Guide to Federal Tax Incentives for Residential Geothermal Heat Pumps

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Highlights

Federal Income Tax Credit:

- 30% of total system cost
- Credit limited to $2000 for 2008
- No limit to credit amount for 2009 and beyond
- Can be used to offset AMT tax
- Can be used in more than one year
- Can be combined with solar and wind tax credits
- Can be combined with energy efficiency upgrade credits

Eligibility:

- Home must be located in the U.S.
- Does not have to be your main home
- Includes houses, apartments, condos, mobile homes
- Geothermal heat pump must meet Energy Star requirements
- Installed between 1/1/2008 and 12/31/2016

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Residential Energy-Efficient Property Credit

In October 2008, geothermal heat pumps were added to section 25D of the Internal Revenue Code, which provides a 30% tax credit for spending on qualified property placed in service through the end of 2016. The credit was made retroactive to the beginning of 2008, and was capped at $2,000. In February 2009, the $2,000 cap was removed for property placed in service after December 31, 2008.

Eligible Geothermal Heat Pump Property

The tax credit may be claimed for spending on “qualified geothermal heat pump property” installed in connection with a new or existing dwelling unit located in the United States and used as a residence by the taxpayer. It does not have to be the primary residence.

The term “qualified geothermal heat pump property” means any equipment which—

(i) uses the ground or ground water as a thermal energy source to heat the dwelling unit or as a thermal energy sink to cool the dwelling unit, and

(ii) meets the requirements of the Energy Star program which are in effect at the time that the equipment is installed.

Spending for labor costs properly allocable to the installation of the geothermal heat pump property and for any associated piping, wiring, and ducting are included.

Excluded Property

The credit cannot be claimed on spending for equipment used solely to heat a swimming pool or hot tub, or on previously used equipment.

Placed in Service Requirement

The credit can only be claimed on spending for property that is “placed in service” during the period from 2008 to 2016. In general, property is considered to be placed in service when the original installation is completed. However, if the geothermal heat pump property is part of the construction or reconstruction of a house, it is considered to be placed in service when the taxpayer takes up residence in the new or renovated house.

Tax Credit Amount and Maximum Cap

An individual can claim a tax credit equal to 30% of spending on qualified geothermal heat pump property. For property placed in service during 2008, the maximum tax credit is capped at $2,000 (30% of the first $6,667 in spending). For property placed in service after January 1, 2009, there is no limit on the amount of the tax credit that can be claimed. The tax credit can be used to offset both regular income taxes and alternative minimum taxes (AMT). If the tax credit exceeds the income tax liability, the remaining balance can be carried forward into future years.

Cooperatives and Condominiums

A corporation usually owns cooperative apartment buildings, and the residents are shareholders in the corporation. If the corporation spends money on installing qualified geothermal heat pump property, each shareholder is allowed to claim a tax credit on his or her share of the spending.

Owners of condominiums contribute to the upkeep of the condominiums by paying money to a condominium management association. Where such a management association spends money on installing qualified geothermal heat pump property, each member of the association can claim a tax credit on his or her share of that spending. However, the association must qualify as a “homeowners’ association” under section 528(c)(1) of the tax code, and “substantially all” of the units in the condominium project must be used as residences.

Effect on the Tax Basis on a House

Amounts that are spent on improvements are added to the tax basis of the house. A higher tax basis generally means there is a smaller taxable gain when a house is later sold. Spending on geothermal heat pump property adds to the tax basis, but must be reduced by the amount of the tax credit received.

Business Use

If a dwelling unit serves a dual purpose, such as for a home office in the dwelling, the spending may have to be allocated between residential and business use. If the portion considered residential spending is at least 80%, then all the spending qualifies for the residential credit. There is a 10% tax credit available for business use of geothermal heat pump property, and 5-year MACRS accelerated depreciation.

Claiming the Credit

IRS Form 5695 (2008) is used to claim the Residential Energy Efficient Property Credit for 2008. Form 5695 for 2009 has not been published yet.

Residential Credit Examples

Existing Home Example – 2008 Deposit with 2009 Completion

The taxpayers spent $12,000 to install a geothermal heat pump system in their existing home. They paid an initial deposit of $5000 in 2008 and the balance in 2009 when the system was completed.

2009 Tax Credit: $12,000 x 30% = $3,600

The deposit had no effect on the residential credit, which is entirely determined on the basis of the placed in service date.

Major Renovation Example – 2008 System Completion with 2009 Occupancy

The taxpayers spent $30,000 to install a geothermal heat pump system in a home they are renovating. They paid for the geothermal heat pump system upon its completion in 2008, but did not move into the home until 2009.

2009 Tax Credit: $30,000 x 30% = $9,000

Even though the geothermal system was completed and paid for in 2008, it is considered to have been placed in service when the taxpayers moved into their home in 2009.

New Home Example – 2007 Contract with Early 2008 Occupancy

The taxpayers contract to build a new home in 2007. Their builder spent $18,000 to install a geothermal heat pump system. They move into the home in March, 2008.

2008 Tax Credit: $18,000 x 30% = $5,400 ($2,000 cap in 2008) = $2,000

Even though the geothermal system was placed in service before the residential credit became law, the credit was made retroactive for all of 2008.

New Condominium Example

The taxpayers move into a new condominium in 2009. The condominium developer spent $450,000 to install a geothermal heat pump system in the 30 unit condominium structure.

2009 Tax Credit: $15,000 ($450,000 / 30) x 30% = $4,500

The developer allocates the proportionate geothermal heat pump system costs to each condominium purchaser.

Replacement Unit Example

The taxpayers spend $7,000 to install a new geothermal heat pump in 2009. The geothermal heat pump is replacing a prior geothermal heat pump installed in 1985.

2009 Tax Credit: $7,000 x 30% = $2,100

Qualified geothermal heat pump property expenditures include replacement units as long as they meet the eligibility requirements.

Second Home Example

The taxpayers spend $14,000 to install a geothermal heat pump system in their lake home during 2010. They previously installed a geothermal heat pump in their main home during 2009.

2010 Tax Credit: $14,000 x 30% = $4,200

There is no limitation on the number of times that the residential credit can be claimed.

Additional Tax Incentives Available to Geothermal Heat Pump Purchasers

Non-Business Energy Property Credit for Existing Homes

Section 25C of the Internal Revenue Code provides a 30% tax credit for spending on qualified energy efficiency improvements made to an existing home during 2009 and 2010. The maximum credit is capped at $1,500. The improvements include qualified insulation, windows, doors, and solar reflective roofing materials. The improvements must be installed in or on a dwelling unit located in the United States that is owned by the taxpayer and used as the principal residence. IRS Form 5695 (2009) is used to claim the credit. Form 5695 for 2009 has not been published yet.

Existing Home Example – 2009 or 2010 Completion with Insulation Upgrades

The taxpayers spend $16,000 to install a geothermal heat pump system in their existing home during 2009 or 2010. At the same time they spend $6,000 upgrading their insulation and installing new windows.

2010 Energy Efficiency Tax Credit: $16,000 x 30% = $4,800

2010 Energy Property Tax Credit: $6,000 x 30% = $1,800 ($1,500 cap) = $1,500

Total Tax Credit = $6,300

New Energy Efficient Home Credit

Section 45L of the Internal Revenue Code provides building contractors a $2,000 tax credit for the construction or substantial renovation of a new home that achieves a 50% heating and cooling energy cost saving relative to a comparable dwelling that meets the minimum requirements of 2004 IECC energy code. The home must be sold prior to the end of 2009 for the builder to receive the credit. The energy consumption reduction must be verified by an independent accredited certifier, such as a RESNET home energy rater. IRS Form 8908 is used to claim the credit. IRS Notice 2008-35 provides detailed guidance.

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