

**OVERVIEW OF THE  
ENERGY TAX INCENTIVES ACT OF 2005  
AND  
SAFE, ACCOUNTABLE, FLEXIBLE, EFFICIENT,  
TRANSPORTATION EQUITY ACT OF 2005**

Individuals are the recipients of two significant changes made by the above two Acts.

1. Prospective car and light truck purchasers will have new incentives to purchase a vehicle powered by other than a traditional gasoline engine. Due to certain restrictions in the statute, anyone contemplating such a purchase in the near future should study their options and consider deciding sooner than later.

The Energy Tax Incentives Act creates four new tax credits to encourage the development, manufacture, and use of alternative fuel motor vehicles. The credits are collectively claimed under the title of “**Alternative Motor Vehicle Credit**”. The Clean Fuel deduction is repealed for vehicles purchased after Dec 31, 2005.

The common elements in each of the four credits are the following:

1. The original use of the vehicle commences with the taxpayer
2. The vehicle is acquired for use or lease by the taxpayer and not for resale, and
3. The vehicle is made by a manufacturer.

For vehicles used in a trade or business, it is part of, and subject to the rules of, the general business credit. Also, as you would expect, the basis of the vehicle is reduced by the amount of the credit allowed.

For individuals, the credit comes after all of the personal credits, and is limited by tentative AMT.

**New Qualified Fuel Cell Motor Vehicle Credit**

The vehicle must be propelled by power derived from one or more cells which convert chemical energy directly into electricity by combining oxygen with hydrogen fuel.

The credit amounts are as follows:

less than 8,500 lbs	\$8,000
if placed in service after 2009	\$4,000
8,500 - 14,000 lbs	\$10,000
14,000 - 26,000 lbs	\$20,000

more than 26,000 lbs \$40,000

Also, passenger autos or light trucks that are extremely fuel efficient (based on 2002 city fuel economy standards) can get an additional credit from \$1,000 - \$4,000.

The credit applies from 2006 - 2014.

### **New Advanced Lean Burn Technology Motor Vehicle Credit**

An eligible vehicle must be a passenger automobile or light truck with an internal combustion engine which:

is designed to operate primarily using more air than is necessary for complete combustion of the fuel,

incorporates direct injection, and

achieves at least 125% of the 2002 model year city fuel economy standards.

The credit amounts are as follows:

125 - 150% of 2002 standard	\$400
150 - 175%	\$800
175 - 200%	\$1,200
200 - 225%	\$1,600
225 - 250%	\$2,000
250% or greater	\$2,400

There may be an additional Conservation credit of \$250 - \$1,000, depending on the vehicle.

Also, the credit is reduced after a manufacturer has sold a combined 60,000 Lean Burn and Qualified Hybrid Motor Vehicles after 12/31/2005. This is designed to favor domestic manufacturers over companies like Toyota, which already have an established market.

The Credit expires for vehicles purchased after 12/31/2010.

### **New Qualified Hybrid Motor Vehicle Credit**

The vehicle must draw propulsion energy from onboard sources of stored energy that are both and internal combustion or heat engine using consumable fuel, and a rechargeable energy storage system.

The term “qualified hybrid motor vehicle” shall **not** include any vehicle which is not a passenger

automobile or light truck if the vehicle has a gross vehicle weight of less than 8,500 lbs.

**Comment:** This, apparently, is an attempt by Congress to exclude buyers of sport utility vehicles (SUV's) from claiming the qualified motor vehicle credit.

The credit amounts are as follows:

125 - 150% of 2002 fuel standard	\$400
150 - 175%	\$800
175 - 200%	\$1,200
200 - 225%	\$1,600
225 - 250%	\$2,000
250% or greater	\$2,400

Again, depending on the vehicle, an additional conservation credit of \$250 - \$1,000 may be available.

The credit expires for vehicles purchased after 12/31/2010.

### **New Qualified Alternative Fuel Motor Vehicle Credit**

The only requirement is that the vehicle is only capable of operating using an alternative fuel.

“Alternative Fuels” are compressed natural gas, liquefied natural gas, liquefied petroleum gas, hydrogen, and any liquid at least 85% of the volume of which consists of methanol.

**Comment:** This definition of alternative fuels does not include ethanol or other alcohols as does the definition of clean fuel under IRC 179A(e)(1).

The credit amount is computed as follows:

The incremental cost of the vehicle times 50%, or an addition 30% if the vehicle is ultra-clean.

The “Incremental Cost” for any new alternative fuel motor vehicle is equal to the excess of MSRP over the MSRP for the equivalent gas or diesel model.

The incremental cost available for the credit cannot exceed the following:

vehicle weight 8,500 lbs or less	\$5,000
8,500 - 14,000 lbs	\$10,000
14,000 - 26,000 lbs	\$25,000
greater than 26,000 lbs	\$40,000

Mixed fuel vehicles may be able to claim a reduced credit. A mixed fuel vehicle is: a vehicle whose gross vehicle weight rating is more than 14,000 lbs, and is certified by the manufacturer as being able to perform efficiently in normal operation on a combination of an alternative fuel and a petroleum based fuel.

The credit is based on the percentage of the alt fuel mixture used by the vehicle.

The credit expires for vehicles purchased after 12/31/2010.

### **Additional Miscellaneous Provisions**

The excise tax imposed on the sale by the manufacturer or importer on “gas guzzlers” is repealed for limousines.

**Comment:** This must be important. It takes effect October 1, 2005.

2. Homeowners were not totally left out of the energy bill. There is a lifetime credit of up to \$500 for energy efficient improvements made to an existing residence in 2006 and 2007. There is also credit available for the installation of solar or photovoltaic or fuel cell property of up to \$2,000 per year.

### **Residential Energy Property Credit**

A tax credit of up to \$500 is available to individuals for nonbusiness energy property, such as residential exterior doors and windows, insulation, heat pumps, furnaces, central air conditioners, and water heaters. The credit is equal to (1), 10% of the costs of qualified energy improvements (insulation, windows, skylights, exterior doors), plus (2), the cost of qualified residential energy property (heat pumps, water heaters, furnaces, central air, etc). There is a max credit of \$200 for windows, \$50 for a main air circulating fan, \$150 for any qualified natural gas or propane furnace, and \$300 for any item of energy efficient building property.

### **Credit for Residential Alternative Energy Expenditures**

A tax credit is available to help individual taxpayers pay for residential alternative energy equipment. The credit is 30% of the cost of eligible solar water heaters, solar electricity equipment, and fuel cell plants. The maximum credit is \$2,000 per year for **each** category of solar equipment, and \$500 for each half kilowatt of capacity of fuel cells installed per year. Eligible equipment must be placed in service after 12/31/2005 and before 2008.

Note: The credit can only be used to offset regular tax to the extent of tentative AMT. The unused credits can be carried forward. It is also non-refundable.

Solar water heating property are panels that are used for water heating. The credit does not apply to expenditures that are properly allocable to a swimming pool, hot tub, or any other medium that has a function other than energy storage. Homemade, uncertified solar waters are not eligible for the credit.

Qualified fuel cell property. Portable fuel cell generators are available for home use. However, they do not appear to be eligible for the credit because they are not “installed” on or in connection with the home, and the “integrated system” requirement may require the fuel cell to be connected to the grid.

An interesting nuance: second and vacation home installations are eligible for the solar heater and photovoltaic credits. However, there is a principal residence requirement for the fuel cell property.

## General Small Business Provisions

### Section 197 Intangibles

This provision has nothing to do with either energy or highways, but somehow made it into the Energy Act as a revenue offset.

Section 197 intangibles are items such as goodwill, going concern, covenant not to compete, and things such as patents and client databases. They are required to be amortized over 15 years straight-line. Section 1245 provides that gain on depreciable property must be recaptured as ordinary income to the extent of depreciation previously claimed. The recapture amount is computed separately for each item of property. Section 197 intangibles are treated as 1245 property for this purpose.

New Law - If multiple Section 197 assets are sold or disposed of in a single transaction or series of transactions, the seller must calculate recapture as if **all** the Section 197 intangibles were a single asset. Thus, any gain on the sale of the intangibles is recaptured as ordinary income to the extent of deductions claimed on **any** of the Section 197 intangibles.

The new law makes the allocation of sale proceeds unnecessary for purposes of determining the amortization recapture amount.

The new law **does not apply** to any 197 intangible with respect to which the adjusted basis exceeds FMV.

### Energy Efficient Commercial Buildings Property Deduction

Taxpayers may claim a deduction for costs associated with energy-efficient commercial building property placed in service after 12/31/2005 and before 01/01/2008. The maximum amount that can be deducted is \$1.80 per square foot.

Energy-efficient commercial building property must be depreciable or amortizable property that is installed in a domestic building, that is within the scope of Standard 90.1-2001. Secondly, the property must be installed as part of:

The interior lighting system  
the heating, cooling, ventilation and hot water systems, or  
the building envelope.

Third, the property must be installed pursuant to a plan intended to reduce the total annual energy and power costs of the building (with respect to interior lighting, heating, cooling, ventilation, and hot water supply systems) by 50% or more in comparison to a reference building that meets the minimum requirements of Standard 90.1-2001. Such a plan must be certified by the IRS.

## **Business Solar Investment Tax Credit**

The business investment tax credit for solar energy property is increased from 10% to 30%.

**Comment:** The credit for solar energy property, hybrid solar lighting systems and qualified fuel cell property is 30%. For any other energy property, the credit percentage is 10%.

The increased credit applies to (1) equipment which uses solar energy to generate electricity, to heat or cool (or provide hot water for use in) a structure, or to provide solar process heat, and (2) equipment which uses solar energy to illuminate the inside of a structure using fiber-optic distributed sunlight, effective for periods ending before 01/01/2008.