

Dear Client or Contact of McDonald Jacobs,

On August 8, President Bush signed the "Energy Policy Act of 2005" into law. This new law carries \$14.5 billion in tax incentives designed to improve energy production, transportation and efficiency. Although the Energy Act includes many new incentives for energy companies to boost energy production and efficiency, it also includes substantial **tax incentives for individuals** to make energy saving (and some energy creating) improvements to their homes. The incentives come in the form of tax credits which reduce your federal tax bill on a dollar-for-dollar basis. What's more, the credits are not phased out at higher-income levels.

Here's an overview of the new tax breaks you can look forward to in 2006, when the new tax incentives will begin. Keep in mind that you probably won't have to determine for yourself whether a home improvement creates or saves enough energy to qualify for a tax credit under the new law's complex and technical rules. In all likelihood manufacturers will certify, in the materials that come with their products, whether equipment and materials create or save enough energy to qualify for a tax credit. You will, of course, have to shop around for the best deal and the best product. You will also have to conclude whether your use of the equipment qualifies you for tax breaks, and how to make the best use of them. Any one of our tax advisors at McDonald Jacobs will be able to help you make this determination.

### **New tax credits for solar and fuel-cell equipment**

You will be able to claim a tax credit each year for:

- (1) 30% of the cost of equipment that uses solar energy to generate electricity (photovoltaic property), up to a \$2,000 maximum tax credit.
- (2) 30% of the cost of solar water heating equipment, up to a \$2,000 maximum tax credit.
- (3) 30% of the cost of a fuel cell power plant (new technology that converts fuel into electricity using electromechanical methods, and meets other detailed requirements), up to a \$500 maximum tax credit.

"Cost" includes installation as well as hardware costs. The equipment in the first two categories may be installed in your main home or second home (e.g., vacation home); the equipment in the third category must be installed in your main home. "Home" includes a co-op or condo as well as a traditional house. All three types of equipment must be installed in a home located in the U.S., and can't be used to heat a swimming pool or hot tub. Tax credits for solar and fuel-cell property will only be available for equipment placed in service in 2006 or 2007.

**Illustration:** In 2006, you buy \$8,000 of solar energy equipment and install it in your main home; you buy another \$4,000 of solar water heating equipment and install it in your vacation home. Your total tax credit for 2006 is \$3,200, consisting of:

- \$2,000 for the solar energy equipment (30% of \$8,000 is \$2,400, but the credit limit is \$2,000); plus
- \$1,200 for the solar water heating equipment (30% of \$4,000).

In 2007, you buy \$6,000 of solar energy equipment for your second home. When you file your return for the 2007 tax year, you'll be able to claim another \$1,800 tax credit (30% of \$6,000).

### **New tax credits for energy efficient improvements**

You will be able to claim a tax credit for buying an assortment of energy saving improvements and installing them in your main home. The credit depends on the type of improvement plus there's an overall lifetime dollar limit for all improvements.

The credit per improvement is:

- 10% of the cost of energy efficient building envelope components. These consist of: insulation materials or systems that reduce heat loss/gain; exterior windows (including skylights); exterior doors; and certain metal roofs with special coatings designed to reduce heat gain. You must be the first user of the equipment, which must be expected to last for at least five years.
- Up to \$300 tax credit for the cost of energy-efficient building property (electric heat pump water heater, electric heat pump; geothermal heat pump, central air conditioner, and natural gas, propane, or oil water heater meeting specific energy efficiency standards).
- Up to \$150 credit for a natural gas, propane, or oil furnace or hot water boiler.
- Up to \$50 credit for an advanced main air circulating fan.

Your overall lifetime tax credit for all of the above improvements is \$500, but only \$200 of this credit amount may be for buying and installing energy-saving windows. Tax credits for energy efficient improvements will only be available for equipment placed in service in 2006 or 2007.

**Illustration:** In 2006, you spend \$3,000 of certified energy efficient insulation for your main home, and install certified energy efficient windows costing \$2,000. In 2007, you spend \$2,000 on a new certified energy efficient natural gas boiler for your main home. For 2006, you may claim a \$500 tax credit (10% of the \$3,000 insulation, plus 10% of the \$2,000 windows). You've attained your lifetime maximum, so there's no tax credit for the boiler you install in 2007.

As you can see, the Energy Act has created substantial tax incentives for homeowners to upgrade and add equipment that generates electricity or uses less electricity or other energy. For more details on how you and your residence(s) can benefit from the Energy Act, I encourage you to call your McDonald Jacobs tax advisor at (503)-227-0581.