

Statement for the Record
Submitted Jointly by

Air Conditioning Contractors of America (ACCA)
Heating, Air-conditioning & Refrigeration Distributors International
(HARDI)
Plumbing-Heating-Cooling Contractors Association (PHCC)

Submitted for the hearing of the

House Ways and Means
Subcommittee on Select Revenue Measures

for the

Hearing on Certain Expiring Tax Provisions

April 26, 2012

The Air Conditioning Contractors of America (ACCA), the Heating, Air-conditioning & Refrigeration Distributors International (HARDI), and the Plumbing-Heating-Cooling Contractors Association appreciates the opportunity to submit this joint written statement for the hearing on certain expiring tax provisions.

Our three organizations represent the distributors and installers of residential heating, ventilation, and air conditioning (HVAC) and hot water equipment, two segments of an industry supply chain that employs more than one and a half million workers who help homeowners enjoy the comforts and cost savings of higher efficiency appliances.

We hope this submission for the hearing record on potential federal energy tax incentives will assist the committee as it considers legislation that impacts small business owners and homeowners in these trying economic times.

Nonbusiness Energy Property Credit (Section 25)

Since 2006, Section 25C of the tax code has allowed eligible taxpayers to claim tax credits for qualified improvements designed to make their primary residence more energy efficient. The tax credits help defray the initial investments costs and shorten the payback period of qualified furnaces, central air conditioners and heat pumps, hot water heaters, and other energy savings appliances or building improvements.

The 25C tax credit was originally authorized in the Energy Policy Act of 2005 for tax years 2006 and 2007. At that time, lifetime claims were limited to 10% of the installation costs of the improvement, up to \$500, with specified caps placed on individual appliances or retrofit measures.

The American Recovery and Reinvestment Act of 2009 (ARRA) renewed the tax credits for 2009 and 2010, with several important modifications, most significantly boosting the value of the tax credits to equal 30% of the installed costs, up to a \$1,500 limit. Other changes eliminated the lifetime cap on cumulative claims, making a homeowner eligible for claims each time the credit was renewed; and removal of the caps on individual appliances or retrofit measures.

The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 enacted in December of 2010 extended the 25C tax credits for 2011 but at a significantly lower value for homeowners. The tax credit value was reduced back to 10% of the installed costs; the \$500 lifetime credit limit was reinstated; as were the caps on individual appliance or retrofit measures.

When comparing the tax credits for residential HVAC and hot water appliances available in 2009/2010 and 2011, the maximum amount an eligible taxpayer could claim for a qualifying furnace or boiler was reduced from \$1,500 to \$150. The maximum amount an eligible taxpayer could claim for a qualified central air conditioner, heat pump, or hot water heater was reduced from \$1,500 to \$300. In addition to these drastic reductions the taxpayer was limited to \$500 in cumulative credits over his/her lifetime for qualified energy efficient upgrades.

Success of the 25C Tax Credits

Surveys of ACCA contractor members conducted in 2009 and 2010 found the 25C tax credits to be an effective financial incentive that encouraged homeowners to reach for and obtain higher efficiency HVAC equipment while stimulating economic activity.

A key finding of the surveys demonstrate that the 25C tax credit helped taxpayers afford higher efficiency appliances that are the primary user of energy while helping the HVAC industry maintain a steady demand for its products and services, despite the severe economic downturn.

According to the surveys, 46% of ACCA's contractor members saw a "significant" increase in the sale of qualifying HVAC equipment after the passage of the stimulus bill. Another 32% saw a small increase in the sales of qualifying HVAC equipment. When taken in tandem, more than 75% of ACCA's contractor members saw an increase in the sale of qualifying higher efficiency furnaces, central air conditioners, heat pumps, and hot water heaters in the two year period when the tax credits were worth up to \$1,500.

And even though 25C tax credits are aimed at individual taxpayers, these valuable incentives helped the small businesses of the HVACR industry.

Those surveyed provided a number of positive comments from members, including:

"Without the stimulus bill for 95% efficient furnaces we would have had an extremely bad time of it last year (2009). The stimulus helped us to stay in business and helped a lot of consumers as well.

"My business has grown and prospered through our down economy and my customers are more than ever more comfortable and saving more money month to month for the more precious things in life such as their children's welfare."

"It is crucial that these tax credits stay in effect as proposed and not cancelled prematurely."

"Thank goodness for the tax credits or our business would have seen a much larger drop off as people's spending habits changed whether out of concern for their jobs or due to the inability to obtain financing."

"Last fall was my busiest season in the 30 years I have been in business. All of my equipment sold was top of the line high efficiency."

"The tax incentive helped us not only survive a down year, but turn it into a reasonably profitable one."

"Without the \$1500 tax credit, we would have had massive temporary and some permanent layoffs. Instead, we have been able to keep steady work during a traditionally slow time."

Indeed, the higher value tax credits are helping homeowners elect to replace equipment that may be in need of repair, reversing a three year trend in the industry.

IRS Data

According to IRS statistics, fully 93% of tax credit claims under sections 25C and 25D (for solar, geothermal, wind, and photovoltaic properties) were made by taxpayers with an adjusted gross income of no more than \$200,000, which is indicative of a middle class tax program.

Examining the 2009 Estimated Data Line Counts for Individual Tax Returns gives a clear picture of how homeowners used \$1,500 residential energy tax credits in 2009.

Taxpayers use Form 5695 worksheet to claim one of several available residential energy credits. The taxpayer first calculates the total cost of qualified expenditures, reduces that amount by 30%, and compares that value with \$1,500. The taxpayer is eligible for tax credits equal to the lesser amount.

Data from the Form 5695 in 2009 tells us how many taxpayers claimed the residential energy tax credits; how many claimed a credit for the purchase of a qualified central air conditioner, heat pump, or hot water heater; a qualified furnace or hot water boiler, or an advanced main air circulating fan; and the total expenditures on these improvements.

In 2009, 6,753,885 households filed Form 5695 to claim a credit against their tax liability for installing some type of energy efficient appliance or retrofit measure in their primary home.

Of that total amount, 976,380 households made claims for purchasing and installing “energy efficient building property,” otherwise known as qualified **central air conditioner, heat pump, and hot water heater** totaling \$3,968,715,000 in expenditures.

In 2009, 1,290,640 taxpayers claimed tax credits for “**qualified natural gas, propane, or oil furnace or hot water boilers**” and reported total expenditures of \$4,310,456,000.

And 221,274 taxpayers claimed some credit for an **advanced main air circulating fan**, an energy efficient component on a furnace, with an aggregate expenditure amount of \$694,422,000.

For all retrofit measures and appliances that qualified for the tax credit, including energy efficient windows and door, insulation, and roofing materials, American taxpayers claimed \$5.17 billion in tax credits on \$25.1 billion worth of work. This significant amount only represents the amount filed with the IRS in claiming a tax credit. What’s missing is the work performed for a taxpayer who chose not to use the tax credit.

The National Association of Home Builders estimates every \$100,000 in remodeling expenditures generates 1.11 full-time jobs.

25C Should Be Extended And Expanded

The section 25C tax credits expired at the end of 2011 and our three organizations recommend that Congress extend the credits and boost their value to at least 10% of the installed costs, up to a limit of \$1,000 for 2012. This will allow taxpayers to continue to make energy efficient retrofits to their homes and support work in the retrofit market.

The extension should remove the caps on individual retrofit measures and allow for the costs of labor to be included in the calculation of all qualified improvements. Furthermore, the credit-eligible water heater levels should be divided into storage and tankless, to better reflect the advantages of both technologies and allow for more consumer choice.

As a result of changes made by ARRA, heating, ventilation, and air conditioning (HVAC) contractors saw an increase in the number of qualifying systems sold and installed in the United States. The 25C tax credit succeeded in helping millions of Americans afford upgraded and higher efficiency HVAC equipment, resulting in lower utility bills and more spending money. It had the additional benefit of accelerating the retirement of systems using refrigerants with a higher global warming potential while providing a boost to the economy through the creation of jobs for HVAC equipment manufacturers, distributors, and installers.

Impact of Short Term Extensions on Small Businesses

Since 2005 when Section 25C was first authorized for the tax years 2006 and 2007 as part of the Energy Policy Act of 2005, Congress has extended or modified the tax credit three times.

While the HVAC and plumbing industry appreciates the extension of the 25C tax credit, the timing and method of the extension make planning difficult for manufacturers, distributors, contractors, and consumers.

The original 25C tax credit expired on December 31, 2007, and was not reauthorized for the 2008 tax year. On October 3, 2008, President Bush signed into law a 25C extension for tax year 2009 as part of the Emergency Economic Stabilization Act of 2008. With the extension finalized in early October, the HVAC and plumbing industries had plenty of time to plan for the production, purchasing, stocking, and marketing of eligible equipment to coincide with the reinstatement of the tax credits.

Just six weeks into 2009, the tax credit was modified and expanded midstream by the American Recovery and Reinvestment Act of 2009. Changes to the qualifying criteria for some products made it more difficult for homeowners to take advantage of the tax credit for certain upgrades, but HVAC manufacturers, distributors and contractors pivoted to meet the demand of the new tax credit levels.

In 2010, after months of debate, an extension was signed into law on December 17, 2010, less than two weeks before the tax credit was set to expire. With no advanced notice, the 25C tax credit value was reduced to the 2006-2007 levels, greatly reducing its attractiveness to the consumer.

The HVAC supply chain budgets for purchasing and marketing months in advance. It is nearly impossible for a small business' ability to plan and compete when Congress passes short term extensions of provisions in the tax code so close to their expiration date. The uncertainty over the future of the 25C tax credits make it very difficult for small businesses to prepare for and successfully market these valuable incentives to consumers.

Inspector General's Report

Our organizations are aware of the April 19, 2011, Department of Treasury's Inspector Generals Report that finds fault with IRS's ability to verify eligibility for the 25C and 25D tax credits.

The IRS could not verify whether individuals claiming Residential Energy Credits are entitled to them at the time their tax returns are processed. It is true that the IRS does not require individuals to submit any third-party documentation supporting the purchase of qualifying home improvement products and/or costs associated with making energy efficiency improvements or whether these qualified purchases and/or improvements were made to their principal residences. However, a taxpayer is required to retain a manufacturer's certificate verifying a products qualifying efficiency rating. In case of an IRS audit, the homeowner should be able to present such documentation.

While the report did note a number of deficiencies with the IRS process for establishing verification of eligibility for the credit, not being able to establish eligibility does not mean they were all illegitimate or ineligible claims. In addition, the IRS notes that it can improve its processes to add additional safeguards and improve its ability to verify eligibility. Our organizations stand ready to assist the government in making sure that the credit is only going to those who truly deserve the benefit.

There are a variety of methods that should be explored to provide an identifying number or code that could be included on tax returns to help the IRS establish the eligibility of a product for the tax credit which could be implemented for use with electronic filing. We remain willing to continue to work with Congress and the IRS to improve the system of product verification and taxpayer eligibility.

Section 179

Section 179D, the Commercial Building Tax Deduction, allows a \$1.80 per square foot tax deduction for building owners who make qualified improvements in overall performance. Unfortunately, the incentive falls short and is not meeting expectations. Although the deduction has been successfully used to build and retrofit some larger energy efficient buildings, the economic crisis has reduced the amount of building design, construction and renovations across the country. In addition, the deduction is based on energy consumption reductions compared to model building code ASHRAE 90.1 2004,

which some older builders do not meet without major and expensive retrofits. Furthermore, the expensive nature of many HVAC and water heating upgrades require major initial outlays of capital, another difficult hurdle in today's difficult economy.

Our organizations support the passage of legislation to increase the maximum allowable deduction from \$1.80 per square foot to \$3.00 per square foot (\$1.00 in the case of individual subsystems) to create jobs. Furthermore, allowing deductions or tax credits for specific HVAC and water heating components such as chillers, boilers, or roof top units, combined with an allowable square footage deduction of \$3.00, Congress could immediately stimulate building design, construction, and renovation across the country, spurring job creation in every state and region, while enhancing our energy independence and improving our nation's infrastructure for the 21st century.

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