat or cool (or provide hot water for use in) a structure, or to provide solar process heat, and (2) equipment which uses solar energy to illuminate the inside of a structure using fiber-optic distributed sunlight. This credit applies to expenditures made after December 31, 2005 and before January 1, 2008.

3. Credit for Qualified Fuel Cell Property/Stationary Microturbines.

Energy property includes qualified fuel cell property and stationary microturbine property for purposes of the business energy credit. The credit is 30 percent of the basis of qualified fuel cell property placed in service during the tax year. The energy credit for any qualified fuel cell property cannot exceed \$500 for each 0.5 kilowatt of capacity.

Effective dates for the tax credit are January 1, 2006 thru December 31, 2007.

4. *New credit for manufacturing energy-efficient appliances.*

The *Energy Policy Act of 2005* adds a new tax credit for the manufacture of energy efficient appliances such as dishwashers, clothes washers and refrigerators. The credit is a part of the general business credit. The credit applies to appliances manufactured between January 1, 2006 and December 31, 2007.

5. *Homebuilder's credit for new energy-efficient homes.*

An eligible contractor may claim a tax credit of \$1,000 or \$2,000 for a qualified new energy-efficient home that a person acquires from the contractor during 2006 and 2007 for use as a residence during the tax year. An eligible contractor is a person who constructs a new energy efficient home or a manufacturer that produces a qualified new energy-efficient manufactured home. The credit applies to new homes and those substantially reconstructed. While the contractor, rather than the homeowner, gets the credit, the purchasers may benefit from a price reduction since the contractor's net costs are less if the credit is factored in.