Taxes

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ETIA of 2005 and New Energy-Efficient Homes

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The Energy Tax Incentives Act of 2005 (ETIA) provides tax benefit provisions that apply to individuals' residence, business property, automobiles, electricity, coal, oil & gas, and fuel production, just to name a few. These provisions fall into one of two classifications: energy efficiency or energy production.

Last month, we looked at the tax credits made available for energy conservation improvements to alternative energy sources in an existing residence. In this column, we discuss the business tax deductions and credits for construction of new energy-efficient homes, production of energy-efficient products, and the incorporation of energy-efficient business property. Next month, we will look at the new credit for the eligible production of certain energy-efficient appliances, such as dishwashers, clothes washers, and refrigerators.

New Energy-Efficient Homes Credit

New IRC §45L adds a new general business credit to the Code. This new section provides a credit for the construction of a qualified new energy-efficient home. One would expect numerous economic ripples as a result of this tax credit. For example, it *should* encourage builders to take advantage of the tax credit by including energy-efficient products in new residential construction, which *should* then encourage manufacturers to increase production of energy-efficient products, which *should* reduce the demand on energy needs of the newly constructed energy-efficient homes, and which ultimately *should* lower the cost for the homeowner.

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Needless to say, the above economic ripple effects are appealing. But this provision is short lived; it is effective for only 2006 and 2007 (another two-year provision like IRC §25C, which we discussed in April's column).

When one considers the time needed to manufacture the energy products, to build the new energy-efficient homes, and to sell them to the new owner, two years doesn't seem like a sufficient time. Perhaps during the next Congressional session, Congress will propose the extension of this provision so that the true economic benefit is realized.

In general, IRC §45L(a)(2) provides a general business credit to an eligible contractor for each qualified new energy-efficient home. To be eligible, the new home must be certified to have a level of annual heating and cooling energy consumption that is at least 50% (or 30% in the case of a qualified manufactured home) below the annual level of heating and cooling energy consumption of a comparable dwelling unit

Errata

In the February Taxes column, an example about Thomas, an active service member, said he had $10,000 of regular basic pay. It should have indicated $1,000. Thomas would then use $1,000 in determining gross income and $13,000 in calculating the amount of earned income for the earned income tax credit or refundable portion of the child tax credit, instead of the $10,000 and $22,000, respectively, that were mentioned. Additionally, be aware that these credits do phase out as income increases. A person needs to calculate the credit for including and excluding the combat pay to determine whether to include or exclude it in order to maximize the tax benefits. We apologize for the error.

(see IRC §45L(c)(3)(A)). More specifically, the contractor is eligible for $2,000 in the case where the constructed home or manufactured home meets the 50% standard or $1,000 in the case where the manufactured home meets the 30% standard.

The producer of a manufactured home is eligible for the new energy-efficient home tax credit if the qualified manufactured home satisfies either the 50% or 30% standards. But the 30% standard doesn't apply for qualified new energy-efficient home construction. It applies to a qualified manufactured home only. Another important aspect of this provision is there is no limitation on the number of homes that a contractor can build or claim the credit on.

Additional Criteria

Not all constructed homes qualify for the credit. A qualified new energy-efficient home means a dwelling unit that is located in the United States, whose construction is substantially completed after the date of the enactment (i.e., August 8, 2005), and that meets the appropriate energy conservation standard. Obviously, Treasury will be called on to provide guidance on the meaning of "*substantially completed*."

The dwelling unit also must be constructed by an *eligible contractor*; it must be acquired by a person from the contractor for use as a principal residence during the taxable year; and it must be acquired before January 1, 2008. Once again, we are looking at little more than a two-year window of opportunity.

What is an eligible contractor? An eligible contractor is one that is either a manufactured home producer, in the case of a manufactured home, or a person who constructed the qualified new energy-efficient home.

At first glance, a person is left with the impression that only new construction qualifies for this credit. New IRC §45L(b)(3) states, however, that construction includes substantial reconstruction and rehabilitation. But the law also says that the property must be *acquired* by the owner, which means renovation work doesn't qualify under this tax provision but does qualify under new home efficiency improvement provisions (IRC §25C and §25D).

Another hurdle that one must overcome to qualify for the new energy-efficient home credit pertains to the building envelope component of the improvements. Specifically, the building envelope component of the improvements must account for at least one-fifth of the 50% (i.e., 10%) or at least one-third of the 30% (i.e., 10%).

Although the new Code section doesn't elaborate on the meaning of the building envelope, the House Ways & Means Committee did state that the building envelope component means any insulation materials or system specifically and primarily designed to reduce heat loss or gain, exterior windows (including skylights), doors, and any duct sealing and infiltration reduction measures. This position is consistent with the meaning provided in new IRC §25C(c)(2) for nonbusiness energy property, discussed last month.

Keep in mind that the basis of the dwelling is adjusted for any credit taken. That is, the property's basis is increased by the qualified expenditure and decreased by the credit amount. This treatment is also similar to the nonbusiness energy credit.

With proper planning, both the contractor and taxpayer may be able to enjoy the energy credit on a qualified new energy-efficient home. The contractor, on one hand, can qualify under new IRC §45L; the taxpayer, on the other hand, may want to separately contract for the installation of specific qualifying property under new IRC §25C and §25D. This advanced planning could be a win-win situation for everyone: contractor, taxpayer, and government! ■

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