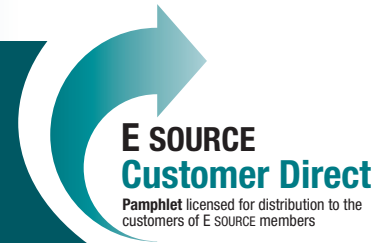


\$2,000 Tax Credit Available for Home Builders



The U.S. Energy Policy Act of 2005 (EPAAct 2005) was signed into law by President George W. Bush on August 8, 2005, and became effective January 1, 2006. EPAAct 2005 includes many different provisions regarding coal, natural gas, renewable energy, efficiency, transmission, distribution, and other energy-related topics. What you may not have known is that buried deep in the myriad details of the legislation is a tax credit for builders of energy-efficient homes.

It is important to note that the U.S. Department of the Treasury has yet to write certain implementation rules for EPAAct 2005, namely, the specific process for applying for this credit. The pertinent rules for builders should be completed soon. Builders should always check their individual situations with their own tax attorneys or tax advisers.

Logistics of the Builders' Credit

The "credit for construction of new energy efficient homes," found in Section 1332 of EPAAct 2005, states that contractors or builders of new energy-efficient homes are eligible for a \$2,000 tax credit if the home they construct uses 50 percent less energy for heating and cooling than a baseline home. The energy code referenced by EPAAct 2005 is Chapter 4 of the 2004 Supplement to the International Energy Conservation Code (IECC). The U.S. Department of Energy (DOE) has recommended that the 2006 version of the IECC be set as the baseline code, but this recommendation had not yet become a final ruling at the time of this writing.

EPAAct 2005 sets two other mandates not included in the IECC. First, all heating and cooling equipment installed by the builder must meet the latest minimum DOE efficiency standards, including the new rules for central air conditioners that set the minimum efficiency at a seasonal energy-efficiency ratio (SEER) of 13. Second, at least 20

percent of the improvements needed to attain a 50 percent reduction in heating and cooling energy use must come from improvements to the building envelope. Some examples of such improvements that could increase energy efficiency include high-performance windows and well-insulated walls, foundations, ceilings, attics, and roofs.

In addition to the energy-efficiency guidelines, there are several other eligibility requirements for obtaining the \$2,000 tax credit. The credit is applicable to new homes purchased after December 31, 2005, and before December 31, 2007. Homes that have been substantially reconstructed or rehabilitated also qualify for the credit. The qualifying home must be used as a primary residence; it may not be used as a rental property. EPAAct 2005 doesn't clarify eligibility rules for multi-family dwellings, but such buildings qualified for the tax credit at the time of this writing.

There is no limit to the number of \$2,000 tax credits a builder can receive. This means that a builder who is constructing 100 new homes in one year could theoretically claim a credit of \$200,000. The credit is not refundable (meaning that if a credit reduces your taxes below zero, the government will not send you a check), but it can be carried over (meaning that if the credit drives your tax below zero, any unused amount may be applied in a future year).

There is some crossover from other relevant EPAAct 2005 tax incentives. For example, the builder may claim the credit for the high-efficiency home, and the homeowner may claim tax credits available under other provisions of EPAAct 2005, including solar-heated water or photovoltaic (PV) and fuel cell systems.

What Doesn't Qualify for the Tax Credit?

There are two categories of items that builders cannot count toward the 50 percent energy-use reduction. First are measures

for which a builder is claiming other tax credits. For example, investment tax credits are available for those who rehabilitate a historical structure; if that building becomes 50 percent more energy efficient than a baseline building, it would also qualify for the \$2,000 EAct 2005 tax credit. However, a builder may claim only one of these credit options for that building.

The second category of measures that don't count toward the 50 percent reduction is anything not included in Chapter 4 of the IECC. For example, builders cannot count on-site renewable energy, including PV systems and geothermal power, toward the 50 percent reduction required for the \$2,000 tax credit. Builders can only design the homes to use less energy than the thresholds included in the IECC. Because neither EAct 2005 nor the IECC mentions renewable energy, it cannot be used for efficiency trade-off calculations needed to beat the code.

Remember that the EAct 2005 tax credit is applicable only to a 50 percent reduction in heating and cooling energy use. This means only building envelope and mechanical equipment will contribute to the energy reduction. Because PV systems don't help offset heating and cooling energy use, they aren't applicable.

Compliance Verification

In order to receive the tax credit, a builder has to obtain a written certification that verifies the energy savings and the building envelope components, the heating and cooling equipment, and their respective energy performance. At the time of this writing, the secretary of the U.S. Department of the Treasury had not yet established the final guidelines for certification. We suggest checking www.energytaxincentives.org/tiap-new-homes.html to find out when the method of certification has been decided.

Regardless of the final rules, there are two components to compliance verification: (1) Builders will have to demonstrate savings using software, and (2) a third party must

perform a field inspection of the property to ensure that the proper equipment was installed correctly.

The U.S. Department of the Treasury will maintain a list of approved models for both the software and the inspection. Builders will have to depend on approved performance software models such as the REM software series and EnergyGauge. At this time, builders cannot demonstrate compliance with the free software called REScheck that the DOE sponsors for verifying code compliance. REScheck is a trade-off calculation tool, not a performance model, so its range is limited.

A certified third-party provider must perform the field inspection to demonstrate compliance. These providers will be empowered to do RESnet field inspections and analysis but will not necessarily have to be RESnet-certified. (RESnet is an organization that sets the procedures and standards for quality of home energy rating services.) Builders may obtain a list of approved providers by contacting their local utility.

In some cases, builders will have to demonstrate compliance with two codes—one to meet local standards and one to meet the IECC baseline necessary for this tax credit. This situation will exist if the local baseline code isn't the IECC 2006 code or the 2004 supplement, whichever is determined to be the final reference code. For example, if the local code is tied to the less-stringent IECC 2000, or if the builder is in California and uses Title 24 as the baseline, the builder will have to demonstrate compliance with the appropriate version of the IECC to get the tax credit.

How to Obtain the Tax Credit

Once builders have constructed homes to beat heating and cooling energy use requirements in the IECC 2004 by 50 percent and has verified compliance, they apply for the \$2,000 credit by claiming it on their annual taxes. The U.S. Internal Revenue Service will publish forms and instructions for claiming the credit on 2006 and 2007 tax returns.

Note that only builders filing a business tax return may claim the credit; a builder filing an individual tax return is not eligible. Similarly, people building their own homes may not claim the credit themselves—they will need to hire contractors, who could then agree to pass the credits through to the homeowners.

For More Information

To keep track of relevant new rules, visit www.energytaxincentives.org/tiap-new-homes.html.

For more information about the REM software series, visit www.archenergy.com/products/rem.

For more information about EnergyGauge, visit <http://energygauge.com>.

For more information about REScheck, visit www.energycodes.gov/rescheck.

For more information about tax credits available to homeowners, for example, for solar energy systems, visit www.energytaxincentives.org/tiap-consumers.html.

To view the Energy Policy Act of 2005 in its entirety, visit http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=109_cong_public_laws&dodid=f:publ058.109.

For U.S. Department of Energy minimum efficiency standards, visit www.eere.energy.gov/buildings/appliance_standards.

For clarification or for questions regarding this tax credit, contact your tax adviser.

