

Overview of Tax Credit Provisions in the *American Recovery and Reinvestment Act of 2009* (otherwise known as the “Stimulus Package”)

The American Recovery and Reinvestment Act of 2009 (ARRA) was signed into law by President Obama on February 17, 2009. Included in the many provisions of the ARRA were modifications to Section 25C, the Internal Revenue Code, which affect the personal income tax credits available to taxpayers who make certain energy efficiency improvements in their principal residence.

What provisions are made for credits on water heaters?

- A taxpayer can claim up to 30% of the costs incurred to purchase and install a natural gas, propane, or oil water heater “which has either an energy factor of at least 0.82 or a thermal efficiency of at least 90 percent”, or for a heat pump water heater with an EF of at least 2.0. The wording of Section 25C allows the credit to cover the cost of the heater and the labor cost of installation, but not the cost of the materials needed for the installation. This is confirmed by paragraph 5.04 of IRS Notice 2006-26 regarding the credit, which states that the credit is based on the cost of the item “and expenditures for *labor costs properly allocable* to the onsite preparation, assembly, or original installation of the property.” (Emphasis added.)

What are the limitations?

- A VERY IMPORTANT, BUT CONFUSING, DOLLAR LIMITATION: The total credit allowed for tax years 2009 and 2010 for a taxpayer is \$1,500. This cap is determined by applying the 30% to the total of amounts paid or incurred for qualified energy improvements AND qualified energy property expenditures during the tax years 2009 and 2010.
 - Qualified energy improvements are primarily building envelope components which meet specific criteria, and have an expected life of at least 5 years, such as:
 - An Energy Star metal roof
 - Improved insulation
 - Windows, doors, and skylights
 - Other components complying with specific criteria in the International Energy Conservation Code
 - Qualified energy properties include, in addition to the water heaters described above, the following items that meet specified performance levels:
 - Central air conditioners
 - Electric heat pumps (HVAC)
 - Natural gas, propane, or oil furnaces or hot water boilers (which are rated in AFUE)
 - Advanced main air circulating fans
 - Biomass fuel stoves
 - Wood stoves
- Location limitations: The heater must be installed in a dwelling in the United States, and used as the taxpayer’s principal residence.
- It must be originally placed into service by the taxpayer claiming the credit.
- Time limitations: The heater must be placed into service after February 17, 2009 (when the ARRA was signed into law) and before January 1, 2011.
 - *Note: If it was installed between January 1, 2009, and February 16, 2009, it would be eligible for the \$300 tax credit in effect under the provisions of the Energy Improvement and Extension Act (EIEA) of 2008. The credit allowed under the EIEA provisions was superseded by the ARRA provisions, upon enactment of ARRA.*

What exactly does this all mean?

- If all a taxpayer installs is a qualifying water heater, it's easy – they can claim a credit for 30% of the cost of the heater plus the cost of the installation labor when filing income taxes for the year that they install it (so long as it is either 2009 or 2010). Example: If they install a heater in March, 2009, for a total cost of heater and installation labor of \$2,000, they can claim a credit of \$600 on their 2009 income tax return.
- If they make several qualifying energy improvements in their house in 2009 (say more insulation and new windows), along with buying a new water heater, a new furnace, and a new air conditioner (all of which meet the qualifying performance levels), and the entire cost of remodeling is \$50,000, then they can claim the maximum credit of \$1,500 on their 2009 taxes. Thirty percent of \$50,000 is \$15,000, but the cap of \$1,500 applies.
- If they make \$4,000 of qualified improvements in 2009, they can claim a credit of \$1,200 on their 2009 taxes. Then, in 2010, they install a qualifying water heater for a cost of \$2,000. Even though 30% of \$2,000 is \$600, they can only claim a credit of \$300 on their 2010 taxes because they already claimed \$1,200 of the \$1,500 maximum allowed in 2009.