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## North Carolina Energy Star Conference

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## Energy Tax Incentives Act of 2005

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- The Energy Tax Incentives Act of 2005 contains a \$14.5 billion package of tax breaks that include both renewable energy provisions and incentives for the oil, gas, coal, and nuclear industries. Here's a summary of the more widely applicable tax changes in the Act:



## Energy Tax Incentives Act of 2005

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- The Act includes a number of tax incentives for consumers to buy energy efficient assets and for manufacturers and builders to provide them.
- Solar Energy Incentives
- New Tax Credits for Energy Efficient Improvements to Existing Homes
- New Tax Credit for Contractors Building Energy Efficient Homes
- New Deduction for Energy Efficient Commercial Buildings



## Solar Energy Incentives

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- New 30% tax credit for the purchase of qualifying residential solar energy equipment. The maximum credit is \$2,000 (for solar equipment) and \$500 for each half kilowatt of capacity (for fuel cells). The credit applies for property placed in service after 2005 and before 2008.
- Residential Systems
  - Under Pre Act law no credit was available
  - New law provides a nonrefundable personal income tax credit for purchase of:
    - Photovoltaic Equipment (uses solar energy to generate electricity)
    - Solar Water Equipment used exclusively for purposes other than heating swimming pools and hot tubs
- Credits are more valuable than deductions as they reduce tax liability dollar-for-dollar.



## Solar Energy Incentives

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- The credit equals 30% of the investment
  - With a maximum credit for each of those systems of \$2,000 (so the maximum credit would be \$4,000 if both systems were installed). Labor costs related to installation qualify for the credit.
  - The credit applies to equipment placed in service in 2006 or 2007.
- Business Systems:
  - Pre-Act law provides a 10% business energy credit for the cost of solar energy equipment.
  - The new law increases the 10% credit to 30% for solar energy property
  - In addition, the new law makes equipment that uses fiber-optic distributed sunlight to illuminate the inside of a structure solar energy property eligible for the 30% credit.
  - However, property used to generate energy for the purposes of heating a swimming pool is not eligible solar energy property.



# Solar Energy Incentives

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## Effective Dates

- The increase in the credit rate and the provision relating to fiber-optic distributed sunlight apply to periods after December 31, 2005 and before January 1, 2008.
- The credit reverts back to the permanent 10% level after 2007.
- The provision with respect to the heating of swimming pools applies to periods after December 31, 2005, and applies permanently



## Energy Efficient Improvements to Existing Homes

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- 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 existing home.
  - 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. The first category is:
    - “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% 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.



## Energy Efficient Improvements to Existing Homes

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- The 2nd qualifying category is for the purchase of certain property
  - The credit for certain kinds of energy-saving property is simply a set amount.
  - 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 service by the taxpayer.

### Effective Dates

- The credit starts in the 2006 tax year and is NOT available after the 2007 tax year.



## Credit for Contractors for Building Energy Efficient Homes

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- Eligible contractors can qualify for a new tax credit when they construct qualified new energy-efficient homes.
- The credit is either \$2,000 or \$1,000 per qualifying home. Here is an overview of the new credit.
- **Credit requirements.**
  - For a structure to qualify for the credit:
    1. it must be located in the U.S.;
    2. its construction (which includes substantial reconstruction and rehabilitation) must be substantially completed after Aug. 8, 2005 and it must be acquired in 2006 or 2007;
    3. it must meet specific energy saving requirements explained below;
    4. it must be built by the “eligible contractor” (the person who constructed the home, or the manufacturer, if the structure is a manufactured home); and
    5. it must be acquired by a person from the eligible contractor for use as a residence during the tax year.



## Credit for Contractors for Building Energy Efficient Homes

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- **When \$2,000 credit applies.**
- A home qualifies for the \$2,000 credit if:
- It is certified in accordance with guidance to be issued by IRS to have a projected level of annual heating and cooling energy consumption that meets the standards for a 50% reduction in usage, compared to a comparable dwelling built in accordance with the standards of chapter 4 of the 2003 International Energy Conservation Code as in effect (including supplements) on Aug. 8, 2005, and the Federal minimum efficiency standards specified in Code Sec. 45L(c)(1)(A)(ii); and
- Its building envelope component improvements account for at least one-fifth of the 50% reduction.



## Credit for Contractors for Building Energy Efficient Homes

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- A manufactured home qualifies for the \$2,000 credit if it meets the above requirements, and it conforms to Federal Manufactured Home Construction and Safety Standards (section 3280 of title 24, Code of Federal Regulations).



## Credit for Contractors for Building Energy Efficient Homes

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- **When \$1,000 credit applies.**
- A manufactured home qualifies for a \$1,000 credit if it conforms to Federal Manufactured Home Construction and Safety Standards and meets *either* of the following two conditions:
  1. It is certified in accordance with guidance to be issued by IRS to have a projected level of annual heating and cooling energy consumption that meets the standards for a 30% reduction in usage, compared to a comparable dwelling built in accordance with the standards of chapter 4 of the 2003 International Energy Conservation Code as in effect (including supplements) on Aug. 8, 2005, and the Federal minimum efficiency standards specified in Code Sec. 45L(c)(1)(A)(ii); and its building envelope component improvements account for at least one-third of the 30% reduction.
  2. It meets the requirements established by the Administrator of the Environmental Protection Agency under the Energy Star Labeled Homes program.



## Credit for Contractors for Building Energy Efficient Homes

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- **What is the “building envelope”?**
  - This includes insulation materials or systems specifically and primarily designed to reduce heat loss or gain, exterior windows (including skylights), doors, and any duct sealing and infiltration reduction measures.



## Credit for Contractors for Building Energy Efficient Homes

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- **Other rules.**
  - The new credit is part of the general business credit.
  - No credits attributable to energy efficient homes can be carried back to any tax year ending on or before the effective date of the credit.
  - There's a basis reduction in the property for the amount of credit claimed.



## New Deduction for Energy Efficient Commercial Buildings

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- The Act created a major incentive for building owners to:
  - Upgrade systems
  - New structures – to design them in an energy efficient manner
  - The deduction is available for both new and used buildings



## New Deduction for Energy Efficient Commercial Buildings

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- **New deduction.**
- The maximum energy efficient commercial building (EECB) deduction is equal to (1) \$1.80 per building square foot (\$.60 per building square foot, for certain separate building systems), less (2) the aggregate amount of EECB deductions allowed for the building for prior years.
- It is important to note that there is no overall per-building dollar limitation on the EECB deduction.



## New Deduction for Energy Efficient Commercial Buildings

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- **Who gets the deduction?**
- The EECB deduction generally may be claimed by the building owner.
- The deduction is expressed as an amount equal to the cost of EECB property placed in service during the taxable year.
- An exception, however, applies for EECB property installed on or in property owned by a federal, state or local government (or political subdivision).
  - Here, under regs to be issued, the deduction will be allocated to “the person primarily responsible for designing the property in lieu of the owner of the property.”



## New Deduction for Energy Efficient Commercial Buildings

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- **Qualifying for the maximum deduction.**
- The new deduction is available only if the EECB property meets all of the following conditions:
  - It is property that is otherwise depreciable or amortizable.
  - It is installed on or in any building located in the U.S. that is within the scope of Standard 90.1-2001 of the American Society of Heating, Refrigerating, and Air Conditioning Engineers and the Illuminating Engineering Society of North America (ASHRAE/IESNA).
  - It is installed as part of (a) the interior lighting systems, (b) the heating, cooling, ventilation, and hot water systems, or (c) the building envelope.
  - It is certified as being installed as part of a plan designed to reduce the total annual energy and power costs with respect to the interior lighting systems, heating, cooling, ventilation, and hot water systems of the building, by 50% or more in comparison to a reference building which meets the minimum requirements of Standard 90.1-2001 (as in effect on April 2, 2003). Detailed certification requirements must be met in order to qualify for the deduction, with IRS to promulgate regs explaining how the fuel savings targets are to be measured.



## New Deduction for Energy Efficient Commercial Buildings

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- **Partial allowance of EECB deduction.**

- In general, if a building does not meet the overall building requirement of a 50% energy savings, a partial deduction is allowed for each separate building system that comprises energy efficient property and which is certified by a qualified professional as meeting or exceeding the applicable system-specific savings targets established by IRS. These targets to be established by IRS are those that would result in a total annual energy savings with respect to the whole building of 50%, if each of the separate systems met the system specific target. The separate building systems are (1) the interior lighting system, (2) the heating, cooling, ventilation and hot water systems, and (3) the building envelope. The maximum allowable deduction is \$.60 per square foot for each separate system.



## New Deduction for Energy Efficient Commercial Buildings

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- Until IRS issues final regs, the system-specific energy savings target for lighting systems is treated as met by a reduction in Lighting Power Density of 25% (50% in the case of a warehouse) of the minimum requirements in Table 9.3.1.1 or Table 9.3.1.2 (not including additional interior lighting power allowances) of ASHRAE/IESNA Standard 90.1-2001.
- Also, in the case of a lighting system of a non-warehouse building that does not reduce lighting power density by at least 40%, a prorated partial deduction is allowed. Certain lighting level and lighting control requirements must also be met in order to qualify for the partial lighting deductions.



## New Deduction for Energy Efficient Commercial Buildings

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- **Basis reduction.**
  - The basis of the commercial property is reduced by the amount of the EECB deduction.
- **Effective date.**
  - The new deduction for energy-efficient commercial buildings applies to property placed in service after Dec. 31, 2005, and before Jan. 1, 2008.



## Energy Production Tax Breaks

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- The Energy Tax Incentives Act of 2005 contains a wide array of tax incentives for the oil, gas, coal, and nuclear industries.
- The incentives generally consist of cost recovery changes and tax credits. Here's a summary of the Act's incentives for energy production.



## Energy Production Tax Breaks

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- 15-year writeoff for natural gas distribution lines (instead of the pre-Energy Tax Act law's 20-year writeoff), generally effective for lines the original use of which commences with the taxpayer after Apr. 11, 2005, and before Jan. 1, 2011. There's also a 15-year writeoff (instead of the pre-Energy Tax Act law's 20-year writeoff) for certain assets used in the transmission of electricity for sale and related land improvements, generally effective for property placed in service after Apr. 11, 2005.
- Two-year writeoff of geological and geophysical expenses paid or incurred in tax years beginning after Aug. 8, 2005.
- Expensing of 50% of the cost of certain capacity-increasing refinery investments, generally effective for property placed in service after Aug. 8, 2005 and before 2012. The original use of the property must begin with the taxpayer.
- For purposes of the small refiner exception to the oil depletion deduction, the pre-Energy Tax Act 50,000-barrel-per-day limit for independent producers is increased to 75,000 barrels a day, and is based on average daily production for the tax year (instead of actual daily production). These changes are effective for tax years ending after Aug. 8, 2005.



## Energy Production Tax Breaks

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- Seven-year recovery period for natural gas gathering lines, generally effective for lines the original use of which commences with the taxpayer after Apr. 11, 2005.
- A new production tax credit for qualifying advanced nuclear power facilities (certain facilities that produce electricity), effective for production in tax years beginning after Aug. 8, 2005.
- Elective five-year carryback of net operating losses (NOLs) for certain electric companies of up to 20% of the cost of electric transmission capital and pollution control expenses. This applies to NOLs arising in 2003, 2004, and 2005; the election may be made during any tax year ending after Dec. 31, 2005, and before Jan. 1, 2009.
- Two-year extension (through Dec. 31, 2007) of the placed-in-service date for wind, closed-loop biomass, open-loop biomass, geothermal, small irrigation power, landfill gas, and trash combustion facilities that produce electricity for which the renewable electricity production credit under Code Sec. 45 may be taken. The Act does not extend the placed-in-service date for solar facilities (Dec. 31, 2005) or refined coal facilities (Dec. 31, 2008). The Act also adds two new qualifying energy resources: hydropower and Indian coal, and equalizes the credit period over which the credit may be taken at ten years for facilities placed in service after Aug. 8, 2005.



## Energy Production Tax Breaks

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- New tax credits, effective for periods after Aug. 8, 2005, for investments in clean coal facilities producing electricity (20% for industrial gasification or integrated gasification combined cycle, 15% for other advanced coal-based projects that produce electricity).
- 84-month amortization for the cost of power-plant air pollution controls, generally effective for air pollution control facilities placed in service after Apr. 11, 2005.
- Inclusion of the Code Sec. 29 tax credit for fuel produced from non-conventional sources in the “general business credit,” resulting in 1-year carryback, 20-year carryforward for unused credits, for tax years ending after Dec. 31, 2005. Also the tax credit is extended to coke and coke gas from qualified facilities placed in service before Jan. 1, '93, or after June 30, '98, and before Jan. 1, 2010. The credit applies to production during a four-year period beginning on the later of Jan. 1, 2006, or the date the facility is placed in service.
- Expands the small ethanol producer credit to producers with annual production capacity of 60 million gallons (up from 30 million gallons under pre-Energy Tax Act law), effective for tax years ending Aug. 8, 2005; and adds to the biodiesel fuels credit a small agri-biodiesel producer credit, effective for tax years ending after Aug. 8, 2005, with a sunset after 2008.
- Extends the tax incentives for biodiesel (e.g., income and excise tax credits) through Dec. 31, 2008, and effective for fuel sold or used after Dec. 31, 2005, allows producers of “renewable diesel” to claim similar income and excise tax credits at the \$1.00 rate applicable to agri-biodiesel.