



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
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OFFICE OF THE CHIEF COUNSEL

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The Honorable Bernard Sanders  
United States Senator  
1 Church Street, 2<sup>nd</sup> Floor  
Burlington, VT 05401

Attention:

Dear Senator Sanders:

I am responding to your inquiry dated February 1, 2011, on behalf of your constituent, . asked about the tax credit for a qualified geothermal heat pump property.

Two different credits are available for geothermal heat pump property—a 30 percent tax credit (residential credit) for a geothermal heat pump used in property that a taxpayer uses as a residence and a 10 percent business energy credit (business credit) for a geothermal heat pump that a taxpayer uses in a trade or business or for the production of income. The information from indicates that he may qualify for the residential credit on the portion of the heat pump cost allocable to the residence and for the business credit on the portion of the cost allocable to business or rental use.

#### Residential Energy Efficient Property Credit

Taxpayers can take a 30 percent tax credit on expenditures made during a taxable year for qualified geothermal heat pump property that they place in service before January 1, 2017. This residential credit is available for residential energy efficient property (section 25D of the Internal Revenue Code (the Code)). Qualified geothermal heat pump property means any equipment that uses the ground or ground water as a thermal energy source to heat the home or as a thermal energy sink to cool the home. The equipment must also meet the requirements of the Energy Star program in effect at the time that the taxpayer made the expenditure for the equipment. The labor costs for the onsite preparation, assembly, and original installation of the qualified property, and the labor costs for the piping or wiring to interconnect the property to the home are also eligible for the credit.

Taxpayers residing in either a newly constructed home or an existing home are eligible for this tax credit. A taxpayer must use the home as a residence to qualify for the credit. However, the law provides an allocation rule that may require a taxpayer to take a reduced credit if he or she uses a portion of the property for business purposes.

According to the law, if a taxpayer uses more than 20 percent of qualified geothermal heat pump property for business purposes, the taxpayer can only take the portion of the expenditures that is properly allocable to use for nonbusiness purposes. Therefore, if business use of the geothermal heat pump is more than 20 percent, he should exclude the costs of the qualified geothermal heat pump property allocable to the business use when calculating the 30 percent residential credit.

### Business Energy Credit

The law also provides a business credit for a specified percentage of the basis of certain energy property that a taxpayer places in service during a taxable year (section 48 of the Code). The business credit is not a personal credit for a residence but is part of the general business credit. It provides a 10 percent credit for the cost of equipment that uses the ground or ground water as a thermal energy source to heat a structure or as a thermal energy sink to cool a structure for periods ending before January 1, 2017. Generally, those costs that qualify for the residential credit will qualify for the business credit.

The business credit is only available for property that a taxpayer can depreciate (section 48(a)(3)(C) of the Code). Generally, a taxpayer can take a depreciation deduction for the exhaustion and wear and tear of property used in a trade or business, or of property held for the production of income, such as a rental property. A taxpayer using a dwelling unit as a residence may only depreciate the portion of the dwelling unit that the taxpayer also uses in a trade or business or for the production of income (section 167 of the Code).

Although \_\_\_\_\_ may not be able to include the full cost of the geothermal system in calculating the 30 percent residential credit, he may be eligible for the 10 percent business credit for the cost of the geothermal system allocable to his use of the system in a trade or business, or for the production of income.

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I hope this information is helpful. If  
contact or me at

or you have any questions, please  
for further assistance.

Sincerely,

Charles B. Ramsey  
Chief, Branch 6  
Office of Associate Chief Counsel  
(Passthroughs & Special Industries)