

New Tax Credits Can Offset the Costs of Energy-Efficient Home Improvements

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With energy costs soaring, some homeowners are looking for ways to make their homes more energy efficient. However, energy-efficient home improvements can be quite costly.

To make these improvements more affordable, the federal government offers tax credits to offset the costs, while some state and local governments offer additional tax credits. Thanks to the Inflation Reduction Act of 2022, two substantial federal income tax credits for energy-efficient home improvements have been extended and expanded:

- The *residential clean energy credit*
- The *energy efficient home improvement credit*

In this SWC singlette, we cover these credits and the steps you need to take to claim them.



The Residential Clean Energy Credit

The federal income tax credit for eligible energy saving home improvements, formerly called the residential energy efficient property credit, is now called the residential clean energy credit. Before explaining how the credit has changed, let's look at how it works under the "old rules" for eligible home improvements made in 2020–2022.

The Old Rules — for 2020–2022

The residential energy property credit varies, depending on when you had the work done:

- 26 percent of qualified expenditures for energy-saving home improvements in 2020–2021
- 30 percent of qualified expenditures for energy-saving home improvements in 2022 (thanks to the Inflation Reduction Act)

Note that there are no income limits. Even billionaires can take advantage of these tax credits. And given the high cost of many energy-saving home improvements, this tax credit can be substantial. For example, the credit for installation of a new \$35,000 geothermal system in 2022 is \$10,500!

Qualified expenditures include costs for site preparation, assembly, installation, piping, and wiring for the following:

1. Qualified solar electricity generating equipment for your U.S. residence, including a vacation home.
2. Qualified solar water heating equipment for your U.S. residence, including a vacation home. To qualify for the credit, at least 50 percent of the energy used to heat water for the property must be generated by the solar water heating equipment. No credit is allowed for solar water heating equipment unless it is certified for performance by the nonprofit Solar Rating Certification Corporation or a comparable entity endorsed by the state in which your residence is located. Keep the certification with your tax records.
3. Qualified small wind energy equipment for a U.S. residence, including a vacation home.
4. Qualified geothermal heat pump equipment for a U.S. residence, including a vacation home.
5. Qualified fuel cell equipment for your U.S. principal residence. The maximum credit is limited to \$500 for each half kilowatt of fuel cell capacity.
6. Qualified biomass heating equipment for your U.S. residence. Credit for biomass heating equipment ends after 2022.

Prior to the Inflation Reduction Act, the residential clean energy credit percentage was scheduled to be 26 percent for 2022, dropping to 22 percent for 2023, and then disappearing after 2023. All that changed with the passage of the Inflation Reduction Act.

The New Rules — for 2023–2034

The Inflation Reduction Act changed the rules as follows:

- Increases the credit percentage to 30 percent.
- Makes the 30 percent credit available for expenditures for eligible equipment placed in service in 2022–2032.
- Reduces the credit to 26 percent for qualified equipment placed in service in 2033.
- Reduces the credit to 22 percent for qualified equipment placed in service in 2034.
- Schedules an end to the credit after 2034.

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- Makes expenditures for biomass heating equipment no longer eligible for the credit after 2022.
- Makes expenditures for qualified battery storage technology eligible for the credit for 2023–2034.

The Energy Efficient Home Improvement Credit

The *energy efficient home improvement credit*, formerly called the *nonbusiness energy property credit*, is a much less substantial tax credit intended to offset the costs of certain energy efficient home improvements, such as:

- Insulation
- Skylights
- Exterior windows and doors

The energy efficient home improvement credit also helps to cover the cost of a home energy audit and may even be claimed for certain equipment, such as electric panels or natural gas water heaters.

In the following sections, we explain how this credit applies to the cost of energy efficient home improvements in 2022 and changes you can look forward to in the coming years.

The Old Rules — for 2022

Under the old rules, which apply to energy efficient home improvements done in 2022, you can claim the following:

- 10 percent of the costs of installing certain energy-efficient insulation, skylights, windows, exterior doors, roofing, and similar energy-saving improvements.
- 100 percent of the costs associated with certain energy efficient water heaters, heat pumps, air conditioning systems, furnaces, hot water boilers, and air circulating fans.

However, the following lifetime limits severely restrict the value of the credit:

- \$500 total, so if you claimed a \$300 credit in 2021, the maximum you can claim in 2022 is \$200
- \$200 for new windows
- \$50 for circulating fans
- \$150 for certain furnaces and boilers
- \$300 for certain water heaters, heat pumps, and air conditioners

The New Rules — for 2023–2032

The Inflation Reduction Act ushered in the following changes:

- Increased the credit from 10 percent to 30 percent of the costs for all eligible home improvements.
- Removed the lifetime limits.

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- Added an annual limit of \$1,200 (a special \$2,000 annual credit limit applies to specified heat pumps, heat pump water heaters, and biomass stoves and boilers)
- Expanded the list of qualifying expenditures to cover the cost of certain biomass stoves and boilers, electric panels and related equipment, and home energy audits.
- Removed roofing and air circulating fans from the list of qualifying home improvements.

Additional annual credit limits also apply:

- \$600 for residential energy property expenditures, windows, and skylights
- \$250 for any one exterior door and a total of \$500 for all exterior doors

For specified property items placed in service after 2024, no credit will be allowed unless:

1. The item is produced by a qualified manufacturer, and
2. You include the qualified product identification number of the item when attempting to claim the energy efficient home improvement credit

Pro Tip No. 1: *With the removal of the lifetime limits, it makes sense for homeowners to schedule their energy efficient home improvements over the course of multiple years to maximize their qualified credit. For example, if your home has two exterior doors, you may want to replace one door this year and the other next year.*

Claiming the Credits

As your tax professional prepares your tax returns, they can help you claim all the tax credits for which you're eligible. And here at SWC, we need you to provide us with the information and documentation required to claim the credit.

For example:

- Be sure to work with reputable and reliable home-improvement contractors who can provide you with the documentation you need to claim these valuable credits. Documentation may include receipts, certification from approved manufacturers, product identification numbers, and dates.
- Keep a detailed record, including receipts, to prove how much you spent on qualifying equipment and any extra costs for site preparation, assembly, and installation.
- Keep records to show when installations are completed and placed in service because credits can only be claimed for the year when that happens.

Pro Tip No. 2: *You can increase the tax basis of your home by the amount of expenditures that qualify for the credits explained in this singlette, but you must then reduce the basis by the amount of credits claimed. Your CPA can crunch the numbers for you while preparing your tax returns.*

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State and Local Tax Incentives and Rebates

Although the federal tax credits we present in this singlette may offer the biggest savings on your energy efficient home improvements, they're probably not the only incentives available. You may also be eligible for the following:

- State and local tax benefits
- Subsidized state and local financing deals
- Utility company rebates

Working with licensed contractors who are well-informed about these and other benefits is often the savviest approach to determining what you may be eligible for. Some may even help you through the process of filing a claim and ensuring you have the required documentation.

We're also here to help. It's a whole new-and-improved ballgame for federal residential energy tax credits. Federal, state, and local governing bodies; utility companies; and home improvement contractors are all highly motivated to transition to a green economy. And that can benefit you as a homeowner as well, by saving both on home improvements and energy costs.

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