

Energy Policy Act of 2005 Creates Federal Tax Benefits for Businesses

FACT SHEET

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The Energy Policy Act of 2005 created several federal tax benefits for businesses that install qualifying energy efficiency and renewable energy measures. This legislation was signed into law by President George W. Bush on August 8, 2005 and became effective January 1, 2006. These tax benefits include tax credits for some equipment and tax deductions for others.

Incentives, Credits and Deductions: Is There a Difference?

Several terms—tax incentives, credits and deductions—are often used to refer to tax benefits. These terms do mean different things. In the 2005 Energy Policy Act, the definitions are:

- **Tax incentives** reduce the amount of tax owed, dollar for dollar.
- **Tax credits** are the same as tax incentives, at least as they apply to the federal 2005 Energy Policy Act.
- **Tax deductions** reduce overall taxable income. The value depends on your tax bracket.

Tax credits or deductions are available for equipment purchased and installed between January 1, 2006 and December 31, 2007. The Department of Treasury is currently creating the Internal Revenue Service (IRS) Guidelines and Forms that businesses will need to claim the tax credits. When this information is available, Focus on Energy will post links to both the forms and guidelines at www.focusonenergy.com/taxincentives.

One important note: if you obtain a rebate from a utility or state program such as Focus on Energy, you must subtract this rebate amount from the total equipment cost, before you can claim the tax credits or deductions offered by the Energy Policy Act of 2005.

Tax Benefit Information, by Business Sector

The new federal tax benefits are available to commercial businesses, nonprofit organizations such as public agencies, and industrial manufacturers.

- Commercial building owners can obtain a tax deduction for specific energy efficiency equipment in both new construction and existing building improvements.
- Publicly-owned federal, state, local government or school district buildings can assign this tax deduction to the building's designer. The designer's fee could then be negotiated to reflect this tax deduction benefit. Churches and nonprofit corporations are not eligible because they are exempt from federal taxes.
- Commercial businesses and industrial manufacturers are eligible for tax credits on solar energy systems, fiber optic solar lighting, fuel cells and microturbines.

Federal Tax Benefit Information, by Type

This section discusses the federal tax benefits that are now available as a result of the Energy Policy Act of 2005. All qualifying energy efficiency and renewable energy projects must meet specific technical eligibility requirements and require certification documentation. All projects must be "put in service" between January 1, 2006 and December 31, 2007. Many of the specific guidelines and requirements have not been released by the IRS as of March 31, 2006. As soon as these become available, Focus on Energy will post them at its Website at www.focusonenergy.com/taxincentives.

Commercial Building Systems

Commercial building owners have two options. First, they can obtain a tax deduction not to exceed \$1.80 per square foot for the design



and construction or renovation of new or existing buildings. These buildings must be designed and constructed or renovated to reduce the total annual energy and power costs of interior lighting, heating, cooling, ventilating, hot water and building envelope systems by 50 percent or more, when compared to a reference building which meets the minimum requirements of ASHRAE Standard 90.1-2001 (in effect on April 2, 2003). All buildings must be certified to qualify for this tax deduction.

Second, they can obtain a tax deduction for improvements to specific systems in new or existing buildings. This benefit can be the lesser of: 1) \$0.60 per square foot, or 2) the actual costs incurred. Efficiency improvements can be made to one or more of three qualifying building systems: building envelope, lighting, and/or heating, cooling, ventilation and hot water systems that meet goals consistent with achieving energy use 50 percent better than ASHRAE 90.1-2001 for that building system. One-third of the \$1.80 per square foot (\$.60/Ft²) may be taken as a deduction for each of the three systems that use 50 percent less energy than the ASHRAE 90.1-2001 standard for the system. All projects must be certified to qualify for the deduction.

For lighting systems, the law provides a special provision for a tax deduction that is proportional to percent of the 50 percent goal that is attained. The tax deduction may be \$0.30 to \$0.48 per square foot if energy density is 25 percent to 40 percent below ASHRAE/IESNA 90.1 watts per square foot levels. Certain lighting level and lighting control requirements must also be met in order to qualify for the partial interim lighting deductions. For example, exit signs and compact fluorescent lamps are excluded and task lighting must be permanently installed. Bi-level switching is required in most applications; it includes manual and/or automatic controls that provide two levels of lighting power in a space (not including off).

Solar Energy Systems

Commercial and industrial businesses that install qualified solar water heating and photovoltaic systems and solar fiber-optic lighting can obtain a tax credit of 30 percent of the cost of the system. If any of the cost is financed from tax-exempt bonds or subsidized energy financing, special rules apply.

Fuel Cells and Microturbines

Commercial and industrial businesses can obtain a tax credit of 30 percent of the cost (for a maximum of \$500 per 0.5 kW of capacity maximum) for installing a fuel cell. Microturbine systems qualify for a tax credit of 10 percent (for a maximum of \$200 per kW) for systems sized less than

two MW. The basis of the equipment is reduced by the amount of the tax credit for tax depreciation purposes. Existing law already provides a 10 percent tax credit for geothermal electric generation property (26 USC 48(a)).

Efficient Cars

Businesses that want to purchase hybrid gasoline-electric, hybrid diesel, battery-electric, alternative fuel and fuel cell vehicles can qualify for a tax credit. This tax credit is based on a formula determined by vehicle weight, technology, and fuel economy compared to base year models. To learn more, visit <http://www.aceee.org/transportation/hybtaxcred.htm>.

Small Biodiesel and Ethanol Producers

This tax credit will benefit small agri-biodiesel producers by offering a 10 cent per gallon tax credit for up to 15 million gallons of agri-biodiesel produced. In addition, the limit for the \$.10 per gallon tax credit on production capacity for small ethanol producers increased from 30 million to 60 million gallons. These incentives are available for tax years ending after August 8, 2005 but before January 1, 2008.