



IRS Nationwide Tax Forum | 2023

New and Improved §25C and 25D Credits for Taxpayers for Home Energy Credits as a Result of the Inflation Reduction Act of 2022

Presented by the

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Learning Objectives

At the end of the presentation, attendees will have a better understanding of energy efficient home improvements and residential energy property credits

More information for properly filling out Form 5695

Understand the distinction between principal residence and dwelling unit

Background of the Old Law for §25C Home Energy Credits

- The energy provisions of §25 C were temporary provisions since 2007 which constantly expired and were repeatedly extended until December 31, 2021.
- Inflation Reduction Act of 2022 retroactively extended the old law to December 31, 2022

Background of the Old Law for §25C Home Energy

- The credit had a lifetime limit of \$500
- There was a 10% credit for “qualified energy efficiency improvements”
- There was also a dollar limitation for “residential energy property expenditures”

“Qualified Energy Efficiency Improvements”

- Any energy efficient “building envelope” component that met specific “energy efficiency certification” requirements
- The “building envelope” included items on a principal residence in the United states specifically and permanently designed to reduce heat gain or heat loss

Building Envelope

- The “building envelope” items which qualified were:
- Exterior windows (limited to \$200)
- Exterior doors
- Skylights, and
- Metal roofs or asphalt roofs

Energy Efficient Building Property

- The interior of the principal residence provided credits for property such as:
- Furnaces
- Boilers
- Electric heat pumps and water heaters
- Central air conditioners
- Advanced main circulating fans

Retroactive to January 1, 2022

- All §25 C credits which had expired December 31, 2021 were retroactively reinstated only for 2022
- §25C is a nonrefundable credit
- Lifetime limitation of \$500
- Reported on Form 5695, Page 2

§25C Credits After December 31, 2022

- The new §25C credit is available for tax years 2023 through 2032
- There is now a 30% credit for the sum of:
 - a. the amount paid or incurred by the taxpayer for “qualified energy efficiency improvements” installed during the year, plus
 - b. the amount of “residential energy property expenditures” paid or incurred by the taxpayer during the year

New Law “Qualified Energy Efficiency Improvements”

- Revises the energy efficiency certification requirements for “building envelope components”
- Eliminates the treatment of roofs as “building envelope components”
- Adds “air sealing insulation” to the definition of “building envelope component”

Revised Definition of “Residential Energy Property Expenditures”

- Repeals the requirement that “residential energy property expenditures” must be made with respect to the taxpayer’s “principal residence”.
- Therefore, “dwelling units” used as a residence are permitted for purposes of the credit

“Dwelling Unit” Defined

- A “dwelling unit” is any property where the taxpayer can cook, and sleep and the property has a bathroom
- Mobile homes and boats qualify as “dwelling units”

“Residential Energy Property” Defined

- “Residential energy property” expenditures are those made by the taxpayer for “qualified property” which is:
 - a. installed on or in connection with a “dwelling unit” located in the United States and used by the taxpayer as a residence
 - b. originally placed in service by the taxpayer, and
 - c. reasonably expected to remain in use for at least five years

“Residential Energy Property”

- “Residential energy property” includes expenditures for labor cost properly allocable to the on- site preparation, assembly, or original installation of the property

Annual Limitation Replaces Lifetime Limitation

- The \$500 lifetime limitation is replaced by an annual limitation amount of \$1,200.
- There are annual limits of \$600 for credits with respect to “residential energy property expenditures” which are defined as windows and skylights.
- There is a maximum \$250 credit for any exterior door.
- There is a maximum \$500 limit for all exterior doors.

Example #1

- In 2023 taxpayer spends **\$2,500** on Energy Star most-efficient windows, **\$700** on one Energy Star “exterior” door and **\$900** on a second Energy Star “exterior” door.

Taxpayer’s credit is calculated as follows:

- **Total Windows:** $\$2,500 \times 30\% = \750 : the credit is the *lesser* of \$750 or \$600. Therefore, the taxpayer’s credit for all windows is limited to **\$600**.
- **Exterior Door #1:** $\$700 \times 30\% = \210 : the credit is the *lesser* of \$250 or \$210. Therefore, the taxpayer’s credit for Door #1 is limited to **\$210**.

Example#1 continued

- **Exterior Door #2:** : $\$900 \times 30\% = \270 : the credit is the *lesser of* \$250 or \$270. Therefore, the taxpayer's credit for Door #2 is limited to **\$250**.
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- The maximum credit for all exterior doors is \$500. The taxpayer's credit for all doors is limited to the lesser of \$500 for Door #1 for **\$210** and Door #2 for **\$250** for a total of **\$460**.
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- The taxpayer's total "residential energy property expenditure" credit in 2023 is **\$1,060** which is **\$600** for all windows and **\$460** for all "exterior" doors.
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Example #2

- **Example #2:** The taxpayer adds air **sealing insulation** to his home in 2023 at a cost of **\$5,000**. His maximum credit is the lesser of **30% x \$5,000 = \$1,500** or **\$1,200**. Therefore, the taxpayer's maximum credit for 2023 is limited to **\$1,200**.

Separate Annual §25C Credit for Specified Energy Savings Improvements

- In addition to the annual §25C credit already discussed, there is an additional **separate \$2,000 §25C** annual credit for property installed in the taxpayer's residence for specified:
 - Heat pumps,
 - Heat pump water heaters, and
 - Biomass stoves and boilers.

Special Credit for Heat Pump and Biomass Stoves and Boilers

- The \$1,200 annual limit and the \$600 residential energy property limit do not apply to heat pumps and biomass stoves and boilers.
- Heat pumps and biomass stoves and boilers have a separate annual maximum credit of \$2,000.

Additional Separate Annual credit

- A taxpayer could spend up to \$6,667 on a new heat pump or biomass stove or biomass boiler and still be eligible for the full credit of 30% of \$6,667 which is equal to \$2,000

Example of Additional §25C Credit

In 2023, taxpayer spends:

- a. \$5,000 to upgrade their home's **insulation**, and
 - b. \$6,600 to install a new **heat pump**.
 - The credit is calculated as follows:
 - For the **Insulation**, the credit is the *lesser of*:
 - a. $30\% \times \$5,000$, which equals \$1,500, or
 - b. The **maximum** annual amount of \$1,200.
- Therefore, his credit is the lower **\$1,200** amount

Example of Additional §25C Credit

- For the **Heat Pump**, the credit is the *lesser of*:
 - a. **30% x \$6,600** which equals **\$1,980**, or
 - b. the **maximum** annual amount of **\$2,000**.
- Therefore, the credit is the lesser amount of **\$1,980**.
- As a result, the total §25C credit for 2023 is **\$3,180**, which is **\$1,200** for the **insulation** and **\$1,980** for the **Heat Pump**.

Tax Professional Awareness

- The Legislation also provides that the required “energy efficiency standards” for all of these energy savings expenditures will be modified and changed to update overtime without additional legislative action by Congress.

News §25C(a)(3) Home Energy Audit

- The annual **\$1,200** credit includes an amount spent for a “home energy audit”
- A “home energy audit” is defined as an “inspection and written report” with respect to a “dwelling unit” located in the United States and owned or used by the taxpayer as the taxpayer’s “principal residence” under §121.

“Home Energy Audit” Specifications

- The purpose of a “home energy audit” is to identify the most significant and cost-effective energy efficiency improvements with respect to such dwelling unit.
- The audit will include an estimate of the energy and cost savings with respect to each such improvement.

“Home Energy Audit” Specifications

- The “home energy audit” must be conducted and prepared by a “home energy auditor” that meets the certification or other requirements specified by the Secretary in regulations and other guidance, as prescribed by the Secretary not later than 365 days after the date of enactment. Therefore, by August 16, 2023.

Home Energy Audit Credit Amount

- §25C(b)(6)(A) provides that the credit amount allowed with respect to a “home energy audit” cannot exceed \$150.
- There is a “substantiation requirement”.
- No credit shall be allowed **unless** the taxpayer includes with the taxpayer’s return, information or documentation as the Secretary may require.

Lack of Substantiation

- **Omission** of information or documentation will **Disallow** the credit.

“Identification Number Requirement”

- The Act provides that no credit shall be allowed with respect to any item of “specified property” placed in service *after December 31, 2024*, **unless** the item is:
 -
 - a. produced by a “qualified manufacturer”, **and**
 -
 - b. the taxpayer includes the “qualified product identification number” of the item on the return of tax for the tax year.

“Qualified Product Identification Number” Defined

- The term “qualified product identification number” is the product identification number assigned to an item of “qualified property” by the “qualified manufacturer” under a methodology (including alphanumeric) that will ensure that the number is unique to such item

“Qualified Manufacturer” Defined

- A “qualified manufacturer” is defined as any manufacturer of “specified property” which enters into an agreement with the Secretary which provides that the manufacturer will comply with the “product identification number requirements”.

Requirements of the “Qualified Manufacturer”

- The “qualified manufacturer” must label the item with such number in such manner as the Secretary may provide and must make periodic written reports (at such times and in such manner) as the Secretary may provide of the “product identification numbers”.

Omission of a Correct “Product Identification Number”

- An omission of a correct “product identification number” is treated as a mathematical or clerical error subject to the “summary assessment” and abatement procedure for such error.
- A “summary assessment” disallows the taxpayer the right to submit a petition to Tax Court for resolution.

Effective Dates of Provisions

- These provisions generally apply to property placed in service after December 31, 2022.
- The “product identification number requirement” applies to property placed in service after December 31, 2024

Extension and Modification of §25D “Residential Clean Energy Credit”

- Before the enactment of the Inflation Reduction Act of 2022, §25D(a) provided that individual taxpayers were allowed a personal tax credit, known as the “residential energy efficient property” (REEP) credit, for:
 - a. solar electric,
 - b. solar hot water,
 - c. fuel cell,
 - d. small wind energy,
 - e. geothermal heat pump, and
 - f. biomass fuel property installed in homes.

Background of the §25D Credit

- Before the Inflation Reduction Act of 2022, for property placed in service *after* **December 31, 2019**, and *before* **January 1, 2023**, the REEP credit rate had an “applicable percentage” which was **26%**.
- Therefore, the REEP credit was **26%** of the taxpayer’s “qualified expenditures”.

Background of the §25D Credit

- The old law also provided that for property placed in service *after December 31, 2022*, and *before January 1, 2024*, the “applicable percentage” was scheduled to be **22%**.

Changes Made by the Inflation Reduction Act of 2022

- Provides that the credit is available for property installed in years *before* 2035.
- The Act also makes the credit available for “qualified battery storage technology” expenditures.

“Qualified Battery Storage Technology” Expenditures Defined

“Qualified battery storage technology expenditure” as an expenditure for battery storage which:

- a. Is installed in connection with a “dwelling unit” located in the United States and used as a residence by the taxpayer, and
- b. Has a capacity of not less than 3 kilowatt hours.

Increase in Credit Percentages

§25D(g) now provides that the “applicable rate” is:

- a. 26% for property placed in service *before* January 1, 2022,
- b. 30% for property placed in service *after* December 31, 2021, and *before* January 1, 2033,
- c. 26% for property placed in service *after* December 31, 2032, and *before* January 1, 2034, and
- d. 22% for property placed in service *after* December 31, 2033, and *before* January 1, 2035.

“Qualified Battery Storage Technology” Expenditures

- “Qualified battery storage technology” expenditures qualify for the credit for the expenditures made *after* **December 31, 2022.**

Example: Property Installed in 2022-2032

- **Example #1:** Taxpayer installs a **\$20,000** solar panel system on his dwelling unit that he uses as a home in **2022**. His credit is **30%** of the cost of the **\$20,000** expenditure for the system. As a result, his credit is **\$6,000**.



Example: Placed in Service in 2033

- **Example #2:** If the taxpayer waits to install the \$20,000 solar panel system on his dwelling unit that he uses as a home in **2033**, then his credit will be only **26%** of the \$20,000 expenditure for the system. As a result, his credit will be **limited** to **\$5,200**.

Nonrefundable Credit With Carry forward

- The **§25D** Residential Clean Energy Credit is not a refundable credit but it can be carried forward to reduce the taxpayer's tax liability in future years.

Applicable Costs for §25D Property

For purposes **§25D** credits, costs are treated as being paid:

- a. when the original installation of the item is completed, or
- b. in the case of costs connected with the reconstruction of the taxpayer's home, when the original use of the reconstructed home begins.

Year to Report the §25D Credit

- For purposes of the §25D residential clean energy credit, costs connected with the **construction** of a home are treated as being paid **when** the taxpayer's original **use** of the constructed home begins.
- If less than 80% of the use of an item is for nonbusiness purposes, then only that portion of the costs that is allocable to the nonbusiness use can be used to determine the §25D credit.

Subsidies Received

- If the taxpayer receives a subsidy from a public utility for the purchase or installation of an energy conservation product and that subsidy was not included in the taxpayer's gross income, then the taxpayer must reduce the cost of the product by the amount of that subsidy before calculating the §25D credit.
- This rule also applies if a third party (such as a contractor) receives the subsidy on the taxpayer's behalf.

The Condominiums and Cooperative Housing Associations

- If a cooperative housing association installs property or improvements that qualify for a credit under **§25C** or **§25D**, then the tenant-stockholders of the corporation can claim the credit in much the same way they claim an itemized deduction for property taxes.
- Therefore, the expenditure is allocated to the tenant-stockholder on their “proportionate share” of the expenditure.

The Condominiums and Cooperative Housing Associations

- Taxpayer is an owner in a housing cooperative and owns 55 shares, which is 2.8947% of the total outstanding stock in the corporation's 1,900 shares. If the building spends **\$60,000** in 2025 to replace some of the windows with Energy Star most efficient windows, then the taxpayer can report on their 2025 personal tax return that they spent **\$1,737** on the windows and claim a **§25C** credit of **\$521**.
- Also, if the taxpayer spent the **\$1,737** on their own for the windows without going through the housing cooperative, then the taxpayer is still eligible for the **§25C** credit.

The Condominiums and Cooperative Housing Associations

- A taxpayer would have the same treatment if the property was **§25D** property such as solar panels on the roof of the cooperative building.

Refer to the Office of Chief Counsel's letter in IRS Information Letter 2010-0244, which ruled that when a tenant-stockholder arranges for and purchases the improvement themselves, they are entitled to a credit based on the entire expenditure.

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