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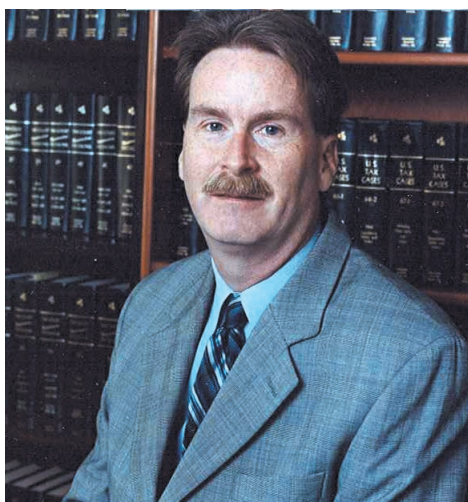


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Energy Tax Incentives for 2006

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There's plenty of incentive for businesses to conserve energy or increase its production in the new energy tax incentives bill signed into law earlier this year, says author Stephen King.

On August 8, 2005, The Energy Tax Incentives Act of 2005 was signed into law. Although this new law carries many new incentives for energy companies to boost energy production and efficiency, it also includes substantial tax incentives for both businesses and individuals to make energy saving improvements. For the most part, the tax incentives are for U.S. property placed in service after Dec. 31, 2005 and before Dec. 31, 2007. The termination dates for Alternative Powered Vehicles vary with the type of vehicle.

Conservation

The Act impacts four major areas: conservation, alternative energy, energy infra-

structure and domestic energy production. Conservation tax incentives are aimed at encouraging the design and improvement of energy-efficient homes, appliances and green vehicles.

Benefits for Businesses: A commercial building deduction will result in an immediate deduction for the cost of energy-savings improvements to commercial building property rather than recovery through depreciation over 39 years as required presently. It includes property installed as part of the interior lighting systems, heating, cooling, ventilation, and hot water systems, or the building envelope. To qualify for the deduction, annual energy and power consumption for the building will need to be reduced by half with respect to the above items, which will need to be certified by certain outside parties. The deduction is limited to \$1.80 per square foot (but \$.60 per square foot in some cases) and reduces the basis of the property.

Benefits for Contractors: Residential home builders will benefit by building new energy efficient homes. If the dwelling unit is certified to have an energy consumption of at least 50 percent of a comparable dwelling, the credit will be \$2,000 per unit. Manufactured homes that do not meet the 50 percent test, but meet a 30 percent standard, are eligible for a \$1,000 credit per unit. To qualify for the credit, the contractor must sell the unit during the same tax year that the home is occupied as a personal residence. The credit applies not only to home construction, but also includes substantial

reconstruction and rehabilitation.

Benefits for Manufacturers: Manufacturers producing energy efficient appliances will qualify for a new General Business Tax Credit. Washing machines and dishwashers, depending on energy efficiency, can qualify for a credit up to \$100 per unit. Refrigerators, again depending on energy efficiency and the year manufactured, qualify for a credit ranging from \$75 to \$175 per machine.

Benefits for Individuals: Individuals making energy-efficient improvements, such as insulation, exterior doors and windows, to their personal residence will be able to claim a tax credit for part of the cost of the improvements.

Residential home builders will benefit by building new energy efficient homes.

Under the new law, a taxpayer will be able to claim a lifetime credit of up to \$500 for making qualifying energy saving improvements to his or her existing home. However, only \$200 of this credit may be for qualifying window expenditures. Subject to the \$500/\$200 lifetime caps, the credit equals the sum of the amounts in two categories:

(1) "Envelope" improvements. This encompasses building components such as insulation, new windows (including

skylights) and doors, and certain roofing material. The credit may be claimed for 10 percent of the cost of such improvements. The component must be installed in or on a dwelling unit (including a manufactured home) located in the U.S. Also, the dwelling unit must be used by the taxpayer as his principal residence, so improvements to a second home or to a rental property wouldn't qualify. Finally, the energy-conserving components will need to be "reasonably expected" to remain in use for at least five years and the taxpayer must be the original user of the components.

(2) Purchases of certain property. The credit for certain kinds of energy-saving property is simply a set amount. For example, for an advanced main air circulating fan, up to \$50 of the cost is credit-eligible. For a natural gas, propane, or oil furnace or hot water boiler, up to \$150 of the cost is credit-eligible. For energy-efficient building property such as a heat pump, up to \$300 is credit-eligible. Eligible expenses include labor costs for onsite preparation, assembly, and original installation of the property. Finally, the energy-saving property must be installed on or in connection with a dwelling unit located in the U.S. that is owned and used by the taxpayer as his principal residence, and the energy-saving property must be originally placed in the service by the taxpayer.

Alternative Energy

Benefits for Businesses: The new law increases the 10 percent existing businesses energy credit for the cost of solar energy equipment to 30 percent for solar energy property.

Benefits for Individuals: For qualifying residential solar water heating, photovoltaic equipment and fuel cell property, there is a 30 percent tax credit with a maximum credit of \$2,000.

Alternative vehicles qualify for several credits depending on the type of vehicle. A hybrid vehicle uses both gas and electricity and qualifies for a credit ranging from \$400 to \$2400 depending on its fuel economy. It also qualifies for a con-

servation credit of \$250 to \$1,000 based on the vehicle's lifetime fuel savings. Toyota, Honda and Ford manufacture hybrid vehicles. Toyota is going to double its production of hybrid vehicles for 2006. By the end of 2006, it will add hybrid versions of its luxury sedans sold under the Lexus brand.

A hybrid vehicle uses both gas and electricity and qualifies for a credit ranging from \$400 to \$2400 depending on its fuel economy.

The credit replaces the current clean fuel vehicle deduction for vehicles purchased after Dec. 31, 2005. Under the clean fuel vehicle deduction, hybrid's purchased in 2005 are entitled to a deduction up to \$2,000. A tax credit may have a greater tax savings than the deduction, making it a consideration to delay a planned purchase until 2006. The credit is also available to taxpayers who lease qualifying vehicles whereas the deduction was not available for leased vehicles.

Three other vehicle types qualify for the credit.

- Advanced lean-burn technology vehicles, which have combustion engines designed to use more air than necessary for complete combustion of the fuel. This results in achieving at least 125 percent of the 2002 model year city fuel economy.

- Alternative fuel vehicles, which use compressed or liquefied natural gas, liquefied petroleum gas, hydrogen or other qualifying fuels.

- Vehicles using a fuel cell of hydrogen as the main source of power will qualify when they are available for purchase.

Electric vehicles do not qualify for the new credit, but they still qualify for the electric vehicle credit under present law.

Benefit for Auto Dealerships: Automobile dealers may also claim cred-

its for themselves for those vehicles sold to certain tax-exempt organizations. The person that sells the vehicle to the tax-exempt entity is treated as the taxpayer for purposes of the new alternative motor vehicle credit and the credit is allowed to the seller, but only if the seller clearly discloses to the entity at the time of any sale the specific amount of any alternative motor vehicle credit allowable.

Energy Infrastructure

To encourage the building of new energy infrastructure, the act speeds up the time frame for capital investments to be deducted, either through faster depreciation or expensing in full under the Energy Efficient Commercial Buildings Deduction. The provisions benefit all types of energy including electric, gas, clean coal facilities and even nuclear. Previous energy credits and deductions concentrated solely on renewable energy sources such as solar, wind and alternative fuels.

Domestic Energy Production

Benefits for Businesses & Individuals: Although there are very specific incentives for the energy industry, their incentive should also provide a benefit to all individuals and businesses to the extent the savings are passed along to the consumers in lower prices. Congresswoman Shelley Moore Capito (R-WV), believes that "more fuel to the pump means more stability and lower prices."

As you can see, the Energy Act has created substantial tax incentives to either conserve or generate energy. Although there are very specific rules and restrictions that need to be followed, your tax advisor should be able to guide you through them.

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