

# Energy Bill Gives Breaks to Home Improvers

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Unless you plan to drill for oil in your backyard, you won't reap a lot of tax breaks from the energy bill approved by Congress last week. Most of the \$14.5 billion in tax incentives went to oil and gas companies and electric utilities. But if you're interested in making your home more energy efficient or buying a hybrid car, you may be able to shave some money from your tax bill.

## **Efficient homes**

You can claim a tax credit of up to 10% of the cost of energy-saving home improvements, up to a lifetime maximum of \$500. Tax credits are more valuable than deductions because they represent a dollar-for-dollar reduction in your tax bill. You don't have to itemize to claim them.

The credit is limited to improvements made between Dec. 31, 2005, and Jan. 1, 2008. The amount you can claim for specific improvements is capped, but you can do a combination to reach the \$500 limit.

## **Eligible upgrades include:**

- Insulation or similar systems designed to reduce the loss of heat or air conditioning. Adding insulation is a good idea even without the tax benefit, says Brian Castelli, executive vice president of the Alliance to Save Energy. Many older homes have insulation that met the minimum code requirements at the time they were built, "And codes have changed," he says. Plus, "Insulation is not an expensive upgrade," he says.
- New exterior windows. The credit for windows is capped at \$200, and if you have a lot of windows, that won't go very far. Still, it will offset some of the cost, and installing energy-efficient windows is one of the most effective ways to reduce your energy bills, Castelli says.
- A highly efficient central air conditioner, heat pump or water heater. The credit for these purchases is capped at \$300. Homeowners who install a highly efficient furnace or boiler can claim up to \$150.
- Homeowners who install solar-powered hot-water systems are eligible for a credit worth 30% of the cost, up to \$2,000. Solar heaters installed for hot tubs or swimming pools aren't eligible.

Taxpayers may also get an indirect benefit from business tax breaks in the energy bill. The bill includes tax credits for contractors who build energy-efficient homes and manufacturers who make energy-efficient appliances. The incentives could lower prices for consumers, Castelli says. Base your home-improvement decisions on energy savings, not the size of the tax credit, says Steve Baden, executive director of Residential Energy Services Network, a non-profit that promotes energy-efficient homes and businesses.

"Just because it costs more doesn't mean you're going to get more return on the investment," he says.

Baden recommends getting an energy rating for your home to determine which improvements will deliver the biggest reductions in energy bills. The cost ranges from \$350 to \$450, he says. You can locate a certified energy rater at [www.natresnet.org](http://www.natresnet.org).

### **Hybrid cars**

The energy bill also includes a new tax credit for buyers of hybrid cars, which combine an electric motor with an internal-combustion engine. Starting next year, hybrid-car buyers will be eligible for tax credits ranging from \$1,700 to \$3,000. The credit will be tied to two components: hybrids that save the most fuel compared with 2002 models, and the vehicle's estimated lifetime fuel savings.

The credit will take effect Jan. 1, replacing the existing \$2,000 tax deduction for hybrid vehicles. That deduction was scheduled to fall to \$500 next year. Because a tax credit is worth more than a deduction, the law provides a greater incentive to buy a hybrid after Jan. 1, according to an analysis by CCH, the tax publishing company.

But there's a potential penalty for waiting too long to buy. The law limits the tax credits to 60,000 vehicles from each automaker, so credits on popular models could disappear well before the tax break expires at the end of 2009.

### **The AMT problem**

A quirk in the tax law may prevent many upper-middle-income homeowners and car buyers from getting the tax break, says Mel Schwarz, tax legislation director for accounting firm Grant Thornton.

Unless Congress changes the law, individual taxpayers who are subject to the alternative minimum tax will be ineligible for the new credits, Schwarz says.

A provision in the tax code has the effect of exempting this type of credit from the AMT, but it expires at the end of 2005, he says. The AMT, a parallel tax system originally designed to target the very wealthy, threatens to affect 20 million taxpayers next year.

A tax-reform panel has recommended eliminating the tax, but repeal would cost \$1.2 trillion over the next decade.



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