

The Energy Tax Incentives Act: Building Benefits for Efficiency

By Jim Bailey

Although tax law changes can sometimes be detrimental, there is good news for commercial developers with the enactment of the Energy Tax Incentives Act of 2005. Billed in part as a mechanism to encourage new construction, the Act encompasses new tax breaks intended to promote domestic energy production and conservation—and for those in the construction industry the financial impact packs a positive punch.

While the Act provides incentives targeted at improving the national power grid to help prevent major blackouts like those experienced in the Northeast and Midwest a couple years back, it also provides some cost-saving motivation for individuals and businesses to make specific energy conservation or alternative energy expenditures.

Passed by Congress in July and signed into law by President Bush on August 8, the Act provides tax credits, deductions and incentives (to the advertised tune of \$14.5 billion) for those purchasing energy efficient vehicles and retrofitting their homes with fuel-efficient heating systems. It also favors the manufacturers of appliances that don't waste power. And for contractors who construct energy efficient homes or commercial buildings (or add energy efficiencies to existing commercial structures), the credits and deductions can be substantial.

An immediate deduction – as opposed to multi-year depreciation – is allowed for the cost of qualified energy-saving improvements to commercial buildings in the United States. The maximum deduction is generally limited to \$1.80 per square foot on a lifetime basis for commercial buildings that achieve a 50% reduction in annual energy cost to the user, as compared to a reference building that meets the minimum requirements defined by the industry standard. The improvements must be installed as part of the heating, cooling, interior lighting and hot water heating and ventilation systems or the building envelope, since only these uses are within the scope of the industry standard and within the control of the building designer. In some circumstances, a reduced deduction amount of 60 cents per square foot for those buildings that fail the 50% test may apply.

In order to qualify for the full deduction, the overall cost reduction plan must target all the systems, namely the interior lighting, heating, cooling, ventilation and hot water supply systems. The targeted reduction applies to the overall energy savings, not the savings of any particular system.

Eligible buildings include commercial buildings such as: offices, retail buildings, warehouses, etc., rental housing of four stories or more, and publicly-owned buildings. For publicly-owned buildings, there is a provision allowing the credit to pass through to the "person primarily responsible for designing the building."

The aforementioned deductions are available for qualified energy efficient commercial building improvements put in use after December 31, 2005 and before the calendar year 2008, although extenders increasing the eligibility through 2009 are a possibility.

Compliance is determined by third party inspectors who review the plans and the actual in-place construction. Energy savings are determined by software that must be certified by the Department of Energy (DOE) as meeting criteria of consistency and accuracy.

Contractors building new homes in the United States are eligible for a tax credit of \$2,000 for residential structures that reduce energy use for heating and cooling by at least 50% below that of comparable units. Producers of manufactured homes can also qualify for a reduced tax credit of \$1,000 for homes that save 30%. This \$1,000 credit for reaching 30% savings is not available for site built homes, which must reach the 50% savings tier to qualify for the \$2,000 credit.

Eligible homes must demonstrate savings using software that has been approved by the DOE and builders must exhibit compliance by the use of third party inspectors certified according to DOE rules.

Incentives apply to homes purchased after December 21, 2005 and before 2008, although, again, the possibility exists for an extension to that condition. These credits will benefit homebuyers to the extent that contractors pass along their tax savings making it a win-win situation for all involved.

A business tax credit is also allowed for manufacturers who produce qualifying energy efficient dishwashers, clothes washers, and refrigerators in the United States and is available for appliances manufactured, as mentioned above, in calendar years 2006 and 2007. This credit will go directly to appliance manufacturers but should indirectly benefit consumers of these products.

We've just scratched the surface of all the new rules included in the fairly massive 2005 Energy Act. To determine how you can best benefit from this new legislation, contact a qualified Certified Public Accountant firm for the most up-to-date information.

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