

# ABOUT INVESTMENT TAX CREDITS

## What Are Federal Energy Investment Tax Credits (ITCs)?\*

The federal energy Investment Tax Credits available under 26 USC § 48 were expanded significantly by the Energy Improvement and Extension Act of 2008 (H.R. 1424), enacted in October 2008. The new law extended the duration, by eight years, of the existing credits for solar energy, fuel cells and microturbines; increased the credit amount for fuel cells; established new credits for small wind-energy systems, geothermal heat pumps, and combined heat and power (CHP) systems; extended eligibility for the credits to utilities; and allowed taxpayers to take the credit against the alternative minimum tax (AMT), subject to certain limitations. Credits are available for eligible systems placed into service on or before December 31, 2016. The credit for geothermal property, with the exception of geothermal heat pumps, has no stated expiration date. The credit for solar energy property reverts to 10% after December 31, 2016.

**Solar:** The credit is equal to 30% of expenditures, with no maximum credit limit stated. Eligible solar energy property includes equipment that 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. (Passive solar systems and solar pool-heating systems are not eligible.) Hybrid solar lighting systems are those that use solar energy to illuminate the inside of a structure using fiber-optic distributed sunlight.

**Fuel Cells:** The credit is equal to 30% of expenditures, with no maximum credit limit stated. The credit for fuel cells is capped at \$1,500 per 0.5 kilowatt (kW) of capacity. Eligible property includes fuel cells with a minimum capacity of 0.5 kW that have an electricity-only generation efficiency of 30% or higher. (Note that the credit for property placed into service on or before October 3, 2008, is capped at \$500 per 0.5 kW.)

**Small Wind Turbines:** The credit is equal to 30% of expenditures, with a maximum credit of \$4,000. Eligible small wind property includes wind turbines up to 100 kW in capacity. This credit applies to eligible property placed into service after October 3, 2008.

**Geothermal Systems:** The credit is equal to 10% of expenditures, with no maximum credit limit stated. Eligible geothermal energy property includes geothermal heat pumps and equipment used to produce, distribute or use energy derived from a geothermal deposit. For electricity produced by geothermal power, equipment qualifies only up to, but not including, the electric transmission stage. For geothermal heat pumps, this credit applies to eligible property placed into service after October 3, 2008.

**Microturbines:** The credit is equal to 10% of expenditures, with no maximum credit limit stated. The credit for microturbines is capped at \$200 per kW of capacity. Eligible property includes microturbines up to two megawatts (MW) in capacity that have an electricity-only generation efficiency of 26% or higher.

**Combined Heat and Power:** The credit is equal to 10% of expenditures, with no maximum limit stated. Eligible CHP property generally includes systems up to 50 MW in capacity that exceed 60% energy efficiency, subject to certain limitations and reductions for large systems. The efficiency requirement does not apply to CHP systems that use biomass for at least 90% of the system's energy source, but the credit may be reduced for less-efficient systems. This credit applies to eligible property placed into service after October 3, 2008.

In general, the original use of the equipment must begin with the taxpayer, or the system must be constructed by the taxpayer. The equipment must also meet any performance and quality standards in effect at the time the equipment is acquired. The energy property must be operational in the year in which the credit is first taken.

If the project is financed in whole or in part by subsidized energy financing or by tax-exempt private activity bonds, the basis on which the credit is calculated must be reduced. Subsidized energy financing means "financing provided under a federal, state, or local program, a principal purpose of which is to provide subsidized financing for projects designed to conserve or produce energy." Therefore, a business must reduce the basis for calculating the credit by the amount of any such incentives received. Businesses who receive other incentives are advised to consult with a tax professional regarding how to calculate this federal tax credit.

## What Is the 5-Year Modified Accelerated Cost-Recovery System (MACRS)?\*

Under the federal Modified Accelerated Cost-Recovery System ("MACRS"), businesses may recover investments in certain property through depreciation deductions. The MACRS establishes a set of class lives for various types of property, ranging from three to 50 years, over which the property may be depreciated. For solar, wind and geothermal property placed in service after 1986, the current MACRS property class is five years. For certain biomass property, the MACRS property class life is seven years. Eligible biomass property generally includes assets used in the conversion of biomass to heat or to a solid, liquid or gaseous fuel, and to equipment and structures used to receive, handle, collect and process biomass in a waterwall, combustion system, or refuse-derived fuel system to create hot water, gas, steam and electricity.

The Federal Energy Policy Act of 2005 classified fuel cells, microturbines and solar hybrid lighting technologies as five-year property as well. The federal Economic Stimulus Act of 2008, enacted in February 2008, included a 50% bonus depreciation provision for eligible renewable-energy systems acquired and placed in service in 2008. To qualify for bonus depreciation, a project must satisfy these criteria: the property must have a recovery period of 20 years or less under normal federal tax depreciation rules;

- the original use of the property must commence with the taxpayer claiming the deduction;
- the property generally must be acquired during 2008; and
- the property must be placed in service during 2008 (or, in certain limited cases, in 2009).

If property meets these requirements, the owner is entitled to deduct 50% of the adjusted basis of the property in 2008. The remaining 50% of the adjusted basis of the property is depreciated over the ordinary depreciation schedule. The bonus depreciation rules do not override the depreciation limit applicable to projects qualifying for the federal business energy tax credit. Before calculating depreciation for such a project, including any bonus depreciation, the adjusted basis of the project must be reduced by one-half of the amount of the energy credit for which the project qualifies.

\*Source: Database of State Incentives for Renewables & Efficiency - <http://www.dsireusa.org>



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